ARE THE FINANCIAL RECORDS OF THE FEDERAL GOVERNMENT RELIABLE?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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ARE THE FINANCIAL RECORDS OF THE FEDERAL GOVERNMENT RELIABLE?

FRIDAY, MARCH 31, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn and Kanjorski.

Staff present: J. Russell George, staff director and chief counsel; Louise DiBenedetto, GAO detailee, Bonnie Heald, director of communications; Bryan Sisk, clerk; Ryan McKee, staff assistant; Trey Henderson, minority counsel; and Jean Gosa, minority clerk.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order. Today the Department of the Treasury is releasing its third financial report of the U.S. Government's fiscal affairs. This report, which covers fiscal year 1999, is required by the Government Management Reform Act of 1994. The law specified that no later than March 31st of each year, the Secretary of the Treasury in coordination with the Director of the President's Office of Management and Budget annually prepares and submits to the President and Congress an audited financial statement for the preceding fiscal year. After this year, the statutory deadline has been met.

I commend the Treasury Department, the General Accounting Office, AND the Office of Management and Budget for meeting this deadline of undoubtedly a lot of hard work and personal effort that went into this endeavor. I believe that all parties agree that some progress has been made.

However, I am disheartened but not surprised that significant accounting discrepancies and financial weaknesses have again prevented the Comptroller General of the United States from issuing a clean opinion on the government's financial statements. In subcommittee hearings on individual agencies over the last few years, we have had at least two executive branch departments acknowledge that they spent billions of dollars in inappropriate overpayments. For example, auditors of the Health Care Financing Administration, which administers the Medicare and Medicaid programs, estimated that in 1999, the agency overpaid Medicare claims by $13.5 billion. This massive amount represents nearly 8 percent of all Medicare fee for service benefits paid out that year.

The stewards of our tax revenues, the Internal Revenue Service, has its own problems. Auditors examining the agency's 1999 books found one instance in which the IRS issued a $15,000 tax refund even though the individual had been identified as owing nearly $350,000 in outstanding taxes. With such loose financial controls, is it any wonder that taxpayers have little confidence that their hard earned money is being well spent?

Despite laws some nearly a decade old that require agencies to be financially accountable, the General Accounting Office continues to warn us about the potential for fraud, waste, and misuse of billions of dollars of taxpayer provided dollars.

Today the subcommittee is issuing a third report card grading the 24 largest executive branch departments and agencies on the quality of their 1999 financial statements. Again, the grades are dominated with Ds and Fs. Only 22 of the 24 agencies submitted the required financial reports. As of yesterday, neither the Department of the Interior nor the Department of State had submitted their 1999 financial statements, which were due on March 1, 6 months after the end of the fiscal year. Obviously they both received Fs. On the other hand, the Social Security Administration, which is also a large and complex agency, managed to complete its financial statements 6 weeks after the end of the fiscal year. Perhaps the Office of Management and Budget, which oversees financial management as well as budgets in the executive branch, can explain the disparity in accountability.

Based on this year's consolidated audit report, the subcommittee has determined that overall the Federal Government earned a D-plus. Although 13 agencies received clean audited opinions, they have still missed the most important goal, which is to maintain financial systems that will allow them to produce accurate, reliable financial information on a day-to-day basis.

On a related matter, we are also concerned that the Social Security-Medicare boards of trustees have again released their latest projections on the solvency of these vital programs only 1 day before the consolidated audit report is due. These program projections which are included in today's audit report are now already outdated. I understand that by law the trustees must release the new projections by April 1, but surely the law does not preclude them from providing this new information early enough to include it in the government's audited financial report. Such poorly timed data creates confusion about the financial status of two very important programs. It also raises serious questions about the Government's ability and commitment to report accurately on its finances.

We will be looking very carefully at this issue. We have many questions for our witnesses, all of which hold key roles in determining the credibility of the Government's financial management. We welcome each of you and look forward to your testimony.

[The prepared statement of Hon. Jim Turner follows:]

Opening Statement of the Honorable Jim Turner
GMIT Hearing: "Are the Financial Records of the Federal Government Reliable?"
March 31, 2000

Thank you, Mr. Chairman. This is the fifth in a series of oversight hearings on the financial management practices at federal agencies. The timely completion of the third audit of the federal government's books submitted today represents a huge effort by this Administration and by the General Accounting Office. This audit would not have been possible without the hard work of employees at the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget. I commend you all for your dedication and accomplishment.

American taxpayers deserve a full accounting of when, where and how their tax dollars are spent. The President and the National Performance Review under Vice President Gore embraced this principal early in their first term. In September 1993, the NPR recommended the preparation of an annual consolidated financial report and the creation of comprehensive governmentwide accounting standards. This proposal became law as part of the Government Management Reform Act of 1994, passed by a Democratic Congress and signed by the President.

When you consider the fact that 10 years ago, almost no agencies prepared and issued audited financial statements, we have made great strides toward securing financial accountability in our government. For fiscal year 1993, only one of the 24 major agencies had a clean opinion; by fiscal year 1997, 11 agencies had clean opinions. This year, 13 of the agencies already have clean opinions.

Despite the significant progress we have made in this area, for the second year in a row, the GAO is still unable to render an opinion on the federal government's financial statements because the necessary financial information is incomplete. In addition, significant material deficiencies that affect both the financial statements and the management of government operations were reported. Furthermore, it appears that the federal government was still having problems with its internal controls.

I want to commend the Chairman for his focus on this issue and welcome the witnesses here this morning. The federal government is working hard to eliminate the largest obstacles to a clean opinion. Clearly, there is much long-term work ahead and we must remember that this is not an easy job. Everyone supports the goal of sound financial management. I look forward to the testimony today and hope that it advances that goal.

Mr. HORN. We will now start with panel one, the Comptroller General of the United States, the Honorable David Walker. If you will rise, General, and raise your right hand.

[Witnesses sworn.]

Mr. HORN. The clerk will note that the oath has been affirmed, and we welcome you here and you are into your second year now, I guess. It seems like just yesterday when you started.

Mr. WALKER. Seventeen months on the calendar. Three years on the clock and a lot of frequent flier miles, Mr. Chairman.

Mr. HORN. You're doing a great job.

STATEMENT OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JEFF STEINHOFF, ACTING ASSISTANT COMPTROLLER GENERAL FOR ACCOUNTING INFORMATION MANAGEMENT DIVISION; AND BOB DACEY, DIRECTOR OF THE CONSOLIDATED FINANCIAL AUDIT

Mr. WALKER. Thank you. It's a pleasure to be before this subcommittee again, Mr. Chairman. I'd also like to note at the outset that several GAO personnel have accompanied me, in particular Jeff Steinhoff, who is sitting right behind me, the Acting Assistant Comptroller General for the Accounting Information Management Division, and Bob Dacey, who is the Director of the Consolidated Financial Statement Audit. I point out that they are here and, if necessary, are available to this committee for detailed questions.

I'm pleased to be here today to discuss our report on the U.S. Government's financial statements for the year 1999. Today's hearing comes at an especially appropriate juncture. First, we're nearing the 10th anniversary of the Chief Financial Officers Act's passage, which has provided the underpinning for financial management reform necessary to help improve the economy, efficiency, and effectiveness of the Federal Government. A critical financial management reform component established by the Congress entails requirements for annual audited financial statements for the 24 major Federal departments and agencies beginning in fiscal 1996. We have seen steady increase in the number of vacancies that have obtained unqualified opinions on their financial statements and agencies' timeliness in issuing them has also improved.

In addition, and importantly, in October 1999, the American Institute of Certified Public Accountants recognized the Financial Accounting Standards Advisory Board as an authoritative standard setting body. As a result, we now will be able to say and other auditors in accordance with generally accepted accounting principles, which is very important because that is a term which the public is accustomed to and therefore can serve to enhance credibility of financial management reporting.

At the same time several major departments are not yet able to produce audited financial statements on a consistent basis. The most significant in this regard is the Department of Defense, which represents a large percentage of the Government's assets, liabilities, and net cost. None of the military services of the department as a whole has yet been able to produce auditable financial statements. For the last 2 years, we reported that because of serious deficiencies in the Government's systems, recordkeeping, documentation, financial reporting, and controls, amounts reported in the U.S. Government's consolidated financial statements and related notes may not provide a reliable source of information for decisionmaking by the Government or the public.

In other words, Mr. Chairman, we unfortunately have had to disclaim an opinion. The executive branch recognizes that because of the extent and severity of financial management deficiencies addressing them will require concerted improvement efforts across government. Annual financial audits represent an important means to assure continued progress in connection with improving Federal financial management.

Further, the President has designated Federal financial management improvement as a priority management objective and efforts are under way across government to address pervasive, generally long-standing financial management problems.

However, while clean opinions are essential to providing an annual public scorecard, they do not guarantee that agencies have financial statements needed to dependently produce reliable financial information on a timely basis. As you said, Mr. Chairman, while obtaining a clean opinion, it's an important and objective milestone and a true accomplishment. It is not the end game.

The purpose of Federal financial management is to assure that there is timely, accurate, and useful information available day to day to make informed management decisions. And in addition, it's critically important that there be effective, internal controls and in addition, it's also critically important that there be systems in place to assure compliance with applicable laws and regulations.

Agency financial systems are in poor condition in many cases and they do not provide adequate information to effectively manage day-to-day government operations and to hold managers accountable. Over the longer term, improving financial systems will involve harnessing technology and applying the information technology management framework outlined in the Clinger-Cohen act.

Another integral part of financial management reform is revamping human capital practices to build greater capacity, to implementing change management, and to achieve the discipline needed to follow sound financial management and reporting practices.

Mr. Chairman, the remainder of my testimony will focus on matters and findings in our report on the consolidated financial statements of the U.S. Government for fiscal year 1999. But before I do give that bottom line summary, I would first like to address an important financial information topic that you touched on in your opening remarks, and that is the issue of Social Security and Medicare.

The Government's fiscal year 1999 financial report and therefore our report on the audit of these financial statements includes certain information concerning the Social Security and Medicare Part A trust funds, such as projected contributions and expenses, dates where expenditures are expected to exceed contributions and dates when such funds are expected to be exhausted. Such information is as of January 1, 1999 for Social Security and as of September 30, 1999 for Medicare Part A. This was the most recent information publicly reported by the Government and made available to the GAO.

Yesterday, as you noted, the trustees issued updated information on these two important Federal programs as of January 1, 2000. The Government's issuance of dated information in this financial report at about the same time that it issues more current information may cause confusion to the Congress and the public. This can serve to reduce the confidence in and the credibility of the Government's annual financial report. This is especially true when there are significant differences in the trustees' new projections and those contained in the annual report, which is the case this time, which was the case last year as well.

Given the importance of this information, steps should be taken in future years to assure that the Government's financial report contains up-to-date information as of no earlier than the end of the most recent fiscal year in these important Federal programs. Because the current information on the solvency of Social Security-Medicare is critical to assessing the financial condition of the Nation, aging and budget deliberations—aiding in budget deliberations and fostering public debate, we will include the updated information on these two important Federal programs in our report on the audit as a supplement when we issue it within the next couple of weeks.

I might note, Mr. Chairman, that the new numbers are on page 1 of the Washington Post. They are also in the New York Times. I hope we get page 1 tomorrow but I doubt very seriously we will. So this serves to reinforce how important this information is to the public and to other parties and it is critically important that the annual financial report include up-to-date information.

In addition, Mr. Chairman, I might note that at present, this critical information is not subject to audit. I think that needs to be reviewed as well given the importance of this topic.

Mr. HORN. On that point, I might say you bring a particular perspective to this because you served on one of those trustee boards. Which one was it?

Mr. WALKER. I served on all of them, Mr. Chairman. I served on the Social Security and Medicare Board of Trustees for 5 years, 1990 to 1995. I think it's critically important that the trustees be able to go through their process and that they be able to announce what their conclusions are with regard to these projections. At the same point in time, I think it's critically important that it be done in a manner that will allow for inclusion and a timing that will allow for inclusion of the most up-to-date information in this annual consolidated financial statement audit because this is a subset of the overall audit. So it is important that the overall audit include up-to-date information.

Mr. HORN. Is this a problem of a law that needs to be changed so that the trustees would be in synchronization with the rest of the Government?

Mr. WALKER. Mr. Chairman, I think that while the trustees have a statutory responsibility to report by April 1, theoretically they can report before that. In my opinion, I think one of the things that we need to look at is first work together with the trustees to try to accelerate their reporting. And it may also make sense to accelerate the statutory due date for their report.

In addition, I might note for the record that the trustees have for a number of years conducted their projections as of January 1 or, in other words, the calendar year rather than the end of the fiscal year. If they were to conduct their projections as of the end of the fiscal year, September 30, which is the same date as the financial statements, that change in and of itself ought to be able to accelerate their reporting date by 3 months. So I think this is something that, one, we have already talked to OMB about and the Treasury Department and I think it's something we will continue to work with you and the Congress on what, if any, changes might be appropriate here.

Mr. HORN. What are the options the trustees would have in terms of a particular set of numbers when we're talking about reform in both political parties, of Social Security, Medicare, where we know there's been a lot of waste in Medicare and everybody admits it and we've got to help them focus in on that? What kind of game plan could be the result of either not having those numbers tied in with the rest of the whole government or with putting them in, say, the day before the hearing?

Mr. WALKER. Well, I think first merely by what has happened in the last 2 years where new numbers have been released in this particular case a day before the consolidated financial statements, last year a day after the consolidated financial statements, I think frankly it makes government look foolish. These numbers are the largest numbers in the financial statements. These numbers are arguably probably the most important numbers in the financial statements and yet within a 24-hour period either before or after the issuance of this report, we have whole new numbers coming out.

You know as well as I do, Mr. Chairman, how important these programs are to Americans. You know that there are current debates ongoing with regard to whether and to what extent these programs should be reformed and how they ought to be reformed, and I think not having consistent information in both these reports serves to undermine credibility and confidence in this report and I think that's inappropriate.

Mr. HORN. These are 70-year projections, right?

Mr. WALKER. Seventy-five years.

Mr. HORN. Now, over the history of those projections, have we ever had someone go back and say, well, what were the projections in the late 30's, the 40's, the 50's, the 60's, and how accurate were they?

Mr. WALKER. That does get done and in fact in the report, in the longer report, there is data dealing with some historical projections. I think we have to realize that there can be significant differences from year to year. In fact, in the Medicare program alone, there has been a 22-year improvement in the last 3 years in the estimated date of exhaustion for Medicare. That's a dramatic change in Medicare.

There are many reasons for that. In some cases it's because of improved economy. In some cases it's because the trustees or actuaries believe that the recent changes in health care cost, the lowering of those costs are likely to continue. I think that's debatable. But the fact of the matter is the first issue is we ought to have consistent information so we're not confusing the public and so we don't inadvertently undermine credibility but, second, I think the second issue that needs to be focused on is whether and to what extent this information should be subject to audit.

Mr. HORN. Well, I would think one of the options is people could say, well, look, we're in a very healthy shape, why do we have to reform anything? And is that one option that comes out of this with the numbers in this situation so that people just give up on it and say we don't need to touch it anymore?

Mr. WALKER. One of the concerns that we had, Mr. Chairman, is it decreases the sense of urgency. Second, it may also increase the momentum to expand benefits in a program that already has $2.9 trillion in unfunded promises that eventually we're going to have to come to grips with. But that's a policy decision the Congress will have to make. But I think each of the quotes that are in the Washington Post paper today from several Senators and other Members note that it's a double-edged sword, these new projections, because we know we're going to have to reform these programs. There's no debate about that. It's a matter of when and how that gets accomplished.

Would you like me to complete, Mr. Chairman?

Mr. HORN. Just to round this one out, are those numbers audited by the trustees? Do they have that authority to bring in people or how does that work?

Mr. WALKER. Mr. Chairman, the way it works right now is the trustees ultimately must approve the assumptions, the key demographic assumptions, the key economic assumptions, and the key assumption in the case of Medicare, which is the health care cost trend rate, what they call the market basket rate, what's going to happen with health care costs going forward. They rely to a great extent, as is understandable, on the recommendations and the advice and counsel of the Social Security actuary and HCFA actuary who are very capable individuals. At times it may take supplemental efforts to try to reach outside that to try to draw upon other experts, as we did when I and Stan Ross were trustees.

So ultimately they have to buy off on the assumptions and the actuaries of Social Security Medicare do issue an actuarial opinion to say that the projections have been done in accordance with generally accepted actuarial methods and that the assumptions are reasonable in their opinion, but they are not subject to separate independent audit. And in fact, comparable sets of numbers to the extent that you can say they are comparable, pension projections, health and welfare projections in the State and local government arena as well as in the private sector would be subject to audit and they are not at the present point in time at the Federal level.

Mr. HORN. Will that take a law to provide that?

Mr. WALKER. Mr. Chairman, no, I don't believe it will. I think that what we would have to do is—I frankly need to converse with my colleagues, the Director of OMB in particular, to talk about this. As you know, the Financial Accounting Standards Advisory Board sets accounting and reporting standards but they don't set auditing standards. We might be able to accomplish this administratively. Obviously a law would assure that it would happen, but

I think we can try to proceed and see whether or not it's possible to do it administratively.

Mr. HORN. Social Security and Medicare are really the only group within the Federal Government where they have this particular situation of special trustees, actuarial agreement and all that. No other agency does it and maybe HUD does. I don't know. There would be something there in terms of projections.

Mr. WALKER. Nothing of the significance and magnitude that we're dealing with here, Mr. Chairman. Right now, as you know, the information with regard to Social Security and Medicare is provided in a required supplemental stewardship statement. And those statements aren't currently subject to audit. There's more than just these two statements, but what I'm really focusing on right now quite frankly is the information with regard to these two programs. I mean, this just reinforces the importance of this information and please don't—I don't want anybody to misunderstand that I think it's important the trustees be able to continue what they are doing. I think it's important that they continue to be able to release this information and the fact that it's not audited shouldn't be drawing an inference one way or the other as to the reliability of their projections. I just think it's important that we do it in a coordinated manner and I think serious consideration needs to be given as to whether or not they ought to be audited in order to further enhance public confidence, especially given the magnitude of these numbers.

Mr. HORN. I know you have a lot more in your statement and what we are going to do when you get done with the big thrust of the statement, we'll get panel two up and if you could stay, we'll have a dialog then between the three of you.

Mr. WALKER. I'd be happy to, Mr. Chairman. Let me see if I can just summarize the major points in our audit. Our audit on the U.S. Government's financial statements for fiscal year 1999 states that certain significant financial system weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal control, including computer controls, continue to prevent the Government from accurately reporting a significant portion of its assets, liabilities, and cost.

Major challenges include in the Federal Government, in this area relate to, first, the inability to properly account for and report material amounts of properly—materials and supplies, certain stewardship assets primarily at the Department of Defense; to properly estimate the cost of certain major Federal credit programs and the related loans receivable and loan guarantee liabilities primarily at the Department of Agriculture; to estimate and reliably report material amounts of environmental and disposal liabilities and related costs primarily at the Department of Defense; to determine the proper amount of various reported liabilities, including post retirement health benefits for military employees and accounts payable and other liabilities for certain agencies; to accurately report major portions of net cost government operations; to ensure that all disbursements are properly recorded and to properly prepare the financial—government's consolidated financial statements, including balancing the statements, accounting for substantial amounts of transactions between governmental entities, and reconciling the results of operations to budget results.

Mr. Chairman, we also pointed out several material internal control weaknesses, deficiencies dealing with such things as improper payments, the Government's tax collection activities. I would like to reinforce, Mr. Chairman, that while a clean opinion on the financial statements is an important milestone and it's one the public understands and it's one that should be deemed to be an accomplishment, that it is not the end game and it is not enough and in fact it can be misleading because there are certain departments and agencies that have undertaken heroic efforts and spent a lot of money in order to be able to get in a position where auditors can express a clean opinion and yet they don't have effective controls and they don't have the type of systems in place to be able to have information to make informed decisions every day, and I would say that having effective controls and having—and being in compliance with FFMIA and related statutes are equally important as just getting a clean opinion on the financial statements, especially if that clean opinion is obtained 6 months or in some cases up to a year after the end of the year which is being examined.

In summary, Mr. Chairman, progress has been made. It is fair to say that progress has been made every year in this area and as one knows, for the Federal Government unfortunately it has been a lag indicator in financial management. The private sector has had to have its act together for years. State and local governments have been ahead of us, although State and local governments many times took a number of years to come around to comply as well.

I think it's critically important that this continue to be a top priority. I think we have to look beyond clean opinions and also look at internal controls and also look at effective systems to have timely, accurate, useful information every day. And I would like to commend you, Mr. Chairman, and this subcommittee for your continued diligence and efforts in placing attention on this important matter and we look forward to continuing to work with you and making further progress in the years ahead and I hope, Mr. Chairman, that during my 15-year tenure that I will be able to at some point in time express an unqualified or clean opinion on the financial statements of the U.S. Government.

Thank you, Mr. Chairman.

Mr. HORN. We share in that hope. The question is next year, 2 years, 10 years, and I think with you in there with your 15 years, you're very conscious of getting the things done soon. So I would hope the executive branch would get that regardless of who is in control of the executive branch.

Mr. WALKER. I think it very well may be possible, Mr. Chairman, that we get to the point of having some qualified opinion before we get to the point of having a clean opinion, as has been the case with a number of the different departments and agencies that you've noted.

Mr. HORN. Well, we will now have panel two join panel one. We have Joshua Gotbaum, the Controller, Executive Associate Director, Office of Management and Budget, and Donald V. Hammond, the Fiscal Assistant Secretary, Department of the Treasury. If you gentlemen will stand and raise your right hands. And anybody that's also going to help you with that from the staff, please have them stand so we don't have to swear them in. Do you have anybody behind you?

Mr. GOTBAUM. No.

[Witnesses sworn.]

Mr. HORN. The clerk will note that both have affirmed the oath and we will now start with Mr. Gotbaum, who's had a very rich career in government.

STATEMENTS OF JOSHUA GOTBAUM, CONTROLLER, EXECUTIVE ASSOCIATE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET; AND DONALD V. HAMMOND, FISCAL ASSISTANT SECRETARY, DEPARTMENT OF THE TREASURY

Mr. GOTBAUM. Mr. Chairman, thank you very much. I appreciate the opportunity to be here today. Mr. Chairman, I have been Controller since the end of November and before I start, and I realize my time is limited but I just wanted to pay an individual note of thanks to the folks in the Office of Federal Financial Management with whom I have worked now for 4 or 5 months. When I was confirmed, Sheila Conley, who had just been promoted to a Branch Chief at OMB, a management position, was the Acting Controller, the Acting Deputy Controller, and the Branch Chief. She had a lot of work to do. I'm joined here by Joe Kull, who we just appointed as Deputy Controller, and James Short, Dave Zavada, Kim Geier, Karen Shaffer. I just wanted to say and to put on the record the appreciation I have for these incredibly hard-working, very professional people.

I also want to say before I get to the formal testimony that I thought General Walker's characterization of the state of Federal financial management, which is what we do want to talk about today, was accurate.

We have made very substantial progress. We're proud of it. It was the result of a lot of effort. We also have a heck of a long way to go. I thought, Mr. Chairman, that the most useful thing I could do to start is to talk about where we've come because 10 years ago when Congress passed the CFO Act, no agencies prepared financial statements. The Federal Government as a whole couldn't produce consolidated financial statements, let alone audited financial statements. Now agencies issue those statements annually and the Federal Government, and my colleague Don Hammond will talk about it, has produced its third governmentwide financial statement. We have plenty to do but the fact is we've come a long way.

In 1990, the Federal Government did not have a set of governmentwide accounting standards. We buckled down. We created the Federal Accounting Standards Advisory Board and over the years they have produced a set of standards. This past year we have accomplished something of which we are quite proud: the AICPA has recognized FASAB standards as generally accepted accounting principles. So we've created a set of standards and they have been recognized by the international standard setting community as "generally accepted accounting principles."

Financial management systems, such as they were, did not keep standard accounts, couldn't communicate with each other, and couldn't provide accurate, timely or meaningful information. Let's be clear, Mr. Chairman, many of those challenges remain today. General Walker was entirely accurate in that regard. But we are making progress.

We have developed standards for these systems. We've established a program jointly with the GAO, the Joint Financial Management Improvement Program Office for comprehensive testing of these systems, and we've said to government agencies "Unless the financial systems you buy pass muster in these tests, you can't buy them."

Mr. Chairman, there's plenty yet to achieve but the community has made real strides. This is the result of a lot of work by thousands of people. They track down financial information that the Federal Government had never before kept. They recorded that information in standardized accounts using standards we didn't before have. They developed new computer systems to maintain those accounts. They created financial reports that we never before made and they had those reports independently audited. I lay all this out, Mr. Chairman, because I think it is important we all recognize that this is an extraordinarily complicated and difficult endeavor.

Let me turn to the 1999 financial statements for the agencies. Thanks to the miracle also of modern technology and thanks to your staff, if you look at the chart, we have, as General Walker said, made progress in the agency reports each year. Within the last year, we have improved in timeliness because obviously one of the most important things about financial information is: it's got to be timely to be used. Last year 15 of the 24 CFO Act agencies came in by the deadline. This year we got 19. I will tell you Mr. Chairman, we would have had one more, but one agency that had achieved a clean opinion wanted to take the time to talk with the GAO and convince themselves that they were all doing the right thing, so they held off a few days to have that conversation. So from my perspective I think it would actually have been 20.

Also, Mr. Chairman, the quality of those statements has been improved. Last year by this time there was an issue of both timeliness and cleanliness. We had 8 of the 24 CFO Act agencies that had clean opinions. Ultimately 12 made it. This year we have already received 13 clean opinions. The two agencies that have not yet reported did achieve clean opinions last year, so we're hopeful that number might even go up, and might be as much as 15.

Within those numbers, Mr. Chairman, I think it's important to recognize some real progress. The Departments of Commerce and Transportation, which last year had disclaimers, because their accounts were in such shape that their auditors couldn't express an opinion at all, this year got a clean opinion. The FAA got a clean opinion. The Departments of Health and Human Services, Energy, Veterans Affairs, and the Health Care Financing Administration within the Department of Health and Human Services moved from qualified opinions to clean opinions. This is real progress, Mr. Chairman.

Now, we should also be frank that we had hoped to do better. Even as late as January of this year, all of the 24 CFO Act agencies expected that they would be able to meet the March 1 deadline and 18 of them expected that they would be able to achieve clean opinions. Over the course of the first several months of this year as those agencies worked with their own financial information and worked with their auditors, a number of them found that their accounts did not meet standards. In some cases they could not reconcile new systems with old systems or they could not reconcile accounts from one part of their agency with accounts from another part of an agency. For a variety of different reasons, they discovered issues that made their financial reports incapable of meeting these standards. In some of those cases those issues could not be resolved by the March 1 deadline. In two of those cases the agencies slipped from last year.

What are we going to do about it? We're going to do what we have been doing: OMB, the Treasury, and GAO are jointly working with all of those agencies that are not clean, with all of those agencies that are not timely. We are working on both their statements and their systems to make sure that they continue to progress and that next year we see continued progress.

I want to make a second point: despite the fact there has been undeniable progress, there's a lot to do. This committee, Mr. Chairman, was intimately involved in the Government's involvements in Y2K. You know the level of effort, the difficulty, and the complexity that is involved any time you talk about changing a system. Upgrading and improving the Federal Government's financial systems is, if anything, an even more complicated task. There are hundreds of computer systems in the Federal Government. Many of them were designed before there were financial standards. Many of them were designed without financial accountability in mind. As a result the task of upgrading them, modernizing them, improving them, which is absolutely essential as General Walker said, to being able to produce reliable timely statements, it's a huge and enormous task. Congress helped by passing the Federal Financial Management Improvement Act and giving the force of law to this obvious and clear need, and we are working to do so.

The only thing I want to say beyond that on this subject, Mr. Chairman, is that as in Y2K, we think it is quite important that there be a recognition of the difficulty of the task and continued pressure as to the importance of the task.

I realize time is short but I did not want to pass by, since I know this committee has a range of concerns about financial management, without at least mentioning some of the other financial management issues that we do pay attention to, that we are working on. I will leave it to you as to whether you want to deal with them in questions, but we are working to implement the Debt Collection Improvement Act and improve the way the Federal Government handles its financial portfolios.

We've set up a priority management objective—I know you're familiar with the PMOs—to work on this issue. We've set up a priority management objective to deal with the issue of verifying that the right person gets the right benefit, to deal with these issues of reducing erroneous or improper payments. We have set up a priority management objective to deal with the issues in computer security and we have done one as well for capital planning and systems because we think the mandate that the Congress laid out in Clinger-Cohen is essential to be implemented and to be implemented assiduously.

In closing, Mr. Chairman, I just want to lay out a comparison. We think this job is important and difficult and I think it's important to recognize that the progress is very real. It might be useful for the committee to consider a comparison, which is State governments.

State governments, as General Walker mentioned, were ahead of the Federal Government in developing modern financial reporting. They began in the 1970's to develop audited financial statements. In 1980, Standard & Poors—you'll forgive me, Mr. Chairman, I'm a former investment banker so as a result, I look to the Standard & Poors for some benchmark. In 1980, Standard & Poors said to the States, "if you don't have financial statements audited in accordance with GAAP on a timely basis, we are going to downgrade you. We are going to affect your rating."

So that was 1980. Ten years later, Mr. Chairman, 10 years later, 43 States of the 50 issued GAAP based statements, and half of them had clean opinions, half. The Federal Government has been issuing agency financial statements for 4 years and this year, Mr. Chairman, fiscal year 1999, more than half of them will be clean. So we have in the Federal Government done in 4 years what State governments took more than a decade to do.

We're going to continue these efforts. We think they are extremely important. We think the continued support and sponsorship of the Congress is essential and the reason we're going to do so again, to take a lead from my colleague and friend General Walker, is because we view these financial reports as an essential tool in implementing GPRA, in integrating management and resource decisions to financial information and, taking a lead from my friend again, to provide accountability people expect and deserve from their government.

Thank you.

[The prepared statement of Mr. Gotbaum follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Statement of Joshua Gotbaum
Executive Associate Director and Controller
Office of Management and Budget

Before the Subcommittee on Government Management,
Information & Technology
of the Committee on Government Reform
US House of Representatives
March 31, 2000

Mr. Chairman and members of the Subcommittee, I am here today to discuss the progress made during the last year in Federal financial management and to describe the challenges that still face us.

Federal Financial Management: Real Progress, But Still Far To Go

In enacting the Chief Financial Officers (CFO) Act in 1990, the Congress recognized that the Federal Government lagged far behind private businesses and State and local governments in financial management. The Government Management Reform Act extended this mandate by requiring annual audited agency financial statements; that requirement took effect four years ago. Over this period, we have come a long way. Consider where we were then and where we are now:

- Ten years ago, almost no agencies prepared and issued audited financial statements. The Federal Government as a whole could not produce consolidated financial statements, let alone audited statements. Now, agencies issue these statements annually, and the Federal Government has just produced its third Government-wide financial statement.

- In 1990, the Federal financial community did not have a set of Government-wide accounting standards. The creation of the Federal Accounting Standards Advisory Board (FASAB) in 1990 paved the way for the development and issuance of a complete set of basic accounting standards and concepts by 1996.

- In October 1999, as validation of our process and progress, the American Institute of Certified Public Accountants (AICPA) recognized FASAB standards as "generally accepted accounting principles" (GAAP). This independent acknowledgment by an internationally recognized standard setting authority marks a significant milestone in improving public confidence in Federal financial management.

- Financial management systems, such as they were, did not keep standard accounts, could not communicate with each other, and could not provide accurate, timely, and meaningful information. Many of these challenges remain; nonetheless, today we have developed standards for these systems and established a program of comprehensive testing of commercial systems to ensure that they meet them. Only those systems certified as compliant may be purchased by Government agencies.

There is plenty yet to achieve, but the Federal financial community has made great strides in just 10 years. This progress is due to hard work by thousands of people throughout the Government who:

- *Tracked down financial information that the Federal Government had never before kept;*
- *Recorded that information in standardized accounts, using standards we never before had;*
- *Developed new computer systems to maintain these accounts;*
- *Created financial reports we never before made; and*
- *Had those reports independently audited.*

1999 Financial Statements

Achieving an unqualified opinion on the financial statements of individual Federal agencies and ultimately the consolidated Government-wide financial statement is a major milestone toward putting our financial house in order. Striving to get clean opinions leads to the development of better financial information which, when provided to management on a timely basis, provides the basis for producing better decisions. For the FY 1999 statements, we made significant progress toward our goals of clean opinions for individual agencies and the Government as a whole.

The timeliness of financial reports improved. Last year, 15 of the 24 CFO Act agencies met the statutory March 1 deadline for producing financial statements. This year, 19 did so, and we received an additional three statements during March. Two statements are still outstanding.

The quality of these financial statements also improved. Last year by this time, only 8 of the 24 CFO Act agencies had received clean opinions on their financial statements; ultimately 12 did so. This year, 13 agencies have already received clean opinions, and we have hopes that the two who have not yet reported will do so as well, for a total of 15. Seven agencies improved measurably over last year, moving from a disclaimer or a qualified opinion to a qualified or a clean opinion. The Departments of Commerce and Transportation jumped from disclaimers to clean opinions – significant accomplishments for these departments whose financial records were in such poor shape the year before that the auditors could not provide an opinion. The Departments of Health and Human Services, Energy, and Veterans Affairs advanced from qualified to clean opinions. The Departments of Education and Justice moved from disclaimers to qualified opinions.

Work continued on efforts to resolve the two leading obstacles to a Government-wide clean opinion – accounting for property, plant, equipment and inventories at the Department of Defense, and accounting for intra-governmental transactions. The Department of Defense is investing significant contractor support resources to resolve the difficulties in accounting for property, plant, equipment, and inventories. An interagency task force with representatives from the Office of Management and Budget (OMB), the Department of the Treasury, and the General Accounting Office (GAO) continued to work with the CFO Council to develop short- and long-term solutions to the complex challenge of identifying and reporting transactions between Federal Government entities or intra-governmental transactions.

We had hoped to do even better. Throughout this process, OMB staff remained in close contact with agency CFOs and Inspectors General on the progress of the audited financial statements. As late as the end of January, all 24 agencies anticipated meeting the March 1 due date and 18 agencies were projecting clean opinions. In late January and February, however, as the agencies worked with the financial information and their auditors, some found that their accounts still did not meet standards. In some cases these could not be resolved by the March 1 deadline; as a result, the opinions of two agencies slipped from the prior year.

OMB will continue to work with GAO and the other auditors, the Department of the Treasury, and the agencies that missed the statutory deadline or did not receive clean opinions to identify and eliminate the obstacles to timely and clean opinions for agencies and the Federal Government as a whole.

Despite undeniable progress, there is still much to do. Developing financial reports in accordance with GAAP, then achieving clean audits of those statements, is a major milestone, but it is nonetheless not the final goal. Ultimately, we want financial systems that provide this information in a reliable timely way, to improve Government decision-making and provide accountability.

As we learned from our experience with the Year 2000 (Y2K) challenge, improvement in automated systems is an enormous task. There are hundreds of separate systems used in the two dozen major agencies. Many of these were developed before financial reporting was required. In 1996, two years after requiring the preparation of financial statements, Congress enacted the Federal Financial Management Improvement Act (FFMIA) of 1996. Essentially, FFMIA requires Federal agencies to use financial management systems that support full disclosure of Federal financial data, including full costs of Federal programs and activities, to citizens, Congress, and agency management, so that programs and activities can be considered on their full costs and merits. To achieve this goal, we must plan, authorize, and fund the necessary investments to upgrade or replace many deficient financial management systems, as well as the human capital needed to manage those systems.

Other Efforts to Strengthen Government Financial Management

In order to improve Government management, each year the Director of OMB, after consulting with the President, the Vice President, and others in the Administration, designates a series of Priority Management Objectives (PMOs). Issues designated as PMOs receive coordinated, sustained, and intensive management attention. Last year, PMO #1 was the Y2K challenge.

It should come as no surprise to anyone that the first PMO in the FY 2001 Budget is to use performance information to improve program management and make better budget decisions. The Government Performance and Results Act (GPRA) seeks to integrate budget and financial information with performance and results. Agencies and the Government as a whole must continue to work to implement systems that report financial and program information quickly and reliably, and then to use that information in our stewardship of the Nation's resources.

Improving financial management information is PMO #2. This effort includes not only improved and timely financial reporting, backed by independent audits, but also the achievement of the financial systems goals of FFMIA.

There are, in addition, other PMOs that are of importance to our efforts to modernize and systematize financial management:

- To better manage Federal financial portfolios, we are working to implement the Debt Collection Improvement Act and other authorities to reduce delinquencies and defaults on obligations to the Government, through a combination of (1) borrower pre-screening prior to extending credit, (2) reporting and tracking delinquent debt, (3) greater use by agencies of the full range of collection tools, including collection services provided by Treasury and the Department of Justice, and (4) sale of loan portfolios to private institutions that can manage them more effectively.

- Another PMO is devoted to verifying that the right person is getting the right benefit. This is a three-pronged effort to (1) prevent improper payments up-front; (2) measure existing improper payments; and (3) recover identified overpayments. Sharing data across agencies can help achieve these goals, for example, by allowing up-front verification of identity, location, and income when appropriate for benefits programs. Information sharing can reduce underpayments based on mistakes in location; and reduce overpayments and corresponding costs in audit and collection efforts. The benefits of these efforts must be carefully weighed to take into account intrusions into personal privacy and paperwork burden.

- In addition to ensuring that agencies have adequate financial management systems, we also are concerned about the security of all Government systems. One of our PMOs focuses on computer security and protecting critical information infrastructure. OMB is working closely with the CFO Council, the Chief Information Officers Council, and the inspector general community to address cross-cutting issues in this area.

- We are also working to ensure that capital planning and investment control are used properly to ensure that information technology decisions meet Clinger-Cohen Act requirements.

Benchmarking Progress

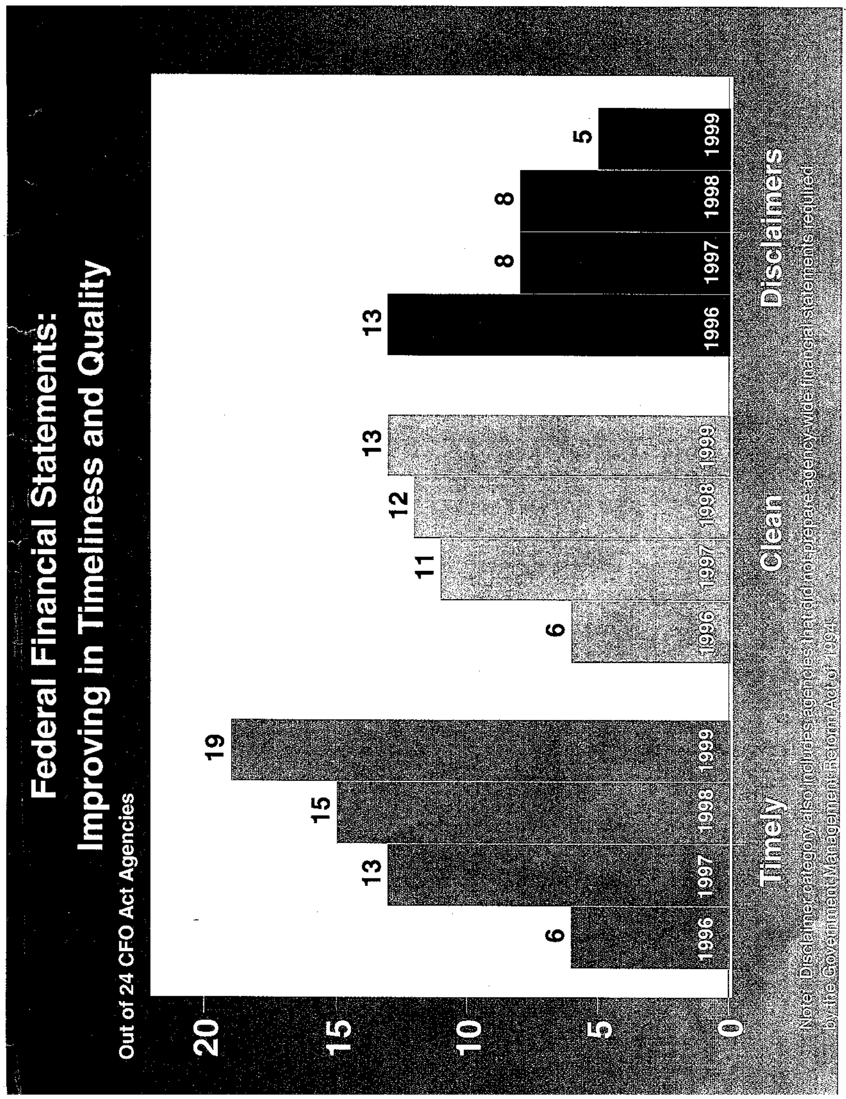
As this Committee knows, these improvements are difficult and progress requires great effort. We are making that effort. We have shown steady progress in each of the four years that audited agency financial statements have been required. Yet we have far to go. We expect much more in the coming years, for this is a process of years, not months. Modernizing financial management and reporting is a long-term process.

Nonetheless, what has been accomplished by the Federal Government in the past four years is extraordinary. Consider, for comparison, the experience of state governments, which began well before the Federal Government to prepare timely financial reports backed by independent audits. With few exceptions, individual states began issuing GAAP-based financial statements in the 1970s. In 1980, Standard & Poors, a rating agency, issued a policy statement directing that all state bond issuers' financial reports should be prepared in conformity with GAAP, audited by independent auditors and issued within six months of year end, lest their ratings be affected. By 1990 -- *ten years later* -- 43 states issued GAAP-based statements; of those, 25 -- *50% of all state governments* -- received an unqualified opinion. In 1995 -- fifteen years later – 49 out of 50 states issued GAAP statements; however, only about three-quarters received clean opinions.[1] By comparison, more than half (54%) of the CFO Act agencies were able to achieve clean opinions *in just four years*.

We will continue our efforts. We remain convinced that accurate, timely and complete financial statement information, supported by solid financial management systems, can help identify issues, establish priorities and provide the basis for sound policy decisions. This information will enable us to implement GPRA and integrate performance information into resource decisions and program management. And it will help provide the American people with the accountability they expect from their Government.

# # #

[1] Information obtained from surveys conducted by the National Association of State Comptrollers, *State Comptrollers: Technical Activities and Functions* in 1992 and 1996.


Federal Financial Statements:
Improving in Timeliness and Quality
Out of 24 CFO Act Agencies
20
15
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Timely
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Disclaimers
Note: Disclaimer category also includes agencies that did not prepare agency-wide financial statements required by the Government Management Reform Act of 1994.

Mr. HORN. Thank you. I just have one question before I call on Mr. Hammond, but that relates directly to OMB. Last year the administration set a goal of receiving a clean audit on the Government's 1999 consolidated financial statements. Now, in July 1999, you projected that 21 agencies would receive clean opinions but last month you revised the number to 18. Now we have 13 with clean opinions. What's the story on that?

Mr. GOTBAUM. As I mentioned in my testimony, Mr. Chairman, we think it's important to set goals and to be ambitious in our expectations for the agencies. This is an important effort and it's one we take very seriously. The agencies have been working and we, all of us, GAO, Treasury, and OMB, have been working with them to get their financial accounts in order. As recently as early January, all of the agencies thought they could meet the March 1 deadline and 18 of them thought they would be able to produce financial reports on which they would be able to get a clean opinion in some cases their auditors are GAO, in some cases their auditors are IGs, and in some cases they are private financial firms. In the process of developing their financial reports, a number of agencies found that they could not get clean opinions for a range of reasons. I'll give you just some examples so you get a sense of this, sir.

One agency did something that we think is absolutely essential: they installed a new financial management system. We think automated reports matter. One of the things that you must do when you install a new financial management system is you need to reconcile it to your old one. You need to transfer your data and make sure your accounts reconcile. That proved to be an enormous task and they couldn't finish it by March 1. They asked their auditor if they could keep going and their auditor said "no, I don't think this is something that can be resolved in a couple of weeks," and so that agency got a disclaimer whereas before they had gotten a clean opinion.

Other agencies found that when they were trying to reconcile information from their bureaus, that they didn't match the central accounts. This is again a little like Y2K, Mr. Chairman. When you find something that doesn't match, you then need to go back and figure out why these two things don't reconcile. And what happened is a number of agencies just couldn't do so.

We think two things are important. One is that we encourage progress and we continue to encourage progress and we continue to hold people accountable, to steal a phrase from my friend here again. We also think it's important to recognize when there is progress. My message here, Mr. Chairman, is that although we are a long way from the promised land, we've made very real progress.

Mr. HORN. Well, let me just followup with that. I noted in the earlier data that in 1999, July 1999, you projected 21 agencies that would receive clean opinions. Then last month you revised that number to 18 and now we presumably have 13 clean opinions; is that right?

Mr. GOTBAUM. We have 13 so far, Mr. Chairman.

Mr. HORN. As I understand it, when you released some data from your office on March 27, that was 18 agencies met your goal of receiving clean opinions. So I'm just trying to get it straight as to what your goals are going to be in a number next year. Are you saying everybody or are we saying 20. Are we saying 30, what?

Mr. GOTBAUM. In the budget, Mr. Chairman, when we put it together last fall we canvassed the agencies and even as late as January when we published the budget, 18 thought they could get clean opinions and we listed that as a goal. It is a goal. And for the reasons that I described, not all the agencies met their goal. We intend to keep pushing both to get clean opinions and to follow on the other point that both you and General Walker made, which is to make sure that we have the basis, we have the financial systems, et cetera, to continue to meet these goals on a reliable basis. That's really how we view our job.

Mr. HORN. Thank you.

Mr. Hammond, you have a rich background in government. When did you join the Treasury?

Mr. HAMMOND. 1980. February 1980.

Mr. HORN. I remember when I first came to this town as a young congressional fellow in 1950's the regard for Treasury and its career service there was the highest of any government agency and department. So I thought you might well have come up through that route and I noticed you now have a very awesome job, which is to be the Fiscal Assistant Secretary, and we welcome you and I know you've been before us before on loans and other things dear to my heart.

Thank you. We're glad to have you here.

Mr. HAMMOND. It's my pleasure.

Mr. Chairman, I'm pleased to appear today to discuss the matters involving the third annual financial report of the U.S. Government that we've issued in accordance with the Government Management and Reform Act. First, I'd like to thank you, Mr. Chairman, for your continued focus on the priority need to improve financial accountability and reporting in the Federal Government. And on a more personal note, I want to express my sincere appreciation for the outstanding effort and long hours of countless members of Treasury staff, especially at the Financial Management Service, GAO, and OMB, in making this report possible. A large number of the audience today is made up with professionals from Treasury and Financial Management Service who literally have spent an incredible couple of weeks making sure we met our timeliness objective, and I want to thank them very much.

While we have made steady progress and improvements over the last few years, significant challenges must be met before we can produce entirely reliable financial statements of the highest quality for the U.S. Government. The Department of the Treasury has been and continues to be a strong proponent of the development of financial statements for government agencies and for consolidated financial statements for the Government as a whole. Timeliness of reporting is an important first step in this process and it's one we always intend to meet.

The financial report is prepared based on the accrual basis of accounting as promulgated by the FASAB, which was this year designated as generally accepted accounting principles by the American Institute of Certified Public Accountants. We are extremely pleased and proud of this accomplishment and believe that GAAP recognition will improve the professionalism and public perception of our reports.

I think it's also interesting to note that the Federal Accounting Standards Advisory Board was formed, as my colleagues have pointed out, in 1980 through the joint efforts of GAO, OMB, and Treasury. I think what you've seen is 10 years of three agencies working hard together for a common purpose and that's a great example of the type of work that's been done.

Given the daunting challenges that faced us when we began this process just over 3 years ago, we have made substantial incremental progress this year. The preparation and audit processes are a rigorous one which must be completed subject to severe time constraints. It involves collecting and analyzing data from over 70 Federal entities. Since issuing the first consolidated financial statements, we have been working in close cooperation with OMB, GAO, and the program agencies to improve the quality of the report.

This past year we continued to focus much of our attention in three critically important areas: Consistency of financial information, elimination of intergovernmental transactions, and reconciliation of fund balances. I am pleased to report that we have made substantial progress in each of these three areas, because it is essential that the information provided by the agencies to Treasury for inclusion in the financial report be consistent with the information in the individual agency level financial statements. The agency level financial statements are audited separately and the audit of the governmentwide financial statements relies in large measure on the audits conducted of the agency level financial reports.

During the past year, OMB, Treasury, and GAO have worked diligently to dramatically improve the consistency of the financial information. We convened an interagency working group to identify barriers to consistency and to recommend solutions which resulted in a new verification process. This procedure I might point out is based on the U.S. Government's Standard General ledger, or SGL, which is required to be used in all agency financial systems by FFMIA. In addition, Treasury worked with each agency to reconcile their fiscal year 1998 ending net position. This reconciliation effort has improved significantly the opening balances for this year's report with the ultimate goal of having Treasury's opening balance agree with each of the agencies' opening balances.

The new process we're using to ensure consistency is a considerably more rigorous one. We are now in a position to review the data and do analyses to improve its consistency. However, this process is constrained by tight timeframes, dictated by the report's due date. We expect continued improvement in this area as the agencies become more comfortable with the reporting requirements. We feel comfortable that progress is being made although the consistency problem has not yet been resolved.

The audits have also disclosed that the agencies continue to be ineffective in identifying transactions with each other so that transactions can be reconciled or eliminated in the preparation of the governmentwide statements. If these transactions are not properly eliminated, total government assets, liabilities, revenues and expenses will be misstated by the net amount of these transactions. Starting 2 years ago, we provided two-digit identification codes for agencies to use in identifying their governmental transaction partners. The consistent use of these codes is critical to our ability to eliminate these intragovernmental transactions. During fiscal year 1999, trading partner data was distributed to agencies so that they could review and analyze the information and I might note that this year we received over 99 percent of the financial dollar value of transactions identified with those codes.

This past year we continued to focus also on resolving the intergovernmental elimination areas for the transactions between program agencies in either the Bureau or the Public Debt of the Federal Financing Bank, both Treasury entities. We instituted a new policy requiring program agencies to confirm and reconcile their end of fiscal year investment and borrowing balances with these entities. I can report for this year's activity the unexplained difference issue for these types of transactions has been resolved. Our progress in this area is evident when one recognizes that gross intragovernmental investments and borrowings not including annual activity amount to more than $2 trillion.

During fiscal year 1999, Treasury also put in place new procedures for reconciling transactions with the Department of Labor relating to the Federal Employees Compensation Act and transactions with the Office of Personnel Management relating to employee benefits.

Regarding buying and selling transactions between Federal agencies, we issued elimination guidance to all agencies covering accounting and reconciling procedures for fiscal year 1999 reporting. The requirements for reconciliation with agency trading partners on a regular basis are more detailed and formalized than in previous years and are designed to create a disciplined routine approach to these transactions.

Treasury has also made significant efforts to assist agencies in reconciling their fund balance amount with the amount reported to them by Treasury. The fund balance amount is an agency level asset account and it reflects the available budget spending authority for that agency. We regularly notify agencies of their discrepancies in their fund balances and work with them to help them resolve them in a timely fashion.

During this past year, Treasury issued policy and detailed procedural guidelines for reconciling the fund balances and offered numerous education programs. These differences are for the most part timing differences and most are now quickly resolved. As an example of that, when you review those differences greater than 5 months old, in explanation, in three key areas, deposits, disbursements, and checks issued, the differences governmentwide are $91 million, $58 million, and $251 million respectively. We do, however, agree that further improvements in this area need to be made. Reconciliation of fund balances needs to be a routine, ongoing accounting function that is done on a timely basis. Agencies have made significant strides to institutionalize the process and we expect more progress this year.

Despite the substantial progress in the past year, the current state of Federal financial reporting requires significant improvements in a number of areas. I am confident that with the coordinated, committed effort of Treasury, OMB, the CFO council, and the GAO these improvements will be achieved. In the short term, we will continue to make those changes necessary to improve the preparation of our report. In the long term, as I announced last year, we are embarking on a project to make fundamental changes in the way we do Federal accounting.

Our most significant short-term challenges in addition to fund balance reconciliations continue to be in three specific areas and they come as no surprise: Consistency of agency data, eliminating intragovernmental transactions, and providing a complete reconciliation of the budget results with the financial statements. Regarding consistency in April we will meet with GAO and OMB to jointly evaluate the new process that we just implemented and formulate further improvements in procedures, guidance, and analysis.

Regarding the elimination of intragovernmental transactions, most of our efforts will be to identify and put in place additional processes to improve reconciliations with Labor and OPM as well as to reconcile buying and selling transactions between Federal agencies. We will be successful when we have accomplished this completely.

Regarding reconciliation of the budget results, we have developed a data model to systematically reconcile the majority of the necessary transactions. We will be testing this model this summer. We have pilot agencies and, working with GAO, we hope to be able to make significant progress in this area this year.

A further challenge for us in improving the reliability and accuracy of financial information is the need to increase the use of the SGL in agency accounting systems. As agencies move closer to full compliance with FFMIA and more importantly use SGL base data as the basis for statements, financial reporting at every level will be considerably improved.

For the future, I'd like to close with just a couple of thoughts of where we're going. The preparation of this report has highlighted that our current systems for reporting budget execution information also need to be improved. In conjunction with the changes being made, Treasury working through its governmentwide accounting modernization initiative at the Financial Management Service will improve the processes associated with the reporting of budget information as well as associated with maintaining each fund account balance with Treasury. This project will fundamentally change the processes that program agencies use to report financial data to the central agencies and provide program agencies with more useful and timely presentation also of their data and improve the reliability of governmentwide totals published by OMB and Treasury.

On a short term basis we intend to make improvements using Web based technology to allow information from our Legacy systems to be accessed. In the longer term, we intend to make fundamental changes to the overall processes to streamline reporting, eliminate reconciliation burdens and further improve access to accounting data. The major objectives are to provide program agencies with one stop shopping using Internet technology to retrieve information provided to Treasury and to greatly reduce the reporting and reconciliation burdens on the agencies.

In closing, improving financial management and accountability has been and remains an important Treasury priority. We have taken and will continue to take actions to correct weaknesses and address problems in the preparation of the governmentwide financial statements and will continue to take a leadership role in providing guidance and assistance and support to agencies in their ongoing efforts. Our ultimate success will be achieved when we can reliably report on the disparate financial activities of the many components of government seamlessly, as if they were a single entity.

Thank you, Mr. Chairman. That concludes my formal remarks this morning.

Mr. HORN. I thank you. We appreciate the complexity to which you went.

[The prepared statement of Mr. Hammond follows:]

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EMBARGOED UNTIL 10:00 A.M. EST
Text as Prepared for Delivery
March 31, 2000

TREASURY FISCAL ASSISTANT SECRETARY DONALD V. HAMMOND TESTIMONY BEFORE THE HOUSE GOVERNMENT REFORM SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY

Mr. Chairman and members of the Subcommittee, I am pleased to appear today to discuss matters involving the Financial Report of the U.S. Government. First, I would like to thank the Chairman, the Ranking Member, and other members of the Subcommittee for your continued focus on the priority need to improve financial accountability and reporting in the Federal Government. While we have made steady progress and improvements over the last few years, significant challenges must be met before we can produce entirely reliable financial statements of the highest quality for the U.S. Government.

BACKGROUND

The Department of the Treasury has been, and continues to be, a strong proponent of the development of financial statements for Government agencies and for consolidated financial statements for the Government as a whole. The Government Management Reform Act of 1994 (GMRA) requires the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, to submit to the President and the Congress not later than March 31 of each year audited financial statements for the preceding fiscal year covering all accounts and associated activities of the executive branch of the United States Government. This is the third year audited financial statements have been prepared on a government-wide basis and submitted in accordance with the statutory due date of March 31. Timeliness is an important first step in the process and one we always intend to meet. The Financial Report of the U.S. Government for FY 1999, which includes the financial statements, provides the President, the Congress, and the American people with information about the Government's financial position, the cost of its operations, and its sources of financing.

The Financial Report of the U.S. Government is prepared based on the accrual basis of accounting as prescribed by generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB). GAAP recognition was achieved this year by FASAB through a comprehensive process developed by the American Institute of Certified Public Accountants (AICPA). We are extremely pleased and proud of this milestone because it clearly demonstrates that the government's standards have been developed through a fair and open process and that our accounting aspirations are of the highest magnitude. In addition, GAAP recognition will improve the professionalism and public perception of our reports. We also believe that this reflects favorably on the level of financial professionalism in the Federal government and, thereby, allow us to more effectively compete for essential accounting expertise.

PROGRESS MADE

We continue to be committed to producing financial statements that meet the highest standards. Given the daunting challenges that faced us when we began this process just over three years ago, we have made substantial incremental progress this year towards this goal. Since issuing the first consolidated financial statements in March 1998, we have been working in close cooperation with OMB, GAO, and the program agencies to improve the quality of the Financial Report. Within the Treasury Department, the Financial Management Service (FMS) undertakes the tremendous operational task of producing these statements under very tight deadlines. This past year we continued to focus much of our attention in three critically important areas. First, ensuring that the financial information reported to us by the program agencies is consistent with the information in the agencies' own financial statements. Second, identifying, reconciling and eliminating intragovernmental transactions. And third, assisting agencies in reconciling their fund balances with Treasury records. I am pleased to report that we have made substantial progress in each of these areas.

Consistency of Financial Information

It is essential that the information provided by agencies to Treasury for inclusion in the Financial Report be consistent with the information in the individual agency-level financial statements. The agency-level financial statements are audited separately and the audit of the government-wide financial statements relies in large part on the audits conducted of the agency-level financial statements. Consistency problems arise when agencies provide information to Treasury that is classified differently or fail to provide information that was included in their agency-level financial statements. This is a problem that needs to be addressed at the agency level and uniformly across government with guidance from OMB, Treasury, and GAO. During the past year, OMB, Treasury, and GAO have worked diligently to dramatically improve the consistency of the financial information. We have taken significant steps towards accomplishing this objective.

Treasury has taken many actions to improve consistency. We convened an interagency working group to identify barriers to consistency and recommend solutions. As a result of the efforts of this working group, a new verification procedure was implemented. This procedure requires that agency CFOs and IGs work together to submit a comprehensive worksheet to Treasury, OMB, and

GAO, which crosswalks the agency audited financial statement data to the data submitted to Treasury. This worksheet enables OMB, GAO and Treasury to determine if the financial data is consistent. It also provides the central agencies with a more detailed understanding of the data presented in the agencies' statements though it shifts much of the burden of the analysis from the agencies to FMS and GAO. This worksheet is based on the U.S. Government Standard General Ledger (SGL), which is required to be used in all agency financial systems by the Federal Financial Management Improvement Act (FFMIA) of 1996.

In addition, during this past summer, Treasury worked with each agency to reconcile their FY 1998 ending net position. This reconciliation effort has improved significantly the FY 1999 opening net position balances, with the ultimate goal of having Treasury's opening balance agree with the agencies' opening balance. Treasury also met with all 32 reporting entities that are required to verify consistency to discuss processes, to review performance, and to understand issues that affect agency financial statements.

Agencies report both adjusted trial balance (ATB) data and more detailed footnote data to Treasury. In the past, the amounts reported in the two sets of data often did not agree. To help rectify this problem, this past year Treasury introduced an enhancement that informed agencies of the ATB totals at the time they report their footnote data. This procedure was designed so that agencies can make certain that their totals agree before the footnote data is transmitted to Treasury.

Treasury also held a Senior Executive Forum, which was well attended by agency CFOs and IGs. The forum allowed CFOs and IGs, OMB, Treasury, and GAO to exchange ideas and information in search of solutions to these common problems.

We have made substantial progress over the past year in improving data consistency. The new process we're using to ensure consistency is a considerably more rigorous process than was used last year. With the agency worksheets, we are now in a position to review the data and do analyses to improve the consistency of the data. However, this process is limited by the tight timeframes dictated by the report's due date. This process will show continued improvement as the agencies become more comfortable with the reporting requirements. We feel comfortable that verifiable progress is being made although the consistency problem has not yet been resolved.

Elimination of Intragovernmental Transactions

The audits of the agencies' financial statements have disclosed that the agencies continue to be ineffective in identifying transactions with each other so the transactions can be reconciled or "eliminated" for government-wide reporting. If these transactions are not properly eliminated, total Government assets, liabilities, revenues, and expenses will be misstated by the net amount of these transactions.

Treasury continues to make significant progress to achieve the goal of reconciling certain intragovernmental transactions so that they can be properly eliminated. Starting two years ago, Treasury provided two-digit identification codes for agencies to use in identifying their governmental transaction partners. The consistent use of these codes is critical to our ability to eliminate these intragovernmental transactions. During FY 1999, trading partner data was distributed to agencies so that they could review and analyze the information.

This past year, Treasury continued to focus on resolving the intragovernmental elimination issues for the category of transactions with the largest dollar amounts. These involve transactions between program agencies and either the Bureau of the Public Debt or the Federal Financing Bank (FFB). Last year, we reported that we were unable to explain $1.426 billion in intergovernmental investment and borrowing transactions. I can report that for this year's activity the unexplained difference issue for these transactions has been resolved. A major reason for this is that Treasury instituted a new policy requiring program agencies to confirm and reconcile their end of fiscal year investment and borrowing balances with Public Debt and the FFB. We don't have specific explanations for about $6.4 million in differences, however, we are confident these transactions have no impact on the financial statements. Our progress in this area is evident when one recognizes that gross intergovernmental investments and borrowings, not including annual activity, amount to more than $2 trillion.

During FY 1999, Treasury also put in place new procedures for reconciling transactions with the Department of Labor relating to the Federal Employees' Compensation Act (FECA) and transactions with the Office of Personnel Management (OPM) relating to employee benefit programs. We made progress in this area in disclosing out of balance conditions but more work will be necessary before a complete reconciliation can be effectively performed.

Regarding buying and selling transactions between Federal agencies (which have high transaction volumes but smaller dollar amounts), Treasury issued elimination guidance to all agencies covering accounting and reconciling procedures for FY 1999 reporting. The requirements for reconciliation with agency trading partners on a regular basis are more detailed and formalized than in previous years and designed to create a disciplined, routine approach to these reconciliations.

In addition, Treasury, OMB, and GAO have been actively working together in governmentwide task forces to solve the elimination problems and improve the financial reporting of the government. Recently, the CFO Council Intragovernmental Eliminations Task Force was created to sponsor an initiative to develop a web-based application that will support the FY 2000 confirmation and reconciliation process. The CFO Council also formed another group to more clearly define the issues preventing us from completely eliminating intragovernmental buying and selling transactions and suggest long-term solutions to the issues identified.

Treasury is committed to continue working with agencies to assure that intragovernmental transactions are properly accounted for and reported in agency financial statements and also properly identified and eliminated at the consolidated financial report level.

Reconciliation of Fund Balances

Treasury has made significant efforts to assist agencies in reconciling their fund balance amount with the amount reported to them by Treasury. The fund balance amount is an agency level asset account that reflects the available budget spending authority of that agency. Treasury regularly notifies agencies of potential discrepancies in their fund balances, as compared to Treasury records, and agencies are responsible for resolving the differences in a timely fashion. Today, the discrepancies most often are a result of timing differences and are normally quickly resolved.

During this past year, Treasury issued policy and detailed procedural guidelines for reconciling the fund balances; we held agency forums in San Francisco, Dallas, Kansas City, Philadelphia and Washington; and, we continued to offer formal training courses. Since being established last year, the FMS web-site on this subject has been accessed over 1,000 times. FMS, through its Center for Applied Financial Management, continues to offer a number of core competency courses in financial reporting and reconciliation. One such course is "Reconciling Fund Balance with Treasury". As an example of the level of interest, more than 200 individuals from 12 cabinet departments have taken this training.

Recently, Treasury and DOD personnel concerned with problems and issues associated with these reconciliations established a program of monthly meetings to facilitate communication and to further improve the reconciliation process at DOD.

On a government-wide basis, as of September 30, 1999 there were about \$883.1 million, \$104.0 million, and \$7,312.7 million net differences between our records and those of the program agencies in three key areas - Deposits, Disbursements, and Checks Issued. These differences represent cumulative net differences since the early 1960's when the current central accounting system was originally built. These differences are, for the most part, timing differences (much like your checkbook and your bank statement) and most are quickly resolved by the agencies. For example, when you review only those differences greater than five months old, the differences are \$91.6 million, \$58.8 million, and \$250.9 million respectively.

We do, however, agree that further improvements in this area need to be made. As discussed in our long-term challenges, this is an area where change is needed. Reconciliation of fund balances needs to be a routine, on-going accounting function that is done on a timely basis. Agencies have made significant strides to institutionalize the process and we expect to see additional improvements in FY 2000.

CHALLENGES

While we believe we have made substantial progress in the past year, the current state of federal financial reporting requires significant improvements in a number of areas. I am confident that with a coordinated, committed effort by Treasury, OMB, the CFO Council and the GAO these improvements will be achieved. Much remains to be done both in the short and long-term horizons. In the short term, we will continue to make those changes necessary to improve the preparation of the Financial Report of the U. S. Government. In the long term, as I announced last year, we are embarking on a project to make fundamental changes in the way we do federal accounting.

Short-term

Our most significant short-term challenges continue to be in the three specific areas that we have been working on over the last two years as well as eliminating fund balance differences as an area of ongoing concern. First, we need to further refine and improve the process to ensure consistency between agency financial statements and data used to produce the Financial Report of the U.S. Government. Second, we need to continue to make substantial progress in eliminating intragovernmental transactions. Finally, we need to fully develop the process for a complete reconciliation of the budget results with the financial statements' results of operations.

Regarding consistency, in April, we will meet with GAO and OMB to jointly evaluate the new process implemented this year and formulate improvements in procedures, guidance, and analysis. By building on the agency crosswalk process and learning from its implementation in FY 99, we expect to make additional progress in this area. This process also highlighted the need to be able to thoroughly analyze the data submitted by the agencies.

Regarding the elimination of intragovernmental transactions, most of our efforts will be spent working with OMB and the program agencies to identify and put in place additional processes to improve reconciliations with Labor and OPM as well as to reconcile buying and selling transactions between Federal agencies. We will be successful in this area when agencies routinely conduct these reconciliations and resolve any differences on a regular basis.

Regarding reconciliation of the budget results with the Financial Report's results of operations, we have developed a data model to systematically reconcile the majority of the necessary transactions. We have retained a private contractor to help us test the model and assist in identifying any additional information necessary to perform a thorough reconciliation. Two pilot agencies have been identified to participate in this process. This summer, after testing the model and identifying additional data needs, we will make the necessary modifications to reporting systems for data collection for the FY 2000 Financial Report. With the continued assistance of GAO, we are working to improve the process.

A difficult challenge in improving the reliability and accuracy of financial information is the need to increase the use of the SGL in agency accounting systems. Our ability to prepare the consolidated financial report using SGL data so that it is consistent with data in agency statements is hampered by the fact that a large number of agencies do not properly use the SGL. In many instances, agencies cannot adequately produce and send the SGL data to Treasury because their systems do not record accounting events using the SGL at the transaction level as mandated by the FFMIA. This results in additional workload and processes to ensure that amounts are recorded in the proper accounts. Additionally, this frustrates attempts to maximize efficiency through the creation of automated analytical tools. As agencies move closer to full compliance with FFMIA, and more importantly, use SGL-based data as the basis for their agency financial statements, financial reporting at every level will be considerably improved.

Long-term

The preparation of a consolidated financial statement for the U.S. Government has highlighted that our current systems for reporting budget execution information also need to be improved. In conjunction with the changes being made to improve the processes associated with the Financial Report, Treasury, through its Governmentwide Accounting Modernization Initiative, will improve the processes associated with the reporting of receipts and outlays in the "Monthly Treasury Statement" and the "Annual Report" as well as those associated with maintaining each fund account's balance with Treasury.

This project will fundamentally change the processes that program agencies use to report financial data to the central agencies, provide program agencies with more useful and timely presentations of their data and improve the reliability of governmentwide totals published by OMB and Treasury. Our approach is to work with program agencies, OMB and GAO in implementing both short-term and long-term improvements in central accounting and reporting processes. On a short term-basis we intend to make improvements which should assist agencies in reconciling their fund balances by making information available from our legacy system using web-based technology. Accounting information will be available "next day" whereas it is not now available until 5-6 weeks after the transaction occurs.

In the long-term, we intend to make fundamental changes to the overall processes in our central accounting system to streamline reporting, eliminate reconciliation burdens, and further improve access to accounting data. The major objectives are to provide program agencies with one stop shopping using internet technology to retrieve information provided to Treasury and to greatly reduce the reporting and reconciliation burden on program agencies.

CONCLUSION

Improving financial management and accountability has been and remains an important Treasury priority. We have taken and will continue to take actions to correct weaknesses and address problems in the preparation of the governmentwide financial statements. Treasury will also continue its leadership role in providing guidance, assistance and support to agencies in their on-going efforts to improve their accounting practices and financial management systems. Our ultimate success will be achieved when we can reliably report on the disparate financial activities of the many components of government seamlessly as if they were a single entity.

Thank you, Mr. Chairman. This concludes my formal remarks and I would be happy to respond to any questions.

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Mr. HORN. Let me ask you this question.

Under the Government Management Reform Act, agencies are required to submit audited financial statements by March 1 following the end of the fiscal year. In your testimony, a number of you have noted that five agencies did not meet the March 1 deadline, and OMB noted two still have not reported. Social Security, on the other hand, managed to have audited financial statements 6 weeks after the end of fiscal year. Obviously, my query to the administration is, why is there a disparity in agency reporting performance and what prevented the five agencies from meeting the March 1 deadline?

Mr. GOTBAUM. Probably I should take a crack at that, Mr. Chairman.

Mr. HORN. Yes.

Mr. GOTBAUM. The reason that different agencies have different performance is because some agencies started earlier than others.

The Social Security Administration, for example, very admirably a long time ago instituted the requirement that they report and began developing the automated computer systems that permit them to do so reliably and quickly. That is precisely the goal Don talked about that we aim for for the government as a whole.

Most other Federal agencies are in a different circumstance. They are simultaneously having to develop the account structure, because they don't all use the standard general ledger, and develop the computer systems to use that account structure, to integrate their various enterprises. And different agencies are at different levels of the process.

Mr. HORN. Is there a penalty that the executive branch has on any of the agencies that are laggards?

Mr. GOTBAUM. We are active with the agencies and as a group—GAO, Treasury, and OMB—we meet with the agencies. We met with them in the fall. We have talked with them continually during the audit process, and we will continue doing that.

Mr. HORN. The answer to the question is—the penalty is talking to GAO, OMB, and Treasury? What do you do? If you have constantly some agencies that don't get it, what can you do with them?

Mr. GOTBAUM. Mr. Chairman, when we both testified before House Rules a week or so ago, I made a point that some of the activities that we do in the course of management internally at the executive branch are what I will characterize as "private criticism." I think it behooves us not to say we affected people's budgets, affected personnel decisions, etc. But I think it is important and entirely appropriate for the committee to ask.

I think it is important that the committee should know that OMB is involved in the budgetmaking process actively for each of these agencies. And we are—courtesy of you, we are also involved in the personnel decisions. Without getting into individual cases, I wanted to say that we work on it case by case, agency by agency, and their circumstances are different.

Mr. HAMMOND. If I might add, as we focus more and more on resolving the issues on a governmentwide basis, timeliness has a key factor in playing into that. So it receives a lot of attention with regard to their individual statements but also in solving the governmentwide reporting issues.

Mr. WALKER. Mr. Chairman, if I can reiterate a couple of things.

First, Social Security, as an example, voluntarily prepared financial statements, voluntarily decided to have an external audit before it was required to do so; and I think Social Security in many ways has been a model in a variety of ways with regard to management. They had commitment from the top and got their systems together, and the result of that is that they have not only gotten clean opinions for a number of years, but they have been able to issue their financial statements 6 weeks after the end of the year.

Just to reiterate what I said before, it is important to get these clean opinions. That is an objective milestone, but in many cases I think too much emphasis gets placed on that such that people think that after they have gotten a clean opinion the ball game is over. They have won. They have hit the milestone. And, in many cases, they are just getting started.

Mr. GOTBAUM. Mr. Chairman, one further point. General Walker is exactly right. We put a lot of emphasis on the fact that we are getting an increasing number of clean reports, but, frankly, I take as much pride from that last set of lines on the chart, which is that the number of agencies whose accounts were in such shape that no opinion could be expressed at all, disclaimers, has gone from 13 in fiscal year 1996 to 5 in fiscal year 1999. So General Walker is exactly right. There is more to this game than just clean opinions, but we think that we are working agency by agency and making very real progress.

Mr. HORN. I am delighted to have Mr. Kanjorski for the ranking member today. He may take such time as he wishes to ask all of the questions that he wants.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Walker, when they arrive with that clean bill of health, they do not carry on and keep an accounting system ongoing, is that the problem that you are facing?

Mr. WALKER. The issue really is that it is not just getting a clean opinion on your financial statements as of a date, 6 months after the end of the year. It is making sure that you have sound internal controls throughout the year, and it is making sure that you have timely, accurate financial and management information throughout the year such that you can make informed decisions to maximize performance and ensure accountability.

I think what we are seeing, quite frankly, is that there has been such a change in the world with the advent of technology that, while getting clean opinions on historical financial statements is important and it is something that ought to be demanded, the fact of the matter is that of increasing importance are things about internal controls, things about basic systems, things about projections looking forward, things about results and what type of results are generated for the dollars that have been provided. And so I think we have to recognize that getting a clean opinion is important, but a lot of times these agencies will get clean opinions but they don't have their act together for day-to-day decisions.

Mr. KANJORSKI. Have we provided the funds consistent with getting their accounts together?

Mr. WALKER. There are circumstances under which we are going to have additional targeted investments in order to get where we need to be.

For example, if you look at the clean opinions, there is no doubt that there has been progress, and if you look at the number of disclaimers, that is great, but if we look at compliance with the Federal Financial Management Improvement Act, an overwhelming majority are not in compliance with the act and an overwhelming majority are not in compliance with that act because of computer security and other systems problems and because of these legacy systems.

I think it is critically important that we recognize that not just for financial management but for accountability and performance management reasons we have to look at whether or not there is being enough invested to get those to where they need to be to ensure that we have a results-oriented government.

Mr. KANJORSKI. There is a movement on the Hill among a lot of Members seriously now looking at a 2-year budgeting cycle. Would that be helpful in the process of management of the executive branch of government?

Mr. GOTBAUM. Coming from the Office of Management and Budget, I should say that it is our view, Mr. Kanjorski, since we are intimately involved in the management and budgeting process, we have thought that it did make sense to consider a 2-year budgeting cycle for two separate reasons. One is that over the past several years what we have found is that the decisionmaking process, both internal to the executive branch and the appropriation and budgeting process in the Congress, has begun to overlap. It has become more involved, it has become more time-consuming, and so we are getting to the point where we are in the process of spending a lot of time, sometimes in the same day, negotiating one fiscal year's budget while attempting to put together the next year's. So we think that there is some benefit from working on a 2-year process rather than one.

The other reason is that it would also permit the opportunity for both us and for the Congress in the off year, whatever it is, to focus on oversight and management and to give a stage, if you will, for these issues which we think are very important, but which necessarily compete in your decisionmaking and in our decisionmaking for time. So we think that there is a benefit, and we hope the Congress will consider it.

Mr. HORN. I might add that we—at least I agree with you, and I so testified before the Rules Committee, that the appropriations subcommittees ought to do a better job, and we think that they could with at least a pilot experiment and see what happens.

Mr. KANJORSKI. My experience in the last 15 years of Congress is that the organizational structure is woefully inadequate in terms of who has jurisdiction over what. For instance, I am involved in examining new technology of—nanotechnology. I look through the departments and bureaus, and there is no individual who has responsibility over that. It is scattered throughout. Four or five departments have programs in this. It seems to me that it is an extraordinary staffing cost, and it tends to be a jurisdictional dispute.

Who has more troops in the field and who has the largest segment of the budget so they are bigger than the other guy?

Over the last several years I have been coming to the thought that when the Congress tries to legitimately inquire into the functioning of the executive branch, we don't do a very good job because of the mismatch of jurisdiction and function within the government.

Now the question is, all of that is a prelude. Do you think that it is time in the beginning of the 21st century with the advantage of having five living Presidents as of January 21, former Presidents, to ask and maybe form on the executive branch something similar to the Hoover Commission for reorganization of the executive branch but simultaneously to study and reorganize the legislative branch to make them more synergistic in relationship and jurisdiction?

If we did that, how long would it take to establish the plan and how long would it take to implement the study?

Mr. WALKER. Mr. Kanjorski, 2 days ago, I testified before the Senate Governmental Affairs Committee on the issue of management challenges in the 21st century. That testimony was directly relevant to your question.

One of the things that we used as a basis for that testimony was our new strategic plan which summarizes the major challenges facing our country and Nation for the next 6 years in accordance with GPRA's strategic planning horizon. It is clear when you look at that plan that there are major challenges both in the legislative branch as to how it is organized and whether it can effectively address those challenges as well as the executive branch. Because, in many cases, what we find is that the organizational structure was set up years ago, and that more and more we are having issues that require a multiplicity of skills and entities to get involved in order to solve it.

And so we do believe at the GAO that the time has come for government to step back and look forward rather than back and ask ourselves about whether or not we are focusing on the right things and whether we are organized in the right manner in order to maximize performance and assure accountability.

We also issued a report 2 days ago at that same hearing noting a tremendous number of duplications and overlaps in areas like food safety, anti-terrorism, etc, where in food safety you have 6 different entities involved and anti-terrorism, you have 40, and in some cases you don't have anybody in charge. Yes, the time is right. A commission is one possible option.

There were two Hoover commissions. One was more successful than the other, and I think we ought to learn from the ones that are more successful versus the ones that are not. We would be happy to work with Congress to try to provide additional information as to what has and hasn't worked in that regard.

Mr. KANJORSKI. Do you have any idea as to how long it would take to draw the plan? If Congress were to act in the latter part of this session, how long would it take to send something up on how it would function?

Mr. WALKER. Senator Thompson and Senator Lieberman introduced a bill which focused more on the executive branch. The legislative branch issue did come up in the hearing, but I don't think that it is the subject of the bill. I think they were talking about a period of 1½ to 2 years. I wouldn't want to comment whether that is adequate or not.

Mr. KANJORSKI. Is that a defined plan or was it to go through the study?

Mr. WALKER. That would be for the commission to report. That is, I think, potentially ambitious. I think their thought was to try to get it authorized and get it—the commission started and to end within one Congress. Now that is ideal. It may or may not be possible.

Mr. KANJORSKI. We have been working diligently for the last 25 years on campaign finance reform and have a tendency to run into difficulties. One of the thought processes I have been going through is that seems to me to be as a result of its immediate effect on the political advantages or disadvantages of the majority, the minority, and the various party structure.

Would it be possible to do executive reorganization and legislative reorganization and take maybe 8 or 10 years for it to be actually triggered so that those of us who make the decision will not be interfering with whatever our relative positions are in government and will probably be out of government by the time it is implemented and, therefore, it is not a threat to the personalities involved, either in the executive branch or the legislative branch?

Mr. WALKER. It is not uncommon when one is engaging in a major restructuring that there be a phase-in with regard to those restructurings. From a practical standpoint, for a commission to be successful, part of the issue is that it has to be focused on what I would call a theme of good government which inherently is nonpartisan or nontheological. It is not what government is going to do, per se, but how can government best go about attacking the issues, that there has already been decisions regarding what government ought to be doing, so how best can we go about it.

I think that has the greatest degree of hope of being able to accomplish and being done on a bipartisan basis. When you get into the issue of what government ought to be doing, and there is a legitimate need to talk about that, too, at the dawn of the 21st century, that is inherently important, but it is inherently more difficult.

Mr. KANJORSKI. The financial statements and the progress that you have made over the last several years, are they structured in such a way that they would be helpful in that process so there is better understanding and accountability? Is this system able to be utilized for the next step, if you will?

Mr. HAMMOND. I will take a stab at that.

I think the governmentwide financial statement, as it is currently organized, does allow you to get—once the data behind it is reliable, to get an accurate picture of the scope of government operations in a nonagency-specific fashion. It tends to present the information by program or core function of government and consolidates and brings in the pieces from each of the agencies that would flow into those various components. That is one of the reasons that it is so difficult to put it together, is to try to piece the pieces out of this agency and that agency that flow together in a particular format.

I think it would be somewhat helpful in giving at least the financial understanding of the scope of the government's operations and where its resources are most heavily devoted, but sometimes that can be deceptive. Certainly Social Security payments are a huge portion of the government's outlays but as a practical matter represent a very small portion of the government's operations from a personnel standpoint, for example.

Mr. KANJORSKI. You can say off accounting and off the organizational structure. Even though there are large segments, we are talking about the operating portion of government?

Mr. HAMMOND. Right.

Mr. WALKER. Mr. Kanjorski, for the record, I think it is important to note that we at GAO, which is an entity, as you know, that has a broad view of the government, we get involved in everything that the government is doing. We are using the strategic plan that I mentioned earlier as a basis to reorganize and realign ourselves to be better positioned for the future. And I might commend to you and the chairman this accountability report that we just issued last week, which is our accountability report for fiscal year 1999 which includes our financial statements and our performance report but also a one-pager on our strategic plan which, frankly, might be helpful with regard to the issue that you are talking about.

Mr. KANJORSKI. I don't know whether I should ask you a real subjective question, but we used to have an office around the Hill that served the Congress with technical assistance. I think the Contract with America shot that down, and we seem less prepared than ever to have an understanding of the technical side of what government is dealing with. Is there any way that we can find a new institution of that nature to substitute for the role that it used to play?

Mr. WALKER. Mr. Kanjorski, I don't have intimate familiarity with what happened to that entity, but you have the General Accounting Office. I think the amount of knowledge that exists within that agency——

Mr. KANJORSKI. Mr. Walker, I appreciate your agency; but, quite frankly, the time between the question and the answer, three wars could be fought and resolved. Our problem is for Members, when we get things that are far out of our realm of understanding, to act and decide intelligently, we need a faster response than is generally available.

Mr. WALKER. I am glad you mentioned that. Because one of the things that we are doing right now is looking forward and trying to reinvent ourselves. We are looking at our portfolio of products and services, and you are probably talking about our blue cover reports, and it does take a considerable amount of time to get those out. We will always do those, but it is clear to me that our products and services need to be modified in the future in order to provide more technical assistance and quick turnaround assistance. There needs to be a more strategic partnership between the committees and the GAO to really focus on the most important issues where we can make a difference, and I think the Government Reform

Committee is uniquely positioned in the House to deal with the range of cross-cutting issues that have to be focused on.

Mr. KANJORSKI. Let me give you an example.

We had a hearing in the Banking Committee last week on reexamining the nature of regulation of government service enterprises. There was suggested new ways of doing things. One thing involved a very small authority that the Congress had given to the Federal Home Loan Banks, the right to have a super-lien capacity. It is in order to save time of placing liens in the Federal Home Loan Bank system that they always have a priority and they don't have to go through the normal processes in the 50 States to perfect their liens. It was thought that would be done away with, and they would have to follow the same order to perfect their liens.

Just a brief analysis. It seemed to suggest that it would cost something like $50 million to implement that little process, when in fact all of the regulators' costs, looking at the new mission, was $46 million.

I know—it was an unintended consequence. We are often coming up with what we think are smart solutions but are terribly expensive and, quite frankly, reregulating to an extent and not taking advantage of modern technology. That would be less apt to follow, but the result of that hearing was very interesting, too.

Just by raising the question, it affected the markets to the extent that the securities being sold that day went up about 14 basis points; and on one small issue of $5 million of certificates, it cost the agency or the GSE $50 million of additional cost and, as a result, drove up the interest rate on mortgages from that agency long term for all consumers in America a 16th of a point or something like that. We have a tendency to do these things all of the time and don't realize that tipping the ship or standing up in the boat can be very dangerous if you don't know the unintended consequences.

Mr. WALKER. I am somewhat familiar with those issues because in a prior life I was head of the Pension Benefit Guaranty Corporation, and there are certain statutory liens associated with that.

That is an example. You are obviously dealing with a quick timeframe. I think that is why you and we and other government agencies need to think about what can we do to make sure that you have the ability to draw upon the knowledge that we have in a timely manner, rather than having to wait on blue cover reports or whatever else. It is so-called technical assistance, if you will. I expect a much higher percentage of our resources at GAO will be dedicated to those types of activities because that is what is needed.

Mr. KANJORSKI. Very good. From everything that I hear with regard to the financial system that you are structuring, it is better than it has ever been, and it is moving forward. I want to compliment all of the individuals who have been involved with it. We have not reached nirvana, but we are still striving. Thank you.

Mr. HORN. I thank the gentleman for his wise words, and I agree with you on what you are trying to do with GAO with almost strike squads, because we have a difference of time without question here, as opposed to, let's say, to the executive branch. You have fundamental documents of state such as the budget and the economic adviser's report and that type of thing, and they come at certain times and their budget process is at certain times in relation to us, but we haven't changed much in Congress over time, as you know. We didn't have an executive budget until President Harding was finally able to get it through Congress. Before that, the Secretary of the Treasury simply took everybody's estimates, shipped it up here and everybody tore that apart in 13 subcommittees, and the House did abolish the whole appropriations committee in the late 19th century, and then they found money was going everywhere, and then they put the appropriations committee, which they started in 1865, they started over again with the appropriations committee.

Of course, with the Hoover Commission, you had two people that clicked, and that was President Truman and President Hoover. Franklin Roosevelt never even sent a postcard to Herbert Hoover. Truman was wiser and knew that there was a lot of experience that Mr. Hoover had done. He had been Wilson's food administrator in the First World War. He was Secretary of Commerce when it reflected every regulatory agency in this town. Hoover did that.

So what happens, I find, if you are going to get reform in Washington, it happens with a change of party. In 1946, they did a splendid job in terms of the Legislative Reorganization Act, the La Follette Act, and the Republicans could implement most of it. The Democrats would not implement it. Now that is not that there is something wrong with them. It is the fact that people are dug in in this place, more so in the Senate, by seniority.

I guess the prize example is little things like railways. It should have been with Transportation for the last 40 years. It hasn't been. Why? Because the long-serving Member and chairman from then West Virginia said, hey, I will only be around another couple of terms. Let's leave it with me. So the change came, and the gentleman who was next in line was told by the Speaker, Tip O'Neill, I think, that we would like to move it. And he said, over my dead body. You didn't make the deal with me.

So we didn't get those changed until 1995 when Speaker Gingrich started doing all sorts of things around here. And, guess what, railroads went with what was then Public Works and Transportation, now Transportation and Infrastructure. It was just a matter of major barons, be they Republican or Democrat, didn't want to change.

We spent $1 million when I came here in the 103d Congress on reform of the House in certain ways. That was a very distinguished group. That was Lee Hamilton on the Democratic side, David Dreier on the Republican side. They did an excellent job. Guess what? It never came to the floor. They didn't want reform or change.

Mr. WALKER. Mr. Chairman, two comments.

One, inside the same report talking about reform, reform can take time. There is a quote from Thomas Jefferson in 1802 where he is talking about the need for financial management reform in the U.S. Government. So let's hope on some of these things we can be on a little more timely basis.

Mr. KANJORSKI. 198 years ago.

Mr. WALKER. We didn't rush into it, Mr. Kanjorski.

Second, I would like to add for the record my thanks to the GAO team that was involved in this as well as others. Because I know, as one example, there were many people involved over many months, but I know a lot of people, including a number of our people and Treasury people, pulled an all-nighter on Wednesday in order to make sure that we hit this deadline, and I think everyone should be complimented for that.

Mr. HORN. My last substantive question relates to human capital. Are we getting the type of people that can help us in the new Civil Service in the next century that relate to fiscal resources and are we losing people? We know on the Y2K thing that a lot of fine people in the Federal Government were bought off by industry, and localities did the same thing. What are we doing to reach out and get top-flight people to help with this financial resource problem?

Mr. GOTBAUM. This is an extremely important issue. It is one which we in the executive branch look at and take seriously.

If I may talk about a couple of things that we are doing, and then I think it is important to let David talk about the long-term view.

Within the Chief Financial Officers' Council for the last several years, there has been a concerted effort both to assess what our needs are and how we can address them, and they have done a variety of things. This is under the leadership of the CFO of the Department of Labor. One is, change job descriptions to take advantage of the flexibility that we do have but we don't always use.

Second, joint recruiting. Agencies' CFO shops didn't go to three or four or five schools to get the best and brightest, nor did they develop joint recruiting materials.

So what we are beginning to do—and this is not to say that we have a solution or that we know that this is done, I don't want to mislead the committee in that regard—but what we are working on now is a variety of fronts to use the skills and the people we have and the flexibility we do have to bring in the talent we have, bring in the talent we need.

We are looking at other questions like, do you need job designations? Do you need changes in pay scales, etc? And we are not at the point where we can say definitely that we don't have the current flexibility within the Civil Service system to meet this challenge. So I don't want to mislead you and say that we don't think that there is an issue there. We think that there is an issue there, and it is an issue that we are working on using the current authorities and asking whether or not we need to come to you for additional authorities.

Mr. WALKER. Mr. Chairman, as I have said on more than one occasion, while there have been a number of management reforms throughout the 1990's—GPRA, CFO Act, FFMIA, Clinger-Cohen, etc—the missing link in performance- oriented government is the people link, the human capital link.

The Federal Government faces an emerging human capital crisis of significant proportion. It is smaller. Our human capital profile is that we are smaller and we are out of shape, and there are major succession planning challenges. This is an area likely to be on our high-risk list in January 2000. We are placing a lot of time and attention not only within GAO but governmentwide.

I know that the President has made this a PMO, the area of human capital. And I also would note for the record that we have published at least two recent blue cover documents that were done on a much more timely basis, I might add, talking about private-sector best practices and human capital as well as a self-assessment guide to try to help department agency heads help themselves deal with these challenges; and I think it is a major issue that this committee needs to be involved with.

Mr. HORN. I agree with you completely. We have a separate Civil Service Subcommittee, and that is one situation, but this is, as you say, a real crisis as people are starting to retire that were hired in, say, the 1960's and 1970's.

The same with universities across the country. One of my reforms, which took me 5 years to persuade various trustees, was the flexible pay in the university system for administrators. Overnight, it changed things. Because you worked out a contract. What are you going to do for the next 6 months? What goals are you going to achieve? We had flexibility, $10,000, got rid of all of the Civil Service bit, this little bit; and if you didn't say the magic word like Groucho Marx hanging up there, you didn't get an improvement and better pay.

Focus in on the ones where you really need people. Acquisition and purchasing, people bought off by private industry, what can we do to keep them in the Civil Service?

Mr. WALKER. We need to focus on key skills and competency, critical occupations; and we have to end up linking performance management systems, meaning performance award systems, with strategic plans and performance plans. That's when you'll get a situation where you are maximizing performance and ensuring accountability, and I think it means in time more flexibility in compensation so you can pay people for skills and performance.

Frankly, the American people should support that. If they are getting—if they are critical skills and they are getting performance, they are getting return on their investment, and that is what they care about.

Mr. HORN. Absolutely.

Mr. KANJORSKI. We may need to study how we can provide some educational programs for our staff so they don't have to leave to go to graduate school. I probably have lost 10, 15 excellent staffers that would have remained for 4 or 5 years more, but they had to leave to get a graduate degree and could not come back to government because of the cost involved.

Mr. HORN. We did have a group in the early 1960's, four of us that were assistants to the Democratic and Republican Whips in both Senate and House, we had money through the American Political Science Association to send them off to major institutions in the East and West to build their resources, and we were able to keep most of those people.

Mr. KANJORSKI. Does that slush fund still exist?

Mr. HORN. No. But our basic question was, how many books have you read recently? And I would hate to say that the committee didn't do that well in answering it. We have tried to invest in people here, and that is obviously needed, and you can at least get them away for 6 months or so. If we went to the 2-year cycle, we could help do that in both the executive branch and the legislative branch.

Well, any other questions you would like to ask your colleagues for the good of the order since you are all under oath? Don't say it is a pleasure to be here either, since you are under oath.

We really appreciate your coming, and we are glad to see progress, and we hope our little grading system will get on a few Cabinet office doors so they can get the machinery moving.

I want to thank the legislative people that put this hearing together: J. Russell George, staff director and chief counsel, on my left, your right; Louise DiBenedetto, GAO detailee to us; Bonnie Heald, director of communications; Bryan Sisk, clerk; Ryan McKee, staff assistant.

For Mr. Kanjorski, the minority staff, Trey Henderson, counsel, and Jean Gosa, minority clerk.

And we have had two people as court reporters, and that is Laurie Harris and Doreen Dotzler.

With that, we thank you for the help, and we thank you for the testimony.

[Whereupon, at 11:41 a.m., the subcommittee was adjourned.]

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