FINANCIAL REPORT OF THE U.S. GOVERNMENT
FOR FISCAL YEAR 2003

HEARING

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY
AND FINANCIAL MANAGEMENT
OF THE
COMMITTEE ON
GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES
ONE HUNDRED EIGHTH CONGRESS
SECOND SESSION
MARCH 3, 2004

Serial No. 108–145

Printed for the use of the Committee on Government Reform

Available via the World Wide Web: http://www.gpo.gov/congress/house
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE
93-724 PDF
WASHINGTON : 2004
# CONTENTS

Hearing held on March 3, 2004 .............................................................................. 1  
Statement of:  
  Hammond, Donald V., Fiscal Assistant Secretary, Department of the  
  Treasury ................................................................. 51  
  Springer, Linda M., Controller, Office of Federal Financial Management,  
  Office of Management and Budget ................................................. 39  
  Walker, David M., Comptroller General of the United States, U.S. General  
  Accounting Office ......................................................... 4  
Letters, statements, etc., submitted for the record by:  
  Hammond, Donald V., Fiscal Assistant Secretary, Department of the  
  Treasury, prepared statement of ................................................. 54  
  Platts, Hon. Todd Russell, a Representative in Congress from the State  
  of Pennsylvania, prepared statement of ........................................ 2  
  Springer, Linda M., Controller, Office of Federal Financial Management,  
  Office of Management and Budget, prepared statement of ............... 42  
  Towns, Hon. Edolphus, a Representative in Congress from the State  
  of New York, prepared statement of ......................................... 48  
  Walker, David M., Comptroller General of the United States, U.S. General  
  Accounting Office, prepared statement of ................................. 7
Mr. Platts. This hearing of the Subcommittee on Government Efficiency and Financial Management will come to order. I appreciate everyone’s attendance and participation here today. Because of your fine patience in waiting for us to get started here belatedly because of votes.

I am going to dispense with an opening statement and submit mine and, with the ranking member, Mr. Towns and others, I will ask them to do the same when they arrive. We will go actually right to our witnesses and get into your opening statements and then into questions.

[The prepared statement of Hon. Todd Russell Platts follows:]
Opening Statement
Congressman Todd R. Platts
March 3, 2004

The Financial Report of the United States and the accompanying audit of the report performed by the General Accounting Office (GAO) were released on an accelerated timeframe this year on February 27, 2004. Unfortunately, for the seventh straight year, GAO was unable to render an opinion on the Federal government’s financial statements. Again this year, GAO reported significant material deficiencies that affected both the financial statements and the management of government operations.

For fiscal year 2003, twenty of the 23 Chief Financial Officer Act agencies received unqualified or “clean” audit opinions on their individual financial statements. Of the 28 “major” departments, 24 received clean opinions. These numbers represent a leveling off of the progress that we have seen in financial reporting since 1997. The Department of Defense, the Small Business Administration, and the National Aeronautics and Space Administration, all CFO Act agencies, failed to receive clean opinions this year. Additionally, the Department of Homeland Security, which is not subject to the CFO Act, received a disclaimer opinion.

GAO points out in their audit report of the consolidated statement that the financial management problems at DOD are “pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department.” President Bush’s Administration has made improving financial performance a top priority. Secretary of Defense Donald Rumsfeld and the financial management team at DOD are working hard to improve the Department’s financial management system. With each fiscal year, DOD gets closer to obtaining an audit opinion. However, until DOD solves their financial problems and receives a clean opinion, the entire Federal government’s financial statement will continue to be unreliable.

The Department of Homeland Security, which came into being five months into the 2003 fiscal year, has made important strides in financial management. Having
inherited 18 material weaknesses from component agencies, they have managed to complete their audit and address many of the challenges they faced and obtain a qualified opinion on two of their statements. The other four statements, however, received disclaimers, revealing that although progress has been made, DHS still has a long way to go before its financial management is where it needs to be.

Congress has placed significant emphasis on the financial accountability of publicly traded companies and their responsibility to provide accurate information to investors. Congress and the Federal government have an equal, if not greater responsibility, to be accountable to our investors, the American taxpayer.

Our witnesses today will provide the Subcommittee with insight on the results of the consolidated financial statement and discuss areas that need improvement. Today, we are honored to have The Honorable David M. Walker, Comptroller General of the United States; The Honorable Linda Springer, Controller for the Office of Federal Financial Management at the Office of Management and Budget; and Donald V. Hammond, Fiscal Assistant Secretary at the Department of Treasury. I look forward to your testimonies.
Mr. PLATTS. I again appreciate your preparation in sharing your written statements ahead of time, and also being here with us today, and do thank you for your patience in waiting for us to get back over here.

We will start if we could ask each of you to stand and be sworn in, and any who will be advising you as part of your testimony also should stand and take the oath.

[Witnesses sworn.]

Mr. PLATTS. The clerk will note that all witnesses affirmed the oath, and again we appreciate your written testimonies. If it is OK with you, I was going to give a little bit of background on each of you, but for time sensitivities, everyone probably knows who you are and what you do and it will not be keeping much from them. So I think what we will do is go right into the statements.

Mr. Walker, if you would like to begin?

STATEMENT OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GENERAL ACCOUNTING OFFICE

Mr. Walker. Thank you, Mr. Chairman. It is a pleasure to be back to this annual hearing on the consolidated financial statements and our audit opinion relating thereto. I would like for my entire statement to be entered into the record, with your permission. Now I will move to summarize it. Let me note that I have a number of executives and other members of our financial management assurance team with me today. They are the ones on the front line doing the work that results in the issuance of our opinion. I want to thank all of them for their continued efforts and excellent work.

I would also like to note for the record that we have several colleagues from our sister organization, the National Audit Office in the United Kingdom who are visiting with us because for the first time in the United Kingdom's history, they will be required to express an opinion on the consolidated financial statements for the government of the United Kingdom for fiscal year ended 2004. So we are exchanging knowledge.

With that, I would like to note at the outset that this is an annual process which I appreciate the subcommittee making time for. It is a very important topic. Frankly, I think more people need to look at the results of these audits and the related financial statements.

As you know, as in the previous 6 fiscal years in which we have been required to report on the consolidated financial statements, certain material weaknesses in internal control and selected accounting and reporting practices resulted in conditions that did not enable us to provide an opinion to the Congress and the American citizens as to whether the consolidated financial statements of the U.S. Government are fairly stated in accordance with U.S. Generally Accepted Accounting Principles [GAAP].

I think it is important to note that this year, the principals of the Joint Financial Management Improvement Program, which includes the Director of the Office of Management and Budget, the Secretary of the Treasury, the Director of OPM and myself agreed to accelerate the agency financial statement reporting due date to
November 15 for the individual agencies for 2004 fiscal year, and to December 15 for the consolidated financial statements.

For fiscal year 2003, OMB required the CFO Act agencies to deliver their performance and accountability reports, including their audited financial statements to OMB by January 30, 2004. I am pleased to say, and I am sure Linda and Don will be even more pleased to say that all 23 of the CFO Act agencies met that January 30 deadline. Of these 23 CFO Act agencies, 8 actually issued theirs by mid-November, which is an encouraging sign.

A 24th major agency, the Department of Homeland Security, which is not presently subject to the CFO Act, issued its financial statements on February 13, 2004. As you know, Mr. Chairman, this is the first year they have had to issue and it is an amalgamation of a number of different departments and agencies.

With regard to the results, we see that 20 of 23 CFO Act agencies were able to obtain an unqualified audit opinion on their financial statements. That is up from six in 1996. At the same point in time, however, only 3 of the 23 CFO Act agencies had neither a material weakness in internal control or an issue involving compliance with applicable laws and regulations or an instance that lacked substantial compliance with FFMIA.

So of the 23 CFO Act agencies, 20 with clean opinions, but only 3 truly met the green requirement presumably for the President's management agenda, which I assume that Linda will be speaking more to that. In fact, there is another requirement in order to get a “green” designation, namely, having systems that provide for timely, accurate and useful information to make informed management decisions on a day-to-day basis. These three may or may not meet that requirement. Linda may know that.

The three major impediments to an opinion on the consolidated financial statements are, No. 1, serious financial management problems at the Department of Defense; No. 2, the Federal Government’s inability to fully account for and reconcile transactions between Federal Government entities, so-called intragovernmental transactions; and No. 3 the Federal Government’s ineffective process for preparing the consolidated financial statements.

If I can, Mr. Chairman, it is important to note what is not in the balance sheet of the U.S. Government. If you look at the balance sheet of the U.S. Government, you will see that since the beginning of our republic, we have an accumulated negative results of operations of approximately $7 trillion. That $7 trillion equals approximately the same amount as total Federal debt, both public debt as well as intragovernmental debt.

It is important to note what is not in the financial statements. The chart includes a few of the commitments, contingencies and obligations that are not in the financial statements. If you look at things like the debt held in the trust funds, which are not presently deemed to be a liability of the U.S. Government; if you look at the difference between promised benefits and funded benefits for Social Security and Medicare, and the discounted present value of the difference between related revenues and expenses of these funds, the number is not $7 trillion, it is more like $30 trillion or approximately $100,000 for every man, woman and child in the United States.
In addition, if you consider the preliminary estimates for the new prescription drug benefit, that new benefit is going to add probably another $7 trillion on a preliminary basis to that number. So we have a serious financial and fiscal problem that is going to require sustained attention by the Congress and others in order to close that gap because candidly the gap is simply too great to grow our way out of the problem.

This is one scenario, potentially, Mr. Chairman. If discretionary spending grows by the rate of the economy, and as you know discretionary spending includes defense, homeland security, the judicial system, education, the infrastructure of our Nation, and if all of the expiring tax provisions do not sunset, this is illustrative, it is not saying they should or they should not, expire, then this is the future. The gap is simply too great to grow our way out of the problem. Tough choices will be required with regard to entitlement programs, discretionary and other spending, and tax policy.

We have noted this in our transmittal letter that accompanies our audit report in the Financial Report of the U.S. Government because it is important not just to focus on what the financial statements say. It is also important to note what they do not say.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Walker follows:]
United States General Accounting Office

Testimony
Before the Subcommittee on Government Efficiency and Financial Management,
Committee on Government Reform,
House of Representatives

FISCAL YEAR 2003
U.S. GOVERNMENT
FINANCIAL STATEMENTS

Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation’s Future Fiscal Challenges

Statement of David M. Walker
Comptroller General of the United States
FISCAL YEAR 2003 U.S. GOVERNMENT FINANCIAL STATEMENTS

Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges

What GAO Found

As in the 6 previous fiscal years, certain material weaknesses in internal control and in selected accounting and reporting practices resulted in conditions that continued to prevent GAO from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements of the U.S. government are fairly stated in conformity with U.S. generally accepted accounting principles. Three major impediments to an opinion on the consolidated financial statements continue to be (1) serious financial management problems at DOI, (2) the federal government's inability to fully account for and reconcile transactions between federal government entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements.

For fiscal year 2003, 20 of 23 Chief Financial Officers (CFO) Act agencies received unqualified opinions, the same number received by these agencies for fiscal year 2002, up from 6 for fiscal year 1996. However, only 9 of the CFO Act agencies had neither a material weakness in internal control, an issue involving compliance with applicable laws and regulations, nor an instance of lack of substantial compliance with Federal Financial Management Improvement Act requirements.

The requirement for timely, accurate, and useful financial and performance management information is greater than ever as the nation faces major long-term fiscal challenges that will require tough choices in setting priorities and linking resources to results. Given the nation's large and growing long-term fiscal imbalance, which is driven largely by known demographic trends and health care costs, coupled with new homeland security and defense commitments, the status quo is unsustainable. Current financial reporting does not clearly and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending and provides an unassailable and even misleading picture of the federal government’s overall performance and financial condition. In addition, too many significant federal government commitments and obligations, such as Social Security and Medicare, are not fully and consistently disclosed in the federal government’s financial statements and budget, and current federal financial reporting standards do not require such disclosure.

A top-to-bottom review of government activities to ensure their relevance and fit for the 21st century and their relative priority is long overdue. The federal government needs a three-pronged approach to (1) restructure existing entitlement programs, (2) reexamine the base of discretionary and other spending, and (3) review and revise the federal government's tax policy and enforcement programs. New accounting and reporting approaches, budget control mechanisms, and metrics are needed for considering and measuring the impact of spending and tax policies and decisions over the long term.

United States General Accounting Office
Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our report on the U.S. government's consolidated financial statements for fiscal years 2003 and 2002. Both the consolidated financial statements and our report are included in the fiscal year 2003 Financial Report of the United States Government, which was issued by the Department of the Treasury (Treasury) on February 27, 2004, and is available through GAO's Internet site, at www.gao.gov, and Treasury's Internet site, at www.fin.treas.gov/fr/index.html.

At the outset, I would like to thank the subcommittee for continuing an annual tradition of oversight hearings on this important subject. The work of the Subcommittee on Government Efficiency and Financial Management and its predecessor has for years been a catalyst to facilitate government management reform. The involvement of this subcommittee remains critical to ultimately assuring public confidence in the federal government as a financial steward that is accountable for its finances.

As in the 9 previous fiscal years, certain material weaknesses1 in internal control and in selected accounting and reporting practices resulted in conditions that continued to prevent us from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements of the U.S. government are fairly stated in conformity with U.S. generally accepted accounting principles (GAAP). Until the problems discussed in our report are adequately addressed, they will continue to (1) hamper the federal government's ability to accurately report a significant portion of its assets, liabilities, and costs; (2) affect the federal government's ability to accurately measure the full cost as well as the financial and nonfinancial performance of certain programs while effectively managing related operations; and (3) significantly impair the federal government's ability to adequately safeguard certain significant assets and properly record various transactions.

While the federal government has not yet been able to prepare auditable financial statements, the requirement to do so at the consolidated level as well as at the agency level has already yielded important results. We see

---

1A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that maintenance, losses, or noncompliance material in relation to the financial statements or to narrow-scope information would be prevented or detected on a timely basis.
continuous movement toward the ultimate goals of annual accountability and, more importantly, development of the day-to-day financial information that the federal government will need to best address today's budgetary challenges and the looming longer-term fiscal imbalance driven by demographic trends, rising health care costs, and new homeland security and defense commitments. Across government, financial management improvement initiatives are under way that, if effectively implemented, have the potential to appreciably improve the quality of the federal government's financial management and reporting. Federal agencies continue to make progress in their efforts to modernize their financial management systems and improve financial management performance as called for in the President's Management Agenda.²

The Principals of the Joint Financial Management Improvement Program (JFMP)³ agreed with the Office of Management and Budget's (OMB) initiative to accelerate the agency financial statements reporting date to November 15 for fiscal year 2004. For fiscal year 2003, OMB required the Chief Financial Officers (CFO) Act agencies⁴ to deliver their Performance and Accountability Reports, including their audited financial statements, to OMB by January 30, 2004. However, to prepare for meeting the required November 15 accelerated reporting date for fiscal year 2004, OMB encouraged the CFO Act agencies to accelerate the issuance of their fiscal year 2003 audited financial statements to November 15, 2003, or as close to that date as possible. OMB reported that 8 CFO Act agencies—the Department of Education, the Environmental Protection Agency, the

²The President's Management Agenda is the Bush administration's strategy for improving the management and performance of the federal government. Its purpose is to identify and address the most significant problems facing the federal government. It contains five governmentwide and nine agency-specific goals to improve federal management and deliver results to the American people.

³JFMP is a joint and cooperative undertaking of the Department of the Treasury, GAO, the Office of Management and Budget (OMB), and the Office of Personnel Management working in cooperation with each other and other federal agencies to improve financial management practices in the federal government. Leadership and program guidance are provided by the four Principals of the JFMP—the Comptroller General of the United States, the Secretary of the Treasury, and the Directors of OMB and the Office of Personnel Management.

⁴5 U.S.C. 901(b). One of the 34 CFO Act agencies, the Federal Emergency Management Agency, was transferred to the new Department of Homeland Security effective March 1, 2003. With this transfer, the Federal Emergency Management Agency will no longer be required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 33 CFO Act agencies.
Department of Health and Human Services, the National Science Foundation, the Social Security Administration, the Department of the Treasury, the Agency for International Development, and the Department of Veterans Affairs—were able to issue their fiscal year 2003 financial statements with unqualified audit opinions by mid-November 2003. Another 10 CFO Act agencies issued their financial statements by December 31, 2003, and the remaining 5 CFO Act agencies issued by the end of January 2004. A 24th major agency, the Department of Homeland Security (DHS), issued its financial statements on February 15, 2004. DHS faced a Herculean challenge with respect to issuing audited financial statements, since the department had been in operation only for the last 7 months of the fiscal year and involved a transfer of operations from a number of diverse entities, some with known financial management problems.

While these results represent a significant improvement over previous years in the timeliness of CFO Act agencies' issuance of audited financial statements, they also demonstrate the significant challenges that the federal government will face in meeting the November 15 accelerated reporting date for fiscal year 2004. Auditors at several of the CFO Act agencies reported that the agencies may not be able to produce auditable financial statements within the accelerated time frame for fiscal year 2004 without making fundamental changes to improve a number of their financial management practices. For example, certain federal agency auditors reported that major improvements are needed in (1) management controls to monitor established policies and procedures for conducting financial analyses and reconciliations throughout the year, (2) fully integrating financial management systems, and (3) providing adequate and skilled staff to support efficient, effective preparation of federal agency consolidated financial statements. Our experience as the auditor of the financial statements of the Internal Revenue Service, which successfully accelerated its reporting to November 15 beginning with its fiscal year 2002 financial statements, showed that significant changes had to be made.

DHS is not a CFO Act agency and is therefore not subject to CFO Act requirements. However, along with most other executive branch agencies not covered by the CFO Act, DHS is required to prepare and have audited financial statements under the Accountability of Tax Dollars Act of 2002, Pub. L. No. 107-296, 116 Stat. 2040. For fiscal year 2002, the act provided that DHS could grant executive branch agencies' requests for waivers from having audited financial statements for fiscal year 2002. However, DHS and certain other agencies chose to prepare and have their fiscal year 2003 financial statements audited.
to improve routine financial management procedures in order to be able to accelerate reporting.

For fiscal year 2003, as in fiscal year 2002, 20 of 23 CFO Act agencies were able to attain unqualified audit opinions on their financial statements (see app. D), up from 9 agencies for fiscal year 1996. This is the same number of unqualified opinions received by these CFO Act agencies for fiscal year 2002. However, 2 agencies' fiscal year 2003 opinions were different from those they received for fiscal year 2002. The Agency for International Development received an unqualified opinion on all of its fiscal year 2003 financial statements for the first time, while the National Aeronautics and Space Administration, which for fiscal year 2002 received an unqualified opinion on its financial statements, received a disclaimer of opinion for fiscal year 2003. DHS, which as I mentioned before prepared consolidated financial statements for fiscal year 2003 covering its first 7 months of operations, received a qualified opinion on two of the six required financial statements.

In identifying improved financial performance as one of its five governmentwide initiatives, the President's Management Agenda recognized that a clean (unqualified) financial audit opinion is a basic prescription for any well-managed organization. At the same time, it recognized that "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records" at or after year-end. The President's Management Agenda further recognized that without sound internal control and accurate and timely financial information, it is not possible to accomplish the agenda and secure the best performance and highest measure of accountability for the agencies.

1At least 4 CFO Act agencies received certain of their audited fiscal year 2002 financial statements to correct misstatements to such financial statements. All 4 of the agencies had received unqualified opinions on their fiscal year 2002 financial statements. These misstatements were not material to the consolidated financial statements.

2DHS began operations as an agency 5 months after the start of the fiscal year, on March 1, 2003. Transfers of funds, assets, liabilities, and obligations from 22 existing federal agencies to DHS began on March 1, 2002. DHS's auditors issued a qualified opinion on the consolidated balance sheet and statement of custodial activity as of September 30, 2003, and declared no consolidated transactions not restated, consolidated statement of changes in net position, combined statement of consistency, consolidated statement of financial position, and consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of net position as of September 30, 2003. In accordance with Federal Accounting Standards Advisory Board Technical Bulletins 2000-b, Certain Questions and Answers Related to the Homeland Security Act of 2002, the fiscal year 2003 activities that occurred prior to the transfer of operations to DHS were to be reflected in the transferring agencies' financial statements.
American people. The JFMIP Principals have defined certain measures, in addition to receiving an unqualified financial statement opinion, for achieving financial management success. These additional measures include being able to routinely provide timely, accurate, and useful financial and performance information and having no material internal control weaknesses or material noncompliance with laws and regulations and the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). As shown in figure 1, while the severity and magnitude of the problems identified vary greatly, reports of inspectors general and their contract auditors indicated that for fiscal year 2003 only 3 of the 23 CFO Act agencies had neither a material weakness in internal control, an issue involving compliance with applicable laws and regulations, nor an instance of lack of substantial compliance with the requirements of FFMIA.

<table>
<thead>
<tr>
<th>Agencies with unqualified opinions</th>
<th>Agencies with unqualified opinions and no material weaknesses or noncompliances</th>
</tr>
</thead>
<tbody>
<tr>
<td>20%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: OMB.


In this testimony, I will highlight the major issues relating to the consolidated financial statements for fiscal years 2000 and 2002, discuss systems problems that continue to hinder federal agency accountability, and describe progress that has been made toward addressing major impediments to an opinion on the consolidated financial statements. I will then discuss why sound financial management today and in the future is critical to meeting tomorrow’s fiscal needs and the need for “truth and transparency” in connection with our nation’s financial condition and fiscal outlook.
<table>
<thead>
<tr>
<th>Highlights of Major Issues Related to the U.S. Government’s Consolidated Financial Statements for Fiscal Years 2003 and 2002</th>
</tr>
</thead>
</table>

As I mentioned earlier, as has been the case for the previous 6 fiscal years, the federal government continues to have a significant number of material weaknesses related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation. Several of these material weaknesses (referred to hereafter as material deficiencies) resulted in conditions that continued to prevent us from forming and expressing an opinion on the U.S. government’s consolidated financial statements for the fiscal years ended September 30, 2003 and 2002. There may also be additional issues that could affect the consolidated financial statements that have not been identified.

Major challenges include the federal government’s inability to:

- property account for and report property, plant, and equipment and inventories and related property, primarily at the Department of Defense (DOD);
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities and related costs at DOD, and ensure complete and proper reporting for commitments and contingencies;
- support major portions of the total net cost of government operations, most notably related to DOD, and ensure that all disbursements are properly recorded;
- fully account for and reconcile intragovernmental activity and balances;
- demonstrate how net outlay amounts reported in the consolidated financial statements were related to net outlay amounts reported in the underlying federal agencies’ financial statements; and
- effectively prepare the federal government’s financial statements, including ensuring that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP.

In addition to these material deficiencies, we identified four other material weaknesses in internal control related to loans receivable and loan guarantee liabilities, improper payments, information security, and tax collection activities.

---

Recurring Systems Problems Hinder Accountability

The material weaknesses identified by our work are discussed in more detail in appendix III.

The ability to produce the data needed to efficiently and effectively manage the day-to-day operations of the federal government and provide accountability to taxpayers and the Congress has been a long-standing challenge at most federal agencies. The results of the fiscal year 2003 assessments performed by agency inspectors general or their contract auditors under FPMA show that these problems continue to plague the financial management systems used by most of the CFO Act agencies. While the problems are much more severe at some agencies than at others, their nature and severity indicate that overall, management at most CFO Act agencies lacks the full range of information needed for accountability, performance reporting, and decision making. These problems include nonintegrated financial systems, lack of accurate and timely recording of data, inadequate reconciliation procedures, and noncompliance with accounting standards and the U.S. Government Standard General Ledger (SGL).

Agencies' inability to meet the federal financial management systems requirements continues to be the major barrier to achieving compliance with FPMA. Under FPMA, CFO Act agency auditors are required to report, as part of the agencies' financial statement audits, whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the SGL at the transaction level. As shown in figure 2, auditors most frequently reported instances of noncompliance with federal financial management systems requirements. These instances of noncompliance involved not only core financial systems, but also administrative and programmatic systems.

For fiscal year 2003, auditors for 17 of the 23 CFO Act agencies reported that the agencies' financial management systems did not comply substantially with one or more of FFMA's three requirements. For the remaining 6 CFO Act agencies, auditors provided negative assurance, meaning that nothing came to their attention indicating that the agencies' financial management systems did not substantially meet FFMA requirements. The auditors for these 6 agencies did not definitively state whether the agencies' systems substantially complied with FFMA requirements, as is required under the statute. DHS is not subject to the requirements of the CFO Act and, consequently, is not required to comply with FFMA. Accordingly, DHS's auditors did not report on DHS's compliance with FFMA. However, the auditors identified and reported deficiencies that related to the aforementioned three requirements of FFMA.

Federal agencies have recognized the seriousness of their financial systems weaknesses and have efforts under way to implement or upgrade their financial systems to alleviate long-standing problems. We recognize
that it will take time, investment, and sustained emphasis to improve agencies' underlying financial management systems.

Addressing Major Impediments to an Opinion on Consolidated Financial Statements

As I mentioned earlier, for the past 7 fiscal years, the federal government has been required to prepare, and have audited, consolidated financial statements. Successfully meeting this requirement is tightly linked to the requirements for the CFO Act agencies to also have audited financial statements. This has stimulated extensive cooperative efforts and considerable attention by agency chief financial officers, inspectors general, Treasury and OMB officials, and GAO. With the benefit of the past 7 years' experience by the federal government in having the required financial statements subjected to audit, more intensified attention will be needed on the most serious obstacles to achieving an opinion on the U.S. government's consolidated financial statements. These major impediments to an opinion on the consolidated financial statements are (1) serious financial management problems at DOD, (2) the federal government's inability to fully account for and reconcile transactions between federal government entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements.

Financial Management at DOD

Essential to achieving an opinion on the consolidated financial statements is resolution of the serious financial management problems at DOD, which we have designated as high risk since 1995. In accordance with section 1009 of the National Defense Authorization Act for Fiscal Year 2002, DOD reported that for fiscal year 2003, it was not able to provide adequate evidence supporting material amounts in its financial statements. DOD stated that it is unable to comply with applicable financial reporting requirements for (1) property, plant, and equipment (PP&E); (2) inventory and operating materials and supplies; (3) environmental liabilities; (4) intragovernmental eliminations and related accounting adjustments; (5) disbursement activity; and (6) cost accounting by responsibility segment. Although DOD represented that the military retirement health care liability data had improved for fiscal year 2003, the cost of direct health care provided by DOD-managed military treatment facilities was a significant

\(^{6}\)GAO identifies areas at high risk due to either greater vulnerabilities to waste, fraud, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness.

amount of DOD's total recorded health care liability and was based on estimates for which adequate support was not available.

Overhauling DOD's financial management operations represents a challenge that goes far beyond financial accounting to the very fabric of DOD's range of business operations, management information systems, and culture. As I have reported in past years, DOD's financial management problems are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. To date, none of the military services or major DOD components has passed the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls. DOD has been up front about the seriousness of these problems and the need to transform the way it does business. To address these problems, DOD has taken several positive steps in many key areas. For example, the Secretary of Defense has included improving DOD's financial management as one of his top 10 priorities, and the department has taken a number of actions under its Business Management Modernization Program, including development in April 2003 of an initial business enterprise architecture to guide operational and technological changes. DOD is currently working to refine and implement that architecture and expects to issue new versions of it during 2004. DOD reports that it is also developing detailed financial improvement plans intended to provide disciplined leadership, identify corrective actions, implement solutions, and result in a favorable audit opinion on the fiscal year 2007 DOD-wide financial statements. But DOD still has a long way to go, and top leadership must continue to stress the importance of achieving lasting improvement that truly transforms the department’s business systems and operations. Only through major transformation, which will take time and sustained leadership from top management, will DOD be able to meet the mandate of the CFO Act and achieve the President's Management Agenda goal of improved financial performance.

Although not all DOD components, the Military Retirement Fund received an unqualified opinion on its fiscal year 2003 financial statements, and the OPM Medicare Eligible Retiree Health Care Fund received a qualified opinion on its fiscal year 2003 financial statements.

### Intragovernmental Transactions

OMB and Treasury require the CFOs of 35 executive departments and agencies, including the 23 CFO Act agencies, to reconcile selected intragovernmental activity and balances with their "trading partners" and to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts. A substantial number of the agencies continue to be unable to fully perform reconciliations of intragovernmental activity and balances with their trading partners, citing reasons such as: (1) trading partners not providing needed data; (2) limitations and incompatibility of agency and trading partner information systems; and (3) lack of human resources. Amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance in the aggregate for both fiscal years 2003 and 2002.

We reported in previous years that the heart of the intragovernmental transactions issue was that the federal government lacked clearly articulated business rules for these transactions so that they would be handled consistently by agencies. In this regard, at the start of fiscal year 2003, OMB issued business rules to transform and standardize intragovernmental ordering and billing. To address long-standing problems with intragovernmental exchange transactions between federal agencies, Treasury provided federal agencies with quarterly detailed trading partner information during fiscal year 2003 to help them better perform their trading partner reconciliations. In addition, the federal government began a three-phase Intragovernmental Transactions e-gov project to define a government-wide data architecture and provide a single source of detailed trading partner data. Resolving the intragovernmental transactions problem, though, still remains a difficult challenge and will require a commitment by the CFO Act agencies and continued strong leadership by OMB.

### Preparing the Consolidated Financial Statements

The federal government did not have adequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP. In this regard, Treasury is developing a new system and procedures to prepare the consolidated financial statements beginning with the statement for fiscal year 2004.

---

4Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.
Treasury officials have stated that these actions are intended to, among
other things, directly link information from federal agencies' audited
financial statements to amounts reported in the consolidated financial
statements and resolve many of the issues we identified in the process for
preparing the consolidated financial statements. Resolving issues
surrounding preparing the consolidated financial statements will require
continued strong leadership by Treasury management.

Our nation's large and growing long-term fiscal imbalance, which is driven
largely by known demographic trends and rising health care costs—
coupled with new homeland security and defense commitments—serves
to sharpen the need to fundamentally review and re-examine basic federal
entitlements, as well as other mandatory and discretionary spending, and
tax policies. As we look ahead, our nation faces an unprecedented
demographic challenge with significant implications, among them
budgetary and economic. Between now and 2050, the number of people
who are 65 years old or over will double, driving federal spending on the
elderly to a larger and ultimately unsustainable share of the federal
budget. As a result, tough choices will be required to address the resulting
structural imbalance.

GAO prepares long-term budget simulations that seek to illustrate the
likely fiscal consequences of the coming demographics and rising health
care costs. Our latest long-term budget simulations reinforce the need for
change in the major cost drivers—Social Security and health care
programs. As shown in figure 3, by 2040, absent reform of these
entitlement programs, projected federal revenues may be adequate to pay
little beyond interest on the debt.
Current financial reporting does not clearly and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending and provides an unrealistic and even misleading picture of the federal government's overall performance and financial condition. Few agencies adequately show the results they are getting with the taxpayer dollars they spend. In addition, too many significant federal government commitments and obligations, such as Social Security and Medicare, are not fully and consistently disclosed in the federal government's consolidated financial statements and budget, and current federal financial reporting standards do not require such...
disclosure. Figure 4 shows some selected fiscal exposures. The spectrum of these exposures ranges from covering only the explicit liabilities that are shown on the consolidated financial statements to implicit promises embedded in current policy or public expectations. These liabilities, commitments, and promises have created a fiscal imbalance that will put unprecedented strain on the nation’s spending and tax policies. Although economic growth can help, the projected fiscal gap is now so large that the federal government will not be able to simply grow its way out of the problem. Tough choices are inevitable.

Figure 4: Selected Fiscal Exposures

<table>
<thead>
<tr>
<th>Type</th>
<th>Example (dollars in billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explicit liabilities</td>
<td></td>
</tr>
<tr>
<td>Publicly held debt ($3.5T)</td>
<td></td>
</tr>
<tr>
<td>Military and civilian pension and post retirement health ($2.6T)</td>
<td></td>
</tr>
<tr>
<td>Veterans benefits payable ($3T)</td>
<td></td>
</tr>
<tr>
<td>Environmental and disposal liabilities ($200B)</td>
<td></td>
</tr>
<tr>
<td>Loan guarantees ($22B)</td>
<td></td>
</tr>
<tr>
<td>Explicit financial commitments</td>
<td></td>
</tr>
<tr>
<td>Undelivered orders ($50B)</td>
<td></td>
</tr>
<tr>
<td>Long-term leases ($47T)</td>
<td></td>
</tr>
<tr>
<td>Explicit financial contingencies</td>
<td></td>
</tr>
<tr>
<td>Undistributed claims ($88B)</td>
<td></td>
</tr>
<tr>
<td>Pension Benefit Guarantee Corporation ($26B)</td>
<td></td>
</tr>
<tr>
<td>Other national insurance programs ($71B)</td>
<td></td>
</tr>
<tr>
<td>Government corporations e.g. Fannie Mae</td>
<td></td>
</tr>
<tr>
<td>Implicit exposure implied by current policies or the public’s expectations about the role of government</td>
<td></td>
</tr>
<tr>
<td>Debt held by government accounts ($2.8T)</td>
<td></td>
</tr>
<tr>
<td>Future Social Security benefit payments ($2.6T)</td>
<td></td>
</tr>
<tr>
<td>Future Medicare Part A benefit payments ($5.9T)</td>
<td></td>
</tr>
<tr>
<td>Future Medicare Part B benefit payments ($5.6T)</td>
<td></td>
</tr>
<tr>
<td>Life cycle cost including deferred and future maintenance and operating costs (amount unknown)</td>
<td></td>
</tr>
<tr>
<td>Government Sponsored Enterprises e.g. Fannie Mae and Freddie Mac</td>
<td></td>
</tr>
</tbody>
</table>

Some GAO estimates.

*This amount includes $774 billion in securities held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

*Estimates for Social Security and Medicare are as of January 1, 2000, and are estimated over a 75-year period. These amounts represent net present value and are net of debt held by the trust funds (e.g., Social Security: $1.3T; Medicare: $3T). Estimates for Social Security are taken from the Social Security Trustees' 2000 annual report. There is no similar estimate for Medicare, which is included in the Medicare Trustees' 2000 annual report. Medicare Part D was enacted after the end of fiscal year 2000.

**The Federal Accounting Standards Advisory Board has a project under way to consider recognition, measurement, and display of social insurance obligations.
Particularly troubling are the many big-ticket items that taxpayers will eventually have to deal with. The federal government has pledged its support to a long list of programs and activities, including pension and health care benefits for senior citizens, medical care for veterans, and contingencies associated with various government-sponsored entities, whose claims on future spending total trillions of dollars. Despite their serious implications for future budgets, tax burdens, and spending flexibilities, these unfunded commitments get short shrift in the federal government's current financial statements and in budgetary deliberations.

The federal government's gross debt as of September 2003 was about $7 trillion, or about $24,000 for every man, woman, and child in this country today. But that number excludes items such as the gap between promised and funded Social Security and Medicare commitments and veterans health care benefit commitments provided through the Department of Veterans Affairs. If those items are factored in, the burden for every American rises to well over $100,000. In addition, the new Medicare prescription drug benefit will add thousands more to that tab.

The new drug benefit is one of the largest unfunded commitments ever undertaken by the federal government. The Trustees of the Social Security and Medicare trust funds will include an official estimate of the discounted present value cost of this new benefit over the next 75 years in their annual report, which is scheduled for issuance later this month. Preliminary estimates of its long-term cost range up to $7 trillion in discounted present value terms over a 75-year period. To put that number into perspective, it is as much as the total amount of the federal government's gross debt outstanding as of September 30, 2003. Even before the prescription drug benefit was enacted, our long-term budget simulations showed that by 2040, the federal government may have to cut federal spending in half or double taxes to pay for the mounting cost of the government's current unfunded commitments. Either would be devastating.

Proper accounting and reporting practices are essential in the public sector. After all, the U.S. government is the largest, most diverse, most complex, and arguably the most important entity on earth today. Its services—homeland security, national defense, Social Security, mail
delivery, and food inspection, to name a few—directly affect the well-being of almost every American. But sound decisions on the future direction of vital federal government programs and policies are made more difficult without timely, accurate, and useful financial and performance information.

Fortunately, we are starting to see efforts to address the shortcomings in federal financial reporting. The President’s Management Agenda, which closely reflects GAO’s list of high-risk government programs, is bringing attention to troubled areas across the federal government and is taking steps to better assess the results that programs are getting with the resources they are given. The Federal Accounting Standards Advisory Board is also making progress on many key financial reporting issues.

In addition to these efforts, we have published a framework for analyzing various Social Security reform proposals7 and will soon publish a framework for analyzing health care reform proposals. We have also helped to create a consortium of “good government” organizations to stimulate the development of a set of key national indicators to assess the United States’ overall position and progress over time and in comparison to those of other industrialized nations.

Budget experts at the Congressional Budget Office (CBO) and GAO continue to encourage reforms to the federal budget process to better reflect the federal government’s commitments and signal emerging problems. Among other things, we have recommended that the federal government issue an annual report on major fiscal exposures. The President’s fiscal year 2005 budget also proposes that future President’s budget report on any enacted legislation in the past year that worsens the unfunded obligations of programs with long-term actuarial projections, with CBO to make a similar report. Such reporting could be a good starting point.

Although these are positive initial steps, much more must be done given the magnitude of the federal government’s fiscal challenge. A top-to-bottom review of government activities to ensure their relevance and fit for the 21st century and their relative priority is long overdue. As I have

spoken about in the past, the federal government needs a three-pronged approach to (1) restructure existing entitlement programs, (2) reexamine the base of discretionary and other spending, and (3) review and revise the federal government's tax policy and enforcement programs. New accounting and reporting approaches, budget control mechanisms, and metrics are needed for considering and measuring the impact of spending and tax policies and decisions over the long term.

Closing Comments

Our report on the U.S. government's consolidated financial statements for fiscal years 2000 and 2001 highlights the need to continue addressing the federal government's serious financial management weaknesses. With the significantly accelerated financial reporting time frame for fiscal year 2004 and beyond, it is essential that the federal government move away from the extraordinary efforts many federal agencies continue to make to prepare financial statements and toward giving prominence to strengthening the federal government's financial systems, reporting, and controls. This is the only way the federal government can meet the end goal of making timely, accurate, and useful financial and performance information routinely available to the Congress, other policymakers, and the American public. The requirement for timely, accurate, and useful financial and performance management information is greater than ever as our nation faces major long-term fiscal challenges that will require tough choices in setting priorities and linking resources to results.

The Congress and the President face the challenge of sorting out the many claims on the federal budget without the budget enforcement mechanisms or fiscal benchmarks that guided the federal government through the previous years of deficit reduction into the brief period of surplus. While a number of steps will be necessary to address this challenge, truth and transparency in federal government reporting are essential elements of any attempt to address the nation's long-term fiscal challenges. The fiscal risks I mentioned earlier can be managed only if they are properly accounted for and publicly disclosed. A crucial first step will be to face facts and identify the significant commitments facing the federal government. If citizens and federal government officials come to understand various fiscal exposures and their potential claims on future budgets, they are more likely to insist on prudent policy choices today and sensible levels of fiscal risk in the future. In addition, new budget control mechanisms will be required, along with effective approaches to successfully engage in a fundamental review, reassessment, and reprioritization of the base of federal government programs and policies that I have recommended previously.
Public officials will have more incentive to make difficult but necessary choices if the public has the facts and comes to support serious and sustained action to address the nation's fiscal challenges. Without meaningful public debate, however, real and lasting change is unlikely. Clearly, the sooner action is taken, the easier it will be to turn things around.

I believe a national education campaign and outreach effort is needed to help the public understand the nature and magnitude of the long-term financial challenge facing this nation. An informed electorate is essential for a sound democracy. Members of Generation X and Y especially need to become active in this discussion because they and their children will bear the heaviest burden if policymakers fail to act in a timely and responsible manner.

We at GAO are committed to doing our part, but others also need to step up to the plate. By working together, I believe we can make a meaningful difference for our nation, fellow citizens, and future generations of Americans.

In closing Mr. Chairman, I want to reiterate the value of sustained congressional interest in these issues, as demonstrated by this subcommittee's hearings and those the former Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations held over the past several years to oversee financial management reform. It will also be key that the appropriations, budget, authorizing, and oversight committees hold agency top leadership accountable for resolving these problems and that they support improvement efforts.

Contacts

For further information regarding this testimony, please contact Jeffrey C. Steinhoff, Managing Director, and Gary T. Engel, Director, Financial Management and Assurance, at (202) 512-4500.
### Appendix I: Selected Major Federal Departments and Agencies: Fiscal Year 2003 Audit Results, Principal Auditors, and Number of Other Audit Contractors

<table>
<thead>
<tr>
<th>23 CFO Act agencies</th>
<th>Audit results</th>
<th>Principal auditor</th>
<th>Number of other audit contractors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency for International Development</td>
<td>Unqualified</td>
<td>Inspector General</td>
<td>1</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Unqualified</td>
<td>Inspector General</td>
<td>3</td>
</tr>
<tr>
<td>Commerce</td>
<td>Unqualified</td>
<td>KPMG LLP</td>
<td>0</td>
</tr>
<tr>
<td>Defense</td>
<td>Disclaimer</td>
<td>Inspector General</td>
<td>1</td>
</tr>
<tr>
<td>Education</td>
<td>Unqualified</td>
<td>Ernst &amp; Young LLP</td>
<td>0</td>
</tr>
<tr>
<td>Energy</td>
<td>Unqualified</td>
<td>KPMG LLP</td>
<td>0</td>
</tr>
<tr>
<td>Environmental Protection Agency</td>
<td>Unqualified</td>
<td>Inspector General</td>
<td>0</td>
</tr>
<tr>
<td>Environmental Services Administration</td>
<td>Unqualified</td>
<td>PricewaterhouseCoopers LLP</td>
<td>0</td>
</tr>
<tr>
<td>Health and Human Services</td>
<td>Unqualified</td>
<td>Inspector General</td>
<td>4</td>
</tr>
<tr>
<td>Housing and Urban Development</td>
<td>Unqualified</td>
<td>Inspector General</td>
<td>1</td>
</tr>
<tr>
<td>Interior</td>
<td>Unqualified</td>
<td>KPMG LLP</td>
<td>0</td>
</tr>
<tr>
<td>Justice</td>
<td>Unqualified</td>
<td>PricewaterhouseCoopers LLP</td>
<td>2</td>
</tr>
<tr>
<td>Labor</td>
<td>Unqualified</td>
<td>R. Navarro &amp; Associates, Inc.</td>
<td>2</td>
</tr>
<tr>
<td>National Aeronautics and Space Administration</td>
<td>Disclaimer</td>
<td>PricewaterhouseCoopers LLP</td>
<td>0</td>
</tr>
<tr>
<td>National Science Foundation</td>
<td>Unqualified</td>
<td>KPMG LLP</td>
<td>0</td>
</tr>
<tr>
<td>Nuclear Regulatory Commission</td>
<td>Unqualified</td>
<td>R. Navarro &amp; Associates, Inc.</td>
<td>0</td>
</tr>
<tr>
<td>Office of Personnel Management</td>
<td>Unqualified</td>
<td>KPMG LLP</td>
<td>0</td>
</tr>
<tr>
<td>Small Business Administration</td>
<td>Disclaimer</td>
<td>Cotton &amp; Company LLP</td>
<td>0</td>
</tr>
<tr>
<td>Social Security Administration</td>
<td>Unqualified</td>
<td>PricewaterhouseCoopers LLP</td>
<td>0</td>
</tr>
<tr>
<td>State</td>
<td>Unqualified</td>
<td>Leonard G. Rubenstein and Company, LLP</td>
<td>2</td>
</tr>
<tr>
<td>Transportation</td>
<td>Unqualified</td>
<td>Inspector General</td>
<td>2</td>
</tr>
<tr>
<td>Treasury</td>
<td>Unqualified</td>
<td>Inspector General</td>
<td>0</td>
</tr>
<tr>
<td>Veterans Affairs</td>
<td>Unqualified</td>
<td>Deloitte &amp; Touche LLP</td>
<td>0</td>
</tr>
<tr>
<td>Other major agency</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Homeland Security</td>
<td>Disclaimer</td>
<td>KPMG LLP</td>
<td>0</td>
</tr>
</tbody>
</table>

In addition, GAO audited the Internal Revenue Service’s financial statements and the Schedule of Federal Debt Managed by the Bureau of the Public Debt.

DHS began operations as an agency 5 months after the start of the fiscal year, on March 1, 2003. Transfers of funds, assets, liabilities, and obligations from 22 existing agencies to DHS began on March 1, 2003. DHS’s auditors issued a qualified opinion on the consolidated balance sheet and statement of net cost of the consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of operations for the 7 months ended September 30, 2003.
## Appendix II: Primary Effects of the Material Weaknesses Described in This Report

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant, and equipment and inventories and related property</td>
<td>Without accurate asset information, the federal government does not fully know the assets it owns and their location and condition and cannot effectively (1) safeguard assets from physical deterioration, theft, or loss, (2) account for acquisitions and disposals of such assets, (3) ensure the assets are available for use when needed, (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand, and (5) determine the full costs of programs that use these assets.</td>
</tr>
<tr>
<td>Liabilities and commitments and contingencies</td>
<td>Problems in accounting for liabilities affect the determination of the full cost of the federal government’s current operations and the extent of its liabilities. Also, improper asset accounting may result in unnecessary expenditure and unnecessary prior year fund balances.</td>
</tr>
<tr>
<td>Cost of government operations and disbursement activity</td>
<td>Inaccurate cost information affects the federal government’s ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by federal agencies for inclusion in the President’s budget concerning obligations and outlays.</td>
</tr>
<tr>
<td>Accounting for and reconciliation of intragovernmental activity and balances</td>
<td>Problems in accounting for and reconciling intragovernmental activity and balances impair the government’s ability to account for billions of dollars of transactions between governmental entities.</td>
</tr>
<tr>
<td>Net outlays</td>
<td>Until the differences between the total net outlays reported in federal agencies’ Statements of Budgetary Resources and the records kept by the Department of the Treasury to prepare the Statement of Changes in Cash balance from Unified Budget and Other Activities are reconciled, the effect that these differences may have on the U.S. government’s consolidated financial statements will be unknown.</td>
</tr>
<tr>
<td>Preparation of consolidated financial statements</td>
<td>Because the federal government did not have adequate systems, controls, and procedures to prepare its consolidated financial statements, the federal government’s ability to ensure that the consolidated financial statements are consistent with the underlying auditing agency financial statements, balanced, and in conformity with U.S. generally accepted accounting principles was impaired.</td>
</tr>
<tr>
<td>Improper payments</td>
<td>Without a systematic measurement of the extent of improper payments, federal agency management cannot determine (1) if improper payment problems exist that require corrective action, (2) mitigation strategies and the appropriate amount of investments to reduce them, and (3) the success of efforts implemented to reduce improper payments.</td>
</tr>
<tr>
<td>Loans receivable and loan guarantee liabilities</td>
<td>Weaknesses in the procedures and practices for estimating credit risk, determining the government’s ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.</td>
</tr>
<tr>
<td>Information security weaknesses</td>
<td>Information security weaknesses over computerized operations are placing enormous amounts of federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption.</td>
</tr>
<tr>
<td>------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Tax collection activities</td>
<td>Weaknesses in controls over tax collection activities continue to affect the Federal government's ability to efficiently and effectively account for and collect revenue. Additionally, weaknesses in financial reporting affect the Federal government's ability to make informed decisions about collection efforts. As a result, the Federal government is vulnerable to loss of tax revenue and exposed to potentially billions of dollars in losses due to inappropriate refund disbursements.</td>
</tr>
</tbody>
</table>

Source: GAO
## Appendix III: Material Deficiencies

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the consolidated financial statements of the U.S. government, as described below. These material deficiencies contributed to our disclaimer of opinion on the consolidated financial statements and also constitute material weaknesses in internal control.

| Property, Plant, and Equipment and Inventories and Related Property | The federal government could not satisfactorily determine that all PP&E and inventories and related property were included in the consolidated financial statements, verify that certain reported assets actually exist, or substantiate the amounts at which they were valued. Most of the PP&E and inventories and related property are the responsibility of DOD. As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably the National Aeronautics and Space Administration, reported continued weaknesses in internal control procedures and processes related to PP&E. |
| Liabilities and Commitments and Contingencies | The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. Further, the federal government could not determine whether commitments and contingencies, including those related to treaties and other international agreements entered into to further the U.S. government’s interests, were complete and properly reported. |
| Cost of Government Operations and Disbursement Activity | The previously discussed material deficiencies in reporting assets and liabilities, material deficiencies in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably related to DOD. With respect to disbursements, DOD and certain other federal agencies did not adequately reconcile disbursement activity. For fiscal years 2003 and... |
2002 there were unsupported adjustments to federal agencies’ records and uncleared disbursement activity, including unreconciled differences between federal agencies’ and Treasury’s records of disbursements, totaling billions of dollars, which could also affect the balance sheet.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

OMB and Treasury require the CFOs of 35 executive departments and agencies, including the 23 CFO Act agencies, to reconcile selected intragovernmental activity and balances with their “trading partners” and to report to Treasury, the agency’s inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts. A substantial number of the agencies did not fully perform the required reconciliations for fiscal years 2001 and 2002, citing reasons such as (1) trading partners not providing needed data, (2) limitations and incompatibility of agency and trading partner information systems, and (3) lack of human resources. For both of these years, amounts reported for federal agency trading partners were significantly out of balance, Treasury’s ability to eliminate certain intragovernmental activity and balances is impaired by these federal agencies’ problems in handling their intragovernmental transactions.

Net Outlays

OMB Bulletin 01-06, Form and Content of Agency Financial Statements, states that outlays in federal agencies’ Statements of Budgetary Resources (SBR) should agree with the respective agency’s net outlays reported in the budget of the U.S. government. In addition, SFAS No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, requires explanation of any material differences between the information required to be disclosed (including net outlays) and the amounts described as “actual” in the budget of the U.S. government.

We found material differences between the total net outlays reported in selected federal agencies’ audited SFAS and the records used to prepare the SBRs.

1Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

2Office of Management and Budget Bulletin No. 01-06, Form and Content of Agency Financial Statements (Washington, D.C., Sept. 25, 2001). This bulletin is OMB’s official guidance for the form and content of federal agencies’ financial statements.
the Statement of Changes in Cash Balance from Unified Budget and Other Activities (Statement of Changes in Cash Balances)\(^1\) totaling about $140 billion and $186 billion for fiscal years 2003 and 2002, respectively.\(^2\) Two agencies (Treasury and the Department of Health and Human Services (HHS)) accounted for about 90 percent and 75 percent of the differences identified in fiscal years 2003 and 2002, respectively. We found that the major cause of the differences for the two agencies was the treatment of offsetting receipts.\(^3\) Some offsetting receipts for these two agencies had not been included in the agencies' SBRs, which would have reduced the agencies' net outlays and made the amounts more consistent with the records used to prepare the Statement of Changes in Cash Balance.\(^3\) For example, we found that HHS reported net outlays for fiscal year 2003 as $596 billion on its audited SBR, while the records that Treasury uses to prepare the Statement of Changes in Cash Balance showed $509 billion for fiscal year 2003 for this agency. Until these differences between the total net outlays reported in the federal agencies' SBRs and the records used to prepare the Statement of Changes in Cash Balance are reconciled, the effect that these differences may have on the U.S. government's consolidated financial statements will be unknown. OMB has stated that it plans to work with the agencies to address this issue.

| Preparation of Consolidated Financial Statements | The federal government did not have adequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements. |

\(^1\)OMB and U.S. generally accepted accounting principles (GAAP) require agencies to report net outlays in the SBR. The Statement of Changes in Cash Balance also reports unified budget outlays-actual. Both are intended to represent the same amount and be consistent with the information presented in the budget of the U.S. government.

\(^2\)In some agencies' fiscal year 2003 financial statements, the comparable fiscal year 2002 amounts were reclassified.

\(^3\)Offsetting receipts are collections that are credited to general fund, special fund, or trust fund receipt accounts and that offset gross outlays at the agency or governmentwide level.

\(^4\)These two agencies did not adequately explain their fiscal year 2003 differences between the net outlays reported on the SBR and the budget of the U.S. government in their notes to the fiscal year 2003 financial statements.
balanced, and in conformity with generally accepted accounting principles (GAAP). During our fiscal year 2003 audit, we found the following:

- The process for compiling the consolidated financial statements does not directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements, and therefore does not ensure that the information in the consolidated financial statements is consistent with the underlying information in federal agencies' audited financial statements and other financial data.
- Internal control weaknesses exist in Treasury's process for preparing the consolidated financial statements, such as a lack of (1) segregation of duties and (2) appropriate documentation of certain policies and procedures for preparing the consolidated financial statements.
- The net position reported in the consolidated financial statements is derived by subtracting liabilities from assets, rather than through balanced accounting entries. To make the fiscal years 2002 and 2003 consolidated financial statements balance, Treasury recorded a net $29.5 billion and a net $17.1 billion decrease, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which it labeled "Unreconciled Transactions Affecting the Change in Net Position." An additional net $11.5 billion and $12.5 billion of unreconciled transactions were recorded in the Statements of Net Cost for fiscal years 2003 and 2002, respectively. Treasury does not identify and quantify all components of these unreconciled activities, nor does Treasury perform reconciliation procedures, which would aid in understanding and controlling the net position balance as well as eliminating the unreconciled transactions associated with compiling the consolidated financial statements.
- Significant differences in other intragovernmental accounts, primarily related to appropriations, still remain unresolved. Intragovernmental activity and balances are "dropped" or "offset" in the preparation of the consolidated financial statements rather than eliminated through balanced

---

7The same issues we identified in fiscal year 2003 existed in fiscal year 2002, and some have existed for a number of years. In October 2003, we reported in greater detail on the issues we identified in U.S. General Accounting Office, Financial Audit; Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement, GAO-04-66 (Washington, D.C., Oct. 29, 2003). This report included 14 recommendations to address weaknesses we identified. It also included recommendations related to 16 disclosure areas that are required by GAAP. We recommended that the 16-disclosures that are not included in the consolidated financial statements either be included or that the rationale for their exclusion be documented.

8Although Treasury was unable to determine how much of the unreconciled transactions, if any, relate to operations, it reported unreconciled transactions as a component of net operating cost in the consolidated financial statements.
accounting entries. This contributes to the federal government's inability to determine the impact of these differences on amounts reported in the consolidated financial statements.

- The federal government did not have an adequate process to identify and report items needed to reconcile the operating results, which for fiscal year 2003 showed a net operating cost of $656 billion, to the budget results, which for the same period showed a unified budget deficit of $374.8 billion.
- The consolidated financial statements include certain financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, there are undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence or disclose in the consolidated financial statements that such excluded financial information was immaterial.
- Treasury lacks an adequate process to ensure that the financial statements, related notes, Stewardship Information, and Supplemental Information are presented in conformity with GAAP. We found that certain financial information required by GAAP was not disclosed in the consolidated financial statements. Treasury did not provide us with documentation of its rationale for excluding this information. As a result of this and certain material weaknesses noted above, we were unable to determine if the missing information was material to the consolidated financial statements.

Other Material Weaknesses

In addition to the material deficiencies noted above, we found four other material weaknesses in internal control as of September 30, 2003:

1. Several federal agencies continue to have deficiencies in the processes and procedures used to estimate the costs of their lending programs and value their related loans receivable; (2) most federal agencies have not reported the magnitude of improper payments in their programs and activities; (3) federal agencies have not yet fully institutionalized comprehensive security management programs; and (4) material internal control weaknesses and systemic deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities.
In general, federal agencies continue to make progress in reducing the number of material weaknesses and reportable conditions related to their lending activities. However, significant deficiencies in the processes and procedures used to estimate the costs of certain lending programs and value the related loans receivable still remain. The most notable deficiencies existed at the Small Business Administration (SBA), which, while improved from last year, continues to have a material weakness related to this area. For example, SBA did not adequately document its estimation methodologies, lacked the management controls necessary to ensure that appropriate estimates were prepared and reported based on complete and accurate data, and could not fully support the reasonableness of the costs of its lending programs and valuations of its loan portfolio. SBA’s material weakness plus deficiencies at other federal credit agencies related to the processes and procedures for estimating credit program costs continue to adversely affect the government’s ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.

Across the federal government, improper payments occur in a variety of programs and activities, including those related to health care, contract management, federal financial assistance, and tax refunds. While complete information on the magnitude of improper payments is not yet available, based on available data, OMB has estimated that improper payments exceed $85 billion annually. Many improper payments occur in federal programs that are administered by entities other than the federal government, such as states. Improper payments often result from a lack of or an inadequate system of internal controls. Although the President’s Management Agenda includes an initiative to reduce improper payments, most federal agencies have not reported the magnitude of improper payments in their programs and activities.

---

9Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the federal government’s ability to meet the internal control objectives relating to financial reporting and compliance with laws and regulations.

9Improper payments include inadvertent errors, such as duplicate payments and overpayments, payments for unenrolled or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.
The Improper Payments Information Act of 2002 provides for federal agencies to estimate and report on their improper payments. It requires federal agencies to (1) annually review programs and activities that they administer to identify those that may be susceptible to significant improper payments, (2) estimate improper payments in susceptible programs and activities, and (3) provide reports to the Congress that discuss the causes of improper payments identified and the status of actions to reduce them. In accordance with the legislation, OMB issued guidance for federal agencies’ use in implementing the act. Among other things, the guidance requires federal agencies to report on their improper payment-related activities in the Management Discussion and Analysis section of their annual Performance and Accountability Reports (PAR).

While the act does not require such reporting by all federal agencies until fiscal year 2004, OMB required 44 programs and 14 CFO Act agencies to report improper payment information in their fiscal year 2003 PARs. Our preliminary review of the PARs found that 12 of the 14 agencies reported improper payment amounts for 27 of the 44 programs identified in the guidance. We also found that, for the programs where improper payments were identified, the reports often contained information on the causes of the payments but little information that addressed the other reporting requirements cited in the legislation.

Information Security

Although progress has been made, serious and widespread information security weaknesses continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. GAO has reported information security as a high-risk area across government since February 1997. Such information security weaknesses could result in compromising the reliability and availability of data that are recorded in or transmitted by federal financial management systems. A primary reason for these weaknesses is that federal agencies have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security weaknesses, resolving information security problems, and managing information security risks on an ongoing basis. The Congress has shown continuing interest in addressing these risks, as evidenced by recent hearings on information security and

---

1Pub. L. No. 107-300, 116 Stat. 2200. The act’s reporting requirement applies only to an agency program or activity with estimated improper payments exceeding $5 million.
enactment of the Federal Information Security Management Act of 2002\textsuperscript{a}
and the Cyber Security Research and Development Act.\textsuperscript{b} In addition, the
administration has taken important actions to improve information
security, such as integrating information security into the Executive
Branch Management Scorecard.\textsuperscript{c}

Tax Collection Activities

Material internal control weaknesses and system deficiencies continue to
affect the federal government's ability to effectively manage its tax
collection activities.\textsuperscript{d} Due to errors and delays in recording activity in
taxpayer accounts, taxpayers were not always credited for payments made
on their taxes owed, which could result in undue taxpayer burden. In
addition, the federal government did not always follow up on potential
unreported or underreported taxes and did not always pursue collection
efforts against taxpayers owing taxes to the federal government.

\textsuperscript{c}The Executive Branch Management Scorecard highlights agencies' progress in achieving
management and performance improvements embodied in the President's Management
Agenda.
\textsuperscript{d}U.S. General Accounting Office, Financial Audit, IRS's Fiscal Years 2000 and 2002
**GAO's Mission**

The General Accounting Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analysis, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

**Obtaining Copies of GAO Reports and Testimony**

The fastest and easiest way to obtain copies of GAO documents at no cost is through the Internet. GAO's Web site (www.gao.gov) contains abstracts and full-text files of current reports and testimony and an expanding archive of older products. The Web site features a search engine to help you locate documents using key words and phrases. You can print these documents in their entirety, including charts and other graphics.

Each day, GAO issues a list of newly released reports, testimony, and correspondence. GAO posts this list, known as "Today's Reports," on its Web site daily. The list contains links to the full-text document files. To have GAO e-mail that list to you every afternoon, go to www.gao.gov and select "Subscribe to e-mail alerts" under the "Order GAO Products" heading.

**Order by Mail or Phone**

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. General Accounting Office
441 G Street, NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDI: (202) 512-2507
Fax: (202) 512-6091

**To Report Fraud, Waste, and Abuse in Federal Programs**

Contact:

Email: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

**Public Affairs**

Jeff Nelligan, Managing Director; NelliganJ@gao.gov (202) 512-4800
U.S. General Accounting Office, 441 G Street, NW, Room 7440
Washington, D.C. 20548

PRINTED ON △ RECYCLED PAPER
Mr. PLATTS. Thank you, Mr. Walker. That was certainly a very important final point there. It is looking at the big picture, as opposed to a more blinders-on approach.

Before we go to Ms. Springer, I would like to recognize our Vice Chair, Mrs. Blackburn from Tennessee. I appreciate your zipping over here as well.

Ms. Springer, if you would like to proceed?

STATEMENT OF LINDA M. SPRINGER, CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

Ms. SPRINGER. Thank you, Mr. Chairman. As well, I would like to have my entire written testimony entered into the record. I will just highlight some accomplishments and progress and an outlook that we have with respect to that progress.

We are pleased to report to you that much has been accomplished in the area of financial management and financial reporting during this fiscal year. The very fact that we are here on this day in March, a full month earlier than last year, indicates that financial reporting deadlines are being accelerated. More specifically for fiscal year 2003, a record 18 of 24 major agencies and departments completed not only their audited financial statements, but their combined performance and accountability report by the end of December. That compares to only two agencies in fiscal year 2002. So we went from 2 up to 18. Of those agencies, eight accelerated the submission of their performance and accountability reports to mid-November 2003, a year ahead of the 2004 requirement. All of those eight received unqualified audit opinions.

Of the 23 CFO Act agencies, as was reported just previously, 20 received an unqualified opinion on their financial statements. Agencies for the first time completed quarterly financial statements. Up until 2003, there was 1 year where there was a mid-year requirement for financial reporting. Prior to that, it was strictly annual. So last year was the first time that there was ever quarterly financial reporting.

The Department of Homeland Security created 5 months into the fiscal year, elected to forego its first year waiver for preparing audited financial statements, but instead not only prepared those statements, but also went through the rigor in the process of the audit to get the insights and to provide the opportunity to get a good, strong audited balance sheet to start off fiscal year 2004. They did in fact get a qualified opinion on the balance sheet, which again sets them up well for going into fiscal year 2004.

USAID received an unqualified opinion on its audited financial statements for the first time ever in its history, and also met the mid-November reporting date, 1 year ahead of schedule.

The Department of Defense’s Medicare-eligible retiree health care fund financial statements received a qualified opinion in their first year, and the National Reconnaissance Office received an unqualified opinion on its statements. It is important to be aware of the fact that the Department of Defense has more than one financial statement. While it is consolidated, into one, but it is made up of 22 component financial statements.
The Small Business Administration developed their significantly revised credit models for five of its programs during the course of the year. Again, that is a positioning remediation-type effort that positions them for going into fiscal year 2004.

The total number of material weaknesses reported by auditors was reduced by 13 percent for fiscal year 2003, and the total number of FFMIA material weaknesses was reduced by over 40 percent.

New financial management systems, which are often critical to the production of quality financial information, went into effect in many agencies. Four agencies put systems on line after the close of the year, but before the end of the calendar year. So there is a lot of activity on that front as well.

So what is the outlook? My outlook for improving not only timeliness, but quality of financial statements and financial reporting to the American citizen is very positive at this stage. Many challenges remain, but others that appeared similarly insurmountable just a few short years ago, like accelerating reporting from 5 months after the end of the fiscal year to 45 days after the end of the fiscal year, are now being achieved. So it is our view that we should be very positive and we believe that these other challenges can be addressed and can be met, and in fact are.

It is often said that such achievements can only be accomplished by heroic efforts. Hard work is always a factor, but these results are a tribute to detailed planning, effective management and excellent execution. I want to repeat, those achievements are the result of good planning, management and execution. That is not heroism. That is just doing our jobs. In my mind, heroism is what is going on overseas in Iraq and Afghanistan. Good financial management, good financial reporting is our job.

Now, acceleration targets are critical and they will be achieved by all agencies. This year, in fiscal year 2004, the agencies will all hit that November 15, 2004 date. That is our goal. We are meeting with each agency to make sure that happens, that they have plans, that they have specificity, that there is a name to each step of that plan. Throughout the course of this hearing I hope to share some other observations about keys to success that we have learned from the CFO Council from the eight agencies that made the goal in 2003.

Beyond acceleration, what we are really after as a main goal is the incorporation of timely and accurate financial information into management decisionmaking and operational assessment. That is a first-class financial management organization. Progress toward this goal was made during fiscal year 2003, as shown by the addition of two agencies to the green status level of the President’s management agenda. Those two agencies are the Social Security Administration and the Environmental Protection Agency. They join the NSF, National Science Foundation, in that group of green. Subsequent to the end of the fiscal year, the Department of Education also fulfilled the criteria for achieving green status. So at this point, we now have four agencies.

In my office, the Office of Federal Financial Management within the Office of Management and Budget, we look forward to continuing our execution of our duties and leading the agencies to achieve higher and higher standards of financial management. That is our
job, and we do not consider that heroism either. That is our job and we are working very diligently with the agencies and we look forward to reporting back to this committee through the year on the full spectrum of financial issues.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Springer follows:]
Testimony of
The Honorable Linda M. Springer
Controller, Office of Federal Financial Management
Office of Management and Budget
Before the
Subcommittee on Government Efficiency and Financial Management
Committee on Government Reform
United States House of Representatives
March 3, 2004


Thank you, Mr. Chairman and Members of the Subcommittee.

I am happy to provide our commentary and response to the auditor’s report on the Financial Report of the United States Government (the Financial Report) for fiscal year 2003. I also will share with you the significant progress made by Federal agencies during the past year that underlies the Financial Report and positions us for the future.

Auditor’s Opinion and Material Weaknesses

The General Accounting Office (GAO) issued a disclaimer of opinion on the 2003 Financial Report. In making this determination, GAO continued to identify three main impediments to rendering an opinion: financial management problems at the Department of Defense (DoD), deficiencies in accounting for intragovernmental transactions, and ineffective processes for preparing the consolidated financial statements. The Office of Management and Budget (OMB) concurs with these observations. Efforts are underway to address these issues as noted in the auditor’s report.

Getting an opinion, qualified initially, on the government-wide financial statements remains our goal. OMB is working closely with the Department of the Treasury (Treasury) to create a closer link between audited agency financial statements and the government-wide statements reflected in the Financial Report. Beginning with fiscal year 2004, a new process will be implemented to better align the agency statements with the government-wide report.

Weaknesses at DoD are being addressed. Progress is being made, but it is important to recognize that long-standing issues in a department having over 300 sub-entities are not easily remediated. In many cases, elimination of DoD material weaknesses is dependent upon the new financial management systems implementation. OMB meets periodically with both the DoD Chief Financial Officer (CFO) and its Inspector General (IG) to review plans for each area of concern and to monitor progress.
The inability to balance significant amounts of intragovernmental transactions is being addressed on several fronts by OMB and Treasury. Process enhancements such as more frequent reporting and reconciliation, and new tools like the Intragovernmental Reporting and Analysis System (IRAS), will support our efforts to eliminate reporting errors. Also, the Intragovernmental Transaction Portal (IGTP) is scheduled to be implemented in fiscal 2004 to help standardize the transaction processing for certain intragovernmental exchange transactions.

GAO's report comments on timeliness issues at the agency level that impacted its audit scope. It should be understood that this was the direct result of variations in the degree to which agencies were able to accelerate from the official 2003 fiscal year reporting date of January 30, 2004. Moving forward from this transitional year, we will return to the single Performance and Accountability Report (PAR) due date of November 15th.

Internal Control

The internal control environment of any entity is an area of focus for management as well as its auditor. The agencies of the Federal Government are no exception. There are several existing laws that govern the agencies in assessing and representing the quality of their internal control. Agency heads are required to provide reasonable assurance of compliance with the Federal Manager's Financial Integrity Act (FMFIA) with respect to both management control and financial management systems. Agency heads are also required to certify that their systems satisfy specified requirements under the Federal Financial Management Improvement Act (FFMIA). The Federal Information Security Management Act (FISMA) provides for government-wide management and oversight of information security risks and agency information security programs. As such, FISMA requirements provide an additional standard for financial systems control.

Not all Federal agencies are able to provide these statements of assurance; however all continue to make progress in eliminating barriers to compliance. Because financial systems are a major part of the universe to which these statutes apply, it is entirely possible that positive assurance from the collective group of agencies will emerge over a period of years due to the time required for new system design, development and implementation.

Both OMB and the Chief Financial Officers (CFO) Council are keenly aware of the internal control challenges and related new assurance requirements that have been reported in the private sector. We are actively engaged with the Inspector General community in reviewing these requirements and their potential applicability to Federal Government agencies.

Erroneous Payments

Eliminating erroneous payments within the Federal Government has been, and continues to be, a major focus of the President's Management Agenda (PMA). When the
Improper Payments Information Act of 2002 (PIPA or the Act) was passed, we enthusiastically endorsed the efforts in Congress to create a review process that would identify and eliminate erroneous payments throughout all major Federal programs and activities. The Office of Federal Financial Management issued guidance implementing the Act in May of 2002 and subsequently met with the Offices of the CFO and the IG at each major agency to ensure that plans to meet the requirements of the PIPA were being developed. We directed all agencies to submit by November 30, 2005, their plan for complying with the Act. Further, we are now in the process of meeting with each agency CFO office to ensure that progress is being made according to its plan. Agency reports will be included in the 2004 PARs as required by the guidance.

Federal Accounting Standards

During the 2003 fiscal year, the Federal Accounting Standards Advisory Board (FASAB) issued Statement of Federal Financial Accounting Standard (SFFAS) No. 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment. Among the provisions of this standard is the requirement that the Statement of Social Insurance, which is currently reported in the stewardship section of the Financial Report, become a basic financial statement with full audit scrutiny. This Statement provides estimates for important components of the Social Security and Medicare programs and is accompanied by an expansive discussion of underlying assumptions and sensitivity analyses. This requirement of the standard is scheduled to be effective for fiscal 2005 and will enhance the significance and the prominence of what is one of the most extensively presented components of the current Financial Report.

Effective with the 2003 Financial Report, DoD is required to report the value of its national defense property, plant and equipment on the balance sheet under SFFAS No. 23, Eliminating the Category National Defense Property, Plant and Equipment. Process and system refinements that will provide the basis for this valuation in the future will decrease reliance on surrogate estimates.

Agency Accomplishments and Progress

Clearly challenges remain, but I can report to you that much has been accomplished in the area of financial reporting during the past fiscal year. The very fact that we are here on this day in March – a month earlier than last year – indicates that financial reporting deadlines are being accelerated. For fiscal 2003,

- a record 18 of the 24 (75%) major agencies and departments completed their PARs by the end of December, compared to only two agencies in fiscal year 2002;

- of these agencies, eight accelerated the submission of their PARs to mid-November of 2003, a year ahead of the 2004 requirement, all with unqualified audit opinions;
• 20 of the 23 CFO Act agencies received an unqualified opinion on their financial statements;
• agencies completed quarterly financial statements for the first time ever;
• the Department of Homeland Security (DHS), created five months into the fiscal year, elected to forgo its first-year waiver and prepare audited financial statements for the first time;
• DHS received a qualified opinion on its Balance Sheet and Custodial Activity Statement;
• the United States Agency for International Development (USAID) received an unqualified opinion on all of its audited financial statements for the first time in its history and met the mid-November reporting date;
• DoD’s Medicare-Eligible Retiree Health Care Fund financial statements received a qualified opinion in its first year and the National Reconnaissance Office received an unqualified opinion on its statements;
• the Small Business Administration (SBA) developed or significantly revised credit models for five of its programs during the course of the year;
• the total number of material weaknesses reported by auditors was reduced by 13% in 2003;
• the total number of FMFIA material weaknesses was reduced by 41% in 2003;
• new financial management systems went live in many agencies, including four between the close of the fiscal year and the end of December.

Outlook for the Future

Our outlook for improving the quality and timeliness of financial reporting to the American citizen is positive. Many challenges remain, but others that appeared similarly insurmountable just a few years ago are being solved. Who would have thought that the Administration’s goal of shortening the time for agencies to prepare audited financial statements from five months to 45 days after the end of the year would be attained by a third of the major agencies a year in advance of the deadline?

It is often said that such achievements can only be accomplished by heroic efforts. Hard work is always a factor, but these results are a tribute to detailed planning, effective management and excellent execution.
While the acceleration targets are critical and they will be achieved by all agencies, they are not our ultimate objective. The discipline and improved control needed to accelerate financial reports are only the foundation for ensuring the availability of useful financial information. The incorporation of timely and accurate financial information into management decision-making and operational assessment continues to be our main goal. Progress toward this goal was made during fiscal year 2003, as shown by the addition of two agencies, the Social Security Administration and the Environmental Protection Agency, that achieved green status under the PMA Improved Financial Performance initiative. They were joined by the Department of Education in the first quarter of fiscal 2004.

We look forward to continued execution of our role in leading the Federal financial management community and reporting additional progress across the financial management spectrum to you in the months ahead.

Thank you for listening. I am happy to entertain your questions.
Mr. PLATTS. Thank you, Ms. Springer. I appreciate your testimony.

I would like to recognize our ranking member, Mr. Towns from New York who has joined us, as well as Mrs. Maloney from New York. Thank you for joining us. Did you have a statement you want to submit for the record?

Mr. TOWNS. I ask that my opening statement be submitted for the record.

Mr. PLATTS. OK.

[The prepared statement of Hon. Edolphus Towns follows:]
Congressman Ed Towns
Subcommittee on Government Efficiency and Financial Management
Consolidated Financial Statements of the Federal Government
March 3, 2004

Thank you Mr. Chairman for holding this hearing on the Consolidated Financial Statement of the Federal Government for 2003. Mr. Chairman, while I am pleased to see that the agency community is continuing to make progress in meeting their imposed deadlines for annual auditing requirements, I remain concerned that our continued progress towards an unqualified opinion for the entire federal government has been hampered by only a few. For FY 2003, the GAO was able to give 20 out of 23 agencies a clean audit opinion, which is the same as last year's outcome when factoring in FEMA’s move to DHS. While we continue to make progress with most members of the agency
community, efforts to ensure that the entire federal
government receives a clean audit must continue if we are to
identify and improve upon the inadequacies of those
remaining deficient.

Despite all of our collective efforts, the object of a clean
government-wide audit continues to elude us. It also
remains clear that the financial management problems at
DOD remain pervasive and ingrained in nearly all facets of
their business operations, and the results of GAO’s work for
FY 2003 does little to assure me that recent efforts to
improve their outcomes have been beneficial. While I realize
that DOD remains pressed in their managerial functions due
to increased commitments abroad, we must continue in our
efforts to improve the managerial structure and financial
management of DOD. In a time of scarce federal resources,
the efficient operation of all federal agencies is a necessary priority.

As in previous years, the Comptroller noted continued weaknesses in financial systems throughout the executive branch, imbalances in intergovernmental transactions, and excessive amounts of improper payments. Only long-term focus on systemic financial management reform will enable the agency community to develop adequate and appropriate financial information systems.

I look forward to hearing from our witnesses about the ways in which our government can become more effective and efficient in the areas of financial management and accountability.
Mr. PLATTS. Mr. Hammond.

STATEMENT OF DONALD V. HAMMOND, FISCAL ASSISTANT SECRETARY, DEPARTMENT OF THE TREASURY

Mr. HAMMOND. Thank you, Mr. Chairman. Mr. Chairman, members of the subcommittee, I am glad to be here today to present and discuss the financial report of the U.S. Government for fiscal year 2003.

The Treasury Department gratefully appreciates your continued focus on improving the Federal Government’s financial management and reporting, further highlighting the importance of this important area.

My written statement presents the government’s financial reports for the year, relates some of the significant highlights in the report, and discusses financial reporting issues and the progress we have made in addressing them. I would ask that my written statement be included in the record.

Mr. PLATTS. Without objection.

Mr. HAMMOND. In my time available today, I will highlight some key items in our quest to make the report fully effective in meeting its objectives. The Treasury Department has a longstanding commitment to report accurate and useful financial information. Starting with the first Treasury Secretary, Alexander Hamilton, Treasury has fulfilled its core responsibility to report on the Nation’s finances. Through the financial report, our intent is to provide the Congress and the public with a reliable, understandable and useful report on the cost of the government’s operations, the sources used to fund its operations, and the implications of its financial commitments.

I am pleased that we were able to submit this year’s financial report a month earlier than last year. Showing the commitment to accelerated reporting this year, three-quarters of the major agencies completed their audited financial statements by the end of December, and eight agencies issued their statements by mid-November, a year ahead of schedule. When this accelerated reporting timeframe is accomplished by all agencies, it will set the stage for even more timely preparation of this consolidated report so that its information is available to support the budget deliberation process.

Because of the GAAP accounting standards under which the report is prepared, this accrual-based information helps to assess the long-term impact of policy decisions and enhances the traditional receipts and outlays information in the budget. The 2003 financial results show an accrual-based net operating cost of $665 billion, compared to the budget deficit of $375 billion. The main reasons for this difference are the recognition of the actuarial liabilities for civilian and military employee benefits and veterans compensation, as well as the accounting treatment for capitalized assets.

The report goes beyond simple reporting of accounting results, though, and displays the full effects of all significant liabilities, stewardship responsibilities, and other commitments. Examples of stewardship responsibilities are social insurance programs such as Social Security and Medicare. While these are not liabilities on the balance sheet, they are nonetheless commitments that the government will be obligated to pay in the future.
Since the first audited governmentwide report was issued for fiscal year 1997, we have worked continuously to improve the accuracy, reliability and timeliness of this important report. We have made considerable progress, but still need to resolve some important reporting issues. As noted, the General Accounting Office again issued a disclaimer of opinion on the 2003 report. Making the needed improvements will require a concerted effort by all government agencies and auditors, along with continued strong leadership from Treasury and OMB.

There are three major areas of governmentwide focus. Treasury needs to directly link agencies' audited financial statements with the agency data we collect. Agencies are not consistently or properly reconciling their financial activities with the other agencies. And unreconciled or unexplained transactions that affect the change in the position must be resolved.

The Financial Management Service, the operational arm of Treasury responsible for these important accounting responsibilities, is making real progress in addressing them. First, to address the need to directly link agencies' audited financial statements with the data agencies provide to Treasury, FMS is implementing a new automated process. The governmentwide financial reporting system will go active in 2004 and will be a system used for the first time to compile the report directly from agency audited financial information.

Second, we have been focusing on the problem of intragovernmental activity and a solution, frankly, is in sight. FMS's intragovernmental reporting and analysis system has been instrumental in classifying the interagency activity and balances by reciprocal category. Treasury and OMB recently required agencies to report and reconcile this activity quarterly. These more frequent reconciliations and adjustments should help to eliminate the interagency differences.

Related to the intragovernmental problem are the unreconciled or unexplained transactions. We believe this problem has its roots in the unreconciled intragovernmental balances. When that problem is understood, it may also suggest a solution for this problem.

I would like to just mention a couple of other improvements underway because I think they are in fact significant. First, we have accelerated the reporting of budget information so that now the monthly Treasury statement is issued on the ninth workday of each month. Later this year, we will accelerate to the seventh workday. The significance of this acceleration I think reflects the commitment of all agencies, because they feed the information which supports the release of that report. So what that means is agencies today are now submitting their information within 3 days of the end of each month on all their budget execution.

We also have the governmentwide accounting modernization project. I have mentioned it in years past. We are starting to see some real results from that program. When it is fully available, we think that it will totally revolutionize the way budgetary accounting is done at the Federal level.

While I am pleased with the progress we have been making at both the agency level and the consolidated level, I know that much work remains. Some real challenges ahead are to resolve the prob-
lems with intragovernmental transactions, issue our 2004 reports
much earlier and to provide information that is useful and supports
decisionmaking.

Even as we achieve more timely reporting, it is important to ob-
tain the full value of financial reporting by having reports that are
useful. That is our goal. We will not be done until we have accom-
plished that objective, which is useful financial reporting for the
public and the citizens.

I want to thank you for your patience. I would be happy to an-
swer any questions that you may have.

[The prepared statement of Mr. Hammond follows:]
Statement of Donald V. Hammond
U.S. Department of the Treasury Fiscal Assistant Secretary
before the
House Government Reform Subcommittee on Government Efficiency
and Financial Management
March 3, 2004


Mr. Chairman and Members of the Subcommittee,

I am glad to be here today to present and discuss the Financial Report of the United States Government for fiscal year 2003. The Treasury Department greatly appreciates your continued focus on improving the Federal Government’s financial management and reporting. Your attention to these issues highlights their importance. Today I will present the government’s financial results for the year, relate some of the significant highlights in the report, and discuss some financial reporting issues and the progress we have made in addressing them. While the annual Financial Report is an important document that adds to the information available to the public, we need to address some significant challenges to make it fully effective in meeting its objective.

TREASURY FINANCIAL REPORTING

The Treasury Department has a long-standing commitment to report accurate and useful financial information on the operations of the United States government. Starting with our first Treasury Secretary, Alexander Hamilton, Treasury has fulfilled its core responsibility to report on the nation’s finances. Through the consolidated financial statements in the report, our intent is to provide the Congress and the public with a reliable, understandable and useful report on the cost of the government’s operations, the sources used to fund its operations, and the implications of its financial commitments. In pursuit of this objective, we will continue to commit significant resources in a cooperative effort with all agencies.
As you know, the Government Management Reform Act of 1994 requires the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, to prepare and submit to the President and the Congress the preceding fiscal year's audited financial statements, not later than March 31. I'm pleased that we were able to submit this year's Financial Report to the Congress a month earlier than last year. This is another indication that the government is making progress in accelerating its reporting.

This year, three-fourths of the major agencies had completed audited financial statements by the end of December. Eight agencies had issued their statements by mid-November, a year ahead of the accelerated deadline that goes into effect in 2004. When this accelerated reporting timeframe is accomplished by all agencies, it will set the stage for even more timely preparation of this consolidated report so that its information is available to support the budget deliberation process.

**IMPORTANCE OF THE REPORT**

Because the financial statements, subject to audit, have been prepared in accordance with generally accepted accounting principles (GAAP), they provide a standardized reporting framework that ensures consistency and provides for comparability and ease of understanding. Under the accrual method, transactions are recorded when a liability occurs, or when the events giving rise to the transactions occur, whereas under a cash basis of accounting, transactions are recorded when cash is received or paid. Because of the standards under which the report is prepared, this accrual-based information helps to assess the long-term impact of policy decisions and enhances the traditional receipts and outlays information in the Budget.

The Financial Report covers all accounts of the Executive Branch. Additionally, the report contains almost all information from the Legislative Branch and budget information from the Judicial Branch. In order to fully and properly reflect information from the Legislative and Judicial Branches, we would need to receive their audited financial statements and accompanying information. Appendix A shows a list of significant Executive Branch entries contained in the report, including, for this year, the new Department of Homeland Security.
REPORT HIGHLIGHTS

Some highlights of the report I want to mention are the government’s net operating cost, its total financial responsibilities, and the federal debt subject to limit.

The 2003 financial results show an accrual-based net operating cost of $665 billion, compared to the budget deficit of $375 billion. The main reasons for the difference are the actuarial liabilities for civilian and military employee benefits and veterans’ compensation and benefits. The report provides a statement that fully reconciles the difference. Another major difference in the report is the accounting treatment of capitalized fixed assets, including depreciation, in the Department of Defense and other civilian agencies.

The report goes beyond simple reporting of accounting results and displays the full effects of all significant liabilities, stewardship responsibilities and other commitments. The 2003 balance sheet shows assets of $1.4 trillion and liabilities of $8.5 trillion. These liabilities are accurately reported using current accounting standards, but they do not include some of the government’s other major financial responsibilities, which the accounting standards do not treat as liabilities. Examples are social insurance programs such as Social Security and Medicare. While these are not liabilities on the balance sheet, they are nonetheless commitments that the government will be obligated to pay in the future. Taken together, current liabilities and the net present value of our additional responsibilities (over a 75-year period) are estimated at $3.61 trillion.

Financing the government’s cash requirements while remaining within the debt limit is an ongoing challenge for us. In 2003, debt held by, or owed to, the public was $3.9 trillion and was the government’s largest liability. Debt held by government accounts, was $2.8 trillion and, while it is also subject to the debt limit, it is not shown as a liability because this debt is an internal transaction between two government accounts. The combination of these two reflects the total federal debt subject to limit, a total of $6.8 trillion.
The Congress has traditionally exercised control over the size of the debt by establishing a statutory limit on the amount of Treasury securities that can be outstanding. When the debt limit is reached, the Secretary of the Treasury can employ a number of statutory tools to remain within the cap for a short period of time. He was required to do this in 2003. On May 27, 2003, legislation was enacted that increased the debt limit to $7.4 trillion. Based on current projections, these actions will be required again in 2004.

REPORTING ISSUES

Since the first audited government-wide report was issued for fiscal year 1997, we have worked continuously to improve the accuracy, reliability and timeliness of this important report. We have made considerable progress, but still need to resolve some important reporting issues.

The General Accounting Office issued a disclaimer of opinion on the 2003 report. GAO cited material weaknesses in internal controls in Treasury's report preparation processes and in some agency financial statements. We have been working to eliminate these problems; however, making these improvements will require a concerted effort by all government agencies and auditors, along with continued strong leadership from Treasury and OMB.

There are three major areas of focus which I will list first, and then discuss the improvements underway to address them.

- Treasury needs to directly link agencies' audited financial statements with the agency data that we collect through our centralized systems to prepare this report.

- Agencies are not consistently or properly reconciling their financial activities with other agencies. Some of these intragovernmental accounts are significantly out of balance. In 2003, the net amount that did not match was about $163 billion and the unexplained amount was about $65 billion. A table in Appendix B details the out-of-balance condition.
• Unreconciled or unexplained transactions affect the change in net position. In 2003, these unreconciled or unexplained transactions amounted to a $24.5 billion increase in net position.

IMPROVEMENTS UNDERWAY

To resolve the material weaknesses mentioned above and improve financial management, we have a number of initiatives underway. The Financial Management Service (FMS), the operational arm of Treasury for these important accounting responsibilities, is making real progress. While some of these initiatives are in the developmental phase, in others, FMS has already had success.

First, to address the need to directly link agencies’ audited financial statements with the data agencies provide to Treasury for the government-wide consolidated statements, FMS is implementing a new process called the Government-wide Financial Report System (GFRS). This process will help ensure that agency financial statements contain the same information that agencies input for the government-wide consolidated statements and will ensure that that these data are linked. Five agencies have pilot-tested this new, internet-based system. The test agencies entered their own audited financial statements, and then reclassified those amounts in the standard format used to prepare the government-wide consolidated statements. In June 2004, the system will be tested government-wide as agency personnel trained in GFRS start entering their fiscal 2003 actual data. Then in November, after their statements are issued, agencies will report their fiscal 2004 data using the new process. GFRS will provide a clear audit trail that will facilitate the audit of the Financial Report and demonstrate that it is consistent with the underlying information in agencies’ audited financial statements.

Second, we have been focusing on the problem of intragovernmental activity and balances and are devoting much attention to help agencies fully reconcile these imbalances. FMS has added a useful new tool to help agencies record and properly identify intragovernmental transactions. The Intragovernmental Reporting and Analysis System (IRAS) has been instrumental in classifying inter-agency activity and balances by reciprocal category. This
system will help to identify differences, provide information for agencies to correct reporting errors, and reconcile material differences between agency "trading partners." As we continue to expand its use, IRAS will serve as: a centerpiece in the repository of intragovernmental transactions at the reporting level, a database solution for tracking quarterly accounting errors and timing differences, and a systematic documentation of the different accounting methods used by the various agencies. Treasury and OMB recently required agencies to report and reconcile intragovernmental activity quarterly instead of just at the end of the year. These more frequent reconciliations and adjustments should help to eliminate the inter-agency differences.

Related to this intragovernmental problem are the unreconciled or unexplained transactions that affect the change in net position. We believe this problem has its roots in the unreconciled intragovernmental balances, and we are therefore focusing our efforts on this area first. When that problem is resolved, it may also suggest a solution for this problem. We need to eliminate the intragovernmental problems first, so that we can see what other issues remain.

In addition to the progress we are making to resolve issues raised by our auditors, we have also enhanced our reporting, and the reliability and timeliness of our data, and made other improvements in the government's financial management.

A significant reporting improvement this year was the incorporation of a new accounting standard promulgated by the Federal Accounting Standards Advisory Board. This standard requires recording on the balance sheet the value of national defense property, plant and equipment (e.g., ships, aircraft, combat vehicles, weapons). To begin applying this standard immediately, in 2003 the Department of Defense (DoD) based the value of its military equipment on data provided by the Bureau of Economic Analysis. DoD is now revising its accounting processes and systems so that in the future, the basis for these valuations will come from DoD systems. The estimated total acquisition cost of equipment was $1.2 trillion. The value of this equipment net of depreciation was $316.6 billion.

We have also made improvements in the reliability and timeliness of data. There have been measurable improvements in the government's financial data quality since the first
government-wide audit was conducted for the fiscal 1997 Financial Report. At that time, only eight of the 24 major agencies had received clean opinions on their financial statements. This year, 27 of 31 major agencies that completed 2003 financial statements received clean opinions. A clean opinion helps assure the public that the government is providing reliable data and properly accounting for its money.

A major timeliness initiative implemented over the course of the fiscal year has resulted in earlier agency data input and an earlier release of the Monthly Treasury Statement of Receipts and Outlays of the United States Government (MTS). Each month, the MTS displays official budget results, including data on the budget deficit or surplus. Agencies are now submitting their monthly financial data to Treasury within three workdays of the end of the month, compared with five to seven days a year ago. This accelerated reporting has enabled Treasury to provide agency expenditure balances and other financial information which agencies need to prepare their financial statements much earlier than in the past. Several years ago, the MTS was released on the 17th workday after the end of the month; at the start of 2003, it was released on the 14th workday and now is being released on the 9th workday. Our goal is to accelerate the release of the MTS to the 7th workday. By providing timely information, we can better inform the decision-making process.

Another Treasury initiative that will improve financial management in future years is the Government-wide Accounting Modernization Project (GWA). GWA will provide agencies with better tools for reporting their financial information and monitoring its status. Currently, agencies do not see their account balances until the 10th or 11th workday after the end of the month. Treasury is now rolling out an account statement module that allows agencies to view their account balances on a near real-time basis. Also, the project has been expanded to web-enable agencies' monthly reporting of disbursement and collection data. GWA, when fully operational, will provide more timely financial information to agencies and will also eliminate duplicative reporting and costly, manually-intensive reconciliations.
CHALLENGES AHEAD

While I am very pleased with the progress we have been making at both the agency level and the consolidated level, I know that much work remains. Some real challenges ahead are to resolve the problems in recording intergovernmental transactions, to issue our 2004 reports much earlier, and to provide information that is useful and supports decision making.

As I mentioned earlier, a real and continuing challenge is to improve the accuracy of the financial information that agencies supply to Treasury, particularly in recording and accounting for their transactions with other agencies and transfers between agencies. Correcting this problem requires agencies understanding the process and applying consistency and attention to detail in recording information at the points where the transactions take place. This is basic to accurate and consistent financial reporting.

There is no single, centralized systems solution to solving the intragovernmental elimination problem. Rather, improving the data quality and reconciling with trading partners must be an agency management priority. Adhering to the standard business rules issued by OMB in October 2002 for processing intragovernmental transactions is a necessity. In addition, agencies must conduct the required quarterly reconciliations with their trading partners so that there is less work to do at year-end when the financial statements are prepared. Moving forward, Treasury plans to initiate a process through which agencies will confirm their intragovernmental balances with their trading partners on an annual basis.

The CFO community has accepted the challenge of further improving the timeliness of financial reporting. To this end, departments and agencies are scheduled to submit their 2004 financial reports by November 15 (45 days after the end of the fiscal year), and Treasury is scheduled to issue next year’s Financial Report on December 15. Achieving these timelines will require significant improvements in business processes, information accuracy, and the use of estimation techniques to develop financial data. The successful acceleration of the financial statement deadline will also require the auditors to be actively involved throughout the year, working with the agencies to understand their estimation techniques, review quarterly
intragovernmental balances and reconciliations, and audit third-quarter financial information. I look forward to meeting this due date, but I recognize the difficulties involved. We are dealing with improvements that still need to be made in our central reporting processes and working with agencies whose financial reporting is not yet where it needs to be to meet this date.

A third challenge, even as we achieve more timely reporting, is to obtain the full value of financial reporting by having reports that are useful. Producing accurate, reliable, and on-time financial reports that comply with statutory and administrative requirements has largely been accomplished. These basic elements are necessary, but not sufficient to achieve the full value of financial reporting. Usefulness is the final element of good financial reporting. Does financial reporting assist agency heads and managers in making decisions? Does it provide important performance information? Here lies the greatest challenge and potentially the greatest benefit from financial reporting.

In conclusion, we have come a long way in the past year, our upcoming challenges are significant but manageable, and I am confident that 2004 will be a year of real progress. Thank you, Mr. Chairman. This concludes my formal remarks and I would be happy to respond to questions.

Appendix A: List of 35 significant entities
Appendix B: Report on intragovernmental out-of-balance condition
APPENDIX A

Significant Executive Branch Entities in FY 2003 Financial Report

Cabinet Departments
Agriculture
Commerce
Defense
Education
Energy
Health and Human Services
Homeland Security
Housing and Urban Development
Interior
Justice
Labor
State
Transportation
Treasury
Veterans Affairs

Other major agencies (CFO Act)
Agency for International Development
Environmental Protection Agency
General Services Administration
National Aeronautics and Space Administration
National Science Foundation
Nuclear Regulatory Commission
Office of Personnel Management
Small Business Administration
Social Security Administration

Other entities
Export-Import Bank
Farm Credit Insurance Fund
Federal Communications Commission
Federal Deposit Insurance Corporation
National Credit Union Administration
Pension Benefit Guaranty Corporation
Railroad Retirement Board
Securities and Exchange Commission
Smithsonian Institution
Tennessee Valley Authority
US Postal Service
### APPENDIX B

Report on Fiscal Year 2003 Intergovernmental Activity/Balances
United States Governmentwide Aggregate by Reciprocal Category

<table>
<thead>
<tr>
<th>Cat. Description</th>
<th>FY 2003</th>
<th>FY 2002</th>
<th>Net Increase/Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FIDUCIARY ACTIVITY/BALANCES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>01 Investments in Federal Securities/Federal Debt</td>
<td>$399</td>
<td>$1,067</td>
<td>($668)</td>
</tr>
<tr>
<td>02 Interest Receivable/Payable</td>
<td>(217)</td>
<td>169</td>
<td>(386)</td>
</tr>
<tr>
<td>03 Exchange Interest Revenue/Expense</td>
<td>(8,000)</td>
<td>2,761</td>
<td>(10,761)</td>
</tr>
<tr>
<td>04 1/ Non-Exchange Interest Revenue/Expense</td>
<td>(584)</td>
<td>0</td>
<td>(584)</td>
</tr>
<tr>
<td>17 Loans Receivable/Payable</td>
<td>(10,553)</td>
<td>12,358</td>
<td>(22,911)</td>
</tr>
<tr>
<td>21 Employee Benefits Contributions Receivable/Payable</td>
<td>456</td>
<td>96</td>
<td>360</td>
</tr>
<tr>
<td>26 Employee Benefits Contributions Revenue/Expense</td>
<td>1,465</td>
<td>1,084</td>
<td>381</td>
</tr>
<tr>
<td><strong>Total Fiduciary Activity/Balances</strong></td>
<td>($17,034)</td>
<td>$17,533</td>
<td>($34,569)</td>
</tr>
<tr>
<td><strong>NON-FIDUCIARY ACTIVITY/BALANCES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18 Financing Sources without Reimbursement Transferred In/Out</td>
<td>$41,362</td>
<td>$8,605</td>
<td>$2,757</td>
</tr>
<tr>
<td>19 2/ Appropriations Transferred In/Out</td>
<td>49,973</td>
<td>0</td>
<td>49,973</td>
</tr>
<tr>
<td>27 Federal Transfers Receivable/Payable</td>
<td>5,284</td>
<td>4,990</td>
<td>98</td>
</tr>
<tr>
<td>28 Unexpended Appropriation Transferred In/Out</td>
<td>19,231</td>
<td>113,793</td>
<td>(94,562)</td>
</tr>
<tr>
<td><strong>Total Federal Transfers</strong></td>
<td>$66,150</td>
<td>$117,380</td>
<td>($51,230)</td>
</tr>
<tr>
<td>22 Buy and Sell Related</td>
<td>$17,144</td>
<td>$11,970</td>
<td>$5,174</td>
</tr>
<tr>
<td>23 Buy and Sell Related Accounts Receivable/Payable</td>
<td>13,740</td>
<td>10,013</td>
<td>3,727</td>
</tr>
<tr>
<td>24 Buy and Sell Related Revenue/Expense</td>
<td>47,798</td>
<td>30,952</td>
<td>16,846</td>
</tr>
<tr>
<td><strong>Total Buy and Sell Related</strong></td>
<td>$78,682</td>
<td>$52,935</td>
<td>$25,747</td>
</tr>
<tr>
<td><strong>Total Non-Fiduciary Activity/Balances</strong></td>
<td>$164,832</td>
<td>$180,323</td>
<td>($15,491)</td>
</tr>
<tr>
<td><strong>TOTAL FIDUCIARY &amp; NON-FIDUCIARY ACTIVITY/BALANCES</strong></td>
<td>$164,832</td>
<td>$187,858</td>
<td>($50,026)</td>
</tr>
<tr>
<td>3/ Non-Reciprocal Category Activity/Balances</td>
<td>$15,050</td>
<td>$35,879</td>
<td>($20,829)</td>
</tr>
<tr>
<td><strong>TOTAL GOVERNMENTWIDE ACTIVITY/BALANCES</strong></td>
<td>$162,848</td>
<td>$223,737</td>
<td>($57,889)</td>
</tr>
</tbody>
</table>

*FY 2003 aggregate out-of-balance condition for Fiduciary activity reflects trading partner reporting exceeded Central Fiduciary Agency total
1/ Non-Exchange Interest Revenue was combined with Exchange Revenue in FY 2002.
2/ Appropriations transferred In/Out was combined with reciprocal category 18 in FY 2002.
3/ Intergovernmental activity/balances reported in this category is related to contra accounts.
Mr. PLATTS. Thank you, Mr. Hammond. I appreciate your testimony, and also all three of you and your staffs in working with the subcommittee staff in not just preparing for this hearing, but week-in and week-out as we try to work as partners with each of you and your agencies, and the expertise that you bring in both guiding the agencies week-in and week-out through OMB in preparation of the reports, and then the auditing of the reports by GAO.

There are a lot of areas that you touched on in your written testimony and your opening. I have debated where to start. I think I am going to start, Mr. Walker, with when you talked about the three largest impediments. The first one up is DOD. Given the size of that impediment, I think we will start there.

Can you expand on your opening comments? What are the good signs? What should we be pleased about regarding where DOD is today versus a year ago, as they were trying to get their arms around all their systems and bring it together? And then also, what is the biggest concern that we should keep in mind?

Mr. WALKER. Mr. Chairman, I believe that current leadership at the Department of Defense fully recognizes that they have a serious problem here. They are taking it seriously. There is a commitment from Secretary of Defense Rumsfeld and also the Deputy Secretary, the Controller and others are committed to try to address this. The Congress has provided additional funding to help modernize financial management systems.

At the same point in time, while our Department of Defense is No. 1 in the world in fighting and winning armed conflicts, so it is the gold standard on that basis, they are a D, and that is graded on a curve, in economy, efficiency, transparency and accountability. Candidly, for decades financial management has never been a priority. They have never been held accountable by the Congress or anybody else for not making it a priority. That is changing, but the fact of the matter is it has taken them decades to get where they are. It is going to take them a number of years to get to where they need to be.

My personal opinion is that, among other things, in addition to the continued top management commitment and congressional oversight and support, the Department of Defense faces a fundamental business transformation challenge that is going to require at some point in time the considered attention of a top-level professional who is focused solely on the business transformation process at the Department of Defense from a strategic and integrated perspective.

We have recommended before that consideration be given to creating a chief management officer, a level two-type person, who would have a term appointment, 5 to 7 years, and a performance contract, and whose job it would be to focus not just on financial management, but information technology, human capital transformation and various other areas on a sustained, and integrated basis. I have my doubts as to whether or not the DOD will ultimately be successful without taking this step.

Furthermore, I believe that the Department of Defense also needs to take control of the tremendous amount of money that Congress appropriates to it each year, they need to have more centralized control over the allocation of those resources with regard to ex-
isting systems and new systems development, and also to further accelerate the progress that they have made, in connection with developing an enterprise architecture. But I think that they need to recognize that if they are going to pass the money down to the different services and the different operating units, once you pass the money down you lose a lot of control.

So they need to think about differentiating between war-fighting systems and management information systems, including financial management systems, and maintain more centralized control over them, more control over what type of systems are allowed to go forward, and which ones should be terminated in order to ultimately get them to where they need to be.

Mr. PLATTS. Mr. Walker, to followup, you mentioned actually one of the issues I was going to raise, which is the architecture enterprise, and trying to put that in place. To do so, they need to first know what they have and what systems are out there and how to bring them in line, and then to make sure as they go forward that everything is matching up. My understanding is they still do not have an accurate assessment of what financial management systems, how many and exactly what they are yet kind of tabulated.

And then in the 2003 defense authorization bill, we said that they were not to approve any new ones that were more than $1 million without ensuring through the CFO that it would line up with the direction they are going for their business transformation. I understand that is not occurring either. Both of those raise further concerns that we are talking about the right things, but we are not really seeing the action. Does that tell me that we are still wasting good money on bad ideas? I think last year the one program we had spent $100 million on to realize it was not going to work. Are we still doing that at DOD?

Mr. WALKER. My understanding, Mr. Chairman, is that at last count there were roughly 2,400 systems at the Department of Defense, but they were still counting. My understanding Mr. Chairman, is that a number of the $1 million-plus systems have been approved by the Controller, but not all of the systems. As you know, enterprise architecture is a framework. We are not going to have one system for the Department of Defense, but it does provide specifications that we need to assure that all the systems comply with in order to have interoperability and in order to be able to achieve the broader objectives.

Again, top management is committed, but it comes back to a point that I made before. They need to have more control over the resources. If they do not have more control over the resources, by the time you find out you have a problem, it may be too late.

Mr. PLATTS. The contract is already let and the money is spent.

Mr. WALKER. The money is already spent.

Mr. PLATTS. I want to yield to our ranking member, but a quick followup is, we talked about this being so critical to getting a clean consolidated report in the fiscal year 2007. Is that realistic regarding DOD in any sense, that we could get them in line by then?

Mr. WALKER. I think they are committed to make best efforts to hit that date. I think it is unrealistic to expect that they will do it before that date. Obviously, we are going to try to do everything
that we can, but at the same point in time, ultimately it is management's responsibility to do what they have to do.

Mr. Platt. OK. Thank you.

Mr. Towns.

Mr. Towns. Thank you very much, Mr. Chairman.

Let me begin with you, Mr. Hammond. What level of success have you had in recovering improper payments referred to you for collection?

Mr. Hammond. From a Treasury perspective, improper payments to us look very similar to any other form of delinquent debt. So what that means is that it will have been referred to us for collection after certain agency actions. So I would not have any specific information that would be able to differentiate, for example, an improper payment from another type of debt collection activity.

We have had very good success collecting delinquent debts relative to the age that they have been submitted to us.

Mr. Towns. Looking at it across the board, then, is there anything more that we need to do here in the Congress to make it possible for you to be able to carry out your function?

Mr. Hammond. I think with regard to the debt collection component of that, which would certainly be after an agency had exhausted its efforts to recover a payment, and then had forwarded it to us for ultimate collection, I believe we are in pretty good shape with regard to the tools that we have. Obviously, what makes that work effectively is prompt agency referral of debts. The older a debt gets, the more difficult it is to collect, obviously.

Mr. Towns. Right.

Mr. Walker. May I respond to Mr. Towns' comment on that? First, I think one of the things that should possibly be considered and the administration may want to take a look at this is, whether and to what extent they might need additional authorization from the Congress in order to engage in additional data matching activities. For example, to match people or entities who are getting Federal contracts and are delinquent taxpayers or other types of activities. There might be some barriers there that they might want to consider pursuing. That is one area off the top of my head that might make sense to pursue possibly further.

Ms. Springer. There are several things that we have proposed from a legislative standpoint that would be of assistance. For example, access to new-hires data bases would be one example, and access to other data bases that help an agency that does not have access to that today to be able to validate individuals or the accuracy of payments to the universe of people that are subject to a program.

So yes, there are, I think, three different things and we could get those for you that from a legislative standpoint would be helpful tools for us to get.

Mr. Towns. Right.

Mr. Walker. Mr. Towns, one more thing, if I might real quick. The other issue that we have testified on before in the past is there is a prompt payment act, where if the Federal Government does not pay in a timely manner, they have to pay penalties and interest. On the other hand, if the Federal Government overpays a contractor, a contractor is not required to notify the Federal Govern-
ment of that and in fact they do not have to pay any interest or penalty. So that is an area I think that there could be some opportunities.

Obviously, to the extent that we are looking at this data-matching issue as well, one of the issues that has to be considered is the privacy issues, too. There has to be a balancing of interest there, but it is something where additional progress could, and should be made.

Ms. SPRINGER. Yes, part of that often will come into play with the use of contractors. For example, what access would you give to a contractor to certain data bases. So it is incumbent on us to craft that access in a way that protects privacy, but it can be done and I think that there are several areas where we could do that.

Mr. TOWNS. Mr. Hammond, can you think of anything that we need to do on this end to be helpful?

Mr. HAMMOND. In particular with regard to debt collection?

Mr. TOWNS. Yes.

Mr. HAMMOND. Taking in its broader focus.

Mr. TOWNS. You want to go to broader focus. I will even entertain that. [Laughter.]

Mr. HAMMOND. Yes, because I think a debt from our standpoint, and I know it sounds oversimplified, but a debt from our standpoint is a debt. What caused the resulting debt is really an agency issue, whether it had to do with loan administration or contract administration. As Linda mentioned, there are some legislative proposals in the President’s budget which would on the margin increase the effectiveness of debt collection. But the program is frankly reaching a point of maturity, which is very encouraging. We have been very, very happy with the results that we have been getting to date.

The data-matching will continue to be one of the balancing acts that is important with regard to debt collection, in particular as we look at tax-related debts, because the tradeoffs between 6103, which is the IRS tax code provision having to do with privacy of tax information, and the access to taxpayer information with regard to debt collection is a very, very difficult balancing act. I know it is one that my colleagues at the IRS struggle with every day.

Mr. TOWNS. Alright. Ms. Springer, can you tell us what is being done by both OMB and the agencies to ensure the sustainability of unqualified audit opinions?

Ms. SPRINGER. There are several things that we do. First off, every year we start off the fiscal year by meeting with the CFO and the IG of every agency, every major agency, CFO Act agency and Department of Homeland Security. We review the status of material weaknesses. We review the challenges that are impediments to getting a clean audit in the case of the few agencies that did not get that. We review the areas that were challenges for the agencies that did get unqualified opinions. We set a plan for the entire fiscal year that will make sure that those areas are a part of a very specified detailed working plan with names next to the tasks, so that by the end of that fiscal year those issues are being addressed. We make sure that there is engagement between the Office of the IG and the Office of the CFO throughout the year, so that there are no surprises at the end of the year, so that every
agency is working very much hand-in-glove between those two offices.

It is our job to make sure that if there are impediments, for example systems issues, that they are being addressed as well. One of the other things we do is work through the CFO Council, which is a group of all the major CFO Act agency CFOs. We just recently, for example, performed a survey of the CFOs, those who were able to get unqualified opinions and accelerate the reporting and those who were not, to ask them to list what the challenges were, what the barriers were, what the keys to success were. At some point during this hearing, I would like to share those with you.

And then we provide those best practices across the board to all of the CFOs and we will do the same presentation to the PCIE so that the IGs have that same benefit. But we find that a lot of the things that are challenges can be dealt with if they are identified and they are assigned to responsible individuals and there is accountability throughout the year, as opposed to waiting until the very end when the contract auditor comes in to perform their review. It is OMB's job to make sure that activity is occurring through the year.

Mr. Towns. Thank you very much. My time has expired.

Mr. Platts. Thank you, Mr. Towns.

Before I go to Mrs. Blackburn, a quick followup, Mr. Hammond, on the question from Mr. Towns regarding your debt collection of improper payments. Would there be a benefit, as we are trying to get our arms around the improper payments issue, what type they are, how much, what is the size of the improper payment dollar amount, to complete the loop by delineating those that are identified as improper payments, and your success. It seems like there might be some benefit to understanding the payments and how easily or not easily we can go after them after they have been identified.

Mr. Hammond. I think understanding improper payments and their nature, because they are a very diverse group of payment types, is very useful. Whether that would need to be drilled down to the level of those referred for ultimate Treasury debt collection or not, I think is still an open question. The agencies are now really doing comprehensive reporting and identification of those payments at their end. Oftentimes, that is really the best source of collecting or correcting the improper payment.

Mr. Platts. The example would be if you get five different types of improper payments referred to you for collection because they were wrongful payments. If we track your success and that you have great success in the first type in the sense of the cost/benefit that you know you will go after those in the sense that the taxpayer is awaiting a quick return on the effort, whether there is any thought to that.

Mr. Hammond. I think there is some merit in looking at that. I think the thing to understand about those types of erroneous or improper payments are that when the government has a continuing relationship with the entity or the individual who received the payment, there is a much easier or a much higher prospect of ultimate correction or collection of the problem.
When you get into the world, for example, of vendor payments where the relationships may not be ongoing or may be more sporadic, then you get into a very different type of collection when you are trying to collect it.

Mr. PLATTS. I agree that it is not in place of the agency-by-agency identification and understanding of what type of improper payments are being made, but it may complement that information.

Ms. Springer, did you want to add something?

Ms. SPRINGER. Yes, I was just going to comment that the Improper Payment Information Act requirements are right now being put into place at each of the individual agencies, so it dovetails with the debt collection activity at the Department of Treasury. So all agencies have submitted their plans. We gave them until the end of November of last year. They have done that, and all five steps under the act are being addressed. Again, it is our directive to the agency that those plans have dates for each of those five steps and we have those right now.

So many agencies have started. They have done their inventorying of their programs. We are making sure that those inventories total all the expected outlays of the 2004 budget. And then from that point, their initial risk assessment, going on to statistical sampling where that is required, and then the remediation plan, and then developing the baseline and the opportunity year by year for actual savings.

So agencies are at different points. They all have plans, but they are in various stages along the way of that assessment. Obviously, the agencies that have already done their Section 57 from the previous OMB guidance have a head start on that. But every dollar of Federal outlays will be inventoried at the very beginning and then we will move through the process.

Mr. PLATTS. And given the conservative sum being that $35 billion or so——

Ms. SPRINGER. For the first trillion.

Mr. PLATTS [continuing]. Right, it is certainly a worthy effort in what we need to do to protect the taxpayer's hard-earned dollars. If it is possible to have those plans as they are being finalized and completed shared with the subcommittee so we can see how the departments are approaching this challenge pursuant to the law, that would be very helpful.

Ms. SPRINGER. We would be glad to share that with you.

Mr. PLATTS. Thank you.

Mrs. Blackburn, I apologize. It was not a quick followup.

Mrs. BLACKBURN. That is quite all right.

Mr. PLATTS. I recognize the Vice Chair.

Mrs. BLACKBURN. Thank you, sir. I think that we are all interested in hearing what you all have to say. We always appreciate your coming over here and giving us information. We just hope that we honor your time by coming up with good legislation and follow-through and oversight. So as always, we thank you.

Mr. Walker, I can tell you, the comments that you had made some months ago about the over 2,300 accounting systems in DOD and trying to find a way to pull those into one enterprise architecture, that is something that I have thought about time and time again. Recently, I talked to a company that does the data conver-
sion. We were doing a GSA program. I said, my goodness, I think we might have some folks that would be interested in talking about what you all do and the talent you have that knows how to convert this data and bring it all in-house.

We continue to look forward to DOD being able to have a way to manage both their management systems and their war systems, and pull that into one architecture, and then have the security, the information security that is necessary to support that. I think the security is one of the things that does concern me and I would like for you to speak to the impact, what impact do the weaknesses have on the Federal operations and safeguarding the Federal assets, and on the progress that we are making toward being able to pull that architecture together.

Mr. Walker. First as we have noted before, we do have concerns about material control weaknesses dealing with information security in various agencies of government. With regard to the Department of Defense, there is no question that they are taking this matter very seriously. It is getting top-level and sustained attention. At the same point in time, it is going to take years of concerted effort in order to effectively address a challenge that has arisen over a number of decades.

I come back, though, to a comment that I made before. That is, if you do not get control of the people and if you do not get control over the money, the degree of difficulty in getting the job done is increased exponentially. I still continue to believe that the Department of Defense needs to differentiate between war-fighting systems, which ought to be delegated and have more flexibility on a decentralized basis; and management information systems, which are more than just financial management. They have to understand what they have versus what they need, and they have to have very tight control over any new dollars involved in developing new systems on the management information system side, and much more centralized control over that area.

The concern that I have is that they are still finding out what they have and the other thing is is that when the money is passed down, you lose visibility and control. Let’s keep in mind, our Department of Defense is arguably the largest single entity on Earth, including the private sector. It is a huge, complex, and important enterprise.

So I am continuing to try to work with Secretary of Defense Rumsfeld and Comptroller Zackheim and others to try to help make progress here. They are making some progress, but it is a massive undertaking.

Mrs. Blackburn. Last year when you spoke, there really was not a timeline. DOD did not have a timeline for completion of this. Are they far enough along that they can formulate a timeline at this point?

Mr. Walker. They have a timeline for a date that they hope to have some type of opinion on their financial statements, and that is for fiscal year 2007. With regard to the enterprise architecture which is an important contributor to that, they have their initial enterprise architecture design, but they expect to end up having at least a couple of additional refinements to that design this fiscal
year. I am not aware that they have an estimated completion date. In fact, I do not believe they have one at this point in time.

Mrs. BLACKBURN. OK.

Ms. SPRINGER. They do have a plan that is supposed to come out in April of this year that will look ahead and establish some of those dates.

Mrs. BLACKBURN. Great. That is great.

Ms. Springer, looking at the internal audits and people completing things, moving ahead, being ahead with their financial statements a year in advance, what is being done to prevent agencies from just simply coming along and putting a lot of human capital and energy behind getting on a schedule? Are they setting up a schedule and a structure in their offices that would sustain this reporting year-in-year-out and keeping it on schedule?

Ms. SPRINGER. The better agencies are putting in place cultural changes that will sustain their ability to get these accelerated audits in the future. I can share with you some of the things that they are telling us that they are doing. I think you will get a good flavor for it.

They are enhancing their reconciliation processes. They have earlier and more frequent coordination with the OIG and with their contract auditors. They are improving the data submission process and data control quality reviews. They have earlier coordination with external organizations. For example, we have agencies that get information from States or from grantees and things like that. They are accelerating dates when they get that information.

They have automated a number of things including automated footnotes. The footnotes comprise over one-third of this financial report, about 40 pages worth. The footnotes in the past were never prepared until year-end. They are now preparing those footnotes at earlier quarters. So for example, the third quarter footnotes are prepared. They have three-quarters of the year done. They can hand that to their auditor and that becomes the way of operating in the future, and you get a head start on things.

So a lot of it is just better planning, and common sense in a lot of cases. That does not require extra people. It just requires operating in a different way. They have improved the use of estimates. There are many cases where in the past they would chase down the last penny and wait until everything was closed down to the last date. For example, you would have an agency that would say: we can give you until September 30th, the last day of the fiscal year, to get in your request for using funds for some purpose. Well, if you close that a few days ahead of time, that gives you a head start on being able to get things done.

One thing that we found is that a number of agencies were taking weeks and weeks to get sign-off from their agency head on the audit report and their assurance statement. All the work would have been done, and even last year one agency took over a month from when the PAR was done, the performance and accountability report was done, until they got the sign-off from the agency head. Well, that is how much time they have this year coming up to do everything from the end of the year until the report is due.
So a lot of it is just operating more efficiently and effectively, using some tools, and just flat-out common sense. It is not all resources.

Mrs. Blackburn. Thank you.
Thank you, Mr. Chairman.
Mr. Platts. Thank you, Mrs. Blackburn.
Mrs. Maloney.
Mrs. Maloney. Thank you very much.
I would like to ask the Director of GAO, and I truly appreciate the fact that we have a nonpartisan independent body that assesses what is happening and give us nonpartisan unbiased viewpoints. I think you do a fantastic job. All the reports from your office I try to study because I feel they are accurate and the way government should be.

I would like to ask you, how do we get a better control of what is actually happening to the budget of the United States of America? Very briefly, in 1977 my city, New York City, went bankrupt. The mayor had a set of books, the controller had a set of books, the city council had a set of books. There were three different reports. The press had their set of books. No one knew what was happening. We went bankrupt and out of that process, in fact it was my bill, a simple bill that you have one set of books, one set of books. The mayor can have his guy in there; the controller can have his in; they have to agree on what the numbers are and they project where we are.

Since that has gone into place, we do not have confusion over where we are. We know what our deficit is and we know what our projected liabilities are going to be.

Right now, it is very confusing. OMB has their projection. Treasury has theirs. Somebody else uses dynamic scoring; another person does not. We have the Office of Economic Advisers coming out 2 weeks, and their report is that the deficit will be cut in half in 5 years and we will generate 2.5 million jobs in 1 year. Then you have other people saying that what they are saying is not accurate. All of this is happening.

What has happened is that Greenspan, the head of the Fed, whose job is monetary policy, his job is not to project the numbers of the country, really. He has become the de facto spokesperson on what the actual numbers are. He came out and said this country does have a challenge with Social Security and Medicare in years 2013 to 2030.

My question is, we should not have to rely on a Mr. Greenspan in the Federal Reserve position when it is not even his job to project the economic health of this country. I do not mean this in a partisan way. One of my good friends on the other side of the aisle, he came up to me and he told me he was going to put in a bill to abolish Mankiw’s job and him because his numbers were so crazy.

I would not even go that far. This was one of my Republican friends who said they were going to do that. I do not know if they are going to do that. It may be just gossip or he did not like the report or whatever. I do not know. In any event, I think that in a nonpartisan way, both sides of the aisle would like a proper projection of where we are going, what the deficit is going to be, the
Social Security, the Medicare. And then you read that some agencies look at payroll numbers; others look at the numbers from the census for unemployment projections. Everybody is using a separate set of books on how they are projecting what is happening.

I think there can be honest policy debates, really, between how you advance a country economically and monetary policy, but there should not be a debate on what the numbers are. The numbers should be factual. They should be reliable. They should be the best numbers that everybody can come up with. And it should be clear, this is with dynamic scoring; this is without it; this is the unemployment numbers which the experts in our country believe is the best way to predict it. But right now, I tell you, I read the financial papers and I literally get a headache because everybody says something different.

My question to the nonpartisan independent GAO body is, how can we come up with a system that just gives us accurate numbers from which we then can begin the debate?

Mr. WALKER. First, Mrs. Maloney, let me say that I want to send you a copy of the speech that I gave the National Press Club on September 17 of last year that addresses much of this issue and some of the work that we are doing in this regard. Let me just give you an example. If you take the financial statements of the U.S. Government, they are based largely on an accrual basis, based upon generally accepted accounting principles. There are different numbers you can get out of the financial statements.

On the budget side, the unified budget deficit, which unified budget deficit was about $375 billion. You can get an operating budget deficit, which is without the Social Security and Medicare surpluses, which is much higher. That is on the budget side. On the financial statements and an accrual basis side, you get $665 billion. On the budget basis, you have the unified which is about $375 billion and the operating deficit which is much higher. If you look at the financials, you can also find numbers for the difference between promised benefits on Social Security and Medicare is the supplemental schedules. However, some numbers don’t appear such as any liability for future veterans health benefits provided by the Department of Veterans Affairs.

The bottom line is this. GAO is the supreme audit institution in the United States. GAO is nonpartisan, professional, and objective. I consider myself the chief accountability officer and we are doing more and more work to try to bring truth and transparency to what the real numbers are, because everybody is entitled to their opinion, but there only should be one set of facts.

Now, importantly, projections and simulations require assumptions. There are no right assumptions. There are differences of opinion on, for example, what is GDP growth going to be; what is inflation going to be; what is immigration going to be; what is the cost of health care increases going to be. But I do believe that part of the answer is to provide more consistency, more transparency, more disclosure with regard to key assumptions. We are absolutely committed to playing an increased role in that regard.

Mrs. MALONEY. May I do a followup question?

Mr. WALKER. Sure.
Mrs. Maloney. Personally, I do not think that GAO should be the people that should have to come up with the accurate numbers. A lot of times, you do these studies on where we should be going and this that and the other. We should figure out within the institutions of government what the game rules are for unemployment and deficit and this that and the other. Certainly, assumptions are a whole different category. Who really knows? But we should have factual numbers. We are not even getting factual numbers. Sometimes Treasury and OMB, they are separate; they are different.

So the question is, I do not think that GAO should have to be the keeper of the actual numbers. How do we make the institutions that are sitting there, work? Obviously in New York City, we basically told the controller and the mayor, who had the main responsibility, that their offices had to get together and enter into one computer the one number that was the real number of what we are spending and what we are doing. Since we did that, it has actually worked. Why can't we do that in the Federal Government?

Mr. Walker. Let me clarify what I mean. Management, meaning the executive branch, has the responsibility and accountability with regard to financial management and reporting. So they should have the primary responsibility to make sure that we have consistent and reliable numbers there.

Mrs. Maloney. So you are talking about OMB? So it should come from OMB?

Mr. Walker. I am talking about the agencies, the CFOs are responsible.

Mrs. Maloney. No, no. There has to be one central place it comes from. Where should it come from?

Mr. Walker. In the final analysis, OMB has to look at this on a consolidated basis, along with Treasury, for the President. If you take, for example, last year's audited financial statements, there was a $24.5 billion plug, the difference between what the individual agencies said the numbers were and what the consolidated numbers were.

So I think with regard to financial management, it is the responsibility of the executive branch. I would respectfully suggest, however, that we need to have more transparency over commitments that are not in the financial statements. At GAO, we have suggested that OMB should have to prepare an annual report to the Congress that we could look at and comment on with regard to these commitments and contingencies.

Furthermore, I would suggest that part of the problem is the Congress' budget process. It is a 10-year cash-flow based system. As a result, especially given the way that CBO is required by law to do its estimates, can provide a misleading picture as to what the future really is. So I think reforms are necessary in several dimensions and I think responsibility is shared by a variety of parties.

Mr. Hammond. If I could just speak to one part of your question. I think that the financial report that we are looking at today and talking about today goes a long measure toward bringing about looking at what has happened and reporting on the past, and bringing that form of uniform, consistent, comparable——

Mrs. Maloney. And which financial report are you talking about?
Mr. HAMMOND. The financial report of the U.S. Government.

Mrs. MALONEY. The financial report of the U.S. Government should be——

Mr. HAMMOND. Which is prepared by Treasury in coordination with OMB and then audited by GAO.

Mrs. MALONEY. Then the CBO is always different, right?

Mr. HAMMOND. Well, the difference is, accounting deals with reporting that which has taken place, either as it is to be measured into the future because it exists, or what took place during the prior period. I think the report once it is perfected will go a long way toward solving the first part of your quandary, which is giving everyone one source for all the information dealing with what has happened in the past.

As for projections, I think the Comptroller General has an excellent point. Assumptions drive projections, and it is totally appropriate for different entities to use different assumptions at different times in forecasting. I think as you look into the future, it is a much more challenging task, but the beauty of that is the future is something that you get to adapt and deal with.

Ms. SPRINGER. Let me add one other thing to round out the panel's comments at least. If you look in this report, one of the values of this report is that there are probably about 20 pages on one of the largest commitments going forward, which is Social Security and Medicare. The information has been made available in this report, even though it is not part of GAAP, generally accepted accounting principles, today. But because of its importance, it is in here in this one source, the same information that you would find in the trustee's report of Medicare and Social Security. That report comes out every March, but we have it included in here because of the value of having that in this one place.

Now, one thing that we have all worked on, all of the organizations here participate in the FASAB organization, which is the government equivalent of FASB in many respects. This past year, Statement of Accounting Standard 25 came out which requires that in the future that those assumptions and that statement of the social insurance, which gets at this large piece, will be subject to audit scrutiny and actually a significant part will move up into the front of the report to be alongside of the balance sheet and the cost statement and other statements that are there today.

So we recognize the importance of this. I would direct you to page 60, for example, where there is a reconciliation of the accrual basis, which is the generally accepted accounting basis for the cost of operations, the reconciliation of that to the deficit that you hear about. Again looking back it is set for 2003. There is no guesswork, no assumption involved. This is looking back to fiscal year 2003.

So while it is not perfect and it certainly is not looking to the future in many respects, as far as the past goes, this is a pretty definitive source.

Mr. WALKER. There is no question that there has been tremendous progress made in the last several years in improving this financial report, including increasing transparency with regard to long-range commitments and contingencies. For example, when I first became Comptroller General in 1998, there were no disclosures about the estimated difference in the costs between promised
Social Security and Medicare benefits and funded benefits. Now, if these numbers are in the annual report, not only is it disclosed, but as Linda mentioned, it is going to be subject to audit in the near future.

So we are headed in the right direction, but we have a way to go.

Mrs. Maloney. I congratulate all of you on your commitment. I know it is a very tough job. I would love to see a copy of your speech on this particular issue that you referenced.

Thank you.

Mr. Platts. Thank you, Mrs. Maloney.

I look at the report as the Clint Eastwood movie paraphrasing the title, the good, the bad and the unknown. [Laughter.]

What we find in the report, and some of the unknown is that future debt that we are making projections about, but cannot be certain.

Mr. Hammond, in talking about how the information will be used as we are getting to this goal of more uniform reporting throughout the departments and agencies, and allowing us to come together and having a useful consolidated financial report for the entire Federal Government. In your testimony, you touched on a couple of aspects of that. The first is timely reporting. The administration has been great. One of the examples, as with including Social Security and Medicare in the report, although it is not mandated, that is the administration being proactive in that way, in moving up the deadlines to November 15, although the deadline is March 31 in law, no later than, that the administration has said, well, we want it sooner because March 31, the new budget has already been proposed and it is not going to be very helpful.

Your department, Treasury, and seven other agencies have been great in meeting that November 15 deadline this year. What would be your message to the other departments, one, on the key to meeting that deadline, as all of them are going to have to this coming November 15, and the benefit that your department has gained as you went into the 2005 budget process because of meeting that deadline.

Mr. Hammond. I think those are really important issues, because we have found that by accelerating, especially to meet these very aggressive timetables, you have to fundamentally change the way you manage financial information. By fundamentally changing that, what you do is improve the data quality. There is not an agency that I have spoken to that has not cited the principal benefit of just the first phase of accelerating the financial reporting, of getting better data sooner inside the agency.

What that does is it means that there is now information available for management to use to understand what is going on within their programs and their activities, when they can actually do something with it and actually try to make a change, make a difference with regard to the management of a particular program, administration of a contract. It is a huge unknown benefit that only becomes visible when agencies do the acceleration, because it is so comfortable today processing the data, massaging it on an after the fact relaxed path.
What happens is reconciliations are something that you do when you have time. When you have to accelerate the information now, you have to do the reconciliations currently. You find problems right up front and you are able to deal with them before they become serious. You are able to influence programs. And then you have better actual data with which to set your meaningful performance measures for the development of your budget for the next year.

I think that is one of the beauties of the accelerated timetable, quite frankly, is that we will have the prior year out of the way well before the President's budget is released, plus allowing everyone to look at what happened last year; make sure it is reflected in the performance measurement; and make sure everyone understands what the impact is for the future. I think that really goes to building better projections of what is going to go on as well.

Mr. Platts. The quarterly reporting requirement I assume it is safe to say that is critical or helpful in getting to that earlier deadline because it is forcing the agencies and departments, yours included, to be more proactive throughout the year, rather than waiting until the end and that heroic effort being the norm. You really cannot do that anymore because of the requirements we are placing on you.

Mr. Hammond. Very definitely. What we found with agencies doing quarterly reporting is that as they started that, the requirements are for fairly skeletal quarterly reporting. They found that it made much more sense to do more complete quarterly reporting. It allowed them to better understand their programs. It gave them more information to share with their auditors throughout the year. Because that is the other thing that comes out of this process, is that audit becomes a year-round environment and it becomes much more of almost a, I shudder to use the word "partnership," but it is very much along those lines as people are working through the information throughout the year, instead of a hand-off at the end of the year.

Mr. Platts. In that year-round audit approach, then, it is not just giving the administration a more big picture assessment or Congress, but to the actual department that they can make adjustments throughout the year as they have that information more readily available to act upon.

Mr. Hammond. Absolutely. I think people lose sight of the fact that financial reporting is really simply one work product of good financial management. You cannot have good financial management without effective financial reporting, but having effective financial reporting is in and of itself not good financial management. Good systems, good financial management allow for easy, effective financial reporting, but the real benefit is what management does with that information.

Mr. Platts. Right. The usefulness and how it is acted upon once it is provided.

Mr. Hammond. Exactly.

Mr. Platts. Ms. Springer, Mr. Hammond mentioned when he talked, the quarterly reports being more substantive. Is your assessment of the various agencies and departments and the quar-
terly reports, is the more substantive approach becoming the norm with the agencies and departments?

Ms. Springer. It is. In addition to just statements themselves, as I mentioned earlier, the actual preparation of footnotes. The footnotes are really the explanatory element that goes along with the statements. There are very few pages in this report that have statements. Almost one-third of the report is footnotes.

I am not going to say that they would have 40 pages each quarter, but that work effort is what really surface issues. If you cannot put your footnotes together, then you can't explain the results, and then that is an indicator that you are headed for trouble. So doing that at least at the third quarter, and many agencies do it every quarter—that is the extra substance that you mentioned—really has been an important factor in accelerating, and having useful information.

Under the President's management agenda, getting your financial reports done early, getting rid of material weaknesses, will not get you to a green score. You cannot get a green score unless you can prove that you are integrating financial information into your day-to-day management. That is why we only have four agencies that are green.

Mr. Platts. Right. And then again, that gets to how the information is going to be used or if it is going to be used at all. It does not make much sense to have it if it is not acted upon.

I would be interested from all three of you with the timeliness issue being focused on by the administration and with all departments and agencies here, the November 15 deadline coming up this year and the quarterly report playing a helpful role in that process. That is something the administration has chosen to do, but not required by law.

Is that something we should be looking at that should be changed in statute instead of no later than March 31? Should it be November 15 or no later than December 31? Should we statutorily be looking to move that deadline up, or should discretion still remain with the administration? The second part of that is the quarterly report aspect. Should that be a part of the statutory requirement regarding the financial reports?

Ms. Springer. That is the standard to which we hold the agencies. I do not see why we should expect anything less. I do not know if there are any other dependencies of that particular part of the statute that might cause that to be modified. But barring any of those, I would say that should be the legal requirement.

Mr. Platts. The current administration, you are setting a great example and I would hate to see us get on this track and then, for whatever reason, we slip back until we are back to having reports in February or March and pass the new budget process being done, and again trying to look to have the good approaches maintained into the future.

Yes?

Mr. Walker. Mr. Chairman, I would say that this administration is clearly committed to accelerated reporting dates, and that is not an issue. But if for some reason there was ever a slippage in the future, then I think the Congress should consider requiring accelerated reporting dates.
I think one of the reasons that we are much better off today than we were just a few short years ago is because these accelerated reporting dates have forced agencies to focus on improving their systems and controls in a way that has improved financial management overall. What was happening before is that people were not really focusing on a lot of issues until after the end of the year.

They were wasting a tremendous amount of human and financial resources to try and do a lot of things after the end of the year in order to be able to get a clean opinion several months later, but yet they did not have timely, accurate and useful information to be able to make sound management decisions on a day-to-day basis.

One of the things that our UK colleagues noted is they even have a more lax reporting deadline than we do. I think they need to seriously consider whether to tighten it up, either voluntarily or statutorily, because people may not take sound financial management and reporting seriously enough with lengthy due dates. With accelerated reporting dates, people are not going to be able to play games. They are going to have to solve the underlying problems if they have to report much quicker than historically they were accustomed to doing.

Mr. Platts. It is human nature. My 7-year-old son, if I give him until the end of the week to clean up his room, I know it is going to be Friday versus today. [Laughter.]

Human nature is, I don't have to meet that deadline until Friday so why do it today?

Mr. Walker. You are lucky. It could have been Sunday. [Laughter.]

Mr. Platts. He is going to go out and play soccer or something in the meantime.

Mr. Towns, do you have further questions?

Actually, I apologize. I wanted to ask Mr. Hammond on the statutory aspect from a department perspective, on whether from your perspective as a department would it be advantageous for your department to know it is in statute November 15, or something of that nature?

Mr. Hammond. I think the momentum will overtake that requirement. It is the kind of thing, once we get to November 15 of this year, it is hard for anyone to go backward. I do think getting a consistent understanding of all the major entities of reporting deadlines will be very important. It is more than just the CFO Act agencies. The Accountability for Tax Dollars Act brought into play a whole other range of executive branch agencies.

I think we need to also get clarity with regard to the legislative and judicial branches. We would like to keep them included in this report, but there will come a time in the not-too-distant future when we will need audited financial statements for those major components as well. Those do not have to be statutory requirement, but they do in fact have to meet the preparation timetable.

Mr. Platts. Thank you.

Mr. Towns.

Mr. Towns. On that note, I hear you. Let me just ask, it is my understanding that a lot of these agencies, that the contractor support for their financial statement, how does this affect the agencies' ability to comply with something like that?
Mr. HAMMOND. It would depend on what they are using contractor support for. I think you certainly historically saw a lot of contractor support used in the preparation and year-end closing cycle when they have 5 months to do that. It was a very easy situation, in my words, to throw money at the problem. Accelerated time-frames make that very, very untenable.

So now the use of contractors is really designed to improve business processes, reengineer the way financial management is done, bring about systems change. So while the use of contractors is still prevalent, I suspect, at many agencies, the types of uses are much more productive and are much more designed to improving management at the agency for the future, as opposed to simply producing a financial statement this year.

Mr. TOWNS. So you are saying, really, in a case like that, it would not affect the ability of a person to meet the timetable?

Mr. HAMMOND. Right. I think what you will find is that people who are using contractors today are looking at them for the ability to bring in best practices and revise the way they do their business throughout the year, not the actual production of financial statements at the year-end.

Mr. TOWNS. Yes. Does this bring about a savings for the agency?

Mr. HAMMOND. You would think so. I think agencies have found that what it has allowed them to do is reallocate resources, to better financial management. I think it has also identified something that you see throughout government in the financial management arena, which is a huge skill gap. Historically, financial management in the Federal Government was data processing, whether it was manual or not. It was moving information from here to there. Financial management for the future is analytical. It is taking that information that is timely available and doing something with it. That is in many agencies highlighting a huge skill gap. As they accelerate their financial information, they are finding now they have time available on their staff, but now they have to position their staff to be able to do that value-added work.

Mr. TOWNS. I am just thinking that, help me with this, do they have to get contracts? For instance, if I use you this year and I want to use somebody else next year, is that a problem? I am just thinking in terms of things that might slow down the process here, that might make it difficult to have this thing done in a timely fashion.

Mr. HAMMOND. I have not heard any complaints about the contracting process and its ability to meet the accelerated timetables, but perhaps others have.

Mr. TOWNS. Have you?

Mr. WALKER. Mr. Towns, there are two aspects: To what extent are they using contractors for basic financial management and to assist in that function; and second, to what extent are they using external contractors, typically one of the big four accounting firms, to actually do the audit of the departmental financial statements, but I have not heard any difficulties expressed with regard to this issue.

Ms. SPRINGER. Actually, all but one of the CFO Act agencies use a contract auditor, as David just mentioned. Typically, one of the
big firms for the actual audit opinion that is rendered on each individual statement, in the same way that GAO renders an opinion on entire governmentwide consolidated report. In fact, GAO is in a couple of cases, I guess, the auditor for rendering an opinion.

Mr. Walker. We audit the IRS, the Bureau of Public Debt, the FDIC, and soon we will audit the SEC. We also audit the consolidated financial statements of the U.S. Government.

Mr. Towns. You have answered my question. Thank you very much.

Let me just ask Mr. Walker one other thing. I have some concerns related to the lending and credit activities within many of our Federal agencies. Can you speak to the material problems facing the agency community and how to adequately determine credit programs’ costs? Are these programs viewed as governmentwide, as opposed to just SBA?

Mr. Walker. We have had some challenges with regard to the credit estimation modeling. These credit estimation models are important not just for financial statement reporting purposes, but they are also used sometimes for submitting budgets to the Congress. This past year, we had a serious problem with the Small Business Administration which ultimately we were able to resolve. But it is an example of something that cannot be allowed to happen in the future if we are going to be able to hit accelerated reporting deadlines for the audit reports.

We are going to have to be able to audit on a continuous basis. While it will not be a partnership because we have to maintain our independence, we will have to work constructively and on an ongoing, continuous basis with the executive branch agencies. We will need timely access to the information that is required of the external auditor, or else we will not be able to hit the accelerated reporting deadlines.

Mr. Towns. Do you want to add anything to that, Mr. Hammond?

Mr. Hammond. I think, and I will yield to my colleague, Ms. Springer from OMB, with regard to credit reform, but I think the challenges of the credit reform model, the complexity as it applies, is something that makes a significant hurdle for preparation of agency financial statements.

Ms. Springer. And that is one of the things that, in the same ways that agencies on the CFO council identify keys to success, they identify challenges. One of the challenges is that the agencies that have loans, have some issues with the credit reform process as it relates to acceleration and timeliness of various information.

Agencies like SBA are very model-dependent, both for their budget work and for their financial statement work. In the case of SBA, there were some long overdue upgrades and, frankly, replacements of models that were in use. So you saw that for all of their five key programs, there were new models that were either put in place or upgraded last year. It takes a lot of time. It takes more time than they thought it was going to.

One of the reasons for their disclaimer is that they, frankly, were not able to complete all that work, but they had in effect decided to use those models to support their financial statement. So they ran out of time to be able to put this together in a timely fashion.
and in enough time for the auditor to be able to review the model and the data that came out of it.

That is why we have better hopes for this year, 2004, because those models are in place, they are getting reviewed, and should be reliable. But they face challenges, the credit reform agencies do face challenges that some of the other agencies do not.

Mr. TOWNS. Is there anything that the Congress should do?

Ms. SPRINGER. My sense is that it is not so much a congressional issue as it is just an issue of the agencies having the right type of systems and processes to be able to manage their programs that have those additional requirements.

Mr. TOWNS. Thank you very much.

I yield back, Mr. Chairman.

Mr. PLATTS. Thank you, Mr. Towns.

Mrs. Maloney.

Mrs. MALONEY. I just would like to ask, and maybe it is a silly question, why are the numbers between OMB and the CBO always different? I know the CBO had a change this year to allow dynamic scoring in their numbers. Does OMB allow dynamic scoring in their numbers? Just any comments on it? Do you support dynamic scoring or are you opposed to it? What is your position on it?

Ms. SPRINGER. The Comptroller General I am sure will have some comments because his scope and his reach of activities is much broader than mine. But I just want to point out to you that from the standpoint of this report, that issue is not present because it is not a question of an estimate of CBO versus an estimate of OMB. We are talking about historical facts that already happened, transactions out of the ledgers of these subsidiary entities.

I think where the issue that you are mentioning comes into play is more from the prospective look in the budget and the projections of programs and costs. In my world, that is not a factor fortunately. I am very happy it is not. There are other parts of OMB that deal with that, but I am sure Mr. Walker, who has a broader scope, would want to comment.

Mr. WALKER. Just to reinforce. The report that was issued last Friday——

Mrs. MALONEY. I understand the report. I am talking prospective. They are always different.

Mr. WALKER. Prospectively, as you know, the OMB has the responsibility to do the estimates for the President. The CBO has the responsibility to do the estimates for the Congress. Both of them are looking over the same time period. However, both of them can come up with different assumptions on things like what do they estimate that economic growth is going to be; what do they estimate that inflation is going to be; what do they estimate, for example, what are the costs associated with the new prescription drug benefit going to be. We saw that manifested recently where the administration had one number; and CBO had another.

Part of that difference was because they were talking about a different 10-year period. Part of the difference was because they had different assumptions as to what the estimated cost increases for prescription drugs were going to be during the 10-year period. Again, since it is based on projections, there is no one right answer.
What is important is that there be disclosure such that we understand what the differences are and what are the reasons for the differences, so that Congress and others can make an informed judgment about which one do you think you have more comfort with.

Mrs. MALONEY. That is great that you gave that example. That was really helpful. CBO has now incorporated dynamic scoring in their projections. Does OMB use dynamic scoring? That was a big debate on whether CBO should go to dynamic scoring or not and they voted to do it. But does OMB use dynamic scoring? I really do not know.

Ms. SPRINGER. It is not my area, so I really am not prepared to comment.

Mr. WALKER. Not to my knowledge, but I am not sure.

Mrs. MALONEY. Not to your knowledge. That is one difference between the two. And what is your opinion on dynamic scoring, or anybody if they would like to make a comment.

Mr. WALKER. My opinion would be is that if you were going to do that, you ought to do it both ways. My personal opinion would be is you do it non-dynamic and then dynamic and then disclose what are the assumptions underneath the dynamic and then Congress can decide what it wants to use.

Mrs. MALONEY. Great answer. Thanks.

Mr. PLATTS. Thank you.

I would like to get into two specific parts of the consolidated reports, two specific agencies. You mentioned one, the SBA, and some of the challenges they still have, and specifically, the issue of the loan sales. My understanding is the numbers in dealing with $5 billion worth of loans that were sold over 4 years, a loss of about $1 billion to the American taxpayers, versus what was initially reported as a savings of maybe $600 million or so. Obviously, that is a huge difference, that we made money versus we lost even a larger sum.

What is OMB, Ms. Springer, doing specifically in how you are working with SBA to try to address that. Part of it is, are you assessing SBA's ability in their staffing to be engaged in this activity? Do they have the professional expertise to continue to engage in this type of program?

Ms. SPRINGER. It is an excellent question, and obviously the staff of this subcommittee and the committee itself has been very visible in expressing the need for SBA to do a better job in this area. Obviously, the loan sales have stopped. And when it became apparent to us at OMB as well as to the agency itself that there were problems in their modeling, that they could not go forward with any additional sales. There was one that was in the works and it was stopped. So that was obviously the first step.

But the next step, then, was to review the models. The models comprehensively have been reviewed and they have been modified or replaced and rebuilt. OMB was very involved. We had people from OMB, not from my area specifically, but from the part of OMB that is dedicated to SBA, both on the budget and their management issues, that were integrally involved in assessing and in reviewing the model as it was developed. None of those models
were even presented to the auditor before OMB reviewed them very extensively.

So we are confident that those models now of disaster loans and all the other programs are doing the job they should. Having said that, sales have not started back up again and they would not startup again until two things occur: We are very sure that these models and the data coming out of them would be very, very accurate and reliable; but also as you mentioned, that the staff is in place that is equipped and trained in that area. That is an area that my office, as well as the other parts of OMB, would want to get involved.

As you may know, we have had an initiative to look at asset management across the Federal Government. We have started with real property. We issued an Executive order just the beginning of last month. We have issued a new President's management agenda program initiative. It is not one of the five governmentwide ones, but it joins the other nine program initiatives. We are expecting that after the real property area, that we will move on to financial assets like loans. SBA would obviously be an area that we would spend time with.

Mr. PLATTS. Mr. Walker, does GAO have an opinion on SBA specifically regarding whether they should even get back into at all the loan sale effort, and then in a broader sense regarding other agencies?

Mr. WALKER. Well, they are constantly trying to improve their modeling capabilities, but I would also respectfully suggest and agree with Linda that part of it is do they have enough people with the right kind of skills and knowledge to do this. They have had to rely on other agencies, and that is fine, but the government as a whole has a shortage of people with the right type of skills and knowledge in this and other areas, and it is something we need to address.

Mr. PLATTS. That human capital challenge goes well beyond SBA. We will followup with GAO with putting a followup request in to have you look at that specifically, but in the broader sense, as we are trying to meet these new requirements, timeliness, usefulness, substantive nature of the reports, we are going to be in need of more and more qualified financial experts. What is your assessment of our ability to meet the human capital needs? Is there anything we need to be looking at from Congress' perspective as giving more discretion or incentives in the area of financial management to recruit and retain the key people?

Mr. WALKER. As you know, Mr. Chairman, the lack of an effective and strategic human capital strategy in the entire Federal Government is something that is on our high risk list. I think there has been more progress, frankly, made in the last 2 years than in the last 20. I am cautiously optimistic more progress is going to be made in the next 2.

Mr. PLATTS. And you are setting an example.

Mr. WALKER. We are leading by example, that is correct. We are, and we are committed to continue to do so. But as Mr. Hammond mentioned, a part of the challenge is that historically financial management from a people standpoint in the government was viewed as data entry and processing transactions. Most of that is
automated now. So the type of people that you need along with the type of knowledge and skills are fundamentally different. There is going to have to be a restructuring of the existing financial management functions and also an extensive effort to try to recruit and retain top talent.

I think one of the things that hopefully the CFO council is doing or is contemplating doing is to ascertain whether and to what extent additional flexibilities might be necessary for this community. Historically what has happened is that people have tended to look at these issues on a department-by-department or agency-by-agency basis, rather than on a cross-functional basis or a functional basis across government. I think that is something that hopefully they might take a look at.

Mr. PLATTS. In giving GAO additional flexibility to meet your needs and restructure, that assessment of whether there is enough flexibility existing under the law today for OMB and the administration to do that cross-agency, cross-department approach, because otherwise you are competing with each other for a select few to fill all these spots.

Is there any type of review ongoing now, Ms. Springer, within OMB to look at that, what flexibility you have, and what additional flexibility you may need to meet the human capital aspect of financial management?

Ms. SPRINGER. Financial management is one of the parts within the human capital initiative of the President’s management agenda. That would be one of the areas that is reviewed in the broader context of the initiative, to ensure that the right human capital resources and assets are in place at the agencies. But there is no question that is a consideration for the executive branch, as well as for GAO.

If I may, I had one other thing that I take as a good sign on SBA’s account, they learned that there might be an additional request from this subcommittee to have GAO go in and look further at some models, they embraced that. I take that very positively on their part, that they feel, A, good about what they have done; and B, that they see value in that process both for themselves and for their contract auditor.

Mr. PLATTS. Good to hear.

Mr. Towns, did you have additional questions?

Mr. TOWNS. I have a question, Mr. Chairman.

Mr. Walker, in your assessment, are the problems at NASA and SBA in need of a long-term solution? Or do you think it is something that can be repaired in a year?

Mr. WALKER. At NASA and SBA? Well, they are very different problems. I think they could be repaired within a reasonable period of time. Whether or not it is a year, I have my doubts, but I think we are not talking about many years. We are not talking about anything like the scale of a Department of Defense, which is a number of years.

By the way, we are working with all of the high-risk designated functions to provide them with specific things that we think need to be done in order to address their high-risk designation. We are working in a very constructive and cooperative manner with OMB.

If you look at the President’s management agenda, it bears a very
close resemblance to GAO's high-risk list, and that is not an accident. I think that is a positive development.

Mr. TOWNS. Thank you.

Mr. PLATTS. Thank you, sir.

Mr. TOWNS. I yield back, Mr. Chairman.

Mr. PLATTS. OK. Thank you, Mr. Towns.

You probably will not be surprised to hear me ask about the Department of Homeland Security, as one who has spent a lot of time, and we have a hearing next week on that department specifically. One, I would be interested in doing the compilation of the report, Mr. Hammond, and in the audit, DHS made a decision and I commend them for the decision, not to take the pass and use the waiver of having their financials audited this year and waiting a year. They embraced it. They testified before us in September that they would meet the November 15 deadline.

In the end, they were about 2 weeks past the January 31 deadline. But I think given it being their first year and they are kind of a hybrid starting 5 months into the fiscal year before they actually assumed responsibility, it is better that they be a little later and try to get it as right as possible.

What impact did that delay have with your compilation? How did it play into it? And then the audit, and the fact that it is 7 months of the fiscal year that DHS had and the 5 months that were with all the disparate agencies.

Mr. HAMMOND. It had only a very limited effect on the actual preparation of the report. We got financial information from them throughout the cycle. So even though they had not finished their financial statements, we got comprehensive detailed information from them.

It is noteworthy that if this had been next year, it would have been problematic. Next year we are going to a system that relies on the audited financial statements to compile the report. This year, we were collecting data at a much more detailed level, so we were able to get that information.

Mr. PLATTS. Is your assessment in looking ahead to next year that DHS is going to be in position to meet November 15 and in that uniform sense?

Mr. HAMMOND. Based on everything that I know today, I would say that they are certainly shooting for November 15, just as every major agency is. I think the other thing that is worth noting is that the hand-off of the transferred assets, because it was already 5 months into the fiscal year, the date of the transfer from the agencies to Homeland, we found that process worked very well for the compilation of our report. The coordination between the granting agencies and then the receiving agency, Homeland, allowed for a very, very effective data transfer. We felt pretty good about that.

Mr. PLATTS. Mr. Walker, on the auditing, given the split, 5 months, 7 months?

Mr. WALKER. It was not a problem this year, but it will be a problem next year if they cannot end up accelerating their time-frames.

Mr. PLATTS. Do you think they have the resources? We were talking about DOD making it a priority, and know that they have
a long way to go, the leadership has embraced it. Does DHS have the resources and is it the priority it needs to be?

Mr. Walker. At DHS, it is a priority and they are ahead of DOD. [Laughter.]

Mr. Platts. Good.

Mr. Walker. Yes, and they are considerably ahead of DOD. As far as whether or not they need any additional resources, I would have to talk to my people about what our views are on that before saying anything on the record.

Mr. Platts. And the $64 million question, my piece of legislation, your opinion on the benefits of having DHS under the CFO Act statutory requirement and the benefits that we believe that brings to the other agencies, Cabinet-level especially, should DHS be under the CFO Act?

Mr. Walker. We believe they should be.

Mr. Platts. I think they are doing the best to comply with the requirements now, setting the example and to me, I have told Secretary Hale that they are making the case for my legislation by their actions. We can make it permanent and that would be a good approach.

Mr. Walker. They are voluntarily complying and I think they should be commended for that.

Mr. Platts. Yes, absolutely. And given the weaknesses they inherited, you know, the 18 material deficiencies and they are working on chipping away at them, I agree that they are doing their best and hopefully will continue in that positive direction.

The Sarbanes-Oxley Act that we passed in trying to have more accountability in disclosure for the investor, we have in effect the requirement of internal controls. I would be interested in really all three of your different perspectives on whether we should be mandating audits of internal controls across our departments and agencies. Or should we, as in the legislation with DHS that I have, about doing kind of a cost-benefit assessment first? Or do we have the information to make an informed decision already?

Mr. Walker. I think we need to do a cost-benefit assessment. As you know, Mr. Chairman, GAO has voluntarily expressed an opinion on internal accounting controls for the entities that we audit. We believe it is critically important and we believe it passes a cost-benefit test for the entities that we are responsible for.

At the same point in time, it is not required by generally accepted government auditing standards or so-called “yellow book” standards which were promulgated by the Comptroller General. This is an issue that we are going to be looking at as to whether and to what extent standards should be updated. I think it would be premature to mandate it at this point in time.

Mr. Platts. Is there a timeframe for your review of the issue?

Mr. Walker. I will get back to you for the record, Mr. Chairman, on that. I also think that this, along with the relative merits of financial management committees or audit committees at selected departments and agencies is something that needs to be looked at, as well as the result of Sarbanes-Oxley. That is something that we are trying to also work in a coordinated fashion through the Joint Financial Management Improvement Program, the Secretary of the Treasury, the Director of OMB, the Director of OPM, and myself.
I am hoping that we are going to be able to make some progress on that, too.

Mr. Platts. OK.

Ms. Springer. We would agree with that. Actually, Mr. Chairman, we applaud and are happy to see that the language in your bill has mandated the study, the cost-benefit analysis by the joint effort of the CFO council and the PCIE, the inspectors general community. That work is already started and we are anticipating passage of your bill.

Mr. Platts. I appreciate the optimistic approach. [Laughter.]

Ms. Springer. Either way, we were already planning to start that, frankly, because we think that it is an emerging issue. It is a fact of life, certainly in the private sector. We are very attentive to what is going on in the private sector. We seek to be more private sector-like as far as the admirable features of the private sector.

It is important to note that just a week or two ago, the SEC extended the deadline for the internal control report for the private sector. So this obviously has some challenges. It will have challenges as well for the Federal Government.

Having said that, the cost-benefit study is underway by those groups. We expect to follow a timetable that is outlined in your bill, visiting with GAO on the results of that study, and visiting with this committee.

Mr. Walker. Mr. Chairman, I think the cost-benefit test will hopefully be helped by the fact that the firms that are doing the audits for many of the departments and agencies are the same entities that are going to have to figure out a way to render an opinion on internal accounting controls for large private sector public companies. So therefore, hopefully we will be able to obtain some of the efficiencies of that. We have done it for years at GAO, so this is just another example of where we have led by example.

Mr. Platts. OK. Mr. Hammond, what is Department of Treasury's approach? Are you auditing your internal controls?

Mr. Hammond. The governmentwide report does receive an opinion review, or is subject to an opinion-level review by GAO. The Treasury statements themselves, I believe, is a report on internal control.

Mr. Platts. OK.

Mr. Hammond. I would echo the sentiments of my colleagues with one addition. I think once the cost-benefit analysis is done, looking at it from a governmentwide perspective, consistency will be important. I do not want to begin to understand what the challenges I would face to get an opinion-level review at a governmentwide level statement if agencies were not getting an opinion-level review. So I think a consistent approach, when all is said and done, will be very important.

Mr. Walker. We are already expressing an opinion on a governmentwide basis. What is not happening is there are a number of the other departments and agencies that we do not audit that are not. So if we can do it, they ought to be able to do it.

Mr. Hammond. It is a difference as to whether it should be voluntary versus required by law.
Mr. PLATTS. And that goes to the leading by example, and I appreciate GAO's efforts in doing that.

Mr. Walker, you certainly are helpful in your frankness regarding the challenges facing our Nation long term, and how to look ahead and make the tough decisions year-in and year-out with what lies ahead.

Relate to that would be the pay-as-you-go discipline on the past that we have gone away from. I would be interested in your opinion, and both Ms. Springer and Mr. Hammond if you want to also add if you think we should return to that more fiscal disciplined approach of pay-as-you-go?

Mr. WALKER. In the speech that I gave at the National Press Club this past September, I included a number of items that I thought that Congress should seriously consider, including returning to the pay-go requirements, including additional transparency with regard to major tax and spending proposals, and a variety of other actions. Candidly, we have been digging pretty fast lately. We have had a long-range fiscal imbalance for a number of years, even when we had current surpluses in the 1990's, we had long-range fiscal imbalances. But now the surpluses have turned to deficits, the long-range imbalance is worse in part because of the passage of prescription drugs, and it is more immediate.

Mr. PLATTS. One of my constituents at my town meeting made sure to remind me to speak accurately when we talk about surpluses. They were not really surpluses in the big picture, maybe in that limited 1-year isolated approach, but if you took Social Security, Medicare trust funds, they really were not surpluses even when we thought they were good years. That type of frank, transparent outlook is something we need to have, and we appreciate your efforts in trying to promote that.

Mr. WALKER. Thank you, Mr. Chairman.

Ms. SPRINGER. Mr. Chairman, if you look in the President's fiscal year 2005 budget, it is actually in the analytical perspectives section, you will find that there is a proposal there for spending controls and discipline that essentially reflects an extension of the Budget Enforcement Act. So that is a part of the President's proposal and it can be found in the budget.

Mr. PLATTS. Great. I meant, having seen your statement from last September, but I forgot that was in there. So thank you. I appreciate the reminder.

I have just two other questions I would like to touch on quickly. Mr. Towns, did you have anything?

Mr. TOWNS. No further questions.

Mr. PLATTS. OK. One is on the dynamic versus static, and I appreciate the dialog with Mrs. Maloney on that, because it is one of the challenges. I hear from my constituents and I use the Medicare bill where they say, your numbers are already wrong. I explain, well, actually we did not change any numbers. Those are somebody else's numbers. CBO stands by their $395 million; OMB at $537 million or so. It is interesting because one of the big assumptions that is different in those numbers is OMB is making the assumption that more seniors will embrace the new choices they are going to be given, and thus cost the program more because of embracing
the new opportunities being provided, versus traditional fee-for-service approach.

Your discussion of that, I guess I do not have a question, but just appreciate the dialog on that as members and then the public try to understand comparing apples and apples.

My final question is on the debt limit and where we are, and if there is a guesstimate of what by mid-year we are clearly going to need an increase, what sum we may be looking at. I do not know if there are any projections any of the three of you would like to make.

Mr. Hammond. I certainly will not make any projections. I will say that I think it is a matter of public record that we believe that we will hit the current ceiling toward the last part of this fiscal year, so in the August-September timeframe. Obviously, those kinds of projections can move a little bit this way or that and could require an increase in the debt ceiling limit before the Congress recesses.

Mr. Platt. But no estimate at this time what that ceiling increase may be?

Mr. Hammond. I believe that our position has been and will continue to be that the Congress should appropriately give us the ceiling that they are most comfortable with, consistent with the budgets that are before them.

Mr. Platt. A diplomatic approach.

Mr. Walker. It sounds like they have passed the ball, Mr. Chairman. [Laughter.]

Mr. Platt. Ms. Springer or Mr. Walker, do you want to hazard a guess? A wise decision probably. [Laughter.]

Mr. Walker. Let’s just say, Mr. Chairman, it will be a big number.

Mr. Platt. We are in difficult times, but actually I do town meetings week-in and week-out because of being in my district every day. I started in York this morning at 5 minutes of 6, and I will end there tonight at some hour. But I do talk about the historic times that we are in that is driving a lot of these numbers.

The recession that we were already in, September 11 and the huge cost of responding to September 11, and now kind of getting out of it and the increased costs associated with now guarding against a wholly new threat here in the homeland and the homeland security efforts. There are some unique circumstances. They do not change the fact that we need to be proactive looking ahead,

Mr. Walker. That is true, Mr. Chairman, but I think if we look at the numbers closely, you will find that of the estimated deficit for fiscal year 2004, less than 25 percent relates to Iraq, Afghanistan and incremental costs on homeland security. While economic growth for the last several years has until recently not been what we all would hope for, I mean, it is getting better. It has gotten better. We have not been in a recession since November 2001. So we do have a serious issue that we are going to have to come to grips with.

Mr. Platt. But if you add in the economic impact on those numbers on top of that 25 percent, you get a pretty significant part of that deficit is then related to those happening at the same time;
not just having a war on terrorism and responding to a terrorist
attack, but coming out of recession at the same time.

I again just appreciate each of you and your testimony here
today, your extensive written testimony you have provided us and
each of your staff for the great work they are doing. I thank you
personally and your offices for your work on behalf of the American
public.

We will keep the record open for 2 weeks for any additional in-
formation to be submitted and look forward to continuing to work
with each of you and your offices as we go into the rest of the year.

This hearing stands adjourned.
[Whereupon, at 4:25 p.m., the subcommittee was adjourned, to
reconvene at the call of the Chair.]
[Additional information submitted for the hearing record follows:]
For the Record:

Donald V. Hammond’s response to the question posed by the Honorable Marsha Blackburn

Q1. One page 5 of your testimony, you reference unexplained transactions amounting to 24.5 billion dollars. Is this accrued as annual?

A1. The unreconciled transactions in the amount of $24.5 billion do not represent separate costs; it is actually an increase or gain to the net position and is currently unexplained. We believe this problem probably has its roots in the unreconciled intragovernmental balance problem. The Consolidated Financial Report of the United States Government is based on generally accepted accounting principles (GAAP) and is a consolidation of the financial status and activities of the Government. As a part of the consolidation, intragovernmental activities and balances (transactions occurring between Government agencies) must be eliminated. For the elimination to occur properly there must be balanced entries resulting from each agency being able to match their intragovernmental activities and balances with their trading partner. Given the diverse nature of these activities, it is likely that the unreconciled transactions are comprised of both accrual and annual amounts.

We are taking several actions in order to understand and eliminate these unreconciled transactions including:

- OMB issued business rules in 2002 to standardize accounting treatment of several significant areas of intragovernmental transactions to facilitate eliminations.
- In 2003, FMS developed a system that is a useful tool for agencies to use to identify differences in intragovernmental transactions at a low enough level of detail to permit effective corrective actions to be taken by agency personnel.
- Treasury and OMB have required agencies to report and reconcile intragovernmental activity quarterly instead of just at the end of the year. These more frequent reconciliations and adjustments should help to eliminate interagency differences.
April 30, 2004

The Honorable Todd R. Flatts
Chairman
Subcommittee on Government Efficiency
and Financial Management
Committee on Government Reform
House of Representatives

Subject: Responses to Posthearing Questions Related to GAO's Testimony on the
U.S. Government's Consolidated Financial Statements for Fiscal Year 2003

Dear Mr. Chairman:

On March 3, 2004, I testified before your subcommittee at a hearing on our report on
the U.S. government's consolidated financial statements for fiscal year 2003. This
letter responds to your questions related to our testimony and to subsequent
questions from the Vice Chairman that you asked us to answer for the record.

Questions from Chairman Flatts

1. Do you think that the Department of Homeland Security (DHS) has
adequate resources to meet the November 15 financial reporting deadline
for fiscal year 2004?

During his March 10, 2004, testimony before your subcommittee, DHS's chief
financial officer (CFO) expressed satisfaction with the current level of accounting
staff in his office and in the department's bureaus but indicated that additional staff
may be needed in the future. In DHS's fiscal year 2003 Performance and
Accountability Report, however, DHS's independent financial statement auditor
reported that one of the agency's seven material weaknesses was related to financial
management and personnel. Specifically, the auditor reported that DHS's Office of

United States Government, issued by the Department of the Treasury on February 27, 2004, is available

2A material weakness is a reportable condition in which the design or operation of one or more
internal controls do not reduce to a relatively low level the risk that honest, noncompliance, or
misstatements in amounts that would be material in relation to the financial statements may occur and
not be detected within a timely period by employees in the normal course of their assigned duties.
the Chief Financial Officer (OCFO) "has not hired or contracted qualified personnel to properly perform financial reporting functions of an executive branch department CFO's office." The fact that DHS's independent auditor listed financial management and personnel as a material weakness and recommended that OCFO hire or contract for additional accounting personnel who possess complementary technical accounting skills suggests that additional resources may be needed as DHS continues to address the transformation of its financial systems and reporting.

2. Is there a time frame for GAO's review of whether it would be cost-beneficial to require an opinion on internal control in conjunction with federal agencies' Yellow Book audits?

As we discuss in further detail later in this letter, we believe that requiring opinions on internal control over financial reporting (including safeguarding of assets) and compliance with relevant laws and regulations for CFO Act agencies and DHS is a reasonable and necessary step to evaluate and to inform the public as to whether agencies have sufficient financial reporting systems and controls in place. As discussed later in our response to Vice Chairman Blackburn's question 2, the Sarbanes-Oxley Act of 2002 requires such reporting for public companies. In this regard, 3 of the 23 CFO Act agencies' already receive auditor opinions on their internal control. Importantly, in our view, extending any requirement for opinions on internal control over financial reporting to all federal agencies and Yellow Book financial statement audits would not pass a cost/benefit test.

The first step is for management to conduct an assessment of its internal control. The agency head would communicate the results of this assessment in a written statement, or an assertion, and would express an overall conclusion as to the effectiveness of the controls in providing reasonable assurance that the objectives are achieved. The auditor, as part of the financial statement audit, would then provide audit assurance on the agency head's assertion and on the effectiveness of internal control. This audit assurance would be provided following generally accepted government audit standards.

In this regard, at the federal level with the 1982 passage of the Federal Managers' Financial Integrity Act (FIA), the Congress required agency management to continually assess and report annually to the President as to whether the agency's system of internal control meets the Comptroller General's Standards for Internal Control.
Control in the Federal Government. The responsibility for assuring the adequacy of internal control rests with management and not the auditor. As envisioned by the Congress when it enacted FIA more than 20 years ago, the auditor though must play an important role in evaluating management’s efforts to carry out the letter and intent of the act. Reporting on the adequacy of internal control would help the inspectors general in carrying out their role under FIA. It is also important to note that underlying the Sarbanes-Oxley Act requirement for the auditor to provide an opinion on internal control is a requirement of public company’s management to assert as to the effectiveness of its system of internal control. If agency management has made a proper ongoing assessment of its system of internal control and is meeting its obligation under FIA, then the additional work needed by federal auditors in providing an opinion on management’s assertion and on the effectiveness of an agency’s system of internal control would be minimized.

As you know, the Yellow Book applies to a wide range of entities that vary greatly in both size and complexity. GAO is currently developing guidance for use in considering whether and under what circumstances an auditor’s opinion on an entity’s internal control is appropriate and cost-beneficial for non-CFO Act federal agencies and certain state and local governments that receive financial audits under the Yellow Book. We hope to have the guidance out in draft form later this year, at which time we will request comments from all constituencies involved. The guidance will provide a framework for government entities, and those who oversee those entities, to use when considering whether an auditor’s opinion on internal control would be beneficial.

Questions from Vice-Chairman Blackburn, Submitted on March 10, 2004

1. If agencies were fully compliant with FFMIA, what effect would that have on their financial statements and on their internal controls?

The Federal Financial Management Improvement Act of 1996 (FFMIA) builds on the foundation laid by the CFO Act by emphasizing the need for agencies to have financial management systems that can generate reliable, timely, and useful information with which to make informed decisions and to ensure accountability on an ongoing basis. FFMIA requires that the departments and agencies covered by the CFO Act implement and maintain financial management systems that comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the U.S. government Standard General Ledger at the transaction level.

---

As the Office of Management and Budget (OMB) discussed in its January 2001 guidance on FFMIA, agencies that are substantially compliant with FFMIA can prepare financial statements and other required financial and budget reports using information generated by their financial management systems. Agencies that do not have modern, integrated financial management systems typically must expend major effort and resources to develop information that their systems should be able to provide on a daily or other recurring basis. For example, the auditor for the Department of Health and Human Services (HHS) reported in November 2003 that systems and internal control weaknesses, such as lack of an integrated financial management system, continued to make it difficult for certain HHS operating divisions to prepare timely and reliable financial statements. The National Institutes of Health (NIH) financial system, for example, was not designed for financial reporting purposes and has not fully adopted the U.S. government Standard General Ledger. As a result, NIH must spend an inordinate amount of time consolidating and adjusting its numerous institutes' and centers' trial balances to prepare financial statements. For fiscal year 2003, this process generated about 1,900 nonstandard accounting entries with a value of about $14.2 billion.

Accurate and timely recording of financial information is key to successful financial management and to being in substantial compliance with FFMIA. Timely recording of transactions can facilitate accurate reporting in agencies' financial reports and other management reports that are used to guide managerial decision making. The Comptroller General's Standards for Internal Control in the Federal Government states that transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. Systems that do not require timely recording of transactions during the fiscal year can result in agencies making substantial efforts at fiscal year-end that are susceptible to error and increase the risk of misstatements. For example, the auditor for the U.S. Agency for International Development (AID) reported for fiscal year 2003 that AID lacked an adequate system or process to recognize its worldwide accounts receivable in a timely manner and had to rely on a Web-based collection tool to determine year-end accounts receivable amounts. What is important here is that the information was not available on an ongoing basis for day-to-day management.

Being substantially compliant with FFMIA means that a federal agency's financial management systems as a whole substantially comply with the three requirements mentioned earlier. Internal control is embodied in these three requirements. At the same time, internal control comprises much more than substantial compliance with FFMIA. Internal control is an integral component of an organization's management.

---

Footnotes:


*According to federal financial systems requirements, integrated financial management systems provide effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the system. Integrated systems share common data elements, transaction processing, and consistent internal control. Data needed to support financial functions should be entered only once.

GAO/AIMD-00-51.3.1.
that provides reasonable assurance that the following objectives are being achieved:
(1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and
(3) compliance with applicable laws and regulations. Internal control should be an
integral part of each system that management uses to regulate and guide operations,
including, but not limited to, financial management systems.

2. What additional reforms would be needed to ensure that agencies have
sufficient financial systems and adequate internal controls?

Over the past two plus decades, the Congress has enacted a series of management
reform laws to improve the accountability and effectiveness of government programs.
We believe that, in conjunction with the annual financial statement audits of the CFO
Act agencies and DHS, the next logical steps are (1) for these agencies to report
annually on management’s assessment of the effectiveness of agency internal control
over financial reporting (including safeguarding of assets) and compliance with
relevant laws and regulations and (2) to require auditor opinions on both
management’s assessment and on the effectiveness of agencies’ internal control over
financial reporting (including safeguarding of assets) and compliance with relevant
laws and regulations.

We believe that the legislative framework in place provides the foundation for moving
to this next step. The Congress passed the Federal Managers’ Financial Integrity Act
of 1982 (FIA) (now codified at 31 U.S.C. 3512(c), (d)) to strengthen internal control
and accounting systems throughout the federal government. In the 1980s and 1990s,
the Congress passed additional management reform legislation to improve the
general and financial management of the federal government. The combination of
reforms ushered in by (1) the Single Audit Act of 1984 and the Single Audit Act
Amendments of 1996,\(^\text{10}\) (2) the Prompt Payment Act,\(^\text{11}\) (3) the CFO Act, (4) the
Government Performance and Results Act of 1993,\(^\text{12}\) (5) the Government Management
Reform Act of 1994,\(^\text{13}\) (6) FFMIA, (7) the Clinger-Cohen Act of 1996,\(^\text{14}\) (8) the Debt
Collection Act of 1982\(^\text{15}\) and the Debt Collection Improvement Act of 1996,\(^\text{16}\) and (9)
the Accountability of Tax Dollars Act of 2002,\(^\text{17}\) if successfully implemented, provides
a basis for improving accountability and effectiveness of government programs and
operations and routinely producing valuable cost and operating performance
information, thereby making it possible to better assess and improve the
government’s effectiveness, financial condition, and operating performance.

In the private sector, the Sarbanes-Oxley Act of 2002 requires principal executive
officials and financial officers of public companies to certify their conclusions about

---
\(^{10}\) 31 U.S.C. § 7501 et seq.
internal control effectiveness. Auditing Standard No. 2, issued by the Public Company Accounting Oversight Board (PCAOB) in response to the requirements of the Sarbanes-Oxley Act of 2002, requires auditors of U.S. publicly traded companies to (1) report on the scope of internal control testing that was performed as part of the audit, (2) issue an opinion on whether management’s assessment of the effectiveness of the company’s internal control is fairly stated, and (3) issue an opinion on the effectiveness of the company’s internal control.\footnote{Pub. L. No. 107-204, § 302.116 Stat. 745, 777.}

We believe that requiring auditor opinions on both the effectiveness of CFO Act agencies’ and DHS’s internal control and management’s assessment of the effectiveness of those controls in appropriate circumstances would help the Congress assess the impact and the effectiveness of existing reform legislation and help target agencies’ efforts in improving financial reporting systems and controls.

Requiring officials of CFO Act agencies and DHS to certify their assessment of the effectiveness of agency internal control and requiring auditor opinions on both management’s assessment and on the effectiveness of internal control are reasonable and necessary steps to evaluate whether agencies have sufficient financial reporting systems and internal controls in place. With these requirements, CFO Act agencies and DHS would operate with the same accountability and transparency related to internal control that the Congress requires for publicly traded companies. As discussed earlier in this letter, 3 of the 23 CFO Act agencies already receive auditor opinions on their internal control. In GAO’s efforts to lead by example, as the Comptroller General of the United States, I annually report my assessment of the effectiveness of GAO’s internal control over financial reporting (including safeguarding of assets) and compliance with relevant laws in our Performance and Accountability Report, and our independent auditors opine on the adequacy of internal control in conjunction with their audit of GAO’s financial statements.

As previously discussed, there are already statutory requirements for agencies to evaluate the effectiveness and report annually to the President on their assessment of the effectiveness of internal control. If agency management has done a proper assessment, we believe that the additional work needed to issue an opinion on management’s assessment and the effectiveness of internal control as part of the financial statement audits should not be significant. We believe that a requirement for auditor opinions on management’s assessment and the effectiveness of internal control as part of the financial statement audit is necessary and appropriate for CFO Act agencies and DHS. These measures should move the departments and agencies closer to the objectives of adequate financial systems and internal control to safeguard and manage the resources entrusted to them by the American people.

\footnote{PCAOB is a private, nonprofit corporation created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies to protect the interests of investors and further public interest in the preparation of informative, fair, and independent audit reports.}

\footnote{Public Company Accounting Oversight Board, Release 2004-001, Auditing Standard No. 2, An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements (Mar. 9, 2005).}
3. In your opinion, does FFMIA need improvements? In what areas and how should they be done?

Our reports on FFMIA assessments since fiscal year 2000 have highlighted that auditors are providing negative assurance on agencies' compliance with FFMIA as called for in OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.* As I testified before this subcommittee on March 3, 2004, for fiscal year 2003, 6 of the 23 CFO Act agency auditors reported that the results of tests disclosed no instances in which the agencies' systems did not substantially comply with FFMIA. These auditors did not definitively state whether the agencies' financial management systems substantially complied with FFMIA, as required by the law. This distinction is important. The auditors for these agencies reported in accordance with OMB Bulletin No. 01-02, which does not require the auditors to make a definitive statement as to an agency's financial management systems' substantial compliance with FFMIA. Rather than requiring such a definitive statement, the OMB bulletin permits auditors to report negative assurance. With negative assurance, auditors are not saying that they determined the systems to be substantially compliant. If readers of the audit report do not understand the distinction between negative and positive assurance, they may have a false impression that the agency's financial management systems have been fully tested and found to be substantially compliant with FFMIA.

To provide positive assurance, or an opinion on an agency's financial management systems' substantial compliance with FFMIA, auditors will need to consider many aspects of financial management systems beyond those applicable to rendering an opinion on the financial statements. We believe that providing positive assurance and performing the work required to support such a statement are consistent with the language and intent of FFMIA.

OMB's revised FFMIA implementation guidance, issued in January 2001, has also raised concerns related to the meaning of substantial compliance. Auditors for many of the CFO Act agencies are concerned about the ambiguity in this guidance, particularly the lack of a clear definition of substantial compliance. Until this term is clarified in OMB's guidance, the CFO and audit communities believe that the interpretation and application of the guidance will remain inconsistent throughout the federal government.

To compel agency auditors to report in accordance with the law and to address issues concerning the definition of substantial compliance, we have recommended that OMB enhance its audit guidance related to FFMIA assessments. Specifically, we recommended that OMB (1) require agency auditors to provide a statement of positive assurance as to an agency's financial management systems' substantial
compliance with FFMAIA and (2) clarify the definition of substantial compliance. In its comments on our most recent FFMAIA report, OMB disagreed with our recommendation that it require agency auditors to provide such a statement of positive assurance and stated that it would consider our recommendation concerning clarification of the definition of substantial compliance in the context of any future policy and guidance updates. OMB stated that, in its view, positive assurance does not measure the quality or usefulness of the financial information.

We agree with OMB that the ultimate measure of whether an agency has good financial management systems is its ability to routinely provide reliable, useful, and timely financial information, not just at year-end or for financial statements, so that federal leaders will be better positioned to invest resources, reduce costs, and oversee programs. Agency systems' compliance with federal financial management systems requirements, applicable accounting standards, and the U.S. government Standard General Ledger are building blocks to help achieve this goal. At the same time, providing positive assurance, as the law requires, means that auditors must independently validate and report unequivocally whether financial management systems substantially comply with FFMAIA requirements and provide a basis for achieving the end goal of routinely providing reliable, useful, and timely financial information.

The Accountability of Tax Dollars Act of 2002 extended the requirement to prepare and submit audited financial statements to most executive agencies not subject to the CFO Act, including the Department of Homeland Security, unless exempted by OMB. However, the act does not require that these agencies have systems that are compliant with FFMAIA. Extending the coverage of FFMAIA to these agencies' financial management systems could help ensure that these systems achieve the objective of routinely providing reliable, useful, and timely financial information.

4. What actions do you recommend that would produce financial statements that accurately reflect the federal government's assets and liabilities?

Presently, there are three major impediments to producing financial statements that accurately reflect the federal government's assets and liabilities that should be addressed. These major impediments are (1) serious financial management problems at the Department of Defense (DOD), (2) the federal government's inability to fully account for and reconcile transactions between federal government entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition, improved clarity and transparency are needed in federal financial reporting. In the past, we have made hundreds of recommendations related to financial management and financial systems issues across government.

Given the significance of DOD's activities and balances to the consolidated financial statements, until DOD improves its financial and business management systems,
processes, and controls, the consolidated financial statements will not accurately reflect the federal government's assets, liabilities, and costs. The Secretary of Defense has included improving DOD's financial management as one of his top 10 priorities, and the department has taken a number of actions under its Business Management Modernization Program, including development in April 2003 of an initial business enterprise architecture to guide operational and technological changes.\(^6\) DOD is currently working to refine and implement that architecture and expects to issue new versions of it during 2004 and 2005. Only through major transformation, which will take time and sustained leadership and persistent attention from top management, will DOD be able to meet the mandate of the CFO Act and achieve the President's Management Agenda goal of improved financial performance.

In my recent testimony on further actions needed by DOD to achieve successful financial management and business transformation, I reiterated the keys to successful business transformation and made two suggestions for legislative action: (1) that a senior management position be established to spearhead and integrate DOD-wide business transformation efforts and (2) that the leaders of DOD's functional areas, as opposed to the military services, receive and control system investment resources.\(^7\) I offered these suggestions for legislative consideration to improve the likelihood of meaningful, broad-based reform in financial management and related business at DOD.

To address its long-standing problems with intragovernmental exchange transactions between federal agencies, OMB issued business rules in 2002 to transform and standardize intragovernmental ordering and billing, and Treasury provided federal agencies with quarterly detailed trading partner information during fiscal year 2003 to help them better perform their trading partner reconciliations. In addition, the federal government began a three-phase Intragovernmental Transactions e-gov project to define a governmentwide data architecture and provide a single source of detailed trading partner data. We have recommended that OMB (1) develop policies and procedures that document how it will enforce business rules provided in OMB Memorandum M-03-01, Business Rules for Intragovernmental Transactions,\(^8\) and (2) require that significant differences noted between business partners be resolved and the resolution documented.\(^9\) Resolving the intragovernmental transactions problem remains a difficult challenge and will require a commitment by the CFO Act agencies and continued strong leadership by OMB.

To ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with

---


U.S. generally accepted accounting principles, Treasury is developing a new system and procedures to prepare the consolidated financial statements for fiscal year 2004. According to Treasury officials, these actions are intended to, among other things, directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements. Without this direct link, the information in the consolidated financial statements may not be reliable. In October 2003, we provided many recommendations to Treasury to improve its process and correct the internal control weaknesses related to preparing the consolidated financial statements.38 Resolving issues surrounding preparing the consolidated financial statements will require continued strong leadership by Treasury management.

Proper accounting and reporting practices are essential in the public sector. Services provided by the federal government—homeland security, national defense, Social Security, mail delivery, and food inspection, to name a few—directly affect the well-being of almost every American. Sound decisions about the future direction of vital federal programs and policies are made more difficult, however, without timely, accurate, and useful financial and performance information.

Current financial reporting does not clearly and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending and provides an unrealistic and even misleading picture of the federal government's overall performance and financial condition. Few agencies adequately show the results they are getting with the taxpayer dollars they spend. In addition, significant federal government commitments and obligations, such as Social Security and Medicare, are not fully and consistently disclosed in the federal government's financial statements and budget, and current federal financial reporting standards do not require such disclosure. The Federal Accounting Standards Advisory Board has a liabilities project under way to define liabilities and specify the definition's application to social insurance programs. Subsequently, the board will consider recognition, measurement, and display of social insurance obligations.

I am providing copies of this letter to the Ranking Minority Member and Vice Chairman of your subcommittee. This letter is also available on GAO's Web site at www.gao.gov.

38In October 2003, we issued a report based on prior consolidated financial statement audits that discusses in greater detail weaknesses in financial reporting procedures and internal control over the process for preparing the consolidated financial statements. We made 44 recommendations that address weaknesses identified and 16 recommendations that address consolidated financial statement disclosures required by U.S. generally accepted accounting principles. See GAO-04-45.
If you or your staff have questions about the responses to your questions, please contact me at (202) 512-5500 or Gary T. Engel, Director, at (202) 512-3406 or engels@gao.gov.

Sincerely yours,

David M. Walker
Comptroller General
of the United States