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15 YEARS OF THE CFO ACT—WHAT IS THE CURRENT STATE OF FEDERAL FINANCIAL MANAGEMENT?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE, AND ACCOUNTABILITY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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15 YEARS OF THE CFO ACT—WHAT IS THE CURRENT STATE OF FEDERAL FINANCIAL MANAGEMENT?

THURSDAY, NOVEMBER 17, 2005

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
FINANCE, AND ACCOUNTABILITY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:40 p.m., in room 2247, Rayburn House Office Building, Hon. Todd Russell Platts (chairman of the subcommittee) presiding.

Present: Representative Platts.

Staff present: Mike Hettinger, staff director; Tabetha Mueller, professional staff member; Dan Daly, counsel; Erin Phillips, clerk; Adam Bordes, minority professional staff member; and Cecelia Morton, minority office manager.

Mr. PLATTS. This hearing of the Government Reform Subcommittee on Government Management, Finance, and Accountability will come to order.

As stewards of the taxpayers' money, we in Congress have perhaps no greater responsibility than to ensure that every dollar is spent wisely. Regardless of party affiliation or ideological bent, all of us entrusted with public resources agree that they must be managed effectively and safeguarded from fraud or misuse.

Toward that end, President George Herbert Walker Bush signed the Chief Financial Officers Act on November 15, 1990. The CFO Act was heralded as the beginning of a new era not only in Federal management and accountability but also in efforts to improve government operations. The law laid a foundation for comprehensive reform, establishing Chief Financial Officers in all major executive agencies as well as a Deputy Director for Management and a Controller in the Office of Management and Budget.

With the understanding that transparency brings accountability, the CFO Act also instituted the requirement for Federal agencies to submit audited financial statements, begun on a piloted basis and eventually extended to all agencies.

In 1996, when the first year audits were performed government-wide, agencies took 5 months to close their books. Only six were able to earn a clean opinion. Fifteen years later, we have seen progress. Instead of 5 months, agencies now have only 45 days to submit audited statements. As opposed to only a handful of agencies, the majority of Federal departments now earn clean opinions

on a regular basis. Two days ago, all agencies were required to submit their statements for fiscal year 2005, and we will discuss the results of those audits here today.

It is important to note that sound financial management does not end with a clean opinion. In fact, clean audits are merely a starting point. What we need is timely, accurate, useful financial data to manage programs effectively, to shift resources if necessary, and to make informed decisions. This was a need that was highlighted by the response to this year's devastating hurricane season.

Despite progress in a general sense, the audits reveal a troubling picture at some of our most important departments. As a nation at war and under the threat of terrorism, management at the Department of Defense and Homeland Security should be top-notch. Yet these two departments have never been able to earn a clean opinion, a trend that unfortunately continues this year. It is dangerous to assume that an important front-line mission should relegate management to the back burner. On the contrary, sound financial management can only enhance mission performance. This is why it must be a priority at every department. This level of transformation can only occur with the commitment of top leadership.

We are honored to have two influential leaders in financial management before us today. The Honorable Dr. Linda Combs is the Controller for the Office of Federal Financial Management at OMB, one of the key positions established by the CFO Act. Dr. Combs has served as CFO at the Department of Transportation and the Environmental Protection Agency and brings an important perspective as she guides CFOs governmentwide.

Mr. Jeffrey Steinhoff is the Director of Financial Management and Assurance at the Government Accountability Office. He was part of the team that was instrumental in drafting and enacting the CFO Act.

We thank both of you for being here today and for your continued work with the subcommittee. We will look forward to your testimonies. As a practice, we will have both of you stand and be sworn in. If Mr. Towns joins us during your testimony, we will see if he has a statement that he would like to offer before we then go into questions, depending on his interest.

If you would both raise your right hand, and any staff that will be guiding you today, if they would stand and be sworn in as well.

[Witnesses sworn.]

Mr. PLATTS. Thank you. The clerk will note all witnesses affirmed the oath.

We appreciate, as always, your substantive written testimonies and allowing us to be well prepared for a good dialog here today. We are going to set the clock for 8 minutes, but we really do appreciate both your time and efforts, and that is a guide. But don't worry, if you need more time to complete your statements, please take the time. We really want to hear what you have to say.

Dr. Combs.

STATEMENT OF DR. LINDA COMBS, CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

Ms. COMBS. Thank you, Chairman Platts, and we welcome the opportunity to be with you today. It is a great opportunity to appear before this committee and discuss the CFO Act and the overall state of financial management in the Federal Government.

When the CFO Act was passed in 1990, I was the Assistant Secretary for Management at the Department of the Treasury. So for those of us who have worked on the CFO Act from its initial passage and have been passionate about financial management in the Federal Government for all these years, it is indeed a welcomed opportunity to have a 15-year reflection and to remind ourselves of how far we have actually come thanks to the committed efforts of people sitting here at this table and people behind the bench where you sit as well. So I thank you again for this opportunity and for the financial management support that you give in the Federal Government.

I think there has been tremendous, strong progress in Federal financial management, and recognizing the accomplishments of hard working financial managers across the Federal Government is a tremendous, wonderful way to celebrate the 15 years that we are here to talk about today.

When the CFO Act was signed 15 years ago, the Federal Government was responding to many financial management challenges. And in responding to these challenges, the act, as you pointed out, set forth many ways in which financial management should be strengthened. One of those ways was in the leadership. Another was in implementing more disciplined financial controls and producing more timely and reliable financial information for day-to-day decisionmaking.

I am proud to share that today. Here 15 years later, we do have the CFO community that's committed to very, very strong financial leadership, committed to transparency in financial reporting, and committed to meeting the very highest standards in reporting, and that we are reporting on those highest standards to be the highest in our modern memory.

The administration monitors our financial goals using the improved financial performance initiative under the President's management agenda. We are definitely looking for results in financial management. We believe that what gets measured gets done.

The improving financial performance initiative, as part of the President's management agenda, includes a very detailed set of financial standards that every Federal agency is accountable for meeting. As the Controller in the Office of Management and Budget, I work very closely with each of our agencies' CFOs to develop financial management improvement plans and to monitor those results.

I want to say that I am very, very proud of our CFOs. I am proud of their hard work, diligent efforts, and continuing efforts to improve Federal financial management. We in the administration know that money we spend is indeed the taxpayers' money. Therefore, we must be good stewards of the people's money. And over the

past few years, we have made tremendous strides in accelerating, improving, and streamlining financial management processes.

Timely audits are vital for ensuring that taxpayer money is spent honestly and wisely. When the CFO Act was passed in 1990, as I recall there were only five agencies at that time that were participating in a pilot to see if they could even produce auditable financial statements. As I recall, the result of that was that one of those pilots actually attained a clean audit.

Moving forward to 10 years later, in 2000, when we came into this administration, the CFO Act agencies were taking as long as 5 months still at that time to complete their financial statements. And now we have Federal agencies that are reporting 45 days after the end of the fiscal year. And this year, just 2 days ago, we reached a remarkable milestone in regard to that 45-day reporting deadline. On Tuesday, November 15, every major Federal agency completed its performance and accountability report just 45 days after year end of the 2005 fiscal year. This is the first time every audit was completed since that deadline was set in 2001. That is, in and of itself, a remarkable success story.

As a result of the accelerated reporting process and the expectations of high standards, the overall quality of financial reporting at Federal agencies has consistently produced clean audits. For 3 consecutive years the number of unqualified opinions has remained relatively stable. Additionally, I believe our steps to bring about stronger internal controls, which are emphasized in the revisions to Circular A–123, represent tremendous advances toward timely and reliable financial information.

Beginning with this fiscal year, and already in progress, agency managers are required to undertake a strengthened internal control assessment process. Key milestones from these plans are being incorporated into the improved financial performance initiative scorecard to ensure that agencies are accountable for meeting their goals. These efforts will culminate in the agencies' first management assurance statement for internal controls over financial reporting on June 30, 2006.

In closing, I continue to believe that the President's management agenda is one of the most effective tools we have in promoting financial improvement and excellence to hold agencies accountable for good, positive results. The administration remains dedicated to being a good steward of taxpayer dollars through strong financial management. Specifically, we hope to accomplish this through continued good leadership, our dedication to transparency, and our adherence to the highest standards possible.

I look forward to continuing to work with this subcommittee on the overall financial management of the Federal Government. Thank you, Mr. Chairman, for the opportunity to be here with you today. I will be pleased to address at the appropriate time any questions that you may have. Thank you.

[The prepared statement of Ms. Combs follows:]

Statement of The Honorable Linda M. Combs
Controller, Office of Federal Financial Management
Office of Management and Budget

Before the
Subcommittee on Government Management, Finance, and Accountability
Committee on Government Reform
United States House of Representatives
November 17, 2005

Thank you, Chairman Platts and Members of the Committee.

I am pleased to be here today to provide this Subcommittee with the Administration's perspective on the past, present, and future of the Chief Financial Officers (CFO) Act and the state of financial management within the Federal Government. I will discuss the circumstances that brought about the Act, compare the environment fifteen years ago to today, describe what the Administration has accomplished to date to further the Act, and speak to the road ahead.

When the CFO Act was signed fifteen years ago, the Federal Government was responding to numerous financial management challenges. At that time, the former Comptroller General testified that billions of dollars were 'at risk' in the Federal Government's programs due to inadequate financial management systems and controls. The CFO Act was a direct response to these deficiencies and was directed toward reforming financial management practices within the Federal Government. In short, the Act called for stronger financial leadership, more disciplined financial controls, improved financial management systems, and accurate and timely financial information for decision-making. These requirements have driven significant financial management reform over the past fifteen years and continue to advance financial management improvement.

Today, the primary mechanism the Administration uses to promote financial improvement is the President's Management Agenda (PMA) initiative for Improving Financial Performance. Under this initiative, the President identified a limited number of clear, meaningful, and attainable financial goals that every Federal agency must meet. Each individual goal (e.g., receiving an unqualified opinion on audited annual financial statements) is an indicator of financial management excellence. Agencies who do not meet individual goals must prepare action plans for meeting them as well as demonstrate ongoing progress in achieving results.

Stronger Financial Management Leadership

A significant improvement driven by the PMA's financial improvement effort has been its influence in unifying the government's CFOs. Namely, every CFO across the Federal Government now shares common goals for improving financial performance.

Further, Federal agencies, Congress, and the public can compare how well each agency is performing in meeting those goals. In my role as Controller, I work closely with each of the CFOs to develop financial management improvement plans and monitor results. I am encouraged by their hard work and professional efforts to improve Federal financial management.

I have observed that when agencies are preparing their plans to respond to their specific weaknesses, the CFOs seek the counsel of other CFOs for best practices and other innovative ways to address financial weaknesses. Because of this collaborative spirit, I believe we have gone beyond the CFO Act's organizational and leadership requirements of a centralized financial management leadership structure within the Office of Management and Budget (OMB) as well as having CFOs at every agency. Specifically, we have created a financial management community that works closely with one another through councils and forums across the Federal Government to respond to long-standing and arising financial challenges.

More Disciplined Financial Reporting and Controls

In addition to requiring stronger financial leadership, the CFO Act addressed the need for reporting practices that disclosed the current and probable future costs of operating and investment decisions. To satisfy this requirement, the Act required that agencies prepare and submit annual audited financial statements. This provision addressed the need for greater accountability over how taxpayer dollars were being spent. The first year after its enactment, five pilot agencies prepared and submitted financial statements on their fiscal year 1990 activity. It was apparent, however, that there was a need for more transparency into the government's financial health in order to fulfill the financial statement reporting requirement and enable comparison across Federal agencies and programs.

To respond to the need, the Federal Accounting Standards Advisory Board (FASAB) was created to develop generally accepted financial accounting and reporting standards across the Federal Government. Federal agencies were required to comply with this common set of accounting and financial reporting standards and their compliance was measured by independent audits.

The FASAB standards were only a first step. Agencies continued to spend considerable time and effort after the end of the fiscal year to produce reliable financial reports. To put this into perspective, when this Administration came to office, the CFO Act agencies took as long as five months to complete their financial statements. Today, I am pleased to report that CFO Act agencies are able to prepare and have audited their financial statements in about 45 days. A majority of these agencies have also received unqualified opinions on their financial statements in an environment of heightened accountability. In addition to reducing the amount of time for producing audited financial statements, since fiscal year 2001, agencies have reduced the number of auditor-reported material weaknesses by nine percent and the number of management reported weaknesses by 75 percent. This result is especially noteworthy since greater fiscal

discipline was needed to successfully meet the new and more aggressive reporting deadline.

To make accelerated financial reporting more routine, the Federal Government is committed to strengthening internal controls and improving the efficiency of our financial processes. A strong foundation of effective internal control is essential to support the production of timely and reliable financial information. OMB has emphasized this in OMB Circular A-123, *Management's Responsibility for Internal Control* (A-123). The A-123 defines management's accountability and responsibility for maintaining effective internal control. Revisions were made to A-123 in December 2004 providing agencies with a framework for assessing and managing financial reporting risks more strategically and effectively. Beginning in fiscal year 2006, management is required to undertake a strengthened internal control assessment process, including documenting and testing the controls over financial reporting. This process is similar to what public companies must follow under the Sarbanes-Oxley Act. OMB is taking a very active oversight role in implementing the new requirements contained in A-123.

To ensure agencies are continuing on the right path, OMB has required that agencies submit agency-specific implementation plans for the new A-123 requirements. Over the next several months, agencies will complete risk assessments, identify key processes and controls, and test these controls to determine their effectiveness. This effort will culminate in the agencies' first management assurance statement for internal control over financial reporting as of June 30, 2006. Key milestones from the plans will also be incorporated into the Improving Financial Performance initiative scorecard under the PMA to ensure agencies are accountable for meeting their goals. While the Administration anticipates that the A-123 activities may uncover more weaknesses in the near-term, we believe financial reporting will only be strengthened in the long-term. We will continue to use the PMA goals, the agency plans to comply with these goals, and our ongoing interaction with agencies to ensure that agencies continue to make measurable progress.

Timely and Reliable Financial Information

As agencies continue to reduce the timeframe to publicly report their financial results as well as reduce the number of material deficiencies, agencies move closer to the true goal of financial accountability. Namely, we are ensuring that agencies produce complete, reliable, timely, and consistent financial information for use by the executive branch of the Government and the Congress in the financing, management, and evaluation of Federal programs. To produce reliable and timely information, agencies need financial management systems that support accounting standards and controls. Thus, another PMA goal is that agencies implement modern, compliant financial management systems that provide reliable, useful, and timely financial information for decision-making. Agencies are making steady progress in achieving this goal.

The PMA also focuses on ensuring that the resources entrusted to the Federal Government are well managed and used wisely. One of the guiding principles for the

President's vision is for the government to be results-oriented. To achieve 'green' status, agencies must go beyond having an unqualified audit opinion, meeting reporting deadlines, and resolving material weaknesses. Agencies must present evidence to OMB that financial information is available for managers on demand and that information is actively being used to drive results in key areas of operations. OMB assesses many factors including: the outcomes that agencies are looking to achieve, how agencies are using data strategically to drive the outcomes, and how agencies will measure the results to know the desired outcomes were achieved. In order to maintain 'green' status, agencies need to have a plan to continually expand their efforts so that all managers have the financial information needed to operate their programs.

The Road Ahead

The outlook for the Federal Government to improve the quality and timeliness of financial reporting and to fulfill our stewardship responsibilities to the American citizen is favorable. Using the PMA, the Administration has identified and focused every Federal financial manager on addressing the most significant financial deficiencies across the government. The road ahead continues to follow the path that the President has laid out: continuing to use financial information more strategically, strengthening internal control, and quantifying improvements and achievements in terms that everyone understands. Keeping this in mind, I would like to highlight two key initiatives where the Administration is focusing its efforts for using financial information to manage and reduce cost: eliminating improper payments and improving the stewardship and accountability over real property.

Reducing improper payments is a key indicator of agency financial management improvement efforts. This year's Performance and Accountability Reports will report that agencies are making significant progress in reducing the approximately $45 billion of improper payments identified last year, and that they are continuing to improve their detection and prevention of additional improper payments. As "new" improper payments are identified, agencies are moving quickly to initiate corrective actions to address the root causes of error.

Another component of sound fiscal management is managing our real property and inventories at the right size and cost. The Federal Real Property Asset Management initiative under the PMA has heightened awareness of this objective and is leading to better asset management decisions. The ultimate goal of this initiative is to develop and implement the necessary tools (e.g., planning, inventory, performance measures) to improve management decision-making so that property inventories are maintained at the right size, cost, and condition to support agency mission and objectives. Through the PMA, the Administration is holding agencies accountable to utilize improved planning and data gathering to implement specific rightsizing activities that will reduce surplus assets, improve the condition of mission critical assets, and ensure that assets are managed at the right cost.

A foundation of effective internal control is critical to realizing the goals above. Federal agencies are making significant progress in mitigating risks and reducing the amount of material internal control weaknesses that may lead to program inefficiencies and improper payments. CFOs will need to continue to provide strong leadership, innovative thinking, careful planning, and more disciplined processes as they manage more diverse and complex operations with less resources and tighter timeframes than fifteen years ago. As Controller, I will continue to lead the Federal financial management community in achieving the President's vision and goals for improving financial management.

Thank you, Mr. Chairman for the opportunity to speak before you today. I am pleased to address any questions.

Mr. PLATTS. Thank you, Dr. Combs. We appreciate your testimony. Mr. Steinhoff.

STATEMENT OF JEFFREY C. STEINHOFF, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, GOVERNMENT ACCOUNTABILITY OFFICE

Mr. STEINHOFF. Chairman Platts, it is a special privilege to be here today on the 15th anniversary of the passage of the CFO Act, widely heralded as the most far-reaching financial management reform legislation in 40 years. A decade and a half later, the act has clearly stood the test of time and is the foundation of efforts to strengthen financial accountability.

Today, I would like to do three things: Provide a quick historical perspective of what the framers of this act were trying to achieve; second, share my thoughts on the impact of the act to date; and, finally, to talk about some of the challenges going forward, as we are not yet at the finish line.

Let me quickly touch on the historical perspective. In 1990, the environment was one where financial systems and controls were abysmal and there was hardly any good year-end financial reporting. Clearly, financial management was not a high priority and the CFO job was typically part of a broader range of duties and received short shrift. The CFO Act was directed at establishing financial accountability and managing the cost of government. It was even recognized back then that we did face serious financial challenges and we had to manage our costs much better.

While understandably there is a lot of focus on the audited financial statements, the end game has always been the establishment of a fully functioning CFO operation that includes a cadre of highly qualified CFOs and supporting staff, modern financial management systems that provide reliable, timely, and useful information to support day-to-day decisionmaking and that enable the systematic measure of performance—this is not about accounting, it is about accountability—and, finally, sound internal controls that safeguard assets and ensure accountability.

Regarding the impact of the act 15 years later, I would like to answer a few questions tied directly back to the act's objectives.

Has the quality of financial management leadership been strengthened? The answer is an emphatic yes. The CFO position has moved from the back room to the board room. Dr. Combs, who came to this job with a proven track record in financial management, not in something else, exemplifies today's CFO.

Have financial management systems improved? Again, yes. While systems continue to be the most difficult challenge by far, we are not close to the finish line there. There has been important progress, people have come a long way, whether it be standardization, core systems, or better defining what is required and needed. And for most agencies the problems are not nearly on the order of magnitude they were in 1990. There are, nevertheless, very difficult challenges ahead, and they fall mainly in the area of systems.

Have there been improvements in internal control? Again, yes, but it is with financial management systems that additional improvements are needed. Importantly, recent revisions to a 123 that

you and Dr. Combs referred to, which GAO fully supports, have bolstered the emphasis in this important area.

Has financial reporting improved? As you pointed out in your opening statement, 18 clean opinions versus 6. In 1990, no one even imagined we would have a requirement for audited financial statements. There were pilots. They weren't expected to go too far. No one would have ever imagined one clean opinion versus 18, much less in 45 days. Where the law gives folks 5 months, the fact of the matter is in some of those earlier years, there were some agencies that took up to 13 and 14 months. So this is a major achievement.

Most importantly, we have witnessed a culture transformation. In 1990, not everyone in the CFO community was supportive of the CFO Act. Some believed the demand for reform would simply run its course and fade away. Well, that has not been the case. We have seen strong support from the past three administrations. From the outset of the current administration, improved financial management has been one of the cornerstones of the President's management agenda. We have seen strong support and continuous oversight by the Congress. Especially important has been this subcommittee's strong leadership.

As Dr. Combs mentioned, you get what you measure. And one measure, a very important measure, is whether Congress really cares.

Fifteen years later, people no longer question the value of the concepts in the CFO Act. Today, the question is no longer why do I have to do these things, but rather how can I do them better?

While I have spoken about the positive impact of the act, the journey to excellence in financial management is far from over. I see five principal challenges for the future.

First and foremost, agencies must take full advantage of modern technology and develop financial management systems that are integrated with a range of other business systems. This is a key requirement of the CFO Act.

The past is littered with far too many failed systems initiatives and/or projects that simply perpetuated stovepipe systems. One need only look at the Department of Defense. Despite spending tens of billions of dollars, and at last count having over 4,200 business systems, DOD remains high risk in every primary business area and cannot produce auditable financial information. Today, we see strong commitment in DOD to transform its business operations and to overhaul financial management. But it will take many years under the best of circumstances to address deeply rooted problems.

Second, the financial management work force of the future will have to be able to provide even greater strategic decision support in order to add value to program managers. The goal is to move primary focus from transaction processing and reconciliation and cleaning up of errors to the systematic measurement of performance and the development of cost information, as called for in the CFO Act. This will require a different skill set.

Third, addressing internal control weaknesses will be an ongoing challenge. Good internal control requires constant vigilance. It is not a one-time event and an ability to leverage technology. Im-

proper payments and computer security are two cross-cutting issues that are now being addressed.

Fourth, we must continue to refine financial reporting so that there is better transparency regarding our Nation's fiscal condition. A summary consolidated financial report and different ways of recognizing the range of Federal commitments are two areas on the radar screen.

Finally, we must deal with the long-term nature of reform and provide for continuity in an environment where leadership changes are a way of life. The President's management agenda has provided a sound framework for reform. It fully supports the concepts of the CFO Act and has been very important in what we have seen in the last 5 years. The job, though, will not be complete at the end of this administration and continuity will be critical going forward.

In closing, I want to thank this subcommittee and its predecessors who had the vision to enact the CFO Act and for the positive continuous support and oversight over the past 15 years. Your continued attention has been instrumental to the very positive results we have seen to date and will be essential in reaching the goals of the CFO Act going forward.

This completes my summary statement. I will be pleased to answer any questions that you may have at this time.

[The prepared statement of Mr. Steinhoff follows:]

United States Government Accountability Office

GAO

Testimony Before the Subcommittee on Government Management, Finance and Accountability, Committee on Government Reform, House of Representatives

For Release on Delivery
Expected at 2:30 p.m. EST
Thursday, November 17, 2005

CFO ACT OF 1990

Driving the Transformation of Federal Financial Management

Statement of Jeffrey C. Steinhoff
Managing Director, Financial Management and Assurance

GAO-06-242T

November 17, 2005

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-06-242T, a testimony before the Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

CFO ACT OF 1990

Driving the Transformation of Federal Financial Management

Why GAO Did This Study

In 1990, the Chief Financial Officers (CFO) Act, heralded as the most comprehensive financial management reform legislation in 40 years, was enacted. The Act's goal is to improve management through reliable, useful, and timely financial and performance information for day-to-day decisionmaking and accountability. This testimony outlines the legislative history of the CFO Act, and its key elements, progress to date in implementing the Act, and the challenges for the future.

Prior to passage of the CFO Act, the seemingly never ending disclosures of fraud, waste, abuse, and mismanagement in federal programs painted a picture of a government unable to manage its programs, protect its assets, or provide taxpayers with the effective and economical services they expect. The enactment of the CFO Act represented a broad-based recognition that federal financial management was in great need of fundamental reform.

The Act mandated a financial management leadership structure; required the preparation and audit of annual financial statements; called for modernized financial management systems and strengthened internal control; and required the systematic measurement of performance, the development of cost information, and the integration of program, budget, and financial systems.

www.gao.gov/cgi-bin/getrpt?GAO-06-242T.

To view the full product, click on the link above. For more information, contact McCoy Williams at (202) 512-6906 or williamsm1@gao.gov.

What GAO Found

In the 15 years since the enactment of the CFO Act, the federal government has made substantial progress in strengthening financial management. The past 3 administrations have all made financial management reform a priority. Improved financial management has been one of the cornerstones of the President's Management Agenda from the outset of the current administration. There has been a clear cultural change in how financial management is viewed and carried out in the agencies and a recognition of the value and need for good financial management throughout government, which was not the case in 1990. There are now qualified CFOs across government, who bring to the job proven track records in financial management. Financial management systems and internal control have been strengthened. Generally accepted government accounting standards have been developed. For fiscal year 2005, 18 of 24 CFO agencies received clean audit opinions on their financial statements, up from just 6 in fiscal year 1996. This year's audited financial statements were issued in just 1½ months after the close of the fiscal year as opposed to 5 months, which is the deadline in the Act. Agencies are also now preparing performance and accountability reports that tie together financial and performance information. Though not yet auditable, primarily because of problems in the Department of Defense, comprehensive annual consolidated financial statements are being issued in 2½ months as opposed to the 6-month timeframe allowed in the Act.

While there has been marked progress in the past 15 years and the CFO Act has proven itself as the foundation for financial accountability, GAO has identified five principal challenges to fully realizing the world-class financial management anticipated by the CFO Act. The need to:

1. modernize and integrate financial management systems to provide a complete range of financial and cost information needed for accountability, performance reporting, and decision making, with special emphasis on the Department of Defense, which has deeply-rooted systems problems,
2. build a more analytic financial management workforce to support program managers and decisionmakers,
3. solve long-standing internal control weaknesses,
4. enhance financial reporting to provide a complete picture of the federal government's overall performance, financial condition, and future fiscal outlook, and
5. ensure that financial management reform is sustained given the leadership changes that occur at the end of any administration and the long-term nature of many of the ongoing reform initiatives.

The continuing strong support of the Congress has been a catalyst to the important progress that has already taken place and will be essential going forward.

United States Government Accountability Office
Washington, DC 20548

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today on the 15th anniversary of the enactment of the Chief Financial Officers Act of 1990[1] (CFO Act) to discuss the effect of this groundbreaking legislation as well as the challenges that still remain. Having worked closely with the members of Congress on passage of the CFO Act, I can attest first hand that while many challenges still exist, the state of federal financial management has come a long way since 1990. Nearly all the CFO Act agencies[2] have made marked improvements in financial management and have shown that issuing timely audited financial statements can become a routine part of doing business at the federal level. At the same time, there are opportunities to take federal financial management to the next level, which will be important as the federal government faces difficult fiscal challenges that will require reliable financial and performance information to support timely decisions on spending, and pressures to address fraud, waste, abuse, and mismanagement will only intensify. Also, certain material weaknesses in internal control and in selected accounting and financial reporting practices have continued to prevent the GAO from being able to issue an opinion on the consolidated financial statements of the U.S. government. These weaknesses which hinder management's ability to manage day-to-day operations, most notably at the Department of Defense, need to be resolved.

Today, I would like to

- highlight the legislative history of the CFO Act;
- summarize the key elements of the CFO Act;
- outline progress made to date in implementing the CFO Act; and
- provide our views on the challenges remaining.

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

[2]The CFO Act agencies are the executive branch agencies listed at 31 U.S.C. §901(b). See Appendix I.

CFO Act Enacted to Address Longstanding Problems

Prior to passage of the CFO Act in 1990, the seemingly never ending disclosures of fraud, waste, abuse, and mismanagement in federal programs painted a picture of a government unable to manage its programs, protect its assets, or provide taxpayers with the effective and economical services they expect. As the Comptroller General pointed out around the time the CFO Act was passed,[3] the problems that existed were not limited to a few agencies or a few programs; rather, all of the major agencies had serious problems. For years, GAO and the Inspectors General had reported a litany of problems that resulted in wasteful spending, poor management, and losses totaling billions of dollars. In some cases, the government's ability to carry out crucial programs had been severely hampered.

The financial management environment was in such disarray that not only were audited annual financial statements not required, most in the federal financial management community did not even see the value of annual financial reporting. The need for federal financial statements was an area of major disagreement. Budgeting was what financial management was all about, and accountability for how the money was being spent was not the priority. Federal managers in the government were more concerned with the budget and did not focus on improved financial management.

Concerned about the ever-growing problems in federal financial management and the need for a more integrated, comprehensive, and systematic approach to reform, in 1985 the Comptroller General issued a two-volume report entitled, *Managing the Cost of Government: Building an Effective Financial Management Structure*.[4] This report laid out the nature and scope of the problem and provided the conceptual framework for the reforms needed to improve the federal financial management and therefore, manage the cost of government. Problems included the poor quality of financial management information and antiquated financial management systems, with recommended reforms such as strengthened accounting, auditing, and financial reporting and the systematic measurement of performance. In addition, GAO and the Office of Management and Budget (OMB) conducted separate studies of "high risk" programs that demonstrated breakdowns in internal control affecting

[3]GAO, *Financial Management Reform*, GAO/T-AFMD-90-31 (Washington, D.C.: Sept.17, 1990).

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

hundreds of billions of dollars. Since January 1990, GAO has designated certain federal programs and operations as high risk because of their greater vulnerabilities to fraud, waste, abuse, and mismanagement. The increased awareness of the nature and extent of high-risk programs further bolstered the need for broad-based congressional action.

While the federal government had not made concerted progress in reforming financial management, state and local governments had moved beyond the federal government in this area because of key factors including federal legislation such as the Single Audit Act of 1984.[5] The Single Audit Act of 1984 established financial audit requirements for state and local governments that receive federal financial assistance in excess of certain dollar thresholds in any fiscal year. The Single Audit Act also included a requirement for independent auditors to review whether state and local governments have adequate internal control over federal funds. The need to comply with this law prompted states and local governments to focus on improving financial management and accountability. In the 1980s, many states began producing financial reports based on generally accepted accounting principles to provide a more complete picture of their financial situation. Consequently, in 1990, many in the financial management community believed that state and local governments were ahead of the federal government.[6]

To address the underlying problems that plagued federal financial management in March 1986, Senator William Roth introduced S.2230, the Federal Management Reorganization and Cost Control Act of 1986. Over the ensuing 4½ years, the concepts in S.2230 were refined and debated.[7] What resulted was the CFO Act of 1990. The CFO Act, with bipartisan and bi-cameral support, had as its principle sponsors Senators John Glenn and William Roth and Representatives John Conyers and Frank Horton. Signed into law by President George H.W. Bush on November 15, 1990, the CFO Act was the most comprehensive and far-reaching financial management improvement legislation since the Budget and Accounting Procedures Act of 1950. The CFO Act established a leadership structure, provided for long-

[5]Pub. L. No. 98-502, Stat. 1510 (Oct. 19, 1984).

[6]The Single Audit Act was later amended by the Single Audit Act Amendments of 1996. Pub. L. No.104-156. 110 Stat. 1396 (Jul. 5, 1996).

[7]See H.R. Rep. No. 101-818, Part 1 (1990).

range planning, required audited financial statements, and strengthened accountability reporting.

The CFO Act was the beginning of a series of management reform legislation to improve the general and financial management of the federal government, and laid the foundation for other key legislative reforms that followed a common thread of increased accountability and better management practices. The first legislation that followed the CFO Act was the Government Performance and Results Act of 1993[8] (GPRA), which requires agencies to develop strategic plans, set performance goals, and report annually on actual performance compared to goals. GPRA was followed by the Government Management Reform Act of 1994[9] (GMRA), which made permanent the pilot program in the CFO Act for annual audited agency-level financial statements, expanded this requirement to all CFO Act agencies, and established a requirement for the preparation and audit of governmentwide consolidated financial statements. The Federal Financial Management Improvement Act of 1996[10] (FFMIA) built on the foundation laid by the CFO Act by reflecting the need for CFO Act agencies to have systems that can generate reliable, useful, and timely information with which to make fully informed decisions and to ensure accountability on an ongoing basis. The Clinger-Cohen Act of 1996[11] (also known as the Information Technology Management Reform Act of 1996) sets forth a variety of initiatives to support better decision making for capital investments in information technology, which has led to the development of the Federal Enterprise Architecture and better-informed capital investment and control processes within agencies and across government. The Accountability of Tax Dollars Act of 2002[12] (ATDA) required most executive agencies that are not otherwise required, or exempted by OMB, to prepare annual audited financial statements and to submit such statements to Congress and the Director of OMB.[13] Lastly, the Department of Homeland Security Financial Accountability Act of 2004[14]

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

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

[10]Pub. L. No. 104-208, div. A., sec. 101(f), title VIII 110 Stat. 3009, 3009-389 (Sept. 30, 1996).

[11]Pub. L. No. 104-106, div. E, 110 Stat. 186, 679 (Feb. 10, 1996).

[12]Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002).

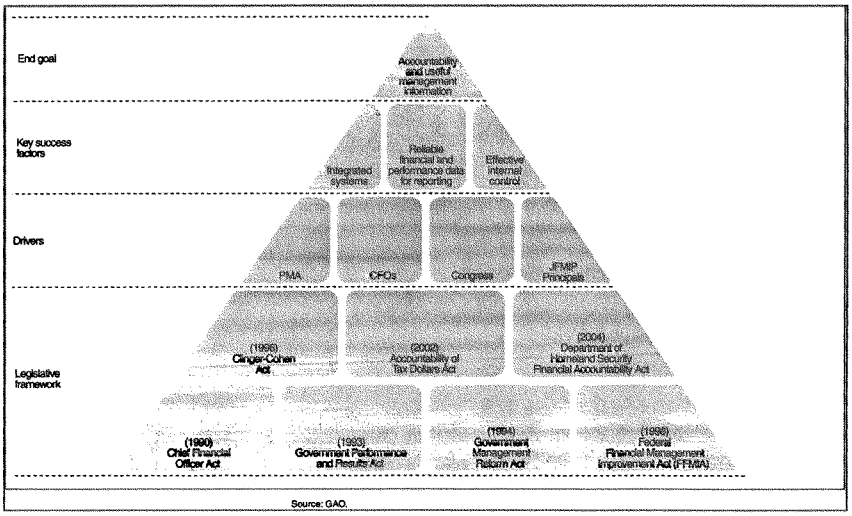
[13]ATDA agencies are not required to comply with FFMIA.

[14]Pub. L. No. 108-330, 118 Stat. 1275 (Oct. 16, 2004).

added the Department of Homeland Security (DHS) to the list of CFO Act agencies.

As shown in figure 1, if successfully implemented, these reforms provide a solid basis for improving accountability of government programs and operations as well as routinely producing valuable cost and operating performance information.

Figure 1: Federal Financial Management Reform Framework



Source: GAO.

The CFO Act Mandated Numerous Changes

The enactment of the CFO Act represented a broad-based recognition that federal financial management was in great need of fundamental reform. Key elements of the CFO Act require centralized financial management leadership, both governmentwide and at the agency level, and as expanded by GMRA, agency-level and governmentwide annual audited financial

statements. To facilitate stewardship and accountability at executive branch agencies, the CFO Act designated CFOs with broad responsibility for modernizing financial management systems, financial reporting, asset management, and strengthened internal control practices. The systematic measurement of performance, the development of cost information, and the integration of financial management systems are some of the financial management practices called for by the CFO Act that, if properly implemented, will significantly improve financial management throughout the federal government. Furthermore, the Act statutorily designates the 24[15] executive departments and agencies covered. These 24 departments and agencies represent 95 percent of net outlays in fiscal year 2004.

Strong centralized leadership is essential to solving the government's long-standing financial management problems. The CFO Act provided for such leadership by giving OMB broad new authority and responsibility for directing federal financial management, modernizing the government's financial management systems, strengthening financial reporting, and internal control. The CFO Act also created a new position in OMB, the Deputy Director for Management, who serves as the government's chief official responsible for financial management. In addition, the CFO Act established a new Office of Federal Financial Management (OFFM) in OMB to carry out the government-wide financial management initiatives and responsibilities. To head this office, the CFO Act established the position of Controller, an individual who must possess demonstrated ability and practical experience in accounting, financial management, and financial systems. This individual has responsibility for handling the day-to-day operations of OFFM to ensure that financial operations are being properly carried out government-wide.

Executive-level leadership is a critical success factor for building a foundation of control and accountability that supports external reporting and performance management, which is needed to achieve the goals of the CFO Act. For this reason, an agency CFO must be a key figure in an agency's top management team. The CFO Act stipulates that the CFO is a

[15]As shown in appendix I, initially, 23 agencies were designated as subject to the CFO Act. Upon its establishment as an independent agency, the Social Security Administration was added in 1994. The Federal Emergency Management Agency, one of the original CFO Act agencies, was transferred to the Department of Homeland Security in 2003. The Department of Homeland Security Financial Accountability Act of 2004 added DHS to the list of CFO Act agencies thus bringing the number of CFO Act agencies again to 24 for fiscal year 2005.

presidential appointee or appointed by the agency head and is assisted by a Deputy Chief Financial Officer. Both the CFO and the Deputy CFO generally must possess demonstrated ability in accounting, budget execution, financial and management analysis, systems development, and practical experience in financial management practices in large governmental or business entities. Among the CFO's responsibilities are developing and maintaining integrated accounting and financial management systems, directing, managing, and providing policy guidance and oversight of all agency financial management personnel, activities, and operations, and overseeing the recruitment, selection, and training of personnel to carry out agency financial management functions. In addition, each CFO for the 24 agencies serves on the Chief Financial Officers Council, which regularly meets to advise and coordinate the activities of the agencies of its members on such matters as consolidation and modernization of financial systems. The CFO Act created the council and specified that the council will be chaired by OMB's Deputy Director for Management. Other members will be OMB's Controller and the Department of the Treasury's Fiscal Assistant Secretary.

The CFO Act, as expanded by GMRA, required that annual financial statements be prepared and audited for each CFO Act agency covering all accounts and associated activities of each office, bureau, and activity of the agency.[16] The CFO Act also requires that the financial statements prepared pursuant to the act be audited in accordance with applicable generally accepted government auditing standards. These audits are the responsibility of the Inspectors General, but may be conducted by, and at the discretion of, the Comptroller General, in lieu of the Inspectors General. Inspectors General may contract with independent public accountants to conduct financial statement audits.

Important Progress Made to Achieving CFO Act Goals

The federal government has made substantial progress in financial management in the 15 years since the enactment of the CFO Act. If I were to summarize in just a few words the environment in 2005 as compared to 1990, financial management has gone from the backroom to the boardroom.

[16]The CFO Act initially called for pilot financial statements from selected agencies that covered all of the offices, bureaus, and activities of that department or service.

Achieving Cultural Change—Perhaps most importantly, we have seen true cultural change in how financial management is viewed, this has been accomplished through a lot of hard work by OMB and the agencies and continued strong support and oversight by Congress. As I previously discussed, federal financial management had suffered from decades of neglect and an organizational culture that for the most part, had not fully recognized the value of good financial management—as a means of ensuring accountability and sound management.

Although the views about how an organization can change its culture vary considerably, the organizations we and others have studied[17] identified leadership as the most important factor in successfully making cultural changes. Top management must be totally committed in both words and deeds to changing the culture and the fundamental way that business is conducted. At the top level, federal financial management reform has gained momentum through the committed support of top federal leaders. For example, improved financial performance is one of the six governmentwide initiatives in the President's Management Agenda (PMA). Under this initiative, agency CFOs share responsibility—both individually and through the efforts of the CFO Council—for improving the financial performance of the government. To achieve the goals of the financial performance initiative, agencies must now have more timely and reliable financial information, improve the integrity of their financial activities, and have sound and dependable financial systems. In conjunction with the other governmentwide program initiatives of the PMA, the federal government is improving its financial reporting practices and overall accountability.

Establishing a Governmentwide Leadership Structure—As established by the CFO Act, OFFM, the OMB organization with governmentwide responsibility for federal financial management, has undertaken a number of initiatives related to improving financial management capabilities ranging from requiring the use of commercial-off-the-shelf financial systems to the promotion of cost accounting. In addition to assessing agency financial performance for the PMA, OFFM has issued financial management guidance to agencies. Some of OFFM's initiatives are in collaboration with the CFO Council and are broad-based attempts to

[17]Grant Thornton LLP and the Association of Government Accountants, *CFO Survey: Preparing for Tomorrow's Way of Doing Business*, (Alexandria, Virginia: March 1998) and GAO, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: April 2000).

reform financial management operations across the federal government. While reforming federal financial management is an undertaking of tremendous complexity, it presents great opportunities for improvements in financial management and related business operations. In their efforts to continue financial management improvement, OFFM has recently collaborated with the CFO Council on initiatives in the following areas:

- internal control,
- full implementation of FFMIA,
- asset management,
- improper payments, and
- control over federal charge cards

Selecting Qualified CFOs—The CFO Act established CFOs at the major departments and agencies and established minimum qualifications for CFOs. Measured in terms of coming to the job with a proven track record in financial management, the background of individuals selected for these positions has improved tremendously over the past 15 years. For example, the CFO at the Department of Labor has held a range of CFO and CFO-related positions in the private sector and government over a 30-year career that included serving as Treasury's CFO in a previous administration. Testifying with me today, Dr. Linda M. Combs, the Controller at OMB, brings impeccable credentials and extensive experience to the federal government's financial management leadership and policy-setting organization and exemplifies today's federal CFO.

Improving Financial Management Systems and Operations—Since 1990, progress has been made towards improving financial management systems in the federal government. Improved agency financial management systems and operations are essential to support management decision making and results-oriented activities as addressed by the CFO Act. At a minimum, federal managers must have financial information that is reliable, useful, and timely to support this effort. Federal financial management systems requirements for the core financial system, managerial cost system, and 12 other administrative and programmatic systems, such as grants, property, revenue, travel, and loans, which are part of an overall financial management system, have been developed. Beginning in 1999, OMB required agencies to purchase commercial-off-the-shelf (COTS) software that had been tested and certified through the Joint

Financial Management Improvement Program (JFMIP)[18] Program Management Office[19] against the systems requirements that I just mentioned as well as the standard general ledger issued by the Department of Treasury. With these requirements, the federal government has better defined the functionality needed in its financial management systems which has helped the vendor community understand federal agencies needs. Concurrently, there has been an evolving realization that agencies need to change their business processes to adapt to the practices embedded in commercially available software versus modifying the software to accommodate their existing practices.

Looking at financial management systems from another perspective, the federal government has acted on opportunities to consolidate operations. For example, a number of agencies perform accounting or business operations on behalf of others, consequently, the number of agencies processing payroll has been dramatically reduced from 22 to 4. According to OMB, through these initiatives, millions of dollars will be saved through shared resources and processes and by modernizing on a cross-agency, governmentwide basis. Further, OMB had established agency task forces that focused on developing Centers of Excellence to (1) reduce the number of systems that each individual agency must support, (2) promote standardization, and (3) reduce the duplication of efforts. If we were to compare the state of financial management systems today to where agencies were 15 years ago, the evolution has been dramatic. On the other hand, systems are at the top of our list in terms of remaining challenges for the future. As I will discuss later, agencies continue to struggle with developing and implementing integrated systems that achieve expected functionality within cost and timeliness goals.

Preparing Auditable Financial Statements—Most CFO Act agencies have obtained clean or unqualified audit opinions on their financial statements.

[18] JFMIP was originally formed under the authority of the Budget and Accounting Procedures Act of 1950 and was a joint and cooperative undertaking of the Government Accountability Office, the Department of the Treasury, OMB, and the Office of Personnel Management (OPM), working in cooperation with each other to improve financial management practices in the federal government. In a December 2004 memorandum, OMB announced a realignment of JFMIP's responsibilities for financial management policy and oversight in the federal government.

[19] Under the realignment of JFMIP's responsibilities announced in December 2004, the Program Management Office will continue its software certification process. Also, systems requirements will be issued by OFFM. Therefore, JFMIP ceased to exist as a separate organization, although the Principals will continue to meet at their discretion.

Unqualified audit opinion for CFO Act agencies financial statements have grown from 6 in fiscal year 1996 to 18 in fiscal year 2005. Improvements in timeliness have been even more dramatic this year. Agencies were able to issue their audited financial statements within the accelerated reporting time frame—all of the 24 CFO Act agencies issued their audited financial statements by the November 15, 2005 deadline, set by OMB, just 45 days after the close of the fiscal year. The CFO Act calls for agency financial statements to be issued no later than March 31st, which is 6 months after the fiscal year end, and in the earlier years some agencies were unable to meet that timeframe. OMB has incrementally accelerated the financial statement issuance date to address the timeliness of the information provided by the financial statements. Just a few years ago, most considered this accelerated timeframe unachievable. While the increase in unqualified and timely opinions is noteworthy, we are concerned about the number of CFO Act agencies that have had to restate certain of their financial statements to correct errors. I will discuss these issues in more detail later in this statement.

Preparing Performance and Accountability Reports—Another clear indication of progress to date is the preparation of the annual Performance and Accountability Reports (PAR) by CFO Act agencies. The PARs provide financial and performance information that enables the President, the Congress, and the public to assess the performance of an agency relative to its mission and to demonstrate accountability. These reports summarize program, management, and financial performance data, including the Annual Performance Reports required by GPRA with annual financial statements and other reports, such as agencies' assurances on internal control, accountability reports by agency heads and Inspectors' General assessments of agencies' most serious management and performance challenges. These reports serve as the federal government's report to the American public and provide an accounting for the return on the taxpayers' investment. This information is also provided to decision - makers who are interested in CFO Act agencies' performance, such as OMB and the Congress. Furthermore, the Association of Government Accountants recognizes federal agencies for their high-quality performance and accountability reports by its annual awarding of the Certificate of Excellence in Accountability Reporting (CEAR). For the most recent evaluation of 21 agencies performance and accountability reports, 10 agencies were recognized for achieving excellence in their reports. Of particular note, the Social Security Administration and Department of Labor have received the CEAR award for the past 7 and 5 years, respectively. As part of our effort to be a model agency, GAO has been awarded the CEAR award since it first applied in 2001 and for the

19th consecutive year, independent auditors gave our financial statements an unqualified opinion with no material weaknesses and no major compliance problems.

Strengthening Internal Control—Accountability is part of the organizational culture that goes well beyond receiving an unqualified audit opinion; the underlying premise is that agencies must become more results-oriented and focus on internal control. In December 2004, OMB revised its Circular No. A-123, *Management's Responsibility for Internal Control*, to provide guidance to federal managers on improving the accountability and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on management controls. Requiring federal managers, at the executive level, to focus on internal control demonstrates a renewed emphasis on identifying and addressing internal control weaknesses. Based on our 2005 assessment of high-risk programs,[20] three programs previously designated as high-risk, largely due to financial management weaknesses, were removed from the list. The Department of Education's Student Financial Aid Programs, the Federal Aviation Administration's Financial Management, and the Department of Agriculture's Forest Service Financial Management all sustained improvements in financial management and internal control weaknesses and thus warranted removal. Further, as I testified[21] before this subcommittee earlier this year, thousands of internal control problems were identified and fixed over the past two decades, especially at the lower levels where internal control assessments were performed and managers could take focused actions to fix relatively simple problems. But again as I will discuss later, this type of work is far from complete.

Developing New Accounting Standards—Another definitive example of progress made to date as well as a critical component of improved financial performance is the establishment of the Federal Accounting Standards Advisory Board (FASAB). In conjunction with the passage of the CFO Act, the OMB Director, Secretary of the Treasury, and the Comptroller General established FASAB to develop accounting standards and principles for the newly required financial statements and other federal entities. FASAB is comprised of a 10-member advisory board of 4 knowledgeable individuals from government and 6 non-federal members

[20]GAO, *High-Risk Series an Update*, GAO-05-207 (Washington, D.C.: January 2005).

[21]GAO, *Financial Management: Effective Internal Control is Key to Accountability*, GAO-05-321T, (Washington, D.C.: Feb. 16, 2005).

selected from the general financial community, the accounting and auditing community, and academia to promulgate proposed accounting standards designed to meet the needs of federal agencies and other users of federal financial information. The mission of FASAB is to develop accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users. These accounting and reporting standards are essential for public accountability and for an efficient and effective functioning of our democratic system of government. To date, FASAB has issued 30 statements of federal financial accounting standards (SFFAS) and 4 statements of federal financial accounting concepts (SFFAC).[22] The concepts and standards are the basis for OMB's guidance to agencies on the form and content of their financial statements and for the government's consolidated financial statements. The standards developed by FASAB have been recognized by the American Institute of Certified Public Accountants as generally accepted accounting standards for federal entities.

Challenges Remain to Fulfilling the Objectives of the CFO Act

While there has been marked progress in financial management, as I have just highlighted, a number of challenges still remain. The principal challenges remaining are (1) modernizing financial management systems, (2) improving financial reporting, (3) building a financial management workforce for the future, (4) addressing long-standing internal control weaknesses, and (5) ensuring the continuity of financial management reform. Fully meeting these challenges will enable the federal government to provide the world-class financial management anticipated by the CFO Act. While there continues to be much focus on the agency and governmentwide audit opinions, getting a clean audit opinion, though important in itself, is not the end goal. The end goal is the establishment of a fully functioning CFO operation that includes (1) modern financial management systems that provide, reliable, timely, and useful information to support day-to-day decision-making and oversight and for the systematic measurement of performance; (2) a cadre of highly qualified CFOs and supporting staff; and (3) sound internal controls that safeguard assets and ensure proper accountability.

[22]Accounting standards are authoritative statements of how particular types of transactions and other events should be reflected in financial statements. SFFACs explain the objectives and ideas upon which FASAB develops the standards.

Financial Management Systems

First and foremost, agencies must take full advantage of modern technology and develop financial management systems that are integrated with the range of other business systems. The federal landscape is littered with far too many unsuccessful financial management system implementation efforts. Most notable has been the Department of Defense (DOD) where billions of dollars have been invested in financial management systems with little return on the investment. DOD has historically been unable to develop and implement business systems on time, within budget, and with the promised capability. For example, we recently reported[23] that the Department of Navy spent approximately $1 billion for four largely failed pilot Enterprise Resource Planning (ERP) system[24] efforts, without marked improvement in its day-to-day operations. The Navy now has underway a new ERP project, which early Navy estimates indicate will cost another $800 million. While the new project, as currently envisioned, has the potential to address some of the Navy's financial management weaknesses, it will not provide an all-inclusive end-to-end corporate solution for the Navy. Further, there are still significant challenges and risks ahead as the project moves forward, such as developing and implementing 44 system interfaces with other Navy and DOD systems and converting data from legacy systems into the ERP system.

The results of the fiscal year 2005 assessments performed by agency inspectors general or their contract auditors under FFMIA show that these problems continue to affect financial management systems at most of the 24 CFO Act agencies. While the problems are much more severe at some agencies than at others, the nature and severity of the problems indicate that overall, management at most CFO Act agencies do not yet receive the complete range of information needed for accountability, performance management and reporting, and decision making.

[23]GAO, *DOD Business Systems Modernization: Navy ERP Adherence to Best Business Practices Critical to Avoid Past Failures*, GAO-05-858 (Washington, D.C.: Sept. 29, 2005).

[24]An ERP solution is an automated system using commercial off-the-shelf (COTS) software consisting of multiple, integrated functional modules that perform a variety of business-related tasks such as payroll, general ledger accounting, and supply chain management.

As we recently testified in September 2005[25], managerial cost accounting essentially entails answering very simple questions such as how much does it cost to do whatever is being measured, thus allowing assessments of whether those costs seem reasonable. In other cases, it could involve establishing a baseline for comparison with what it costs others to do similar work or achieve similar performance. To date, accumulating and analyzing the relevant financial and nonfinancial data[26] to determine the cost of achieving performance goals, delivering programs, and carrying out discrete activities has proven difficult to do. Among the barriers standing in the way of this enhanced data are nonintegrated financial systems, lack of accurate and timely recording of data, inadequate reconciliation procedures, noncompliance with accounting standards, including the cost management standard, and failure to adhere to the U.S. Government Standard General Ledger (SGL).

What is most important is that the problem has been recognized. Across government, agencies have efforts underway to implement new financial management systems or to upgrade existing systems. Agencies expect that the new systems will provide reliable, useful, and timely data to support day-to-day managerial decision making and assist taxpayer and congressional oversight. Whether in government or the private sector, implementing and upgrading information systems is a difficult job and brings a degree of new risk. Organizations that follow and effectively implement accepted best practices in systems development and implementation (commonly referred to as disciplined processes) can manage and reduce these risks to acceptable levels, organizations that do not typically suffer the consequences. For example, our work at DOD[27] and the National Aeronautics and Space Administration[28] this past year has shown that these agencies, which have experienced significant problems in the past in implementing new financial management systems, were not following the necessary disciplined processes for efficient and effective

[25]GAO, *Managerial Cost Accounting Practices: Departments of Labor and Veterans Affairs*, GAO-05-1031T (Washington, D.C.: Sept. 21, 2005)

[26]Nonfinancial data measures the occurrences of activities and can include, for example, hours worked, units produced, grants managed, inspections conducted, or people trained.

[27]GAO, *Army Depot Maintenance: Ineffective Oversight of Depot Maintenance Operations and System Implementation Efforts*, GAO-05-441 (Washington, D.C.: Jun. 30, 2005).

[28]GAO, *Business Modernization: Some Progress Made toward Implementing GAO Recommendations Related to NASA's Integrated Financial Management Program*, GAO-05-799R (Washington, D.C.: Sept. 9, 2005).

development and implementation of such systems. As I mentioned earlier, NASA is on its third attempt to implement a new financial management system. The first two attempts, which cost $180 million, failed and the current system initiative which is expected to cost close to $1 billion, has experienced problems. As we pointed out in recent testimony[29] before this subcommittee, many of the problems the National Aeronautics and Space Administration has been experiencing with its financial management system stemmed from inadequate implementation of disciplined processes. As the federal government moves forward with ambitious financial management system modernization efforts to identify opportunities to eliminate redundant systems and enhance information reliability and availability, adherence to disciplined processes is a crucial element to reduce risks to acceptable levels.

Financial Reporting

In the area of financial reporting, we see two challenges: (1) the elimination of restatements and (2) greater transparency in financial reporting. Many CFO Act agencies have obtained clean or unqualified audit opinions on their financial statements, but the underlying agency financial systems and controls still have some serious problems. This manifested itself last year when a number of CFO Act agencies had to restate their financial statements. As we have previously testified,[30] at least 11[31] of the 23[32] CFO Act agencies restated their fiscal year 2003 financial statements, and 5[33] CFO Act agencies restated their fiscal year 2002 financial statements. The restatements to CFO Act agencies' fiscal year 2003 financial statements ranged from correcting 2 line items on an

[29]GAO, *National Aeronautics and Space Administration: Long-standing Financial Management Challenges Threaten the Agency's Ability to Manage Its Programs*, GAO-06-216T (Washington, D.C.: Oct. 27, 2005).

[30]GAO, *Fiscal Year 2004 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges*, GAO-05-284T (Washington, D.C.: Feb. 9, 2005).

[31]Departments of Agriculture, Defense, Health and Human Services, Justice, State, and Transportation, and the General Services Administration, National Science Foundation, Nuclear Regulatory Commission, the Office of Personnel Management, and the Small Business Administration.

[32]At the time of our review there were only 23 CFO Act agencies because as we discussed earlier, FEMA was no longer required to prepare and have audited financial statements under the CFO Act, leaving 23 CFO Act agencies for fiscal years 2003 and 2004.

[33]Departments of Agriculture, Health and Human Services, the Interior, Transportation, and the Treasury.

agency's balance sheet to numerous line items on several of another agency's financial statements. The amounts of the agencies' restatements ranged from several million dollars to over $91 billion. Nine[34] of those 11 agencies received unqualified opinions on their financial statements originally issued in fiscal year 2003. Seven of the 9 auditors issued unqualified opinions on the restated financial statements, which in substance replace the auditors' opinions on their respective agencies' original fiscal year 2003 financial statements. For 2[35] of these nine agencies, the auditors not only withdrew their unqualified opinions on the fiscal year 2003 financial statements but also issued other than unqualified opinions on their respective agencies' restated fiscal year 2003 financial statements because they could not determine whether there were any additional misstatements and the effect that these could have on the restated fiscal year 2003 financial statements. We have reported[36] on some of these agency restatements and have work ongoing[37] at a number of other agencies to more fully understand the issues surrounding these restatements. We have not yet had a chance to look in any depth at restatements for fiscal year 2005 because fiscal year 2005 financial statements, which would identify any such restatements, were just issued by the deadline of November 15. We did note though, that there were a number of restatements.

The second challenge is that 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. The current financial reporting model provides information on financial position and changes in such position during the year, as well as budget results. However, more important than current and short-term deficits, we face large and growing

[34]General Services Administration, National Science Foundation, Nuclear Regulatory Commission, Office of Personnel Management , and the Departments of Agriculture, Health and Human Services, Justice, State, and Transportation.

[35]Nuclear Regulatory Commission and the Department of Justice.

[36]GAO, *Financial Audit: Restatements to the Department of State's Fiscal Year 2003 Financial Statements*, GAO-05-814R (Washington, D.C.: Sept. 20, 2005). *Financial Audit: Restatements to the Nuclear Regulatory Commission's Fiscal Year 2003 Financial Statements*, GAO-06-30R (Washington, D.C.: Oct. 27, 2005).

[37]Departments of Agriculture, Health and Human Services, Justice, and Transportation, the General Services Administration, National Science Foundation, and Office of Personnel Management.

structural deficits in the future due primarily to known demographic trends, rising health care costs and relatively low federal revenues as a percentage of the economy. Our nation's current fiscal path is unsustainable and failure to highlight, analyze and appropriately respond to the resulting long-term consequences could have significant adverse consequences on our future economy and standard of living. While the Statement of Social Insurance will provide long-term information for those specific programs, in our view, more comprehensive reporting is necessary to fully and fairly reflect the nation's longer-term fiscal challenges. Consequently, a top priority should be communicating important information to users about the long-term financial condition of the U.S. government and annual changes therein. Furthermore, FASAB recognized that tax expenditures, which can be large in relation to spending programs that are measured under federal accounting standards, may not be fully considered in entity reporting. Reporting information on tax expenditures would ensure greater transparency of and accountability for such expenditures.[38]

Financial Workforce

Changing the way business is done in a large, diverse, and complex organization like the federal government is not an easy undertaking. According to a survey of federal CFOs,[39] federal finance organizations of the future will have fewer people, with a greater percentage of analysts, as opposed to accounting technicians. However, today, most functions within federal finance organizations are focused primarily on (1) establishing and administering financial management policy; (2) tracking, monitoring, and reconciling account balances; and (3) ensuring compliance with laws and regulations. While they recognize the need for change, according to the CFOs surveyed, many questions remain unanswered regarding how best to facilitate such changes. When it comes to world-class financial management, our study[40] of nine leading private and public sector financial organizations found that leading financial organizations often had the

[38]GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to be Reexamined*, GAO-05-560 (Washington, D.C.: Sept. 23, 2005).

[39]Grant Thornton LLP and the Association of Government Accountants, *CFO Survey: Preparing for Tomorrow's Way of Doing Business*, (Alexandria, Virginia: March 1998).

[40]GAO, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: April 2000). Appendix II includes a synopsis of the key concepts discussed in the study. See Appendix II.

same or similar core functions (i.e., budgeting, treasury management, general accounting, and payroll), as the federal government. However, the way these functions were put into operation varied depending on individual entity needs. Leading organizations reduced the number of resources required to perform routine financial management activities by (1) consolidating activities at a shared service center and (2) eliminating or streamlining duplicative or inefficient processes. Their goal was not only to reduce the cost of finance but also to organize finance to add value by reallocating finance resources to more productive and results-oriented activities like measuring financial performance, developing managerial cost information, and integrating financial systems.

The federal financial workforce that supports the business needs for today is not well-positioned to support the needs of tomorrow. A JFMIP study[41] indicated that a significant majority of the federal financial management workforce performs transaction support functions of a clerical and technical nature. These skills do not support the vision of tomorrow's business that will depend on an analytic financial management workforce providing decision support. The financial management workforce plays a critical role in government because the scale and complexity of federal activities requiring financial management and control is monumental. Building a world-class financial workforce will require a workforce transformation strategy devised in partnership between CFOs and agency human resource departments, now established in law as Chief Human Capital Officers, working with OMB and the Office of Personnel Management. Agency financial management leadership must identify current and future required competencies and compare them to an inventory of skills, knowledge, and current abilities of current employees. Then, they must strategically manage to fill gaps and minimize overages through informed hiring, development, and separation strategies. This is similar to the approach that we identified when we designated strategic human capital management as a high-risk area in 2001 recognizing that agencies, working with Congress and OPM, must assess future workforce needs and determine strategies to meet those needs, especially in light of long-term fiscal challenges.[42] Achieving the financial management vision of the future will be directly effected by the workforce who support it.

[41] JFMIP, *Building a World Class Financial Workforce, The Federal Financial Management Workforce of the Future*, (Washington, D.C.: September 2003).

[42] GAO-05-207.

Internal Control

Earlier, I noted that while important progress in strengthening internal control has been made, the federal government faces numerous internal control problems, some of which are long-standing and are well-documented at the agency level and governmentwide. As we have reported for a number of years in our audit reports on the U.S. government's consolidated financial statements, the federal government continues to have material weaknesses and reportable conditions in internal control related to property, plant, and equipment; inventories and real property; liabilities and commitments and contingencies; cost of government operations; and disbursement activities, just to mention a few of the problem areas.

As an example, consider DOD which has many known material internal control weaknesses. Of the 25 areas on GAO's high-risk list, 14 relate wholly or partially to DOD, particularly its financial management problems. Overhauling DOD's financial management controls and operations represents a challenge that goes far beyond financial accounting to the very fiber of DOD's range of business operations, management information systems, and culture. Although the Secretary of Defense and several key agency officials have shown commitment to transformation, as evidenced by key initiatives such as the Business Management Modernization Program[43] and the Financial Improvement and Audit Readiness Plan, little tangible evidence of significant broad-based and sustainable improvements has been seen in DOD's business operations to date. For DOD to successfully transform its business operations, it will need a comprehensive and integrated business transformation plan; people with the skills, responsibility, and authority to implement the plan; an effective process and related tools, such as a business enterprise architecture;[44] and results-oriented performance measures that link institutional, unit, and individual personnel goals and expectations to promote accountability for results.

[43]GAO, DOD Business Systems Modernization: Long-standing Weaknesses in Enterprise Architecture Development Need to Be Addressed, GAO-05-702 (Washington, D.C.: Jul. 22, 2005)

[44]A business enterprise architecture is a well-defined blueprint for operational and technological change.

As I testified before you in February 2005, we support OMB's efforts to revitalize internal control assessments and reporting through the December 2004 revisions to Circular No. A-123. These revisions recognize that effective internal control is critical to improving federal agencies effectiveness and accountability and to achieving the goals established by Congress. They also considered the internal control standards issued by the Comptroller General,[45] which provide an overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

Effective internal control, as envisioned in the newly revised Circular No. A-123, inherently includes a successful strategy for addressing improper payments. Our prior work[46] has demonstrated that attacking improper payment problems requires a strategy appropriate to the organization involved and its particular risks. We have found that entities using successful strategies to address their improper payment problems shared a common focus of improving the internal control system—the first line of defense in safeguarding assets and preventing and detecting errors and fraud. Moreover, as we testified[47] before this subcommittee in July of this year, even though progress has been made, certain agencies have not yet performed risk assessments of all their programs and/or estimated improper payments for their respective programs.

I pointed out in my February 2005 testimony, six issues critical to effectively implementing the changes to Circular No. A-123, specifically, the need for

1. development of supplemental guidance and implementation tools to help ensure that agency efforts are properly focused and meaningful;

2. vigilance over the broader range of controls covering program objectives;

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

[46]GAO, *Financial Management: Effective Implementation of the Improper Payments Information Act of 2002 Is Key to Reducing the Government's Improper Payments*, GAO-03-991T (Washington, D.C.: Jul. 14, 2003).

[47]GAO, *Financial Management: Challenges in Meeting Governmentwide Improper Payment Requirements*, GAO-05-907T (Washington, D.C.: Jul. 20, 2005).

3. strong support from managers throughout the agency, and at all levels;

4. risk-based assessments and an appropriate balance between the costs and benefits of controls;

5. management testing of controls in operation to assess if they are designed adequately and operating effectively, and to assist in formulating corrective actions;

6. management accountability for control breakdowns.

Since that time, in July 2005, the CFO Council, in collaboration with the President's Council on Integrity and Efficiency (PCIE)[48] and OMB, issued an implementation guide to assist departments and agencies in addressing the Circular No. A-123 requirements related to internal control over financial reporting. As I mentioned earlier, this is a positive first step to helping the federal government clearly articulate its objectives and criteria for measuring whether the objectives of Circular No. A-123 have been successfully achieved. Equally important will be the rigor with which these criteria are applied.

Continuity of Leadership

The federal government has always faced the challenge of sustaining the momentum of transformation because of the limited tenure of key administration officials. The current administration's PMA has served as a driver for governmentwide financial management improvements. It has been clear from the outset that the current administration is serious about improved financial management. We have been fortunate that, since the passage of the CFO Act, all three administrations have been supportive of financial management reform initiatives. And, as I discussed earlier, we've seen a positive cultural shift in the way the federal government conducts business. Given the long-term nature of the comprehensive changes needed and challenges still remaining to fully realize the goals of the CFO Act, it is unlikely they will all occur before the end of the current administration's term. Therefore, sustaining a commitment to

[48] The PCIE is an interagency council comprised principally of the presidentially appointed and Senate-confirmed IGs, which is governed by Executive Order No. 12805 (1992), to coordinate and enhance the work of the IGs. The Deputy Director for Management in OMB serves as the chair.

transformation in future administrations will be critical to ensure that key management reforms such as the CFO Act are fully attained.

In closing, over the past 15 years, we have seen continuous movement toward the ultimate goals of accountability laid out in the CFO Act. I applaud the CFO and audit communities for the tremendous progress that has been made. While early on some were skeptical, the CFO Act has dramatically changed how financial management is carried out and the value placed on good financial management across government. Sound decisions on the current results and future direction of vital federal programs and policies, while never easy, are made less difficult when decision makers have timely, reliable, and useful financial and performance information. Across government, financial management improvement initiatives are underway, and if effectively implemented, have the potential to greatly improve the quality of financial management information. Proper accounting and financial reporting practices are even more essential at the federal level than they were 15 years ago given the difficult spending challenges and the long-term fiscal condition of the federal government.

Further, I want to reiterate the value of sustained congressional interest in these issues, as demonstrated by this subcommittee's leadership. It will be key that going forward, the appropriations, budget, authorizing, and oversight committees hold agency top leadership accountable for resolving remaining problems and that they support improvement efforts that address the challenges for the future I highlighted today. The federal government has made tremendous progress in the past 15 years, and sustained congressional attention has been and will continue to be a critical factor to ensuring achievement of the CFO Act's goals and objectives.

Mr. Chairman, this completes my prepared statement and I want to thank you for the opportunity to participate in this hearing and for the strong support of this Subcommittee in addressing the need for financial management reform and accountability. I would be happy to respond to any questions you or other members of the subcommittee may have at this time.

Contacts and Acknowledgments

For information about this statement, please contact Jeffrey C. Steinhoff at (202) 512-2600 or McCoy Williams, Director, Financial Management and Assurance, at (202) 512-6906 or williamsm1@gao.gov. Individuals who made key contributions to this testimony include Felicia Brooks, Kay Daly,

and Chanetta Reed. Numerous other individuals made contributions to the GAO reports cited in this testimony.

Appendix I: Chief Financial Officers Act Agencies

Agency
The Department of Agriculture
The Department of Commerce
The Department of Defense
The Department of Education
The Department of Energy
The Department of Health and Human Services
The Department of Housing and Urban Development
The Department of the Interior
The Department of Justice
The Department of Labor
The Department of State
The Department of Transportation
The Department of the Treasury
The Department of Veterans Affairs
The Environmental Protection Agency
The National Aeronautics and Space Administration
The Agency for International Development
The Federal Emergency Management Agency[1]
The General Services Administration
The National Science Foundation
The Nuclear Regulatory Commission
The Office of Personnel Management
The Small Business Administration
The Social Security Administration
The Department of Homeland Security

[1]The Federal Emergency Management Agency, one of the original CFO Act agencies, was transferred to the Department of Homeland Security in 2003 and thus removed from the original list of CFO Act agencies. The Department of Homeland Security Financial Accountability Act of 2004 added DHS to the list of CFO Act agencies thus bringing the total number of CFO Act agencies again to 24.

Appendix II: Key Concepts of World-class Financial Management

Key Concepts from a GAO Executive Guide: Creating Value through World-class Financial Management April 2000, GAO/AIMD-00-134

To help promote effective implementation of federal financial management reform, we studied the financial management practices and improvement efforts of nine leading public and private sector finance organizations to identify success factors, practices, and outcomes associated with world-class financial management. Organizations studied from the public sector were the state governments of Massachusetts, Texas and Virginia. Private sector organizations studied were Boeing, Chase Manhattan Bank, General Electric, Hewlett-Packard, Owens Corning, and Pfizer. The executive guide also contains case studies in each area as well as strategies to consider.

Goal I - Make Financial Management an Entitywide Priority

Practice 1 Build a Foundation of Control and Accountability That Supports External Reporting and Performance Management

Key Characteristics

The financial reporting and audit process is a basic management and oversight tool

Accountability is part of the organizational culture and goes well beyond receiving an unqualified audit opinion

Internal controls meet both external financial reporting and performance management control objectives without significantly impacting efficiency

Practice 2 Provide Clear, Strong Executive Leadership

Key Characteristics

The chief executive recognizes the important role the finance organization can play in improving overall business performance and involves key business/line managers in financial management improvement initiatives

The CFO is a member of the top management team

Top executives' sustained commitment to improving financial management is reinforced through both their words and actions

Practice 3 Use Training to Change the Organizational Culture and Engage Line Management

Key Characteristics

Nonfinancial managers are educated about the financial implications of business decisions

Training and tools are provided to facilitate and accelerate the pace of change initiatives

Goal II - Redefine the Role of Finance

Practice 4 Assess the Finance Organization's Current Role in Meeting Mission Objectives

Key Characteristics

The percentage of resources spent on strategic support activities is used as an indicator of how well finance is supporting mission objectives

Benchmarking and customer feedback are used to identify performance gaps and best practices

Practice 5 Maximize the Efficiency of Day-to-day Accounting Activities

Key Characteristics

Inefficient processes are eliminated or streamlined

Transaction processing activities are consolidated, standardized, and reengineered at shared service centers

The cost and benefits of outsourcing routine accounting activities are considered

Practice 6 Organize Finance to Add Value

Key Characteristics

The finance organization's mission supports the entity's business objectives

The organizational structure and human capital strategies support strategic business unit needs as well as traditional controllership and transaction processing needs

Goal III - Provide Meaningful Information to Decision Makers

Practice 7 Develop Systems That Support the Partnership between Finance and Operations

Key Characteristics

The general ledger system is integrated into business processes and is adequate for financial reporting and control

Automated systems are designed and deployed that
(1) accurately measure the costs of activities, processes, products, and services and
(2) provide line managers with timely, accurate financial and nonfinancial information on the quality and efficiency of business processes and performance

An enterprisewide system integrates operating, financial, and management information and allows decision makers to access relevant information easily and perform ad hoc data analysis

Practice 8 Reengineer Processes in Conjunction with Implementing New Technology

Key Characteristics

Commercial off-the-shelf software packages implemented with limited modification

Processes and controls adapted to fit commercial off-the-shelf software

Processes are reengineered across functional lines

Practice 9 Translate Financial Data into Meaningful Information

Key Characteristics

Reports are designed around key drivers such as markets, products, and customers

Relevant financial information is presented in an understandable, simple format with suitable amounts of detail and explanation

Goal IV - Build a Finance Team That Delivers Results

Practice 10 Develop a Finance Team with the Right Mix of Skills and Competencies

Key Characteristics

A defined set of technical, management, and leadership skills and competencies is developed as part of the entity's overall approach to strategic human capital planning and is used as a foundation for all human capital management activities and decisions

Training and career development programs use both classroom instruction and rotational assignments

Opportunities to "learn the business" are provided

Practice 11 Build a Finance Organization That Attracts and Retains Talent

Key Characteristics

Top financial leadership participates in the recruitment of new talent

A variety of career path opportunities are offered and staff development programs are used as a means of exposing staff to different career opportunities

Competitive compensation and benefits packages are available

Key Concepts from a GAO Executive Guide: Creating Value through World-class Financial Management April 2000, GAO/AIMD-00-134

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Mr. PLATTS. Thank you, Mr. Steinhoff. Again, both of you, we appreciate your testimony here today and your written testimonies. I think both of you well captured where we are today with some great successes, all major agencies reporting in 45 days versus months and months and months in the past.

Mr. Steinhoff, your statement about the importance that this is about accountability, not simply accounting, and what are the taxpayers getting for their money that is being expended, at the end of the day is it a good investment? And you mentioned the challenges that still lie ahead. But the team effort that has transpired in the last 15 years from those who were behind the legislation, and you certainly played a direct role in writing that legislation, and then everybody since, the Department CFOs in your past positions and now in your current positions, the GAO continuing to be very engaged, OMB, and that Congress needs to stay part of the effort. If we continue as a team in that fine-tuning and strengthening, whoever is sitting in this chair 15 years from now will hopefully, though there is always going to be room for improvement, but hopefully there will be less room for improvement.

And who knows, maybe even DOD will have had a clean opinion, or actually have an opinion. Maybe not clean, but we will take just an opinion.

One of the examples I think that is very relevant, Dr. Combs, that you highlight in your written testimony is the financial management community working closely with each other. The CFO Act in creating the CFO Council, I imagine there was some interaction either informal or formal, but having a formal structure for CFOs to work together and share best practices.

And as we talked earlier this week, the example with Katrina and how your twice-a-week meetings with all the relevant CFOs is a perfect example of that structure being in place to ensure that we are kind of all on the same page and working ahead.

With all the advancements that have occurred, and now in my third year as chair of the subcommittee, I am looking at where we came from and where we are. And when I look at the numbers, despite great advancement, at least 11 different major agencies have received less than unqualified opinions. And as we saw last year, our number of restatements rose from five in 2003 to 11 in 2004. This year, when we look at the numbers, we kind of held even in unqualified opinions at 18 and we dropped from 4 to 3 on those with no material weaknesses, no evidence of noncompliance.

It seems we have kind of leveled off. Is there anything that kind of explains that or that we need to be conscious of to not just stay at this level but to keep pushing? And why are we seeing those numbers where they are; somewhat kind of leveling off? We have seen great gains, but then hit a plateau. We don't seem to be able to continue the path upward.

Ms. COMBS. I think that one of the major situations we are dealing with here relates to the move forward and where we are right now with our internal controls. I think the 45-day deadline has given us a tremendous opportunity to cause quarterly statements to have to be issued during the year to provide a tremendous amount of stability during the year. But I think where we have to go henceforth is continuing to work through those material weak-

nesses, reportable conditions, and our internal controls governmentwide.

Because in each and every department, it's extremely important to do that day-to-day work and to get it done right all during the year and not to wait until year end. I think, if anything, the 45-day time limit has forced agencies to be more aggressive, more determined at each quarter, at each month in presenting their statements. And I think that has had a tremendous impact on where we are right now.

In order to continue to strengthen that base and in order to add two or three or four or more departments to the clean audit rank up for next year, I think we have to work very, very hard this year to certify these internal controls, and I think that will add as much stability as anything that we can do.

I also think Jeff hit it exactly right in terms of the technology and the systems integration that we have to continue to work toward in these departments. It cannot be manual and heroic efforts. It has to be sustained through these diligent internal control efforts and having the right technology and processes in place in order to get continuous improvement.

Mr. PLATTS. The focus on the internal control initiative, I would agree and hope that is kind of the impetus that gets us off the plateau; that initially it could even have us off the plateau in a regressive way. But long term it has to be key to getting not only just 18 but 19, 20, and continue chipping away at a complete success.

So we will be anxious as we move forward with that to see how that plays out.

Mr. Steinhoff.

Mr. STEINHOFF. If you look at 2005, you have three agencies that went down from the previous year. And in looking at the type of problems they cited for two of those three it directly related to putting up a new system, and that's a risky proposition.

We audit the IRS, and they were going to roll out the first module of their system about a year and a half before they did. And as the auditor, we said, "Well, gee, are you really ready to turn that thing on October 1st?" And there was a little bit of a pause there. Well, that's the date. We said, "You're taking a big, big risk here. That's a date driven decision and if you don't do it right, you will probably lose your opinion and you may lose it for several years."

So they stepped back and made sure that disciplined processes were followed. I give Mark Everson a lot of credit for that, and they rolled that system out this year and it worked fine.

But for two of those three that went down, it was a result of having a new system in place. I think people are learning more. There were perhaps problems in previous years that management just was not aware of. There might have been a roll-out in a new site where certain things were not picked up. I think the auditors are becoming more savvy and they have a better understanding of the risk of some of these entities.

When entities have a lot of adjusting entries at year end, it's not what you want to see. Maybe if you have four or five of them, but not thousands of them. And I think some of it is the fact that you have had heroic efforts in the past. And as people become more so-

phisticated, they can get down underneath the numbers a little better.

The other area which I think has driven some of the going back and forth on agencies from clean to a disclaimer or a qualified opinion are some of the unique financial statements, the statement of budgetary resources. Some of these have become somewhat confusing to some. I do not think they're rocket science, I do not think the problem is the lack of guidance from OMB, which some have claimed, but I think it's the lack of familiarity. And I think some of the auditors had to learn what those statements really were. They were signing off on them with gigantic errors that were fairly easy to find.

So I think it's a learning process. The two you mentioned in your opening remarks, DOD and Homeland Security, are the ones that face the biggest problems, biggest challenges. I wouldn't see them on the radar screen for a thumb up or two in the next couple of years.

Mr. PLATTS. Hopefully not my 15-year prediction.

Mr. STEINHOFF. It shouldn't be 15 years. It shouldn't be 15 years.

Mr. PLATTS. Mr. Steinhoff, you touched there and in your written testimony on the system issue.

Mr. STEINHOFF. Yes.

Mr. PLATTS. And in your statement you reference about NASA and DOD not following the necessary disciplined processes for developing the systems. We have seen that earlier in your statement where you referenced the billion dollars the Navy had spent on the four enterprise resource planning systems, and currently underway with a new program, $800 million, what is the best thing we can do, either as a subcommittee with oversight or OMB in their coordination with all these, to try to ensure that type of up-front preparation is occurring?

Because I would think that after the number of failings in DOD alone or elsewhere, anybody out there looking to do one of these systems saying, "All right, what are these disciplines, what are the steps we want to make sure we follow," but that doesn't seem to be the case. So what do we need to do different to ensure that does happen?

Mr. STEINHOFF. I think it's very important that when funding is provided for these systems that the Congress has oversight directly over those that represent a major investment. When you're talking $800 million, a billion, you are talking big dollars there. And it is not uncommon in a large activity like defense to have development projects of that size. They become unmanageable. You don't have any direct accountability over them, you have multiple project managers. At the time it's finished, someone is in charge that had nothing to do with all the mistakes made along the way.

It is a matter of holding someone accountable along the way, having regular oversight, making sure that the agencies and departments are following disciplined processes in practice. Many activities have a good set of rules. If someone wanted to look at a leading organization in terms of written practices, DOD would have those written practices. But these are very complex operations. You have many, many stovepipes involved. You have many players. You have numerous committees or jurisdictions on the Hill that have

responsibility. You're going to have to have a way for the major large dollar investments to have some kind of oversight mechanism where they have to come back to the Congress or come back to OMB or come back to someone and say we have achieved X, Y and Z and here is the return on investment.

I remember a number of years ago looking at a system and the return on investment at that time was projected to be 2 percent. That was before they started. Well, no one would ever invest $1 billion, especially in the early years of computer technology, to get a 2 percent rate of return. Private sector wouldn't invest unless it was a large rate of return.

So systems, I think, are a real difficult issue. The disciplined processes, the enterprise architectures, investment management, concept of operations requirements, management, testing, they can't shortcut any of those things. And, typically, when one does a postmortem when they go down, you will find some or all of those things.

I would think right now, we just issued that Navy ERP report, that some in the Navy would be asking some very tough questions. How is that effort that has just started going to fit in with the other 44 systems it is supposed to integrate with? I do not think they have any idea. So I'm not sure I would invest that amount of money in something until I knew. But it is really a lot of oversight over that is needed.

Mr. PLATTS. Dr. Combs, is there any consideration at OMB to, through executive action, put that type of threshold review in place with OMB; that if it's going to be—and I would probably start low, low relative to DOD—say $10 million, if you are going to spend X amount, whatever X is, on a new system, that it has to be presented to and reviewed maybe by OMB and GAO; that you have dotted the I's crossed the T's before going forward?

Is that something you are doing or are willing to look at as a possible action?

Ms. COMBS. Mr. Chairman, we are already in the process of reviewing each and every financial system upgrade, each and every financial systems change that is being presented. And the way we do that is individually, department by department. It is amazing. There is a considerable amount of knowledge out there about what not to do, and it is quite amazing how much of that knowledge we end up sharing with people who are either beginning the thoughts of their business plan to eventually get into a new financial system.

But first and foremost we are requiring them to do a very detailed business plan for any kind of core financial system.

Mr. PLATTS. What's the consequence if you review it and don't think that they are ready to move forward? How does that play out?

Ms. COMBS. Well, I will give you an example. There was a department this past year, just a few months ago, that we worked with them, they worked with us. It was a very collegial working relationship, because no one wants to be written up as getting on the front page of the Washington Post for wasting the taxpayers' money. There is nobody out there that wants to do that. They all want to do it right. So this department was actually seeking help.

We were able to work with them and show them where the high risk areas were, where the pitfalls potentially could be if they stayed on the same plan that they were on. And they, along with our consultation, decided to do something very similar that Jeff talked about with the IRS. They decided to delay their implementation for a year so that they could get on to a very good business plan, get it broken up into very constructive pieces, and reduce their risk of running into a problem.

Mr. STEINHOFF. One of the difficult challenges, and DOD is a bit different, there is a little bit different kind of oversight in DOD, and in DOD about 80 percent of the financial information comes from nonaccounting systems, so these systems wouldn't necessarily go through that prism of the financial system prism. They would go through a different set. So you have various sets of looking at it and you have totally different, in the end, funding mechanisms in DOD where they are dealing directly with the Congress verses through OMB. They go through OMB but it's different.

Mr. PLATTS. So if it's a specific line item in approps for DOD for this program, that is financial management related but it is specifically delineated in the appropriation, OMB, you are still going to engage; right? Will you still review that type of program, even if it is a specific line item for a program versus here are your funds for financial management and they decide to use some of those funds to upgrade?

Ms. COMBS. Well, I would say that our first and foremost priority is looking at core financial systems. And quite frankly, Mr. Chairman, I'd be really, really in good shape if I think we have reviewed all core financial systems and had them on the right track, not just for the DOD that we are talking about, but for each one of the 24 act agencies as well.

In fact, there are people I have heard recently even stand up at meetings and say, "Oh, I do not think there's anybody out there that has ever kept their clean opinion and done a core financial systems change." Well, I'm here to dispel that. We did it when I was at DOT and the CFO there. So there is a way to do a core financial system, get it into an agency or department and do it right and still keep your clean opinion. That's what we're seeking for all of our agencies.

Mr. PLATTS. I want to make sure I understood you, Dr. Combs. Do I take that to mean that while that review should happen with all programs, it's not necessarily happening?

Ms. COMBS. Well, are you talking about the core financial systems?

Mr. PLATTS. Yes, for the core systems.

Ms. COMBS. The core financial systems are being looked at individually by our division OFFM, the Office of Federal Financial Management, each and every one of those individually, department by department. We are reviewing their business plans, we are reviewing and having a great deal of oversight with anybody who wants to make changes in their core financial system. That is ongoing.

Mr. PLATTS. So that is across the board?

Ms. COMBS. That is ongoing. We welcome transparency and continued good input from our colleagues in GAO as well as the Hill on each and every one of those.

Mr. PLATTS. Mr. Steinhoff, your example in the ERP would be an example in DOD where it is outside of that core financial huge sum. It's a system investment that perhaps doesn't get the same level of scrutiny that OMB is able to give to the core financials?

Mr. STEINHOFF. Yes. And the part of the real challenge is who controls the money. Take, for example, the Navy system. That money really wasn't controlled by the Defense Controller, that was controlled by the Navy.

And one of the things I think the Controller General has spoken to at these hearings is who controls the money. And perhaps in Defense, as they are putting their architecture in place, they should be looking from a corporate perspective. Is it worthwhile to spend this money on this system in the Navy or this system in the Army? Right now these individual services get their own money for their own systems for their own committees. And, again, when it's part of a broader array of systems that feed into a financial system, you need to look even harder at it.

So you don't have the same degree of control when you don't control the funding. To the extent one controls the funding, if the Controller controlled the funding, that would be different. They can provide advice, they can suggest some things. But to the extent whoever controls the funding or oversees the funding makes the ultimate decision.

Mr. PLATTS. With DOD, and this kind of leads to the next question I was going to touch on, is that easy one of what is it going to take at DOD and DHS, and maybe specifically starting with this issue of oversight of these systems investments.

I apologize, my staff maybe can remind me of the name, but with the recent announcement with Acting Deputy Secretary England and taking the lead role on the business modernization—I forget the exact title—the Business Transformation Agency, yes. I was close. Do you see that helping to change the culture there, the environment, to have a more coordinated oversight? Or, again, not when we get into things like this.

Mr. STEINHOFF. OK, yes. First of all, I want to say that I have nothing but admiration for the capability of the defense managers. This is a unique, highly different environment they are in. It is the biggest entity in the world, really. They run cities, towns, school systems, hospitals. You name it, they do it. Seventy-five percent of the procurement dollars, most is discretionary spending. So they have a complex set of issues and have a lot of very highly capable people.

The concern that we have raised is that, yes, we have certainly seen a change at the top in DOD. There were many years of denial or of, well, these rules don't really apply to us. You have now a very concerted commitment from the Secretary on down. You have the deputy, who is involved personally. And I have observed it, having attended some of these Defense business board meetings. He is personally engaged. He's a highly knowledgeable person. Very, very capable. If someone is going to achieve reform and get it done, you would have to do it at that level.

The issue that GAO and the Controller General have raised is the duration of the time it will take for this reform to take place. A Deputy Secretary does not have a span of control or a span of office that is going to be sufficient to complete the task. And one of the proposals that we have made for consideration is to have a chief management official, or chief operating officer.

And what one would do is just really have two deputies. You would have one deputy for the policy or the warfighting side that would be engaged in that, and a separate deputy in charge of business operations, and that person would be empowered to make those decisions across the department. The CFOs from the various services have a very strong dotted line relationship, almost a solid line—which is what the CFO Act envisioned—back to that deputy. That deputy would control the money for business operations.

Granted, you would have to have the logistics heads and all those groups. I mean, they have their needs to carry out their missions. But it would not be the stovepiped type of approaches they have today. Today, it's stovepipe within systems, and that's what they're trying to break down. And we're very supportive of what they are doing, but the real tough question is how far do they get before another group is there, and what kind of staying power do you have?

They have had initiatives before where they have had systems czars and what not, and it is a very difficult cultural type of barrier to break through. So you have to have a very strong person. They have to have unequivocal backing on high, probably some kind of contract or term, and it has to be someone who has done this before and who is going to be there for, let's say, 7 to 10 years to do it.

Mr. PLATTS. That authority over all of those entities, a CFOs analogy on a much smaller scale, is with NASA.

Mr. STEINHOFF. Much smaller.

Mr. PLATTS. And giving the CFO authority over all the center CFOs, so that they really have authority but one-thirtieth or so of the budget.

Mr. STEINHOFF. Yes, much, much smaller. And DHS, which you mentioned before, that's a different situation somewhat.

Mr. PLATTS. I was going to ask you to expand, because, again, a very important department, important mission, with obviously very significant challenges. Is there anything that you want to highlight regarding DHS?

Mr. STEINHOFF. I thought you might ask something about it today, so I gave it some thought. One day they did not exist, the next day they did. And you took a lot of entities, put them all together. They came from disparate agencies, and they all had different systems. Many of them came in there without the best systems in town and they had to operate. And it is probably a work in process in terms of how do you manage and how do you establish a culture.

They say it takes 7 years to make cultural changes, 7 to 10 years. Well, they have been in business a couple of years and they had maybe 10 or 12 cultures when they started. And they just don't have a cohesive set of business systems and they have certainly

had some difficulty getting started because they had a whole host of other things they were trying to deal with.

I remember having meetings there shortly after they set up shop and most people didn't have phones or offices or didn't know who their staff were. So you have a basic startup operation. I think their problems can be resolved much more easily than Defense's, but they do have serious problems. And I think you're going to have to have a very committed vision toward what those business systems are. You're going to have to consider that it won't get done in, let's say, the 3 years remaining in this administration. So you might have to have somebody that can sustain it from one administration to the next. But this is a very difficult challenge. It's not going to be easy.

Mr. PLATTS. Dr. Combs, did you want to add anything on either DOD or DHS?

Ms. COMBS. Well, I think Jeff has hit on the high points. I think one of the real critical elements, whether it's these departments that you have just discussed with him or whether it's any of our other departments, top-level leadership is extremely critical. I think there are some committed people there who are committed to doing the right thing with the management of those departments.

I think the other critical aspect is to have some very, very clear action plans, hold people accountable for those plans of action, and keep breaking those things down into manageable entities so that they can be worked on and people can see some success.

Mr. PLATTS. Actually, before I move on, I want to go back to one followup, Mr. Steinhoff. On those Navy systems that were the $1 billion and the four systems, I expect I know the answer, but to the best of your knowledge was anyone demoted, fired, or any funds recovered regarding the billion dollars that were spent that proved not worthwhile; that they had to start over?

Mr. STEINHOFF. I do not know if there were any personnel actions taken or anything along those lines. In terms of the money spent, the money was spent. There were certainly some lessons learned. There was probably some things they gained they could take to the new project, but certainly not $1 billion worth.

And we felt at the end of the day that the effort was largely a waste. It just shouldn't have started and it really was not a return on investment.

Mr. PLATTS. When I look at those numbers, and having just come to the hearing from the appropriations vote where I voted no on an appropriations bill that failed, the Education-Labor-HHS, and specific things I looked at in this bill, Special Ed funding, an increase, but minimal increase, and proven programs like Even Start that was cut by 67 percent, that have proven successes out there. Then I see us turn around and spend $1 billion on things that really in the end didn't help anyone. It just really makes me more certain that the vote I just cast was the right one.

Dr. Combs, in your position, you have some unique perspective, having been CFO in two agencies and now as Controller. How do you see your role in interacting with those agency CFOs in the environment that you are able to kind of establish the culture out there?

And then what is your read of the major department agencies of the environment for the individual agency CFOs who are trying to really get their financial houses in order?

Ms. COMBS. Well, I'm very, very proud to serve with the cadre of CFOs that I serve with and have served with in the CFO role. I think we have some very hard working, determined, and committed managers out there who have taken very strong leadership roles in each of their respective departments and agencies.

One of the things that I look back on that I think has helped us tremendously in the CFO Act of 1990 was turning financial management into a leadership role. It brought it out of the back room, as Jeff reminded us a bit earlier, and brought it to the front table. And I think of all the things that the CFOs have to work with, the top leadership in their own respective departments and agencies and having that top-level support has given all of us an opportunity to do the right thing and to establish the right processes and know that we are going to be respected for who we are and what we do in each and every one of those departments.

I have been extremely fortunate to always have the senior leadership behind me. The commitments that I have been able to make and the things that I have been able to personally do have all been sustained by upper-level leadership. I think you have to have that in each and every one of these departments.

Mr. PLATTS. Without needing to know specifics of a certain Secretary or department in mind, are there instances in the time you have been Controller that you have seen or are aware of where a certain department or agency is just not responding well to what OMB expects of them from a financial management point; that you or any of your predecessors in going to Director Bolten, or whoever the Director of OMB is, that the financial management issue kind of comes up to the top level at OMB and then to the top level in whatever department or agencies to the Secretary? So rather than your working with a CFO without success, does it then get up kind of to the top boxes of the department in OMB?

Ms. COMBS. Well, I am certain that could happen if it needed to happen. There is no question in my mind that not only do I have that availability to make that happen through my Director or through the Deputy Director, if I needed to utilize that mechanism I could and would do that. Fortunately, as I said earlier, I have a very wonderful cadre of CFOs that have previously been my peers and who are now either ascending into a new CFO role, because we do have some new CFOs, that I have been able to establish a very good working relationship with. And because I have been there and have done this job in so many different departments, I think a lot of people rely and depend on my consultation early in the process, and that's what I want. I want to be a colleague as well as an energizer and someone who does indeed hold them accountable when they need to be held accountable.

I think the issues that I have seen thus far relative to departments that have needed some special help, we talked about the three departments that in essence regained their clean opinion this year. Obviously, they lost it last year. Those were three departments that we came in with and tried to work collegially with them to say, "have you done this, have you done this?" And there are cer-

tain things that you do as a day-to-day management requirement in these departments and agencies that make all the difference in the world relative to quarterly statements, and, consequently, your audited opinion for the year.

So I think it's important to know that top level leadership is behind you and you can utilize it. It's important for your peers and the departments and agencies to know that. And quite often, because of the President's management agenda, everybody is speaking off the same page, so it doesn't matter if the Deputy Secretaries are meeting or if the Secretaries are meeting, which occasionally the President might say to them, how are you doing in your financial management, and they always know that might be a possibility.

So having the President's management agenda is a wonderful tool at all levels. There is no level that is immune from being asked, how are you doing on financial management, and I think that is a great tool, and one we utilize very effectively.

Mr. PLATTS. And I think the importance of that senior leadership cannot be understated, I think it's one of the aspects of President Bush's administration that this issue has not really been, in a broad sense, highlighted as it should be. The administration really has been diligent and very determined in trying to have good financial management be instilled and lasting. And I think that's reflected—DOD has worked with Secretary England in a number of positions, with Navy, or as Navy. Now Deputy Secretary of DOD as well, that sent a very strong message and one that the new agency effort was being kind of rolled out said, "Well, I've got to really learn more about it." But one thing that did give me good confidence was the fact that Deputy Secretary England was going to be there, personally involved, and that was both going to send a very important message out throughout the Department and would provide truly a very good leadership at that senior level.

So the relationship—we've kind of been internally in the financial community, but when we're talking about the financial systems, we get into the Chief Information Officer and the interaction between CIO and CFO and how that impacts the system, the investments that are made.

Could the two of you expand on your view of how that is occurring within agencies, and then specifically with OMB. What, if any, level of intensity or interaction between OMB and CIOs, where it is relating to financial management systems?

Ms. COMBS. I'll speak first within the agencies, because as a CFO in an agency, if you are adopting new financial management systems or any systems that you're working on, maybe it's some enhancements to your system, you really need a very strong partner in your CIO. And both of those positions report directly to the Secretaries or the heads of each of the agencies. So it's very, very important for the CFOs to understand the complete CIO level of involvement as well as you, the CIO, has an expanded level, looking at the entire enterprise, the financial management needs to be a part of that.

And it has always served me very well as a CFO to work very, very closely with the CIO and developing any business plans—of course those are all presented each and every year through the

CIO and through my counterpart, who deals with the CFOs at OMB. She and I have a very close working relationship as well as we're dealing with financial management matters and financial systems that relate to the CIOs in these departments and agencies as well.

So I think the close working relationship is there, both at the OMB level, and it must be there at the departments and agencies for them to be successful.

Mr. PLATTS. Mr. Steinhoff, what do you see as far as good or bad in departments and agencies?

Mr. STEINHOFF. I agree fully with what Linda Combs just said. You have to have a partnership. It has to go both ways. We're really looking here at business systems, business modernization. And there is a fine line between the CIO role, CFO role, program role. You have to have a partnership between all the parties moving toward a common goal of providing business support. That's really what the CFO is doing, providing strategic business information to top management, year-end reporting, stewardship-type of functions, paying bills, etc. And they are doing that on behalf of the programs that are there.

So you have to have people in these roles who can work with other people, have the proper kind of interpersonal abilities, and can see things from multiple sides. You have to look at what the enterprise needs. And for those entities that are most successful, they will have developed these kinds of personal partnerships that Linda Combs spoke to.

If it be that the CFO says I have these powers, I'm going to do this regardless of what you say, and the CIO says I control the system, I'm going to do X, Y and Z, and then the program manager on the other side says well, I want it another way, there has to be a partnership and there has to be a very clear plan in a department that deals with its range of business systems of which the accounting or financial is part of it.

Mr. PLATTS. Is there any department that you're seeing where that type of relationship is not occurring, that interaction, that partnership, that concerns you?

Mr. STEINHOFF. It's not something that I could really address across government. I can say that in the experiences I've had in DOD they seem to be trying to establish that partnership between these various units. There are problems and their systems are huge, but I can't really speak to any—I can get back to you if we have issued any reports out of our IT team that's spoken to that.

I'm sure from just a common sense view there probably are some that don't work well together, but those are the kind of things that the head of the agency, head of the department should be aware of. And the head of the department should make sure that's really what their job is, they and the deputy, to make sure these business partners are working together. Because if they're not working together you will suboptimize the results, and you will find yourself in the same position year after year.

Ms. COMBS. And I will just add to that. I think if Jeff and I probably went back and looked at the lessons learned from some of the failed areas, we probably would find that at least one of the top three areas were considered to be some of the causes for it.

Mr. PLATTS. That partnership broke down and didn't occur?

Ms. COMBS. Correct.

Mr. PLATTS. On DHS in specific, Dr. Combs, when we passed the Financial Accountability Act, DHS Financial Accountability Act, we tried to place greater emphasis on financial accountability to bring it in compliance with the CFO Act, to move forward so that this major agency is on the same plane as all the others.

In your initial review of their end of the year 2005 statement, do you see progress being made in DHS this year versus last year? And Mr. Steinhoff's highlighted what the challenge is as a new agency, 22 agencies come together inheriting multiple material weaknesses, it's a pretty staggering assignment, but do you see progress being made there?

Ms. COMBS. Well, I think the mere fact that they presented on time is certainly something to applaud them over.

I think there is tremendous hard work going on, and we've talked about in the past some heroic efforts. I think that—because of what Mr. Steinhoff had to say earlier about the way this department came together, that it is a major, major task to have come as far as they have actually come over the last couple of years for the very same reasons he referred to.

I think that the progress is continuous, and I think that it will continue to be toward the positive.

Mr. PLATTS. You mentioned about past heroic efforts and not just at DHS, but in your assessment with all of them making the 45 days. I agree, it's a great step to get that information now and be able to review and act on it rather than waiting another several months. What is your read on how their role, the heroic effort played into the 24 agencies and departments in getting that done versus the quarterly statements happen to guard against that or negate the necessity of that type of heroic effort?

Ms. COMBS. I've talked with a number of CFOs over the course of the last couple of weeks, and I've also talked with some IGs as well to get their sense of whether or not they think things are better or, "less heroic" than they have been in the past, and I think 100 percent of those have indicated to me that it gets better and better every year, and that this year is better than last. But it is because of those monthly and quarterly statements, it's because of that discipline that has had to be interjected in each and every department each and every month along the way. And that discipline is serving us all well. And one of the ways that discipline continues to serve us there is that fewer and fewer heroic efforts are having to be engaged in at year end in order to get the clean audit.

Mr. PLATTS. Mr. Steinhoff, your assessment on the heroic effort issue?

Mr. STEINHOFF. I would basically agree. I think that when we went from 5 months to 1½ months, that wasn't nibbling at the edges. And someone couldn't just throw five more people at it. They had to fundamentally change the processes that they used to prepare financial statements, they had to step back. It wasn't a matter of telling the auditor to work harder or faster, it was a matter of being able to project information forward, to prepare quarterly statements, and to organize materials. And we find every year in our audit of the IRS—we are the auditors of IRS—it's a very large

audit. It's a very large entity. It's got a lot of complex issues that are involved there. They do have a lot of systems challenges, a lot of control challenges, but they made fundamental changes in their processes for preparing statements. They took the various business owners, people who have owned the inventory or whatever it might be, they forced them to the table to change their processes. So they were routinely doing certain things like reconciling each month, taking fiscal inventories if that was part of the job, it was built into what people would do day to day, and therefore it wouldn't be an add-on at the end of the year.

We have found that the audit, the preparation has gone smoother in the last few years. Auditors will always find some transactions they question. There is always a degree of those. The question is, do they break the threshold for materiality? We find fewer and fewer errors, they correct the errors we find, but fewer and fewer, not material in any way, but fewer and fewer. They've improved at doing that. The fact that they had to accelerate, the fact that one time they had a business there like Charles Rossetti, they changed their personnel, that was extended, and they've got people that know what they're doing. And I have just seen a marketed improvement on their side, having been the auditor up close and personal for years and years. And I would say that is across the board.

Is it difficult? Do they work real hard at it? Do they spend nights and weekends on it? Yes. Do the auditors spend nights and weekends on it? Yes, whether they be private sector or government auditors, so this is a big effort. I remember in the early years one of the agencies I think it took 14 months that 1 year and had something like 3,300 spread sheets, these big spread sheets. So they were taking vouchers and recording numbers on these sheets, and that's how they prepared the statements.

Mr. PLATTS. I'm glad they didn't come and have to present all that before the committee.

Mr. STEINHOFF. Well, they were in this room, I actually saw it. And people were sitting there for 14 months doing that. You just don't see that.

There are a lot of real challenges and a lot of hard work, and there are numbers that must be derived through statistical samples or special analyses which you would like to routinely come from the system, but if they work toward that—in theory, the ultimate is you push the button, your numbers come out, and you would just have the normal things you have to accrue. I think they're all moving in that direction, and they certainly understand what to do. When they first started, they didn't each know how to prepare these things or what to do.

Mr. PLATTS. We will have one heck of a celebration when we get all the departments, agencies to be able to push the button and have them just appear. It will really be something to continue working for because if we get to that with any department, agency, that really is going to get what we're after—that day-to-day, reliable substantive information with which to make informed decisions.

As we go forward, and with the A–123 requirements, you talked about in the short term, there is likely to be some additional weaknesses uncovered because we're kind of digging a little deeper, a

little more thoroughly. In the short term we will have some additional weaknesses which in the end will have long-term benefits. In light of that prediction or belief, which I think is probably a fair one, do you think that in those six we should anticipate some entities that have clean opinions now not getting a clean opinion next year because of the more substantive review that the new internal control requirements will place on them?

Ms. COMBS. Absolutely not. I expect that we will continue to improve the number of clean opinions. I expect that A–123 and the certifications that are done in June are indeed going to uncover some things, but I do believe that they will uncover some things that are not as difficult to correct as some of the things that we already know about.

I think that one of the things that we have seen over the past, if you look at the material weaknesses and you analyze the material weaknesses in each and every department, these are very long-term, pervasive, repeat material weaknesses. And while there may be new material weaknesses that are presented, there may be evidence that some of the internal controls that are not in place that should be put in place. I envision while they may be deeper, they may be indeed easier to correct. That is my hope, my anticipation. Because as you and I have talked before, we will be closer to where we want to be in terms of financial management in each and every department when we have all the program managers and all the financial managers looking at material weaknesses and reportable conditions just like they were the same and correcting them on a day-by-day, month-by-month basis, understanding what they are and understanding what it means to correct them.

So I think that my anticipation at this point is we're going to push forward, we're going to use this opportunity with A–123 that we have to ferret out additional things that need to be corrected, and expect and hold accountable departments and entities in making them happen and making them happen quickly.

Mr. PLATTS. And I think maybe it is a fair statement to say, in that belief it was going to happen is what you have seen at IRS, is that exact type of identification, correction and positive results.

Mr. STEINHOFF. Yes. I think fixing something that you find to be wrong, holding someone accountable. Some things in the past are hung out there for years that could have been relatively simply resolved, and it's having a basic policy perhaps that we expect these things resolved in 3 months or 2 months, whatever it is, and holding someone accountable for doing that. It needn't result in a loss of a clean opinion. If you have done the work in an arduous manner, you should find your problems before year end.

Looking at some of the problems this past year, there were things that were found toward the end of the audit or end of the period sometimes found by management. They didn't know about a certain something. So it's getting on it quickly, it's recognizing when you've got a long-term, deeply rooted problem, what it takes to do that and get on top of that and hold someone accountable, but not having hundreds and hundreds of open weaknesses, hundreds and hundreds of audit recommendations and requiring management to take responsibility.

One of the very important things in the revision to A–123 is it really revitalizes what was in the 1982 act, and that is that management is responsible for this, it's a fundamental responsibility. And there is nothing wrong with finding a control problem. The problem is if one doesn't then fix it. It should be rewarded for finding it and rewarded for fixing it and punished if they don't fix it.

Mr. PLATTS. Agreed. And that approach is certainly what we all are after.

The only two questions that somewhat relate to the personnel issue and continuity, one is we find that many agencies rely heavily on contractors to perform their financial statement production. And how does that impact the long-term ability or continuity of that department or agency using contractors to maintain and really have that knowledge base be there and retained year to year, long term to build on if it's contractors performing the work?

Mr. STEINHOFF. It's not the environment you want to find yourself in. You want to use a contractor if you think this is a body of work that you need it to be done once or twice, you don't have the skill mix; but you wouldn't want to be paying somebody every year to carry out your basic responsibility. There certainly are good reasons to use contractors, especially if you have a skills gap. But if you're totally dependent on a contractor to do just basic things and every year you're paying someone to come in and estimate what your inventory is worth or how much property you have, that's only a number for that 1 day. It doesn't really give you the kind of information to manage day-to-day.

I remember early on in our work at IRS they hired a contractor to come up with an estimate of their property, and we made it very clear to them that 1 day after the end of the fiscal year any number they had was not of any use, and they would have to spend that money again, and again, and again. And you ought to fix the basic system, you want your own people to be generating those numbers. And the fact that they were going to have to keep paying and paying and paying, you want to have your own capacity. But that is not to say that you can't make a business decision in certain areas that it might be more cost effective to use a contractor, but it shouldn't be to process transactions and what not.

Mr. PLATTS. Dr. Combs.

Ms. COMBS. I think it really boils down to management accountability and management effectiveness. I think good managers and good leaders in any organization look across the entire enterprise and they see where the human capital needs are. And you either go out and buy the support you need, whether it's temporary or long term. You might make a long-term decision, as Jeff just mentioned, that is a particular cadre of individuals that maybe we can't attract into the Federal sector like we should. But it all comes back to the general management responsibility and having a leader, a manager look across the entire enterprise of an organization and decide what human capital needs there are. And if there are business reasons and good business reasons for using contractor support versus our own Federal cadre, then I think that needs to be explained by management, both to employees as well as the people that we support.

Mr. PLATTS. Is my understanding correct that with the A–123 work, that's heavy—or maybe not extensive, or mostly contractor done work?

Ms. COMBS. I am aware that there are some agencies and departments that are contracting some of that work out, but I am further aware and have been very clear with other CFOs that this is a management responsibility. This particular element, and certifying these internal controls is nothing that can be delegated, it's nothing that can be bought, this is clearly on the shoulders of management. You have to stand behind whatever work is done, whether it's done by contractors or whether it's done internally.

Mr. PLATTS. OK. The related issues—you have touched on really both of getting the necessary human capital in place, especially in times when we're really trying to emphasize good financial management and really to set a good path for the future.

And Mr. Steinhoff, in your written testimony, I'm going to just quote and I think you capture it well, "building a world class financial work force will require a work force transformation strategy devised in partnership between CFOs and agency human resource departments working with OMB and the Office of Personnel Management." I would be interested if both of you, where are we recording that type of effort, that strategy and all the partners being on the same page to bring that together?

Mr. STEINHOFF. I think this is a huge challenge. We're in a technology age today, it's the very early stages of it. We have a Federal work force that has large numbers that are going to be retiring soon, and we have major opportunity to restructure at the same time. If you look at the financial management arena, the IT arena, both of which are heavily engaged in what a CFO would be doing, the competition for talent is intense. The students get top dollar when they get out of school, you have to aggressively compete for them, you have to be very agile in doing that. And frankly, you have to have a very strong human capital strategy. You have to be able to quickly respond to needs. And I know at GAO I feel very fortunate that we have a lot of these abilities. And I have attended forums in the executive branch and I think they face a real difficult challenge, challenge of being agile and being able to immediately hire somebody to go out and try to get the best people they can get when they're competing against the major consulting firms who are paying top dollar. We have to challenge people when they come into government. The average person today that enters the work force is not going to spend 30 years or 40 years at the same job like yours truly did, they're going to move from job to job. I have kids in their 20's, and I don't think they plan to stay one place for their whole career. But the government's going to have to be able to really compete in a tough, tough market. It presents a good opportunity, but I know that GAO can compete quite well. I'm not sure that some of the agencies are prepared to compete on the same basis.

Mr. PLATTS. Are you seeing that type of—that recognition governmentwide and the strategy that you reference even in the initial stages?

Mr. STEINHOFF. I don't think in the financial management arena, based on just discussions I've had with CFOs, some of the forums

that have been sponsored in the past where people have talked about human capital and they've shared the war stories about 8 months to hire someone, and you know, and they go down to colleges. I know I asked my kids all the time when they were in college, well, when the recruiters came down, you know, how was it. And there was sometimes a big difference between what was sent down to these colleges to recruit these kids. If you're going to be recruiting an accountant, you send a young accountant down, you don't send a personnelist down, you don't send a person down to pass out fliers, you don't give them a 45-page form to fill out with many of the questions not really applicable to them, and you don't spend months getting back to them on it. You have to do it immediately.

We have a lot of summer interns in GAO, we are bringing in sharp people, they're seniors maybe going into their fifth year because most of the cutting students are in 5-year programs now. And we have them there, they're there for the summer, and we make a face to face offer at the end of the summer. We have a competitive wage we're paying them, and we are pursuing them the same way a CPA firm would be. And I think that's really what the executive branch is going to have to be in a position to do.

One of the concerns that I always have whenever we have budgetary problems is some of the first things to go are what are called support functions in financial management. But as people retire, you have an opportunity, but you have to have a good plan for succession. You have to be grooming people for the future and you have to be willing to move quickly, you have to be agile.

I will let Linda speak a little more about some of the authorities they have, but I felt in some of the forums I participated in that I was speaking about a whole different way of procuring services than some others were. And it's not easy for me because I'm competing against all the major accounting firms, I'm competing against all the consulting houses. The government has a lot to offer, and we have to have strategies both for the entry level, we also have to have strategies for those people that want to rebound in their career, they've been with a major firm for 5 or 6 years, they have sort of burnt that out in life, they want to move on. And you have to have very, very astute recruiting strategies there. And I'm not really sure if the CFO community—my sense is that is an area they need to work on, look at in the future on.

Mr. PLATTS. Dr. Combs, I would be interested in your perspective, and especially what, if any, relations with Office of Personnel Management and how to develop that effort.

Ms. COMBS. I, too, am very concerned about our ability to attract and retain financial managers in the Federal Government. I think that the President's management agenda on human capital governmentwide has sensitized people to the fact that we have a particular need in the financial community to strengthen that particular area, as well as others. But Jeff mentioned the IT community. But CFO and IT are more and more difficult to attract and retain people because the outside salaries are so substantial and we can't even come close to those.

But I think the other thing that I would commend GAO on and say that I think we have to buildupon the work that GAO has done

over the last several years in their human capital effort. I think they're probably one of the stars that I have seen in—certainly in the Washington arena, but certainly for a private sector organization as well. I think they've done some remarkable things relative to human capital efforts, and I think that certainly is a priority of the CFO Council.

We have a sitting CFO from the corporate world to come to each one of our CFO Council meetings and talk with us about issues of common concern. They are always the first to bring up human capital, and we listen with intrigue to hear them talk about retention and attracting their share of well-trained financial managers. And I can't help but know, as I hear them talk about the training programs that they embark upon and the tremendous efforts that they undertake in these very large corporations to keep people on their payroll, they do an awful lot once they are able to attract people into their corporation.

We had a loose federation of us CFOs embark upon bringing in some MBAs between their first and second year last summer, and I had done it when I was at EPA and DOT. And I think we had 11 MBAs throughout government this past summer. They had never thought about working for the Federal Government, and would not have thought about it had I not gone and recruited on their campus. They had a tremendous eye opening as to what it was like to work in financial management in the Federal Government. It was a very, very positive experience. But I told them coming in I already apologize to you because I know when you get ready to graduate this coming June, I will not be able to attract you into the Federal Government because the salary I could offer you is so low compared to what you could get in the private sector. I will not be able to touch you. And that breaks my heart to know that is the way we have less vehicles than we need to work with in our human capital.

You asked if I had done some work with OPM. Obviously there are some proposals underway right now, and the financial community is of course a part of some of those proposals, but I truly look forward to a day when I can say to those MBA candidates, you come see me next year, I want to have a shot at you as well. That's where we need to be.

Mr. PLATTS. And some of that is outside of all of our control, and not just meaning salaries, but perspective of the employee that serving in public service is a high calling. And maybe it's money, but there is a way of giving back to the service that makes up for less money, that you're serving your country, whether it be in uniform in the military or civilian in a department or agency.

Mr. STEINHOFF. They have to see they're making a difference, they have be to challenged and motivated, they have to be given responsibilities that they feel are challenging. I think all those things are very, very key. And you have to then, once you have them, to point that finger raised on spending money and developing the people. You have a procurement community right now that's got an acquisition sort of professional that receives certain training and certain special funding. They should have that in the financial management community. I mean, do they have the money to train, to develop, to move people around? And again, it's retain-

ing, it's attracting. And people are attracted, as you say, for a variety of reasons.

Mr. PLATTS. I see it in my immediate office with our district offices and my D.C. office with summer interns. We always have six each summer that split the summer, half in the district, half down in D.C. and then throughout the school year. And one of the things we find, especially when they are in the district, is that making a difference as a college student, either junior or senior year going into, and when they're—because we very quickly throw them in the deep end. We're not interested in having someone around to make copies, we're interested in having them really understand what the work is all about, and very quickly, you know, swim—not sink, swim. But when they start to experience that they've made a difference in the life of a constituent, a veteran in getting their benefits or Social Security, whatever it may be, that feeling of accomplishment that they helped somebody, you know, that goes a long way.

Ms. COMBS. And in the financial community, when you give them projects that are in the billions of dollars of magnitude, that they would never probably work on in a lifetime in a corporation—or maybe not for 10 or 15 years in some of the major corporations—they really have their eyes opened. And many of them have indeed said what you just did. Well, yes, you're right, you can't attract me because of the money, but because I've seen what I've seen about public service and been able to look at the magnitude of responsibility I could have even as a summer employee, and they get to see some of these other capable senior managers in our work force as well, they can tell that they can truly make a difference.

Mr. PLATTS. I have one final specific question, and it really is—again is pretty early, but the GSA disclaimer is one that seems, given a track record of great success, that jumps out. Is there an initial read that either or both of you have on what has transpired there to result in the disclaimer being required?

Ms. COMBS. We have not had a chance to review that completely yet. It's obviously a disappointment. I know that in talking with the CFO there, she was extremely disappointed. It came up, as Jeff talked about, toward the end as well. And very, very committed, though, to doing the right things to turn that around, and we're eager to help in any way we can.

Mr. PLATTS. OK.

Mr. STEINHOFF. We really have not had a chance to look behind it. I think it is somewhat related to some systems changes they made, but we have not had an opportunity to go behind it.

In that case they—as I recall they got a clean opinion on certain statements and disclaimer on others, so they have a mixed kind of opinion for 2005.

Mr. PLATTS. We're kind of anxious to see how that does play out and what we have learned from that because of that, that we're going to move forward in an increasingly positive way and not regress, and they have been an agency as a great example of good work, that continues.

One final more general question, and that is we've talked early this year, and we're continuing to work on I guess behind the scenes on the kind of consolidation, looking at the CFO Act and the

various related financial management pieces of legislation that have been adopted over the last 20 or so years and how they need to be updated and better coordinated.

Is there a benefit for us going forward with that effort to eliminate redundancies? As we're challenging financial managers in lots of ways, is it worth the effort that we're putting forth and will need to continue to put forth to undertake a major consolidation effort that in the end benefit those managers out there day in and day out to have that consolidation occur?

Ms. COMBS. I think any way that we can better define what success looks like to managers in a more streamlined fashion, the way that we continue to look at financial management throughout government, if we can pull together some things that make sense to work together, even in the internal controls efforts, we continue to encourage people to look across their entire enterprise and look at things they already have in place, things that are already being looked at, take those and adopt those. Don't layer on something on top of this, this is not a layering on process, this is a utilization of what is already there and helping management to come to grips and to agreement with the idea that this is a management accountability, and I'm the one certifying this using their own judgment. So those are the kind of I think things I think that help managers a lot to know that they have the authority to do that, and to rely on their own good judgment and their own good processes that are in place.

Mr. STEINHOFF. I think it's also a good idea to do that now. We need to harmonize certain things, we need to clarify certain things, consolidate certain reporting. Some things are now being done that meet the intent of these acts, but they're in a different form. And we need to make that legitimate. We no longer really need to have a separate Federal Manager's Integrity Act report if you make it part of the PAR. We don't need to have some of the things that we presently have.

So a lot of harmonization, perhaps updating certain things to address what's been more refined practices. We can deal with some of the investment issues, place more clearly some of the things that would be, in fact, expected. I think there is a good opportunity for a committee report that would lay out and provide a record of where the Congress is today of where they're expecting this to be, some of the things we've spoken about today. There can even be some human capital proposals in there that deal with training, development, etc. So we look forward to working with you all on it.

And I think it's a good opportunity to kind of step back. All these acts interrelate in some way, and it's not too hard for those who have been involved for a long time to see how they interrelate, but I could certainly see someone coming on the scene new looking at all these laws and all these acronyms and what not and not recognizing that gee, it's not this and that, it's really this broader concept. You don't see some of the things we spoke about today in Black and White in some of those bills.

Mr. PLATTS. Well, as Dr. Combs was saying about a young graduate coming out and the opportunity to work on billion dollars projects, that is the other side. I was thinking of also coming out and saying you have the CFO Act, you have FMFIA, you have—

being a little overwhelmed, because as we kept layering as opposed to bring it in in a cohesive fashion—we are working on that type of report and welcome the continued insights of our offices and staff. And again, part of that same team effort that we're all after at the end of the day, that same goal.

We are very grateful for your testimony here today, and especially day in and day out the work of you and your staffs on what I continue to believe is one of our most important responsibilities, as we like to reference to, accounting for the people's money was laid out in Article I of the Constitution, and I think appropriately so. And it's a little different times today in 2005 than in the 1700's, but the importance and the right of the public to know what their money is being used for is just as important today as it was then. So your efforts are very commendable and appreciated.

We will keep the record open, if there is anything you need to followup with us for 2 weeks, and we will look forward to our continued interactions with you.

Mr. STEINHOFF. Thank you very much.

Mr. PLATTS. This hearing stands adjourned.

[Whereupon, at 4:25 p.m., the subcommittee was adjourned.]