BUDGET AND FINANCIAL INFORMATION—ANNUAL SHAREHOLDERS REPORT: HOW DOES THE CITIZEN KNOW WHAT IS GOING ON?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JULY 11, 1995

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BUDGET AND FINANCIAL INFORMATION—ANNUAL SHAREHOLDERS REPORT: HOW DOES THE CITIZEN KNOW WHAT IS GOING ON?

TUESDAY, JULY 11, 1995

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

The subcommittee met, pursuant to notice, at 2:10 p.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Flanagan, Bass, Maloney, and Mascara.

Staff present: J. Russell George, staff director; Mark Brasher, professional staff member; Andrew G. Richardson, clerk; and Cheryl Phelps, minority professional staff.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order. I'll begin with my opening statement, while we're waiting for the ranking minority member. I regret the 10-minute delay, but we had a vote on the floor of the House that occurred at 1 minute of 2 p.m., when I was here. Our first duty is to cast our votes, and I apologize for starting late.

Today we will hear testimony from experts on the Federal budget process and Federal accounting systems. Too often the annual budget ends up as an after the fact indicator of problems with Federal programs. In its present form, the budget is sort of like a checkbook that shows a balance, but tells little about the program's efficiency or underlying financial health.

We're working toward balancing that checkbook. A balanced budget by itself, however, will not tell enough about our big programs' long-term outlooks. Thus, it's essential to include underlying financial information in the annual Federal budget. Doing so would make it clearer and more understandable to the citizen. It would also provide a financial bill of health on such critical programs as Social Security, Medicare, infrastructure and environmental clean up.

Each American needs to know where the Federal Government stands financially. That knowledge would spur our citizens to demand reform, realizing that current trends cannot be sustained. The Credit Reform Act of 1990, which we will hear more about later, is one example of how we could integrate budget and finan-

cial information. We need to build on that example, and find additional ways to include financial information in the budget.

Congress can and should include in its budget resolution a listing of future liability claims and responsibilities. That way, every Member is accountable to the citizenry, and the citizens and taxpayers will gain insight into the country's long-term financial issues. And the voters will be more informed than they are now, as they cast their vote. Our witnesses this afternoon include Gene Dodaro, Assistant Controller General from the General Accounting Office; Ed DeSeve, of the Office of Management and Budget; Harrison Fox, representing Citizens for Budget Reform; and Lyle Brecht, publisher of AmericaReport.

[The prepared statements of Hon. Carolyn B. Maloney and Hon. Frank Mascara follow:]

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HON. CAROLYN MALONEY -- OPENING STATEMENT

HEARING ON "BUDGET AND FINANCIAL INFORMATION -- ANNUAL SHAREHOLDERS REPORT: HOW DOES THE CITIZEN KNOW WHAT IS GOING ON?"

July 10, 1995

Chairman Horn, thank you for providing the Committee this opportunity to examine how the Federal government organizes and presents budget and financial information. As a nation, we are faced with increasing fiscal constraints and increasingly difficult choices amongst competing social and economic priorities. While we may differ on the best way to approach these issues, clearly all Americans are well-served by improved accountability for public resources and better informed decision-making on the part of the Administration and the Congress.

Currently, the Federal government's budgetary and financial reporting practices do not accurately depict the full costs of Federal operations or the government's true financial condition. According to the General Accounting Office, financial statement audits have identified hundreds of billions of dollars in accounting errors, mistakes and omissions, including problems of uncollected revenues and unrecognized liabilities and potential losses.

I recently released a report on one such area -- delinquent non-tax receivables. These delinquent receivables range from unpaid user fees and court costs to deadbeat parents and nuclear power plant licensing. The shocking bottom line of this report was that in this area alone, dead-beats owe the Federal government over $50 billion. This is a staggering amount in these days of tight fiscal restraint and I am working on legislation to improve our ability to collect some of this money -- money owed to American taxpayers.

Serious deficiencies in Federal accounting procedures render fiscal information provided to Congress and the Executive branch virtually useless. Furthermore, they may impede Congressional efforts to effectively restructure the government, reduce Federal spending, eliminate the deficit and bring balance to the budget.

I am interested in learning from the GAO and OMB whether the implementation of the Chief Financial Officers Act of 1990 and the creation of the Federal Accounting Standards Advisory Board have moved us any closer toward improving budgetary reporting and accounting practices and correcting weaknesses in the government's depiction of its financial operations.

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The CFO Act and the FASAB were specific tools provided by Congress to strengthen the budget process. Have they been implemented as intended? Can we demonstrate measurable results in terms of improved accountability and budget integrity? Have agencies used these tools to better depict their financial condition, priorities, assets and liabilities? Are there additional criteria for effective financial controls and management the CFO Act and the FASAB do not consider? I appreciate the hard work of our private sector witnesses in developing alternatives to current practices and welcome their views on these issues as well.

Chairman Horn, this Subcommittee's oversight and evaluation of the budget and accounting practices of the Federal government is critical to ensuring responsible stewardship of increasingly scarce public resources and assets. Equally important, this oversight can meaningfully progress Congressional action toward balancing the budget. I join you in welcoming today's witnesses and look forward to a constructive discussion of our priorities and ideals for improving financial controls and reporting in the Federal government.

STATEMENT BY CONGRESSMAN FRANK MASCARA

BUDGET INFORMATION HEARING

JULY 11, 1995

GOOD AFTERNOON MR. CHAIRMAN. AS AN ACCOUNTANT AND THE FORMER COMPTROLLER OF WASHINGTON COUNTY, PENNSYLVANIA, THIS IS THE KIND OF HEARING I CAN REALLY SINK MY TEETH INTO.

NUMBERS, ACCOUNTING, THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD (FASAB), THESE ARE ALL THINGS I UNDERSTAND AND RELATE TO!

FOR A NUMBER OF YEARS, I HAVE SHARED THE CONCERN THAT GOVERNMENT BUDGETS, INCLUDING THE FEDERAL GOVERNMENT'S BUDGET,

DO NOT ACCURATELY DEPICT A GOVERNMENT'S FINANCIAL STATE OF HEALTH.

THEY ARE OFTEN HIGH ON SPENDING INFORMATION AND LOW ON ANY KIND OF WAY OF DETERMINING THE GOVERNMENT'S LONG-TERM ASSETS OR FINANCIAL HEALTH.

AT THE FEDERAL LEVEL, OFF-BUDGET LIABILITIES SUCH AS FEDERAL DEPOSIT INSURANCE AND FEDERAL CREDIT PROGRAMS ARE NOT CLEARLY REFLECTED. FAULTS IN THE FEDERAL DEPOSIT INSURANCE PROGRAM THAT WERE NOT CAUGHT IN TIME, LED TO THE TRILLION DOLLAR S&L CRISIS OF THE LATE 1980'S.

TAXPAYERS WILL SIMPLY NOT TOLERATE SUCH ERRORS IN THE FUTURE. AND I AGREE WITH FASAB

THAT BETTER ACCOUNTING METHODS WILL HELP PREVENT SUCH MISTAKES FROM REOCCURRING.

WHILE THE MEMOS PREPARED FOR SUBCOMMITTEE MEMBERS BY BOTH THE MAJORITY AND DEMOCRATIC STAFFS DWELL ON THE PROBLEMS POISED BY THE PRESENT FEDERAL BUDGET, I WAS HAPPY TO READ THAT GAO WILL TESTIFY IT BELIEVES THE SITUATION IS ON THE MEND.

IT IS OBVIOUS WE MUST FIND SOME METHOD OF LAYING OUT THE TRUE COSTS OF GOVERNMENT SO WE CAN BETTER DECIDE HOW TO DIRECT OUR INCREASINGLY SCARE RESOURCES. AND PERHAPS MORE IMPORTANTLY WE MUST ALSO DEVELOP A SIMPLIFIED BUDGET THAT ALL AMERICANS CAN

UNDERSTAND.

THE REALITY IS CITIZENS MUST BE BETTER INFORMED ABOUT WHAT GOVERNMENT ACTUALLY COSTS IF THEY ARE TO BE MORE CENTRALLY INVOLVED IN DETERMINING WHAT GOVERNMENTAL MISSIONS AND GOALS ARE REALISTIC, AFFORDABLE, AND ACHIEVABLE.

I LOOK FORWARD TO THIS AFTERNOON'S TESTIMONY.

THANK YOU MR. CHAIRMAN.

Mr. HORN. Thank you all for coming. We look forward to your testimony. At this point, I will swear you all in, and we will start with the first witness. If you would, stand and raise your right hand.

[Witnesses sworn.]

Mr. HORN. Thank you, please be seated. That is a formality which the subcommittees of the Committee on Government Reform and Oversight follow. We would appreciate it if you could limit your statement to 5 to 10 minutes. I'll give this panel more leeway than usual, because I think we'll be able to proceed easily that way. And then we throw it open to questions, alternating between majority and minority.

And obviously, your full, written statement will be put in the record, after the individual introduction. So summarize the high points any way you would like. You have roughly 5 to 10 minutes to do that. Then we'll throw it open to questions, after you've all finished. So if we can begin with Mr. Dodaro, the Assistant Controller General, Accounting and Information Management Division of the General Accounting Office. Welcome.

STATEMENTS OF GENE L. DODARO, ASSISTANT CONTROLLER GENERAL, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, GENERAL ACCOUNTING OFFICE; DONALD CHAPIN, CHIEF ACCOUNTANT; PAUL L. POSNER, DIRECTOR, BUDGET ISSUES, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION; AND G. EDWARD DESEVE, CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

Mr. DODARO. Thank you, Mr. Chairman. Good afternoon. Having been before this committee several times, I'm prepared for a 5-minute summary. With me today, to my immediate right, is Don Chapin. Don is GAO's Chief Accountant and has been our representative to the Federal Accounting Standards Advisory Board. Also with me is Paul Posner, Director of our budget group, to Don's right.

We're pleased to be here today to discuss efforts to strengthen the reliability and usefulness of information for managing the Government's finances. GAO has long advocated financial reporting reform, and we are pleased to see this committee pursue this topic. Achieving improvement is essential, as you pointed out, to enable more informed decisionmaking and oversight by policymakers, and to better inform the public.

Mr. HORN. I might note at this time that a quorum is present, thanks to Mr. Bass. Go ahead.

Mr. DODARO. Thank you. As you pointed out, Mr. Chairman, difficult decisions are facing the Nation as it implements a new fiscal policy path toward a balanced budget, and those decisions require solid budgetary and financial information that fully discloses the current condition of programs and the stakes flowing from budgetary choices.

Moreover, public demands are high for controlling costs and ensuring accountability. Now, I wish I could report today that the current reporting approaches in the Federal Government give us all the tools we need to address critical questions about the full

cost of programs, or about the value of what the Government owns and what it owes others, or about the Federal Government's financial ability to satisfy future commitments. But that's not currently possible.

The facts are that financial accounting information in particular has not been reliable enough either to facilitate decisionmaking or provide effective public accountability. Also, good information on the cost of Federal programs is frequently absent or difficult to reconstruct. As I've discussed previously before this subcommittee, there are significant problems in agencies' financial systems.

Financial statement audits have identified serious control weaknesses and hundreds of billions of dollars in accounting errors and omissions that can render information provided to the Congress and managers highly questionable. Also, audits are just beginning to shed more light on the Government's true financial condition.

Fortunately, I can report today that the progress is improving in financial reporting, due to implementation of the Chief Financial Officers Act, and the creation of the Federal Accounting Standards Advisory Board. Tools are now being put in place that promise to get the Federal Government's financial house in order. First, beginning next fiscal year, all major agencies, covering about 98 percent of the Government's outlays, are required to prepare annual financial statements, and have them audited.

Second, an audited Governmentwide financial statement is required to be produced, starting for fiscal year 1997. And finally, the Advisory Board is developing new standards that will yield more useful financial information. These recent initiatives hold much promise, but they will require support from agency leaders as well as the Congress to succeed.

As financial information improves, it will also enable greater integration between accounting and budgeting information to better assist policymakers in sorting out claims and allocating resources. One such promising area is the selective use of accrual concepts to record budget authority and outlays. Although cash based budgeting serves budgeting purposes well in most cases, for a select number of programs, it does not adequately reflect the future cost of the Government's commitments, or provide appropriate signals on emerging problems.

In these cases, the accrual approach would better record the full cost to the Government. As you pointed out, in fiscal year 1992, accrual budgeting principles were applied to loan and loan guarantee programs. Other areas, such as Federal insurance programs, could potentially benefit from the accrual approach as well. Our work today, in studying this issue has revealed shortcomings with the cash approach to budgeting for these programs, but also highlighted difficulties in estimating future costs, due to lack of adequate data.

Another opportunity exists to use financial information on liabilities and long-term commitments to help address the sustainability of current budgetary policies. The strength of claims on future resources range from very firm, such as liabilities like the public debt, to commitments to pay social insurance programs, and finally to the mere expectation that current policies and discretionary programs will be continued.

Financial reports based on the Advisory Board's recommended standards will provide valuable information to help sort out these various kinds of long-term claims. Decisionmaking can also be enhanced by using managerial cost concepts in tandem with budget accounts to more easily see the full costs associated with program outputs and outcomes to be reported in financial statements.

Currently, different account structures are used for budget and financial reporting. The Advisory Board calls for capturing the full cost of activities associated with Government activities or results. This type of information is currently not reported in the budget, and there is a need to strive to achieve a better congruence between budget accounts and the accounting system structure.

Several approaches also could be considered to prompt decisionmakers to use financial reports to have a longer term focus on commitments of the Federal Government in making resource allocation decisions. One approach would be to eventually include trends in audited financial information in the reports, over a period of time. Also, longer term simulations of current budget policies at the very least could encourage a public dialog focused on the long-term outlook, and might engender pressures for programmatic reform and fiscal changes sooner than when a crisis emerges.

In closing, I want to emphasize that better financial and budgetary information will not necessarily make difficult resource allocation decisions easier, but it would better ensure that everyone fully understands the implications of various policy choices. Moreover, reliable financial reporting is essential to restoring public confidence in the Government's stewardship of tax funds and in permitting more effective oversight.

We look forward to working with this committee in the future on these important issues. Thank you, Mr. Chairman, that concludes my summary.

[The prepared statement of Mr. Dodaro follows:]

Statement of Gene L. Dodaro
Assistant Comptroller General
Accounting and Information Management Division

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss an issue that the Comptroller General has viewed as extremely important throughout his tenure--ensuring more timely, reliable, useful, and consistent information for managing and assessing the government's finances. GAO has been actively urging improvements in this area for over 20 years. Achieving such improvements is essential to enable more informed decision-making and oversight by congressional and executive branch policymakers and to enhance efforts to better inform the American public of its government's financial operations.

Fortunately, in the last 5 years, progress is beginning to be made toward these goals. This progress, in part, has been stimulated by the passage of the Chief Financial Officers (CFO) Act of 1990 and the creation of the Federal Accounting Standards Advisory Board (FASAB), as well as by efforts to strengthen the budget process. During this period, many professionals involved in budgeting, accounting, and management reporting have devoted much thought and effort to developing a vision for more effective and understandable financial management reporting for the federal government.

Today I will talk about what kinds of information and reports this vision entails to help policymakers to make well-informed

decisions and provide effective oversight. Recognizing that the budget is the primary framework for making most decisions about the use of federal resources, I will also address how financial information and audited financial statements can better contribute to the budgetary debate as well as provide the foundation for ensuring accountability for achieving results and adequate stewardship over federal resources and assets. Finally, I want to discuss the status of efforts to inform the American taxpayer of the government's financial condition.

THE IMPORTANCE OF RELIABLE INFORMATION ON FEDERAL FINANCIAL CONDITION AND COMMITMENTS

The nation is faced with fiscal pressures which will continue to occupy the center of public debate for years to come. We recently simulated the long-term outlook of current budgetary policies for Chairmen Kasich and Domenici.[1] Current trends are unsustainable over the longer term and would lead to deficits exceeding 20 percent of gross domestic product by 2025, due largely to the pressures an aging population will place on social security and health care programs as well as mounting interest costs to finance the debt. Congressional action to move to a balanced budget clearly will help address these concerns.

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[1]The Deficit and the Economy: An Update of Long-Term Simulations (GAO/AIMD/OCE-95-119, April 26, 1995).

Difficult resource allocation decisions are facing the nation in order to implement and sustain a new fiscal policy path. These decisions require good budgetary and financial information that fully discloses the current financial condition of programs and the stakes flowing from budgetary choices--both present and future. Moreover, public demands are high for the government to accurately account for the effective use of a dwindling pool of resources and to provide services cost efficiently.

The federal government's budget process as well as its financial reporting and management systems should be expected to collectively provide the information necessary to address difficult issues. The budget should provide sufficient information to permit decisionmakers to (1) effectively allocate scarce resources among competing programs, (2) formulate fiscal policy addressing macroeconomic goals, and (3) communicate budgetary priorities and program performance data to the public. The budget is a forward-looking plan that should help the nation assess the implications of choices; it should be formulated using accurate and reliable financial data on actual spending and program performance.

Financial statements and reports should also provide reliable and relevant information. In addition to ensuring basic accountability for the proper use of budgetary resources, we should expect such reports to address (1) the full costs of

achieving program results, (2) the value of what the government owns and what it owes to others, (3) the government's ability to satisfy future commitments if current policies were continued, and (4) government's ability to detect and correct problems in its financial systems and controls.

FINANCIAL REPORTING AND MANAGEMENT: A WORK IN PROGRESS

I wish I could report to you today that current budgetary and financial reporting give us all the tools we need to address these critical questions. But I cannot. Financial accounting information in particular has not been reliable enough to use in federal decision-making or to provide the requisite public accountability for the use of taxpayers' money. Also, good information on the full costs of federal operations is frequently absent or extremely difficult to reconstruct. In addition, complete, useful financial reporting is not yet in place.

Significant problems have been revealed in agencies' financial management and accountability systems. For example, financial statement audits have identified hundreds of billions of dollars in accounting errors, mistakes and omissions that can render information provided to the Congress and managers virtually useless. Audits also have identified fraudulent payments and ghost employees at the Department of Defense as well as duplicate payments made to contractors. Moreover, audits are beginning to

shed more light on the government's financial condition, including substantial problems of uncollected revenues and tens of billions of dollars of unrecognized liabilities and potential losses not previously fully disclosed.

However, I can report that financial reporting and information is a work in progress and that tools are now being put in place that promise to get the federal government's financial house in order. First, beginning for fiscal year 1996, all major agencies, covering about 99 percent of the government's outlays, are required to prepare annual financial statements and have them audited. Second, an audited governmentwide financial statement is required to be produced starting for fiscal year 1997. Since 1976, the Department of the Treasury has annually published "prototype" consolidated financial statements of the federal government. These statements, however, have not been auditable since they are based on agency accounting systems which audits have shown to have serious weaknesses that limit their ability to produce accurate financial data. Third, FASAB is recommending new federal accounting standards that will yield more useful and relevant financial statements and information.

In 1990, the CFO Act first required annual financial statement audits for a select group of agencies on a pilot basis, with their continuation subject to evaluations of their cost and benefits. Such audits highlighted problems of uncollected

revenues and billions of dollars of unrecognized liabilities and potential losses from such programs as housing loans, veterans compensation and pension benefits, and hazardous waste cleanup. In our view, the audits bring important discipline to agencies' financial management and control systems. Thanks to the benefits achieved from these pilot audits, the Congress extended this requirement, in the 1994 Government Management and Reform Act, to all major agencies.

In the same act, the Congress also mandated a consolidated set of governmentwide financial statements--to be audited by GAO--for fiscal year 1997. These types of statements will provide an overview of the government's overall costs of operations. It will also provide information on the government's assets and contribution to long-term economic growth. The report's data on liabilities and potential future costs of current policies will give policymakers and the public valuable information to assess the sustainability of federal commitments.

Financial accounting standards currently being developed by FASAB will help ensure that these financial statements address issues in terms that are relevant to the federal environment. As you know, FASAB was established in 1990 to develop and recommend accounting principles for the federal government. The standards FASAB is now recommending will provide a sound foundation for federal financial statements that are relevant to both the budget

allocation process as well as agencies' accountability for resources. FASAB's extensive consultations with users and potential users of financial statements showed that they were interested in getting answers to questions on such topics as:

-- Budgetary integrity: What legal authority was provided to finance government activities and was it used correctly?

-- Operating performance: How much do various programs cost and how were they financed? What was achieved for this spending? What are the government's assets and are they being effectively maintained and used? What are the government's liabilities and how will they be paid for?

-- Stewardship: Has the government's overall financial capacity to satisfy current and future needs and costs improved or deteriorated? What are its future commitments and are they being provided for? How will the government's programs affect the future growth potential of the economy?

-- Systems and control: Does the government have cost effective systems and controls over its programs and assets? Can it detect and correct problems?

These recent initiatives promise to improve financial controls and information in the federal government. However, they will

require agencies to change the way they do business in the financial management arena. Their successful implementation will depend on support both from agency leadership and management as well as the Congress itself. We have been pleased by the support the Congress in general and this Subcommittee in particular have provided for these initiatives and hope to continue working with you on these important issues.

STRENGTHENING BUDGETING THROUGH USE OF FINANCIAL DATA

As financial information improves, it also will enable greater integration of financial accounting information and budgeting to better assist policymakers in sorting out claims and allocating resources. Budget decisions are strongly influenced by the type of information reported and the way choices are framed. We have consistently maintained that budgeting can be enhanced by more integrated consideration of financial data. However, such integration is highly dependent on improving the accessibility of financial information to budget decisionmakers. FASAB, in recommending accounting standards, has attempted to bridge the existing gaps by adopting budgetary approaches to the extent consistent with accrual accounting concepts appropriate for measuring operating performance and reporting on stewardship.

The areas of the budget where the prospects for integration appear most promising include (1) the selective use of accrual

concepts to record budget authority and outlays, (2) the use of financial information on liabilities and long-term commitments to help address the sustainability of current budget policies, and (3) consideration of managerial cost accounting concepts in budget accounts to permit decisionmakers to consider more easily the full costs associated with program outputs or outcomes to be reported in financial statements.

WHEN SHOULD ACCRUED COSTS BE USED AS THE BASIS FOR BUDGETARY ALLOCATIONS?

The method of reporting budgetary transactions influences decision-making. Therefore, choices about the basis of budgetary reporting ultimately represent trade-offs among the purposes of the budget. Cash and accrual represent two alternative measurement bases for budgetary reporting. Cash reporting recognizes transactions when cash is paid or received. Accrual-based reporting, used in financial statements, recognizes transactions or events when they occur regardless of when cash flows occur.

The current federal budget, with limited exceptions, is reported on a cash and obligation basis. Cash-based budgeting focuses on control over current spending and the assessment of the short-term economic impact of fiscal policy. Cash is advantageous as a method of control because it can be easily measured and tracked.

Because of its simplicity, it is readily understandable by policymakers and the public. Cash-based budgeting also reflects the current borrowing needs of the federal government. For most federal programs, cash provides adequate information on and control over the government spending commitments. For example, for activities such as salaries or grant payments, costs recorded on a cash basis do not differ appreciably from accrual-based costs.

However, GAO and others have reported that for a select number of programs, cash-based budgeting does not adequately reflect the future costs of the government's commitments or provide appropriate signals on emerging problems. As a general matter, accrual-based reporting may improve budgetary decision-making in cases where the cash consequences of current decisions are not realized in the budget year but become evident in future years. In these cases, the accrual approach records the full cost to the government of a decision--whether to be paid now or in the future. As a result, it prompts decisionmakers to recognize the cost consequences of commitments made today. Financial statements based on FASAB standards will include accrual-based information for these kinds of programs.

Beginning in fiscal year 1992, accrual budgeting principles were applied to loans and loan guarantee programs with the implementation of credit reform. This recognized that the cash

basis gave decisionmakers misleading signals on the cost comparisons among grants, loan guarantees, and direct loans. Other areas in the federal budget could potentially benefit from the accrual approach.

The Savings and Loan crisis of the 1980s illustrates an area where cash-based budget reporting was misleading. During the 1980's, as hundreds of thrifts failed, the cash-based budgetary system did not signal the Administration and the Congress of the deteriorating financial position and federal budgetary cost commitments associated with the nation's deposit insurance system until cash was actually paid out to depositors. The cash basis reporting in this case was a lagging indicator of trouble that failed to signal budget decisionmakers in time to avert or limit the damage.

Concerns that cash-based budgeting can be misleading for some programs led to proposals to extend the use of accrual budgeting to federal insurance programs. In the fiscal year 1993 budget, the Office of Management and Budget (OMB) proposed using a credit reform approach to budgeting for these programs. We are currently studying the use of accrual budgeting for federal insurance programs. Our work to date has revealed shortcomings with the cash approach to budgeting for these programs, but also highlighted difficulties in estimating future costs for some of them due to the lack of adequate data or to sensitivity to the

assumptions used to model future costs.

For example, for the Pension Benefit Guaranty Corporation (PBGC), the current cash-based budget estimates that collections will exceed outlays by about $1.1 billion for fiscal year 1996. Analysts agree that this is not an accurate indicator of the financial condition of this program, but they disagree on how to measure the federal commitment. OMB has proposed recognizing future obligations for pension insurance at the point the government extends the commitment, using a probabilistic estimate involving long-term projections of bankruptcies of covered firms and the funding status of their pension plans. OMB's most recent estimate of PBGC's obligations, as shown in the Analytical Perspectives of the President's fiscal year 1996 budget, ranges from $20 billion to $40 billion. Financial statements, on the other hand, recognize future obligations based on terminated plans and those plans that are reasonably probable to terminate. On this basis, PBGC's 1994 financial statements, the most recent, reported the present value of future benefits as just over $9 billion for these plans.[2]

Furthermore, future cost estimates may be subject to significant annual fluctuations. Estimates of PBGC's future cost for pension benefits decreased significantly in the last year. OMB's current

[2]FASAB's recommended standards will continue this method of reporting a liability and will also require disclosure of the probabilistic estimate if it differs from reported liability.

estimate represents a downward revision of $40 billion to $50 billion from its fiscal year 1995 estimate. PBGC's September 30, 1994 financial statements also reported a downward adjustment of $1.5 billion from its September 30, 1993 statements. Under an accrual method, these types of estimation fluctuations would have to be reflected in the budget through a reestimation process, which may raise more problems.

In light of these reestimation problems, substantial questions are raised about the practicality of an accrual budget approach for some of these programs. The challenge involves weighing the potential distortions arising from the cash-based approach with the risks and uncertainties involved in estimating longer-term accrued costs for some programs. In areas where accrual information is not considered reliable enough to be directly incorporated into the budget, such information could nevertheless be used as a supplement to the budget. Our upcoming report on budgeting for insurance will address these issues.

HOW CAN OTHER POTENTIAL FUTURE COSTS AND CLAIMS BE CONSIDERED IN BUDGETING?

There are a number of programs that under current policy could result in large future government payments but whose costs are appropriately not booked in the budget as budget authority and outlays. The future costs of Social Security and Medicare are

examples of claims or costs that will encumber future budgets for years to come. Decisionmakers need to consider these potential future costs in their current decisions but also need a framework to sort out the claims based on the strength of the underlying commitment and the reliability of the accompanying estimates.

Although cash may be a misleading indicator of the long-term costs for some of these programs, the long-term costs are typically too uncertain to be booked directly into the budget. Accrual-based cost estimates for them are sensitive to yearly changes in economic and demographic assumptions which can lead to large differences in the present value number used to book future costs. Moreover, the nature of the federal commitment for these kinds of payments generally represents an expectation for the continuation of current programs or benefits. The Congress is not legally bound to continue such commitments. As we have seen this year, government commitments can change.

Policymakers, nevertheless, need to be aware of these costs through understandable supplemental financial data that projects future costs under a range of different assumptions or scenarios. Such information enables early action to be taken to contain or reduce these costs before problems reach crisis proportions.

For example, some programs, such as Social Security and Medicare, pose very large potential future claims on resources. Because of

the size and nature of these programs, understanding their financial condition is important to understanding the financial condition of the government as a whole. However, uncertainty surrounds long-range estimates. For example, the present value of Social Security's 75-year estimate of its actuarial deficit increased by about $1 trillion between fiscal years 1993 and 1994. Nevertheless, decisionmakers need to be aware of this huge deficit--$2.8 trillion as of September 30, 1994--which is looming on the horizon unless actions are taken to address it.

It is crucial for decisionmakers to take claims on future resources into account when budgeting, but the strength of the underlying claim must also be considered. The strength of claims on future resources is really a continuum ranging from very firm, as in the case of actual liabilities like the public debt, to less firm, as in the case of commitments to make payments like social insurance, and finally to the mere expectation that current policies will be continued, such as continued support for education.

There are even claims for future spending that are less firm than the expectation that current spending programs would be continued. These claims could be thought of as unmet needs--spending on needs that have not been addressed in current programs. Examples of estimates for such funding are as much as $425 billion for maintenance and improvements to highway

infrastructure and about $130 billion for water treatment facilities to meet environmental standards. In considering these future claims, one must be careful because unmet needs, which create pressures for spending, are in no sense existing claims on the government. Any effort to compile a list of future claims needs to discriminate among the various strengths of the claims to present a balanced picture of the future for decisionmakers.

Financial reports based on FASAB's recommended standards will provide valuable information to help sort out these various kinds of long-term claims. The recommended standards envision new reports on a broad range of liabilities and liability-like commitments and assets and asset-like spending. Liabilities, such as the federal debt, would be reported on a balance sheet, along with assets owned by federal agencies, like buildings.

Stewardship reporting will be provided on potential future claims that, although not traditional liabilities, represent the government's role in making future social insurance payments. Although these claims are not firm enough to warrant recognition as liabilities on balance sheets, FASAB, in developing standards for reporting on the claims, recognized the unique expectations placed on government for the delivery of services and benefits deemed to be important to the public. Social Security and Medicare are viewed by many people as having characteristics of long-term unfunded liabilities because of their "contributory"

nature. Others view these programs as "pay-as-you-go" entitlements similar to those financed by general revenues, with a liability for only the amounts that are currently payable. There are strongly held views on both sides of the question. The majority view among FASAB members is that no long-term unfunded liability exists although there is a public perception of an enduring commitment and support for liability treatment. FASAB is exposing for public comment an accounting standard that would call for reporting amounts due and payable at year end as a liability and for full disclosure of several different estimates for various populations and time periods of these programs. FASAB believes this is the most feasible way to deal with the issue.

To give a picture of the government's capacity to sustain current public services, stewardship reporting will also include 6-year projections of receipt and outlay data for all programs based on data submitted for the President's budget. As I noted earlier, GAO's own simulations of current budget policies over the longer term helped policymakers understand the sustainability of current policies.

Information in new financial reports on assets owned by the federal government as well as federal investments intended to have future benefits for the nation can also provide a valuable perspective for budgeting. Stewardship reporting would cover

federal investments and some performance information for programs intended to improve the nation's infrastructure, research and development, and human capital due to their potential contribution to the long-term productive capacity of the economy. These kinds of activities would not be reflected on the balance sheet because they are not assets owned by the federal government but rather programs and subsidies provided to state and local governments and the private sector for broader public purposes. Stewardship reporting recognizes that, although these investments lack the traditional attributes of assets, such programs warrant special analysis due to their potential impact on the nation's long-term future.

HOW CAN BUDGET DECISION-MAKING BE STRUCTURED TO CONSIDER MANAGERIAL COST CONCEPTS?

The way budget and financial accounts are organized also influences decision-making. Currently different account structures are used for budget and financial reporting. This makes using these reports together difficult and may prevent decisionmakers from benefiting from all available information.

We are currently finishing a study of the budget account structure for Senators Domenici, Roth, and Hatfield. The report describes the budget's current account structure, which is reflective of the multiple uses of the budget. Because the

current account structure evolved over time in response to specific needs, it is both varied and complex. For example, some accounts are organized by object of expenditure while others are more closely aligned with programs. Accounts also vary in the coverage of costs. Some accounts include both program and operating spending for programs or activities while in other instances, separate accounts are used. Or, a given account may include multiple programs and activities.

FASAB's recent work has emphasized the need to consider the full cost of programs and outputs when making budget and management decisions. FASAB's recommended standards call for the collection of costs by responsibility segment, a component of an agency that is responsible for carrying out a mission or producing products or services. The standards require responsibility segments to capture the "full cost" defined as the costs of all resources used (indirectly or directly) and the cost of support services provided by others, net of any income earned as a result of the program's operations. Financial statements prepared on this basis will then show further breakdowns of cost by the various programs carried out by the responsibility segments. This emphasis on full cost will be crucial because it, rather than cash outlays, is the appropriate cost measure to use with performance measures when evaluating the cost and benefits of a program.

The information provided by these new standards will be useful in budgetary decision-making. Since this type of cost information is not currently clearly reported in the budget, financial statement reporting of it would provide decisionmakers a more complete picture of program costs. And because the budget account structure is generally not aligned with the responsibility segment concepts that will underlie financial reporting, additional analysis or crosswalks would be needed to enable decisionmakers to consider this information in allocating resources. In addition, if the account structure is re-examined in light of various cross-cutting initiatives like those in the Government Performance and Results Act, the question of whether to try to achieve a better congruence between budget accounts and the accounting system structure should be considered.

WHAT OPTIONS COULD PROMPT CONSIDERATION OF THE LONG-TERM FINANCIAL OUTLOOK?

The new financial reports based on FASAB's recommended standards will provide much-needed additional perspective on the long-term prospects for government programs and finances. This information can be used in conjunction with other kinds of actuarial and economic analyses already available. Although most budget decisions are made annually, they carry long-term consequences and potentially encumber future generations' resources. Periodically, the implicit long-term fiscal consequences can be

made more explicit, thereby providing today's decisionmakers with tools to alter this course.

Several approaches could be considered to prompt decisionmakers to use this information when making resource allocation decisions. One approach would be to think of the budget and financial statements as a single package of financial reports. Ideally, they could be provided to decisionmakers at the same time. This would require that audited financial statements be completed earlier and that a formal mechanism be developed to ensure their joint distribution. Although this may seem a trivial issue, I cannot overemphasize the need to stress that the two types of reports are two parts of one whole. This would be most apparent if they are provided together. Even if the most recently audited financial statements are not available when the President's budget is submitted, a financial report showing the trends in financial statements over a period of time could benefit policymakers.

Other mechanisms could be considered to prompt consideration of financial information on the long-term consequences of choices in the budget. For example, long-term simulations of current budget policies, perhaps over a 30-year period, could be prepared periodically to help assess the future consequences of current decisions. The effects of policy changes as well as broader fiscal policy alternatives could be projected over the long term

as well. Such projections could be prepared and presented in the President's budget document as well as in congressional budget documents.

The President's budget as well as congressional budget resolutions might also explicitly discuss how budget proposals would address long-term issues disclosed both by these projections and other financial information. At the very least, such a discussion could encourage a public dialogue focussed on the long-term outlook and might engender pressures for programmatic reform and fiscal changes.

HOW CAN WE COMMUNICATE THE ESSENTIALS TO THE PUBLIC?

The public will benefit from these changes in financial and budgetary reporting and management. Improved accountability for tax dollars and more informed decisions mindful of total costs may help raise the confidence of the public in the federal government.

The public can also benefit from a reporting mechanism that regularly provides them with information about how their federal taxes are spent and managed. To date, this information is provided as part of the tax forms, in special reports prepared by interest groups and the media, and most extensively, in the President's annual budget. Although the budget contains

information on how taxes have been spent and estimates on how future taxes may be spent, it is not intended for the average citizen's use. OMB formerly published a Budget In Brief that was more accessible than the full budget document, but it was discontinued years ago. For fiscal year 1996, OMB once again included a citizen-oriented document as part of the budget documents. A Citizen's Guide to the Federal Budget, Fiscal Year 1996 provided an overview of the budget, highlighting such concepts as the deficit and the debt, and reviewing the President's 1996 proposals. It did not, however, provide much insight on the long-term implications of current spending policies.

The public needs a report that is easy to understand, concisely presented, and able to capture and focus its attention on critical issues. The information contained in such a report should be clear and understandable to the average person. Another essential element of the report would be an explanation of how the government has performed during the past year, including a statement on whether the government and its citizens are better off than they were last year. It also would be important for such a report to include some perspective on the long-term implications of current budget policies and provide a commentary on the relationship between federal fiscal policies and priorities and the future economic well-being of the nation.

While there is general agreement that such a report is needed, there has been no consensus to date on how best to inform the public. Based on a National Performance Review recommendation, the Department of the Treasury is developing a Financial Report to the Citizens which has as its goal the understandable presentation of basic financial data. In the future, when consolidated governmentwide financial statements are being produced and audited, excerpts from those statements could form the basis of such a report to the citizens. This would have the advantage of basing the report on data that have been audited.

CONCLUSION

Improved financial systems and reports are essential to improving the government's ability to provide accountability for public resources. Continuing fiscal pressures will place a premium on the proper stewardship of increasingly scarce public resources. Recent efforts to improve federal financial reporting will, if properly implemented, provide the tools needed to redress long-standing weaknesses.

Improved financial reports and data should also better help policymakers sort out competing claims in the budget process. Improved financial data on the current and future stakes involved in our decisions may help policymakers make decisions focused more on the long-term consequences. The public also stands to gain from these initiatives, both from improved accountability for public resources and more informed decisions.

Mr. HORN. Well, we thank you. Mr. Chapin, do you want to add to that statement? Mr. Chapin is the Chief Accountant of the General Accounting Office.

Mr. CHAPIN. Mr. Chairman, thank you for the opportunity to speak. I would like to add something and in particular inform the committee of the activities of the Federal Accounting Standards Advisory Board. Before the end of the year, hopefully as soon as October, the basic standards for accounting and reporting by the Federal Government should be in place. Although there's some finish-up work to do, these basic standards provide a unique and very useful Federal accounting model.

The Board has followed extensive due process to get acceptance from users for its standards. The process is quite similar to that followed in the private sector by, for example, the FASB, the private sector accounting standards-setting board. Our Board is proud that we have been able to do this in record time. The Board's work has been guided throughout by an extensive study of user needs, which the Board made at the very start of its work.

This user need information has been articulated in the Board's statement on Objectives of Federal Financial Reporting. This has been our guide throughout the process of setting standards, so that we have a degree of uniformity and consistency in all of our work. The accounting information that will flow from these standards will supply what the budget does not. While the budget is an essential planning document, and establishes controls over commitments and outlays, it does not provide all the information needed to manage the Federal Government in an efficient and effective manner.

For example, it does not recognize most Federal assets or many important Federal liabilities—all of which enter into a proper determination of the cost of Government goods and services. Knowledge about these assets and liabilities is also necessary to safeguard the Government's resources and to provide data for future budgets. Armed with the budget and with the accounting information that will flow from these standards, accounting information that can be related to the budget, Federal managers should be able to improve the efficiency and effectiveness of Government operations.

In that respect, the Board has emphasized providing accrual accounting information in a form most useable to those who are used to working with the cash based budget. Where consistency in the budget is not possible because of the basic difference between cash-based accounting and accrual-based accounting, the Board has attempted to provide reconciliations and other types of bridges so that proper communication and understanding can occur.

Throughout its work, the Board has stressed the need to report accurately the gross and net costs incurred by the agencies in each of the sub-groups who will be reporting entities. The bottom line in the principal operating report, the Statement of Net Costs, is the net cost to the taxpayer of the activities carried on by the agency. Importantly, that statement will also show the cost and net cost for each of the agencies' programs.

This information will help make the Government Performance and Results Act effective, and provide the needed and, thus far, the missing cost information to those who formulate budget requests,

and to those who review those requests. The Board has also stressed providing accountabilities, either by recording dollar information on assets, investments, liabilities, contingencies and commitments, or by providing dollar and other kinds of information about them when it is not possible to recognize or measure the dollar data, and include them in the financial statements themselves.

I believe that the Congress will find that reports based on the Board's standards will vastly improve its ability to work with the budget and provide oversight of Federal Government operations. At this point, I'm not worried about whether the Board can perform its difficult task; I think it has substantially accomplished it. My worry for the future is whether Federal accounting systems which, Mr. Chairman, I'm sure you know, are in terrible shape—whether those systems can be made sufficiently operational to execute the Board's standards and provide the much needed accounting reports.

Thank you for the opportunity to make this statement.

Mr. HORN. We thank you for that most helpful statement. We now have Mr. Paul L. Posner, the Director for Budget Issues, Accounting and Information Management Division of the General Accounting Office.

Mr. POSNER. I have no statement, so I'll satisfy the committee's time constraints, and offer my time to someone else.

Mr. HORN. This leaves wonderful time for questions.

Mr. POSNER. That's right.

Mr. HORN. If you were a Ph.D. candidate in an oral, you would want to get the committee members fighting with each other, and then you just wait until the 2 hours is up. OK. Now we have the Honorable G. Edward DeSeve, Controller, Office of the Federal Financial Management in the Office of Management and Budget. Welcome.

Mr. DESEVE. Thank you very much, Mr. Chairman, members of the subcommittee. Thank you for the opportunity to appear before you today. I've submitted more extensive formal testimony for the record, which covers the topic before us today in the broader context of such legislative initiatives as the Government Performance and Results Act, the Chief Financial Officers Act, and the Government Management and Reform Act.

These legislative initiatives are intended to work together to provide the legislative foundation for developing accurate and reliable cost information and performance data. Such information is essential if the executive branch and the Congress are to make informed decisions and move successfully toward a smaller, more efficient Government that focuses on accountability and managing for results.

Within this context, I would like to focus on three areas: the integration of the budget formulation and execution process with financial standards, statements and account structures; the role of performance and program integrity in budgeting and financial management; and the streamline of current reporting processes. The complexity of programs within and across departments requires a carefully designed infrastructure to assure that programs and financial data are available to managers, policymakers, and the Con-

gress as part of the process of formulating and executing the budget.

New technologies are making the storage, transmission and retrieval of data easier and less expensive. At the same time, departments in central agencies must labor hard against the Tower of Babel effect that comes from the lack of financial and data standards. Three initiatives are currently underway to enhance these standards. First, the standard general ledger. Under the guidance of the Interagency Standard General Ledger Board, the SGL is being designed as the basic framework for recording accounting transaction information on a common basis across the Government.

The standardization simplifies systems implementation and data transmission within and across agencies. The second is the Federal Accounting Standards Board, which Mr. Chapin has already talked about. The overall lack of accounting standards for the Federal Government has hampered attempts to ensure accountability for financial resources. By the fall of this year, FASAB will have recommended a framework for financial reporting, and the basic standards needed to carry it out.

FASAB, as you know, was created by the Treasury, GAO and OMB working together. And at that point, OMB's work begins, in a sense. And we expect to issue the standards in formal guidance by the end of the year, and to revise form and contents by the end of fiscal year 1996 so that the standards will not only be issued, but will be operational throughout the Federal Government, at least in the executive branch.

The third initiative is managerial cost accounting. Using the statement of financial accounting standards No. 4, managerial cost accounting, the Joint Financial Management Improvement Program, another tri-partite group—and it's kind of nice today to be with my friends from GAO, because a lot of the work we've done in FASAB and JFMIP has very much been a work of joint development. JFMIP is currently preparing detailed guidance for agencies on how they might collect cost information to support budget and performance reporting.

In the systems area, the concept of the single integrated agency financial management system was first formally promulgated in July 1993, with the issuance of the revised OMB Circular A–127 financial management systems. This clearly defines the relationship of financial programs in mixed systems, and sets a standard for a single data entry that is extremely important in rationalizing the current systems environment in agencies.

To extend the scope of A–127, and to provide practical guidance, the framework for Federal financial management systems was issued by JFMIP in January 1995. We have extra copies for the committee, if they would like them; and there is even an overview document, which is capable of being put in your vest pocket if you'd like to carry it around with you—I recommend it, as a matter of fact.

The implementation of agency systems has also been significantly aided by the creation of the General Services Administration schedule of commercial off-the-shelf software, which qualifies multiple vendors with systems capable of meeting JFMIP core requirements. The schedule, which has been updated recently, allows

agencies to meet the requirements of A–127, and gives vendors an incentive to keep their systems up to date.

I agree with Mr. Chapin—further work needs to be done in the systems area to integrate budget and financial management information within and across agencies. This area needs extensive work at this time so that the agencies can themselves comply with core financial management requirements. However, in many agencies, the account structures themselves do not facilitate the collection of cost data and its association with program data.

In OMB Circular A–11, revised, dated June 6, 1995, "Agencies are encouraged to review their budget account structures, and to propose changes that would allow budget accounts providing resources for a program with program results." This initiative will assist in integrating the requirements of GPRA with the annual budget process. Any proposed changes will be accompanied by extensive congressional consultation.

And if I could digress and put a plug in here, it would be very helpful, at some point, for this committee to perhaps get a briefing on this. We'd be delighted to give it to you, because work with the appropriations committees especially, and aligning account structures so that cost information can be directly related to a program is something that's going to be very important.

And at the moment, we do not have appropriation structures that allow this. For example, in HUD, there is currently a program called the Annual Contribution for Assisted Housing, which has $9 billion worth of budget—had, until the mark-up yesterday—$9 billion worth of budget authority associated with it. That number is somewhat smaller now. It has all of the program areas of HUD and over 40 programs in that one account structure. It makes it very difficult to set up a system, even with the availability of sub-account information.

The final area I'd like to talk about—I'm sorry, the third area I'd like to talk about is program performance and integrity. The Chief Financial Officers Act is taking the lead in recommending to OMB that the implementation of GPRA be closely integrated with the budget process. This has been done through the work of the Chief Financial Officers Council.

Within OMB, a task force is discussing various ways to integrate performance initiatives and streamline work processes, both at OMB and within the agencies, to produce better information with which to evaluate and manage programs. The result of this group's work will be discussed with agencies and the Congress, with the intention of considering changes for the fiscal year 98 budget process.

This does not mean that any changes will be delayed until then. In fact, results of GPRA pilots and the use of performance information contained in the fiscal year 96 budget has already informed resource allocation decisions. The results of the recently concluded OMB spring review of performance, and the use of performance data in the fiscal year 97 data, will continue the progression toward full GPRA implementation, and foster better management.

A focus on performance alone ignores an important component of program execution, program integrity. Lack of program integrity can lead to fraud, waste, or abuse, which will undermine program

performance and public confidence in Government. With the recent publication of revisions to Circular A–123, OMB has highlighted the need for the design of programs and the evaluation of their performance to have, as an integral component, the continual assessment by program managers of the risk inherent in each program component, and strategies for its abatement.

Ideally, this should be done as part of the budget formulation and execution process. Finally, report streamlining. The financial statements required under the CFOs Act and GMRA have been important in identifying weaknesses in accounting structures, and in refining financial data. In many cases, the lack of integration with budgetary reporting and the overlap with other reporting requirements makes these financial statements less useful than they might otherwise be.

In the GMRA, OMB asked for and was given pilot authority to waive statutory reporting requirements in consultation with Congress. In February, Director Rivlin notified Congress of OMB's intention to use this authority to streamline various reporting processes. In concert with the CFO Council, OMB has identified five agencies who are willing to serve as pilots for an accountability report, which would combine financial results, program integrity information and program performance information into a single report.

I might again digress. This is an accountability report, produced by the Department of Veterans Affairs. And I think that if you review it, you'll find that it's a model not only with popular information—for example, you can see the drop in in-patient days in VA hospitals, but you can also see the increase in out-patient days, as part of a strategy to reduce the cost of in-patient stays but improve the treatment by increasing out-patients—and there are very good graphics in it.

It also has a discussion of the high risk areas in its internal control report, and it has its audited financial statement all in one cover. It's not an enormous document; in fact, you probably, if you cut it down another 50 pages, would have something that could be used by the informed public. It's not a popular document, per se. But this is the prototype that we're trying to move toward of getting financial information, performance information, and program integrity information in a single document.

This is the first year it's been done; there's more to come. And we'll be coming back to Congress to discuss the five agency prototypes as soon as they've been through the review process at OMB and have been selected. In order to qualify as a pilot, the agencies will need to assure their resource management organizations—that is the budget side at OMB—that they have the capability to produce their information on a timely basis, and that the information will be useful as part of the budget formulation and execution process.

While the Office of Federal Financial Management, which I head, will continue the consultation with Congress, the active involvement of the RMOs is an important step in the implementation of the integration of management and budget contemplated by OMB 2000. In conclusion, for the public to be able to understand the re-

sults of Federal activities, financial program performance and integrity information, must be presented on an integrated basis.

This should be done not as an add on to current requirements, but as a simplification of current work process, both in central agencies and within the departments. Treasury, OMB, and GAO are working to produce the first Governmentwide audited financial statement. As part of this process, they will develop a popular format for presentation of information. Our job over the next several years is to focus on the content of agency information, and the process by which it is produced.

So the final product, available to the public, will be one that we can be proud of and the public can have confidence in. Thank you very much, Mr. Chairman.

[The prepared statement of Mr. DeSeve follows:]

G. Edward Deseve

Controller, Office of Federal Financial Management

Office of Management and Budget

Mr. Chairman, Members of the Subcommittee, I am pleased to be here today to discuss how the Chief Financial Officers Act of 1990 (CFOs Act) and the Government Management Reform Act of 1994 (GMRA) contribute to efforts to better inform the American taxpayer about how their tax dollars are spent.

Passage of the CFOs act reflected The Congress' continued commitment to better management of Federal resources, and the production of information that is accurate, timely, and helps policy makers make better decisions. This Administration has a strong and deep commitment to better management of the Federal Government and has worked closely with this subcommittee, the full Committee, and the Senate Governmental Affairs Committee to facilitate this improvement. The CFOs Act, the GMRA, and the Government Performance and Results Act (GPRA) must work together to provide the legislative foundation for developing accurate and reliable cost information and performance data. Such information is essential if the Executive branch and The Congress are to make informed decisions and move successfully toward a smaller, more efficient government that focuses on accountability and manages for results.

In this time of resource constraints and questions about the fundamental value of government programs, it is more important than ever that the American taxpayers, managers, elected

than ever that the American taxpayers, managers, elected officials, and policy makers know how much programs actually cost, which programs are working and providing good value, and where changes are needed to improve program effectiveness and efficiency. I believe the topics you asked me to address today all play an essential role in providing these users of financial information with the data they need to make informed decisions on the critical issues faced in better managing the Federal Government.

Today I will provide information on each of the specific topics you requested.

FEDERAL ACCOUNTING STANDARDS

The Federal Accounting Standards Advisory Board (FASAB) was established on October 10, 1990 by Memorandum of Agreement among the three principal agency heads (the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General) concerned with overall financial management in the Federal Government. At that time, the Federal Government did not have a comprehensive set of accounting standards. However, it was widely recognized that a comprehensive set of accounting standards was needed, and that compliance with these standards must be measured on a regular basis in order to ensure the integrity of the financial information reported to the American taxpayers, managers, elected officials, and policy makers.

By the fall of this year FASAB will have recommended a framework for Federal financial reporting and the basic standards needed to carry it out. OMB expects to issue the standards by the end of the year. After issuing the standards, OMB will fulfill its responsibility to prescribe the form and content of agency financial statements by modifying its existing "Form and Content" guidance to incorporate the new standards. The revised "Form and Content" guidance is expected to be completed by late next summer.

FASAB PROGRESS

Accounting Concept Statements

FASAB has recommended and OMB has issued two accounting concept statements ("Objectives of Federal Financial Reporting", and "Entity and Display").

- **The Objectives of Federal Financial Reporting** are designed to guide FASAB in developing accounting standards that address four major objectives:

  Budgetary integrity -- FASAB clearly understands that in developing accounting standards, recognition must be given to: (i) the importance of budgeting in federal financial management; (ii) the complementarity of budgeting and financial accounting; and (iii) the need to assure the accuracy of budget execution.

  Operating Performance -- In developing standards that address this objective, FASAB recognizes that a myriad of performance measures are the Government's counterpart of business income, that expenses need to be matched to the services and goods provided to the public, and that federal managers require cost and other information to manage efficiently and cost effectively.

Stewardship -- With this objective, FASAB is acknowledging that Federal financial condition involves not only the Government's own balance sheet, but its financial ability to continue to carry out its Constitutional responsibilities and its contribution to the wealth and well-being of the Nation.

Systems and Controls -- This objective was adopted to recognize the Federal Government's need for systems and controls that are cost effective, provide appropriate information, and reasonably assure the integrity and efficiency of operations.

- **Entity and Display** is a conceptual statement that provides guidance as to what should be encompassed by Federal Government entity's financial reports, establishes guidelines for the makeup of each type of reporting entity, identifies new types of financial reports for communicating information for each type of reporting entity, and suggests the type of information each type of report should include.

  The concept statement suggests modifications for each of the existing principal financial statements. The most significant modification is to the "Operating Statement" (income statement). That statement is renamed the "Statement of Net Costs" and is modified to show the entity's cost of providing goods and services. The gross cost would be offset by revenue earned when such services are sold to users. The "bottom line" of the Statement of Net Costs would show the entity's cost left to be financed by the general taxpayer or by borrowing.

Statements of Federal Financial Accounting Standards (SFFAS)

FASAB has recommended, and OMB has issued, three Statements of Federal Financial Accounting Standards (SFFAS) providing accounting standards for sixteen financial reporting categories. FASAB has recommended, and OMB is about to issue, a fourth statement encompassing both concepts and standards for managerial cost accounting.

- **SFFAS #1 Accounting for Selected Assets and Liabilities --** This statement provides standards for five asset categories: Cash, Fund Balance with Treasury, Accounts Receivable, Interest Receivable, and Advances and Prepayments; it also provides standards for four liability categories: Investments in Treasury Securities, Accounts Payable, Interest Payable, and Other Current Liabilities.

- **SFFAS #2 Accounting for Direct Loans and Loan Guarantees --** This statement was designed to complement budgeting for Federal Programs under the Credit Reform Act of 1990. This standard represents a break from traditional accounting valuation in that the net present value of the total Federal Subsidy for direct and guaranteed loans is accounted for at the time the loan is made.

- **SFFAS #3 Accounting for Inventory and Related Property --** This statement provides standards for six asset categories: inventory (held for sale), operating materials and supplies, stockpiled materials, seized and forfeited assets, foreclosed property, and goods held under price support and stabilization programs.

- **SFFAS #4 Managerial Cost Accounting --** This statement encompasses both standards and concepts relating to managerial cost accounting. Presently most Federal entities do not have systematic cost accounting methods or procedures. This statement requires Federal entities to accumulate and report the full costs of their activities. This cost information will be useful to taxpayers, managers, elected officials, and policy makers in making decisions about resource allocation and program priorities. Also, cost information will be essential to accurately report on and evaluate performance.

Accounting Standards in Process

FASAB is currently developing separate SFFAS's covering: Liabilities, Property and Equipment, Revenue, and Stewardship. Work on these standards is expected to be completed before the end of the fiscal year with issuance by OMB expected by late fall. When these standards are complete, the Federal Government will have, for the first time, a comprehensive set of basic accounting standards. These standards in process are expected to be effective for reporting periods that end on or after September 30, 1997. Earlier application is encouraged.

- **Liabilities** -- This proposed statement will provide a definition and general principles for the recognition of liabilities. The statement includes specific standards for the recognition and measurement of liabilities for: contingencies, insurance and guarantee programs (other than loans), pensions, other retirement benefits, other post employment benefits, federal debt, and capital leases.

- **Property, Plant, and Equipment (PP&E)** -- This proposed statement divides the diverse universe of PP&E held by federal agencies into 4 categories: General PP&E, Federal Mission Property Plant and Equipment, Heritage Assets, and Stewardship Land. The only category that would require depreciation would be general PP&E. In addition to PP&E, this statement includes accounting standards for deferred maintenance and cleanup costs.

- **Revenue** -- This proposed statement deals with basic standards for classifying, recognizing, and measuring resource inflows. The statement describes revenue as coming from two sources: exchange and non-exchange transactions. Exchange transactions occur when a Federal entity provides goods and services to the public or another Federal entity for a price. Non-exchange transactions arise primarily from the government's power to demand payment from the public, e.g., taxes, duties, fines.

- **Stewardship** -- This proposed statement is to recommend standards for reporting on the Federal Government's responsibility for certain resources entrusted to it. This information would be reported as "Supplementary Stewardship Information." Generally the costs of these resources are reported as expenses in the financial statement. However, these expenses are intended to provide long term benefits to the public. Therefore, in the proposed stewardship statement, the Board has proposed that data on these resources should be highlighted to show the long-term nature of these resources and to demonstrate accountability over them. The statement identifies the following stewardship categories:

  - **Stewardship PP&E**

    Heritage Assets, Federal Mission Assets, Stewardship Land

  - **Stewardship Investments**

    The costs incurred in providing education and training programs financed by the Federal Government for the general public, and the costs incurred in financing research and development efforts

  - **Other Stewardship Information**

    Information that will aid in assessing the sufficiency of future budgetary resources to meet obligations as they become due, including social insurance.

FUTURE FASAB WORK

After completion of the basic standards described above, there will remain considerable work for FASAB, including codification of the standards and assisting in interpreting the standards. In addition, FASAB has identified issues that require attention, but are not addressed in the basic standards. These include: accounting standards for natural resources, the recognition and measurement of expenses, and accounting for the cost of capital.

IMPLEMENTATION OF THE CFOs ACT

Since passage of the CFOs Act, the Federal Government has made significant progress in addressing the challenges faced in improving the financial management of the largest institution in the world. However, much work needs to be done. Progress to date has been considerable in a number of areas including:

Financial Management Systems

The poor condition of financial management systems has been at the heart of the government's financial management problems. An indication of the Administration's commitment to improving financial management systems can be seen in the priority given this issue by the CFO Council. The Council has made improvements to financial management systems its number one priority for the coming year. In spite of the progress that has been made in developing financial management systems policy and defining financial systems requirements much work remains to be done.

Several organizations are working on improving Federal financial management systems including the CFO council, the Joint Financial Management Improvement Program (JFMIP), OMB, Treasury, and individual agencies. Their accomplishments include:

- In January 1995, Treasury implemented FACTS which collects agency standard general ledger (SGL) account balances to be used in producing the Government's Consolidated Financial Statement

- In January 1995, JFMIP published the Framework for Federal Financial Management Systems. In June 1995, it published the Inventory System Requirements.

- In July 1995 OMB began using its government-wide budget system, MAX, to provide budget execution information and related analytical capabilities to OMB program analysts.

Progress is also being made in consolidating and standardizing systems through the use of department-wide systems to replace individual bureau systems. The percentage of agency systems designated as department-wide standard systems has increased from 26% as of September 30, 1993 to 29% as of September 30, 1994. In addition, the number of systems under development designated as department-wide standard systems has increased from 57% to 62% during the same period.

Improvements have been made, but significant work remains to be done to improve and upgrade the agency and government-wide financial management systems themselves. As an example of the task ahead, agencies reported that 53% of their operational systems will need to be replaced or upgraded in the next five years. Substantial resources will be needed to make these financial systems improvements. Without these enhancements, efforts to improve financial management in the federal government will be severely hampered.

Improved Federal Financial Reporting

In November 1993, OMB reported to Congress on the benefits, accuracy, difficulties and costs associated with Federal agencies' audited financial statements. The report concluded that audited financial statements are bringing about marked improvements in the timeliness and accuracy of financial information used for decision making. It also pointed out that the preparation and audit process is uncovering important systems deficiencies, stimulating the strengthening of internal controls, fostering improvements in financial systems, and creating interest in better measures of program performance.

An indication of the financial management improvements agencies are making can be seen in the increase in agencies' financial statements determined by independent audit to be in conformity with prescribed accounting standards (unqualified opinions). For FY 1993, 47.1% of agency audited financial statements were given unqualified opinions by their independent auditors. This is a marked increase from the 34.5% of FY 1991 audited financial statements receiving unqualified opinions. This steady improvement in the quality of agency financial statements is encouraging.

As a result of passage of the GMRA of 1994, major segments of the Federal Government's operations that had not benefited from the organizational discipline brought about by the CFOs Act, which applied only to limited agency functions and certain pilot agencies, will now benefit from that experience. These operations include, for example:

- about $16 billion, or nearly 63%, of the Department of Energy's annual appropriations accounted for by its integrated contractors

- about $90 billion appropriated to the Navy

- more than $11 billion, or about 90%, of the Department of Justice's budget authority.

In addition to requiring agency-wide financial statements, GMRA requires the Director of OMB to designate agency components that must prepare and submit separate stand-alone audited financial statements. OMB is working closely with the agencies to develop criteria for determining the agency components subject to this requirement.

We anticipate that the improvements in the timeliness and accuracy of financial information reported by OMB to the Congress in November 1993, will extend to all agency activities as a result of the expansion of the audited financial statement requirements of the CFOs act.

Strengthening Financial Management Personnel and Organizations

Essential to successful achievement of the CFOs Act requirements is a quality Federal financial management work force and appropriate CFO organizational structures to achieve financial management priorities. To achieve these objectives, agency CFOs

- have established CFO organization structures to ensure effective delegation, communication, and accountability;

- are working to improve recruitment, training, and retention of qualified financial management personnel; and

- have developed a shared, government-wide vision for financial management, and goals and strategies for achieving this vision.

The CFO Council's Human Resources Committee published a document entitled The CFOs Role in Strengthening Financial Management at the Component Organizational Level. It identifies ways that CFOs can strengthen the relationships between headquarters and financial and program personnel in the field.

The strength of a CFO organization can be measured by the quality of the personnel it employs. In order to strengthen the quality of financial management personnel, a variety of training and continuing professional development programs have been established by the CFOs community.

In May 1995, the CFO Council established priorities for the upcoming year consistent with their vision statement goals, and strategies. The 1995 Financial Management Status Report and Five Year Plan, required by the CFOs Act, will address the status and plans for each of these priorities.

Management Accountability and Control

Improving management accountability is the goal of a number of related efforts underway across the Federal Government. OMB and the CFO Council have given priority to two specific initiatives: (i) implementing a new approach to management controls that helps managers achieve results, and safeguard the integrity of their programs; and (ii) integrating and streamlining management reports to provide more useful information, especially performance reporting, to decision makers.

OMB has revised Circular A-123, Management Accountability and Control, to eliminate the requirement for paperwork intensive, stand-alone management control programs in agencies. Too often these programs focus on the reporting process, rather than on building appropriate controls into agency operations to ensure good management.

Agencies have traditionally produced a myriad of program and management reports. Producing separate, overlapping management reports has not served internal or external decision makers well. Therefore, the CFO Council has recommended that management reports produce better planning information and performance data. This initiative was undertaken after enactment of GMRA which permits the streamlining of financial management reports after consultation with the appropriate Congressional Committees.

GOVERNMENT-WIDE AUDITED FINANCIAL STATEMENTS

The Congress and this Administration saw the need for an audited government-wide financial statement that would provide the Congress and the American public with a complete picture of where its government stands financially. Our Federal Government is the world's largest financial operation. Yet, it operates without ever knowing its overall financial status, a situation that would be short-lived in State and local governments or the private sector. The National Performance Review recommended an audited consolidated annual report on the finances of the Federal Government and the Congress took steps to make the recommendation a reality by including a provision in the GMRA of 1994 requiring a government-wide audited financial statement. The first government-wide audited financial statement is to cover fiscal year 1997 activity and is due by March 31, 1998, and each year thereafter.

OMB, Treasury, and GAO have been working closely with agency CFOs and Inspectors General to develop a strategy and a plan for preparing and auditing the first ever consolidated financial statement of the U.S. Government.

One of the first steps taken was to request the 24 agencies covered by the CFOs Act to complete an auditability self-assessment. The self-assessment was designed to highlight impediments that agencies will face in preparing and auditing the FY 1996 agency-wide statements required by GMRA. The following is an example of the information disclosed by the self-assessment

- Seven agencies reported that their financial management systems could produce auditable agency-wide financial statements (with limited manual intervention) for FY 1996

- Seven agencies expect that systems enhancements will be completed in time to produce auditable agency-wide financial statements (with limited manual intervention) for FY 1996

- Nine agencies reported system enhancements will not be completed in time to produce auditable agency-wide financial statements (with limited manual intervention) for FY 1996, and

- One agency, the Department of Defense, does not expect to produce auditable financial statements for FY 1996 even with manual intervention.

After analyzing the survey results, OMB, GAO, and Treasury formed a task force comprised of agency CFO and IG representatives. The objective of the task force is to develop a strategy and a plan to overcome impediments disclosed by the self-assessment and to assure preparation and audit of the fiscal year 1997 government-wide financial statement.

Two subgroups have been established within the task force to address separately preparation and audit issues and bring those issues to the full task force for resolution. The full task force and the subgroups have been meeting regularly and are making substantial progress.

This concludes my prepared testimony, Mr. Chairman, and I look forward to answering any questions.

Mr. HORN. We thank you for that most helpful statement. I now yield to the gentleman from New Hampshire, Mr. Bass, for questioning of the witnesses.

Mr. BASS. Thank you very much, Mr. Chairman. Mr. DeSeve, I gather from your testimony that the Federal Government is in the process now of establishing—or you guys are, OMB is in the process of trying to establish a real financial statement for the Federal Government. Did I understand that correctly?

Mr. DESEVE. The Government Management and Reform Act of 1994 specifies the creation of such a statement. The actual folks who are putting the statement and auditing the statement are our friends at GAO. The compilers of the statement are our friends at Treasury. And OMB sets the form and content and policy that goes along with it. So it's a tri-partite effort.

Mr. BASS. And it's going to be a statement that contains real numbers. For example, we're going to be hearing some testimony from individuals who put together a document here, which is somewhat unusual, to put it mildly. The statements that you're talking about coming up with are assets and liabilities, income and expenditures, accrued expenses and so forth—just the way any business would have a statement.

For example, unfunded liabilities for Social Security, Federal retirement, so forth, would be placed there and trust funds and so forth. Are you going to have a real financial statement? Are you going to have assets and liabilities in this?

Mr. DESEVE. Yes.

Mr. BASS. I see.

Mr. DESEVE. I can say yes because I see Gene Dodaro shaking his head.

Mr. BASS. Any of you can answer these.

Mr. DODARO. If I might add, Congressman, there have been prototype financial statements prepared by the Department of Treasury for many years now, which lay out standard financial statements of the type that you're mentioning. Those financial statements however are not accurate. And we've included a letter from GAO every year in the financial statements, saying that the users have to be cautioned about the reliability of that information because they have not been audited.

We now have, through the Chief Financial Officers Act and the Government Management Reform Act, which this Congress passed last year, basically now, for the first time, in fiscal 96, you have a requirement for every agency to prepare financial statements covering the operations of that agency; and then to have that information audited so you can have reliable data of the type that you're talking about.

So, one of the big initiatives that we've been working on is increasing the reliability of information that's currently being reported. No. 2 is the fact that through the Financial Accounting Standards Advisory Board, we're trying to create financial statements that are much more useable in the Federal environment, and not just adaptations of private sector financial statements. And that effort is nearing completion as well.

So hopefully, with both of those initiatives coming to the forefront, you'll have more reliable information and all the information of the type that you mentioned.

Mr. DESEVE. The first statement is scheduled for production after fiscal year 1997, Don?

Mr. CHAPIN. Right.

Mr. DESEVE. And that would mean it would be in calendar 1998. And I can assure you that one of the fondest wishes of the President is that he be there to receive the first statement.

Mr. BASS. Sure, I believe that. I have a couple questions I'd like to ask you gentlemen, just to get into the record here. OMB Circular A–11 has been revised to ask agencies to include in the fiscal year 1996 budget more program performance measures, and to link goals to the resources required to produce them. Will this initiative result in useable information at this stage of the implementation of the GPRA? Or is it premature to require it of the agencies at this time?

Mr. DESEVE. We think that it has and does provide important information. During the Director's review last fall for fiscal year 96 budgets, there was extensive discussion of performance in those hearings. Similarly, we just finished what we call our spring review of program performance, where we went in great detail with many agencies about what it was they intended to accomplish; how they intended to accomplish it; and what resources they would be using.

We focused there on the key programs, the most important programs. It's our intention to expand that in the fiscal year 97 budget; and as agencies develop their strategic plans and move toward performance budgets in 1999, to continue that expansion. We'll be happy to share that information with the committee or with the appropriate appropriations committees who will also be interested in it.

Mr. DODARO. My view is that it would be appropriate at this time to begin using the performance measures in that context. And it's consistent with the schedule outlined in the Government Performance and Results Act, which was gradually to go from pilot status and expand it to Governmentwide use eventually.

I would, however, caution, at this juncture that the need to use discretion in interpreting and using those performance measures, in terms of their reliability, the underlying data used to support them, and also the absence of a lot of cost information on unit costs of performance to eventually get there. But I think it's quite appropriate to begin the dialog on this, because it's going to take some time for full implementation, the way that Congress envisioned when they passed the Government Performance and Results Act.

Mr. POSNER. If I can just add one additional point to that. I think the plan for the Government Performance and Results Act was very much of a phased in implementation, and appropriately so, because performance information, particularly on outcomes and measurement is not an easy thing to do. We at GAO, several years ago, did a study of the States that were reputed to be the leaders in performance measurement.

And we looked to see to what extent were these measures used by the legislature in appropriating funds. And we found that by and large they weren't, because the legislature did not view the

measures as having sufficient credibility. And what we came away with was a consensus by all State officials that you need an incubation period, which is why we have the pilots, particularly for some of the sensitive areas.

Mr. BASS. Another question—if an account has multiple programs in it, that makes measuring cost by program exceedingly difficult. Are current Federal accounting systems adequate to break down costs by programs?

Mr. DESEVE. The answer is, probably not; which is one of the reasons we want to go through the process with agencies of realigning their account structures, working with appropriators to get some agreement on that. If we fail in doing that, we can create pseudo-codes; we can create artificial crosswalks to allow it to happen.

But right now, the account structures in many agencies need significant revision. And that's why we, in A–11 this year, asked agencies to consider those revisions.

Mr. BASS. Performance reports are being described as providing useful information about agencies. To be truly useful, the information included in the reports must be reliable, verifiable, and comparable over agencies. Is there any plan to develop performance measurement standards that can facilitate performance auditing?

Mr. DODARO. Part of that—the testing, the reliability of the performance measures—is expected to be done through the annual audit requirement under the Chief Financial Officers Act. Many of the data that's included in what's now termed to be the overview of the reporting entity in assessment of performance, there's certain requirements that the auditor has to check to make sure that that data is not inconsistent with information presented in the financial statements.

But we do need to look at, in the future, how best to assure the reliability of all performance measures, particularly those performance measures that are not financial based. And that's something that's an excellent point, and I think needs to be worked on. Right now we're trying to just get the basic financial data straightened out. But the reliability of performance measures is key.

And we need to focus on that. We've had many discussions about it, and I think we need to focus on that a little bit more.

Mr. DESEVE. The second part of your question is more difficult; that is the establishment of standards either within an agency or across agencies. In order to do that, you have to first, along with Congress, get an agreement about what an appropriate standard is. For example, in a credit program is it an appropriate standard to have a 10 percent default rate, for example, in that program?

It may be that that's exactly what you're trying to do, and if you only had a 5 percent default rate, you wouldn't be broadly meeting the mandate of that program to go out and find first time home buyers or minority home buyers along the way. So there needs to be a dialog between Congress, which establishes the authorizing purpose for, again, for example, for a student loan.

If we had a zero default rate on the student loan, we probably would not be making the right student loans, according to the congressional intent along the way. So there needs to be a dialog as Congress looks at the performance measures. They need to ask,

and begin to set themselves, not necessarily in legislation, which has been proposed, but perhaps in colloquy or reports, some notion of what they think acceptable performance really looks like.

Mr. BASS. That's it, Mr. Chairman. Thank you very much.

Mr. HORN. I thank the gentleman, and now yield to the ranking minority member, Mrs. Maloney of New York. Do you perhaps have an opening statement?

Mrs. MALONEY. Yes, I do, Mr. Chairman. May I have it submitted to the record in the appropriate place?

Mr. HORN. Without objection, that statement will be put in at the beginning of the hearing. Mr. Mascara's statement will also be put in at the beginning of the hearing.

Mrs. MALONEY. Great. Quite frankly, I was rather amazed to hear your testimony, Mr. Dodaro and Mr. DeSeve, that in our great country you think that our accounting reports aren't accurate and that the numbers on which they're based aren't accurate. I am just amazed, with all the resources we have in the Federal Government, why we just can't have general accounting practices that are acceptable, in place and performing well.

I mean, I'm amazed. You said we couldn't rely on the numbers because the information wasn't accurate. And if you'll allow me to reminisce a little bit, Mr. Chairman, I come from a city that is not well known for good management. But I'll tell you one thing—you can walk into the mayor's office or the controller's office, and within an hour, they can give you a report on the financial status of the city.

It may not be what you want to hear. In 1977, when we had financial problems, the mayor had one set of books, the controller had another. And after that, they decided we're going to have an office that is comprised of independent appointees from the mayor's office and the controller's office. And they went into general accounting practices; they went on-line in computers. And at the very least, they can give you an accurate accounting of the financial status of the city.

And I don't quite understand why we have not accomplished that in the U.S. Government. And when is that going to be accomplished? I think at the very least, we should be able, before you get into performance standards, have a complete and accurate financial status reporting system that is available to the Congress and anyone else. Why has that not been accomplished; and when will it be accomplished?

Mr. DODARO. I'll take a first stab at that. Quite frankly, good financial management has not been a priority of administrations over the years, and difficult to get the Congress to act on. We, for a number of years—at least 12—had been advocating legislation to have audited financial statements become a normal management practice in the Federal Government, as they are in the private sector and State and local governments.

But the same type of incentives aren't there in place. At the State and local level, you have to float bonds and there are all kinds of requirements that the marketplace puts in place, as well as the Federal Government or the private sector. But it wasn't a priority. In fact, this Comptroller General, Chuck Bowsher, is in

his 14th year of his 15-year term, and has been advocating audited financial data for all that period of time.

Additionally, when we finally did get legislation passed—to just tell you the mood of the Congress at the time—in 1990, when the CFO Act was passed, audited financial statements for departments were only put in place on a pilot program. And there was to be a study done, which OMB did, looking at the cost and benefits as to whether or not it made sense in the Federal Government environment to have financial statements and to have them audited on a regular basis.

So this has been slow going. We have been astounded ourselves over the years as to why we couldn't get this in place. I think we're finally over the wrangling about whether or not this is a good management practice for the Federal Government to be in. There's a firm commitment on the part of the administration to go forward in this area, which is something we have not seen in the past, over the 20 years I've been with the General Accounting Office.

I do think we're going to get there, but it's going to take a lot of commitment. And I think the Congress can do its part.

Mrs. MALONEY. When are we going to get there?

Mr. DODARO. Well, the requirements kick in for fiscal year 1996. We do have a significant greater portion of the Federal expenses under audit now than we've had historically. We have over half the budget under financial audit now, in preparing statements. By fiscal year 1996, the law calls for all—virtually all Federal outlays for the 24 major agencies to be under financial statements, and to have those statements be audited.

The Governmentwide financial statements are due in fiscal year 1997. So that's the timetable set up by the legislation. Ed might want to speak to the administration's plan in that area.

Mrs. MALONEY. Could I ask, in the framework of a system that's worked very well in New York, called the Integrated Information System, and really it literally, in one office, you can get all this information about all of the 25 different agencies in the city. It seems to me that you still have it decentralized. You have each agency accounting for it, and then you send it over to Treasury and they compile everything. Is that how it works?

Mr. DESEVE. You pose a very good question. I'm also from a State and local government background. I worked in a couple of cities in California, one in New York, as an advisor, and several States as an advisor. The tradition in the Federal Government, the history in the Federal Government is the 24 major operating departments have stand-alone responsibility. They have what we would call profit and loss responsibility.

And the strategy that was used in 1990, under the CFO Act, was to start with the basic, simple idea that they should account for their own information, rather than taking the $1.5 trillion budget and centralizing it in one accounting system. Each agency should be a tub that stood on its own bottom.

Mrs. MALONEY. But isn't that more complicated? Wouldn't it be better to be uniform?

Mr. DESEVE. You and I may not disagree. I'm trying to give you kind of a history.

Mrs. MALONEY. OK.

Mr. DESEVE. And we're playing the history out now. Mr. Chapin is probably chomping at the bit at the moment, because he and I both think that the idea of moving toward what I've called an accounting utility, which you call a single integrated financial management system, on a Governmentwide basis makes a lot of sense.

Until, though, we get the transaction level reconciliations done, so that we know that even at the lowest level, the financial system is working, it's harder to do the design of the very large system. Frankly, the very large system will be enormously larger than New York. I don't mean to make this sound so difficult.

It's a big job. And so the decision was made in 1990, that we're implementing now, was that at least the Defense Department—$250 billion—have a single financial management system, subject to audit. That in itself is extraordinarily difficult for them. They currently, according to Mr. Hamry, have about $19 billion worth of mismatched expenditures and obligations.

Mrs. MALONEY. Wow. Excuse me, is the audit an independent audit, or is it a Governmental audit?

Mr. DESEVE. Well, we think it's independent, because it will be done by GAO.

Mrs. MALONEY. OK. They do excellent audits, I think. That's why I'm amazed that this has never happened before. I mean, it's just fundamental good management practice to know how much you have in the bank.

Mr. DODARO. Part of the problem—and I'm going to ask Don to expand on this a little bit, because he comes with 30 years' experience from the private sector. But part of the problem, before the Chief Financial Officer was passed, we had to get agencies voluntarily to put together the financial statements and sort of not invite us in for an audit, but at least agree to be audited, because it requires a lot of significant involvement.

What you've not had at the Federal Government level yet is what you had in New York City, a financial crisis in the early 1970's. And you've had a lot of motivation for change and discipline that's been imposed by market forces. New York City can't borrow money and do other things unless they have it. At the Federal Government level, we just keep cranking the money out.

But this is an area Don has a lot of good thoughts on. I'm going to ask him to comment on it.

Mr. CHAPIN. I came to Washington in 1989, and undertook Mr. Dodaro's present position. One of the first things I did was to conduct an audit of the U.S. Air Force. The results were shocking, absolutely shocking to me, who had spent many, many years auditing in the private sector. I had never seen anything like it. Just appalling, appalling.

Mr. HORN. Could you translate those words into a few examples? You're now getting my interest quite excited, and Mrs. Maloney is similarly excited.

Mr. CHAPIN. Tens of billions of dollars unaccounted for. Inventories that no one had reconciled with the records. Materials that couldn't be found. Liabilities that weren't recorded. The financial statements made no sense. They were patched together from pieces of information, not from a real set of books. We'd take a little piece

of information here, a little piece of information here—most of it wrong—and put together a financial report.

The GAO—excuse the expression—raised hell. We got a lot of people's attention, including people at the Department of Defense. But change comes very slowly. When you have thousands and thousands of people used to doing things in a sloppy manner—and sloppy is the word—it's hard to get even the clerks to do things right. In the accounting systems, when you don't have a set of books, when you've never used a general ledger, when you don't have reconciliations, where no one has done any auditing of the financial statements, where there haven't been any financial statements before—I mean, this is Third World.

This is God-awful. And that was the beginning. And that's the nature of the—it's an extreme example, but not atypical of what we found when we began to do the audits of these agencies in the Federal Government. Some are OK, but few, very few, escaped the qualified opinion. Most, in the first few years, get a disclaimed opinion, because we haven't the foggiest idea about whether they're right or wrong.

The Internal Revenue Service, which we've audited for years is a total—well, was a total mess. It's beginning to shape up a bit. But if you look at some of these reports the GAO issues now, you'd be appalled. I recommend to you, when it comes out, reading the report, our report on the Internal Revenue Service, which will be out soon. It will give you a sense of what's wrong in the Federal Government; what's wrong with the systems; what's wrong with the accounting; what needs to be done.

And work has to be done. The systems have to be put in place. The people have to be trained. We need better people in Government; we need people with more expertise. It's just an immense task. It's unbelievably hard for anybody to understand how this could occur. But it has occurred, and it's slowly beginning to respond. When I came down here—I'm running off at length—but when I came down to the Federal Government, I knew we had a problem.

And I thought that, well, I'll come down a few years, we'll fix it. A few years went by and we were still trying to make people aware of the fact that we had a huge problem. Fortunately, we were fortunate with the Congress that they passed the CFO Act, which gave us a start. The act has now been extended. We're beginning to roll. It's like trying to push a big rock up a mountain, with resources as small as ants.

So we make a little progress and we slide back; we make a little more progress and we slide back. I will tell you that we're making progress. I wouldn't be here if we weren't. I would be totally disappointed. I think we've got it underway. I think we're going to cure this problem. I'm afraid I'm going to be retired before it's all cured, but I think we've got this thing underway. And the Congress has done the right thing by equipping the administration with laws—the CFO Act, its extension; the GPRA.

The Congress has done everything it could to respond to the needs, by providing the administration with the incentives to get it done. But I tell you, when you have a job like this, it takes time.

Mr. DODARO. I think the one thing I'm really encouraged by, this past year was the first time, on the Senate side, the Appropriations Committee overseeing the Department of Defense held a hearing on financial management. And Chuck Bowsher testified at that, in a hearing held by the Armed Services Committee. Before it was basically the Government Reform and Oversight and its predecessors, and the Senate Committee on Governmental Affairs, and those committees that have legislative responsibilities.

But the appropriations committees and the oversight committees, the authorization committees really need to focus on this issue to get the agencies' attention. It's become important at Defense because it's draining money away that could be used to enhance readiness. Ed mentioned the problem of unmatched disbursements. Defense has $28 billion that they've made payments, that they can't trace back to know what they paid for.

They overpaid contractors by at least $1 billion, where the contractors voluntarily return the payments. And I could go on and on to define the appalling that Don mentioned, but I won't. But we did add the Department of Defense and the Internal Revenue Service to our high risk program this year, to try to provide adequate impetus to put in place the requisite changes.

Mrs. MALONEY. I have a series of questions, but I'm going to defer to the chairman. You've given graphic examples, and I thank you. But very quickly, if you had to name the five worst managed agencies, you just named two, what would they be in the Federal Government? DOD, IRS, what else?

Mr. DODARO. That's always a difficult question. The only more difficult question is what are the top five best managed agencies.

Mr. DESEVE. Mrs. Maloney, can we get you a copy of the high risk list, because I think it has them ranked, in a sense, on it?

Mrs. MALONEY. OK. And then you mentioned that you had five agencies for your pilot project reports.

Mr. DESEVE. Right.

Mrs. MALONEY. What are those five agencies?

Mr. DESEVE. We're talking right now—we don't know who's going to come out. We don't know if we're going to get all five right now.

Mrs. MALONEY. Are you going to try to get well-managed agencies to begin with?

Mr. DESEVE. Yes, we are. Well-managed in the sense that they've been able to give audited financial statements a high priority, and have been producing good audited financial statements over time. We're going to be looking at VA; we're going to be looking at SSA. The Social Security Administration is a leader in this area. It may have other problems, but audited financials are not among them. Veterans Affairs, Treasury, Nuclear Regulatory Commission—I think that's five.

Mr. HORN. Let me just ask one question, following up on Mrs. Maloney's opening there, which is very helpful, before I yield to Mr. Flanagan. I want to get it straight. I heard the figure $19 billion, and I thought I——

Mr. DESEVE. I was trying to give Mr. Hamry—Gene may be closer to it than I am.

Mr. HORN. This is a recent story in the paper——

Mr. DESEVE. That's right.

Mr. HORN [continuing]. About the Defense Department can't find $15 billion somewhere.

Mr. DODARO. I believe this is accurate, Mr. Chairman. I can go back and get you the accurate figures. But I believe as of March of this year, $28 billion sticks in my mind as the figure that was unmatched.

Mr. HORN. $28 billion?

Mr. DODARO. $28 billion.

Mr. HORN. They only leaked half of the story, then, out of the Pentagon.

Mr. DODARO. Well some of it—and I can provide the accurate figures, but that one sticks in my mind. And a lot of it—the different figures—have to do with the amount of time that the disbursements have been unmatched. And that's why there's a subset of the $28 billion that have been unmatched for a period of time.

And there was some discussion as to whether they were going to stop looking, as to whether they could find the accurate documentation to it, because a lot of these processes are still manual paper-driven processes, and they can't locate a lot of the contract records.

Mrs. MALONEY. Would the chairman yield for a second?

Mr. HORN. Certainly.

Mrs. MALONEY. I am appalled by what I'm hearing; I'm absolutely appalled. And I compliment you on all the fine hearings you've had this year. You've worked at two or three hearings a week, it seems like—more than any other committee. But I think that you should have a hearing on this. I mean, this is outrageous. I mean, I find this unbelievable.

Mr. BASS. Will the chairman yield for just 1 second?

Mr. HORN. Certainly.

Mr. BASS. Is that $28 billion—you alluded to it—over a long period of time? It's not an annual figure, but rather it's a cumulative number over some number of years or decades; is that correct?

Mr. DODARO. That's correct, that's correct. And I must say, the department, prompted by a legislative requirement, is beginning to try to get a handle on this. For example, beginning this summer, due to this legislative requirement, they're not to make any payment over $5 million without checking and matching it first. And then that figure gradually is to drop down to $1 million.

And we're monitoring that effort to see if they're actually going to be able to pull that off. And they're trying to do it electronically—by introducing some electronic ability to do the matching. But we're focusing in on that, and trying to monitor what's going on.

Mr. HORN. What Mr. Chapin found in his audit of the U.S. Air Force is why they tell every officer candidate, get yourself a good master sergeant who can keep the paper flowing. Well, they've kept a lot of paper flowing. But let me ask a more fundamental question. The General Accounting Office used to audit the Pentagon regularly. When did they stop doing that?

Mr. DODARO. To my knowledge, the first financial audit that we did of the records was in 1989, when we started with the Air Force. And we would audit—GAO, historically, like we audited other agencies, would audit discreet programs or activities that would

take place. But we never undertook an audit of an entire service. We started out in some of the civilian agencies, with GSA, the Veterans Administration, Social Security Administration, which is why, as Ed mentioned, those agencies have been producing financial statements now for about 7 years and are having regular audits.

So there are some pockets of excellence in the Federal agencies, and those are good models. But in fact many people thought we were crazy when we went in and started auditing the Air Force. It was too big to do all at once. Then we did the Army next, with similar results. And we're attempting to do an audit of the Navy now, for the first time. And the Defense Department Inspector General is doing an audit of the defense business operation fund, which is about a $75 billion operation.

So we're getting a lot of good coverage. But the first set of financial statements for the Department of Defense, as a whole, are due to be produced in fiscal year 1996, and those are to be subject to audit.

Mr. HORN. What I would like, Mr. Dodaro, is to leave a big hole in the record of a couple of pages, and have the General Accounting Office furnish in that space what did they do in the 1930's? Now, this office was created out of the separate controllerships, as you know.

Mr. DODARO. Right.

Mr. HORN. With the Budget and Accounting Act of 1921; and created in the legislative branch. And up until the Second World War, there was very strict auditing by the General Accounting Office, even during the Second World War, which was probably the greatest undertaking in which this country engaged in the 20th century. Think of the tremendous expenditures at stake, life and death, all the rest.

I would be interested to know when we let up on the type of audits that GAO regularly did from the time of the Budget and Accounting Act. Now, my impression is, it's the last decade, decade and a half, two decades. But we need somebody with an institutional memory or some scholar that has written a book on the subject to get us some facts here. Because Government became so massive, no question about it. The Johnson budget of 1965 was $100 billion.

That's half of the interest we pay annually on the national debt of $4.8 trillion. And that was considered a huge budget, and it was the first time we had a unified budget. So I'd just be interested in a little statement from GAO on how things changed.

Mr. DODARO. Sure.

[The information referred to follows:]

GAO's Response to
Chairman Horn's Question for the Record
Subcommittee on Management, Information and Technology
Committee on Government Reform and Oversight
House of Representatives
July 11, 1995 Hearing

Please provide a brief history of the evolution GAO's work.

Origins and Early Years[1]

From its creation in 1921 until the end of World War II, GAO's work consisted of detailed auditing of individual vouchers. During this period, much of GAO's work was characterized by a highly formal, legalistic review of each voucher, with approval for payment and the settlement of the affected accounts being dependent on the payment's conforming to an elaborate set of rules governing the use of public funds. Additionally, GAO made decisions on payments of public funds, reviewed claims and settled accounts, and prescribed accounting systems and forms.

The Second GAO

GAO's first major institutional transformation occurred during the 1940s and 1950s. As a result of the expanded federal role in the New Deal and the vast expenditures of World War II, the voucher audit process grew beyond the capacity of GAO's staff. Even with a staff of over 14,000, most of whom were audit clerks, GAO could not begin to keep up with the waves of paper. The GAO annual report for 1945 reported a backlog of $35 million of unaudited vouchers.

Ultimately, GAO's wartime experience proved decisive in influencing the agency to change. Comptroller General Warren (1940-1954) recognized the futility of trying to maintain a centralized voucher audit process. Thus, in 1947, after the end of the war, he joined with Treasury Secretary, John Snyder and Budget Director, James Webb to design a new approach to financial management and auditing. Warren reorganized GAO, establishing new divisions to develop and carry out comprehensive audits of federal agencies. Under the new system, the departments and agencies would do their own voucher checking and accounting; GAO would concentrate on prescribing accounting principles and checking the adequacy of agencies' financial accounting procedures and controls. This concept was subsequently embodied in the Accounting and Auditing Act of 1950. From a total staff of almost 15,000 employees at the end of the War, GAO shrank to

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[1]For a more complete discussion of GAO's history see GAO History 1921-1991 (GAO/OP-3-HP, November 1991) and The Evolution of the General Accounting Office: From Voucher Audits to Program Evaluations (GAO/OP-2-HP, January 1990).

about 6,000 by the end of the Warren era.

The GAO of the 1950s and 1960s was modeled on the public accounting firms of the time. GAO was increasingly staffed by professional accountants, many being CPAs, and a significant number of GAO leaders were recruited directly from public accounting firms. Staff levels continued to decline to about 4,000 by the mid 1960s. While much of GAO's work continued to concentrate on financial aspects of federal programs, gradually more attention was given to the examination of program objectives. A good deal of effort was still devoted to reviewing the legality of agency activities.

In the early 1950s, GAO expanded its field work, establishing regional and overseas offices. The number of Defense audits increased during the 1950s and 1960s. GAO's defense audits became the subject of controversy in the 1960s. GAO reports criticized both contractor and DOD practices, alleged overpayments, identified by name persons allegedly involved in fraud and malpractice and recommended voluntary refunds from contractors. Controversy surrounding this work culminated in 1965 with hearings before the Military Operations Subcommittee of the House Committee on Government Operations. Chairman Chet Holifield severely castigated GAO for its supposedly unfair treatment of the defense industry. The Holifield hearings occurred concurrently with the creation of the Defense Contract Audit Agency (DCAA), an organization devoted to defense contract auditing. The creation of DCAA, along with the implementation of the 1962 Truth in Negotiations Act, led to a reduction in GAO's defense contract audit work in the late 1960s.

The Modern GAO

The appointment of Elmer Staats (1966-1981), an economist and career civil servant, set the stage for GAO's second major transformation. Staats stressed program results and the type of analysis employed in the planning, programming, budgeting system (PPBS) framework. Staats reorganized GAO to better carry out its work, creating functional divisions with issue area responsibilities.

In 1967, GAO was asked to make its first major program evaluation when Senator Winston Prouty sponsored a provision in the Economic Opportunity Act Amendments requiring GAO to review the effectiveness of poverty programs. The Congress soon endorsed GAO program evaluation work in the Legislative Reorganization Act of 1970 which required the Comptroller General to "review and analyze the results of Government programs and activities carried on under existing law, including the making of cost benefit studies..." These new responsibilities were then expanded in the Congressional Budget and Impoundment Control Act of 1974.

Program evaluation became an increasingly common activity. For example, during the 1970s, GAO reviewed the effectiveness of the

municipal waste water treatment construction grant program and the New Jersey negative income tax experiment. Congress also turned to GAO for information and analysis during the oil supply disruption of 1973 and to review, on a regular cycle, the quality of data produced by the Energy Information Agency.

GAO's evolution continued under the current Comptroller General, Charles Bowsher, who was appointed by President Ronald Reagan and assumed office in 1981. GAO's work continued to involve a mix of issues extending from the very detailed to the very broad. The expanding scope of GAO's activities was exemplified by GAO's alerting the Congress to the financial condition of the nation's savings and loan and banking institutions and its increasingly outspoken concern about the financial condition of the government. As the 1980s unfolded, GAO assessed the problems of the government's finances and suggested a conceptual framework for a new financial management system embodying an integrated approach to the budget and accounting components. In addition, GAO's work provided recommendations aimed at improving the budgetary process.

GAO also renewed its emphasis on financial auditing. GAO urged the departments and agencies to produce meaningful annual financial statements and to ensure the reliability of those statements through an independent audit. Those views gained acceptance and in 1989, GAO audited the financial statements of the U.S. Air Force, an effort whose scope exceeded that of any previous financial audit in history.

In the years that have followed, GAO worked closely with the Congress to improve the financial management of the Government. In 1990, the Chief Financial Officers (CFO) Act, which GAO strongly supported, was passed, creating a federal government pilot program for agency-wide financial statements. As part of the implementation of the CFO Act, GAO conducted several large scale audits and assisted agencies in developing their financial management systems. In 1994, Congress expanded the CFO Act by passing the Government Management Reform Act. This Act requires annual agency-wide audited financial statements for the 24 largest executive departments and agencies beginning with fiscal year 1996, and sets the stage for GAO to audit the consolidated government wide financial statements starting for fiscal year 1997.

Mr. HORN. Because you went in, and I thoroughly endorsed it. In fact, I wrote a book that's made that recommendation—Program Review. As I remember, you were permitted to do that because the Legislative Reorganization Act of 1946 wanted you to do it. But Sam Rayburn, Speaker, and Clarence Cannon, chairman of Appropriations, never permitted that to be done, as long as both of them were alive.

It was only after they died that the GAO was able to get into program review, which I think you've done a very fine job in that area. But I wonder, and I see this in universities as they talk about policy studies and forget public administration, if we got so imbued with program review that we forgot about the nuts and bolts of basic financial systems.

Now, it's sort of like the little boy saying the emperor has no clothes. If there's no system in that financial system, I can see the frustration a trained and skilled accountant like Mr. Chapin would have when he says, what is this stuff?

Yet thousands of people are employed, making this sort of Wizard of Oz atmosphere come true. And when you throw it all back, there's nothing there—the old guy is hiding behind a machine, and that's the Wizard of Oz. Well, that's the financial system we've got.

Mr. DODARO. Well, we can get you the detailed statement.

Mr. HORN. We'll save a little space for you on that subject.

Mr. DODARO. But my recollection of history is that from 1921 up until World War II, GAO's role was examining individual vouchers and certifying payment ahead of time.

Mr. HORN. Right.

Mr. DODARO. And as World War II came about, the decision was made that Government had grown too much. And then our role was changed the Accounting Act of 1950, to basically have the executive agencies keep their own accounting systems and put them in place. And GAO was to have an audit role.

Mr. HORN. Spot check, if you would.

Mr. DODARO. Spot check those systems. And you're right, as Government grew in the 1960's and the 1970's, we moved more into program evaluation. But I can detail that all out.

Mr. HORN. Well, we can all say more on the Defense. Mrs. Maloney and I are suitably outraged generally over there. So maybe we'll get into it a little more. I now yield to the gentleman from Illinois, Mr. Flanagan.

Mr. FLANAGAN. Thank you, Mr. Chairman.

Mr. HORN. The distinguished vice chairman of this committee, and I'm glad he's here.

Mr. FLANAGAN. Vice chairman, perhaps, distinguished remains to be seen. Good afternoon gentlemen. I join the outrage of the panelists here, and I'm glad for my opportunity now to vent, as well. What's $28 billion among friends? I have a deep question. As you were talking about the different agencies and the problems that they're encountering and the different accounting methods, apparently, that they're going to engage in and then report back to you on their various successes and failures.

I am deeply confused as to why that power is decentralized, and why the agencies are going to run with this on their own, maybe succeeding and maybe not. We were discussing earlier, were we

not, that the agencies are going through a various set of programs, and they're going to try to establish accounting methods on their own. And they're going to try to do something without a lot of centralized guidance or without a lot of, perhaps, even liaison or coordination amongst themselves.

Mr. DESEVE. Let me distinguish—the question I was trying to answer for Mrs. Maloney was why there wasn't a single accounting system within the Federal Government.

Mr. FLANAGAN. Yes.

Mr. DESEVE. I guess the answer is that historically, and I can't again, vouch for history, the chairman may want the same type of report from me. But historically, each agency was asked to produce its own financial information. Now, this is not to say that we don't supply standards across the Government. As Mr. Chapin indicated, the Financial Accounting Standards Advisory Board will be finalizing those standards very shortly.

OMB, throughout the years, GAO's yellow book, various OMB circulars tell agencies how to do that. And we then make sure they comply uniformly with how they're supposed to do it. The continuation of those standards, so that the Department of Housing and Urban Development should look like the Department of Energy, should look like the Environmental Protection Agency, is very much there. You shouldn't be misled.

If you are, then we've got to go back and fix why you're misled. But it's almost like a company like General Electric, for example, which would say to one of its subsidiaries, you keep your own records in GE credit; you keep your own records in the large steam generator division; and you do your accounting—we don't have a single accounting system here at General Electric. That's a strategy that General Electric uses to produce audited financial statements for each of its divisions.

They then consolidate those at the central level. What Mrs. Maloney was saying was that in New York, and certainly in Pennsylvania and certainly in Philadelphia where I come from, we used a different strategy. We had a single accounting system, and the State police didn't have their own accounting system any more than the welfare department did. They all bought into a central system.

Here in the Federal Government, it's been decentralized, I suspect, for historical purposes. I suspect that both the agencies and Congress felt that they wanted independence from the great heavy hand of OMB, or the great heavy hand of GAO. The chairman might even have better insights than I do as to why it happened. What we're trying to do is make sure now that there is standardization across each system, and we're getting closer and closer to that each day, and that the information is reliable.

About 47 percent of the agencies who are currently under audited financial statements have clean opinions. That means about roughly 25 percent of the agencies throughout the Government. And it's growing over time. We're not there yet. But as Gene indicated, in about 2 years, they'll all be audited; for 1996, they'll all be audited. We hope that more and more of them over time will get clean opinions as they go.

Mr. FLANAGAN. Well, that is encouraging, and I'm glad you clarified that for me. Because the thought of turning HUD or DOD or IRS loose and saying, "why don't you tell us how well you've done this year," is kind of scary. I'm glad that we're moving on our way to standardization. I appreciate the difficulty of trying to juggle $1.5 trillion, give or take a couple of hundred billion, and accomplish this at the same time.

I'm sufficiently sympathetic, but I'm still, nevertheless, appalled that we've come to the point where we're finally bringing in ledger sheets. We're now beginning to talk about how much money we have and how much we can spend. I mean, I will sit on the floor and I will argue for an hour and a half about a $2 million rifle range in Tennessee. And, if we're to believe Mr. Chapin—and I have no reason not to—we don't know if it's built.

We don't care if it's built. And, when it's not built, we won't find out about it for a couple of years. But I will have burned an hour of the people's time, and God knows how much effort, over discussing it. I am suitably appalled. I would like a candid answer from any of you as to, in these individual a la carte appropriations that we have a tendency to do on the floor, how much of that resonates anywhere?

I mean, how much of this stuff is nonsense and are we wasting our time, or does it actually ever echo down somewhere, and somebody one day will hopefully be able to point to a rifle range or a weapons system, or a warehouse full of material that the Air Force may or may not have here or there? I'm just picking on DOD, because it seems to be the Department du jour today.

How much of my time is wasted? Feel free to answer as frankly as you like.

Mr. CHAPIN. I'll try to add something to your understanding of this. The services maintain stoutly that they have adequate unit records. In other words, they claim that they know where their tanks are, how many they have, what condition they're in. And although we found some problems, the unit accounting was better than the dollar accounting. And the reason is that the unit accounting is based on logistics records. The dollar accounting has always been done sort of on the side. The systems weren't tied together. So when you moved a tank from here to there, you might have been able to track it, in terms of its existence; but if you sold it or you lost it, the dollar accounting didn't necessarily get done. So we have a disconnect here between the accounting systems and the operating systems.

Now, businesses don't operate that way, because businesses care about the dollars. They live and die by the dollars. But the services live and die by readiness, and readiness has always been the focal point of their function. And everyone would agree that that should be done. But we don't agree that you can't do the dollar accounting, too. And so that's the way it's been; that's the way it's developed.

The whole emphasis has been on unit records and readiness and so on. Unfortunately, when the services come to Congress, they have to present some dollar information. And frequently, that is created out of the kinds of records I described before, which are not necessarily accurate. So when you get reports on—you get SARS reports, for example. SARS are weapons systems reports that

would describe, for example, the costs of—the program costs, presently and in the future, for a system like the F–18 attack bomber, which is the mainstay of the Navy's aircraft carrier capability. And it's planned to be the continuation of that capability. And the program, I think, is—and the SARS shows something like $65 billion of present and future expenses for this. Now, of course, future information is problematic, but the historical information should be accurate. But we found that even the SARS information is not totally accurate. There are some development costs, for example, that sort of get lost in the shuffle.

So even these kind of special reports that you get aren't always accurate. But they're more equipped to produce special reports than they are equipped to produce general financial statements. It's when you try to put all of these bits and pieces together, and you don't have a general ledger—you don't have a ledger account that says this is our assets and subsidiary records that tie in that are also related to the logistics records.

When you don't have that kind of connection between your systems, you're bound to have problems. And then if no one cares about the accounting, if no one cares what the balance sheet looks like, if no one cares what the dollars are, you're bound to have this kind of result. And for years, no one cared. So that's sort of a history—I could go on at length. It's the kind of thing that you have.

Mr. FLANAGAN. I am amazed, and I'm very nearly dumbstruck, so I'm going to move on to a variation of the question, with your indulgence, Mr. Chairman. This committee is moving, as you know, to procurement reform. And we have some very specific ideas on how we're going to accomplish that. We've had extensive hearings about it. If you have a collective or individual opinion on this, how will your accounting processes be affected by this, or even enhanced, in any way, shape or form?

Mr. DODARO. One of the ways that it has an impact is through the procurement of information systems and technology. One of the big issues in modernizing these systems is to provide for ready means of procurement. And that's one connection that I could see off hand. And I think that's something that's been a problem in the past in information systems generally, and accounting systems in particular.

And whatever can be done to streamline the procurement process could go a long way toward facilitating that process.

Mr. DESEVE. I think the view that I've had for some time is that moving toward electronic commerce, moving toward higher payment thresholds with accountability, utilizing that kind of technology to free accountants, auditors, payroll clerks, payment clerks and so on, to do other work is very appropriate. So to the extent that we can use a VISA card now, and with the VISA card, we get a record of all of the transactions that's broken out.

But the work is not done by Government clerks, but done by others. So we don't have to input the data; we don't have to move a piece of paper through five different work stations in order to get the transaction recorded. We can initiate the transaction in one place; we can get a record; we can use that record as an audit trail, as necessary; and even, in some cases, have a tape from VISA or

another vendor post to our own general ledger so that we then have an accounting record subject to audit.

That electronic streamlining will give us, a: more accurate information; b: it will free up a lot of people. And we need those people to do the kind of audit work that we were just talking about. If FTE is a scarce resource, and it's a pool, and we can move FTE from being data entry clerks to working on financial statements, we've achieved a tremendous increase in the skill level of those individuals.

We've also probably achieved better accountability for resources along the way. So that's one of the things that we see in procurement reform.

Mr. FLANAGAN. OK. You've described the indirect benefit of using the VISA card as to more or less privatize the paper trail, just as a matter of consequence of streamlining the system.

Mr. DESEVE. And I was using that as an example. We very heavily support, first of all, the integration of procurement and financial systems. Right now, they really are two different systems. Mr. Chapin was in fact describing them, in a sense, in the Defense Department. But the integration of those systems, first of all; and second, as much privatization as possible of those systems.

One of the difficulties, as you know, in procurement reform, though, is in a Government objective, fairness and making available to many vendors the availability of Government procurements is very different from the commercial side, where they will choose three or four vendors, and they'll use just those three or four vendors exclusively. We have, for a variety of reasons, a different problem. So our problem is more difficult and even more needful of electronic solutions than even the commercial process.

Mr. FLANAGAN. One wrap-up question, Mr. Chairman, and it will be easy for them to answer because I think our panelists will say I don't know. But I'll give you a chance anyway. The processes begin this year, 1996. We're embarking on something exciting; we're getting near the end of our road. When are we going to be at a point when we can look at a sheet and say, it's red, or hopefully, in 7 years, it's black, and we know that to some degree of certitude?

Mr. DODARO. The answer to that varies by department. Some you can do right now with some certitude. When we will have that for the entire Federal Government—one of the critical paths, quite frankly, is the Defense Department. Until we can get the Defense Department, which is a significant portion of Federal discretionary spending, straightened out, you're not going to be able to have reliable Governmentwide statements. You'll have individual agencies that are achieving change.

So Defense, to me, is the critical path. That and Medicare, Medicaid expenditures. Social Security has had a good system for a while. IRS, from the revenue collection side, we're making some progress there. They're not there yet, but they're at least committed and trying to work with us on it. So we at least have the revenue side of Government trying to be covered.

So I think we're short term, relatively short term. And when I say short term, in an institutional——

Mr. FLANAGAN. Within my lifetime.

Mr. DODARO. Yes, within our lifetimes, we can see it. The Defense Department, in my mind, is the one that, because of cultural issues there and size issues, I wouldn't want to—or I'd hesitate to predict.

Mr. FLANAGAN. Thank you. Thank you, Mr. Chairman; thank you, gentlemen.

Mr. HORN. Thank you very much, Mr. Flanagan. Let me pursue several questions, Mr. DeSeve, that you have in your written testimony. On page 21, you sum up that the 24 agencies that are covered by the Chief Financial Officers Act, what the standard was to complete an audit on the self-assessment. And as you sum it up, you say, seven agencies reported that their financial management systems could produce auditible agency-wide financial statements, with limited manual intervention for fiscal year 1996, the target date.

So that's 7 of 24. Then the next seven agencies expect that systems enhancements will be completed in time to produce auditible agency-wide financial statements with limited manual intervention for fiscal year 1996. In other words, they're hopeful, and conceivably that will happen. So that gets us to 14 of 24 that have likelihood of meeting the test of the act.

Nine agencies reported that system enhancements will not be completed in time to produce auditible agency-wide financial statements with limited manual intervention for fiscal year 1996. And then our favorite agency comes up. The Department of Defense does not expect to produce auditible financial statements for fiscal year 96, even with manual intervention. Now, what I'd like for the record at this point is the names of the 24 agencies; what amount of the fiscal year 1995, I guess, the completed fiscal year budget, do they have in dollars and percentage of the budget; and then what is left out, I'd like to have there.

[The information referred to follows:]

OFFICE OF MANAGEMENT AND BUDGET
FY 1996 MID-SESSION BASELINE
FY 1995 ESTIMATES FOR CFO AGENCIES AND OTHERS
(dollars in thousands)

AGENCIES/ENTITIES COVERED BY FINANCIAL STATEMENTS CFO AGENCIES	GROSS OUTLAYS	OUTLAYS AS PCT OF TOTAL FED. BUDGET	OUTLAYS AS PCT OF TOTAL CFO AGENCIES
Agriculture	84,144,054	3.93 %	4.13 %
Commerce	5,114,852	.24 %	.25 %
Defense-Military /a	364,294,673	17.01 %	17.88 %
Defense-Civil /a	46,583,823	2.18 %	2.29 %
Military Sales /a	13,604,104	.64 %	.67 %
Education	34,103,644	1.59 %	1.67 %
Energy	25,258,631	1.18 %	1.24 %
Health and Human Services	367,812,787	17.18 %	18.05 %
Housing and Urban Develpment	39,160,417	1.83 %	1.92 %
Interior	11,116,561	.52 %	.55 %
Justice	15,183,440	.71 %	.75 %
Labor	40,582,626	1.90 %	1.99 %
State	6,627,566	.31 %	.33 %
Transportation /b	44,751,053	2.09 %	2.20 %
Federal Maritime Commission /b	19,168	.00 %	.00 %

FOOTNOTES:
a/ Agencies included in Defense Department Financial Statement.
b/ Agencies included in Department of Transportation Financial Statement.
c/ Agencies included in Agency for International Development Financial Statement.

OFFICE OF MANAGEMENT AND BUDGET
FY 1996 MID-SESSION BASELINE
FY 1995 ESTIMATES FOR CFO AGENCIES AND OTHERS
(dollars in thousands)

AGENCIES/ENTITIES COVERED BY FINANCIAL STATEMENTS CFO AGENCIES	GROSS OUTLAYS	OUTLAYS AS PCT OF TOTAL FED. BUDGET	OUTLAYS AS PCT OF TOTAL CFO AGENCIES
Treasury	384,473,364	17.95 %	18.87 %
Veterans Administration	43,921,493	2.05 %	2.16 %
EPA	6,973,755	.33 %	.34 %
NASA	14,554,567	.68 %	.71 %
AID /c	4,060,629	.19 %	.20 %
Multi-cultural Assistance /c	2,386,360	.11 %	.12 %
Internatnl Security Assist /c	6,598,896	.31 %	.32 %
FEMA	5,357,527	.25 %	.26 %
GSA	10,683,279	.50 %	.52 %
NSF	3,043,334	.14 %	.15 %
NRC	553,298	.03 %	.03 %
OPM	80,109,628	3.74 %	3.93 %
SBA	2,348,152	.11 %	.12 %
SSA	374,208,602	17.47 %	18.36 %
TOTAL CFO AGENCIES	2,037,630,283	95.15 %	100.00 %

FOOTNOTES:
a/ Agencies included in Defense Department Financial Statement.
b/ Agencies included in Department of Transportation Financial Statement.
c/ Agencies included in Agency for International Development Financial Statement.

OFFICE OF MANAGEMENT AND BUDGET
FY 1996 MID-SESSION BASELINE
FY 1995 ESTIMATES FOR CFO AGENCIES AND OTHERS
(dollars in thousands)

	GROSS OUTLAYS	OUTLAYS AS PCT OF TOTAL FED. BUDGET	OUTLAYS AS PCT OF TOTAL CFO AGENCIES
TOTAL OTHER AGENCIES	103,784,842	4.85 %	.00 %
REPORT TOTAL	2,141,415,125	100.00 %	.00 %

Mr. HORN. Are we dealing, off the top of the head, is it one-third left out, or is it less than a third? What do these 24 really eat up in budgetary resources?

Mr. DESEVE. These 24 are 90 percent, gentlemen?

Mr. DODARO. Ninety-eight.

Mr. HORN. Ninety percent.

Mr. DESEVE. Ninety-eight, almost, yes.

Mr. HORN. So we've left 10 percent out.

Mr. DESEVE. Yes.

Mr. HORN. The smaller agencies.

Mr. DODARO. Exactly, and that's of the executive branch, not considering the legislative and judicial.

Mr. HORN. Well, I'm going to get to both the judiciary and the legislative—we might just as well take that up now, because we'll just put that as an exhibit in the record. I'm interested in sort of getting it in proportion so the average citizen, the average member can see it. Now, in terms of the executive branch, we know they're getting there. Where they got off the track, I'm not sure. If I remember, isn't the current Comptroller General a former Assistant Secretary of the Navy, was it?

Mr. DODARO. Yes.

Mr. HORN. For financial management?

Mr. DODARO. That's correct.

Mr. HORN. He must have had a pretty good idea when he came here how fouled up they were.

Mr. DODARO. Yes, he did, and that's one of the reasons he's made it a priority over his tenure, to try to get change.

Mr. HORN. I gather that the commendable actions of the Comptroller General in trying to straighten this out weren't exactly welcomed by Congress at the time he started on that crusade. Is that a fair statement?

Mr. DODARO. Yes, it is.

Mr. HORN. OK. I am told that the chairman of the Appropriations Committee at that time opposed the thought of a Chief Financial Officers Act, and that he didn't want to give them any money to implement the act. Is that a fair statement?

Mr. DODARO. Yes. That occurred right after the act was amended. In fact, there was a subsequent vote on the floor on that issue.

Mr. HORN. What do you think motivated the chairman on that point?

Mr. DODARO. I'm really not in a position to comment on the motivations. I think there was some concern that some of this activity may duplicate some of the work that was being undertaken at that time. I think there was also a certain degree of satisfaction on the part of certain people, that they thought they had all the information that they needed through the budget process and the appropriation process on the Hill.

That was part of the discussion and debate. I think a lot of people felt the cost of implementing audited financial statements would have outweighed the benefits of it. So there was some of that discussion at that point in time. So those were some of the arguments against moving in that direction, and that a lot of this information really wasn't needed, from that standpoint.

Mr. HORN. The chairman I'm talking about is Jamie Witten, former chairman of the Committee on Appropriations; is that correct?

Mr. DODARO. That's correct.

Mr. HORN. I suspect, knowing a lot of the gentlemen of the era of the 1960's, 1970's, and into the 1980's, that many of them knew how to work the system, and they really didn't need anybody else knowing how to work the system. And one of the problems was to share information here, even with the members or other chairmen or subcommittee chairmen. So it wasn't just denying it to the citizenry; it was denying information to colleagues.

And it's really been the last 10, 15 years where there's been a growing revolt in the House that, sorry, we don't do business that way, which leads me to the legislative branch and the judiciary. As you know, Speaker Gingrich has ordered a complete financial audit of the Congress. To my knowledge—I might be wrong, and GAO may correct me if I am and we'll put it at this point in the record that the chairman is wrong and here's the truth.

To my knowledge, no audit of this branch has ever been conducted since 1788, in the first election of the Congress that met in New York in 1789. Does GAO have any other information that we ever had an audit on anything around here?

Mr. DODARO. There were audits of selected activities of both the House and Senate that we were asked to do, GAO was asked to do. The House bank being one——

Mr. HORN. The House bank. So when something blew up in somebody's face, they called GAO in.

Mr. DODARO. But you're correct in saying there has not been a comprehensive audit of either House of Congress. It's an accurate statement. There are other parts of the legislative branch, like the Government Printing Office, and General Accounting Office have had regular annual audits now for 5 years. And they're included in our study.

Mr. HORN. How about the Library of Congress?

Mr. DODARO. Library of Congress is not audited on a regular basis. We did attempt to do an audit, I think, back in 1988 of the Library of Congress. But there isn't an annual audit requirement there.

Mr. HORN. Anyhow, Speaker Gingrich is trying to get this place audited. Hopefully it will happen in time so the public remembers that, we weren't in charge, we're just getting the audit done. So that's one danger we have if it drags on a year or something; that we will look like we're the ones that fouled things up. I'm curious whether GAO is involved in that audit in any way? Has GAO been consulted by the leadership, in terms of getting the private auditors to do this?

Mr. DODARO. Yes. In fact, we were asked to cooperate in using our contract that we have with public accounting firms, to actually hire the firm. We helped in shaping the scope of work; worked very extensively with John Lanehart, the House Inspector General. We also gave the auditors, Price Waterhouse, access to all our work papers on selected aspects of the House that we had audited before.

So we've had a lot of close consultation with them in that audit that they're doing currently.

Mr. HORN. Now let's move to the judiciary. What is the status of the judicial branch in terms of audits? Does GAO audit anything in the judicial branch?

Mr. DODARO. We do selected type of reviews; like, for example, courthouse construction and those type of things. But no financial audits have been done. We've not been asked to do those. We don't do those. So the status is that basically the judicial branch is not subject to an annual financial audit requirement.

Mr. HORN. You would have to be asked by whom? The Chief Justice of the United States or the Committees on the Judiciary or what?

Mr. DODARO. It could be either one. We would probably have to be asked by one of the committees. And one of the problems that we have, from a resource standpoint, is that we're trying to get enough audit coverage of the executive branch and cover a lot of the money. The judicial branch is about, I think, somewhere between 2 and 3 or 4 percent of the Federal budget. So we haven't made that a top priority, because of the limited amount of money over there, and the fact that we've been trying to get the bulk of the dollars in the executive branch audited.

So it's really more of a matter of a resource constraint from our standpoint, than anything else.

Mr. HORN. Well, let's have our committee staff, both majority and minority, and your staff take a look at that, and see if somewhere we can work in, just for the sake of having a base with the administrative office of U.S. courts, which is a very well-run operation. See what they're doing. And if we could be helpful to have a joint audit as a base, then we're agreed.

I don't think any branch of the Federal Government, be it legislative, executive or judicial, should be exempt from a basic audit now and then. And I think the Speaker felt the same way with the legislative branch. They've been exempt since 1788 somehow; so let's change that.

Mr. DODARO. And for the record, Mr. Chairman, I know the Comptroller General feels very strongly the same way. We've had a number of discussions along these lines. And I'm sure he'd be happy to talk with you about it as well.

Mr. HORN. Well, let's work out something, and see if we can't do that, just as a base.

Mr. DODARO. OK, good.

Mr. HORN. Now, what I'd like to know, and maybe Mr. DeSeve, you're the one to do this, and Mr. Chapin, certainly, with your private sector experience—you can all comment on it. What are the principal differences in the accounting systems between the private sector and the Federal Government? Why are there principal differences? Can we not apply corporate financial accounting of the private sector to the executive branch? I realize there's no profit; although when I was doing my book on the Senate appropriations process years ago, I was talking to Senator Ellander, who, without question, was the hardest working member of the Appropriations Committee.

And I got into the problem of nonprofits. And he immediately said, Steve, nonprofits are where they divide up the profits among the staff. So that was his view of nonprofits, which I always

thought was probably pretty accurate. And we've seen a few sort of scandalous affairs in the country in the last few years. Apparently some were implementing the Ellander Doctrine.

But I'd just be curious, what are the differences, if any, that you see that should be of concern to us?

Mr. DESEVE. Well, I guess the primary differences in my mind, are two. First, that the transaction which begins the financial process, the planning process, is the budget appropriation. There is no real analog, per se, in the private sector. You can have a profit plan in the private sector, but you have to have customers. So in the first case, you're dealing with appropriated dollars.

In the Federal Government, unlike State and local governments, the cash based accounting is used almost exclusively, so that the accrual of obligations, once a contract is entered into, is of less moment than the budget authority as it exists, and then the actual expenditure or outlay of those dollars, depending on how that is measured. So there's a measurement difference with the private sector and the State and local sector, which almost exclusively use either full accrual or a modified accrual form of accounting.

Those are, I think, the two fundamental differences. Don Chapin is a much better person to answer those questions than I am, with more specificity.

Mr. CHAPIN. I think Ed DeSeve has named the principal differences. But I would point out, the private sector has no equivalent to our Federal Government non-exchange transactions.

Mr. HORN. Can you clarify that?

Mr. CHAPIN. By that I mean tax collecting, for example. It's very difficult to determine accounting information when there isn't an exchange transaction; when one side and the other don't exchange values. In the case of the American taxpayers, it's very difficult to determine how much they owe. So that's a very difficult accounting problem. It's not so much a systems problem as it is an information flow problem.

Mr. HORN. Well, you're talking about voluntary versus involuntary. Voluntarily, in the private sector, we decide to buy something; sometimes it's compulsory, if the State has mandated, say, an air pollution cleaning element under the environmental laws. But in the taxes, why can't you just consider that the same as revenue that you'd have in a private corporation?

Mr. CHAPIN. Well, we have a voluntary tax system. We don't know that a taxpayer owes any amount of money to the Federal Government until he files a return or the Revenue Service agents are able to find him and assess the tax.

Mr. HORN. But we don't know a person is going to buy a product until they buy the product.

Mr. CHAPIN. But we don't have to account for that transaction until the transaction actually occurs. There is a meeting of buyer and seller, at which point there is the possibility to recognize the transaction and to measure it accurately. And that's typical of the private sector. In the public sector, when we have non-exchange transactions, there is an assessment process, and there is a time in which the taxpayer is supposed to file his return.

But the Revenue Service doesn't know who all the taxpayers are or how much income they have earned, and therefore, how much

tax they owe. And as you may know, there is over $100 billion said to be in what's called the tax gap. And we have no way of finding out accurately, at present, how much that is, who owes it, what sectors of the economy owe it and so on.

There are various efforts to measure that, but it's not subject to a typical private sector accounting system. There have to be new ways of finding out who owes that money and how we can collect it. So that's a major difference. One other difference——

Mr. HORN. I must confess, I fail to see the point, after having studied accounting and studied accounting in relation to the firm, as seen by an economist, and so forth and so on, I just don't see the point. And I guess I'm dense today. But you have a transaction when they pay those taxes.

Mr. CHAPIN. Right.

Mr. HORN. The fact that there's $100 billion still out there, that we all agree is probably pretty correct, with the underground economy, which is partly Congress' doing. They let millions of people off the hook from filing income taxes, under the 1986 act. And in our cash economy, our illegal alien economy, there's no question there's a mutual agreement as to avoid the law. You've got this tremendous cash group, certainly in southern California, Texas, Florida, and Michigan, coming over the Canadian border.

The only way you would get them is through the sales tax. You don't get them through the income tax, obviously.

Mr. CHAPIN. Right.

Mr. HORN. But a transaction is there; it can be accounted for. It can be posted on the revenue stream. Now, the fact that we miss some, granted you can't predict it. But you can't predict that the people aren't going to buy your product this year because some nut says it's been poisoned suddenly, and all your sales drop. But your sales drop, so you have less to post on the revenue side of the private firm. So I guess I'm missing something here.

Mr. CHAPIN. We both agree on what the fundamentals are. I would like to think that ultimately, the accounting for revenue from the Federal Government could be extended to the point where we had some accurate measurements of those who owe taxes and have not yet filed returns, or not been audited yet. Once we can get to that point, where we have more accurate information, the revenue stream of the United States will be enhanced. We'll be able to go after the people that owe taxes.

People that are paying more than their fair share because others don't pay, will be benefited. So I think it's a goal. And the revenue service right now is trying to enhance its measurement system so it does do better accounting. If I can elaborate?

Mr. HORN. Sure.

Mr. CHAPIN. It's only been since the GAO has started its audit that the Revenue Service has made an attempt to recognize, in its accounts, the amount that's actually receivable for assessments that it has made. In other words, we have been on a cash accounting basis until just recently. And even now, there is no systematic measurement of the accounts receivable of the Revenue Service. It's done basically through statistical estimation—by looking at the operating file and making an estimate of the total amount of taxes that taxpayers owe.

So even now, we don't have a good handle on the admitted liabilities. So I'm perhaps going way into the future, but I'd like to see us do that accurately, systematically, and then extend it to those who should be paying who don't. And if we can get that far, we'll improve the tax collecting ability of the country.

Mr. HORN. Well, I'll add one more point to this subject. You have a good point on what you're saying. And I'd like to improve that ability. But if the Internal Revenue Service did what the Customs Service did years ago, about 20 or 25 years ago, which is go after some of these tax avoiders with a net worth analysis, based on what they're doing. Now, the minute a lot of that function went out of Customs over to the Department of Justice, they dropped the ball.

The great cry up here was, well, let's get those people in Justice, because they enforce the law. Nonsense. Customs was enforcing the law in the Treasury. And my understanding is the Department of Justice has done very little along that line. Maybe I'm wrong, and GAO probably ought to take a look at that. Because the whole net worth analysis works out well in court.

Mr. CHAPIN. Right.

Mr. HORN. And you can either get them on the criminal side or the civil side. That would shake a few trees of huge tax avoiders.

Mr. CHAPIN. That's right.

Mr. HORN. I'm thinking of the drug enforcement area, where they dropped the ball also on that.

Mr. CHAPIN. That's correct.

Mr. HORN. So I think it's a very interesting discussion. Is there anything else you want to say on comparability?

Mr. CHAPIN. One other point. The private sector, as Ed said, doesn't have the dual accounting responsibility—the dual systems requirement—that arises as a result of having to do budget accounting on a cash basis and financial accounting on an accrual basis. But I don't believe the private sector has the diverse needs for information. If you look at some of the accounting systems of the Federal Government, you'll see that Federal managers want all kinds of different kinds of data.

There's no uniform agreement as to what data is required. So you have unbelievably complex account structures. That's another problem that we face in Government—to try to get people to settle for less than everything they need, because by providing everything they need, we increase the chances of inaccurate information. So if we can get agreement on what's needed, what information is needed, then we'll be able to simplify the information structures.

Mr. HORN. That's an excellent point. There's no question part of the problem is not only Federal mangers, but congressional managers on micromanagement, where they're asking for data that sometimes has no relationship to the information you need to make a decision—political, executive, legislative decision. And it would be nice if we could work out an agreement—and we've held hearings on this benchmarking idea that Oregon is doing, in terms of what are the goals; how do we measure when we're part way there, halfway there, all the way there, in terms of a consensus of a community of people served and the Governors, elected by the people to serve them.

And I think there's a real need to get some agreement. My experience in parts of the Federal Government, on the executive side, have been, they're often counting things that you can count, and they aren't attempting to measure things that really count, which aren't necessarily the things you can easily count. So I would hope between OMB, GAO, the congressional groups and Chief Financial Officers Council, and other executive groups, that we get some agreement on when do we know progress has been made and how we're doing.

Mr. POSNER. If I could just add, as a non-accountant, to this discussion. One concept that really FASAB's been very important in discussing, that I think is a key difference, is the stewardship responsibility of the Federal Government. We like to think of the Federal Government as an operating entity that, much like business, has payroll and large organizations. But it also has a unique responsibility, as you well know, to the long-term and short-term economy.

And I recall when I was here several weeks ago, we were talking about this concept of how do you recognize the investment contribution the Federal Government's programs are making to that economy. And unlike a private business, the important things we care about, we generally don't own. They're not traditional assets. They're things that contribute to long-term values, which is why the GPRA makes more sense when you're thinking about setting your goals for that.

And that's why you've got to think about a different way of valuing that contribution.

Mr. HORN. That's a very good point. Let me put four questions before you. You don't have to answer them today, you can answer them in writing. But the first is, besides the insurance and credit, what other areas would accrual accounting help Congress make better budget decisions, and how about Federal retirement programs?

The next question is, with GAO, you mentioned credit reform in your testimony as an example of a use of accrual accounting. Some costs associated with a loan are not counted in budgeting for the loan, and would, including administrative costs and the subsidy determination, allow for more rational budget deliberation by Congress?

Another question that's important is, what is your reaction to the so-called zero cost credit programs not subject to appropriations? Several new Government-sponsored enterprises have recently been proposed, such as Government-sponsored enterprise for small business investment corporations, and another for venture capital. Is there a danger that these entities, not controlled by any annual appropriations process, might result in taxpayer losses?

And last, currently, agencies pre-fund only about 25 percent of retirement costs for Federal employees. This results in an unfunded liability, which will have to be recognized in the future. It also understates agency personnel costs, skewing the decision between investment and personnel and competing needs. How should a Federal balance sheet and a Federal budget treat this retirement liability, which is a cost of employing someone that is not realized

on a cash basis until far in the future; and how did the FASAB handle this issue?

So we'd be interested in responses to all of those. There might be a few more that we have. Reluctantly, we're going to have to close this portion of the hearing. We thank you for your time. I think it's been tremendously helpful. You've all had something that is very pertinent to the needs of the committee. So thank you for spending this sunny afternoon up here.

Mrs. MALONEY. Could I just add a note, that I enjoyed very much your testimony, and that I have never voted to cut appropriations for your agencies. I think you're doing a great job, and you bring a lot of accountability. I did my own study recently on what was owed the Federal Government. And I found out $50 billion was owed to the Federal Government. Why don't we have a central collections office that comes forward with goals and manages it? It seems like that would make sense.

Mr. DESEVE. There is legislation that will be coming to you shortly, if it hasn't already come to you, to centralize debt collection within the Treasury Department, for that purpose. So we think that's a start. It's not as comprehensive as you might like it, but it's a real beginning.

Mrs. MALONEY. OK. Thank you very much.

Mr. HORN. Thank you, and we'll recess for about 15 minutes.

[Recess.]

Mr. HORN. The subcommittee will resume its hearing, and we have with us today, on panel two, which is leading generally to a complete financial statement with the Federal Government, Mr. Harrison W. Fox, Jr., the president of Citizens for Budget Reform; Mr. Lyle A. Brecht, publisher of AmericaReport. Gentlemen, you know our tradition on the committee. If you wouldn't mind raising your right hand.

[Witnesses sworn.]

Mr. HORN. I might say, usually the witnesses start out violating their oath—it's a pleasure to serve before the subcommittee. But we welcome you, and Mr. Fox, we'll have you first, followed by Mr. Brecht.

STATEMENTS OF HARRISON W. FOX, JR., PRESIDENT, CITIZENS FOR BUDGET REFORM; AND LYLE BRECHT, PUBLISHER, AMERICAREPORT

Mr. FOX. Thank you, Mr. Chairman, for the opportunity to present my views about a citizens budget. First of all, I'd like to submit a number of documents that we developed for the record. I'd like to present our USA Annual Shareholders Report; a Benchmark Mission, Goals, and Objectives Study we've done for the Department of Defense—a prototype that we hope will be adopted, perhaps, throughout Government; a Federal Reporting System Outline; a Government Productivity Report; a summary of recommendations from my testimony; and a Federal Information and Regulatory Survey Proposal, which we think is important to take a look at.

Mr. HORN. Without objection, all those items will be put in the record at this point.

[Note.—Due to high printing costs, the information referred to above can be found in subcommittee files.]

Mr. FOX. Thank you very much. Budgeting is often the subject of public consideration. But it usually loses most people's attention. As Gladstone has observed, "budgets are not merely affairs of arithmetic, but in 1,000 ways go to the root of individuals, the relationship of classes and the strength of kingdoms." I think the lack of attention is being somewhat overcome in recent times by events in California, of which, Mr. Chairman, you're very much aware.

In Orange County, the consequences of not including a balance sheet and an asset liability strategy as part of the budget and financial process has been catastrophic. Orange County bankruptcy has shocked the Nation's financial markets, and placed every citizen in Orange County at risk. And some of the things I'd like to talk about today relate directly to the lessons we're learning from Orange County, from Mexico, from Brazil, many from New York City, from Bridgeport, CT—all Government who have gone bankrupt in times past.

I did a little calculation a few minutes ago, as I was listening to the previous witnesses. And it's my calculation that the Government has added to its liability, since this hearing started, a little over 3 hours ago, about $200 million, or about $2 million a minute. For a few of these minutes, in terms of actual expending resources, we could come up with a system which would satisfy many of the needs, I think, that were expressed earlier, when you were questioning the other witnesses.

We're not talking about a lot of money, at least for the first round, when we're developing these systems that are normally in place in the private sector. And Mr. Chairman, I'd like to compliment you for you observations earlier about the importance of applying many of the tools and concepts that the private sector currently uses to the Federal Government. This is something we need to do.

I've worked in the Congress for seven Members of Congress. Between these stints, I move out to the private sector, and I've worked for 7½ years with financial institutions. During my work with these financial institutions, many of which were in as bad shape as the Federal Government is now, when I went to see them. In many cases, in a matter of a few months, we were able to put into place systems that would at least allow the management to make the kinds of decisions they needed to make to hopefully get themselves in a solvent position.

What we're talking about today is very doable. The resources are not that extensive, compared to the amount that we're losing each year or adding to our liabilities. We're adding over $1 trillion a year to our liabilities, because of poor management. That's our calculation. I'd like to spend about 2 more minutes summarizing, and then I want to give a short demonstration of a software package that we are developing that would help provide the information I think you and others are looking for.

I have here, as part of my submission, a summary of recommendations from my testimony, and I'll just read the general recommendation. The current unified budget presented by the President each February and acted on by the Congress should be

modified and expanded to include a comprehensive Federal budget, balance sheet and financial plan. The comprehensive Federal balance sheet, Federal budget and financial plan should be used for improving budget information accessibility, comparability and consistency, risk assessment, efficiency effectiveness, and measuring outcome and results.

I've also added recommendations in terms of subject areas by budget, by liabilities, assets, asset liability strategy, and balance sheet. And I won't burden you with those, but hopefully it will be reprinted in the record. Now, let me take just a minute——

Mr. HORN. All of those items will be put in the record, if they have not already been submitted. This is the one titled, "Citizens Budget," your testimony.

Mr. FOX. That's right. Let me move to my demonstration.

Mr. HORN. Are you going to turn that one around so we can see it?

Mr. FOX. It will be up on the wall here.

Mr. HORN. Oh, OK. Do you need the lights dimmed?

Mr. FOX. Well, just 1 second, let me get this turned on.

Mr. HORN. I wondered why Andrew was back there. Now I know.

Mr. FOX. OK, I think we can go ahead and move on. It will just take a second for this to wind up. Let me just say that what we've done is we've taken the accounting records of the General Accounting Office—I'm sorry, the Office of Management and Budget, and these records are only available now in three places in the world. They're available in the CBO, Congressional Budget Office; at the OMB; and on this little laptop here.

And we have all the information from those records, about 10 megabytes worth of records—very extensive and very useful when you start looking at them. In fact, lots of things that you wouldn't imagine you might have access to. Now, let me bring up the software package that we're developing. What we have is a number of different ways of looking at the system. And this is going to be put in a Windows environment.

Today, we're just looking at it in a strictly punch and shoot environment. But let me just bring up the appropriations piece, and give you an idea of the kinds of things that we might be able to—now, what we can do is, using this information, we can come down and we've been talking quite a bit about Defense. Why don't we go into the Defense piece.

You're going to be looking at the various sub-accounts in Defense. Now, one thing that we found when we show this to Members, they get real excited that you can all of a sudden begin to get all this account information in great detail. What needs to be done, though, is tying the account information to the program information. And once that's done, and that can be done, I think, in a fairly short period of time.

Then you would have the details of what's going on, and you also could tie in the benchmarks, et cetera. So what you have here is—let me try one more detail. We'll go down into the detail of an account—you can look at the various accounts and you can project it out any way you want to. What we're proposing is that the user be provided with a great deal of flexibility and the ability to be able to import this into spreadsheets like most corporations do today.

Even Ma and Pa grocery stores can work with their financial information in a Lotus type spreadsheet. OK, I think this is probably enough of this. You can turn the lights back on.

Mr. HORN. Let's say there is a mobilization. Or three mobilizations. How do we differentiate what those are?

Mr. FOX. OK.

Mr. HORN. Peacekeeping operations?

Mr. FOX. Yes. What you have to do in the future is to identify these programs with program information, as well as to provide details in terms of performance outcomes, et cetera. What we're trying to show is, a lot of this information is already available. What you need to do is begin to develop the capability to access it. That concludes my testimony at this point.

[The prepared statement of Mr. Fox follows:]

Harrison W. Fox, Jr. Ph.D.
President
Citizens for Budget Reform
The Citizens' Budget

Mr. Chairman, thank you for the opportunity to present my views about The Citizens' Budget.

The essence of my views are summarized below.

The current "unified" budget presented by the President each February and acted on by the Congress should be modified and expanded to include a **Comprehensive Federal Budget, Balance Sheet, and Financial Plan.**

The Concept of the Comprehensive Federal Budget, Balance Sheet, and Financial Plan

What should be included in the comprehensive budget of the United States? It should present -- the "essential ingredients" of the financial plan; federal assets and liabilities and risks inherent in both; and missions, goals, objectives, benchmarks, and outcome and results measures, for all federal programs. All these should be presented for the coming year and for at least five years into the future. The comprehensive federal budget should be a "living document", with daily updates available electronically to citizens, the media, Congress, the President and his appointed officials, as well as federal managers.

The comprehensive budget serves many purposes:[1]

* It provides citizens with information about the national economy essential for private business, labor, agriculture, and other groups, and for an informed assessment by individuals of governmental stewardship of the public's money and resources.
* It presents the President's budget. The President's budget makes requests of the Congress for funding programs -- old and new, for outlays and appropriations, and revenues as well as identifying federal assets and liabilities, the risks inherent them, and strategies that will manage these risks.
* It presents the congressional budget. The congress' budget responds to the President's request by establishing functional dollar targets, levels of spending -- authorizations and appropriations, appropriate revenues, and deficit or surplus as well as accepting or proposing new asset/liability strategies.
* It proposes an allocation of resources between the private and public sectors, and within the public sector.
* It establishes national and program missions, goals, and objectives as well as establishing benchmarks.
* It provides for the measurement of program outcomes and results in order that the programs that are working can be continued and those that are not can be redirected or terminated.
* It embodies the fiscal policy of the federal government for promoting jobs, price stability, economic growth, trade, commerce, and the general welfare of all citizens.
* It provides the basis for executive and agency management of federal programs.

[1] These purposes are adapted from, **Report of the President's Commission on Budget Concepts**, page 2. Substantial modification and updates are provided.

* It gives the Treasury Department needed information for its management of cash resources and the public debt.
* It provides the Presidential and congressional support agencies -- OMB, CBO, GAO, and CRS -- with the data and policy direction they need to perform their assigned tasks.

These many purposes require a **Comprehensive Federal Budget, Balance Sheet, and Financial Plan**. In order to inform the public and increase executive and congressional understanding, the federal budget and financial plan should satisfy the following criteria. The budget and financial plan should

* be simple -- "readily understood"
* be a honest and fair representation of the financial condition of the federal government
* promote thrift -- "does a program, service, or activity provide real value"
* protect freedom and promote equality

These values - simplicity, honesty, thrift, freedom and equality -- are widely held by the citizens of the United States.[2] Every time an elected or appointed official and federal workers makes a decision or performs a service she/he should ask themselves if what they are doing satisfies the above value criteria. Specifically they should seek to reflect these widely held values, of their fellow citizens, as they put into operation the missions, goals, objectives, and benchmarks prescribed by the comprehensive federal budget.

Program outcome and results measures indicate whether a government has been successful or failed in it's attempt to meet the budget and financial plan's underlying values. The hierarchy of values-missions-goals-objectives-benchmarks-policies-programs-outcomes and results should be the frame of reference for government budgeting, balance sheet management, and financial planning decisions by those entrusted by citizens with government office or employment.

Federal "check book" Budgeting

Today's federal unified budget is little more than "check book" budgeting. It does not serve US citizens, the Congress, federal managers, or the President very well.

The federal government manages its finances with little more than a check book. Check book budgeting tracks on a yearly basis federal spending and income with limited attention paid to program outcomes and results. Little systematic professional review is given the promises (liabilities) the federal government is responsible for, it's assets, or the risks inherent in both. And at the end of the year, the deficit-- no surplus since 1969 -- is added to the national debt.

If a family used the federal government check book budgeting approach, they might describe their budget arithmetic as -- "we need $35,000 to live this year, but we will spend $45,000. At the end of the year, we will just add the extra $10,000 to our credit card debt. And then we will be able to start the new year with a zero check book balance!" This approach is not sustainable for the family or the federal government.

After many federal budget, program, and financial management failures, citizens are in revolt. Severe strains are showing. Taxpayers perceive that they are not receiving value for their tax dollars from federal check book budgeting. They are justifiably concerned as federal managers often have little guidance as to the goals, objectives, and benchmarks that they should be striving for. Furthermore the decision makers,

[2] Milton Rokeach, **The Nature of Human Values**, The Free Press: New York.

the Congress and the President, are frustrated by the limits that check book budgeting places on their ability to change federal program priorities, propose new economic policies, and propound their philosophy of the role of government.

A further complication is that federal check book budgeting -- with it's convoluted rules, procedures, and requirements -- is often not understood by many members of Congress, federal managers, and Presidential executives that are charged with running our government.

Check book budgeting has failed!

Today's federal check book budgeting is modeled on the unified budget proposed by the President's Commission on Budget Concepts in October 1967. The unified budget first adopted by the President for Fiscal Year 1969[3] was intended to present the total financial plan for the federal government.

The current federal budget and financial plan have many inadequacies. They

* under represent the true yearly deficit by over $100 billion per year
* do not indicate the massive yearly increase in federal liabilities by over $1 trillion per year
* use cash rather than accrual basis for the presentation of most receipts and expenditures[4]
* focus on incremental increases in outlays and budget authority rather than on program outcomes and results
* provide inadequate tools for implementing fiscal policy
* fail to match assets, including the power to tax, with liabilities (promises)
* do not recognize massive risks -- interest rate, management, operation, credit, or political
* lack the ability to identify waste and duplication within and among programs
* are not comprehensive, in that billions of dollars have been moved "off-budget"
* allow offsetting calculations to remove over $100 billion from on-budget decisions
* impose a paperwork "blizzard" on federal managers
* use "numerous and dissimilar program categories" that make it difficult to track actions, to evaluate how well the federal programs are working, and set priorities

Citizens for Budget Reform recommends that a **Comprehensive Federal Budget, Balance Sheet, and Financial Plan** be used for improving budget information accessibility, comparability, and consistency; risk assessment; efficiency; effectiveness; and measuring outcome and results.[5]

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[3] See The Budget of the United States Government, Fiscal Year 1969," Special Analysis A Comparison of New and Old Budget Concepts", pages 464 - 472. [House Document No. 225, Part 1, 90th Congress, 2nd Session]

[4] Note that accrual accounting was adopted in 1990, as Title 5 of the Congressional Budget and Impoundment Control Act, for the identification of federal loan subsidies including the capitalization of the interest subsidies at the time the loan is disbursed. The use of accrual basis was recommended by the President's Commission on Budget Concepts on October 10,1967.

[5]This **Plan** is an updated version of the outline proposed by the President's Commission on Budget Concepts in October 1967 An important part of CBR's proposal is that budget and financial data should be collected and updated on a daily basis, organized by the categories noted below, with appropriate cross walks between authorization line items, Appropriations line items by subcommittee, functions and subfunctions, budget accounts, "programs", and departments and agencies. Instant electronic access should be provided to citizens, federal managers, media, Congress, and the President's executives.

Recommended Federal Budget, Balance Sheet, and Financial Plan
[Outline/Summary]

I. Congressional and President's Budgets
- President's proposed for
  - action by Congress
  - not requiring action by Congress [multiyear, no year appropriations and direct/mandatory spending]
- Congress' proposed
  - by Budget Committees [Budget Resolution], by authorization committees, by Appropriations subcommittees, and by Ways and Means and Finance Committees

II. Budget receipts, expenditures, lending, and recognition of other spending or losses
- Receipt - expenditure account:
  - Receipts
  - Expenditures (excluding net lending)
    - Expenditure account surplus or deficit
- Plus: Loan account:
  - Loan disbursements
  - Loan repayments
    - Net lending
- Plus: Recognition of full increase of federal debt:
  - Interest on private and non publicly held debt
  - Other increases in federal debt
- Plus: Other promises, spending, and losses:
  - Including emergency expenditures expected during fiscal year
  - Accruals
    - Total
- Equals: Total budget:
  - Receipts
  - Expenditures; net lending; full increase of federal debt; other promises, spending, losses; and accruals

III. Means of financing
- Borrowing from the public
- Borrowing from the federal government (i.e. trust funds)
- Reduction of cash balances, sale of assets, etc.
  - Total budget financing

IV. Outstanding federal liabilities
- Federal securities (including Debt and Yearly Surplus [deficit]):
  - Gross amount outstanding
    - Held by the public
    - Held by the federal government (i.e. trust funds)
- Federal credit programs:
  - Direct loans outstanding
  - Guaranteed and insured loans outstanding
- Plus: Interest on Debt, Entitlements, Insurance, Sponsored Enterprises, Medical, Infrastructure, Facilities/Resources, Environmental, Claims Against Government, Long-term Contracts, Undelivered Orders, Other contingencies

V. Federal assets
- Plus: Cash and Monetary Assets, Accounts Receivable, Inventories, Loans Receivable, Property, Plant, and Equipment, Deferred Retirement Costs, Financial Assets, Advances and Prepayments, and Other Assets

VI. Net federal assets and asset/liability strategy
- Assets - (minus) liabilities = Net federal assets

VII. Federal expenditure tracking via "chart of accounts"
- by department/agency for 1,223 budget accounts[6]
  - [object class data collected and maintained]

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[6] General Accounting Office, Accounting and Information Management Division Budget Issues Group, "Federal Budget Accounts: Fiscal Year 1996, page 61.

Recommended Federal Budget, Balance Sheet, and Financial Plan Discussion with Recommendations (Underlined)

I. Congressional and President's Budgets

The Comprehensive Federal Budget, Balance Sheet, and Financial Plan provides a system that reflects recent advances in financial management. It begins with the President's budget. The Presidents budget should move away from a focus on incremental increases in expenditures --outlays and budget authority-- and revenues towards a focus on program outcomes and results. The Presidents budget should define for each budget account a program's mission, goals, objectives, benchmarks, and measures of outcomes and results.

The congressional budget should be developed using the framework suggested for the President. Each authorization committee, Appropriations subcommittee, and the Ways and Means and Finance committees should provide the appropriate foresight, legislative initiatives, and oversight. And the congressional budget/authorization/appropriations process should be simplified. The complexity created by the current systems make it virtually impossible to meet deadlines and review constructively federal programs.

Federal programs achieving the expected outcome and results should be identified and federal managers rewarded. If a program does not fully succeed, it should be either immediately changed, reduced in size, or terminated.

Also, legislative and executive action needs to be taken to require regular congressional approval for direct/mandatory spending. These so called "uncontrollables" should be brought under regular control by the appropriate committees.

II. Budget receipts, expenditures, lending, and recognition of other spending or losses

The President's and congressional budgets should fully reflect receipts, expenditures, lending, and recognize all other spending or losses that might be expected. Off-budget federal activities should be placed back on budget. The current Presidential and congressional budgets are not fully unified budgets as existing legislation has placed certain activities off-budget. This has resulted in understatement of the deficit by over $100 billion per year.

"Measures of budget resources and spending are frequently misleading, making it difficult for budget users to compare program and policy levels, and to understand the full magnitude of governmental operations."[7] For example, the federal government's use of offsetting calculations "removes from visibility" billions in revenues and outlays. All offsetting receipts should be fully accounted for in the budget documents.

Private companies and many families and individuals plan for emergency or unexpected spending. The federal government should plan for "regular" emergencies or natural disasters. The federal budget should set aside each year, in a reserve account, funds for emergencies and natural disasters.

Today expired appropriations are available for expenditure for up to five years. No funds should be obligated or spent unless legislation is enacted extending the expired appropriations.

[7] Elmer Staats, "Federal Budget Concepts and Procedures Can be Further Strengthened", United States General Accounting Office, March 3, 1981, page 3.

The current federal budget fails to recognize the full increase in federal debt. The federal budget should identify explicitly the full increase in the federal debt each year. This would include interest expenses associated with so called federal "trust funds".

Finally, the federal budget should list all spending -- cash and accrual -- where promises or actual payments have been made. For instance, government worker pension reserves are grossly under funded and many potential future environmental cleanup costs are not fully recognized in the federal budget.

Finally the total budget deficit equals net lending, plus the expenditure account deficit, full increase in the federal debt and other promises, spending, and losses.

III. Means of financing

The total budget deficit is financed by borrowing, the reduction of cash balances, sale of assets, and other financing. Means of financing "shows how much of a budget deficit is to be financed by borrowing, and how much by other means." Treasury and Federal agency borrowing from the public and from federal trust funds are included as means of financing.

The current federal budget should be changed so that it reflects the total budget deficit that is financed. The increase in the total budget deficit will include borrowing from trust funds.

IV. Outstanding federal liabilities

The increase in federal liabilities each year is now over $1 trillion per year or about $2,000 per United States citizen. In 1995, this will include over $300 billion in additional Social Security unfunded liability, $318 billion increase in federal debt, and tens of billions of increases for nuclear waste cleanup, road and bridge repairs, medical payments, federal employee pensions, and environmental cleanup promises. This yearly increase added to the already huge federal debt raises serious questions about the future ability of our children and grandchildren to pay for our current lack of stewardship.

The yearly increase in debt and other liabilities is unsustainable. America is in bankruptcy. The workout should begin!

Federal liabilities are the total of all promises, loans, guarantees, claims, contingencies, contracts, and undelivered goods. Federal government liabilities include fourteen categories of promises that must be met by the taxpayers. On September 30, 1995 these liabilities totaled over $36 trillion.

Retirement related liabilities add up to 25 percent of USA federal government liabilities. Future welfare benefits are responsible for over 15 percent of federal liabilities. Bank, savings and loan, and credit union deposit insurance equal nearly 14 percent of taxpayer liabilities. The unfunded Social Security liability is approaching $8 trillion. "This liability represents the present value of the projected excess of future benefit payments to those presently participating in the Social Security program over contributions still to be made by them and by their employers on their behalf."[8] The top ten federal liabilities are each over $1 trillion. And the next nineteen total over $100 billion each.[9]

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[8] **Consolidated Financial Statements of the United States Government, 1993 Prototype**, Department of Treasury, page 32.
[9] **USA Annual Shareholders' Report for Fiscal Year Ending September 30, 1994**, Citizens for Budget Reform, pp. 5 -11.

Finally, federal liabilities should be categorized by the percentage of federal exposure to liability. For instance, the federal civilian and military pension liability is expected to result in a dollar for dollar expenditure -- 100 percent liability -- of federal funds. The bank deposit insurance liability will result in a 2 to 4 percent future expenditure of federal funds. Liabilities should be classified by the likelihood of future expenditure (in percent) of federal funds.

Federal government liabilities should be given a top-to-bottom review and most should be dramatically reduced. Approximately, 40 percent of the USA's current liabilities will need to be ended to reach the goal of balancing assets and liabilities by 2004.

V. Federal assets

Federal assets are things of value that are owned. The assets of the federal government include hard assets and other assets. Hard assets of the federal government total nearly $1.5 trillion. They include cash and monetary assets, gold, accounts receivable, inventories, loans receivable, property/plant/equipment, deferred retirement costs, financial assets, advances and prepayments, and other assets.

A comprehensive listing of federal assets should be a part of the President's and congressional budget and financial plan. Past values and future projected values of federal assets should be recorded in the budget and financial plan.

Federal assets are often neglected. Federal lands, resources, material, plants, and equipment should be better managed. Benchmarks need to be set for these efforts. Federal government managers should be given the resources to do a creditable job and held accountable for meeting goals, objectives, and benchmarks.

The Power to Tax is the most vital federal government asset. The Power to Tax is only as good as citizens' willingness to pay federal taxes. The future value of the Power to Tax is calculated to be in excess of $16 trillion.[10]

An additional federal government asset includes the Power to Create Dollars. "The federal government--through the Federal Reserve--also has the power to create money and to control its supply. This ensures that creditors will be repaid, at least in nominal terms. When the government's debt is large, it also provides a temptation to create money, as well as inflation."[11] Finally, the federal government has the Power to Borrow. This power has resulted in a $5 trillion debt.

VI. Net federal assets and asset/liability strategy

Developing a balance sheet for the federal government is the first step in gaining control of the many risks that it faces.

[10] John H. Makin, "Perspective on America's Fiscal Policy," American Enterprise Institute's Annual Policy Conference, 1991.

[11] Office of Management and Budget, "Objectives of Federal Financial Reporting", September 2, 1993.

There are over a dozen categories of government liabilities. Each liability (promise) should be matched with an asset. If it is not matched; the federal government's promise to citizens, contractors, or retirees may not be able to be met.

One of many promises that the federal government makes is to repay it's debt. The United States federal government's debt is 14 percent of it's total liabilities. Other major promises include pensions, welfare payments, medical care, roads and bridges, and education expenses.

Constructing a federal balance sheet brings together all the promises and assets that have made by a government. Elected officials, government managers, and citizens all gain from this exercise.

The federal Balance Sheet Template includes the following categories:

Balance Sheet Template

Assets	Liabilities (Promises)
Cash and Monetary Assets	Debt & Yearly Surplus (Deficit)
Accounts Receivable	Interest on Debt
Inventories	Entitlements
Loans Receivable	Insurance
Property, Plant, and Equipment	Loans & Credit Guarantees
Deferred Retirement Costs	Sponsored Enterprises
Financial Assets	Medical
Advances and Prepayments	Infrastructure
Other Assets	Facilities/Resources
	Environmental
	Claims Against Government
	Long-term Contracts
	Undelivered Orders
	Other Contingencies

Each of the federal balance sheet's asset and liability categories may have dozens of specific items. Information about each item, within asset and liability categories, must be collected and projections made as to it's long term cost or value.

After the balance sheet is completed. A federal asset/liability strategy should be formulated. One of the major components of this strategy is the reduction of risks. Many risks are faced by the federal government including interest rate, credit, liquidity, operation, management, and liquidation risks to name a few.

The federal government must give immediate attention to the full range of risks that it faces. A comprehensive risks catalogue is produced via balance sheet and the Asset/liability strategy. Thus constructing a balance sheet and then developing an asset/liability strategy is a high priority item in today's "*bankruptcy*" prone government operations.

The President and congress should include a balance sheet with their yearly budget and financial plan. An asset/liability management strategy should be formulated and included as well. This strategy will identify

risks, match assets and liabilities, and propose a plan that will bring federal assets and liabilities into balance.

VII. Federal expenditure tracking via "chart of accounts"

When citizens and the media join in the debate about the public services they consume and the price they are willing to pay, government responds with more careful and creative taxing and spending choices. **As citizens becoming increasing aware of the tremendous overlap and duplication among federal programs, they are demanding that program numbers and size be reduced.**

The tracking of federal expenditures "chart of accounts" via a Programs Reporting System (PRS) is urgently needed. PRS will identify how many programs are currently operated by the federal government. This will be done in a manner that can be easily and widely understood. The PRS project will give the media, citizens, elected officials, and government managers--timely information and the analytical tools they need to gain control over the federal government's programs. More careful and creative taxing, spending, and program reduction choices--more bang for the taxpayer's bucks--will be the result.

Gaining access to federal program information and analysis is often frustrating. In fact, no one knows how many federal programs there are! No electronic link between federal budget accounts and programs exist. A senior economist of the House Budget Committee Majority staff recently observed that "is very difficult to obtain information about the full range of federal programs." Without readily accessible program information, duplication, waste, and inefficiency is running rampant within the federal government.

For example, over 300 federal welfare and 157 federal jobs overlapping programs are currently operated by the federal government. Unlike most businesses, the federal government does not often compare, review, and identify and then eliminate redundant programs that are "on the books."

Developing a program reporting system (PRS) is the first step in gaining control of the federal government welfare, health, education, defense, foreign operations, and social service systems.

PRS will be electronically available to citizens, press, government managers, and members of Congress and their staffs. Overlapping and duplicative programs will be identified. The PRS will provide ready access to budget, management, accounting, and eventually performance program data. The major goal of PRS is to provide incentives for legislators and program managers to improve federal program efficiency and effectiveness. These incentives are largely lacking today -- as little is known about programs by the average citizen and legislator.

The PRS Project will be produced in three phases. Phase I - Program Data Collection will identify current program data, collect historical program data, assemble program data projections and all information will be electronically added to database. Phase II - Program Analysis will generate the capacity to review federal program trends, provide the ability to use program data for management and projection purposes, provide for the analysis of programs -- clarified and enhanced by program goals, objectives, and benchmark comparisons, allow the presentation of program by types -- welfare, health, children, jobs, for example, and provide the ability to compare and contrast programs across program types.
Phase III - Program Options will allow strategic presentation of federal program options, insure measures of program performance across programs and agencies, provide knowledge of effects of program modifications on budgets, and allow comparison of program options in constant and current dollars.

PRS will be user-friendly and will make timely and comprehensive information more readily accessible to the media, taxpayers, citizen groups, and elected and appointed officials of the United States.

Conclusion

The federal government should adopt and use on a daily basis a Comprehensive Federal Budget, Balance Sheet, and Financial Plan which will provide

* the identification of a broad range of risks inherent in federal promises (liabilities)
* an in-depth Program Reporting System
* a comprehensive compilation of federal spending and revenues
* a complete listing of federal assets and revenues
* an easy to use electronic "window" accessing the detailed working of the federal government
* the latest financial management techniques and tools, including asset/liability management

Adoption of these changes will result in massive changes in the way the federal government works. The Citizen's Budget is needed to help end the bankrupt behavior of the federal government and provide all taxpayers with value for their tax dollars.

Mr. HORN. I notice the firm that has the copyright on that was Allspice Technologies. Is this readily available to the public now, or what?

Mr. FOX. Yes, we would make this available to anyone. In fact, we do have—the House Oversight Committee is in the process of having a comparable program built. They're actually entered into a contract with the programmer that runs Allspice. And they're going to be able to move various agencies and programs from one department to another, to see what reorganization would do in terms of the actual budgetary implications.

So you can begin to see the power of these tools. For very little money, you can begin to develop the tools that allow you to do virtually anything. The things that you had promised to do as a new Congress. Right now, frankly, many of the promises that have been made will not be able to be kept, unless you have the ability to work with the data and to manipulate it. Because the staff—and being a staff member many years myself—you're in there trying to grab volumes off the shelf, trying to make sense out of this.

Often you can't do it because you don't have the program expertise. This system would allow you to reach into the lowest level, lowest common denominator and pull out that data almost instantaneously. We would hope that eventually this would be updated on a daily basis.

Mr. HORN. Now, you said House Oversight is looking at his for the standpoint of departments, within the legislative branch?

Mr. FOX. No, this would be Federal Governmentwide.

Mr. HORN. How are they into that with their jurisdiction? I'm just fascinated.

Mr. FOX. That's a question I can't answer.

Mr. HORN. Yes. They aren't.

Mr. FOX. Well, they're in the information business, through the House Information System.

Mr. HORN. Yes.

Mr. FOX. And they're oversight there.

Mr. HORN. Well, if they're putting it on House Information Systems so we can all access it——

Mr. FOX. That's right, exactly.

Mr. HORN. There's about 20 other committees that have an interest in it.

Mr. FOX. Exactly, exactly.

Mr. HORN. Interesting.

Mr. FOX. One final comment is, we've been working on this for about 4 years, in terms of trying to interest individuals. And almost universally, when we present this to budget analysts at OMB, to Members of Congress, to citizens, they all say, wow, you mean we don't have this now; or, this would be our dream.

The problem has been that no one has been willing to put the cash on the table. We've gone to foundations; we've gone to this Congress, through House Information System; and we've gone to individuals. But nobody seems to be willing to bite the bullet and say, let's do it. And I found this true in the private sector as well. What you have to do is get one of the senior or the chief operating officer, chief executive officer, get someone at the top to say, we're going to do this—like a Speaker of the House, chairman of a com-

mittee, chairman of a subcommittee—and say, we're going to do it; we're going to spend the money that needs to be done, and just do it.

And that's the decision we need to have made now, is somebody to say, we're going to do this.

Mr. HORN. Doesn't OMB already have this on disks and can manipulate it?

Mr. FOX. Yes, they can. They will not do this——

Mr. HORN. Why don't they just send us one of the disks?

Mr. FOX. This is it, right here.

Mr. HORN. Yes.

Mr. FOX. I mean, you can buy it for $24 now at the—you can buy a version that basically represents the budget that's published. Now, this is the full data base, the 10 meg of data, that would allow you to manipulate all the data which they have, and present on a one time a year basis. Now, the actual development of software will not be the major cost. The major cost, of course, will be in the daily updating of the information.

Mr. HORN. As to expenditures for the current year or what?

Mr. FOX. That's right. You would want to keep this up to date in terms of authorization and appropriations process, as well as the actual transactions that are taking place within each agency as collected by the Department of the Treasury. And I can get into the details of how that can be done. They collect this data. You'd have to collect an additional few variables, in terms of the checks that they cut and so forth, including object class information.

But it could be fairly easily done. I mean, this is not—you know, the previous panel seemed to say, well, this is tough. One of them informally said it will be 20 years before we really can get this done. It could be done in a matter of months, rather than years, if the decision is made to do it. And before the financial implications are realized, that decision should be rapidly made. As I pointed out earlier, in our estimation, it's costing us at least $1 trillion a year not to do this, or about $2 million a minute.

Mr. HORN. Amazing. Well, that completes your summary then, Mr. Fox.

Mr. FOX. Yes, it does, thank you.

Mr. HORN. All right. Mr. Brecht, welcome, we're delighted to have you here.

Mr. BRECHT. Thank you, Mr. Chairman. My name is Lyle Brecht, and I'm the author of AmericaReport, which I believe that most of the committee members should have a copy of.

Mr. HORN. We will put that in the record, along with your full statement. Yes, it looks like everything can go, even some of their line drawings, so that's fine.

Mr. BRECHT. Chairman Horn, distinguished members, thank you for your invitation to testify this afternoon. These comments and suggestions are based on my experience as the author of AmericaReport, A Common Sense Annual Report to the Citizens of the United States. Today neither citizens nor Government managers nor some Members of the Congress know as much about the financial affairs of the Federal Government as they do about publicly traded businesses in this country.

This was my vision with AmericaReport—to report on the affairs of Government, so that any citizen can understand where the money each household invests each year is being spent, and what results are achieved by the Government. I believe that such an annual report is actually the missing link between the Government and the citizens. Presently, Government publishes thousands of reports each year.

Many are very difficult to understand. Many of them require some actual expertise to really work through. And in this process, for the Government to try to communicate to the people in this fashion is like trying to talk underwater. The end result is a garbled and disconnected set of contradictory facts that citizens believe are the truth about Government.

As a Nation, I believe we lack three fundamental things: a unifying vision of where we are heading for the future; answering what purpose or mission Government should play in achieving this vision; and clarifying what the core values that we'll use to work at this purpose day in and day out. Today no document produced by the Federal Government explains this vision. This is what citizens want to know, more than anything else.

Any report to citizens must address our Nation's vision for the future. Congress should require that every agency, every department, every program manager communicate their financial results in a way that common people can understand. We need Government to use language that means something to citizens, and reflects how they make decisions. Also the process for producing a report to citizens may be just as important as the report itself.

In the research I did for AmericaReport, I encountered Government officials who believe that the amount of debt the Government owes to citizens makes no difference, because we owe it to ourselves. If this argument is carried out to its extreme, there is no incentive to budget prudently, since whether the Government borrows $1,000 from each citizen or $1 billion matters little.

I encountered officials who believe that the Federal Government is not a business. Now, this seems obvious, but leaves the door open for an accounting of Government activities that makes little sense to ordinary citizens who engage in the business of the economy. I encountered one Government official who believes that the White House will never let us tell citizens the truth concerning the financial situation of the Nation.

However, this official was reminiscing about trying to get reports through both Republican and Democratic controlled White Houses over the past 20 years. I encountered a Government official who believes that as long as the gross domestic product is increasing, there is absolutely nothing to worry about. Gross domestic product does not account for many externalities. Some countries actually have negative real growth, even with positive growth from GDP, when externalities are taken into account.

My research suggests that this may also be the case for the U.S. economy. I encountered, also, House Members who remain unconvinced, even at this state, that the budget deficit is a problem or should be a priority for congressional action. The process of developing an annual report to citizens hopefully will uncover and clarify these misperceptions.

Such a process can also produce a closer collaboration with Federal managers. These Federal managers are the ones who must lead, organize, inspire, deploy, measure and reward those who implement the programs Congress funds. I have a number of recommendations for the budget process. My assessment right now is that the budget process itself creates many financial problems for the Nation. Congress needs to change the budget process now.

Two budget process reforms I believe that are needed are, Congress needs to immediately start using a capital allocation process for determining which programs to fund, which to eliminate, and which should be done by someone other than the Federal Government. In any organization, even one as big and powerful as the U.S. Federal Government, there is a limited amount of available capital.

This limited capital must be spent in the most productive fashion possible. As a Nation, we must prioritize and focus on what is important. We cannot do everything. Every dollar must be allocated to those activities that produce measurable results. Programs should be funded because they create measurable value for shareholders, the citizens.

Congress must decide what produces the greatest value from a fixed amount of capital. Also, Congress should decide which level of Government should manage these programs, or whether the private sector should manage the activity. Also, Congress needs to immediately start using modern information technology to track the results of Government programs in real time, and distribute this information directly to the people. Program level financial information should be combined with the program's mission, benchmarks and performance results into a one to three-page summary, and shared widely.

Systems deployed at the program level can gather information and make it available in real time. For example, this information could be published on the Internet's World Wide Web. That concludes my summary remarks for today, Mr. Chairman, subcommittee members. Thank you.

[The prepared statement of Mr. Brecht follows:]

Testimony of Lyle A. Brecht to the Subcommittee on
Government Management, Information & Technology
11 July 1995

CREATING SHAREHOLDER VALUE: THE NEW STANDARD FOR EVALUATING GOVERNMENT PROGRAMS

Mr. Chairman, distinguished Members, thank you for inviting me here to testify this afternoon. I will make comments for the record concerning this subcommittee's plan to publish a "Report to Citizens." I will also suggest ideas for reforming government operations. My comments and suggestion are based on my experience publishing *AmericaReport: A Common Sense Annual Report to the Citizens of the United States* (exhibit attached).

Background - the Starting Premise

In a participatory democracy, the budgetary problems government faces cannot be solved without input from the citizens - the shareholders of this government.

It is essential for shareholders of a business to be well informed about the business' operating results. Shareholders of a business need this information in order to judge if its managers wisely invested the capital shareholders let them use.

It is essential for shareholders of government, the citizens, to be well informed about government's operating results. This is absolutely necessary in order for citizens to participate in decisions concerning where to invest the capital citizens make available to the government.

What concerns citizens is whether the nation is receiving value for the dollars they "invest" each year. Whatever money government spends or promises to spend must create value for citizens - if not today, then tomorrow.

The federal government presently spends one quarter of the annual GDP for the United States. Yet, there are few concrete measures to determine whether this is the right amount of capital to allocate to government operations, too much, or too little.

Programs are rarely funded based on performance or results. A rational means is seldom used to determine the budget for an activity. As a result, it is almost impossible for citizens to judge

whether the capital allocated to specific government programs produces value.

It is difficult to obtain useful financial information concerning the programs the federal government manages. Program level information is often buried deep within thick, inaccessible documents. What financial information one can get is hard to interpret. This is because financial data is presented without the context of program mission, benchmarks and measures of performance.

Lawmakers end up making budget decisions without the benefit of knowing what programs are producing value - and which programs are not performing. Without this basic information, budgeting is primarily political, subject to special interests lobbying. The question of what produces the most value from a fixed amount of capital is never addressed.

The Vision

The solution to the problems mentioned above is to publish a "Report to Citizens." The budget process must also be reformed.

Budget Reform Measures

Two budget process reforms are required:

1) the development and use of a rational capital allocation process for determining which programs to fund. Programs should be funded because they create measurable value for shareholders - the citizens. Also, a discussion of which level of government should manage these programs or whether the private sector should manage the activity needs to take place for each program.

2) the use of modern information technology to track the results of government programs in real time and distribute this information widely.

Three things are necessary to implement a capital allocation process for determining what programs to fund:

- the mission of the proposed program

- o benchmarks for establishing long-term goals and objectives
- o performance measures that help government managers track progress toward the benchmarks.

Congress should focus its efforts at defining mission and establishing benchmarks for programs. Without this foundational step, formulating a budget for the program is mere guesswork and involves directing money toward "good works" rather than toward producing results.

Meaningful performance measures for each program should drive decisions as to which programs to fund and at what level.

Program level financial information can be displayed using World Wide Web Internet technology. Systems deployed at the program level can gather information and make it available in real time. There is no need to wait for the Agencies and Departments to build expensive, financial management systems.

The Congress should reengineer the budget process in ways that produce collaboration with the federal managers. These federal managers are the ones who must lead, organize, inspire, deploy, measure, and reward those who implement the programs Congress funds.

Citizens Need an Objective "Report to Citizens"

Each year literally thousands of documents are churned out purporting to report the reality of government operations. These reports are merely one Agency, or Department's, or special interests idea of reality - and often a narrow slice of reality.

To compound the confusion, this torrent of segmented information hits the media where it is sanitized, packaged into digestible bite-size tidbits, and washed down the citizen's gullet between advertising messages. The end result is a garbled impasto of disconnected, contradictory facts that citizens believe are the truth about government.

This swirl of misunderstandings, dis- and misinformation has been going on a long time. This imbroglio is caused primarily by the lack of three fundamental things: 1) the need for a unifying vision of where we are heading in the future; 2) answering what purpose or mission government should play in achieving this vision; and 3) clarifying what the core values are that we'll use to

work at this purpose day-in and day-out.

If the Congress chooses to produce a report for citizens, wrestling with these issues should be the meat of the report. This is much more important than trying to worry financial accounting numbers into intelligibility. The financial numbers themselves have little value without a shared meaning.

This shared meaning only can result from a shared vision of where we are going, what purpose or mission the federal government should play, and what core values we will use to get there. This is what the shareholders of the business of the federal government want to know more than anything else.

Some Ideas for the Report to Citizens

1. Get away from negative statements and treating "citizens as taxpayers." Negative visions don't inspire citizens. Focus on citizens as taxpayers implies enforced compliance and passivity - in a country where it should be deemed a privilege to be a citizen.

   We commonly use the term "welfare" to describe transfer payments to one group of citizens and "entitlements" to describe transfer payments to another group of citizens. Congress needs to look for positive metaphors and positive missions. I adopted the metaphor of citizens as shareholders in the business of the federal government, who "invest" capital in the business each year.

2. Make all those big numbers more meaningful. I calculated budgetary expenditures in terms of dollars per household, which became a placeholder for how much a family might be "investing" each year in that activity. This feature alone was viewed as a major innovation by knowledgeable individuals both in and outside of the government.

3. Make the report short (32 pages) so as to not waste the readers' time.

4. Make the report interesting and pretty. If I'm receiving a shareholders' report on the largest, most important organization on earth, shouldn't the report be at least as interesting as an annual report put out by The Coca Cola Company?

5. Make assumptions explicit. As Einstein remarked, "our theories determine what we measure." Peter Drucker, a respected management consultant, says, "what you measure is what you get and if you can't measure it, forget it, it is probably not worth doing in the first place."

6. Producing a Report to Citizens is a divergent problem. Convergent problems are those problems where the more we study them, the more we converge on an acceptable, clear solution. With a divergent problem, the more we study the problem, the more divergence in views and ideas for solving the problem appear.

7. Say something important in the report. In my conversations, I encountered:

   - government officials who believe that the amount of debt the government owes to citizens "makes no difference because we just owe it to ourselves." Given this perspective, what is the incentive to budget more prudently since whether the government has borrowed $1,000 from each citizen or $1 billion matters little?

   - government officials who believe that the federal government is not a business. This seems obvious, but leaves the door open for an accounting of government activities that makes little sense to ordinary citizens who engage in the business of the economy. The result is, as Harrison Fox's work has uncovered, liabilities that are unaccounted for, either on the balance sheet of the federal government or their impact on the P&L statement measured, as *AmericaReport* attempts to do.

   - a government official who believes that "the White House will never let us tell the citizens the real truth" concerning the financial situation of the nation. However, this official was reminiscing about trying to get certain financial reports through both Republican and Democratic controlled White Houses over the past twenty years. His judgement was that "less than half of *AmericaReport* would get by the White House."

   - a chief of an influential Congressional reporting unit believes that "as long as the Gross Domestic Product is increasing, there's nothing to worry about." GDP masks or does not account for so many externalities. Some small countries have negative real economic growth even with positive growth in GDP when

externalities where taken into account. *AmericaReport* suggests that this may also be the case for the U.S. economy.

- o Members of the House who remain "unconvinced that the budget deficit is a problem or should be a priority for Congressional action." Why do they believe that the budget deficit does not present a problem to the U.S. economy?

Congress needs to address each of these divergent opinions explicitly and take a stand. Again, to quote Albert Einstein, "the significant problems we face cannot be solved at the same level of thinking we were at when we created them."

8. Take responsibility. Any report to citizens must be connected to those responsible for setting the priorities of government. Come up with some meaningful way of measuring the performance of each Member. I chose the number of extra minutes each day citizens would need to work to pay for the programs recommended by that Member of Congress. Find a better measure, but include this information in the report.

If "the government is us" as Theodore Roosevelt claims - we created the problems that we face in America today. There is no us versus them. The people need a Report to Citizens that informs and involves all of us in the process of governing and making decisions that create a future worth living in.

Mr. Chairman, Members of the Subcommittee, thank you for listening to my testimony and thank you for your time this afternoon. I would be happy to entertain any questions you may have for me and I'll do my best to answer them.

THANK YOU!

Testimony of Lyle A. Brecht to the Subcommittee on
Government Management, Information & Technology
11 July 1995

Background of Author

The genesis for *AmericaReport* started around our family's dining room table over dinner. My seventh grade daughter asked me a simple question, "Daddy, what does the government actually do?" I thought that was a reasonable question for her to ask so I pursued it.

Before I go on any further, let me say a few things about my background so you'll understand better where I ended up from this pursuit. My educational background includes graduate level degrees in systems thinking (Univ. of Minnesota) and business (Harvard). My first job out of graduate school was to analyze the economics of nuclear power plants. I read everything written on this subject at the time. I concluded that the methodology used to judge whether nuclear power was a good investment was fundamentally flawed. This caused quite a stir at the time. It was contrary to the conventional wisdom of the day, although it later proved to be true.

One of my next jobs was for the U.S.E.P.A. I performed field research concerning the 201 grants program. This program gave money to localities for waste water treatment plants. I discovered that many of the cash flow analyses done by consulting engineers to support the type and size of treatment plant were incomplete. Future operating and maintenance costs were often understated. Thus, a community accepting "free money" from the feds might find themselves bankrupt or senior citizens forced out of their homes as local tax rates were raised to keep up with these unexpected costs. Working with EPA, I designed a marketing program for less costly waste water treatment. This program saved communities $1.2 billion over previously projected construction costs.

Since these early jobs in my career, I have done consulting work for a variety of public and private sector clients. My clients include some of the largest companies in the world. I performed unique and often highly complex analytical work. I read annual reports for fun. I've read maybe a few thousand over the years. I also read extensively in many technical disciplines.

With this background, I pursued answering my daughter's question concerning government. What I was looking for was a simple report that described what government was doing, why it was doing it, and what results it was accomplishing. I also didn't want a spin - just the simple truth. What I discovered was that such a document did not exist.

My next approach was to get somebody else to write it. I failed at this attempt - so I wrote it myself. It took me about a year and a half to read a few tens of thousands of government documents and a few hundred books by experts who purported to understand various aspects of government operations. Then it took me about six months to write up what I had learned and to publish it in a pretty format so that others might enjoy this information.

When I wrote it, my hope was to produce a politically neutral report. I wanted to just tell the truth as well as I understood it at the time. I used the metaphor of the federal government as a business.

The resulting *AmericaReport* has been praised by various individuals and groups of vastly differing political views and persuasions. Some say it is the best thing that has ever been written on the budget for the layman. The report has been recommended by the Financial Executives Institute, a professional association of 14,000 Chief Financial Officers, Treasurers, and Controllers - whose members actually produce the annual reports of public companies.

Members of the House Budget Committee distributed copies of *AmericaReport* at a town meeting they held last fall prior to the budget deliberations - with favorable reception by citizens attending these meetings.

In the past few months, officials and staff from the U.S. Treasury, Office of Management & Budget, National Economic Council, National Performance Review, Government Accounting Office, General Inspectors' Office, Federal Accounting Standards Advisory Board, Association of Government Accountants, and the White House have spoken to me about various aspects of my report. Some of these conversations were initiated by me and some were initiated by the various officials.

AmericaReport was produced at great personal sacrifice to me and my family. Many times along the way, I wanted to stop. However, it was almost as if I couldn't stop myself from thinking about these issues of budget and government and what these issues mean to all Americans and to future generations. This is my small contribution to the vision on which America was founded.

Mr. HORN. We're going to have to recess for about 10 minutes. There's a vote on the floor, and we will return. So at 4:35 p.m., roughly, we're recessing. Let's hope we can make it by 4:45 p.m.

[Recess.]

Mr. HORN. The hearing will resume. Let me ask you, gentlemen, you heard the testimony of the officials from the General Accounting Office and the Office of Management and Budget, which preceded you. You mentioned a little bit of your reaction, but I'd like a fuller view for the record of your reaction to their testimony. And given what you're trying to do to present the holistic picture of not only financial transactions, but the implications of what it means.

And obviously, they haven't really touched on the areas both of you have testified. What's your reaction to what you heard?

Mr. BRECHT. I'm reminded of the Russian missile gap. They came in and basically said, things are a mess but things will get better in the future; it's just going to take a long time. That was one of the impressions I had. Another one was that accounting for Government operations is different.

Mr. HORN. Do you agree with that statement?

Mr. BRECHT. Well, absolutely, I do. And at the same time, I believe that the business community has some tried and true accounting principles, methodologies, and probably more important, ways of thinking about how to allocate capital, which I believe needs to go above and lay on top of any accounting principles. We don't need to reinvent the wheel for the Government. We really have a very, very strong place to start.

Mr. HORN. You heard my discussion with regard to the transaction and taxation.

Mr. BRECHT. Yes, I'm with you. I was having the same difficulty as you were, not understanding what Mr. Chapin was saying, but why he was using that as an excuse why not to book revenues or think about things——

Mr. HORN. Right. Treat taxation exactly as a business treats income and revenues.

Mr. BRECHT. Well, in my report I suggest that we might even want to at least, conceptually. It may not work out entirely practically in all ways. But conceptually, imagine that indeed the Federal Government is delivering products and services for a fee. Citizens pay the cost of those goods and services, hopefully——

Mr. HORN. I think it was Oliver Wendell Holmes that said, "taxes are the price of civilization."

Mr. BRECHT. Well, and again, the orientation that, if we're going to pay these taxes, what value are we receiving? We have to have some way to communicate that with to the citizens, as the Government, so that we don't have a situation like we have now, where there's just lots of negativity out there. We're always blaming Government for something or another. And Government does a lot of things well.

It can improve in a lot of areas, but people want to know what they're getting for their money.

Mr. HORN. Right. Now, you mentioned the capital allocation process.

Mr. BRECHT. I had one other point, in terms of what I took away from the testimony.

Mr. HORN. OK.

Mr. BRECHT. That is the very clear understanding that we need big financial management computer systems to get the basic data for actually running our country. I don't know whether or not I agree with—I agree with the statement, but I don't know if—I see how it's being implemented out there in the agencies, and I'm not agreeing how they're doing that.

Mr. HORN. Do you want to elaborate on that? Are you worried about excessive investment in computers of the past decade, as opposed to how one——

Mr. BRECHT. We're not dealing with computers of the past decade, we're dealing with computers from about 1977, 1987 model computers out there. No, what's happened in business, for example, is they've done just exactly what, for example, Mr. Chapin was discussing, where they pull together the operating systems and the accounting systems. What they call them is transaction management systems. You don't have this bifurcation, like there is right now in the Federal Government.

But what's happening at the Federal level in the agencies, what I see, is that they're investing in what I call big, hard wired systems—lots of COBOL programming, lots of designing data elements. I don't know if you've seen the data element book itself for this massive system they're talking about; it's 8 inches thick. You can't build a system. That's part of my background, I've actually designed and implemented large transaction systems out in the private sector. Something that complex is not doable, for any amount of money, for any amount of timeframe.

My suspicion is that we may not have to do that to get where we want to. We may not have to account for every nit and nat, which is typically an orientation that you'd want from an accounting standpoint. But from a management standpoint, you need to generally know enough about what's going on to make good management decisions. And I believe that's where we should start.

Mr. HORN. That's interesting. Mr. Fox.

Mr. FOX. Yes. First of all, I've been—I want to correct one thing that I said earlier in the fact that the data base was only available in three places. The data is also available at the General Accounting Office, for general information, as well as the development and historical data base, which we just found out about fairly recently, that goes back a number of years. And I think this is going to be very useful.

And hopefully we can make it available through the House Information System and the Thomas System. My direct response, in terms of what was said in the previous panel is, No. 1, relates to the pace at which the various systems are being developed. For years I've dealt with the General Accounting Office, as a staff person on Capitol Hill. And typically, when you make a large request, they're very good about many small requests, they will send up five or six people and try to talk you out of doing the request.

And they all go out in the hall and wring their hands, and pat each other on the back when they back you down a little bit. But I think this is an indication of the basic problems that we face in the Government. Many times the solutions are seen in terms of years or decades when, in fact, with the liabilities increasing at $1

trillion a year or $2 million a minute, and the kinds of social disasters that we're seeing around the country in terms of especially the low income, we need answers in months and days.

Just as a way of moving away from that, I think that the part of our population that's being immediately affected by the ineffectual accounting systems and measurement systems and ineffective and almost no use of asset liability management, those sectors of the population that are suffering the most are the low income. I know this from personal experience, being vice chair of the Public Housing Authority in Rockville, MD. In the last 2 years, the money that is being expended by the State of Maryland for aid to families with dependent children program has decreased by 25 percent.

When Government starts cutting back and starts experiencing problems, as we are with our poor financial systems, the people that suffer the most are the ones with the least power, the least lobbying capability. And what we're seeing is that those people that are at the lower end of our economic scales are suffering tremendously. And they cannot go on suffering very long. We're seeing some tremendous things building up, and I think we're going to need to make some changes.

And I think that's one of the strongest arguments, I think, for making these changes fairly rapidly, and determining which programs work to help people economically and socially, as well as the financial component. So I find that they're very unresponsive to the social needs of the country. I've felt that, I think, in my own personal interaction with many people from the General Accounting Office and other Government agencies. They have been focusing on the dollar transaction, and not looking at the social consequences.

Although many GAO reports now are beginning to reflect the social as well as the economic consequences. And I think the Members of Congress would be well advised to take a look at those reports. The second thing that I find is that they talk about the complexity of these systems, and how difficult it's going to be to implement them. Well, the Coast Guard has already implemented a system, an executive information system, which is on par with most any private corporation.

They're integrating many different accounting, management, personnel systems, and they're adding performance into this. So we can show that actually a Government agency can do this, if they make up their mind to do it. This is the Commandant of the Coast Guard decided he was going to have a system which was comparable to systems in the private sector. And he's developed this now over the last 3 or 4 years. It's in operation; it's being used.

I just talked to a Coast Guard officer a few days ago, and he said it's very, very helpful; in virtually everything they do they refer to it. You might imagine it would be, if you had a system like this available.

Mr. HORN. We did have some testimony from the Coast Guard, and it was very helpful.

Mr. FOX. Good, so you're well acquainted with that.

Mr. HORN. Right.

Mr. FOX. So that's the bottom of the pyramid, in terms of information. Our estimate is that it would take about $1 billion to im-

plement that system Governmentwide, in probably 5 to 10 years. The top of the pyramid is——

Mr. HORN. You're thinking of the Coast Guard system, or you're thinking of what they're working on under the Chief Financial Officers Act?

Mr. FOX. The Coast Guard system.

Mr. HORN. The Coast Guard.

Mr. FOX. A Coast Guard type system that would fully integrate information. Now, it may be less, give or take a few hundred million. But it seems like it cost the Coast Guard $2 million or $3 million to develop this system. And if you multiply that times, considering the size of the Coast Guard, times other agencies, you're talking about hundreds of millions of dollars, perhaps $1 billion.

Now, the top of the pyramid is what I demonstrated earlier. And that could be generated for very limited amount of expenditure, and very quickly—in a matter of months. It would virtually change the way Congress works. It would change the way the media reports the way Congress works. And I think this is—the previous panel fails to recognize the importance of making this information available to citizens and the media and the Members of Congress.

As you are well aware, and pointed out earlier, with your comments about Mr. Witten, information is power. And when the information becomes available to every member, the media and citizens, you'll have a retired gentleman in Des Moines calling you up next week, if he had access to the information, and saying, "Congressman Horn, do you realize, when you were talking about Defense"—this had been televised on C–SPAN, hypothetically—"do you realize when you were talking about these programs that you can go in now and get this information." And then he gives you a 15-minute discourse on his analysis.

You're taking notes furiously because you say, "yes, let's ask those kinds of questions. You'll have citizens—"

Mr. HORN. Right.

Mr. FOX. And this moves us back, very interestingly enough, to the Athenian democracy as developed in 6th century, B.C., where each citizen had to actively participate in Government a number of times in their life. They would actually take a month or a year off and actually become an actual manager, implementer of Government activities. What I'm predicting for the 21st century is, we'll begin to see very active citizen involvement.

Maybe not millions of people, but thousands of people will become involved with this information as it becomes available, just as they're involved with C–SPAN now, and be calling up members, becoming kind of watch dogs in various areas that they have an interest in. This is one reason why we need to make this available.

Mr. HORN. That's why the Internet is so popular.

Mr. FOX. Exactly, exactly. I would also like to say that the Federal Accounting Standards Advisory Committee was created in 1990. It's interesting, it was created on October 10th, which was, I believe, the 28th anniversary of the report of the President's Commission on Financial Standards on Budget Concepts. And they are now going to produce their final report this year, which is 5 years later.

Now, they seem to think that was very rapid. I think this underlines my point about their timeframe and mine are very different. I think we need to move very quickly in developing the information and so forth.

Also, one final comment. The use of accrual methods in accounting are very important. And they're recommending—the previous panel recommended selected use of accrual throughout the report. This has been recommended many, many times, as you are well aware of, through the last 25 or 30 years, by various commissions and boards and so forth.

Mr. HORN. I think the Hoover Commission did it in 1949.

Mr. FOX. Exactly, exactly. And it's been recommended—almost every major commission has recommended that we move in that direction. We are moving in that direction with Title V of the Congressional Budget Act, which requires credit transactions, loans, be accrued for. We need to use this on a broad array of transactions.

And if you look at my annual report, you'll notice that there are a number of categories on page 44 and 45—liabilities and potential liabilities. We need to use accrual accounting for all of these. And the fact that the General Accounting Office has recommended it be used for loans, and now beginning to consider their use for a couple other areas, I would strongly recommend that we look at these other areas, for instance, in terms of pensions, also means tested benefits, insurance programs.

Mr. HORN. For the reader of this transcript, who is not likely to understand the concepts of accrual accounting——

Mr. FOX. Yes.

Mr. HORN [continuing]. Explain how either accrual or regular accounting can be misleading in terms of the figures that are used. Give us some examples.

Mr. FOX. OK. Regular cash accounting, you're just keeping track of the dollars as they come in and out. In accrual accounting, you're basically saying—when I ran my own business, my accountant said, you should be accruing for sick leave for your employees because eventually, you're going to have to pay for that. So he made me set aside each month dollars in an account for the sick leave, as my employees began to accumulate it.

And I think that's important. You need to plan for the future, and show that you actually recognize an expenditure that you may have to make in the future. And that's what accrual accounting is all about, is saying, well, someday we're going to have to write a check for a certain amount to an individual, and we should plan for that.

Mr. HORN. Let's take the small firm example you started with. Could you use accrual accounting on such obvious monthly payments as the rent?

Mr. FOX. Exactly.

Mr. HORN. OK. So everything that you can anticipate, you should have some way to fund it.

Mr. FOX. Exactly, exactly. And my argument is, you can anticipate almost everything. I mean, maybe I take an extreme position there, but it seems like in most all these categories that have been identified—and I'd like to point out that in our annual report, we're using data that's been provided by the Federal Government or up-

dated by the Federal Government. And we're not just making these numbers up. These are numbers which are generally provided directly from the General Accounting Office and Congressional Budget Office.

Mr. HORN. Now, to what degree are any of the numbers you have here on page 45—the liabilities, potential liabilities, which begins on 44—to what degree are those stated in the annual budget of the President of the United States?

Mr. FOX. Very limited number. You have some reflection in terms of Social Security liability. The best comparison to be made with the report that was mentioned earlier, it's a consolidated financial statement for the United States which is published annually by the Treasury Department. And we don't have time to go through and make a detailed comparison, but there are some parallels. But the bottom line is, they underestimate liabilities by about a factor of four or five at least.

And we're estimating liabilities in our new report coming out for 1995—I have some preliminary numbers. We're looking at probably about $50 trillion in liabilities. Some of those would have to be indexed, in terms of potential losses. But you're looking at some very, very large numbers that have to be taken into consideration; the largest being the Social Security unfunded liability, which is now over $8 trillion, and increasing at the rate of between $250 billion and $400 billion a year, which is not put into any of the calculations in the current budget.

Much of the debt each year is not included, because it's so-called off budget increases—interest paid on trust funds, et cetera. So I don't necessarily want to get into nitty gritty details of my testimony, but the bottom line is that we need to develop a comprehensive approach to budgeting, and that would include a balance sheet and a financial plan.

Mr. HORN. So what you're recommending is that the annual budget document submitted by the President to the Congress ought to include these areas.

Mr. FOX. Exactly.

Mr. HORN. Now, one way they could include the liability section, for example, would be in the special appendices end of the budget, where we have asked them—when I was vice chairman of the U.S. Commission on Civil Rights, I went over to see the Director of Budget, and he did implement it. The idea of cross cutting where are civil rights and funding throughout the executive branch.

Mr. FOX. Exactly.

Mr. HORN. And I don't know if that document still exists, because I haven't had a chance to look at that part of the budget yet. But it did appear starting in the Nixon administration; and last I knew, it was in. But it could either be in there, or just as a separate section, so Congress knows up front what you have to worry about.

Mr. FOX. Exactly.

Mr. HORN. The American citizens get some sensitivity to that, too.

Mr. FOX. Each one of those lines, too, in your balance sheet, should be linked back into the budget, since you're matching the accruals with long-term liabilities. And what this does for you is it

gives you a truer indication of true cost of Government programs and promises. The bottom line is that the Congress and the President and the Federal Government have made a lot of promises which they are not going to be able to keep.

And I think people in the country, as you're well aware in talking to your constituents and many others, are well aware of this. And what they're telling Members of Congress and the President and others in the Federal Government is, we want this straightened out. And I think that's one of the reasons why we had the election on November 8th. They're saying, there's something wrong, we want it straightened out.

Mr. HORN. They can't put their finger on it, but they know it's wrong.

Mr. FOX. That's right. What I'm saying is, you will not be able to straighten it out unless you have information. And we need to start with this basic information. Once we get the basic information, then you build your data base in terms of performance and outcomes and programs. And you're very right—we need to maybe move away, or continue to develop information about programs.

But we need to first of all get our financial information together, program descriptions and so forth together, so we can begin to see how many programs we have. We don't know how many Federal programs there are. We don't know how many people work for the Federal Government. We know virtually nothing, in gross detail, about what happens in the Federal Government or what's going on here on a daily basis. It's just outrageous. And when you talk to individual citizens, they just go nuts when you start describing this.

Mr. HORN. Yes. Recently, as you know, the House of Representatives looked at the number of employee training programs.

Mr. FOX. Yes.

Mr. HORN. And the figures had been thrown around that it's somewhere between 150 and 160; it was in there somewhere. I don't know if they're still sure they have all of them. But the idea was to block grant that to give Governors and others a choice where the jobs are needed or where the skills are needed to take advantage of moving industry into an area.

Mr. FOX. Exactly.

Mr. HORN. It can't be done here.

Mr. FOX. Lyle can give you some good explanations and discussions about this very point, in terms of how it affects private industry, because he's been working with private industry for many years who go in and start making these consolidations and cuts indiscriminately. And I'll let Lyle comment a little bit on the implications for the Federal Government if we just start cutting away indiscriminately, and the impacts that's had on private industry in terms of disasters that have happened. You've had to go in and straighten those out.

Mr. HORN. Mr. Brecht.

Mr. BRECHT. Mr. Chairman, I call that a slash burn mentality. The idea that—again, it comes back to this idea which you originally were querying me about. It had to do with capital allocation, and what that really means.

Mr. HORN. Right, I never finished the sentence. Go ahead.

Mr. BRECHT. Excuse me?

Mr. HORN. I say, we're going to get to that; I never finished the sentence.

Mr. BRECHT. Yes, but this ties into the same concept.

Mr. HORN. Right.

Mr. BRECHT. That is that realizing that you have a fixed amount of money or capital. Capital is broader than money. Capital has to do with all the aspects that actually go in to producing whatever results you're looking for. But in any organization, you have a limited amount of that capital. So there needs to be some form of disciplined process to decide what's really most important.

If you, for example, just come up with an idea—oh, well, we need to, for example in private industry, we have to make profits this year; so let's slash and burn our current budget. You run into situations, for example, people will cut R & D, which is the future of the firm. And so the concern for the Federal Government is, is there a way that we can think about these issues so that we're not just cutting into our muscle and our marrow, rather than cutting the fat out?

Mr. HORN. Eating our seed corn, was the title of one report the Electronic Association did.

Mr. BRECHT. Absolutely.

Mr. HORN. It's a good phrase for what we've been doing to ourselves.

Mr. BRECHT. Absolutely. And then it fits into your notion about consolidating a lot of the programs together into a generally similar mission, that have similar missions. But these missions are articulated by the Congress. Instead of worrying about line items in the budget as much as we think about what should be the mission of Government? What are the general missions that all these programs fit under? Do mission oriented budgeting—give that money in block grants not just to the States and the cities, but to Federal managers, and let them work out the issues, under the guidelines of the benchmarks that Congress has established, how they want to implement these programs.

What it does is it raises the level of input that Congress might have in the management of the Federal Government. Because you start having to have very deep conversations and dialogs about what's really important here; what should Government be doing; what shouldn't it be doing; what are the general types of missions that the Federal Government should be doing, as opposed to just trying to do a little bit of everything.

What's really clear from Harrison's analysis is that the Government can't do everything, and it can't even follow through on many things that it has promised the citizens. So my sense is that what citizens are looking for is a positive mission, a positive vision of what the future looks like. Just balancing the budget or cutting the deficit might be a stop gap, but it's a negative mission. I think what we need to do is turn that around.

I also think we need to be very careful about the vocabulary we use, so that we're just not scaring people and making people feel more disempowered and negative. We need the strength and the imagination, the ingenuity and the creativity of the American pop-

ulace. And I think that the Congress can do a lot to engender that energy.

Mr. HORN. Point well taken. As you know, the successful corporations and private businesses have been those that have asked the people that are on the firing line, making the product, how they could improve the product. Those of you that are management consultants go in and get paid for doing what the boss ought to be doing, which is walking around and listening to the employees. So you make some good suggestions here.

Now, let me get back to the capital situation. One of the proposals before the Congress, authored by the chairman of the full committee, so I am very sympathetic with it, is the idea of a capital budget. Now, what are your feelings on the idea of a capital budget, which would include the investment money of the Government that has a long-term return to society, whether you're talking about bridges, highways, railroads—all the things that Congress did to fund the expansion and the Westward movement, for example, the transcontinental railway, canals, so forth, moving people and products around more conveniently than if they trudged through mud roads.

We have longer-term ones. And the definitional problem, obviously, is important here because the idea is to get those particular funds off budget in the sense that we now have an airport improvement fund; we now have a highway trust fund. As you know, Presidents, regardless of party, regardless of ideology, have sat on expending those moneys to use them as a reduction of the annual deficit and making the fiscal situation look better than it really is.

So I'd just be interested in your feelings on this. And if you don't like those ideas, what's a better substitute?

Mr. FOX. Capital budgets are very important, as you know, for most governments in the United States—both State and local governments.

Mr. HORN. Often they are part of the basic budget.

Mr. FOX. That's right.

Mr. HORN. Not separated into the separate capital budget, though.

Mr. FOX. That's right.

Mr. HORN. Except in Pennsylvania, and maybe one or two others.

Mr. FOX. That's right; you're right. My feeling is that, for instance, in the area of highways, the State collects the tax in most cases. Why not just quit collecting a Federal tax, and let States collect a comparable tax, more or less, whatever they would like to do?

Mr. HORN. Well, they do, but your problem at the Federal level comes in equalization. In other words, Wyoming and Montana don't really get enough money to maintain their interstate highways.

Mr. FOX. That's right, that's right.

Mr. HORN. These are States with lots of miles—or as I remember, a British debating team came through Texas. They said, Texas is miles and miles of miles and miles.

Mr. FOX. That's right.

Mr. HORN. So that's Montana and Wyoming, with very few people, except the people driving through the State, to leave some guest tax on.

Mr. FOX. I think the solution to that is Lyle's capital allocation argument. You let the States collect what they need, and then if you feel that there is a need for additional miles of road in Montana, South Dakota or wherever, you allocate capital to that State rather than skew the formulas around trying to make people happy one way or the other. It seems to me that capital budgeting, as practiced by State and local governments, as you pointed out, ought to be at least looked at in great detail and perhaps even tried in the Federal Government level.

But I think a lot of the development and so forth could be done by State and local governments themselves. So you might not have a whole lot of capital to worry about, in terms of are you going to use a separate capital budgeting concept, or are you going to integrate it into your current budget. Those are questions that you'd have to look at in terms of the extensiveness of the capital that you're actually—if you have the current system and you have quite a bit of capital spending, it would probably—and you would have tremendous arguments within Congress of what capital spending should be.

Should it be education spending; should it be other kinds of social program spending? It would be very divisive. And it would be a tough battle to face, and it might change from year to year, from Congress to Congress, depending on——

Mr. HORN. Well, it's also subject to manipulation.

Mr. FOX. Exactly.

Mr. HORN. In the sense that if you want to get a number of programs going off budget, you simply say, gee, this is a capital budget expenditure.

Mr. FOX. That's right.

Mr. HORN. And people in sincerity can make a good argument, and you cited one in education.

Mr. FOX. That's right. I'm against——

Mr. HORN. One of the greatest bills of this century is the GI bill.

Mr. FOX. Exactly.

Mr. HORN. It was done for economic stabilization, not for education.

Mr. FOX. That's right.

Mr. HORN. But it created a post-War generation that essentially have designed, built, constructed this country.

Mr. FOX. That's right. But we did pay for that on a year to year basis, as the money—and there's some fairly large expenditures in the late 1940's, early 1950's, as you're well aware. I feel very strongly that everything should be on budget. I think that taking things off budget helps to cover up and to allow loopholes that people will naturally gravitate to—that Members of Congress will gravitate to, that interest groups will be pushing for—to get things off budget so it doesn't really have to come under the full constraint of the Federal budgeting process.

One further comment I'd like to make is, you mentioned earlier the importance of getting the ideas and generating ideas from your employees and so forth. But another concept I think needs to be more fully developed within the Federal Government is the Wal-Mart philosophy of dealing with customers. I worked recently for

Congressman Inglis from South Carolina. And this was a very interesting concept that he had.

When he started evaluating many programs, he would say, what's the Wal-Mart philosophy here; how does the customer look at this; how does the citizen look at this? And I think that this is something that we need to pay more attention to, in terms of particularly those means tested programs that affect the poor; those programs that affect veterans; and those programs that affect the aged. We need to be looking more and more to them for evaluation, for analysis on what we can do to make that program more successful for them.

And I think in many cases, you'll find that the people have great ideas about cutting costs and so forth. And I think that's one thing the Federal Government does not do very well. We don't really pay attention to the customer. And we need to do that.

Mr. HORN. Successful businesses have done that.

Mr. FOX. Exactly, and this is——

Mr. HORN. I don't know if you're familiar with Target stores. Here's a successful operation. The customer is always right.

Mr. FOX. That's right. I ran into a situation just recently where the passport office in Rockville, MD is open from 9 a.m. to 11 a.m., Monday through Friday. Now, that's not a very friendly customer operation.

Mr. HORN. Yes.

Mr. FOX. I mean, these are the kinds of things that all of us are well aware the Federal Government does that we need to change. Perhaps we should turn that over to a private operation, to someone who's open 8, 10, 15 hours a day—let them handle the passport procedures. But this is just one example of many things that need to be done in the Federal Government to make it more customer friendly.

Mr. HORN. Right. Do you want to add something, Mr. Brecht, to the capital budget?

Mr. BRECHT. Yes, thank you. I see two problems. One, if you segregate capital budgeting from the rest of the budget, you're making an assumption that those specific capital items have economic value. The example that was previously used was education. There is a built-in assumption, for example, that if you spend money on education, it does produce value. But yet if you believe the reports that the Department of Education is putting out, where half the schoolchildren, or three-quarters of the schoolchildren are not able to read proficiently at their age level.

And there are all the different commission reports on the deficits of our educational system. That begs the question.

Mr. HORN. On the other hand, it might be Wizard of Oz-edry, but the statistics have been steady over time, that if you're a college graduate plus graduate school, you make more than the average college graduate. If you're a college graduate, you make more than the average high school graduate. And the average high school graduate, now I'm talking with a diploma, makes more than the person who has completed the eighth grade.

Mr. BRECHT. Absolutely.

Mr. HORN. So there seems to be some correlation, no matter how incompetent some schools might be. It might just be that they've

anointed them with a diploma. I once said to an entering class at the university, I feel like we should give you your Bachelor of Arts degree when you enter; that would please your parents, please society, and then ask who wants to stay around for an education. We could then have the students that are serious about it.

Mr. BRECHT. No, the point I was making that you'd have to look at every single specific investment that was made to determine it was really producing economic value or not, and not relying on the fact that, oh, well, this is an education item so therefore it's a capital budget item; or a road, automatically a capital budget item. If you're using the definition, the conceptual meaning of that, it means that it produces economic value.

There would have to be some feedback mechanism to tell you whether or not you actually produced economic value from that investment, as opposed to a definitional, ah, education, therefore always——

Mr. HORN. It's a good, you're saying.

Mr. BRECHT. Yes, it's sort of like good intent produces results. So you've got a problem there. Also, there's an issue in the sense, again, if you're really using the concept the way it's intended to be used—or at least conceptually it's been used in the past—is that you have to be willing to write off that amount of the investment if it doesn't produce economic benefits.

The question I would have is, if this is pushed down to the program level, do we have Federal program managers out there that are willing to take a big hit on their annual budget by writing off a capital item that is no longer useful? In business, if you invest in a plant that is technologically obsolete, you write it off—you just don't leave it hung out there—to give the manager some feed back of whether they made a good decision or not to fund that in the first place; or to reflect current conditions, current reality.

So the question I would have—and I've never seen any conversation about that in any of the discussion documents that I've read on capital budgeting. It's always been an accounting trick technique that was being applied, but only halfway. And I'm concerned about that. One of the positive aspects that I like about the concept of capital budgeting is that what the Federal Government spends money on is tremendously important.

Much of the history of our country is Federal Government funding things that no none else would be willing to fund at the time, and creating huge industries and creating wealth for this great Nation, because the Federal Government stepped in and took a risk.

Mr. HORN. Some Members fought it all the way, and said, this is pork barreling. You know, the transcontinental railroad—there was a fight every step of the way. Three month expeditions to the West, Lewis and Clark, that whole history of the 19th century that changed America.

Mr. BRECHT. It's going on today, too.

Mr. HORN. There were people here that didn't want to spend a dime. There are people here now that don't want to spend a dime.

Mr. BRECHT. And there needs to be some way to have those conversations so that we can recognize that the Federal Government really is a generator of wealth for our entire country. One of the things that I, for example, did with my report is, as I started think-

ing about it, I started realizing that if we just focus on the budget of the Federal Government, or the balance sheet of the Federal Government, we're probably missing the big picture.

What I did is, I said, well, I'm going to think about the Federal Government as a project of the U.S. economy, because it may not be terribly important about exactly how much money the Federal Government spends. It may have to do with, how does that flow through and how does the whole economy look; is the economy healthy or not? Also, it's potentially misleading for the Federal Government, for Congress, for example, to cut an item out of its budget, thinking that somehow it's saving taxpayers money, when in truth all it's doing is downstreaming those costs to the States or to local governments.

And they get picked up there, and sometimes they get picked up with less efficiency. So it actually costs the taxpayer more money. And so these things are—it's not like there's any report that you can look at that tells you this. It's not like anybody has figured all this stuff out. As I started going through my own analysis, and looking at the cash-flow of the entire economy, it's terribly complex.

I mean, it's much bigger than any one person or probably any one group of people can figure out. But at the same time, to me, these issues are foundational. They're real important because otherwise you make decisions thinking you have knowledge about what you're doing, and you have good intentions, you want to produce some results. And in truth, what ends up happening is that you create additional costs or you downstream costs or you produce an economy that's less capable to respond to the global marketplace, which is unbelievably competitive right now.

One of the big things that characterizes the modern global economy is that you have the capital—you have a free flow of capital across national boundaries—anywhere in the world, wherever in the world it's needed, instantaneously. And that kind of dynamic doesn't lend itself to multi-year Government Accounting Office, OMB processes, where they're trying to figure out what it is that they're accounting for.

We don't have that kind of time if we want to be competitive and continue to be a world power on this Earth. These kinds of conversations to me are real interesting.

Mr. HORN. You've given another reason why we should have faith on occasion.

Mr. BRECHT. You've got to have faith.

Mr. HORN. That's what it's gotten down to. Some people had vision and other people didn't; they took a risk. Seward's Icebox, known as the State of Alaska, for example. All of these things that people said, you're crazy; why are you doing that? They probably said it about the Louisiana Purchase, which was the best land deal in history.

Mr. BRECHT. Every business, every successful organization is managed beyond the numbers, or underneath the numbers. You can't use the numbers to drive every decision. You've got to have that vision.

Mr. FOX. Let me just say a couple things very quickly. One of the things—I'm very intrigued by Lyle's discussions, and I think he adds a great deal to the debate. But one of the things that I've

found is that we need to use the tools, going back to your original concept that there are a lot of tools out there that the private sector uses that we should be taking a strong look at. And one of the things that I haven't talked too much about—I'd like to just talk for a minute or two about—is the balance sheet.

And the balance sheet that we've developed for the Federal Government is really a tool, a categorization. And it's kind of like Lenais in the early 1700's, developed this notion of kingdom, phylum, all the way down to species, varieties. This balance sheet is really a framework, a categorization for analysis. And one thing that you can use the balance sheet for is to go through and say, what's really important; what are the priorities.

And for instance, if you start going down the list, and you say, insurance, loans and credit guarantees, Government sponsored enterprises, these probably have a less priority than Social Security, retirement security, paying interest on the debt, perhaps pensions. And I think this is one thing that we can gain from having a balance sheet, being made part of your full budgeting financial planning process, is we begin to say, "well, it would be nice to have insurance, but maybe that's something the Federal Government should not do." Same thing with loans and credit guarantees, and as well as Government sponsored enterprises, which are a fairly recent phenomena since the 1930's, when the Federal Home Loan Bank Board was established.

And those are the kind of hard decisions, those are difficult decisions, because insurance like the FDIC bank insurance fund is almost un-American to challenge that as saying well, the Government shouldn't be in that.

But the facts are, only Canada and the United States, in terms of Western developed countries, have a Federal Deposit Insurance Program. It's very inefficient. Just the savings, the BIF fund for the savings and loans has lost 15 to 20 percent in terms of its total insured worth over the last 3 or 4 years. That's an incredible hit.

That's a hit that no private insurance company probably would ever allow happen. And so we have to begin to look at what the Federal Government should be doing. The balance sheet helps us determine some of those things. Also, that feeds into the information. If we have the information, then we can be looking at this overlap in terms of jobs programs, et cetera. We just have an awful lot to do in, I think, a fairly short period of time.

And my final comments would be that we need to develop an overall strategy in combination with this committee, perhaps Congressman Cox, the Budget Committee, other Members who are very interested in developing an overall strategy to tackling this incredibly complex financial management and social management challenge, and put together something that we can do quickly. I've been working in this institution off and on since the late 1960's. And I have to leave after, many times, 2 or 3 years, because I get so frustrated at how slowly we operate. I just can't stand it anymore.

I go out and work in a private sector, and eventually come back and try to do a few more things. But I think we're at a take-off stage. The people want this; I think that's probably the most important thing. And we have the technology. Technology is very ca-

pable of doing these things fairly quickly. We have the PCs which are fabulously easy to work with, and they're able to generate information very quickly for us. And my feeling is that you would just need a leader or two to stand up and say, we'll do it.

I am appealing to you and to your colleagues, to say, "let's just do it and get it done" and do it fairly quickly. I appreciate the opportunity to testify, and look forward to working with you in the future.

Mr. HORN. I think the ranking minority member has a question.

Ms. MALONEY. No.

Mr. HORN. OK. We appreciate both of you coming; it's been very helpful. Now let me ask Mr. Brecht, are you going to do that on an annual basis, or do you want us to try and integrate these ideas into the congressional bloodstream; in which case, we have a lot of people in the stream. And the question is, will they take the risk, as was suggested? What are your plans with your own statement that you've prepared?

Mr. BRECHT. My hope is to be able to continue to work on the idea part of it, to keep pushing the envelope, so to speak. I really don't have the personal funds to continue to publish this on my own.

Mr. HORN. Well, it's an excellent example. I would hope that we can do something on the floor, frankly, with both of these documents. So perhaps you could work with staff. I'd like to do that. Last year we simply made a few remarks and put it in the record. At this time, I'd like to get out with a few charts and show people what we're talking about.

Mr. BRECHT. That would be great.

Mr. HORN. Good. So if you could work with the staff, I'd appreciate that, and we'll get some presentation boards and what best illustrates what we gain in information that can be put to intelligent decisionmaking that we don't gain by the current process.

Mr. BRECHT. That's great.

Mr. HORN. We need to get that out, and you have to keep after it. As the Speaker says, when you're tired of hearing it, you've just begun to get through to somebody.

Mr. BRECHT. That's right.

Mr. HORN. So keep at it, we'll do that.

Mr. FOX. We appreciate your support and your commitment through the years. Unfortunately, we haven't had that many Members giving support to these kinds of efforts, but it's growing. And I think with your leadership, we'll go quite a ways.

Mr. HORN. Well, I thank you. We can't do it without creative people spending a little time and risking their own fortunes in trying to show us how to do the right thing. So good luck, and thanks for coming.

Mr. BRECHT. Thank you, Mr. Chairman.

Mr. FOX. Thank you.

Mr. HORN. Let me thank the various people that have been involved with this hearing. First, Mark Brasher, who's the professional staff member for the committee in this area, sitting to my left and your right; Anna Young, professional staff member; subcommittee staff director, Russell George; and our clerk, Andrew Richardson.

For the minority, we thank Cheryl Phelps; Mark Stephenson; and David McMillen; and we've had two reporters today, since we seem to go into the evening, Marianne Nash and Elma Dirolf. Thank you very much for coming, and with that, we are adjourned.

[Whereupon, at 5:45 p.m., the hearing was adjourned, subject to the call of the Chair.]

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