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CAN THE FEDERAL GOVERNMENT BALANCE ITS BOOKS? A REVIEW OF THE FEDERAL CONSOLIDATED FINANCIAL STATEMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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CAN THE FEDERAL GOVERNMENT BALANCE ITS BOOKS? A REVIEW OF THE FEDERAL CONSOLIDATED FINANCIAL STATEMENTS

WEDNESDAY, MARCH 31, 1999

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

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

Present: Representatives Horn, Davis, and Turner.

Staff present: J. Russell George, staff director and chief counsel; Bonnie Heald, director of communications/professional staff member; Mason Alinger, clerk; Paul Wicker, Kacey Baker, and Richard Lukas, interns; Faith Weiss, minority counsel; Jean Gosa, minority clerk; and Earley Green, minority staff assistant.

Mr. HORN. A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order.

Last year, the Nation's first ever governmentwide audit provided a comprehensive accounting of a multitude of financial problems with the executive branch of the Federal Government. I am disheartened to report that the results of the fiscal year 1998 audits are equally dismal. Once again, billions of taxpayers' dollars were lost to waste, fraud, and mismanagement, or just can't be accounted for. This audit is required by the Government Management Reform Act of 1994, a bipartisan law in the 103d Congress.

The law specified that no later than March 31, 1998 and each year thereafter, the Secretary of the Treasury, in coordination with the Director of the President's Office of Management and Budget, shall annually prepare and submit to the President and Congress an audited financial statement for the preceding fiscal year. The audited financial statement should cover all accounts and associated activities of the executive branch of the Federal Government.

The required audit conducted by the legislative branch's General Accounting Office is being released today. The audited report shows that the Federal Government is unable to report accurately to the taxpayers or to Congress how it spent more than $1.8 trillion in fiscal year 1998.

The audit report also shows that Federal agencies were unable to safeguard an account for $1.6 trillion in government assets, and estimates of future costs are off by billions of dollars.

Also today we are issuing our second report card summarizing the results of the 1998 audit reports on the 24 largest Federal agencies. As you can see from the grades, there has been very little improvement. In fact, some agencies have taken a step backward.

Of the 17 agencies that submitted the required report, 5 received F's, 6 received D's. Only two agencies, the National Aeronautics and Space Administration and the National Science Foundation, earned A's. Perhaps some of those distinguished scientists could be loaned out to help unscramble the tangled financial web which seems to plague the few other agencies.

The grades provide a summary status of these agencies that have submitted their reports. But as of yesterday, 7 of the 24 agencies still had not submitted reports, even though it is 1 full month after the legal filing date and 6 full months after the end of the fiscal year.

You will notice that these agencies, which include the Departments of Commerce, Education, Interior, State, and Transportation, received F's on their report card. It is troubling to this subcommittee that they are unable to provide this report in a timely way.

Both the General Accounting Office's audit report and the individual agency reports weave a woeful tale of poor financial management practices within the Federal Government and the financial risks created by those weaknesses. We must pay close attention to the details of these reports because of their wide-ranging effects.

This report is our second warning. Next year there must be significant improvement.

I thank our distinguished witnesses for being here today to discuss the results of this comprehensive and important effort. We are delighted to have the new Comptroller General of the United States, Mr. David Walker, who is in charge of the General Accounting Office. It is Mr. Walker's first time before this subcommittee, and we welcome him. Accompanying him is Assistant Comptroller General Gene Dodaro.

Also before us are a number of other key witnesses from the Office of Management and Budget and the Department of the Treasury, the Honorable G. Edward DeSeve, Deputy Director for Management, Office of Management and Budget. We wish him well as he moves to the private sector. This is his last day technically on the job for the executive branch. He has done a fine job in a very difficult circumstance.

He is accompanied by Ms. Deidre A. Lee, the Administrator, Office of Federal Procurement Policy, Office of Management and Budget. The other key witness is Dr. Donald V. Hammond, the Fiscal Assistant Secretary of the Department of the Treasury.

I now yield to the ranking Democrat, Mr. Turner of Texas, who will have some opening comments, and then to the gentleman from Virginia, Mr. Davis.

Mr. Turner.

[The prepared statement of Hon. Stephen Horn follows:]

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"Federal Consolidated Financial Statements: Can the Federal Government Balance Its Books?"

Opening Statement of Chairman Stephen Horn (R-CA)
Subcommittee on Government Management, Information, and Technology
March 31, 1999

A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order.

Last year, the nation's first-ever governmentwide audit provided a comprehensive accounting of a multitude of financial problems within the executive branch of the Federal Government.

I am disheartened to report that the results of the Fiscal Year 1998 audits are equally dismal. Once again, billions of taxpayer dollars were lost to waste, fraud, and mismanagement.

This audit is required by the Government Management Reform Act of 1994, a bipartisan law in the 103rd Congress. This law specified that no later than March 31st of 1998, and each year thereafter, the Secretary of the Treasury, in coordination with the Director of the President's Office of Management and Budget, shall annually prepare and submit to the President and Congress an audited financial statement for the preceding fiscal year. The audited financial statements should cover all accounts and associated activities of the executive branch of the United States Government. The required audit, conducted by the legislative branch's General Accounting Office is being released today.

The audit report shows that the Federal Government is unable to report accurately – to the taxpayers or to Congress – how it spent more than $1.8 TRILLION dollars in fiscal year 1998.

The audit report also shows that Federal agencies were unable to safeguard and account for $1.6 trillion dollars in Government assets. And estimates of future costs are off by billions of dollars.

Also today, we are issuing our second report card summarizing the results of the 1998 audit reports on the 24 largest Federal agencies. As you can see from the grades, there has been very little improvement. In fact, some agencies have taken a step backward.

Of the 17 agencies that submitted the required report, five (5) received "F's," and six (6) received "D's."

Only two agencies – the National Aeronautics and Space Administration (NASA) and the National Science Foundation, earned "A's."

Perhaps some of those distinguished scientists could be loaned out to help unscramble the tangled financial web which seems to plague the other agencies.

The grades provide a summary status of those agencies that have submitted their reports. But as of yesterday, 7 of the 24 agencies still have not submitted reports, even though it is one full month after the legal filing date, and six full months after the end of the fiscal year.

You will notice that these agencies, which include the Departments of Commerce, Education, Interior, State and Transportation, received "F's" on their report card.

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Both the General Accounting Office audit report and the individual agency reports weave a woeful tale of poor financial management practices within the Federal Government, and the financial risks created by these weaknesses.

We must pay close attention to the details of these reports because of their wide-ranging effects.

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I thank our distinguished witnesses for being here today to discuss the results of this comprehensive and important effort.

We are delighted to have the new Comptroller General of the United States, Mr. David Walker, who is in charge of the General Accounting Office. It is Mr. Walker's first time before this subcommittee, and we welcome him.

I look forward to the testimony of all our witnesses.

Mr. TURNER. Thank you, Mr. Chairman. The second audit of the Federal Government's books submitted to us today reflects a significant effort by the administration and the General Accounting Office.

I want to commend the people who are responsible for the second timely audit. It would not have been possible without the dedication and hard work of a number of employees at the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget.

The American taxpayers deserve to know when, where, and how their tax dollars are being spent. The President in the National Performance Review under Vice President Gore embraced this principle early in their first term. In September 1993, the National Performance Review recommended the preparation of an annual consolidated financial report and the establishment of comprehensive governmentwide accounting standards. These recommendations became law as part of the Government Management Reform Act passed by the Congress and signed by the President.

Government financial audits highlight a number of serious financial management concerns and show the extent to which certain Federal agencies have experienced difficulty in keeping track of their property and equipment, which is significant, because without maintaining reliable inventories, it is impossible for agencies to make new purchases and purchase supplies in a cost-effective manner.

As we have heard prior to today's testimony, the Department of Defense, Department of Agriculture, and the Department of Transportation have experienced similar property and equipment accounting problems.

Another area of concern that has been revealed deals with the various agencies' abilities to gain a clear picture of the scope of their respective liabilities. Without a clear understanding of the scope of liabilities, agencies cannot adequately minimize costs to the taxpayers.

For instance, the Departments of Defense and Energy have experienced difficulty in estimating among their overall potential liabilities their respective environmental liabilities. Initially, some of the largest credit agencies, such as the Departments of Agriculture and Veterans Affairs, still lack historical data on their credit programs, which is required by the Federal Credit Reform Act of 1990 and by Federal accounting standards since fiscal year 1992.

Simply put, these audits impose new financial discipline on Federal agencies and provide new information relating to the cost of Federal programs. For these reasons, there should be bipartisan support for this audit effort and for the improved financial management that they have rendered.

I notice that the majority staff has assigned grades to the various audits. I notice there are a lot of D's and F's on the report. I might offer a word of caution, because it is my opinion, Mr. Chairman, that the letter grades may be an oversimplified reflection of what is actually happening in these various audits.

Clearly there have been improvements in the audited practices and performance of these agencies in the last 3 years that we have

mandated to be performed. Agencies are showing definite improvement in audit results.

Only 1 of the 24 major agencies had reliable financial statements, which we call a clean or unqualified opinion, in 1993. However, by fiscal year 1997, 11 agencies received clean opinions, and this year the Office of Management and Budget anticipates that 13 agencies will receive clean opinions. Overall, we clearly have witnessed steady progress from our Federal agencies and improved audit results.

I have a chart that I think illustrates this very clearly, which shows the results of the audits for the past several years. You will note on there that there has been steady progress. In 1993, as I said, only one agency received a clean audit. In 1996, we had six. By 1997, we had 11. In 1998 we had 13.

I am pleased to see progress. That does not indicate that there is not much work to be done, but I do want to underscore that the results of grading the agencies may not fairly reflect that there has been significant progress.

I also found it interesting that the minority staff, Mr. Chairman, took the majority staff's grading approach and applied it to the Congress. I have another chart that shows these results. If we looked at the Congress itself and applied the same standards applied to our 24 Federal agencies, we would see that the Congress, measured by the three standards of the grading system, would receive a D-minus.

I know the chairman is very much aware, as I am, that the Congress has made significant progress in the last several years in its auditing results. So while there is much work yet to be done, we should at least acknowledge, I think, the fact that there has been progress made, and we hope that progress will continue.

Clearly we need to eliminate some of the obstacles that we will hear about today that would result in a clean opinion, and I hope all of us share, as I know the chairman does, the importance of the auditing work that is ongoing and the importance of approaching it in a bipartisan way.

Thank you, Mr. Chairman.

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

Opening Statement of the Honorable Jim Turner
Hearing on the Federal Government's Second Governmentwide Financial Statement
March 31, 1999

Thank you Mr. Chairman. The second audit of the federal government's books submitted today represents a significant effort by the Clinton Administration and the General Accounting Office. I want to commend the people responsible for the second timely audit. It would not have been possible without the dedication and hard work of a number of employees at the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget.

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

Government financial audits highlight a number of serious financial management concerns and can show the extent to which certain federal agencies have experienced difficulty in keeping track of their property and equipment; which is significant because without maintaining reliable inventory

records, it is impossible for agencies to purchase new equipment and supplies in a cost-effective manner. As we have heard prior to today's testimony, the Department of Defense, the Department of Agriculture, and the Department of Transportation have experienced similar property and equipment accounting problems.

Another area of concern that has been revealed deals with the various agencies' abilities to gain a clear picture of the scope of their respective liabilities. Without a clear understanding of the scope of liabilities, agencies cannot adequately minimize costs to the taxpayer. For instance, the Departments of Defense and Energy have experienced difficulty in estimating, among their overall potential liabilities, their respective environmental liabilities. Additionally, some of the largest credit agencies, such as the Departments of Agriculture and Veterans' Affairs, still lack historical data on their credit programs, which is required by the Federal Credit Reform Act of 1990 and federal accounting standards since fiscal year 1992.

Simply put, these audits impose a new financial discipline on federal agencies and provide new information relating to the cost of federal programs. For these reasons, there should be bipartisan support for these audits and the improved financial management they have rendered. Unfortunately, the current grading method being used by the Majority has made this issue partisan. The Majority has assigned a lot of D's and F's to the federal agencies to convey the impression that the Administration is failing to take financial management seriously.

In fact, just the opposite is true. Under Vice President Gore's leadership, this Administration has done more than any other to improve the financial accountability of the federal government. The Clinton Administration is resolving financial management problems that have existed for decades. Only one of the 24 major agencies had reliable financial statements (called a "clean or unqualified opinion") in fiscal year 1993. However, by fiscal year 1997, 11 agencies received clean opinions. This year, OMB anticipates that 13 agencies will receive clean opinions. Overall, we clearly have witnessed steady progress from federal agencies, and I have a chart that illustrates this point.

One way to illustrate the partisanship surrounding the grading process is to look to our own body, the U.S. House of Representatives. During their tenure in the majority, the Republicans have improved the House's financial management. Since 1994, the House has replaced its outdated cash-based accounting system and discontinued its reliance on manual ledger cards. Both of these revisions improved the overall financial management of the House.

However, look at what happens if we apply the same grading scale to the House that the Majority has applied to the Administration. If you were to review the results of the House's Fiscal Year 1997 audit, which were released in November 1998, you would learn that the House received a qualified opinion, and according to the audit, experienced internal control weaknesses and a few instances of noncompliance with House rules. Although, there remains room for improvement, the House audit, overall, reveals progress.

But if we were to apply the Majority's grading system, a less favorable picture would be depicted. Using the Majority's grading system, the House's financial audit results (if I can direct you to a board that illustrates the results of the audit, which demonstrate a qualified opinion and problems with internal controls and compliance) would fall into the same category as HHS, HUD, Treasury, and VA did last year, receiving an overall grade of a D-. In fact, under this year's newest criteria, which is timeliness, the House would have received an F.

Now, clearly there are examples of taxpayer money being wasted in the House of Representatives. For example, Chairman Burton had difficulty accounting for the expenses of his campaign finance investigation -- an investigation that was duplicative of the Senate's campaign finance investigation and that cost the taxpayers $7 million and resulted in only 15 days of hearings.

However, my example illustrates the problems with the grading scheme, because I do not believe that the House would have deserved a D- for last year's financial audit, given its progress with financial management. In short, I think that this low grade unfairly skews the perception of the current status of financial management in the House of Representatives. In exactly the same way, the low grades received by the federal agencies unfairly skew perception of the progress being made by the Administration.

The federal government is working hard to eliminate the most formidable obstacles to a clean opinion. Clearly, there is much long-term

work ahead. We should support the goal of sound financial management on a bipartisan basis. I look forward to the testimony today and thank the Chairman for holding this hearing.

Mr. HORN. I thank the gentleman, and appreciate his comments. I would merely say, with reference to Congress, after 210 years the first audit in the history of the Congress was the one that the Speaker commissioned when we took over in 1995, and every Member was sent a complete audit of the Congress for the first time in history.

I now yield to the gentleman from Virginia, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. I am not sure whether to argue if the glass is half full or half empty. I count, from the material given to us, we have eight agencies that are in compliance. We have a number of incompletes.

The ones that I have, for the record, in compliance are NASA, National Science Foundation, GSA, Labor, the Social Security Administration, FEMA, HUD, and the Nuclear Regulatory Commission. We have others that are qualified, and we have had no reports yet from Commerce, Education, EPA, Interior, Small Business Administration, State, and DOT. Hopefully some of these will bring themselves into compliance. That is eight.

Even if we had 13 clean opinions, that would mean 11 are not clean opinions after several years of working with this. If these were my kids and that was their report card, they would be grounded and they would be getting some tutorial to try to bring them up to snuff, even though progress may be slightly in the positive direction.

Also, if this was a taxpayer and they submitted records like this, it would be referred to the U.S. Attorney's Office. This is just unacceptable in many of these cases with what is coming forward.

Let me just say, I look forward to the testimony today. For Ed DeSeve, I think this will be his last testimony before an agency. Ed, good luck in the private sector. I have enjoyed working with you on a number of projects, and I think I can safely say for all of us that you have left this city a lot better than you found it. When you leave government, that is as good as it gets, I think.

And you have Dee Lee with you, and you have worked on a number of projects in my neighborhood, and Don Hammond, so I can't beat up on you too much.

But Ed, we really appreciate the efforts that you have made. You have made a huge difference for the District of Columbia and the Federal Government. You will be missed in public service.

Mr. HORN. I thank the gentleman very much.

We will now start with the Comptroller General. We welcome you, and since we are an investigating committee, all the subcommittees of Government Reform have all witnesses sworn in, so Comptroller General and Mr. Dodaro, if you will rise.

[Witnesses sworn.]

Mr. HORN. The clerk will note both witnesses have affirmed the oath.

Your statement is automatically put in the record, as will the other witnesses' statements, once we introduce you. Please feel free to proceed, whether you want to summarize it, whether you want to read it. I have read it all and it is a very thoughtful statement, as we would expect. We would welcome your comments.

STATEMENTS OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY GENE L. DODARO, ASSISTANT COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE

Mr. WALKER. Thank you, Mr. Chairman. It is a pleasure to be here today. I will summarize my statement, since the entire statement has been put into the record.

I might note, Mr. Chairman, that you obviously don't grade on a curve, and that it is my understanding that if GAO had been applied to your ratings, that we might have gotten an A. At least that is my understanding. I think it is important that we lead by example, because after all, we are the agency that is overseeing others. I think it is important for us to do that.

Mr. Chairman, members of the committee, I am pleased to be here today to discuss our report on the U.S. Government's financial statements for fiscal year 1998, and to underscore the importance of continually improving how Federal departments and agencies manage the finances of our National Government.

The Federal Government has underway the implementation of important legislative reforms to promote greater accountability in managing the finances of our National Government. Timely, accurate, and useful information has not been available across government to assure financial accountability and to help continuously improve the economy, efficiency, and effectiveness of our government.

It is essential to improve how Federal departments and agencies manage our finances in order to achieve better accountability at the Federal Government level.

Fortunately, the President and the Office of Management and Budget have taken financial management in general and the annual audit in particular very seriously, and they have made it a priority. As a result, considerable effort is being made by agencies to achieve the mandate of achieving a clean financial statement opinion and eliminating material control weaknesses from their financial reporting. Steady improvements in financial accountability are occurring.

However, several major agencies are not yet able to produce auditable financial statements on a consistent basis, and they have major obstacles to overcome. Similar challenges exist in producing reliable statements for the entire U.S. Government.

The historic, longstanding inattention to financial management issues in the government, combined with the size and complexity of government operations, make corrective actions difficult, but imperative. Moreover, the pace of improvement will be greatly influenced by the progress government organizations are able to make in, first, modernizing their information systems and internal controls; second, revamping their human capital practices to enhance capacity; and third, implementing change management strategies to achieve the discipline needed to follow sound financial management and reporting practices.

I might add a fourth, Mr. Chairman. It is absolutely critical that there be sustained attention and commitment at the very top of all the departments and agencies, as well as by the President and the

Office of Management and Budget, to get this job done and to make continuous improvement.

The executive branch recognizes the extent and severity of existing deficiencies. Addressing them will continue to require concerted improvement efforts across government. With concerted effort, the Federal Government can continue to make progress toward achieving accountability and generating reliable financial and management information on a regular basis.

It is critically important, Mr. Chairman, that we have this information on a regular basis, not just at year end. I will come back to that later.

The balance of my remarks, Mr. Chairman, will be focused on several points: first, outlining the findings of our report and the financial statements of the U.S. Government for fiscal year 1998; underscoring the critical need to fully implement legislative reforms; emphasizing that unqualified or so-called "clean" opinions must be accompanied by timely and reliable data, stronger controls, and better financial and management information systems that will help to continuously improve the economy, efficiency, and effectiveness of government.

Stated differently, receiving a clean audit opinion is not an end in and of itself. It is an important and objective milestone which we must strive for. However, we need to make sure that the systems and controls are in place to assure timely, accurate, and useful information to make informed decisions, and to improve the economy, efficiency, and effectiveness of government on an ongoing basis.

I would like to highlight the fact that human capital must absolutely become a more critical part of the management reform agenda in order to achieve the objectives of the Results Act and to move toward a more performance-based government. I would urge that the focus be on the term "accountability," not accounting. We are called the General Accounting Office, but we are about accountability, and financial management is one element of accountability, but there are others that are important as well.

With regard to results, Mr. Chairman, last year the GAO reported in the first ever report on the U.S. Government's financial statements for fiscal year 1997, that because of serious deficiencies in the government systems, recordkeeping, documentation, financial reporting and controls, amounts reported in the financial statements and related notes do not provide a reliable source of information for decisionmaking by the government or the public.

These deficiencies also affect the reliability of the financial statements and the government's ability to measure the full cost and financial performance of programs and to manage related operations.

Our report on the U.S. Government's financial statements for fiscal year 1998, which is being released today, has reached the same conclusion. Specifically, due to these deficiencies, we are unable to express an opinion on the financial statements of the U.S. Government.

Major challenges include the Federal Government's inability to: 1) properly account for and report on billions of dollars of property, equipment, materials, and supplies, and certain stewardship assets; 2) properly estimate the cost of most major Federal credit pro-

grams and the related loans receivable and loan guarantee liabilities; 3) estimate and reliably report material amounts of environmental and disposal liabilities and related costs; 4) determine the proper amount of various reported liabilities, including post retirement health benefits for military employees, accounts payable, and other liabilities; 5) accurately report major portions of the net cost of government operations; 6) determine the full extent of improper payments that occur in major programs and that are estimated to involve billions of dollars annually; 7) ensure that all disbursements are properly recorded; and 8) properly prepare the Federal Government's financial statements, including balancing the statements, accounting for billions of dollars of transactions between governmental entities, in other words, intragovernmental transactions between one department and another, and properly and consistently compiling the information to present consolidated financial statements.

Overall, we have found significant financial systems weaknesses and problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal controls, including computer controls. These deficiencies continue to prevent the government from accurately reporting a significant portion of its assets, liabilities, and costs, and affect the reliability of the financial statements and the government's ability to accurately measure the full cost and financial performance of programs and to manage its operations.

Mr. Chairman, you noted earlier the current status of individual agency audit efforts, and Ranking Minority Member Turner also noted the progress made over the last several years, but we have still got a ways to go. I think it is important to note that a number of agencies still have not completed their required audits, and yet we are a number of months past the fiscal year end.

This in and of itself serves to demonstrate the challenges and the complexities that these agencies face, and the underlying issues associated with the lack of adequate management information systems to prepare timely, accurate, and useful information for the audit, much less for day-to-day decisionmaking and ongoing operations.

Producing audited financial statements by the March 1 statutory deadline is still a challenge, but improvements were made this year by certain agencies; in particular, the Department of Health and Human Services. In addition, some agencies for the first time have received clean audit opinions or unqualified audit opinions. I might note, the Department of Housing and Urban Development, it is my understanding, has received a clean opinion.

We have designated as high-risk certain agencies with the most serious challenges: Financial management at DOD, IRS, the Forest Service, and the FAA. All, however, have efforts underway to address these deficiencies. Importantly, the Customs Service was removed from our high-risk list due to their concerted efforts and demonstrated progress in achieving positive results.

Audited financial statements are essential to providing an annual public scorecard on accountability. However, an unqualified or clean audit opinion, while certainly being important and an objective milestone, is not an end in and of itself.

For some agencies, the preparation of financial statements requires considerable reliance on ad hoc programming and analysis of data produced by inadequate systems that are not integrated or reconciled, and often require significant audit adjustments. Some agencies undertake heroic efforts to obtain reliable year-end data that can be audited, but these efforts are not backed up by fundamental improvements in the underlying financial and management information systems and control mechanisms to support ongoing program management and accountability.

As a result, these heroic efforts will not achieve the intended results of the CFO Act over the long-term; namely, the CFO Act is intended to enhance overall accountability, and assure that the financial and management information systems and controls are in place to continuously improve the economy, efficiency, and effectiveness of government.

To do so, systems must provide timely, accurate, and useful information for informed decisionmaking. Improving financial and management information systems is essential.

For fiscal year 1997, agency financial auditors reported that 20 of 24 major agencies' financial management systems did not comply with the act's requirements. Similar results are expected for fiscal year 1998. In addition, agencies face the year 2000—Y2K—computing challenge of assuring that their systems can function properly as we change to the new millennium.

This task is appropriately taking priority, and will temporarily sidetrack agencies from much needed other improvements in their systems.

Strengthening computer controls is vital as well. We continue to find serious and widespread computer security weaknesses that place enormous amounts of Federal assets at risk of fraud and abuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption.

The GAO, as you know, Mr. Chairman, has done a tremendous amount of work with the Congress to provide leadership, along with working with the administration on the Y2K effort. It is very clear that computer security will be fast on its heels once we get past the new millennium.

Human capital, Mr. Chairman, is an integral part of financial and information management reform, and indeed, any management initiative. It involves acquiring, developing, and retaining the human capital needed to achieve results.

Enlightened leaders understand that effectively managing employees, otherwise known as human capital, is essential to maximizing the effectiveness of any organization's performance. Only when the right employees with the right skills are on board and are provided with the training, tools, structure, incentives, and accountability to work effectively, is organizational success possible.

As it relates specifically to financial management, the CFO Act recognizes the importance of leadership in creating CFO positions throughout government and in establishing a goal of improving the qualifications of financial management personnel throughout government.

While some attention to delineating critical core competences, needed skills, and appropriate training has occurred in the government, a great deal more needs to be done.

We plan to give greater attention to recommending the ways that the government can improve the strategic approaches to human capital planning, the acquisition and development of staff with skills to meet critical needs, and the creation of performance-oriented organizational cultures, while protecting reasonable merit principles.

Without a firm foundation of reliable, timely, accurate, and useful financial and management information, the many reforms underway across government to move to a performance-based focus will never be successfully fulfilled. Only then can the government assure adequate accountability to taxpayers, manage for results, and help decisionmakers make timely and well-informed judgments.

Experimentation is now underway across government to develop single accountability reports on individual departments and agencies. These reports will consolidate and integrate audited financial statements and reporting under the Results Act and other related laws, to show the degree to which an agency meets goals, at what cost, and will aid the reader in determining whether the agency is well run.

I might note that the Social Security Administration is leading the way in this effort, and should be commended for it. Reliable accountability reports, including information on the full costs and results of carrying out Federal activities, will help to correct the problem of a lack of complete and reliable information that has been a source of concern for congressional and agency decisionmakers for decades, and it will greatly aid decisionmaking for our National Government.

Reliable financial information also is essential for analyzing the government's financial condition and helping inform the budget deliberations by providing additional information beyond that provided in the budget.

In closing, Mr. Chairman, I would like to commend you and the subcommittee for its diligent oversight and actions to improve financial management of our Federal Government. Your hearings have helped to underscore the critical importance of the issue, and to make progress at a more rapid pace.

I look forward to working with you and the other members of this subcommittee as we strive to enhance accountability and to continuously improve the economy, the efficiency, and the effectiveness of the Federal Government. Thank you, Mr. Chairman.

[The prepared statement of Mr. Walker follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Management, Information and Technology, Committee on Government Reform, House of Representatives

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AUDITING THE NATION'S FINANCES

Fiscal Year 1998 Results Highlight Major Issues Needing Resolution

Statement of David M. Walker
Comptroller General of the United States

GAO/T-AIMD-99-131

B-282395

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our report on the U.S. Government's financial statements for fiscal year 1998 and to underscore the importance of improving how federal departments and agencies manage the finances of our national government. Historically, timely, accurate and useful information has not been available across government to assure financial accountability and to help improve the economy, efficiency, and effectiveness of government. Fortunately, the Congress has legislated major reforms, which if successfully implemented, will help achieve these objectives and build the necessary foundation to effectively run a performance-based government.

A critical reform component entails requirements for annual audited financial statements for 24 major federal departments and agencies beginning with fiscal year 1996--a best practice in the private sector for decades and in state and local governments for many years. Considerable effort is being made by agencies to achieve this mandate, and steady improvements in financial accountability are occurring. However, several major agencies are not yet able to produce auditable financial statements on a consistent basis, and major obstacles need to be overcome.

Similar challenges exist in producing reliable statements for the entire U.S. government. Last year, in the first-ever report on the U.S. government's financial statements, we reported that because of the serious deficiencies in the government's systems, recordkeeping, documentation, financial reporting, and controls, amounts reported in the financial statements and related notes do not provide a reliable source of information for decision-making by the government or the public.[1] Our report on the U.S. government's financial statements for fiscal year 1998 has reached the same conclusion.[2] These deficiencies affect the reliability of the financial statements and the government's ability to accurately measure the full cost and financial performance of programs and manage its operations.

The government must overcome significant challenges to improve this situation. The historic, long-standing inattention to financial management issues combined with the size and complexity of government operations make corrective actions difficult. Moreover, the pace of improvement will be greatly influenced by the progress government organizations are able to make in modernizing their

[1] Financial Audit: 1997 Consolidated Financial Statements of the United States Government (GAO/AIMD-98-127, March 31, 1998) and U.S. Government Financial Statements: Results of GAO's Fiscal Year 1997 Audit (GAO/T-AIMD-98-128, April 1, 1998).
[2] Financial Audit: 1998 Consolidated Financial Statements of the United States Government (GAO/AIMD-99-130, March 31, 1999).

information systems and internal controls, in revamping human capital practices to build greater capacity, and in implementing change management to achieve the discipline needed to follow sound financial management and reporting practices.

The executive branch recognizes the extent and severity of existing deficiencies and that addressing them will continue to require concerted improvement efforts across government. In response to our March 1998 report, the President required heads of agencies with significant financial management deficiencies to submit corrective action plans to the Office of Management and Budget (OMB). Further, the President has designated financial management reform as a top management priority.

We are continuing to work with OMB, the Treasury, and agencies across government to recommend the actions necessary for achieving legislative reform goals. Additionally, working cooperatively with the Inspectors General, we are continuing to evaluate progress and make specific suggestions for fixing weaknesses in recordkeeping, financial reporting, and internal controls. With concerted effort, the federal government can continue to make progress toward achieving accountability and generating reliable financial and management information on a regular basis.

My testimony will focus on

- outlining the findings of our report on the financial statements of the U.S. government for fiscal year 1998;
- underscoring the critical need to fully implement legislative reforms;
- emphasizing that unqualified "clean" opinions must be accompanied by timely and reliable data, stronger controls, and better financial and management information systems that will help to continuously improve the economy, efficiency, and effectiveness of government;
- highlighting the fact that human capital must become a more critical part of the management reform agenda; and
- urging that the focus be on accountability, and not just accounting.

RESULTS OF GAO's AUDIT OF U.S. GOVERNMENT's FINANCIAL STATEMENTS FOR FISCAL YEAR 1998

Our report on the U.S. government's financial statements for fiscal year 1998 states that, overall, significant financial

systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal controls, including computer controls, continue to prevent the government from accurately reporting a significant portion of its assets, liabilities, and costs.

Major challenges include the federal government's inability to:

- properly account for and report (1) billions of dollars of property, equipment, materials, and supplies and (2) certain stewardship assets;
- properly estimate the cost of most major federal credit programs and the related loans receivable and loan guarantee liabilities;
- estimate and reliably report material amounts of environmental and disposal liabilities and related costs;
- determine the proper amount of various reported liabilities, including postretirement health benefits for military employees, accounts payable, and other liabilities;
- accurately report major portions of the net cost of government operations;
- determine the full extent of improper payments that occur in major programs and that are estimated to involve billions of dollars annually;
- ensure that all disbursements are properly recorded; and
- properly prepare the federal government's financial statements, including balancing the statements, accounting for billions of dollars of transactions between governmental entities, and properly and consistently compiling the information in the financial statements.

In addition, we found that (1) widespread and serious computer control weaknesses affect virtually all federal agencies and significantly contribute to many of the material deficiencies discussed above and (2) material control weaknesses affect the government's tax collection activities. Major issues identified by our work are discussed below.

General Property, Plant, and Equipment and Inventories and Related Property

The federal government--one of the world's largest holders of physical assets--does not have adequate systems and controls to ensure the accuracy of information about the amount of assets held to support its domestic and global operations. A majority of the $466 billion of these reported assets is not adequately supported by financial and/or logistical records. Assets that are not adequately supported include: (1) buildings, structures, facilities, and equipment, (2) various government-owned assets that are in the hands of private sector contractors, and (3) operating materials and supplies comprised largely of ammunition, defense repairable items (such as navigational computers, landing gear, and transmissions), and other military supplies. Also, the government cannot ensure that all assets are reported. Further, national defense asset unit information reported as Stewardship Information was incomplete.

Because the government lacks complete and reliable information to support its asset holdings, it could not satisfactorily determine that all assets were included in the financial statements, verify that reported assets actually exist, or substantiate the amounts at which they were valued. For example, periodic physical counts have shown that property records contain significant error rates. Further, weak controls significantly impair the government's ability to detect and investigate fraud or theft of assets. Also, deferred maintenance information was not reported.

Accurate asset information is necessary for the government to (1) know the assets it owns and their location and condition, (2) safeguard its assets from physical deterioration, theft, or loss, (3) account for acquisitions and disposals of such assets, (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand, and (5) determine the full costs of government programs that use these assets.

Loans Receivable and Loan Guarantee Liabilities

Most federal credit agencies responsible for federal lending programs were unable to properly estimate the cost of these programs in accordance with federal accounting standards and budgeting requirements. As of the end of fiscal year 1998, the government reported $167 billion of loans receivable and $38 billion of liabilities for estimated losses related to estimated future defaults of guaranteed loans. However, the net loan amounts expected to be collected and guarantee amounts expected to be paid could not be reasonably estimated because of a lack of adequate historical data or other evidence. Reliable information about the cost of

credit programs is important in supporting annual budget requests for these programs, making future budgetary decisions, managing program costs, and measuring the performance of credit activities. Federal credit programs include direct loans and loan guarantees for farms, rural utilities, low and moderate income housing, small businesses, veterans' mortgages, and student loans.

Environmental and Disposal Liabilities

Liabilities for remediation of environmental contamination and disposal of hazardous waste, reported at $225 billion, were materially understated by at least tens of billions of dollars primarily because no estimate was reported for environmental and disposal liabilities associated with certain major weapons systems, such as aircraft, missiles, ships and submarines, and for ammunition. Further, only a small portion of the total cost, estimated to be over $10 billion, to remove unexploded ordnance from training ranges has been reported. Additionally, significant portions of the government's reported liability for environmental management and legacy waste related to nuclear weapons development lacked adequate support, were not complete, and did not reflect material changes in cleanup scope, costs, or schedules. Properly stating these liabilities and improving internal controls supporting the process for their estimation could assist in determining priorities for cleanup and disposal activities and allow for appropriate consideration of future budgetary resources needed to carry out these activities.

Liabilities

Adequate systems and cost data were not available to accurately estimate the reported $223 billion military postretirement health benefits liability included in federal employee and veteran benefits payable. Information used to develop such estimates did not include the full cost of providing health care benefits. Also, some agencies do not maintain adequate records or have systems to ensure that accurate and complete data were used to estimate a reported $90 billion of accounts payable and a reported $155 billion in other liabilities. For example, a liability was not reported for certain amounts owed to contractors that, under the terms of the contracts, were held by the government pending the acceptance of goods or services. Further, the government was unable to provide adequate information to determine whether commitments and contingencies were complete and properly reported. These problems significantly affect the determination of the full cost of the government's current operations, the value of its assets, and the extent of its liabilities.

Cost of Government Operations

The government was unable to support significant portions of the more than $1.8 trillion reported as the total net cost of government operations. The previously discussed material deficiencies in reporting assets and liabilities and the lack of effective cash disbursement reconciliations, as discussed below, affect reported net costs. Further, we were unable to determine whether the amounts reported in the individual net cost categories on the Statement of Net Cost and in the subfunction detail in Supplemental Information were properly classified. Accurate cost information is important to the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required.

Improper Payments

The government is unable to determine the full extent of improper payments--that is, payments made for other than valid, authorized purposes. Across government, improper payments occur in a variety of programs and activities, including those related to contract management, federal financial assistance, and tax refunds. Reported estimates of improper payments total billions of dollars annually. Such payments can result from incomplete or inaccurate data used to make payment decisions, insufficient monitoring and oversight, or other deficiencies in agency information systems and weaknesses in internal control. The risk of improper payments is increased in programs involving (1) complex criteria for computing payments, (2) a significant volume of transactions, or (3) an emphasis on expediting payments. The reasons for improper payments range from inadvertent errors to fraud and abuse.

The full extent of improper payments, however, is unknown because many agencies have not estimated the magnitude of improper payments in their programs, nor have they considered this issue in their annual performance plans. The use of appropriate performance measures relating to improper payments can provide management focus on reducing related losses. For example, the Department of Health and Human Services (HHS) has reported a national estimate of improper payments in its Medicare fee-for-service benefits since fiscal year 1996. For fiscal year 1998, the Department reported estimated improper payments of $12.6 billion, or more than 7 percent, of Medicare fee-for-service benefits--down from about $20 billion, or 11 percent, reported for fiscal year 1997 and $23.2 billion, or 14 percent, for fiscal year 1996. Analysis of improper Medicare payments helped lead to the implementation of several initiatives intended to reduce improper payments. Annual estimates of improper payments in future audited

financial statements will provide information on the progress of these initiatives.

Cash Disbursement Activity

Several major agencies are not effectively reconciling cash disbursements. These reconciliations are intended to be a key control to detect and correct errors and other misstatements in financial records in a timely manner--similar in concept to individuals reconciling personal checkbooks with a bank's records each month. There continued to be billions of dollars of unresolved gross differences between agencies' and Treasury records of cash disbursements as of the end of fiscal year 1998. As a result, the government is unable to ensure that all disbursements are properly recorded. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by agencies for inclusion in the President's budget concerning fiscal year 1998 obligations and outlays.

Preparation of Financial Statements

The government does not have sufficient systems, controls, or procedures to properly prepare financial statements for the U.S. government. Such deficiencies, described below, impair the government's ability to (1) properly balance the government's financial statements and account for billions of dollars of transactions between governmental entities, (2) properly and consistently compile the information in the financial statements, and (3) effectively reconcile the results of operations reported in the financial statements with budget results.

Unreconciled Transactions

To make the financial statements balance, Treasury recorded a net $24 billion item on the Statement of Operations and Changes in Net Position, which it labeled unreconciled transactions. Treasury attributes this net out-of-balance amount to the government's inability to properly identify and eliminate transactions between federal government entities and to agency adjustments that affected net position. Certain intragovernmental accounts do not reconcile by a total of more than $250 billion (e.g., intragovernmental receivables exceeded intragovernmental payables by over $200 billion).

Agencies' accounts can be out of balance with each other, for example, when one or the other of the affected agencies does not properly record a transaction with another agency or the agencies record the transactions in different accounting periods. These out-of-balance conditions can be detected and corrected by instituting procedures for

reconciling transactions between agencies on a regular basis and in a timely manner. Generally, such reconciliations are not performed. These unreconciled transactions result in material misstatements of assets, liabilities, revenues, and/or costs.

Financial Statement Compilation

The federal government cannot ensure that the information in the financial statements of the U.S. government is properly and consistently compiled in an accurate manner. To prepare the federal government's financial statements, about 70 agencies submit data to Treasury on approximately 2,000 separate reporting components, each having many account balances. However, several major agencies were unable to provide assurance that all agency amounts included in these financial statements reconciled with their agency financial statements. In addition, material adjustments and reclassifications were required to (1) make the financial statements more consistent with agency financial statements, (2) correct identified inconsistencies in reporting similar transactions, (3) conform footnote information to related financial statement line items, and (4) record other audit adjustments.

These problems are compounded by the substantial volume of information submitted and limitations in the federal government's general ledger account structure. As a result, additional misclassifications and misstatements in the government's financial statements could exist.

Reconciling the Results of Operation With Budget Results

The federal government did not have a process to obtain information to effectively reconcile the reported $134 billion excess of net cost over revenue and a reported unified budget surplus of $69 billion. Consequently, it could not identify all of the items needed to reconcile these amounts. Certain differences are expected to occur because the financial statements of the U.S. government are prepared on the accrual basis in accordance with federal accounting standards, which is a different basis than the budget. Under accrual accounting, transactions are reported when the events giving rise to the transactions occur, rather than when cash is received or paid. By contrast, federal budgetary reporting is generally on the cash basis in accordance with accepted budget concepts and policies.

Beginning in fiscal year 1998, major agencies were required by federal accounting standards to reconcile their reported net costs to budget information, which could provide a basis for preparing the reconciliation in the 1998 Financial Report of the United States Government. However,

significant amounts reported in certain agency reconciliations, including unliquidated obligations and certain other budget information, lacked adequate supporting information and may be unreliable. For example, significant weaknesses in Department of Defense (DOD) systems and controls resulted in reported obligations incurred that may have exceeded available budget authority for certain appropriations. Once the federal government produces reliable financial statements, an effective reconciliation could help provide additional assurance of the reliability of budget results.

NEED TO CONTINUE REFORM EFFORTS

In addition to financial statements for the U.S. government, 24 major individual departments and agencies across government have been required to prepare annual audited financial statements, beginning with fiscal year 1996. Eleven of these agencies received unqualified audit opinions for fiscal year 1997--up from 6 for fiscal year 1996. As of March 19, 1999, 15 of the 24 agencies had received audit opinions or disclaimers on their fiscal year 1998 financial statements, with 7 receiving unqualified opinions,[3] 3 qualified opinions, and 5 disclaimers.

While the results continue to be mixed, effort is now being exerted by individual agencies to address financial management problems. Several agencies that have received unqualified opinions on their financial statements are continuing to work on resolving significant weaknesses in financial systems and internal controls.

Producing audited financial statements on time--by the March 1 statutory deadline--is still a challenge, but improvements were made this year by certain agencies such as the Department of Health and Human Service. Also, the Social Security Administration continues to demonstrate best practice by producing its audited financial statements and accountability report in November, less than 2 months after the close of the fiscal year.

We have designated as high risk, certain agencies with the most serious problems.[4] These include financial management at the Department of Defense, IRS, the Forest Service, and the Federal Aviation Administration. All, however, have concerted efforts underway to address their deficiencies, and we will continue to work with them and the

[3]The Social Security Administration, the Department of Labor, the General Services Administration, the National Science Foundation, the National Aeronautics and Space Administration, the Nuclear Regulatory Commission, and the Federal Emergency Management Agency.
[4]High-Risk Series: An Update (GAO/HR-99-1, January 1999).

cognizant Inspectors General to advance recommendations and evaluate progress.

CLEAN OPINION MUST BE ACCOMPANIED BY MODERN SYSTEMS AND BETTER CONTROLS

Audited financial statements are essential to providing an annual public scorecard on accountability. However, an unqualified audit opinion, while certainly important, is not an end in itself. For some agencies, the preparation of financial statements requires considerable reliance on ad hoc programming and analysis of data produced by inadequate systems that are not integrated or reconciled, and often require significant audit adjustments. Efforts to obtain reliable year-end data that are not backed up by fundamental improvements in underlying financial management systems and operations to support ongoing program management and accountability will not achieve the intended results of the Chief Financial Officers Act over the long term.

For example, after several years of concerted effort by IRS and GAO, for fiscal year 1997 we were for the first time able to conclude that IRS' custodial financial statements, covering most of the government's revenue, were reliable. Prior to fiscal year 1997, weaknesses in IRS' internal controls and financial management systems prevented it from producing reliable year-end financial information. Our ability to conclude that the fiscal year 1997 custodial financial statements were reliable was a mark of progress. For fiscal year 1998, IRS was able to reliably report on the results of its custodial activities, including nearly $1.8 trillion of tax revenue, $151 billion of tax refunds, and $26 billion of net federal taxes receivable.[3] However, as in 1997, this was accomplished only after extensive use of ad hoc programming by IRS to extract data from its systems, followed by numerous adjustments to these data totaling tens of billions of dollars to produce final financial statements. IRS' controls and systems remain plagued by weaknesses that affect its ability, among other things, to report reliable financial information throughout the year.

Improving Systems

The central challenge in generating timely, reliable data throughout the year is overhauling financial and related management information systems. To help stimulate attention to this challenge, the Congress passed the Federal Financial Management Improvement Act (FFMIA) of 1996, which requires auditors performing financial audits to report whether agencies' financial management systems comply substantially with federal accounting standards, financial systems

[3] Financial Audit: IRS' Fiscal Year 1998 Financial Statements (GAO/AIMD-99-75, March 1, 1999).

requirements, and the government's standard general ledger at the transaction level. For fiscal year 1997, agency financial auditors reported that 20 of 24 major agencies' financial systems did not comply with the act's requirements, indicating the overall continuing poor condition of agency financial systems.[6] As we noted in our report on the government's financial statements for fiscal year 1998, similar results are expected for fiscal year 1998.

Most federal agencies' financial management systems do not meet systems requirements and cannot provide reliable financial information for managing day-to-day government operations and holding managers accountable. Therefore, it will take time and effort to raise federal financial systems to the level of quality and reliability envisioned in FFMIA. In addition, agencies face the Year 2000 computing challenge of ensuring that their systems function properly at the turn of the century. This task is appropriately taking priority and will likely temporarily sidetrack longer term systems modernization.

Over the longer term, agencies must address their serious systems problems by applying the framework outlined in the Clinger-Cohen Act and implementing guidance. This includes adopting sound information technology investment and control processes, designing well-developed architectures to guide information flows and technical standards, and establishing disciplined approaches for developing and acquiring computer software. Strong partnerships between Chief Financial Officers and Chief Information Officers are essential to achieve these goals.

Strengthening Computer Controls

Continuing serious and widespread computer security weaknesses are placing enormous amounts of federal assets at risk of fraud and misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. Significant computer security weaknesses in systems that handle the government's unclassified information have been reported in each of the major federal agencies. The most serious reported problem is inadequately restricted access to sensitive data. Other types of weaknesses pertain to not adequately segregating duties to help ensure that people do not conduct unauthorized actions without detection, preventing unauthorized software from being implemented, and mitigating and recovering from unplanned interruptions in computer service. In today's highly computerized and

[6] Financial Management: Federal Financial Management Improvement Act Results for Fiscal Year 1997 (GAO/AIMD-98-268, September 30, 1998).

interconnected environment, such weaknesses are vulnerable to exploitation by outside intruders as well as authorized users with malicious intent.

The consequences of computer security weaknesses could be devastating and costly--for instance, placing billions of dollars of payments and collections at risk of fraud and impairing military operations. Also, identified weaknesses at federal entities such as IRS, the Department of Health and Human Service's Health Care Financing Administration, SSA, the Department of State, and the Department of Veterans Affairs place tax, medical and other sensitive records at risk of unauthorized disclosure, modification, and destruction.

The government cannot estimate the full magnitude of actual damage and loss resulting from federal computer security weaknesses because it is likely that many such incidents are either not detected or not reported. However, GAO and agency reviews and documented incidents, such as the following, illustrate the potential for negative impacts.

- Attackers have accessed systems and stolen, modified, and destroyed both data and software at DOD and shut down entire systems.

- We have been successful, as part of computer security reviews, in readily gaining unauthorized access to systems that would allow intruders to read, modify, or delete data for whatever purpose they had in mind. Tests by agencies have revealed similar results.

- SSA's IG has reported criminal convictions involving SSA employees, most of which involved creating fictitious identities, fraudulently selling SSA cards, misappropriating refunds, or abusing access to confidential information.

- IRS has identified incidents of employees browsing taxpayer data and inappropriately using other systems containing taxpayer data.

GAO and the IGs have issued numerous reports that identify information security weaknesses in the federal government and made recommendations to address them. Also, GAO has reported information security as a high-risk area across government since February 1997. Agencies need to fully institute a framework for assessing risk and ensuring that necessary policies and controls are in place and remain effective on an ongoing basis.[7]

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[7] Information Security: Serious Weaknesses Place Critical Federal Operations and Agencies at Risk (GAO/AIMD-98-92, September 23, 1998) and

HUMAN CAPITAL INITIATIVES MUST BECOME
A MORE CRITICAL PART OF REFORM AGENDA

An integral part of financial and information management reform, and indeed, any management initiative, is building, maintaining, and marshaling the human capital needed to achieve results. Leading organizations understand that effectively managing employees--or human capital--is essential to reaching and maintaining maximum performance. Only when the right employees are on board and provided the training, tools, structure, incentives, and accountability to work effectively is organizational success possible.

As it relates specifically to financial management, the Chief Financial Officers Act recognized the importance of leadership in creating CFO positions throughout government and in establishing a goal for improving the qualifications of financial management personnel throughout government. While some attention to delineating core competencies and training has occurred, a great deal more needs to be done. We plan to give greater attention to this area, with emphasis on recommending ways to improve the strategic approaches to human capital planning; the acquisition and development of staff with skills to meet critical needs; and the creation of performance-oriented organizational cultures, while protecting merit principles.[8]

STRENGTHENING FINANCIAL MANAGEMENT
KEY TO ASSURING ACCOUNTABILITY

Without a firm foundation of reliable and timely financial and management information, the many reforms underway across government to move to a performance-based focus will never be successfully fulfilled. That is why it is so essential that efforts continue to build the necessary fundamental foundation through lasting financial management reform. Only by generating reliable and useful information, can the government assure adequate accountability to taxpayers, manage for results, and help decisionmakers make timely well-informed judgments.

Providing such data in meaningful, user-friendly reports is also critical. Experimentation is now underway across government to develop single accountability reports on individual departments and agencies. These reports will consolidate and integrate audited financial statements and reporting under the Government Performance and Results Act and other related laws, to show the degree to which an

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Information Security: Strengthened Management Needed to Protect Critical Federal Operations and Assets (GAO/T-AIMD-98-312, September 23, 1998).

[8]Performance and Accountability Series: Major Management Challenges and Program Risks: A Governmentwide Perspective (GAO/OCG-99-1, January 1999).

agency met its goals, at what costs, and will aid the reader in determining whether the agency was well run.

Accountability reports that present an agency's financial condition and the results of its operations in an integrated way hold great promise for enhancing the usefulness of performance information. Such reports and independent audits will help correct the problem of the lack of complete and reliable information that has been a source of concern for congressional and agency decisionmakers for decades. Reliable accountability reports that include information on the full cost and results of carrying out federal activities will greatly aid decisionmaking for our national government.

Reliable financial information also is essential for analyzing the government's financial condition and helping inform budget deliberations by providing additional information beyond that provided in the budget. The budget of the federal government is primarily formulated on a cash basis which also is generally the basis for calculating the annual budget surplus or deficit. The financial statements are prepared generally on the accrual basis of accounting. The most significant difference between the two bases is the timing of recognition and measurement of revenues and costs. Accrual information can be used along with budgetary information to provide a valuable perspective on the costs of agency programs and the government's assets and long-term commitments.

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In closing, Mr. Chairman, I want to commend your Subcommittee for its diligent oversight of actions to improve financial management of government. Your hearings have helped underscore the critical importance of the issue and the need to make greater progress. I look forward to working with you and other Members of the Congress, along with the executive branch, in bringing about the type of quality financial management envisioned by legislative goals and expected by the American people.

I would be pleased to answer questions.

(919363)

Mr. HORN. We thank you for that very fine statement.

What we are going to do now is alternate between Members here of 5 minutes each, and as chairman, I will yield my first 5 minutes to the gentleman from Virginia, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

Mr. Walker, you talked about a clean audit opinion, while certainly important and almost a starting point, is not an end in itself. Could you just briefly elaborate on that?

Mr. WALKER. Obviously, a clean audit opinion or an unqualified opinion is generally recognized and is an objective measure. It is one that we should strive for, and ultimately should hope to achieve clean audit opinions on all agencies and departments, as well as at the overall Federal Government level.

However, it is possible to achieve a clean or unqualified audit opinion and still have fundamental problems with regard to the financial and management information systems, and have material control weaknesses that subject the agency to potential fraud, waste, abuse, and mismanagement.

As a result, while we want to get the clean audit opinion, we want to make sure that structural improvements are made, too, at the same time.

Mr. DAVIS. Without a clean audit opinion, though, it is much more difficult to get at the core issues, isn't it?

Mr. WALKER. I would say that one of the benefits of striving for a clean audit opinion is it focuses you on these underlying issues. However, it is possible and, in fact, it has already occurred, as evidenced by the summary sheet; some agencies that have clean audit opinions have not dealt with the underlying problems and need to deal with the underlying problems, because it is possible, through heroic efforts, to do a tremendous amount of work as of the beginning of the year and the end of the year to get a clean audit opinion, but yet the agencies don't have the systems to make ongoing management decisions.

Mr. DAVIS. Now, to make the governmentwide financial statements balance, Treasury recorded a net $24 billion item which it labeled unreconciled transactions. If this number is a net number, what is the gross number or real amount of the difference?

Mr. WALKER. We can't tell you that, Congressman. If we knew what the gross number was, I think we would be able to make more progress in allocating it properly. That is the net number and it is one of the reasons that we can't express an opinion.

Mr. DAVIS. But it could literally——

Mr. WALKER. Gene.

Mr. DODARO. We do know, for example, Mr. Davis, that in just the intergovernmental accounts or transactions that occurred, there was a net difference of about $250 billion. So we don't know exactly what the total gross differences are, but there are a number of problems that occur. One is the fact that Treasury records do not agree with the agency records in all cases, and there are a lot of unreconciled transactions. That is No. 1.

No. 2 are these intergovernmental transactions. The government does a tremendous amount of business among agencies. Agencies cannot eliminate all of those transactions when it comes to the Treasury level. Treasury thus has difficulty reconciling those trans-

actions. So the amounts that are out of balance also includes adjustments to the agency statements that come in. It is not yet clear that the data that are on these agency individual statements is the same data that Treasury is using to roll into the governmentwide statements.

Progress has been made this past year in providing greater certification that that has happened, but that is why the process of compiling these statements is still a problem.

Mr. DAVIS. If the taxpayers sent this kind of form up to the IRS, what would be the reaction, do you think?

Mr. WALKER. The IRS would probably be less lenient.

At the same point in time, one has to recognize——

Mr. DAVIS. It would spark an investigation if you sent these kinds of records up, wouldn't it, if you were a normal taxpayer, a corporate business?

Mr. WALKER. I couldn't tell you that, Congressman.

Mr. DAVIS. You don't think it would; they would say, this is fine, if the numbers don't add up?

Mr. WALKER. I didn't say it was fine. They would be very concerned about it, there is no question about it. We have to keep in mind——

Mr. DAVIS. Very concerned? It could in fact be a referral, couldn't it?

Mr. WALKER. It could. I think we have to keep in mind that unlike the private sector, where audits have been in existence for decades, and even, frankly, in the State and local government sector where audits have been in existence for a couple of decades, the Federal Government rightly or wrongly is a laggard in this regard. We are a fairly new player to having audited financial statements.

I think that we should have had better financial and management information systems all along. But the fact that we are now having this audit demonstrates a lot of the challenges that existed before that had not been brought to light.

Mr. DAVIS. I understand that the Department of Defense Inspector General reported that the Department of Defense made over $1.5 trillion in adjustments to its financial records in an attempt to prepare financial statements.

Is that possible? Is that number accurate?

Mr. WALKER. My understanding is that is correct.

Mr. DAVIS. What does this tell us about the state of confusion over there?

Mr. WALKER. I would say that the Defense Department probably represents the single largest challenge in the area of financial management. It probably represents also——

Mr. DAVIS. It is probably half the spending of all the agencies, right?

Mr. WALKER. It is half of discretionary spending, I think. As you know, mandatory spending keeps going up every year. Mandatory spending is about 70 percent of the Federal budget. It is a major challenge, and it is not only a challenge with regard to financial management, Congressman, it is also a challenge with regard to virtually every other area of management: strategic planning, human capital, information technology, et cetera.

Mr. DAVIS. Let me ask just one last question. You talked about human capital, effectively managing employees, and the challenge in an information age.

There is a worldwide and certainly a national and regional shortage of finding qualified people to do things. We see this every day in the private sector, where they are bidding up people. Of course, in private companies you have stock options and a whole host of what we call golden handcuffs to hold onto people and retain them.

The government does not have that available. Are current government compensation levels adequate to attract key managers in these areas? Or is that just something maybe you are not—you haven't focused on?

Mr. WALKER. I was in charge of Arthur Andersen's global human capital practice, so compensation is something I know a little bit about. Obviously, the Federal Government is not and never will be competitive with the private sector with regard to compensation. We rely to a great extent on getting individuals who are dedicated to public service to come here.

There are, however, real, serious issues we need to look at in the compensation area in the Federal Government, especially for certain critical skills where there is a tremendous imbalance. I think there is a need for comprehensive human capital reform in the Federal Government, and compensation is one of the areas we need to look at.

Mr. DAVIS. I would just note that I agree with that. We had FEPCA a few years ago, the Federal Employees Pay Comparability Act. Every year the administration has come in well under the numbers that would have been recommended in keeping that up. It seems in some of these very critical areas we are losing people. In procurement we are losing people. We are losing people in key management positions, where they can walk across the street and get significantly more money, compensation, and a career path, and the Federal Government today just doesn't offer the same kind of opportunities.

Maybe we are asking our agencies to do things that, under the current compensation formulas, are very, very difficult to do. I would just leave that parting thought with you.

Thank you very much, Mr. Chairman.

Mr. HORN. I completely agree with the gentleman from Virginia. We are delighted to have a number of dedicated public servants before us today, both you in the legislative branch and those that are to come in the executive branch.

I yield 5 minutes to the gentleman from Texas, Mr. Turner.

Mr. TURNER. One of the things that I would like for you to explain to put everything in context, I know when you do these audits and come up with less than perfect opinions, that it could mean that there was a lack of documentation and evidence furnished by the respective agency, or it could be that there is something there that would show us that there is some fraud or waste and abuse.

Could you give me an example of something that is found in these audits that would clearly show us that there is fraud or waste or abuse in that agency, as compared to something that is found that we really don't know until we look deeper?

Mr. WALKER. I will start, and then ask Mr. Dodaro if he wants to add to it.

I think the absence of effective internal controls is—where you have material control weaknesses over disbursements, for example—represents an area where you clearly have an opportunity for waste, fraud, abuse, or mismanagement.

One area where progress has been made in this regard is Medicare, where they have estimated for the last several years the amount of improper payments.

A lot of reasons can lead to an improper payment. Part of this was because of the focus that was placed on this issue as a result of the audit of HCFA and HHS. The amount of improper payments, fortunately, has come down from about $20 billion a couple of years ago to I think about $12.6 billion this year.

So HCFA is making progress, but a lot of the reasons improper payments are possible is because of the lack of adequate internal controls. But again, one of the benefits of this audit is that agencies are now focused on it, and they are trying to make progress.

Gene.

Mr. DODARO. I think the area of improper payments that the Comptroller General was just noting is probably one of the most vivid examples where the financial audits have served to quantify how much money is going out of those programs that should not be.

The area of Medicare is a clear example. The reason is it ranges from inadvertent error to fraud and abuse. We know in the Medicare area that there is a significant amount of fraud and abuse of that system.

Other areas have been rent subsidies for the Housing and Urban Development program, the Supplemental Social Security program, the SSI program. They have been able to quantify overpayments, so that has been very effective.

Also in the computer security area, we know, for example, the SSA IG found employees stealing, identity fraud, that led to the creation of false Social Security forms and subsequent issues. We also know at DOD that they and we have found in a number of cases where embezzlements have occurred.

The other area is in safeguarding assets. The Federal Government has a tremendous amount of inventory, property, and sometimes those assets are not properly safeguarded and could be subject to theft or unnecessary deterioration.

So it is a combination. We certainly have those items that you mentioned. There is an awful lot of documentation that is not there so that leaves a lot of questions unresolved. So it is a combination of both issues.

Mr. TURNER. Mr. Walker, are you satisfied that once these audits are done, that the agencies actually take the results of them seriously and begin to try to resolve the problems that the audits reveal?

Mr. WALKER. It is clear to me that by the President making financial management a priority and setting goals for having clean audit opinions for all the agencies, as well as the Federal Government, and with the Office of Management and Budget's followup,

that they are taking it a lot more seriously today than they were several years ago. Progress is being made.

However, we have a ways to go. One of the challenges we face is that agencies have to deal with new reporting standards and new accounting standards that have become effective. Some have a difficult time being able to deal with that because of some of the inherent weaknesses in their financial and information systems.

Mr. TURNER. One of the things that disturbs me the most about the results that we are looking at today is the seven agencies that have failed to complete their audit by the March 1st deadline.

I guess I could reserve this question also for Mr. DeSeve, but I would like to know why these agencies did not meet the statutory deadline.

Mr. WALKER. I think it is best to direct that question to Mr. DeSeve. It is my understanding that several of these agencies had difficulty in dealing with some of the new accounting standards and the new reporting requirements that were effective for this year. That could be one of the reasons. But I would suggest that you ask him about that.

I think it is a problem, however, that here we are, March 31st, and the fiscal year end was September 30, and we are 1 month past the deadline for the agencies to present their audited financial statements, and they still haven't done that. That shouldn't happen. If that was the case in the private sector, you would have serious problems with getting credit and your stock price would probably be adversely affected.

Mr. TURNER. I look forward to hearing those explanations. Obviously, some of the reasons may be understandable, but when we talk about—one significant portion of this audit is to determine whether the agency has complied with Federal laws and regulations, and obviously one of them is this deadline of March 1st to complete this audit. I would hope the agencies would take that seriously.

One other question that I would have for you. When we look at the intergovernmental transfer issue, which you threw out a big number a moment ago, I think it would be helpful if you would just explain to us what an intergovernmental transfer is, give us an example of one, and then from that example, explain how that cannot be properly accounted for and why we have that kind of problem.

Mr. DODARO. A good example would be the Internal Revenue Service purchases a lot of goods from the Government Printing Office for the tax forms that are sent to the public. The IRS records may indicate an amount that they owe the Government Printing Office.

Part of the problem is rooted in the fact that years ago agencies were having difficulty with one another actually recouping the amounts that were owed them, so the Treasury set up a process—and Mr. Hammond can explain this because they are trying to fix this right now, where in this case, GPO could go to Treasury and say the IRS owes us a certain amount of money for these tax forms that we have printed and mailed directly to the public, for postage, et cetera, and take the money out of IRS's account at the Treasury, because the Treasury maintains fund balances. The agencies do not have, by and large, cash accounts where they write checks. It is all

done through central banking functions, pretty much, by and large, except for some defense activities.

In this case, the IRS accounting records may show a different payable that would be different than what would be on the GPO's books. When those records then go up to the Treasury Department, they are unable to reconcile them. On one hand the IRS would show a payable to GPO, GPO's records might show not a compensating receivable, and then you wouldn't be able to eliminate that.

Those types of transactions go on all across the government. For example, Social Security Administration performs a lot of services for HCFA in the Medicare area, in actually issuing Medicare cards. Then Social Security charges HCFA. HCFA basically then pays them.

We have situations where the General Services Administration operates a lot of government buildings and actually charges the agencies rent. So the rent that is on the GSA books might not necessarily correlate to the amounts that the agencies say that they owe GSA.

A lot of agencies buy equipment from the Federal prison system. It just goes on and on throughout the government. There are estimates of several hundreds of billions of dollars of buying and selling that goes on among the agencies.

Right now there is not an identification in the systems, and this goes back to a systems problem, that would allow Treasury to properly consolidate that the way you would in the private sector if you had a large holding company with several subsidiaries, and you need to be able to consolidate.

Mr. HORN. I thank the gentleman.

Let me ask a few more questions, and then we will go to our next witnesses. I believe—can you stay with us, Comptroller General?

Mr. WALKER. Yes, we can, Mr. Chairman.

Mr. HORN. Let me get into the trust funds for a minute. Comptroller General, your General Accounting Office's report states that the trust fund investments and liabilities, which amounted to $1.8 trillion as of September 30, 1998, are netted out to zero in the statements.

Could you explain to me what that means and what is the significance of those amounts being, in essence, eliminated?

Mr. WALKER. Basically, it represents a practice that is consistent with what would happen in the private sector. Let's take Social Security as an example. Under current law for trust funds, to the extent that you end up having excess receipts over disbursements in a given year, the excess must be invested in U.S. Government securities. That, obviously, represents an obligation of the U.S. Government.

So, you have a situation where, on one hand, you have a budget account known as the trust fund that has obligations of the U.S. Government. That is a receivable. On the other hand, you have the U.S. Government, the operating entity, that owes money to the trust fund, which is a liability or a commitment to that trust fund.

Intergovernmental transactions get eliminated in consolidated financial statements. So as a result, the only debt that you have in

these consolidated financial statements is debt held by the public, which is third-party debt.

One point I would like to make on this, Mr. Chairman, if I can, is our report was issued today. Yesterday the trustees' report for Social Security and Medicare was released.

Some of the information which I think is important that it receive more prominent disclosure in the annual consolidated financial statement audit is stewardship information with regard to Social Security and Medicare.

The fact is, the information that we have in the 1998 audit is based on last year's trustees' report, because this had not been released, and yet they are coming out one day apart.

I think one of the things that really needs to be considered is whether the consolidated financial statement audit might come possibly a couple of weeks later, such that significant information like this could be incorporated into the consolidated financial statements, so we don't end up confusing the public by, in a matter of days, talking about different numbers or different dates on programs as important as Social Security and Medicare.

Mr. HORN. Having heard your answer to that, I guess I would ask this: "Does it provide us with the proof, when you take a look at the Federal Government as a whole, that is, the consolidated financial statement, that indeed there is no money set aside to pay for those future costs of programs supported by those trust funds?" How does that work?

Mr. WALKER. Basically, under current law, the trust funds are invested in government securities. Those government securities are backed by the full faith and credit of the U.S. Government. They are guaranteed as to principal and interest. In effect, they represent a first call on general revenues in the future. They do not represent what you and I would normally refer to as a normal trust fund that is a separate and distinct legal entity with hard assets in it, that are invested in the markets, that are subject to fiduciary responsibilities, so the Federal trust funds are a claim on future general revenues.

Mr. HORN. One of the things that concerns me is the money that comes in from FICA, Social Security, and Medicare. Is it sort of just dumped in a general pot? It doesn't come in and go to a FICA trust account, Social Security, or Medicare. It simply goes into the nearest bank designated by the Department of the Treasury, and there is a group in the IRS, sort of an office of estimates, where they somehow just speculate as to what amount of that money really ought to go into the "Social Security trust fund," because there really isn't much of a trust fund.

I just wonder what you as a new Comptroller General think you ought to look at with regard to this—how they do it? Let's take Social Security. Where the employer is responsible for half the payments, the employee is responsible for half of the payments. The employer is really taking both payments of the 15 percent and sending a check for maybe two times the number of employees, maybe times 2,000 or 200,000, to the Internal Revenue Service. And yet, we really aren't sure that every check that said, well, this is my FICA contribution on the quarterly reports, we don't know if it is ever in the right place.

Mr. WALKER. There are some challenges here, Mr. Chairman, that I think both the executive branch and we need to keep our eye on.

For one thing, the information that is reported as far as revenues that are received, as you properly point out, are really handled by the Treasury and the IRS. The amounts used by Social Security for benefit payments are different and, therefore, there can be circumstances in which individuals are getting paid for benefits that the government never, ever collected the taxes on the underlying wages.

This is one of the areas that we pointed out in our report that needs to be focused on to a greater extent. I would ask Gene to speak on that.

Mr. DODARO. Yes. The issue of allocation to the trust fund is one that we have focused a lot on in doing the audit of the consolidated statements, and we have been working with other auditors.

It is a fairly complicated process, and part of the reason that there are estimates and allocations made emanates from the fact that the IRS believes it would create an undue burden on taxpayers to have them identify all the different types of taxes at the time the taxes are deposited.

Right now the only basic separation are among income and payroll taxes, because they are withheld at source, by and large, and are deposited by companies into financial institutions and then flow to Treasury. So there is a category they check, we sent in $100 million this month. Of the $100 million, $70 million was for income taxes that we withheld for individuals, as well as Social Security withholdings and Medicare withholdings, and $30 billion was for excise taxes that we owe.

Then that—because that money is not identified at that point in time—is the only information comes in when the tax return is filed by that company. Then the IRS uses that information on these tax returns from the companies to determine how much is apportioned to the trust funds, and then it goes back and double checks the estimates, and makes any sort of adjustments at the end of the year.

As you point out, the adjustments are given by the Office of Tax Assessment at the Treasury Department. They give the amount of allocations on how to distribute the revenues to the Treasury Financial Management Service, and they make the allocations to the trust funds during the year in terms of the appropriate securities that should be credited to the trust funds.

The excise taxes are a little bit different, since they are supposed to be allocated based on collections, rather than assessments. We have pointed that out as a problem in the past, and the IRS has come up with a new approach on how to handle that. But we strive to look at this issue from the inception from the revenue coming to the government, how it is allocated through this process to the individual trust funds, and to make sure they are properly credited.

So we are trying to cover that and every year we get a little bit better at making sure we have the total picture covered. But that is one area we think is very important, Mr. Chairman, and we have been focusing a lot of attention on that.

Mr. HORN. Well, what you are saying is of the 15 major trust funds, you would like to see all of them in a real, true trust fund relationship where money is earmarked if it is to go into the trust fund and you don't have an office of estimates on this or tax assessments?

Mr. DODARO. We think with modern computer systems now that it would be very beneficial to have the information in electronic form, if most taxpayers could submit it, a break-out of the specific taxes at the time those taxes are actually deposited by the organizations into the Treasury accounts. We have pointed that out in every audit we have done of the IRS. We have had this area on the radar screen with them for a while now. Unfortunately, they have been sidetracked because of their preparations for the year 2000 problem. They have also had, as you know, some major systems failures over the past few years. Treasury has a new electronic tax deposit system now that has a lot greater capability and we plan to work with Treasury to try to identify a way to do this that doesn't impose any undue burden on the taxpayers. But that is the only way to really make sure that you track it as it is being deposited into the Treasury account, and then it can flow through the process without an estimation approach.

Mr. HORN. What would be the impact on the Presidents? Regardless of party, we know that Presidents have dipped into the general revenue of the Treasury, much of which was being sent to be in Social Security or Medicare.

What would be the economic impact and the political impact if what you say and what a lot of us up here say, we ought to isolate these funds so that they are clearly set aside and we can say to the American people on the unfunded liabilities that we have the proper amount in there to cover the unfunded liabilities? Is there any danger in that in terms of future Presidents, current Presidents, it doesn't matter what party they are in; they have all dipped into the Treasury funds to some extent, to show that we have less of a deficit, shall we say? If we isolated that off, would that be part of the national debt deficit, or would it just be on its own and sitting out there, to be invested, obviously?

Mr. WALKER. There is a difference obviously between the economic, the investment and the accounting aspects of this issue. It is a very, very complicated issue. We have stated on the record that we believe that reducing, from an economic standpoint, debt held by the public is a good thing to do because it ends up helping build future economic capacity. We have also stated that obviously, with regard to Social Security, a lot of the current unified budget surplus, in fact all of it this year, is coming from Social Security. I think it is a separate issue as to what the investment policy ought to be, but the only kind of debt that is going to be appearing on the consolidated financial statements of the U.S. Government under current accounting principles is debt held by the public.

We do, however, believe that it is important to more prominently disclose in the consolidated financial statements of the Federal Government, information with regard to Social Security and Medicare because every American cares about those programs. This audit report is not just for the Congress and not just for the Federal Government, it is for the American people too.

Mr. HORN. All right. I now yield 5 minutes to the gentleman from Texas, and after that we will call up the Treasury witness and the OMB witnesses, and then you will be sitting with them, and we can in any case get back to more questions for everybody.

The gentleman from Texas.

Mr. TURNER. Mr. Chairman, I yield back my time. I don't believe I have any further questions.

Mr. HORN. OK. Mr. Turner is going to yield his time until a future occasion after the Treasury and OMB have testified. So if we can have those witnesses come forward. The Honorable G. Edward DeSeve, the Deputy Director for Management, Office of Management and Budget, accompanied by Administrator Deidre A. Lee, head of the Office of Federal Procurement Policy, Office of Management and Budget; and Mr. Donald V. Hammond, Fiscal Assistant Secretary of the Department of the Treasury.

[Witnesses sworn.]

Mr. HORN. I would like to note that all three witnesses have affirmed the oath.

We will begin with the distinguished gentleman. This is the last day of government service for this round, and Mr. DeSeve, we are glad to have you here. We wish you well. You have done a fine job for the administration and for the people. So we hope you will do as very fine a job in the private sector.

STATEMENTS OF G. EDWARD DeSEVE, DEPUTY DIRECTOR FOR MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY DEIDRE A. LEE, ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET; AND DONALD V. HAMMOND, FISCAL ASSISTANT SECRETARY, DEPARTMENT OF THE TREASURY

Mr. DESEVE. Thank you very much, Mr. Chairman, members of the subcommittee. I am here today to discuss the progress made during the last year in financial management, and particularly as reflected in the financial report of the U.S. Government. I am also here to describe the challenges that still face us.

In his transmittal of the audit report, audit of the financial report, Comptroller David Walker said, "These financial reporting requirements are prompting steady improvements in financial accountability and there has been good progress toward meeting legislative objectives. At the same time, major departments are not yet able to produce auditable financial statements consistently."

The requirement for a governmentwide financial report began with fiscal year 1997 and a similar requirement extending coverage of the Chief Financial Officers Act to all major agencies that was contained in the Government Management Reform Act. Chart one shows the progress under these statutes over the last 6 years. It is very similar to the chart that Mr. Turner showed you earlier, although not quite as colorful as his chart.

In addition, the GAO report—actually, I want to stop for a second and congratulate the Department of Housing and Urban Development, the Federal Emergency Management Agency, and the National Science Foundation who, for the first time, received unqualified opinions on their financial statements.

In addition, the GAO report of the financial report of the U.S. Government for fiscal year 1998 stated that "Action is now underway across the government to address pervasive, generally longstanding problems discussed in this report."

Chart two depicts our expectations. Mr. Turner asked, what progress do you expect to continue? What you see is what we anticipate for 1998. The blanks are disclaimers for qualified opinions. What we see in 1999 is that we expect 20 of 24, and then finally 23 of 24 in the year 2000. The lone exception will be the Defense Department, which does not expect a clean opinion at this point until beyond the year 2000.

While agencies have made substantial progress, challenges remain. Recognizing these challenges, President Clinton issued a memorandum to all agency heads on May 26, 1998, directing agencies to develop corrective action plans for addressing these challenges and to submit quarterly reports of progress. Agencies submitted these plans and reports to OMB. They formed the basis for discussion between senior agency officials, including the Inspectors General, and senior executives from OMB, Treasury, and GAO on the process the agencies were employing to meet planned goals and their prospects for success. The team's assessment is that while the challenges facing certain agencies are daunting, the commitment of the agencies is reassuring.

Chart three, please. I would like to show you these challenges by functional area and by department for those agencies that do not have clean opinions. The departmental challenge is primarily in the Department of Defense, with the Department of Agriculture and a couple of others having some challenges. But the functional area that faces us with the most difficult problems is the one that we talked about earlier, intragovernmental payments. The Defense Department has taken significant steps to deal with its problem. The department believes that lasting effective solutions to its difficulties in producing reliable information in the form of audited financial statements requires a Defensewide management information overhaul, and they have embarked on such an effort. Over the last few years the department has streamlined its numerous incompatible finance and accounting systems by eliminating over 200 systems that did not collect information needed to comply with current accounting standards.

More recently, the department has been developing a blueprint for financial management reform and in the fall released the first comprehensive financial management improvement plan. We and GAO, and Treasury and the department Inspectors General have worked with them to review and refine that plan.

IRS revenue collection and public debt receive clean opinions is my next headline. In addition to the progress previously referred to in terms of the number of unqualified agency financial statements, for fiscal year 1998, the GAO reported on the results of the audits in the Internal Revenue Service and the Bureau of Public Debt. The Internal Revenue Service's statement of custodial activities, which the chairman referred to earlier, received an unqualified opinion. The schedule of public debt reflected a similar unqualified opinion. The amount of money that the IRS covered was

about $1.8 trillion and over $5.5 trillion of public debt was similarly included.

GAO also points out in addition to the qualification in opinions a series of areas that need ongoing attention. These are the management internal control weaknesses that the Comptroller General talked about earlier.

The administration for the past several years has been putting out a report on priority management objectives. I would like to get the next chart, please. These priority management objectives are chosen, as the President said in his budget, to reflect "areas in need of real change that will receive ongoing attention for the administration." We didn't put these out in response to last year's report or the report of the year before. We put them out because they are things that the administration wants to get done. You can see that heading the list is managing the year 2000 problem, followed closely by improving the results orientation of program management. That is PGPRA.

Next, audited financial statements, improving financial management information. These are things that were formally committed to, were managed with a monthly planning process in response to these.

I don't need to tell you, Mr. Chairman, where we are in Y2K. We last night gave you the results of the flash reports from the precincts, the flash reports from the agencies that show that more than 92 percent of the financial systems are compliant. We expect that the committee will want a full review of that, and we will be happy to provide that information as it comes in.

We agree with the Comptroller General that protecting critical infrastructure and particularly computer security is the next Y2K challenge. In fact, we are using the techniques that we have developed in Y2K to begin that process. The President issued PDD–63 last year, requiring agencies to prepare plans and requiring a national plan for computer security to be prepared. Sector groups, going out into the private sector, led by Federal agencies, just as we are doing in Y2K, will be mobilized in the computer security area.

Another area that the Comptroller General pointed out in his report is better managing financial portfolios. We agree that loan portfolios in particular need to have improved management. Working with this committee, the Debt Collection Improvement Act has given us some new tools, and my formal statement gives you the ways that we are implementing those tools.

Next, verifying that the right person is getting the right benefit. We also agree with the Comptroller General that for fiscal year 1997 we had a 14 percent error rate in the Medicare program. Unacceptable. Totally unacceptable. The current error rate of about 7 percent is similarly unacceptable, but it is half the previous rate, and that is because we have been trying to manage that problem that was identified through auditing.

Throughout the government, there are a series of report crosscutting groups that are working together to set standards. The Federal Accounting Standards Advisory Board, the Joint Financial Management Improvement Project and the Chief Financial Officers Council, as well as the Chief Information Officers Council are

bringing agencies together to prepare standards that give us the ability to tackle some of the challenges that don't exist just in one agency. One agency doesn't have an intragovernmental payment problem. It takes at least two to have such a problem.

In summary, Mr. Chairman, I would like to again quote the Comptroller General by saying,

> The executive branch recognizes the extent and severity of the financial management deficiencies and that addressing them will require concerted improvements across government. The administration has set goals for individual agencies as well as government as a whole to complete timely audits and receive unqualified opinions. With concerted effort the Federal Government as a whole can continue to make progress toward generating reliable information on a regular basis.

Mr. Chairman, and members of the subcommittee, the administration has demonstrated from the President on down that it recognizes the need for continued concerted action to continue to make progress. Given where we were in 1993 and the obstacles we face, the progress we have made to date is extraordinary. Notwithstanding the formidable nature of the remaining challenges we set a high bar for ourselves and will redouble our efforts to improve the reliability of financial information provided by agencies and the government.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. DeSeve follows:]

Statement of G. Edward DeSeve
Deputy Director for Management
Office of Management and Budget
March 31, 1999

Mr. Chairman and members of the sub-committee, I am here today to discuss the progress made during the last year in financial management and particularly as reflected in the Financial Report of the United States Government for 1998 (the Financial Report). I am also here to describe the challenges that still face us.

PROGRESS HAS BEEN MADE, CHALLENGES REMAIN

In his transmittal of the audit of the Financial Report Comptroller General David Walker wrote, "These financial reporting requirements are prompting steady improvements in financial accountability and there has been good progress toward meeting legislative objectives. At the same time, several major departments are not yet able to produce auditable financial statements consistently."

The requirement for a government-wide financial report, beginning with Fiscal 1997, and a similar requirement extending coverage of the Chief Financial Officers Act to all major agencies, was contained in the Government Management Reform Act of 1994 (the Act).

Chart 1 shows the progress under these statutes over the last six years. It shows that:

- For 1993, only one agency received an unqualified opinion on its financial statements.
- For Fiscal 1996, six of the 24 agencies covered by the Act received unqualified opinions on their financial statements.
- For Fiscal 1997, eleven of the covered agencies received unqualified opinions on their financial statements, an increase of 120%.
- For Fiscal 1998, we expect that thirteen of the 24 agencies will receive unqualified opinions on their financial statements (seven have been received to date);
- Also for Fiscal 1998, three agencies, the Department of Housing and Urban Development, Federal Emergency Management Agency, and the National Science Foundation received unqualified opinions on their financial statements for the first time.

In addition, the GAO's report on the Financial Report of the United States Government for Fiscal 1998 states that "Action is now underway across the government to address the pervasive, generally long-standing problems discussed in this report."

Chart 2 depicts on an agency basis our expectations for Fiscal 1998, 1999, and 2000.

While agencies have made substantial progress, challenges remain. Recognizing these challenges, President Clinton issued a memorandum to all agency heads on May 26, 1998, directing agencies to develop corrective action plans for addressing these challenges and to submit quarterly reports of progress. Agencies submitted these plans and reports to OMB. The plans formed the basis for discussions between senior agency officials, including the Inspectors General, and senior executives from OMB, Treasury, and the General Accounting Office (GAO), on the process the agencies were employing to meet planned goals and their prospects for success. The team's assessment is that, while the challenges facing certain agencies are daunting, the commitment of these agencies is reassuring.

Chart 3 presents these challenges by functional area and by department. There are two major challenges; one is Departmental and the other is functional. From a departmental perspective, the Department of Defense has formidable challenges in a number of functional areas, particularly accounting for property, plant, and equipment, and inventory. From a functional perspective, accounting for and eliminating intra-governmental transactions is our most serious challenge.

The Department of Defense has taken significant steps to deal with its problems. The Department believes that lasting effective solutions to its difficulties in producing reliable information in the form of audited financial statements requires a Defense-wide management information overhaul. The Department has embarked on such an effort. Over the last few years, the Department streamlined its numerous incompatible finance and accounting systems by eliminating over 200 systems that did not collect information needed to comply with current accounting standards.

More recently, the Department has been developing a blueprint for Defense financial management reform, and in the fall of 1998 released its first comprehensive Financial Management Improvement Plan. The Plan includes an accounting and finance concept of operations that describes the manner in which the Department intends to carry out its finance and accounting operations in the future. The Department estimates that new and modified financial and accounting systems will not be able to produce fully compliant financial statements prior to Fiscal 2003.

In addition to these long-term initiatives, the Department has been pursuing interim solutions intended to enable it to comply with accounting standards. The Department has hired contractors to assist in the valuation of its property and in the development of new regulations addressing accountability matters. The Department is also working with the audit community to develop more detailed policy guidance to assist the various DOD components in identifying and reporting additional information not now provided. OMB, the GAO, and the Department's Inspector General are fully engaged in the development and review of these initiatives. Progress is being monitored by OMB, GAO, and the Inspector General on a quarterly basis.

With respect to intra-governmental transactions, the problem pertains to identifying and eliminating transactions between agencies. An OMB, GAO, Treasury team are completing work on defining the principal causes of the problem and appropriate short and long term solutions. As soon as the team finalizes the solutions, they will begin testing within agencies. OMB, GAO, and Treasury will will carefully monitor progress towards resolving this problem.

IRS REVENUE COLLECTION AND PUBLIC DEBT RECEIVE CLEAN OPINIONS

In addition to the progress previously referred to in terms of an increasing number of unqualified opinions on agency financial statements, for Fiscal 1998 the GAO reported on the results of its audits of the Internal Revenue Service and the Bureau of the Public Debt. It provided an unqualified opinion on:

- The Internal Revenue Service's Statement of Custodial Activity, which reflects the agency's tax collection activities, and
- The Schedule of Public Debt managed by the Bureau of the Public Debt.

The report on the custodial activities of the Internal Revenue Service covered over $1.8 trillion in revenue and the report on the Schedule of Public Debt covered over $5.5 trillion in debt.

PRIORITY MANAGEMENT OBJECTIVES EMPHASIZE ONGOING ATTENTION OF ADMINISTRATION

The GAO's audit report also discusses key management issues. The principal management framework of the Administration is the Priority Management Objectives contained in the President's Budget which states, "These were chosen as areas in need of real change, and will receive ongoing attention from the Administration."

Chart 4 presents these Priority Management Objectives and I would like to discuss a few of them this morning.

Manage the Year 2000 Computer Problem

In cooperation with John Koskinen, Assistant to the President and Chair of the President's Council on Year 2000 Conversion, OMB continues to work closely with individual agencies to ensure they are making the necessary progress in meeting the Government-wide goals for successfully addressing the Year 2000 computer problem.

In the latest OMB quarterly report based on data received through February 19,1999, of the 6,399 mission critical systems, 79 percent were found to be fully compliant. Of the remaining 1354 mission critical systems, 71 percent are being repaired, 20 percent are being replaced, and 9 percent will be retired. Results through March 31, 1999, will be available soon.

While all agencies expect that their mission critical systems will be ready by December 31, 1999, they are developing business continuity and contingency plans to ensure program delivery in the event of a system failure or malfunction, whether within or outside of the agency. Agencies that are behind schedule are emphasizing completion of their remediation efforts for the remaining mission critical systems.

As agencies complete work on fixing their mission critical systems, they are now focusing on demonstrating that programs and services, especially those critical to public safety, health, and welfare, will be operational. New guidance from OMB will direct agencies to work with other Federal agencies, State and local governments, the private sector, and others, to assure the readiness of 40 high-impact public programs.

Protecting Critical Infrastructure

Assuring that Federal computer systems are doing what they are supposed to do and will be there when we need them is of concern to all of us. A growing body of audit evidence based on reports of agency Inspectors General and the GAO shows that agency programs often have significant problems, with weaknesses in access controls, planning, and management being the most common.

Building on the legislative framework established by The Computer Security Act of 1987, The Paperwork Reduction Act of 1995, and The Clinger-Cohen Act of 1996, the Administration is working to address computer security issues on three fronts:

- Enhance computer security awareness
- Prepare agency system vulnerability assessments, and
- Develop a national plan for protecting agency systems.

These efforts will build on the results of our Y2K remediation management activity and the work of the President's Commission on Critical Infrastructure Protection, which resulted in Presidential Directive 63, "Critical Infrastructure Protection."

Better Manage Financial Portfolios

Working through the Housing Consortium, which includes agencies which manage housing loan programs, and with the Federal Credit Policy Working Group, which represents agencies with significant receivables, the Administration has worked to improve the tool set agencies have available to manage financial assets. Examples include:

- Simplified procedures to enable agencies to acquire technical support in the management and sale of portfolios.
- The use of electronic commerce and the Internet to test streamlined procedures for student loan applications and the drawing of funds electronically, which we believe will provide better customer service and enable better tracking of loan activity to students.
- A training manual on Credit Reform to improve management of Federal credit programs under the Credit Reform Act.
- Electronically sharing of information across housing agencies to better manage single-family home loans and, if successful, we will apply the same model to other lending programs.

Verifying that the right person gets the right benefit

The Department of Health and Human Services Inspector General, in connection with the audits of the financial statements of the Health Care Financing Administration (HCFA) for Fiscal 1996, 1997 and 1998, undertook an extensive effort to assess the extent of improper payments in the Medicare program and the causes for such payments. For Fiscal 1998, HCFA reported estimated improper payments of $12.6 billion or 7.1 percent, down from about $20.3 billion, or 11 percent, for Fiscal 1997, and $23.2 billion, or 14 percent, for Fiscal 1996, a significant improvement. Analysis of improper Medicare payments helped lead to the implementation of several initiatives intended to reduce improper payments. Departmental program staff will continue to work with the IG to reduce improper payments.

Several initiatives are in place to complement the work of the Inspectors General. The Administration is working to facilitate electronic sharing of data among agencies to strengthen the integrity of program decisions. For instance, in the Year 2000 HUD will begin verifying tenant-reported income against other Federal income data. This will help ensure that housing assistance goes to those entitled to these benefits. The Department of Education is proposing legislation to permit the use of information in the National Directory of New Hires to improve collection on defaulted student loans. Further, the Department of Education plans to verify data contained in student aid applications with income data maintained by the Internal Revenue Service, as authorized under the Higher Education Amendments of 1998. In all these data share and electronic initiatives we will ensure the protection of individual privacy and the security of data.

CROSSCUTTING INTRA-AGENCY ACTIVITIES

Again, as discussed in the President's Budget, an important strategy of the Administration has been to empower cross cutting agency groups to deal with issues of critical importance. Let me discuss a few of those.

The Federal Accounting Standards Advisory Board

The Federal Accounting Standards Advisory Board (FASAB) was created by the Director of the Office of Management and Budget, Secretary of the Treasury, and Comptroller General to recommend accounting standards for the Federal Government. Accounting standards provide the foundation for financial accountability on a consistent basis government-wide and are critical for assessing budgetary integrity, operating performance, stewardship, and systems and controls.

To date the FASAB has recommended two Concepts Statements and thirteen Statements of Federal Financial Accounting Standards. The Director of the Office of Management and Budget and the Comptroller General have adopted Statements which incorporate all of the FASAB recommendations. Federal agencies must use these standards in the preparation of their financial statements.

In addition, the OMB, Treasury, GAO, CFOs Council and the PCIE created the Accounting and Auditing Policy Committee (AAPC). The AAPC has eleven members and is charged with assisting the Federal Government in improving financial reporting through the timely identification, discussion, and recommendation of solutions to accounting and auditing issues within the framework of existing accounting and auditing literature.

Joint Financial Management Improvement Program

The Joint Financial Management Improvement Program works to support the financial community on behalf of the GAO, Treasury, OMB, OPM and GSA, all of whom serve on the JFMIP Steering Committee. JFMIP supports information exchange and professional development for the financial management community. This year JFMIP is leading initiatives to update the existing financial systems requirements and to develop financial system requirements for additional functions to assist Federal agencies in eliminating material weaknesses and in complying with the Federal Financial Management Improvement Act. JFMIP is also now responsible for testing and certifying core financial system software for use by federal agencies. In the future, agencies that procure new accounting systems can do so with confidence that the systems meet carefully developed and agreed-upon requirements. This process will be fully implemented in Fiscal 2000.

The Chief Financial Officers Council

The Chief Financial Officers Council, authorized by the CFO Act represents the 24 largest Federal agencies as well as senior officials from Treasury and OMB. They have been instrumental

in implementing the GPRA, sharing best practices and solving problems on common issues, implementing the use of electronic commerce by the government, and enhancing the professional development of financial staffs of the government. CFOs include as a priority for their Council, getting unqualified opinions on financial statements and supporting the accounting standards process.

The President's Council on Integrity and Efficiency

The President's Council on Integrity and Efficiency includes the 27 Presidentially-appointed IGs. They work collectively to address integrity, economy and efficiency issues which transcend individual agencies. They have recently completed reviews of controls of the Federal Electronic Benefits Transfer System and agency processes for debt collection. They are now engaged in an analysis of non-tax delinquent debt.

The Chief Information Officers Council

The Chief Information Officers Council, authorized by Executive Order 13011, represents 28 of the largest Federal agencies as well as senior officials from OMB and the National Archives and Records Administration. They have been instrumental in the implementation of the Clinger-Cohen Act and have worked to ensure that Federal systems will be Year 2000 compliant before the March deadline. CIOs include as a priority for their Council the following items in the next year -- ensuring that Federal programs will operate through the millennium change, establishing sound capital planning and investment practices for information technology investments, and ensuring computer security practices to protect government services.

SUMMARY: CONCERTED EFFORT NEEDED TO MAKE PROGRESS

It is appropriate to summarize by quoting the Comptroller General.

"The executive branch recognizes the extent and severity of the financial management deficiencies and that addressing them will require concerted improvement efforts across government. The administration has set goals for individual agencies, as well as the government as a whole, to complete timely audits and receive unqualified opinions. With concerted effort, the federal government as a whole, can continue to make progress toward generating reliable information on a regular basis."

Mr. Chairman and members of the sub-committee, the Administration has demonstrated, from the President on down, that it recognizes the need for continued concerted action to continue to make progress. Given where we were in 1993, and the obstacles we faced, the progress we have made to date is extraordinary. Notwithstanding the formidable nature of the remaining challenges, we have set a the bar high for ourselves and will redouble our efforts to improve the reliability of financial information provided by agencies and the Government.

Chart 1

Number of Agencies With Or Anticipating Unqualified Audit Opinions For The Fiscal Years Indicated (Covered Agencies - 24)						
Year	1993	1996	1997	1998*	1999*	2000*
Audits Completed	10	24	24	24	24	24
Agencies with Unqualified Opinions	1	6	11	13	20	23**

*Anticipated
**DOD does not anticipate an unqualified opinion until FY 2003

Chart 2

Agencies With Or Anticipating Unqualified Audit Opinions For The Fiscal Years Indicated (Covered Agencies - 24)			
Agency	**1998 Anticipated**	**1999 Goal**	**2000 Goal**
USDA	Disclaimer		
DOC	Disclaimer		
DOD	Disclaimer		
ED			
DOE	Qualified		
HHS	Qualified		
HUD			
DOI			
DOJ	Disclaimer		
DOL			
State			
DOT	Disclaimer		
Treasury	Qualified		
DVA	Qualified		
AID	Disclaimer		
EPA			
FEMA			
GSA			
NASA			
NSF			
NRC			
OPM	Disclaimer		
SBA			
SSA			
Total Unqualified	**13**	**20**	**23**

*Shading signifies an unqualified opinion

Chart 3

Obstacles to an Unqualified Opinion on the Financial Statements of the Federal Government

	Property, Plant, and Equipment	Inventory	Loans and Accounts Receivable and Loan Guarantees	Environmental Liabilities	Pension, Health, and Other Liabilities	Unreconciled Disbursements	Intra-Governmental Transactions	Reconcile Change in Net Position with Budget Results
USDA	X		X				X	
DOD	X	X		X	X	X	X	
Education			X				X	
HHS			X				X	
HUD			X				X	
DOI							X	
DOJ							X	
DOT (FAA)	X						X	
Treasury							X	X
VA			X				X	
OPM					X		X	
Other Agencies							X	

Chart 4

PRIORITY MANAGEMENT OBJECTIVES

STRENGTHENING GOVERNMENT-WIDE MANAGEMENT

1. Manage the year 2000 (Y2K) computer problem
2. Use results to improve program management
3. Improve financial management information
4. Protect critical information infrastructure
5. Strengthen statistical programs
6. Implement acquisition reforms
7. Implement *electronic Government* initiatives

IMPROVING STEWARDSHIP OF ASSETS

8. Better manage financial portfolios
9. Better manage real property

IMPROVING PROGRAM OPERATIONS AND INTEGRITY

10. Verify that the right person is getting the right benefit
11. Use competition to improve operations

IMPROVING PROGRAM MANAGEMENT

12. Modernize student aid delivery
13. Improve DOE contract management
14. Strengthen the HCFA's management capacity
15. Implement HUD reform
16. Resolve disputes over Indian trust funds
17. Implement FAA management reform
18. Implement IRS reforms
19. Streamline SSA's disability claims system
20. Revolutionize DOD business affairs
21. Improve management of the decennial census
22. Manage risks in building the International Space Station
23. Improve security at diplomatic facilities around the world
24. Reengineer the naturalization process and reduce the citizenship application backlog

Mr. HORN. We thank you. We now go to Mr. Hammond, the Fiscal Assistant Secretary of the Department of the Treasury. You are a career member as I recall, is that correct?

Mr. HAMMOND. That is correct, Mr. Chairman.

Mr. HORN. How many years have you had with the Treasury?

Mr. HAMMOND. Fifteen.

Mr. HORN. Well, you are going on 30 then, right?

Mr. HAMMOND. We are off to a good start.

Mr. HORN. I knew Bill Parsons, who was about 30 years ahead of you and one of the great fiscal assistant secretaries and management secretaries down there. So welcome.

Mr. HAMMOND. Thank you very much. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear today to discuss matters involving the second annual financial report of the U.S. Government. First, I would like to take this opportunity to thank the chairman, the ranking member, and other members of the subcommittee for your continued support and encouragement to improve financial accountability and reporting in the Federal Government. Last year was the first year in its history in which the government prepared comprehensive financial statements covering all of its diverse activities. While a great deal of work has been done and progress made over the last year, there are still significant challenges and obstacles that must be overcome to enhance and improve the reliability of the accrual-based financial information presented for the U.S. Government.

The Government Management Reform Act of 1994 requires that not later than March 31 of each year, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, shall prepare and submit to the President and the Congress audited financial statements for the preceding fiscal year, covering all of the accounts and associated activities of the executive branch. This is the second time such audited financial statements have been prepared on a governmentwide basis. The financial report of the U.S. Government for fiscal year 1998 provides the President, the Congress, and the American people with information about the government's assets and liabilities, its cost of operations, and its sources of financing. The financial report is prepared on the accrual basis of accounting as prescribed by Federal accounting standards. These differ from the cash basis of accounting used in the preparation and reporting of budget results. Each method is a useful tool in its own right for looking at the government's operations for different purposes.

Since the passage of the Government MRA, we have been working very closely in cooperation with OMB, GAO, and the Federal program agencies to create the standards and systems necessary to create and implement an entirely new system of identifying and tracking all of the operations of the U.S. Government.

This past year, Treasury focused much of our attention on three important areas: first, increasing the consistency of information reported to us by program agencies; second, identifying and reducing inaccurate eliminations of intragovernmental transactions; and third, assisting agencies in reconciling their fund balances with Treasury records. I will briefly summarize our efforts in each of these three areas.

It is essential that the information used by Treasury to prepare the governmentwide statements be consistent with the information contained in the respective agency-level financial statements. The agency-level financial statements are separately audited and the audit of the governmentwide financial statements relies heavily on those audits. Consistency problems need to be addressed by the agencies working in very close cooperation with OMB, Treasury and the GAO.

This past year, Treasury initiated actions to provide agencies with ongoing support, guidance and training. We issued written guidance to program agencies in an effort to improve consistency. Treasury has also conducted both formal and informal training with agencies directed at the specific consistency problems associated with their respective financial systems.

As a result of our close work with the agencies this year, we achieved a 20 percent increase in consistent reporting; 25 of the 32 entities so reported this year. We will continue to work with the program agencies on this important issue and, based on our experiences this past year, we are very optimistic that future reporting will improve. Both last year's and this year's audits of the financial statements disclosed transactions between agencies for governmentwide reporting. If these transactions are not properly eliminated, total government assets, liabilities, revenues and expenses will be misstated by the amount of those transactions.

Treasury, OMB, and GAO have been actively working together in a governmentwide task force to find methods and solutions for the elimination problem. The task force has looked for solutions that not only help the agencies identify and reconcile transactions among themselves, but also improvements to the Treasury's process of creating the governmentwide financial statements. After careful analysis, the task force identified several detailed categories which can be summarized in two broad categories of intragovernmental transactions: Investment and loan transactions and all other activity between the agencies.

During fiscal year 1998, we focused most of our attention on resolving the intragovernmental issues for investment and loan transactions. These investment and loan transactions are primarily the types of transactions discussed earlier occurring between the trust funds and various government agencies, and at least at one endpoint involves the Treasury Department. They involve trillions of dollars on an annual basis. In December, Treasury, after consultation with the agencies, issued elimination guidance for the preparation of the fiscal year 1998 statements. As a result of these efforts, significant progress, as detailed in my written statement, was made in fiscal year 1998 in reconciling these intragovernmental investment and loan transactions. We plan to make even more progress in fiscal year 1999.

In addition to assisting the agencies with other transactions, Treasury provided two digit identification codes, the use of which is absolutely critical to the ability to eliminate and reconcile the purchase and sale and other activity between the agencies. In fiscal year 1998, 24 of the 32 agencies required to use these partner codes were able to identify 80 percent or more of the dollar value

of their transactions. That is good progress. We are not there yet, and we need to do considerably more to deal with this issue.

The third issue has to do with our activity of reconciling fund balances. Since Treasury acts as a banker for the government, as agencies request payments to be made or receive funding, their account balance with the Treasury will change. This fund balance amount is an agency-level asset account that reflects the agency's available budget spending authority. Both the agency and Treasury independently track the account balance. Treasury notifies agencies of discrepancies in their fund balances as determined from our records, and agencies are then responsible for resolving these differences. We have made significant efforts to assist agencies in reconciling their fund balance amounts with the amounts reported by us, including surveys of their information needs, the issuance of standard operating procedures, training, improved communication between us and the agencies, and the provision of technical assistance. We are expecting continued and significant improvements in agencies' abilities to reconcile fund balances again for this year.

However, we are facing many challenges as we go forward. As Secretary Rubin stated, "A great deal of work has been done, but the development of this new method of reporting is an immense task and a great deal of additional effort will be necessary to create and implement an entirely new system of reporting on the operations of the U.S. Government."

We at Treasury are committed to this effort, and we have both short-term and long-term actions underway to address them.

In the short term, we will continue to make those changes necessary to continue to improve the preparation of the financial report. In the long term, we are embarking on a project to make fundamental changes in the way we do business. Our most significant short-term challenges are in three specific areas. First, we need to continue to make substantial progress in eliminating intragovernmental transactions. Second, additional improvements are needed to make data reported to Treasury for the financial report consistent with the agency's audited financial statements. And third, we need to enhance the process of identifying the data needed to do a complete reconciliation of the budget results reported on the cash basis with the financial statements' results of operations.

Regarding the elimination of intragovernmental transactions, Treasury intends to put in place additional procedures and processes to ensure that progress in eliminating transactions in the investment and loan category continue, but most of our efforts this year will be spent working with OMB and the program agencies to identify and put in place processes to effect the other types of intragovernmental transactions. We feel confident that by continuing our focus on attention in these areas we can again make more progress.

With respect to ensuring consistency of reporting, this year's report, or this year's process has identified areas where we can continue to improve and make reporting less burdensome on the government agencies. We have also identified several problems agencies had in verifying their financial statements with the detailed information sent to us. These problems relate to the need for additional information, formatting issues, and the reporting of changes

in opening balances. Building from this base, we will take further steps to again show improvements in consistency next year.

Finally, regarding reconciliation of the budget results with the financial statements results of operations, a team of Treasury staff with assistance from private contractors will develop the necessary information requirements and procedures to accomplish this reconciliation. Our plans are to ask for the necessary information in next year's report process, and our goal is to make significant strides in identifying all of the information necessary to complete such a reconciliation next year.

While making short-term changes to improve the financial statements process is important, we have also committed and recently initiated a major project to fundamentally rethink and redesign our central accounting system and processes. We will be working with OMB, GAO, the program agencies, and the Federal Reserve System in developing new processes that will provide more timely, accurate, accessible accounting information, follow established accounting standards, and support the control of resources and management decisionmaking. Goals of the new processes include reducing the reporting and reconciliation burden on program agencies.

We also intend to develop processes that maximize data accuracy at the time of collection and capture information once at the earliest time possible to meet multiple reporting requirements. Improving financial management and accountability is a Treasury priority. We have taken and will continue to take actions to correct weaknesses and problems in the preparation of our government-wide financial statements. We are working hard to resolve these problems, but much work remains to be done. Treasury will also continue its leadership role in providing guidance, assistance and support to the agencies in their ongoing efforts to improve their accounting practices and financial management systems.

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

[The prepared statement of Mr. Hammond follows:]

EMBARGOED UNTIL 10:00 AM
Text as Prepared for Delivery
March 31, 1999

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

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear today to discuss matters involving the second annual Financial Report of the U.S. Government. First, I would like to thank the Chairman, the Ranking Member, and the other members of the Subcommittee for your continued support and encouragement to improve financial accountability and reporting in the Federal Government. Last year was the first year in its history in which the government prepared comprehensive financial statements covering all of the diverse operations of 70 agencies that include over 2000 components of the federal government. While a great deal of work has been done and progress made over the last year, there are still significant challenges and obstacles that must be overcome to enhance and improve the preparation of reliable accrual based financial statements for the U.S. Government.

BACKGROUND

The Government Management Reform Act of 1994 (GMRA) requires that not later than March 31 of each year, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, shall prepare and submit to the President and the Congress audited financial statements for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the United States Government. This is the second time audited financial statements have been prepared on a government-wide basis. The Financial Report of the U.S. Government for FY 1998, which includes the financial statements, provides the President, the Congress, and the American people with information about the Government's assets and liabilities, the cost of its operations, and its sources of financing. The Financial Report

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is prepared on the accrual basis of accounting as prescribed by federal accounting standards. This differs from the cash basis of accounting used in the reporting of budget results. Each method is a useful tool for looking at the government's operations for different purposes.

PROGRESS MADE

Since the passage of the GMRA, we have been working in close cooperation with OMB, GAO, and the federal program agencies to create the standards and systems necessary to create and implement an entirely new system of identifying and tracking all the operations of the United States Government. This past year, Treasury focused much of its attention in three important areas: first, increasing the consistency of information reported to us by program agencies; second, identifying and reducing inaccurate eliminations of intra-governmental transactions; and third, assisting agencies in reconciling their fund balances with Treasury records. I will briefly summarize our efforts in these areas.

Consistency of Financial Information

It is essential that the information used by Treasury to prepare the government-wide statements be consistent with the information contained in the respective agency-level financial statements. The agency-level financial statements are separately audited and the audit of the government-wide financial statements relies heavily on those audits. However, there are consistency problems which arise when information is treated differently in agency statements than by Treasury or information is not provided to Treasury that was included in the agency-level financial statements. This is a problem which needs to be addressed by the agencies working closely with OMB, Treasury, and GAO.

This past year, Treasury initiated actions to provide agencies with on-going support, guidance and training. We issued written guidance to program agencies in an effort to improve consistency, including a list of specific data elements submitted to Treasury that must be verified against the agency statements, and detailed instructions and requirements for agency financial reporting, related footnote disclosures and adjustment transactions. Treasury has also conducted both formal and informal training with agencies directed at the specific problems associated with their agency financial systems.

As a result of our close work with the agencies, we achieved a 20% increase in consistent reporting in FY 1998. In FY 1997, 14 of the 24 reporting entities verified consistent reporting. In FY 1998, we increased the number of agencies required to verify and 25 of the 32 reporting entities required to verify consistency verified consistent reporting. We will continue to work with program agencies on this important issue and, based on our experiences this year, including the continuing progress made by program agencies in receiving unqualified opinions, we are optimistic that future reporting will improve.

Elimination of Intra-governmental Transactions

Both last year's and this year's audits of the Federal Government's financial statements disclosed that Treasury did not effectively eliminate transactions between agencies for government-wide reporting. If these transactions are not properly eliminated, total Government assets, liabilities, revenues, and expenses will be misstated by the amount of these transactions.

Treasury, OMB, and GAO have been actively working together in a government-wide task force to find methods and solutions for the elimination problem. The task force has looked for solutions that not only help the agencies identify and reconcile transactions among themselves but also improvements to the Treasury's process of creating the government-wide financial statements. After careful analysis, the task force identified several detailed categories which can be summarized into two broad categories involving significant intra-governmental transactions: investment and loan transactions and other transactions.

During FY 1998, Treasury focused most of its attention at resolving the intra-governmental elimination issues for investment and loan transactions. These investment and loan transactions are primarily transactions that occur between Treasury and other federal agencies and account for trillions of dollars annually. In December 1998, Treasury issued elimination guidance for FY 1998 reporting to all agencies. The elimination guidance was developed in consultation with the agencies.

As a result of these efforts, significant progress was made in FY 1998 in reconciling intra-governmental investment and loan transactions. Specifically, for investments and Federal debt securities, the difference last year was $3.1 billion; the difference this year is $3.9 million. For interest receivable and interest payable, the difference last year was $3.2 billion; the difference this year is $855 million. For interest revenue and interest expense, the difference last year was $8.5 billion; the difference this year is $214 million. For loans receivable and amounts due Treasury, the difference last year was $7 billion; the difference this year is $353 million. We plan to make continued progress on this issue in FY 1999.

To assist agencies for other transactions, Treasury provided two digit identification codes so that agencies could identify their governmental transaction partners. The use of these codes is critical to our ability to eliminate or reconcile these intra-governmental transactions. In FY 1998, 24 of the 32 agencies required to report intra-governmental transaction partner codes were able to identify 80% or more of the dollar value of their intra-governmental transactions using the two digit codes.

Reconciliation of Fund Balances

Since Treasury acts as the "banker" for the government, as agencies request payments to be made or receive funding, their account balance with the Treasury will change. This fund balance

amount is an agency level asset account that reflects the agency's available budget spending authority. Both the agency and Treasury independently track the account balance. Treasury notifies agencies of discrepancies in their fund balances, as compared to Treasury records, and agencies are responsible for resolving these differences. Most often, the discrepancies are a result of timing differences and are quickly resolved.

Treasury has made significant efforts to assist agencies in reconciling their fund balance amount with the amount reported to them by Treasury. We sent surveys to agencies to determine what specific guidance was needed. Standard operating procedures are being developed to further assist in the reconciliation process and training is being provided. In addition, a web site was established to facilitate communication. Treasury's Financial Management Service has offered a new training course entitled "Reconciling Fund Balance with Treasury" and has assembled a Fund Balance Team which has contacted agencies to assist them in reconciling differences.

We are expecting continued and significant improvements in agencies' ability to reconcile fund balances for FY 1999.

CHALLENGES

As Secretary Rubin has stated, "A great deal of work has been done, but the development of this new method of reporting is an immense task and a great deal of additional effort will be necessary to create and implement an entirely new system of reporting on the operations of the U.S. Government." Treasury is committed to this effort and we have both short term and long term actions underway. In the short term, we will continue to make those changes necessary to continue to improve the preparation of the Financial Report of the U. S. Government. In the long term, we are embarking on a project to make fundamental changes in the way we do business.

Short-term

Our most significant short-term challenges are in three specific areas. First, we need to continue to make substantial progress in eliminating intra-governmental transactions. Second, additional improvements are needed in making data reported to Treasury for the Financial Report consistent with the agencies audited financial statements. Third, we need to enhance the process of identifying the data needed to do a complete reconciliation of the budget results with the financial statements' results of operations.

Regarding the elimination of intra-governmental transactions, Treasury intends to put in place additional procedures and processes to ensure that progress in eliminating transactions in the "investment and loan" category continues. Most of our efforts, however, will be spent working with OMB and the program agencies to identify and put in place processes in the other areas of intra-governmental transactions. We feel confident that, by continuing to focus our attention in these areas, we can again make substantial progress.

With respect to ensuring consistency of reporting, this year's process has identified areas where we can continue to improve and make reporting less burdensome on the program agencies. We have identified several problems agencies had in verifying their financial statements with the detailed information sent to Treasury. First, the data requested from agencies was not sufficient to properly classify some types of revenue in the verification reports. This missing information has been identified and will be requested in a Treasury document providing guidance to the agencies. Second, problems occurred in the roll-up of detailed data to departmental-level statements for verification by the agencies. Due to changes in the format of agency financial statements that were made very late in the process, some items in Treasury's verification report did not easily correlate to the departmental statements. Lastly, the verification report this year was modified to detect unreported changes in agency opening balances. Unreported agency opening balances make it extremely difficult to do proper verification. Building on these changes, we will take further steps to again show improvements in consistency next year.

Regarding reconciliation of the budget results with the financial statements' results of operations, as pointed out in the Financial Report, we did not collect this year the data required to adequately identify all the information necessary to do a complete reconciliation. We will, however, begin to do that for next year's Report. A team of Treasury staff with some help from private contractors will develop the necessary information requirements and procedures to accomplish the reconciliation. Our plans are to ask for the information in next year's report process and our goal is to make significant strides in identifying all the information necessary to complete a reconciliation for FY 1999.

Long-term

While making short-term changes to improve the financial statements preparation process, we have recently initiated a project to fundamentally rethink and redesign our central accounting systems and processes. We will be working with OMB, GAO, the program agencies and the Federal Reserve in developing new processes that will provide more timely, accurate, and accessible accounting information, following established accounting standards, to support the control of resources and management decision-making. Goals of the new processes include reducing the reporting and reconciliation burden on program agencies.

Treasury also intends to develop processes that maximize data accuracy at the time of collection and capture information once, at the earliest phase possible, to meet multiple reporting requirements.

Improving financial management and accountability is a Treasury priority. We have taken and will continue to take actions to correct weaknesses and problems in the preparation of the government-wide financial statements. We are working hard to resolve these problems. Treasury will also continue its leadership role in providing guidance, assistance and support to

agencies in their on-going efforts to improve their accounting practices and financial management systems.

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

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Mr. HORN. We thank you. We would now like the Comptroller General, Mr. Walker, and the Assistant Comptroller General to come forward and join the panel, so that we will have the concluding questions over the next 20 minutes.

The gentleman from Texas, Mr. Turner, will begin.

Mr. TURNER. Mr. DeSeve, you heard me earlier ask the question about the seven agencies that failed to meet the March 1st deadline for failing to meet the financial statements requirements. Could you give the reasons that they failed to do so?

Mr. DESEVE. Yes, sir, I think I can. Let me first describe the process that we use throughout the year. We meet with the agencies, their Inspectors General and their financial staffs in their agencies and spend a considerable amount of time talking with them about the very specific problems that they are having. And then literally weekly and sometimes daily, we talk to them about what the status of their audit reports are.

We are finding two major problems this year. One is a new set of auditing standards and financial statements that the agencies did not have to deal with before, particularly the statement of budgetary results. It is a new one, and it is giving some of them problems. As a result, whenever you have a problem in this circumstance, you will have an independent auditor or sometimes an outside auditor and an Inspector General and the financial folks who together have to agree that the information that is put together is, in fact, correct. So getting agreement on these new statements is a big challenge for some.

Of the seven, we expect that five will have clean opinions, and that relates to the second issue. Some of them are the heroic efforts that the Comptroller General talked about where they are in the midst of doing special studies on things like loan portfolios that have taken them beyond the deadline. We expect them to be clean, but not timely. We, like you, share the desire to have them be both clean and timely and we have been encouraging them in that direction.

Mr. TURNER. So it is not a lack of sensitivity to meeting the March 1st deadline, and you feel every agency is working diligently to get the work done?

Mr. DESEVE. Yes, sir. It is not unwillingness, it is inability to in this case.

Mr. TURNER. One of the things that Mr. Hammond mentioned in his written statement, you were referring to the progress that the Treasury has made in reconciling intragovernmental investment and loan transactions. I was noticing in your written statement you said with regard to that, specifically for investments and Federal debt securities, the difference last year was $3.1 billion. The difference this year was $3.9 million for interest receivable and interest payable, the difference last year was $3.2 billion, the difference this year was $855 million. For interest revenue and interest expense, the difference last year was $8.5 billion; the difference this year was $214 million. And for loan receivables and amounts due the Treasury, the difference last year was $7 billion. The difference this year is $353 million.

That seems to be significant progress. What accounts for the dramatic reduction, and do you feel you are going to even move beyond the progress you have made?

Mr. HAMMOND. We do feel that that is significant progress, but obviously those numbers need to come down to zero.

What accounts for that progress this year are two things. First, we learned a lot from last year's process and were able to build in enhancements in this year's process that allowed us to plan for those types of transactions. We focused a lot of time and attention on the investment and loan accounts.

In addition, Treasury has the advantage of being at one end of pretty much every one of those transactions. As a result, because of the clean opinion we received on the statement of the public debt, we have great confidence in the numbers that we produce and are, therefore, able to go back and work with the individual agencies, note differences, and be able to work to resolve them. The progress you see there really reflects that close cooperation with the agencies who hold the trust funds for their program needs, and to be able to walk through the appropriate transactions.

The differences that remain typically result from timing differences on behalf of the agencies, as well as circumstances where they may be doing certain technical adjustments to interest accounts such as accruing interest receivables or amortizing discount and premium over different periods or using different accounting methods. We need to get a consistency of approach between the agencies and we think those numbers will then go to zero.

Mr. TURNER. You know, it is really hard to imagine what it must have been like before the Chief Financial Officers Act was passed in 1990 and the Government Management Reform Act passed in 1994, because prior to that, we wouldn't even be here having this discussion today. I want to commend the chairman on his diligence in making sure that both of those pieces of notable legislation are working by continuing to hold the agencies accountable for the implementation of both of those Federal statutes.

One of the things that struck me about your testimony, Mr. Hammond, was your reference to the goals that the Treasury has for reducing the reporting and reconciliation burden on agencies. It seems to me that with these new laws and requirements for reporting, there are probably many a Chief Financial Officer who is feeling a tremendous burden of all of the various reporting that takes place. It would be helpful, I think, to give us an example of some of the burden you are talking about and what you are thinking about doing that would reduce the burden of all of this multitude of activities that they are charged with performing.

Mr. HAMMOND. I would be happy to. I think that is in fact a very significant area of stress for a number of agencies of all of the various reporting requirements. As we look at the compilation of the governmentwide financial statements, fundamentally what we have done is we have tried to accomplish the production of these statements by using information that comes from systems that weren't designed to produce the information needed for an accrual-based financial report. The result is that we ask agencies to take budget information, present it to us in a different format, and then provide it to us in a way that then has to be reconciled back to the informa-

tion they are using to present their own financial statements, as well as the information that they are doing for their budgetary reporting. Given the short-term horizon and the need to produce these statements, it is the best we can do in the short term and we continue to work around the edges to enhance that. But fundamentally, the systems needed to supply information to produce these systems shouldn't be the type of situation where you have system A coming in, system B coming in, system C, and creating the need for all of these reconciliations as you move along. They should, in fact, come from a common source of information, and then simply present that same information in different formats. That, in essence, is the principal goal or one of the principal goals of our longer-term effort to redesign the central accounting system.

Mr. DESEVE. Mr. Turner, may I add to that and make a small commercial here. The Comptroller General earlier referred to accountability reports of the Social Security Administration, the Veterans' Administration, and others have produced those. Those are an attempt to consolidate information from GPRA, FFMRA, FFMIA, the GMRA, the CFO Act and even some other statutes, and potentially the IG semi-annual reports into a single location in a readable form so people can actually use them as a corporate annual report is used.

Right now there are pilots under the Government Management Reform Act for accountability reports. We would like to work with the committee to propose extending those pilots, and encouraging agencies, if not making those kinds of reports mandatory for agencies, because we think it will give them the ability to have a single report that contains lots of different information. I would think we could even add some Clinger-Cohen information to it as well.

Mr. TURNER. Thank you.

Mr. WALKER. Mr. Chairman, we have supported these pilot projects and we believe that the idea of expanded accountability reports where you end up getting valuable information on a consolidated basis in plain English with charts and graphs is a good idea.

Mr. HORN. I want to pick up on that, Comptroller General. On page 10 of your statement you refer to the Brown Act which was Senator Brown from Colorado, now retired, and who really knew a lot about this type of audit and accounting, and that is the Federal Financial Management Improvement Act of 1996. And then you also note the difference in conformity here between 1997 and 1998, and that similar results are expected for fiscal year 1998.

I would just ask this question. Are some of the problems with these agencies that they don't have a full-time Chief Financial Officer where either the Assistant Secretary for Management or somebody else there has said, "I am the Chief Financial Officer?" That bothers me. I know the people that work in OMB. Mr. Hammond, these are 18 hour-a-day jobs, often 7 days a week. It just seems to me when they bury the CFO under some of these other agency rubrics like Assistant Secretary for Management, I realize they might not want to give up all that power they have as Assistant Secretary for Management, but somebody has to focus strictly on the financial aspects, and that is why Congress put into the law Chief Financial Officer with a direct reporting relationship to the appro-

priate executive, the Deputy Secretary or the Secretary. I just wonder what your thinking is on that.

Mr. WALKER. Well, I think there is little question that—given the challenges that we face in the financial management area, and given the fact that the objective is not just to get a clean opinion, but to have underlying financial management information systems that will be continuously improved to improve economy, efficiency, and effectiveness—the CFO for any major department or agency is a full-time job. I might ask if Ed has any comments.

Mr. HORN. Does anybody else want to comment on that?

Mr. DESEVE. We would be delighted to, Mr. Chairman. We have seen different organizational structures in different agencies. The Justice Department has the Assistant Secretary for Management structure, the Department of Housing and Urban Development has the stand-alone CFO structure. The act permits either, as you know, as long as the reporting requirement is clear.

I think the decision made by the reporting agency to give the appropriate amount of responsibility is even more important. We strongly support budget authority in the hands of the CFO. There is still at least one agency and there may be two where budget authority is not in the hands of the CFO. We have been very active in trying to move them in that direction.

We also find though that the role of the career Deputy CFO is terribly important. When we and the CFO counsel merged the two groups—the groups of Deputies and the CFOs—into a single body, it became much more apparent to us that that career Deputy in many cases was the go-to guy, go-to gal in lots of places. Where we had career CFOs who would come and go over a 2 or 3-year period, the Deputies were the continuity. So it is the strength of the organization up and down the organization. My own preference would be in most cases, in most departments to see a single CFO in those departments. It has always been my preference, and that person should be at least at the Assistant Secretary level. There may be some departments where the Under Secretary level could be an appropriate focus for the CFO organization.

Mr. HORN. I am certainly not against a Deputy CFO, and it ought to be a career person, without question. We want a strong CFO in that agency and we want to see a different result next year.

Now, you are not going to be here next year. You might be on contract, but——

Mr. DESEVE. Mr. Chairman——

Mr. HORN. You may be working as a contractor.

Mr. DESEVE. I have been working in-house and out-house for many years.

Mr. HORN. I don't want to followup on the in-house and the outhouse.

Mr. DESEVE. I realize we are on TV, so we both have to be circumspect about that. But I think the desire that I have and that the administration has is that the Chief Financial Officer responsibilities are well done in each agency and we have tried to make that case time and time again to some of the agencies.

Mr. WALKER. Mr. Chairman, I think one other thing has to be emphasized in addition to the importance of the CFO. There has

to be an active partnership between the CFOs and the CIOs in this regard, because we are looking to a move toward integrated systems that will provide key financial and other management information. The CIO job is a big job too. Eventually we are going to have to end up looking to something else, and that is CHCO, chief human capital officer, because people are the most valuable asset we have, and we don't pay enough attention to it.

Mr. HORN. Let me move to one that everybody has mentioned at one time or another, and that is the computer security control weaknesses that have been found and reported across the government, and there are various instances where auditors were unable to gain authorized access or penetrate the systems. These weaknesses affect the integrity and reliability of the government's financial and programmatic information. I guess I would ask all of you how pervasive are these weaknesses, and are you able to penetrate a lot of these systems, and what are the agencies and OMB needing to do to correct these weaknesses? Mr. DeSeve.

Mr. DESEVE. I think the statutory framework that we have at this point is probably a pretty good one. I am satisfied that from the Computer Security Act of 1987 to the Paperwork Reduction Act of 1995 and on to Clinger-Cohen, we have the laws in place. What we have had to do is increase awareness within the departments and agencies, especially when they were overtaken with the idea of Y2K. Y2K in some ways is a security problem. It is a problem that we created for ourselves, it is not an external problem. The Defense Department, working with the rest of the intelligence community, has engaged, and Gene can tell you more about this than I can in some ways, has engaged in a very major review of the external threats to the Federal Government from cyber terrorism. We would be happy to get you a briefing on cyber terrorism. It is very real, it is something we are very concerned about, and with the National Security Agency and DOD, they have been building a set of scanning systems and deflection systems. Much of that information is classified, but again we would be happy to get you a briefing on it.

Mr. HORN. Comptroller General, do you want to comment on that?

Mr. WALKER. Mr. Chairman, we are doing a lot of work in this area, because obviously there are many aspects that are troubling when you deal with computer security. It is not just getting accurate, timely and useful financial information, it also involves issues that deal with national security, defense, as well as economic security, as well as personal privacy. We spent a fair amount of time in this area already. We anticipate that this area will be our No. 1 area of focus in the information management area after we get past Y2K. Gene might have some comments on anything in specific that he might think might be appropriate here.

Mr. DODARO. Basically, this is a serious pervasive problem across government we have computer systems that are more integrated, more accessible. We have seen examples in just the last day or two of how vulnerable computer systems are through the introduction of some of these viruses. There are two types of problems. One is vulnerability of people outside the agencies being able to hack into the systems, and there are vulnerabilities there. There are also

vulnerabilities of authorized users within the systems that have too much access, and both problems are plaguing the Federal Government. We raised this as a high-risk area across the government in February 1997. As Mr. DeSeve pointed out, in October of that year the President's Commission on Critical Infrastructure Protection said, this is not only a problem for the Federal Government, it is a problem across all sectors. They have taken some initiatives to address this issue. We suggested the CIOs made computer security a priority. They have done that. GAO has gone out and studied best practices in the private sector. We have issued those. The CIO counsel has endorsed those best practices and are in the process of putting them in place. We think each agency needs a comprehensive risk assessment approach and followup process. Also, there needs to be coordinated efforts at the governmentwide level of OMB, the National Security Council and others, and we have made those recommendations. They are beginning to do that, but there is a long way to go. I do think there is a need to reexamine the basic statutory framework, and the Computer Security Act was issued in 1987. It has been a long time since that has been looked at. We are in the process of thinking about ways to strengthen those requirements.

Mr. HORN. Thank you very much.

I yield to the gentleman from Texas, Mr. Turner.

Mr. TURNER. Mr. Chairman, I have only a brief remark. I just really think it would be appropriate for us to acknowledge the good work that Mr. DeSeve has given to the administration since its inception in his role at the Office of Management and Budget. His service to the administration has been commendable, and his willingness to endure the vigorous oversight of this Congress also is to be commended. We wish you well in your transition to the private sector, and we appreciate the contributions that you have made to us all.

Mr. DESEVE. Thank you.

Mr. TURNER. I know there are many people listening today who are probably in the same position I am in. I am beginning to start my work and fill out my tax return, and I had it all spread out on the kitchen table the other night. And you know the way it always is, you always find something you know you have to go retrieve before you can actually do it. So I am at that stage now.

There is one question that was on my mind as I began my tax return preparation, and I know it is going to be on the minds of a lot of taxpayers, and I am sure, Mr. DeSeve, you can answer this question as one of your final responses to this subcommittee.

I noted that this year I have to make out my check to pay my taxes to the U.S. Treasury instead of the Internal Revenue Service, and I wish you would explain to us why we are changing who we pay our taxes to, and perhaps that will relieve the minds of a lot of us taxpayers.

Mr. DESEVE. I am really going to let Mr. Hammond from the Treasury Department handle the question. I think the vigorous oversight of this committee has talked to Commissioner Rossotti and other folks in the IRS about the major restructuring that is going on there. I think that we will see over the next several years perhaps not a kinder, gentler IRS, but one that is more customer-

oriented and one that understands better how to deal in an electronic age with taxpayers, where they live, and in the kinds of organizations in which they find themselves.

But I am going to kick the question on IRS versus the Treasury to Mr. Hammond. You are sending the check to Mr. Hammond.

Mr. HAMMOND. Hopefully not personally.

Mr. DESEVE. Of course not personally.

Mr. HORN. Is your fax machine going to be jammed?

Mr. HAMMOND. That's right. No. I think there are two reasons, actually. One is that the payee information of the U.S. Treasury better indicates that the taxpayer is, in fact, not supporting the operations of the Internal Revenue Service by their payment, but is, in fact, making a tax payment on behalf of the entire government. In addition, I think it also helps deal with some of the characterizations, when the address "Internal Revenue Service" lent itself in some cases to people putting IRS on check payee information which, in some cases I believe was eligible to be forged or manipulated, and so I think there is also a corrective action attached to this.

Mr. DODARO. Mr. Chairman, I might add that our audits of IRS, as this committee has heard, that last point that Mr. Hammond raises is a valid one. A lot of people would change the IRS abbreviation. Even though the instructions would say "Internal Revenue Service," to spell it out, if they put an I in there, they changed the I to an M, and then it became "Mrs.", and put a name on. That issue has been a problem in the past with people basically taking some of those checks and falsifying them. So we are pleased to see that change.

Mr. TURNER. Well, I thought somebody was going to tell me that we had eliminated an intragovernmental——

Mr. DODARO. That is one of the few where everything is working well.

Mr. TURNER. What I think I learned is that we are just paying our taxes to a friendlier payee.

Mr. WALKER. The amount doesn't change, though.

Mr. TURNER. Right.

Thank you, Mr. Chairman. It has been a pleasure to have all of our witnesses before us today.

Mr. HORN. Well, I agree with you on that, and I must say I have suggested this in the past, but I don't get too many followings in the House on this. All Members of Congress should sit in the House of Representatives on April 15th with no tax advisors and make out their own 1040 Form, and file that one with a check. I think we would reform the tax laws so fast we wouldn't know what hit us. But you know, we are all getting a little comfortable with the Beardsley Rommel idea of withholding its source which, if we had to pay one big check at the end of the year with no withholding, that too would create a tax revolution. But apparently those ideas aren't acceptable to a majority here.

Let me just mention a few comments that I want to get out of you and your thoughts. One of our problems in these various financial statements that are before us involve the nuclear cleanup liability. Comptroller General, in your testimony you say the executive branch has significantly underestimated the future costs that

will be needed to clean up environmental contamination and the disposal of hazardous waste.

What is the amount that GAO has picked on this particular area?

Mr. WALKER. Mr. Chairman, it is difficult for us to estimate what the exact amount is. That is one of the reasons that this is a problem area. But we know that it is in the tens of billions of dollars range.

Mr. HORN. Would it be more than $100 billion? Because we are talking nuclear reactor waste, we are talking nuclear submarines being chopped up and their waste, and as I understand it, a lot of this occurs in the State of Washington, and we know nationwide we have this in the nongovernmental sector, hospitals, nuclear waste piled up waiting for disposal.

Mr. WALKER. It could be, but it is probably not, because there have been increases that have occurred over the last several years to increase the estimate of that liability, and I think as you know, Mr. Chairman, there is a range of issues here. It is not only with regard to the defense industry, for example, the decommissioning of nuclear subs, but it is also in the utility sector, the energy field with regard to nuclear power plants. It is a very serious issue, especially in light of base closings and other things where you have things that aren't nuclear, that there can be environmental issues associated with that as well that aren't nuclear related.

Mr. HORN. Well, I think we had the problem throughout the executive branch. One, the Department of Defense has a strong program in terms of cleaning up the environment on bases that have been closed. But I must say, I don't see much action in that area, and I think there should be a lot more. And we also have the problems in other agencies on their own assets that they really can't account for them and put a dollar figure on them, which is very hard. What is the dollar figure on Yellowstone? It is priceless. You don't have—$100,000 or $100 million wouldn't be relevant. How are we going to handle objects like that?

Mr. WALKER. Well, I think that is why we have to look at what is meaningful financial information to the Congress, to the President, and to the American public, and to the extent that it provides meaningful financial information, then we ought to express it in dollar amounts. To the extent that it really doesn't and it is more of a stewardship responsibility, there needs to be accountability—the numbers don't necessarily mean anything. We have to keep in mind what the purposes of these financial statements are and who the users are when we are thinking about things like heritage assets, such as monuments, national parks, even weapons systems. It is appropriate to have some accountability for the cost of weapons systems, but how significant is it to know what the discounted amortized cost of a B–2 bomber is? What are we going to be able to do with it? I doubt that we are going to have an alternative use for it.

Mr. HORN. Of all of the agencies that the General Accounting Office looked at, which agencies have the worst inventory records on their supplies and all the rest?

Mr. WALKER. DOD.

Mr. HORN. And that is known as the Department of Defense?

Mr. WALKER. That is correct, the Defense Department.

Mr. HORN. And they tell us they are low on munitions. So do they just not have a system that tells us where they have in warehouses all over the world, or what?

Mr. WALKER. They have real challenges with regard to the inventory area. Our high-risk report noted that there was about $22 billion, is that correct? It was about $22 billion worth of inventory items that they may have, they just don't know where they are. Now, obviously that creates difficulty in trying to decide how to utilize inventory when you need it, whether you ought to order any additional materials to replace it, how you can effectively secure it, a range of issues. And a lot of this is normal inventory items rather than major weapons systems.

Mr. DESEVE. Let me take the department's part in this in two ways. One, the department had systems for logistics and inventory that were controlled at various levels, they weren't necessarily centralized, and they didn't talk to their financial systems. Why? Never asked them to. We have never asked these questions before. So the department feels that it has good controls; they are not perfect controls, but good controls over its inventory and over its property. It has never had to do valuation before. The challenge of valuing Yellowstone is similar to the challenge of valuing Fort Ord or valuing some of the other properties that the department operates. So the valuation challenge remains and they are in the process of solving that problem.

But second, I think we have to be careful not to mix apples and oranges here in the sense of a field commander knowing where his inventory is, being able to get a logistics system to get him that information or get him that material quickly is one test. Having that under control, under good asset control, having a central agency or a subordinate—a superior officer being able to see several inventories is also very important. But the department I think would tell you that they believe they have adequate controls in lots of different places. GAO would suggest that controls could be better, the efficiency of the department and its effectiveness would be improved by having better visibility of these assets. I agree with both things.

Mr. WALKER. Mr. Chairman, if I could add on that, I think DOD, the Department of Defense is a good example. As I look at government, there are two dimensions—the business of government and the mission of government. Missions vary, depending upon what department and agency you are dealing with. But all aspects of government need to run from an economical and an efficient basis. If you look at DOD from an effectiveness standpoint, some of the logistical issues that Ed is talking about are clearly an "A" on effectiveness. We are No. 1 militarily, we have proved it time and time again. On the other hand, from the standpoint of economy and efficiency, at best they are a "D." We need to place a lot more time and attention on getting that grade up and freeing up billions of dollars for readiness, to close the delta on the needs versus wants versus affordability issue on critical weapons systems. Part of DOD's problem is that they have so many silos and mini silos and so many different systems nobody talks to each other. That is a

management problem which can affect effectiveness as well. Fortunately, it hasn't to a great extent.

Mr. HORN. I agree with you on that.

Mr. DODARO. Mr. Chairman, I might add, on the inventory area, the DOD inventory area, we at GAO have had that as one of our high-risk areas since 1990. There are problems in terms of keeping accurate inventories, and in some cases this is a contributing factor to over-purchasing in order to make sure everything is on hand. We are working with the department to try to improve their inventory-taking procedures to make sure that they have accurate perpetual inventories. They have so much inventory it is very difficult to use conventional end-of-the-year, wall-to-wall, inventory-taking type techniques. So they need to improve that.

The one positive thing I would say is that for the first time this past year, the logistical community and the acquisition community have engaged with GAO, the IGs, in undertaking efforts to work with the financial management community to support and fix some of these systems. Eighty percent of all of the information to prepare DOD's financial statements comes from outside the financial services arena, and in many cases their logistical records and some of the documentation and support of logistical records is not there as well.

Mr. HORN. I thank you.

I want to wind this up now. We might send a few questions to each of you for the record, and without objection, the question and answers will be put in at this point.

Let me first thank the staff that has worked on this hearing. J. Russell George, the staff director, chief counsel for the Government Management, Information, and Technology Subcommittee; Bonnie Heald, the director of communications, professional staff member; to my immediate left, the person that has had the most work on this particular subject is Larry Malenich, the detailee from the General Accounting Office; and Mason Alinger, the clerk for our subcommittee; and then our faithful interns, Paul Wicker, Kacey Baker, Richard Lukas; and for the minority we have Faith Weiss and Jean Gosa. Faith is the counsel, Jean is the clerk for the minority. Willie Green is staff assistant; and our two court reporters, Lee Dotson and Julie Bryan.

Let me just say in closing a few words. The financial story that we have portrayed over the last 2 hours probably is disconcerting to various taxpayers in the Nation, and I think we should all share with them, while progress has been made over 5 years. When we passed the act in the 103d Congress, we gave the executive branch 5 years to prepare for the first balance sheet in the history of the country. Well, progress is coming, but we sure have a lot more to do, and I will look to the Comptroller General, the Director of the Budget, and the Secretary of the Treasury working together, despite two branches of the Constitution being involved. I think our work has just begun in a lot of ways and we have a long way to go.

In terms of the ongoing series of financial oversight by this subcommittee, we have already held hearings on the Internal Revenue Service, on the Federal Aviation Administration, on the Department of Justice, and on the Health Care Financing Administration.

We will be going into this with other agencies, and health care financing in particular is one that concerns us, just as it concerns the administration. We would rather have all of that money that sometimes is overpayments or sometimes fraud, waste, and abuse in the program helping people, rather than sort of a loss to the Nation.

We will continue our oversight on the financial accountability of the Department of Defense next month. We have them scheduled for then. Clearly, we need strong leadership in this area, and often, as we all know, financial accountability sort of wears people out and they sort of start dozing and their eyes droop and all of that. But it is very important. This is the taxpayers' money, and we want to make sure it is put to good use.

I want to thank you again for coming and testifying and wish you all well. With that, we are adjourned.

[Whereupon, at 12 p.m., the subcommittee was adjourned.]