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A LOOK AT THE FISCAL YEAR 2010 CONSOLIDATED FINANCIAL REPORT OF THE U.S. GOVERNMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT ORGANIZATION, EFFICIENCY AND FINANCIAL MANAGEMENT

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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A LOOK AT THE FISCAL YEAR 2010 CONSOLIDATED FINANCIAL REPORT OF THE U.S. GOVERNMENT

WEDNESDAY, MARCH 9, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT ORGANIZATION,
EFFICIENCY AND FINANCIAL MANAGEMENT,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2247, Rayburn House Office Building, Hon. Todd Russell Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts, Lankford, Gosar, Farenthold, Issa, Towns, Cooper, Connolly, and Norton.

Staff present: Ali Ahmad, deputy press secretary; Robert Borden, general counsel; Sharon Casey, senior assistant clerk; John Cuaderes, deputy staff director; Linda Good, chief clerk; Frederick Hill, director of communications; Christopher Hixon, deputy chief counsel, oversight; Sery E. Kim, counsel; Tabetha C. Mueller, professional staff member; Cheyenne Steel, press assistant; Ronald Allen, minority staff assistant; and Beverly Britton Fraser, minority counsel.

Mr. PLATTS. The committee will come to order.

I apologize, one, for keeping both my colleagues and our witnesses waiting. I am coming from a breakfast meeting I was hosting for Pennsylvania National Guard and it was, while focused on maybe military issues, related to our discussion here today in that one of the takeaway points from the acting Adjutant General of the Pennsylvania Guard, General Craig, was the bargain, when we talk about trying to rein in spending and defense spending that the Army National Guard costs 5 percent of the total budget for the military, yet is 40 percent of the Army combat resources, and on the Air Guard 7 percent of the budget and about a third of the Air Force resources.

In other words, what a good bargain the Guard is when we try to wrestle with spending, how to deal with the out of control spending that we currently have. So a different issue, but related to what we are going to talk about here today.

The Subcommittee on Government Organization, Efficiency and Financial Management is gathered here today to talk a look at the fiscal year 2010 Consolidated Financial Report of the U.S. Government, prepared annually by the Office of Management and Budget and Treasury, in conjunction with each other, and audited by the

Government Accountability Office. This hearing will set the stage for our oversight of executive branch financial management systems throughout the 112th Congress, examining both Government-wide accountability issues and the fiscal implications of program spending decisions.

The financial statements in the accompanying audit present two separate but equally important issues of concern for the subcommittee. First is the story told by the numbers themselves, what the statements reveal about our fiscal future. Second is a process by which those numbers are derived, what the audit shows in terms of how well the Government keeps the books and demonstrates accountability.

Unfortunately, we have another disclaimer of opinion for 2010, which has been the case since the Government-wide audit was first required. When I was chairman of this subcommittee from 2003 to 2006, we looked at this report every year, and the issues seem to be almost the same 5 to 8 years later, and the challenges we are dealing with.

We would like to make some progress over the next 2 years, particularly in the area of improving internal controls, so that we can address the root causes of the problems that we are facing on the financial front. We would also like to bring more attention to financial management issues.

At our first hearing we were pleased to hear from members of the task force assembled by the Federal Accounting Standards Advisory Board to look at ways to improve the Consolidated Financial Report. Today we are honored to have the auditor of the report, as well as the authors. We have with us the Honorable Gene Dodaro, Comptroller General of the United States, with the Government Accountability Office, which is responsible for conducting the audit and for establishing governmentwide auditing standards and standards for internal control.

General Dodaro, we are delighted to have you with us. Always great to have a fellow Pennsylvanian here with us.

Also, we have the Honorable Daniel Werfel, Controller and Director of the Office of Federal Financial Management, Office of Management and Budget. This office oversees financial management practices at Federal agencies and prescribes the form and content of agency financial statements.

Finally, the Honorable Richard Gregg, First Assistant Secretary of the Department of the Treasury. Mr. Gregg's office is responsible for compiling the Consolidated Financial Report.

Certainly, thank each of you for being here today and, most importantly, your written testimony you provided and gave us a chance to look at ahead of time, and your oral testimony here today, as well as being willing to take questions. The insights that each and all of you have are so important to this subcommittee's work, and we are not just glad to have you here today, but look forward to partnering with you as we go forward over the next 2 years of this session and really doing our utmost to have the Federal Government be more accountable, more transparent, more efficient in how we use the resources of the American people. So thanks for your testimony.

With that, I would like to recognize the distinguished ranking member, former chairman of this subcommittee as well as the full committee, Mr. Towns, for an opening statement.

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

This hearing on the issue of the Federal Government's financial report for fiscal year 2010 is very timely and important, particularly as the body is working to finalize the Nation's budget. I thank you for holding it, Mr. Chairman and I noticed that some of the things that we are talking about and dealing with, we had when I was chairman, then had them when I was ranking, then had them when you were chairman. Now I hope that we can get rid of while I am ranking, because when I come back and I am chairman, I want these things to be gone.

Two weeks ago we held a hearing on how best to present the information contained in the Consolidated Financial Report so that it is clear and usable by Congress and the public. Today we get into the details of what the financial reports actually say about the financial conditions of this country.

For 14 years in a row, GAO has been unable to give an opinion on the audit of the Government's financial statements. As we have seen in the past, there are still serious financial management problems at the Department of Defense. There is a continuing problem with government agencies not reconciling their balance sheets for transactions they do with each other. And GAO is telling us that the process of preparing the Government's financial statement is ineffective. GAO has been reporting the same problems to Congress year in and year out for more than a decade.

Treasury reports that government agencies have greatly improved accounting for the transactions they do with each other. Happy to hear it. Mr. Gregg's written testimony says that the balance sheet difference fell from $102 billion in fiscal year 2009 to $40 billion in fiscal year 2010. This is encouraging and we are looking for continued improvement.

I am also aware that some government agencies have made substantial improvements in preparing their financial statements. It is commendable that 31 out of 35 of the largest government agencies have received clean audit opinions from GAO. Others, it seems, have stood still, didn't move. The DOD still needs to invest significant time and personnel resources in improving its financial statements. It is good to note that OMB and Treasury are working with DOD to resolve some of its more serious accounting weaknesses.

I have been hearing constant references to the shrinking window of opportunity for making policy changes to meet our ongoing challenges in producing credible financial reports. We still have too much work to do. I hope that the window is not closed by now.

I thank our panel of witnesses for their testimony and look forward to their observations of what further policy changes we can make and how we can improve the process of producing reliable financial statements.

Thank you, Mr. Chairman. On that note, I yield back.

Mr. PLATTS. Thank you, Mr. Towns.

Would any of the other Members like to make an opening statement?

[No response.]

Mr. PLATTS. The record will be kept open for 7 days if there is anything you want to submit in writing. If not——

Mr. CONNOLLY. Mr. Chairman, I just have an opening statement to insert in the record.

Mr. PLATTS. OK, without objection.

Mr. CONNOLLY. I thank the Chair.

Mr. PLATTS. With that, General Dodaro, if you would like to begin.

Actually, if we could have each of you rise for the oath.

Raise your right hands.

[Witnesses sworn.]

Mr. PLATTS. Thank you. Sorry about that.

General Dodaro.

STATEMENTS OF GENE L. DODARO, COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; DANIEL I. WERFEL, CONTROLLER, OFFICE OF MANAGEMENT AND BUDGET; AND RICHARD L. GREGG, FISCAL ASSISTANT SECRETARY, U.S. DEPARTMENT OF THE TREASURY

STATEMENT OF GENE L. DODARO

Mr. DODARO. Good morning, Mr. Chairman, Ranking Member Towns, Congressman Cooper, Connolly, and Gosar. It is very much of a privilege to be with you this morning to discuss the results of our audit of the 2010 financial statements of the U.S. Government. I commend you, Mr. Chairman, and this subcommittee for having this hearing. It is very important to make sure that there is sustained attention to look at the status of the outcomes of the financial audits across the Federal Government every year.

Now, this past year, as was mentioned in the opening statements, again, at the governmentwide Consolidated Financial Statement level, GAO was unable to give an opinion on the accrual-based financial statements of the U.S. Government. There are three main reasons for that: serious financial management problems at the Department of Defense; the inability of Federal agencies to properly account for intragovernmental activity and reconcile balances between agencies; and, last, an ineffective process for preparing the Consolidated Financial Statements.

We have made many recommendations to Treasury and OMB. They have implemented many; they are in the process of implementing others. So we are hopeful that there is continued progress in addressing these weaknesses.

Also, I would note in the 2010 statements we were unable to give an opinion on the statement of social insurance, which in the prior 2 years we were able to. This was due to management disclosures of significant uncertainties underlying the assumptions in preparing those statements.

Also, 2010 was the unveiling of a new statement of sustainability which shows the Federal Government's fiscal path over a long period of time. This is something that is a very good development and should aid the Congress and the citizens in understanding a long-term path. Now, this report and statement disclosed, similar to what was disclosed in GAO and CBO long-range simulations, that

the Federal Government is on an unsustainable fiscal path over a long period of time.

So we think this new statement of sustainability, along with the citizens guide that has been prepared now for a while, will be added education tools that can be used to help illustrate the serious financial challenges facing the Federal Government.

Now, if you go down from the governmentwide to the agency financial statements, the picture there is a big more encouraging. Twenty of the 24 largest Federal departments and agencies in the Federal Government were able to obtain an unqualified opinion. That is up from six in fiscal year 1996, which was the first year that all departments and agencies across the Federal Government were actually required to prepare financial statements and to have them audited. They have also been able to produce these statements on an accelerated timeframe and have moved now to being able to produce them 45 days after the close of the fiscal year, which is a good development as well.

Now, in addition, our report points out a couple of material weaknesses across the Federal Government. One is the problem of improper payments. The current estimate in the report is $125 billion. I am very encouraged, however, to report that by actions by the administration and the Congress, and this committee's support through passage of the Improper Payments Elimination and Recovery Act last year, there are efforts under way to tackle this problem.

But it is probably going to get worse before it gets better because not all agencies and programs are reporting right now any improper payments. But targets are being set, accountability is being fixed, and I think this is a very important endeavor, particularly given the serious challenges we have facing our Federal Government and from fiscal pressures. In addition, you have a $290 billion tax gap between taxes owed and taxes collected. So these areas are important for the Federal Government to tackle going forward.

So, in summary, Mr. Chairman, I think that it is very important for sustained attention to be made by the Congress. I would encourage this committee to have continuing hearings on these subjects. We just updated our high-risk list and testified before the full committee. A couple areas came off the list, but the lesson learned is through high level attention by departments and agencies, with sustained congressional oversight, progress is possible, it is needed, and given the fiscal pressure facing our Nation going forward, I believe financial management needs to be a top priority of the administration and the Congress.

I thank you for your time and attention. I would be happy to answer questions at the appropriate time.

[The prepared statement of Mr. Dodaro follows:]

United States Government Accountability Office

GAO

Testimony before the Subcommittee on Government Organization, Efficiency and Financial Management, Committee on Oversight and Government Reform, House of Representatives

For Release on Delivery
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FISCAL YEAR 2010 U.S. GOVERNMENT FINANCIAL STATEMENTS

Federal Government Continues to Face Financial Management and Long-Term Fiscal Challenges

Statement of Gene L. Dodaro
Comptroller General of the United States

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Highlights

Highlights of GAO-11-363T, a testimony before the Subcommittee on Government Organization, Efficiency and Financial Management, Committee on Oversight and Government Reform, House of Representatives

Why GAO Did This Study

GAO annually audits the consolidated financial statements of the U.S. government. Congress and the President need reliable, useful, and timely financial and performance information to make sound decisions and conduct effective oversight of federal government programs and policies.

Over the years, certain material weaknesses in internal control over financial reporting have prevented GAO from expressing an opinion on the accrual-based consolidated financial statements. Unless these weaknesses are adequately addressed, they will, among other things, continue to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; and (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities.

This testimony presents the results of GAO's audit for fiscal year 2010 and discusses certain of the federal government's significant long-term fiscal challenges.

What GAO Recommends

Over the years, GAO has made numerous recommendations directed at improving federal financial management. The federal government has generally taken or plans to take actions to address our recommendations.

View GAO-11-363T or key components. For more information, contact Jeanette M. Franzel or Gary T. Engel at (202) 512-2600.

March 9, 2011

FISCAL YEAR 2010 U.S. GOVERNMENT FINANCIAL STATEMENTS

Federal Government Continues to Face Financial Management and Long-Term Fiscal Challenges

What GAO Found

Three major impediments continued to prevent GAO from rendering an opinion on the federal government's accrual-based consolidated financial statements: (1) serious financial management problems at the Department of Defense, (2) federal entities' inability to adequately account for and reconcile intragovernmental activity and balances, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition to the material weaknesses underlying these major impediments, GAO noted material weaknesses involving billions of dollars in improper payments, information security, and tax collection activities. With regard to the Statement of Social Insurance (SOSI), GAO was unable to, and did not, express an opinion on the 2010 SOSI because of significant uncertainties discussed by management in the consolidated financial statements, primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2010 SOSI. GAO was, however, able to render unqualified opinions on the 2009, 2008, and 2007 SOSIs.

Since the enactment of key financial management reforms in the 1990s, the federal government has made significant progress in improving financial management activities and practices. For fiscal year 2010, 20 of 24 Chief Financial Officers (CFO) Act agencies were able to attain unqualified audit opinions on their accrual-based financial statements within an accelerated reporting timeframe, up from 6 CFO Act agencies for fiscal year 1996. Also, accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. Further, the preparation and audit of financial statements has identified numerous deficiencies, leading to actions to strengthen controls and systems.

Much work remains, however, to improve federal financial management. For example, it is essential that the Department of Defense, the Department of the Treasury, and the Office of Management and Budget, along with other federal entities, address the major impediments discussed above. Also, it is important for the individual federal departments and agencies to remain committed to maintain the progress that has been achieved in obtaining positive audit results and to build upon that progress to make needed improvements.

The *2010 Financial Report of the United States Government (Financial Report)* introduces the first sustainability statement required under a new financial reporting standard, which presents comprehensive long-term fiscal projections for the U.S. government. Such reporting provides a much needed perspective on the federal government's long-term fiscal position and outlook. The *Financial Report*, like the latest Congressional Budget Office long-term budget outlook and GAO simulations, shows that the federal government is on an unsustainable long-term fiscal path.

Mr. Chairman, Ranking Member Towns and Other Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss our report on the U.S. government's consolidated financial statements for fiscal years 2010 and 2009. Given the federal government's fiscal challenges, there is a significant need for transparency and for the Congress, the administration, and federal managers to have reliable, useful, and timely financial and performance information. Even though significant progress has been made since the enactment of key financial management reforms in the 1990s, our report on the U.S. government's consolidated financial statements illustrates that much work remains to improve federal financial management. Consequently, financial management needs to be a top priority of this administration and the new Congress. I would like to commend you, Mr. Chairman, and this Subcommittee, for continuing the annual tradition of oversight hearings on this important subject. Your involvement is critical to assuring continued progress.

Our testimony today discusses the following major issues relating to the consolidated financial statements for fiscal years 2010 and 2009: (1) the results of our audit, including continued major impediments to an opinion on the accrual-based consolidated financial statements[1] and certain significant uncertainties that resulted in us being unable to render an opinion on the 2010 Statement of Social Insurance;[2] (2) the effects of the recent economic recession and the federal government's actions to stabilize financial markets and promote economic recovery on the federal government's financial condition; and (3) challenges posed by the federal government's long-term fiscal outlook. We performed sufficient audit work to provide our report on the consolidated financial statements, internal control, and compliance with selected provisions of laws and regulations. We considered the limitations on the scope of our work in forming our conclusions. Our audit was conducted in accordance with U.S. generally accepted government auditing standards.

[1]The consolidated financial statements other than the Statement of Social Insurance are referred to as the accrual-based consolidated financial statements. Most revenues reported in these financial statements are recorded on a modified cash basis.

[2]We rendered unqualified opinions on the 2009, 2008, and 2007 Statements of Social Insurance.

Both the consolidated financial statements and our related audit report are included in the fiscal year *2010 Financial Report of the United States Government (Financial Report)*. Our audit report would not be possible without the commitment and professionalism of inspectors general throughout the federal government who are responsible for annually auditing the financial statements of individual federal agencies. The *Financial Report* was issued by the Department of the Treasury (Treasury) on December 21, 2010.[3] This report is available through GAO's Internet site, at http://www.gao.gov/financial/fy2010financialreport.html and Treasury's Internet site, at http://www.fms.treas.gov/fr/index.html.

Results of Our Audit of the U.S. Government's Consolidated Financial Statements for Fiscal Years 2010 and 2009

Since the enactment of key financial management reforms in the 1990s, the federal government has made significant progress in improving financial management activities and practices. For fiscal year 2010, 20 of 24 Chief Financial Officers (CFO) Act agencies were able to attain unqualified audit opinions[4] on their accrual-based financial statements within an accelerated reporting timeframe, up from 6 CFO Act agencies for fiscal year 1996. Also, accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. Further, the preparation and audit of financial statements has identified numerous deficiencies, leading to actions to strengthen controls and systems. It is important for the individual federal departments and agencies to remain committed to maintain the progress that has been achieved in obtaining positive audit results and to build upon that progress to make needed improvements.

Although this progress is commendable, the federal government was unable to demonstrate the reliability of significant portions of the U.S. government's accrual-based consolidated financial statements for fiscal years 2010 and 2009, principally resulting from limitations related to certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work. As a result, we were unable to provide an opinion on such statements. Further, significant

[3]Also, see GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-05-958SP (Washington, D.C.: September 2005). In September 2009, we issued an update to this guide to reflect recent changes to the federal accounting standards and resulting changes to the *Financial Report*; see GAO-09-946SP (Washington, D.C.: September 2009).

[4]See appendix I for the fiscal year 2010 audit results for the 24 CFO Act agencies.

uncertainties (discussed in Note 26 to the consolidated financial statements), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2010 Statement of Social Insurance, prevented us from expressing an opinion on that statement. We were, however, able to render unqualified opinions on the 2009, 2008, and 2007 Statements of Social Insurance.[5] Given the importance of social insurance programs like Medicare and Social Security to the federal government's long-term fiscal outlook, the Statement of Social Insurance is critical to understanding the federal government's financial condition and fiscal sustainability.

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the U.S. government's accrual-based consolidated financial statements. The underlying material weaknesses in internal control,[6] which generally have existed for years, contributed to our disclaimer of opinion on the U.S. government's accrual-based consolidated financial statements for the fiscal years ended 2010 and 2009.[7] Those material weaknesses relate to the federal government's inability to

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by the Department of Defense (DOD), were properly reported in the accrual-based consolidated financial statements;
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;

[5]We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance. Social insurance programs included in the Statement of Social Insurance are Social Security, Medicare, Railroad Retirement, and Black Lung.

[6]A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

[7]A more detailed description of the material weaknesses that contributed to our disclaimer of opinion, including the primary effects of these material weaknesses on the accrual-based consolidated financial statements and on the management of federal government operations, can be found on pages 238 through 244 of the *Financial Report*.

- support significant portions of the reported total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain federal entities;
- adequately account for and reconcile intragovernmental activity and balances between federal entities;
- ensure that the federal government's accrual-based consolidated financial statements were (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in conformity with U.S. generally accepted accounting principles (GAAP); and
- identify and either resolve or explain material differences between (1) certain components of the budget deficit reported in Treasury's records that are used to prepare the Reconciliation of Net Operating Cost and Unified Budget Deficit, the Statement of Changes in Cash Balance from Unified Budget and Other Activities, and the Fiscal Projections for the U.S. Government (included in the Supplemental Information section of the *Financial Report*) and (2) related amounts reported in federal entities' financial statements and underlying financial information and records.

These material weaknesses continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner.

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, we found the following three other material weaknesses in internal control.[8]

[8]A more detailed discussion of these weaknesses, including the primary effects of the material weaknesses on the accrual-based consolidated financial statements and on the management of federal government operations, can be found on pages 245 through 248 of the *Financial Report*.

These other material weaknesses were the federal government's inability to

- determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce improper payments,[9]
- identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and
- effectively manage its tax collection activities.

Also, many of the CFO Act agencies continue to struggle with financial systems that are not integrated and do not meet the needs of management for reliable, useful, and timely financial information. Often, agencies expend major time, effort, and resources to develop financial information that their systems should be able to provide on a daily or recurring basis.

Addressing Impediments to an Opinion on the Accrual-Based Consolidated Financial Statements

Three major impediments continued to prevent us from rendering an opinion on the U.S. government's accrual-based consolidated financial statements: (1) serious financial management problems at DOD that have prevented DOD's financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. Additional impediments, such as certain entities' fiscal year 2010 financial statements that, as of the date of our audit report, received disclaimers of opinion or were not audited, also contributed to our inability to render an opinion on the U.S. government's accrual-based consolidated financial statements. Extensive efforts by DOD and other entity officials and cooperative efforts between entity chief financial officers, Treasury officials, and Office of Management and Budget (OMB) officials will be needed to resolve these obstacles to achieving an opinion on the U.S. government's accrual-based consolidated financial statements.

Improving Financial Management at DOD

Given DOD's size and complexity, the resolution of its serious financial management problems is essential to achieving an opinion on the U.S. government's consolidated financial statements. Reported weaknesses in DOD's financial management and other business operations adversely

[9]Federal entities reported estimates of improper payment amounts that totaled $125.4 billion for fiscal year 2010, which represented about 5.5 percent of $2.3 trillion of reported outlays for the related programs.

affect the reliability of DOD's financial data; the economy, efficiency, and effectiveness of its operations; and its ability to produce auditable financial statements. Several DOD business practices, including financial management, continue to be included on GAO's list of high-risk programs designated as vulnerable to waste, fraud, abuse, and mismanagement[10] or in need of transformation.

To transform its business operations, DOD management must have reliable financial information. Without it, DOD is severely hampered in its ability to make sound budgetary and programmatic decisions, monitor trends, make adjustments to improve performance, reduce operating costs, or maximize the use of resources.

DOD continues to take steps toward resolving the department's long-standing financial management weaknesses. The department's Financial Improvement and Audit Readiness (FIAR) Plan, which defines DOD's strategy and methodology for improving financial management operations and controls, has continued to evolve and mature. DOD's Comptroller has established two priority focus areas—first, strengthening processes, controls, and systems that produce budgetary information and support the department's Statements of Budgetary Resources; and second, improving the accuracy and reliability of management information pertaining to mission-critical assets, including military equipment and real property, and validating improvement through existence and completeness testing. In 2010, DOD revised its FIAR strategy, governance framework, and methodology to support the DOD Comptroller's direction and priorities.

We are supportive of this initiative and believe that a focused and consistent approach may increase DOD's ability to demonstrate incremental progress toward auditability in the short term. Budgetary and asset-accountability information is widely used by DOD managers at all levels. As such, its reliability is vital to daily operations and management. In this regard, the U.S. Marine Corps (USMC) recently underwent an audit of its fiscal year 2010 Statement of Budgetary Resources (SBR). Although the auditors were unable to express an opinion on the USMC SBR, DOD indicated that the lessons learned from the audit will be applied to the fiscal year 2011 USMC SBR audit currently underway and shared with the other DOD components to assist them in their audit readiness efforts.

[10]GAO, *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011).

A key element of DOD's strategy is successful implementation of Enterprise Resource Planning (ERP) systems. However, inadequate requirements management, inadequate systems testing, ineffective oversight over business system investments, and other challenges have hindered the department's efforts to implement these systems on schedule and within budget. Effective and sustained leadership and oversight of the department's ERP implementation will be important to ensure that these important initiatives result in the integrated capabilities needed to transform the department's financial management and related business operations.

The Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (NDAA)[11] lists actions that DOD is required to take and include in its FIAR Plan. The NDAA requires the DOD Comptroller to, among other things,

- establish interim milestones for achieving audit readiness of DOD's financial statements consistent with the requirements of section 1003 of the National Defense Authorization Act for Fiscal Year 2010,[12] which requires DOD's financial statements to be validated as audit ready no later than September 30, 2017. The interim milestones shall include, for each military department and for the defense agencies and defense field activities, interim milestones for (1) achieving audit readiness for each major element of the Statement of Budgetary Resources, and (2) addressing the existence and completeness of each major category of assets, including military equipment, real property, and operating material and supplies; and
- examine the costs and benefits of alternative approaches to the valuation of DOD assets, select a valuation approach, and begin to prepare a business case analysis supporting the selected approach.

Important to the success of DOD's current priorities and the FIAR program are high-quality, detailed plans, and effective implementation at all levels. Long-term, to achieve financial statement auditability and improve financial management information, it will be important that DOD establish sound strategic planning and effective implementation across the department, and at all levels, with efforts that can be sustained through leadership transitions.

[11]Pub. L. No. 111-383, Div. A, Tit. VIII, § 881, 124 Stat. 4137, 4306 (Jan. 7, 2011).

[12]Pub. L. No. 111-84, Div. A, Tit. X, § 1003, 123 Stat. 2190, 2439-2441 (Oct. 28, 2009).

We are encouraged by continuing congressional oversight of DOD's business transformation and financial management improvement efforts and the commitment of DOD's leaders to implementing sustained improvements in the department's ability to produce reliable, useful, and timely information for decision making and reporting. We will continue to monitor DOD's progress in addressing its financial management weaknesses and transforming its business operations.

Reconciling Intragovernmental Activity and Balances

Federal entities are unable to adequately account for and reconcile intragovernmental activity and balances. For both fiscal years 2010 and 2009, amounts reported by federal entity trading partners for certain intragovernmental accounts were not in agreement by significant amounts. Although OMB and Treasury require the CFOs of 35 significant federal entities to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners, a substantial number of the entities did not adequately perform those reconciliations for fiscal years 2010 and 2009. As a result of these circumstances, the federal government's ability to determine the impact of the unreconciled differences between trading partners on the amounts reported in the accrual-based consolidated financial statements is significantly impaired.

GAO has identified and reported on numerous intragovernmental activities and balances issues and has made several recommendations to Treasury and OMB to address those issues. Treasury and OMB have generally taken or plan to take actions to address these recommendations. Treasury continues to take steps to help resolve material differences in intragovernmental activity and balances. For example, during fiscal year 2010, Treasury established additional focus groups, consisting of Treasury and agency personnel, to begin identifying and resolving certain reported material differences. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment by federal entities to fully implement guidance regarding business rules for intragovernmental transactions issued by OMB and Treasury as well as continued strong leadership by OMB and Treasury.[13]

[13]On November 8, 2010, Treasury issued the Treasury Financial Manual (TFM) Bulletin No. 2011-04, *Intragovernmental Business Rules*, which rescinded and supersedes TFM Bulletin No. 2007-03, *Intragovernmental Business Rules* (October 31, 2007). This guidance is effective for fiscal year 2011 and has updated the previous guidance to include, among other things, a new *Intragovernmental Dispute Resolution Request Form* to be certified by federal entity CFOs and disputes to be resolved by Treasury's Deputy Assistant Secretary—Accounting Policy, Office of Fiscal Assistant Secretary.

Preparing the Consolidated Financial Statements

While further progress was demonstrated in fiscal year 2010, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited entity financial statements, properly balanced, and in conformity with GAAP.[14] For example,

- Treasury's process did not ensure that the information in certain of the accrual-based consolidated financial statements was fully consistent with the underlying information in 35 significant federal entities' audited financial statements and other financial data.
- To make the fiscal years 2010 and 2009 consolidated financial statements balance, Treasury recorded net increases of $0.8 billion and $17.4 billion, respectively, to net operating cost on the Statement of Operations and Changes in Net Position, which it labeled "Unmatched transactions and balances."[15] Treasury recorded an additional net $3.8 billion and $8 billion of unmatched transactions in the Statement of Net Cost for fiscal years 2010 and 2009, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.
- Treasury's reporting of certain financial information required by GAAP continues to be impaired, and will remain so until federal entities, such as DOD, can provide Treasury with complete and reliable information required to be reported in the consolidated financial statements.

A detailed discussion of additional control deficiencies regarding the process for preparing the consolidated financial statements can be found on pages 240 through 243 of the *Financial Report*.

During fiscal year 2010, Treasury, in coordination with OMB, continued implementing corrective action plans and made progress in addressing certain internal control deficiencies we have previously reported regarding the process for preparing the consolidated financial statements. Resolving

[14]Most of the issues we identified in fiscal year 2010 existed in fiscal year 2009, and many have existed for a number of years. Most recently, in July 2010, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action in GAO, *Management Report: Improvements Needed in Controls over the Preparation of the U.S. Consolidated Financial Statements*, GAO-10-757 (Washington, D.C.: July 30, 2010).

[15]Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relate to net operating cost, it reported this amount as a component of net operating cost in the consolidated financial statements.

some of these internal control deficiencies will be a difficult challenge and will require a strong commitment from Treasury and OMB as they continue to execute and implement their corrective action plans.

Addressing Other Impediments

While not as significant as the major impediments noted above, financial management problems at the Department of Homeland Security (DHS) and the Department of Labor (Labor) also contributed to the disclaimer of opinion on the federal government's accrual-based consolidated financial statements for fiscal year 2010. About $28 billion, or about 1 percent, of the federal government's reported total assets as of September 30, 2010, and approximately $235 billion, or about 5 percent, of the federal government's reported net cost for fiscal year 2010 relate to these two agencies. The auditors for DHS and Labor reported that they were unable to provide opinions on the financial statements because they were not able to obtain sufficient evidential support for certain amounts presented in financial statements. For example,

- only selected DHS financial statements were subjected to audit, and the auditors stated that DHS was unable to provide sufficient evidence to support certain financial statements balances at the Coast Guard and Transportation Security Administration; and
- auditors for Labor reported that the department was unable to provide sufficient support for certain accounts in Labor's fiscal year 2010 financial statements.

The auditors for DHS and Labor made recommendations to address control deficiencies at the agencies, and management for these agencies generally expressed commitment to resolve the deficiencies. It will be important that management at each of these agencies remain committed to addressing noted control deficiencies and improving financial reporting.

Significant Uncertainties Result in Disclaimer of Opinion on 2010 Statement of Social Insurance

Because of significant uncertainties (as discussed in Note 26 to the consolidated financial statements), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2010 Statement of Social Insurance, we were unable to, and we did not, express an opinion on the 2010 Statement of Social Insurance.[16] The Statement of Social Insurance presents the actuarial present value of the federal

[16]About $22.8 trillion, or 74 percent, of the federal government's reported total present value of future expenditures in excess of future revenue for 2010 relate to the Department of Health and Human Services' 2010 Statement of Social Insurance, which received a disclaimer of opinion.

government's estimated future revenue to be received from or on behalf of participants and estimated future expenditures to be paid to or on behalf of participants, based on benefit formulas in current law and using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs.[17]

The significant uncertainties, discussed in further detail in Note 26 to the consolidated financial statements, include:

- Medicare projections in the 2010 Statement of Social Insurance were based on full implementation of the provisions of the Patient Protection and Affordable Care Act (PPACA),[18] including a significant decrease in projected Medicare costs from the 2009 Statement of Social Insurance related to (1) reductions in physician payment rates totaling 30 percent over the next 3 years and (2) productivity improvements for most other categories of Medicare providers. However, there are significant uncertainties concerning the achievement of these projected decreases in Medicare costs.

- Management has noted that actual future costs for Medicare are likely to exceed those shown by the current-law projections presented in the 2010 Statement of Social Insurance due to the likelihood of modifications to the scheduled reductions.[19] The extent to which actual future costs exceed the projected current-law amounts due to changes to the physician payments and productivity adjustments depends on both the specific changes that might be legislated and on whether legislation would include other provisions to help offset such costs.

- Management has developed an illustrative alternative projection intended to provide additional context regarding the long-term

[17]The projection period used for the Social Security, Medicare, and Railroad Retirement social insurance programs is 75 years. For the Black Lung program, the projections are through 2040.

[18]Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

[19]Subsequent to the date of our report, the Medicare and Medicaid Extenders Act of 2010, Pub. L. No. 111-309, § 101 overrode the scheduled reductions in physician payments through December 2011 and reduced non-Medicare outlays by limiting a health insurance tax credit.

sustainability of the Medicare program and to illustrate the uncertainties in the Statement of Social Insurance projections. The present value of future estimated expenditures in excess of future estimated revenue for Medicare, included in the illustrative alternative projection, exceeds the $22.8 trillion estimate in the 2010 Statement of Social Insurance by $12.4 trillion.

Effects of the Recent Economic Recession and Stabilization Efforts on the Federal Government's Financial Condition

The recent economic recession and the federal government's actions to stabilize financial markets and promote economic recovery continued to significantly affect the federal government's financial condition.

In December 2007, the United States entered what has turned out to be its deepest recession since the end of World War II. Gross domestic product (GDP) fell 4.1 percent from the beginning of the recession through the second quarter of 2009, which marked the recession's end. Since the end of the recession, GDP has grown slowly and unemployment remains at a high level.

As of September 30, 2010, the federal government's actions to stabilize the financial markets and to promote economic recovery resulted in assets of over $400 billion, which is net of about $75 billion in valuation losses. In addition, the federal government reported incurring significant liabilities and related net cost resulting from these actions. Although the federal government has received positive returns from investments in certain large financial institutions, it continues to report significant costs overall related to these actions. Because the valuation of the related assets and liabilities is based on assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions, actual results may be materially different from the reported amounts.

Actions taken to stabilize financial markets—including aid to the automotive industry—increased borrowing and added to federal debt held by the public. The revenue decreases and spending increases enacted in the American Recovery and Reinvestment Act of 2009 also added to borrowing and federal debt held by the public. Federal debt held by the public increased from 40 percent of GDP as of September 30, 2008, to 62

percent as of September 30, 2010.[20] The economic downturn and the nature and magnitude of the actions taken to stabilize the financial markets and to promote economic recovery will continue to shape the federal government's near-term budget and debt outlook. While deficits are projected to decrease as federal support for states and the financial sector winds down and the economy recovers, the increased debt and related interest costs will remain.

The ultimate cost of the federal government's actions to stabilize the financial markets and promote economic recovery will not be known for some time as these uncertainties are resolved and further federal government actions are taken in fiscal year 2011 and later. Looking ahead, it will be important for the federal government to continue to determine the most expeditious manner in which to bring closure to its financial stabilization initiatives while optimizing its investment returns.

Long-Term Fiscal Challenges

The 2010 *Financial Report* includes the first sustainability statement required under new financial reporting standards.[21] This statement presents comprehensive long-term fiscal projections for the U.S. government, expanding on similar information presented in recent years' financial reports and consistent with the fiscal simulations that GAO has published since 1992. This enhanced reporting will hopefully increase public awareness and understanding of the long-term fiscal outlook: both its overall size and the major drivers of that outlook. Information on the imbalance between revenues and spending currently built into the structure of the budget can help stimulate public and policy debates and help policymakers make more informed decisions about the overall sustainability of government finances.

[20]Federal debt held by the public relative to GDP is a function of the federal government's fiscal policy as well as overall economic conditions. Congress and the President have enacted laws to establish a limit on the amount of federal debt that can be outstanding at one time. Federal debt subject to the limit includes both debt held by the public and debt held by government accounts (intragovernmental debt holdings). In February 2011, we reported on the debt limit in GAO, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203 (Washington, D.C.: Feb. 22, 2011).

[21]Under such standards, the new statement will be audited beginning in fiscal year 2013.

For more than a decade, GAO has been running fiscal simulations to tell more about this longer-term story. The Congressional Budget Office (CBO) has also published long-term simulations for many years.

The federal government faced large and growing structural deficits—and hence rising debt—before the instability in financial markets and the economic downturn. Under the projections included in the *Financial Report* and under the most recent CBO and GAO simulations using a range of assumptions, these structural deficits—driven on the spending side primarily by rising health care costs and known demographic trends—lead to continuing increases in federal debt held by the public as a share of GDP, which is unsustainable.

Closing Comments

In closing, even though progress has been made in improving federal financial management activities and practices, much work remains given the federal government's long-term fiscal challenges and the need for the new Congress, the administration, and federal managers to have reliable, useful, and timely financial and performance information to effectively meet these challenges.

The recent economic recession and the federal government's actions to stabilize financial markets and promote economic recovery continued to significantly affect the federal government's financial condition. The accrual-based consolidated financial statements for fiscal year 2010 include, as they did for fiscal year 2009, substantial assets and liabilities resulting from these actions. The valuation of certain assets and liabilities is based on assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions. As such, there will be differences between the estimated values as of September 30, 2010, and the actual results, and such differences may be material. These differences will also affect the ultimate cost of the federal government's market stabilization and economic recovery actions. Going forward, a great amount of attention will need to continue to be devoted to ensuring (1) that sufficient internal controls and transparency are established and maintained for all financial stabilization and economic recovery initiatives; and (2) that all related financial transactions are reported on time, accurately, and completely.

Further, sound decisions on the current and future direction of all vital federal government programs and policies are more difficult without reliable, useful, and timely financial and performance information. In this

regard, for DOD, the challenges are many. We are encouraged by DOD's efforts toward addressing its long-standing financial management weaknesses and its efforts to achieve auditability. Consistent and diligent top management oversight toward achieving financial management capabilities, including audit readiness, will be critical going forward. Moreover, the civilian CFO Act agencies must continue to strive toward routinely producing not only annual financial statements that can pass the scrutiny of a financial audit, but also quarterly financial statements and other meaningful financial and performance data to help guide decision makers on a day-to-day basis. Federal entities' improvement of financial management systems will be essential to achieve this goal.

Moreover, of utmost concern are the federal government's long-term fiscal challenges that result from large and growing structural deficits that are driven on the spending side primarily by rising health care costs and known demographic trends. This unsustainable path must be addressed soon by policymakers.

Finally, I want to emphasize the value of sustained congressional interest in these issues, as demonstrated by this Subcommittee's leadership. It will be key that, going forward, the appropriations, budget, authorizing, and oversight committees hold the top leadership of federal entities accountable for resolving the remaining problems and that they support improvement efforts.

Mr. Chairman and Ranking Member Towns, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the Subcommittee may have at this time.

GAO Contacts and Acknowledgments

For further information regarding this testimony, please contact Jeanette M. Franzel, Managing Director, or Gary T. Engel, Director, Financial Management and Assurance, at (202) 512-2600. Key contributions to this testimony were also made by staff on the Consolidated Financial Statement audit team.

Appendix I: Fiscal Year 2010 Audit Results

Table 1: Chief Financial Officers (CFO) Act Agencies: Fiscal Year 2010 Audit Results and Principal Auditors

CFO Act agencies	Opinion rendered by agency auditor	Agencies' auditors reported material weaknesses or noncompliance[a]	Principal auditor
Agency for International Development	Unqualified	√	Office of Inspector General (OIG)
Agriculture	Unqualified	√	OIG
Commerce	Unqualified		KPMG LLP
Defense	Disclaimer	√	OIG
Education	Unqualified	√	Ernst & Young LLP
Energy	Unqualified		KPMG LLP
Environmental Protection Agency	Unqualified	√	OIG
General Services Administration	Unqualified		KPMG LLP
Health and Human Services	[b]	√	Ernst & Young LLP
Homeland Security	[c]	√	KPMG LLP
Housing and Urban Development	Unqualified	√	OIG
Interior	Unqualified	√	KPMG LLP
Justice	Unqualified		KPMG LLP
Labor	Disclaimer	√	KPMG LLP
National Aeronautics and Space Administration	[d]		Ernst & Young LLP
National Science Foundation	Unqualified		Clifton Gunderson LLP
Nuclear Regulatory Commission	Unqualified		Urbach Kahn & Werlin LLP
Office of Personnel Management	Unqualified	√	KPMG LLP
Small Business Administration	Unqualified	√	KPMG LLP
Social Security Administration	Unqualified		Grant Thornton LLP
State	Unqualified	√	Kearney & Company
Transportation	Unqualified		Clifton Gunderson LLP
Treasury	Unqualified	√	KPMG LLP
Veterans Affairs	Unqualified	√	Clifton Gunderson LLP

Source: GAO.

[a]Reported noncompliance with applicable laws and regulations and/or substantial noncompliance with one or more of the Federal Financial Management Improvement Act requirements.

[b]The auditors expressed an unqualified opinion on the Department of Health and Human Services' fiscal year 2010 accrual-based financial statements, but not on the department's 2010 Statement of Social Insurance. The auditors were unable to render an opinion on that financial statement.

[c]For fiscal year 2010, only the Consolidated Balance Sheet and the related Statement of Custodial Activity of the Department of Homeland Security were subject to audit; the auditors were unable to express an opinion on these two financial statements.

[d]The auditors of the National Aeronautics and Space Administration's fiscal year 2010 financial statements issued a qualified opinion because of the affect of certain matters related to property, plant, and equipment and operating materials and supplies balances.

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Mr. PLATTS. Thank you, General Dodaro.
Mr. Werfel.

STATEMENT OF DANIEL I. WERFEL

Mr. WERFEL. Thank you, Chairman Platts, Ranking Member Towns, Congressman Cooper, Congressman Connolly, and Congressman Gosar, and other members of the subcommittee for the invitation to be here today to discuss the Consolidated Financial Report of the United States and Federal financial management.

Improvements in financial management are paramount to the effectiveness stewardship of taxpayer dollars. The annual results of agency financial statement audits are an important indicator of progress in carrying out our stewardship responsibilities effectively. For the past several years, the vast majority of Federal agencies have achieved an unqualified or clean opinion on their annual financial statements, and auditor-identified weaknesses across the Government have been steadily declining.

As Mr. Dodaro just pointed out, fiscal year 2010 was somewhat of a high watermark for us in terms of 20 of the 24 major CFO Act agencies achieving a clean opinion. Also worth noting that we reported 31 auditor-identified material weaknesses across government. When you compare that to the 61 material weaknesses that were reported in 2000, you see that steady progress was made across the last decade.

Mr. Dodaro also pointed out that all major agencies are meeting the 45-day deadline for producing audited financial statements, a timeframe that actually exceeds the official statutory deadline of reporting by more than 100 days.

Of course, although we are making great progress, not all of our financial audit goals have been met. In particular, four agencies did not achieve a clean opinion in fiscal year 2010, which in part led to the disclaimer on the Government-wide financial statement. Our office is committed to working with those agencies to make the necessary improvements in financial reporting practices so that all agencies achieve acceptable results on their annual audits.

While audit results signal financial management success in many areas, there are critical financial management objectives not currently evaluated or addressed through standard financial statement audit activities. Informed by recent discussions surrounding the 20-year anniversary of the CFO Act and my experience as the day-to-day leader of Federal financial management efforts across government, I believe there are three improvements to our financial reporting model that represent the greatest opportunity to drive bottom-line results for taxpayers: first, improving reporting on where Federal taxpayer dollars are spent; second, instituting stronger internal controls to mitigate government waste and error; and, third, increasing access to reliable information on the cost of agency operations.

As highlighted in my written testimony, while the current financial audit process does not address these issues directly or comprehensively, the administration and the Federal financial management community are focused on improving results in these areas. In particular, through the Accountable Government Initiative launched by this administration, we are preventing and increasing

the recoveries of improper payments, eliminating unneeded real estate, turning around underperforming technology modernization projects, creating performance benchmarks for improved financial operations, and providing unprecedented transparency into Federal spending.

Important early results are being achieved. I thank Mr. Dodaro for recognizing the efforts that the executive branch is undertaking to attack the improper payments problem. In fiscal year 2010 we saw a decrease in the overall governmentwide improper payment rate, and that decrease helped prevent $3.8 billion in improper payments that would have otherwise been made. Also, Federal agencies recaptured $687 million in improper payments made to contractors and vendors. That is a 300 percent increase in recoveries from the prior year, fiscal year 2009.

Despite this progress, more work and tools are needed to address improper payments. I think it is important for me to note that the President's 2012 budget recognizes this and includes in that budget a suite of program integrity proposals that, if enacted, would result in over $160 billion in savings over 10 years.

I would like to also mention that the President's budget includes a bold new proposal related to civilian real estate. In 2010, the President directed agencies to accelerate efforts to realign civilian real property and save $3 billion by fiscal year 2010. The President's new proposal builds on the success so far and expands that savings opportunity to $15 billion. This is achieved through the creation of an independent board that will make recommendations for up or down vote by Congress on the elimination or consolidation of excess Federal civilian assets, including realignment and streamlining of agency field offices.

In sum, we have built a foundation of strong accounting practices, internal controls and reporting processes that are leading to better audit results. This has positioned us to achieve better bottom line results in terms of error reduction and cost efficiencies. But our work is not done and I am confident it will continue to drive critical improvements in all areas of Federal financial management.

Thank you for inviting me to testify today. I look forward to answering your questions.

[The prepared statement of Mr. Werfel follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
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Testimony of Daniel I. Werfel
Controller, Office of Management and Budget
before the
Subcommittee on Government Organization, Efficiency, and Financial Management
House Committee on Oversight and Government Reform
March 9, 2011

Thank you, Chairman Platts, Ranking Member Towns, and members of the Subcommittee, for the invitation to discuss the Consolidated Financial Report of the United States Government (*Financial Report*) and Federal financial management with you today.

Improvements in financial management are paramount to the effective stewardship of taxpayer dollars. Specifically, sound financial management enables reliable public reporting of the Government's finances, robust internal controls to mitigate the risks of error and fraud in Government programs, and timely reporting of information to agency decision-makers on day-to-day and longer-term management challenges.

The annual results of agency financial statement audits are an important indicator of progress in carrying out these activities effectively. For the past several years, the vast majority of Federal agencies have achieved an unqualified or "clean" opinion on their annual financial statements and auditor-identified weaknesses across government have been steadily declining. However, not all of our financial audit goals have been met. In particular, four agencies did not achieve a clean opinion in FY 2010, which in part, led to a disclaimer on the government-wide financial statements. The Office of Management Budget (OMB) is committed to working with agencies to make the necessary improvements to financial reporting practices so that all agencies achieve acceptable results on their annual audits.

While audit results signal financial management success in many areas, there are critical financial management objectives not currently evaluated or addressed through standard financial statement audit activities. The recent 20-year anniversary of the Chief Financial Officers Act of 1990 (CFO Act) has sparked a new and important dialogue among Federal financial management stakeholders concerning the gaps in our current reporting process and how best to close them. Informed by these discussions and my experience as the day-to-day leader of Federal financial management efforts across government, I believe there are three improvements to financial reporting that represent the greatest opportunity to drive bottom-line results for taxpayers –

(i) Improving reporting on where Federal taxpayer dollars are spent;
(ii) Instituting stronger internal controls to mitigate government waste and error; and
(iii) Increasing access to reliable information on the cost of agency operations.

As highlighted in my testimony below, while the current financial audit process does not address these issues directly or comprehensively, the Administration and the Federal financial community are focused on improving results in these areas. In particular, through the Accountable Government Initiative, we are preventing and increasing recoveries of improper payments, eliminating unneeded real estate, turning around underperforming technology modernization projects, creating performance benchmarks for improved financial operations, and providing unprecedented transparency into Federal spending.

Over the longer-term, we look forward to working with this Subcommittee and the broader community on aligning these areas so that our tireless efforts to obtain improved audit results serve as a more effective reinforcement of our equally tireless efforts to drive down government waste and make Federal spending more transparent for the public.

2010 Audit Results

Since the implementation of the CFO Act, Federal agencies have made important progress in producing reliable and timely financial statements that can pass the scrutiny of an independent auditor. In FY 2010:

- Twenty of the 24 CFO Act agencies achieved an unqualified or "clean" opinion, as compared to 18 of 24 unqualified opinions in FY 2001;
- We reported 31 auditor-identified material weaknesses, as compared to 61 material weaknesses reported in FY 2000; and
- All major agencies met the 45-day deadline for producing audited financial statements at year-end, a timeframe that exceeds the official statutory deadline for financial reporting by more than 100 days.

However, weaknesses in basic financial management practices continue to prevent four major agencies, and the Government as a whole, from achieving an unqualified audit opinion. The Departments of Defense, Homeland Security, and Labor, as well as the National Aeronautics and Space Administration experienced difficulty, such as implementing a new financial system and reporting on property, plant, and equipment, in achieving an unqualified audit opinion.

One of the largest organizations in the Government, the Department of Defense (DOD), faces several challenges in obtaining an unqualified audit opinion largely due to the size and complexity of the Department. In addition, DOD's financial processes were established many years ago and designed for budgetary accounting, not proprietary or financial accounting. Accordingly, much of DOD's systems and processes cannot meet the financial accounting standards called for in the CFO Act. DOD is fully committed to having auditable financial statements by 2017 as mandated by Congress.

To achieve this goal, DOD has established a streamlined path forward that is segmented and focuses on improving information the Department uses most to manage

amount and location of mission critical assets. This new approach has resulted in broader support and participation throughout the Department. To further these efforts, DOD has increased resources dedicated to obtaining auditable financial statements and established a strong, visible governance structure • • •

Federal agencies operate and maintain more real property assets than are needed. This includes 14,000 assets currently designated as excess and 55,000 buildings identified as under- or not-utilized. In June 2010, the President directed agencies to accelerate efforts to remove excess and surplus property for a savings of $8 billion by the end of 2012. The Department of Defense is on track to achieve $5 billion in real property cost savings through the Base Realignment and Closure (BRAC) process. To date, Federal agencies have identified $1.7 billion of the $3 billion in non-defense savings opportunities that the President has requested. This year the President introduced a proposal in his 2012 Budget that will significantly expand on our current efforts. The proposal creates a corporate-like Board that recommends for Congressional action the elimination or consolidation of excess civilian Federal assets, and the realignment and streamlining of agency field operations. The Board's recommendations will go directly to a floor vote in Congress, where only a "no" vote would prevent the recommendations from moving forward, ensuring that the recommendations are considered as a whole and in an expedited manner. The proposal aligns with the Administration's goal to reduce the Government's carbon footprint and addresses a Fiscal Commission recommendation to target excess Federal real estate as part of our deficit reduction efforts.

- Decreasing the Cost of Financial System Modernizations. Complexity and inefficiency in our financial management operations have led to an increasingly expensive environment for modernizing financial systems. Also, once deployed, our modern systems do not consistently meet our business needs or produce the right information to support decision-making. In June, OMB instituted a review of agency financial system modernizations to identify opportunities to accelerate deployment on mission critical functionality and reduce the cost and complexity of the overall project. To date, 20 agencies have reviewed and realigned their financial system plans through splitting projects into smaller, simpler segments with clear deliverables; focusing on the most critical business needs first; and ensuring ongoing, transparent project oversight. As a result, agencies are more focused on their core business priorities while still being held accountable for demonstrating results.
- Driving Efficiencies Through Benchmarking. In order to drive business intelligence and improve performance, OMB has partnered with Federal Agencies to develop benchmarks for financial management functions. These metrics will compare similar processes across agencies and identify best practices and common challenges. Ultimately, these benchmarks will be used to significantly increase business intelligence for driving functional efficiencies and cost analysis.
- Improving Data Quality for Federal Spending Information. Ensuring the quality of Federal spending information has been central to OMB's efforts in implementing the Federal Funding Accountability and Transparency Act. Access to both prime --- and now sub-award --- data offers the public unprecedented amounts of information on Federal spending. This increased transparency will ensure that the Federal Government is held

fully accountable for the administration of Federal programs. Notwithstanding these accomplishments, efforts must continue to address data quality concerns.

Aligning Financial Reports to the Citizens' Bottom Line

As noted above, the achievement of a clean audit opinion is an important indicator of financial management success, but there are critical financial management objectives not currently captured in our financial statements and audit. Accordingly, OMB in coordination with the Chief Financial Officers' Council (CFOC) is evaluating enhancements to the Federal Reporting Model. The CFOC formed a Reporting Model Task Force to review the current reporting model and provide recommendations on improvements to achieve a better use of resources and better alignment with the financial management environment.

The task force, comprised of both auditors and preparers from the Federal financial management community, identified three areas for improving the current model to better serve the user in today's financial management environment. First, the task force recommended that agencies focus resources on management and taxpayers' needs by developing a new Statement of Spending that shows how and where money was spent. A Statement of Spending would provide a high-level view of how agencies are spending taxpayer money. Implementation of this recommendation will respond to public and management needs and provide needed information for decision-making. As a result, OMB will pilot this Statement in 2011.

Second, the task force recommended that agencies focus resources on increasing the reliability of internal controls by requiring audits of agencies' internal controls for certain high risk areas beyond basic accounting and financial reporting. This recommendation would strengthen accountability throughout the Government by focusing on targeted reviews of programmatic and related financial data. Implementation of this recommendation will help maintain accountability and discipline in the agencies that were achieved through the audited financial statement process.

Third, the task force recommended that the federal government focus asset and liability reporting at the Government-Wide level with a more focused audit on internal controls at the agencies to mitigate fraud, waste, and abuse. The audit coverage of this data for the agencies would be limited to items significant at the Government-Wide level and high-risk areas in the agencies. This approach could also enable more robust requirements around the availability of reliable and timely data on the cost of agency operations. Implementation of this recommendation would maintain accountability to the public at the government-wide level and permit a refocus of resources at the agency level, providing an efficient use of limited resources.

Closing

The Financial Management Community has made critical progress over the last year – decreasing the Government-wide Improper Payment rate resulting in $3.8 billion less in estimated improper payments, increasing the amount of recaptured improper payments by approximately 300 percent, and identifying $1.7 billion in non-defense savings opportunities with real property. Despite this progress, financial managers need to move beyond the status quo to address the sweeping challenges in the Government today. The financial management

environment is changing from producing annual audited financial statements to producing financial reports more frequently, at a more granular level, and accompanied by non-financial information. Identifying continued improvements by reviewing what we have achieved during the last 20 years and what would like to achieve during the next 20 years is vital to the Federal financial community—particularly as we enter a new era of accountability, transparency, and open government.

We look forward to working with the Congress, GAO, and the CFO community to achieve our mutual goal of providing reliable and relevant financial information in a readily available and easily accessible format.

Thank you for inviting me to testify today. I look forward to answering your questions.

Mr. PLATTS. Thank you, Mr. Werfel.

Before I go to Mr. Gregg, we are delighted and honored to be joined with the full committee chairman, Mr. Issa.

Mr. Gregg.

STATEMENT OF RICHARD L. GREGG

Mr. GREGG. Thank you, Chairman Platts, Ranking Member Towns, members of the subcommittee, for inviting me to testify today on the financial report for fiscal year 2010 and the audit. Your interest in improving financial management is greatly appreciated.

The financial report is prepared from all the financial statements of the 35 largest Federal agencies and other information provided by more than 100 smaller independent agencies. In fiscal year 2010, 31 of the largest agencies earned unqualified or clean audit opinions on their financial statements.

For fiscal year 2010, as Gene had mentioned, the GAO was again unable to express an opinion on the governmentwide financial statements, including the statement of social insurance. The disclaimer on the remainder of the statements stems from three longstanding material weaknesses: first, serious financial reporting issues at the Department of Defense; second, the Government's inability to adequately account for and reconcile intragovernmental activity and balances between agencies; and, third, the Government's deficiencies in the process for preparing the consolidated financial statements.

I will cover a few key issues included in the financial report and, following that, I will talk about some of the financial management improvements we are working on with OMB and other agencies.

As noted in the financial report, the Government's budget deficit for fiscal year September 30, 2010, decreased slightly, from $1.4 trillion to $1.3 trillion. On an accrual basis, the Government net operating costs for fiscal year 2010 increased from $1.3 trillion to $2.1 trillion, due primarily to substantial increases in estimated actuarial costs for veteran benefits and Government employee programs, which are not reflected in the budget deficit. The Government's recorded total assets of $2.7 trillion and total liabilities of $16 trillion, comprised largely of $9 trillion in debt held by the public and $5.7 trillion in Federal employee and veteran liabilities.

The financial report also discusses the long-term fiscal challenges of funding Social Security, Medicare, and other social insurance programs. The Government's financial statements currently project a social insurance shortfall of $31 trillion over 75 years. The important message conveyed in this year's report is consistent with previous years that the sooner action is taken to resolve these shortfalls, the smaller the revenue increases and/or spending decreases necessary to return the Nation to a fiscally sustainable path.

The Department of Treasury, in cooperation with GAO and OMB, issues a annual citizens guide, and this 10-page document utilizes user-friendly graphs and charts to provide a summary of the financial report's key information to the public.

I would like to now talk about a number of initiatives that were taken over the past year to improve this report and financial management in general.

We have reduced differences in transactions between agencies in fiscal 2010 from $102 billion to $40 billion on an absolute value basis. We have reduced the number of GAO audit findings from over 150 to 52 in fiscal year 2009. OMB, Treasury, and DOD are focusing on a few key areas to resolve DOD accounting and processes. We will then move on and broaden the scope of the work of DOD.

Another issue we are working on is creating a general fund, and this fund will provide dual entry accounting for some of the central government activities. This was not included in the accounting system that we have developed over the years; this has been a gap, in my view, of the accounting process, and we are in the process of filling that gap.

Treasury is also expanding the governmentwide electronic invoice portal that will enable Government agencies and vendors to improve control, streamline purchases, and reduce costs. We are also working with OMB and agencies to develop a system and process that will resolve longstanding differences in transactions when one agency does business with another. Also, Treasury has, in the last 6 months or so, expanded the use of electronic transactions for payments, savings bonds, and tax collections. These three initiatives, when fully implemented, will save $600 million over the first 5 years.

We have also taken steps to sharply increase the debt collection within Treasury. We are looking to expand that to at least $5 billion over the next 10 years. In a couple days you will have a hearing with Commissioner Lebryk on debt collection.

Finally, Treasury is supporting OMB to reduce improper payments by establishing and supporting the administration's VerifiedPayment.gov portal to prevent ineligible recipients from receiving payments from the Federal Government.

Treasury looks forward to continuing its good working relationship with OMB and GAO and the agencies to make further improvements in financial management reporting and financial management in general.

That concludes my statement. Thank you very much.

[The prepared statement of Mr. Gregg follows:]

Statement of Richard L. Gregg
Fiscal Assistant Secretary
U.S. Department of the Treasury

House Committee on Oversight and Government Reform
Subcommittee on Government Organization, Efficiency, and Financial Management

March 9, 2011

Chairman Platts, thank you for inviting me to the Subcommittee's hearing to discuss the Fiscal Year (FY) 2010 Financial Report of the United States Government (Financial Report) and the related audit. Your interest in improving Federal financial management is greatly appreciated.

The Financial Report of the U.S. Government provides the President, Congress, and the American people with a comprehensive view of the Federal Government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The Report also discusses important financial issues and significant conditions that may affect future operations. This year's Report gives emphasis to two key issues: the Government's ongoing efforts to strengthen the economy and create jobs, and the need to achieve fiscal sustainability over the medium and long term.

Fiscal Year 2010 Audit Results

The Financial Report is prepared from audited financial statements of the 35 largest Federal agencies, and other information provided by more than 100 smaller, independent agencies. In FY 2010, 31 of the largest agencies earned unqualified, or "clean", opinions on their financial statement audits.

For Fiscal Year 2010, the Government Accountability Office (GAO) was again unable to express an opinion on the government-wide financial statements, including the Statement of Social Insurance which was impacted by the delayed issuance of the Social Security and Medicare Trustees Reports.

The disclaimer on the remaining statements stems from three groups of long-term material weaknesses:

1. Serious financial reporting issues at the Department of Defense.
2. The Government's inability to adequately account for and reconcile intragovernmental activity and balances between agencies.
3. The Government's deficiencies in the process for preparing the consolidated financial statements.

As I will elaborate on later in this testimony, Treasury, working in cooperation with OMB and GAO, is actively pursuing a number of strategies and solutions to resolve these weaknesses and improve financial management across the Federal government.

Financial Highlights

As noted in the Financial Report, the Government's budget deficit, for the fiscal year ended September 30, 2010, decreased slightly from $1.4 trillion to $1.3 trillion. On an accrual basis the Government's net operating cost for fiscal year (FY) 2010 increased from $1.3 trillion to $2.1 trillion due primarily to substantial increases in estimated actuarial costs for the veteran benefit and Government employee programs that are not reflected in the budget deficit.

Revenues remained relatively stable in 2010 after a more than $450 billion decrease in 2009. Notably, corporate tax revenues increased nearly 40 percent in FY 2010.

The Government recorded total assets of $2.7 trillion and total liabilities of $16 trillion, comprised largely of $9 trillion in debt held by the public and $5.7 trillion in Federal Employee and Veterans Benefit liabilities.

The Government's balance sheet also reflects that many investments made pursuant to the economic recovery efforts have been repaid or are generating positive returns. For example, Treasury has disbursed $387.7 billion in direct loans and investments through the Troubled Asset Relief Program (TARP) through September 30, 2010. Over half ($204.1 billion) of those TARP funds have been repaid, and the investments generated $27.8 billion from cash received through interest dividends and the proceeds from the sale and repurchase of assets in excess of cost. As of September 30, 2010, TARP had $179.2 billion in gross outstanding direct loans and equity investments, valued at $142.5 billion.

Fiscal Sustainability

The Financial Report also discusses the long-term fiscal issues surrounding the funding of the Social Security, Medicare, and other social insurance programs.

The Statements of Social Insurance (SOSI) provide estimates of the status of the most significant social insurance programs: Social Security, Medicare, Railroad Retirement (RRB), and Black Lung. The estimates are actuarial present values of the projected expenditures and related revenues for the programs over a 75-year period (except for Black Lung) assuming current law remains in place indefinitely. Projections are based on the economic and demographic assumptions representing the trustees' best estimates as set forth in the Trustees Reports for Social Security and Medicare and in the annual financial statements for the Railroad Retirement Board and the Department of Labor (Black Lung).

The 2010 SOSI currently projects a social insurance shortfall of $31 trillion over 75 years, compared to $46 trillion in FY 2009. The important message conveyed in this year's report is consistent with previous years: that the sooner action is taken to resolve these shortfalls, the smaller the revenue increases and/or spending decreases necessary to return the Nation to a fiscally sustainable path.

The Citizen's Guide and the Financial Report on the Web

The Treasury Department, in cooperation with GAO and the Office of Management and Budget (OMB), issues an annual *Citizen's Guide*. This 10-page document summarizes the Financial Report's key information with the aid of "user-friendly" tables and charts. In addition, within the past month, the Treasury Department launched an enhanced Financial Report website. This improved site allows readers to: (1) more quickly and easily navigate through the Report, (2) view the source information for the Report's charts and graphs, and (3) access other related sites and information.

IMPROVING FINANCIAL MANAGEMENT

The Treasury Department, in cooperation with OMB and GAO, are actively pursuing a number of solutions and strategies aimed at resolving the long-standing Governmentwide audit weaknesses and improving financial management across the Government:

Addressing the Audit Weaknesses:

- DOD, Treasury, GAO, and OMB have agreed on and DOD is implementing a strategy to resolve some of DOD's more significant accounting and audit weaknesses, initially targeting important management information for expedient resolution and then focusing on other areas for future resolution.
- Treasury efforts have resulted in resolving tens of billions of dollars in intragovernmental imbalances. The absolute value of the intragovernmental differences fell from $102 billion in FY 2009 to $40 billion in FY 2010. Over the past few years, differences stemming from Treasury's borrowing and investment activities have been reduced from $20 billion to $167 million. Treasury intends to expand its detailed analytical approach during FY 2011. While good progress has been made, much work remains.
- It should be noted that while much work remains to resolve these weaknesses, we have reduced the number of GAO audit findings from over 150 to just 52 in FY 2009.
- The Department is currently developing a central account or 'General Fund' against which millions of transactions across hundreds of agencies can be reconciled and validated – a long unfulfilled need in the Federal Governments accounting process. With implementation expected in the next couple of years, this will be the cornerstone of the strategy to resolve this weakness.
- Treasury is developing a standard, government wide electronic invoice portal. Vendors can use the portal to submit invoices against any government purchase order. This will significantly reduce invoicing burdens and allow both agencies and their vendors to verify the current status of a payment on line. This effort will reduce costs and improve service.
- Treasury is developing a system and process to help resolve long-standing weaknesses in intragovernmental transaction processing and reconciliation. Agencies devote significant resources attempting to reconcile these transactions. Resolving this issue will reduce costs and improve the accuracy of financial transactions.

Other Financial Management Improvement Strategies and Actions:

- Treasury has expanded the use of electronic transactions, initiating plans to gradually eliminate paper check benefit payments, discontinue paper savings bond purchases, and discontinue paper tax deposits by businesses. These initiatives will reduce costs and increase efficiency. This effort is estimated to save $600 million in the next five years.
- Treasury, working with OMB, has taken steps to significantly increase the collection of delinquent debt by more than $5 billion over the next 10 years.
- Finally, Treasury is supporting OMB to reduce improper payments by establishing and supporting the Administration's VerifyPayment.gov portal to prevent ineligible recipients from receiving payments from the Federal government.

Conclusion

The information collected in the Financial Report of the U.S. Government and annual agency financial reports can have a significant impact on ensuring effective management and control of the Government's finances.

The process of preparing the Financial Report is a complex one – dependent upon the coordinated efforts of thousands of dedicated personnel across hundreds of agencies. These individuals and organizations should be commended for their tremendous efforts each year to improve and ensure the integrity of the Federal Government's financial information. While vast improvements have been made in Federal financial management in recent years, opportunities for improvement remain, and budget realities compel us all to find ways to not only make the financial reporting process more effective and efficient. Treasury looks forward to working with OMB, GAO, and the many Federal agencies to improve Federal financial management.

Thank you, Mr. Chairman. This concludes my testimony. I look forward to your questions.

Mr. PLATTS. Thank you, Mr. Gregg. And we do look forward to our hearing on Friday on debt collection and working closely with Treasury and your recommendations of changes in law that may be necessary to strengthen debt collection efforts.

We will begin a questioning round, 5 minutes each, and hopefully we will have time to come back around for a second time.

I am going to begin with the big picture and the issue of sustainability and the statement of sustainability, kind of a new addition here to the CFR, and the very stark statement, General Dodaro, that you included in your written statement, that we cannot sustain the level of public debt that we are taking on driven by a number of issues, demographics and medical costs in particular.

In the big picture—and I think I know the answer you are going to give, but I don't want to put words in your mouth—when we look at that issue of sustainability, the direction we are heading and the amount of debt we have and are taking on without significant changes, what would be the No. 1 recommendation that you think we as a Congress should be looking at to change that trend, that debt level trend to get us back onto a sustainable level? What category spending or area? What is your most important recommendation?

Mr. DODARO. The size of this problem is so large that the Government has to look at entitlement spending, revenues, and discretionary spending. Everything needs to be looked at in the Federal budget and dealt with in order to bring this problem under control. And I think it is being driven largely by rising spending and health care costs and demographic changes, as you point out. Those are the primary drivers, but the solution is something that needs to be holistically looked at across the spectrum of the Federal Government's activities. If that is not done, this will not be solved.

Mr. PLATTS. Is it accurate for me to say, though, and I agree with everything has to be on the table and looked at to be more responsible in our spending, but the specific issue of entitlements, that given that they are now roughly two-thirds of our expenditures, that while we can make improvements in discretionary across the board, including defense, unless we get our hands around entitlements and specifically Medicare spending, that everything else will almost be for naught if we don't deal with that issue?

Mr. DODARO. That is correct. Entitlement spending has to be dealt with in order to deal with this problem; that is the primary driver behind the cost increases and needs to be an effective part of the solution if there is going to be a material change in this path.

Mr. PLATTS. Given the importance of entitlements, and a question actually to all three of the witnesses, one of the other significant concerns I have with the consolidated financial reports is the disclaimer on the statement of social insurance. Given how important getting our hands around entitlement spending is to fiscal sanity, that we have a statement of social insurance that really, I think we all agree, is not an accurate reflection of the cost of Medicare in particular because of assumptions that were made regarding Medicare costs going down in response to the health care bill passed just over a year ago.

If all three of you could address that and how you look at those assumptions and the accuracy of inaccuracy of the assumptions made in the statement of social insurance.

Mr. DODARO. Basically, we start with reviewing the report by the Social Security-Medicare trustees, and in that report the trustees disclosed a number of uncertainties with regard to the cost assumptions, particularly in the Medicare area; this isn't quite true in Social Security. And the uncertainties settled on a couple of key factors: one being whether or not the scheduled reductions in cutting back the payments for Medicare providers was going to take place as scheduled over the period of time, it was about a 30 percent reduction over a 30-year period was assumed.

And, of course, as we know, Congress, last year, deferred that scheduled payment reduction by the first year, during the first year. Second, there are assumptions in the estimates about productivity gains that would be enhanced by other providers in the system, and there is real uncertainty as to whether or not those productivity improvements would be realized at the size they are estimated and, more importantly, sustained over a period of time.

So given those uncertainties, the auditors for HHS, which originally looked at the statement of social insurance, disclaimed an opinion and we agreed with that decision and sustained that on our statements.

Mr. PLATTS. Mr. Werfel.

Mr. WERFEL. Chairman, thank you for the question. The first thing I want to point out in response is that I would argue that historically accounting and the process that we have gone through has looked back on the previous year or years and the effort is to capture the transactions, capture the value of our assets, the value of our liabilities.

What we are entering into now with things like the statement of social insurance and the statement of fiscal sustainability is forward-looking accounting, where we are doing projections. And some of the projections here, as noted, are 75 years into the horizon, and that creates additional elements of uncertainty when you are looking to establish metrics and measures looking out over a 75-year horizon.

So I think that it is to be expected that as the trustees or HHS or others look to assess these values, that they are going to have qualifying statements and concerns about some of those uncertainties. And when you apply the auditors' scrutiny to that, what typically is looking backward at whether the books are kept to looking forward to a 75-year projection, I believe there are going to be times where those uncertainties are going to cross a threshold and create a discomfort level for the auditor in order to render opinion, and there will be times where those uncertainties will not cross that threshold.

I think the last 2 years the uncertainties did not cross that threshold, and what that tells me is that the process that we have, the process that HHS and Social Security and the other agencies undergo to develop their tables, to develop their numbers, to report this information is generally sound, but there will be moments in time where those uncertainties exceed a threshold by which the auditors don't feel comfortable rendering an opinion.

I would urge that the values that are reported still have value, and they still should be looked at closely and considered by Congress. But I think that we have to recognize that when you get into the business of auditing statements that are projecting 75 years into the future, you are going to run into situations where issues of uncertainty affect the audit opinion.

Mr. PLATTS. Mr Gregg.

Mr. GREGG. Mr. Chairman, I think we have pointed out a number of times in the fiscal sustainability area that they were not projections, they were really mathematical extrapolations. I think it is important to keep that in mind. I think that is what they are, and they are based on the math, not saying this is what we think is going to happen.

On the trustee report, I think a couple of things there that I would just add to what Danny said. First of all, the huge piece of legislation and trying to figure out what is going to happen 75 years out is very difficult and, second, I think as a result of when it was passed, it was not as much time as the actuaries normally have to assess that sort of thing. I think those were factors.

Having said that, it does look like that the HHS actuary did another illustrative sample of what the costs might be and, looking at that, the savings are still very considerable. And just to reiterate what Danny said, I think the process that the Medicare and Social Security trustees go through in having accurate data has been there for several years and I think that we will get back, at least I hope we will get back to a clean opinion for that report in the years ahead.

Mr. PLATTS. Thank you, Mr. Gregg.

Before I yield to the ranking member, the one aspect of that, and I appreciate when you are talking 75 years in projections or extrapolations, but a key part of those assumptions were a 30 percent reduction in provider reimbursements, which we have never done, and every year, historically, the record shows, we won't do that, as we did not in the very first year. We didn't even make it 1 year without reversing that legislation.

Given that reversal, my hope is that when the statement of social insurance is issued for 2012, a year from now or less than a year from now, that HHS is going to look at what did occur and that those savings were not achieved in those provider reimbursements and are not likely to ever be achieved, so that we get a more realistic understanding of where Medicare stands. Because unless we are realistic and honest about Medicare, we will never be honest about our fiscal picture and truly getting our hands around this challenge.

I am way over my time. General Dodaro.

Mr. DODARO. I just want to add that while there are various alternative assessments and projections, if you will, or simulations, over any scenario over the long range it is not sustainable, and I think we shouldn't overlook that point while we debate the numbers and timing.

Mr. PLATTS. Exactly.

Mr. Towns.

Mr. TOWNS. Mr. Chairman, I am prepared to yield to the—oh, he is no longer here. OK. I was getting ready to yield to the chairman

of the full committee, but he disappeared. OK. Because I am sensitive to that chairmanship thing, you know. [Laughter.]

Let me begin.

First of all, I want to thank all of you for being here. The Federal Government made $125 billion in improper payments in fiscal year 2010. Some of these payments were overpayments and some were underpayments. Some were made without sufficient documentation to support them and some should not have been made at all.

In recent years, Federal agencies have been given more tools to deal with improper payments and, of course, Congress passed the Improper Payment Elimination and Recovery Act in 2010. OMB has issued guidance as well. Even though not all improper payments are an indication that fraud has taken place, the potential for fraud, waste, and abuse remains extremely high.

Mr. Gregg, with the law on your side and all the guidance, why have the improper payments continued to increase every year?

Mr. GREGG. I will give my answer and defer to OMB to some extent. We are making, just Treasury alone makes a billion payments a year on behalf of agencies, and the pressure to get everything done accurately and timely is tremendous on the agencies and Treasury.

At the same time, I think we can and we are doing a lot more. Until fairly recently, under the direction of OMB, we really hadn't had agencies starting doing business intelligence assessments of going into the payment files and looking for potential problems before the payments reached Treasury, and I think that is a very important step.

There are tools out there that we just haven't been using fully, and I think that we are working on that with OMB to get those tools in place to go work with the agencies to do pilots to say what are the potentials here, some of it may be fraud; some of it is also just errors. But being able to identify those through sophisticated analytic tools.

The other thing we are doing that Dave Lebryk will talk about on Friday is on the debt collection side we are looking to do the same thing, we are looking at the debt portfolio that we have and trying to identify how best to find those debtors and go out and collect the money even though the payments have already been out and the debt is there.

We are looking for ways to use better tools that we now have available to find people who owe the Government money, to determine whether or not someone is who they—we may have a file from an agency that says someone's name is John McDonald and our debt file may say Jack McDonald. We now have tools that will help us identify whether or not that is the same person. We obviously don't want to try to collect a debt that isn't owed by someone, but through those tools we are going to be able to really hone in and say, yes, that is in fact the same person.

So I think there is a lot going on, and I would defer to Danny Werfel for more on the improper payments.

Mr. TOWNS. Thank you very much.

Mr. Werfel.

Mr. WERFEL. Thank you, Mr. Gregg and thank you, Congressman Towns. I would start by saying that progress is being made.

The error rates in key programs are going down and they are going down at the governmentwide level. But the challenge and the mathematical reality is as outlays outpace those error rate reductions, the error total grows.

So we are up to $125 billion, but we are up to $125 billion in an environment where the Medicare error rate went down, the Medicaid error rate went down, the key Social Security program error rate went down, and the list goes on. So one of the things to reflect is to understand, I think, that important mathematical nuance to understand the progress that is being made.

But also it raises how important this is, because as more money goes out the door, it raises the stakes for how important it is to get these payments right, because a 1 percent error when $100 is going out is very different than a 1 percent error when $1,000 is going out. And that is the situation we have right now; more money is going out the door even though the error rates are declining, improper payment amount goes up.

Why is this happening? We are doing, I think, a better and better job of understanding what makes up our errors. In some situations you still have agencies making basic mistakes. It is within their direct control and they should, in the immediate term, be able to take steps to better address the errors; whether the payments are going to clearly ineligible individuals, whether they have been suspended or debarred, or something that is very basic.

But in many situations, Congressman, the effort to identify whether someone is eligible for a payment is extraordinarily complicated and involves a variety of different factors, and when you go down and audit that payment, you find that mistakes are made. I think a good example of that is in the earned income tax credit, which has the highest error rate of any program.

The eligibility characteristics for someone to be eligible for the earned income tax credit are very challenging. For example, an individual has to have lived with their dependent child for more than 6 months. We don't have a global childhood residency data base to validate that, and we find a lot of improper payments occur when we go down an audit and find they didn't live with their dependent child for more than 3 months, or something of that kind.

So part of the challenge is finding those third-party data sources and figuring out better ways to validate eligibility. That is really, if I could boil it down in one bullet or one phrase, the real challenge we have, is how can we do a better job than we are doing today validating eligibility when those eligibility assessments are very complex.

Mr. TOWNS. Let me just ask this, Mr. Chairman. You can sort of understand, in terms of dealing with the public and private sector, but when government agencies deal with each other, it seems to me that we should be able to correct this and be able to move forward. Is there anything else that we need to do? I am talking about the Congress.

Mr. WERFEL. Well, first, if I could just jump back to improper payments. I mentioned in my testimony, in my oral and both my written, that in the President's budget we have a suite of proposals that relate to driving down improper payments in key programs, in Social Security, HHS, IRS, and Labor, that, if enacted, we believe

would save $160 billion over 10 years. So the first thing would be to call your attention to those provisions and ask for help in getting them enacted.

In terms of the intragovernmental transactions, I think that the process that we have today for accountability has driven us to be on the precipice of a solution; it is a chronic material weakness that GAO has identified as a key source of our disclaimed opinion. We have had fits and starts over the years in defining a solution, but, with Mr. Gregg's leadership, solutions are emerging right now for improvements on intragovernmental transactions.

So what I would ask of the Congress is to continue to call us before you and hold us accountable. I am telling you now that I believe we are on the precipice of a solution that is going to drive significant improvements, and call me back and hold me to that commitment.

Mr. TOWNS. Right.

Mr. GREGG. Congressman Towns, I just would add to Mr. Werfel's statement that I think one of the issues on the intragovernmental—and I was here when we did the first audited financial statement a number of years ago.

Mr. TOWNS. I was here too.

Mr. GREGG. Then went away. But I think we, in Treasury, felt that it should be able to correct itself with the agencies, and I came to the realization with my staff last year that it is not. So I made a commitment that someone needs to take responsibility for this to develop a system and a process and a small team of accountants to work with the agencies when there are differences. If we can't solve this, we ought to pack up our bags and go home, because this is, as the saying goes, not rocket science. It is not easy, but it certainly is not rocket science, and we should get this fixed.

Mr. TOWNS. I agree with you, Mr. Gregg.

On that note, I yield back, Mr .Chairman.

Mr. PLATTS. Thank you, Mr. Towns.

Dr. Gosar.

Mr. GOSAR. Mr. Werfel, you referenced the percentage of mispayments and fraud. I actually question the accuracy of those numbers, because these are self-reported numbers and, as a businessman, I understand how those things can be skewed, particularly the statistics and accuracy of those numbers.

So I also believe in a checks and balances system, especially when we are grasping accurate numbers for policy assumptions. Were entities like Congress, the American people, the CBO misled, when calculating the cost of PPACA or Obamacare, as we know it, by using bad accounting methods?

Mr. WERFEL. I am sorry, I am not sure what your question is.

Mr. GOSAR. Let me reiterate. Were entities like Congress, the American people, and the CBO misled when calculating the cost of PPACA, which is Obamacare, utilizing bad accounting methods?

Mr. WERFEL. No, I don't think they were misled. I think one of the important things that we do when we report our financial reports and our estimates is we report with that all the assumptions that were made, and those assumptions can be challenged. This is somewhat of a thick book and it is thick because there are footnotes and alternative analyses and alternative presentations; and

I think that what we have empowered is a situation where academics, think tanks, Members of Congress and GAO can debate these numbers and have a healthy dialog about whether the estimates and the projections and the extrapolations that are being reported are valid.

And hopefully if there is enough information to challenge these numbers, then that debate will come to the fore. That is really our job and I consider that my mission at OMB, to make sure that whatever we are reporting, that our assumptions, our underlying assumptions are clear so that experts and others can fairly criticize them and hold them under a light and debate their reliability.

Mr. GOSAR. Well, it really becomes a he said, she said without an authority in the middle. So, with that said, how do you do the accountability for the new 68 nebulous discretionary grants as described in HHS policy?

Mr. WERFEL. I need a clarification on the question. How do we do the accounting of what——

Mr. GOSAR. How do you do accounting on the new 68 nebulously written discretionary grants as described in Health and Human Services policy in that bill? How do you account for that?

Mr. WERFEL. Well, it depends on what you are asking about those dollars. Are you asking about if the discretionary grants are——

Mr. GOSAR. Well, let's go further.

Mr. WERFEL. The appropriation should be clear in terms of what its amounts are. The question then becomes what information about those dollars are you interested in understanding, and then I can talk more about how they might be accounted for and supported.

Mr. GOSAR. Well, let me be more specific. It says can use such sums as necessary. How do you do accounting for that?

Mr. WERFEL. Well, the accounting statements that we are reporting on today, for the most part, look backward at what the agencies spent. So we have financial systems, automated systems that help us track which money from HHS goes to which grantee, and we can tell you almost to a daily basis exactly how much money has gone out the door.

If you are asking how much would be spent in the future by a particular grantee, that is not something that we estimate in the financial statements; they are considered an appropriation that would be looked at in the budget, but predicting how much of that appropriation would be spent is not something that I am aware we put a report out on.

Mr. GOSAR. So you couldn't score it.

Mr. WERFEL. Well, if it is an appropriated amount, you could certainly understand what the limit is. You can't go above the appropriated amount. So you would know the ceiling, but you might not know where you might fall under that ceiling.

Mr. GOSAR. But by definition it says such sums necessary. I want to take it down to the provider level. You know, you can skew numbers any which way. For example, in dialysis. We are actually withholding payment from dialysis patients to show better numbers on self-reporting numbers. This is where the fraud is, and we can't even get a grip on this.

What we need to be able to do is have numbers that are apples to apples for comparison. And if Congress can't get this, neither can the American people. And we can't even look at what agencies look at, and this is just the tip of the iceberg. So I question even the reality of what these numbers actually are.

Do you understand my frustration here?

Mr. WERFEL. In the area of Medicare fraud and improper payments, I could not agree with you more; we have a significant problem, an estimate that exceeds $60 billion, and it is unacceptable. I can sit here today and tell you that the error rates are trending down, but I can't say that we are at an acceptable level. So I completely agree with your frustration.

Mr. GOSAR. And it is not just those mispayments; it is also misuse from the agency itself in not paying out providers and hospitals and patients. It is on the same aspects. It is not just mispayments; it is withholding of payments.

Mr. WERFEL. Now you are venturing into a programmatic area that I don't have familiarity with, so I apologize.

Mr. GOSAR. Thank you.

Mr. PLATTS. Thank you, Dr. Gosar.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

I thank the witnesses for being here.

At a time when record numbers of Americans are questioning the Federal Government's ability to manage its own affairs. It is kind of amazing, this hearing is in one of the smallest, hardest to find rooms on Capitol Hill, is not even covered by C–SPAN 3. This is a missed opportunity for anyone who is concerned about the future of the Federal Government, because what you gentlemen are discussing is, in my opinion, the most comprehensive report on how the Federal Government is doing. It is the only one that uses real business accounting, so-called accrual accounting. That is not cruel, it just tries to take into account what is on the Government credit card, which Lord knows every family, every business, every government needs to focus on.

So it is amazing to me, when people are concerned not only about government finances, but their own personal finances, and people worry about the stocks that they are holding in the stock market and they look at the annual report they get from a company, and here you gentlemen have worked hard to present a report to the American people, even with its own handy citizens guide to make it extra easy for people to understand. People are getting their favorite companies' annual report. Somehow they don't even know their favorite country's annual report exists.

What we are discussing here today is one of the best kept secrets in America. To my knowledge, there is not one businessman I have ever met who knows this report exists. There is not one business lobby that makes this a priority to focus on this. There is not one newspaper in America that regularly uses accrual accounting to describe the situation we are in.

And this is an amazing, well, it is a missed opportunity for my friends in the other party, because the first plank of the Republican contract with America was no more congressional hypocrisy. We should play by the same rules we require of the regular citizens,

and regular businesses of any size have to use real accounting. But not the Federal Government? So why aren't we holding ourselves up to the private sector standard?

So you gentlemen know this already because you are accounting experts, and it is hard for you sometimes to translate your knowledge to average members, but in response to Dr. Gosar's question, I would urge him to look at the conclusion section of the citizens guide, handy citizens guide, which says two very helpful sentences here: The United States took a potentially significant step toward fiscal sustainability in 2010 by enacting the ACA, what he chooses to call Obamacare.

It also says the legislative changes for Medicare and Medicaid and other parts of the health care system hold the prospect of lowering the long-term growth trend for health care costs and significantly reducing the long-term fiscal gap. That should be our primary job here on the Hill, to lower the fiscal gap.

Now, accounting will never be perfect; it is just an approximation of what goes on. But this is the best report we have, and very few people know about it. So I look forward to the first lobbying group in Washington celebrating and spreading this report. I look forward to the average Rotarian back home being able to access and know about this report. It is true it is available on the Web, but nobody knows when they are reading the Wall Street Journal everyday, as I did this morning, that they are reporting cash numbers only. So they really don't know what is on the national credit card, and I think they are entitled to know that.

There are many things we could go into into the details of your report. I am thankful that you gentlemen prepared this report, and you sometimes get grief and misunderstanding when you do it. Let's work on improving the mistake in payments; let's reduce that to the bare minimum. You gentlemen are working hard on that already.

But the key thing is not to miss the big picture: that this is a more important look at the Federal Government than probably any other document, and if you were to poll Members of Congress, most of them have never read it, have never heard of it, and don't know its significance, even though they guard their investments pretty carefully and care about which stocks they invest in.

Well, this is our only country, and we need to make sure that the American people are aware of this because, in simple terms, the deficit, if you want to call it—of course, the proper term here is net operating cost—is much higher than the cash number, and it is higher for some very specific reasons and reasons that aren't necessarily fun to go into, because a lot of that discrepancy has to do with veteran spending and military retiree spending and civil service spending and things like that, using traditional cash measures, we are keeping up with. We are not admitting what is on our credit card.

So I hope we can work together to increase the prominence of this report, increase its accuracy, and let's make this even more of a gold standard than it is already today.

I see my time has expired, Mr. Chairman.

Mr. PLATTS. Thank you, Mr. Cooper. Appreciate your attention to the time.

If I could briefly respond. One is your statements, I think, about the importance of this report are right on point, and maybe jointly, in a bipartisan way, to offer to Treasury I think this past year the report was issued on December 21st with little fanfare, no press release, just issued, I believe, is that this subcommittee would gladly partner with Treasury come this December to do a joint announcement of this report to start the process of getting more people aware of it and aware of its importance, and to set the stage for that in what would be going forward.

So, Mr. Gregg, if you don't mind taking that back to Treasury as a formal request, that as we prepare next year's report, that we look at partnering with this subcommittee for the release of it and, again, raising awareness.

Also, Mr. Cooper, I know in the past you have introduced legislation regarding accrual accounting, and I share with you today that I would like to work with you this session on the possibility of reintroducing that legislation, because I think we need to hold ourselves to the same standards that are we holding State and local governments and the private sector to.

Yield to Mr. Lankford for questions.

Mr. LANKFORD. Thank you very much. I do want to just be able to followup with the conversation with Mr. Werfel earlier about a lot of focus looking forward in the next 75 years, and it is a challenge to be able to look back and try to do both simultaneous on that. I will continue to emphasize the importance of being able to look back for the accountability side of that is a very big deal, while we are busy looking forward to seeing what is happening next, which is important for all of us. Accountability, we have to know what was just behind us so we are able to be able to do our task as well and to learn the lessons that we have seen behind us.

Your report is very good in being able to mention several items that are up. I don't know if we have mentioned before the real property comments that you made in it. Extrapolate a little more on what you anticipate as far as the release of some of these properties, the jobs that are related to those and how we begin to transition from a piece of property that is underutilized or not utilized at all to having that then gone. What do you see as the process?

Mr. WERFEL. Thank you for the question, Congressman Lankford. There are many areas of inefficiency and waste in government that we are looking to attack, and the real estate holdings of the Federal Government are one of them.

We have 14,000 properties that agencies have identified as excess, but there are an additional 55,000 assets beyond that have been classified as underutilized by agencies but have not yet been placed in excess and, therefore, are not in the cue to be gotten rid of. And then I have concerns that beyond that 55,000 there are additional assets that have not been scrubbed closely and looked at for realignment opportunities.

The process that we have today is somewhat bureaucratic.

Mr. LANKFORD. There is a surprise.

Mr. WERFEL. Yes. There are three problems with our process for getting rid of a property. The first is red tape. Unfortunately, every property, whether it is a warehouse in a rural location or an office building in a downtown location that is no longer needed, needs to

go through the very same process, which, depending on how good the agency is at doing it, could take anywhere from a year to 2 years, which is unacceptable in terms of the more critical needs we have to not be maintaining these assets at a cost to taxpayers.

The second reason is incentives and financing. It costs money to relocate; it costs up-front money to get an asset ready for sale, and often we allow these short-term costs to be a barrier to long-term and broader savings. So we need to think about how to address that.

And the third area is politics. We have found it, in many case, to be difficult to remove the Federal presence from an asset that is underutilized because local officials or congressional delegations rally around keeping that Federal presence there, even if there is an opportunity for realignment and consolidation.

We looked at different ways of addressing these three areas, and one area that we have had some success is in the Defense Department's base realignment and closure program, whereby vesting the process in an independent commission and giving them the flexibility and empowering them to make decisions on bundled opportunities, a lot has been done.

Mr. LANKFORD. I saw that in your report as well. Who are the individuals that you are currently recommending and what is the process to try to pull that together?

Mr. WERFEL. Ever since the President's budget came out and we had this proposal in there, we have been getting contacted by commercial real estate experts and other community development experts around the country who would like to participate. We need legislation for this to occur. BRAC was put in place by legislation. This civilian realignment proposal would be the same.

The moment we get it enacted, and I hope we get it enacted soon, we will begin putting together this commission. We propose a seven member commission or seven member board, and we are already starting to gather names for that. But I think it would be premature to get started before Congress acts.

Mr. LANKFORD. Let me just reaffirm that, to continue to push on both us and for you to be able to think through this as well. It is a big issue for us to have this many properties that are sitting idle, underutilized or not utilized at all, while we are dealing with a budget deficit. That is a low hanging fruit piece. We should be pushing on and continue to move forward to get those things into the private sector.

I would encourage you, as well, to continue to push on your 55,000 number. I am skeptical with you that is all we have. Based on the fact that you can look at—I am in Oklahoma. If you look to the west of Oklahoma, almost all the country is owned or controlled by the Federal Government. When you look west, there are a lot of properties and pieces that are sitting out there that should be available to the public sector that are now very tightly controlled by the Federal Government, so whether that is a building or whether that is property, we need to look at that.

And as far as your red tape, I completely concur. I am a freshman this year, and when I walked in my district office, there is an IBM Selectric typewriter that is sitting there that has apparently been there for a very long time that they are trying to work out

of inventory, and it has taken forever to get a typewriter out. I can only imagine what it is going to take to get a building out. So press on and we will try to help where we can.

Mr. WERFEL. Thank you.

Mr. PLATTS. Thank you, Mr. Lankford.

Mr. Connolly.

Mr. CONNOLLY. Thank you, Mr. Chairman, and thank you for these hearings. And let me echo what my colleague, Mr. Cooper said. I think this actually is one of the most important hearings we could have if you want to get a handle on the fiscal situation of the Federal Government, and I want to express my shock at learning that C–SPAN 3 is not here. [Laughter.]

But let me just pick up on the last point that our colleague, Mr. Lankford, was making on property, because I have had experience, actually, in my jurisdiction of acquiring excess Federal property, and one of the concerns I guess I would have is the valuation of that property. I think you mentioned, Mr. Dodaro, a figure of something like $2½ trillion estimated assets held by the Federal Government. Whatever the number is, in local government we value property based on highest best use.

So it is one thing to say X property is excess, and if we decide that is going to go to Oklahoma City as a park, that has one value. If, on the other hand, we decide, no, we are going to actually develop it as a research park with office buildings and lots of workers, well, that has a very different value. And I guess I would be concerned about how we value property and when we dispose of excess property.

Talk about politics. From the Federal Government's point of view, if we really mean it about the fiscal situation and addressing it, we want to sell it or dispose of it for the highest best use, not the lowest use, and that, I assure you, is not so easy. With the best of intentions it is not so easy. Would that not be correct, Mr. Werfel?

Mr. WERFEL. It is. In fact, one of the questions that I sometimes get when I raise this issue of why politics can prevent the assets is if you have an asset that is mostly empty, why would the local jurisdiction have concerns? And it is really about what happens to the property afterwards; it is the competing stakeholder interests that emerge, whether someone wants it for a park or someone wants to develop it commercially or sometime wants it gifted to a local university for education purposes. All noble objectives. The problem is those competing interests come into play and there isn't a rational process to reconcile them.

Mr. CONNOLLY. Right.

Mr. WERFEL. That is why this independent board, we believe, is the correct solution, because it would be empowered to move quickly to determine what the right impact is for the community, for the taxpayer, and reconcile those issues in a condensed period of time and reach a decision.

Mr. CONNOLLY. Thank you.

Mr. Dodaro and/or Mr. Gregg, improper payments in terms of $125 billion a year, estimated, right? What is the scale or the ratio between military, Pentagon, improper payments and civilian agency improper payments?

Mr. DODARO. I believe most of the $125 billion are civilian agency payments, half of which are in Medicare and Medicaid, although in Medicare the Part D prescription drug program does not yet have an estimate, so that will have to be added in the future. The DOD one is relatively low.

Mr. CONNOLLY. Of the $125 billion?

Mr. DODARO. I believe so.

Mr. CONNOLLY. Let me ask about the 75 year projection. I was just thinking 75 years ago was 1936. The idea that we can project 75 years into the future with any accuracy and anticipating actions by a Congress, by a series of presidents, by the public, technology. I mean, think back 75 years and ask oneself how accurate would we have been in 1936 in predicting 2011. So I guess I would ask you to comment on how valuable is a 75-year time horizon really.

Mr. DODARO. Well, I think it is very important, recognizing there are a lot of uncertainties and inherent difficulties in doing it, for the Government to have a longer term view of some of its policy decisions at the time. One of the concerns that we have had is if you look at just the next budget year, or even 5 years out, you really don't understand comprehensively the long-term consequences of policy decisions. So I think some things have to be there.

In some of these areas we know the population is already here and will turn a certain age at a certain period of time, so there is relative certainty to some of the assumptions in the estimates. Now whether it is 75 years, 30 years, 20 years, the importance is to have a longer term perspective of it.

Mr. CONNOLLY. General Dodaro, I would agree with you, but I would suggest 75 years may be so long as to be meaningless. Very misleading in terms—I mean, if you look at, for example, demographics. If you looked at a 75-year horizon, I assure you demographic projections were profoundly inaccurate in terms of population estimates and fertility rates and human behavior and spacing of families, for example. So I just think that, yes, I agree with you we need a longer time horizon, but 75 may be not the tool we hope it to be.

Thank you, Mr. Chairman. My time is up.

Mr. PLATTS. Thank you, Mr. Connolly.

Ms. Norton.

Ms. NORTON. Thank you very much, Mr. Chairman.

I would just like to add to what my colleague said about 75 years. I think 75 years is dangerous. When it comes to things like Social Security and Medicare population-based, perhaps, there will be people here who fasten upon such a figure as if it were the Bible, because that is what numbers can do to people. It makes you look like fortunetellers.

And I think the reason your report has credibility is that it is, so far as you can humanly do, science-based. The configurations, even the best of you say 5 years out, even 10 years out, are wildly off base, so I would like to also see a spike put in 75 years, as if that is something anyone could rely upon, except for population-based notions, which turn out to be more accurate than perhaps some others.

I note on page 12 of the GAO report it talks about the notion of the Government's return on some of its investments. At page 12 it

says in December 2007 the United States entered into what has turned out to be the deepest recession since the end of World War II. Gross domestic product fell 4.1 percent from the beginning of the recession through the second quarter 2009. Then you note that GDP has grown slowly; unemployment remains at a high level.

In the second paragraph you note the economic recovery that the Government's actions to stabilize the financial markets and to promote economic recovery resulted in assets of $400 billion, which is a net of about $75 billion in valuation losses.

Now, this is a very little talked about notion. We always hear about what, of course, is most prominent, and that is what the Government loses. Would you elaborate on this recovery of some of these assets? Break them down. Many would be surprised, perhaps in a short period of time than anticipated.

Mr. DODARO. This is in the——

Ms. NORTON. GAO report?

Mr. DODARO. No, it is in the management discussion analysis that is prepared by Treasury and OMB, it is not our report.

Ms. NORTON. Well, whoever wants to discuss it, be my guest.

Mr. DODARO. OK.

Mr. WERFEL. Congresswoman, I will share at a very high level. I think we are going to have to get back to you on some of the specific breakdowns of the assets. I happen to know that the Federal Government has purchased, according to our report, $225 billion in mortgage-backed securities; we have $75 billion back in principle and interest; we have made $378 billion in TARP disbursements and been repaid $204 billion.

I think the important point here is that some of the investments, in particular that the Treasury made as part of our Economic Recovery Act, either through the HERA legislation or the Issa legislation, were set out with an expectation of a return, where money is paid back to us or investments that we are made provide value to us that improve the bottom line associated with these financial statements.

And I would agree that it is a point that sometimes gets lost. When the TARP bill was passed, it was widely reported $700 billion were authorized, and I think there was a notion at that high level that $700 billion was gone.

But, as it turns out, and as it is playing out and as is reported here, that $700 billion is not the cost of that legislation, and it is remarkably lower than that. And part of that is due to the fact of being repaid and part of that is due to the fact that investments that were made by the United States continue to have value and, in some cases, the Government and the taxpayer actually have made a profit on those investments.

Mr. GREGG. We can get back to you with a more full description, but yesterday Treasury announced that they had a repayment from AIG of $6.9 billion, and right now we have 70 percent of the amount that we have gone out in investments have been repaid, and the quote is that we are looking to have little or no money actually for those types of investments actually cost the taxpayers anything. So the money has been coming back through those investments, AIG and other entities that we have had under manage-

ment, and it is a continuing process, but good progress has been made.

Ms. NORTON. Well, I must say I think it is a disservice not to report to the American people, who were very concerned, and rightly so, that the Government had to lay out so much money, not to report every jot and tittle of every cent we have gotten back, every amount we may have made over what we expected and in what period of time. For those who read deeply into the newspaper, frankly, to get back as much as we have gotten back in so short a period of time turns out to be a big surprise, and one of the best kept surprises of this recovery.

And I thank you very much, Mr. Chairman.

Mr. PLATTS. I thank the gentlelady. And if the witnesses would work with the gentlelady for any specifics, additional information that she is looking for.

We need to wrap up in about 8 or 9 minutes. I am going to try to get through a couple more questions here for those who have. I am going to kick it off on a specific issue, and this goes to frustration. I hear from constituents often that when we have either wrongful conduct in the Federal Government or just mismanagement, there is never any consequences. And one of the three major impediments identified by GAO to a clean opinion was the inability of so many of our Federal agencies and departments to adequately account or reconcile intragovernment payments, between agencies.

In General Dodaro's statement there is referenced that Treasury and OMB require our 35 largest agencies, our CFOs to quarterly do that reconciliation. But as the general's statement says, a significant number of these entities did not adequately perform those reconciliations for fiscal years 2010 and 2009. I guess one question is, General Dodaro, I don't know if you have with you today, but what is a significant number? How many of those 35 did not adequately do it on a quarterly basis?

And then specifically to our Treasury and OMB witnesses, what, if any, consequences occurred regarding those CFOs' failure to comply with your department and agency requirement? Was anyone disciplined, suspended, fired for not doing what they are required to do? Because when they don't do this, as GAO is telling us, this is one of the major impediments to us fully understanding what is going on and getting a clean opinion. Yet, we have a significant number of agencies not complying with OMB and Treasury.

So I guess, first, General Dodaro, if you have a number.

Mr. DODARO. I can provide the specific number. Mr. Gregg might actually know the specific number. But I couldn't agree with you more that there ought to be consequences.

Mr. PLATTS. Mr. Gregg, I don't know if you know, of the 35, how many agencies, departments of those 35 did not comply with the quarterly reconciliation.

Mr. GREGG. Well, I don't know offhand, but the thing that has been missing, and I alluded to it before, is that what happens is that agencies do business and one agency may not identify when a trade comes in that actually what it is, so our job at Treasury, now that we have taken this on, is to build some kind of system where we make sure that they can easily identify that they are talking about the same transaction.

And then the role that I have also agreed to take on is that we are going to be following up with the agencies, and if they don't get those reconciled quickly, we are going to be after them and we will elevate it as high as we need to in the agency to get those taken care of. We can't do this once a year and be successful; this has to be an ongoing process. And it is not just quarterly, it is an ongoing transaction process that we need to stay on top of, and we haven't been doing it, Treasury hasn't been doing it, no one has been doing it sitting in the seat of being responsible and holding the agencies responsible.

Mr. PLATTS. And that is my point here, is accountability. That is what the American people expect of us. And if we have rules in place that are to seek that accountability and those requirements are not then followed through on, there have to be consequences so that we send that message.

And if this is across all agencies and departments that they understand, the personnel understand that if they don't do their jobs, there will be consequences for their failure to do their jobs. It sounds like we have not had consequences in the past, but Treasury is trying to put in place a system to allow more stringent requirements and consequences to be imposed.

Mr. GREGG. Treasury, the Financial Management Service does send out a report after each financial report comes in and, in essence, kind of grades the agencies on how they did. The CFOs at the agencies don't especially appreciate getting that.

Mr. PLATTS. Is that report given to the head of the agency as well?

Mr. GREGG. It is given to just the CFO, the highest level.

Mr. PLATTS. If I could make a suggestion that report card, since it's the CFO that has this responsibility and you are giving him or her their own report card, well, as a parent, I want to see my child's report card to hold them accountable. Let's make sure the agency head sees that report card so they can hold their CFO accountable, because otherwise the fox is guarding the hen house.

So I have great respect for our CFOs in the work, but if they are not doing a good job their agency head needs to know it. So if you can followup with me on that request that Treasury look at that change in how you distribute the information to the agency head.

Mr. GREGG. I will do that.

Mr. DODARO. Mr. Chairman, I would say Treasury is in a difficult position because they are on a peer level. So I think your idea is exactly right. OMB, on behalf of the President or the President has to send the direction to the agency heads to get this solved.

Mr. PLATTS. That is a very important point. If we can have OMB's engagement on this as well, to partner with Treasury and this subcommittee, that we really have consequences. Again, this is one of the three main criteria that is highlighted as why we can't get a clean opinion, so I think it has to be one of the issues we are most serious about going after.

Mr. WERFEL. I agree and I think alerting the agency head of some of these key metrics is something we are certainly interested in doing, and we will work with Treasury and you on that.

The other thing I would just add is that I do think there is a positive development that has occurred over the last 5 years of

more and more a demand from OPM for quantifiable metrics in Federal employee performance evaluations, and in the CFO realm we have a treasure trove of quantifiable metrics to hold CFOs, not just the CFOs themselves, but their entire teams.

So I can't sit here and say that all the right people are seeing all the right impacts on their performance evaluations due to some of the weaknesses that we see, but I can tell you that it is getting better and it is entering into the fray.

Mr. PLATTS. And getting that treasure trove of information to that CFO's superior is I think what I am asking in this regard specifically, so that we can do a better job.

I have other questions but I don't know, Mr. Towns, if you have anything else.

Mr. TOWNS. I just have a very quick one. How does the IG play in this? The point is, it seems to me, that they can provide some technical assistance here that might help us. Do they have a role anyway?

Mr. WERFEL. Congressman, the IGs have a central role. Ultimately, the IGs are responsible for the financial statement audit element, the audit element. The IGs often contract with independent audit firms, although they don't all do that, but the IGs are overseeing the audits of their agencies and, therefore, are a central partner in helping figure out what the financial management weaknesses of the agency are and how to address them.

So they do play a central role, it just so happens that they don't always write the audit report; sometimes they hire an independent auditor to write the audit report for them. But they bless it and they have to sign off on it.

Mr. TOWNS. Thank you very much. Because I think that is very, very important.

Thank you.

Mr. PLATTS. Thank you, Mr. Towns.

Dr. Gosar.

Mr. GOSAR. Real quickly, gentlemen. Are the Federal Reserve numbers accurate, to your understanding, in the terms of the accounting method?

Mr. DODARO. I believe they have an independent audit done and that the numbers—we don't have any basis to question the numbers at this point. I would add, though, that due to legislation and the Wall Street Reform Act, we now have at GAO broader responsibilities to audit the emergency lending facilities at Federal Reserve, and we are doing that now and expect a report by this summer.

Mr. GOSAR. Wonderful. Can I just followup with a real quick question, then? Do these accounting issues impact monetary policy like quantitative easing at the Federal Reserve level?

Mr. DODARO. Just to clarify, the Federal Reserve is really not included in the report.

Mr. GOSAR. I understand.

Mr. DODARO. So I would say we at GAO are statutorily prohibited from reviewing monetary policy.

Mr. GOSAR. Thanks.

Mr. DODARO. I would, Mr. Chairman, if I might, add just on the 75-year question that came up earlier, I just want to clarify for the

record that the trustees, Social Security and Medicare trustees, are required by law to use the 75-year number.

Mr. PLATTS. And I am going to close with two quick questions, just to make sure my understanding is correct, before we adjourn for the joint session.

On Medicare Part D, when we talk about improper payments, Medicare and Medicaid, half of that $125 billion number, it is my understanding that when we look at the Medicare Part D—and, Mr. Werfel, you referenced that the improper payments rate is going down—Medicare Part D currently is not part of that number, that they are not being assessed for what improper payments are, is that correct?

Mr. WERFEL. That is correct. I was referring to Medicare fee for service and Medicare Part C. Both of those have separate error rates and both of those have declined, although they are still at unacceptably high levels. We are in the process of developing an error measurement for Part D.

Mr. PLATTS. And given the size of Part D, the importance of that——

Mr. WERFEL. Yes. You can anticipate that given the size of the outlays, even if we somehow achieve a 1 percent error rate——

Mr. PLATTS. We are talking billions still.

Mr. WERFEL [continuing]. We are still talking big numbers.

Mr. PLATTS. Yes. And on the issue of Medicare Part D, we currently have in law a 30-day payment requirement for Medicare payments. Is that something that, given a billion transactions that Treasury is handling and the number that Medicare is handling, by having that 30-day payment requirement, which we want to pay providers as quickly as possible, but given the volume, is that too short to better ensure accuracy and the honesty of the claims we are paying?

Mr. WERFEL. It is certainly something to look at. One of the goals of the improper payments legislation is to understand the root causes of these errors and understand what kind of adjustments need to be made. And if there is a sense that the timing is too short to do the necessary due diligence, that should come in HHS's financial report and be reported out, and then we would want to talk to you about those types of statutory changes. But I think we need to certainly evaluate that as we go forward, in terms of that timing.

Mr. PLATTS. Thank you. I certainly appreciate all three of you, your service to our Nation and your expertise in this area. We look forward to partnering with you as we go forward.

Just one cautionary reminder. If we are talking next year about this, at least for one more year I believe I will be the chairman; I don't know about after that. But if we see as one of those major impediments being intragovernment payments, I am going to be asking what did we do with that CFO report card where there wasn't adequate compliance on at least a quarterly basis, and that we are going after that issue. So just to put you on fair notice.

We will keep the record open for 7 days for any other additional information from witnesses or for Member statements, and our thanks to our witnesses for being here. This hearing stands adjourned.

[Whereupon, at 11:04 a.m., the subcommittee was adjourned.]