United States General Accounting Office

GAO

Briefing Report to the Honorable
Larry E. Craig, House of Representatives

June 1988

FINANCIAL MANAGEMENT

Responses to 17 Questions

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GAO

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Accounting and Financial
Management Division

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June 20, 1988

The Honorable Larry E. Craig
House of Representatives

Dear Mr. Craig:

Your March 14, 1988, letter asked that we respond to a series of questions concerning federal financial management, financial reporting, and accounting operations. During May 1988, we discussed the responses to the questions with your office. Our written responses are included as appendix I.

As stated in your letter, the Congress is beginning to give a high priority to financial management reform. Legislation introduced in the 99th and 100th Congresses proposed significant improvements in federal financial management operations. We have proposed legislation which would, among other things, (1) establish an Under Secretary of the Treasury for Federal Financial Management and similar positions in the departments and major agencies, (2) provide for a 5-year plan to guide financial management improvement efforts, and (3) require the annual preparation and independent audit of agency financial statements. We hope that continuing congressional emphasis on these areas will facilitate passage of this important legislation.

During the past few years, we have taken a series of steps to bring about improved financial management. Some examples follow.

-- In February 1985, we issued Managing the Cost of Government (GAO/AFMD-85-35), which identified problems affecting federal financial management and proposed a conceptual framework to guide critically needed reform efforts.

-- In March 1986, the Comptroller General of the United States and the Auditor General of Canada issued a joint study entitled, Federal Government Reporting Study (GAO/AFMD-86-30). This study discussed the type of financial reporting needed for various groups, including legislators, citizens, government managers, and lenders.

-- In June 1987, the Comptroller General submitted draft legislation to improve federal financial management to the Chairmen of the House Committee on Government Operations and the Senate Committee on Governmental Affairs. The proposed legislation would establish the position of Under

Secretary of the Treasury for Federal financial Management and corresponding positions in executive agencies. It would also require agencies to prepare annual financial statements and have them audited. In July 1987, the Comptroller General testified before the Senate Committee on Governmental Affairs on S.1529, the "Federal Financial Management Reform Act of 1987" (GAO/T-AFMD-87-18). This bill parallels much of GAO's draft financial management legislation.

Overall, we believe that an awareness of the need for federal financial management reform exists and that progress is being made. This long-term challenge involves many issues and requires a concerted commitment by the Congress, the administration, and the operating agencies. Executive branch leadership is a crucial element of the reform process.

Currently, executive branch leadership is vested in the Chief Financial Officer (CFO), a position administratively established in the Office of Management and Budget in July 1987. We recently responded to a request from Senator Glenn for an assessment of progress on the financial management agenda the CFO presented in a July 1987 hearing (GAO/AFMD-88-52). While we are encouraged that OMB has recognized that a CFO is key to supporting improvements in financial practices and systems, efforts related to particular initiatives reflected on the CFO's agenda have had mixed results. The future status of the CFO position is uncertain with the change in administrations and the new Congress next January. In order to provide permanence and continuity to the financial management reform efforts, we believe the CFO position should be legislatively established.

The enclosed responses to your questions were based upon published documents, GAO's institutional knowledge, and staff level discussions about financial management issues. I hope that they will assist you in your efforts to improve federal financial management. Unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from its date. At that time, we will send copies to other interested parties. If you or members of your staff would like to discuss the information included in this letter and the enclosure or have any additional questions, please call me at 275-9454.

Sincerely yours,

Jeffrey C. Steinhoff

Jeffrey C. Steinhoff
Associate Director

 APPENDIX I

QUESTIONS AND RESPONSES CONCERNING FEDERAL FINANCIAL MANAGEMENT, FINANCIAL REPORTING, AND ACCOUNTING OPERATIONS

QUESTION 1

HOW HAS THE TREASURY COORDINATED ITS EFFORTS OF FINANCIAL MANAGEMENT WITH THE OFFICE OF MANAGEMENT AND BUDGET (OMB) AND THE GENERAL ACCOUNTING OFFICE?

RESPONSE

Treasury is one of the members of the Joint Financial Management Improvement Program (JFMIP), which is a cooperative undertaking of GAO, OMB, Treasury, and the Office of Personnel Management. The JFMIP members work together with operating agencies to improve financial management policies and practices. Treasury also participates in the Council of Chief Financial Officers, headed by the Chief Financial Officer (CFO) for the Federal Government. The council is an advisory body on governmentwide accounting and financial management policy. The Council considers topics such as consolidating and modernizing financial systems and improving the quality of financial information. Treasury's Fiscal Assistant Secretary serves as the Council's Deputy Chairman.

An August 1986 memorandum signed by the Comptroller General, the Director of OMB, and the Secretary of the Treasury also demonstrates coordination among GAO, OMB, and Treasury. This memorandum conveys top level commitment to major financial management improvements and supports both the revised Treasury financial reporting requirements and the U. S. Government Standard General Ledger, which provides a uniform chart of accounts and transactions which demonstrate the use of the Standard General Ledger. The Standard General Ledger's purpose is to help standardize federal agency accounting and support standard external reports.

Further coordination is evident in a January 1988 memorandum the central agency heads signed in support of the Core Financial Systems Requirements, which specifies minimum requirements for agency financial management systems. A JFMIP task force developed the requirements and Treasury has offered to be the governmentwide coordinating agency.

In February 1987, senior OMB and Treasury officials signed a memorandum of understanding which also gave Treasury operational responsibility for implementing OMB Circular A-127, "Financial Management Systems." The Circular prescribes policies and procedures federal agencies must follow in developing, operating, evaluating, and reporting on financial management systems. It calls for increased standardization of agency financial systems and information. Under OMB Circular A-127, agencies are required to prepare a 5-year plan for developing a single integrated financial management system. Also, OMB gave Treasury operational responsibility for the administration's initiatives to improve credit management, debt collection, and cash management programs.

Over the past few years, Treasury has coordinated its efforts with OMB and GAO in financial reporting as well as in accounting system modernization, credit management, debt collection, and cash management.

QUESTION 2

WHAT FISCAL RESPONSIBILITIES DO THEY [OMB, TREASURY, AND GAO] JOINTLY SERVE? IN WHAT AREAS IS THERE STILL ROOM FOR NEGOTIATIONS?

RESPONSE

Each of the three central financial agencies--GAO, OMB, and Treasury--has responsibilities in establishing financial management policy, developing regulations, and monitoring agency performance. In some instances (as described below), OMB establishes policy and delegates operational responsibility to Treasury.

OMB assists the President in preparing the budget, formulating the government's fiscal program, and supervising and controlling administration of the budget. OMB establishes program policy and direction, provides overall guidance, resolves interagency issues, and sets broad priorities. The Chief Financial Officer position was established in July 1987 to provide leadership, policy direction, and oversight over federal financial information and systems, productivity measurement and improvement, credit and asset management, cash management, and internal controls.

Treasury performs the central accounting and reporting for the government, collects and disburses funds, manages federal debt, and establishes financial reporting requirements and accounting procedures for agencies. Also, Treasury has the lead agency responsibility for major financial management initiatives, such as credit management, debt collection, and cash management, and for implementation of the U. S. Government Standard Ledger.

The Budget and Accounting Act of 1921 as amended (31 U.S.C. 701 et seq.) created the General Accounting Office under the direction of the Comptroller General. The Budget and Accounting Procedures Act of 1950 made agency heads responsible for establishing and maintaining internal accounting and administrative controls that are consistent with standards prescribed by the Comptroller General (31 U.S.C. 3512). The act also states that the Comptroller General shall prescribe accounting principles and standards for the agencies to follow (31 U.S.C. 3511).

GAO performs audits of executive branch activities, including evaluations of compliance with financial management legislation such as the Federal Managers' Financial Integrity Act (31 U.S.C. 3512(b) and (c)), the Debt Collection Act (Public Law 97-365), and the Prompt Payment Act (31 U.S.C. 3901-3906). GAO publishes standard terminology, definitions, classifications, and codes for federal fiscal, budgetary, and program-related data and information. GAO reports to the Congress on the executive branch's compliance with the Balanced Budget and Emergency Deficit Control Act of 1985, and impoundments by the executive branch.

We believe these traditional roles are essentially the proper ones. We have proposed one change, which relates to the Chief Financial Officer. In draft legislation submitted to the House Committee on Government Operations and the Senate Governmental Affairs Committee, we recommended the establishment of an Under Secretary of the Treasury for Federal Financial Management. The Under Secretary would serve as the Chief Financial Officer. We recommended Treasury as the appropriate agency to house this position for the following reasons:

-- Treasury has long-standing responsibilities and a historical mission for central financial and reporting functions.

-- Treasury has lead responsibility for agency financial management systems improvements, credit management, debt collection, and cash management.

-- Treasury has an organization, the Financial Management Service, which could fulfill many duties of the Chief Financial Officer.

-- Treasury's primary mission is financial management, in contrast to OMB's primary focus on budget matters.

QUESTION 3

WHAT ARE THE COSTS, BENEFITS AND PROGRAMMATIC IMPLICATIONS OF MODERNIZING THE FINANCIAL MANAGEMENT SYSTEMS OF THE FEDERAL GOVERNMENT?

RESPONSE

Financial systems are the cornerstone of good internal control and are critical to ensuring accountability. The costs of inadequate federal financial management systems have been chronicled--fraud, waste, and abuse amounting to billions of dollars, and the American public's loss of confidence in the federal government.

In passing the Federal Managers' Financial Integrity Act of 1982, the Congress called for improved accountability by requiring each agency to report on whether their accounting and internal control systems meet the Comptroller General's principles and standards. While the law, since 1950, has required agencies to maintain adequate accounting systems, there is a recognition today that most of the government's accounting systems are outdated, inefficient, and ineffective, and that improvements in financial management are urgently needed.

For the most part, the federal government has continued to rely on antiquated accounting systems that do not provide the information needed for effective management and decisionmaking. The basic structure of many current systems was laid out in World War II, and many of them were built around 1950s vintage concepts and computers. As new requirements have been layered on old ones, the basic structure has remained unchanged and the systems have become inefficient. The systems are costly to operate and maintain.

Modernized financial management systems can provide significant benefits to the federal government, including the agencies' ability to produce complete, consistent, reliable, and timely information. Such information can assist financial managers in formulating and executing agency budgets; controlling collections, outlays, fund availability, property and other assets; and evaluating the financial results of the agency's activities. Program managers need adequate financial information to efficiently and effectively direct their activities. Furthermore, the modernized systems would provide timely and reliable financial reports to external users, such as the Congress and the central agencies. Such informative reporting would provide a mechanism to hold managers accountable for the resources entrusted to them.

For fiscal years 1987 through 1992, agencies have planned hundreds of system projects estimated at approximately $2 billion. A comprehensive financial management reform effort should result in a more focused approach, thus providing opportunities to identify unnecessary duplication in system improvement efforts. It should also disclose potential opportunities for cross-servicing arrangements, whereby one agency provides financial services such as accounting, payroll/personnel, property, and collections to other agencies.

In the past, successful completion of such financial management improvement efforts has often been elusive. There is an emerging consensus within the Congress and the executive branch that effective and lasting improvement must be sustained across administrations and guided by a cohesive framework under centralized leadership. As discussed in our response to question 17, we have proposed legislation that would establish the needed organizational structure and require a comprehensive plan to guide financial management reform initiatives, including system upgrade efforts.

QUESTION 4

HOW IS FMS CARRYING OUT THE POLICIES OF OMB CIRCULAR A-127, WHICH DEALS WITH FINANCIAL SYSTEMS?

RESPONSE

As discussed in our response to question 1, a February 1987 joint OMB and Treasury memorandum of understanding designated Treasury's Financial Management Service (FMS) as the lead agency with operational responsibility for financial systems. The memorandum was developed to confirm OMB and Treasury commitment to improve federal financial management systems and clarify the roles and responsibilities of the two organizations. One of the stated objectives in the memorandum of understanding was to achieve full compliance with OMB Circular A-127.

FMS established the Federal Agency Financial System Program to fulfill Treasury's financial systems responsibilities. FMS's goal is to modernize federal financial systems and, in so doing, improve the timeliness, reliability, and accuracy of financial information. FMS has focused its attention on 23 departments and major agencies. We understand FMS held meetings with those organizations and OMB to discuss their specific goals; in addition, it has reviewed the organizations' plans. We were also told that FMS has focused on providing information and technical assistance. They held a workshop on OMB Circular A-127 to communicate financial systems policies to all agencies and coordinated an assistant secretary level meeting with OMB and the Treasury Fiscal Assistant Secretary. In addition, we were told they surveyed agencies in order to serve as a liaison between agencies that could provide cross-servicing and agencies that needed such assistance.

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QUESTION 5

HOW WILL FMS ENSURE THAT GOVERNMENT AGENCIES ARE IMPLEMENTING THE OMB-RECOMMENDED STANDARD GENERAL LEDGER?

RESPONSE

In a September 1987 bulletin, Treasury announced to heads of departments and agencies that FMS had been assigned operational responsibility for the U. S. Government Standard General Ledger. We understand that FMS has met with the departments and major agencies to review their implementation plans, assess progress, identify problems, and initiate solutions. FMS has established a working group to provide a forum in which agency representatives can address concerns and problems in implementing the Standard General Ledger. The Standard General Ledger is an important undertaking, and sustained leadership from Treasury is critical to its success.

QUESTION 6

SHOULD THE FEDERAL GOVERNMENT MOVE TOWARD A SINGLE PRIMARY ACCOUNTING SYSTEM WITH INTEGRATED SUBSIDIARY AND PROGRAM SYSTEMS?

RESPONSE

We do not advocate a single centralized system to process all transactions for the entire federal government. Although this approach would provide maximum control and uniformity of information, it would be difficult to accommodate the varying internal management needs of diverse agencies. Furthermore, maintaining security and reliability in such a large system would be a problem.

Each department and major agency, however, should have a single primary accounting system which incorporates standard governmentwide features, such as the U. S. Government Standard General Ledger, Core Financial System Requirements, and title 2 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies. Standardization across the government is the key. The agency's primary system should be integrated with its subsidiary and program systems and should also be compatible with Treasury's central accounting operations. This would facilitate the process of preparing consolidated financial information for the entire government.

QUESTION 7

WHAT ARE THE ADVANTAGES/DISADVANTAGES IN PREPARING FINANCIAL STATEMENTS FOR THE FEDERAL GOVERNMENT? IS IT BETTER THAT THESE FINANCIAL STATEMENTS BE IMPLEMENTED ON AN AGENCY-SPECIFIC BASIS?

RESPONSE

We have called for the annual preparation of financial statements at the agency level. We do not foresee any major disadvantages in preparing such statements. The 1984 revision of title 2 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies provides that financial statements shall be prepared annually by all departments and independent agencies. This is a critical step toward comprehensive upgrading of federal financial management systems. Such financial statements

-- represent the end-product of reliable financial management systems,

-- are the culmination of a process involving consistent application and enforcement of specifically defined standards which instill discipline in the system, and

-- are the basic year-end accounting of upper management that discloses their stewardship of resources and their performance for the period.

Furthermore, these financial statements will provide information about the magnitude of government operations that is not available from one concise source. For example, they include information on

-- short- and long-term receivables to help plan future cash needs;

-- property, plant, and equipment to help plan for capital replacement;

-- cost data to help assess performance; and

-- commitments, guarantees, and insurance programs to help judge the total exposure of the government to make future payments.

We are not advocating the adoption of business-type financial statements for the federal government. Rather, we are looking to the development of financial statements tailored specifically to the unique circumstances and requirements of the federal government. We are developing a discussion paper which identifies major federal accounting and financial reporting issues and associated subissues to determine the proper accounting treatment to produce the most meaningful federal financial statements. When completed, the discussion paper will be circulated within and outside of the government to obtain comments that will be considered in the next revision of title 2.

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QUESTION 8

IS IT POSSIBLE AND PRACTICAL FOR THE GOVERNMENT TO EFFICIENTLY PREPARE FINANCIAL STATEMENTS THAT CAN BE AUDITED WITH PUBLIC SCRUTINY?

RESPONSE

Yes, we believe the concept of audited financial statements can be efficiently applied at the federal level. Both the possibility and practicality of government agencies having their financial statements audited has been demonstrated.

First, we have performed financial audits of government corporations, such as the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation (FSLIC), and the Export-Import Bank of the United States, for a number of years under authority of the Government Corporation Control Act of 1945. The case of FSLIC clearly demonstrates the value of financial statements for a federal entity. FSLIC's accrual-based statements show that it had a deficit of $13.7 billion as of December 31, 1987, while receipts and outlays data would make FSLIC appear to have substantial funds. The cash basis data would not show the enormous costs that exist for the bankrupt institutions FSLIC has insured because it does not have the money to close them down. By reflecting FSLIC's true financial condition, the financial statements have helped attract the attention of the Congress and focus discussion upon the recapitalization of the agency.

Second, a number of departments and major agencies have prepared financial statements which are being audited. During the past several years, the financial statements of the following agencies have been or are being audited by GAO, the agency's inspector general, or a public accounting firm:

-- Department of Agriculture,

-- Department of Labor,

-- Environmental Protection Agency,

-- General Services Administration,

-- Social Security Administration, and

-- Veterans Administration.

In the Social Security Administration's 1988 annual report, the Commissioner stated the following:

"All federal agencies are now being asked to provide a public accounting of their financial stewardship. Thus, for the first time this year, the Social Security Administration is publishing financial statements as part of this annual report. The statements fully disclose financial information on all agencyadministered programs. Audited by the Department of Health and Human Services Office of Inspector General, the statements demonstrate the financial soundness of Social Security."

The Inspector General for the Department of Health and Human Services stated in a memorandum to the Coordinating Conference of the President's Council on Integrity and Efficiency that the Commissioner of Social Security took major steps to improve SSA's financial management by appointing a Chief Financial Officer and requiring preparation of the agency's first financial statements. He further stated that conducting an audit of the financial statements provided opportunities for improving the agency's systems and information. The SSA derived two benefits from this process. First, they were able to provide the public, the beneficiary community, and the Congress with an objective, non-political report. Second, the SSA identified opportunities for financial management improvements.

Since 1934, publicly held corporations have been required by law to prepare annual financial statements which can withstand the scrutiny of an independent audit. The Government Corporation Control Act has provided for GAO audits of the financial transactions of government corporations since 1945. Also, the Single Audit Act of 1984 requires virtually all major state and local governments to have financial statement audits. Financial audits are a common business practice in the private, state, andlocal government sectors. We believe the practice should also be followed by the federal government.

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QUESTION 9

IN WHAT WAYS CAN FEDERAL AGENCIES CAPITALIZE ON THE USE OF OFF-THE-SHELF SOFTWARE TO CUT ADMINISTRATIVE COSTS?

RESPONSE

The use of off-the-shelf software is an alternative to the historical approach of developing agency-specific software. It enables agencies to take advantage of what has already been developed or to adapt existing software to their needs. Off-the-shelf software can provide a less costly approach and save time in installing new systems.

The Joint Financial Management Improvement Program recently sponsored an interagency task force which published Core Financial System Requirements for the federal government. These system elements are mandatory for federal agencies. They will promote greater consistency and reliability in department and agency financial systems, and will improve financial reporting.

Furthermore, the requirements enabled the General Services Administration (GSA) to develop a request for proposals which will be used to solicit off-the-shelf software to be evaluated for compliance with central agency requirements. Qualifying software will be included in a GSA schedule from which agencies can select software that best meets their needs. Consequently, agencies will be able to minimize the time-consuming and expensive tasks of establishing requirements and designing the specifications. In addition, the GSA qualification of the software will give the agencies assurance that the packages meet the minimum requirements of the central financial management agencies.

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QUESTION 10

HOW IS FMS MAXIMIZING THE USE OF CROSS-SERVICING AGREEMENTS WITH OTHER FEDERAL AGENCIES?

RESPONSE

FMS has supported the cross-servicing concept, where one agency provides financial services to other agencies. FMS will be directly involved in cross-servicing when it develops the capability to provide accounting services to other agencies. We understand that FMS is also working with agencies to identify other potential providers and recipients under this concept.

QUESTION 11

BASED EXCLUSIVELY UPON RECEIPTS AND OUTLAY INFORMATION, IS PRESENT FINANCIAL REPORTING SUFFICIENTLY ADEQUATE, PROPERLY INFORMATIVE AND ESSENTIALLY CORRECT?

RESPONSE

No. We believe that receipt and outlay information should be supplemented by accounting data which reflect the government's assets and liabilities. Receipt and outlay information (cash basis accounting) helps establish cash and debt management policy, but it leaves out important information about the long-term costs of government. With passage of a 1956 amendment to the Budget and Accounting Procedures Act of 1950, the Congress required accrual basis accounting for the federal government. It provides information needed to control costs, manage program and agency performance, and put us in a better position to determine the government's overall financial condition.

Briefly stated, the difference between the cash and accrual basis of accounting centers on when transactions are recognized in the accounting systems and the resulting reports. The cash basis recognizes transactions only when cash changes hands (budget receipts or outlays). This "checkbook" type of accounting for the deficit does not reflect information about assets, liabilities, or future commitments, nor does it consistently disclose actual costs, current and deferred.

The accrual basis of accounting recognizes the financial impact of government transactions, decisions, and activities as they happen--when revenues are earned, when resources are used, and when liabilities and costs are incurred--regardless of when obligations are incurred or when cash is received or paid.

Consequently, accrual basis accounting can provide important information on the financial position of the federal government and individual agencies which is not available under cash basis accounting. Unfortunately, accrual information is not readily available to the federal government because agencies, for the most part, continue to use and rely on receipt and outlay information, even though accrual based information has been required by law for more than 30 years.

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QUESTION 12

WHAT INSTRUMENTS OF MEASUREMENT AND ANALYSIS DOES THE TREASURY NOW HAVE AT ITS DISPOSAL? IN WHAT WAYS ARE THEY USEFUL? IN WHAT WAYS ARE THEY INADEQUATE?

RESPONSE

The Budget and Accounting Procedures Act of 1950 requires the Secretary of the Treasury to prepare reports on the financial operations of the government and provides that each executive agency must furnish reports and information that the Secretary of the Treasury may require. Two required reports are the TFS Form 220, "Report on Financial Position," and TFS Form 221, "Report on Operations," which were upgraded in 1986 as part of the TFS revision. Form 220 includes the reporting entity's assets, liabilities, and equity as of the reporting date. It requires disclosure of the valuation basis for major asset categories, significant restrictions on assets, and significant contingent liabilities. TFS Form 221 includes revenues and other financing sources and operating expenses.

Treasury is developing a governmentwide financial data base to provide an analytical capability all agencies can use in evaluating financial performance. This program has three major objectives:

-- to increase the usefulness of Treasury-gathered financial data to agency program and financial managers,

-- to provide guidelines and assistance to agencies in assessing their financial management programs, and

-- to better integrate financial data into the budgetary process and improve decision-making in the federal government.

The first module of the data base is to assist FMS and agencies in analyzing reported accounts and loans receivable. These analyses would identify ratios on such things as the overall delinquency rate and rates of debt write-off, rescheduled receivables, and the amount of collections.

We understand that Treasury plans to complete the design work of this first module by December 1988, at which time it will be available to all government users. Treasury is developing similar applications for inventories, liabilities, and other balance sheet data.

If the analytical capability being developed by Treasury is fully implemented, it will be a valuable tool to assist federal financial managers and analysts in evaluating the performance and efficiency of agency programs. However, it is dependent on the quality of data in the financial systems. Improvements are needed in that area before the reports and analyses will be fully useful.

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QUESTION 13

IN CONJUNCTION WITH OTHER FEDERAL DEPARTMENTS AND AGENCIES, HOW CAN THE TREASURY ENHANCE ITS ABILITY TO PROVIDE RELEVANT FINANCIAL INFORMATION TO THE GENERAL PUBLIC?

RESPONSE

Treasury has been providing prototype governmentwide financial statements to the general public since 1976. The objective of these statements is to convey relevant summary information about the financial condition and operations of the federal government. The statements are intended to disclose the magnitude of the government's assets, liabilities, and the full cost of operations for the year.

The Treasury needs to continue working with agencies to improve the quality of the information in their individual financial reports. The immediate goal is to improve the agencies' financial systems to ensure that they produce reliable information.

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QUESTION 14

DOES THE CONGRESS PRESENTLY HAVE SUFFICIENT AND UNDERSTANDABLE DATA TO FULFILL ITS MANDATE OF APPROPRIATING AND AUTHORIZING PUBLIC FUNDS?

RESPONSE

Government financial information focuses primarily on obligations (when an item or service is ordered) and outlays (when the bill is paid). Obligation basis reporting is essential for fund control purposes in monitoring the extent to which agencies are making commitments for future payments. Cash basis reporting is essential in managing fiscal, debt, and credit policies. Both are important, but neither is a completely reliable measure of the resources being consumed in carrying out government programs. Accrual basis reporting is essential in determining the cost of units of delivered service. (See the response to question 11 for a comparison of cash basis and accrual basis accounting.)

The Congress depends heavily upon the data reported in the President's annual budget. Unfortunately, the structure and concepts of the President's budget obscure important information and result in several problems:

-- Under current budget rules, disbursements for capital acquisitions are treated the same as disbursements for current expenses, even though in the former the government receives assets that benefit future periods in return for its capital outlays. State governments recognize that debt incurred for capital items is an investment whose cost should be spread over its useful life rather than solely be a factor in determining the surplus or deficit for the current year. Most of the states have balanced budget requirements that focus on the current expenses part of governmental activities. At the federal level the lack of such a distinction between capital and current amounts forecloses this option. This is why we have proposed a capital budgeting approach within the unified federal budget with subtotals for both "operating surplus or deficit" and "capital financing requirements."

-- The budget total does not adequately distinguish between trust and non-trust fund amounts. The merging of present trust fund surpluses with the non-trust fund deficit in a single, unified budget total masks the magnitude of the deficit for the non-trust fund activities. For example, in fiscal year 1987, the $150 billion total deficit actually was comprised of a surplus of $73 billion in the trust funds and a deficit of $223 billion in the non-trust funds. If more prominence were given to separate budget totals for the trust and non-trust funds, government officials and the public could better understand the degree to which trust fund surpluses, which may not continue indefinitely, are obscuring the severity of the operating deficit problem.

The masking effect has recently received considerable attention with respect to the Social Security trust funds' growing balances. The annual balances--that is, annual payroll tax revenues in excess of annual benefit payments--have grown significantly since the 1983 Social Security amendments. By law, the annual balances of these and other trust funds must be invested in U. S. Treasury securities, thereby financing the debt incurred for the non-trust fund activities of the government.

Current projections are that the Social Security trust funds will begin to run annual deficits sometime in the first quarter of the 21st century, requiring the funds' administrators to redeem their Treasury securities to obtain the cash needed for benefit payments. This need not present a problem to Treasury, provided there is a sound fiscal balance between the trust and non-trust sides of governmental operations. If, however, the government is borrowing heavily to finance a large non-trust fund deficit at that time, there could be economic reasons to avoid significant new borrowing to redeem the securities. In that case, the needed funds could be made available through new taxes or spending cuts, but both of these approaches could present problems as well.

Unfortunately, the current structure of budget information, with its focus upon a single surplus or deficit total, does not facilitate the kind of analyses needed to assure a proper fiscal relationship between trust and non-trust operations. Improved budget reporting on the annual trust fund surpluses or deficits would address this masking problem.

-- The current cash-based budget reporting provides incomplete cost information on some major future liabilities because it does not include them in the budget totals reviewed by the Congress. The federal government incurs certain liabilities, such as future pension payments, which may not require cash outlays until long after the liability has been incurred. In such cases, the cash-based budget does not always recognize the liability.

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QUESTION 15

IN WHAT WAYS CAN THE TREASURY PROVIDE MORE ACCURATE AND CONCISE DATA TO ENHANCE THE PRESIDENT'S DECISION-MAKING CAPABILITIES REGARDING FISCAL POLICY?

RESPONSE

As discussed in question 11, it is important for the government to have accrual basis information as well as receipt and outlay information. The ability to provide the President with accurate and concise data depends upon the consistency, accuracy, and timeliness of data reported by the agencies, and the effectiveness of Treasury's systems to summarize and analyze the information. Improved financial management systems throughout the government are the key to providing good information upon which to base decisions at all levels of government.

QUESTION 16

HOW CAN MODERNIZED FINANCIAL ANALYSIS BE FURTHERED TO EVALUATE THE EFFECTIVENESS OF PAST SPENDING DECISIONS WITHIN THE GOVERNMENT?

RESPONSE

Financial analysis and the product of that analysis--improved financial management--would be enhanced by taking the needed steps in financial management reform. Analysis depends on reliable information and, as we have pointed out in testimony and in audit reports, managers currently receive information from financial management systems that need to be updated and modified. Analysis of past spending decisions and planning based on that analysis is flawed because of the financial management problems within our government.

Our response to question 17 presents views on what is needed to reform federal financial management.

QUESTION 17

WHAT, IF ANY, LEGISLATIVE COURSE SHOULD THE CONGRESS TAKE TO ASSIST THE FEDERAL GOVERNMENT IN UPGRADING ITS FINANCIAL MANAGEMENT SYSTEMS?

RESPONSE

We strongly believe that the Congress should establish a legislative mandate to ensure that financial management reform occurs, is guided by a comprehensive plan, and transcends individual administrations. Consequently, in 1987 we developed draft legislation which would establish leadership and instill permanence in the reform process. Our draft legislation embodies three critical elements:

-- centralized leadership that is responsible for developing and implementing a governmentwide plan to improve financial management systems and report annually on the plan's progress,

-- corresponding financial management leadership in executive branch departments and agencies, and

-- annual preparation and audit of agency and governmentwide financial statements to foster accountability and system integrity.

Legislation will provide a permanence that is absent from administratively based initiatives. GAO studied centrally directed, governmentwide improvements made in the 1970s and found that few initiatives had lasting impact.[1] In our view, many of these initiatives would have resulted in more permanent changes if there had been a legislative mandate to ensure their continued existence and consistency across successive administrations. Similarly, in a 1983 report, Revitalizing Federal Management, a panel of experts at the National Academy of Public Administration concluded that the government had experienced a decade of declining managerial effectiveness despite efforts to solve specific management problems. They reported that improvement efforts had been sporadic, poorly planned, and inadequately backed and staffed.

The President's report, Management of the United States Government--Fiscal Year 1989, calls for "legislation that will define and provide statutory underpinning for a permanent Chief Financial Officer structure throughout Government." It further stated that a legislatively based organization would provide continuity of financial operations and improvement programs during changes in administrations.

Legislation provides an ongoing requirement for action through the congressional oversight process. It also promotes continuity which otherwise may be lost during a change in

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[1]Selected Government-Wide Management Improvement Efforts--1970 to 1980 (GAO/GGD-83-69, August 8, 1983).

administrations. Therefore, we strongly support enactment of legislation to establish an adequate financial management structure, promote long range planning, and require the annual preparation and audit of agency and governmentwide financial statements.

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☆U.S. G.P.O. 1988-201-749:80171