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Financial Management, Committee on Government  
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**FISCAL YEAR 2002  
U.S. GOVERNMENT  
FINANCIAL STATEMENTS**

**Sustained Leadership and  
Oversight Needed for  
Effective Implementation  
of Financial Management  
Reform**

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





Highlights of [GAO-03-572T](#), testimony before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

# FISCAL YEAR 2002 U.S. GOVERNMENT FINANCIAL STATEMENTS

## Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform

### Why GAO Did This Study

GAO is required by law to audit the consolidated financial statements of the U.S. government.

Timely, accurate, and useful financial information is essential for making informed operating decisions day to day, managing the federal government's operations more efficiently and effectively, meeting the goals of federal financial management reform legislation, supporting results-oriented management approaches, and ensuring accountability on an ongoing basis.

The importance of such information is heightened by the unprecedented demographic challenge of an aging population. Federal spending on the elderly, health care, and new homeland security and defense commitments increases the need to look at competing claims on the budget and at new priorities.

Over the past year, the Principals of the Joint Financial Management Improvement Program continued efforts to accelerate progress in financial management reform. Also, President Bush has implemented the President's Management Agenda to provide direction to, and closely monitor, management reform across government, which encompasses improved financial management performance. To effectively implement federal financial management reform, sustained leadership and oversight are essential.

[www.gao.gov/cgi-bin/getrpt?GAO-03-572T](http://www.gao.gov/cgi-bin/getrpt?GAO-03-572T).

To view the full report, including the scope and methodology, click on the link above. For more information, contact Jeffrey Steinhoff or Gary Engel at (202) 512-2600.

### What GAO Found

As in the 5 previous fiscal years, the federal government continues to have a significant number of material weaknesses related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation. Several of these material weaknesses resulted in conditions that continued to prevent us from expressing an opinion on the U.S. government's consolidated financial statements for the fiscal years ended September 30, 2002 and 2001.

Three major impediments to an opinion on the consolidated financial statements are (1) serious financial management problems at DOD, (2) the federal government's inability to fully account for and reconcile billions of dollars of transactions between federal entities, and (3) the federal government's inability to properly prepare the consolidated financial statements.

Federal agencies have continued to make progress in obtaining unqualified audit opinions—21 of 24 Chief Financial Officers (CFO) Act agencies for fiscal year 2002 (see table), up from 6 for fiscal year 1996. Irrespective of the unqualified opinions, many federal agencies do not have timely, accurate, and useful financial information and sound controls with which to make informed decisions and to ensure accountability on an ongoing basis.

Building on the success achieved in obtaining unqualified audit opinions, federal agency management must continue to work toward fully resolving the pervasive and generally long-standing material weaknesses that have been reported for the past 6 fiscal years. The President's Management Agenda stated that without sound internal control and accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people.

**Fiscal Year 2002 CFO Act Agency Results Reported by Auditors**

Agencies with unqualified opinions	Agencies with unqualified opinions and no material weaknesses or noncompliances
21 <sup>a</sup>	4 <sup>b</sup>

Source: GAO.

<sup>a</sup> Agriculture, Commerce, Education, Energy, Federal Emergency Management Agency, Health and Human Services, Housing and Urban Development, Interior, Justice, Labor, State, Transportation, Treasury, Veterans Affairs, Environmental Protection Agency, General Services Administration, National Aeronautics and Space Administration, National Science Foundation, Nuclear Regulatory Commission, Office of Personnel Management, and Social Security Administration.

<sup>b</sup> Energy, General Services Administration, National Science Foundation, and Social Security Administration.

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our report on the U.S. government's consolidated financial statements for fiscal years 2002 and 2001. Both the consolidated financial statements and our report are included in the fiscal year 2002 *Financial Report of the United States Government*, which was issued by the Department of the Treasury (Treasury) on March 31, 2003, and is available through GAO's Internet site, at [www.gao.gov](http://www.gao.gov), and Treasury's Internet site, at [www.fms.treas.gov/fr/index.html](http://www.fms.treas.gov/fr/index.html). At the outset, I would like to thank the subcommittee for continuing an annual tradition of oversight hearings on this important subject. The work of the former Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, along with its leader, former Congressman Stephen Horn, has been a catalyst to facilitate government management reform over the past 6 years. The continued involvement of this subcommittee will be critical to ultimately restoring public confidence in the federal government as a financial steward that is accountable for its finances.

As in the 5 previous fiscal years, certain material weaknesses<sup>1</sup> in internal control and in accounting and reporting prevented us from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements are fairly stated in conformity with U.S. generally accepted accounting principles. Until the problems discussed in our report are adequately addressed, they will continue to (1) hamper the federal government's ability to accurately report a significant portion of its assets, liabilities, and costs, (2) affect the federal government's ability to accurately measure the full cost and financial performance of certain programs and effectively manage related operations, and (3) significantly impair the federal government's ability to adequately safeguard certain significant assets and properly record various transactions.

Across government, financial management improvement initiatives are under way that, if effectively implemented, have the potential to appreciably improve the quality of the federal government's financial management and reporting. A number of federal agencies have started to

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<sup>1</sup>A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

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make progress in their efforts to modernize their financial management systems and improve financial management performance as called for in the President's Management Agenda. For example, the Department of the Treasury's Internal Revenue Service (IRS) has made significant progress in addressing its financial management weaknesses, including addressing controls over budgetary activity and its accountability over property and equipment. Resolving many of IRS's most serious financial management weaknesses—identified by GAO as a high-risk area since 1995—will require a sustained, long-term commitment of resources, continued strong involvement of senior IRS management, and sustained progress in systems modernization.

This year marks the earliest that federal agencies' audited financial statements have ever been available. For the first time, Chief Financial Officers Act (CFO) Act agencies were required to combine their audited financial statements with performance reports and deliver both to the Office of Management and Budget (OMB) by February 1, a month earlier than last year. Furthermore, the Principals of the Joint Financial Management Improvement Program (JFMIP)<sup>2</sup>—the Secretary of the Treasury, the Directors of OMB and the Office of Personnel Management (OPM), and I, as Comptroller General of the United States—have agreed to accelerate the agency financial statement reporting date to November 15 for fiscal year 2004. The Social Security Administration (SSA), which has a long-standing record of delivering its audited financial statements well before the mandated deadline, issued its fiscal year 2002 audited financial statements on November 19, 2002. Treasury also accelerated its time frame and issued its fiscal year 2002 audited financial statements on November 15, 2002, which was more than 3 months earlier than for fiscal year 2001.

For fiscal year 2002, 21 of the 24 CFO Act agencies were able to attain unqualified audit opinions on their financial statements (the appendix lists the 24 CFO Act agencies, their audit results, and auditors), up from 6 agencies for fiscal year 1996. Also, 4 CFO Act agencies showed improvement by receiving unqualified opinions from their auditors this year—the Department of Education, the National Aeronautics and Space Administration (NASA), the Federal Emergency Management Agency, and

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<sup>2</sup>JFMIP is a joint and cooperative undertaking of Treasury, GAO, OMB, and OPM working in cooperation with each other and other federal agencies to improve financial management practices in the federal government. Leadership and program guidance are provided by the four JFMIP Principals.

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the Department of Agriculture (USDA), which received an unqualified audit opinion for the first time. On the other hand, after receiving unqualified opinions on its financial statements since fiscal year 1996, the Small Business Administration's (SBA) independent auditor withdrew its unqualified audit opinions on the agency's fiscal years 2001 and 2000 financial statements and issued disclaimers of opinion on the agency's fiscal years 2002 and 2001 financial statements.

Although obtaining unqualified audit opinions is important, according to the President's Management Agenda, "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records." Further, the President's Management Agenda stated that without sound internal control and accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people. It will be increasingly difficult for federal agencies to continue to rely on significant costly and time-intensive manual efforts to achieve or maintain unqualified opinions until automated, integrated processes and systems are implemented that readily produce the necessary information. As a result, many federal agencies must accelerate their efforts to improve underlying financial management systems and controls, which is consistent with reaching the financial management success measures envisioned by the JFMIP Principals and called for by the President's Management Agenda.

Before discussing the results of the audit of the U.S. government's consolidated financial statements in more detail, I would like to discuss why sound financial management is especially necessary for the future, as well as for today, to meet tomorrow's fiscal needs. I then will highlight the major issues relating to the consolidated financial statements for fiscal years 2002 and 2001. I will then discuss the urgency of providing sustained leadership and oversight for effective implementation of financial management reform, provide my perspectives on the importance of federal agencies' building on the success of their unqualified audit opinions by significantly improving underlying financial management systems, and underscore the need to address major impediments to an opinion on the consolidated financial statements. Also, I will present my observations on selected audit matters that are key to protecting the public interest.

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## Meeting Tomorrow's Fiscal Needs

The requirement for timely, accurate, and useful financial and performance management information is greater than ever. The long-term fiscal pressures created by the retirement of the baby boom generation and new homeland security and defense commitments, including the ongoing Operation Iraqi Freedom, sharpen the need to look at competing claims on federal budgetary resources and new priorities. In previous testimony, I noted that it should be the norm to reconsider the relevance or “fit” of any federal program or activity in today’s world and for the future.<sup>3</sup> Such a fundamental review is necessary both to increase fiscal flexibility and to make government fit the modern world. Stated differently, there is a need to consider what the proper role of the federal government will be in the 21st century and how the government should do business in the future. The budget and performance integration initiative undertaken as part of the President’s Management Agenda should help provide information for use in conducting such reviews. OMB’s Program Assessment Rating Tool (PART) represents a step toward more structured involvement of program and performance analysis in the budget. PART includes general questions on (1) program purpose and design, (2) strategic planning, (3) program management, and (4) program results. It also includes a set of more specific questions that vary according to the type of delivery mechanism or approach the program uses.

As we look ahead, the federal government faces an unprecedented demographic challenge. A nation that has prided itself on its youth will become older. Between now and 2035, the number of people who are 65 years old or over will double. As the share of the population over 65 climbs, federal spending on the elderly will absorb larger and ultimately unsustainable shares of the federal budget. Federal spending on health and entitlement programs for the elderly is expected to surge as people live longer and spend more time in retirement. In addition, advances in medical technology are likely to keep pushing up the cost of providing health care. Moreover, the baby boomers will have left behind fewer workers to support them in retirement, prompting a slower rate of economic growth from which to finance these higher costs. Absent substantive reform of related entitlement programs and/or dramatic changes in tax or discretionary spending policies, we will face large, escalating, and persistent deficits.

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<sup>3</sup>U.S. General Accounting Office, *Budget Issues: Long-Term Fiscal Challenges*, [GAO-02-467T](#) (Washington, D.C.: Feb. 27, 2002) and U.S. General Accounting Office, *Budget Issues: Effective Oversight and Budget Discipline are Essential—Even in a Time of Surplus*, [GAO/T-AIMD-00-73](#) (Washington, D.C.: Feb. 1, 2000).

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These trends have widespread implications for our society, our economy, and the federal budget.

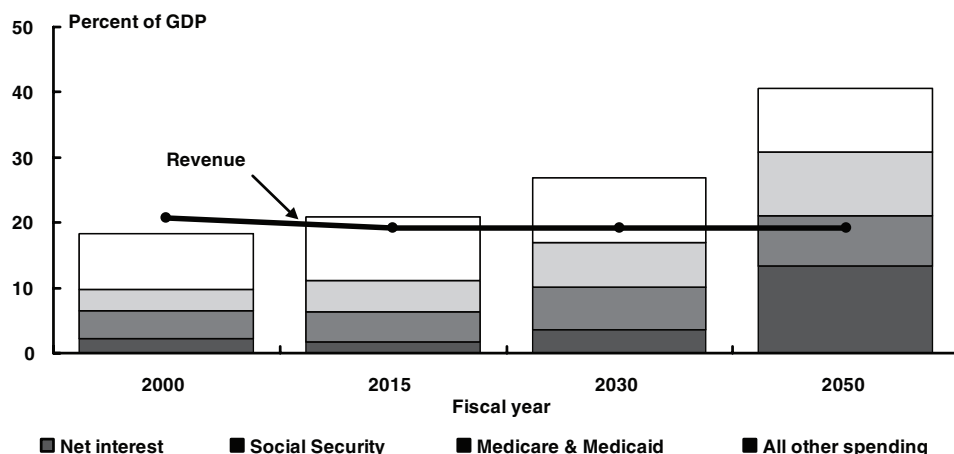
On March 17, 2003, the Trustees of the Social Security and Medicare trust funds reported on the current and projected status of these programs over the next 75 years. The Trustees report that the fundamentals of the financial status of both Social Security and Medicare remain highly problematic. However, they stated that Medicare faces financial difficulties that are more severe than those confronting Social Security because costs of the Medicare program are projected to rise faster than costs of the Social Security program. The projections show a 20 percent increase to about \$6.2 trillion over the prior year in the Present Value of Resources Needed Over the 75-Year Projection Period for Federal Hospital Insurance (Medicare Part A), while the Social Security projection showed an 8 percent increase to about \$4.9 trillion. Once again, the Trustees state that action to address the financial difficulties facing Social Security and Medicare must be taken in a timely manner and that the sooner these financial challenges are addressed, the more varied and less disruptive the solutions can be.

Early action to change these programs would yield the highest fiscal dividends for the federal budget and would provide a longer period for prospective beneficiaries to make adjustments in their own planning. Waiting to take action entails risks. First, we lose an important window where today's relatively large workforce can increase saving and enhance productivity, two elements critical to growing the future economy. Second, we lose the opportunity to reduce the burden of interest in the federal budget, thereby creating a legacy of higher debt as well as elderly entitlement spending for the relatively smaller workforce of the future. Third, and most critically, we risk losing the opportunity to phase in changes gradually so that all can make the adjustments needed in private and public plans to accommodate this historic shift.

We prepare long-term budget simulations that seek to illustrate the likely fiscal consequences of the coming demographic tidal wave and rising health care costs. Our latest long-term budget simulations reinforce the need for change in the major cost drivers—Social Security and health care programs. As shown in figure 1, by midcentury, absent reform of these entitlement programs, projected federal revenues may be adequate to pay little beyond interest on the debt and Social Security benefits. Further, the shift from surplus to deficit means that the nation will move into the future in a weaker fiscal position than was previously the case.

Figure 1:

**Composition of Spending as a Share of GDP**  
Assuming Discretionary Spending Grows with GDP after 2003  
and the 2001 Tax Cuts Do Not Sunset



Source: GAO's March 2003 analysis.

Note: Assumes currently scheduled Social Security benefits are paid in full throughout the simulation period.

Although the need for structural change in Social Security is widely recognized, this change would not be sufficient to overcome the long-term fiscal challenges confronting the nation. For example, the long-term fiscal imbalance would not come close to being eliminated even if Social Security benefits were to be limited to currently projected trust fund revenues, because Medicare and Medicaid—spending for which is driven by both demographics and rising health care costs—present an even greater problem.

While addressing the challenges of Social Security and Medicare is key to ensuring future fiscal flexibility, a fundamental review of major programs, policies, and operations can create much-needed fiscal flexibility to address emerging needs. As I have stated previously, it is healthy for the nation periodically to review and update its programs, activities, and priorities.<sup>4</sup> Many federal programs and policies were designed years ago to respond to earlier challenges. Ultimately, the federal government should strive to hand to the next generation the legacy of a government that is effective and relevant to a changing society—a government that is as free



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as possible of outmoded commitments and operations that can inappropriately encumber the future.

A reexamination of existing programs and policies could help weed out items that have proven to be outdated or persistently ineffective or alternatively could prompt us to update and modernize activities through such actions as improving program targeting and efficiency, consolidation, or reengineering of processes and operations. Such a review should not be limited to only spending programs but should include the full range of tools of governance that the federal government uses to address national objectives. These tools include loans and loan guarantees, tax expenditures, and regulations.

In the last decade the Congress put in place a series of laws designed to improve information about cost and performance. This framework and the information it provides can help structure and inform the debate about what the federal government should do. In addition, GAO has identified a number of areas warranting reconsideration based on program performance, targeting, and costs.

The events of the past few years have served to highlight the benefits of fiscal flexibility. Addressing the long-term drivers in the budget is essential to preserving any flexibility in the long term. In the nearer term, a fundamental review of existing programs and policies can also create much-needed fiscal flexibility. In this regard, the federal government must determine how best to address the necessary structural challenges in a reasonably timely manner in order to identify specific actions that need to be taken. As steward of the nation's future, the federal government must begin to prepare for tomorrow.

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## Need for New Metrics and Mechanisms

Today's budget decisions shape, in part, the choices and resources available to future decision makers and taxpayers. Accordingly, today's budget decisions involve tradeoffs between meeting current needs and fulfilling stewardship responsibilities. The government undertakes a wide range of responsibilities, programs, and activities that may call for future spending or create an expectation for such spending. Figure 2 illustrates some of these claims on future federal resources.

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<sup>4</sup>[GAO/T-AIMD-00-73](#).

Figure 2:

## Selected Fiscal Exposures: Sources and Example (End of Fiscal Year 2002)

Type	Example (dollars in billions)
Explicit liabilities	<ul style="list-style-type: none"><li>• Publicly held debt (\$3,540)</li><li>• Military &amp; civilian pension &amp; post-retirement health (\$2,673)</li><li>• Veterans benefits payable (\$849)</li><li>• Environmental and disposal liabilities (\$273)</li><li>• Loan guarantees (\$28)</li></ul>
Explicit financial commitments	<ul style="list-style-type: none"><li>• Undelivered orders (\$539)</li><li>• Long-term leases (\$50)</li></ul>
Explicit financial contingencies	<ul style="list-style-type: none"><li>• Unadjudicated claims (\$9)</li><li>• National insurance programs (\$43)</li></ul>
Implicit exposures implied by current policies or the public's expectations about the role of government	<ul style="list-style-type: none"><li>• Debt held by government accounts (\$2,674)</li><li>• Future Social Security benefit payments (\$3,549)*</li><li>• Future Medicare Part A benefit payments (\$5,931)*</li><li>• Life cycle costs including deferred &amp; future maintenance and operating costs (amount unknown)</li></ul>

Source: GAO.

\*These amounts represent NPV over 75 years and are net of debt held by the Trust Funds (\$1,378 billion for Social Security and \$235 billion for Medicare Part A). Figures for Social Security and Medicare Part A are as of January 1, 2003.

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A better understanding and more transparency about these “fiscal exposures” is needed. The budget needs to employ new metrics and measures and processes—relying more on long-term estimates and present value concepts in making resource allocation decisions. Neither current budget reporting nor financial statements are designed to promote the recognition and explicit consideration of all of these exposures. Our nation’s fiscal exposures cover a wide range: from explicit liabilities to implicit promises embedded in current policy or public expectations. Some, like accounts payable and loan guarantees, are included in both the budget and financial statements and some are not. Others, such as liability for environmental cleanup, are reported in the financial statements, but only a single year’s figures are in the budget. Some implicit exposures, such as future Social Security and Medicare benefits, are not included in the budget or reported as liabilities in the financial statements<sup>5</sup> but are captured in long-range budget projections. Other implicit exposures, such as the risk assumed by insurance programs, may not be captured in either budget or financial reporting.

The failure to understand and address these fiscal exposures can have significant consequences, encumbering future budgets and reducing fiscal flexibility. Further, the failure to capture the long-term costs of a proposal or decision limits the Congress’s ability to control fiscal exposures at the time it is being asked to make the decision.

As the figure makes clear, there is wide diversity in the nature of these fiscal exposures. This diversity suggests that it would be most useful to look at different types of fiscal exposures and tailor metrics and changes to address each type. We recently recommended<sup>6</sup> that OMB report annually on fiscal exposures, including a concise list and description and cost estimates where possible. We also recommended that, where possible, OMB report the estimated costs associated with certain exposures as a new budget concept—“exposure level”—as a notational item in the President’s budget. These two steps would help alert both the public and policy makers about the long-term implications of programs, policies and activities.

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<sup>5</sup>The stewardship information section of the U.S. government’s consolidated financial statements presents the present value of long-range actuarial projections for the Social Security and Medicare programs, together with related information.

<sup>6</sup>U.S. General Accounting Office, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, GAO-03-213 (Washington, D.C.: Jan. 24, 2003).

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It is important to recognize that for trust funds, greater transparency and fuller disclosure means going beyond trust fund balances or solvency measures. For federal trust funds the balances do not provide meaningful information about program sustainability. These balances do not increase the government's ability to meet long-term commitments. Nor do they necessarily represent the full future cost of existing promises. For example, the projected exhaustion date of the Hospital Insurance (HI) Trust Fund is a commonly used indicator of HI's financial condition. Under the Trustees' 2003 intermediate estimates, the HI Trust Fund is projected to exhaust its assets in 2026. Long before that, however, HI's program outlays will exceed program tax revenues. Under the Trustees' 2003 intermediate estimates, this will begin in 2013. To finance program cash deficits, HI will need to draw on the special-issue Treasury securities acquired during the years of cash surpluses. For HI to "redeem" its securities, the government will need to obtain cash through some combination of increased taxes, spending cuts, and/or increased borrowing from the public (or, if the unified budget is in surplus, less debt reduction than would otherwise have been the case). HI's negative cash flow will place increased pressure on the federal budget to raise the resources necessary to meet the program's ongoing costs.

Ultimately, the critical question is not how much a trust fund has in assets, but whether the government as a whole and the economy can afford the promised benefits now and in the future and at what cost to other claims on available resources. Extending a trust fund's solvency without reforms to make the underlying program more sustainable can create a false sense of security and delay needed reform. Because the balances can be misleading, we need to reconsider how trust funds, and the nonmarketable federal government securities contained therein, are treated in both the budget and the federal government's financial statements.

Today the Congress and President Bush face the challenge of sorting out these many claims on the federal budget without the budget enforcement mechanisms or fiscal benchmarks that guided the federal government through the years of deficit reduction.<sup>7</sup> However, it is still the case that the federal government needs a decision-making framework that permits it to evaluate choices against both today's needs and the longer-term fiscal future that will be handed to future generations. More complete, visible,

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<sup>7</sup>We have recently issued a report offering some suggestions on how to better improve information about the long-term cost implications of various programs and activities. See [GAO-03-213](#).

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and transparent reporting of fiscal exposures can better position decision makers to do this.

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## Highlights of Major Issues Relating to the U.S. Government's Consolidated Financial Statements for Fiscal Years 2002 and 2001

As I mentioned earlier, as has been the case for the past 5 fiscal years, the federal government continues to have a significant number of material weaknesses related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation. Several of these material weaknesses (referred to hereafter as material deficiencies) resulted in conditions that continued to prevent us from expressing an opinion on the U.S. government's consolidated financial statements for the fiscal years ended September 30, 2002 and 2001.<sup>8</sup> There may also be additional issues that could affect the consolidated financial statements that have not been identified.

Major challenges include the federal government's inability to

- properly account for and report property, plant, and equipment and inventories and related property, primarily at the Department of Defense (DOD);
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities and related costs at DOD, and ensure complete and proper reporting for commitments and contingencies;
- support major portions of the total net cost of government operations, most notably related to DOD, and ensure that all disbursements are properly recorded;
- fully account for and reconcile intragovernmental activity and balances; and
- properly prepare the federal government's financial statements, including fully ensuring that the information in the consolidated financial statements is consistent with the underlying agency financial statements, balancing the statements, adequately reconciling the results

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<sup>8</sup>We previously reported that material deficiencies prevented us from expressing an opinion on the fiscal years 1997, 1998, 1999, and 2000 consolidated financial statements.

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of operations to budget results, and eliminating transactions between governmental entities.

In addition, we identified material weaknesses in internal control related to loans receivable and loan guarantee liabilities, improper payments, tax collection activities, and information security.

I would now like to discuss in more detail the material deficiencies identified by our work.

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### Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that all such assets were included in the consolidated financial statements, verify that certain reported assets actually exist, or substantiate the amounts at which they were valued. A significant portion of the property, plant, and equipment and the vast majority of inventories and related property are the responsibility of DOD. DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably NASA, reported continued weaknesses in internal control procedures and processes related to property, plant, and equipment.

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### Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, the federal government was not able to reliably estimate key components of DOD's environmental and disposal liabilities and could not support its estimate of military postretirement health benefits liabilities included in federal employee and veteran benefits payable. Further, the federal government could not determine whether commitments and contingencies, including those related to treaties and other agreements entered into to further the U.S. government's interest, were complete and properly reported.

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### Cost of Government Operations and Disbursement Activity

The previously discussed material deficiencies in reporting assets and liabilities, material deficiencies in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of government operations, most notably related to DOD. As it relates to disbursement reconciliations, some federal agencies did not adequately

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reconcile disbursements to Treasury's records of disbursements, which is intended to be a key control to detect and correct errors and other misstatements in financial records in a timely manner. We have seen progress in this area over the past 6 years. However, for fiscal years 2002 and 2001 there were unsupported adjustments and unreconciled differences between federal agencies' and Treasury's records of disbursements totaling billions of dollars.

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### Accounting for and Reconciliation of Intragovernmental Activity and Balances

OMB and Treasury require CFO Act agencies to reconcile selected intragovernmental activity and balances with their "trading partners"<sup>9</sup> and to report on the extent and results of intragovernmental activity and balances reconciliation efforts. However, a substantial number of the CFO Act agencies did not fully perform such reconciliations for fiscal years 2002 and 2001. For both of these years, amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance. I will discuss these issues further later in this testimony, as well as certain related corrective actions being taken.

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### Preparation of Consolidated Financial Statements

The federal government did not have adequate systems, controls, and procedures to properly prepare its consolidated financial statements. Specifically, we identified problems with compiling the consolidated financial statements, such as adequately ensuring that the information for each federal agency that was included in the consolidated financial statements was consistent with the underlying agency financial statements. In addition, we identified problems with the elimination of intragovernmental activity and balances. Later in this testimony, these matters are discussed further, along with certain corrective actions being taken. Also, disclosure of certain financial information was not presented in the consolidated financial statements in conformity with U.S. generally accepted accounting principles.

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### Ineffective Internal Control

In addition to the material deficiencies noted above, we found four other material weaknesses in internal control as of September 30, 2002: (1) several federal agencies continue to have significant deficiencies in the

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<sup>9</sup>Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

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processes and procedures used to estimate the costs of their lending programs and value their loan receivables; (2) most federal agencies have not estimated or reported the magnitude of improper payments in their programs; (3) material internal control weaknesses and systems deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities; and (4) federal agencies have not yet institutionalized comprehensive information security management programs.

## Loans Receivable and Loan Guarantee Liabilities

Prior to fiscal year 2001, we cited accounting for loans receivable and loan guarantee liabilities as a material deficiency contributing to our disclaimer of opinion because certain key federal credit agencies could not reliably estimate the costs of their lending programs or determine the net loan amounts expected to be collected. In fiscal year 2001, due to significant improvements at USDA, we removed this area from the list of issues contributing to our disclaimer. Nevertheless, several federal agencies continue to have significant deficiencies in the processes and procedures used to estimate the costs of their lending programs and value their loan receivables.

In a recent report on SBA's loan asset sale program,<sup>10</sup> we reviewed SBA's budgeting and accounting for loan sales and found that SBA incorrectly calculated the accounting losses on the loan sales and lacked reliable financial data to determine the overall financial impact of the sales. Further, because SBA did not analyze the effect of loan sales on its remaining portfolio, its reestimates of loan program costs for the budget and financial statements may contain significant errors. In addition, SBA could not explain significant declines in its loss allowance account for disaster loans. SBA's inspector general and its independent auditor agreed with our findings, and the independent auditor withdrew its unqualified audit opinions on SBA's fiscal years 2001 and 2000 financial statements. Until SBA corrects these errors and determines the cause of the precipitous decline in the loss allowance account for disaster loans, SBA's financial statements cannot be relied upon. Further, the reliability of current and future subsidy cost estimates will remain unknown. These errors and the lack of key analyses also mean that congressional decision makers are not

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<sup>10</sup>U.S. General Accounting Office, *Small Business Administration: Accounting Anomalies and Limited Operational Data Make Results of Loan Sales Uncertain*, [GAO-03-87](#) (Washington, D.C.: Jan. 3, 2003).



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receiving accurate financial data to make informed decisions about SBA's budget and the level of appropriations the agency should receive.

In addition, we again noted that certain other federal credit agencies continue to require significant adjustments to the estimates of program costs, net loan amounts to be collected, and related notes. Auditors for these agencies reported related material internal control weaknesses.

## Improper Payments

Across the federal government, improper payments occur in a variety of programs and activities, including those related to health care, contract management, federal financial assistance, and tax refunds.<sup>11</sup> Many improper payments occur in federal programs that are administered by entities other than the federal government. In general, improper payments often result from a lack of or an inadequate system of internal controls. While estimates of improper payments disclosed in federal agency financial statements totaled approximately \$20 billion for both fiscal years 2002 and 2001, the federal government did not estimate the full extent of improper payments. The President's Management Agenda includes addressing erroneous payments (a term we consider synonymous with improper payments) as one of the key elements for improving financial performance.

The Department of Health and Human Services (HHS) has been reporting a national estimate of improper Medicare fee-for-service payments as part of its annual financial statements since fiscal year 1996. In fiscal year 2002, HHS reported estimated improper Medicare fee-for-service payments of approximately \$13.3 billion, or about 6.3 percent of such benefits. HHS's Centers for Medicare and Medicaid Services (CMS) has initiated projects to improve the precision of Medicare fee-for-service improper payment estimates and aid in the development of corrective actions to reduce improper payment losses. For example, CMS developed a comprehensive error-testing program that will produce contractor-, provider-, and benefit-specific error rates. These error rates can be aggregated to add greater precision to the national Medicare fee-for-service error rate estimates.

However, most federal agencies have not estimated or reported the magnitude of improper payments in their programs and comprehensively

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<sup>11</sup>Improper payments include inadvertent errors, such as duplicate payments and miscalculations, payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.

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addressed this issue in their annual performance plans under the Government Performance and Results Act (GPRA) of 1993. For example, IRS follows up on only a portion of the suspicious Earned Income Tax Credit (EITC) claims it identifies, although the EITC has historically been vulnerable to high rates of invalid claims. In February 2002, IRS estimated that taxpayers filed returns for tax year 1999 claiming at least \$8.5 billion in invalid EITCs, of which only \$1.2 billion (14 percent) either was recovered or was expected to be recovered through compliance efforts. Although the full extent of refunds resulting from invalid EITCs is unknown, IRS has not routinely estimated the potential magnitude of invalid refunds and has not disclosed an annual estimate of improper payments in its financial reports. As a result, the amount of improper payments included in the almost \$28 billion IRS disbursed for EITCs for fiscal year 2002 is unknown.

Without systematically measuring the extent of improper payments, federal agency management cannot determine (1) whether problems exist that merit agency action, (2) what mitigation strategies are appropriate and the amount to invest in them, and (3) whether efforts implemented to reduce improper payments are successful. OMB, which has shown leadership in this area, now requires annual submissions on improper payments from 15 federal agencies. Specifically, OMB requires actual and projected information on erroneous payment rates and the status of actions taken to reduce improper payments. Further, the Improper Payments Information Act of 2002<sup>12</sup> requires federal agencies to (1) annually review programs and activities that they administer to identify those that may be susceptible to significant improper payments, (2) estimate improper payments in susceptible programs and activities, and (3) provide reports to the Congress that include such information as the status of actions to reduce improper payments for programs and activities with estimated improper payments of \$10 million or more.

## Tax Collection Activities

Material internal control weaknesses and systems deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities.<sup>13</sup> This situation continues to result in the need for extensive, costly, and time-consuming ad hoc programming and analyses, as well as material audit adjustments, to prepare basic financial

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<sup>12</sup>Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).

<sup>13</sup>U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2002 and 2001 Financial Statements*, [GAO-03-243](#) (Washington, D.C.: Nov. 15, 2002).

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information. As further discussed later in this testimony, this approach cannot be used to prepare such information on a timely, routine basis to assist in ongoing decision making. Additionally, the severity of the system deficiencies that give rise to the need to resort to such procedures for financial reporting purposes, as well as deficient physical safeguards, result in burden on taxpayers and lost revenue.

The lack of appropriate subsidiary systems to track the status of taxpayer accounts and material weaknesses in financial reporting affect the government's ability to make informed decisions about collection efforts. Due to errors and delays in recording activity in taxpayer accounts, taxpayers were not always being credited for payments made on their tax liabilities. In addition, the federal government did not always follow up on potential unreported or underreported taxes and did not always pursue collection efforts against taxpayers owing taxes to the federal government. This could result in billions of dollars not being collected and adversely affect future compliance.

The federal government continues to be vulnerable to lost tax revenue due to weaknesses in controls intended to maximize the government's ability to collect what is owed and to minimize the risk of payment of improper refunds. The federal government identifies billions of dollars of potentially underreported taxes and improper refunds each year. However, due in large part to perceived resource constraints, the federal government selects only a portion of the questionable cases it identifies for follow-up investigation and action. In addition, the federal government often does not initiate follow-up on the cases it selects until months after the related tax returns have been filed and any related refunds disbursed, affecting its chances of collecting amounts due on these cases. Consequently, the federal government is exposed to potentially significant losses from reduced revenue and disbursements of improper refunds. Finally, continued weaknesses in physical controls over cash, checks, and sensitive data received from taxpayers increase both the federal government's and the taxpayers' exposure to losses and increases the risk of taxpayers becoming victims of crimes committed through identity fraud.

IRS senior management continues to be committed to addressing many of these operational and financial management issues and has made a number of improvements to address some of these weaknesses. Successful implementation of long-term efforts to resolve these serious problems will require the continued commitment of IRS management as well as substantial resources and expertise.

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## Information Security Weaknesses

GAO has reported information security over computerized operations as a governmentwide high-risk area since February 1997.<sup>14</sup> Information security weaknesses are placing enormous amounts of federal government assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. The federal government is not in a position to estimate the full magnitude of actual damage and loss resulting from federal information security weaknesses because it is likely that many such incidents are either not detected or not reported. Although progress has been made, federal agencies have not yet institutionalized comprehensive security management programs, which are critical to resolving information security problems and managing information security risk on an ongoing basis.

The information security weaknesses continue to cover the full range of information security controls. For example, access controls were not effective in limiting or detecting inappropriate access to information resources, such as ensuring that only authorized individuals can read, alter, or delete data. In addition, software change controls were ineffective in ensuring that only properly authorized and tested software programs were implemented. Further, duties were not appropriately segregated to reduce the risk that one individual could conduct unauthorized transactions without being detected. Finally, sensitive operating system software was not adequately controlled, and adequate steps had not been taken to ensure continuity of operations.

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<sup>14</sup>U.S. General Accounting Office, *High-Risk Series: An Update*, [GAO-03-119](#) (Washington, D.C.: January 2003).

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Through the recently enacted Federal Information Security Management Act of 2002 (FISMA),<sup>15</sup> the Congress has continued its efforts to improve federal information security by permanently authorizing and strengthening the information security program, evaluation, and reporting requirements established by federal government information security reform legislation.<sup>16</sup> This information security reform legislation has been a significant step in improving federal agencies' information security programs and addressing their serious, pervasive information security weaknesses, and, among other benefits, has increased management attention to and accountability for information security. FISMA will further strengthen federal information security by requiring the National Institute of Standards and Technology to develop mandatory minimum information security requirements.

The administration has also taken actions to improve information security. For example, OMB created an annual reporting process that includes federal agency preparation of corrective action plans to track progress in correcting identified weaknesses. Further, in February 2003, the President issued the *National Strategy to Secure Cyberspace*, which sets national priorities for reducing threats from and vulnerabilities to cyberattacks and improving the nation's response to cyberincidents.

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## Providing Sustained Leadership and Oversight for Effective Implementation of Financial Management Reform

Over the past year, the JFMIP Principals continued our efforts, begun in August 2001, to accelerate progress in financial management reform. This involved our personal commitment to provide the leadership necessary to address pressing governmentwide financial management issues. Also, President Bush has implemented the President's Management Agenda to provide direction to, and to closely monitor, management reform across government, which encompasses improved financial performance. Actions such as these are important elements of ensuring the government's full and effective implementation of the federal financial management reforms enacted by the Congress.

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<sup>15</sup>Pub. L. No. 107-347, Title III, 116 Stat. 2946 (Dec. 17, 2002).

<sup>16</sup>Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, Pub. L. No. 106-398, Title X, Subtitle G, 114 Stat. 1654A-266 (Oct. 30, 2000).

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## The JFMIP Principals' Initiative

Since August 2001, the JFMIP Principals have established an excellent working relationship, a basis for action, and a sense of urgency through which significant and meaningful progress can be achieved. In fiscal year 2002, JFMIP Principals continued the series of regular, deliberative meetings that focused on key financial management reform issues such as

- defining success measures for financial management performance that go far beyond an unqualified audit opinion on financial statements and include measures such as financial management systems that routinely provide timely, reliable, and useful financial information and no material internal control weaknesses or material noncompliance with laws and regulations and Federal Financial Management Improvement Act of 1996 (FFMIA) requirements;<sup>17</sup>
- restructuring the Federal Accounting Standards Advisory Board's (FASAB) composition to enhance the independence of the Board and increase public involvement in setting standards for federal financial accounting and reporting;
- significantly accelerating financial statement reporting to improve timeliness for decision making and to discourage costly efforts designed to obtain unqualified opinions on financial statements without addressing underlying systems challenges;
- establishing audit advisory committees for selected major federal agencies; and
- addressing difficult accounting and reporting issues, including impediments to an audit opinion on the U.S. government's consolidated financial statements and reporting updated social insurance financial information in the U.S. government's consolidated financial statements.

Continued personal involvement of the JFMIP Principals is critical to the full and successful implementation of federal financial management reform and to providing greater transparency and accountability in managing

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<sup>17</sup>FFMIA requires auditors, as part of CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards (U.S. generally accepted accounting principles), and (3) the federal government's SGL at the transaction level.

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federal programs and financial resources. At the end of fiscal year 2002, I ended my 2-year term as Chair of the JFMIP Principals, and the Chair rotated to Office of Management and Budget Director Daniels. I look forward to working with the new Chair, Treasury Secretary Snow, and Office of Personnel Management Director James in the upcoming months to continue this important dialogue and build on the strong working relationships that we have established.

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## The President's Management Agenda

President Bush has established an agenda for improving the management and performance of the federal government that targets the most apparent deficiencies where the opportunity to improve performance is the greatest. It is no accident that the President's Management Agenda has a strong correlation to GAO's high-risk list. This is just one example of how GAO and OMB have worked constructively to identify key issues deserving increased attention throughout government. As stated in the President's Management Agenda—and we wholeheartedly agree—there are few items more urgent than ensuring that the federal government is well run and results-oriented.

The President's Management Agenda, which is a starting point for management reform, includes improved financial management performance as one of the five governmentwide management goals. Other governmentwide initiatives of the President's Management Agenda include strategic management of human capital, competitive sourcing, expanded electronic government, and budget and performance integration.

In particular, the improved financial management performance initiative is aimed at ensuring that federal financial systems produce accurate and timely information to support operating, budget, and policy decisions. Also, this initiative focuses special attention on addressing erroneous payments, credit card abuse in the federal government, and asset management, areas for which we have reported problems and challenges.<sup>18</sup>

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<sup>18</sup>U.S. General Accounting Office, *Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems*, [GAO-02-749](#) (Washington, D.C.: Aug. 9, 2002); *Government Purchase Cards: Control Weaknesses Expose Agencies to Fraud and Abuse*, [GAO-02-676T](#) (Washington, D.C.: May 1, 2002); *High-Risk Series: Federal Real Property*, [GAO-03-122](#) (Washington, D.C.: January 2003).

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Under the improved financial management performance initiative, agencies are expected to improve the timeliness, enhance the usefulness, and ensure the reliability of financial information. The expected result is integrated financial and performance management systems that routinely produce information that is (1) timely, to measure and effect performance immediately, (2) useful, to make more informed operational and investing decisions, and (3) reliable, to ensure consistent and comparable trend analysis over time and to facilitate better performance measurement and decision making. This result is a key to successfully achieving the goals set out by the Congress in the CFO Act and other federal financial management reform legislation.

Central to effectively addressing the federal government's management problems and providing a solid base for successful transformation efforts is recognition that the five governmentwide initiatives cannot be addressed in an isolated or piecemeal fashion from other major management challenges and high risks facing federal agencies. Rather, these efforts are mutually reinforcing and must be addressed in an integrated way to ensure that they drive a broader transformation of the cultures of federal agencies.

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## The Executive Branch Management Scorecard

The administration is using the Executive Branch Management Scorecard to highlight federal agencies' progress in achieving management and performance improvements embodied in the President's Management Agenda. The Executive Branch Management Scorecard grades selected federal agencies' performance regarding the five governmentwide initiatives by using broad standards and a red-yellow-green coding system to indicate the level at which agencies are meeting the standards.



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In the financial management area, while recognizing the importance of achieving an unqualified opinion from auditors on financial statements, the scorecard focuses on the fundamental and systemic issues that must be addressed in order to generate timely, accurate, and useful financial information. The scorecard also measures whether agencies have any material internal control weaknesses or material noncompliances with laws and regulations, and whether agencies meet FFMIA requirements. The December 31, 2002, scorecard's results show dramatically the extent of work remaining across government to improve financial and other management areas. For financial performance, most of the selected federal agencies were scored in the red category. This is not surprising, considering the well-recognized need to transform financial management and other business processes at federal agencies such as DOD, the results of our analyses under FFMIA, and the various financial management operations we have designated as high risk.<sup>19</sup> Some of the selected agencies improved their scores from the initial baseline evaluation as of September 30, 2001; however, other agencies' scores declined, reflecting increased challenges.

The focus that the administration's scorecard approach brings to improving management and performance, including financial management performance, is certainly a step in the right direction. The value of the scorecard is not in the scoring per se, but in the degree to which scores lead to sustained focus and demonstrable improvements. This will depend on continued efforts to assess progress and maintain accountability to ensure that agencies are able to, in fact, improve their performance. It will be important that there be continuous rigor in the scoring process in order for this approach to be credible and effective in providing the proper incentives that produce lasting results. Also, it is important to recognize that many of the challenges the federal government faces, such as improving financial management, are long-standing and complex, and will require sustained attention.

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<sup>19</sup>As reported in [GAO-03-119](#), we have identified financial management as a high-risk area at DOD, Treasury's IRS, USDA's Forest Service, and the Department of Transportation's Federal Aviation Administration.

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## Building on the Success of Unqualified Audit Opinions

Building on the success that has been achieved in obtaining unqualified audit opinions, federal agency management must continue to work toward fully resolving the pervasive and generally long-standing material weaknesses that have been reported for the past 6 fiscal years. The underlying causes of these issues are significant financial management systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal control. In identifying improved financial management performance as one of its five governmentwide initiatives, the President's Management Agenda stated that a clean (unqualified) financial audit opinion is a basic prescription for any well-managed organization. It recognized that "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records." Further, the President's Management Agenda stated that without sound internal control and accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people.

Irrespective of the unqualified opinions on their financial statements, many federal agencies do not have timely, accurate, and useful financial information and sound controls with which to make informed decisions and to ensure accountability on an ongoing basis. While federal agencies have continued to make progress in obtaining unqualified audit opinions on annual financial statements, many of these opinions were obtained by expending significant resources on extensive ad hoc procedures and making billions of dollars in adjustments to derive the financial statements months after the end of a fiscal year. Several examples follow. The need for such resource-intensive procedures primarily results from inadequate financial management systems.

- After receiving a disclaimer of opinion for fiscal year 2001, NASA was able to produce auditable financial statements for fiscal year 2002; however, the auditors reported that significant weaknesses still existed in NASA's internal controls related to accounting for the International Space Station and for equipment and materials held by contractors. Because of these control weaknesses, the auditors found numerous errors in property records and had to significantly expand the scope of their testing. To correct auditor-identified errors, NASA had to make about \$11 billion of adjustments to its records. The auditors also identified a material weakness related to NASA's process for preparing its financial statements and performance and accountability report.

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Deficiencies included errors made in recording significant adjustments to the statements and reports. Auditors attributed the errors to insufficient resources to address the volume of work needed to compile the financial statements, lack of an integrated financial management system, lack of understanding by NASA staff of new federal reporting requirements, and lack of quality controls over financial reporting.

- After 8 consecutive years of disclaimers of opinion, USDA received an unqualified opinion on its fiscal year 2002 financial statements. While we consider this a positive step toward achieving financial accountability, it took extraordinary efforts outside the normal business processes by the department and its auditors, particularly at the Forest Service. The USDA Office of Inspector General's transmittal letter for the fiscal year 2002 Forest Service audit report stated that "the Forest Service does not yet operate as an effective, sustainable, and accountable financial management organization. The fiscal year 2002 ending account balances were primarily derived from a 2-year audit effort on beginning balances and numerous statistical samples of fiscal year 2002 transactions. As a result of these efforts, multiple adjustments were processed to the general ledger and/or subsidiary ledgers. For example, the financial statement line item General Property, Plant and Equipment, Net, was reduced by over \$1 billion based on audit coverage. The achievement of an unqualified opinion, therefore, did not necessarily result from improvement in underlying financial management systems, but rather as an extensive ad hoc effort." If USDA is to achieve and sustain financial accountability, it must fundamentally improve its underlying internal controls, financial management systems, and operations to allow for the routine production of accurate, relevant, and timely data to support program management.
- Our unqualified opinions on IRS's fiscal years 2002 and 2001 financial statements were made possible by the extraordinary efforts of IRS senior management and staff to develop processes to compensate for serious internal control and systems deficiencies. As noted earlier in this testimony, IRS made significant progress during fiscal year 2002. Nonetheless, it continued to require costly, resource-intensive processes; statistical projections; external contractors; substantial adjustments; and monumental human efforts to derive reliable year-end balances for its financial statements. For example, IRS still does not have a detailed record, or subsidiary ledger, for taxes receivable to allow it to track and manage amounts due from taxpayers. To enable it to report a reliable taxes receivable balance in the absence of a subsidiary

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ledger, IRS has, for the last 6 years, relied on a complex statistical sampling approach that requires substantial human and financial resources to conduct, takes months to complete, and yields tens of billions of dollars of adjustments. Similarly, while progress has been made, IRS does not have an integrated property management system that appropriately records property and equipment additions and disposals as they occur and links costs on the accounting records to the property records.

It will be increasingly difficult for federal agencies to continue to rely on significant costly and time-intensive manual efforts to achieve or maintain unqualified opinions until automated, integrated processes and systems are implemented that readily produce the necessary information. As a result, many federal agencies must accelerate their efforts to improve underlying financial management systems and controls, which is consistent with reaching the financial management success measures envisioned by the JFMIP Principals and called for by the President's Management Agenda.

FFMIA requires auditors, as part of CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards (U.S. generally accepted accounting principles), and (3) the federal government's Standard General Ledger (SGL) at the transaction level. For fiscal year 2002, auditors for 19 CFO Act agencies reported that the agencies' financial management systems did not comply substantially with one or more of these three FFMIA requirements. For the remaining 5 CFO Act agencies, auditors provided negative assurance, meaning that nothing came to their attention indicating that these agencies' financial management systems did not substantially meet FFMIA requirements. The auditors for these 5 agencies did not definitively state whether these agencies' systems substantially complied with FFMIA requirements, as is required under the statute. Meeting the requirements of FFMIA has presented long-standing, significant challenges. These challenges will be resolved only through time, investment, and sustained emphasis on correcting deficiencies in federal financial management systems. GAO plans to report to the Congress by October 1, 2003, on CFO Act agencies' FFMIA implementation for fiscal year 2002, as required by the act.

While federal agencies continue to make progress in addressing weaknesses in their financial management systems, the serious shortcomings reported for these systems result in the lack of reliable

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financial information needed for making operating decisions day to day, managing the federal government's operations more efficiently and effectively, measuring program performance, executing the budget, maintaining accountability, and preparing financial statements.

For example, federal agency financial management systems are required to produce information on the full cost of programs and projects. This is not a new expectation—the requirement for managerial cost information has been in place for more than a decade, since 1990 under the CFO Act and since 1998 stemming from applicable accounting standards. Currently, some federal agencies are only able to provide cost accounting information at the end of the fiscal year through periodic cost surveys. Some federal agencies, such as the Department of the Interior's Bureau of Land Management, are experimenting with methods of accumulating and assigning costs to obtain the managerial cost information needed to enhance programs, improve processes, establish fees, develop budgets, prepare financial reports, and report on performance. Having such financial information is the goal of FFMIA and the CFO Act, necessary for implementing GPRA, and critical to the transition to a more results-oriented federal government as envisioned in the President's Management Agenda.

To remedy financial management systems weaknesses and carry out the President's Management Agenda for improving financial management, OMB, and the CFO Act agencies will need to aggressively and rigorously collaborate. Our work to identify financial management best practices in world-class organizations<sup>20</sup> has identified key factors for successfully modernizing financial systems, including (1) reengineering business processes in conjunction with implementing new technology, (2) developing systems that support the partnership between finance and operations, and (3) translating financial data into meaningful data. We identified other financial management best practices as well, such as (1) providing clear, strong executive leadership, (2) making financial management an entitywide priority, and (3) building a culture of control and accountability.

The size and complexity of many federal agencies and the discipline needed to overhaul or replace their financial management systems present

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<sup>20</sup>U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: April 2000).

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a significant challenge—not simply a challenge to overcome a technical glitch, but a demanding management challenge that requires attention from the highest levels of the federal government along with sufficient human capital resources to effect lasting change. This will be a particular challenge at the new Department of Homeland Security (DHS), where federal agencies, many of which have ongoing challenges in their systems, processes, or internal controls over financial information, are becoming part of the new department. DHS, along with other federal agencies, has a stewardship obligation to prevent fraud, waste, and abuse, to use tax dollars appropriately, and to ensure financial accountability to the President, the Congress, and the American people. In addition to addressing incoming agencies' challenges, DHS will need to focus on building future systems as part of its enterprise architecture approach to ensure an overarching framework for the agency's integrated financial management processes. Plans must be developed and implemented to bridge the many financial environments in which incoming agencies currently operate to an integrated DHS system.

We recognize that it will take time, investment, and sustained emphasis on correcting deficiencies to improve federal financial management systems at DHS and other federal agencies to the level required by FFMIA. The JFMIP Principals' leadership, commitment, and oversight will be important to provide the needed impetus to meet this challenge.

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## Addressing Major Impediments to an Opinion on Consolidated Financial Statements

As I mentioned earlier, for the past 6 fiscal years, the federal government has been required to prepare, and have audited, consolidated financial statements. Successfully meeting this requirement is tightly linked to the requirement for the 24 CFO Act agencies to also have audited financial statements. This has stimulated extensive cooperative efforts and considerable attention by agency chief financial officers, inspectors general, Treasury and OMB officials, and GAO. With the benefit of several years' experience by the federal government in having the required financial statements subjected to audit, the time has come to focus even more intensified attention on the most serious obstacles to achieving an opinion on the U.S. government's consolidated financial statements. In this regard, the JFMIP Principals have discussed plans and strategies for addressing impediments to an opinion on the U.S. government's consolidated financial statements. Three major impediments to an opinion on the consolidated financial statements are (1) serious financial management problems at DOD, (2) the federal government's inability to fully account for and reconcile billions of dollars of transactions between

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federal entities, and (3) the federal government's inability to properly prepare the consolidated financial statements.

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## Reforming Financial Management at DOD

Essential to achieving an opinion on the consolidated financial statements is resolution of the serious financial management problems at DOD, which we have designated as high risk since 1995. In accordance with provisions of the National Defense Authorization Act for fiscal year 2002,<sup>21</sup> DOD reported that the department's financial management systems were not able to provide adequate evidence supporting material amounts in its fiscal year 2002 financial statements. DOD asserted that it is unable to comply with applicable financial reporting requirements for (1) property, plant, and equipment, (2) inventory and operating materials and supplies, (3) military retirement health care actuarial liability, (4) environmental liabilities, (5) intragovernmental eliminations and related accounting adjustments, and (6) cost accounting by suborganization/responsibility segment and major program. Based largely on DOD's assertion, the DOD inspector general again disclaimed an opinion on DOD's financial statements for fiscal year 2002 as it had for the previous 6 fiscal years.

To date, none of the military services or major DOD components has passed the test of an independent financial audit because of pervasive weaknesses in DOD's financial management systems, operations, and internal control, including an inability to compile financial statements that comply with generally accepted accounting principles. The department has made progress in a number of areas but is far from solving a range of serious financial management problems. Their resolution, however, is key to having auditable consolidated financial statements because DOD had budget authority of \$385 billion for fiscal year 2002, or about 18 percent of the entire federal budget; is accountable for a vast amount of government assets worldwide; and incurs a substantial amount of the reported liabilities.

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<sup>21</sup>Section 1008 of the National Defense Authorization Act for fiscal year 2002, Pub. L. No. 107-107, 115 Stat. 1012 (Dec. 28, 2001), provides a framework for redirecting the department's resources from the preparation and audit of financial statements to improvement of DOD's financial management systems and financial management policies, procedures, and internal controls. Under this legislation, the department will also be required to report to the Congress on how resources have been redirected and the progress that has been achieved.

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DOD's financial management deficiencies adversely affect not only the department's ability to prepare auditable financial statements, but also its ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget (such as for health care, weapons systems, and environmental liabilities), measure performance, maintain control of funds, prevent fraud, and address pressing management issues. For example, we recently reported on fundamental flaws in DOD's systems, processes, and overall internal control environment, such as those related to

- pervasive purchase and travel card breakdowns that resulted in numerous instances of potentially fraudulent, improper, and abusive transactions and increased DOD's vulnerability to theft and misuse of government property;
- adjustments to DOD's closed appropriations that resulted in about \$615 million in adjustments that should not have been made, including \$146 million that were illegal; and
- accountability over critical items, such as chemical and biological protective garments, that resulted in DOD's excessing and selling unused garment sets for about \$3 each, while simultaneously procuring hundreds of thousands of similar garment sets for over \$200 per set.

As discussed in our recent reporting<sup>22</sup> on the management challenges facing the government, overhauling DOD's financial management operations represents a major challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. In prior years, DOD expended significant resources and made material amounts of adjustments to derive its financial statements. However, such statements were determined to be unauditible. In this regard, as previously mentioned, section 1008 of the National Defense Authorization Act for fiscal year 2002 provides a framework for redirecting the department's resources from the preparation and audit of financial statements to improving DOD's financial management systems and financial management policies, procedures, and internal controls. Administrations over the past 12 years have attempted to address these problems in various ways but have largely been unsuccessful despite good intentions and significant effort.

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<sup>22</sup>U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-03-98 (Washington, D.C.: January 2003).



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As we testified in March 2002 and highlighted in our more recent reports, four underlying causes of problems have impeded past reform efforts at DOD:

- The lack of accountability and sustained top-level leadership hinders DOD's ability to meet its performance goals. Major improvement initiatives must have the direct, active support and involvement of the Secretary and Deputy Secretary of Defense to ensure that daily activities throughout the department remain focused on achieving shared, agencywide outcomes and success. Furthermore, sustaining commitment by top leadership to performance goals is a particular challenge for DOD because the average tenure of DOD's top political appointees is only 1.7 years. Based on our survey of best practices of world-class financial management organizations, it is clear that strong executive leadership is essential to (1) making financial management an entitywide priority, (2) redefining the role of finance, (3) providing meaningful information to decision makers, and (4) building a team of people that delivers results.
- Cultural resistance to change and stovepiped operations have impeded DOD's ability to implement broad-based management reforms. We found that the effectiveness of the Defense Management Council, established in 1997, was impaired because members were not able to put aside their particular military services' or DOD agencies' interests to focus on departmentwide approaches. DOD's stovepiped approach is most evident in its current financial management systems environment, which DOD recently estimated to include 1,800 systems and system development projects—many of which were developed in piecemeal fashion and evolved to accommodate different organizations, each with its own policies and procedures.
- Lack of clear, linked goals and performance measures impedes DOD's ability to attain strategic goals with the risk that units are operating autonomously, rather than collectively. In our assessment of DOD's fiscal year 2000 Financial Management Improvement Plan—its most recent plan—we found that it presented the military services' and DOD components' individual improvement initiatives but did not clearly articulate how their individual efforts would result in a collective, integrated DOD-wide approach to financial management improvement. In addition, the plan did not include performance measures to assess DOD's progress in resolving

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financial management problems. Furthermore, while DOD plans to invest billions of dollars in modernizing its financial management systems, it is in the initial stages of developing an overall blueprint, or enterprise architecture, to guide and direct these investments.

- Lack of incentives to change existing “business-as-usual” processes, systems, and structures contributes to DOD’s inability to carry out needed fundamental reform. Traditionally, DOD has focused more on justifying its need for more funding and moving programs and operations through the process than on achieving better program outcomes. It does not (1) reward behaviors that contribute to DOD-wide and congressional goals, (2) develop motivational incentives for decision makers to guide them toward better program outcomes, or (3) provide congressional focus on more results-oriented and resource allocation decisions.

On September 10, 2001, Secretary of Defense Rumsfeld recognized the far-reaching nature of DOD’s financial management problems and announced a broad, top-priority initiative intended to “transform the way the department works and what it works on.” This new broad-based business transformation initiative, led by DOD’s Senior Executive Council and the Business Initiative Council, incorporates a number of defense reform initiatives begun under previous administrations but also encompasses additional fundamental business reform proposals. In announcing his initiative, Secretary Rumsfeld recognized that transformation would be difficult and expected the needed changes would take 8 or more years to complete. The Secretary’s initiative is consistent with the findings of an independent study he commissioned that concluded that DOD would have to undergo “a radical financial management transformation” and that it would take more than a decade to achieve. Secretary Rumsfeld recently included improving DOD’s financial management as one of his top 10 priorities, and DOD has already taken a number of actions intended to address its serious financial management problems. In addition, as I previously mentioned, DOD has a major effort under way to develop a DOD enterprise architecture that is intended to prescribe a blueprint for operational and technological changes in its financial and related business systems operations. While DOD has a long way to go, its efforts over the past year represent important progress. The level of top leadership that has been brought to bear on this challenge will have to be sustained with a goal of achieving lasting improvement that truly transforms DOD’s business systems and operations and enables the department to meet the mandate of

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the CFO Act and achieve the President's Management Agenda's goal of improved financial management performance.

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## Addressing Intragovernmental Transactions

OMB and Treasury require CFO Act agencies to reconcile selected intragovernmental activity and balances with their "trading partners" and to report on the extent and results of intragovernmental activity and balances reconciliation efforts. The inspectors general reviewed these reports and communicated the results of their reviews to OMB, Treasury, and GAO. A substantial number of the CFO Act agencies did not fully perform the required reconciliations for fiscal years 2002 and 2001, citing reasons such as (1) trading partners not providing needed data, (2) limitations and incompatibility of agency and trading partner systems, and (3) human resource issues. For both of these years, amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance. In addition, significant differences in other intragovernmental accounts, primarily related to appropriations, will need to be resolved.

As we reported last year, the heart of the intragovernmental transactions issue is that the federal government lacked clearly articulated business rules for these transactions so that they would be handled consistently by agencies. To address certain issues that contributed to the out of balance condition for intragovernmental activity and balances, OMB has established a set of standard business rules for governmentwide transactions among trading partners and is requiring quarterly reconciliations of intragovernmental activity and balances beginning in fiscal year 2003. For example, in accordance with one of the business rules, beginning in fiscal year 2003 for intragovernmental investments with Treasury's Bureau of the Public Debt (BPD), BPD and trading partner agencies are required to use the same method for recording amortization on market-based notes, bonds, and zero coupon securities. In the past, differences in the amortization methods being used have caused out of balance conditions for related intragovernmental activity and balances. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a commitment by the CFO Act agencies and continued strong leadership by OMB.

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## Preparing the Consolidated Financial Statements

The federal government did not have adequate systems, controls, and procedures to properly prepare its consolidated financial statements, as described below. Also, disclosure of certain financial information was not

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Consolidated Financial  
Statement Compilation

presented in the consolidated financial statements in conformity with U.S. generally accepted accounting principles.

Due to the current financial statement compilation process, the federal government could not adequately ensure that the information for each federal agency included in the consolidated financial statements was consistent with the underlying agency financial statements. This process also requires significant human and financial resources and does not adequately leverage the existing work and work products resulting from federal agencies' audited financial statements. The problems are further compounded by the need for broad changes in the structure of the government's SGL accounts and the process for maintaining the SGL.

The net position reported in the consolidated financial statements is derived by subtracting liabilities from assets, rather than through balanced accounting entries. To make the fiscal years 2002 and 2001 consolidated financial statements balance, Treasury recorded a net \$17.1 billion and \$17.3 billion decrease to net operating cost, respectively, on the Statement of Operations and Changes in Net Position, which it labeled unreconciled transactions. An additional net \$12.5 billion and \$3.9 billion of unreconciled transactions were improperly recorded in net cost for fiscal years 2002 and 2001, respectively. Treasury attributes these net unreconciled transaction amounts primarily to the federal government's inability to properly identify and eliminate transactions between governmental entities, federal agency adjustments that affected net position, and other errors. Treasury was unable to adequately identify and explain the gross components of such amounts. Unreconciled transactions also may exist because the federal government does not have effective controls over reconciling net position.

The federal government did not have an adequate process to reconcile the operating results, which for fiscal year 2002 showed a net operating cost of \$364.9 billion, to the budget results, which for the same period showed a unified budget deficit of \$157.7 billion.<sup>23</sup>

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<sup>23</sup>Statement of Federal Financial Accounting Standards No. 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, issued January 2003, requires the federal government to provide a financial statement that reconciles net operating revenue (or cost) and the annual unified budget surplus (or deficit).

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Treasury is currently developing a new system and procedures to prepare the consolidated financial statements beginning with fiscal year 2004. These actions are intended to, among other things, directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements and facilitate the reconciliation of net position. Resolving the consolidated financial statement compilation process issues will require continued strong leadership by Treasury management.

Elimination of  
Intragovernmental Activity and  
Balances from the Consolidated  
Financial Statements

Consolidated financial statements are intended to present the results of operations and financial position of the components that make up a reporting entity as if the entity were a single enterprise. When preparing the consolidated financial statements, the preparer must eliminate intragovernmental activity and balances between the federal agencies. Because of federal agencies' problems in handling their intragovernmental transactions, Treasury's ability to eliminate these transactions is impaired. Significant differences reported in intragovernmental accounts, as noted above, have been identified. To help federal agencies better perform their reconciliations, Treasury recently began providing agencies with detailed trading partner information. Intragovernmental activity and balances are "dropped" or "offset" in the preparation of the consolidated financial statements rather than eliminated through balanced accounting entries. This contributes to the federal government's inability to determine the impact of these differences on amounts reported in the consolidated financial statements. The continued strong leadership of Treasury will be important to resolving the issues surrounding the elimination of intragovernmental activity and balances from the consolidated financial statements.

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Protecting the Public  
Interest

Two audit matters have come to the fore and are key to protecting the public interest. One matter involves auditors' responsibilities for reporting on internal control, and the other concerns auditor independence.

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## Auditors' Responsibilities for Reporting on Internal Control

We have long believed that auditors have an important responsibility to provide an opinion on the effectiveness of internal control over financial reporting and compliance with laws and regulations. Currently, this is not required by American Institute of Certified Public Accountants (AICPA) auditing standards or by OMB in its guidance<sup>24</sup> to auditors conducting federal agency financial statement audits.

For financial statements audits that we conduct—which include the U.S. government's consolidated financial statements, the financial statements of the IRS, the Schedules of Federal Debt managed by the Bureau of the Public Debt, and the financial statements of the Federal Deposit Insurance Corporation Funds and numerous small entities' operations and funds—we issue a separate opinion on the effectiveness of internal control over financial reporting and compliance with laws and regulations.

For years we have provided opinions on internal control effectiveness because of the importance of internal control to protecting the public's interest. Our reports have engendered major improvements in internal control. As you might expect, as part of the annual audit of our own financial statements, we practice what we recommend to others and contract with an independent public accounting firm for both an opinion on our financial statements and an opinion on the effectiveness of our internal control over financial reporting and compliance with laws and regulations.

Although OMB requires testing of these internal controls, auditors are not required to provide an opinion on internal control effectiveness. However, we found that 3 of the 24 CFO Act agency auditors (those for the General Services Administration, SSA, and the Nuclear Regulatory Commission) provided an opinion on the effectiveness of internal control as of September 30, 2002. Our hope is that all CFO Act agencies and the new DHS will follow suit in future years. In this regard, last year, in response to major breakdowns in corporate accountability, auditing, and corporate governance in the private sector, the Congress passed the Sarbanes-Oxley Act of 2002<sup>25</sup> to, among other things, improve quality and transparency in financial reporting and independent audits of publicly traded companies ("issuers"). In the area of internal control reporting, issuers are required to

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<sup>24</sup>Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, Bulletin 01-02 (Washington, D.C.: Oct. 19, 2000).

<sup>25</sup>Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002).

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establish and maintain adequate internal control structure and procedures for financial reporting and include in the annual report a statement of management's responsibility for and management's assessment of the effectiveness of those controls and procedures. In addition, an issuer's auditor is required to attest to, and report on, the assessment made by the management of the issuer on the effectiveness of internal control over financial reporting. In other words, an issuer's auditor will provide an attestation, or opinion, on management's assertions about the effectiveness of internal controls over financial reporting.

"Internal controls and procedures for financial reporting" is generally defined as controls that pertain to the preparation of external financial statements that are fairly presented in conformity with generally accepted accounting principles. Specifically, controls over financial reporting include the objectives of ensuring that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity generally accepted accounting principles.

GAO strongly believes that auditor reporting on internal control is a critical component of monitoring the effectiveness of an organization's internal control and accountability. By giving assurance about internal control, auditors of federal financial statements can better serve their clients and other financial statements users and better protect the public interest by having a greater role in providing assurances of the effectiveness of internal control in deterring fraudulent financial reporting, protecting assets, and providing an early warning of internal control weaknesses.

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## Auditor Independence and Government Auditing Standards

The independence of auditors—both in fact and appearance—is critical to the credibility of financial reporting. Auditors have the capability of performing a range of valuable services for their clients, and providing certain nonaudit services can ultimately be beneficial to federal entities. However, in some circumstances, it is not appropriate for auditors to perform both audit and certain nonaudit services for the same client. In these circumstances, the auditor, the client, or both will have to make a choice as to which of these services the auditor will provide.

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These concepts, which I continue to strongly believe are in the public interest, were reflected in the revisions to auditor independence requirements for government audits,<sup>26</sup> which GAO issued last year as part of *Government Auditing Standards*.<sup>27</sup> The standard, among other things, strengthens the rules associated with providing nonaudit services and includes a principle-based approach to addressing this issue, supplemented with certain safeguards. The two overarching principles in the standard for nonaudit services are that

- auditors should not perform management functions or make management decisions, and
- auditors should not audit their own work or provide nonaudit services in situations where the amounts or services involved are significant or material to the subject matter of the audit.

In making judgments on independence under *Government Auditing Standards* and applying the independence standard's principles and safeguards, audit organizations should take a "substance over form" approach and consider the nature and significance of the services provided to the audited entity—the facts and circumstances. Before an audit organization agrees to perform nonaudit services, it should carefully consider the need to avoid situations that could lead reasonable third parties with knowledge of the facts and circumstances to conclude that the auditor is not able to maintain independence in conducting audits. It is imperative that auditors always be viewed as independent in fact and appearance.

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<sup>26</sup>U.S. General Accounting Office, *Government Auditing Standards, Amendment No. 3, Independence*, GAO-02-388G (Washington, D.C.: January 2002).

<sup>27</sup>*Government Auditing Standards* was first published in 1972 and is commonly referred to as the "Yellow Book." It covers federal entities and organizations that receive federal funds. Various laws require compliance with the standards in connection with audits of federal entities and funds. Further, many states and local governments and other entities, both domestically and internationally, have voluntarily adopted these standards.



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Understandably, GAO received many inquiries about the new independence standard due to its significant effect on auditors in connection with audits of those who are required to use or have adopted the use of *Government Auditing Standards*. Working with the Comptroller General's Advisory Council on Government Auditing Standards<sup>28</sup> and other interested parties, we issued further guidance in the form of questions and answers related to the independence standard's implementation time frame, underlying concepts, and application in specific nonaudit circumstances.<sup>29</sup>

The independence standard and the recently issued question and answer document are the initial steps in GAO's continuing efforts to enhance *Government Auditing Standards* and educate auditors on revisions to these standards and on implementation issues surrounding the independence standard. Within the next several months, GAO will issue revisions to *Government Auditing Standards* to help ensure that the standards continue to meet the needs of the audit community and the public it serves. The revision will expand and change (1) the types of audits and services that can be performed under the standards and (2) the application of the standards, where relevant, to be consistent with the various types of audits. Changes are also being made to enhance the understandability of the standards. To educate the audit community about the revised standards as well as the independence standard, GAO continues to provide many presentations to government auditors and private practitioners, in addition to answering hundreds of questions regarding implementation issues.

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## Closing Comments

Our report on the U.S. government's consolidated financial statements for fiscal years 2002 and 2001 highlights the need to continue addressing the government's serious financial management weaknesses. Looking beyond current progress by federal agencies in attaining unqualified opinions on financial statements, it will be essential for the federal government to begin moving away from the extraordinary efforts many federal agencies continue to use to prepare financial statements and toward giving

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<sup>28</sup>The Advisory Council includes 21 experts in financial and performance auditing and reporting—drawn from all levels of government, academia, private enterprise, and public accounting—who advise the Comptroller General on *Government Auditing Standards*.

<sup>29</sup>U.S. General Accounting Office, *Government Auditing Standards, Answers to Independence Standard Questions*, [GAO-02-870G](#) (Washington, D.C.: July 2002).

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prominence to strengthening the government's financial systems, reporting, and controls. This approach becomes even more critical as the federal government progresses to an accelerated financial statement reporting time frame, and it is the only way the government can meet the end goal of making timely, accurate, and useful financial information routinely available to the Congress, other policymakers, and the American public.

The requirement for timely, accurate, and useful financial and performance management information is greater than ever, as the Congress and the administration prepare to meet tomorrow's fiscal challenges. This type of financial information is central to managing the federal government's operations more efficiently, effectively, and economically and in supporting GPRA. Moreover, meaningful financial and performance information can form the basis for reconsidering the relevance or "fit" of any federal program or activity in today's world and for the future.

In closing Mr. Chairman, I want to underscore the importance of the additional impetus provided by President Bush through his President's Management Agenda and the Executive Branch Management Scorecard for coming to grips with federal financial management problems, indeed management problems across the board. Regarding DOD in particular, Secretary of Defense Rumsfeld's vision and approach for transforming the department's full range of business processes is serious and encouraging. These efforts will be key to fulfilling the President's Management Agenda and addressing the largest obstacle to an opinion on the U.S. government's consolidated financial statements. The cooperative efforts spearheaded by the JFMIP Principals have been most encouraging in developing the short- and long-term strategies and plans necessary to address many of the problems I have discussed this morning. In addition, GAO has probably never had a better working relationship with OMB and cabinet level and other key officials on a range of "good government issues" that are of critical importance and are inherently non-partisan in nature. While these and other factors provide an enhanced likelihood for success, in the end it is results that count.

Finally, I want to reiterate the value of sustained congressional interest in these issues, as demonstrated by this hearing and those the former Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations held over the past several years to oversee financial management reform. It will also be key that the appropriations, budget, authorizing, and oversight committees hold agency top leadership

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accountable for resolving these problems and that they support improvement efforts.

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## Contacts

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# CFO Act Agencies: Fiscal Year 2002 Audit Results, Principal Auditors, and Number of Other Audit Contractors

<b>24 CFO Act agencies</b>	<b>Audit results</b>	<b>Principal auditor</b>	<b>Number of other audit contractors</b>
Agency for International Development	Qualified <sup>a</sup>	Inspector General	1
Agriculture	Unqualified	Inspector General	2
Commerce	Unqualified	KPMG LLP	1
Defense	Disclaimer	Inspector General	1
Education	Unqualified	Ernst & Young LLP	0
Energy	Unqualified	KPMG LLP	4
Environmental Protection Agency	Unqualified	Inspector General	0
Federal Emergency Management Agency	Unqualified	KPMG LLP	0
General Services Administration	Unqualified	PricewaterhouseCoopers LLP	0
Health and Human Services	Unqualified	Inspector General	4
Housing and Urban Development	Unqualified	Inspector General	1
Interior	Unqualified	KPMG LLP	0
Justice	Unqualified	PricewaterhouseCoopers LLP	2
Labor	Unqualified	Inspector General	5
National Aeronautics and Space Administration	Unqualified	PricewaterhouseCoopers LLP	1
National Science Foundation	Unqualified	KPMG LLP	0
Nuclear Regulatory Commission	Unqualified	R. Navarro & Associates, Inc.	0
Office of Personnel Management	Unqualified	KPMG LLP	0
Small Business Administration	Disclaimer	Cotton & Company LLP	0
Social Security Administration	Unqualified	PricewaterhouseCoopers LLP	0
State	Unqualified	Leonard G. Birnbaum and Company, LLP	0
Transportation	Unqualified	Inspector General	2
Treasury	Unqualified	Inspector General	6 <sup>b</sup>
Veterans Affairs	Unqualified	Deloitte & Touche LLP	0

<sup>a</sup>Qualified for the Statement of Net Cost; unqualified for all other statements.

<sup>b</sup>In addition, GAO audited the Internal Revenue Service's financial statements and the Schedules of Federal Debt Managed by the Bureau of the Public Debt.

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