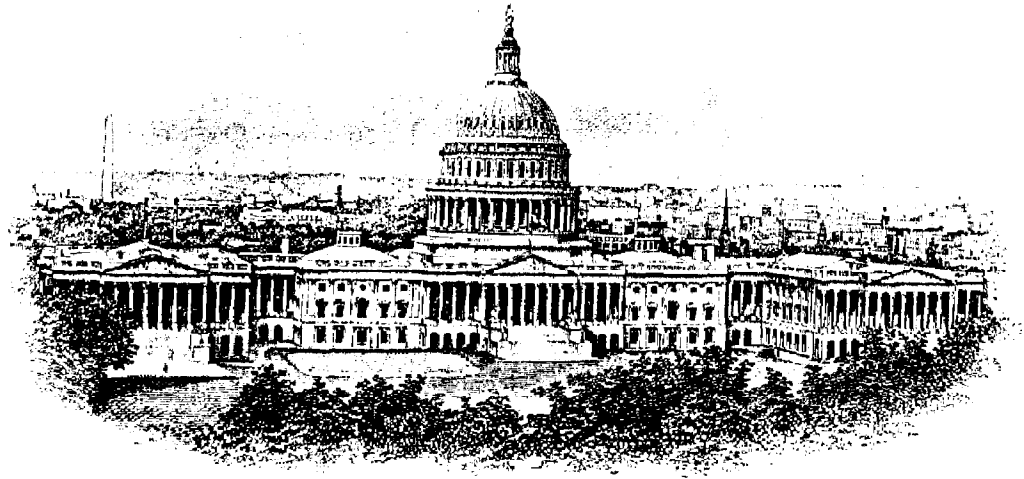


GAO

COMPTROLLER GENERAL'S 1988 ANNUAL REPORT

138929

SP-015



UNITED STATES GENERAL ACCOUNTING OFFICE

GAO is a nonpartisan legislative branch agency that assists the Congress, its committees, and Members in their legislative and oversight work. GAO carries out legal, accounting, auditing, and claims settlement functions as assigned by the Congress and makes recommendations for more efficient and effective government operations.

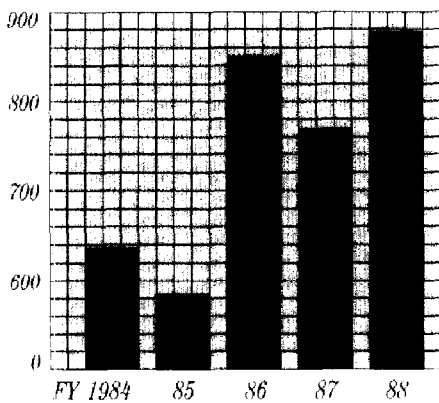
HIGHLIGHTS

The stock market crash, threats to the environment, drug abuse, and the air traffic control system. These were among the major national issues GAO focused on in 1988. GAO also was among the first to warn the Congress that defense procurement and spending plans will exceed probable resources by \$200 billion over the next 5 years, that the deterioration of the aging U.S. nuclear weapons complex will require more than \$100 billion to fix, and that taxpayers will likely be required to provide at least \$85 billion to rescue the nation's imperiled savings and loan industry.

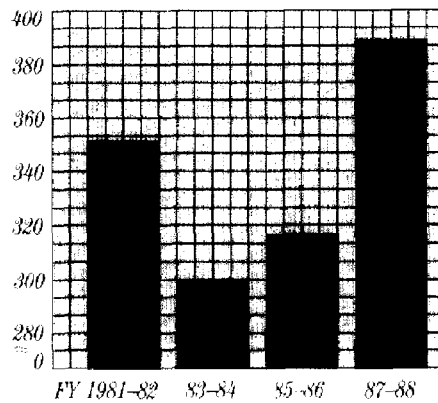
In 1988, GAO produced a record number of reports and testimony—1,100 products in all. The Office issued 873 reports and testified 166 times before House Committees, 60 times before Senate Committees, and 1 time before a joint committee. GAO made 981 recommendations and identified \$23.6 billion in financial benefits.

TRENDS IN GAO WORK

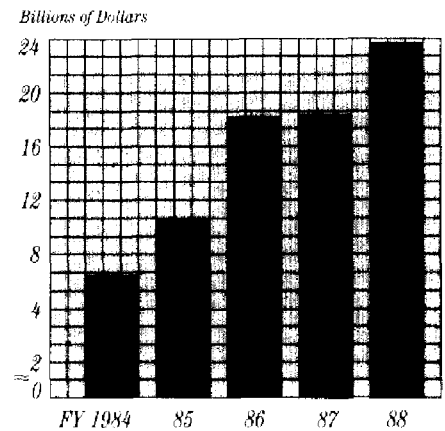
Reports Issued 1984-88



Testimony to the Congress 1981-88



Financial Benefits 1984-88





MESSAGE FROM THE COMPTROLLER GENERAL

The inauguration of a new President represents an opportunity to reconsider national priorities and to focus upon new and continuing challenges.

As the auditing arm of Congress, the General Accounting Office is committed to helping Congress and the new administration make the right decisions. To further this goal, GAO has prepared a series of transition reports, primarily based on the agency's past work, to help congressional and executive branch leaders focus on major issues facing the nation.

The Congress relies upon GAO to assess the efficiency and effectiveness of federal programs. In carrying out this work, GAO has become increasingly concerned about the consequences of the federal deficit, which has fallen so far out of balance that the nation is losing its flexibility to deal with emerging problems and is in danger of falling short on investment in essential government operations. Federal officials often have been forced to adopt a makeshift system that substitutes inefficient expedients for cost-effective long-range solutions. Unless we find a way to deal with the deficit soon, the consequences will haunt the nation for generations to come.

Of special concern are commitments already made, both military and domestic, that will cost billions of dollars. These include the B-2 "Stealth" bomber, the cost of bailing out hundreds of insolvent thrift institutions, and the tens of billions of dollars that will be needed to modernize and clean up the nation's nuclear weapons complex.

The ultimate issue of the budget is one of "affordability," the dilemma of balancing our commitments with the revenues available to pay for them. To resolve this dilemma, the Congress and the administration must make painful choices among competing demands, including the choice of how much additional revenue to raise and how to do it. At the same time,



Among the committees with which GAO has worked on procurement and other defense issues is the Senate Armed Services Committee, chaired by Senator Sam Nunn.

Opposite page: In one of several meetings held with new Cabinet members, top GAO officials met with Office of Management and Budget Director Richard Darman. With Comptroller General Bousher and Mr. Darman are Assistant Comptrollers General Richard Fogel, Harry Havens, and Frederick Wolf.



*Assistant Comptroller General
Harry Havens, Special Assistant
to the Comptroller General
Milton Socolar, Assistant Comptroller
General Donald Horan
and Ralph Carlone.*

the United States cannot afford to postpone investment in programs essential to the security and well-being of the American public or to the efficient operations of the government itself. Today, as never before, the United States cannot afford a government that does not work well.

In 1988, GAO made almost 1,000 recommendations and issued almost 3,800 legal decisions and opinions. We contributed to legislative and executive actions that resulted in \$23.6 billion worth of financial benefits, which amounts to \$71 in financial benefits to the taxpayers for each dollar we spent. GAO officials testified 227 times before the Congress and issued 873 reports during the year, the vast majority of them aimed at improving government efficiency.

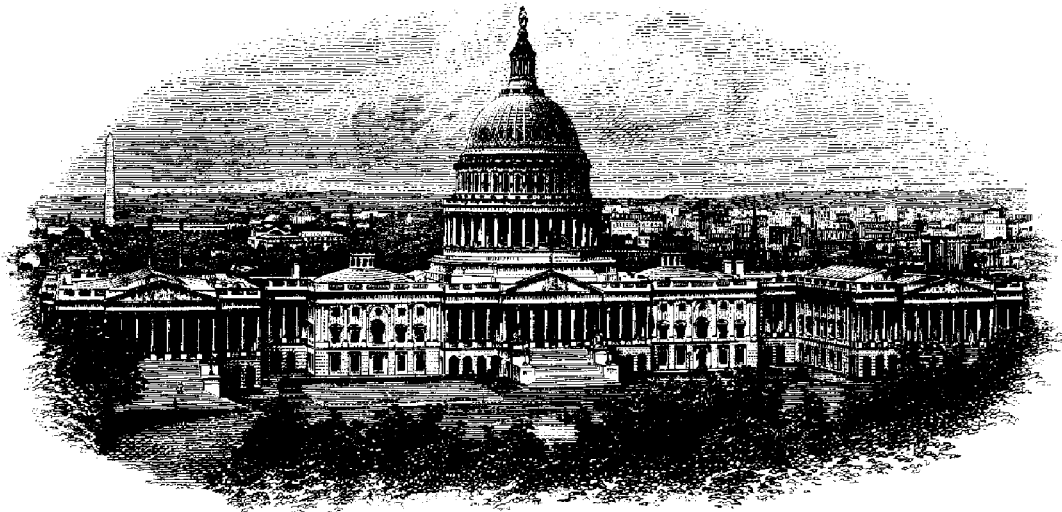
I am proud of the contributions made by the GAO staff in assisting the Congress and the administration. We all share a common goal in meeting the many challenges that lie ahead.

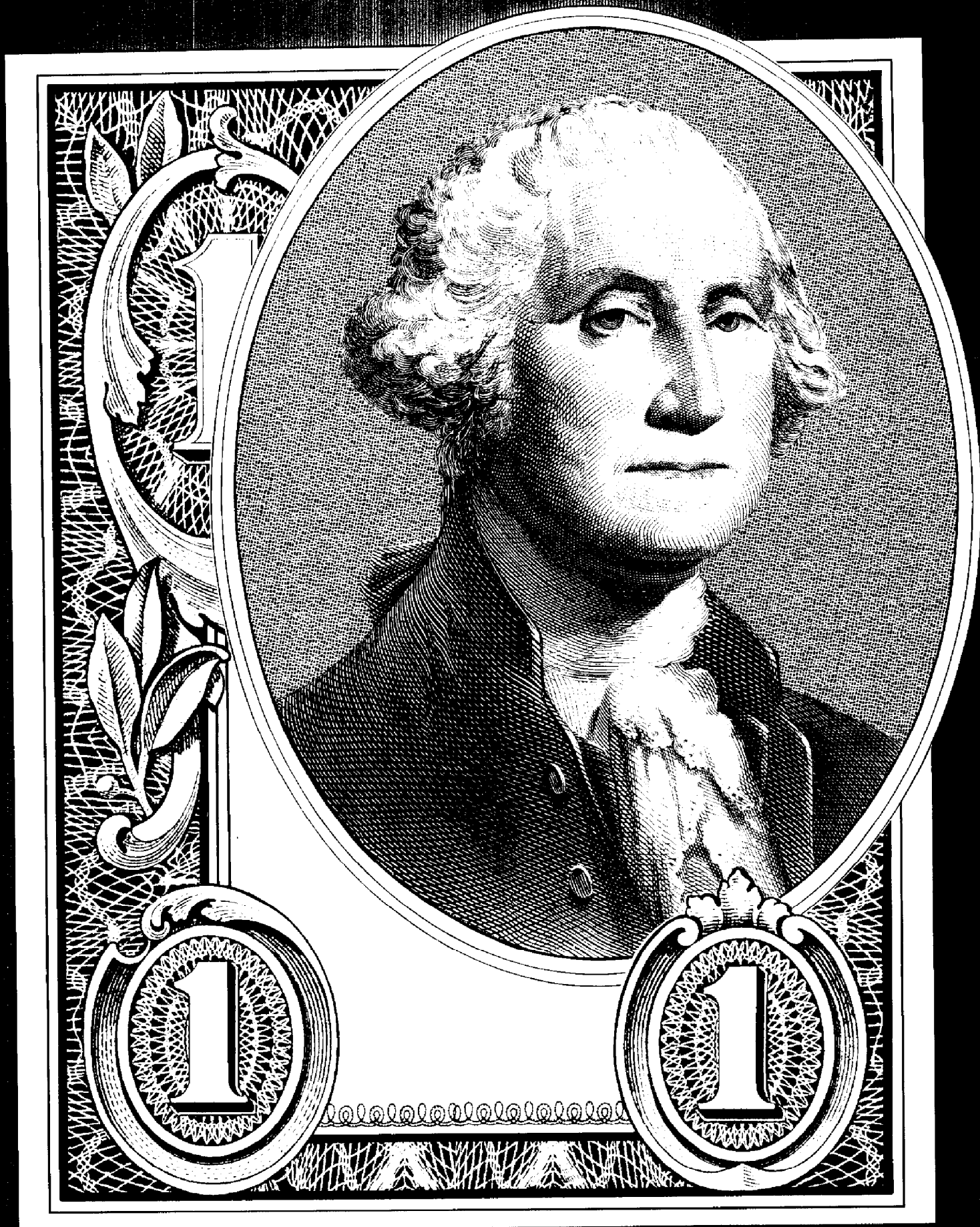
Charles A. Bowsher

Charles A. Bowsher
Comptroller General of the United States

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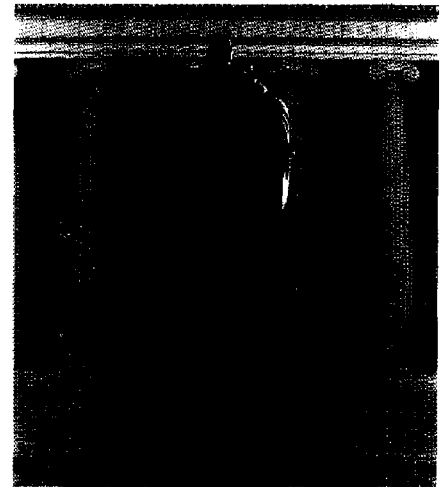
GOVERNMENT FINANCIAL MANAGEMENT

The major fiscal problem facing the nation today is the federal budget deficit. Continuing budget deficits contribute to the country's trade deficit; make us more vulnerable to foreign sources of financing; impose a large burden on future generations; and constrain our ability to plan for and meet major new spending requirements, such as assistance to failing financial institutions and long-term health care for an older population.

Difficult decisions on both the revenue and spending sides of the budget have to be made to reduce the deficit. GAO has issued several reports and other information to assist the Congress, the President-Elect, and the National Economic Commission. GAO has proposed that any strategy of spending cuts should focus upon the affordability of defense and entitlement programs. On the revenue side, several options should be considered, including the use of a value-added tax and taxing Social Security benefits above an income threshold. In transition reports to the President-Elect and the Congress, GAO pointed out that we cannot "grow" or "freeze" our way out of the deficit problem or gather in some magic pool of uncollected revenues to pay our way out. Nor can the Gramm-Rudman-Hollings Act, which currently exempts 70 to 80 percent of the budget, solve the problem in a mechanistic way. The new President and the Congress must commit the nation to a bipartisan multiyear budget strategy of spending cuts and, if necessary, tax increases to work our way out of the crisis of continuing deficits.

I *is particularly
pleasing for me to be
able to announce to you,
that the revenues which
have been established,
promise to be adequate
to their objects.*

*George Washington
Annual Address to the Congress, 1791*

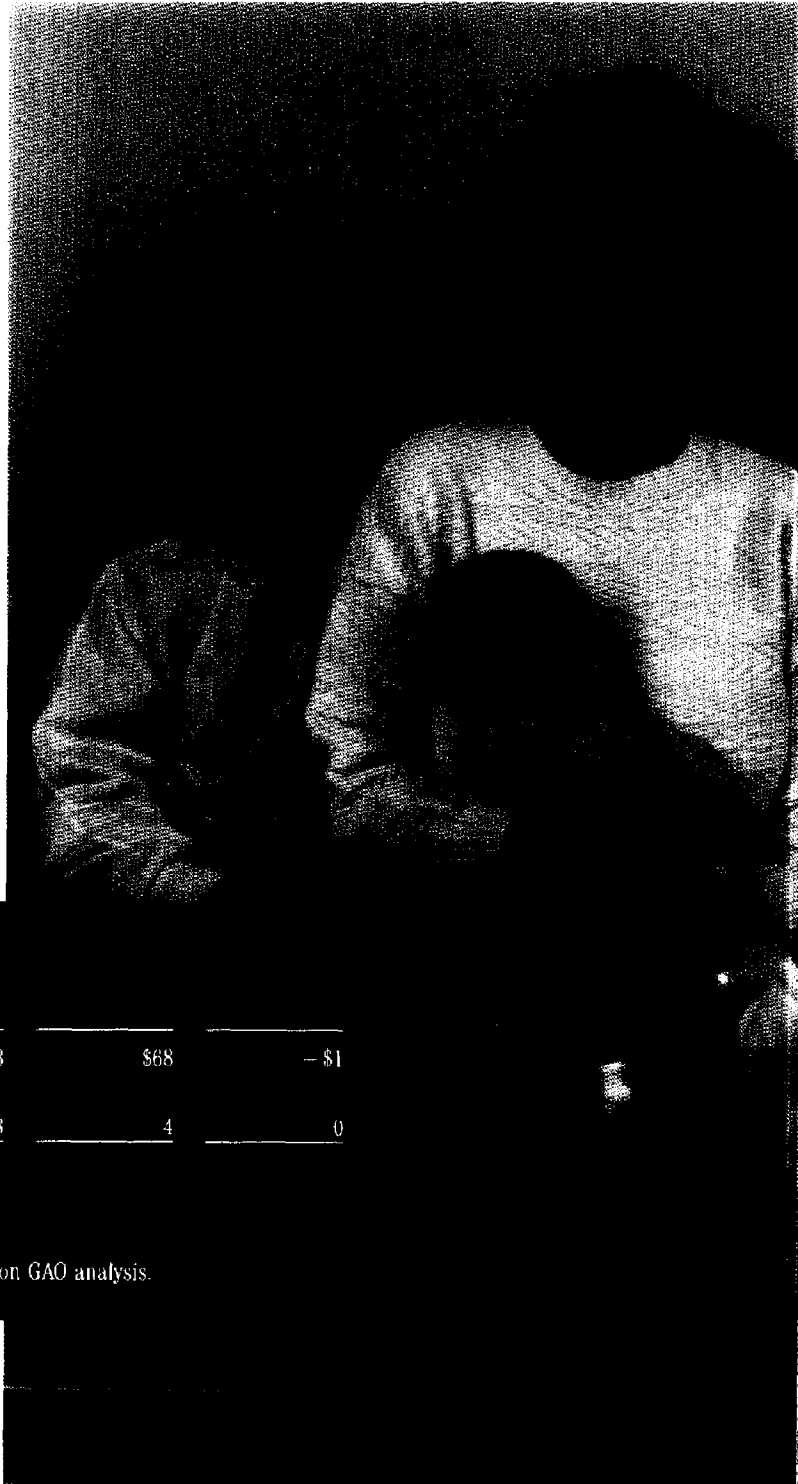


BUDGET AND FINANCIAL MANAGEMENT The last major reform of the budget structure, which occurred 20 years ago, created the unified budget. That was an important step forward; it is time for another. Today's fiscal problems center on the structural imbalance between revenue and spending for general government activities and on the imbalance between spending on current operations and investment in capital. Neither issue is adequately highlighted in the present structure of the unified budget. The debate over budget policy is heavily influenced by the way information is presented, so GAO has suggested changes in the budget structure that would draw greater attention to the central issues. Without sacrificing the comprehensiveness of the unified budget, the GAO proposals would subdivide the totals between general funds, trust funds, and government enterprises and between operating costs and capital investment. The table below shows how the fiscal year 1987 budget would have been recast by the GAO proposal, which expands the focus beyond the single deficit figure of \$150 billion for that year.

Increasingly, the Congress also recognizes the need to streamline the budget process, which at times has crowded out other legislative business. GAO suggested that the Congress address the layering, the fragmentation, and the duplication of the current process by promoting better integration among the leadership and the committees involved in budget matters. On the basis of studies of state biennial budgeting and various federal-level biennial proposals, GAO also

thinks that biennial budgeting, particularly at macro budget levels as exemplified in the 1987 congressional White House budget summit agreement, could help streamline the process.

Finally, agency financial management systems should be improved because good budgeting must be based on reliable information.



(Dollars in billions)

Operating surplus/deficit (-)	- \$ 96	- \$183	\$68	- \$1
Net capital financing requirements	- 54	- 58	4	0

Note: Except for the \$150 billion total, the amounts are estimates based on GAO analysis.

SOCIAL SECURITY'S BUDGET IMPACT The importance of the way the budget is structured is particularly evident in the Social Security system. Current budget reporting masks the severity of the deficit problem because temporary trust fund surpluses, such as those for Social Security, highways, and airports, are being spent on other government programs, thus

reducing the overall reported deficit. The \$155 billion 1988 deficit would have been \$252 billion if not offset by a \$97 billion surplus in trust fund accounts.

Much of this surplus is in the Social Security program, which is accumulating reserves for the retirement of the "baby boom" generation. By the end of 1988, these reserves had reached \$100 billion. However, these and other trust fund reserves are not like drawers full of cash that are set aside. The government buys treasury securities with these funds and spends the cash on *current* operations.

The Treasury securities represent a promise to provide the cash that will be needed to pay future benefits. When the "baby boomers" retire and the government must make good on the promise, the securities will have to be redeemed. The Treasury then will have to undertake some combination of new borrowing, taxes, or spending cuts. In 1988, GAO reported on the need for a new set of budget subtotals, for trust and nontrust operations, to assist planning for that time.

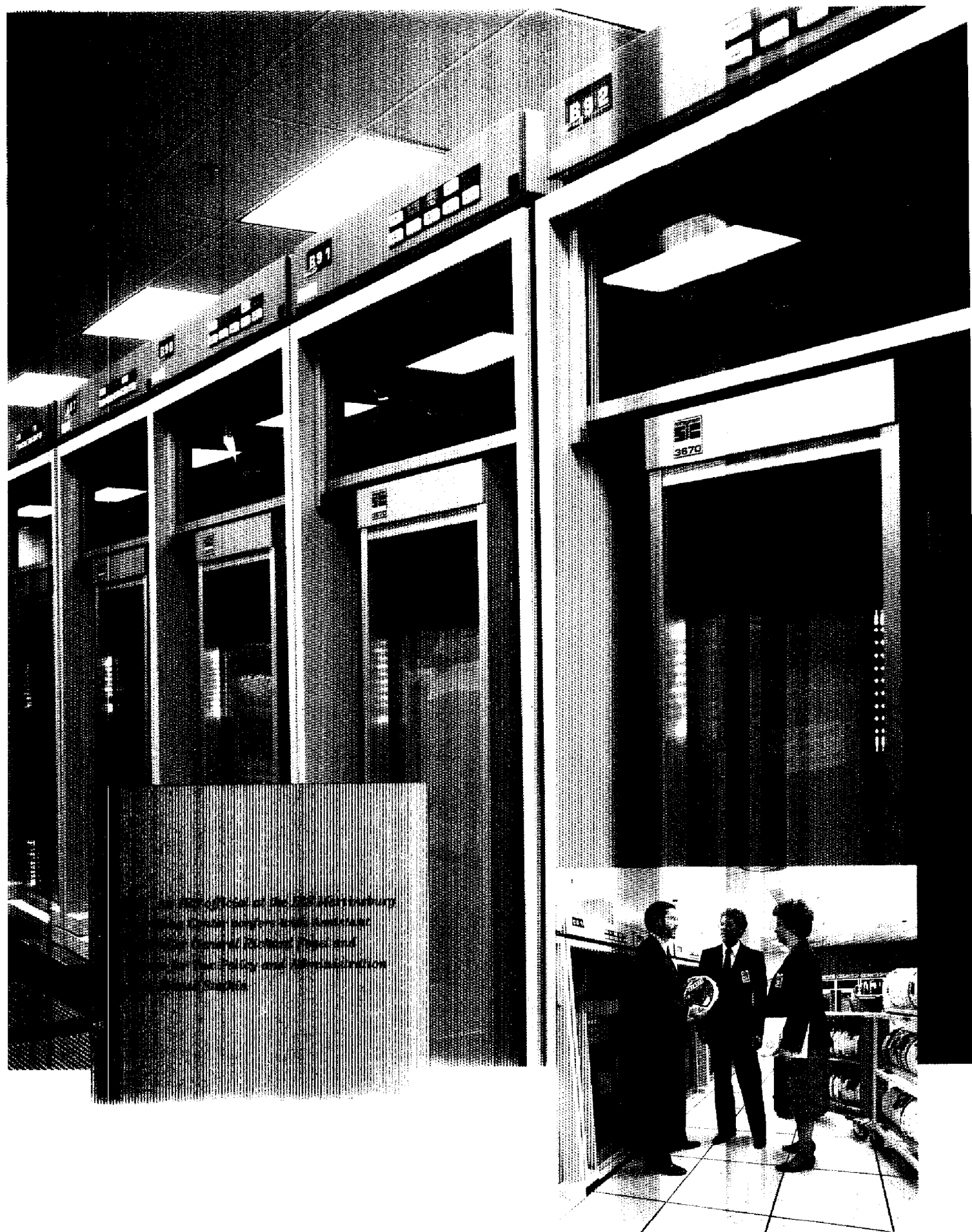


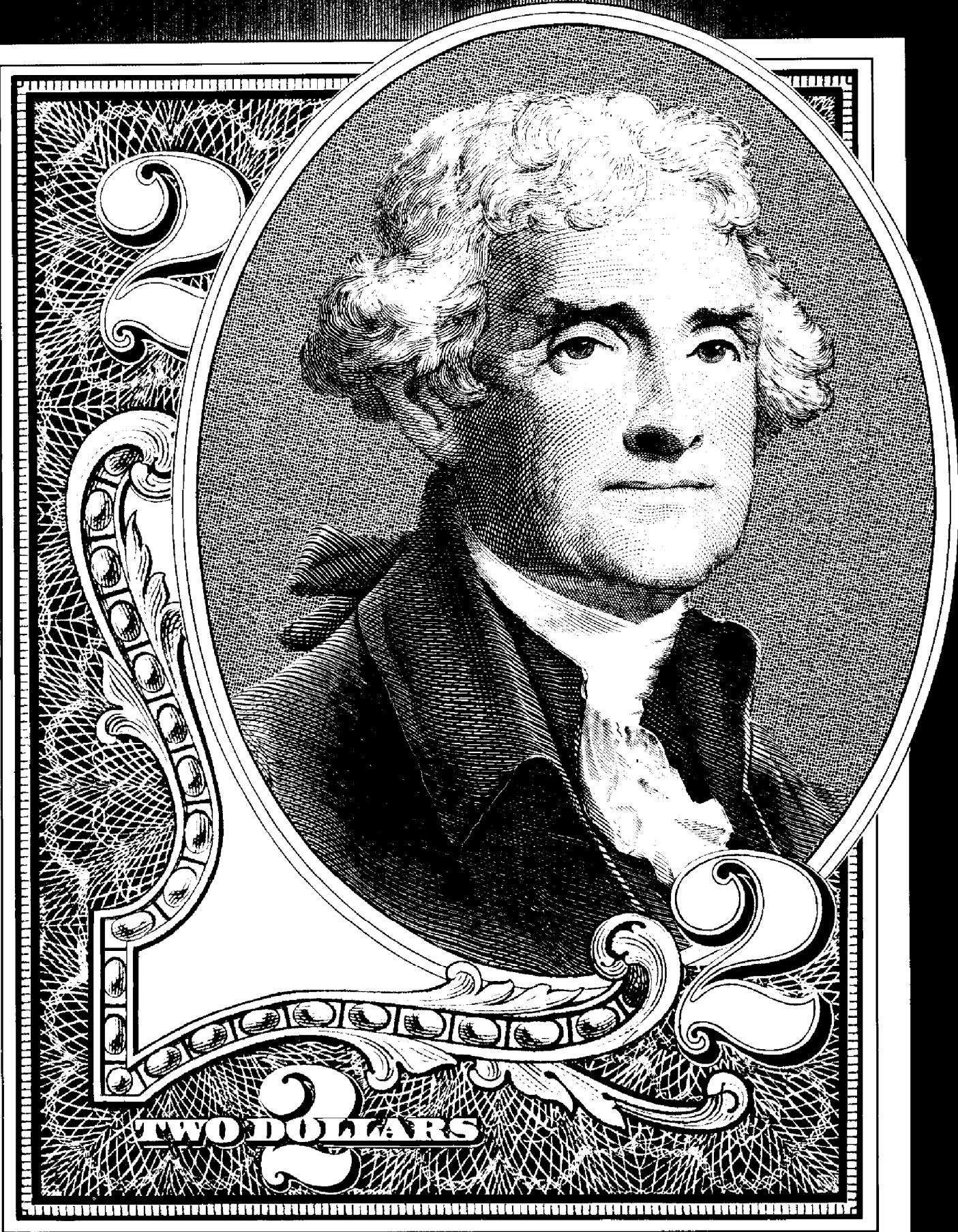
COLLECTING REVENUE As the government's tax collector, an effective Internal Revenue Service (IRS) is essential to any solution of the deficit problem. In 1987, IRS collected \$886 billion, 90 percent of all federal revenues. But in fiscal year 1988, its accounts receivable grew from \$54 billion to \$59 billion and taxpayer noncompliance resulted in an additional estimated \$87 billion in unpaid taxes. GAO directed recommendations to improve performance in these and other areas. Regarding tax compliance, the difference between taxes owed and taxes paid, the "tax gap," is expected to exceed \$100 billion by 1992. GAO recommended increased enforcement efforts that could narrow this gap but also reported that gaining additional revenue from enforcement will take time.

IRS needs to modernize its outdated, labor-intensive tax-processing system. GAO advised the Congress that unless IRS takes immediate steps to provide greater computer capacity by the 1990s, it could encounter major problems processing tax returns, similar to those faced in 1985. A GAO management review—in cooperation with IRS—produced numerous recommendations to improve the IRS information systems modernization, strengthen its financial management systems, oversee its vast decentralized operations, and help IRS attract and retain high quality personnel.

A high quality staff with proper training is especially important to IRS service to taxpayers. As GAO reported, IRS has had difficulties in answering taxpayer questions and corresponding with taxpayers accurately. The quality of taxpayer assistance, a long-standing problem complicated by a series of tax law changes, could have a major impact on compliance, because taxpayers who do not receive adequate assistance from IRS are less likely to file returns or properly pay taxes owed.







MANAGING DEFENSE

Managing the nation's defense will be an ever-greater challenge. In an era of huge budget deficits and mounting pressure to restrain defense spending, defense managers will be required to make difficult decisions as they seek to balance strength with affordability. Since 1980, \$2.5 trillion has been appropriated for the largest peacetime defense buildup in this country's history. Hundreds of billions of dollars have been spent developing new state-of-the-art weapon systems. In the coming years, funding demands will increase as these systems reach high rate production levels and begin entering the inventory. The fiscal year 1988-1992 Five Year Defense Program contained items that would cost about \$200 billion more than the Department of Defense (DOD) can expect to receive. With dramatic increases in the defense budget unlikely, there are just too many systems chasing too few dollars and there is an urgent need for careful planning and rational choices.

Adding to the management challenge is the need to restore and ensure the integrity of DOD's procurement system amid a wide ranging investigation of fraud, waste, and abuse. As weapon programs compete for limited funding, defense managers will have to guard against overly optimistic cost and performance estimates that eventually lead to cost overruns and systems not working as promised. GAO continues to be actively involved in identifying and addressing such management issues.

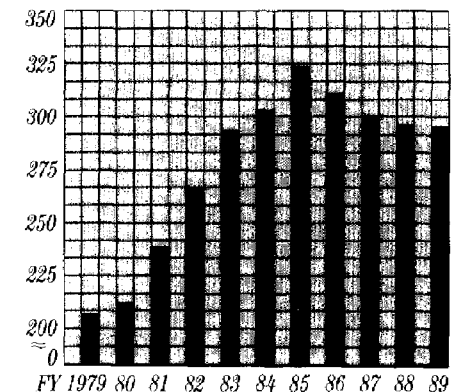
We confide in our
strength, without
boasting of it; we respect
that of others, without
fearing it.

Thomas Jefferson
Letter, 1793

Defense Faces an Era of Limits After a Rapid Buildup

Defense Appropriations

Billions of Constant
Fiscal Year 1989 Dollars



BALANCING STRENGTH WITH AFFORDABILITY Current defense planning and acquisition policy reflects U.S. commitments to deal with the Soviet threat on a global basis. There is growing concern in the Congress and elsewhere over the extent to which this burden is shared by our North Atlantic Treaty Organization allies and Japan, particularly when compared with the large costs incurred by the United States. The viability of U.S. worldwide commitments and the current levels of burden sharing by U.S. allies are being rethought, and GAO will continue to assist in this effort.

Over the last several years, funding for improving defense readiness and sustainability has increased substantially. There is no doubt that the forces are more capable today than at any time in the recent past. Nonetheless, military commanders believe they do not have all the forces and material they need to carry out our worldwide commitments.

On the other hand, GAO's analysis of DOD's inventory of secondary items, such as spare parts, has shown

that 31 percent of the \$94 billion inventory exceeds its requirements. GAO will continue its efforts to identify more efficient inventory management that will provide opportunities for enhancing readiness and sustainability while saving money.

One further defense activity with enormous budgetary implications is the manufacture and maintenance of nuclear weapons at 16 installations around the country operated by the Department of Energy. This defense nuclear complex is fraught with reactor safety and environmental problems, such as extensive groundwater and soil contamina-

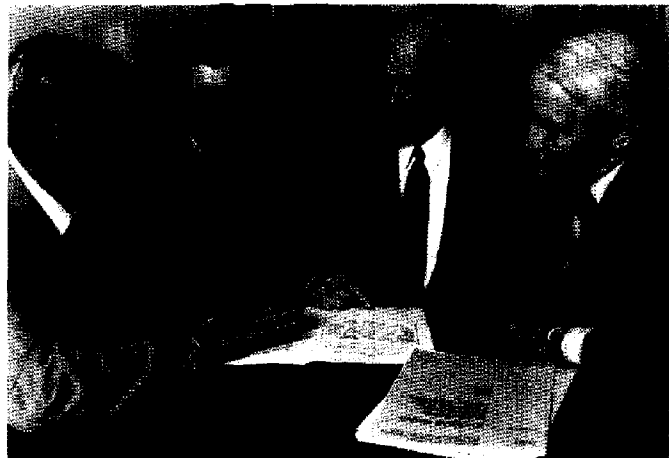
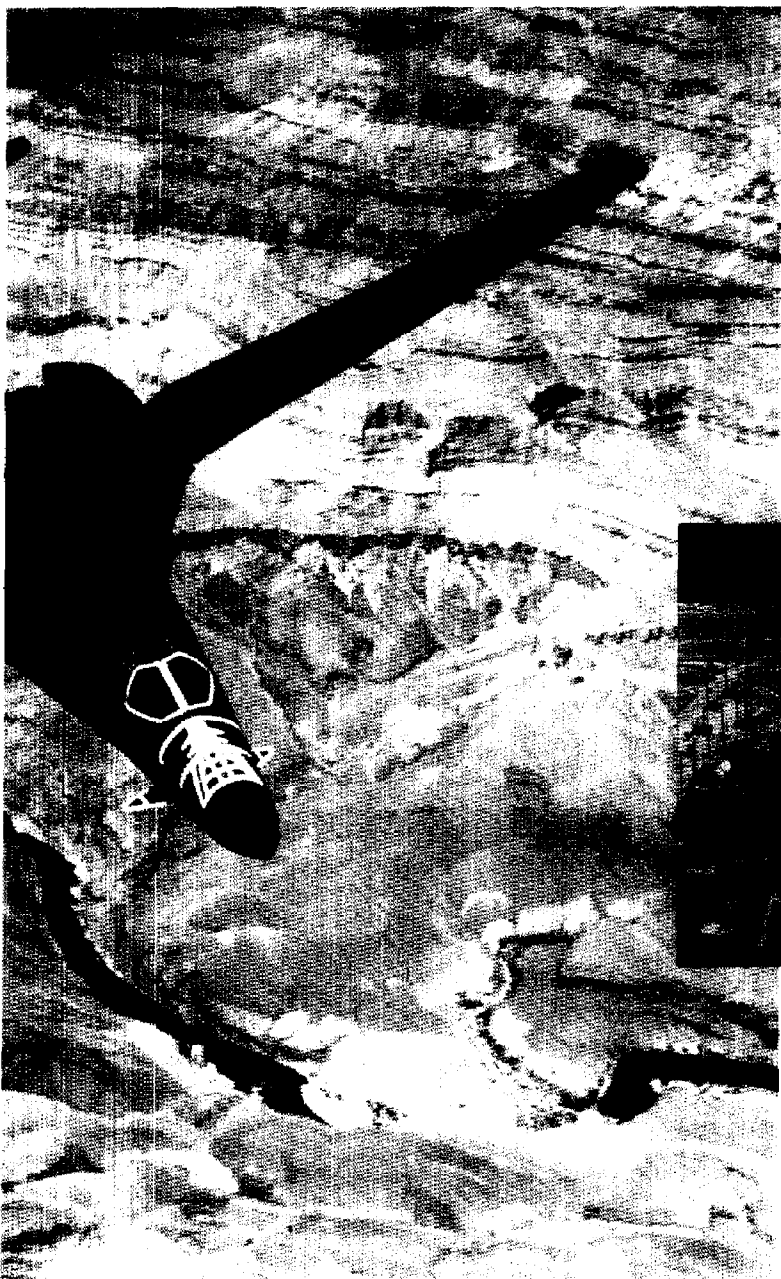


tion, which have received widespread national attention as a result of GAO's work. GAO estimated that costs for upgrading existing capability, environmental cleanup, and waste disposal will total between \$100 billion and \$130 billion over the next 25 years.

Because much of the complex was built in the 1950s, some facilities have deteriorated to the point of requiring constant attention. Many facilities need to be upgraded to meet safety, health, and environmental standards. Maintenance and upgrades will cost about \$20 billion.

Another \$35 billion to \$65 billion is needed to clean up areas where the disposal of wastes has contaminated groundwater and soil. Even so, to clean up some installations may not be technically possible. Finally, the cost of disposal of radioactive wastes and decontaminating previous holding facilities will likely be more than \$45 billion.

In 1988, GAO testified 10 times and over the past several years has issued more than 50 reports and testimonies on the defense nuclear complex. In 1989, GAO will continue to help the Congress address this issue.



PROCUREMENT The integrity and the effectiveness of DOD's procurement system are judged largely on its ability to provide reasonably priced weapons, goods, and services that meet performance requirements when needed.

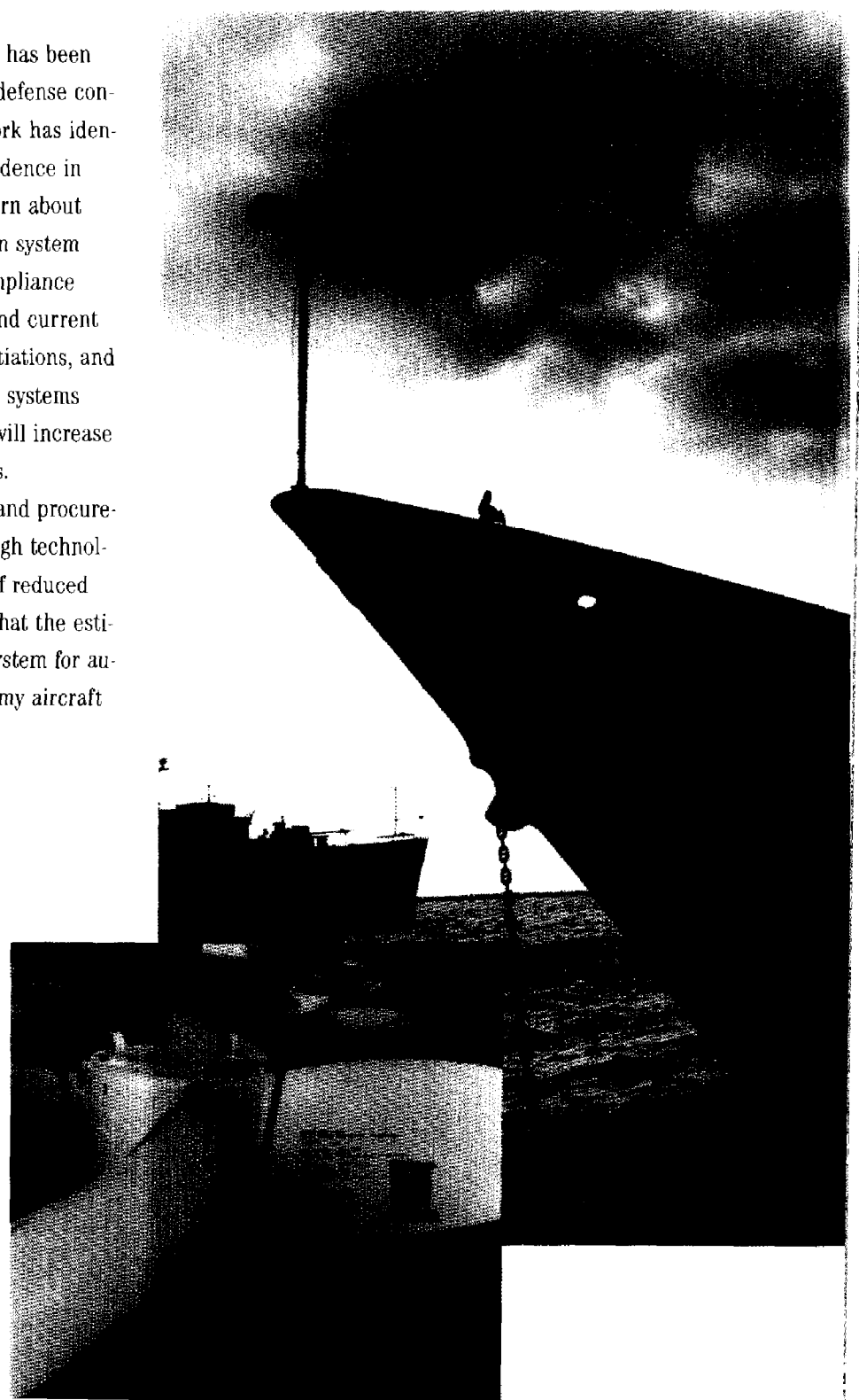
The rapid pace of the weapon systems buildup in recent years has placed tremendous pressures on DOD's procurement system. Procurement scandals of the mid-1980s and the more recent investigations are indicative of the kind of problems that can occur when growth exceeds a system's management and control capabilities.

Confidence in the procurement system has been shaken seriously by the current investigations of defense contractors, consultants, and DOD officials. GAO's work has identified a number of practices that undermine confidence in the acquisition process. GAO has expressed concern about (1) the way in which contractor profit and weapon system cost data are reported, (2) lack of contractor compliance with legal requirements for disclosing complete and current cost data to the government before contract negotiations, and (3) ineffectiveness of contractors' cost-estimating systems and evaluations of subcontractor proposals. GAO will increase its efforts in reviewing DOD industry relationships.

Prospects for continued cost overruns and procurement stretch-outs in shipbuilding, aircraft, and high technology weapon systems are high in an environment of reduced defense budget growth. For example, GAO found that the estimated cost of the Army's command and control system for automatically detecting, tracking, and targeting enemy aircraft

has risen \$900 million from \$2.6 billion in mid-1986 to \$3.5 billion in mid-1988; it is likely to increase further as recent budget reductions cause the program to be stretched out. This system is just one of five elements constituting DOD's forward air defense network being developed following the cancellation of the DIVAD, the Division Air Defense system.

There are prospects for substantial cost growth in Navy shipbuilding. In October 1987, GAO reported projected

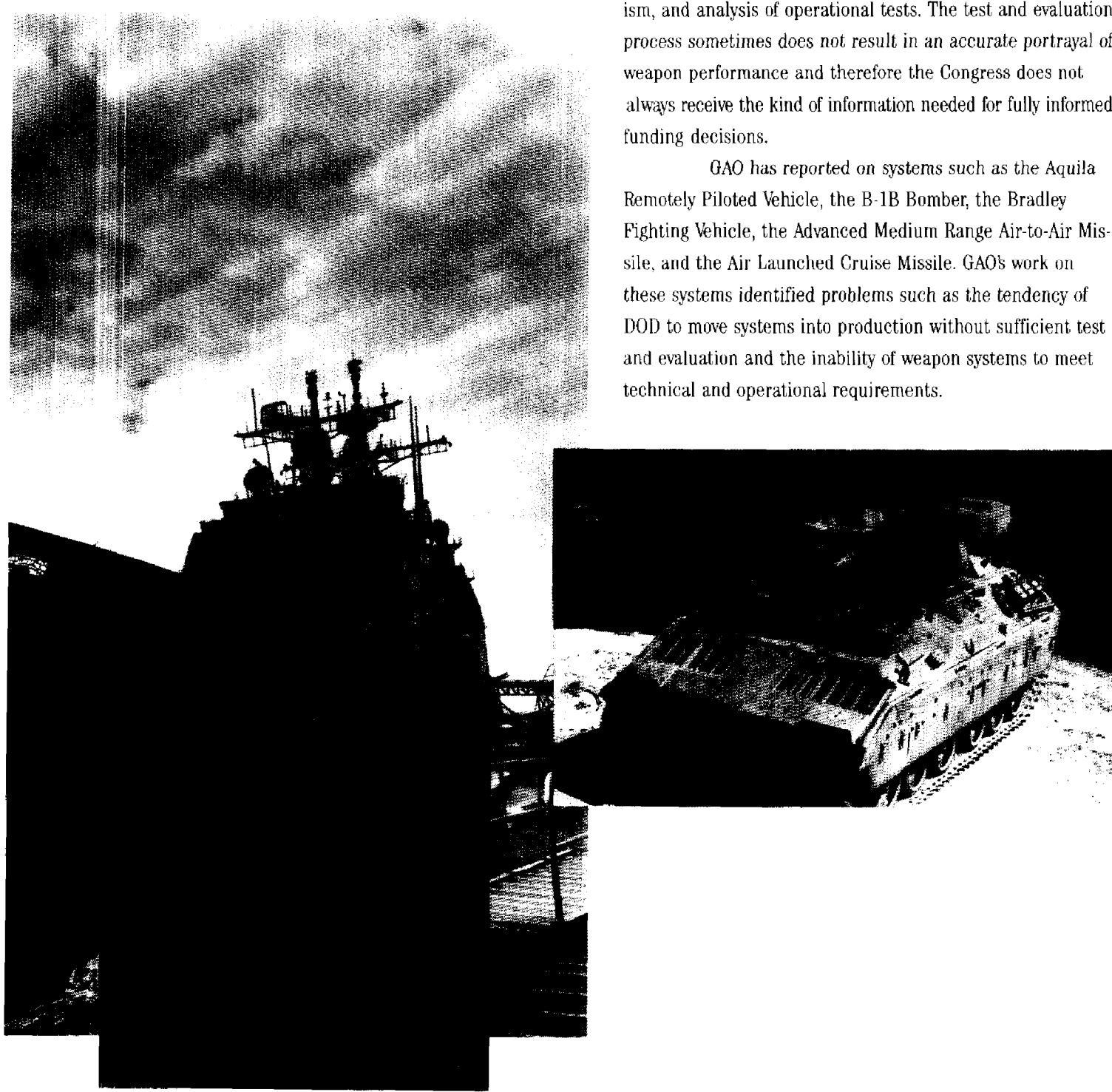


cost overruns of \$1.4 billion on 19 Navy ship construction contracts. By February 1988, the projected cost overruns had climbed to \$1.7 billion for 17 of the contracts, and the 4 contracts awarded the previous year were already projecting overruns of \$403 million. These overruns will be shared between the Navy and the shipbuilder. Such overruns increase the probability of contractor claims against the Navy and place demands on future budgets.

TEST AND EVALUATION This is a critical function in DOD's acquisition process. Short of war, it is the primary means for determining how well multimillion-dollar weapon systems perform their missions before deployment to operational forces. Because of its importance, GAO has emphasized and will continue to emphasize reviews of DOD weapon testing and evaluation activities.

GAO reports on military test and evaluation activities have identified problems in the planning, execution, realism, and analysis of operational tests. The test and evaluation process sometimes does not result in an accurate portrayal of weapon performance and therefore the Congress does not always receive the kind of information needed for fully informed funding decisions.

GAO has reported on systems such as the Aquila Remotely Piloted Vehicle, the B-1B Bomber, the Bradley Fighting Vehicle, the Advanced Medium Range Air-to-Air Missile, and the Air Launched Cruise Missile. GAO's work on these systems identified problems such as the tendency of DOD to move systems into production without sufficient test and evaluation and the inability of weapon systems to meet technical and operational requirements.





THE TROUBLED FINANCIAL SECTOR

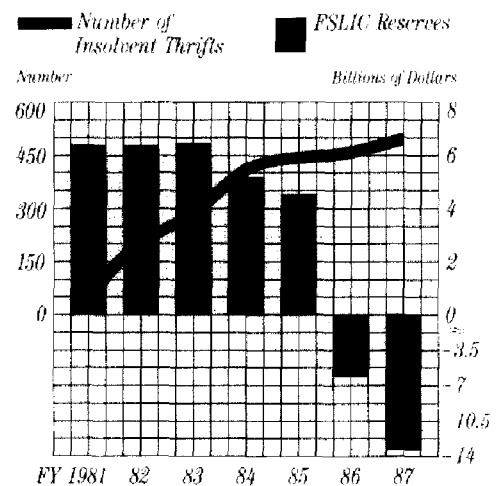
Never have our nation's financial institutions and their regulators faced the multiplicity of domestic and international challenges they face today. Depository institutions are failing in numbers exceeded only during the Great Depression. By mid-1988, about 500 thrifts were insolvent. GAO has reported that the Federal Savings and Loan Insurance Corporation (FSLIC) is also insolvent, with little prospect that its future cash flow would be adequate to close failed institutions.

On October 19, 1987, a day called "Black Monday," the nation's and the world's financial markets suffered one of their worst shocks ever. The New York Stock Exchange's Dow Jones Industrial Average index plunged more than 500 points, and stock values declined almost \$1 trillion during the first 19 days of October. Other markets, both here and abroad, were equally turbulent. The specter of the 1929 crash and the Great Depression haunted the markets and left investors uncertain. Everyone wanted to know how such an event could happen so quickly and what, if anything, could be done to prevent a recurrence. Diagnosing the situation and resolving the problems is made more difficult by continued rapid changes in the structure of the financial services industry. Differences between banks and securities firms, for example, have begun to blur. Meanwhile, markets that were once separate, such as the stock markets in New York and the financial futures markets in Chicago, are now linked.

The dogmas of the quiet past are inadequate to the stormy present.

*Abraham Lincoln
Annual Message to the Congress, 1862*

Problems and Remedies in the Financial Services Industry



DEPOSITORY INSTITUTIONS GAO and other industry observers estimate that a thrift industry cleanup will cost at least \$85 billion. Without fundamental changes in FSLIC's management of the risks it underwrites, the thrift industry's problems will continue to mount. GAO has called for decisive and immediate actions to resolve thrift problems and to ensure that they are not repeated.

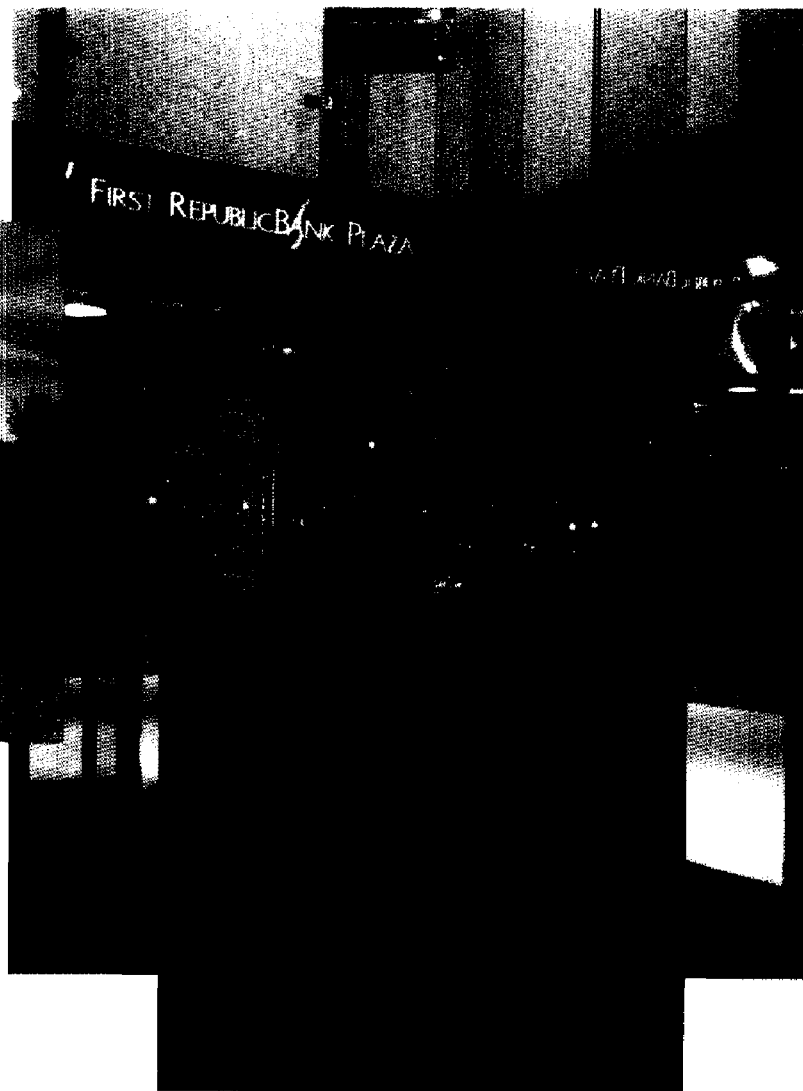
The commercial banking industry, insured by the Federal Deposit Insurance Corporation (FDIC), is healthier on average than the thrift industry. Nevertheless, 200 banks failed in 1988, and FDIC identified another 1,500 of the nation's 14,500 banks as "problem institutions." Even though FDIC is solvent, recent losses have reduced its ratio of reserves to insured deposits to the lowest level in years. Expensive financial rescues of Texas banks, together with the looming possibility of additional large bank failures, have increased apprehensions about the long-run viability of FDIC.

A combination of unfavorable economic conditions, poor management practices, inadequate internal controls, insufficient capital standards, as well as inadequate oversight and supervision, have caused depository institutions' problems. These problems occurred against a backdrop of growing integration within the financial services industry. Of particu-

lar note, the integration of the banking and securities industries has significantly eroded the effect of laws intended to separate them. This trend will continue, in all likelihood gaining momentum as it proceeds.

These developments pose additional dangers because the activities pursued by institutions no longer conform to the traditional boundaries that largely define the roles of regulators. The regulators, therefore, seem no longer equipped to adequately supervise the evolving industry.

In light of these problems, GAO recommended modernization of banking laws to keep pace with the changing financial services industry. With lessons learned from past mistakes in mind, GAO recommended a number of steps to accompany changes to banking laws that should better (1) preserve bank safety and soundness, (2) prevent abusive conflicts of interest, (3) protect consumer interests, and (4) minimize the chances that unforeseen events would destabilize our financial system.



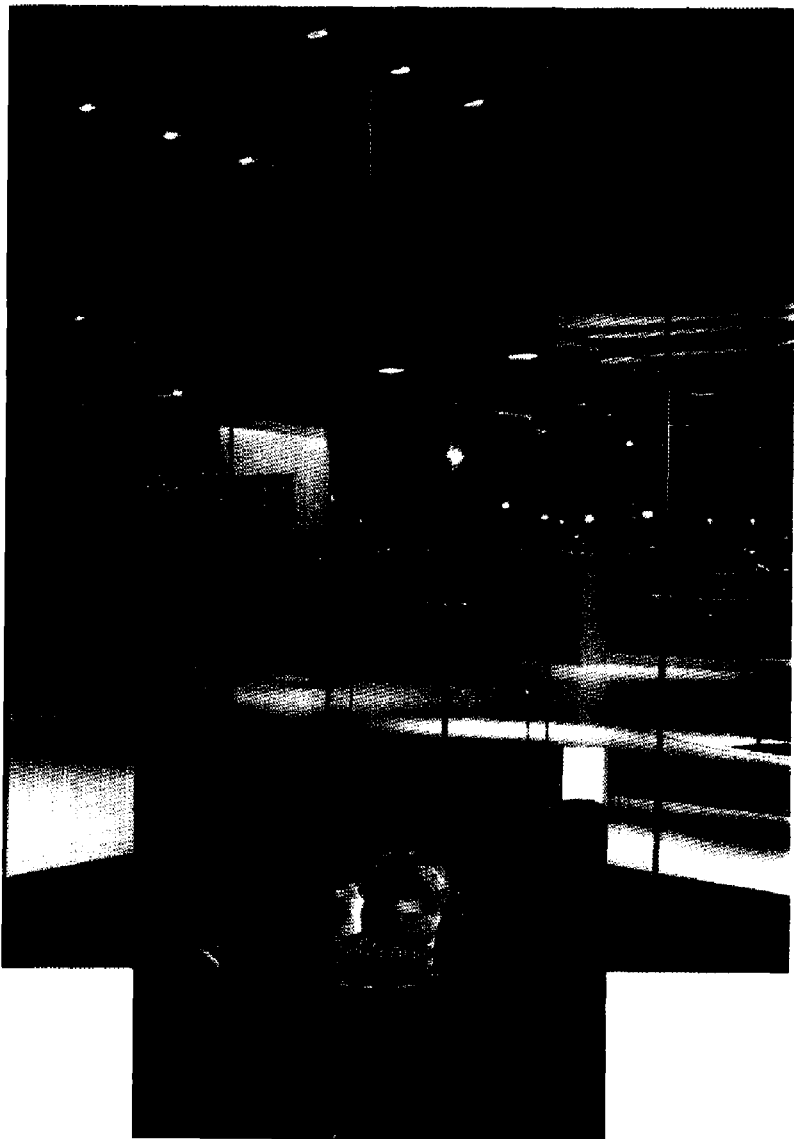
SECURITIES MARKETS GAO issued a major report in January 1988, testified several times on the stock market crash, and continues to explore related issues. While many calls for immediate and sometimes drastic action followed the crash, GAO recommended a measured approach because of inadequate information about its specific causes. Fear and uncertainty clearly had much to do with the downward spiral in stock prices. And GAO's recommendations to develop contingency plans between markets, better coordinate regulation, and improve automated trading systems on the exchanges were designed to alleviate fear and uncertainty and help regulators and market participants better cope with financial crises in the future.

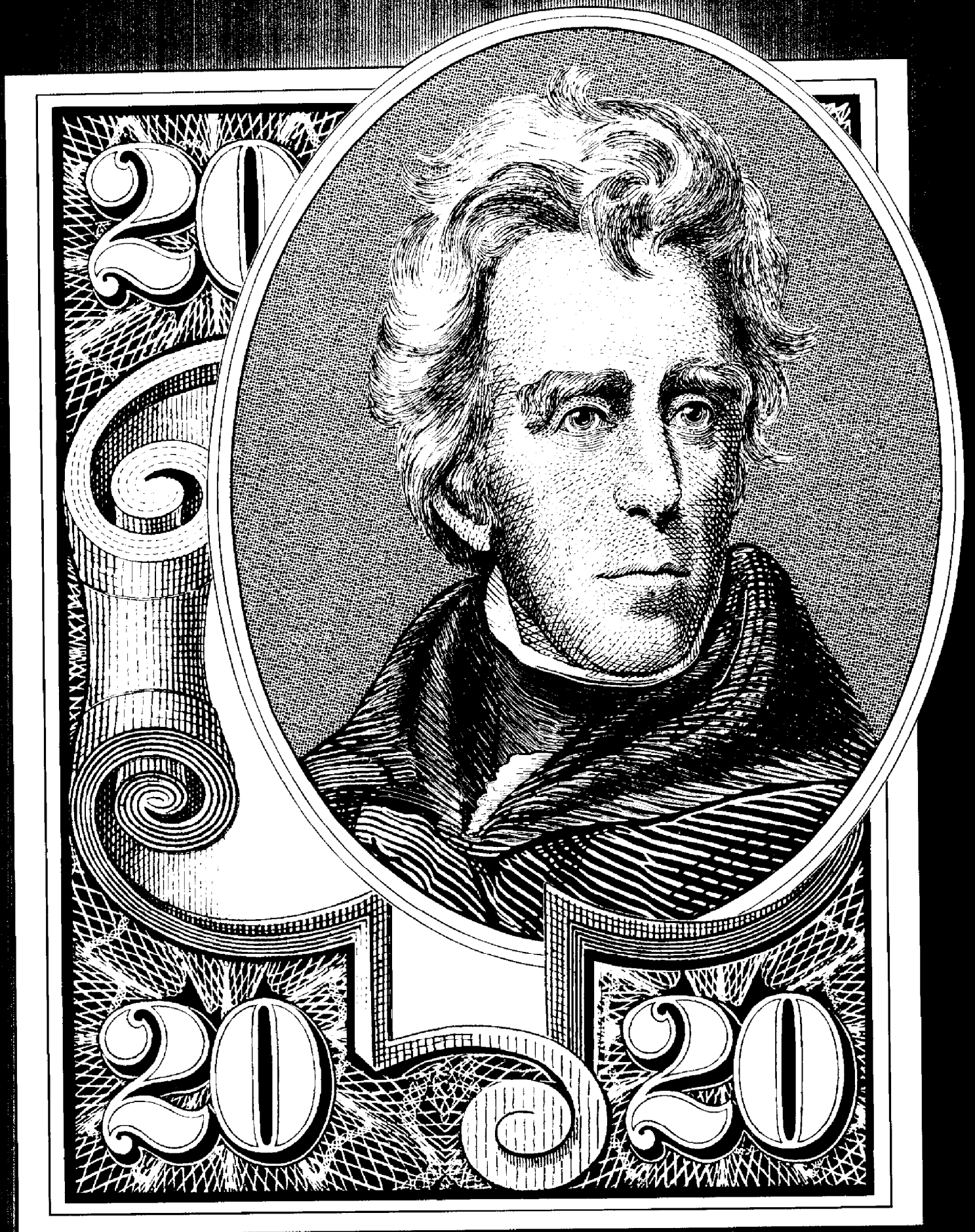
The market crash heightened concern over repealing existing banking laws. Critics of bank expansion believe that laws separating the banking and securities industries prevented the spread of the crash to the credit markets. But regardless of how the expansion question is decided, banks

are, and will remain, significantly exposed to the risks flowing from price volatility in financial markets because of the crucial role they play in extending credit to market professionals in the clearing and settlement processes. This was typified by the Federal Reserve's action in supplying liquidity to the panicked markets through the banking system, a step that most observers believe stopped the spreading crisis.

Nevertheless, concerns remain about the adequacy of clearing and settlement processes. As the mechanisms that directly link the credit and securities markets, they are essential to smoothly functioning financial markets. Any breakdown in these processes would create the greatest potential for widespread financial disruption should the events of October 19, 1987, repeat themselves.

GAO continues to explore options for the Congress to consider in designing a regulatory structure that recognizes the reality of interrelated domestic markets and increasingly linked international markets. GAO is examining possible improvements in clearing and settlement processes and is exploring issues associated with a nationwide system of trading securities, the growing internationalization of markets, and individual investor protection.





PROTECTING THE PUBLIC'S HEALTH

National health expenditures now approach \$600 billion annually, and Medicare and Medicaid account for about 25 percent of these dollars. Almost all of this money is spent on medical treatment. Between 1981 and 1991, the cost to treat the first 370,000 cases of acquired immune deficiency syndrome (AIDS), for example, could be as much as \$22 billion, with an increasing share borne by the public sector over time.

Many believe, however, that more use of preventive medicine can significantly reduce treatment costs in the long run. Investing judiciously in improved prenatal care and in education programs to prevent AIDS and drug abuse, for example, could save lives and yield other important public health benefits. In 1987 GAO reported that \$400 in prenatal care could make the difference between a healthy baby and one that might need an average of \$15,000 in newborn intensive care. The lifetime costs of caring for a single infant with disabilities resulting from low birthweight—often avoidable with adequate prenatal care—can be several hundred thousand dollars.

In addition to saving billions in treatment costs for premature infants, terminal AIDS patients, and drug rehabilitation clinics, preventive strategies yield improvements in quality of life that are mutually reinforcing. Success in school, employability and productivity at work are accomplished by healthy and drug-free youth and working adults.

While GAO will continue to review health care financing and delivery of services in the Medicare and Medicaid programs, its work will also assess the socioeconomic impact of prevention strategies. This work will help the Congress evaluate public health programs that coincide with sound fiscal policy.

***In the full enjoyment
of the gifts of Heaven
and the fruits of
superior industry,
economy, and virtue,
every man is equally
entitled to protection by
law.***

*Andrew Jackson
Veto Message, 1832*



CHILDREN'S HEALTH GAO's work on prenatal care in 1987 led to the Comptroller General's membership on the National Commission to Prevent Infant Mortality, which reported a need to stress prevention rather than treatment strategies as a more effective—and more humane—use of resources.

The Commission concluded that the measures to prevent infant mortality have been known for decades, but the nation lacks the effective governmental and institutional structures needed to implement those measures. In 1989, GAO will examine successful programs in the United States and other countries to provide the Congress with proven, cost-effective options for action.

One component of the prevention strategy is the \$1.8 billion high-nutrition food program the federal government provides to at-risk expectant mothers and babies. Because of limited resources, however, this program serves less than half of those eligible. In 1988, GAO's review of the state-run supplemental food program ("WIC"), funded through the Agriculture Department, found that six states had developed cost-saving approaches to buying infant formula that allowed them to serve thousands more. Used nationally, these approaches could benefit hundreds of thousands more women and infants. GAO will examine other state and local child

health programs to identify similar cost-saving innovations that could stretch existing health care resources to reach more at-risk children.

In 1989, GAO will also report on whether the care of chronically ill children can be made more efficient and more humane. GAO is contacting hundreds of families with seriously ill children to identify barriers to obtaining care at home—often a more cost-effective alternative to institutional care. GAO is finding, for example, that better care coordination leads to more efficient services and reduced emotional burdens on both the families and the children. From its work in several states and children's hospitals, GAO hopes to examine promising options, such as care coordination networks, that the Congress can consider in reducing barriers to obtaining care.



FIGHTING AIDS The threat to public health posed by AIDS continues to grow. As a consequence, federal expenditures for AIDS research and prevention have doubled every year since 1983 and now exceed \$1 billion.

Because prospects for a successful vaccine are not promising and treatment options are limited, education is still the best preventive measure for containing the AIDS epidemic. For the past 2 years, GAO reports have supported education as a budget priority that could avert higher future treatment costs. Early research indicates that investing in education paid off in the homosexual community, for instance, where infection rates recently decelerated in San Francisco. Similar efforts to educate other high-risk groups, especially those without adequate insurance, can reduce future public sector expenditures for their care.



GAO has focused on targeting education at such groups—intravenous drug abusers and their sex partners, children, and minorities. GAO has urged especially quick action to control AIDS among drug abusers, who spread the virus to the general population. GAO is also reviewing education campaigns in less heavily affected areas, where important opportunities to forestall the further spread of AIDS still exist.

In 1988, GAO reported that a stronger federal role is needed to guide the states in developing a national strategy for preventing AIDS. Federal leadership could promote innovative ways to prevent and treat AIDS developed by communities hit early in the epidemic.

GAO, in fact, testified that improved monitoring of new, federally funded programs could quickly identify those that do not work and instead direct funds to programs that are more likely to save lives. In 1988, for example, GAO found significant variations in the ways communities with similar AIDS caseloads provide prevention and treatment services. GAO's ongoing work will foster better use of federal funds to develop cost-effective alternatives to expensive hospitalization and identify successful prevention campaigns.



REDUCING DRUG DEMAND The problem of drug abuse, contributing to the spread of AIDS, also necessitates a focused federal prevention strategy. Despite billions of dollars devoted to drug interdiction, an increasing number of experts believes that in the face of enormous demand, the nation is losing its war against drugs.

For several years GAO has reported on the international and domestic activities, including the use of the military, to control drug supply. While these efforts should not be reduced, the Comptroller General testified that more emphasis and resources should be aimed at reducing drug demand.

While devoting substantial resources to reviewing law enforcement and international narcotics control programs, GAO will increasingly evaluate drug prevention, treatment, and research to help the Congress target federal funds at actions that will be most cost-effective in the long term. In 1988, GAO reported that although the Anti-Drug Abuse Act of 1986 increased drug abuse prevention and education funding, the states did not conduct uniformly sufficient evaluations to identify what works to prevent such abuse. Consequently, millions of dollars will be spent with uncertain benefits. GAO recommended tying federal funding to program effectiveness and widely disseminating information on the success of state and local programs.

In a special report on illicit drugs in the United States, also issued in 1988, GAO noted that public treatment facilities in some major cities were greatly overloaded. GAO is assessing the adequacy of drug treatment capacity and examining federal, state, and local government roles in financing and delivering services.

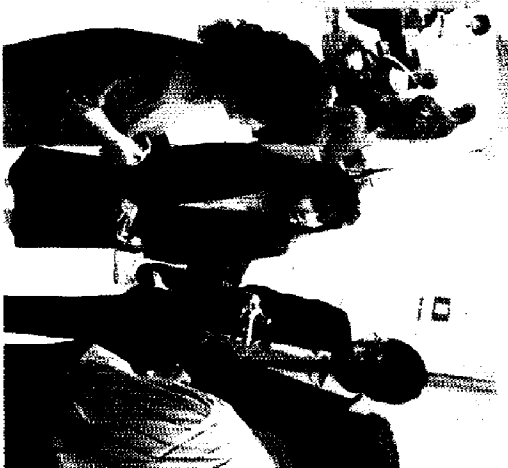
GAO is also assessing methadone maintenance programs. Used to treat heroin addiction, methadone substitutes for heroin, either weaning the abuser of the heroin addiction or shifting the addiction to a drug that is taken orally rather than injected by disease-spreading needles. However, because of abuses by addicts and high recidivism, these programs are controversial.

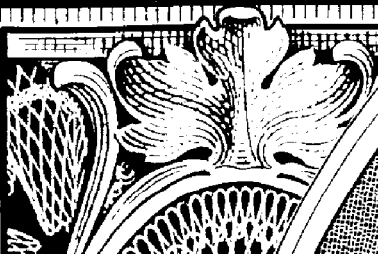
Finally, GAO has begun evaluating the plans and objectives of the National Institute on Drug Abuse and the Office of Substance Abuse Prevention. With the help of a national panel of experts, GAO will advise the Congress on the development of a strategy to reduce illegal drug demand.



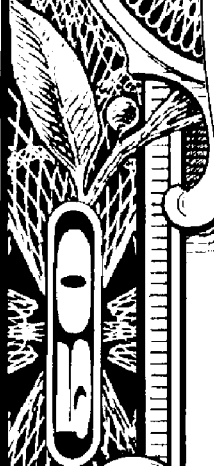


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ENHANCING PUBLIC AND ENVIRONMENTAL SAFETY

Among the most important regulatory functions of the federal government is protecting public safety. While GAO has assisted the Congress in its oversight of many regulatory issues, two areas—aviation safety and environmental protection—are especially illustrative of GAO's work.

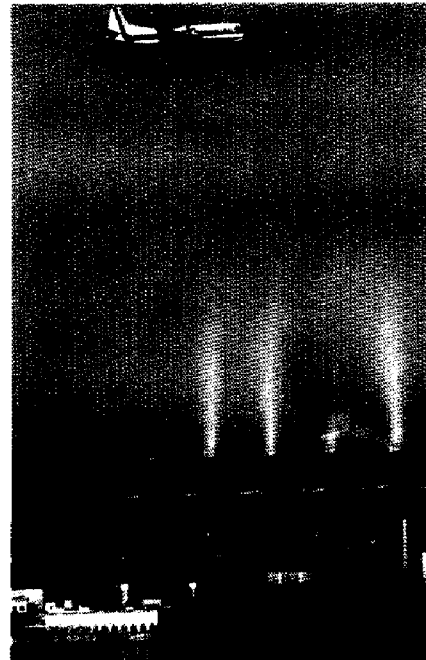
For anxious air travelers, the loudspeaker announcement that "our flight has been delayed" is an all too familiar refrain. Following the Congress's deregulation of airfares and airline routes in 1978, U.S. air travel experienced unprecedented growth. From 1978 to 1988, the annual number of air passengers surged—from 278 million to 461 million—and by the year 2000 may reach 800 million. This growth has been accompanied by air traffic congestion, delays and greatly increased concern about safety.

Many vacationers in 1988 faced problems of a different sort at their destinations. Seeking to escape 1988's record-breaking heat wave, coastal visitors were horrified to find beaches littered with vials of blood and used syringes. Medical waste quickly became the latest on the long list of public health threats we have learned about since the environmental movement began. Having spent over \$700 billion on cleaning up our air and water, we now face an even greater investment to deal with newly discovered threats from hazardous chemicals in our drinking water, radon in our homes, and the global problems of acid rain and the greenhouse effect.

GAO has focused on the management improvements and substantial federal investment required to effectively carry out air transport and environmental responsibilities to enhance public safety.

*I renew my
recommendation that
the public lands be
regarded as a heritage
to our children.*

*Ulysses S. Grant
Annual Message, 1872*

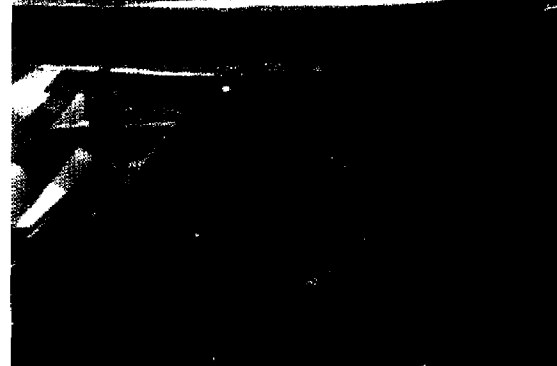


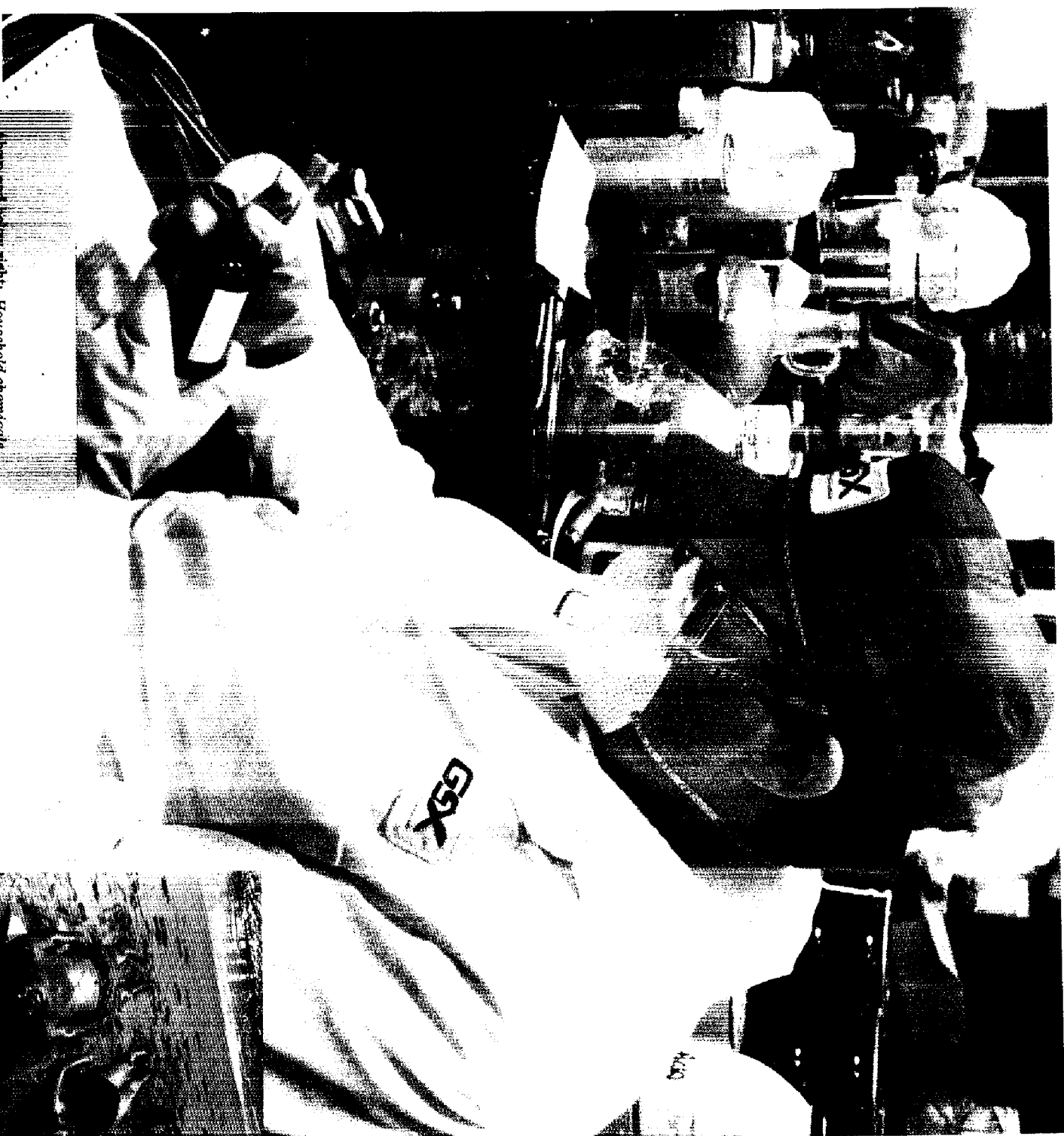
ENVIRONMENTAL PROTECTION Over the last year, GAO's work has covered the range of environmental issues. For example, to ensure that infectious wastes are properly managed, GAO is investigating the adequacy of state regulations and the need for federal intervention. GAO is also looking at the accuracy of devices to measure radon, an invisible gas that may be responsible for up to 20,000 cancer deaths yearly.

Responding to congressional concerns about hazardous wastes, GAO found that the Environmental Protection Agency (EPA) has not effectively managed the hazardous waste problem and needs measurable program goals and strategies to turn its program around. GAO also reported that as many as 425,000 hazardous waste sites around the country may have to be assessed before EPA can gauge the full extent of contamination and cleanup costs, already estimated as high as \$80 billion for 4,000 sites.

On the basis of GAO's recommendations, the Congress passed legislation in 1988 to protect consumers from cancers and birth defects caused by pesticide residues on imported foods. GAO also recommended approaches to protecting groundwater, the source of drinking water for about half the nation, and reducing ozone, a contributor to lung disease. About one-third of the American people live in areas that exceed safe ozone levels.

Although reducing individual pollutants is important, their complex interplay calls for a comprehensive regulatory strategy. In its 1988 management review of EPA, GAO recommended that EPA develop quantitative indicators of environmental quality that can be used to set priorities and measure agency progress toward established goals. EPA also needs to better link its budgeting and planning systems. These actions can best ensure that EPA resources are directed at essential environmental protection issues.





Above and below right: Household chemicals, which also pose hazards, are collected at a Montgomery County, Maryland, safe disposal program.

Below right: EPA is examining issues associated with damage to the stratospheric ozone layer, where ozone depletion lessens natural protection from the sun's rays, leading to an increase in the incidence of skin cancer.

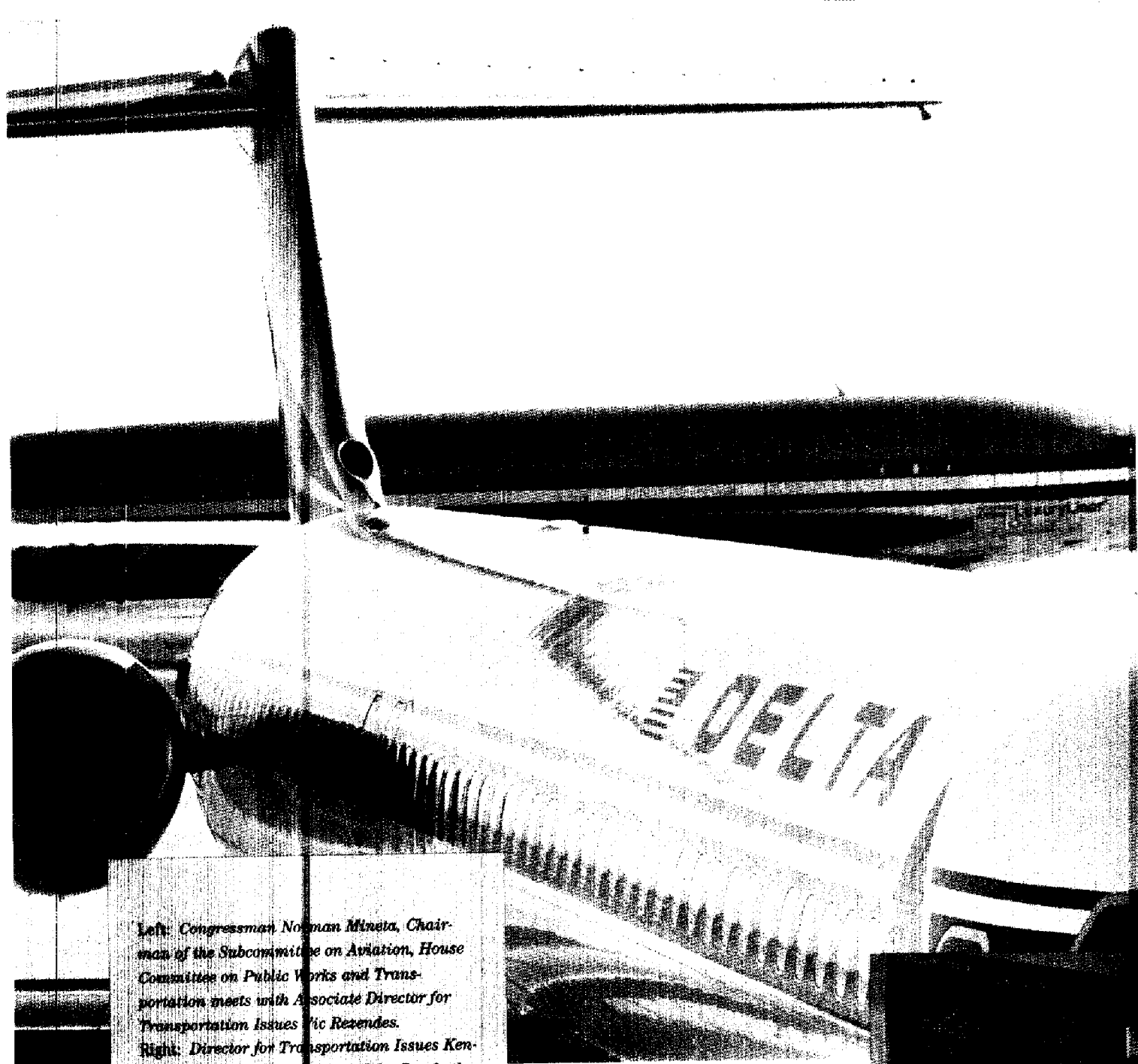


AVIATION SAFETY Amid the huge growth of planes and passengers in the sky, the Federal Aviation Administration (FAA) has been challenged to maintain air safety by rebuilding its work force and modernizing aging air traffic control equipment. One of the most visible challenges occurred in 1981, when the nation's air traffic controllers went on strike and over 11,000 were subsequently fired. Seven years later, fully qualified controllers number almost 4,000 fewer than before the strike. Also, 4,300 technicians—over half of the current work force—who maintain air traffic control equipment are expected to retire by 1995. GAO has identified the need to develop effective staffing standards for controllers and recommended accelerating the hiring of maintenance technicians since it takes 2 to 5 years to train them.

Many of FAA's National Airspace System modernization projects are already 1 to 4 years behind schedule. Moreover, modernization costs may total \$25 billion, over twice the initial estimate, partly because FAA underestimated the size and the complexity of the task and did not follow prudent acquisition guidance for designing and testing systems. To ensure that costly new systems will work safely and reliably and avoid costly retrofitting, GAO recommended that FAA thoroughly test new equipment before committing to buy it in significant quantities. FAA intends to use this approach for such key systems as hazardous weather detection, the proposed \$1.6 billion microwave landing system, and the \$5 billion advanced automation system for air traffic control. For this last system, GAO also emphasized that FAA should examine alternative approaches for achieving its objectives, including one approach that could result in savings of about \$550 million.

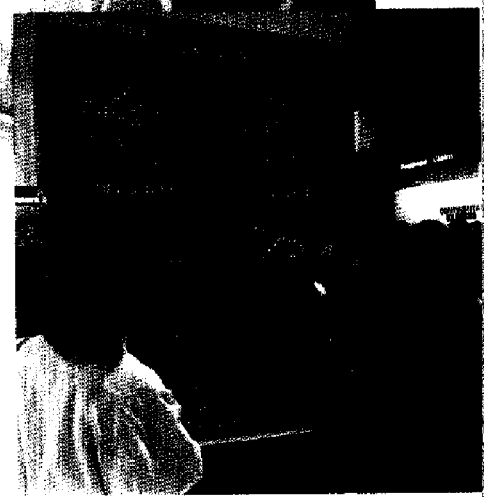
The scope, the complexity, and the cost of modernization and FAA's work force needs have contributed to proposals to "privatize" the agency or make it independent of the Department of Transportation (DOT). Regardless of whether FAA is "privatized" or separated from DOT, rebuilding its work force and modernizing the air traffic control system will continue to pose a significant challenge to maintaining safe and efficient air travel.





Left: Congressman Norman Mineta, Chairman of the Subcommittee on Aviation, House Committee on Public Works and Transportation meets with Associate Director for Transportation Issues Eric Retendes.

Right: Director for Transportation Issues Kenneth Mead meets with Senator John Danforth, Ranking Minority Member of the Senate Committee on Commerce, Science, and Transportation.





SPECIAL FOCUS AND GAO AT WORK

In January 1989, a new administration took office, as has a new Congress. To assist the Congress, the new President, and his key officials, the Comptroller General established an Office-wide initiative to present a series of reports on major issues they will face. Directed by Assistant Comptroller General Richard L. Fogel, the project involved staff from all GAO divisions.

GAO's "transition team" identified about 100 issues drawn from GAO reports and testimony. The issues have several things in common. They (1) are unresolved, (2) are of major importance, and (3) need immediate or sustained attention. Many also involve critical decisions, such as what to do about the budget deficit and what to do about failing savings and loan institutions. They address programmatic; management; financial; and, in some cases, policy concerns.

Starting in November 1988, GAO issued 26 reports to the Congress, the President-Elect, and new agency heads. The series of reports received widespread attention in the press and in the Congress. Senior GAO officials also have been conferring with new Cabinet members and other top agency appointees.



Immediately following the election, Clark Clifford addressed a meeting of the Comptroller General's Consultant Panel.

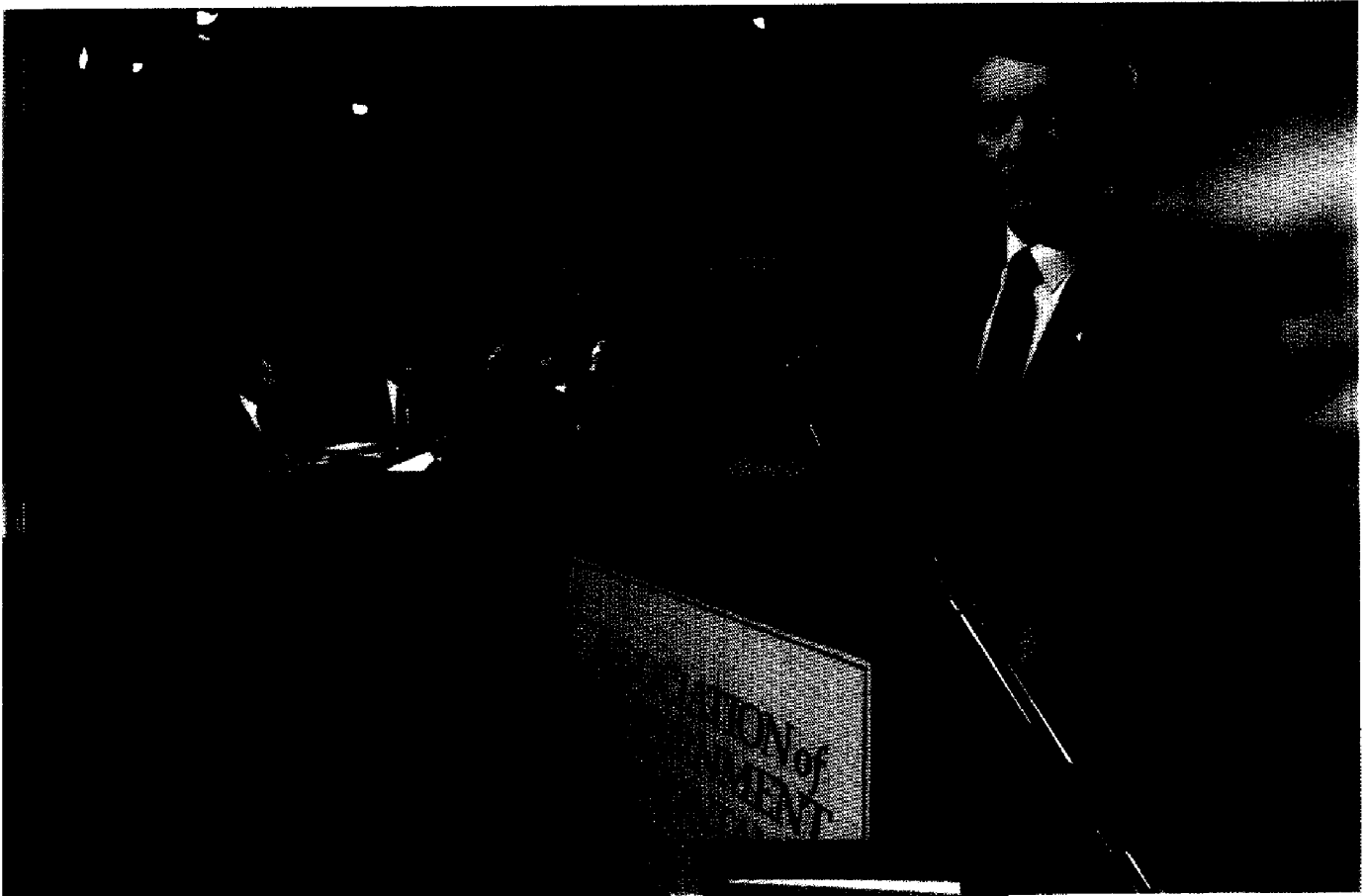
Opposite page: GAO officials briefed congressional leaders, including Congressman Frank Horton, Ranking Minority Member of the House Government Operations Committee. With Mr. Horton are Director of Congressional Relations M. Thomas Hagenstad, Assistant Comptroller General Richard Fogel, and transition series coordinator Bernard Ungar.



*Richard Holborow training with
GAO Evaluator Kurt Kroemer.*



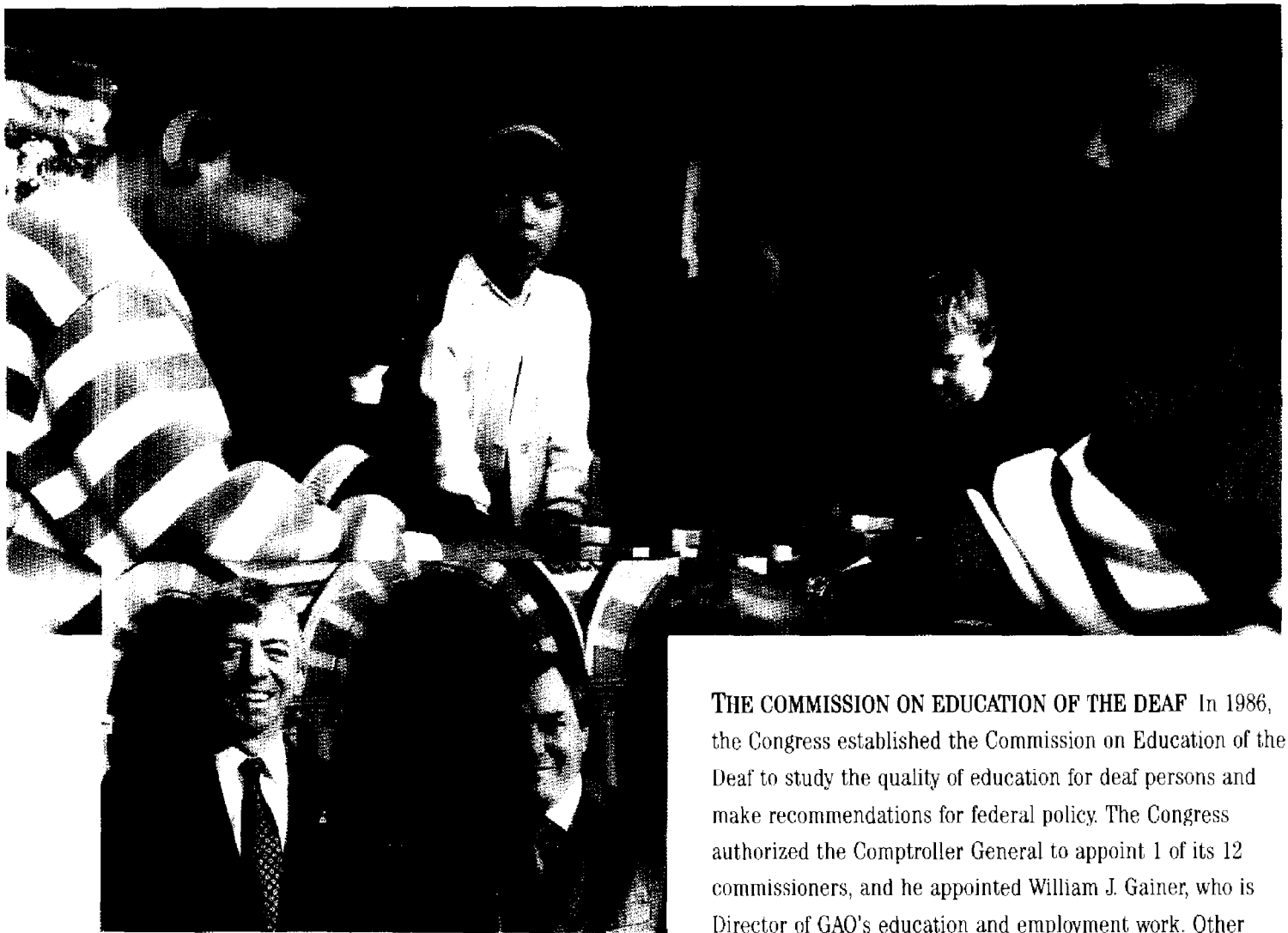
GAO'S CHAMPION ATHLETE On October 24, 1988, GAO Evaluator Richard Holborow ran the marathon in Seoul, South Korea, at the 8th Paralympic Games, the world games for the disabled. Coming from 62 nations, 4,000 athletes who are visually impaired, have cerebral palsy, have spinal cord injuries, or are otherwise disabled competed in a variety of events and shared their dreams. Holborow, who is blind, finished fifth in the 26.2-mile event with a time of 3 hours, 3 minutes, and 48 seconds. He has previously won gold and silver medals in the national championships of the United States Association of Blind Athletes, competing in both track and swimming events, and at the Can Am Pacific Games, where he set a record for the 5,000-meter race. Fellow GAO employees have helped Holborow train, cheered him on, and helped to provide the financial support for his trip to Seoul.



GOVERNMENT AUDITING STANDARDS In July 1988, the Comptroller General released the 1988 revision of *Government Auditing Standards*, commonly known as the "Yellow Book." These standards will help ensure that audits are fair, objective, and reliable assessments of government performance. In revising the standards, GAO went through an extensive process that involved the entire government audit community and included the appointment of an advisory council of top officials from government, public accounting, and academia to advise the Comptroller General on the revisions. GAO has also undertaken an extensive program of training and information.

The revised standards contain a number of major changes, including continuing education and training requirements, participation by the audit organization in an external quality control review, and the responsibilities of the auditor for detecting and reporting on illegal acts. The revised standards became effective for audits starting January 1, 1989.

Bill Broadus, Assistant Director, Accounting and Financial Management Division, at a video conference transmitted to over 100 cities.



*I. King Jordan and
William Gainer.*

THE COMMISSION ON EDUCATION OF THE DEAF In 1986, the Congress established the Commission on Education of the Deaf to study the quality of education for deaf persons and make recommendations for federal policy. The Congress authorized the Comptroller General to appoint 1 of its 12 commissioners, and he appointed William J. Gainer, who is Director of GAO's education and employment work. Other GAO staff provided testimony and assistance to the Commission on the basis of past GAO work, and GAO provided graphic design and printing for the final Commission report.

The Commission received national attention in March 1988 when its report coincided with Gallaudet University student protests demanding the appointment of a hearing-impaired president for the nation's only university for the deaf. I. King Jordan, who is deaf, was named president after the Gallaudet Board of Trustees' original selection stepped down in the wake of the controversy. Dr. Jordan is also a former member of the Comptroller General's Research and Education Advisory Panel.

The Commission made 52 recommendations for improving the quality of education for hearing-impaired Americans, many of which are included in pending legislation.

JOHN MACY INTERNSHIP In 1987, a summer internship for students at Wesleyan University was established in honor of John Macy, Jr., a Wesleyan graduate and a dedicated public servant who chaired the Civil Service Commission during the Kennedy administration. A number of John Macy's former colleagues in government, academia, and business who established the internship decided that it should be regularly housed in GAO given the agency's unique vantage point for observing federal operations. During the summer of 1988, Gordon Agress, the first John Macy intern chosen by Wesleyan, worked in the National Security and International Affairs Division's Foreign Economic Assistance group whose Director, Nancy Kingsbury, served as his mentor.

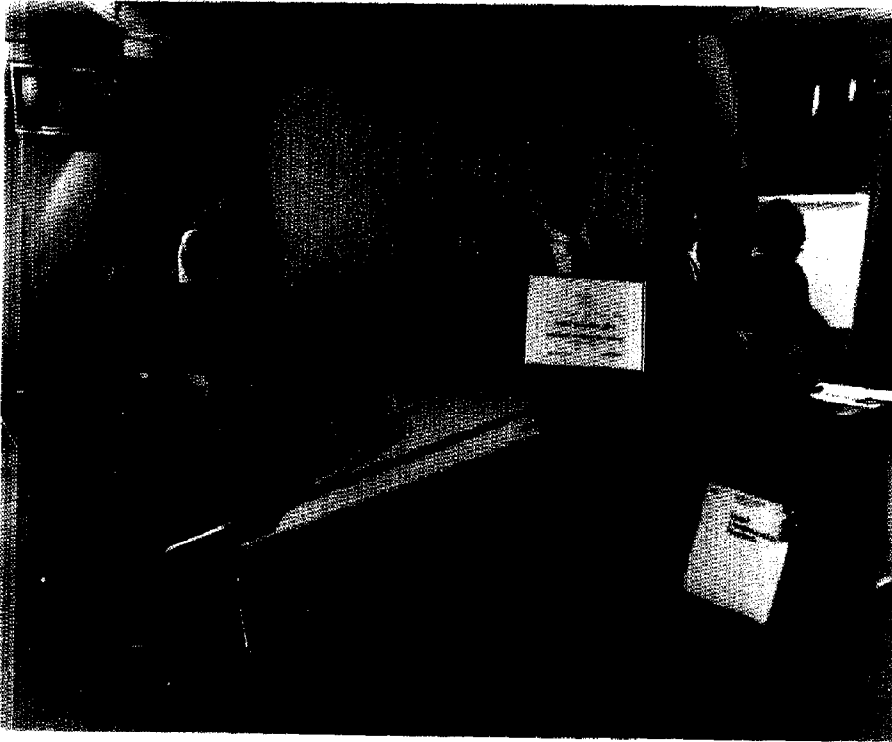


GAO'S TASK FORCE ON AIDS The Comptroller General formed a task force in December 1986 to examine how AIDS could be expected to affect the GAO workplace and to identify any policy changes needed to address the problem. The task force developed a strategy to achieve four objectives: ensure a safe and healthful work environment, provide for fair and humane treatment of employees with AIDS, avoid disruptions to agency productivity, and help managers deal efficiently and sensitively with the problems AIDS poses in a work environment. Recommendations emphasized employee education, managerial knowledge, and a continuing effort to monitor the epidemic; blood testing of employees was not advocated. Since GAO published the task force report in December 1987, it has been cited as exemplary by many groups and organizations, including the Office of Personnel Management and the Presidential Commission on the Human Immunodeficiency Virus Epidemic.



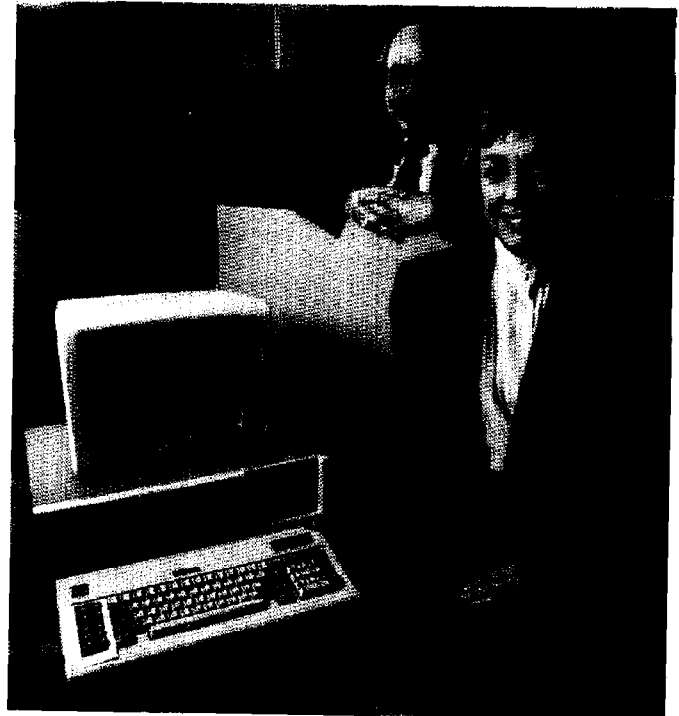
*GAO's AIDS Task Force Chair
Eleanor Bednisky with Admiral
James Stockius, Chairman of the
Presidential Commission.*

GAO AT WORK



A team of communications experts, including designers, writers, and computer specialists, under the overall leadership of Director of the Office of Publishing and Communications Larry Rolufs, produced GAO's *Visual Communication Standards*, which won a prestigious Federal Design Achievement Award. The GAO project, selected from more than 500 submissions to the quadrennial Presidential Design Awards competition, was cited by the National Endowment for the Arts as setting "an impressive standard of design excellence in the Federal government for others to follow." GAO's standards were developed to make publications easier to read, more professional looking, and easier to produce.

In 1988, GAO reorganized its training activities and established its Training Institute led by Director Terry Hedrick with senior faculty member Kenneth Hunter. The Institute serves as the central training authority for the agency, working closely with divisions and offices to ensure that staff have the knowledge and skills necessary to do audit and evaluation work. A variety of courses, from microcomputer skills to the federal budget process, are taught to GAO evaluators, specialists, and support staff. When possible, the Institute accommodates staff from other government agencies.

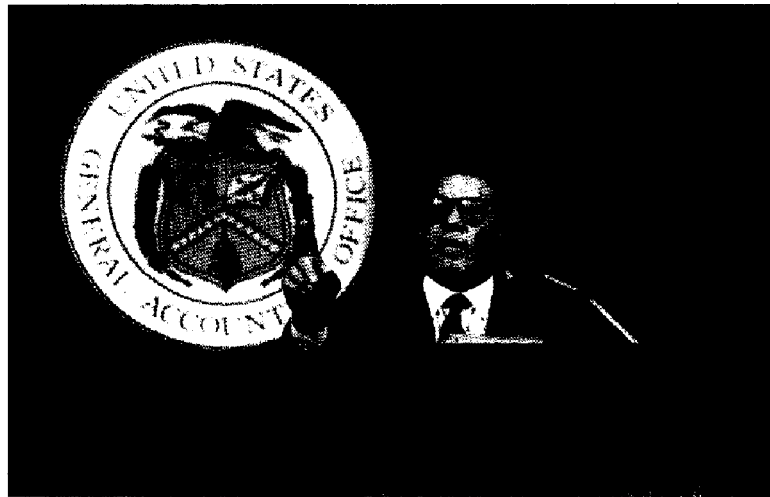




The spring of 1988 saw the debut of *The GAO Journal*, a new public policy quarterly featuring the work both of GAO employees and writers from the worlds of government, business, and education. Edited by Stephen Altman, it aims at a wide audience, providing a forum for people at GAO who, by virtue of their studies of federal programs and their professional training, often have acquired special expertise or insights worth sharing with both decisionmakers and the public. Outside contributors to *The GAO Journal* have included Felix G. Rohatyn, Peter G. Peterson, David Packard, and John Kenneth Galbraith.



Cable has and will continue to be a major force in creating a new generation of public policy analysts. In a film clip, the author of the book, "The Fourth Deadly Sin," discusses the impact of cable over a case study of the impact of cable on sets in Congress. The author also discusses the impact of video and cable on the recent GAO work in the hazardous waste commission. Shown are evaluators Chet Jarwin and John Helm with a technician in the Senate floor last study.

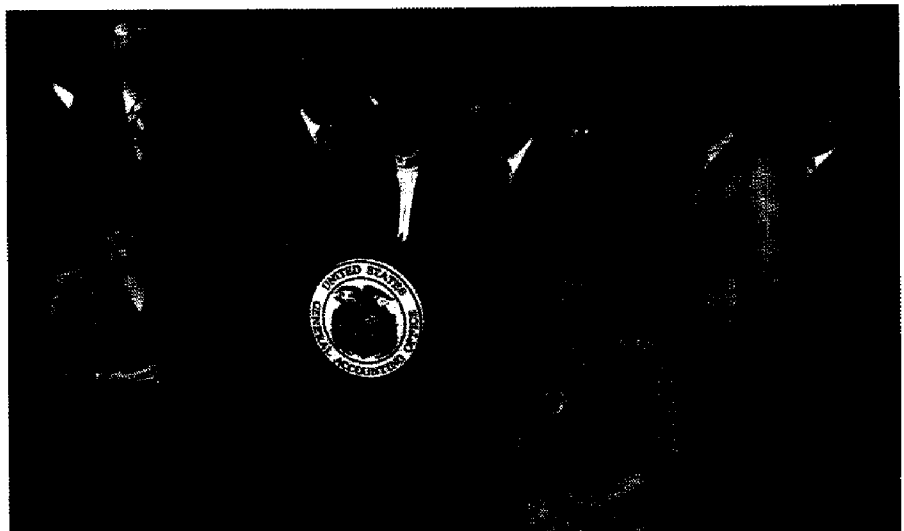


Congressman Esteban E. Torres was the featured speaker at the 1988 GAO Hispanic Heritage Program, which celebrated the talents of Hispanic Americans and their many contributions to the cultural and economic enrichment of this country. A poster exhibition demonstrated the Hispanic culture and spirit in American television, film, music, design, dance, art, business, politics, and sports. The program also included remarks by Dr. Thomas W. Merrick, who discussed a number of demographic characteristics of the Hispanic population in the United States, and entertainment by Rumisonko, an Andean folk music group.



Providing a high quality work environment that promotes efficient operations and pride in public service continues to be a GAO priority. Shown are Dallas Regional Office Manager Robert Peterson with staff members Joyce Akins and Karen Strauss (standing) and Rita Neitz and James Morgan (seated) in new space which the Regional Office moved to in late 1988 as a part of GAO's facilities modernization program. The new office, which incorporates computer-compatible furniture and advanced telecommunications capabilities, fulfills the program's goal of providing a modern work environment that enhances the effectiveness and quality of life of GAO employees.

Congressman Vic Fazio, Chairman of the House Appropriations Subcommittee on the Legislative Branch, was the featured speaker at the San Francisco Regional Office's annual awards ceremony in October. Congressman Fazio presented awards to staff who had demonstrated outstanding overall performance and made exceptional contributions to GAO work in 1988. Led by Manager Tim McCormick, the San Francisco Regional Office has staff in both San Francisco and Sacramento.



Here with Comptroller General Bowsher and Assistant Comptroller General for Operations Ira Goldstein are Regional Managers Mary Hamilton (New York), George Grant (Los Angeles), William Moore (Cincinnati), and John Luke (Detroit). Mr. Bowsher meets with GAO's 16 field office managers throughout the year to discuss the Office's worldwide operations.



FINANCIAL REPORT

FINANCIAL INFORMATION

This section of the *Annual Report* includes commentary on GAO's financial resources and expenses and the results of assessments of its system of internal controls similar to those conducted by executive branch agencies under the Federal Managers' Financial Integrity Act (FMFIA) of 1982. GAO's financial statements for fiscal years 1988 and 1987 are also included, together with the opinion of the independent accounting firm, Price Waterhouse, that audited the statements.

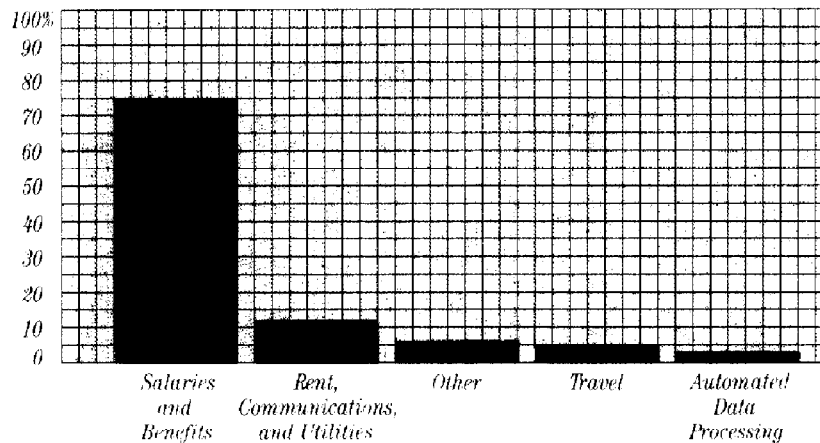
Financial Resources and Operating Expenses

The accompanying financial statements summarize the financial position of GAO, disclose the full cost of operations during fiscal years 1988 and 1987, and present all significant sources and uses of resources during the 2 fiscal years.

The cost of operating GAO during fiscal years 1988 and 1987 amounted to about \$327 million and \$308 million, respectively. Over 99 percent of this was financed through appropriations from the Congress. The remainder came from reimbursements from other government agencies and sales of publications to the public. The percentage of operating expenses financed by appropriations has been about the same over the last 5 years.

During fiscal year 1988, expenses for salaries and related costs totaled \$244 million and constituted about 75 percent of GAO's total operating expenses. This supported a staffing level of 5,042 full-time equivalent staff-years, most of which were employed in carrying out GAO's audit and evaluation activities. This staffing level has remained relatively constant during the past decade.

GAO's Operating Expenses



Results From
Financial Integrity
Act Reviews

Although not subject to the provisions of FMFIA, GAO continues to be firmly committed to the spirit and intent of the act. Since 1983, GAO has annually reviewed its operations to assess its vulnerability to fraud, waste, and mismanagement. As a result of these reviews, GAO's internal controls have been strengthened and operational improvements made in several areas.

During 1988, under the direction of the Assistant Comptroller General for Operations, GAO developed a comprehensive plan to guide its FMFIA efforts for the next 5 years. This plan ensures that the internal controls in all major functions and activities will be evaluated. At the end of fiscal year 1988, comprehensive reviews were under way of GAO's auditing and reporting activities, travel, property management and security operations, and GAO's accounting system. In addition to these reviews, other major FMFIA projects that were under way during 1988 are summarized below.

Projects Under Way

Accountability and control of property. GAO has made many improvements to its property system to ensure that the information in the system is reliable and accurate and is appropriately entered into the accounting system for inclusion in the financial statements. A 100 percent inventory of accountable property is conducted each year to verify the property records. Further improvements will result with the issuance of revised policies and procedures for property and with the move of the property system to the Department of Agriculture's National Finance Center in 1990.

Physical security of property and space. In recent years, GAO has improved the security over its property, particularly over microcomputers and transportable equipment. An ongoing inspection program maintained by the Office of Security and Safety identifies deficiencies in units' physical security safeguards over property and recommends improvements. Employees' awareness of security issues has been increased through the issuance of security bulletins and other guidance. A new security manual is currently in the review process.

Planning, executing, and reporting on the results of specific assignments. GAO continually strives to improve the quality of its work. In 1983, GAO instituted an ongoing quality review program to promote consistency in and adherence to GAO policies and procedures and identify necessary changes. The 1988 review concluded that GAO has adequate quality control processes and procedures in place to ensure high quality products. The review team made several recommendations aimed at further improving the quality of our work. Actions to implement the recommendations have been taken or are under consideration. These include revising policies and procedures, changing training courses, and increasing emphasis on adherence to the Office's requirements.

Report of
Management's
Responsibility

GAO's financial statements and all related information in this section are the responsibility of management. The statements have been prepared in conformity with generally accepted accounting principles and title 2 of GAO's *Policy and Procedures Manual for Guidance of Federal Agencies*. Such financial statements are necessarily based in part on best estimates and judgments.

GAO maintains a system of internal accounting controls designed to provide reasonable assurance, at appropriate cost, that GAO's assets are protected and that transactions are executed and recorded in accordance with established policies and procedures. Management monitors the system of internal control for compliance through a program of self-assessment (initiated to implement the concepts of FMFIA) and an internal audit program. In addition, as part of its audit of GAO's financial statements, Price Waterhouse evaluated GAO's system of internal accounting controls to establish a basis for determining the nature, timing, and extent of audit tests to be applied. Actions are underway to address certain deficiencies affecting the operation of the financial accounting system that were identified during the audits of the financial statements. The independent public accountants and the internal auditors have free and independent access to the Comptroller General to discuss the results of their audits or any other matters relating to GAO's financial affairs.

Management has reviewed all prior years' self-assessment results and the internal and external auditors' recommendations concerning GAO's system of internal control and has completed or initiated actions to respond to the identified areas warranting improvement in an appropriate and cost-effective manner.



Assistant Comptroller General
for Operations



Controller

Report of
Independent
Accountants

Comptroller General of the United States

We have audited the accompanying statements of financial position of the General Accounting Office, an agency of the legislative branch of the government of the United States of America, as of September 30, 1988 and 1987 and the related statements of operations and financing sources and of changes in financial position for the years then ended. These financial statements are the responsibility of the General Accounting Office's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the *Government Auditing Standards* issued by the Comptroller General. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Also, in accordance with those standards and as an integral part of our examination, we issued separate reports that describe the scope of our review and findings related to internal accounting controls and compliance with laws and regulations. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements audited by us present fairly, in all material respects, the financial position of the General Accounting Office at September 30, 1988 and 1987 and the results of its operations and the changes in its financial position for the years then ended in conformity with generally accepted accounting principles and title 2 of the General Accounting Office's *Policy and Procedures Manual for Guidance of Federal Agencies*.

Price Waterhouse

Washington, D.C.
January 18, 1989

FINANCIAL STATEMENTS

U.S. GENERAL ACCOUNTING OFFICE STATEMENT OF FINANCIAL POSITION AS OF SEPTEMBER 30, 1988 AND 1987

Dollars in Thousands	1988	1987
Assets		
U.S. Treasury funds	\$37,224	\$33,096
Future appropriations due	22,936	22,361
Travel and other advances	1,082	1,138
Accounts receivable	2,235	1,656
Supplies inventory	485	590
Furniture and equipment, net of \$6,840 and \$4,450 accumulated depreciation, respectively	9,354	7,480
Total Assets	\$73,316	\$66,321
Liabilities		
Salaries and benefits	\$16,167	\$12,420
Employee travel	1,482	1,742
Accounts payable	7,843	7,624
Other liabilities	3,533	2,108
Accrued annual leave	21,846	21,212
Total Liabilities	\$50,871	\$45,106
Net Assets	\$22,445	\$21,215

The accompanying notes are an integral part of the financial statements.

**U.S. GENERAL ACCOUNTING OFFICE
STATEMENT OF OPERATIONS AND FINANCING SOURCES
FOR FISCAL YEARS ENDED SEPTEMBER 30, 1988 AND 1987**

Dollars in Thousands	1988	1987
Operating Expenses		
Salaries and benefits	\$244,387	\$231,536
External training	1,263	1,508
Travel	15,731	15,027
Rent, communications, and utilities	36,092	30,782
Computer and other ADP services	9,937	10,487
Other contract services	10,754	9,499
Supplies and materials	3,055	3,307
Printing and document copying	3,116	2,884
Depreciation	2,459	1,851
Other	453	1,421
Total Operating Expenses	\$327,247	\$308,302
Financing Sources		
Realized appropriations	\$326,504	\$307,492
Reimbursements and publication sales	2,870	3,463
Less amounts remittable to U.S. Treasury	(2,127)	(2,653)
Total Financing Sources	\$327,247	\$308,302

The accompanying notes are an integral part of the financial statements.

U.S. GENERAL ACCOUNTING OFFICE
 STATEMENT OF CHANGES IN FINANCIAL POSITION
 AS OF SEPTEMBER 30, 1988 AND 1987

Dollars in Thousands	1988	1987
Sources of Funds		
Appropriations and other financing sources	\$327,247	\$308,302
(Increase)/decrease in receivables and advances	(1,097)	72
(Increase)/decrease in supplies inventory	106	(32)
Increase in payables and other liabilities	5,764	1,945
Total Sources of Funds	\$332,020	\$310,287
Funds Used in Operations		
Operating expenses	\$327,247	\$308,302
Less expenses not requiring funds:		
Depreciation and amortization	(2,459)	(1,851)
Loss on disposal of capital assets	(90)	(198)
Total Funds Used in Operations	\$324,698	\$306,253
Other Uses of Funds		
Acquisition of capital assets	\$ 4,424	\$ 1,629
Increase in net assets	(1,230)	(60)
Total Other Uses of Funds	\$ 3,194	\$ 1,569
Total Uses of Funds	\$327,892	\$307,822
Increase in U.S. Treasury Funds	\$ 4,128	\$ 2,465
U.S. Treasury Funds:		
Beginning of year	33,096	30,631
End of year	\$ 37,224	\$ 33,096

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

**Note 1.
Summary of
Significant
Accounting
Policies**

A. Basis of Accounting

The Statement of Financial Position, Statement of Operations and Financing Sources, and Statement of Changes in Financial Position are presented in accordance with the accrual accounting principles prescribed by title 2 of GAO's *Policy and Procedures Manual for Guidance of Federal Agencies*. These principles differ from budgetary reporting principles. The differences relate principally to the capitalization and depreciation of furniture and equipment and the recognition of long-term assets and liabilities in the accompanying financial statements. Also, for financial statement purposes, budgetary appropriations are realized as a financing source as accrued expenses are recognized.

B. Accounts Receivable

GAO's accounts receivable are due principally from federal government corporations and other federal agencies for audit and other reimbursable services. They are recorded, when appropriate, net of allowance for amounts that may not be collectible.

C. Fixed Assets

Furniture and equipment costing more than \$5,000 are capitalized and depreciated. Bulk purchases of lesser-value items that aggregate more than \$100,000 are also capitalized. Depreciation is calculated on a straight-line basis over the estimated useful life of the property, which ranges from 5 to 20 years.

Improvements to leased office space costing \$5,000 or more are capitalized and amortized over 5 years. Library and other resource materials are depreciated over 10 years.

D. Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. The accrued leave liability is principally long-term in nature. Sick leave and other types of leave are expensed as leave is taken.

**Note 2.
Reconciliation to
Budgetary Accrued
Expenditures**

A reconciliation of operating expenses, as included in the Statement of Operations and Financing Sources, to budgetary expenditures, as reported to the Office of Management and Budget, is presented below.

Dollars in Thousands	1988
Total operating expenses as included in Statement of Operations and Financing Sources	\$327,247
Expenses financed by direct reimbursement	(743)
Increase in annual leave and retirement benefit expenses recognized in financial statements but not in budgetary accrued expenditures	(575)
Effect of capitalizing assets	1,296
Total Budgetary Accrued Expenditures	\$327,225

Note 3. U.S. Treasury Funds GAO does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The balance of U.S. Treasury funds represents appropriated funds that are available to pay current liabilities and finance authorized purchase commitments.

Note 4. Future Appropriations Due The balance of future appropriations due represents the aggregate of amounts that will be included in future years' appropriations to finance congressionally authorized long-term liabilities (annual leave and retirement benefits for Comptrollers General), which are financed (funds appropriated) in the year payment is required.

Note 5. Leases *A. Operating Leases*
GAO leases office space from the General Services Administration and the State Department and has entered into various other operating leases for office communication and ADP equipment. These leases are cancelable without penalty. Lease costs for office space and equipment for fiscal years 1988 and 1987 amounted to approximately \$30,250,000 and \$25,700,000, respectively.

B. Capital Leases

GAO has entered into several noncancelable capital leases under which the ownership of the equipment covered under the leases transfers to GAO when the leases expire. Lease payments of approximately \$530,000 remained to be paid on these leases as of September 30, 1988. When GAO enters into these leases, the value of the future lease payments is capitalized and recorded as a liability.

Note 6. Retirement Benefits All permanent employees participate in the contributory Civil Service Retirement System or the Federal Employees Retirement System, which became effective January 1, 1987. Temporary employees are covered under Social Security. GAO's costs associated with these programs during fiscal years 1988 and 1987 amounted to approximately \$22,850,000 and \$19,500,000, respectively. While GAO has no liability for future payments to employees under these programs, the federal government is liable for future payments to employees through the various agencies administering the programs.

Comptrollers General and their surviving beneficiaries who qualify and so elect are paid retirement benefits by GAO under a separate program. These benefits are funded from current year appropriations. Since GAO is responsible for future payments under this program, the present value of future payments is included in future appropriations due and other liabilities.

Note 7. Net Assets GAO operates in a fashion that does not require permanent capital, and its operations are not expected to generate an operating surplus or deficit. The composition of net assets is as follows:

Dollars in Thousands	1988	1987
Unrealized appropriations related to:		
Capitalized assets	\$ 9,310	\$ 7,932
Purchase commitments	13,135	13,283
Total Net Assets	\$22,445	\$21,215

The change in the unrealized appropriations related to capitalized assets is principally attributable to additions and depreciation related to fixed assets. The change in unrealized appropriations related to purchase commitments is attributable to a decrease in outstanding undelivered orders as of September 30, 1988.

**Note 8.
Contingent
Liabilities**

GAO has certain claims and lawsuits pending against it. Where claims are expected to result in payments, appropriate provision has been included in the accompanying financial statements. In the opinion of management and legal counsel, the resolution of other claims and lawsuits will not materially affect the financial position or operations of GAO.

**Note 9.
Trust and Other
Governmentwide
Functions**

GAO is responsible for conducting three trust functions for the federal government: (1) collecting delinquent claims receivables, (2) administering Davis-Bacon Act receipts and payments, and (3) administering assets of Americans who die abroad.

GAO is accountable to the Congress and the public for the proper administration of the assets held in the trusts. Trust assets under administration by GAO aggregated approximately \$5,414,000 on September 30, 1988. Of this amount, assets aggregating a face value of \$1,244,000 relate to governmentwide debt collection activities. Amounts ultimately collected, which cannot be reasonably predicted, will be remitted to the U.S. Treasury when received. The remaining assets of \$4,170,000 are related to Davis-Bacon Act funds and the estates of Americans who die abroad; they are not the assets of GAO or the federal government and are held for distribution to appropriate claimants. *Since these trust assets and related liabilities are not assets and liabilities of GAO, they are not included in the accompanying financial statements.*

In addition to the trust activities, GAO is also responsible for authorizing the payment of certain adjudicated and administratively settled claims against the federal government from a special appropriation. During fiscal years 1988 and 1987, GAO authorized approximately \$1,424,000,000 and \$370,000,000, respectively, in claims for payment from this special appropriation. The increase in fiscal year 1988 was for payments involving land acquisitions pursuant to the Redwood National Park Expansion Act.

**Note 10.
Subsequent Event—
Transfer of Control
of the
GAO Building**

Public Law 100-545 transferred control of the General Accounting Office Building in Washington, D.C., from the General Services Administration to GAO, effective October 28, 1988. The Comptroller General shall have exclusive custody and control of the building, including all facets of its operation and maintenance. The depreciated value of the building and results of its operations will be included in GAO's financial statements beginning in fiscal year 1989. The depreciated value of the building at the time of transfer was \$16,855,000.

