

Comptroller General of the United States

United States Government Accountability Office Washington, DC 20548

December 15, 2008

The President
The President of the Senate
The Speaker of the House of Representatives

The need for reliable, high-quality financial information has never been greater. However, our report illustrates that much work remains to be done on improving the state of federal financial management. Continued improvement needs to be a top priority of the new administration and Congress to help provide the financial accountability the public deserves and the information decision makers need to help evaluate government programs and manage the government in a cost-effective manner.

Our report on the U.S. government's consolidated financial statements for fiscal years 2008 and 2007 is enclosed. In summary we found the following:

- Certain material weaknesses in financial reporting and other limitations on the scope of our work resulted in conditions that prevented us from expressing an opinion on the financial statements other than the 2008 and 2007 Statements of Social Insurance. About \$847 billion, or 43 percent, of the federal government's reported total assets as of September 30, 2008, and approximately \$833 billion, or 23 percent, of the federal government's reported net cost for fiscal year 2008 relate to four of the Chief Financial Officers (CFO) Act agencies' fiscal year 2008 financial statements that, as of the date of our report, received disclaimers of opinion or were not audited.<sup>1</sup>
- The 2008 and 2007 Statements of Social Insurance are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; we disclaim an opinion on the 2006 Statement of Social Insurance.<sup>2</sup>
- The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2008.

<sup>1</sup>Of the 24 CFO Act agencies, the agencies that, as of the date of our report, received disclaimers of opinions on all of their fiscal year 2008 financial statements were the Department of Defense, Department of State, and the National Aeronautics and Space Administration. For the Department of Homeland Security for fiscal year 2008, only the Consolidated Balance Sheet and the Statement of Custodial Activity were subjected to audit; the auditor was unable to express an opinion on these two financial statements.

<sup>2</sup>Beginning in fiscal year 2006, the Statement of Social Insurance became a principal financial statement and was audited as part of the applicable federal agencies' financial statements. We disclaimed an opinion

on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance.

 Our work to test compliance with selected provisions of significant laws and regulations in fiscal year 2008 was limited by the material weaknesses and scope limitations discussed in our report.

While significant progress has been made in improving financial management since the federal government began preparing consolidated financial statements 12 years ago, three major impediments have continued to prevent us from rendering an opinion on the accrual basis consolidated financial statements over this period of time:<sup>3</sup> (1) serious financial management problems at the Department of Defense, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition to the material weaknesses underlying these major impediments, we noted three material weaknesses involving the federal government's inability to (1) determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to costeffectively reduce improper payments, (2) identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and (3) effectively manage its tax collection activities. Until the problems outlined in our audit report are adequately addressed, they will continue to have adverse implications for the federal government and American taxpayers.

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

The federal government is taking unprecedented actions to restore stability to financial markets, including specific actions in fiscal year 2008 to address capital and liquidity problems at the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which together held or guaranteed approximately \$5 trillion of mortgages and mortgage-backed securities as of September 30, 2008. In addition, legislation enacted early in fiscal year 2009 authorized the creation of the Troubled Asset Relief Program (TARP) that enables the federal government to purchase or insure certain troubled assets that it deems necessary to promote financial

-

<sup>&</sup>lt;sup>3</sup>The accrual basis consolidated financial statements for the fiscal years ended September 30, 2008 and 2007 consist of the (1) Statements of Net Cost, (2) Statements of Operations and Changes in Net Position, (3) Reconciliations of Net Operating Cost and Unified Budget Deficit, (4) Statements of Changes in Cash Balance from Unified Budget and Other Activities, and (5) Balance Sheets, including the related notes to these financial statements. Most revenues are recorded on a modified cash basis. The 2008 and 2007 Statements of Social Insurance, including the related notes, are also included in the consolidated financial statements. The Statements of Social Insurance do not interrelate to the accrual basis consolidated financial statements.

market stability. Under TARP, the federal government has injected billions of dollars into certain financial institutions. These and other actions the federal government has taken to stabilize financial markets and restore the availability of credit for Americans are discussed in this 2008 Financial Report of the United States Government. These actions will likely have a significant effect on the federal government's financial condition, at least in the short-term, through increased borrowing. In addition, the current recession could significantly affect the federal government's future tax revenues and the value of certain of its assets and liabilities.

Currently, policymakers are understandably focused on dealing with stabilizing financial markets and stimulating the economy. However, once these issues are addressed, the nation's new and returning leaders will need to turn their attention to the long-term challenges of addressing the federal government's large and growing structural deficits that are driven primarily by rising health care costs and known demographic trends. As discussed in this 2008 Financial Report of the United States Government, the federal government is on an unsustainable long-term fiscal path. The Statement of Social Insurance, for example, shows that projected scheduled benefits exceed earmarked revenues for social insurance programs (e.g., Social Security and Medicare) by approximately \$43 trillion<sup>5</sup> in present value terms over the 75-year projection period. GAO also prepares long-term fiscal simulations that are based on the Social Security and Medicare Trustees' projections, but provide a more comprehensive analysis of fiscal sustainability because they include revenue and expenditure projections for all other government programs. Our most recent long-term fiscal simulation was issued in September 2008.<sup>6</sup>

Accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. However, further enhancements to accounting and financial reporting standards are needed to more effectively convey the long-term financial condition of the federal government and annual changes therein. For example, it should include a Statement of Fiscal Sustainability —providing information on the long-term sustainability of social insurance programs in the context of all federal programs—and other sustainability information, including intergenerational equity and an analysis of changes in sustainability during the year. <sup>8,9</sup> In addition, there is a need for a combined report on the performance and financial accountability of the federal government as a

<sup>6</sup>GAO, *The Nation's Long-Term Fiscal Outlook: September 2008 Update*, GAO-09-94R (Washington, D.C.: September 2008).

<sup>&</sup>lt;sup>4</sup>The TARP was established by the Department of the Treasury under authority provided in the Emergency Economic Stabilization Act of 2008 (Pub. L. No. 110-343).

<sup>&</sup>lt;sup>5</sup>On an open group basis (current and future participants).

<sup>&</sup>lt;sup>7</sup>The Statement of Fiscal Sustainability would show the relationship between the present value of projected revenues and outlays for social insurance and for all other federal programs.

<sup>&</sup>lt;sup>8</sup>Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain federal responsibilities.

<sup>&</sup>lt;sup>9</sup>On September 2, 2008, the Federal Accounting Standards Advisory Board (FASAB) issued an exposure draft concerning long-term fiscal sustainability, *Reporting Comprehensive Long-Term Fiscal Projections* for the U.S. Government; and on November 17, 2008, an exposure draft was issued concerning accounting for social insurance, *Accounting for Social Insurance, Revised*.

whole. This report would include, among other things, key outcome-based national indicators (e.g., economic, security, social, and environmental), which could be used to help assess the nation's and other governmental jurisdictions' position and progress.

- - - -

This report would not be possible without the commitment and professionalism of Inspectors General throughout the federal government who are responsible for annually auditing the financial statements of individual federal agencies. We also appreciate the cooperation and assistance of the Department of the Treasury and Office of Management and Budget officials, as well as the federal agencies' CFOs. We look forward to continuing to work with these individuals, the new administration, and the Congress to achieve the goals and objectives of financial management reform.

Our audit report begins on page 165. Our guide<sup>10</sup> to the *Financial Report of the United States Government* is intended to help those who seek to obtain a better understanding of the *Financial Report*. In addition, our guide<sup>11</sup> on *Understanding Similarities and Differences between Accrual and Cash Deficits* provides a useful perspective on the different purposes cash and accrual measures serve in providing a comprehensive picture of the federal government's fiscal condition today and over time. These guides are available on GAO's Web site at <a href="https://www.gao.gov">www.gao.gov</a>.

Our report was prepared under the direction of Robert F. Dacey, Chief Accountant, and Gary T. Engel, Director, Financial Management and Assurance. If you have any questions, please contact me on (202) 512-5500 or them on (202) 512-3406.

J. Dollano

Gene L. Dodaro

Acting Comptroller General

of the United States

cc: The Majority Leader of the Senate

The Minority Leader of the Senate The Majority Leader of the House

The Minority Leader of the House

(198521)

10,

<sup>&</sup>lt;sup>10</sup>GAO, Understanding the Primary Components of the Annual Financial Report of the United States Government, GAO-05-958SP (Washington, D.C.: September 2005).

<sup>&</sup>lt;sup>11</sup>GAO, *Understanding Similarities and Differences between Accrual and Cash Deficits*, GAO-07-117SP (Washington, D.C.: December 2006). In January 2007 and 2008, we issued updates to this guide for fiscal years 2006 and 2007, GAO-07-341SP (Washington, D.C.: January 2007) and GAO-08-410SP (Washington, D.C.: January 2008).