Statement of
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before the
Legislation and National Security Subcommittee
Committee on Government Operations
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NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EDT), Thursday, September 22, 1988.

Mr. Chairman, I am pleased to have this opportunity to present the views of the Congressional Budget Office (CBO) on the proposal of the General Accounting Office (GAO) to improve the quality of federal financial information. In my statement, I will make three points:

- First, the quality of information about federal financial activity needs to be improved;

- Second, much research and discussion are needed before we can settle on a single solution to our information needs, and hence the proposal of the General Accounting Office is premature;

- Third, the Congress may wish to consider a more incremental, less sweeping, approach to improved federal financial accounting.

Current Inadequacies

CBO strongly supports the efforts of this Subcommittee and others, including the Office of Management and Budget (OMB), the General Accounting Office, and the Treasury, to explore the failings of the current federal accounting system and to improve it. For example, much government accounting information is recognized to be of uneven quality and reliability--in part, because it is not developed from consistent systems. Further, data are often difficult to obtain on a timely basis and are unavailable for particular programs at an appropriate level of detail. In some cases, the numbers used to represent program costs do not measure accurately the use of federal financial resources.

In our view, deficiencies in the federal financial information process are of two types: shortcomings in systems and shortcomings in concepts. Some agency accounting systems are still incapable of providing routine management information, such as monthly status reports on loan delinquencies by loan type. In addition, certain basic accounting concepts--borrowed from private reporting practice--seem to be inappropriate to the special requirements of federal accounting and budgeting. For example, it is generally accepted private accounting practice to report loan guarantees as contingencies, which are disclosed in footnotes rather than recognized as a use of resources when issued. Losses on guarantees are recognized only when: (a) it is "probable" that a loss has occurred, and (b) when the amount of loss can be "reasonably" estimated. While this practice may be appropriate for reporting private for-profit earnings, we believe it would be more appropriate to recognize expected losses in federal budgeting at the point of control--when the guarantees are issued.

CBO has become especially aware of such shortcomings in the federal financial information process as a result of the Balanced Budget Reaffirmation Act requirement that CBO report to the Congress on ways of more accurately measuring the costs of federal loans and guarantees and comparing the cost of credit programs with other forms of federal assistance. In attempting to determine the costs of federal credit assistance, we have encountered cases where losses incurred by individual programs could not be determined easily, in part because accounts are maintained at the multiprogram revolving fund level. Further, in the current system, data on delinquencies and defaults are not recorded for all credit programs on a comparable basis. Also, guarantee costs are not recognized in the budget until after a default has occurred.

It would be unfair, however, to ignore the improvements that have been achieved recently in the accounting system. A governmentwide chief financial officer (CFO) was appointed by the Director of the Office of Management and Budget in July 1987. Since then, each federal agency has designated a chief financial officer. These agency officers, with the leadership of the governmentwide CFO, have overseen and coordinated efforts to adopt a standard general ledger of accounts--developed by the Joint Financial Management Improvement Program--for all federal agencies. This is a major step in assuring that all agency accounting systems have a consistent structure so that information from different agencies will be comparable. The financial officers have also supported planning for so-called "primary accounting systems" to provide consistent accounting information at the agency and subagency levels of aggregation. In many cases, these systems have been installed. Significant progress has been made also in improving federal cash management so that the government can minimize the amount it has to borrow, and its interest costs.

Federal financial measurement is now more accurate and consistent than it was, but little has been done to modify private financial accounting concepts so that these can to be applied meaningfully to the federal government. The General Accounting Office proposal is an attempt to continue the improvement of accounting systems, but it does not address the unresolved difficulties of applying private financial reporting standards to the federal government.

The Proposal of the General Accounting Office

The GAO draft financial management proposal seeks to establish an accounting system to meet all the government's evaluation, budgeting, control, and reporting needs. It would build on the Comptroller General's authority to prescribe accounting principles, standards, and requirements for executive agencies. The proposed bill goes further, however, and would enact into law some of the Comptroller General's existing standards. Specifically, consistent with private financial reporting practice and the GAO accounting manual for the guidance of executive agencies, the statute would require the preparation of business-type statements of financial position, operating results, and changes in financial position by each executive agency. The Secretary of the Treasury would be required to prepare consolidated financial statements for the U.S. government, including a balance sheet of assets, liabilities, and government equity. GAO has also proposed a capital budget for the federal government and might be expected to prescribe capital budgeting statements if this bill were enacted.

The draft proposal creates the position of the Under Secretary of the Treasury for Federal Financial Management to oversee the development of accounting systems capable of complying with the Comptroller General's prescribed principles, standards, and requirements. The Under Secretary would carry out the functions of the governmentwide chief financial officer now located in OMB. The bill also establishes controllers in 22 agencies and requires the Under Secretary to prepare a five-year schedule for the improvement of the financial management of the U.S. government. As an enforcement mechanism, the agencies would be required to explain the extent to which their budget submissions are derived from accounting systems that conform with the principles, standards, and requirements prescribed by the Comptroller General. The proposal would shift some authority for federal accounting practice from the Executive Office of the President to the Treasury and GAO.

Difficulties with the GAO Proposal

While CBO supports the intent of this proposal to continue recent progress toward improved agency accounting systems, we have several concerns about it. Major among these is its failure to address adequately the unresolved conceptual issues raised by attempts to apply private financial reporting standards to federal government accounting. We do not believe, nor is there any agreement between accountants and budget analysts, that private financial reporting concepts can be meaningfully applied to the federal government, especially to federal budgeting. There are two parts to this objection: first, the federal government is not a private firm; and, second, financial reporting is not budgeting.

The federal government can tax and create money. This distinguishes it from private firms in an important way. Specifically, the ever-present danger of bankruptcy and default, which motivates much nonfederal accounting, is not a major concern of the users of federal financial information. Another difficulty is that the federal government acquires assets and liabilities peculiar to government which must be assigned specific values under current GAO accounting requirements. Military hardware, investments in human capital, treaty obligations, and commitments to make indexed benefit payments are examples of the types of resources and claims that present special valuation difficulties for federal accounting. This difficulty is especially severe in cases where, following private practice, the government calculates a balance sheet "bottom line" of assets less liabilities. In private accounting, this difference, or the value of owners' equity, is important in assessing the credit standing of a firm. But based on the work CBO has done with credit revolving funds, I would say that the net worth or government equity of a federal entity is not useful information. The question of whether an agency or a revolving fund is insolvent has no meaningful answer.

In addition, financial reporting is not budgeting. Budgeting focuses on planning the future use of resources and, if effective, recognizes costs in "lumps" at the point of control. Reporting is concerned with describing past financial operations and smoothes cost by spreading its recognition over the period that benefits are received. Private firms appreciate this difference in function;

they typically use managerial accounting systems for budgeting and Generally Accepted Accounting Principles systems for reporting. The consolidated financial statement used in reporting is not appropriate for budgeting, either by private firms or by the federal government.

GAO has acknowledged these difficulties of valuation and differences in function. For example, in its manual for guidance of federal agencies (Title 2), GAO indicates that, in accounting for Old-Age and Survivors Disability Insurance, "a final position on the accounting and reporting treatment has not been reached, but rather is being studied." Further, in the proposed bill, the Secretary of the Treasury is required to include in the consolidated financial statement of the U.S. Government, "a reconciliation to applicable budget reports for the entire federal Government . . . ." No details are provided as to how this reconciliation is to be achieved.

The complexity of these issues suggests that further research and general discussion are needed before everybody can agree on what sort of legislation would be best. Indeed, legislation will probably not be required in order to gain acceptance of accounting principles and practices generally agreed to be sound and useful. Whenever the Comptroller General's guidelines have been regarded in this way by executive agencies, they have been adopted.

Another weakness of the proposed bill is that it would endorse a relatively closed process for the future development of accounting standards. Specifically, all principles, standards, and requirements would be prescribed by the Comptroller General, who would "consult with" the Director of OMB and the Under

Secretary of the Treasury. It is true that the Comptroller General would be advised by a board, appointed by him. But this would be a much less open process than those through which private and state and local government accounting standards are developed. The Financial Accounting Standards Board and the Governmental Accounting Standards Board, which are the private and state and local financial accounting authorities, have elaborate systems of public examination, comment, hearings, and revision. They use these to reach a consensus among accounting practitioners before they establish a standard.

The proposal to create an Under Secretary of the Treasury to oversee the development of federal accounting systems seems somewhat redundant because there is already a governmentwide chief financial officer in OMB. It would seem appropriate to keep this kind of accounting policy leadership for the executive branch in the Office of the President. Moreover, the budgetary requirements for a federal accounting system are likely to be given equal standing with reporting requirements only if the CFO is part of the Office of Management and Budget.

An Alternative Approach

An alternative to the GAO proposal would be to follow the more incremental, consensus approach that is current policy. Under existing law, GAO would presumably continue to issue accounting standards for federal executive agencies and encourage them in the further development of financial accounting systems. The chief financial officer in OMB would likewise continue current efforts to improve federal accounting systems. This approach should yield financial information that is more consistent, program specific, timely, and auditable than that now available. It would have the advantage of permitting contentious issues, such as the production and use of consolidated financial statements for the federal government, to be separated from those on which it is easier to reach agreement.

In addition, the Congress may wish to create an open forum for the continuous development and refinement of appropriate accounting concepts and principles for the federal government. The establishment of a study commission would be one alternative. An expanded role for the Joint Financial Management Improvement Program (JFMIP) might be another. The Congress might also wish to provide a statutory basis for a chief financial officer, if it wishes to assure that the current office will be maintained in the future.