

The background of the slide is a stylized, semi-transparent American flag. The stars are visible in the upper left, and the stripes are visible in the lower right. The text is overlaid on this background.

Transformation
CHALLENGES in
America *and the*
Accountability Profession

The Honorable David M. Walker
Comptroller General of the United States

**Greater Washington Society of
Certified Public Accountants' Symposium**
*Washington, DC
December 14, 2004*

GAO's Strategic Plan



SERVING THE CONGRESS AND THE NATION GAO'S STRATEGIC PLAN FRAMEWORK

MISSION

GAO exists to support the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government for the benefit of the American people.

THEMES

Long-Term Fiscal Imbalance

National Security

Global Interdependence

Changing Economy

Demographics

Science and Technology

Quality of Life

Governance

GOALS & OBJECTIVES

Provide Timely, Quality Service to the Congress and the Federal Government to ...

Address Current and Emerging Challenges to the Well-Being and Financial Security of the American People *related to ...*

- Health care needs and financing
- Education and protection of children
- Work opportunities and worker protection
- Retirement income security
- Effective system of justice
- Viable communities
- Natural resources use and environmental protection
- Physical infrastructure

Respond to Changing Security Threats and the Challenges of Global Interdependence *involving ...*

- Emerging threats
- Military capabilities and readiness
- Advancement of U.S. interests
- Global market forces

Help Transform the Federal Government's Role and How It Does Business to Meet 21st Century Challenges *by assessing ...*

- Roles in achieving federal objectives
- Government transformation
- Key management challenges and program risks
- Fiscal position and financing of the government

Maximize the Value of GAO by Being a Model Federal Agency and a World-Class Professional Services Organization *in the areas of ...*

- Client and customer satisfaction
- Strategic leadership
- Institutional knowledge and experience
- Process improvement
- Employer of choice

CORE VALUES

Accountability

Integrity

Reliability

What Kind of Work Does GAO Do?

Oversight—designed to determine that government entities are doing what they are supposed to, that funds are being spent for the intended purpose, and that applicable laws and regulations are being complied with.

Insight—designed to determine what programs and policies work and those that don't. This involves sharing various best practices and benchmarking information and looking horizontally across the silos of government and vertically between the levels of government.

Foresight—designed to identify key trends and emerging challenges before they reach crisis proportions, e.g., challenges of an aging population and the demands of the information age, to changing security threats and fiscal challenges.

GAO's High Risk List

High Risk Areas

Designated High Risk

Addressing Challenges in Broad-based Transformations

Protecting Information Systems Supporting the Federal Government and The Nation's Critical Infrastructures	1997
Strategic Human Capital Management*	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook*	2001
Implementing and Transforming the New Department of Homeland Security	2003
Modernizing Federal Disability Programs*	2003
Federal Real Property*	2003

Ensuring Major Technology Investments Improve Services

FAA Air Traffic Control Modernization	1995
IRS Business Systems Modernization	1995
DOD Systems Modernization	1995

Providing Basic Financial Accountability

DOD Financial Management	1995
IRS Financial Management	1995
Forest Service Financial Management	1999
FAA Financial Management	1999

Reducing Inordinate Program Management Risks

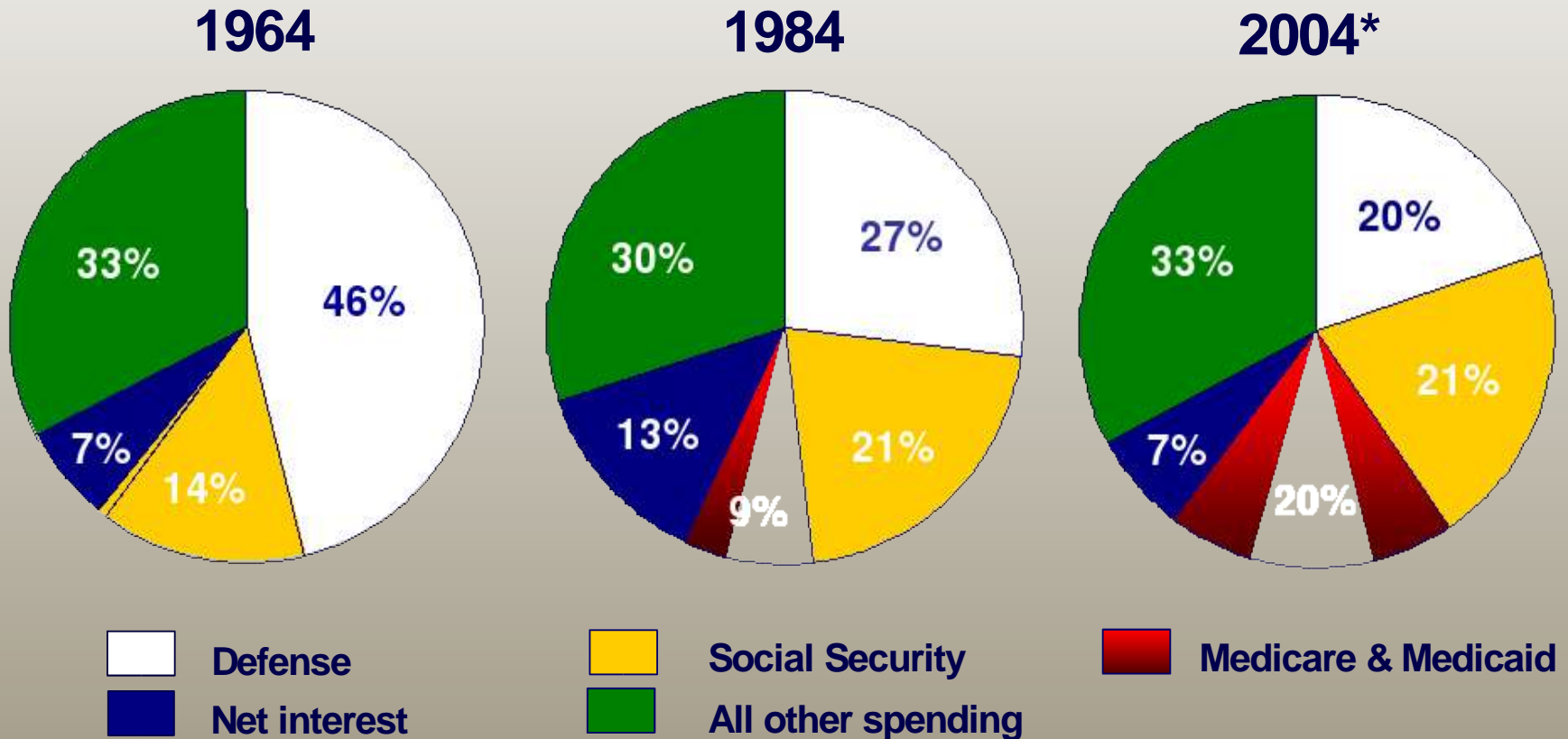
Medicare Program*	1990
Collection of Unpaid Taxes	1990
DOD Inventory Management	1990
Student Financial Aid Programs	1990
HUD Single-Family Mortgage Insurance and Rental Assistance Programs	1994
Earned Income Credit Noncompliance	1995
DOD Support Infrastructure Management	1997
Medicaid Program*	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program*	2003

Managing Large Procurement Operations More Efficiently

DOD Weapon Systems Acquisition	1990
Department of Energy Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992

*Additional authorizing legislation is likely to be required as one element of addressing this high risk area.

Composition of Federal Spending

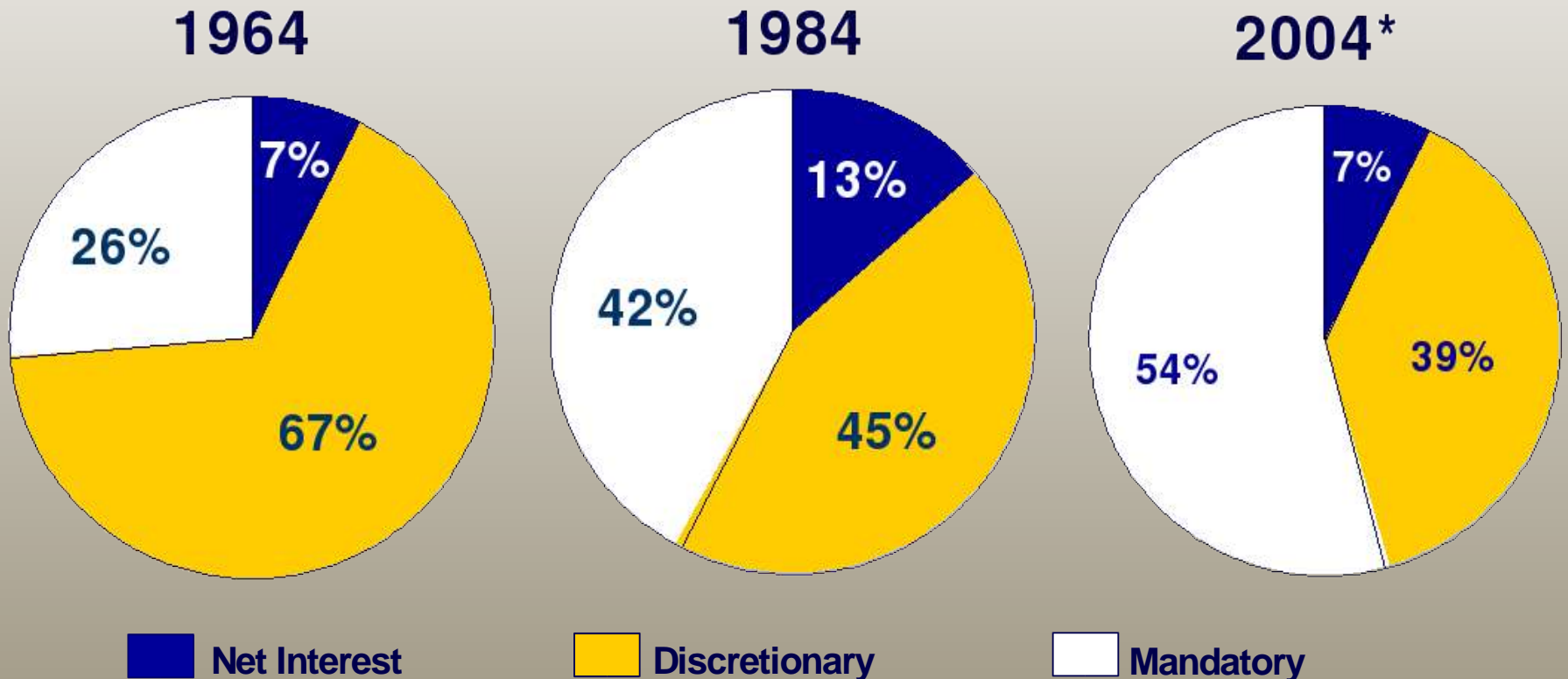


*Current services estimate.

Note: Numbers may not add to 100 percent due to rounding.

Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



*Current services estimate.

Note: Numbers may not add to 100 percent due to rounding.

Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

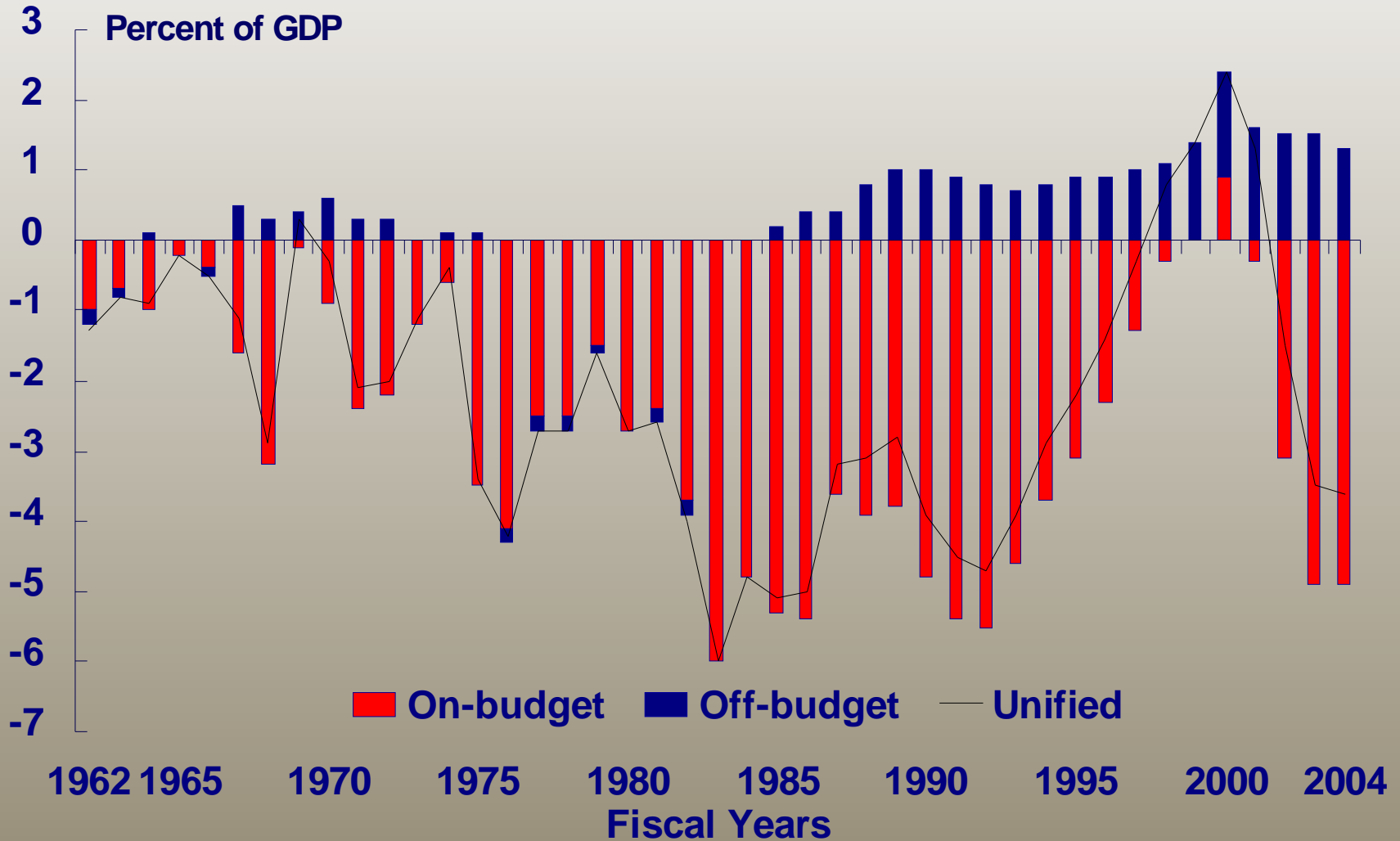
Fiscal Year 2004 Deficit Numbers

	\$ Billion	% of GDP
On-Budget Deficit	(568)	(4.9)
Off-Budget Surplus	155*	1.3
Unified Deficit	(413)	(3.6)

*Includes the \$151 billion Social Security surplus and a \$4 billion surplus for the Postal Service

Surplus or Deficit as a Share of GDP

Fiscal Years 1962-2004



Selected Fiscal Exposures: Sources and Examples

(End of 2003)^a

Type	Example (dollars in billions)
Explicit Liabilities	Publicly held debt (\$3,913) Military and civilian pension and post-retirement health (\$2,857) Veterans benefits payable (\$955) Environmental and disposal liabilities (\$250) Loan guarantees (\$35)
Explicit Financial commitments	Undelivered orders (\$596) Long-term leases (\$47)
Financial contingencies	Unadjudicated claims (\$9) Pension Benefit Guaranty Corporation (\$86) Other national insurance programs (\$7) Government corporations e.g., Ginnie Mae
Exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts (\$2,859) ^b Future Social Security benefit payments (\$3,699) ^c Future Medicare Part A benefit payments (\$8,236) ^c Future Medicare Part B benefit payments (\$11,416) ^c Future Medicare Part D benefit payments (\$8,119) ^c Life cycle cost including deferred and future maintenance and operating costs (amount unknown) Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

^a All figures are for end of fiscal year 2003, except Social Security and Medicare estimates, which are end of calendar year 2003.

^b This amount includes \$774 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

^c Figures for Social Security and Medicare are net of debt held by the trust funds (\$1,531 billion for Social Security, \$256 billion for Medicare Part A, and \$24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be \$10.4 trillion, \$21.8 trillion for Medicare Part A, \$23.2 trillion for Medicare Part B, and \$16.5 trillion for Medicare Part D.

Source: GAO analysis of data from the Department of the Treasury, the Office of the Chief Actuary, Social Security Administration, and the Office of the Actuary, Centers for Medicare and Medicaid Services.

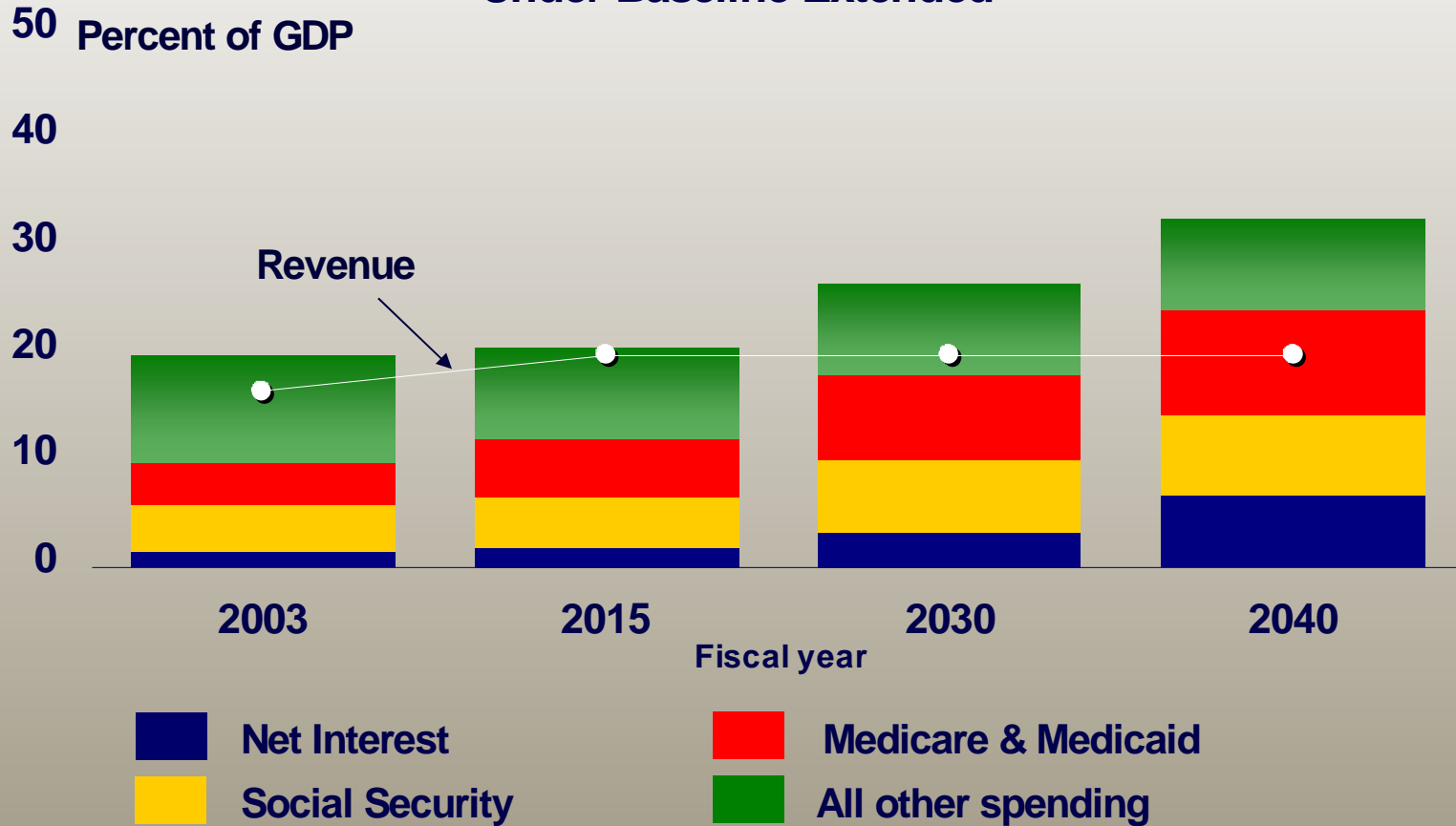
Another Way to Think About These Numbers

- Debt held by the public—\$3.9T
- Trust fund debt—\$2.9T
- Gross debt—\$6.8T
- Gross debt per person—about \$24,000
- If we add everything on the previous slide that is not included in gross debt, the burden rises to more than \$140,000, or about \$330,000 per full-time worker. Alternatively, it amounts to a total unfunded burden of more than \$40 trillion in current dollars, which is about 18 times the current annual federal budget or more than 3 ½ times the current annual GDP.

Note: The calculations only consider a 75-year horizon for Social Security and Medicare.

Composition of Spending As a Share of GDP

Under Baseline Extended

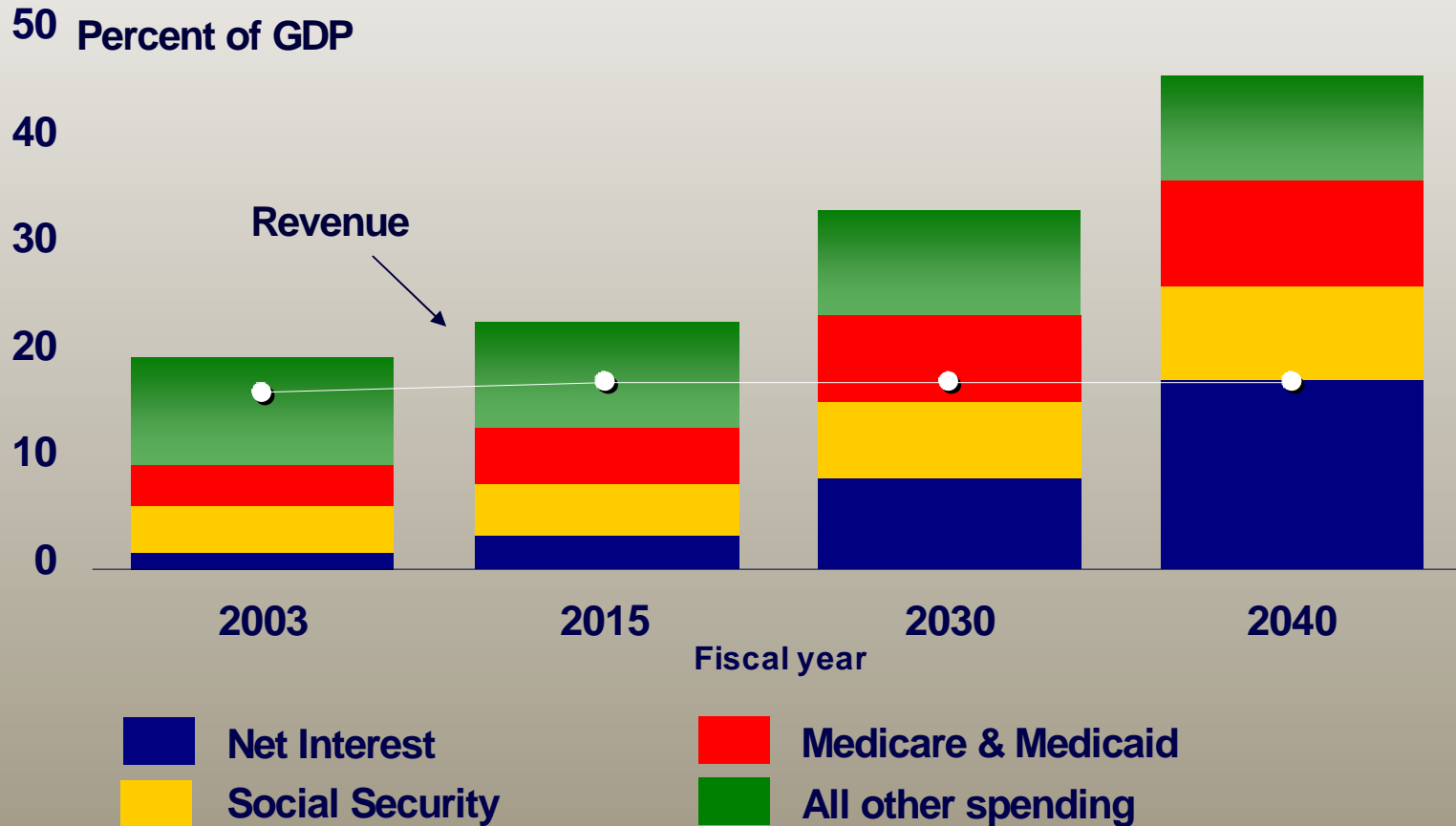


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant. Budgetary effects due to passage of the Working Families Tax Relief Act of 2004 are not reflected in this simulation.

Source: GAO's September 2004 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2004
and All Expiring Tax Provisions are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's September 2004 analysis.

Current Fiscal Policy Is Unsustainable

- **The “Status Quo” is Not an Option**
 - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
 - GAO’s simulations show that balancing the budget in 2040 could require actions as large as
 - Cutting total federal spending by about 60 percent or
 - Raising taxes to about 2.5 times today's level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
 - Closing the current long-term fiscal gap based on responsible assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
 - During the 1990s, the economy grew at an average 3.2 percent per year.
 - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
- **The Sooner We Get Started, the Better**
 - Less change would be needed, and there would be more time to make adjustments.
 - The miracle of compounding would work with us rather than against us.
 - Our demographic changes will serve to make reform more difficult over time.

The Way Forward

- Implement new accounting and reporting approaches and new budget control mechanisms for considering the impact of spending and tax policies and decisions over the long term
- Develop new metrics for measuring the impact of policies and decisions over the long term (e.g., key national indicators to measure our Nation's position and progress over time and in relation to other countries)
- Reexamine the base—question existing programs, policies and activities

Long-term Fiscal Challenges

Demand New Metrics, Mechanisms, and Processes

- Accounting and reporting policies for trust funds, Social Security, Medicare, Veterans benefits, among other things, need to be reviewed and revised (e.g., possible fiscal burden statement with per capita and intergenerational figures)
- The current budget time horizon [2-year, 5-year, 10-year] does not capture many long-term costs—e.g. Social Security, Medicare, pension insurance—and other major tax and spending provisions
- Cash and obligations-based budgeting is misleading for insurance and some benefit programs
- Budget controls have expired—and we need to go beyond “holding the line” to “changing the base” in spending and tax policies

Improved Metrics, Measures and Processes: Some Ideas

- Provide information on long-term costs of major spending and tax proposals before they are voted on, including showing long-term costs even for proposals that sunset
- Establish an OMB annual report on fiscal exposures, including appropriate measures and how to address them
- Consider fiscal targets, triggers, sunset provisions and points of order with focus on limiting growth of long-term commitments
- Move to accrual budgeting for employee pension, retiree health; disclose “risk assumed” [missing premium] for insurance
- Reinststitute budget controls (caps & PAYGO)

We Need a Multifaceted Approach to Close the Long-Term Fiscal Gap

Policy:

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise our tax policy and enforcement programs

Operations:

- Reassess and revise how the government does business (e.g., management, planning and operational issues)
- Consider who should provide government services (e.g., sourcing strategy)

Selected 21st Century Questions

- Do we need all three elements of the current triad nuclear deterrent strategy and if so, do we need to reconsider the size and nature of each component?
- What opportunities exist to dispose of excess federal facilities or better leverage surplus in private sector capacity to make the federal portfolio more relevant to current mission and less costly?
- How should Social Security be reformed to make it both solvent and sustainable while better aligning it with 21st century economic, demographic and fiscal realities?
- Do tax incentives and preferences need to be reconsidered? For example, can adequate health care coverage be achieved at less cost and greater equity through fundamental redesign of the current health tax preferences?

Key National Indicators

- **WHAT:** A portfolio of economic, social, environmental and security related outcome-based statistics that could be used to help assess the nation's and other governmental jurisdictions' position and progress
- **WHO:** Many countries and several states and localities have already undertaken related initiatives (e.g., Australia, New Zealand, Canada, United Kingdom, Oregon, Washington, and Charlotte)
- **WHY:** Development of such a portfolio of indicators could have a number of possible benefits, including
 - Serving as a framework for related strategic planning efforts
 - Enhancing performance and accountability reporting
 - Informing public policy decisions, including much needed baseline reviews of existing government policies, programs, functions, and activities
 - Facilitating public education and debate as well as an informed electorate
- **WAY FORWARD:** Consortium of key players led by the National Academies domestically and related OECD efforts internationally

Accountability Environment

- The credibility of auditing and financial reporting has suffered in the last several years as a result of the accountability failures in the private sector.
- Forces that led to the corporate scandals and audit failures include:
 - Individual and corporate greed
 - Inadequate corporate governance systems
 - Ineffective regulation and oversight of the accounting and auditing profession
 - Inadequate accounting/reporting standards
 - Audit-related expectation gaps
 - Financial managers and advisors working to achieve certain reporting results and focusing on the legal form versus the economic substance of the transactions
 - Unreasonable and inappropriate executive compensation arrangements
 - Auditors and financial professionals doing what was minimally required and actively fighting tighter standards
 - Confusion over whom the auditors work for
 - Auditors delivering services to clients that impaired their independence

Sarbanes-Oxley Act

- The Sarbanes-Oxley Act of 2002 included reforms in corporate governance and the accounting profession intended to
 - improve corporate financial reporting and internal control
 - strengthen audit committees
 - change the relationship between the auditor and client
 - improve auditor independence
 - provide additional auditor assurance over internal control
 - provide oversight and regulation for auditors of publicly traded companies
- Reforms are currently being implemented, and final impact is still uncertain.

Sarbanes-Oxley Act Provisions with Potential Implications for Government

New audit standards and oversight—PCAOB

- Audit committees with defined responsibilities
- Specific communications between auditors and audit committees
- CEO and CFO certification of financial reports
- Enhanced disclosures of off-balance sheet transactions
- Code of ethics for senior financial officers
- Management attestation on the effectiveness of internal control over financial reporting
- Auditor opinion on the effectiveness of internal control over financial reporting

Excerpts From the 103rd American Assembly Report: The Future of the Accounting Profession*

- Structural Challenges Facing the Accounting Profession:
 - Rules-based versus principles-based standards
 - A revised and expanded financial reporting model
 - New and enhanced audit and attestation standards
 - The number of major accounting/audit firms
 - A balanced approach to auditor liability and accountability
 - Valuing quality audits and audit personnel
 - Reinvigorating audit committees
 - Preparing for the future—the talent search

*Report by The American Assembly, Columbia University, at its national meeting, Lansdowne Resort, Leesburg, Va., November 13-15, 2003, amassembly@columbia.edu

Rebuilding Public Trust

For any system to work, it must address three fundamental issues.

- First, provide incentives for people to do the right thing.
- Second, provide transparency to help assure that people do the right thing.
- Finally, have effective accountability mechanisms if people don't do the right thing.

Restoring public trust will require that every participant in the corporate reporting supply chain embrace and live by the following core concepts*

- 1. A spirit of transparency**—stop playing games with financial and performance data. Use full disclosure.
- 2. A culture of accountability**—management, staff, boards, auditors, and stakeholders. High quality, unbiased information to support decision-making.
- 3. People of integrity**—commitment to individual integrity.

*Excerpts from Building Public Trust: The Future of Corporate Reporting, Samuel DiPiazza, Jr. and Robert G. Eccles, 2002

GAO's Work to Modernize the Accountability Profession

GAO is actively working to modernize and transform the accountability profession, both inside the government and in the private sector, and to lead by example in this area.

- Opinion on system of internal control
- Independence Standard issued in 2002
- Nature of GAO's audit opinion and related products and public activities
- Assistance to the Congress in evaluating accountability profession issues and needed reforms prior to the Sarbanes-Oxley Act
- 2003 revision of *Government Auditing Standards*
- Creation of the U.S Auditing Standards Coordinating Forum (i.e., GAO, PCAOB, ASB)
- Coordination with accountability organizations around the world (e.g., INTOSAI)
- Comment on proposed standards
- Monitor implementation of the Sarbanes-Oxley Act
- Sarbanes-Oxley studies on accounting firm consolidation from Big 8 to Big 4 and on mandatory audit firm rotation
- Definition of success in financial management: clean opinion, no major weaknesses in controls or compliance, and financial systems that produce timely, accurate and useful information for management
- Enhance federal financial management, reporting, and accountability

Selected Federal Government Reporting Challenges

- **Financial and Performance Reporting**
 - long-range fiscal challenges (e.g., per capita burden)
 - “trust funds” (e.g., restricted vs. unrestricted revenues, intra-governmental obligations)
 - DOD assets, liabilities, and contingencies
 - performance reporting
- **Audit Reporting**
 - system of internal control
 - financial vs. performance vs. other information

Selected Government Accountability Issues

Leading by Example

- **Definition of success in financial management**

- Clean opinion on financial statements
- No major control weaknesses
- No major compliance issues
- Systems that produce timely, accurate, and useful financial and management information

- **Scope of audit**

- Internal controls (current)
- Compliance matters (current)
- Performance and projection information (future)

- **Additional issues**

- FASAB restructuring
- Accelerated financial reporting
- Enhanced performance and accountability reporting
- Audit/financial management committees
- Auditor independence

The Federal Financial Audit Environment

The federal financial audit environment is evolving:

- Closer to an opinion on the consolidated financial statements of the U.S. government (CFS)
- GAO, as the auditor of the CFS, needs to be able to use the work of the auditors of the agency financial statements
- Agencies need to meet accelerated due dates, maintain unqualified opinions, and address their internal control and financial management system deficiencies

Major Impediments to an Opinion on CFS

There are three primary reasons why the CFS has remained unauditale

- Serious financial management problems at the Department of Defense
- The federal government's ineffective process for preparing the CFS
- The federal government's inability to account for billions of dollars of transactions between federal entities

Planning for Future CFS Audits

GAO plans a risk-based line item approach

- Potential qualified opinion on the CFS balance sheet
- Ability to use the work of agency auditors
- Need to follow the GAO/IG Financial Audit Manual (FAM)
- Impact of acceleration
 - Growing number of restatements
 - Need for timely access to audit work by agency auditors
 - Need for more timely and ongoing auditing

The Future Accounting/Reporting and Audit Reporting Model

- We need to review and revise the existing accounting/reporting model to reflect several dimensions:
 - Generic provisions
 - Industry information
 - Entity-specific information (i.e., value and risk)
- We need to recognize the difference between certain types of financial and other information:
 - Historical cost
 - Readily marketable assets
 - Non-readily marketable assets
 - Projection information
 - Performance information

The Future Accounting/Reporting and Audit Reporting Model (cont'd)

In modernizing audit reporting we need to:

- Communicate the auditor's considerations in determining the overall "fairness" of the financial statements, including
 - management's selection and application of accounting principles
 - the reasonableness of estimates
 - the adequacy of disclosures
 - whether literal compliance with GAAP results in financial statements that may be misleading

The Future Accounting/Reporting and Audit Reporting Model (cont'd)

- Determine whether changes to the auditor's report are needed, such as
 - stating that the financial statements are not just prepared in accordance with GAAP but that they also “fairly” (or reasonably) present the reporting entity's financial condition
 - providing additional explanation or emphasis of matters
 - conveying that the financial statements and disclosures and the audit process include a series of judgments and estimates
 - recognizing that the financial statements contain information with different degrees of certainty and therefore, possibly, different levels of assurance

Key Concepts in the Accountability Profession

- Public vs. personal interests
- Recognizing the difference between the floor (e.g., law, accounting standards) and the ceiling (e.g., principles, values)
- Doing what is right vs. what is acceptable
- Economic substance vs. legal form
- Being concerned with both fact and appearance (e.g., independence)
- Using judgment vs. completing checklists
- Recognizing that continuing improvement in today's rapidly changing world is essential
- Trust is hard to earn, but easy to lose

Three Key Leadership Attributes Needed for These Challenging and Changing Times

- *Courage*
- *Integrity*
- *Innovation*

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