

The Government Management Reform Act of 1994:

A Retrospective of Achievements and Remaining Challenges and a Look to the Future



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"Achievements will prove to be a journey, not a destination." The words of President Dwight Eisenhower echoed true on November 15, 1990, when President George H.W. Bush signed into law the historic Chief Financial Officers (CFO) Act and signaled a new era for federal financial management.

The CFO Act is the most comprehensive financial management reform legislation in the past 60 years. When the CFO Act is mentioned, most people immediately think about audited financial statements. The thrust of the act, though, was on establishing a leadership structure, building an infrastructure for financial management through people and systems, and providing for the systematic measurement of performance and the development of cost information. The CFO Act had a requirement for audited financial statements. But that requirement was for selected pilots to prove the merit of preparing financial statements and subjecting them to an independent audit.

Three years of pilots later, the concept of audited financial statements had proved its merit. On October 13, 1994, President Bill Clinton signed into law the Government Management Reform Act (GMRA), which has as its goal "to provide a more effective, efficient and responsive government." GMRA has various financial management reform provisions related to the increased use of electronic payments, franchise fund pilots, and reports elimination and consolidation. At the heart of these provisions is a requirement for audited financial statements for all 24 major agencies covered by the CFO Act, the preparation of consolidated financial statements for the federal government as a whole, and an audit of the consolidated financial statements by the Government Accountability Office (GAO). In 2002, the Accountability of Tax Dollars Act further expanded the GMRA requirement for the preparation and audit of annual financial statements to include most other executive branch agencies.

As GMRA approaches its 15-year anniversary, it is a good time to look back at what has been achieved, take stock of the some of the challenges that remain and look ahead to the future. Given the predominance of the financial statement preparation and audit requirement, our focus will be on that facet of GMRA. Now let's look at what has been achieved.

Fifteen Years Later—We've Come A Long, Long Way

By any measure, the federal management community has come a long way in its journey to prepare financial statements that can stand up to the full scrutiny of an independent audit. The federal audit community met the challenge as well, with high-quality financial statement auditing.

Let's look at the some of the hard facts.

- Unqualified audit opinions for the 24 CFO Act agencies have exploded from only six in 1996 to 19 in 2007. The five agencies that did not achieve unqualified opinions for 2007 have all made important progress in improving financial management.
- The acceleration of the timeframe for issuing audited financial statements is even more impressive, going from the statutory deadline of five months to 45 days. For fiscal year 2007, all 24 CFO Act agencies issued audited financial statements within 45 days. This achievement was unimaginable in the early years of GMRA implementation, when agencies and their auditors struggled mightily to meet the five-month deadline, with some agencies taking upwards of 15 months to

issue financial statements that received a disclaimer of opinion. So moving to 45 days is quite an accomplishment.

- Kudos also go to the Department of the Treasury, which has accelerated the preparation of the consolidated government-wide financial statements from the statutory deadline of six months to 75 days. An unqualified or "clean" opinion on the consolidated financial statements has been elusive. It will not be achievable until two things occur: several agencies address long-standing, deeply rooted financial reporting problems that have impeded their ability to obtain an unqualified audit opinion and several government-wide issues are resolved. Treasury, though, has steadily improved the quality and content of the government-wide financial statements and its process for preparing the statements.
- Of particular note is Treasury's and OMB's first-time issuance, in cooperation with GAO, of a summary annual report in 2008. The summary report, *The Government's Financial Health—A Citizen's Guide to the Financial Report of the U.S. Government*, highlights important information in the 186-page consolidated financial statements in an easy-to-read, user-friendly,

eight-page, bottom line-oriented document on our nation's financial health. To quote former Comptroller General of the United States David Walker, in commenting on this notable achievement, "With its more clear and concise language, this guide represents an important step forward in improving public understanding of the federal government's true financial condition and fiscal challenges—both today and over the longer term."

- Another clear indication of progress is the preparation of annual Performance and Accountability Reports (PAR) by the CFO Act agencies. By linking financial and performance information, the PARs provide an accounting for the return on the taxpayers' investment in agency programs and operations. AGA has played a major role in moving this initiative forward by recognizing federal agencies for high-quality performance and accountability reports through the Certificate of Excellence in Accountability Reporting (CEAR) Program. For fiscal year 2007, 17 agencies were awarded the CEAR, up from just two in fiscal year 1998. Through its leadership, AGA has helped foster an environment where excellence in performance and accountability reporting is recognized as a clear indication of a high performing finance organization and has energized the federal financial management community to prepare PARs that meet the high standards set by AGA to be a CEAR recipient.

It was evident from the outset of the current Bush administration that financial management and financial reporting were priorities as integral parts of the President's Management Agenda led by the Office of Management and Budget (OMB). The continued focus on the reform over three successive administrations—dating back to the 1990 passage of the CFO Act—has been critical to the results we have seen and show what can happen when management reforms are sustained and built upon over time.

While a Lot of Things Have Gone Very Well, Challenges Remain

While the federal financial management community should be proud of what it has achieved, challenges remain to achieve the goals of GMRA. Some of these challenges were included in the results of the 2008 AGA Annual CFO Survey, *Financial Management: Providing a Foundation for Transition*, conducted in partnership with AGA by Grant Thornton LLP. A majority of the respondents to AGA's 2008 CFO Survey believed the current financial statements cost too much to prepare and audit while delivering little useful information to government decision-makers. An AGA survey conducted earlier this year found that only 5 percent of citizens are satisfied with the financial information they receive from the federal government.

A Look to the Future—Making GMRA Work Even Better

The issues raised by the AGA CFO Survey respondents come from dedicated financial leaders whose organizations face many challenges with limited resources, an ever-growing set of competing demands and a duty to add value to the management of their agencies. At the same time, the ability to routinely prepare auditable financial statements is a widely accepted prerequisite for high-performing finance organizations around the world. Some of the possible solutions suggested by survey respondents would move our journey away from the path of improvement we have seen under GMRA. Instead, what we need to do is build upon the past 15 years, with a goal of making GMRA work even better, and move the preparation of audited financial statements to the next level. In the words of Jack Nicklaus, "Achievement is largely the product of steadily raising one's level of aspiration and expectation."

There are many reasons for retaining audited financial statements as a benchmark requirement and to steadily raise our level of "aspiration and expectation."

- First, the discipline of preparing financial statements provides a proven framework for assessing and improving the effectiveness of internal controls over financial reporting; developing effective, integrated financial management systems that provide reliable, useful and timely information for management decision-making; and demonstrating stewardship and accountability over federal resources. In addition, the preparation of audited financial statements assists CFOs and agency leadership in assessing and mitigating enterprise risk. A disciplined and structured approach to assessing and dealing with internal controls over the critical flow of funds through the entire agency provides a mechanism that over time mitigates potential damaging breakdowns in financial integrity and mismanagement of funds that can impact the ability of the agency or entity to carry out its mission and severely damage public confidence in the agency or entity.
- Second, audited financial statements were never intended to and never will drive day-to-day decisions. It is, therefore, not surprising that they are not being routinely used by management in this manner.
- Third, as the CFO Act and the GMRA expected, initial investments in the preparation and audit of financial statements have eased through improvements in the agency financial management systems, internal controls and processes.
- Fourth, with a few exceptions, agencies are now receiving clean audit opinions and doing so within 45 days of year-end, which shows this can be done well.
- Fifth, moving away from such a benchmark requirement would set the federal government apart from what is an expectation for financial stewardship worldwide.

- Finally, the message this would send to the American public would not be reassuring and could further erode confidence in government at a time that we can ill afford to do so. As Thomas Jefferson said, "Information is the currency of democracy."

While there are many reasons to retain the requirement for audited financial statements, there is clearly a need to explore options for making federal government financial statements more useful, which is at the heart of the AGA CFO Survey results. This will be heavy lifting as there is no proverbial "silver bullet." We need a range of ideas for making the financial statement preparation and audit process as effective and useful as possible, while retaining this benchmark requirement. This would include the identification of information that people perceive is most useful to decision-makers and, therefore, candidates for inclusion in the financial statements. Specificity will be important since the Federal Accounting Standards Advisory Board (FASAB) has worked hard since its inception to develop accounting standards that consider the financial information needs in the federal government environment and has a number of important initiatives under way today that are directed at making financial statements more useful.

To make meaningful changes, we will need to roll up our sleeves and clearly define what is useful within the framework of the financial state-

ment model. Obtaining consensus on changes will not be easy and will require a deliberative process that engages a wide range of stakeholders—the CFOs, OMB, Treasury, GAO, FASAB, the inspectors general, public accounting firms, professional organizations such as AGA and Congress. Everyone will need to come to the table with ideas, creativity and open minds. To borrow the words of Albert Einstein, "We can't solve problems by using the same level of thinking we were at when we created them." We are confident the problem can be solved if we raise our level of our thinking. After all, while our world of accounting, financial reporting and auditing is challenging, it is certainly not the "rocket science" world of Einstein.

To begin the dialogue, we offer five observations for taking the GMRA journey to its next destination in a way that adds greater value and will result in the federal government being viewed as the gold standard for financial reporting and auditing.

1. We need to broadly reconsider *the federal financial reporting model* to recognize the unique needs of the federal government. Ensuring that information in federal financial statements is useful will ensure the value of financial reporting. Federal accounting standards have continued to evolve to provide transparency and accountability over the federal government's operations, financial condition and fiscal outlook. However, after 11 years of reporting at the government-wide level and 12 years at the agency level, it is appropriate to consider the need for further revisions to the current federal financial reporting model, which could affect both consolidated and agency reporting. Issues that might be addressed by such a broad reconsideration include: the kind of information that may be relevant and useful for a sovereign nation, ways to effectively convey the long-term financial condition of the U.S. government, what information is most useful for management decision-making, and the role of the balance sheet. The reconsideration of the federal financial reporting model should include consideration of the work of other accounting standards-

setters, such as GASB, the Financial Accounting Standards Board (FASB), the International Public Sector Accounting Standards Board and the International Accounting Standards Board.

Reporting model changes should be designed to improve readability, transparency and accountability over the federal government's operations, financial condition and fiscal outlook. For example, can a traditional balance sheet capture the full range of the federal government's assets and liabilities in a way that is meaningful in the federal environment? What is the value of recording historical costs for a weapons system that may have been purchased decades ago? What is the best way to communicate the value of the ability to tax and the intergenerational impacts of federal programs?

Also, as part of improving the reporting model, we need to explore ways to improve the understandability of the financial statements. Citizen-Centric Reports that AGA has championed are the way of future. The eight-page Citizen's Guide is a case in point. It is short, transparent and understandable. Also, an analysis of the highlights pages in the fiscal year 2007 PAR pilots can provide insights into communicating agency financial information more effectively.

FASAB is presently examining social insurance and fiscal sustainability—two topics that are likewise targeted at useful information that is transparent and understandable through the clear presentation of complex information that is critical to understanding the federal government's true financial condition. In addition, a current FASAB project includes plans for surveying financial statement user needs and identifying methods for meeting such user needs.

2. Complementing the reconsideration of the financial reporting model, we should reevaluate the *financial audit process* with an eye toward breaking down any barriers that may exist between CFOs and their auditors and developing a common understanding of what a financial statement audit entails. In discussing CFO's concerns with the auditing standards, the 2008 AGA CFO Sur-



vey pointed more to the application of the standards than the standards themselves and to the bar for getting a clean audit opinion, which CFOs believed was set too high. Both management and auditors should strive to ensure they understand each other's responsibilities and challenges. Auditors need to be able to put themselves in the shoes of a preparer, who may face some unique challenges that require flexibility. Management needs to appreciate what it means for auditors to vouch for a set of financial statements and sign their name and professional reputation on the bottom line. Auditors need to be helpful and constructive in carrying out their role, and preparers need to have an adequate understanding of audit standards and the audit process.

A good reference to assist CFOs in engaging with their auditors in constructive discussions of the financial

statement audit is the three-volume Financial Audit Manual, which was recently updated cover to cover by a joint GAO/inspector general task force and represents best practice in financial statement auditing. It provides a lot of good guidance, which would be useful as well to the preparer and would help the preparer understand what an auditor expects to see in terms of documentation and support. Also, it can provide a common language and framework for constructive engagement between the auditor and CFO.

The auditor and the preparer need to work together collegially, while maintaining their independence and understand the challenges that each face. While GAO, as the auditor of the consolidated financial statements, and Treasury and OMB, as the preparers, do not always agree, the relationship has grown to one of mutual

respect. When you develop this type of relationship, differences begin to narrow and solutions are forged. This relationship was not born overnight but evolved over time as we made the journey together. Preparers and auditors have the same goal of providing accountability to the American public for how their tax dollars were spent and what government has to show for the money spent. Preparers and auditors need to listen to each other and work together to move forward as the GMRA journey continues to its next destination.

3. Better *integration of information systems* (financial, budget and program) is needed so that data is entered one time and flows in an organized manner across an agency's business systems. While GMRA has helped drive the progress in strengthening financial management systems we have seen over the past

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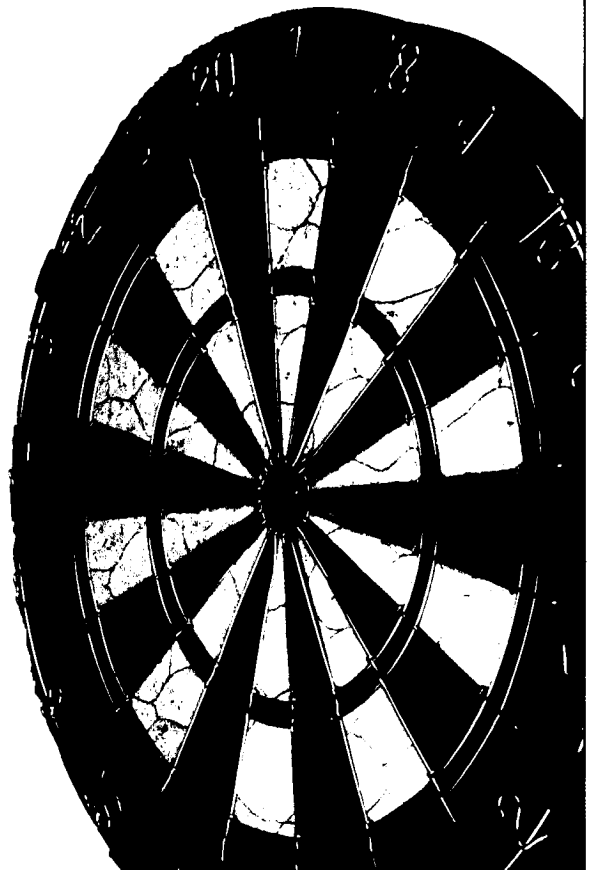
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15 years, some agencies continue to spend far too much time and money pulling together financial information at year-end to prepare financial statements because information systems and processes are not designed to work together. Producing reliable financial statements should be viewed as a byproduct of effective business processes and financial management systems. The primary goal is to improve financial management systems so that financial information from these systems can be used to help manage agencies more effectively. Well-designed and operating integrated financial management systems significantly reduce the cost of preparing financial statements. In addition, agencies would have the reliable, useful and timely information from such systems to assist them in managing their operations day-to-day. But if some agencies face the prospect of seemingly endless heroic efforts to prepare auditable financial statements, the cost-benefit proposition of GMRA will likely continue to be a legitimate concern and center stage in future AGA CFO surveys.

Beyond financial statements, there is the need to support the systematic measurement of performance as called for in the CFO Act. This requires an integration of performance and financial information in a way that enables decision-makers, including program managers, to look at how effectively money is being spent and whether program objectives are being achieved. In a resource constrained environment, it becomes even more important for policy-makers to have the needed information to know which programs are working and which ones are not and to make tough decisions. One of the central themes of a December 2007 forum on financial management systems hosted by GAO was the importance of the integration of program and financial information so that CFOs were providing information of use to program management. This type of information is in line with what CFOs say they value when they question the investment in financial statements.

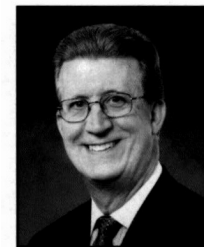
4. Equally important to improved financial management systems is the need for *improved business pro-*

cesses. Agencies should reengineer business processes that are inefficient or ineffective and develop standard business processes. For example, there must be agreement on common business rules for similar transactions that can be reasonably implemented and are enforceable across an agency and across government. In this way, out-of-balance situations can be avoided, such as the inability to properly reconcile intragovernmental transactions, which drain resources and complicate the financial reporting and audit process. This was a problem long before GMRA; the requirement to prepare auditable financial statements just put it on the front burner. There has been progress under the leadership of OMB and Treasury, which we view as a positive result of GMRA; but challenges, such as intragovernmental transactions, have remained difficult.

5. Finally, the time is right for a *forum* targeted at the future of audited financial statements, which could move the dialogue from the survey stage to the next step in the process, exploring a range of viable solutions. GAO's December 2007 forum on financial management systems jump-started the discussion as the participants also touched on financial reporting given the natural relationship between systems and reporting. The GAO forum was attended by a range of financial management and auditing leaders, both inside and outside of government, including AGA's Executive Director, Relmond Van Daniker. It is time to build on the GAO initiative to address the results of the most recent AGA CFO Survey and explore the issues highlighted in this article. Such a forum would involve the CFO and auditing community and need the support of OMB, Treasury and GAO given their respective government-wide leadership roles and its success predicated on the participants truly thinking outside of the box and being open to compromise and experimentation. To again borrow the words of Albert Einstein, "The significant problems we face cannot be solved at the same level of thinking we were at when we created them."

A Few Closing Observations

As we approach the 15th anniversary of the passage of GMRA, the federal financial management and auditing community have come a long, long way in preparing and auditing financial statements. We can all put a big check mark beside the first stage of the journey for a job very well done. As we move to the second stage of making GMRA work better, we must come to the challenge with the same fervor and hard work that have characterized the past 15 years. To be successful, we must stay the course of our journey, work together, think creatively and open our minds to the range of possibilities. In the words of General George Patton, "Accept the challenges so that you can feel the exhilaration of victory."



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