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Reliable Financial Information: A Key to Effective Program Management and Accountability

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Our nation's leaders make decisions almost daily that affect the lives and livelihoods of virtually every American citizen. Their choices, for example, can

- set the level of government debt we shoulder;
- expand or cut the funding of government programs to support our health, safety, education, and recreation needs;
- add to or restrict money made available to maintain the quality and readiness of our nation's defense; and
- determine the amount of taxes we pay.

Reliable financial information can provide a foundation for formulating budgets, managing government program operations, and making difficult policy choices. However, financial data alone do not usually provide hard and fast answers. Policy decisions involve many considerations.

But the difficulty of making informed decisions is increased when complete and reliable information on the cost and consequences of government programs and activities is unavailable. For example, efforts to deal with the deficit or make tough decisions among competing options may be undermined when bad or missing financial information masks huge, hidden costs. It is also difficult to make fully informed budget decisions when information on actual costs for programs is incorrect or unknown.

Financial Systems Have Become Outdated and Controls Have Seriously Deteriorated

The federal government has a responsibility—and an obligation—to American citizens to be a good financial steward of and properly account for their tax dollars. Decades of neglect and failed attempts to improve financial management and modernize outdated financial systems have left the federal government ill-equipped and unprepared to adequately fulfill this responsibility.

Audits have shown that federal financial management is in serious disrepair:

- recordkeeping is sloppy,
- financial reports are inaccurate,
- rudimentary accounting operations are not effectively performed, and
- basic controls are not in place.

The poor state of federal financial systems and controls results in incorrect financial information being provided to the Congress and the administration. Without reliable financial information, government leaders do not have the full facts necessary to make investments of scarce resources, reduce the deficit, or direct programs.

The lack of reliable financial information also impairs the government's ability to adequately fulfill another fundamental obligation to taxpayers—holding agency managers accountable for the way they run government programs.

Today, taxpayers doubt the government's ability to be a good financial steward. Time and again, they see media reports of mismanagement, rampant waste, and scandalous fraud. Each of these reports has a price tag, adding up to billions of dollars in lost taxpayer dollars each year and undermining confidence in government institutions.

At Long Last, Federal Financial Statements Are Becoming a Priority

The Chief Financial Officers (CFO) Act of 1990 laid the legislative foundation for the federal government—the world's largest and most complex operation—to provide taxpayers, the nation's leaders, and agency program managers with reliable financial information through audited financial statements. This kind of financial information has been required in the private sector for over 60 years and in state and local governments since the early 1980s.

Under the CFO Act, as expanded in 1994, the government's 24 major agencies will each prepare annual financial statements, beginning with those for fiscal year 1996. Together, these agencies account for virtually the entire federal budget.

The agencywide financial statements will be subjected to independent audit. These financial audits will

- determine the reliability of the financial information reported,

- report on agencies' compliance with laws and regulations, and
- provide information on the adequacy of systems and controls used to ensure accurate financial reports and safeguard assets.

Also, recent legislation requires auditors performing CFO Act financial audits to report whether agencies' financial management systems comply with federal accounting standards and other requirements.

Reliable financial statements would show the financial results of these agencies' entire operations and interpret, analyze, and provide relevant information on the government's true financial status—information that has never before been available. In addition, reliable financial statements could result in increased accuracy of the numbers reported in the budget as "actual."

The Social Security Administration (SSA), for example, has prepared and had audited annual financial statements showing the status of social security trust funds since 1987. SSA is now starting to report performance information with its financial statements, including information on the adequacy of service satisfaction and promptness in issuing earnings statements and processing claims. Reliable performance and financial data are also necessary in SSA's efforts to reengineer its business processes, such as efforts to reengineer its

disability determination process to reduce the average waiting time.

Beginning with fiscal year 1997, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), is to annually prepare and submit to the President and the Congress audited governmentwide financial statements. These financial statements, which GAO will audit, will encompass the entire federal government.

For the first time, the American public will have an annual scorecard on the national government's financial stewardship.

Providing Reports Tailored to Users' Needs and Based on New Standards

The challenge of developing reports specifically tailored to meet decisionmakers' needs and based on appropriate accounting standards is being met by the Federal Accounting Standards Advisory Board (FASAB). FASAB was created in October 1990 by the Secretary of the Treasury, the Director of OMB, and the Comptroller General to consider and recommend accounting principles for the federal government.

FASAB has put together a new set of accounting concepts and standards to meet the special needs of the U.S. government. These concepts and standards, which are listed in appendix I, underpin OMB's guidance to agencies

on the form and content of their agencywide financial statements.

The objectives of federal financial reporting are to provide users with information about

- **budgetary integrity**,
- **operating performance**,
- **stewardship**, and
- **systems and controls**.

With these as the objectives of federal financial reporting, FASAB has developed a new reporting model for federal government entities. Now decisionmakers and others will have available an annual report on the government's financial condition and financial statements for each major agency that, for example, will

- present a top-level overview discussion of the significance of the financial information in the accounting reports and commentary on performance, goals, and results consistent with measures an agency uses under the Government Performance and Results Act of 1993;

- report and thus enable the audit of (1) budgetary resources made available, (2) obligations incurred, (3) the year-end balances of budgetary resources available and obligations outstanding, and (4) outlays;

- reconcile budgetary obligations incurred to the net costs presented in

the financial statements and explain the differences;

- show total cost, earned revenues (if any), and net cost of an agency's organizations and programs in a manner that enables users to relate costs to outputs and outcomes;

- display the sources of financing for an entity's net cost—including those paid by taxpayers through appropriations and taxes—and the change in financial position for an agency and its organizations;

- report (1) unspent funds, (2) other operating assets available for use in providing government goods, services, and benefits, and (3) all liabilities incurred, with separate display of those which require future funding by the Congress;

- depict the various taxes and other nonearned revenues collected and collectible by the IRS and other collection agencies, as well as the amounts transferred to the general fund and trust funds; and

- reflect the nation's assets and investments for which the federal government has a stewardship responsibility.

Audited Financial Information Will Make a Difference in Program Operations

Financial statements prepared using the new accounting standards will provide essential facts for more informed decision-making and better accountability in practically every major aspect of the government's operations. While providing this information will require substantially improved accounting systems, the new data will be available to gauge progress in meeting program goals, improving program performance, and establishing accountability. The reliability or reasonableness of financial information reported in the financial statements will be determined through the annual audit.

The following are just a few examples of areas where audited financial information will make a difference in program operations.

- **Better financial information will help to improve the collection of revenue used to fund the government.**

Our financial audits at IRS have identified fundamental, persistent problems, including the following. The amounts of total revenue (reported to be $1.4 trillion for fiscal year 1995) and tax refunds (reported to be $122 billion for fiscal year 1995) cannot be verified or reconciled to accounting records maintained for individual taxpayers in the aggregate. The amounts reported for various types of taxes collected (such as social security, income, and excise taxes) cannot be substantiated.

The reliability of reported estimates for fiscal year 1995 of $113 billion for valid accounts receivable and of $46 billion for collectible accounts receivable cannot be determined.

- **Better financial data can help to provide accountability for national defense expenditures.**

  No single military service or major component has been able to withstand the scrutiny of a financial statement audit. Billions of dollars of needed adjustments to financial reports are routinely identified. The stakes are high—DOD has over a trillion dollars in assets and a $250 billion annual budget. Using the new accounting standards, DOD could have available (1) financial information essential for properly managing billions of dollars in inventories and (2) managerial cost data for assessing activities, such as infrastructure modernization and specific military operations.

- **Improved reporting can help to institute better management of federal lending programs.**

  Financial audits have consistently disclosed serious weaknesses in financial systems and reporting for the government's multi-billion dollar loan and loan guarantee portfolios. Decisionmakers can now have a clearer picture of the government's performance and loss estimates for its lending programs for farmers, home buyers, and students.

- **Cost accounting information will be collected to show the full costs of goods and services provided by an agency.**

  Today, only a few federal agencies do any form of cost accounting. This is unfortunate, considering the enormity of the federal government's spending. Better cost information can help agency managers determine the areas where costs are disproportionate to benefits received and where prudent investment can yield the greatest benefits in relation to the costs. Cost accounting information can also cast new light on the efficiency and effectiveness of a host of government-run programs.

- **Environmental damage resulting from government activity will be reported as a liability and recognized as an expense when the damage occurs.**

  Currently, the full magnitude of the government's environmental cleanup liability is unknown. Financial statements will provide information on the nature, location, and magnitude of this exposure, which, at a minimum, will be in the hundreds of billions of dollars.

- **Information will be provided on the condition and the future maintenance requirements for plant, property, and equipment.**

With today's budgetary constraints, agencies often cut corners by failing to maintain the federal government's buildings, equipment, and other property. While deferring maintenance can squeeze scarce resources for other uses, over time it can have an eroding and costly effect on the government's assets. Agencies' financial statements will now report the amount of deferred maintenance on a potentially wide range of assets from our military weapons, embassies around the world, and veterans hospitals to our national parks.

The Next Step—Linking Performance, Costs, and the Budget

What are the American people getting for their investment in the federal government? Addressing this question by measuring performance is central to the 1993 Government Performance and Results Act's goal of focusing on the results and outcomes of federal programs.

The accounting standards can lead to and support linking costs with achieving performance levels. This can give agency managers information for assessing the full costs of goods, services, and benefits compared to program outputs and results. Also, the accounting standards for investments in education, training, and research and development require agencies to develop performance indicators for the

annual costs of these programs and to present the amount invested annually over a period of years.

Another future challenge is to more tightly tie financial reports with the budget. This would enhance the utility and quality of the data considered in budget deliberations because numbers representing the execution of the previous fiscal year's budget would be presented in financial statements and reconciled to audited accounting data.

Also, budget data would be enhanced, for example, by bringing accrual accounting concepts to some areas of the cash-based budget. This new way of thinking is already being tried, for instance, in budgeting for credit programs, as required by the Credit Reform Act.

Ultimately, decisionmakers will have available reliable information on the financial condition of programs and operations as well as the performance and costs of these activities.

In Taxpayers' Eyes There Is No Substitute for Credibility and Accountability

The elements are now in place for a greatly changed accountability system that (1) measures results linked to costs, (2) is based on credible information, and (3) will enable annual reporting to the American public of the national government's financial stewardship. Nonetheless, making federal financial management reform a reality remains a challenge.

But the result should be meaningful financial information showing what the public gets for the taxpayer money the government spends. This information is essential to put the government's financial house in order and to realize broader management improvements.

The American public wants to believe in our government and trust its decisions. Reliable financial reporting that is easy to understand could provide the credible information needed to help restore confidence in government.

The matters presented in this document are further discussed in the related GAO products listed at the end of this document. For additional information, contact:

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Statements of Federal Financial Accounting Concepts and Standards

Statements of Federal Financial Accounting Concepts (SFFAC)	**Objectives of Federal Financial Reporting**[1] (SFFAC 1, September 2, 1993) **Entity and Display**[1] (SFFAC 2, June 6, 1995)
Statements of Federal Financial Accounting Standards (SFFAS)	**Accounting for Selected Assets and Liabilities** (SFFAS 1, March 30, 1993, effective for fiscal year 1994) **Accounting for Direct Loans and Loan Guarantees** (SFFAS 2, August 23, 1993, effective for fiscal year 1994) **Accounting for Inventory and Related Property** (SFFAS 3, October 27, 1993, effective for fiscal year 1994) **Managerial Cost Accounting Concepts and Standards** (SFFAS 4, July 31, 1995, effective for fiscal year 1997) **Accounting for Liabilities of the Federal Government** (SFFAS 5, December 20, 1995, effective for fiscal year 1997) **Accounting for Property, Plant, and Equipment** (SFFAS 6, November 30, 1995, effective for fiscal year 1998)

[1]Effective dates do not apply to Statements of Federal Financial Accounting Concepts.

Accounting for Revenue and Other Financing Sources (SFFAS 7, May 10, 1996, effective for fiscal year 1998)

Supplementary Stewardship Reporting (SFFAS 8, effective for fiscal year 1998)

Related GAO Products

Financial Audit: Examination of IRS' Fiscal Year 1995 Financial Statements (GAO/AIMD-96-101, July 11, 1996).

Budget and Financial Management: Progress and Agenda for the Future (GAO/T-AIMD-96-80, April 23, 1996).

CFO Act Financial Audits: Increased Attention Must Be Given to Preparing Navy's Financial Reports (GAO/AIMD-96-7, March 27, 1996).

Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1994 and 1993 (GAO/AIMD-96-22, February 26, 1996).

Financial Management: Continued Momentum Essential to Achieve CFO Act Goals (GAO/T-AIMD-96-10, December 14, 1995).

Financial Management: Momentum Must Be Sustained to Achieve the Reform Goals of the Chief Financial Officers Act (GAO/T-AIMD-95-204, July 25, 1995).

Managing for Results: Strengthening Financial and Budgetary Reporting (GAO/T-AIMD-95-181, July 11, 1995).

Managing for Results: Steps for Strengthening Federal Management (GAO/T-GGD/AIMD-95-158, May 9, 1995).

Financial Management: CFO Act Is Achieving Meaningful Progress (GAO/T-AIMD-94-149, June 21, 1994).

Improving Government: Actions Needed to Sustain and Enhance Management Reforms (GAO/T-OCG-94-1, January 27, 1994).

Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, December 22, 1993).

The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform (GAO/AFMD-12.19.4, September 1991).

Managing the Cost of Government: Building an Effective Financial Management Structure (GAO/AFMD-85-35 and 35A, February 1985).