U.S. FISCAL OUTLOOK AND THE FISCAL YEAR 2005 GOVERNMENTWIDE FINANCIAL STATEMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE, AND ACCOUNTABILITY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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U.S. FISCAL OUTLOOK AND THE FISCAL YEAR 2005 GOVERNMENTWIDE FINANCIAL STATEMENTS

WEDNESDAY, MARCH 1, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
FINANCE, AND ACCOUNTABILITY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2247, Rayburn House Office Building, Hon. Todd Russell Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts and Towns.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Tabetha Mueller, professional staff member; Erin Phillips, clerk; Adam Bordes, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. PLATTS. This hearing of the Government Reform Subcommittee on Government Management, Finance, and Accountability will come to order. Our ranking member, Mr. Towns, will be joining us shortly.

Because of upcoming floor votes, Comptroller General's schedule, other committee meetings going on for the ranking member and myself, we are going to try to push through as quickly as possible to get into the substance and allow everyone to meet their other obligations as well. But we appreciate your being here.

The 2005 Financial Report of the U.S. Government and accompanying audit, completed by the Government Accountability Office, was released on December 15th. This marks the 9th year that the Department of Treasury has published the report in its current form, and again, this year the report shows fundamental weaknesses in the Departments of Defense and Homeland Security, problems with financial systems, and an inability to reconcile exchanges between agencies.

Today, in addition to focusing on these continuing weaknesses, we hope to explore how the information in the 2005 financial report could be used to inform the annual budget debate and spending decisions made by Congress and the President. One of the concerns that led to the passage of the CFO Act, was that reporting at the time did not accurately disclose the current and probable future cost of operating and investment decisions. The authors of the CFO Act and the Government Management Reform Act, envisioned the financial report as a tool for analyzing long-term obligations and

spending revenue trends. I would like to see us move more in that direction in the years to come.

Perhaps the most important benefit of the audit process is learning how to correct systematic weaknesses. We have seen improvement since the initiation of the Governmentwide audit in 1997. However, we won't benefit from the full value of this report until we can be assured that the reporting information is accurate and GAO can issue a clean opinion. The Government Reform Committee has a responsibility to support sound financial management through proper oversight, and this hearing is an important part of that ongoing effort.

Our witnesses here today will provide the subcommittee with insight on the audit findings of the consolidated financial statements, and discuss how the numbers in this report affect our fiscal future. We certainly are honored to again have with us the Hon. David Walker, Comptroller General of the United States; and Donald Hammond, Fiscal Assistant Secretary at the Department of Treasury.

We appreciate your written testimonies and look forward to testimonies here in person today.

I now yield to our ranking member, the gentleman from New York, Mr. Towns, for the purposes of an opening statement.

[The prepared statement of Hon. Todd Russell Platts follows:]

COMMITTEE ON GOVERNMENT REFORM

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE, AND ACCOUNTABILITY

TODD RUSSELL PLATTS, CHAIRMAN

OVERSIGHT HEARING:

U.S. Fiscal Outlook and The FY 2005 Governmentwide Financial Statements

Wednesday, March 1, 2006, 2:00 PM
2247 Rayburn House Office Building

OPENING STATEMENT OF CHAIRMAN PLATTS

The *2005 Financial Report of the United States Government* and accompanying audit completed by the Government Accountability Office was released on December 15, 2005. This marks the ninth year that the Department of the Treasury has published the report in its current form. Again, this year the report shows fundamental weaknesses in the Departments of Defense and Homeland Security, problems with financial systems, and an inability to reconcile exchanges between agencies.

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Our witnesses today will provide the Subcommittee with insight on the audit findings of the consolidated financial statements and discuss how the numbers in the report affect our fiscal future. We are pleased to have The Honorable David M. Walker, Comptroller General of the United States, and Donald V. Hammond, Fiscal Assistant Secretary at the Department of Treasury. I look forward to the testimony of each of our witnesses.

COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE AND ACCOUNTABILITY
TODD RUSSELL PLATTS, CHAIRMAN

Oversight Hearing:

U.S. Fiscal Outlook and the FY 2005 Governmentwide Financial Statements

Wednesday, March 1, 2006, 2:00 p.m.
Room 2247 Rayburn House Office Building

BRIEFING MEMORANDUM

Summary

The Financial Report of the United States Government (Financial Report) provides one of the best snapshots of the financial health of the Federal government at the end of each fiscal year. The report includes the results of the Federal government's financial operations, its financial condition, its revenues and costs, assets and liabilities, and other obligations and commitments. In contrast to the Federal budget, which uses a cash basis for reporting, the Financial Report is compiled on an accrual basis. This difference makes the Financial Report far more dynamic in contrast to the budget. While the budget can be used as a planning and control tool for the current fiscal year, the Financial Report may be used as a tool for analyzing longer-term obligations and spending and revenue trends.

The 2005 Financial Report of the United States Government (2005 Financial Report)[1] represents the ninth time that the Department of the Treasury has published the report in its current format. The results contained in the 2005 Financial Report show that the net operating cost of the Federal government, which is the excess of expenses over revenues, was $760 billion for fiscal year 2005. The 2005 Financial Report contrasts this number to the $319 billion budget deficit for fiscal year 2005, and explains why although the budget deficit decreased by $93 billion from fiscal years 2004 to 2005, the net operating cost of the Federal government actually increased by $144 billion. The 2005 Financial Report also contains an analysis of the Social Security and Medicare trustees' annual report on the Social Security and Medicare Trust funds. While the 10-year fiscal outlook for these funds is basically stable, the 75-year fiscal outlook for these funds is not nearly as good. In fact, according to the 2005 Financial Report, the net present value of the total resources needed to fund the Social Security and Medicare programs over the next 75 years is approximately $35.6 trillion. This number represents the resources needed above and beyond the funding that these programs will receive from payroll taxes, benefit taxes, and premium payments.

[1] Department of the Treasury, *Financial Report of the United States Government 2005* (Dec. 15, 2005) *available at:* http://www.fms.treas.gov/fr/index.html.

The Subcommittee intends to examine the figures in the 2005 Financial Report and what they say about the fiscal health of the Federal government. This hearing will also provide the Subcommittee with an opportunity to examine the method by which the 2005 Financial Report is created, including the accuracy of the financial information provided by some key Departments and agencies. Finally, the Subcommittee would like to explore how the information in the 2005 Financial Report may be utilized to inform the annual budget debate and spending decisions made by Congress and the President.

The Cost of the Federal Government for Fiscal Year 2005

Understanding the difference between the $760 billion accrual-based net operating cost of the Federal government for fiscal year 2005 versus the $319 billion Federal budget deficit for the same time period requires a brief discussion of the difference between cash and accrual accounting. The financial information contained in the Federal government's financial statements is compiled and reported based on accrual accounting methods. Accrual accounting is also utilized in the private sector. Under the accrual basis of accounting, revenue is recognized when it is earned and expenses are recognized in the period incurred, without regard to when the cash is actually received or disbursed. In contrast to how the Financial Report is compiled, the Federal government largely relies on cash accounting for the annual budget process. The principles of cash accounting are similar to the principles of keeping a checkbook where the focus is on cash deposits, cash payments, and the difference between the two amounts. The difference therefore between the cash and accrual methods of accounting is largely a matter of the timing of the recognition of monetary events, such as increasing a liability or booking revenue.

To give an example of how accrual accounting works differently than cash accounting, let's take the case of the benefits that a Federal employee accrues during their employment. While a person is working for the Federal government that employee is earning a salary as well as health, pension, and other benefits that will be paid in the future during the employee's retirement. Accordingly, each year, on the basis of actuarial calculations of benefits earned, the Federal government records as an expense an estimated amount for these earned benefits and increases the related liability, Federal Employee and Veteran Benefits Payable, for the amount owed to this employee, who could be a civilian or military employee. Thus, the accrual basis of accounting is intended to provide a complete financial picture of the Federal government's annual employee-related costs for the long term instead of just the amount needed to cover those benefits for the current fiscal year as provided for in the Federal budget.[2]

With this backdrop in mind, the 2005 Financial Report discloses that the total net cost of the Federal government's operations for fiscal year 2005 were $2,949.8 billion. The net cost represents the amount of Federal spending that is financed by revenue and borrowing when necessary. To get a sense of what this money is spent on, look below at the chart entitled "Chart B: Net Cost Comparison." This chart shows the major net cost elements of Federal spending over the past 6 fiscal years. Notice that over seventy-five percent of the net cost of government is based on five major elements (figures in billions): the Department of Defense ($677), the Department of Health and Human Services ($583.8), the Social Security Administration ($574.1), the Department of Veterans Affairs ($273.2), and the interest held on the public debt ($181.2). These five elements represent $2,289.3 billion of the $2,949.8 billion net cost of government for fiscal year 2005.

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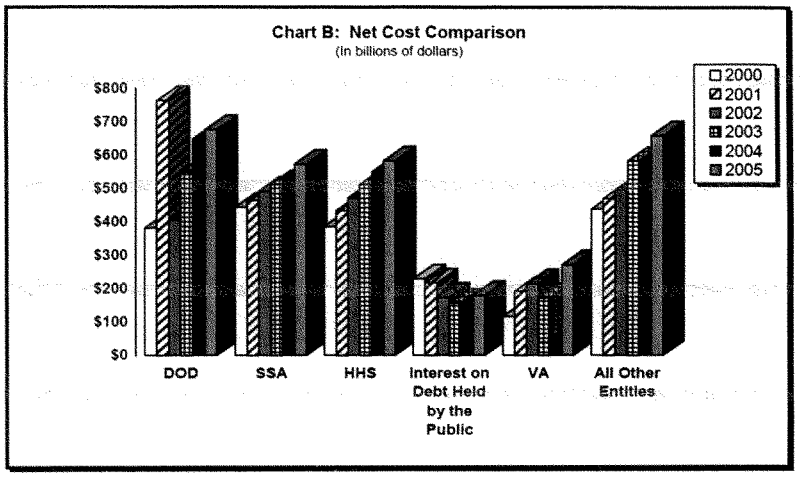
[2] For further discussion of these concepts checkout the following publication: Government Accountability Office, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-05-958SP (Sept. 2005) *available at:* http://www.gao.gov/new.items/d05958sp.pdf.

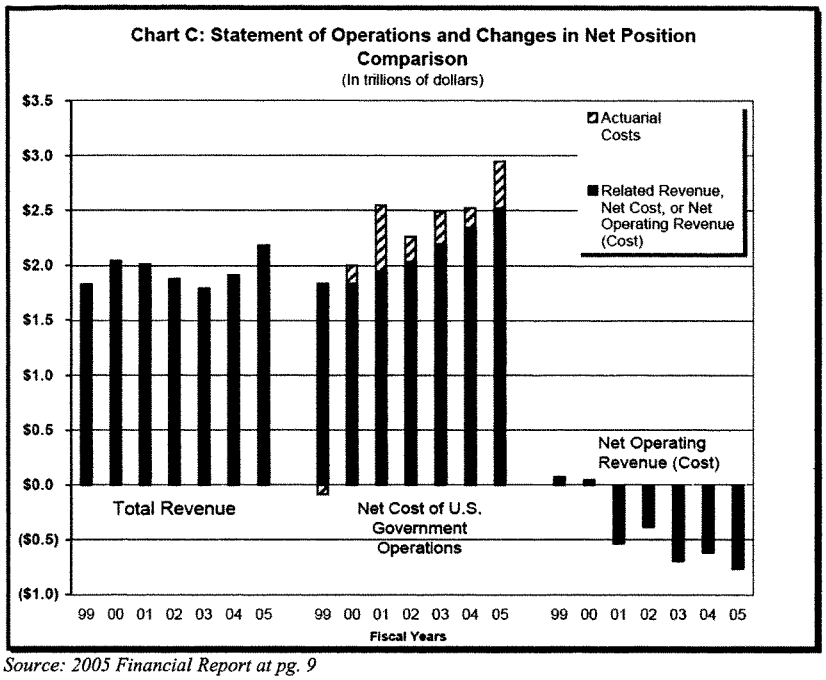


Source: 2005 Financial Report at pg. 7

Even though the net cost of the Federal government was $2,949.8 billion for fiscal year 2005, the Federal government's total revenue for the year was only $2,185.5 billion. The difference between the annual net cost and the total revenue can result in a surplus (net operating revenue), which means revenue exceeded costs, or a deficit (net operating cost), which means costs exceeded revenue. For fiscal year 2005, the net cost of the Federal government exceeded its revenue, which resulted in a net operating cost of $760 billion. As previously discussed, this number is derived using accrual accounting concepts. It is significantly higher than the reported budget deficit for fiscal year 2005 of $319 billion, which is derived using cash accounting. In fact, the budget deficit for fiscal year 2005 was $93 billion lower than the fiscal year 2004 budget deficit of $412 billion. During the same time period however, the net operating cost increased by $144 billion from $616 billion in fiscal year 2004 to $760 billion in fiscal year 2005. This rise in net operating cost is largely due to a change in actuarial assumptions used by the Department of Veterans Affairs that resulted in an increase of actuarial costs of $228 billion. The budget deficit decline of $93 billion helped to offset the effect this increase would have had on net operating cost.

As these figures show, the Financial Report provides a different and valuable perspective of the true nature of the fiscal health of the Federal government. The chart below entitled, "Chart C: Statement of Operations and Changes in Net Position Comparison," demonstrates the current trends in the net cost of Federal government operations over the past 7 fiscal years. The chart shows that the Federal government's revenues actually exceeded its cost for fiscal years 1999 and 2000 resulting in net operating revenues of $101.3 billion in 1999 and $39.6 billion in 2000. In contrast however, fiscal years 2001 through 2005 have all resulted in net operating costs as net cost has exceeded revenue each year (figures in billions): $514.8 for 2001; $364.9 for 2002; $667.6 for 2003; $615.6 for 2004; and $760.0 for 2005. Furthermore, this chart shows how variations in actuarial costs have factored into net cost over time, and that total costs have steadily increased over time, even absent the variations in actuarial costs.

Finally, it should be noted that the fiscal year 2005 revenues of $2,185.5 billion were 14.3 percent higher than in 2004. This increase in revenue is the highest in 20 years and was due in large part to increases in tax revenues in all categories.



Source: 2005 Financial Report at pg. 9

The Federal Government's Assets and Liabilities

The balance sheet is one of the most important pieces of financial information issued by companies in the private sector. The balance sheet shows what a company owes (liabilities) and owns (assets) at a particular point in time. Below is the balance sheet for the Federal government as of the end of fiscal year 2005. The Federal government's assets at the end of the year were $1,456.1 billion. Over 45 percent ($678.4 billion) of the total assets are based on the Federal government's estimate of its property, plant, and equipment. This category of assets consists of tangible assets including land, buildings, structures, software, etc. Unfortunately, the data used to create the property, plant, and equipment number is collected from agencies such as the Department of Defense (DOD) and National Aeronautics and Space Administration (NASA), who perpetually struggle with generating accurate estimates of their physical assets. In the Government Accountability Office's (GAO) report on its audit of the 2005 Financial Report, GAO states that "the federal government does not fully know the assets it

owns and their location and condition."[3] As such, because of financial management problems at agencies like DOD and NASA, there is a strong risk that the Federal government's largest asset is misstated on the balance sheet, which would be a very serious problem for a private company.

United States Government
Balance Sheets
as of September 30, 2005, and September 30, 2004

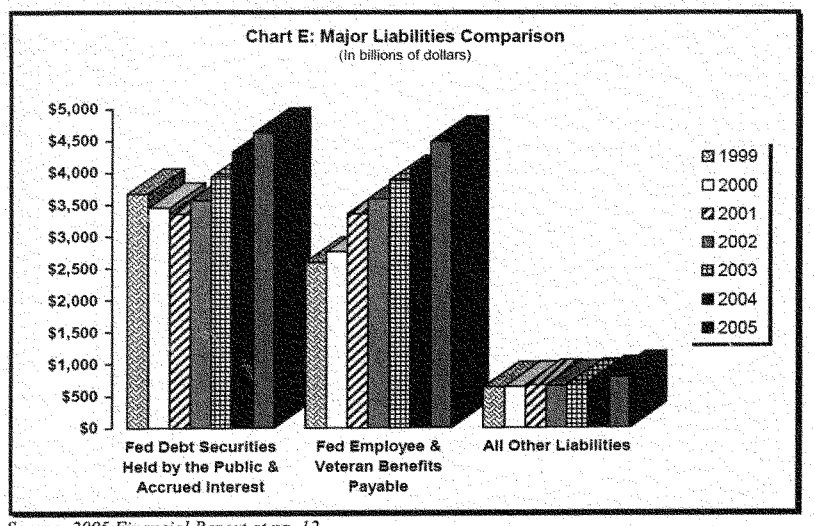
(In billions of dollars)	2005	2004
Assets:		
Cash and other monetary assets (Note 2)	85.8	97.0
Accounts and taxes receivable, net (Note 3)	66.1	56.4
Loans receivable, net (Note 4)	221.8	220.9
Inventories and related property, net (Note 5)	272.0	261.5
Property, plant, and equipment, net (Note 6)	678.4	652.7
Securities and investments (Note 7)	75.3	57.1
Other assets (Note 8)	56.7	51.7
Total assets	1,456.1	1,397.3
Liabilities:		
Accounts payable (Note 9)	67.9	60.1
Federal debt securities held by the public and accrued interest (Note 10)	4,624.2	4,329.4
Federal employee and veteran benefits payable (Note 11)	4,491.8	4,062.1
Environmental and disposal liabilities (Note 12)	259.8	249.2
Benefits due and payable (Note 13)	117.0	102.9
Insurance program liabilities (Note 14)	93.2	62.2
Loan guarantee liabilities (Note 4)	47.7	43.1
Other liabilities (Note 15)	213.2	198.1
Total liabilities	9,914.8	9,107.1
Contingencies (Note 19) and Commitments (Note 20)		
Net position	(8,458.7)	(7,709.8)
Total liabilities and net position	1,456.1	1,397.3

Source: 2005 Financial Report at pg. 40

In fiscal year 2005, the Federal government's liabilities increased by 8.9 percent from $9,107.1 billion to $9,914.8 billion. When this figure is subtracted from the assets figure on the balance sheet, the Federal government is left with a negative net position of $8,458.7 billion as of the end of fiscal year

[3] *2005 Financial Report* at pg. 145.

2005. The chart below entitled, "Chart E: Major Liabilities Comparison," provides a 7 year comparison of the major components of what the Federal government owes (liabilities) based on the balance sheets at the end of fiscal years 1999 through 2005. As seen on the chart, Federal debt securities held by the public and accrued interest ($4,624.2 billion) and Federal employee and veteran benefits payable ($4,491.8 billion) represent over 90% of the Federal government's liabilities. While the figures for Federal debt securities held by the public and accrued interest have varied with budget surpluses and deficits, the Federal employee and veteran benefits payable liability has risen steadily. This liability has increased from $2,600.7 billion at the end of fiscal year 1999 to $4,491.8 billion at the end of fiscal year 2005.



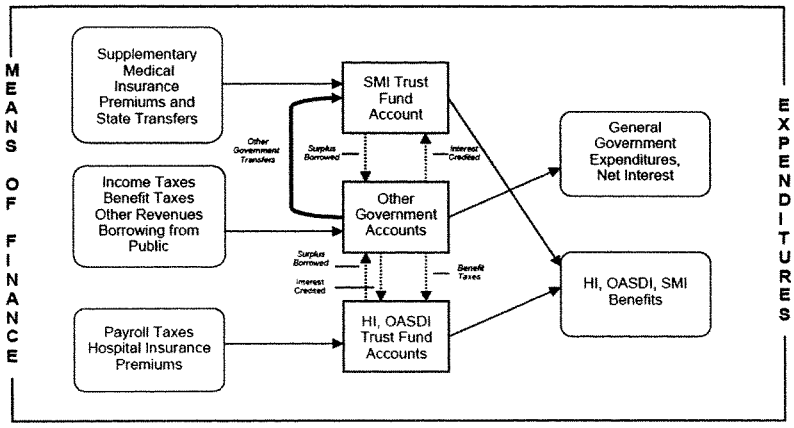
Source: 2005 Financial Report at pg. 12

Long Term Funding Challenges for Social Security and Medicare

As troubling as the numbers are on the Federal government's balance sheet, the balance sheet does not even include all of the Federal government's responsibilities. According to Federal accounting standards, the Federal government's liabilities for future payments for Social Security and Medicare as well as certain other programs are not included on the balance sheet. The Social Security and Medicare programs represent the most significant long-term financial challenges for the Federal government. These programs are funded through four social insurance trust funds. Under the Social Security program, the Old Age and Survivors Insurance (OASI) Trust fund pays retirement and survivors benefits; the Disability Insurance (DI) Trust Fund covers disability benefits. These funds are known in combination as OASDI. The Medicare program is comprised of the Hospital Insurance (HI) Trust Fund, which pays for inpatient hospital and related care, and the Supplementary Medical Insurance (SMI) Trust fund, which is comprised of Part B, which pays for physician and outpatient services, and Part D, which provides for the prescription drug benefit. The financing of these trust funds and their

relationship to other Federal government accounts is complex. The flow chart below entitled, "Figure 1 Social Security, Medicare, and Government Wide Finances," provides a simplified portrayal of the interaction of the Social Security and Medicare Trust funds with other parts of the Federal budget.

Figure 1
Social Security, Medicare, and Governmentwide Finances



Source: 2005 Financial Report at pg. 46

Each year, the six trustees of the Social Security and Medicare Trust Funds[4] provide short-range (ten year), long-range (75 year), and indefinite future estimates for each of the funds. These estimates are based on assumptions, which include economic growth, wages, inflation, unemployment, fertility, immigration, and mortality as well as factors relating to disability incidence and the cost of hospital, medical, and prescription drug services. Three sets of economic and demographic assumptions are used to try to account for uncertainties in the future. As such, the trustees derive three sets of figures for trust fund financing: low-cost (the most optimistic); intermediate (the trustees' best estimate); and high-cost (the most pessimistic).

The trustees' short-range or ten year outlook for the OASI, DI, and SMI trust funds estimates that all three funds are adequately financed for the next ten years. The HI trust fund however does not meet the short-range test of financial adequacy because the trustees' outlook predicts that the HI trust fund's assets will not equal the fund's projected benefit payments in 2014. The 75-year outlook for the funds is significantly worse than the ten-year outlook. The costs for Social Security and Medicare will rise sharply between 2010 and 2030 because the number of beneficiaries will increase rapidly as the baby-boom generation retires. After 2030, the costs for Social Security grow more slowly due to projected increases in life expectancy. However, the costs for Medicare continue to increase based on

[4] The six trustees are the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two members appointed by the President and confirmed by the Senate represent the public.

assumptions that health care costs will keep rising as will the demand for health care services. The table below entitled, "Table 6 – Present Values of Revenue and Cost Components of 75-Year Open Group Obligations HI, SMI, and OASDI," shows the present value of the expenditures and funding sources for the HI, SMI, and OASDI trust funds for the next 75 years. The line in the table entitled, "Net results for Government-wide (budget) perspective," shows from a governmentwide perspective the present value of the total resources needed for the Social Security and Medicare programs for the next 75 years, which amounts to $35,603 billion. This figure represents the resources needed from the budget in addition to all of the other funding mechanism for these programs, such as payroll taxes, benefit taxes, and premium payments. Finding a way to fund these programs in the long term will require difficult choices about the overall levels of Federal spending and the revenue sources utilized to fund that spending.

Table 6
Present Values of Revenue and Cost Components of 75-Year Open Group Obligations HI, SMI, and OASDI

(In billions of dollars, as of January 1, 2005)

		SMI			
	HI	Part B	Part D	OASDI	Total
Revenues from the Public:					
Taxes	9,435	-	-	29,450	38,885
Premiums, State transfers	-	4,187	2,547	-	6,733
Total	9,435	4,187	2,547	29,450	45,619
Total costs to the public	18,264	16,571	11,233	35,154	81,222
Net results for Government-wide (budget) perspective[1]	8,829	12,384	8,686	5,704	35,603
Revenues from other Government accounts	-	12,384	8,686	-	21,071
Trust fund in 1/1/2005	268	19	-	1,687	1,974
Net results for trust fund perspective[1]	8,561	(19)	-	4,017	12,558

[1] Net results are computed as cost less revenue.

Source: 2005 OASDI and Medicare Trustees' Reports.

Source: 2005 Financial Report at pg. 64

Audit Results

GAO is required by law[5] to audit the governmentwide financial statements. The 2005 Financial Report represents the ninth time that the Department of the Treasury has published the report and had it audited by GAO. For the ninth straight year, GAO was unable to express an opinion on the governmentwide financial statements due to significant material weaknesses in the Federal government's financial reporting. Specifically, GAO noted that auditors for four significant agencies out of the 24 Chief Financial Officers Act agencies issued disclaimers of opinion on their agencies' fiscal year 2005 financial statements. These agencies included NASA, DOD, the Department of Energy, and the Department of Homeland Security. As of the end of fiscal year 2005, these agencies represented approximately $848 billion or 58 percent of the Federal government's reported total assets and $751 billion or 25 percent of the Federal government's reported net cost. Inadequate financial management and reporting at these agencies, especially NASA, DOD, and DHS, will continue to significantly hamper the Federal government's ability to obtain an audit opinion on its overall financial statements. The problems at these agencies are of particular concern to the Subcommittee and have been and will continue to be the subject of oversight by the Subcommittee.

Conclusion

The 2005 Financial Report of the Federal government provides incredible amounts of useful information for policy makers, bond rating companies, and the general public. The fiscal outlook laid out in the report presents some serious financial challenges in the long-term for the Federal government, which will require difficult choices. Finally, the financial management and reporting challenges at NASA, DOD, and DHS need to be resolved if the Federal government hopes to ever generate a Financial Report that accurately depicts its financial condition.

Issues To Be Addressed

- What is the current financial status of the Federal government as a whole?
- Should the accounting requirements for the information presented in the Financial Report be adjusted in any way to improve the accuracy of the current financial outlook for the Federal government?
- What information in the report is potentially inaccurate because it includes data provided by major Departments that are facing significant accounting and financial management problems?
- How can both the Congress and the executive branch better utilize the information contained in the Financial Report during the annual budget and appropriations process?

Witnesses

The Honorable David M. Walker
Comptroller General of the United States
U.S. Government Accountability Office

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[5] The requirements for the audit and for the preparation of the report itself were contained in Section 405 of the Government Management Reform Act of 1994, P.L. 103-356, which is codified at 31 USC § 331(e), and states specifically: "(e) (1) Not later than March 31 of 1998 and each year thereafter, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, shall annually prepare and submit to the President and the Congress an audited financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the United States Government. The financial statement shall reflect the overall financial position, including assets and liabilities, and results of operations of the executive branch of the United States Government, and shall be prepared in accordance with the form and content requirements set forth by the Director of the Office of Management and Budget. (2) The Comptroller General of the United States shall audit the financial statement required by this section."

13

Donald V. Hammond
Fiscal Assistant Secretary
Department of the Treasury

Staff Contact Mike Hettinger, Staff Director (202) 225-3741

Mr. TOWNS. Thank you very much, Mr. Chairman. What I would like to do is to put my opening statement in the record and to move directly to hear from the witnesses.

Mr. PLATTS. So ordered, and your ears were ringing when I said we are going to keep moving this along, because of your schedule, and our witnesses' schedules as well.

Mr. TOWNS. Thank you very much.

[The prepared statement of Hon. Edolphus Towns follows:]

Congressman Ed Towns
Committee on Government Reform
Consolidated Financial Statements of the Federal Government
March 1, 2006

Thank you, Mr. Chairman, for beginning our slate of hearings this session with a review of the Consolidated Financial Statement of the Federal Government for 2005. It's good to be back here with you, and I welcome our esteemed witnesses.

Like previous years, the 2005 audit paints a picture of many agencies who demonstrate competent financial management practices, while a handful of others remain hamstrung by inaccurate transaction information, faulty internal controls, and dysfunctional contracting practices. All of this adds up to billions in wasted tax dollars and escalating financial liabilities.

The Comptroller General's report provides us with a snapshot of areas in which we are both making progress and have challenges ahead. Overall, I was glad to see the number of clean audits at agencies increased when compared to last year's results. For FY 2005, 19 out of 24 agencies received a clean audit opinion, as compared to 18

agencies receiving clean audits for FY 2004. Furthermore, this was the first year the Department of Homeland Security was required to submit to an annual audit since its creation in 2003.

The report cites a decrease in the amount of improper payments made by agencies, including nearly a $10 billion decrease in the Medicare program alone. As more agencies evaluate their programs for improper payments, the sooner they will be able to ensure that adequate payment controls are in place.

I remain concerned, however, at the significant number of agencies restating their financial results from the previous year. According to GAO, there were seven agencies that offered restatements for FY 2004. While this is a decline from the eleven agencies who restated their results in 2005, it remains excessive when compared to historic levels.

As the reasons for these restatements vary according to agency, it remains unclear if there are common trends or patterns that are causing them to occur. I've said before that any publicly traded entity who restates its prior results faces increased scrutiny from the SEC and its investors, so

why shouldn't our agencies be scrutinized the same way by Congress and the taxpayers? It is my hope that Mr. Walker can address these concerns before us this afternoon.

In closing, I look forward to hearing from our witnesses and gaining their perspectives for making our government a more effective and accountable institution. Mr. Chairman, this concludes my remarks.

Mr. PLATTS. If we could swear in our witnesses, and then we will proceed right to your testimony.

[Witnesses sworn.]

Mr. PLATTS. The clerk will note that the witnesses both affirmed the oath.

Comptroller General Walker, we will go right to your testimony.

STATEMENTS OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; AND DONALD V. HAMMOND, FISCAL ASSISTANT SECRETARY, U.S. DEPARTMENT OF THE TREASURY

STATEMENT OF DAVID M. WALKER

Mr. WALKER. Chairman Platts, Ranking Member Towns, thank you very much for the opportunity to be back before you on the status of financial management in the Federal Government. Let me, for the record, and as noted in my statement, commend this subcommittee for the fact that you have consistently been committed to this subject matter. I think it is a critically important subject matter. Since you have already entered my entire statement into the record, I will use a few of these visuals to make a few key points, and then we can move on to Mr. Hammond, and then on to Q&A.

The first visual notes the results of the fiscal year 2005 financial statement audits for various departments and agencies, and you will note several things from this chart. First, a significant majority of the agencies received an unqualified opinion on their financial statements. However, an overwhelming majority of agencies had one or more material control weaknesses and/or noncompliance with certain applicable laws and regulations. And last, seven agencies had to restate their fiscal year 2004 financial statements as part of the issuance of their fiscal year 2005 financial statements.

Let me be clear, Mr. Chairman and Mr. Towns, that when someone has to restate their prior financial statements, it means they did not deserve a clean opinion on their prior year financial statements. There are some that don't seem to understand that, and we are looking to possibly modify the Yellow Book requirements to make that point clear, when new reports are issued.

I think the other thing that has happened over the last few years is that there has been a tremendous acceleration in the timing of the work that has been done and the issuance of these annual reports. We have a situation now where agencies are reporting by November 15th, and the consolidated financial statements and related audit report are coming out by December 15th. I think that is a huge accomplishment, and everybody involved should be complimented for that.

Next is to show you a few numbers. Let me note that in the interest of space, I have dropped zeroes, but these numbers are in billions of dollars, and therefore, one would have to add nine zeros behind these numbers in order to really get a sense for what is going on here.

What I would like to do is to point your attention to the second to the last line that says the unified deficit. This is the number that consistently gets a lot of media attention, as well as emphasis

in the legislative branch and the executive branch. It represents the largely cash-based results of operations for the fiscal year. You will see that in fiscal year 2005 it was negative $319 billion, a deficit of $319 billion. That is down from $413 billion. But let me say for the record, that is misleading. While it is technically accurate, it is misleading, because on an accrual basis, as you will note in the financial statements of the U.S. Government which uses an accrual basis and which virtually every private sector company does, our net operating costs or annual based deficit went up $144 billion from fiscal year 2004 to fiscal year 2005. Specifically, it went up from $616 billion to $760 billion, at a time where we had one of the strongest economic growth rates of any industrialized nation. We haven't been in a recession since November 2001, and the costs associated with Iraq, Afghanistan, incremental Homeland Security costs was only about $100 billion of that number.

We are deep in a hole, and it is going to get worse if we don't start doing something about it.

In the last 5 years alone, we have gone from over $20 trillion—now there are 12 zeros behind a trillion, it is just unbelievable—from about $20 trillion in liabilities and unfunded commitments to over $46 trillion in 5 years! $46 trillion, in terms that we might be able to better relate to, is $156,000 for every man, woman and child in the United States, $375,000 for every full-time worker, and $411,000 for each household in America. You compare that to the average wage and average net worth. It is over 90 percent of the entire net worth of every American in the United States, including Bill Gates and Warren Buffett. And the number is going up every second of every day continuing deficits, because of compounding interest costs and known demographic trends.

We need more visibility on this. This slide was prepared using information in the consolidated financial statements of the U.S. Government, but you would have a hard time pulling together all of this to show exactly where we are, and that is part of our problem. We have numbers in MD&A, management discussion analysis. We have numbers on the face of the financial statements. We have got numbers in the footnotes. But we are not pulling these things together enough. I know that Don Hammond, the Secretary of the Treasury, the Director of OMB, myself, and others are working to try to see if we can improve existing financial reporting to convey this information more clearly and concisely.

By the way, a significant part of this increase is related to the Medicare Prescription Drug Bill, the cost of which is almost double Social Security's unfunded obligation.

Next, please. I won't spend a whole lot of time on these. This is based upon CBO's assumptions for what the fiscal future looks like out to 2040. Unfortunately, these are based on certain unrealistic assumptions the CBO is required to make by law: No. 1, no new laws will be passed; No. 2, discretionary spending will grow by the rate of inflation for the next 10 years; No. 3, AMT, alternative minimum tax won't be fixed; and No. 4, that all tax cuts will expire in their entirety, that none will be extended in whole or in part. Even on that basis, we have a long-range imbalance because if the bar is above the line, that is a deficit.

Next one. This is an alternative scenario. Discretionary spending grows by the rate of the economy—it has been growing faster—and all tax cuts are made permanent. The future is probably somewhat in between those two, but both of them say that we are on an imprudent and unsustainable fiscal path, and we need to get serious soon, because nothing less than the future of the republic is at stake.

With that, let me just say that in my statement, I include a summary of the areas where there continue to be challenges to rendering a clean opinion. They are threefold: No. 1, the Department of Defense; No. 2, intragovernmental transactions, transactions between Government agencies; and No. 3, the actual preparation of the consolidated financial statements.

I also note in my statement a number of areas where we think additional progress is necessary with regard to financial reporting and related matters.

Finally, I also note in my statement, areas where the most prominent material control deficiencies and weaknesses still exist.

I thank you again, Mr. Chairman, and Mr. Towns, for your interest in this matter. It is critically important, and more of your colleagues need to be involved here because the stakes are very high.

[The prepared statement of Mr. Walker follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

For Release on Delivery
Expected at 2:00 p.m. EST
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FISCAL YEAR 2005 U.S. GOVERNMENT FINANCIAL STATEMENTS

Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Financial Condition and Long-term Fiscal Imbalance

Statement of David M. Walker
Comptroller General of the United States

GAO-06-406T

March 1, 2006

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-06-406T, testimony before the Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

FISCAL YEAR 2005 U.S. GOVERNMENT FINANCIAL STATEMENTS

Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Financial Condition and Long-term Fiscal Imbalance

Why GAO Did This Study

GAO is required by law to annually audit the consolidated financial statements of the U.S. government. The Congress and the President need to have timely, reliable, and useful financial and performance information. Sound decisions on the current results and future direction of vital federal government programs and policies are made more difficult without such information.

Until the problems discussed in GAO's audit report on the U.S. government's consolidated financial statements are adequately addressed, they will continue to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other 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 economical, efficient, and effective manner.

www.gao.gov/cgi-bin/getrpt?GAO-06-406T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jeffrey C. Steinhoff or Gary T. Engel at (202) 512-2600.

What GAO Found

For the ninth consecutive year, certain material weaknesses in internal control and in selected accounting and financial reporting practices resulted in conditions that continued to prevent GAO from being able to provide the Congress and American people an opinion as to whether the consolidated financial statements of the U.S. government are fairly stated in conformity with U.S. generally accepted accounting principles. Three major impediments to an opinion on the consolidated financial statements continued to be (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. Further, in our opinion, as of September 30, 2005, the federal government did not maintain effective internal control over financial reporting and compliance with significant laws and regulations due to numerous material weaknesses.

More troubling still is the federal government's overall financial condition and long-term fiscal imbalance. While the fiscal year 2005 budget deficit was lower than 2004, it was still very high, especially given the impending retirement of the "baby boom" generation and rising health care costs. Importantly, as reported in the fiscal year 2005 *Financial Report of the United States Government*, the federal government's accrual-based net operating cost—the cost to operate the federal government—increased to $760 billion in fiscal year 2005 from $616 billion in fiscal year 2004. This represents an increase of about $144 billion or 23 percent. The federal government's gross debt was about $8 trillion as of September 30, 2005. This number excludes such items as the gap between the present value of future promised and funded Social Security and Medicare benefits, veterans' health care, and a range of other liabilities, commitments, and contingencies that the federal government has pledged to support. Including these items, the federal government's fiscal exposures now total more than $46 trillion, representing close to four times gross domestic product (GDP) in fiscal year 2005 and up from about $20 trillion or two times GDP in 2000. Given these and other factors, a fundamental reexamination of major spending programs, tax policies, and government priorities will be important and necessary to put us on a prudent and sustainable fiscal path. This will likely require a national discussion about what Americans want from their government and how much they are willing to pay for those things.

We continue to have concerns about the identification of misstatements in federal agencies' prior year financial statements. Frequent restatements to correct errors can undermine public trust and confidence in both the entity and all responsible parties. The material internal control weaknesses discussed in this testimony serve to increase the risk that additional errors may occur and not be identified on a timely basis by agency management or their auditors, resulting in further restatements.

Mr. Chairman and Members of the Subcommittee:

I am most pleased to be here today and commend your subcommittee's tradition of oversight hearings on this and other financial management issues throughout the year. Such hearings continue to play a vital role in ensuring that the federal government is held accountable to the American people. Today I will discuss our report on the U.S. government's consolidated financial statements for fiscal years 2005 and 2004. Our work was conducted in accordance with U.S. generally accepted government auditing standards.

Both the consolidated financial statements and our report on them are included in the fiscal year 2005 *Financial Report of the United States Government*. This most recent report was issued by the Department of the Treasury (Treasury) on December 15, 2005, and is available through GAO's Internet site, at www.gao.gov/financial/fy2005financialreport.html, and Treasury's Internet site, at www.fms.treas.gov/fr/index.html. I also would like to highlight a guide we issued in September 2005 titled *Understanding the Primary Components of the Annual Financial Report of the United States Government*,[1] which was prepared to help those who seek to obtain a better understanding of the Financial Report. This guide can also be found on GAO's Internet site at www.gao.gov/financial/fy2005/guidetofrofusg.pdf.

For the ninth consecutive year, certain material weaknesses[2] in internal control and in selected accounting and financial reporting practices resulted in conditions that continued to prevent us from being able to provide the Congress and American people an opinion as to whether the consolidated financial statements of the U.S. government were fairly stated in conformity with U.S. generally accepted accounting principles (GAAP). Further, we also reported that 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, 2005. Until the problems that I will discuss today and

[1]GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-05-958SP (Washington, D.C.: September 2005).

[2]A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

that are discussed in our audit report are adequately addressed, they will continue to have adverse implications for the federal government and the taxpayers.

More troubling still is the federal government's overall financial condition and long-term fiscal imbalance. While the fiscal year 2005 budget deficit was lower than 2004, it was still very high, especially given the impending retirement of the "baby boom" generation and rising health care costs. Importantly, as reported in the fiscal year 2005 *Financial Report of the United States Government*, the federal government's accrual-based net operating cost—that is, the cost to operate the federal government—increased to $760 billion in fiscal year 2005 from $616 billion in fiscal year 2004. This represents an increase of about $144 billion or 23 percent. To make matters worse, the federal government's liabilities and unfunded commitments, which include military and civilian retirement benefits and promised Social Security and Medicare payments, are growing rapidly. Simply put, our nation's financial condition and long-term fiscal imbalance is on an imprudent and unsustainable course.

In this testimony, I will discuss (1) the federal government's long-term fiscal imbalance, (2) our continued concerns about the identification of misstatements in federal agencies' prior year financial statements, and (3) the major issues relating to the consolidated financial statements for fiscal years 2005 and 2004. I will also discuss systems problems that continue to hinder federal agency accountability, and describe progress that has been made toward addressing major impediments to an opinion on the consolidated financial statements.

The Nation's Fiscal Imbalance

The *Financial Report of the United States Government* provides useful information on the government's financial position at the end of the fiscal year and changes that have occurred over the course of the year. However, in evaluating the nation's fiscal condition, it is critical to look beyond the short-term results and consider the overall long-term financial condition and long-term fiscal imbalance of the government—that is, the sustainability of the federal government's programs, commitments, and responsibilities in relation to the resources expected to be available. More important than the large increase in the government's net operating cost in fiscal year 2005 and persistent short-term budget deficits, fiscal simulations by GAO and others show that over the long term, we face large and growing structural deficits due primarily to known demographic trends, rising health care costs, and lower federal revenues relative to the economy.

As I have testified before, the current financial reporting model does not clearly, comprehensively, and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending. Thus, it provides a potentially unrealistic and misleading picture of the federal government's overall performance, financial condition, and future fiscal outlook. The federal government's gross debt[3] in the U.S. government's consolidated financial statements was about $8 trillion as of September 30, 2005.[4] This number excludes such items as the current gap between the present value of future promised and funded Social Security and Medicare benefits, veterans' health care, and a range of other liabilities (e.g., federal employee and veteran benefits payable), commitments, and contingencies that the federal government has pledged to support.[5] Including these items, the federal government's fiscal exposures now total more than $46 trillion, representing close to four times gross domestic product (GDP) in fiscal year 2005 and up from about $20 trillion or two times GDP in 2000. About one third of the approximately $26 trillion increase resulted from enactment of the Medicare prescription drug benefit in fiscal year 2004. (See table 1.) The federal government's current fiscal exposures translate into a burden of about $156,000 per American or approximately $375,000 per full-time worker, up from $72,000 and $165,000 respectively, in 2000. Furthermore, these amounts do not include future costs resulting from Hurricane Katrina or the conflicts in Iraq and Afghanistan.

[3]The federal government's gross debt consists of debt held by the public and intragovernmental debt holdings.

[4]On December 29, 2005, the Secretary of the Treasury (Secretary) notified the Congress that the statutory debt limit will be reached in mid-February 2006. On February 16, 2006, to avoid exceeding the debt limit, the Secretary began suspending investments in the Government Securities Investment Fund of the Federal Employees' Retirement System (G-Fund) and also suspended the sales of State and Local Government Series securities (SLGS).

[5]A broader discussion of fiscal exposures can be found in GAO, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, GAO-03-213 (Washington, D.C.: Jan. 24, 2003).

Table 1: Estimated Fiscal Exposures

Dollars in trillions	2000	2005
Explicit liabilities	**$6.9**	**$9.9**
• Publicly held debt		
• Military & civilian pensions & retiree health		
• Other		
Commitments & contingencies	**0.5**	**0.9**
• E.g., Pension Benefit Guarantee Corporation, undelivered orders		
Implicit exposures	**13.0**	**35.6**
• Future Social Security benefits	3.8	5.7
• Future Medicare Part A benefits	2.7	8.8
• Future Medicare Part B benefits	6.5	12.4
• Future Medicare Part D benefits	--	8.7
Total	**$20.4**	**$46.4**

Source: U.S. government's consolidated financial statements (CFS)

Note: Estimates for Social Security and Medicare are at present value as of January 1 of each year as reported in the CFS and all other data are as of September 30.

In addition to the approximately $46 trillion of estimated fiscal exposures discussed above, there are exposures that are not included in those figures because the amounts of the exposures are not currently estimable. For example, the Department of Energy, in the footnotes to its fiscal year 2005 financial statements, disclosed that its environmental liability estimates do not include cleanup costs at sites for which there is no current feasible remediation approach, such as the nuclear explosion test area at the Nevada Test Site. It is important to understand the nature and extent of these types of additional exposures in the long-term fiscal planning for the federal government.[6]

[6]For information on how agencies could better recognize, in the budget, the full costs of environmental cleanup and disposal associated with asset acquisitions, see GAO, *Long-Term Commitments: Improving the Budgetary Focus on Environmental Liabilities*, GAO-03-219 (Washington, D.C.: Jan. 24, 2003). Also, at the request of this subcommittee and the House Subcommittee on Energy and Resources, Committee on Government Reform, GAO has ongoing work assessing the adequacy of agency processes and controls for estimating environmental liabilities and the nature and type of uncertainties that could impact the ultimate cost of cleanup. Our report on this study is expected to be issued by the end of this month.

Additionally, tax expenditure amounts are not required to be disclosed, nor are they disclosed, in agency or the U.S. government's consolidated financial statements. Tax expenditures are reductions in tax revenues that result from preferential provisions, such as tax exclusions, credits, and deductions. These revenue losses reduce the resources available to fund other programs or they require higher tax rates to raise a given amount of revenue. As we reported in September 2005, the number of tax expenditures more than doubled since 1974, and the sum of tax expenditure revenue loss estimates tripled in real terms to nearly $730 billion in 2004.[7] Under the most recent estimates, this has risen to more than $775 billion in 2005. Enhanced reporting on tax expenditures would ensure greater transparency and accountability for revenue forgone by the federal government and provide a more comprehensive picture of the federal government's policies and fiscal position.

Further, additional changes are needed to communicate important information to users about current operating results and the long-term financial condition of the U.S. government and annual changes therein. In particular, the government's financial statements should clearly communicate to the user:

- the on-budget or operating results versus unified budget results for the year;
- the long-term sustainability of federal government programs—areas to consider include
  - the relationship of the federal government's existing commitments/responsibilities, including social insurance, to appropriate measures, such as GDP and per capita amounts,
  - the government's long-term fiscal imbalance in relation to appropriate measures, such as GDP, and
  - the magnitude of the potential alternatives for resolving the long term deficits, such as the rate of tax increases or spending reductions necessary to balance the government's long-term finances;

[7]The sum of individual tax expenditure estimates is useful for gauging the general magnitude of the revenue involved, but does not take into account possible interactions between individual provisions. For additional information, see GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690 (Washington, D.C.: September 2005).

- inter-generational equity issues, e.g., assessing the extent to which different age groups may be required to assume financial burdens for commitments already made; and

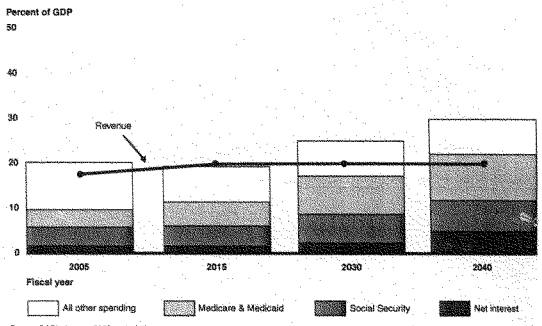
- a liability at the governmentwide level for funds held by Social Insurance trust funds.

Another tool that would serve to more effectively communicate the federal government's finances to the public would be a Summary Annual Report. Such a report would summarize, in a clear, concise, and transparent manner, key financial and performance information included in the *Financial Report of the United States Government.*

The federal government's financial condition and long-term fiscal imbalance present enormous challenges to the nation's ability to respond to emerging forces reshaping American society, the United States' place in the world, and the future role of the federal government. GAO's long-term simulations illustrate the magnitude of the fiscal challenges associated with an aging society and the significance of the related challenges the government will be called upon to address. Figures 1 and 2 present these simulations under two different sets of assumptions. In figure 1, we start with the Congressional Budget Office's (CBO) 10-year baseline—constructed according to the statutory requirements for that baseline.[8] Consistent with these requirements, discretionary spending is assumed to grow with inflation for the first 10 years and all tax cuts currently scheduled to expire are assumed to expire. After 2016, discretionary spending is assumed to grow at the same rate as the economy, and revenue is held constant as a share of GDP at the 2016 level. In figure 2, two assumptions are changed: (1) discretionary spending is assumed to grow at the same rate as the economy after 2006 rather than merely with inflation, and (2) all expiring tax provisions are extended. For both simulations, Social Security and Medicare spending is based on the 2005 Trustees' intermediate cost projections, and we assume that benefits continue to be paid in full after the trust funds are exhausted. Medicaid spending is based on CBO's December 2005 long-term projections under midrange assumptions.

[8]The Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016* (Washington, D.C.: January 2006).

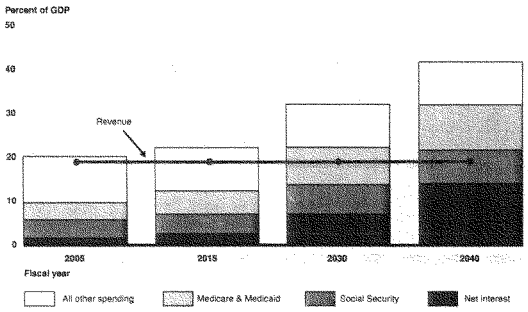
Figure 1: Composition of Spending as a Share of GDP under Baseline Extended



Source: GAO's January 2006 analysis.

Note: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2016 due to (1) real bracket creep, (2) more taxpayers becoming subject to the alternative minimum tax (AMT), and (3) increased revenue from tax-deferred retirement accounts. After 2016, revenue as a share of GDP is held constant.

Figure 2: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows with GDP after 2006 and All Expiring Tax Provisions Are Extended



Source: GAO's January 2006 analysis.

Note: This includes certain tax provisions that expired at the end of 2005, such as the increased AMT exemption amount.

As these simulations illustrate, absent policy changes on the spending or revenue side of the budget, the growth in spending on federal retirement and health entitlements will encumber an escalating share of the government's resources. Indeed, when we assume that all the temporary tax reductions are made permanent and discretionary spending keeps pace with the economy, our long-term simulations suggest that by 2040 federal revenues would be adequate to pay only some Social Security benefits and interest on the federal debt. Neither slowing the growth in discretionary spending nor allowing the tax provisions to expire—nor both together—would eliminate the imbalance.

Although revenues will be part of the debate about our fiscal future, assuming no changes to Social Security, Medicare, Medicaid, and other drivers of the long-term fiscal gap would require at least a doubling of taxes—and that seems to be highly implausible. Accordingly, substantive reform of Social Security and our major health programs is critical to recapturing our future fiscal flexibility. Ultimately, the nation will have to decide what level of federal benefits and spending it wants and how it will pay for these benefits. Our current path also will increasingly constrain

our ability to address emerging and unexpected budgetary needs and increase the burdens that will be faced by future generations. Continuing on this fiscal path will mean escalating and ultimately unsustainable federal deficits and debt that will serve to threaten the standard of living for the American people and ultimately our national security.

As these simulations illustrate, regardless of the assumptions used, the problem is too big to be solved by economic growth alone or by making modest changes to existing spending and tax policies. Rather, a fundamental reexamination, reprioritization, and reengineering of major spending programs, tax policies, and government priorities will be important to recapture our fiscal flexibility and update our programs and priorities to respond to emerging social, economic, and security changes. Ultimately, this will likely require a national discussion about what Americans want from their government and how much they are willing to pay for those things.

Restatements of Agencies' Financial Statements

According to Statement of Federal Financial Accounting Standards (SFFAS) No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, prior period financial statements presented should only be restated for corrections of errors, when such errors caused the financial statements to be materially misstated. Errors in financial statements can result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared.

We continue to have concerns about the identification of misstatements in federal agencies' prior year financial statements. At least 7[9] of the 24 CFO Act agencies restated certain of their fiscal year 2004 financial statements to correct errors. During fiscal year 2005, we reviewed the causes and nature of the restatements made by several Chief Financial Officers (CFO) Act agencies in fiscal year 2004 to their fiscal year 2003 financial statements and recommended improvements in internal controls and audit

[9]Three of these agencies had received an unqualified opinion on their originally issued fiscal year 2004 financial statements while the remaining four had received a disclaimer of opinion on their financial statements. The auditor for one of the agencies withdrew the unqualified opinion that had been previously rendered on the agency's fiscal year 2004 financial statements and issued a qualified opinion on the restated financial statements.

procedures to prevent or detect future similar errors.[10] Generally, the reasons for the restatements we reviewed were agencies' lack of effective internal controls over the processing and reporting of certain transactions and the failure of the auditors to design and/or perform adequate audit procedures to detect such errors. During our review, we noted that the extent of the restatements to the agencies' fiscal year 2003 financial statements varied from agency to agency, ranging from correcting two line items on an agency's balance sheet to correcting numerous line items on several of another agency's financial statements. In some cases, the net operating results of the agency were affected by the restatement. The amounts of the agencies' restatements ranged from several million dollars to more than $91 billion.

Frequent restatements to correct errors can undermine public trust and confidence in both the entity and all responsible parties. Material internal control weaknesses discussed in our fiscal year 2005 audit report serve to increase the risk that additional errors may occur and not be identified on a timely basis by agency management or their auditors, resulting in further restatements.

[10]GAO, *Financial Audit: Restatements to the Department of State's Fiscal Year 2003 Financial Statements*, GAO-05-814R (Washington, D.C.: Sep. 20, 2005); GAO, *Financial Audit: Restatements to the Nuclear Regulatory Commission's Fiscal Year 2003 Financial Statements*, GAO-06-30R (Washington, D.C.: Oct. 27, 2005); GAO, *Financial Audit: Restatements to the General Services Administration's Fiscal Year 2003 Financial Statements*, GAO-06-70R (Washington, D.C.: Dec. 6, 2005); GAO *Financial Audit: Restatements to the National Science Foundation's Fiscal Year 2003 Financial Statements*, GAO-06-229R (Washington, D.C.: Dec. 22, 2005); and GAO, *Financial Audit: Restatements to the Department of Agriculture's Fiscal Year 2003 Financial Statements*, GAO-06-254R (Washington, D.C.: Jan. 26, 2006).

Highlights of Major Issues Related to the U.S. Government's Consolidated Financial Statements for Fiscal Years 2005 and 2004

As has been the case for the previous eight fiscal years, the federal government did not maintain adequate systems or have sufficient reliable evidence to support certain material information reported in the U.S. government's consolidated financial statements. These material deficiencies, which generally have existed for years, contributed to our disclaimer of opinion on the U.S. government's consolidated financial statements for the fiscal years ended September 30, 2005, and 2004 and also constitute material weaknesses in internal control.[11] Appendix I describes the material deficiencies in more detail and highlights the primary effects of these material weaknesses on the consolidated financial statements and on the management of federal government operations. These material deficiencies were the federal government's inability to

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by the Department of Defense (DOD), were properly reported in the consolidated financial statements;
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;
- support significant portions of the total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain federal agencies;
- adequately account for and reconcile intragovernmental activity and balances between federal agencies;
- ensure that the federal government's consolidated financial statements were consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP; and
- resolve material differences that exist between the total net outlays reported in federal agencies' Statements of Budgetary Resources and the records used by Treasury to prepare the Statements of Changes in Cash Balance from Unified Budget and Other Activities.

[11]We previously reported that material deficiencies prevented us from expressing an opinion on the consolidated financial statements of the U.S. government for fiscal years 1997 through 2004.

Due to the material deficiencies and additional limitations on the scope of our work, as discussed in our audit report, there may also be additional issues that could affect the consolidated financial statements that have not been identified.

In addition to the material weaknesses that represented material deficiencies, which were discussed above, we found the following four other material weaknesses in internal control as of September 30, 2005. These weaknesses are discussed in more detail in appendix II, including the primary effects of the material weaknesses on the consolidated financial statements and on the management of federal government operations. These material weaknesses were the federal government's inability to

- implement effective processes and procedures for properly estimating the cost of certain lending programs, related loan guarantee liabilities, and value of direct loans;
- determine the extent to which improper payments exist;
- identify and resolve information security control weaknesses and manage information security risks on an ongoing basis; and
- effectively manage its tax collection activities.

Systems Problems at Agencies Continue to Hinder Accountability

For fiscal year 2005, 18 of 24 CFO Act agencies were able to attain unqualified opinions on their financial statements by the November 15, 2005, reporting deadline established by the Office of Management and Budget (OMB) (see app. III). The independent auditor of the Department of State subsequently withdrew its qualified opinion on the department's fiscal year 2005 financial statements and reissued an unqualified opinion on such financial statements dated December 14, 2005. As a result, 19 CFO Act agencies received unqualified opinions on their fiscal year 2005 financial statements. However, irrespective of these unqualified opinions, many agencies do not have timely, reliable, and useful financial information and effective controls with which to make informed decisions and ensure accountability on an ongoing basis. The ability to produce the data needed for efficient and effective management of day-to-day operations in the federal government and provide the necessary accountability to taxpayers and the Congress has been a long-standing challenge at most federal agencies.

The results of the fiscal year 2005 Federal Financial Managers Integrity Act of 1996 (FFMIA) assessments performed by agency inspectors general or their contract auditors show that certain problems continue to affect financial management systems at most CFO Act agencies. These problems include nonintegrated financial systems, lack of accurate and timely recording of data, inadequate reconciliation procedures, and noncompliance with accounting standards and the U.S. Government Standard General Ledger (SGL).[12] While the problems are much more severe at some agencies than at others, the nature and severity of the problems indicate that overall, management at most CFO Act agencies lack the complete range of information needed for accountability, performance reporting, and decision making.

FFMIA requires auditors, as part of the CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the SGL at the transaction level. The major barrier to achieving compliance with FFMIA continues to be the inability of agencies to meet federal financial management systems requirements, which involve not only core financial systems, but also administrative and programmatic systems.

For fiscal year 2005, auditors for 18 of the 24 CFO Act agencies reported that the agencies' financial management systems did not substantially comply with one or more of the FFMIA requirements noted above. For 5 of the remaining 6 CFO Act agencies, auditors provided negative assurance, meaning that nothing came to their attention indicating that the agencies' financial management systems did not substantially meet FFMIA requirements. The auditors for these 5 agencies did not definitively state whether the agencies' systems substantially complied with FFMIA requirements, as is required under the statute. In contrast, auditors for the Department of Labor provided positive assurance by stating that, in their opinion, the department's financial management systems substantially complied with the requirements of FFMIA. Further, auditors for the Department of Energy and the General Services Administration reported that those agencies' financial management systems did not substantially comply with FFMIA requirements in fiscal year 2005 due to recently

[12]The United States Standard General Ledger provides a uniform Chart of Accounts and technical guidance to be used in standardizing federal agency accounting.

identified internal control weaknesses over financial reporting. The auditors had not reported any FFMIA compliance issues at those 2 federal agencies in fiscal year 2004.

As individual agencies move forward with various initiatives to address FFMIA-related problems, it is important that consideration be given to the numerous governmentwide initiatives under way to address long-standing financial management weaknesses. OMB continues to move forward on new initiatives to enhance financial management and provide results-oriented information in the federal government. Two ongoing developments in this area in fiscal year 2005 were the realignment of responsibilities formerly performed by the Joint Financial Management Improvement Program and its Program Management Office and the development of financial management lines of business. The overall vision of these initiatives is to eliminate duplicative roles, streamline financial management improvement efforts, and improve the cost, quality, and performance of financial management systems by leveraging shared services[13] solutions.

Addressing Major Impediments to an Opinion on Consolidated Financial Statements

Three major impediments to our ability to render an opinion on the U.S. government's consolidated financial statements continued to be: (1) serious financial management problems at DOD, (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. Extensive cooperative efforts between agency chief financial officers, inspectors general, Treasury officials, and OMB officials will be needed to resolve these serious obstacles to achieving an opinion on the U.S. government's consolidated financial statements.

Financial Management at DOD

Essential to improving financial management governmentwide and ultimately to achieving an opinion on the U.S. government's consolidated

[13]As defined by the Association of Government Accountants (AGA), shared services represent "financial and administrative services provided by a single organization established to provide such services efficiently and effectively for the benefit of multiple organizations or entities". See AGA Corporate Partner Advisory Group Research, *Financial Management Shared Services: A Guide for Federal Users*, AGA CPAG Research Series: Report No. 2, July 2005.

financial statements is the resolution of serious weaknesses in DOD's business operations. DOD's financial management weaknesses are pervasive, complex, long standing, and deeply rooted in virtually all business operations throughout the department. To date, none of the military services or major DOD components has passed the test of an independent financial audit[14] because of pervasive weaknesses in business management systems, processes, and internal control. Of the 25 areas on GAO's governmentwide high-risk list, 8 are DOD programs or operations, and the department shares responsibility for 6 other high-risk areas that are governmentwide in scope.[15] These weaknesses adversely affect the department's (and the federal government's) ability to control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; prevent fraud, waste, and abuse; and address pressing management issues.

Effective management, reporting, and decision making depend upon information that is timely, reliable, and useful. Recent actions taken by the department to develop an integrated strategy to better understand and initiate efforts to systematically transform and address weaknesses in its business operations are encouraging. On September 28, 2005, DOD approved two key components of its transformation strategy: the Business Enterprise Architecture and the Business Transition Plan.[16] An enterprise architecture should provide a clear and comprehensive picture of an entity, whether it is an organization (e.g., a federal department) or a functional or mission area that cuts across more than one organization (e.g., financial management). This picture consists of snapshots of both the enterprise's current "As Is" operational and technological environment

[14]Although not major DOD components, the Military Retirement Fund received an unqualified audit opinion on its fiscal year 2005 financial statements, and the DOD Medicare Eligible Retiree Health Care Fund received a qualified audit opinion on its fiscal year 2005 financial statements.

[15] GAO, *High-Risk Series: An Update*, GAO-05-207 (Washington, D.C.: January 2005). The eight specific DOD high-risk areas are: (1) approach to business transformation, (2) business systems modernization, (3) contract management, (4) financial management, (5) personnel security clearance program, (6) supply chain management, (7) support infrastructure management, and (8) weapon systems acquisition. The six governmentwide high-risk areas are (1) disability programs, (2) interagency contracting, (3) information systems and critical infrastructure, (4) information sharing for homeland security, (5) human capital, and (6) real property.

[16]The Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. No. 108-375, §332, 118 Stat. 1811, 1851-1856 (Oct. 28, 2004) (codified, in part, at 10 U.S.C. §2222) required DOD to develop a Business Enterprise Architecture and Transition Plan.

and its target or "To Be" environment. A transition plan should provide the capital investment roadmap for transitioning from the current to the target environment by describing how and when new business systems will be developed and implemented. In November 2005, we reported[17] that while DOD had made important progress toward building a foundation upon which to improve its business operations, it did not fully satisfy the requirements of the Ronald W. Reagan National Defense Authorization Act for 2005.[18] For example, we reported that the architecture did not address how DOD would comply with federal accounting, financial, and reporting requirements, such as the United States Government Standard General Ledger.

In late December 2005, DOD issued its Financial Improvement and Audit Readiness (FIAR) Plan, a third major component of its business transformation strategy. According to DOD briefings, the "purpose of the FIAR Plan is to provide a roadmap to guide the department in improving financial management and achieving a clean audit opinion." Similar to an earlier DOD improvement effort, the Financial Improvement Initiative, the FIAR Plan utilizes an incremental approach to structure its process for examining its operations, diagnosing problems, planning corrective actions, and preparing for audit. However, unlike the previous plan, the FIAR Plan does not establish an overall goal of achieving a clean audit opinion on its departmentwide financial statements by a specific date. Rather, the FIAR Plan appears to recognize that it will take several years before DOD is able to implement the systems, processes, and other changes necessary to fully address its financial management weaknesses. In the interim, DOD plans to focus its initial efforts on four areas: (1) military equipment, (2) real property, (3) military retiree eligible health care fund liabilities, and (4) environmental liabilities. The FIAR Plan also focuses on the U.S. Marine Corps and the U.S. Army Corps of Engineers, Civil Works because these organizations intend to be ready for audit in fiscal years 2007 and 2008, respectively. As the FIAR Plan evolves, DOD intends to refine or include additional goals to improve processes and systems related to other balance sheet line items and financial statements.

[17]GAO, *DOD Business Systems Modernization: Important Progress Made in Establishing Foundational Architecture Products and Investment Management Practices, but Much Work Remains*, GAO-06-219 (Washington, D.C.: Nov. 23, 2005).

[18]Pub. L. No. 108-375, §332, 118 Stat. 1811, 1851 (Oct. 28, 2004).

There will need to be ongoing and sustained top management attention to business transformation at DOD to address what are some of the most difficult financial management challenges in the federal government. As we noted in our November 2005 testimony,[19] we continue to believe that the implementation of a new Chief Management Officer position at DOD will be needed in order for the department to succeed in its overall business transformation strategy. We will continue to monitor DOD's efforts to transform its business operations and address its financial management deficiencies as part of our continuing DOD business enterprise architecture work and our oversight of DOD's financial statement audit.

Intragovernmental Activity and Balances

Federal agencies are unable to adequately account for and reconcile intragovernmental activity and balances. OMB and Treasury require the CFOs of 35 executive departments and agencies to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners.[20] In addition, these agencies are required to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts as of the end of the fiscal year.

A substantial number of the agencies did not fully perform the required reconciliations for fiscal years 2005 and 2004. For fiscal year 2005, based on trading partner information provided in the Governmentwide Financial Reporting System discussed below, Treasury produced a "Material Difference Report" for each agency showing amounts for certain intragovernmental activity and balances that significantly differed from those of its corresponding trading partners. After analysis of the fiscal year 2005 "Material Difference Reports", we noted a significant number of CFOs were still unable to explain their material differences with their trading partners. For both fiscal years 2005 and 2004, amounts reported by federal agency trading partners for certain intragovernmental accounts were significantly out of balance. As a result, the federal government's ability to determine the impact of these differences on the amounts

[19]GAO, *Defense Management: Foundational Steps Being Taken to Manage DOD Business Systems Modernization, but Much Remains to be Accomplished to Effect True Business Transformation*, GAO-06-234T (Washington, D.C.: Nov. 9, 2005).

[20]Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

reported in the consolidated financial statements is impaired. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a commitment by federal agencies and strong leadership and oversight by OMB.

Preparing the Consolidated Financial Statements

The federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP. During fiscal year 2005, Treasury continued the ongoing development of a new system, the Governmentwide Financial Reporting System (GFRS), to collect agency financial statement information directly from federal agencies' audited financial statements. The goal of GFRS is to be able to directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements, a concept that we strongly support, and to resolve many of the weaknesses we have identified in the process for preparing the consolidated financial statements. For the fiscal year 2005 reporting process, Treasury's GFRS was able to capture certain agency financial information from agencies' audited financial statements, but GFRS was still not at the stage that it could be used to fully compile the consolidated financial statements from the information captured. Treasury did, however, make progress in demonstrating that amounts in the consolidated Balance Sheet and Statement of Net Cost were consistent with federal agencies' audited financial statements prior to eliminating intragovernmental activity and balances.

Closing Comments

In closing, given the federal government's overall financial condition and long-term fiscal imbalance, the need for the Congress and the President to have timely, reliable, and useful financial and performance information is greater than ever. Sound decisions on the current results and future direction of vital federal government programs and policies are made more difficult without such information. Until the problems discussed in our audit report are adequately addressed, they will continue to have adverse implications for the federal government and the taxpayers. It will also be key that the appropriations, budget, authorizing, and oversight committees hold agency top leadership accountable for resolving these problems and that they support improvement efforts.

Addressing the nation's long-term fiscal imbalance constitutes a major transformational challenge that may take a generation or more to resolve.

Given the size of the projected deficit, the U.S. government will not be able to grow its way out of this problem—tough choices will be required.

Traditional incremental approaches to budgeting will need to give way to more fundamental and periodic reexaminations of the base of government. Our report, *21st Century Challenges: Reexamining the Base of the Federal Government*,[21] is intended to support the Congress in identifying issues and options that could help address these fiscal pressures.

Further, the Congress needs to have access to the long-term cost of selected spending and tax proposals before they enact related laws. The fiscal risks previously mentioned can be managed only if they are properly accounted for and publicly disclosed, including the many existing commitments facing the federal government. New reporting approaches, as well as enhanced budget processes and control mechanisms, are needed to better understand, monitor, and manage the impact of spending and tax policies over the long term. In addition, a set of key national, outcome-based performance metrics would inform strategic planning, enhance performance and accountability reporting, and help to assess the impact of various spending programs and tax policies.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the subcommittee may have at this time.

GAO Contacts

For further information regarding this testimony, please contact Jeffrey C. Steinhoff, Managing Director, and Gary T. Engel, Director, Financial Management and Assurance, at (202) 512-2600.

[21]GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005).

Appendix I: Material Deficiencies

Material Deficiencies

The continuing material deficiencies discussed below contributed to our disclaimer of opinion on the federal government's consolidated financial statements for fiscal years 2005 and 2004. The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the consolidated financial statements, as described below.

Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that property, plant, and equipment (PP&E) and inventories and related property were properly reported in the consolidated financial statements. Most of the PP&E and inventories and related property are the responsibility of the Department of Defense (DOD). As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably the National Aeronautics and Space Administration, reported continued weaknesses in internal control procedures and processes related to PP&E.

Without reliable asset information, the federal government does not fully know the assets it owns and their location and condition and cannot effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.

Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. Further, the federal government could not determine whether commitments and contingencies, including those related to treaties and other international agreements entered into to further the U.S. government's interests, were complete and properly reported.

Problems in accounting for liabilities affect the determination of the full cost of the federal government's current operations and the extent of its liabilities. Also, improperly stated environmental and disposal liabilities

and weak internal control supporting the process for their estimation affect the federal government's ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, when disclosures of commitments and contingencies are incomplete or incorrect, reliable information is not available about the extent of the federal government's obligations.

Cost of Government Operations and Disbursement Activity

The previously discussed material deficiencies in reporting assets and liabilities, material deficiencies in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably related to DOD.

With respect to disbursements, DOD and certain other federal agencies reported continued weaknesses in reconciling disbursement activity. For fiscal years 2005 and 2004, there was unreconciled disbursement activity, including unreconciled differences between federal agencies' and the Department of the Treasury's records of disbursements and unsupported federal agency adjustments, totaling billions of dollars, which could also affect the balance sheet.

Unreliable cost information affects the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by federal agencies for inclusion in the President's budget concerning obligations and outlays.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

Federal agencies are unable to adequately account for and reconcile intragovernmental activity and balances. The Office of Management and Budget (OMB) and Treasury require the Chief Financial Officers (CFO) of 35 executive departments and agencies to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners.[1] In addition, these agencies are required to report to Treasury,

[1]Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts as of the end of the fiscal year.

A substantial number of the agencies did not fully perform the required reconciliations for fiscal years 2005 and 2004. For these fiscal years, based on trading partner information provided in the Governmentwide Financial Reporting System (GFRS), Treasury produced a "Material Difference Report" for each agency showing amounts for certain intragovernmental activity and balances that significantly differed from those of its corresponding trading partners. After analysis of the "Material Difference Reports" for fiscal year 2005, we noted a significant number of CFOs were still unable to explain the differences with their trading partners. For both fiscal years 2005 and 2004, amounts reported by federal agency trading partners for certain intragovernmental accounts were significantly out of balance. In addition, about 25 percent of the significant federal agencies reported internal control weaknesses regarding reconciliations of intragovernmental activity and balances. As a result, the federal government's ability to determine the impact of these differences on the amounts reported in the consolidated financial statements is impaired.

Preparation of Consolidated Financial Statements

Fiscal year 2005 was the second year that Treasury used its GFRS to collect agency financial statement information taken directly from federal agencies' audited financial statements. The goal of GFRS is to be able to directly link information from federal agencies' audited financial statements to amounts reported in the U.S. government's consolidated financial statements and resolve many of the weaknesses we previously identified in the process for preparing the consolidated financial statements. For both the fiscal year 2005 and 2004 reporting processes, GFRS was able to capture agency financial information, but GFRS was still not at the stage that it could be used to fully compile the consolidated financial statements from the information captured. Therefore, for fiscal year 2005 Treasury continued to primarily use manual procedures to prepare the consolidated financial statements. As discussed in the scope limitations section of our audit report, Treasury could not produce the fiscal year 2005 consolidated financial statements and supporting documentation in time for us to complete all of our planned auditing procedures. In addition, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with U.S.

generally accepted accounting principles (GAAP). Specifically, during our fiscal year 2005 audit, we found the following[2]

- Treasury's process for compiling the consolidated financial statements did not ensure that the information in all of the five principal financial statements and notes was fully consistent with the underlying information in federal agencies' audited financial statements and other financial data. Treasury made progress in demonstrating amounts in the Balance Sheet and the Statement of Net Cost were consistent with federal agencies' audited financial statements prior to eliminating intragovernmental activity and balances. However, about 25 percent of the significant federal agencies' auditors reported internal control weaknesses related to the processes the agencies perform to provide financial statement information to Treasury for preparing the consolidated financial statements.

- To make the fiscal years 2005 and 2004 consolidated financial statements balance, Treasury recorded a net $4.3 billion decrease and a net $3.4 billion increase, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which it labeled "Unreconciled Transactions Affecting the Change in Net Position."[3] An additional net $3.2 billion and $1.2 billion of unreconciled transactions were recorded in the Statement of Net Cost for fiscal years 2005 and 2004, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.

- The federal government did not have an adequate process to identify and report items needed to reconcile the operating results, which for fiscal year 2005 showed a net operating cost of $760 billion, to the budget results, which for the same period showed a unified budget deficit of $318.5 billion. In addition, a net $13.2 billion "net amount of all other differences" was needed to force this statement into balance.

[2]Most of the issues we identified in fiscal year 2005 existed in fiscal year 2004, and many have existed for a number of years. In May 2005, we reported in greater detail on the issues we identified in GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Continues to Need Improvement*, GAO-05-407 (Washington, D.C.: May 4, 2005). This report includes numerous recommendations to Treasury and OMB.

[3]Although Treasury was unable to determine how much of the unreconciled transactions, if any, relate to operations, it reported unreconciled transactions as a component of net operating cost in the consolidated financial statements.

- Treasury's ability to eliminate certain intragovernmental activity and balances continues to be impaired by the federal agencies' problems in handling their intragovernmental transactions. As discussed above, amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance, resulting in the need for unsupported intragovernmental elimination entries in order to force the Statement of Operations and Changes in Net Position into balance. In addition, significant differences in other intragovernmental accounts, primarily related to transactions with the General Fund, have not been reconciled and still remain unresolved. Therefore, the federal government continues to be unable to determine the impact of unreconciled intragovernmental activity and balances on the consolidated financial statements.

- Treasury lacked a process to ensure that fiscal years 2005 and 2004 consolidated financial statements and notes were comparable. Certain information reported for fiscal 2004 may require reclassification to be comparable to the fiscal year 2005 amounts. However, Treasury did not analyze this information or reclassify amounts within various financial statement line items and notes to enhance comparability. For example, the Reconciliations of Net Operating Cost and Unified Budget Deficit showed $47.8 billion and $.2 billion for property, plant, and equipment disposals and revaluations for fiscal years 2005 and 2004, respectively. However, based on the financial information provided by agencies to Treasury in GFRS, the fiscal year 2004 amount would be $25.4 billion. The difference would be reclassified from the net amount of all other differences line item on the Reconciliations of Net Operating Cost and Unified Budget Deficit.

- Treasury did not have an adequate process to ensure that the financial statements, related notes, Stewardship Information, and Supplemental Information are presented in conformity with GAAP. For example, we found that certain financial information required by GAAP was not disclosed in the consolidated financial statements. Treasury submitted a proposal to the Federal Accounting Standards Advisory Board (FASAB) seeking to amend previously issued standards and eliminate or lessen the disclosure requirements for the consolidated financial statements so that GAAP would no longer require certain of the information that Treasury has not been reporting. Comments are due to the FASAB today, on an exposure draft of a proposed FASAB standard, based on the Treasury proposal. Treasury stated that it is waiting for FASAB approval and issuance of this proposed standard to determine the disclosures that will be required in future consolidated financial statements. As a result of Treasury not providing us with adequate documentation of its rationale for excluding the currently required information and certain of the material

deficiencies noted above, we were unable again to determine if the missing information was material to the consolidated financial statements.

- Information system weaknesses existed within the segments of GFRS that were used during the fiscal years 2005 and 2004 reporting processes. We found that the GFRS database (1) was not configured to prevent the alteration of data submitted by federal agencies and (2) was used for both production and testing during the reporting processes. Therefore, information submitted by federal agencies within GFRS is not adequately protected against unauthorized modification or loss. In addition, Treasury was unable to explain why numerous GFRS users appeared to have inappropriate access to GFRS agency information or demonstrate the appropriate segregation of duties exist.

- Although Treasury made progress in addressing them, certain other internal control weaknesses in its process for preparing the consolidated financial statements continued to exist and involved a lack of (1) appropriate documentation of certain policies and procedures for preparing the consolidated financial statements, (2) adequate supporting documentation for certain adjustments made to the consolidated financial statements, and (3) necessary management reviews.

- The consolidated financial statements include financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, there are undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence or disclose in the consolidated financial statements that the excluded financial information was immaterial.

- Treasury did not have the infrastructure to address the magnitude of the fiscal year 2005 financial reporting challenges it was faced with, such as an incomplete financial reporting system, compressed time frames for compiling the financial information, and lack of adequate internal control over the financial statement preparation process. We found that personnel at Treasury's Financial Management Service had excessive workloads that required an extraordinary amount of effort and dedication to compile the consolidated financial statements; however, there were not enough personnel with specialized financial reporting experience to ensure reliable financial reporting by the reporting date.

- Treasury, in coordination with OMB, had not provided us with adequate documentation evidencing an executable plan of action and milestones for short-term and long-range solutions for certain internal control

weaknesses we have previously reported regarding the process for preparing the consolidated financial statements.

Net Outlays-A Component of the Budget Deficit

OMB Circular A-136, *Financial Reporting Requirements*, which incorporated and updated OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, states that outlays in federal agencies' Statement of Budgetary Resources (SBR) should agree with the net outlays reported in the *Budget of the United States Government*. In addition, Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires explanation of any material differences between the information required to be disclosed (including net outlays) in the financial statements and the amounts described as "actual" in the *Budget of the United States Government*.

The federal government reported in the Statement of Changes in Cash Balance from Unified Budget and Other Activities (Statement of Changes in Cash Balance) and the Reconciliations of Net Operating Cost and Unified Budget Deficit (Reconciliation Statement) budget deficits for fiscal years 2005 and 2004 of $318.5 billion and $412.3 billion, respectively. The budget deficit is calculated by subtracting actual budget outlays from actual budget receipts.[4] As we have reported since fiscal year 2003, we found material unreconciled differences between the total net outlays reported in selected federal agencies' SBRs and Treasury's central accounting records, which it uses to prepare the Statement of Changes in Cash Balance. Treasury's processes for preparing the Statement of Changes in Cash Balance do not include procedures for identifying and resolving differences between its central accounting records and net outlay amounts reported in agencies' SBRs.

In fiscal year 2004, we noted reported internal control weaknesses regarding certain agencies' SBRs. In fiscal year 2005, several agencies'

[4]In previous years, the Statement of Changes in Cash Balance reported actual budget outlays and actual budget receipts; however, beginning in fiscal year 2004, the federal government chose not to disclose budget outlays and budget receipts in this financial statement and only included the budget deficit. Receipts and net outlays (unified budget amounts) are also reported in governmentwide reports–specifically, in the President's Budget (annually); Treasury's *Final Monthly Treasury Statement*, as part of leading economic indicators on federal finances (quarterly); and Treasury's annual *Combined Statement of Receipts, Outlays, and Balances of the United States Government*.

auditors reported internal control weaknesses (1) affecting the agencies' SBRs, and (2) relating to monitoring, accounting, and reporting of budgetary transactions. These weaknesses could affect the reporting and calculation of the net outlay amounts in the agencies' SBRs. In addition, such weaknesses transcend to agencies' ability to also report reliable budgetary information to Treasury and OMB and may affect the unified budget outlays reported by Treasury in its *Combined Statement of Receipts, Outlays, and Balances*,[5] and certain amounts reported in the Budget of the United States Government.

OMB has been working with agencies to reduce the differences between the total net outlays reported in the federal agencies' SBRs and the Statement of Changes in Cash Balance. In June 2005, OMB issued its *Differences Between FY 2004 Budget Execution Reports and Financial Statements for CFO Act Agencies* report which discusses various types of differences in federal agency financial statements and budget execution reports, including net outlays, and makes recommendations for OMB and federal agencies to consider in improving both sets of reports in the future.

Until the material differences between the total net outlays reported in the federal agencies' SBRs and the records used to prepare the Statement of Changes in Cash Balance are timely reconciled, the effect of these differences on the U.S. government's consolidated financial statements will be unknown.

[5]Treasury's *Combined Statement of Receipts, Outlays, and Balances* presents budget results and cash-related assets and liabilities of the federal government with supporting details. Treasury represents this report as the recognized official publication of receipts and outlays of the federal government based on agency reporting.

Appendix II: Other Material Weaknesses

Other Material Weaknesses

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, 2005. In addition to the material deficiencies discussed in appendix I, we found the following four other material weaknesses in internal control.

Loans Receivable and Loan Guarantee Liabilities

Federal agencies continue to have material weaknesses and reportable conditions related to their lending activities. The Department of Housing and Urban Development lacked adequate management reviews of underlying data and cost estimation methodologies that resulted in material errors being undetected, and significant adjustments were needed. In addition, the Department of Education's processes do not provide for a robust budget-to-actual cost comparison or facilitate assessments of the validity of its lending program cost estimates. While the Small Business Administration made substantial progress to improve its cost-estimation processes, additional improvements are still needed to ensure that year-end reporting is accurate. These deficiencies plus others at the Department of Agriculture relating to the processes and procedures for estimating program costs continue to adversely affect the federal government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities. Further, these weaknesses and the complexities associated with estimating the costs of lending activities greatly increase the risk that significant errors in agency and governmentwide financial statements could occur and go undetected.

Improper Payments

While agencies have made progress in implementing processes and controls to identify, estimate, and reduce improper payments,[1] such improper payments are a long-standing, widespread, and significant problem in the federal government. The Congress acknowledged this problem by passing the Improper Payment Information Act of 2002 (IPIA).[2] The IPIA requires agencies to review all programs and activities, identify

[1]Improper payments include inadvertent errors, such as duplicate payments and miscalculations, payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.

[2]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).

those that may be susceptible to significant improper payments,[3] estimate and report the annual amount of improper payments for those programs, and implement actions to cost-effectively reduce improper payments. Further, in fiscal year 2005, the Office of Management and Budget (OMB) began to separately track the elimination of improper payments under the President's Management Agenda.

Significant challenges remain to effectively achieve the goals of the IPIA. From our review of agencies' fiscal year 2005 Performance and Accountability Reports (PARs), we noted that some agencies still have not instituted a systematic method of reviewing all programs and activities, have not identified all programs susceptible to significant improper payments, and/or have not annually estimated improper payments for their high-risk programs. For example, seven major agency programs with outlays totaling about $280 billion, including Medicaid and the Temporary Assistance For Needy Families programs, still cannot annually estimate improper payments, even though they were required by OMB to report such information beginning with their fiscal year 2003 budget submissions. In addition, two agency auditors that tested compliance with IPIA cited agency noncompliance with the act in their annual audit reports.

Federal agencies' estimates of improper payments, based on available information, for fiscal year 2005 exceeded $38 billion, a net decrease of about $7 billion, or 16 percent, from the prior year improper payment estimate of $45 billion.[4] This decrease was attributable to the following factors. In fiscal year 2005, the Department of Health and Human Services reported a $9.6 billion decrease in its Medicare program improper payment estimate, principally due to improvements in its due diligence with providers to ensure the necessary documentation is in place to support payment claims. However, in fiscal year 2005, this decrease was partially offset as a result of more programs reporting estimates of improper payments.

[3]OMB defines the term "significant improper payments" as "annual erroneous payments in the program exceeding both 2.5 percent of program payments and $10 million."

[4]In their fiscal year 2005 PARs, selected agencies updated their fiscal year 2004 improper payment estimates to reflect changes since issuance of their fiscal year 2004 PARs. These updates increased the governmentwide improper payment estimate for fiscal year 2004 from $45 billion to $46 billion.

Information Security

Although progress has been made, serious and widespread information security control weaknesses continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. GAO has reported information security as a high-risk area across government since February 1997. Such information security control weaknesses could result in compromising the reliability and availability of data that are recorded in or transmitted by federal financial management systems. A primary reason for these weaknesses is that federal agencies have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security control weaknesses, resolving information security problems, and managing information security risks on an ongoing basis. The Congress has shown continuing interest in addressing these risks, as evidenced with hearings on Federal Information Security Management Act of 2002[5] implementation and information security. In addition, the administration has taken important actions to improve information security, such as revising agency internal control requirements in OMB Circular A-123[6] and issuing extensive guidance on information security.

Tax Collection Activities

Material internal control weaknesses and systems deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities,[7] an issue that has been reported in our financial statement audit reports for the past 8 years. Due to errors and delays in recording taxpayer information, payments, and other activities, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden. In addition, the federal government did not always follow up on potential unreported or underreported taxes and did not always pursue collection efforts against taxpayers owing taxes to the federal government.

[5]Title III of the E-Government Act of 2002, Pub. L. No. 107-347, 116 Stat. 2899, 2946 (Dec. 17, 2002).

[6]OMB Circular No. A-123, *Management's Responsibility for Internal Control* (Revised December 21, 2004).

[7]GAO, *Financial Audit: IRS's Fiscal Years 2005 and 2004 Financial Statements*, GAO-06-137 (Washington, D.C.: Nov. 10, 2005).

Weaknesses in controls over tax collection activities continue to affect the federal government's ability to efficiently and effectively account for and collect revenue. Additionally, weaknesses in financial reporting of revenues affect the federal government's ability to make informed decisions about collection efforts. As a result, the federal government is vulnerable to loss of tax revenue and exposed to potentially billions of dollars in losses due to inappropriate refund disbursements.

Appendix III: Fiscal Year 2005 Audit Results

Table 2: CFO Act Agencies: Fiscal Year 2005 Audit Results, Principal Auditors, and Number of Other Audit Contractors

CFO Act agencies	Opinion rendered by agency auditor	Agencies' auditors reported material weaknesses or noncompliance	Principal auditor	Number of other audit contractors
Agency for International Development	Unqualified	√	OIG	2
Agriculture	Unqualified	√	OIG	3
Commerce	Unqualified	√	KPMG LLP	0
Defense	Disclaimer	√	OIG	1
Education	Unqualified	√	Ernst & Young, LLP	0
Energy	Disclaimer	√	KPMG LLP	0
Environmental Protection Agency	Unqualified	√	OIG	0
General Services Administration	(a)	√	PricewaterhouseCoopers LLP	0
Health and Human Services	Unqualified	√	Ernst & Young, LLP	2
Homeland Security	Disclaimer	√	KPMG LLP	0
Housing and Urban Development	Unqualified	√	OIG	1
Interior	Unqualified	√	KPMG LLP	0
Justice	Unqualified	√	KPMG LLP	2
Labor	Unqualified		R. Navarro & Associates, Inc.	1
National Aeronautics and Space Administration	Disclaimer	√	Ernst & Young, LLP	0
National Science Foundation	Unqualified		KPMG LLP	0
Nuclear Regulatory Commission	Unqualified	√	R. Navarro & Associates, Inc.	0
Office of Personnel Management	Unqualified	√	KPMG LLP	0
Small Business Administration	Unqualified	√	Cotton and Company LLP	0
Social Security Administration	Unqualified		PricewaterhouseCoopers LLP	2
State	(b)	√	Leonard G. Birnbaum and Company, LLP	4
Transportation	Unqualified	√	OIG	3
Treasury	Unqualified	√	KPMG LLP	5
Veterans Affairs	Unqualified	√	Deloitte & Touche LLP	0

Source: GAO.

[a]In 2005, GSA received an unqualified opinion on its Balance Sheet, Statement of Changes in Net Position, and Statement of Net Cost, and a disclaimer of opinion on its Statement of Budgetary Resources and Statement of Financing.

[b]The independent auditors of the Department of State's fiscal year 2005 financial statements issued a qualified opinion because they were not able to examine evidence regarding personal property in time to meet the November 15, 2005, reporting deadline. In late December, GAO was informed by the Acting Chief Financial Officer for the Department of State that subsequent to the issuance of the qualified opinion, the independent auditors satisfied themselves about the amounts presented as personal property. As a result, the auditors issued an unqualified opinion on the Department of State's fiscal year 2005 financial statements dated December 14, 2005.

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CFO Act Agencies

Fiscal Year 2005 Audit Results

CFO Act agencies	Opinion rendered by agency auditor	Agencies auditors reported material weaknesses or noncompliance	Agencies restated FY 2004 financial statements
Agency for International Development	Unqualified	✔	✔
Agriculture	Unqualified	✔	
Commerce	Unqualified	✔	
Defense	Disclaimer	✔	✔
Education	Unqualified	✔	
Energy	Disclaimer	✔	
Environmental Protection Agency	Unqualified	✔	
General Services Administration	(a)	✔	
Health and Human Services	Unqualified	✔	
Homeland Security	Disclaimer	✔	✔
Housing and Urban Development	Unqualified	✔	✔
Interior	Unqualified	✔	
Justice	Unqualified	✔	✔
Labor	Unqualified		
NASA	Disclaimer	✔	
National Science Foundation	Unqualified		
Nuclear Regulatory Commission	Unqualified	✔	
Office of Personnel Management	Unqualified	✔	
Small Business Administration	Unqualified	✔	
Social Security Administration	Unqualified		
State	(b)	✔	✔
Transportation	Unqualified	✔	✔
Treasury	Unqualified	✔	
Veterans Affairs	Unqualified	✔	

Source: GAO.

(a) In 2005, GSA received an unqualified opinion on its Balance Sheet, Statement of Changes in Net Position, and Statement of Net Cost, and a disclaimer of opinion on its Statement of Budgetary Resources and Statement of Financing.

(b) The independent auditors of the Department of State's fiscal year 2005 financial statements issued a qualified opinion because they were not able to examine evidence regarding personal property in time to meet the November 15, 2005 reporting deadline. In late December, GAO was informed by the Acting Chief Financial Officer for the Department of State that subsequent to the issuance of the qualified opinion, the independent auditors satisfied themselves about the amounts presented as personal property. As a result, the auditors issued an unqualified opinion on the Department of State's fiscal year 2005 financial statements dated December 14, 2005.

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Fiscal Year 2004 and 2005 Deficits and Net Operating Costs

	Fiscal Year 2004	Fiscal Year 2005
	($ in Billions)	
On-Budget Deficit	(568)	(494)
Off-Budget Surplus*	155	175
Unified Deficit	(413)	(319)
Net Operating Cost	(616)	(760)

Source: The Office of Management and Budget and the Department of the Treasury.

*Includes $151 billion in fiscal year 2004 and $173 billion in fiscal year 2005 in Social Security surpluses and $4 billion in fiscal year 2004 and $2 billion in fiscal year 2005 in Postal Service surpluses.

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Estimated Fiscal Exposures

($ in Trillions)

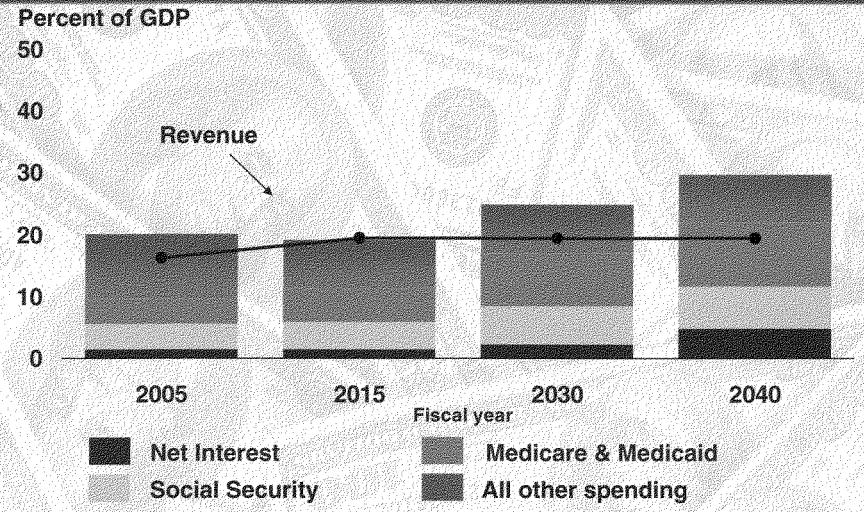
	2000	2005
• Explicit liabilities	$6.9	$9.9
• Publicly held debt		
• Military & civilian pensions & retiree health		
• Other		
• Commitments & contingencies	0.5	0.9
• E.g., Pension Benefit Guarantee Corporation, undelivered orders		
• Implicit exposures	13.0	35.6
• Future Social Security benefits	3.8	5.7
• Future Medicare Part A benefits	2.7	8.8
• Future Medicare Part B benefits	6.5	12.4
• Future Medicare Part D benefits	--	8.7
Total	$20.4	$46.4

Source: U.S. government's consolidated financial statements (CFS).

Note: Estimates for Social Security and Medicare are at present value as of January 1 of each year as reported in the CFS and all other data are as of September 30.

Composition of Spending as a Share of GDP

Under Baseline Extended



Source: GAO's January 2006 analysis.

Note: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2016 due to (1) real bracket creep, (2) more taxpayers becoming subject to the alternative minimum tax (AMT), and (3) increased revenue from tax-deferred retirement accounts. After 2016, revenue as a share of GDP is held constant.

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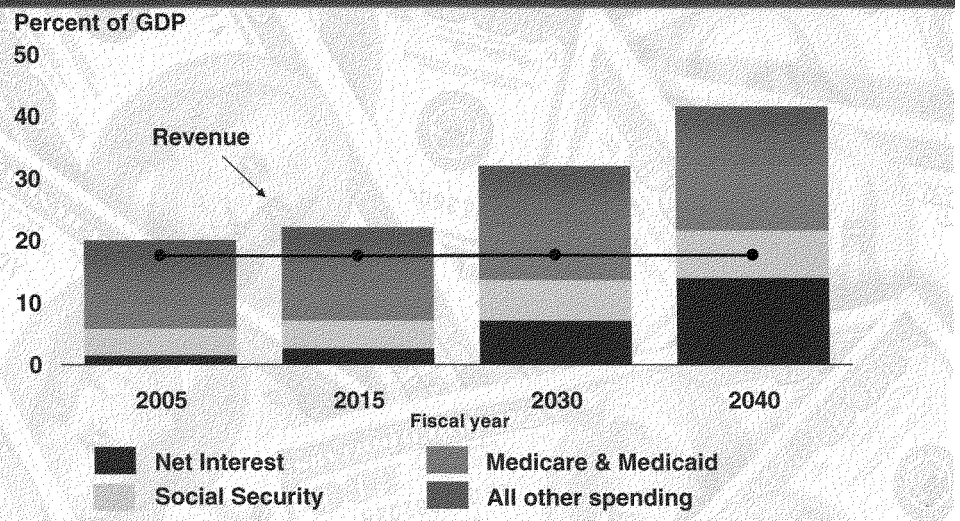
Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2006 and All Expiring Tax Provisions are Extended



Source: GAO's January 2006 analysis.

Note: This includes certain tax provisions that expired at the end of 2005, such as the increased alternative minimum tax (AMT) exemption amount.

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Mr. PLATTS. Thank you, Comptroller General Walker, and again, appreciate your frank testimony. One of the most important roles in Washington is yours, in trying to get the truthful and honest assessment of the financial state of our Nation today and in the future. Your charts do a good job, and we will get into it further with questions of bringing it all together. As you said, that is one of the challenges because there are numbers all over. And, truly, as a parent of a 6-year-old and 9-year-old, to think they will be in their mid forties in 2040, and you look at those numbers, and a third of our expenditure is just going to be interest. What is left for truly critical programs of the Federal Government? It is a scary picture.

Mr. WALKER. Mr. Chairman, you are doing it the right way, because this is about a lot more than numbers. It is about values, it is also about the future of the country, our children and our grandchildren. You are looking at it the right way, what burdens are your children going to have to bear under the path that we're on? What kind of tax levels? What kind of other burdens? What kind of choices are they going to have if we don't start making some changes?

Thank you.

Mr. PLATTS. I have a good friend in the State house, he would look at that and say what you are setting our Nation up for is inter-generational divide, between those on Social Security and Medicare, families and children, and if we don't make some changes now there is no ability to accommodate the needs and interest of all of those different groups. So, again, your frank assessment is much appreciated, and hopefully, well-shared publicly. We certainly are doing our best to allow your data to be known.

Mr. Hammond.

STATEMENT OF DONALD V. HAMMOND

Mr. HAMMOND. Thank you, Mr. Chairman, Ranking Member Towns. I appreciate the opportunity to be here today to talk about the financial report of the Government for fiscal year 2005. And echoing the Comptroller General's comments, the committee's sustained attention over the years to these matters has really led to significant progress and improvements. We greatly appreciate that.

I would ask that you include the full text of my statement in the record.

Mr. PLATTS. Without objection, so ordered.

Mr. HAMMOND. With my time I would like to just briefly touch on a few high points from that written statement, briefly, the results themselves from fiscal year 2005, the actions we are taking to resolve the auditors' finding and recommendations, our plans to make the report more useful, and what I think are the important next steps in the future of Federal financial reporting.

I am pleased that this year, for the second time, we were able to issue the report on December 15th. Even as important, every one of the CFO Act agencies, all 24 of them, issued their reports by November 15th. So timeliness, acceleration in particular, has become not only a priority but it has become a reality. These much more timely submissions are evidence that both Treasury and the agencies have improved their processes, systems and data. Yet, as you

have already heard, evidenced by the GAO's audit report, more needs to be done.

The financial report stated that the Government's fiscal year 2005 net operating cost was $760 billion. You have seen the comparable numbers. The Comptroller General has a chart, as you have seen this afternoon, that displays 2004, evidencing the increase in the net operating costs, while at the same time the budget deficit declined year over year. I think this highlights the importance of financial reporting. It highlights the need to look at things in different ways, and use the different methods of accounting. They complement each other, and it is an important aspect that we need to pay attention to, reinforcing the value of this hearing.

In addition to reporting the financial results of the past year, the financial report provides information on our long-term financial commitments and obligations for programs such as Social Security and Medicare. This information is presented in the report, in the Statement of Social Insurance, which will be a primary statement subject to audit in fiscal year 2006, this coming year.

My written statement includes a summary of these important calculations. Due to longstanding material weaknesses, GAO was unable to express an opinion on the statements, and I recognize that until our statements can withstand audit scrutiny, we will not benefit from the report's full value in informing the Congress and the public of the Government's fiscal position.

We are in agreement with GAO on these principal material weaknesses. Across Government we have been addressing these challenges and we are making progress. The Department of Defense is making headway in improving its systems to correct its financial reporting problems, however, this will be a long time consuming effort. In addition to Defense, Homeland Security and NASA also have significant financial issues, particularly as they relate to property, plant and equipment.

Another significant material weakness is the out-of-balance condition that results from intergovernmental transactions when two agencies record and report differently on a transaction between themselves. We are addressing this critical issue on many fronts, including the active involvement of the CFO Council and agency auditors. I believe that this full array of actions and attention will lead to an improved recording of these transactions and help correct imbalances.

Regarding GAO's findings and recommendations on the preparation of the report, we continue to take steps to address these. We have developed detailed, multi-year corrective action plans and are addressing the material weaknesses. Treasury continues to meet with GAO regularly to discuss the findings and recommendations in detail, and this past year we initiated a process to formally communicate the recommendations that we believe are closed, and will continue this ongoing dialog with GAO. This is the second year that we have used the GFR system to prepare the report, and it has provided us with the opportunity to allow the agencies to take ownership and responsibility for the data provided into the report. This has proved to be a very effective and useful element of the compilation process, and one that I think will bring dividends for years to come.

I should note that each agency was able to meet and report its information into the system this year on time, meeting all the applicable deadlines, which was in and of itself quite an accomplishment. With regard to what is actually disclosed in the report, I testified last year that the Federal Accounting Standards Advisory Board undertook a project to provide explicit consideration of disclosures tailored to the financial report. They have issued an exposure draft, and we expect that if the exposure draft becomes a standard, it will resolve many of the remaining disclosure-related findings.

We have now reached an appropriate point to ask whether our financial reports are useful, and whether they serve as an informative report to the citizens. Clearly, if we want to publish Government financial information that is used more broadly, not just by the dedicated reader, we need to do some things differently. The first question we need to ask is who is our audience? That answered, we need to think seriously about what we have in the report that is of value to them. We must then act to provide them with a better product in order to meet those needs.

I welcome this challenge, and I am frankly committed to doing exactly that. For example, we recently reached outside Treasury for suggestions and ideas for improving the Governmentwide report, seeking advice from a wide range of interested parties. Those discussions were both productive and very informative.

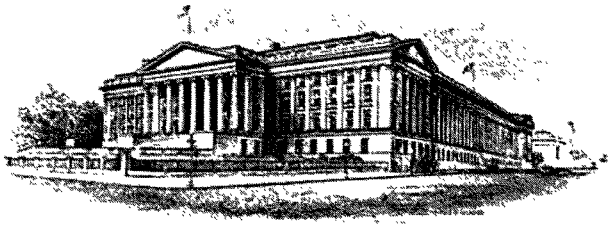
I am also committed to working with OMB and the Chief Financial Officers' Council on developing the Government's financial management strategy for the near future. The improvements in financial systems and business processes that many agencies have made has led to better underlying financial data. We're looking for improved efficiency in the future. To better focus on these objectives, the CFO Council has recently changed its committee structure. As part of this effort, I will co-chair a transformation team that will be devoted to Treasury reporting issues, both budgetary and financial.

I believe that this effort will lead to both near-term efficiencies, and set the stage for changes over the longer term. Agencies are also putting in place improved internal controls, which are essential for improving data reliability and fostering improved reporting and accountability. The improved systems and processes and better internal controls should help reduce restatements and lay the groundwork for further improvements and efficiencies. These enhanced processes can in fact serve as the basis of opportunity for more frequent financial reporting, development of cost accounting data useful to program managers and decisionmakers and other advanced financial management practices.

In conclusion, I want to thank you again for your sustained interest. I am very proud to have been part of the significant progress that has been made over the last few years in Government financial reporting, but as you have heard, we still have a long way to go.

Thank you again, and I am happy to answer any questions the committee may have.

[The prepared statement of Mr. Hammond follows:]



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Statement of Donald V. Hammond
U.S. Department of the Treasury Fiscal Assistant Secretary
before the
House Government Reform Subcommittee on
Government Management, Finance and Accountability
March 1, 2006

Financial Report of the United States Government for Fiscal Year 2005

Mr. Chairman and Members of the Subcommittee:

I appreciate your inviting me here today to discuss the *Financial Report of the United States Government* for fiscal year 2005. The Treasury Department greatly appreciates your continued focus on improving the Federal Government's financial management and reporting. Your sustained attention to these issues highlights their importance and has led to significant improvements. Today I will briefly discuss the fiscal year 2005 financial results including the report's long-range, accrual-based look at the government's liabilities, commitments, and responsibilities. I will describe the actions we are taking to resolve the auditor's findings and recommendations and our plans to make the report more useful. Finally, I will tell you what I believe are the next steps we need to take in government financial reporting.

The annual financial report reflects Treasury's long-standing responsibility to provide the Congress and the public with financial information on the government's

operations. Treasury has fulfilled its core responsibility to report on the nation's finances since Treasury Secretary Alexander Hamilton gave his first report to the Congress in 1790. Our intent is to give you, the Congress, and the public, a timely, reliable, and useful report on the cost of the government's operations, the sources used to fund them, and the implications of the government's financial commitments. The report is designed to encompass the financial results of all three branches of the federal government. We are constantly striving to improve how we carry out these responsibilities.

I'm pleased that this year, as in 2004, we were again able to issue this report on December 15. In addition, this year, all 24 CFO Act agencies published their audited financial statements by November 15. These much more timely submissions are evidence that both Treasury and the agencies have improved their processes, systems and data. While we have improved the timeliness of our reporting and made significant improvements in data reliability, we still have a long way to go. Once again this year, due to long-standing material weaknesses, GAO issued a disclaimer of opinion on the statements. Later in my testimony, I will discuss GAO's findings and recommendations in more detail and describe the steps we are taking to address them.

FY 2005 Results

As Treasury and OMB reported in October, the growing economy increased revenues to a level of $2.2 trillion. This was nearly a 15 percent increase over the previous fiscal year and the largest year-over-year percentage increase in receipts in over 20 years. Consequently, the 2005 federal budget deficit of $318 billion, as reported in the President's Budget, was lower than anticipated and lower than the 2004 deficit of $413 billion. When expressed as a percent of Gross Domestic Product, the 2005 deficit was lower than the deficits in 16 of the last 25 years and was on track to meet the President's deficit-reduction goals.

We reported on December 15 in the Financial Report that the government's FY 2005 *net operating cost* was $760 billion. The comparable net operating cost in 2004 was $616 billion. Thus, while the budget deficit improved from 2004 to 2005, the net operating cost increased. The different amounts and trends stated for the budget deficit and the net operating cost stem from the different methods of accounting used for the two reports. The budget report is prepared on a cash basis, the Financial Report on an accrual basis. For FY 2005, the difference of $442 billion between budget deficit and net

operating cost is primarily due to actuarial increases in federal employee pension and health liabilities, and an increase in actuarial costs of veterans' benefits, due to changes in assumptions in Veterans Affairs' actuarial model that calculates the liability. Examples of some of these assumptions are: the number of veterans and dependents receiving payments, discount rate, cost of living adjustments, and life expectancy.

Reconciliations of Net Operating Cost and Budget Deficits
(In billions of dollars)

	2005	2004
Net Operating Cost	($760)	($616)
Changes:		
Veterans' benefits liability	198	(30)
Federal employee benefits	232	212
Increase in capitalized assets	(36)	(3)
Other, Net	48	24
	442	203
Budget Deficit	($318)	($413)

In preparing the Financial Report's statement of net cost, Treasury makes consolidating entries and cost allocation adjustments to individual agency results in accordance with generally accepted accounting principles (GAAP). Two of the largest of these adjustments are financial transactions between agencies and retirement benefits managed by the Office of Personnel Management. Transactions between agencies, internal to the government as a whole, are viewed as double counting under GAAP and must be eliminated so that only the net results are shown on the government's statements. The retirement benefits managed by OPM relate to the agencies where employees worked during their career. Accordingly, standards require that we allocate these costs to the agencies to better reflect each agency's full costs. The attached schedule, Appendix I, shows these adjustments.

Summary of Social Insurance Responsibilities

In addition to reporting the financial results of the past year, the Financial Report provides information on our long-term financial commitments and obligations. One important measure of the government's fiscal position is the present value cost of its

responsibilities for social insurance programs, primarily Social Security and Medicare. Including these future financial responsibilities in this report gives a more complete look at the government's finances. This information is presented in the report on the Statement of Social Insurance, which will be a primary statement subject to audit in the FY 2006 report.

Each year, the Social Security and Medicare Trustees report on the current financial status of those programs and provide 75-year projections of program income and expenditures. The latest set of projections from the Trustees shows that the 75-year present value of Social Security and Medicare obligations for the Federal Government is $35.6 trillion. I have attached a summary table of the projections as Appendix II.

The trustees project that costs for Social Security and Medicare, relative to GDP, will increase sharply between 2010 and 2030 because the number of people receiving benefits will increase rapidly as the large baby-boom generation retires. Thereafter, growth in Social Security costs will be slower, but will continue to increase due primarily to projected increasing life expectancy. Medicare costs are projected to continue to grow rapidly due to expected increases in the use and costs of health care.

Addressing the Auditor's Findings

As I mentioned earlier, due to long-standing material weaknesses, GAO was unable to express an opinion on the statements. I recognize that until our statements can withstand audit scrutiny, we will not benefit from the report's full value in informing the Congress and the public of the government's fiscal position. We are in agreement with GAO on these principal material weaknesses:

(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,
(3) the federal government's ineffective process for preparing the consolidated financial statements.

GAO raised many valid points in their audits, and there is no one who would like to see us get a "clean" audit opinion on this report more than I would. Across government, we have been addressing these challenges, and we are making progress. The Department of Defense is making headway in improving its systems to correct its financial reporting problems; however, this will be a long, time-consuming effort. In addition to Defense, Homeland Security and NASA also have some significant financial issues. The Department of Homeland Security, when it was organized, brought together 22 agencies, all, for the most part, having their own financial systems. Consequently DHS faces some large financial management challenges, but it is making progress. NASA, which has had weaknesses in internal control procedures and processes related to property, plant and equipment, has made significant progress in FY 2005 in correcting some internal control weaknesses, but still has much to do to resolve this issue.

We concur with GAO that a significant material weakness is the out-of-balance condition that results from intragovernmental transactions, when two agencies record and report differently on a transaction between the two. We are addressing this issue in several ways. First, we are requiring significantly greater detail from the agencies, and we have developed a new tool to track the imbalances, point out where problems exist, and help us better analyze the data. Surprisingly, we discovered that many of the largest differences occur when two agencies record a statutory transfer of budget authority and funds between them. Also, when two agencies conduct business with each other as *trading partners*, they sometimes record and report the same transaction differently.

Second, partnering with OMB, we developed reports that show these inter-agency transfers throughout the government. We find that agencies use these reports, which we post on the web, to analyze their transfers. Third, we brought the agencies together to discuss these matters under the auspices of the Chief Financial Officers Council. Fourth, we have been working with the CFO Council to develop new "business rules" for these intragovernmental transactions, and we believe these new rules will help bring about more consistent accounting transactions. Finally, we required agency auditors to review the out-of-balance condition between their agency and its trading partners in the hope that greater auditor involvement will encourage the agency to accurately record these transactions and correct these imbalances. We plan on expanding these auditor reviews to further assist agencies in resolving their differences, some of which are of long standing.

Regarding GAO's findings and recommendations on the report preparation process, we continue to take steps to address these. We have developed detailed corrective actions plans and are addressing the material weaknesses. Some of the individual plans have solutions which are or will be implemented in a short time period while others will take longer than a year to resolve. Treasury continues to meet with GAO regularly to discuss the findings and recommendations in detail. This past year, we initiated a process to formally communicate to GAO the recommendations that we believe are closed, and we will continue the dialogue with GAO on these issues. In recent discussions with GAO, we agreed to supplement this process with additional documentation to provide the level of assurance GAO requires to close out the recommendations. This year GAO closed out over 20 outstanding recommendations, and they will continue to evaluate the documentation and analyses provided by Treasury on open recommendations.

This is the second year that the Financial Management Service (FMS) has used the Governmentwide Financial Report System (GFRS) to prepare the report. GFRS is an internet application designed to directly link data from agencies' financial statements to the corresponding line items in the Financial Report. Prior to this, the financial information came from other Treasury financial systems that may or may not have tied to the agencies' audited financial statements. GFRS, through a closing package process, requires the agencies to reclassify the financial statement line items from their audited financial reports to the corresponding line items in the Financial Report. It provides the agencies the opportunity to take the responsibility for how their data should be properly consolidated. It also requires the agencies to provide additional financial disclosure information and stewardship information crucial to understanding and supplementing the content of the primary statements.

In developing GFRS, FMS considered and implemented GAO's audit findings on the preparation process. Some findings were specifically related to the manner in which GFRS captured information from the agencies. To address this, FMS modified GFRS to improve the data entry and linkage by the agencies to their audited financial statements. To address recommendations on policies and procedures for GFRS and the resultant compilation process, FMS improved the instructions to the agencies in the Treasury Financial Manual and its internal policies and procedures related to internal control, documentation and management review.

FMS made other improvements in the 2005 process. One of these was accelerating by three days the collection of the budgetary financial information. Also, using lessons learned during the 2004 reporting process, FMS implemented two key processes to ensure agency reporting success in 2005. FMS staff were available after normal working hours to answer agency questions and resolve system problems. FMS also developed and used new analytical tools to specifically identify potential reporting errors and non-submissions and provided timely feedback to the agencies. All the agency preparers met their November 16 deadline for submitting the data, and agency IGs met the November 18 deadline to opine on the data submitted in GFRS. Evidence of the success of GFRS implementation is that agencies were able to submit their data earlier than in the prior years, and this enabled FMS to compile and transmit the Financial Report to the auditor within 10 days of receiving the agency financial information in GFRS.

Finally, many of GAO's findings related to the note disclosures in the report. As I testified last year, the Federal Accounting Standards Advisory Board (FASAB) undertook a project to provide explicit consideration of disclosures tailored to the financial report and specifically related to standards issued prior to January 2003. As a result, FASAB has issued an exposure draft that proposes tailored disclosures that would enhance the financial report's usefulness to the public and be consistent with a general purpose report. The proposed standard would require that the report direct readers to the individual agency financial reports for extensive disclosures that are not viewed as appropriate at the governmentwide level. We expect that if the exposure draft becomes a standard, it will resolve many of the remaining findings

Making the Report More Useful

We have improved our preparation process and are producing more timely reports. Because we had to produce the reports within these accelerated timeframes, we all had to improve our processes and in many cases, our systems. While the acceleration in and of itself improves government reporting, we now must ask whether our financial reports are useful to Congress, to agency heads and other decision makers and whether they serve as a useful and informative report to the citizens.

We recently reached outside Treasury for suggestions and ideas for improving the governmentwide report. We sought advice from the Government Accountability Project

at the Mercatus Center at George Mason University and also from the Partnership for Public Service, and we have incorporated several of their suggestions in the 2005 report. In January, we held a roundtable discussion with Congressional staff, public accounting professionals, analysts from credit rating agencies, economists and interested members of the public to ask their advice on possible report improvements. We received many excellent suggestions and are reviewing them to see how we can prepare a better, more useful report. We are already exploring one suggestion to offer a shorter, more understandable summary report.

Clearly, if we want to publish government financial information that is used more broadly, not just by the dedicated reader, we need to do some things differently. The first question we need to ask is, "Who is our audience?" That answered, we need to think seriously about what we have in the report that is of value to them. We must then act to provide them with a better product and service. I welcome this challenge and am committed to doing this.

Outlook for Federal Reporting

I am also committed to working with OMB and the Chief Financial Officers Council on developing the government's financial management strategy for the near future. The improvements in financial systems and business processes that many agencies have made as a result of audited statements and accelerated timelines has led to better underlying financial data. We are now looking toward improving efficiency through standard systems and processes and a common language and structure for exchanging information and financial data among agencies and between agencies and Treasury.

To better focus on the objectives it wants to achieve, the CFO Council has just changed its committee structure and organized along lines that will transform federal financial management. Among these are modernizing systems and increasing standardization across the government through standard processes, interfaces and data. The goal is to improve financial management, increase efficiency, and also to reduce costs through the use of shared service providers. Closer to home, I will co-chair a transformation team that will examine Treasury reporting issues, both budgetary and financial. I believe that this effort will not only lead to near-term efficiencies, but will also set the stage for changes over the longer term.

Agencies are also putting in place improved internal controls, which are essential for improving data reliability and fostering improved reporting and accountability. All agencies are now operating under a stronger governmentwide policy to establish, assess and report on internal controls. The objectives are to achieve effective and efficient operations, reliable financial reporting, and compliance with laws and regulations. The improved systems and processes and better internal controls should help reduce restatements and lay the groundwork for further improvements and efficiencies. These enhanced processes can serve as the base of opportunity for more frequent financial reporting, development of cost accounting data useful to program managers and decision makers, and other advanced financial management practices.

In conclusion, I believe we have come a long way, but we still have a long way to go. Our upcoming challenges are significant but manageable, and I am confident that we will continue to see real progress. Thank you.

Appendix I

Consolidation of Net Costs in the Financial Report of the U.S. Government for the Year Ended September 30, 2005
(in billions of dollars)

	Agency Net Cost	Adjust-ments	Intra-Gov. Elim	Imputed Costs	Pension & Health Allocation	FR Net Cost
Department of Agriculture	$91.0	-	$(5.2)	$0.7	$6.2	$92.7
Department of Commerce	6.3	-	(0.8)	0.2	2.0	7.7
Department of Defense	634.9	-	0.4	4.5	37.2	677.0
Department of Education	75.2	-	(4.8)	-	0.5	70.9
Department of Energy	40.9	0.6	(3.9)	4.2	1.3	43.1
Department of Health and Human Services	581.3	-	(1.0)	0.3	3.2	583.8
Department of Homeland Security	66.4	-	(2.7)	0.7	3.5	67.9
Department of Housing and Urban Development	40.4	-	1.0	0.1	0.8	42.3
Department of the Interior	13.4	-	(1.4)	0.5	3.8	16.3
Department of Justice	24.3	(0.2)	(3.0)	0.7	4.7	26.5
Department of Labor	50.4	0.5	2.0	(4.0)	1.1	50.0
Department of State	12.0	(0.1)	0.5	0.1	1.1	13.6
Department of Transportation	56.9	-	(1.9)	0.5	6.3	61.8
Department of the Treasury	364.9	(125.9)	(166.3)	-	6.5	79.2
Interest on Treasury Securities held by the public	-	181.2	-	-	-	181.2
Department of Veterans Affairs	263.4	-	(1.7)	1.4	10.1	273.2
Agency for International Development	12.3	0.4	-	-	0.1	12.8
Environmental Protection Agency	8.0	-	(0.5)	0.1	1.3	8.9
General Services Administration	(0.8)	-	(0.4)	0.1	0.9	(0.2)
National Aeronautics and Space Administration	15.2	-	(0.4)	0.1	1.5	16.4
National Science Foundation	5.4	-	-	-	0.1	5.5
Nuclear Regulatory Commission	0.1	-	(0.1)	0.1	0.3	0.4
Office of Personnel Management	63.6	-	70.0	(11.1)	(103.8)	18.7
Small Business Administration	0.8	0.1	(0.2)	-	0.3	1.0
Social Security Administration	568.2	2.3	(1.4)	0.5	4.5	574.1
All Other Non-CFO Act Entities	21.3	8.4	(11.5)	0.3	6.5	25.0
Total	$3,015.8	$ 67.3[1]	$(133.3)	-	-	$ 2,949.8

[1] Includes adjustments for Earned Income Tax Credit (EITC), $40 billion and Child Tax Credit, $15 billion.

Appendix II

Social Security and Medicare Programs
Present Values of Future Expenditures less Future Revenues
(75-year projections)

(in billions of dollars)

Program – (Trust Fund)	2005	2004
Social Security (Fed. Old-Age, Survivors & Disability Ins.)	$5,704	$5,229
Medicare Part A (Fed. Hospital Insurance)	8,829	8,492
Medicare Part B (Fed. Supplementary Medical Insurance)	12,384	11,440
Medicare Part D (Fed. Supplementary Medical Insurance)	8,686	8,119
TOTAL	$35,603	$33,280

Source: 2004 and 2005 Social Security and Medicare Trustees Reports

Mr. PLATTS. Thank you, Mr. Secretary, we appreciate your testimony and the work of you and your staff day in and day out throughout the year.

Jumping to questions, Mr. Walker, you touched on it with your opening statement, just the way things are reported, it takes some effort under the current model to bring it all together. I know you have shared in the past some specifics. If you want to get into some details of how to rework the model to give a more honest assessment to the American public, so that it is easier to understand as opposed to having to bring everything together, but it is just laid out from the get-go. If you want to expand on that, that will be great.

Mr. WALKER. Well, first let me say I am disappointed to have to say that very, very few individuals read the annual financial report of the U.S. Government. I give many speeches inside and outside the beltway during a given year, and one of the things that I have done recently is to ask for a show of hands as to how many individuals have read the financial statements of the U.S. Government. It is well less than 1 percent of all of the audiences that I have addressed, and some of those audiences were comprised exclusively of financial professionals. So that is very disappointing.

Frankly, I think one of the problems is, in today's world, where we have information overload, we need to make this much more user friendly, and there are three projects in particular that the principals of the Joint Financial Improvement Program are working on right now that are relevant to your question, Mr. Chairman. The first is, I believe very strongly that we need to publish a summary annual report that is both useful and used. When I was a trustee of the Social Security and Medicare Trust Funds from 1990 to 1995, myself and my other public trustee, endeavored to do this on our own. We started something back then that has stood the test of time, and now all the trustees are involved. It is a plain English, bigger print, charts and graphs, bottom-line oriented document that is widely distributed and read.

I think we need to do the same thing in connection with the consolidated financial statements, and the Treasury Department has the lead on trying to come together with a proposal for consideration in that regard. That does not take any changes in law if people do it voluntarily. On the other hand, if we can't make progress, it is something that may be worth considering as part of your review of financial management in the Federal Government.

Second, if we look at the numbers, even on a cash basis, a lot of what is going on in Government deals with earmarked revenues, revenues for things like payroll taxes for Social Security and Medicare. Those are spoken for. They are supposed to be dedicated solely for the purpose of meeting the obligations under those programs.

Now, in reality what happens, we take in the money and we spend the money. The trust fund is not really a trust fund. It is a subaccount of the general ledger. We replace the loss with a bond that is backed by the full faith and credit of the U.S. Government, guaranteed as to principal interest, but, one tha is not really marketable does not have any economic significance at all. It has legal, political, moral significance. When you think about how we are presenting in the financial statements the difference between what is

going on in the operating accounts of the Government, or the on-budget, versus what is going on with regard to these earmarked revenues or so-called trust fund accounts, you will see that the cash-based budget deficit was about $175 billion bigger last year because we spend every dime of the Social Security surplus on other operating expenses. That is not new. We have been doing it for years.

That issue is being looked at by OMB. Namely, to take a look at how we might present this information in a clearer manner.

A third has to do with what I call a burden statement. It is the numbers that I showed you before, where if you end up taking the liability numbers off the financial statements, certain numbers off the Statement of Social Insurance, and others from different places, you can pull together something that is more meaningful, to get a sense for where we stand and where we are headed. We need to have something that shows where we are on our total burdens—that means liabilities and unfunded commitments—how we are trending, and we need to translate those numbers into per capita numbers, percentage of GDP, and use various other benchmarks where people can get a better sense of our position.

The other thing we need to do is what you touched on, Mr. Chairman. We need to talk about the inter-generational applications of the path that we are on. We need to be able to demonstrate that if you are 6-years-old and we continue to go on the path that we are, then what kind of tax burdens are you likely to have to bear when you are 40-years-old. This type of information would be much more meaningful to users of financial statements down the road.

I have other examples on pages 5 and 6 of my statement. The only other one that I will mention right now is this country forgoes $700 to $800 billion a year in revenue due to deductions, exclusions, exemptions and credits under the Internal Revenue Code. You will not find this number in the financial statements of the U.S. Government. You also won't find it in the budget or appropriations process of the U.S. Government. We need to have more transparency over these tax expenditures, because, in effect, what is happening, is they represent back-door spending. If you can't achieve something through a direct spending program, there is an incentive for people to create a tax incentive to get it off the books, outside the budget process, but it really does have an impact on the bottom line. It may or may not work because we don't know whether a lot of tax preferences were working or not, and we don't know if a lot of our spending programs are either. Those would be a few examples, Mr. Chairman.

Mr. PLATTS. And those examples, as they relate to the general public understanding the fiscal realities, and also to Congress and the executive branch having information that we actually rely on when we act, and the example here would be, as one who has supported the Medicare Part D, when I see that bottom number of $8.77 trillion in the next 30 years to come, our liability that we have now incurred for benefits that we are going to pay out in the decades to come, that puts it in a different perspective.

Mr. WALKER. That is an important point. Other than the financial reporting, I would respectfully suggest that the budget process

and the legislative process needs to be revised. For example, when the Congress is considering a new entitlement benefit or a new spending program, or a new tax preference, or extending an existing tax benefit, I think the Congress needs to not just know what the 1-year, 5-year and 10-year cash-flow cost is. For the big ticket items, for the ones that are really big and typically get more expensive beyond the 10-year horizon, I think Congress needs to know what the discounted present value cost of that is. That is what the $8.7 trillion Medicare Part D number is. That is how much money you would have to have today invested at treasury rates to close the hole that has been created—not the donut hole—to be able to deliver on the Government's for the next 75 years. None of you had that number, and I would respectfully suggest that if you did, the outcome might have been different. The irony about the Medicare Prescription Drug Benefit is, we were in the hole $15 to $20 trillion for Medicare before that bill. The bill added $8 to $9 trillion more, which is almost double Social Security.

Mr. PLATTS. Two other specifics in this type of reform, and then I want to get to Mr. Towns.

On the entitlement, is it something that we should look at the way we actually fund entitlements? Now it is an automatic, next year 7.6 percent more or whatever, and so unless we take action to change it, it just happens. Should it be the same as discretionary so every year we are forced to look at the realities of these numbers, rather than just being on autopilot unless we do something proactive?

Mr. WALKER. Mr. Chairman, we issued a report within the last several months, which I will make sure that both of you have the benefit of, that talked about what can be done to gain better visibility over and control of mandatory spending programs. If you look at the current budget, over 60 percent of the budget is on autopilot, and it is going up every year. We need some reconsideration triggers based upon the percentage of budget, the percentage of GDP, or various other factors so that Congress is forced to reconsider these programs at least periodically, because if we don't do that, then the Government is not going to be able to do much more than pay interest on the debt and maybe a few other mandatory programs in the out-years.

The other thing we need to do is we need to recognize that we don't just need to do this with regard to direct spending programs, we also need to reconsider some of these tax expenditures that are off the radar screen because they involve a lot of money too.

Mr. PLATTS. One other specific—and I am not familiar with your latest report that you reference, and would be glad to get that and take a look at it. And it is more specific on the discretionary side. I am a believer, having come out of the State house, you balance budgets, and one of the ways you ensure that is a line item veto. Is that something that has been in your discussions that you have looked at on the discretionary side?

Mr. WALKER. The difficulty, Mr. Chairman, as you know, with the line item veto is that would involve a significant give-up of constitutional power from the legislative branch to the executive branch. There are pros and cons to it, but I know who my client is. My client is the legislative branch. I do think there are things

that can and should be done that we have not even done yet. Hopefully, we could pursue some of those actions, and that might end up helping. If those are inadequate, then you can look at more dramatic actions that could end up involving a more fundamental redistribution of power under our current constitutional scheme.

Mr. PLATTS. As a member of the legislative branch, but, obviously, not an appropriator on the legislative branch, I think that we look at our States as laboratories of democracy and what works out there, and I think it is all but three or four States have balanced budget and line item requirement. I sought an action at the State level in Pennsylvania and thought it helped bounce back executive and legislative responsibility. So if it is to be done, it certainly is a constitutional issue.

Mr. WALKER. Can I mention one thing, Mr. Chairman, on that? As you properly pointed out, the States are a laboratory for experimentation, and we need to learn what works for them and what doesn't. One example is, I believe 49 of 50 States—and I will double check it for the record—but I believe 49 out of 50 States have a balanced budget requirement.

Mr. PLATTS. I believe that is correct.

Mr. WALKER. However, it depends upon how you define a balanced budget. There is one very large State on the West Coast, which I won't mention, that defines a balanced budget as balancing cash-flows. If it turns out that expenditures are higher than revenues, then they just go out and borrow the difference and that is deemed to be a balanced budget. I would respectfully suggest that is not a balanced budget. That is balancing cash-flows.

Mr. PLATTS. That is more this approach of you are not accounting for what your future liabilities are, I mean, as far as——

Mr. WALKER. It is similar to what we are doing, which ultimately will catch up to you.

Mr. PLATTS. Rather than us learning from what is working out there, they are learning what is not working here in their approach.

Mr. WALKER. Unfortunately, the Federal Government is not leading by example in this regard.

Mr. PLATTS. Exactly.

Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman.

Let me begin with you, Mr. Hammond. The weaknesses in tax collection activities and system efficiencies have been notable in practically every year on the consolidated statement. Can you update us on efforts to improve the internal controls of the Treasury to ensure efficient operation in the area of collection activities?

Let me just be quite clear, that I understand that if you get more employees, that every time you spend $1, that you are able to collect an additional $4. And I also would like to add I understand that you did not request additional staff in your last budget. So could you respond to those three things?

Mr. HAMMOND. I will give you a very high-level, kind of departmental-wide perspective, but I would respectfully suggest that I am not the right person at Treasury to be speaking to those specific questions. The Assistant Secretary for Management and Chief Financial Officer for the Department, or the Commissioner of the In-

ternal Revenue Service, would probably have, would certainly have more specific responses. We are looking at an environment where enforcement at the IRS is indeed a high priority, and I know that the Commissioner has reallocated resources within the Service to highlight the importance, capitalizing on the efficiencies that he has generated internally in the organization through electronic filing, for example, and being able to redirect those resources toward enforcement activity because they do in fact realize the substantial payoff related to additional enforcement work, so long as it is done consistent with the standards that were laid out a few years ago respecting taxpayer rights.

Mr. TOWNS. Right. Can you update us on the development and efforts under way in recovering improper payments referred to you for collection? Is there any hindrance in your way to effectively recoup these funds? Is there anything that the Congress should do in order to make it easier for you to be able to recoup this money?

Mr. HAMMOND. We actually do have a couple debt collection proposals, legislative proposals that are in the President's budget this year, having to do with somewhat technical aspects, the ability to offset different payment streams, the ability the collect debts on behalf of States where a debtor may cross State lines, and I would refer you to those in the budget. We can get you more specific information on those legislative proposals.

In general, the debt collection program is running extraordinarily well. Last year we collected over $3.2 billion in delinquent debt, some of that Federal, some of that State child support, some of that State income tax debt. There are a couple aspects of that program where we continue to enhance things, the most significant of which is making sure that all vendor payments are included in the process. That is really much more of an issue of fairness, frankly, than of large dollars. Vendor payments are not a significant payment steam, but nonetheless—and there are complexities bringing them into the collection process. But it is something that is a high priority for us, and we have made a lot of progress in the last year or so addressing.

Mr. TOWNS. Mr. Walker, what do you suggest either we should do in order to deal with the public, because those numbers you gave us, I mean, they are very alarming, you know. I want you to know that—and I am not an emotional person, but you brought tears to my eyes. [Laughter.]

What should we do here? Tell it from a legislative standpoint. I mean, there must be something here. I mean something is missing.

Mr. WALKER. Well, Mr. Towns, first, there are several suggestions in my testimony, and I am happy to provide additional ones for the record. There are two issues.

One issue is, what needs to be done in order to be able to obtain better control over our fiscal future? The first thing that I would say is we need to learn the first rule of holes, and that is, when you are in a hole, stop digging. We haven't learned the first rule of holes.

In that regard, it means that we need to be more truthful and transparent about where we are and where we are headed. As the chairman mentioned before, we need to consider what the long-term affordability and sustainability of certain legislative proposals

are before they are enacted into law. I would respectfully suggest that we need to have reasonable spending caps, and pay-as-you-go rules on both sides of the ledger, both the spending side and the tax side. I understand that is controversial, but when you are trying to control the bottom line, you shouldn't exempt one half of the ledger. Afterall, some tax cuts stimulate the economy, all tax cuts do. In addition, very, very few, if any, tax cuts pay for themselves. I have not found an economist who can show me one that did yet.

So we have to do that. We also have to be able to look at mandatory spending. How are we going to get control over mandatory spending? It is not just entitlement programs. It is also other areas. One of the biggest differences between the cash-based budget deficit and the accrual-based budget deficit is pensions and health care for civilian and military employees and veterans. There is a lot that has happened in recent years. The costs are going up dramatically, and we are not going to have to pay them until the future years, but we can see what is coming right now.

I would be happy to provide some more specifics for you, if you want, for the record, but I have testified on numerous occasions on some of the things that I think that the Congress should respectfully consider either through legislation and/or through modifying your own rules. After all, Congress creates its own rules, its own points of order, what goes into the budget resolution each year and things of that nature.

Mr. TOWNS. I am just thinking that when we look at Medicare Pard D, now, should we modify it? Is there anything that we need to do here, Congress itself, because based on your numbers, it is a mess.

Mr. WALKER. I would respectfully suggest, Mr. Towns, that Medicare Pard D is a poster case for two things. No. 1, only considering the short-term cost, not considering the long-term affordability and sustainability of new commitments; and second, the fact that I think most reasonable people would say that certain portions of the Medicare population need help with prescription drugs, and that any modern health care system for seniors would involve some assistance for prescription drugs in appropriate circumstances. At the same point in time, what was done was we just layered on top of Part A and Part B, which by the way, is based largely on Blue Cross/Blue Shield 1965, which has not been modified and reformed in a dramatic way since 1965, already had an unfunded commitment of $15 to $20 trillion, and what we did was we added another $8 to $9 on top of that without really reforming the program. And one of the things that is going to have to happen is I think that Congress—and I have said this publicly—should reconsider Medicare Part D as to the scope, as to the timing, and as to who benefits, because I think you are going to have an extremely difficult time delivering on this promise over time.

Mr. TOWNS. Thank you very much. Mr. Chairman, I yield back.

Mr. PLATTS. Thank you, Mr. Towns.

Secretary Hammond, you mention in your testimony, and it is in both of the written prepared notes, the fact that this year will be the first time we audited the Medicare and Social Security Trust Funds. Can you go into some detail of what we should expect from

that audit and how it will likely impact the financial report for 2006?

Mr. HAMMOND. I think the short-term answer is we don't expect a fundamental change in the report. The schedule itself will stay the same. Its placement will move, I think, maybe a page or so. So the real question is, what will the scope of the audit reveal or what will it indicate?

The Social Security program was audited on these types of estimates a number of years ago, and received, I think—by PriceWaterhouseCoopers at the time—and received a very favorable report. I am not aware of whether or not HHS and the Medicare program had been exposed to the same level of scrutiny. So the result may be that we get some additional information about some of the preparation and the assumptions processes going forward, but I don't expect any startling results.

Mr. PLATTS. Mr. Walker, any insights?

Mr. WALKER. You are correct in saying this is the first year in which the numbers that are in the Statement of Social Insurance will be subject to independent audit, and PriceWaterhouseCoopers is the independent audit firm that is responsible for auditing both Social Security, as well as CMS, and therefore, they will be on the front line of these responsibilities we will also have to get comfortable with these numbers because we are the auditors for the consolidated financial statements.

They will look at the appropriateness of the methodology and the reasonableness of the assumptions. We will have to wait until they are done but I would be surprised if there are any more big findings here although they may wish to point out in their report the fact that there is a considerable degree of uncertainty with regard to some of these numbers. In part, because when you are dealing with health care, only God knows what future health care costs are going to be, and God is not telling us. So there is a much greater degree of uncertainty with regard to health care costs than there is on Social Security, because with Social Security, you have a defined dollar benefit.

Under Medicare, the way that it stands right now, is that you have a defined level of coverage. Therefore, you need to determine what is it going to cost to provide that level of coverage to the applicable population? That is a much more complex process.

Mr. PLATTS. And that, in some degree, relates to, as we are trying to get that transparency and honest discussions of the coming debts, what we are going to have in the future, when we talk about Medicare Part A, B and D. The assumptions, if Part D works as intended, people get their prescription drugs, that perhaps there is a savings in Part A because there are less serious illnesses and hospitalizations. There is no assumption of that at this point in the outlooks?

Mr. WALKER. The actuaries for Medicare, it is my understanding, considered that when they came up with these numbers, they did not believe that there would be any material savings in Part A. The laws of economics haven't proved to be too valid in connection with health care, because the way that our health care system is, everybody wants unlimited health care and access to the newest procedures and technologies, especially if somebody else is willing

to pay for it. Ultimately what we are going to have to do, and we have some work on this too, Mr. Chairman, we are going to have to engage in a much more fundamental discussion about health care and the appropriate division of responsibilities between Government, employers and individuals for health care. Right now, the biggest driver to a long-range imbalance is health care. The second is demographics, but health care is really the biggest driver to a long-range imbalance, and it is not just an issue to the Federal Government. As you know, having been in the State legislature. Medicaid is the fastest-growing cost in State government. It is also the No. 1 competitiveness challenge to the private sector in the United States right now.

Mr. PLATTS. You look at the private sector competing in a world economy, and the expectations of employees from decades of having it provided either at no cost, minimal cost and ability to compete now, where every dollar counts as far as staying in business, you are right, it is not just a Federal and State government challenge, it is a national challenge, public and private.

Let's turn maybe to some of the specifics of the report, and how it presents to the various departments, and this being my 4th year as chairman, and over the 4-years we have had 11 different departments, agencies, that got unqualified opinions. One of the issues specifically I wanted to touch on, was referenced in one of the charts, the number of restatements that have been occurring, 5 in 2003, 11 in 2004, 7 again this year. You know, we are down from 11 to 7, but still, almost a third of the CFO departments and agencies are restating, which means that when we look at the ones that are restating, it looks 4 maybe out of 7, had supposed unqualified opinions last year—my eyes need to be checked here. So it's not a good sign.

And the fact that we have seven restatements again this year, does that mean that we are not moving forward as well as we would like to believe in getting more focus on financial accountability and financial disclosure, or should I read something different from those seven?

Mr. HAMMOND. Let me offer a perspective on that. I actually think that the volume of restatements that we have seen in the last couple of years is a good thing, while recognizing that it is a bad accounting outcome. The reason that is a good thing is that it has, I think, injected even more discipline and seriousness into the process. What has happened is, as agencies have improved their systems, gotten more experienced in the financial statement preparation process, so too have their auditors. I don't think, when we started the financial reporting on an audited statement basis, that, frankly, the level of audits that agencies received at the Federal level was comparable to what you would see in the private sector. And I think that as the agencies have gotten better, the auditors have gotten better, and the sophistication of the process itself is becoming more intense, and it is finding things that perhaps should have been found a long time ago.

I, frankly, think that is a healthy sign of a process taken very seriously by both parties.

Mr. PLATTS. Why are we not finding them the first time around? Because that's how I look at the restatements, that we are 7 times

this year, 11 times last, we are finding it, but after the fact in a sense, and going back in——

Mr. HAMMOND. That is right. I am not sure there is a complete pattern that, you know, you are seeing the same kinds of restatements in all circumstances, the reasons for the restatements vary. I do think that there is a question of audit funding, in some circumstances, and experienced audit staff. That makes it a little bit harder to go forward. Now that most agencies—in fact, I think almost all, maybe all but 1—of the 24 CFO Act agencies now have independent public accounting firms doing the audits. That helps. Sarbanes-Oxley influences and the emphasis on internal controls has certainly helped surface things that may have been just one level below.

It is a bad outcome on an annual basis, but I think it is a healthy sign for what we hope to get out of it going forward.

Mr. PLATTS. Mr. Walker.

Mr. WALKER. It is my understanding, Mr. Chairman, that a couple of common denominators from the misstatements that we have had in the last couple of years are that some of the agencies have been implementing new financial management systems, and they have had difficulty in that implementation process. Second, within the last couple of years we have had the new statement of budgetary resources, where you reconcile the cash-based budget deficit and the accrual-based budget deficit. Some agencies, and their auditors, had difficulties with it. That is not something you see in the private sector.

I would say it is obviously to everybody's benefit that to the extent that there is a misstatement, that it be identified, hopefully as soon as possible. I think it is good that auditors recognize their professional responsibilities to note that and to restate those numbers. I do, however, believe that this is a high percentage, higher than should be acceptable, and that when an agency has to restate its financial statements, it should not be green on financial management under the President's management agenda because it means you didn't deserve a clean opinion if you received a clean opinion in the prior year.

Mr. PLATTS. Is that something that the administration is looking at or willing to look at?

Mr. HAMMOND. I would have to ask my colleagues at OMB as to—I know they look at the criteria for the scoring on the President's score card periodically. It is certainly a question I will take back to them.

I would also note though that this is a trend that—and while the numbers and the percentages certainly are not the same—but it is a trend for increased restatements. It is something we are seeing in the private sector as well. So I think there is a level of seriousness going to the audit process that is, frankly, new in many respects.

Mr. WALKER. If it can, Mr. Chairman, it is true that the number of restatements going in the private sector have gone up post Sarbanes-Oxley, in large part because of the accountability failures that have occurred in the private sector and the relative risk associated thereof, as well as the additional oversight and scrutiny that

is being imposed by the Public Company Accounting Oversight Board, among other things.

However, the percentage of financial statements that have to be restated in the public is way, way, way higher than it has ever been, and much higher than it is ever likely ever to be in the private sector. I mean this would not be anything near an acceptable outcome in the private sector.

Mr. PLATTS. If we had a third of the private sector, it would be front-page news and there would be a lot of concern out there.

Mr. WALKER. Well, in fact, I am going to send you, Mr. Chairman, an opinion piece that recently was published, about the audit report of the consolidated financial statements of the U.S. Government, noting that if the audit report had been on any major corporation in the United States, it would have been on the front page of every major paper, and yet, it didn't even make most papers, much less on the front page. That is a problem.

Mr. PLATTS. That goes to really one of the challenges as Chair of this committee for 4 years, is how to get an appreciation, beyond a small circle, of the importance of the issues discussed in this committee and through your efforts at GAO within the administration. What we are talking about here ultimately impacts everything else going on out there in the sense of the financial realities of our Federal Government. I guess we need to have a major league baseball player sitting next to you, when giving your testimony, give his opinion.

Mr. HAMMOND. That would be great.

Mr. WALKER. I played on a national championship high school football team, but that is not good enough.

Mr. PLATTS. We didn't have that in your bio to get the national media attention. [Laughter.]

It is getting that appreciation and focus beyond just a small group, because otherwise it is hard to overcome the historic practices here.

There was a mention—I think, Mr. Hammond, I think you mentioned Sarbanes-Oxley. You may have both mentioned it. How does that impact your read on it just from a human resource—I guess it is two part. When I look at those restatements, is there a human resource aspect here of just staffing within the departments or agencies? And also the expedited deadlines, does that impact, that there is a rush to get done, and maybe to miss something because of that, and if so, is that still less important that we are getting more timely information?

Mr. HAMMOND. I think it is less a resource issue and more related to a business process issue.

Mr. PLATTS. Internal controls and——

Mr. HAMMOND. And legacy systems. The Comptroller General mentioned, for example, systems conversion efforts. Bringing in new financial systems is a good thing. It is also really hard to do when you are not just upgrading from a good version to the next version of a good system, but in fact, taking a collection of legacy systems, trying to put them together in an environment, and frankly, the Federal Government never had to do accrual-based reporting before these recent initiatives.

These systems were never designed to capture a lot of this information, and there are practices that are unique to the Federal Government, for example, property in the hands of contractors, which if not properly tracked and accounted for during the year with good internal controls, is an absolute reporting nightmare at the end of the year. I think some of what you are seeing is symptomatic of that type of change that is just going on at the agency level.

Mr. PLATTS. Maybe no one better exemplified that than at DOD, as we try to get a handle on their financial management systems, the thousands of different systems. And I will probably misstate the names here, but in the most recent example, their new pay system, the Forward Compatible Pay system where I think we spent $52 million at DOD, and scrapping it and starting over, in essence. I mean that type of trying to modernize, but needing it to be done responsibly, and thinking through everything up front before we keep spending this money with no results. That really leads into, DOD, clearly is the 600-pound gorilla, that unless we fix it, we are never going to get to an unqualified opinion. Your assessment, both of you, on how you view DOD's progress or lack thereof, as specific or general as you like.

Mr. WALKER. First let me make a comment with regard to the general issue that you talked about, and that is, financial management systems improvement efforts. There are many examples of hundreds of millions of dollars being wasted on failed financial management systems improvement efforts. A recent one, the Navy, several followup projects dealing with an ERP project, $1 billion down the drain. One of the fundamental problems that we have is who is being held accountable? The answer is, all too frequently the answer is no one.

Mr. PLATTS. If I could stop you there. On that example, are you aware of any person demoted, fired, funds recouped?

Mr. WALKER. We have not done a study of that, but I asked the question coming up here, as to whether or not some of the same people who are responsible for the failed system are responsible for the new system, and the answer was yes.

My point is—and, frankly, that is a shared responsibility, Mr. Chairman. It is not just a responsibility of the executive branch, it is a responsibility of the legislative branch.

Mr. PLATTS. Our oversight.

Mr. WALKER. We can't continue to have these deja-vu all over again problems, as Yogi Berra used to say. There have to be consequences to these types of failures.

But with regard to DOD, I hope that by the end of my 15-year term, which is October 2013, which mean that it would have to be the 2012 financial statements, I hope that by then the Department of Defense has an opinion on its financials, even if it is qualified, such that we might be in a position to be able to render some type of an opinion other than a disclaimer on the consolidated financial statements.

I know there are a lot of people who are working hard to try to deal with this. I know they are now trying to take an approach of looking at various line items across the Department, horizontally, and looking at various units within the Department—vertically, to try to make progress one step at a time. They have abandoned

their prior plan of having an opinion on DOD by 2007, which was totally unrealistic. You need to have goals and milestones, there is no doubt about that. It is fine to make them aggressive, but they have to be attainable, because if they are not, they are not credible and nobody will pay any attention to them.

I still have not seen a consolidated plan yet that says that the game plan is that over X number of years, we are going to be able to get to the point where we think we can have some opinion that these line items in year X and these entities by year Y, accumulating toward some department-wide outcome. I have not seen that yet, and I don't know that it exists. According to my staff, they don't have one yet. As you know, you have to have a plan or you are going nowhere fast.

Mr. PLATTS. Mr. Hammond, comment on DOD, your perspective?

Mr. HAMMOND. Just let me add that we have found that the financial management community at DOD to be some of the most engaged and supportive people across Government, as far as meeting the needs that we have and pulling together consolidated financial reports. So I think the current situation that they find themselves in is not reflective of the commitment to trying to do this, but I do think that they have a task that is quite challenging.

Mr. PLATTS. My read is there have been a lot of dedicated people trying over there, but it is kind of just a machine just kind of eventually chews them up and spits them out because it is so overwhelming. The Secretary has made the commitment to focus on this, and now with the Deputy Secretary taking the lead on the business transformation and trying to raise the priority of it, but in my 4 years, I am hard pressed to say I can see true progress being made. Effort, yes. Progress I think is something else.

Mr. WALKER. One of the things that we recommended, among many, last year about this time was that the Congress seriously consider requiring that the Department of Defense have a Level 2 Deputy Secretary for Management, in order to separate the policy and military transformation in fighting the global war on terrorism role from the business transformation process. After all, the Department of Defense was created in 1947 and yet it still has 8 or 25 high-risk areas on its own. It shares 6 others, so that it represents 14 of 25. One of the biggest problems that DOD has is that it lacks a person who is responsible and accountable, with the requisite level of experience, at the right level, who is there long enough in order to get these things done, who can deal directly with the unders, who can deal directly with the service secretaries, who can cross the silos, and who has direct access to the Secretary on a day-to-day basis as necessary to get this job done.

A year ago we recommended that. I think the world of Deputy Secretary England. He is an extremely capable professional, and I think that he could do either one of these jobs and do them well. However, I question whether any human being on the planet can do both of them. Secretary England said a year ago to give him a year, and see how it goes with one person trying to do both jobs. I am anxious to hear what he thinks now because our view stands. Namely, that despite how capable and how high a regard we have of him, this is something that has to be addressed, because by definition, Gordon England only has a recess appointment, and even

if he ends up getting a full appointment, this administration doesn't even have 3 years left. You are not going to get anywhere close to fully addressing some of these issues in 3 years. It is going to take many more.

Mr. PLATTS. I think that is one of the benefits of the proposal, that fixed term, whether it is 7 years or, to know, as with your position, that there is going to be continuity, and truly focus on seeing it through, as opposed to this kind of revolving door of—again, whoever is there is making the effort, but the ability to make progress in this Department is just overwhelming.

Mr. WALKER. It makes a difference not only for the person who has the job, it makes a difference for the people who are working with the person who has the job. For example, take Commissioner Everson of the IRS, who is a friend of mine, and who was the former Deputy Director of OMB for Management. One of the things that he has said publicly about the commissioner job of IRS, which is what he has now, is not only is it a No. 1 job rather than a No. 2 job, but it is a term appointment. Therefore, he has more certainty as to how long he is going to be there no matter what happens politically, and the people who are working with him and for him have a higher degree of certainty that he is going to be there, and that makes a big difference.

Mr. PLATTS. I apologize. With the vote that is going on now, but I also know, especially Comptroller General Walker, I know you need to go as well, I don't want to recess and have you wait. So is there anything that you want to make sure we have part of the record that we did not touch on, that you want to highlight before we wrap things up?

Mr. HAMMOND. No. I think just one point I would like to make, which is going forward, one of the things that we are going to need to do in order to raise the infrastructure that supports all of this and gets us to more useful reporting or more practical information, is to find ways to better integrate the budgetary and the financial reporting information streams. Today budgetary reporting is important, and everybody does it well, everybody does it right. There are significant penalties if you mess it up. Financial reporting has always been kind of a weaker cousin to budgetary reporting, and by bringing those together into the same systems, into the same business processes, into the same management chains in some cases, I think gives us an incredible opportunity to drive some of the changes that we want to do from a reporting standpoint.

Mr. PLATTS. That is somewhat reflected just in committee assignments, those who flock to be on the Financial Reporting Oversight Subcommittee versus, perhaps, the Budget Committee, or especially Appropriations, where they are giving the money out, you know, it is that challenge that we have in the sense of raising the level of understanding on the importance of these issues, and that both of you seek to do every day. It is something that we need to chip away at as an elected official, and as father of T.J. and Kelsey, I look at those graphs on what the decades to come will bring, and it is really staggering in the challenge that we are putting on future generations, what they are going to have to deal with.

Comptroller General Walker, did you have anything you want to add?

Mr. WALKER. The only thing I would say, Mr. Chairman, is thank you again for holding this hearing. I would love to have the opportunity at some point in time, if you want, to sit down and talk about some of these issues, and what is the best way forward.

Mr. PLATTS. And one that we have talked about and how to try to approach, and we know that it is not well received within the administration, but the CMO issue at DOD and getting our CFO, you know, the Chief Management Officer over there, how to go after DOD, because we need to keep chipping away at all the departments and agencies, but that one is just so huge that unless we jump start it somehow, we are just going to keep spinning our wheels I think long term.

Mr. WALKER. I know you are also interested in possibly relooking at the financial management legislation, and I would be happy to sit down and talk to you about issues of mutual interest at some point.

Mr. PLATTS. We would welcome your insights.

If there is any additional information, we will keep the hearing record open for 2 weeks if you want to submit. Our appreciation to you and your staffs for your preparation and appearance here today.

This hearing stands adjourned.

[Whereupon, at 3:13 p.m., the subcommittee was adjourned.]