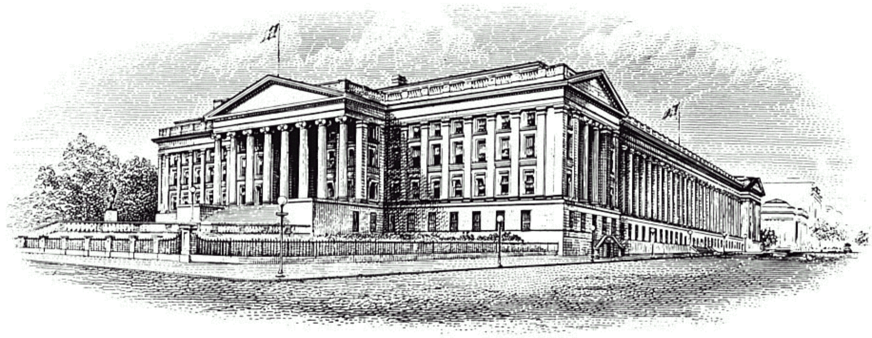

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Statement of Donald V. Hammond
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before the Senate Committee on Governmental Affairs
Subcommittee on Financial Management, the Budget
and International Security

Financial Report of the United States Government Improves
Government Accountability

Mr. Chairman and Members of the Subcommittee, it is my pleasure today to represent the Treasury Department to discuss the status of the Federal government's financial reporting through the Financial Report of the United States Government and the incorporated consolidated financial statements. This important document helps ensure better accountability for the federal funds because it adds to the financial information available to the public, provides insight into the government's complex operations, and sets a framework for consistent reporting throughout the government. We have come a long way in seven years but we face some significant challenges and as such the Financial Report is a work in progress. I will explain more fully the challenges we face as we try to achieve the highest standards of financial performance and accountability. Today's hearing is very timely, and the committee's interest is greatly appreciated.

Treasury Financial Reporting

The Treasury Department has a long-standing responsibility and commitment to report accurate and useful information about the Nation's finances. Our objective in preparing the consolidated financial statements is to provide the Congress and the public with a reliable, consistent, timely, and useful report on the cost of the government's operations, the sources used to fund them, and the implications of its financial commitments.

As you know, the Government Management Reform Act of 1994 requires the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, to prepare and submit to the President and the Congress the preceding fiscal year's audited financial statements, not later than March 31. I'm pleased that we were able to submit the FY 2003 Financial Report to the Congress in February 2004, a month earlier than in previous years.

We were able to submit the report earlier largely because of the progress agencies made in accelerating their financial reporting. Three-fourths of the major agencies completed their audited financial statements by the end of December 2003, and eight agencies issued their statements by mid-November 2003, a year ahead of the accelerated deadline that goes into effect this fall. For the FY 2004 statements, OMB has established the due dates as November 15 for the agency statements and December 15 for the government-wide statements. This more timely preparation of the consolidated report means that this financial information will be available in December, preceding publication of the President's Budget, providing actual data on an accrual basis for reference.

Importance of the Report

The Financial Report is an important addition to federal financial reporting. It provides an across-the-board look at the total costs of the Federal Government, computed in accordance with accrual accounting standards established by generally accepted accounting principles (GAAP). The report presents a picture of government-wide costs that is not otherwise available. Under the accrual method, transactions are recorded as they occur, whereas under the cash basis of accounting, transactions are recorded when cash is received or paid. This accrual-based information complements the traditional outlay information in the Budget and helps to assess the long-term impact of the government's policy decisions. The availability of this additional information more fully informs the budget process.

The standardized reporting framework promotes comparability and consistency in reporting across years and among agencies. The report goes beyond simple reporting of results as it displays the effects of all significant assets, liabilities, stewardship responsibilities and other commitments and responsibilities. The considerable financial implications of the government's social insurance programs (principally Social Security and Medicare) are reported in the stewardship accounting for these programs. For example, the net present value (over a 75-year period) of our additional responsibilities for the social insurance programs was estimated in the

FY 2003 report at $26.9 trillion. These future program responsibilities do not fit neatly into current accounting classifications. The appropriate accounting treatment in the future for these social insurance programs is a current topic of discussion at the Federal Accounting Standards Advisory Board (FASAB).

The report is subject to audit by the GAO, and they have done so each of the seven years the report has been issued. The audit enhances the report's credibility as well as highlighting areas for improvement. Although the report has improved over the years as we have strived to make it more useful, the GAO has been unable to render an opinion on the financial statements, resulting in a disclaimer of opinion.

Challenges in Preparing the Report

For the FY03 report, GAO cited three principal reasons for the disclaimer: (1) serious financial management problems at the Department of Defense (DoD); (2) the federal government's inability to completely account for transactions between federal entities; and (3) deficiencies in the report preparation processes. We will soon receive the related management letter from GAO providing a more detailed description of some of the deficiencies as well as recommendations for their resolution. We recognize that many of the GAO recommendations will improve the accuracy and usefulness of the report. We have been working to address many of the recommendations from the FY02 audit and believe that we are making significant progress.

As the next panel will no doubt discuss, the DoD has displayed a strong commitment to correct its extensive financial management problems through a comprehensive financial management modernization program. Therefore, I will focus my remarks on the two other material weaknesses.

The first of these is the government's inability to account properly for all financial transactions between federal agencies. In essence, two agencies that have been parties to a transaction are reporting different amounts for the same transaction resulting in differences which cannot be eliminated when we prepare the consolidated report. Many of these differences result from the agencies' inconsistent use of accounting conventions or data compilations. These differences indicate a fundamental weakness in data integrity at the agency level.

The second weakness the report preparation process has three aspects: (1) the need to directly link agencies audited financial statements with the agency data used in the consolidated financial statements; (2) unexplained transactions that affect the government's net position and that result in the need for a “plug” or reconciling entry; and (3) ensuring that the financial statements are in compliance with GAAP.

Progress in Addressing GAO Recommendations

We have a number of initiatives underway to resolve the material weaknesses GAO identified and to improve the government’s financial management and accountability. The Financial Management Service (FMS), the Treasury bureau responsible for government-wide accounting operations, is making real progress. Some of these initiatives are in the developmental phase; however, I’m pleased to report that FMS has already succeeded in implementing major improvements.

We have been focusing on the problem of intragovernmental activity and imbalances and are devoting much attention to help agencies fully reconcile these areas. FMS has added a new tool to help agencies properly identify and record these intragovernmental transactions. The *Intragovernmental Reporting and Analysis System (IRAS)* has been instrumental in classifying inter-agency activity and balances. It now identifies recording differences for the same transaction between agency *trading partners* (one agency doing business with another), provides information for agencies to correct reporting errors, and assists them in reconciling major differences. *IRAS* offers a database solution for tracking quarterly accounting errors and timing differences and a systematic documentation of the different accounting methods used by the agencies. This year Treasury and OMB required agencies to report and reconcile intragovernmental activity quarterly instead of just at the end of the year. These more frequent reconciliations have already led to a reduction in differences in agency reporting. I am optimistic that the reporting for June 30 will show even more significant improvement. As we continue to expand its use, *IRAS* will become a centerpiece in tracking the reporting of intragovernmental transactions.

As helpful as *IRAS* has been thus far, there is no single, centralized systems solution to the problem of intragovernmental transaction imbalances. Each agency’s management must make it a priority to improve their agency’s data quality, reconcile amounts with their trading partners, and adhere to the standard business rules issued by OMB for processing intragovernmental transactions. In addition, the agency must conduct the required quarterly reconciliations so that there is less work to do at year-end when the financial statements are prepared. The agency must understand the process and apply consistency and attention to detail in recording information at the points where the transactions take place. This is basic to accurate and consistent financial reporting.

Related to the intragovernmental balance problem is one of the report preparation weaknesses noted by GAO, namely the unreconciled or unexplained transactions that affect the change in net position and that require us to use a reconciling entry or “plug” in the financial statements. We recognize the need to address this long-standing problem, which calls for better reconciliation procedures and balanced accounting entries to derive the change in net position. We believe the larger problem has its roots in the unreconciled intragovernmental balances, and we are therefore focusing our efforts on that area first. When that problem is resolved, we believe it will go a long way toward correcting the net position problem. We have also done some pilot work to determine if certain custodial receipts collected by the agencies may be contributing to the problem. Our early findings indicate that this area may be the cause of some of the unexplained net position differences. We are considering additional analytical approaches to further explain these differences.

We are also addressing the process issue GAO raised about the need to directly link agencies’ audited financial statements with the data they provide to Treasury for compiling the government-wide consolidated statements. FMS is completing the implementation of a new *closing package* process called the Government-wide Financial Report System (GFRS). This process is the foundation for ensuring that the government-wide consolidated statements contain the same information as the agency financial statements.

Five agencies pilot-tested this new, internet-based system last year, and the system has now been introduced government-wide. FMS met with all agency CFOs and IGs to explain the requirements of the new system and is training agency accounting personnel to use it. As they complete the training, agencies are entering their fiscal 2003 actual data. This process will be completed in August. Additionally, GAO has begun its audit work on the new system. In November, as agencies issue their statements, they will then report their fiscal 2004 data using the new process. GFRS will provide a clear audit trail that will facilitate the audit of the Financial Report and demonstrate that it is consistent with the underlying information in agencies’ audited financial statements.

We are also addressing GAO’s recommendation that we ensure that the notes or disclosures in our report are in compliance with generally accepted accounting principles (GAAP). This will entail presenting information we had not previously included. Beginning with the FY 2004 report, agencies will submit through GFRS certain financial statement notes or disclosures. Since this information is being collected government-wide for the first time, it will require analysis and review to determine whether and how it should be consolidated. We are uncertain at this point how many of the new disclosures will be included in the FY2004 Financial Report. Additionally, we are considering approaching (FASAB) for additional clarity on specific disclosures that do not lend themselves to a data roll-up such as treaties and condition reporting.

Other Improvements Underway

In addition to addressing the audit findings, we have been taking steps to support better financial management across government. A major acceleration initiative implemented over the course of the past two fiscal years has resulted in earlier agency data input and an earlier release of the Monthly Treasury Statement of Receipts and Outlays of the United States Government (MTS). Each month, the MTS displays official budget results, including data on the budget deficit or surplus. Agencies are now submitting their monthly financial data to Treasury within three workdays of the end of the month, compared with five to seven days a year ago. This accelerated reporting has enabled Treasury to provide agency expenditure balances and other financial information which agencies need to prepare their financial statements much earlier than in the past. Several years ago, the MTS was released on the 17th workday after the end of the month; at the start of 2003, it was released on the 14th workday and now is being released on the 8th workday. By providing timelier information, we can better inform the decision-making process.

Another Treasury initiative that is improving financial management is the Government-wide Accounting Modernization Project (GWA). GWA provides agencies with significantly better tools for reporting their financial information and monitoring its status. Treasury has implemented an account statement module that allows agencies to view their account balances on a near real-time basis. Prior to this module, agencies were unable to see their account balances until the 9th workday after the end of the month. Another segment of the system now allows agencies to process certain transfers and borrowing transactions and eliminates a burdensome paper process that had existed for many years. In addition, the project has been expanded to allow agencies to access their monthly disbursement and collection data on the Internet. GWA, when fully operational, will provide more timely financial information to agencies and will eliminate duplicative reporting and costly, manually-intensive reconciliations.

Conclusion

I look forward to meeting the new due dates this year, but I recognize the difficulties involved. We are dealing with a new central reporting process, and are working with agencies whose financial reporting is not yet where it needs to be to meet this date. That being said, I visualize the day when we have fully achieved more timely reporting and can obtain the full value of financial reporting by having reports that are truly useful. Accurate, reliable, and on-time financial reports that comply with statutory and administrative requirements are basic elements, but not sufficient to achieve the full value of financial reporting. Usefulness is the final element of effective financial reporting. Financial reports should provide relevant financial and performance information that not only supports management decision making but also informs the public. Here lies the greatest challenge and potentially the greatest benefit from financial reporting.

In conclusion, we have come a long way, our upcoming challenges are significant but manageable, and I am confident that we will continue to see real progress. Thank you, Mr. Chairman. This concludes my formal remarks.

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