Testimony of

The Honorable Linda M. Springer

Controller, Office of Federal Financial Management

Office of Management and Budget

before the

Subcommittee on Government Efficiency and Financial Management

Committee on Government Reform

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Thank you, Mr. Chairman.

I am honored to testify for the first time as the Controller at the Office of Management and Budget (OMB) before this subcommittee. I feel today as I have many times before reporting to the Audit Committee of corporate Boards of Directors. As I did in those meetings, I am here to provide you with a response by management to the issues presented in the auditor's report on the Federal Government's consolidated financial statements for the fiscal years ended September 30, 2002 and 2001.

The General Accounting Office (GAO) has issued a disclaimer of opinion on the consolidated financial statements for these periods. In so doing, material weaknesses were noted in the following areas:

1. Assets: Property, Plant, and Equipment and Inventories and Related Property
2. Liabilities: Liabilities and Commitments and Contingencies
3. Cost of Government Operations and Disbursement Activity
4. Accounting for and Reconciliation of Intragovernmental Activity and Balances; and
5. Preparation of Consolidated Financial Statements.

The primary source of weakness in the first three areas is the Department of Defense. Items 4 and 5 are process impediments that have government-wide impact.

GAO also identified the following material weaknesses in internal control throughout the Executive Branch:

1. Loans Receivable and Loan Guarantee Liabilities
2. Improper Payments
3. Information Security; and
4. Tax Collection Activities.

OMB agrees with GAO that these are areas of weakness. We are not satisfied with this result. In fact, we believe that even unqualified audit opinions and the absence of material weaknesses do not necessarily indicate the presence of first class financial management. First class financial management requires integration of the financial impact of agency activities in operational execution and senior management decision making, accompanied by accountability standard setting, performance tracking and other analyses. These are among the characteristics we should seek in government every bit as much as they are expected in the private sector. And these are the objectives of the Improved Financial Performance Initiative of the President's Management Agenda.

The Administration is making a concerted effort to address the weaknesses identified by GAO and agency Inspectors General and independent auditors. For example, we are working to identify the root causes and current status of, as well as action plans to remedy, the deficiencies at the Department of Defense (DOD). Some of these actions will be near term. Others will take longer and will be dependent on the new financial management systems implementation. OMB has reviewed with DOD its assessment and plans for each area identified by GAO. Our most recent update was just last week at planning sessions we have initiated with every CFO Act agency's CFO and IG. These meetings are the first of what will be an ongoing review of plans to meet the financial reporting objectives of achieving unqualified audit opinions, eliminating material weaknesses, and meeting accelerated reporting deadlines.

In our judgment, DOD is identifying its problems and is engaged in both short and long term remediation activities. This should substantially address the first three material weaknesses. OMB will continue to monitor this progress with both the department and its IG.

Regarding intragovernmental transactions, we have new rules in place that govern the manner in which agencies record intragovernmental transactions. Simply put, these rules once and for all standardize the government-wide processing and recording of intragovernmental activity. This, in conjunction with the automated process by which we will compile the government-wide financial statements in the near future, will go a long way toward resolution of the other material weaknesses that contribute to the disclaimer of opinion by the auditors.

As you have heard at the recent testimony on the President's Management Agenda, notable progress was made in Fiscal Year 2002 in agency financial reporting. This year a record number of the government's major departments and agencies received unqualified opinions on their annual audited financial statements – 21 of 24 – up from 18 in Fiscal Year 2001. Two agencies – Treasury and the Social Security Administration – met the new government-wide standard for timeliness of reliable financial information two years early. In addition to DOD, only the Small Business Administration (SBA) and the U.S. Agency for International Development (USAID) are keeping us from our goal of unqualified audit opinions on the financial statements of the major departments and agencies. I met with the DOD Comptroller just last week to assess the department's status. I am meeting with officials from USAID on April 16th and SBA on May 1st to begin regular updates on their progress in both getting a clean audit opinion and meeting the President's accelerated financial reporting deadline. I want to note for the subcommittee that USAID received an unqualified opinion for 4 of its 5 principal financial statements and a qualified opinion on the fifth statement.

Part of the President's Improved Financial Performance Initiative is our effort to reduce erroneous payments. While GAO in the past had tallied just $20 billion in erroneous payments, OMB reported to the Congress last year that our effort, which requires erroneous payment estimates for major benefit programs that make payments in excess of $1.2 trillion annually, has raised the total estimate of erroneous payments to $35 billion annually. We are expanding our efforts in this area with the implementation of the Improper Payments Information Act of 2002, which originated in this subcommittee. This act requires an estimate of the extent of erroneous payments from *all* federal programs. Program-wide erroneous payment estimates can only help stem the loss to the federal government in waste, fraud, and abuse—too much of which is taking place without an accounting. But our erroneous payment efforts are not just about estimates. The President's FY 2004 budget includes a $100 million increase to clarify Earned Income Tax Credit (EITC) rules and to help ensure only eligible taxpayers receive payments. This investment could help us reduce the more than $9 billion in erroneous EITC payments we make annually. The Administration has also proposed a number of common sense proposals to give agencies tools they can use to verify the eligibility of applicants for Student Financial Assistance, housing subsidies, and unemployment insurance. These provisions, if enacted, could save us billions of dollars over time.

Of course, Mr. Chairman, I would be derelict not to mention one of the great challenges before us. The migration of the component agencies to the new Department of Homeland Security will present a major challenge from a financial management perspective. Disparate systems at different stages of implementation is just one of many complicating issues that the new Department presents. I plan to work closely with Under Secretary Hale to meet these challenges.

Our auditor, GAO, has highlighted many of our weaknesses. I will not pass up the opportunity to highlight some of the favorable assertions made in GAO's report about the efforts the Bush Administration is making to improve financial management throughout the government.

> *Across government, financial management improvement initiatives are under way that, if effectively implemented, have the potential to appreciably improve the*

quality of the federal government's financial management and reporting. A number of federal agencies have started to make progress in their efforts to modernize their financial management systems and improve financial management performance as called for in the President's Management Agenda.

[T]he President's Management Agenda includes improved financial performance as one of the top five governmentwide management goals . . . This is a step in the right direction to improving management and performance.

The attention we are paying to improving financial performance and the progress we have made thus far move us down the playing field, but still short of the goal line. It is important that we not lose sight of these achievements, however. Even though no score appears on the board until we've crossed the line, we have moved inside the red zone and the goal is in sight. This administration is committed, with the help of this subcommittee, to achieving the first class financial management of which we and the American people can be proud.