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before the
House Government Reform Subcommittee on Government Efficiency and Financial Management
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Financial Report of the United States Government for Fiscal Year 2003

Mr. Chairman and Members of the Subcommittee,

I am glad to be here today to present and discuss the *Financial Report of the United States Government* for fiscal year 2003. The Treasury Department greatly appreciates your continued focus on improving the Federal Government's financial management and reporting. Your attention to these issues highlights their importance. Today I will present the government's financial results for the year, relate some of the significant highlights in the report, and discuss some financial reporting issues and the progress we have made in addressing them. While the annual Financial Report is an important document that adds to the information available to the public, we need to address some significant challenges to make it fully effective in meeting its objective.

TREASURY FINANCIAL REPORTING

The Treasury Department has a long-standing commitment to report accurate and useful financial information on the operations of the United States government. Starting with our first Treasury Secretary, Alexander Hamilton, Treasury has fulfilled its core responsibility to report on the nation's finances. Through the consolidated financial statements in the report, our intent is to provide the Congress and the public with a reliable, understandable and useful report on the cost of the government's operations, the sources used to fund its operations, and the implications of its financial commitments. In pursuit of this objective, we will continue to commit significant resources in a cooperative effort with all agencies.

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 this year's Financial Report to the Congress a month earlier than last year. This is another indication that the government is making progress in accelerating its reporting.

This year, three-fourths of the major agencies had completed audited financial statements by the end of December. Eight agencies had issued their statements by mid-November, a year ahead of the accelerated deadline that goes into effect in 2004. When this accelerated reporting timeframe is accomplished by all agencies, it will set the stage for even more timely preparation of this consolidated report so that its information is available to support the budget deliberation process.

IMPORTANCE OF THE REPORT

Because the financial statements, subject to audit, have been prepared in accordance with generally accepted accounting principles (GAAP), they provide a standardized reporting framework that ensures consistency and provides for comparability and ease of understanding. Under the accrual method, transactions are recorded when a liability occurs, or when the events giving rise to the transactions occur, whereas under a cash basis of accounting, transactions are recorded when cash is received or paid. Because of the standards under which the report is prepared, this accrual-based information helps to assess the long-term impact of policy decisions and enhances the traditional receipts and outlays information in the Budget.

The Financial Report covers all accounts of the Executive Branch. Additionally, the report contains almost all information from the Legislative Branch and budget information from the Judicial Branch. In order to fully and properly reflect information from the Legislative and Judicial Branches, we would need to receive their audited financial statements and accompanying information. Appendix A shows a list of significant Executive Branch entities contained in the report, including, for this year, the new Department of Homeland Security.

REPORT HIGHLIGHTS

Some highlights of the report I want to mention are the government's net operating cost, its total financial responsibilities, and the federal debt subject to limit.

The 2003 financial results show an accrual-based net operating cost of $665 billion, compared to the budget deficit of $375 billion. The main reasons for the difference are the actuarial liabilities for civilian and military employee benefits and veterans' compensation and benefits. The report provides a statement that fully reconciles the difference. Another major difference in the report is the accounting treatment of capitalized fixed assets, including depreciation, in the Department of Defense and other civilian agencies.

The report goes beyond simple reporting of accounting results and displays the full effects of all significant liabilities, stewardship responsibilities and other commitments. The 2003 balance sheet shows assets of $1.4 trillion and liabilities of $8.5 trillion. These liabilities are accurately reported using current accounting standards, but they do not include some of the government's other major financial responsibilities, which the accounting standards do not treat as liabilities. Examples are social insurance programs such as Social Security and Medicare. While these are not liabilities on the balance sheet, they are nonetheless commitments that the government will be obligated to pay in the future. Taken together, current liabilities and the net present value of our additional responsibilities (over a 75-year period) are estimated at $36.1 trillion.

Financing the government's cash requirements while remaining within the debt limit is an ongoing challenge for us. In 2003, debt held by, or owed to, the public was $3.9 trillion and was the government's largest liability. Debt held by government accounts, was $2.8 trillion and, while it is also subject to the debt limit, it is not shown as a liability because this debt is an internal transaction between two government accounts. The combination of these two reflects the total federal debt subject to limit, a total of $6.8 trillion.

The Congress has traditionally exercised control over the size of the debt by establishing a statutory limit on the amount of Treasury securities that can be outstanding. When the debt limit is reached, the Secretary of the Treasury can employ a number of statutory tools to remain within the cap for a short period of time. He was required to do this in 2003. On May 27, 2003, legislation was enacted that increased the debt limit to $7.4 trillion. Based on current projections, these actions will be required again in 2004.

REPORTING ISSUES

Since the first audited government-wide report was issued for fiscal year 1997, we have worked continuously to improve the accuracy, reliability and timeliness of this important report. We have made considerable progress, but still need to resolve some important reporting issues.

The General Accounting Office issued a disclaimer of opinion on the 2003 report. GAO cited material weaknesses in internal controls in Treasury's report preparation processes and in some agency financial statements. We have been working to eliminate these problems; however, making these improvements will require a concerted effort by all government agencies and auditors, along with continued strong leadership from Treasury and OMB.

There are three major areas of focus which I will list first, and then discuss the improvements underway to address them.

- Treasury needs to directly link agencies' audited financial statements with the agency data that we collect through our centralized systems to prepare this report.

- Agencies are not consistently or properly reconciling their financial activities with other agencies. Some of these intragovernmental accounts are significantly out of balance. In 2003, the net amount that did not match was about $163 billion and the unexplained amount was about $65 billion. A table in Appendix B details the out-of-balance condition.

- Unreconciled or unexplained transactions affect the change in net position. In 2003, these unreconciled or unexplained transactions amounted to a $24.5 billion increase in net position.

IMPROVEMENTS UNDERWAY

To resolve the material weaknesses mentioned above and improve financial management, we have a number of initiatives underway. The Financial Management Service (FMS), the operational arm of Treasury for these important accounting responsibilities, is making real progress. While some of these initiatives are in the developmental phase, in others, FMS has already had success.

First, to address the need to directly link agencies' audited financial statements with the data agencies provide to Treasury for the government-wide consolidated statements, FMS is implementing a new process called the *Government-wide Financial Report System (GFRS)*. This process will help ensure that agency financial statements contain the same information that agencies input for the government-wide consolidated statements and will ensure that that these data are linked. Five agencies have pilot-tested this new, internet-based system. The test agencies entered their own audited financial statements, and then reclassified those amounts in the standard format used to prepare the government-wide consolidated statements. In June 2004, the system will be tested government-wide as agency personnel trained in GFRS start entering their fiscal 2003 actual data. Then in November, after their statements are issued, agencies will 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.

Second, we have been focusing on the problem of intragovernmental activity and balances and are devoting much attention to help agencies fully reconcile these imbalances. FMS has added a useful new tool to help agencies record and properly identify intragovernmental transactions. *The Intragovernmental Reporting and Analysis System (IRAS)* has been instrumental in classifying inter-agency activity and balances by reciprocal category. This system will help to identify differences, provide information for agencies to correct reporting errors, and reconcile material differences between agency "trading partners." As we continue to expand its use, *IRAS* will serve as: a centerpiece in the repository of intragovernmental transactions at the reporting level, a database solution for tracking quarterly accounting errors and timing differences, and a systematic documentation of the different accounting methods used by the various agencies. Treasury and OMB recently required agencies to report and reconcile intragovernmental activity quarterly instead of just at the end of the year. These more frequent reconciliations and adjustments should help to eliminate the inter-agency differences.

Related to this intragovernmental problem are the unreconciled or unexplained transactions that affect the change in net position. We believe this 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, it may also suggest a solution for this problem. We need to eliminate the intragovernmental problems first, so that we can see what other issues remain.

In addition to the progress we are making to resolve issues raised by our auditors, we have also enhanced our reporting, and the reliability and timeliness of our data, and made other improvements in the government's financial management.

A significant reporting improvement this year was the incorporation of a new accounting standard promulgated by the Federal Accounting Standards Advisory Board. This standard requires recording on the balance sheet the value of national defense property, plant and equipment (e.g., ships, aircraft, combat vehicles, weapons). To begin applying this standard immediately, in 2003 the Department of Defense (DoD) based the value of its military equipment on data provided by the Bureau of Economic Analysis. DoD is now revising its accounting processes and systems so that in the future, the basis for these valuations will come from DoD systems. The estimated total acquisition cost of equipment was $1.2 trillion. The value of this equipment net of depreciation was $316.6 billion.

We have also made improvements in the reliability and timeliness of data. There have been measurable improvements in the government's financial data quality since the first government-wide audit was conducted for the fiscal 1997 Financial Report. At that time, only eight of the 24 major agencies had received clean opinions on their financial statements. This year, 27 of 31 major agencies that completed 2003 financial statements received clean opinions. A clean opinion helps assure the public that the government is providing reliable data and properly accounting for its money.

A major timeliness initiative implemented over the course of the fiscal year 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 9th workday. Our goal is to accelerate the release of the MTS to the 7th workday. By providing timely information, we can better inform the decision-making process.

Another Treasury initiative that will improve financial management in future years is the *Government-wide Accounting Modernization Project (GWA)*. GWA will provide agencies with better tools for reporting their financial information and monitoring its status. Currently, agencies do not see their account balances until the 10th or 11th workday after the end of the month. Treasury is now rolling out an account statement module that allows agencies to view their account balances on a near real-time basis. Also, the project has been expanded to web-enable agencies' monthly reporting of disbursement and collection data. GWA, when fully operational, will provide more timely financial information to agencies and will also eliminate duplicative reporting and costly, manually-intensive reconciliations.

CHALLENGES AHEAD

While I am very pleased with the progress we have been making at both the agency level and the consolidated level, I know that much work remains. Some real challenges ahead are to resolve the problems in recording intergovernmental transactions, to issue our 2004 reports much earlier, and to provide information that is useful and supports decision making.

As I mentioned earlier, a real and continuing challenge is to improve the accuracy of the financial information that agencies supply to Treasury, particularly in recording and accounting for their transactions with other agencies and transfers between agencies. Correcting this problem requires agencies understanding the process and applying 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.

There is no single, centralized systems solution to solving the intragovernmental elimination problem. Rather, improving the data quality and reconciling with trading partners must be an agency management priority. Adhering to the standard business rules issued by OMB in October 2002 for processing intragovernmental transactions is a necessity. In addition, agencies must conduct the required quarterly reconciliations with their trading partners so that there is less work to do at year-end when the financial statements are prepared. Moving forward, Treasury plans to initiate a process through which agencies will confirm their intragovernmental balances with their trading partners on an annual basis.

The CFO community has accepted the challenge of further improving the timeliness of financial reporting. To this end, departments and agencies are scheduled to submit their 2004 financial reports by November 15 (45 days after the end of the fiscal year), and Treasury is scheduled to issue next year's Financial Report on December 15. Achieving these timelines will require significant improvements in business processes, information accuracy, and the use of estimation techniques to develop financial data. The successful acceleration of the financial statement deadline will also require the auditors to be actively involved throughout the year, working with the agencies to understand their estimation techniques, review quarterly intragovernmental balances and reconciliations, and audit third-quarter financial information. I look forward to meeting this due date, but I recognize the difficulties involved. We are dealing with improvements that still need to be made in our central reporting processes and working with agencies whose financial reporting is not yet where it needs to be to meet this date.

A third challenge, even as we achieve more timely reporting, is to obtain the full value of financial reporting by having reports that are useful. Producing accurate, reliable, and on-time financial reports that comply with statutory and administrative requirements has largely been accomplished. These basic elements are necessary, but not sufficient to achieve the full value of financial reporting. Usefulness is the final element of good financial reporting. Does financial reporting assist agency heads and managers in making decisions? Does it provide important performance information? Here lies the greatest challenge and potentially the greatest benefit from financial reporting.

In conclusion, we have come a long way in the past year, our upcoming challenges are significant but manageable, and I am confident that 2004 will be a year of real progress. Thank you, Mr. Chairman. This concludes my formal remarks and I would be happy to respond to questions.

Appendix A: List of 35 significant entities

Appendix B: Report on intragovernmental out-of-balance condition