

**STATEMENT OF DONALD V. HAMMOND
Fiscal Assistant Secretary
U.S. Department of the Treasury
before the
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL
MANAGEMENT
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
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**FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT
FISCAL YEAR 2002**

Mr. Chairman and Members of the Subcommittee,

Thank you for the opportunity to discuss the *Financial Report of the United States Government* (Financial Report). On behalf of the Secretary, I would like to thank you for focusing on and promoting the improvement of Federal Government financial accountability and reporting. These are important transitional times, and we appreciate your leadership on these issues. Before I continue, I wish to congratulate you, Chairman Platts, on your appointment to chair this important panel. We had the pleasure of working very closely with Chairman Horn in previous Congresses on improving government financial management, and we look forward to the same effective working relationship with your Subcommittee in the months and years ahead.

As you know, the Government Management Reform Act of 1994 requires that not later than March 31 of each year, the Secretary of the Treasury, in coordination with the Office of Management and Budget (OMB) Director, shall prepare and submit to the President and the Congress financial statements subject to audit for the preceding fiscal year. They are prepared in accordance with generally accepted accounting principles as established by the Federal Accounting Standards Advisory Board (FASAB).

The Financial Report is prepared in order to provide the President, the Congress, and the American people with reliable information about the financial position of the Federal Government on an accrual basis, the net cost of its operations, and the financing sources used to fund these operations. The Federal Government does not have a single bottom line that reflects its financial status, but the information included in the statements provides a comprehensive view of the Federal Government's finances that is not available elsewhere. The Financial Report consists of management's discussion and analysis, statements of net cost, statements of operations and changes in net position, reconciliations of net operating revenue (or cost) and unified budget surplus (or deficit), statements of changes in cash balance from unified budget and other activities, balance sheets, notes to the principal statements, and other useful information. The Financial Report covers all accounts from the executive branch. Since the legislative and judicial branches are not required to prepare financial statements, some limited reporting information from those branches is included.

IMPORTANCE OF THE FINANCIAL REPORT

The Department of the Treasury is committed to producing accurate and useful government-wide financial statements and continues to devote considerable resources to this effort. This report continues our efforts to fulfill our responsibilities to the Congress and the public by making the government's finances as clear and transparent as possible. Everyone should be able to understand the cost of the government's operations and the implications of its commitments. The Financial Report, which is prepared using the accrual basis of accounting, is intended to meet this objective. Under the accrual basis, transactions are reported when the events giving rise to the transactions occur rather than when cash is received or paid (cash basis).

The importance of this accrual-based report should not be overlooked. The changes affecting the Government over the past decade have resulted in a much smaller share of the budget that is discretionary. Almost two-thirds of the budget goes for mandatory spending such as Social Security and Medicare. Accrual results offer a longer-term view that extends the horizon for making budget decisions. The ability to assess the budget impact of policy decisions is enhanced when this analysis is used in conjunction with our traditional receipts and outlays information. The Financial Report is important in this respect because it highlights this difference, particularly in the Management's Discussion and Analysis section, which goes beyond simply reporting accounting results by discussing the effects of governmental commitments. This year, for the first time, we have grouped together all of the significant liabilities, stewardship responsibilities and other commitments in the front of the report. They total an estimated \$31.1 trillion and represent a measure of the significant commitments the government has made. These amounts have been included separately in the report for several years; however, we believe they become more transparent when they are presented together.

The Financial Report is the only source of this financial information on a government-wide consolidated level, which provides a more transparent picture of the Government's financial position and operations. The importance of this report is also highlighted in this year's results. For fiscal 2002, the Financial Report indicates an accrual-based net operating cost of \$365 billion. This compares to the \$158 billion budget deficit, based generally on the cash basis, for this year's results. The principal difference is the accrual recognition of over \$157 billion of veterans benefit costs. The Financial Report covers the disposition of more than \$1.9 trillion in revenues and \$2.3 trillion in operating costs, as well as extensive stewardship responsibilities and social insurance commitments, such as Social Security, Medicare, and liabilities including civilian and military retirement pensions and benefits.

For Treasury to achieve its goals for improved financial reporting, continued strong support from OMB and all the Chief Financial Officers Act agencies will be critical. We have charted a course for continued improvements, and we expect to implement the plan fully in the fiscal 2004 statements. In my remaining time, Mr. Chairman, I will discuss our progress in the last year and outline some of the planned improvements.

PROGRESS MADE THIS YEAR

This is the sixth year we have prepared consolidated, government-wide financial reports. There have been significant improvements in the agency data. This year, 21 of the 24 CFO Act agencies received clean audit opinions, up from 18 last year and just 6 agencies only 7 years ago. Also, three major agencies, the Social Security Administration, Treasury Department and U.S. Postal Service, completed their financial statement audits by November 15, which was three and a half months earlier than statutorily required. This is a significant achievement and is a model for all agencies to improve the timeliness and usefulness of their financial data. In addition to these improvements in timeliness and data quality, the report includes the summary schedule of total government commitments that improves the transparency of the data.

Data for the Financial Report primarily comes from 24 CFO Act agencies, nine other significant entities and 180 smaller entities. Each agency is financially independent and maintains its own financial system. Preparing the report is a complex task based on a foundation of over 2,000 individual reporting components' standardized Standard General Ledger reporting.

In auditing the Financial Report, GAO was unable to express an opinion on the

reliability of this year's financial statements. This is due primarily to only three areas, data and financial system problems at the Department of Defense (DoD), preparation issues relating to intragovernmental balances both in agency data quality and consolidation eliminations, and consistency with agency financial reporting. However, GAO did acknowledge in its audit report that financial management improvement initiatives are being undertaken that will improve the quality of financial management and reporting in the Federal Government. For example, DoD has been aggressive in improving its financial management and has made real progress in rationalizing and streamlining its systems. In addition, Treasury and OMB have taken a number of steps to address the intragovernmental issue. OMB has issued new intragovernmental business rules for standardizing inter-agency transactions, which will help correct this situation in future years. Also, Treasury's Financial Management Service (FMS) developed a database tool to support Treasury analysis and agency reconciliation of trading partner differences. Finally, consistency will be assured with the identification of a new preparation process I will speak to shortly.

IMPROVEMENTS UNDERWAY

The current state of federal financial reporting needs improvement. I am confident that a creative and committed effort by top management at Treasury, program agencies, OMB, the CFO Council, and GAO can result in breakthrough changes. We are taking aggressive actions to improve government-wide financial management. Later this year, for example, Treasury will provide agencies with a detailed account statement to help them reconcile their fund balance with Treasury. For the very first time, agencies will have more timely access to this statement, as opposed to having to wait up to 45 days for a hard copy report to be issued. The production of this account statement is the next step in a government-wide accounting modernization project that, when completed, will provide agencies with better tools for both reporting their financial information and monitoring its status.

Next year, the plan is to continue the improvement to our systems by beginning to provide agencies the capability to capture and classify transactions directly to the appropriate account at the initiation of the transaction. When fully operational, agencies will have access to financial information in 1-2 days compared to the current timeframe of 15-18 days after the close of the month. This new approach will enable agencies to eliminate duplicative reporting and costly, manually intensive reconciliations.

After extensive consultation with financial managers throughout the government, it was clear that broad and sweeping changes in the compilation process of the Financial Report were necessary to address the “process” material weaknesses (i.e., significantly inadequate systems, controls, and procedures to prepare the Financial Report) identified by GAO. This will require a major rebuilding of the electronic processes used by Treasury’s Financial Management Service to prepare the Financial Report.

Treasury, in coordination with OMB, is adopting a new process to collect agency financial information that will be used to prepare the fiscal 2004 Financial Report. The new data submission, referred to as the “closing package”, will be a web-based submission. Agencies will follow an automated process to convert their audited financial statements to a standardized statement format. Using agency financial statement information in the preparation of the Financial Report will ensure that the data in the Financial Report is consistent with the data in agencies’ audited financial statements. Having consistent data will better leverage audit work done at the agency level and allow GAO to rely on the agency-level audits. These changes, along with modifications in the manner in which FMS performs eliminations and consolidates the data, should eliminate the material compilation weaknesses identified by GAO.

We are also in the process of accelerating agency budget reporting. To facilitate the accelerated deadlines for submission of annual agency-level financial statements and the government-wide financial statements, FMS has accelerated the monthly agency budget reporting timeframes. Federal agencies are required to submit the monthly reporting data within three days following the close of the previous month. The accelerated monthly timeframes will provide the necessary discipline for agencies to prepare their year-end audited financial statements and provide for more timely information to improve decision-making.

The scheduled date for issuing the fiscal 2004 Financial Report is December 15, 2004. Meeting this accelerated timeframe is dependent on agencies improving the quality and timeliness of the information they report and the audit community responding to increased audit responsibilities. While the report was again issued on time, Treasury is the first to acknowledge that reporting financial results six months after the close of a fiscal year is simply not good enough. I currently chair the CFO council committee charged with assisting agencies in meeting the accelerated issuance dates required by OMB for fiscal 2004 for both agency-level financial statements and government-wide financial statements by identifying and removing barriers. This is a significant step forward since we will finally have actual data about the prior year for use in the budget deliberations for the coming year and managers throughout government will have accurate data for day-to-day decision making at all levels.

CONCLUSION

A core responsibility of the Treasury Department is to accurately and effectively report on the nation's finances. Providing transparency to government financial results has been a top priority starting with our first Treasury Secretary, Alexander Hamilton. Long ago we accomplished transparency of budget results. Our challenge is to bring that same transparency to the full extent of our financial

operations. We have made great progress in that quest, and the federal financial community working together will soon realize that vision.

Thank you, Mr. Chairman. This concludes my formal remarks and I would be happy to respond to questions.