



# Federal Financial Reporting: An Overview

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## Summary

Federal financial reporting—defined here as the process of recording retrospective executive department-level financial and performance information—can provide both a snapshot of the government’s financial health at a given moment in time, as well as an accounting of its financial performance over a particular time frame. Federal financial reports may help the federal government demonstrate accountability, provide information for policy formulation and planning, and be used to evaluate governmental performance. Multiple reports are required by law, and all are intended to permit users—Congress, the President, agency heads, program managers, and citizens—to see how the government raises, handles, and expends public money. Congress, in particular, may find the information in federal financial reports useful for oversight.

The Budget and Accounting Procedures Act of 1950 was the first statute to require executive agencies to provide reports and information on their financial condition to the Secretary of the Treasury. The Chief Financial Officers Act of 1990 (CFO Act) mandates the preparation of audited annual financial statements for certain funds and accounts from a number of executive branch agencies, with 10 agencies selected to provide audited annual financial statements for all agency accounts. The latter provision was expanded to every agency covered under the CFO Act (commonly referred to as CFO agencies) in the Government Management Reform Act of 1994 (GMRA) and to every executive agency in the Accountability of Tax Dollars Act of 2002 (ATDA). In addition, the CFO Act requires the director of the Office of Management and Budget (OMB) to furnish an annual financial management status report and a government-wide five-year financial management plan, and GMRA requires the Secretary of the Treasury to provide government-wide annual consolidated financial statements to be audited by the Government Accountability Office (GAO).

GAO has documented improvements to federal financial reporting since the enactment of the CFO Act. Demonstrable progress has been in evidence across numerous financial management indicators, including timeliness, consistency, and auditability. In FY2012, 21 of 24 CFO agencies received unqualified (clean) audit opinions on their annual financial statements, which means that their statements were free of material misstatements and accord with Generally Accepted Accounting Principles (GAAP). Challenges have persisted, though, both within agencies and government-wide.

Unqualified overall audit opinions can obscure material weaknesses that underlie systematic financial management issues. In addition, two agencies—the Department of Homeland Security (DHS) and the Department of Defense (DOD)—have never received unqualified audit opinions, which signifies the persistence of financial problems at these agencies. Government-wide, the U.S. consolidated financial statements have received a disclaimer of opinion every year since they were first required under GMRA. GAO was unable to express an opinion on the FY2012 U.S. consolidated financial statements due to material weaknesses in internal control over financial reporting and other limitations on the scope of its work. Finally, federal financial statements may not provide readily understandable information to their multiple stakeholders.

Congress has recently considered legislation relating to audits of federal financial statements. In the 113<sup>th</sup> Congress, Representative Lee has introduced legislation (H.R. 559) that would require a 5% reduction in a federal agency’s discretionary budgetary authority for failure to produce an annual financial statement or failure to receive either an unqualified or qualified audit opinion on its annual financial statement. H.R. 559 was referred to the Committee on Oversight and

Government Reform and the Committee on Armed Services. The 112<sup>th</sup> Congress considered similar legislation, as well as legislation on audited annual financial statements at DOD and DHS, specifically.

In the 112<sup>th</sup> Congress, Senator Coburn introduced the Audit the Pentagon Act, which would have mandated auditable financial statements by DOD for its FY2017 statements. The legislation also would have required DOD to provide a complete and validated statement of budgetary resources by FY2014. Congress also considered legislation to address problems at the Department of Homeland Security in the 112<sup>th</sup> Congress. The DHS Audit Requirement Target Act of 2012 (DART, 126 Stat. 1591) was signed into law on December 20, 2012. The DART Act directs DHS to obtain an unqualified audit opinion beginning with its FY2013 annual financial statements.

This report will be updated to reflect significant developments.

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## Background

Federal financial reporting—defined here as the process of recording retrospective executive department-level financial and performance information—may provide both a snapshot of the government’s financial health at a given moment in time, as well as an accounting of its financial performance over a given time frame. According to the Federal Accounting Standards Advisory Board (FASAB),<sup>1</sup> the committee that establishes accounting standards for federal entities,

“Financial reporting” may be defined as the process of recording, reporting, and interpreting, in terms of money, an entity’s financial transactions and events with economic consequences for the entity. Reporting in the federal government also deals with nonfinancial information about service efforts and accomplishments of the government, i.e., the inputs of resources used by the government, the outputs of goods and services provided by the government, the outcomes and impacts of governmental programs, and the relationships among these elements.<sup>2</sup>

Responsible stewardship of public money is integral to governmental accountability, and federal financial reports supply information that links stewardship to accountability. According to FASAB, “Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability.”<sup>3</sup> Reliable financial information may facilitate informed decision making, government management, and policy implementation. In addition, federal financial reports may make it easier to monitor waste, fraud, and abuse in federal programs.

Several types of federal financial reports are required by law. Each report presents a distinct array of financial information intended to permit various stakeholders—Congress, the President, agency heads, program managers, and citizens—to evaluate the federal government’s performance relative to the collection and disbursement of public money. Congress, in particular, may utilize the information in federal financial reports for policy formulation and planning, programmatic decision making, and exercising oversight authority (**Figure 1**).

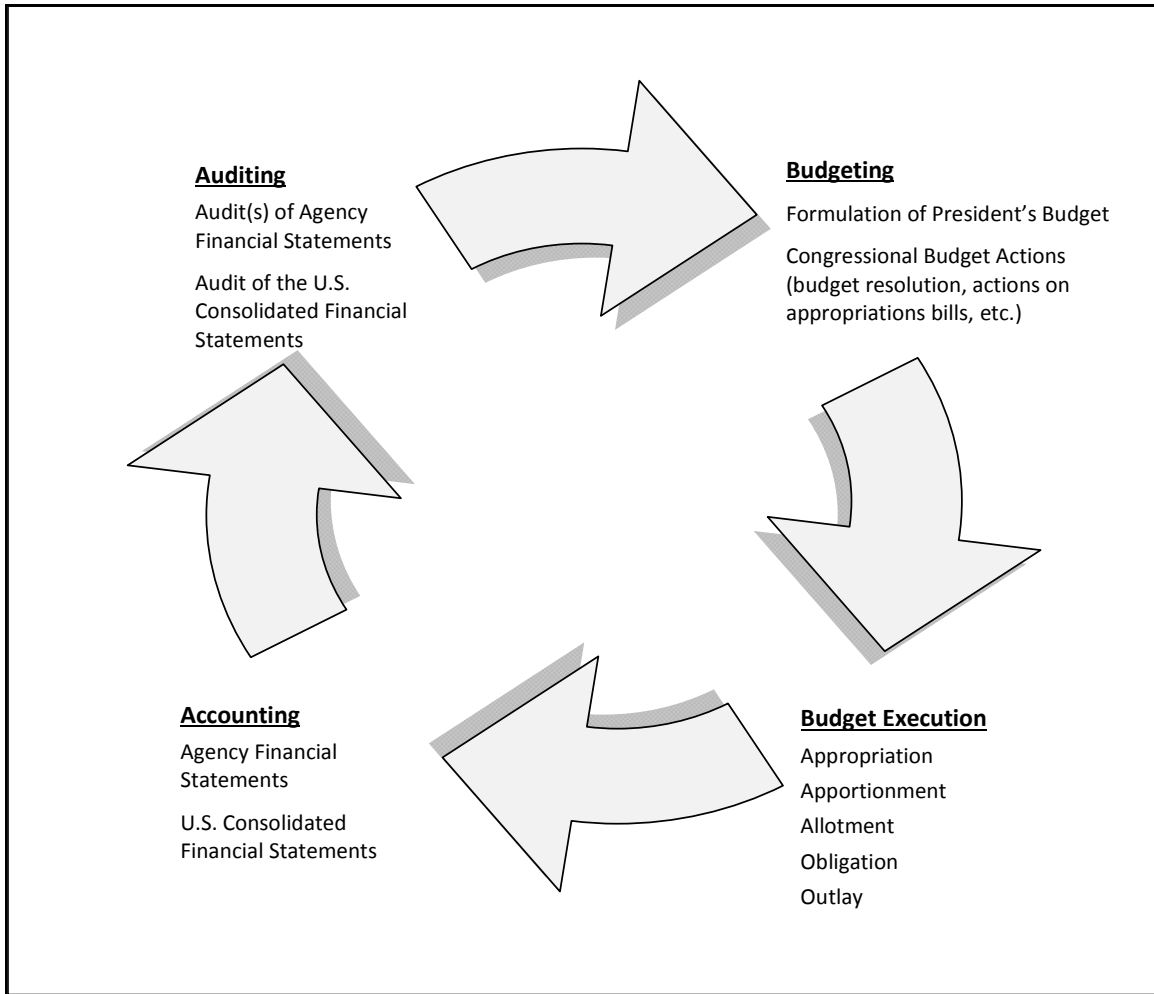
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<sup>1</sup> The Federal Accounting Standards Advisory Board was established in 1990 by the Government Accountability Office (then the General Accounting Office), U.S. Department of the Treasury, and the Office of Management and Budget. Federal Accounting Standards Advisory Board, “The History of FASAB,” webpage, at <http://www.fasab.gov/about/our-history/the-history-of-fasab/>.

<sup>2</sup> Federal Accounting Standards Advisory Board, “SFFAC 1,” in *FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as Amended* (Washington, DC: 2011), p. 10, at [http://www.fasab.gov/pdf/files/2011\\_fasab\\_handbook.pdf](http://www.fasab.gov/pdf/files/2011_fasab_handbook.pdf). SFFAC is an acronym for Statement of Federal Financial Accounting Concepts.

<sup>3</sup> *Ibid.*, p. 21.

**Figure I. The Financial Management Cycle**



**Source:** Adapted from Gerald J. Miller, and Donijo Robbins, “Progressive Government Budgeting,” in Frederic B. Bogui, ed., *Handbook of Governmental Accounting* (Boca Raton, FL: CRC Press, 2009), p. 75.

## Objectives of Federal Financial Reporting

According to FASAB’s “Authoritative Source of Guidance”<sup>4</sup> on generally accepted accounting principles (GAAP), there are four objectives of federal financial reporting: budgetary integrity, operating performance, stewardship, and systems and control.<sup>5</sup> FASAB defines a set of concepts for federal entities’ general purpose financial reporting that meet these objectives.<sup>6</sup> Each statutorily mandated report addresses these objectives, albeit with varying degrees of emphasis.

<sup>4</sup>Federal Accounting Standards Advisory Board, “Authoritative Source of Guidance,” at <http://www.fasab.gov/accounting-standards/authoritative-source-of-gaap/>.

<sup>5</sup> Federal Accounting Standards Advisory Board, “SFFAC 1,” p. 21.

<sup>6</sup> Federal Accounting Standards Advisory Board, “SFFAC 2,” in *FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as Amended*, p. 5. FASAB does not, however, identify those entities actually responsible for preparing and issuing financial statements. Federal statutes, as explained below, enumerate which agencies must issue federal financial reports.

**Budgetary integrity.** A federal financial report may satisfy the budgetary integrity objective if it provides information on “how budgetary resources have been obtained and used.”<sup>7</sup> The Statement of Budgetary Resources, which must be included in agencies’ annual financial statements, accords with the budgetary integrity objective by providing information on budgetary resources, obligations, and outlays.

**Operating performance.** A federal financial report may meet the operating performance objective by providing information on program and activity costs and accomplishments, as well as management of the reporting entity’s assets and liabilities.<sup>8</sup> An example is the Statement of Net Cost required in agencies’ annual financial statements. The Statement of Net Cost specifically addresses the operating performance objective<sup>9</sup> through its inclusion of information on program costs and the net cost of operations for the entire reporting entity, amongst other cost-related items.<sup>10</sup>

**Stewardship.** The stewardship objective concerns the government’s financial position, defined as “a point-in-time snapshot of an entity’s economic resources and the claims on those resources,” and financial condition, which also conveys information about current financial health, as well as future expectations.<sup>11</sup> The *Financial Report of the United States Government*, the annual report on government-wide financial and performance information required by law, documents whether the government’s financial position improved or worsened over the reporting period, indicates whether current budgetary resources are sustainable to meet future obligations, and presents other key indicators of the government’s financial position and condition.<sup>12</sup> In so doing, it permits the reader to evaluate whether the government has been an effective steward of the nation’s resources.

**Systems and control.** The systems and control objective states that federal financial reports should assist readers in determining whether financial management systems, internal accounting, and administrative controls are sufficient to satisfy the three previous objectives of budgetary integrity, operating performance, and stewardship.<sup>13</sup> Management’s assertions about the effectiveness of internal controls<sup>14</sup>—for example, the “Management Assurances” statement in agencies’ annual Performance and Accountability Reports (PARs)—fulfill the systems and control objective by documenting internal control over financial reporting.<sup>15</sup>

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<sup>7</sup> Federal Accounting Standards Advisory Board, “SFFAC 1,” p. 1.

<sup>8</sup> *Ibid.*, p. 2.

<sup>9</sup> Federal Accounting Standards Advisory Board, “SFFAC 2,” p. 22.

<sup>10</sup> Office of Management and Budget, *Financial Reporting Requirements*, August 3, 2012, at [http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a136/a136\\_revised\\_2012.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a136/a136_revised_2012.pdf).

<sup>11</sup> Federal Accounting Standards Advisory Board, “SFFAC 1,” p. 46.

<sup>12</sup> U.S. Department of the Treasury, *2011 Financial Report of the United States Government*, at <http://www.fms.treas.gov/frsummary/frsummary2011.pdf>.

<sup>13</sup> Federal Accounting Standards Advisory Board, “SFFAC 1,” p. 37.

<sup>14</sup> *Ibid.*

<sup>15</sup> Office of Management and Budget, Circular A-123, *Management’s Responsibility for Internal Control*, December 21, 2004, at [http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a123/a123\\_rev.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a123/a123_rev.pdf).

## **Audiences for Federal Financial Reports**

FASAB identifies several audiences of federal financial reports: Congress, the President, agency heads, program managers, and citizens. Federal financial reports might be useful to each of these audiences for different reasons. In addition, certain aspects of federal financial reports might vary in degree of relevance for the stakeholder in question.

- Congress may use financial information contained in financial reports to conduct oversight of federal government programs and policies, consider policy alternatives, make decisions on the financing and execution of programs, monitor the effect of governmental financial commitments on the economy, and address persistent, long-standing accountability problems.
- The President and agency heads may use financial information to evaluate program performance, make program reauthorization decisions, and provide Congress with the resources necessary to perform its oversight function.
- Program managers may use financial information to ensure that resources are allocated properly, detect waste and inefficiency in program operations, and provide information that enables Congress, the President, and agency heads to monitor programs and activities.
- Citizens may use financial information to evaluate whether their elected and appointed representatives are responsible stewards of the public purse and gauge whether “the government is functioning economically, efficiently, and effectively.”<sup>16</sup>

## **Statutory History and Current Authorities**

### **Early Foundations of Modern Federal Financial Reporting**

The U.S. Constitution serves as the foundation for federal financial reporting. Article I, Section 9, paragraph 7 states, “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.” This clause grants Congress the “power of the purse” but also requires a regular report of the receipts and expenditures of public money. In so doing, it links appropriations to accountability. Justice Joseph Story, who served on the U.S. Supreme Court from 1811-1845, stated, “Congress is made the guardian of this treasure; and to make their responsibility complete and perfect, a regular account of the receipts and expenditures is required to be published, that the people may know, what money is expended, for what purposes, and by what authority.”<sup>17</sup> More recently, one Senator has observed of the appropriations-accountability link, “This is Congress’s most important check on the executive branch in the Constitution’s entire scheme of checks and balances. Congress cannot

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<sup>16</sup> “SFFAC 1,” p. 23.

<sup>17</sup> Joseph Story, *Commentaries on the Constitution* (Boston: Hilliard, Gray, and Company, 1833), vol. 3, §§ 1341-43, at [http://press-pubs.uchicago.edu/founders/documents/a1\\_9\\_7s4.html](http://press-pubs.uchicago.edu/founders/documents/a1_9_7s4.html).



know that the executive branch is obeying the first part of the appropriations clause (spending) of the Constitution without confidence in the second (accountability).”<sup>18</sup>

Several measures subsequently established provisions for federal financial reporting that expanded on the constitutional mandate. In 1791, the U.S. House of Representatives approved a resolution on statements of receipts and expenditures. It resolved

That it shall be the duty of the Secretary of the Treasury to lay before the House of Representatives, on the fourth Monday of October in each year, if Congress shall then be in session, or if not then in session, within the first week of the session next following the said fourth Monday of October, an accurate statement and account of the receipts and expenditures of all public moneys, down to the last day inclusively of the month of December immediately preceding the said fourth Monday of October, distinguishing the amount of the receipts in each State or District, and from each officer therein; in which statements shall also be distinguished the expenditures which fall under each head of appropriation, and shall be shown the sums, if any, which remain unexpended, and to be accounted for in the next statement, of each and every of such appropriation.<sup>19</sup>

Two pieces of legislation enacted during the Progressive Era further expanded on federal financial reporting requirements. The Dockery Act of 1894 required the Secretary of the Treasury to provide Congress with “an accurate, combined statement of the receipts and expenditures during the last preceding fiscal year of all public moneys.”<sup>20</sup> Appropriations legislation for FY1908 legislative, executive, and judicial expenses contained a section that required the Secretary of the Treasury to include estimates of current and future public revenue and expenditures in its annual report to Congress.<sup>21</sup>

Finally, the Budget and Accounting Procedures Act of 1950 (BAPA) made significant changes to federal reporting requirements, and arguably was the foundation for present-day financial reporting.<sup>22</sup> BAPA authorized the Comptroller General, in consultation with OMB (formerly Bureau of the Budget) and Treasury, to “prescribe the principles, standards, and related requirements for accounting to be observed by each executive agency, including requirements for suitable integration between the accounting processes of each executive agency and the accounting of the Treasury Department.”<sup>23</sup> Additionally, BAPA required agency heads to “establish and maintain systems of accounting and internal control designed to provide

- (1) full disclosure of the financial results of the agency’s activities;
- (2) adequate financial information needed for the agency’s management purposes;

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<sup>18</sup> Senator Tom Coburn, “Amendment #3111, Importance of Audit the Pentagon Act—Talking Points,” undated, at [http://www.coburn.senate.gov/public//index.cfm?a=Files.Serve&File\\_id=eb595449-4af1-4c8c-a6d3-f1567b1fc60c](http://www.coburn.senate.gov/public//index.cfm?a=Files.Serve&File_id=eb595449-4af1-4c8c-a6d3-f1567b1fc60c)

<sup>19</sup> U.S. Congress, House of Representatives, *Annals of Congress*, 2<sup>nd</sup> Cong., 1<sup>st</sup> sess., December 30, 1791, p. 302.

<sup>20</sup> 28 Stat. 205, July 31, 1894 (at 210). The Dockery Act, it has been written, provided “for a greater centralization of accounting functions and for a single audit of accounts in place of the ancient and cumbersome system of triplicate audits.” Paul Studenski and Herman E. Kroos, *Financial History of the United States* (New York: McGraw-Hill Book Company, 1952), p. 224.

<sup>21</sup> 34 Stat. 949, February 26, 1907.

<sup>22</sup> 64 Stat. 832, September 12, 1950.

<sup>23</sup> 64 Stat. 835.

(3) effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit;

(4) reliable accounting results to serve as the basis for preparation and support of the agency's budget requests, for controlling the execution of its budget, and for providing financial information ... ; [and]

(5) suitable integration of the accounting of the agency with the accounting of the Treasury Department[.]”<sup>24</sup>

BAPA further required the Secretary of the Treasury to use agencies' financial information to prepare “such reports for the information of the President, the Congress, and the public as will present the results of the financial operations of the Government.”<sup>25</sup>

## **The Current Statutory Framework for Federal Financial Reporting**

During the past two decades, Congress has further developed federal financial reporting through enactment of three statutes: (1) the Chief Financial Officers Act of 1990 (CFO Act), the Government Management Reform Act of 1994 (GMRA), and (3) the Accountability of Tax Dollars Act of 2002 (ATDA).

### **Chief Financial Officers Act of 1990**

According to the Government Accountability Office (GAO, then the General Accounting Office), the CFO Act<sup>26</sup>

is the most comprehensive and far-reaching financial management improvement legislation since the Budget and Accounting Procedures Act of 1950 was passed ... The CFO Act will lay a foundation for comprehensive reform of federal financial management. The act establishes a leadership structure, provides for long-range planning, requires audited financial statements, and strengthens accountability reporting.<sup>27</sup>

More specifically, the CFO Act

- established the Office of Federal Financial Management (OFFM) within OMB and designated a CFO in each executive department and major executive agency (subsequently known as CFO agencies);
- requires each CFO agency to prepare and audit annual financial statements for each revolving fund and trust fund and for accounts that performed substantial commercial functions;

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<sup>24</sup> 64 Stat. 836.

<sup>25</sup> Ibid.

<sup>26</sup> 104 Stat. 2838, November 15, 1990.

<sup>27</sup> General Accounting Office, *The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform*, GAO/AFMD-12.19.4, September 1991, p. 1, at <http://www.gao.gov/special.pubs/af12194.pdf>.

- directed 10 agencies, including the Department of Agriculture, the General Services Administration, and the Department of the Army, to prepare audited financial statements for all of their agency accounts;<sup>28</sup> and
- requires the director of the OMB to produce an annual financial management status report and a government-wide, five-year financial management plan.<sup>29</sup>

## **Government Management Reform Act of 1994**

GMRA<sup>30</sup> carried a range of provisions that sought to “improve the management of the Federal government through reforms to the management of human resources, financial management, and by other means.”<sup>31</sup>

With regard to financial reporting, GMRA expanded the number of agencies covered by the CFO Act’s reporting provisions from 10 to all CFO agencies (then 23).<sup>32</sup> The statute also requires

- all CFO agencies to prepare and submit audited financial statements for the previous year for all accounts and activities to the director of OMB;
- the Secretary of the Treasury to coordinate with the Director of OMB to prepare and submit an audited financial statement for the preceding fiscal year (i.e., all accounts and activities of the U.S. government) to the President and Congress beginning with financial statements prepared for FY1997; and
- GAO to audit these financial statements.

## **Accountability of Tax Dollars Act of 2002**

To build upon this improvement, Congress enacted ATDA,<sup>33</sup> which

- further expanded the CFO Act’s reporting requirements to cover all executive branch agencies to prepare and submit audited financial statements to OMB and the Congress; and

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<sup>28</sup> The latter provision was expanded to every covered CFO agency under GMRA and to every executive agency under ATDA.

<sup>29</sup> For an assessment of the CFO Act, see the Chief Financial Officers Council and the Council of Inspectors General on Integrity and Efficiency, *The Chief Financial Officers Act of 1990—20 Years Later*, July 2011, at <http://www.ignet.gov/randp/cigiecfoprpt0711.pdf>.

<sup>30</sup> 108 Stat. 3410, October 13, 1994.

<sup>31</sup> U.S. Congress, Senate, Committee on Governmental Affairs, *Government Management Reform Act of 1994*, report to accompany S. 2170, 2<sup>nd</sup> sess., S. Rept. 103<sup>rd</sup> Congress (Washington: GPO, 1994), p. 1. For example, the statute established a pilot program in 6 agencies that permitted them to sell (“franchise”) services to other federal agencies, and also limited the automatic cost of living raises for Members of Congress, the Executive Schedule, and the judiciary to not exceed those given to General Schedule (GS) federal employees. The statute emerged subsequent to the National Performance Review of President William J. Clinton and Vice President Albert Gore, Jr. See Office of the Vice President, “From Red Tape to Results: Creating a Government that Works Better & Costs Less: Report of the National Performance Review,” 1993.

<sup>32</sup> For a current list of CFO agencies, see the **Appendix**.

<sup>33</sup> 116 Stat. 2049, November 7, 2002.

- permits OMB to exempt a non-CFO agency from this requirement if “the total amount of budget authority available to the agency for the fiscal year does not exceed \$25,000,000; and ... the Director determines that requiring an annual audited financial statement for the agency with respect to the fiscal year is not warranted due to the absence of risks associated with the agency’s operations, the agency’s demonstrated performance, or other factors that the Director considers relevant.”<sup>34</sup>

The Senate committee report on ATDA stated

The financial reporting requirements of GMRA have prompted improvement in federal financial accountability. There has been steady progress at federal agencies toward achieving unqualified, or ‘clean,’ audit opinions. Only 6 of the 24 CFO Act agencies received clean opinions for fiscal year 1996, the first year GMRA was effective. For fiscal year 2001, 18 of the 24 agencies received clean opinions, and all of the CFO Act agencies met the statutory reporting deadline for the second year in a row.<sup>35</sup>

## Selected Federal Financial Reports

Each agency produces a range of reports on its financial activities. These reports are produced on different timetables and include different data and may be intended for either internal or external audiences.

**Table 1** presents a selection of required annual federal financial reports. These reports provide data and analyses that are particularly useful for stakeholders wishing to examine agencies’ financial performance in the previous year.

**Table 1. Selected Federal Financial Reports: Authorities and Requirements**

Report	Authorities	Submitted From	Submitted To	Submission Date	Contains
Agency Financial Report	CFO Act (1990)	Agency head	Congress	November 15	Agency Head Message
	GMRA (1994)		GAO		Management’s Discussion and Analysis (MD&A)
	ATDA (2002)		OMB		Financial Section <sup>a</sup>
			Treasury (Main / FMS)		Other Accompanying Information (OAI)

<sup>34</sup> 116 Stat. 2049.

<sup>35</sup> U.S. Congress, Senate Committee on Governmental Affairs, *Accountability of Tax Dollars Act of 2002*, report to accompany S. 2644, 107<sup>th</sup> Congress, 2<sup>nd</sup> sess., S.Rept. 107-331 (Washington: GPO, 2002), p. 1.

Report	Authorities	Submitted From	Submitted To	Submission Date	Contains
Financial Report of the United States Government	GMRA (1994)	Secretary of the Treasury (coordinates with Director of OMB)	Congress President	December 15	Citizen's Guide Management's Discussion and Analysis (MD&A) Financial Statements Notes to Financial Statements Supplemental Information Stewardship Information GAO Auditor's Report
Federal Financial Management Report <sup>b</sup>	CFO Act (1990)	Director of OMB	Congress	January 31	Description of financial management in the executive branch Summary of agencies' audited financial statements Government-wide 5-year financial management plan

**Source:** Compiled by CRS from several sources: relevant statutory authorities (CFO Act, GMRA, and ATDA); Office of Management and Budget, *Financial Reporting Requirements*, August 3, 2012, at [http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a136/a136\\_revised\\_2012.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a136/a136_revised_2012.pdf); Department of the Treasury, *Financial Report of the United States Government* (selected years), <http://www.fms.treas.gov/fr/index.html>; Government Accountability Office, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-09-946SP, September 2009, at <http://www.gao.gov/assets/80/77222.pdf>.

**Notes:** While the submission date varies for the different reports, each is required annually.

- a. The Financial Section must contain: a CFO Letter, an Auditor's Report, and Financial Statements and Notes. Financial Statements and Notes consists of the principal financial statements—Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, Statement of Custodial Activity (when applicable), Statement of Social Insurance (when applicable), and Statement of Changes in Social Insurance Amounts (when applicable)—and notes to financial statements, required supplementary information (RSI), and required supplementary stewardship information (RSSI). Office of Management and Budget, *Financial Reporting Requirements*, August 3, 2012, at [http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a136/a136\\_revised\\_2012.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a136/a136_revised_2012.pdf).
- b. The most recent Federal Financial Management Report that CRS was able to locate is the 2009 report. Office of Management and Budget, *Federal Financial Management Report 2009*, at [http://www.whitehouse.gov/sites/default/files/omb/assets/about\\_omb/2009\\_fin.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/about_omb/2009_fin.pdf).

## Possible Oversight Issues for Congress

More than two decades have passed since the enactment of the first of the modern financial reporting statutes—the CFO Act. As recounted below, the congressional efforts to upgrade federal financial reporting have produced significant achievements; however, challenges remain.

### Achievements in Federal Financial Reporting Since the CFO Act

Prior to the enactment of the CFO Act, GAO contended that agency-wide problems with internal control, poor executive management, and dated accounting systems were costing taxpayers

billions of dollars.<sup>36</sup> Testifying before the House Committee on Government Operations, then-Comptroller General Charles A. Bowsher stated, “In 1990, the federal government is operating with 1950s vintage accounting systems and concepts that just do not get the job done.”<sup>37</sup> One bureau in a cabinet-level department, for example, had an unexpended balance recorded in its system that differed by over five times that reported by contractors and grantees.<sup>38</sup> Some financial managers attributed the prevalence of such poor financial information to the lack of an auditability requirement for executive departments.<sup>39</sup> Auditable financial statements, GAO has noted, form a pillar of the financial management structure insofar as they enhance the reliability of financial information and assist stakeholders in diagnosing problems preemptively.<sup>40</sup>

Low-quality financial information can have congressional implications. Writing prior to enactment of the CFO Act, GAO observed that financial statements did not disclose fully the federal government’s financial commitments.<sup>41</sup> According to GAO, incomplete disclosures of financial information limited informed policymaking.<sup>42</sup> GAO recommended a permanent federal financial management structure that would ameliorate these problems and recommended that Congress pass legislation that would require, amongst other provisions, the preparation of auditable agency financial statements.<sup>43</sup>

Less than four years after the passage of the CFO Act, Comptroller General Bowsher noted its effect on federal financial reporting:

The act’s requirement for producing annual audited financial statements, in particular, is demonstrating its value in many important ways, including better highlighting the agencies’ true financial conditions. Audited financial statements have also been integral to identifying management inefficiencies and weaknesses and highlighting gaps in safeguarding the government’s assets and possible illegal acts. Additionally, the CFO Act financial audits have identified actual and potential savings of hundreds of millions of dollars.<sup>44</sup>

Further improvements have built on these initial results, with demonstrable progress across numerous financial management indicators, including timeliness, consistency, and auditability.

The CFO Act mandated the production of timely financial information. Overall, agencies have accelerated the delivery of their annual auditable financial statements from the statutorily required

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<sup>36</sup> General Accounting Office, *Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses*, GAO/AFMD-90-10, November 1989, p. 4, at <http://www.gao.gov/assets/150/148414.pdf>.

<sup>37</sup> General Accounting Office, *Financial Management Reform*, T-AFMD-90-31, September 17, 1990, p. 2, at <http://www.gao.gov/assets/110/103480.pdf>.

<sup>38</sup> General Accounting Office, *Managing The Cost Of Government: Building An Effective Financial Management Structure*, GAO/AFMD-85-35-A, February 1985, p. 11, at <http://archive.gao.gov/d10t2/126342.pdf>.

<sup>39</sup> Ibid.

<sup>40</sup> General Accounting Office, *The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform*, p. 14.

<sup>41</sup> General Accounting Office, *Managing The Cost Of Government: Building An Effective Financial Management Structure*, pp. 13-14.

<sup>42</sup> Ibid.

<sup>43</sup> General Accounting Office, *Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses*, p. 54.

<sup>44</sup> General Accounting Office, *Financial Management: CFO Act Is Achieving Meaningful Progress*, GAO/T-AIMD-94-149, June 21, 1994, p. 1, at <http://www.gao.gov/assets/110/105597.pdf>.

five months (following the close of the fiscal year) to the current time frame of 45 days from the end of the fiscal year.<sup>45</sup> According to a joint report in 2011 from the Chief Financial Officers (CFO) Council and the Council of Inspectors General on Integrity and Efficiency (CIGIE), the financial reporting requirements in the CFO Act<sup>46</sup> have translated into higher quality and more consistent financial information, which has “provided increasing levels of credibility and confidence in government finances.”<sup>47</sup> In FY2012, 21 of 24 CFO agencies received unqualified audit opinions on their annual financial statements. As shown in **Figure 2**, the number of CFO agencies per year with unqualified audit opinions has steadily increased over time, from 6 in FY1996 to 13 in FY1999 to 18 in FY2005 to the current high of 21. Unqualified (clean) opinions<sup>48</sup> on financial statements are indicators of strong financial management.<sup>49</sup>

## Ongoing Challenges

The CFO Act, as amended by GMRA and ATDA, established a legislative framework that enhanced federal financial reporting, though several challenges have persisted, both at the agency level and government-wide. In addition, federal financial statements may not provide readily understandable information to their multiple stakeholders.

## Financial Reporting Issues Within the CFO Agencies

Across the CFO agencies, the increase in numbers of unqualified audit opinions reflects the general trend over time (**Figure 2**), but these overall opinions may be only partially revealing. Unqualified overall audit opinions can obscure material weaknesses that underlie systematic financial management issues. In addition, two agencies—the Department of Homeland Security (DHS) and the Department of Defense (DOD)—have never received unqualified audit opinions, which signifies the persistence of financial problems at these agencies.<sup>50</sup>

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<sup>45</sup> Chief Financial Officers Council and the Council of Inspectors General on Integrity and Efficiency, *The Chief Financial Officers Act of 1990—20 Years Later*, p. 13.

<sup>46</sup> As amended by GMRA and ATDA.

<sup>47</sup> Chief Financial Officers Council and the Council of Inspectors General on Integrity and Efficiency, *The Chief Financial Officers Act of 1990—20 Years Later*, p. 12.

<sup>48</sup> An unqualified or clean opinion means that an agency’s financial statements are free of material misstatements and accord with Generally Accepted Accounting Principles (GAAP). Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, OMB Bulletin No. 07-04, September 4, 2007, p. 14, at <http://www.whitehouse.gov/sites/default/files/omb/assets/omb/bulletins/fy2007/b07-04.pdf>. There are three other types of audit opinions: a qualified opinion is issued when financial statements are fairly presented but there is a misstatement or some portion of the financial statements could not be audited; an adverse opinion states that the information contained in the financial statements is materially incorrect; and a disclaimer of opinion indicates that the auditor is unable to form an opinion on the financial statements.

<sup>49</sup> Chief Financial Officers Council and the Council of Inspectors General on Integrity and Efficiency, *The Chief Financial Officers Act of 1990—20 Years Later*, p. 13.

<sup>50</sup> The President’s budget submission for FY2013 includes a request for \$613.9 billion in discretionary budget authority for DOD. Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *Overview: United States Department of Defense Fiscal Year 2013 Budget Request*, February 2012, p. 1-1, at [http://comptroller.defense.gov/defbudget/fy2013/FY2013\\_Budget\\_Request\\_Overview\\_Book.pdf](http://comptroller.defense.gov/defbudget/fy2013/FY2013_Budget_Request_Overview_Book.pdf). According to GAO, this represents about 57 percent of the discretionary federal budget authority requested for FY2013. Government Accountability Office, *DOD Financial Management: Challenges in Attaining Audit Readiness and Improving Business Processes and Systems*, GAO-12-642T, pp. 2-3, at <http://www.gao.gov/assets/600/590203.pdf>.

## ***Material Weaknesses***

Some agencies have received unqualified overall audit opinions despite auditor-identified financial material weaknesses<sup>51</sup> that would not necessarily affect an agency's overall audit opinion but could signal costly underlying financial management issues regardless.<sup>52</sup> GAO has observed that "[m]any CFO Act agencies have obtained clean or unqualified audit opinions on their financial statements, but the underlying agency financial systems and controls still have some serious problems."<sup>53</sup> For example, the Department of Labor (DOL) received an unqualified audit opinion on its FY2011 consolidated financial statements, but the auditor's report still identified three material weaknesses:

- lack of sufficient controls over financial reporting;
- lack of sufficient controls over budgetary accounting; and
- lack of sufficient security controls over key financial and support systems.<sup>54</sup>

The auditor cited one case in which differences between general ledger transactions in DOL's accounting and reporting system and the consolidated trial balance for several general ledger accounts ranged from \$30 billion to \$47 billion for each account.<sup>55</sup> In general, OMB has suggested that as material weaknesses increase, so too does the likelihood of a significant misstatement in financial information.<sup>56</sup> According to OMB, unreliable financial information can inhibit program management and policy implementation.<sup>57</sup>

## ***Financial Reporting Problems at DHS and DOD***

Neither DHS nor DOD has ever achieved an unqualified audit opinion.<sup>58</sup> After eight years of disclaimers, though, DHS received a qualified audit opinion on its FY2011 annual financial statements.<sup>59</sup> The qualified audit opinion represented an improvement over the preceding disclaimers in that most of the line items on DHS's balance sheet were materially correct for the

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<sup>51</sup> According to OMB, "A material weakness is defined as a significant deficiency, or combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected." Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, p. 6.

<sup>52</sup> With regard to internal control over financial reporting, one or more material weaknesses would not necessarily affect the overall audit opinion, provided that the material weaknesses do not result in a limitation on the scope of the auditor's work.

<sup>53</sup> Government Accountability Office, *CFO Act of 1990: Driving the Transformation of Federal Financial Management*, GAO-06-242T, November 17, 2005, p. 16, at <http://www.gao.gov/new.items/d06242t.pdf>.

<sup>54</sup> U.S. Department of Labor, *Agency Financial Report: Fiscal Year 2011*, November 14, 2011, p. 35, at [http://www.dol.gov/\\_sec/media/reports/annual2011/2011annualreport.pdf](http://www.dol.gov/_sec/media/reports/annual2011/2011annualreport.pdf).

<sup>55</sup> DOL's Office of the Chief Financial Officer (OFCO) ultimately provided revised data to the auditors that permitted reconciliation. *Ibid.*, p. 41.

<sup>56</sup> Office of Management and Budget, *Increase Reliability of Financial Information*, Performance.gov, at <http://finance.performance.gov/initiative/increase-reliability/home>.

<sup>57</sup> *Ibid.*

<sup>58</sup> Government Accountability Office, *Financial Audit: U.S. Government's Fiscal Years 2012 and 2011 Consolidated Financial Statements*, GAO-13-271R, January 17, 2013, p. 28, at <http://www.gao.gov/assets/660/651357.pdf>.

<sup>59</sup> Office of Management and Budget, *Increase Reliability of Financial Information*, Performance.gov, at <http://finance.performance.gov/initiative/increase-reliability/agency/DHS>.



first time since FY2003.<sup>60</sup> DHS's FY2012 annual financial statements also received a qualified opinion.<sup>61</sup> DHS has stated that its next financial management objective is progress toward an unqualified audit opinion.<sup>62</sup> In order to accomplish this goal, DHS indicated that it would use risk assessments to identify and correct material weaknesses and deficiencies; implement a plan to modernize its core financial management system; establish standard business practices and internal controls, as well as implement a standard line of accounting; and retroactively obtain a clean, full-scope audit opinion on its FY2012 financial statements.<sup>63</sup>

Unlike DHS, DOD's current objective is auditability. Its annual financial statements have received a disclaimer of opinion since 1997, the first year in which department-wide annual audited financial statements were required.<sup>64</sup>

At a House hearing on financial management at DOD, Daniel Blair, the deputy inspector general for auditing at DOD, identified data quality, internal controls, and financial systems as three impediments to auditability.<sup>65</sup> Between FY2007 and FY2011, DOD's Office of Inspector General (OIG) issued 89 reports citing data quality problems.<sup>66</sup> Deputy Inspector General Blair described one example of a data quality issue in which DOD did not provide reliable information to Congress on the costs of Guam realignment for calendar year 2009—obligations were understated by over 10%, and expenditures were overstated by over 35%.<sup>67</sup> Poor internal controls have also had financial repercussions, according to Deputy Inspector General Blair.<sup>68</sup> In one example, Army Commercial Vendor Services incorrectly coded domestic contractors as foreign and then failed to file federal information returns to the Internal Revenue Service (IRS) for approximately 316 of the incorrectly coded payments in the amount of \$351.92 million.<sup>69</sup> The OIG identified 13 areas of material weakness in DOD's financial reporting for FY2012.<sup>70</sup> Among the issues with financial

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<sup>60</sup> U.S. Department of Homeland Security, *U.S. Department of Homeland Security Annual Financial Report: Fiscal Year 2011*, November 11, 2011, p. 256, at [http://www.dhs.gov/xlibrary/assets/mgmt/cfo\\_afry2011.pdf](http://www.dhs.gov/xlibrary/assets/mgmt/cfo_afry2011.pdf).

<sup>61</sup> U.S. Department of Homeland Security, *Annual Financial Report: Fiscal Year 2012*, November 15, 2012, p. 193, at <http://www.dhs.gov/sites/default/files/publications/dhs-annual-financial-report-fy2012-fullpdf.pdf>.

<sup>62</sup> *Ibid.*, pp. 280-281.

<sup>63</sup> *Ibid.*, p. 281. The DHS Audit Requirement Target Act of 2012 (DART, 126 Stat. 1591), which requires DHS to obtain an unqualified audit opinion beginning with its FY2013 annual financial statements, was passed soon after the publication of DHS's Annual Financial Report for FY2012. The DART Act will be discussed in a subsequent section of this report.

<sup>64</sup> Government Accountability Office, *DOD Financial Management: Improvement Needed in DOD Components' Implementation of Audit Readiness Effort*, GAO-11-851, September 2011, p. 4, at <http://www.gao.gov/new.items/d11851.pdf>; Office of Management and Budget, *Increase Reliability of Financial Information*, Performance.gov, at <http://finance.performance.gov/initiative/increase-reliability/agency/DOD>.

<sup>65</sup> U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on Government Organization, Efficiency, and Financial Management, *The Department of Defense: Challenges in Financial Management*, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., September 23, 2011, H. Hrg. HRG-2011-CGR-0103, p. 23.

<sup>66</sup> *Ibid.*, p. 25.

<sup>67</sup> *Ibid.*

<sup>68</sup> *Ibid.*, p. 27.

<sup>69</sup> *Ibid.*

<sup>70</sup> The 13 auditor-identified material weaknesses are: Financial Management Systems; Fund Balance with Treasury; Accounts Receivable; Inventory; Operating Materials and Supplies; General Property, Plant, and Equipment; Government Property in Possession of Contractors; Accounts Payable; Environmental Liabilities; Statement of Net Cost; Intragovernmental Eliminations; Accounting Entries; and Reconciliation of Net Cost of Operations to Budget. U.S. Department of Defense, *Agency Financial Report: Fiscal Year 2012*, November 15, 2012, p. 73, at [http://comptroller.defense.gov/afr/fy2012/DoD\\_FY12\\_Agency\\_Financial\\_Report.pdf](http://comptroller.defense.gov/afr/fy2012/DoD_FY12_Agency_Financial_Report.pdf).

systems is the Logistics Modernization Program, the Army Working Capital Fund's system for achieving auditable financial statements.<sup>71</sup> According to a 2011 OIG report, the Logistics Modernization Program was in development for 10 years and cost \$1.1 billion, yet did not produce a system that was compliant with the U.S. Standard General Ledger.<sup>72</sup>

While the goal for DOD is auditability, auditability is not an end unto itself.<sup>73</sup> According to Deputy Inspector General Blair, auditable financial statements indicate improvement to the three impediments to auditability—data quality, internal controls, and financial systems.<sup>74</sup> The deputy inspector general noted that improvements in these three areas would permit DOD to provide accurate and timely financial information.<sup>75</sup> In the absence of reliable financial information, DOD is vulnerable to waste, fraud, and abuse. One GAO report states that

DOD financial management has been on GAO's high-risk list since 1995 and, despite several reform initiatives, remains on the list today. Pervasive deficiencies in financial management processes, systems, and controls, and the resulting lack of data reliability, continue to impair management's ability to assess the resources needed for DOD operations; track and control costs; ensure basic accountability; anticipate future costs; measure performance; maintain funds control; and reduce the risk of loss from fraud, waste, and abuse. DOD spends billions of dollars each year to maintain key business operations intended to support the warfighter, including systems and processes related to the management of contracts, finances, supply chain, support infrastructure, and weapon systems acquisition. These operations are directly impacted by the problems in financial management. In addition, the long-standing financial management weaknesses have precluded DOD from being able to undergo the scrutiny of a financial statement audit.<sup>76</sup>

Congress has had a sustained interest in financial management problems at DOD. Reliable financial information helps Congress “distinguish between necessary budget cuts and cuts that would harm our troops and damage military readiness.”<sup>77</sup> Various House and Senate committees have held hearings on the issue, and the House Armed Services Committee convened an oversight panel in the 112<sup>th</sup> Congress to perform a comprehensive review of DOD's financial management system. The House Armed Services Committee Panel on Defense Financial Management and Auditability Reform evaluated DOD's financial management challenges and plans for audit readiness and recommended courses of action in these areas.<sup>78</sup> The severity of the financial

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<sup>71</sup> U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on Government Organization, Efficiency, and Financial Management, *The Department of Defense: Challenges in Financial Management*, p. 35.

<sup>72</sup> Ibid.

<sup>73</sup> Ibid., p. 38.

<sup>74</sup> Ibid.

<sup>75</sup> Ibid., p. 39.

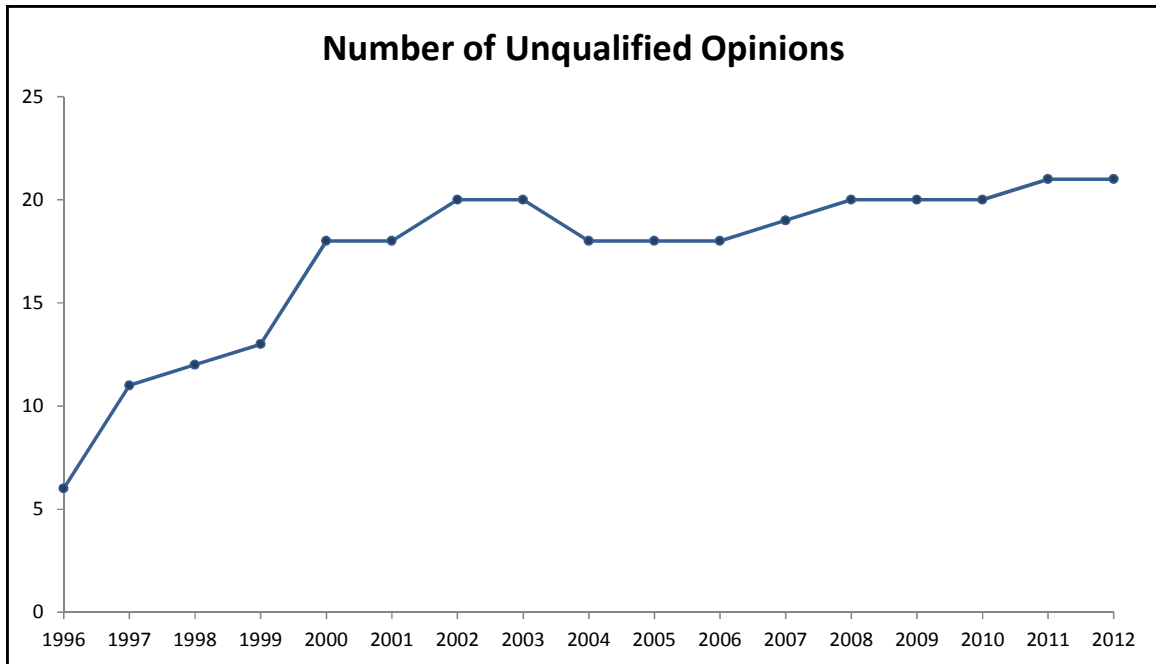
<sup>76</sup> Government Accountability Office, *DOD Financial Management: Numerous Challenges Must Be Addressed to Improve Reliability of Financial Information*, GAO-11-835T, July 27, 2011, Highlights Page, <http://www.gao.gov/assets/130/126745.pdf>. Financial management at DOD remains on GAO's high-risk list. Government Accountability Office, *High-Risk Series: An Update*, GAO-13-283, February 2013, pp. 134-141, at <http://www.gao.gov/assets/660/652133.pdf>.

<sup>77</sup> Statement of Senator Kelly Ayotte, U.S. Congress, Senate Committee on Armed Services, Subcommittee on Readiness and Management Support, *Financial Management and Business Transformation at the Department of Defense*, 112<sup>th</sup> Cong., 2<sup>nd</sup> sess., April 18, 2012, S. Hrg. 112-658, p. 3.

<sup>78</sup> House Armed Services Committee, *Panel on Defense Financial Management and Auditability Reform: Findings and Recommendations*, 112<sup>th</sup> Cong., 2<sup>nd</sup> sess., January 24, 2012.

management problems at DOD extend beyond the agency level to have government-wide implications—GAO has identified the financial management problems at DOD as a barrier to auditing the U.S. consolidated financial statements, as discussed in the next section.

**Figure 2. Agency Unqualified (Clean) Audits**



**Source:** Compiled by CRS from agency data.

## Government-Wide Financial Reporting Issues

Government-wide, the U.S. consolidated financial statements<sup>79</sup> have received a disclaimer of opinion every year since they were first required under GMRA.<sup>80</sup> GAO was unable to express an opinion on the FY2012 U.S. consolidated financial statements due to material weaknesses in internal control over financial reporting and other limitations on the scope of its work.<sup>81</sup> The Comptroller General's transmission letter in the FY2012 *Financial Report of the United States Government* stated,

While significant progress has been made in improving federal financial management since the federal government began preparing consolidated financial statements 16 years ago, three major impediments continued to prevent us from rendering an opinion on the federal government's accrual-based consolidated financial statements over this period: (1) serious financial management problems at DOD that have prevented its financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the

<sup>79</sup> The U.S. government's accrual-based consolidated financial statements are contained in the annual *Financial Report of the United States Government*.

<sup>80</sup> Under GMRA, the first government-wide financial statement was required no later than March 31, 1998.

<sup>81</sup> Government Accountability Office, *Financial Audit: U.S. Government's Fiscal Years 2012 and 2011 Consolidated Financial Statements*, p. 224.

federal government's ineffective process for preparing the consolidated financial statements.<sup>82</sup>

These three enduring issues have continued to mitigate GAO's ability to render an opinion on the U.S. government's consolidated financial statements.<sup>83</sup> For FY2012, GAO identified several other underlying material weaknesses in internal control over financial reporting. GAO stated that the federal government could not

- determine whether property, plant, and equipment (PPE), primarily held by DOD, were properly reported;
- estimate or adequately support amounts reported for certain liabilities;
- support significant portions of the reported net cost of operations; and
- identify and resolve or explain material differences between certain components of the budget deficit and related amounts reported in federal entities' financial statements.<sup>84</sup>

According to GAO, the limitations that preclude it from expressing an opinion on the U.S. financial statements carry consequences. The material weaknesses identified by GAO inhibit the federal government in safeguarding its assets and recording its transactions correctly, as well as in measuring the full cost and performance of programs and activities.<sup>85</sup> They also diminish the reliability of information that would permit the federal government to operate efficiently and effectively.<sup>86</sup>

GAO found four additional material weaknesses beyond those that contributed to its disclaimer of opinion on the U.S. consolidated financial statements. These material weaknesses are improper payments,<sup>87</sup> information security control deficiencies, tax collection issues, and problems associated with federal grants management.<sup>88</sup>

GAO provides recommendations for resolving weaknesses in the U.S. consolidated financial statements. The recommendations, which may be issued in a separate management report, are tracked over time so that it is possible to determine which have been implemented and which have not. In its most recent management report, GAO noted that at the end of FY2011, there were 48 prior year recommendations that had yet to be implemented.<sup>89</sup> Of those, 31 remained open

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<sup>82</sup> Gene L. Dodaro, Comptroller General, Government Accountability Office, *Financial Audit: U.S. Government's Fiscal Years 2012 and 2011 Consolidated Financial Statements*, GAO-13-271R, January 17, 2013, Transmission Letter-2, at <http://www.gao.gov/assets/660/651357.pdf>.

<sup>83</sup> *Ibid.* See also Government Accountability Office, *Fiscal Year 2011 U.S. Government Financial Statements: The Federal Government Faces Continuing Financial Management and Long-Term Fiscal Challenges*, GAO-12-444T, March 1, 2012, p. 6, at <http://www.gao.gov/assets/590/589002.pdf>.

<sup>84</sup> Government Accountability Office, *Financial Audit: U.S. Government's Fiscal Years 2012 and 2011 Consolidated Financial Statements*, p. 227.

<sup>85</sup> *Ibid.*

<sup>86</sup> *Ibid.*

<sup>87</sup> See CRS Report R42878, *Improper Payments and Recovery Audits: Legislation, Implementation, and Analysis*, by Garrett Hatch.

<sup>88</sup> Government Accountability Office, *Financial Audit: U.S. Government's Fiscal Years 2012 and 2011 Consolidated Financial Statements*, pp. 243-246.

<sup>89</sup> Government Accountability Office, *Management Report: Improvements Needed in Controls over the Preparation of* (continued...)

through the end of FY2012, including 14 that were first identified in FY2002.<sup>90</sup> The report identifies steps being taken to implement the recommendations.

## **Accessibility of Federal Financial Reports**

Federal financial statements may not provide readily understandable information to their multiple stakeholders. According to the 2011 joint report prepared by the CFO Council and CIGIE, the ability to analyze financial statements requires specialized knowledge:

Although the information contained in financial statements and Annual Performance Reports for the CFO Act agencies is robust, many believe that there is limited demand for this information outside of government, perhaps due to its technical nature, seeming complexity, and granular characteristics. Analyzing financial statements requires an in-depth understanding of government accounting principles, and most financial and performance reports contain details that may only appeal to the financial management community. In the continuing quest to improve government financial reports and ensure data accuracy, the financial management community should increase efforts to make financial information more relevant to all of its stakeholders, including decision-makers, program managers, and the public.<sup>91</sup>

For example, the various federal financial reports use similar terms (e.g., “cost,” “net cost,” etc.) but the definitions of these terms and the relationships between them and the accompanying financial figures conveyed can be difficult to discern to non-expert stakeholders (**Figure 3**). The Federal Accounting Standards Advisory Board established a task force on the financial reporting model in April 2010.<sup>92</sup> The task force reported that the government-wide financial report was difficult to navigate, even for task force members.<sup>93</sup> FASAB’s user needs study<sup>94</sup> found that federal executives and managers, as well as citizens, found some difficulty in understanding information in financial reports—the prevailing belief was that financial reports were intended for accountants or economists.<sup>95</sup>

In addition, some have suggested that federal financial reports are not necessarily accessible to Congress. A survey of 239 federal financial management executives and managers indicated that the majority of respondents “believed federal financial statements cost too much to prepare and audit while delivering little useful information to government decision makers.”<sup>96</sup> In a House subcommittee hearing on financial information in the federal government, Representative Edolphus Towns appeared to concur. He stated:

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(...continued)

*the U.S. Consolidated Financial Statements*, GAO-13-540, June 2013, p 10.

<sup>90</sup> Ibid.

<sup>91</sup> Chief Financial Officers Council and the Council of Inspectors General on Integrity and Efficiency, *The Chief Financial Officers Act of 1990—20 Years Later*, p. 16.

<sup>92</sup> FASAB, *Financial Reporting Model Task Force: Report to the FASAB*, December 22, 2010, p. 10, at [http://www.fasab.gov/pdf/files/2010dec22\\_financial\\_reporting\\_model\\_task\\_force.pdf](http://www.fasab.gov/pdf/files/2010dec22_financial_reporting_model_task_force.pdf).

<sup>93</sup> Ibid., p. 15.

<sup>94</sup> FASAB, *User Needs Study*, April 14, 2010.

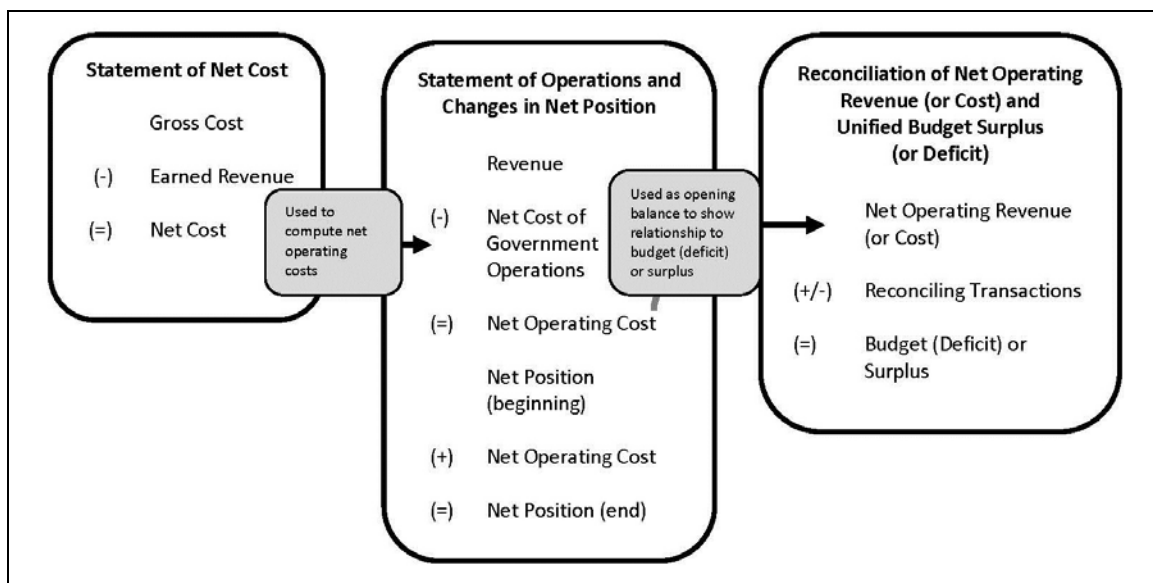
<sup>95</sup> FASAB, *Financial Reporting Model Task Force: Report to the FASAB*, p. 11.

<sup>96</sup> KPMG Government Institute, *Moving to the Next Stage of Federal Financial Reporting: Bringing Greater Value and Transparency through “Open Government” Electronic Reporting*, July 6, 2012, p. 6, at [http://www.kpmginstitutes.com/government-institute/insights/2012/pdf/federal-financial-reporting\\_2.pdf](http://www.kpmginstitutes.com/government-institute/insights/2012/pdf/federal-financial-reporting_2.pdf).

[W]hen it comes to interpreting the actual documents, too much complex information can lead to confusion. Too little information can be misleading.... From our experience, we know that understanding federal government financial statements and reports can be difficult, even for the experts. We need to have more readily available, simplified financial information in order to help both us here in the legislative branch, as well as the public.<sup>97</sup>

Congress requires tractable information to address issues as they arise.<sup>98</sup> Specifically, accessible information permits better understanding of government operations, serves as a shared platform from which policy positions may be established, affords an historical perspective on budgets and spending, allows comparison of agencies' fiscal results relative to budgets, and permits the performance of program evaluations.<sup>99</sup>

**Figure 3. Example of the Relationship Between Terms in Different Federal Financial Reports**



**Source:** Created by CRS based upon U.S. Department of the Treasury, "How the Federal Government's Financial Statements are Related to Each Other," *2006 Financial Report of the United States Government*, December 15, 2006, p. 12, at <http://www.gao.gov/financial/fy2006/fy06financialrpt.pdf>.

## Recent Legislation

Congress has recently considered legislation relating to audits of federal financial statements. In the 113<sup>th</sup> Congress, Representative Barbara Lee has introduced legislation (H.R. 559) that would

<sup>97</sup> Statement of Representative Edolphus Towns, U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on Government Organization, Efficiency, and Financial Management, *Making Sense of the Numbers: Improving the Federal Financial Reporting Model*, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., February 16, 2011, H. Hrg. HRG-2011-CGR-0007, pp. 3-4.

<sup>98</sup> FASAB, *Financial Reporting Model Task Force: Report to the FASAB*, p. 11.

<sup>99</sup> General Accounting Office, *Financial Reporting: Framework for Analyzing Federal Agency Financial Statements*, GAO/AFMD-91-19, March 1991, pp. 11-12, at <http://gao.justia.com/departments-of-veterans-affairs/1991/3/financial-reporting-afmd-91-19/AFMD-91-19-full-report.pdf>.

require a 5% reduction in a federal agency's discretionary budgetary authority for failure to produce an annual financial statement or failure to receive either an unqualified or qualified audit opinion on its annual financial statement. The 112<sup>th</sup> Congress considered similar legislation, as well as legislation on audited annual financial statements at DOD and DHS, specifically.

## **Audit the Pentagon Act**

In the 112<sup>th</sup> Congress, Senator Tom Coburn introduced the Audit the Pentagon Act (S. 3487). S. 3487 would have mandated auditable financial statements by DOD for its FY2017 statements. Specifically, this legislation would have amended Section 1003 of the National Defense Authorization Act for Fiscal Year 2010 (2010 NDAA, P.L. 111-118). The 2010 NDAA required DOD's Chief Management Officer (CMO), in consultation with the Under Secretary of Defense (Comptroller), to ensure that its financial statements are validated as ready for audit no later than September 30, 2017.<sup>100</sup> S. 3487 differed from the 2010 NDAA in that it would have required the statements to be auditable, not just validated as ready for audit.<sup>101</sup>

The legislation also would have required DOD to provide a complete and validated statement of budgetary resources by FY2014. Failure to obtain an unqualified opinion on its FY2017 financial statements would have resulted in (1) the cessation of authorities on reprogramming and availability of funds authorized under the act, (2) a prohibition of expenditures of funds for major defense acquisition program activities beyond Milestone B,<sup>102</sup> and (3) a reorganization of the CMO position. S. 3487 was referred to the Senate Committee on Armed Services and was not enacted by the 112<sup>th</sup> Congress.

Representative Lee introduced companion legislation (H.R. 6528) in the House on September 21, 2012. H.R. 6528 differed from the Senate version in that it did not amend the auditability requirement. It would have imposed a 5% reduction in the discretionary budgetary authority of any agency required to produce an annual auditable financial statement that failed to (1) submit a financial statement for the previous fiscal year or (2) obtain either an unqualified or qualified audit opinion by an independent external auditor. The bill excluded from reduction accounts for military, reserve, and National Guard personnel and the Defense Health Program Account of DOD. In addition, the President would have been permitted to waive the reduction in discretionary budget authority if it jeopardized national security or members of the Armed Forces in combat. H.R. 6528 was not enacted by the 112<sup>th</sup> Congress.

In the 113<sup>th</sup> Congress, Representative Lee introduced the Audit the Pentagon Act of 2013 (H.R. 559).<sup>103</sup> It was referred to the Committee on Oversight and Government Reform and the

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<sup>100</sup> 123 Stat. 2439-2441.

<sup>101</sup> S. 3487 defines "validated as ready for audit" to mean that DOD's audit agencies would have reviewed the financial statements and determined, in writing, that such statements are ready for audit.

<sup>102</sup> Milestone B is defined as a decision to enter into system development and demonstration pursuant to guidance prescribed by the Secretary of Defense for the management of Department of Defense acquisition programs (10 U.S.C. 2366(e)(7)).

<sup>103</sup> Representative Lee introduced the legislation on February 6, 2013.

Committee on Armed Services. H.R. 559 is nearly identical to the legislation proposed in the 112<sup>th</sup> Congress.<sup>104</sup>

## **DHS Audit Requirement Target Act**

Congress also considered legislation to address problems at the Department of Homeland Security in the 112<sup>th</sup> Congress. Senator Scott Brown introduced the DHS Audit Requirement Target Act (DART, S. 1998) on December 15, 2011. Representative Todd Platts introduced the House version of the bill on June 8, 2012. Unlike the Audit the Pentagon Act, the purpose of the DART Act is not auditability. The DART Act directs DHS to obtain an unqualified audit opinion beginning with its FY2013 annual financial statements. In addition, the legislation requires DHS to provide Congress with its plan for meeting the deadline and for achieving better financial management. Congress instituted this requirement for the purposes of enhanced monitoring and oversight.<sup>105</sup> The DART Act of 2012 (126 Stat. 1591) was signed into law on December 20, 2012.<sup>106</sup>

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<sup>104</sup> There are some differences between H.R. 6528 and H.R. 559. The summary of H.R. 559 includes the word “qualified” in reference to an agency’s overall audit opinion, though the text of both H.R. 6528 and H.R. 559 in Sec. 4(c)(2) refers to unqualified and qualified audit opinions. Sec. 4(c)(1) of H.R. 6528 and H.R. 559 contains the financial accountability deadline (i.e., March 2 of each fiscal year in question is when the discretionary budgetary authority adjustment would be imposed). The initial fiscal year would have been FY2013 in H.R. 6528 but was changed to FY2014 in H.R. 559. Lastly, H.R. 559 eliminates the reporting requirement in Sec. 5(1) of H.R. 6528 that would have required the Under Secretary of Defense (Comptroller) to submit a report to Congress itemizing those reports that would no longer be necessary if the financial statements of the Department of Defense were audited with an unqualified opinion.

<sup>105</sup> U.S. Congress, Senate Committee on Homeland Security and Governmental Affairs, *DHS Audit Requirement Target (DART) Act of 2012*, report to accompany S. 1998, 112<sup>th</sup> Cong., 2<sup>nd</sup> sess., November 2, 2012, p. 1.

<sup>106</sup> 126 Stat. 339.



## Appendix. Agencies and Federal Financial Reporting

### Executive Departments and Agencies Subject to the CFO Act (CFO Agencies) Required to Prepare Financial Statements

Department of Agriculture	Department of Transportation
Department of Commerce	Department of the Treasury
Department of Defense	Department of Veterans Affairs
Department of Education	Agency for International Development
Department of Energy	Environmental Protection Agency
Department of Health and Human Services	General Services Administration
Department of Homeland Security	National Aeronautics and Space Administration
Department of Housing and Urban Development	National Science Foundation
Department of the Interior	Nuclear Regulatory Commission
Department of Justice	Office of Personnel Management
Department of Labor	Small Business Administration
Department of State	Social Security Administration

### Executive Agencies Subject to ATDA Required to Prepare Financial Statements

Advisory Council on Historic Preservation	Japan-U.S. Friendship Commission
African Development Fund	Marine Mammal Commission
Appalachian Regional Commission	Merit Systems Protection Board
Architectural and Transportation Barriers Compliance Board	Morris K. Udall Scholarship and Excellence in National Environmental
Armed Forces Retirement Home	Policy Foundation
Barry Goldwater Scholarship and Excellence in Education Fund	National Archives and Records Administration
Broadcasting Board of Governors	National Capital Planning Commission
Central Intelligence Agency	National Commission on Libraries and Information Science
Chemical Safety and Hazard Investigation Board	National Council on Disability
Christopher Columbus Fellowship Foundation	National Credit Union Administration
Commission on Civil Rights	National Endowment for the Arts
Commission of Fine Arts	National Endowment for the Humanities
Commission for the Preservation of America's Heritage Abroad	National Labor Relations Board
Committee for Purchase from People Who Are Blind or Severely Disabled	National Mediation Board
Commodities Futures Trading Commission	National Transportation Safety Board
Consumer Product Safety Commission	Nuclear Waste Technical Review Board

Court Services and Offender Supervision Agency for DC	Occupational Safety and Health Review Commission
Defense Nuclear Facilities Safety Board	Office of Government Ethics
Delta Regional Authority	Office of Navajo and Hopi Indian Relocation Commission
Denali Commission	Office of Special Counsel
Equal Employment Opportunity Commission	Peace Corps
Farm Credit Administration	Presidio Trust
Farm Credit System Insurance Corporation	Railroad Retirement Board
Federal Communications Commission	Securities and Exchange Commission
Federal Election Commission	Selective Service System
Federal Financial Institutions Examination Council Appraisal Subcommittee	Smithsonian Institution (SI)
Federal Housing Finance Board	SI/John F. Kennedy Center for the Performing Arts
Federal Labor Relations Authority	SI/National Gallery of Arts
Federal Mediation and Conciliation Service	SI/Woodrow Wilson International Center for Scholars
Federal Mine Safety and Health Review Commission	Trade and Development Agency
Federal Retirement Thrift Investment Board	U.S. Court of Appeals for Veterans Claims
Federal Trade Commission	U.S. Holocaust Memorial Museum
Harry S. Truman Scholarship Fund	U.S. Interagency Council on Homelessness
Institute of American Indian and Alaska Native Culture and Arts Development	U.S. International Trade Commission
Institute of Museum and Library Services	Vietnam Education Foundation
Inter-American Foundation	White House Commission on the National Moment of Remembrance
James Madison Memorial Fellowship Foundation	

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**Government Corporations Required to Prepare Financial Statements**

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Commodity Credit Corporation	Government National Mortgage Association
Community Development Financial Institutions Fund	Millennium Challenge Corporation
Corporation for National and Community Service	National Credit Union Administration Central Liquidity Facility
Export-Import Bank of the United States	Overseas Private Investment Corporation
Federal Crop Insurance Corporation	Pension Benefit Guaranty Corporation
Federal Deposit Insurance Corporation	Rural Telephone Bank
Federal Home Loan Banks	Resolution Funding Corporation
Federal Housing Administration Fund	Saint Lawrence Seaway Development Corporation
Federal Prison Industries, Incorporated	Tennessee Valley Authority
Financing Corporation	

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**Source:** Constructed from Appendix A, Appendix C, and Appendix D of Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, OMB Bulletin No. 07-04, September 4, 2007, pp. 33, 35-37, at <http://www.whitehouse.gov/sites/default/files/omb/assets/omb/bulletins/fy2007/b07-04.pdf>.

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## **Acknowledgments**

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