

CBO TESTIMONY

**Statement of
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**before the
Subcommittee on Legislation and National Security
Committee on Government Operations
U.S. House of Representatives**

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NOTICE

**This statement is not available
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Mr. Chairman, I am pleased to have this opportunity to present the views of the Congressional Budget Office (CBO) on proposed legislation to improve the quality of information for protecting, managing, and budgeting federal financial resources. In my statement, I will:

- o Review the common elements in the proposals now before the Congress;
- o Assess the rationale for these reforms; and
- o Explain why it may be premature to require audited financial statements for all federal agencies.

PROPOSED REFORMS

Three proposals to improve federal financial management are now before the Congress--H.R. 5492, S. 2840, and the Conyers bill. Each of these would create a governmentwide chief financial officer (CFO) in the Office of Management and Budget (OMB) and a network of agency CFOs. Each would also require the preparation of a long-term plan to improve federal financial management information systems. Such a plan would be developed cooperatively by agency CFOs under the direction of the central CFO office. In addition, each bill requires some federal agencies to prepare annually an

audited financial statement for the purpose of reporting financial performance for the previous year.

THE NEED FOR REFORM

The need to improve federal management information systems is universally recognized. Although the deficiencies of the current system are perhaps less apparent to a support agency such as CBO than to operating agencies, we have some direct experience with the inability of current systems to produce information needed for budgeting. For example, in recent years we have been engaged in an effort to measure more accurately the costs of federal loans and guarantees, so that the costs of these programs can be compared with other forms of federal assistance. In the process of developing subsidy cost estimates for credit assistance programs, we have found that in many cases it is not possible to identify the cash flows associated with a particular federal loan or guarantee even after that loan or guarantee has matured.

Although federal management information systems remain inadequate, significant improvements have been made in recent years as a result of the efforts of this Committee, OMB, the General Accounting Office, Treasury's Financial Management Service, the Joint Financial Management Improvement Project, and the individual agencies. Chief financial officers have been established by statute in the Departments of Veterans Affairs and Housing

and Urban Development. CFOs have also been appointed by administrative action in OMB and in federal agencies. Much remains to be done, however.

CHIEF FINANCIAL OFFICERS AND FINANCIAL MANAGEMENT PLANS

The proposal to establish, by statute, a structure of chief financial officers is consistent with the need to improve federal financial management information systems. By this action, the Congress focuses attention on a significant problem, assigns responsibility for action, and creates the authorities necessary to do the job. By providing a statutory basis for the office of chief financial officer, the Congress also indicates its long-term commitment to meeting the management information needs of the government. In addition, placing the government's chief financial officer in OMB assures that the need for improved budgetary information will be integrated with the effort to improve management.

We have one potential concern with the proposed CFO structure, however. Financial management makes a vitally important contribution to an agency's overall performance. In fact, that conviction motivates this legislation and these hearings. But the desire to link CFOs into a network within the government may result in some separation of agency CFOs from program management within their own agencies. We do not have a specific

solution to offer, but we would encourage steps to assure that financial management is a central part of overall agency management.

Assigning to the newly established CFO structure the task of producing a long-term plan for improving federal financial management is also consistent with the identified need. Developing the plan will provide a unifying focus for the efforts of the CFOs. The agency CFOs are well positioned to know the specific information needs of their organizations. Oversight by the CFO within OMB will enable the needs for information outside the agencies to be addressed.

ANNUAL FINANCIAL STATEMENTS

All three proposals require some form of annual, audited financial statements of performance from some federal agencies. This requirement is one of the most controversial reform proposals and the source of our greatest concern. Two years ago, I testified before this Committee on a proposal to require executive agencies to prepare business-type statements of financial position, operating results, and changes in financial position. At that time, I argued that such a requirement would be premature. Part of my argument was the lack of a conceptually sound accounting basis for reporting the financial performance of the federal government. I suggested that the application of for-profit accounting standards (the only available alternative) to the federal

government would produce information that would be useless at best but, more likely, misleading.

In my view, we still lack a suitable accounting framework for financial reporting by the federal government. For example, the concept of an asset is fundamental to private, for-profit accounting. One of the defining features of an asset for a profit-seeking entity is the asset's ability to contribute to future net cash inflows to the firm. This is a sensible definition in for-profit accounting in that it ties directly to the purpose of a for-profit entity: to produce net cash inflows for the firm's owners. Recognition of the asset's loss of ability to generate income (that is, accounting for depreciation of assets) is also a meaningful, sensible practice. To report for-profit performance, all activities are characterized in terms of their contribution to the entity's goal: profit.

The federal government is not a for-profit, commercial entity. Of course, the government carries on some business-type activities such as producing and selling electric power, making direct loans, issuing loan guarantees, and selling insurance against various hazards. But even in these exceptional cases, the government seeks a purpose other than making a profit. This basic difference in purpose between the federal government and for-profit entities means that the basic concepts of private financial accounting are not generally useful in characterizing federal financial transactions.

Consider the private accounting concept of an asset, which is acquired and valued by a for-profit firm based on the asset's ability to produce net cash inflows. The federal government acquires and values facilities, supplies, and assetlike items based on their usefulness in achieving the government's not-for-profit goals. To the extent that these acquisitions are long-lived, they may entail a continuing net cash outflow from the federal government. Rather than generate net cash inflows, "assets" usually require a continuing expenditure of funds.

The Washington Monument is a suitable example of the difference that federal ownership makes for the appropriate accounting treatment of a facility. For a private firm, the monument might be an asset because, with sufficiently high fees, it would produce a net profit. For the federal government, the Washington Monument represents a commitment to lose money on its maintenance and operation. Does that mean that the Washington Monument is a federal liability? No. Under private accounting standards, the monument might be so classified; but for the federal government, the monument is valuable in the pursuit of federal objectives. This example illustrates the general uselessness of for-profit accounting concepts and standards in accurately describing the financial performance and condition of the federal government.

The conviction that private, for-profit accounting concepts and practices are inappropriate for use by the federal government is not unique

to CBO. In fact, the Senate bill explicitly recognizes the need to develop a conceptual framework that would be useful in federal financial reporting. S. 2840 requires the Comptroller General to study these conceptual issues and to report solutions within one year. More than 100 years have been required to develop existing for-profit financial accounting systems. It therefore seems optimistic to believe that issues of comparable complexity and magnitude could be resolved within a year.

CBO believes that a requirement for all federal agencies to issue audited financial statements should await the development of an appropriate conceptual framework for preparing such statements. Accordingly, we continue to regard as premature the provision to require such statements now or in one year.

One feature of the Conyers bill is especially attractive on this score. The bill requires financial statements only from those entities where for-profit accounting may be most useful and least misleading: commercial-type activities, revolving funds, and trust funds. This form of targeting also reduces the overall cost of the requirement.