

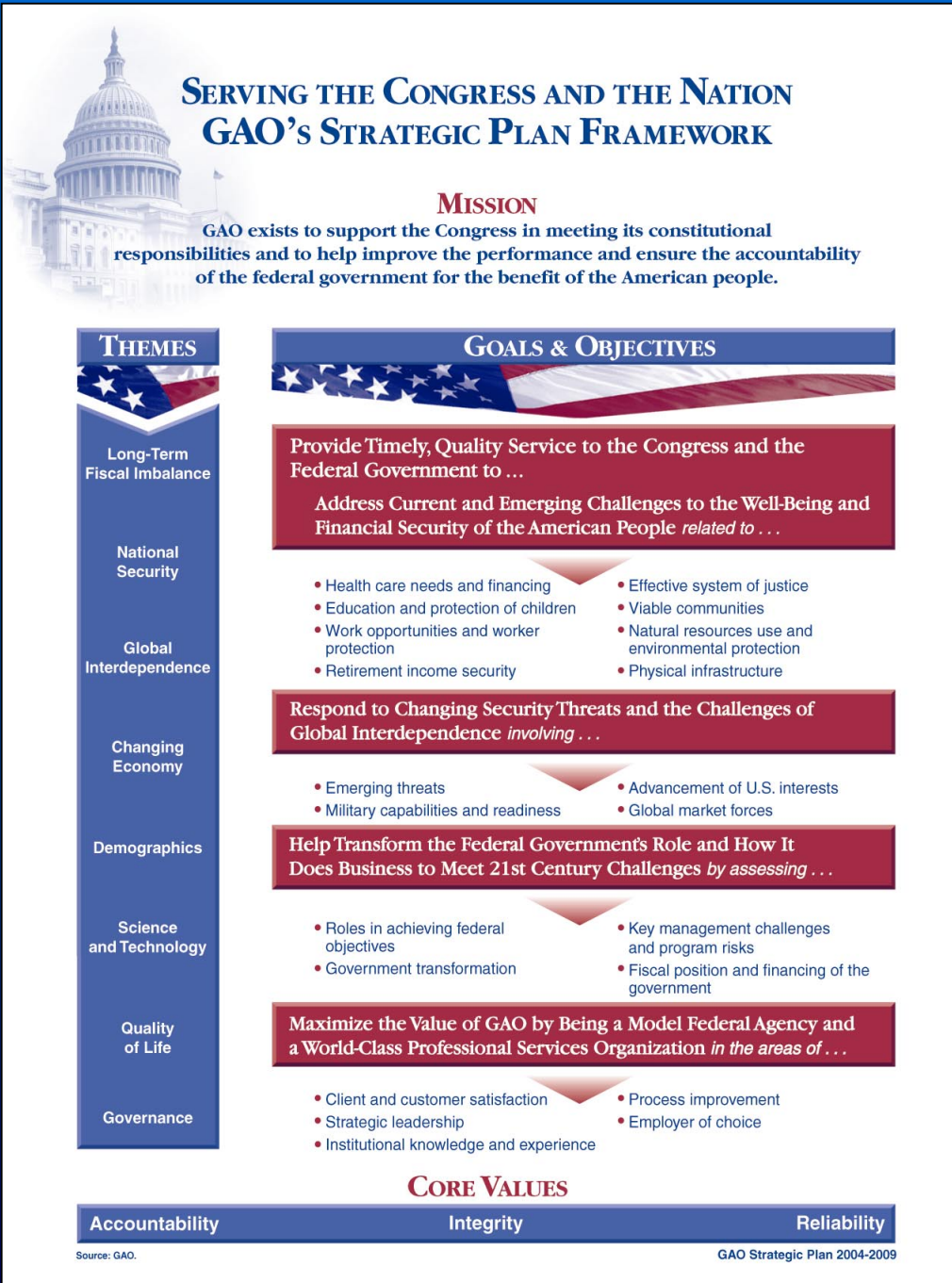
Meeting the Challenges Facing the Accountability Profession

AGA's 53rd Annual Professional Development Conference

**Washington, D.C.
June 28, 2004**

The Honorable David M. Walker
Comptroller General of the United States

GAO's Strategic Plan



Selected Key Concepts for GAO

MISSION

Improve performance and assure accountability, both for today and tomorrow

MEANS

Oversight, insight, and foresight

METHODS

Leading by example and promoting best practices

- Observing protocols
- Employing a constructive engagement approach with entities we audit and evaluate
- Partnering with fellow accountability and selected “good government” organizations

Four Key Institutional Success Elements

- Results
- Clients
- People
- Partnerships

GAO's High Risk List

High Risk Areas

Designated High Risk

Addressing Challenges in Broad-based Transformations

Protecting Information Systems Supporting the Federal Government and The Nation's Critical Infrastructures	1997
Strategic Human Capital Management*	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook*	2001
Implementing and Transforming the New Department of Homeland Security	2003
Modernizing Federal Disability Programs*	2003
Federal Real Property*	2003

Ensuring Major Technology Investments Improve Services

FAA Air Traffic Control Modernization	1995
IRS Business Systems Modernization	1995
DOD Systems Modernization	1995

Providing Basic Financial Accountability

DOD Financial Management	1995
IRS Financial Management	1995
Forest Service Financial Management	1999
FAA Financial Management	1999

Reducing Inordinate Management Program Risks

Medicare Program*	1990
Collection of Unpaid Taxes	1990
DOD Inventory Management	1990
Student Financial Aid Programs	1990
HUD Single-Family Mortgage Insurance and Rental Assistance Programs	1994
Earned Income Credit Noncompliance	1995
DOD Support Infrastructure Management	1997
Medicaid Program*	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program*	2003

Managing Large Procurement Operations More Efficiently

DOD Weapon Systems Acquisition	1990
Department of Energy Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992

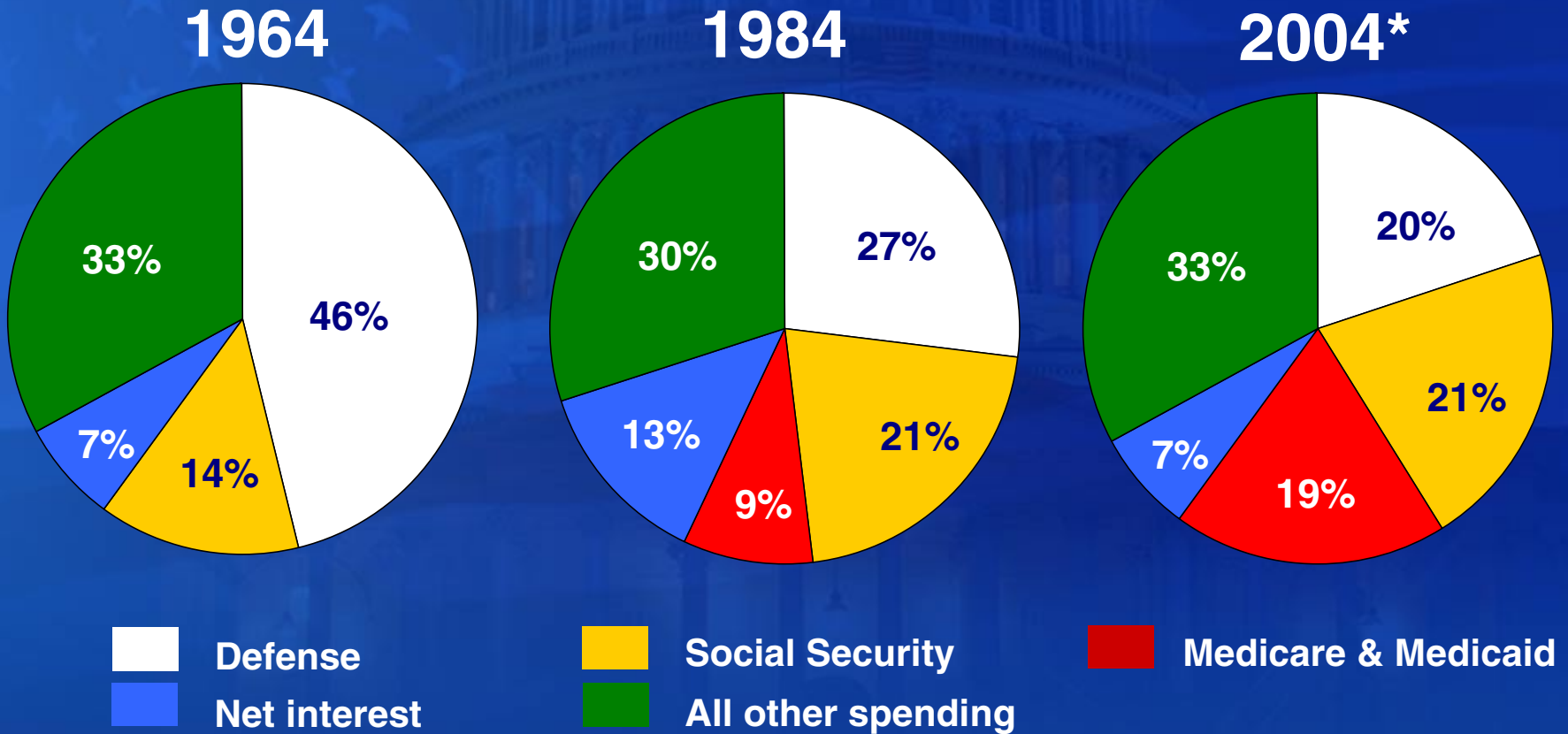
*Additional authorizing legislation is likely to be required as one element of addressing this high risk area.

The Case for Change

Government is on a “burning platform,” and the status quo way of doing business is unacceptable for a variety of reasons, including:

- Past fiscal trends and significant long-range challenges
- Rising public expectations for demonstrable results and enhanced responsiveness
- Selected trends and challenges having no boundaries
- Additional resource demands due to recent terrorism events in the United States
- Government performance/accountability and high risk challenges, including the lack of effective human capital strategies

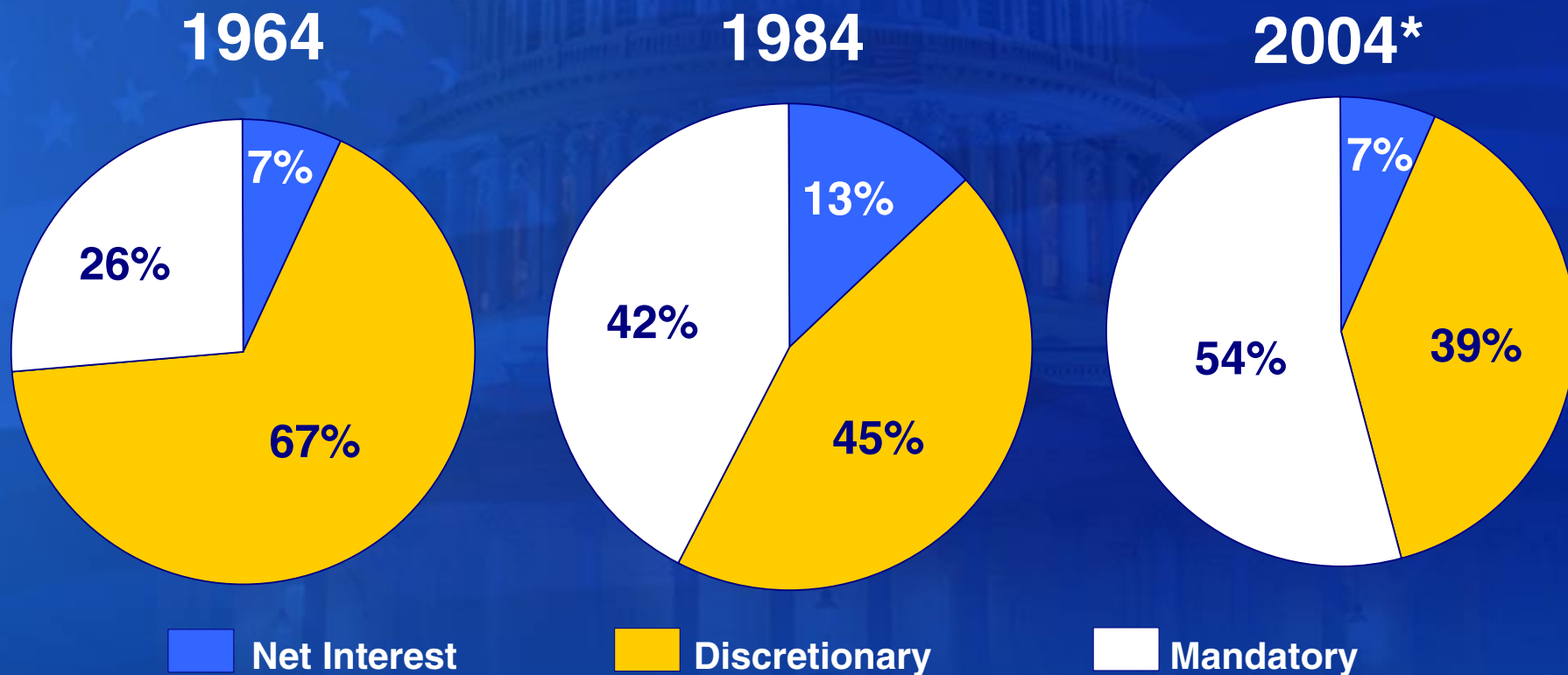
Composition of Federal Spending



*Current services estimate.

Source: *Budget of the United States Government, FY 2005*, Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



*Current services estimate.

Source: *Budget of the United States Government, FY 2005*, Office of Management and Budget.

Selected Fiscal Exposures: Sources and Examples

(End of 2003)^a

Type	Example (dollars in billions)
Explicit liabilities	Publicly held debt (\$3,913) Military and civilian pension and post-retirement health (\$2,857) Veterans benefits payable (\$955) Environmental and disposal liabilities (\$250) Loan guarantees (\$35)
Explicit financial commitments	Undelivered orders (\$596) Long-term leases (\$47)
Explicit financial contingencies	Unadjudicated claims (\$9) Pension Benefit Guaranty Corporation (\$86) Other national insurance programs (\$7) Government corporations e.g., Ginnie Mae
Implicit exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts (\$2,859) ^b Future Social Security benefit payments (\$3,699) ^c Future Medicare Part A benefit payments (\$8,236) ^c Future Medicare Part B benefit payments (\$11,416) ^c Future Medicare Part D benefit payments (\$8,119) ^c Life cycle cost including deferred and future maintenance and operating costs (amount unknown) Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

^a All figures are for end of fiscal year 2003, except Social Security and Medicare estimates, which are end of calendar year 2003.

^b This amount includes \$774 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

^c Figures for Social Security and Medicare are net of debt held by the trust funds (\$1,531 billion for Social Security, \$256 billion for Medicare Part A, and \$24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be \$10.4 trillion, \$21.8 trillion for Medicare Part A, \$23.2 trillion for Medicare Part B, and \$16.5 trillion for Medicare Part D.

Source: GAO analysis of data from the Department of the Treasury, the Office of the Chief Actuary, Social Security Administration, and the Office of the Actuary, Centers for Medicare and Medicaid Services.

Updated 3/30/04.

Another Way to Think About These Numbers

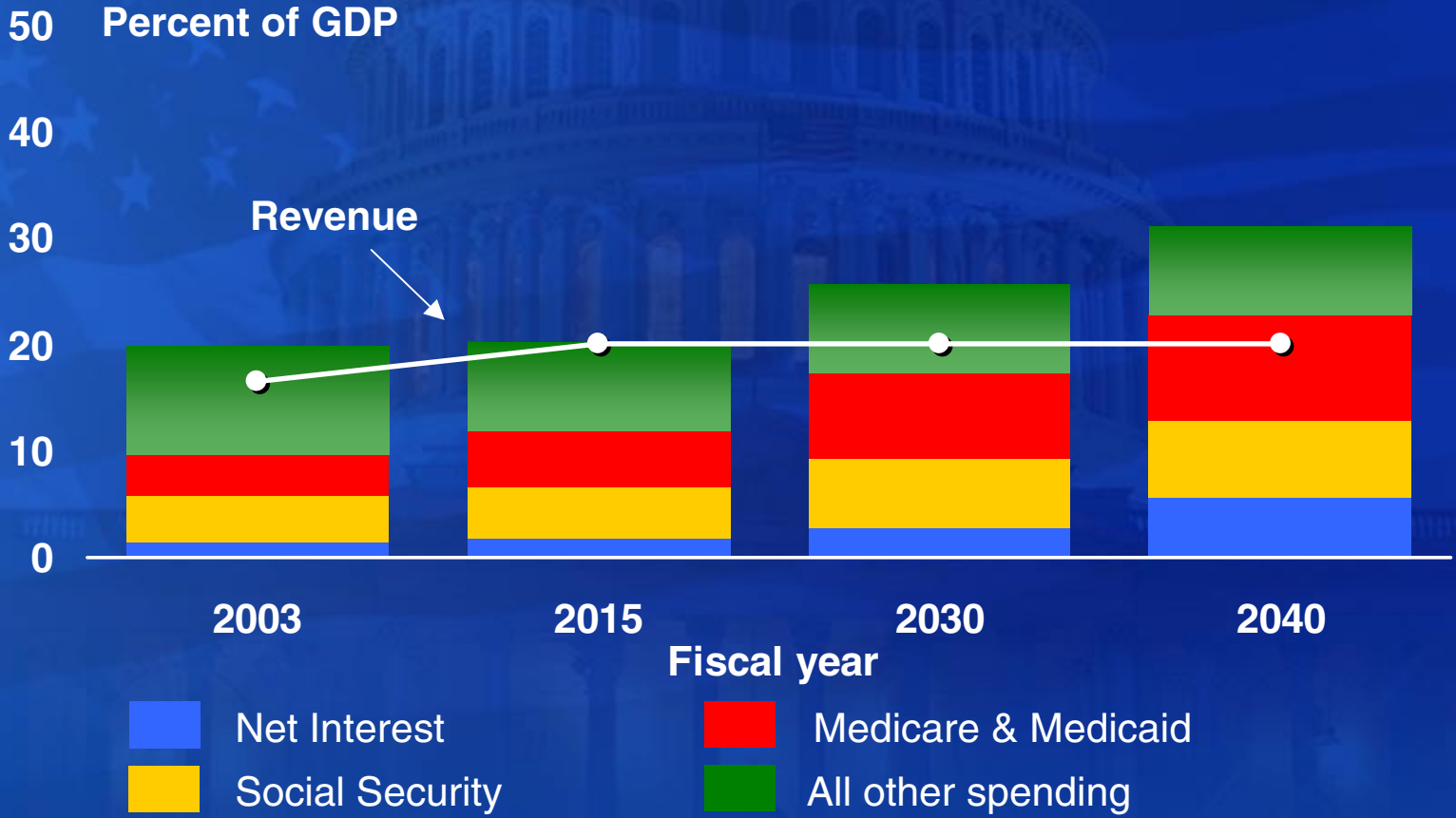
As of the End of FY 03

- Debt held by the public—\$3.9T
- Trust fund debt—\$2.9T
- Gross debt—\$6.8T
- Gross debt per person—about \$24,000
- If we add everything on the previous slide that is not included in gross debt, the burden per person rises to over \$140,000. Alternatively, it amounts to a total unfunded burden of more than \$40 trillion in current dollars, which is about 18 times the current annual federal budget or more than 3 ½ times the current annual GDP.

Note: The calculations only consider a 75-year horizon for Social Security and Medicare.

Composition of Spending as a Share of GDP

Under Baseline Extended

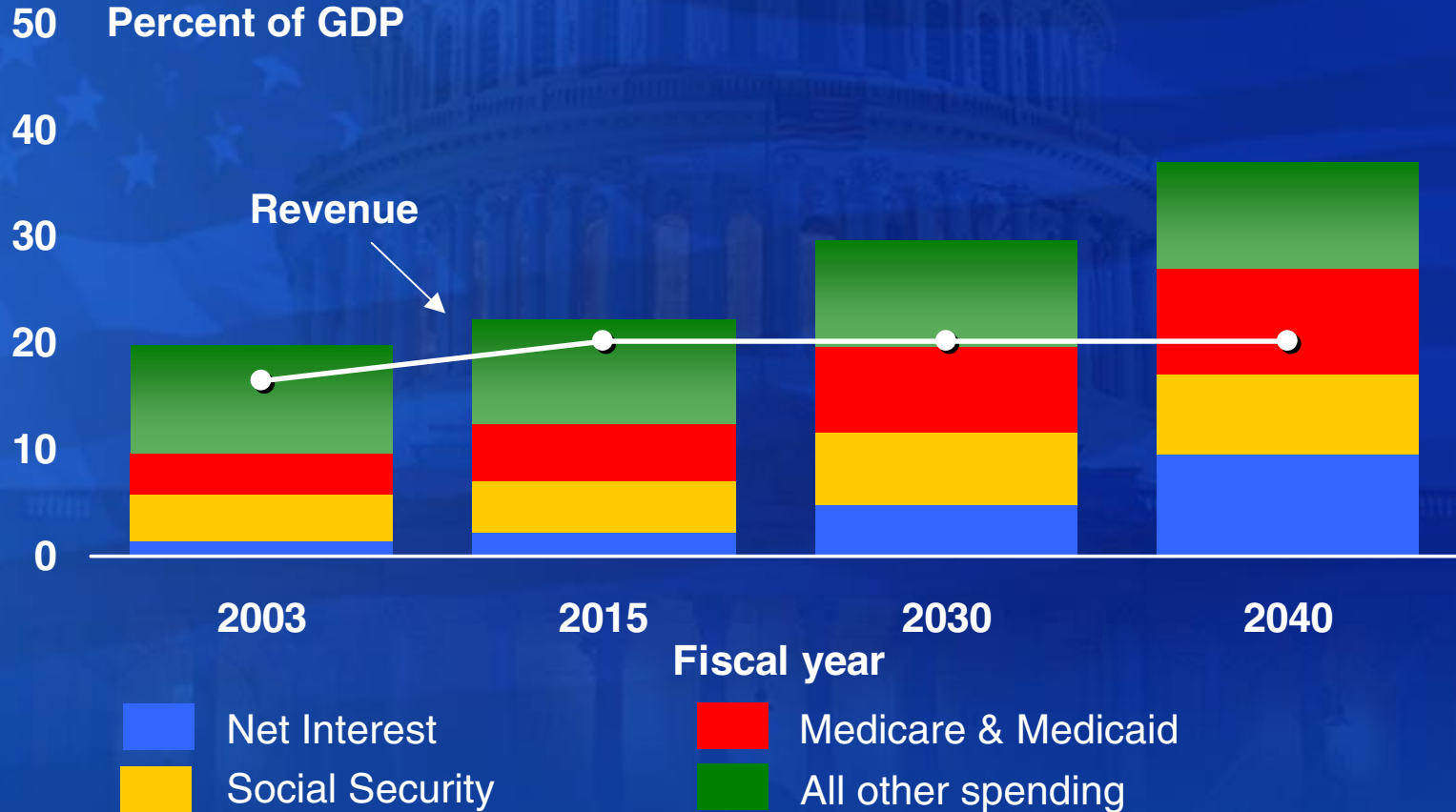


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2004

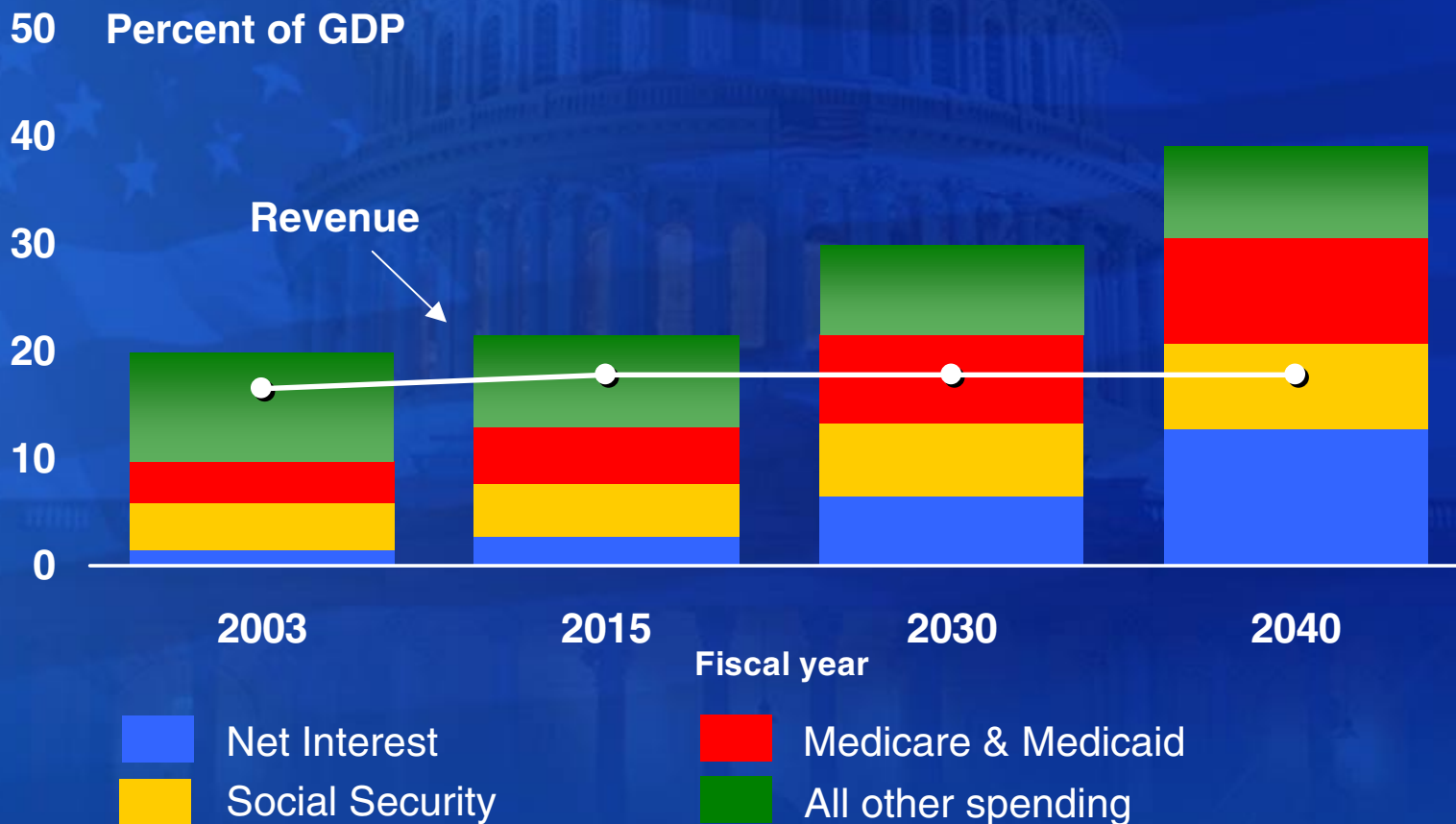


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Source: GAO's March 2004 analysis.

Composition of Spending as a Share of GDP

Assuming All Expiring Tax Provisions are Extended

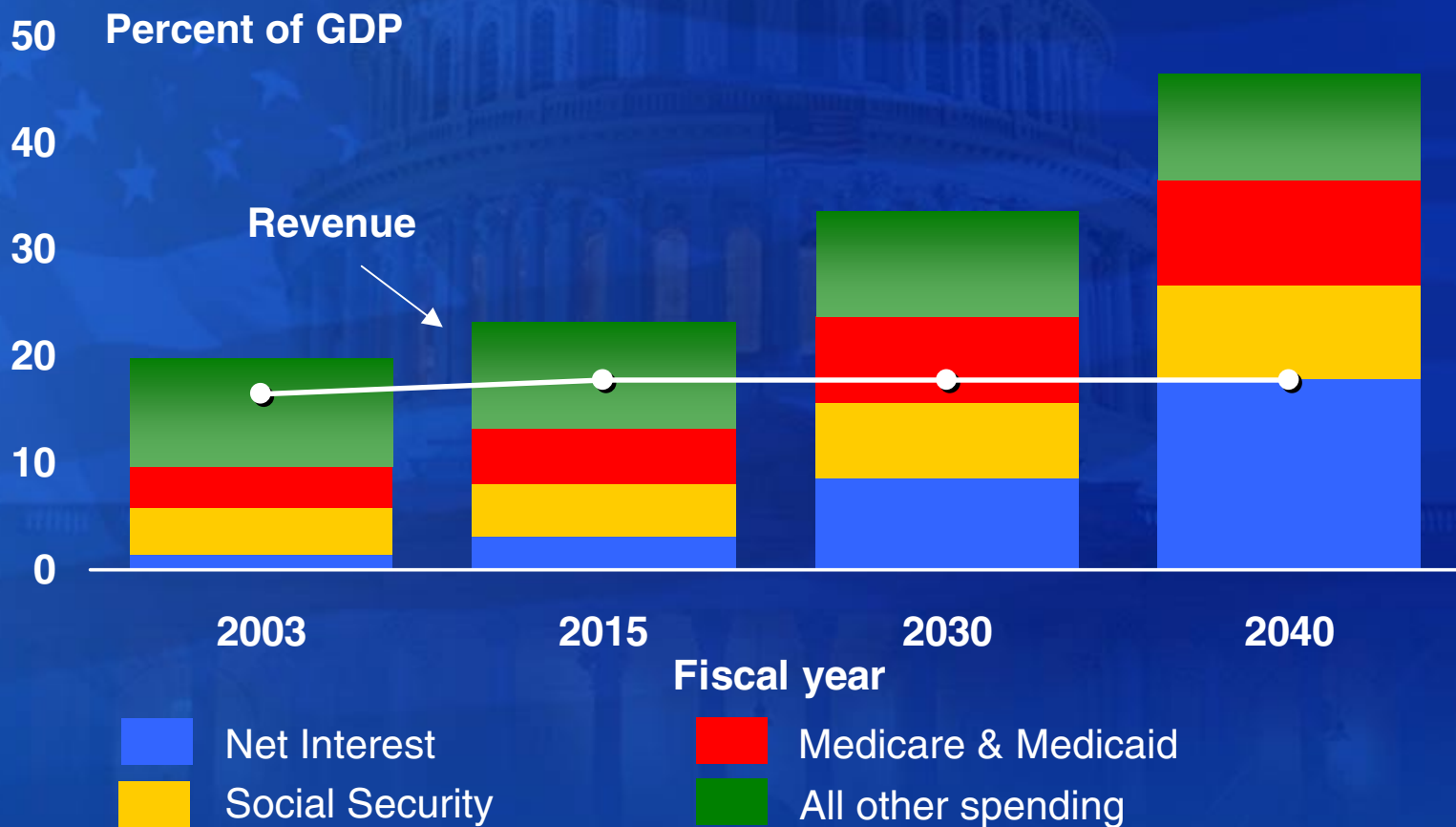


Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP After 2004 and All Expiring Tax Provisions Are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

Current Fiscal Policy Is Unsustainable

- **The “Status Quo” Is Not an Option**
 - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
 - GAO’s simulations show that balancing the budget in 2040 could require actions as large as
 - Cutting total federal spending by about 60 percent or
 - Raising taxes to about 2.5 times today’s level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
 - Closing the current long-term fiscal gap based on responsible assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
 - During the 1990s, the economy grew at an average 3.2 percent per year.
 - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
- **The Sooner We Get Started, the Better**
 - Less change would be needed, and there would be more time to make adjustments.
 - The miracle of compounding would work with us rather than against us.
 - Our demographic changes will serve to make reform more difficult over time.

The Way Forward

- Implement new accounting and reporting approaches and new budget control mechanisms for considering the impact of spending and tax policies and decisions over the long term
- Develop new metrics for measuring the impact of policies and decisions over the long term (e.g., key national indicators to measure our Nation's position and progress over time and in relation to other countries)
- Reexamine the base—question existing programs, policies and activities

We Need a 3-Pronged Approach

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise our tax policy and enforcement programs

Illustrative Generic Re-examination Questions

- Is the program, policy, function or activity a direct result of specific legislation?
- Is the current mission fully consistent with the initial or updated statutory mission (e.g., no significant mission creep or morphing)?
- Does it relate to an issue of nationwide interest? If so, is a federal role warranted based on the likely failure of private markets or state and local governments to address the underlying problem or concern? Does it encourage or discourage these other sectors from investing their own resources to address the problem?
- Have there been significant changes in the country or the world that relate to the reason for initiating it?

Illustrative Generic Re-examination Questions

- If the answer to the last question is yes, should the activity be changed or terminated, and if so, how? If the answer is unclear as to whether changes make it no longer necessary, then ask, when, if ever, will there no longer be a need for a federal role? In addition, ask, would we enact it the same way if we were starting over today? Has it been subject to a comprehensive review, reassessment and re-prioritization by a qualified and independent entity? If so, when? Have there been significant changes since then? If so, is another review called for?
- How does it measure success? Are the measures reasonable and consistent with the applicable statutory purpose? Are the measures outcome-based, and are all applicable costs and benefits being considered? If not, what is being done to do so?
- If there are outcome-based measures, how successful is it based on these measures?
- Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

Illustrative Generic Re-examination Questions

- Is it affordable and financially sustainable over the longer term, given known cost trends and future fiscal imbalances?
- Is it using the most cost effective or net beneficial approaches when compared to other tools and program designs?
- If it fares well after considering all of these questions, is the responsible entity employing prevailing best practices to discharging its responsibilities and achieving its mission (e.g., strategic planning, organizational alignment, human capital strategy, financial management, technology management, acquisitions/sourcing strategy, change management, knowledge management, client/customer service)?

Selected 21st Century Questions

- Do we need all three elements of the current triad nuclear deterrent strategy and if so, do we need to reconsider the size and nature of each component?
- What opportunities exist to dispose of excess federal facilities or better leverage surplus in private sector capacity to make the federal portfolio more relevant to current mission and less costly?
- How should Social Security be reformed to make it both solvent and sustainable while better aligning it with 21st century economic, demographic and fiscal realities?
- Do tax incentives and preferences need to be reconsidered? For example, can adequate health care coverage be achieved at less cost and greater equity through fundamental redesign of the current health tax preferences?

Accountability Environment

- The credibility of auditing and financial reporting has suffered in the last couple of years as a result of the accountability failures in the private sector.
- Forces that led to the corporate scandals and audit failures include:
 - individual and corporate greed
 - inadequate corporate governance system
 - ineffective regulation of the accounting and auditing profession
 - financial managers and advisors working to achieve certain reporting results and focusing on the legal form versus the economic substance of the transactions
 - auditors and financial professionals doing what was minimally required and actively fighting tighter standards
 - confusion over whom the auditors work for
 - auditors delivering services to clients that impaired independence

Current Reforms

- The Sarbanes-Oxley Act of 2002 included reforms in corporate governance and the accounting profession intended to
 - improve corporate financial reporting and internal control
 - strengthen audit committees
 - change the relationship between the auditor and client
 - improve auditor independence
 - provide additional auditor assurance over internal control
 - provide oversight and regulation for auditors of publicly traded companies
- Reforms are currently being implemented, and final impact is still uncertain.

Sarbanes-Oxley Act Provisions with Implications for Government

New audit standards and oversight—PCAOB

- Audit committees with defined responsibilities
- Specific communications between auditors and audit committees
- CEO and CFO certification of financial reports
- Enhanced disclosures of off-balance sheet transactions
- Code of ethics for senior financial officers
- Management attestation on the effectiveness of internal control over financial reporting
- Auditor opinion on the effectiveness of internal control over financial reporting

Excerpts From the 103rd American Assembly Report: The Future of the Accounting Profession

- Structural Challenges Facing the Accounting Profession:
 - Rules-based versus principles-based standards
 - A revised and expanded financial reporting model
 - New and enhanced audit and attestation standards
 - The number of major accounting/audit firms
 - A balanced approach to auditor liability and accountability
 - Valuing quality audits and audit personnel
 - Reinvigorating audit committees
 - Preparing for the future—the talent search

Rebuilding Public Trust

For any system to work, it must address three fundamental issues.

- First, provide incentives for people to do the right thing.
- Second, provide transparency to help assure that people do the right thing.
- Finally, have effective accountability mechanisms if people don't do the right thing.

Restoring public trust will require that every participant in the corporate reporting supply chain embrace and live by the following core concepts*

1. A spirit of transparency—stop playing games with financial and performance data. Use full disclosure.
2. A culture of accountability—management, staff, boards, auditors, and stakeholders. High quality, unbiased information to support decision-making.
3. People of integrity—commitment to individual integrity.

* Excerpts from Building Public Trust: The Future of Corporate Reporting, Samuel DiPiazza, Jr. and Robert G. Eccles, 2002

The Future Accounting/Reporting and Audit Reporting Model

- We need to review and revise the existing accounting/reporting model to reflect several dimensions:
 - Generic provisions
 - Industry information
 - Entity-specific information (i.e., value and risk)
- We need to recognize the difference between certain types of financial and other information:
 - Historical cost
 - Readily marketable assets
 - Non-readily marketable assets
 - Projection information
 - Performance information

The Future Accounting/Reporting and Audit Reporting Model

- We need to review and revise the existing audit reporting model to accomplish at least two objectives:
 - Recognize that the opinion should address whether the financial statements are fairly presented in all material respects and in accordance with generally accepted accounting principles
 - Update the audit reporting model to link it with the new financial reporting model, and provide appropriate degrees of assurance for each type of information
- We need to ultimately go global in connection with all major accounting and audit matters
- We need to coordinate domestic efforts in the interim (e.g., auditing standards coordinating forum)

U.S. Auditing Standards Coordinating Forum

- Composed of PCAOB, GAO, ASB (AICPA)
- Meets several times each year, with ongoing staff coordination
- Seeks to:
 - Maximize complementary standards and coordinate agendas
 - Minimize duplicative or competing efforts, where possible
 - Work toward consistency, where appropriate
 - Identify any significant gaps not being addressed
 - Develop strategies for modernizing the auditing profession both in the U.S. and globally

Selected Government Accountability Issues

Leading by Example

- **Definition of success in financial management**
 - Clean opinion on financial statements
 - No major control weaknesses
 - No major compliance issues
 - Systems that produce timely, accurate, and useful financial and management information
- **Scope of audit**
 - Internal controls (current)
 - Compliance matters (current)
 - Performance and projection information (future)
- **Additional issues**
 - FASAB restructuring
 - Accelerated financial reporting
 - Enhanced performance and accountability reporting
 - Audit/financial management committees
 - Auditor independence

The Federal Financial Audit Environment

The federal financial audit environment is evolving:

- Closer to an opinion on the consolidated financial statements of the U.S. government (CFS)
- GAO, as the auditor of the CFS, needs to be able to use the work of the auditors of the agency financial statements
- Agencies need to meet accelerated due dates, maintain unqualified opinions, and address their internal control and financial management system deficiencies

Major Impediments to an Opinion on CFS

There are three primary reasons why the CFS remained unauditable for fiscal year 2003

- Serious financial management problems at the Department of Defense
- The federal government's ineffective process for preparing the CFS
- The federal government's inability to account for billions of dollars of transactions between federal entities

Planning for Future CFS Audits

GAO plans a risk-based line item approach

- Potential qualified opinion on the CFS balance sheet
- Ability to use the work of agency auditors
- Auditors need to follow the GAO/IG Financial Audit Manual (FAM)
- GAO will need timely access to audit work by agency auditors

Key Concepts in the Accountability Profession

- Public vs. personal interests
- Recognizing the difference between the floor (e.g., law, accounting standards) and the ceiling (e.g., principles, values)
- Doing what is right vs. what is acceptable
- Economic substance vs. legal form
- Being concerned with both fact and appearance (e.g., independence)
- Using judgment vs. completing checklists
- Recognizing that continuing improvement in today's rapidly changing world is essential
- Trust is hard to earn, but easy to lose

Three Key Personal Attributes Needed for These Challenging and Changing Times

- *Leadership*
- *Integrity*
- *Innovation*

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