

**GAO**

Testimony before the Subcommittee on  
Government Organization, Efficiency and  
Financial Management, Committee on  
Oversight and Government Reform, House  
of Representatives

---

For Release on Delivery  
Expected at 9:30 a.m. EST  
Wednesday, March 9, 2011

**FISCAL YEAR 2010 U.S.  
GOVERNMENT  
FINANCIAL STATEMENTS**

**Federal Government  
Continues to Face Financial  
Management and Long-  
Term Fiscal Challenges**

Statement of Gene L. Dodaro  
Comptroller General of the United States



**GAO**

Accountability \* Integrity \* Reliability

---



Highlights of [GAO-11-363T](#), a testimony before the Subcommittee on Government Organization, Efficiency and Financial Management, Committee on Oversight and Government Reform, House of Representatives

## Why GAO Did This Study

GAO annually audits the consolidated financial statements of the U.S. government. Congress and the President need reliable, useful, and timely financial and performance information to make sound decisions and conduct effective oversight of federal government programs and policies.

Over the years, certain material weaknesses in internal control over financial reporting have prevented GAO from expressing an opinion on the accrual-based consolidated financial statements. Unless these weaknesses are adequately addressed, they will, among other things, continue to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; and (2) affect the federal government's ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities.

This testimony presents the results of GAO's audit for fiscal year 2010 and discusses certain of the federal government's significant long-term fiscal challenges.

## What GAO Recommends

Over the years, GAO has made numerous recommendations directed at improving federal financial management. The federal government has generally taken or plans to take actions to address our recommendations.

View [GAO-11-363T](#) or [key components](#). For more information, contact Jeanette M. Franzel or Gary T. Engel at (202) 512-2600.

March 9, 2011

# FISCAL YEAR 2010 U.S. GOVERNMENT FINANCIAL STATEMENTS

## Federal Government Continues to Face Financial Management and Long-Term Fiscal Challenges

### What GAO Found

Three major impediments continued to prevent GAO from rendering an opinion on the federal government's accrual-based consolidated financial statements: (1) serious financial management problems at the Department of Defense, (2) federal entities' inability to adequately account for and reconcile intragovernmental activity and balances, and (3) the federal government's ineffective process for preparing the consolidated financial statements. In addition to the material weaknesses underlying these major impediments, GAO noted material weaknesses involving billions of dollars in improper payments, information security, and tax collection activities. With regard to the Statement of Social Insurance (SOSI), GAO was unable to, and did not, express an opinion on the 2010 SOSI because of significant uncertainties discussed by management in the consolidated financial statements, primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2010 SOSI. GAO was, however, able to render unqualified opinions on the 2009, 2008, and 2007 SOSIs.

Since the enactment of key financial management reforms in the 1990s, the federal government has made significant progress in improving financial management activities and practices. For fiscal year 2010, 20 of 24 Chief Financial Officers (CFO) Act agencies were able to attain unqualified audit opinions on their accrual-based financial statements within an accelerated reporting timeframe, up from 6 CFO Act agencies for fiscal year 1996. Also, accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. Further, the preparation and audit of financial statements has identified numerous deficiencies, leading to actions to strengthen controls and systems.

Much work remains, however, to improve federal financial management. For example, it is essential that the Department of Defense, the Department of the Treasury, and the Office of Management and Budget, along with other federal entities, address the major impediments discussed above. Also, it is important for the individual federal departments and agencies to remain committed to maintain the progress that has been achieved in obtaining positive audit results and to build upon that progress to make needed improvements.

The *2010 Financial Report of the United States Government (Financial Report)* introduces the first sustainability statement required under a new financial reporting standard, which presents comprehensive long-term fiscal projections for the U.S. government. Such reporting provides a much needed perspective on the federal government's long-term fiscal position and outlook. The *Financial Report*, like the latest Congressional Budget Office long-term budget outlook and GAO simulations, shows that the federal government is on an unsustainable long-term fiscal path.

---

Mr. Chairman, Ranking Member Towns and Other Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss our report on the U.S. government's consolidated financial statements for fiscal years 2010 and 2009. Given the federal government's fiscal challenges, there is a significant need for transparency and for the Congress, the administration, and federal managers to have reliable, useful, and timely financial and performance information. Even though significant progress has been made since the enactment of key financial management reforms in the 1990s, our report on the U.S. government's consolidated financial statements illustrates that much work remains to improve federal financial management. Consequently, financial management needs to be a top priority of this administration and the new Congress. I would like to commend you, Mr. Chairman, and this Subcommittee, for continuing the annual tradition of oversight hearings on this important subject. Your involvement is critical to assuring continued progress.

Our testimony today discusses the following major issues relating to the consolidated financial statements for fiscal years 2010 and 2009: (1) the results of our audit, including continued major impediments to an opinion on the accrual-based consolidated financial statements<sup>1</sup> and certain significant uncertainties that resulted in us being unable to render an opinion on the 2010 Statement of Social Insurance;<sup>2</sup> (2) the effects of the recent economic recession and the federal government's actions to stabilize financial markets and promote economic recovery on the federal government's financial condition; and (3) challenges posed by the federal government's long-term fiscal outlook. We performed sufficient audit work to provide our report on the consolidated financial statements, internal control, and compliance with selected provisions of laws and regulations. We considered the limitations on the scope of our work in forming our conclusions. Our audit was conducted in accordance with U.S. generally accepted government auditing standards.

---

<sup>1</sup>The consolidated financial statements other than the Statement of Social Insurance are referred to as the accrual-based consolidated financial statements. Most revenues reported in these financial statements are recorded on a modified cash basis.

<sup>2</sup>We rendered unqualified opinions on the 2009, 2008, and 2007 Statements of Social Insurance.

---

Both the consolidated financial statements and our related audit report are included in the fiscal year 2010 *Financial Report of the United States Government (Financial Report)*. Our audit report would not be possible without the commitment and professionalism of inspectors general throughout the federal government who are responsible for annually auditing the financial statements of individual federal agencies. The *Financial Report* was issued by the Department of the Treasury (Treasury) on December 21, 2010.<sup>3</sup> This report is available through GAO's Internet site, at <http://www.gao.gov/financial/fy2010financialreport.html> and Treasury's Internet site, at <http://www.fms.treas.gov/fr/index.html>.

---

## Results of Our Audit of the U.S. Government's Consolidated Financial Statements for Fiscal Years 2010 and 2009

Since the enactment of key financial management reforms in the 1990s, the federal government has made significant progress in improving financial management activities and practices. For fiscal year 2010, 20 of 24 Chief Financial Officers (CFO) Act agencies were able to attain unqualified audit opinions<sup>4</sup> on their accrual-based financial statements within an accelerated reporting timeframe, up from 6 CFO Act agencies for fiscal year 1996. Also, accounting and financial reporting standards have continued to evolve to provide greater transparency and accountability over the federal government's operations, financial condition, and fiscal outlook. Further, the preparation and audit of financial statements has identified numerous deficiencies, leading to actions to strengthen controls and systems. It is important for the individual federal departments and agencies to remain committed to maintain the progress that has been achieved in obtaining positive audit results and to build upon that progress to make needed improvements.

Although this progress is commendable, the federal government was unable to demonstrate the reliability of significant portions of the U.S. government's accrual-based consolidated financial statements for fiscal years 2010 and 2009, principally resulting from limitations related to certain material weaknesses in internal control over financial reporting and other limitations on the scope of our work. As a result, we were unable to provide an opinion on such statements. Further, significant

---

<sup>3</sup>Also, see GAO, *Understanding the Primary Components of the Annual Financial Report of the United States Government*, GAO-05-958SP (Washington, D.C.: September 2005). In September 2009, we issued an update to this guide to reflect recent changes to the federal accounting standards and resulting changes to the *Financial Report*; see GAO-09-946SP (Washington, D.C.: September 2009).

<sup>4</sup>See appendix I for the fiscal year 2010 audit results for the 24 CFO Act agencies.

---

uncertainties (discussed in Note 26 to the consolidated financial statements), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2010 Statement of Social Insurance, prevented us from expressing an opinion on that statement. We were, however, able to render unqualified opinions on the 2009, 2008, and 2007 Statements of Social Insurance.<sup>5</sup> Given the importance of social insurance programs like Medicare and Social Security to the federal government's long-term fiscal outlook, the Statement of Social Insurance is critical to understanding the federal government's financial condition and fiscal sustainability.

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support certain material information reported in the U.S. government's accrual-based consolidated financial statements. The underlying material weaknesses in internal control,<sup>6</sup> which generally have existed for years, contributed to our disclaimer of opinion on the U.S. government's accrual-based consolidated financial statements for the fiscal years ended 2010 and 2009.<sup>7</sup> Those material weaknesses relate to the federal government's inability to

- satisfactorily determine that property, plant, and equipment and inventories and related property, primarily held by the Department of Defense (DOD), were properly reported in the accrual-based consolidated financial statements;
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;

---

<sup>5</sup>We disclaimed an opinion on the fiscal year 2006 consolidated financial statements, including the Statement of Social Insurance. Social insurance programs included in the Statement of Social Insurance are Social Security, Medicare, Railroad Retirement, and Black Lung.

<sup>6</sup>A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

<sup>7</sup>A more detailed description of the material weaknesses that contributed to our disclaimer of opinion, including the primary effects of these material weaknesses on the accrual-based consolidated financial statements and on the management of federal government operations, can be found on pages 238 through 244 of the *Financial Report*.

- 
- support significant portions of the reported total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain federal entities;
  - adequately account for and reconcile intragovernmental activity and balances between federal entities;
  - ensure that the federal government’s accrual-based consolidated financial statements were (1) consistent with the underlying audited entities’ financial statements, (2) properly balanced, and (3) in conformity with U.S. generally accepted accounting principles (GAAP); and
  - identify and either resolve or explain material differences between (1) certain components of the budget deficit reported in Treasury’s records that are used to prepare the Reconciliation of Net Operating Cost and Unified Budget Deficit, the Statement of Changes in Cash Balance from Unified Budget and Other Activities, and the Fiscal Projections for the U.S. Government (included in the Supplemental Information section of the *Financial Report*) and (2) related amounts reported in federal entities’ financial statements and underlying financial information and records.

These material weaknesses continued to (1) hamper the federal government’s ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government’s ability to reliably measure the full cost as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government’s ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner.

In addition to the material weaknesses that contributed to our disclaimer of opinion on the accrual-based consolidated financial statements, we found the following three other material weaknesses in internal control.<sup>8</sup>

---

<sup>8</sup>A more detailed discussion of these weaknesses, including the primary effects of the material weaknesses on the accrual-based consolidated financial statements and on the management of federal government operations, can be found on pages 245 through 248 of the *Financial Report*.

---

These other material weaknesses were the federal government's inability to

- determine the full extent to which improper payments occur and reasonably assure that appropriate actions are taken to reduce improper payments,<sup>9</sup>
- identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and
- effectively manage its tax collection activities.

Also, many of the CFO Act agencies continue to struggle with financial systems that are not integrated and do not meet the needs of management for reliable, useful, and timely financial information. Often, agencies expend major time, effort, and resources to develop financial information that their systems should be able to provide on a daily or recurring basis.

## Addressing Impediments to an Opinion on the Accrual-Based Consolidated Financial Statements

Three major impediments continued to prevent us from rendering an opinion on the U.S. government's accrual-based consolidated financial statements: (1) serious financial management problems at DOD that have prevented DOD's financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. Additional impediments, such as certain entities' fiscal year 2010 financial statements that, as of the date of our audit report, received disclaimers of opinion or were not audited, also contributed to our inability to render an opinion on the U.S. government's accrual-based consolidated financial statements. Extensive efforts by DOD and other entity officials and cooperative efforts between entity chief financial officers, Treasury officials, and Office of Management and Budget (OMB) officials will be needed to resolve these obstacles to achieving an opinion on the U.S. government's accrual-based consolidated financial statements.

## Improving Financial Management at DOD

Given DOD's size and complexity, the resolution of its serious financial management problems is essential to achieving an opinion on the U.S. government's consolidated financial statements. Reported weaknesses in DOD's financial management and other business operations adversely

---

<sup>9</sup>Federal entities reported estimates of improper payment amounts that totaled \$125.4 billion for fiscal year 2010, which represented about 5.5 percent of \$2.3 trillion of reported outlays for the related programs.

---

affect the reliability of DOD's financial data; the economy, efficiency, and effectiveness of its operations; and its ability to produce auditable financial statements. Several DOD business practices, including financial management, continue to be included on GAO's list of high-risk programs designated as vulnerable to waste, fraud, abuse, and mismanagement<sup>10</sup> or in need of transformation.

To transform its business operations, DOD management must have reliable financial information. Without it, DOD is severely hampered in its ability to make sound budgetary and programmatic decisions, monitor trends, make adjustments to improve performance, reduce operating costs, or maximize the use of resources.

DOD continues to take steps toward resolving the department's long-standing financial management weaknesses. The department's Financial Improvement and Audit Readiness (FIAR) Plan, which defines DOD's strategy and methodology for improving financial management operations and controls, has continued to evolve and mature. DOD's Comptroller has established two priority focus areas—first, strengthening processes, controls, and systems that produce budgetary information and support the department's Statements of Budgetary Resources; and second, improving the accuracy and reliability of management information pertaining to mission-critical assets, including military equipment and real property, and validating improvement through existence and completeness testing. In 2010, DOD revised its FIAR strategy, governance framework, and methodology to support the DOD Comptroller's direction and priorities.

We are supportive of this initiative and believe that a focused and consistent approach may increase DOD's ability to demonstrate incremental progress toward auditability in the short term. Budgetary and asset-accountability information is widely used by DOD managers at all levels. As such, its reliability is vital to daily operations and management. In this regard, the U.S. Marine Corps (USMC) recently underwent an audit of its fiscal year 2010 Statement of Budgetary Resources (SBR). Although the auditors were unable to express an opinion on the USMC SBR, DOD indicated that the lessons learned from the audit will be applied to the fiscal year 2011 USMC SBR audit currently underway and shared with the other DOD components to assist them in their audit readiness efforts.

---

<sup>10</sup>GAO, *High-Risk Series: An Update*, [GAO-11-278](#) (Washington, D.C.: February 2011).



---

A key element of DOD's strategy is successful implementation of Enterprise Resource Planning (ERP) systems. However, inadequate requirements management, inadequate systems testing, ineffective oversight over business system investments, and other challenges have hindered the department's efforts to implement these systems on schedule and within budget. Effective and sustained leadership and oversight of the department's ERP implementation will be important to ensure that these important initiatives result in the integrated capabilities needed to transform the department's financial management and related business operations.

The Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (NDAA)<sup>11</sup> lists actions that DOD is required to take and include in its FIAR Plan. The NDAA requires the DOD Comptroller to, among other things,

- establish interim milestones for achieving audit readiness of DOD's financial statements consistent with the requirements of section 1003 of the National Defense Authorization Act for Fiscal Year 2010,<sup>12</sup> which requires DOD's financial statements to be validated as audit ready no later than September 30, 2017. The interim milestones shall include, for each military department and for the defense agencies and defense field activities, interim milestones for (1) achieving audit readiness for each major element of the Statement of Budgetary Resources, and (2) addressing the existence and completeness of each major category of assets, including military equipment, real property, and operating material and supplies; and
- examine the costs and benefits of alternative approaches to the valuation of DOD assets, select a valuation approach, and begin to prepare a business case analysis supporting the selected approach.

Important to the success of DOD's current priorities and the FIAR program are high-quality, detailed plans, and effective implementation at all levels. Long-term, to achieve financial statement auditability and improve financial management information, it will be important that DOD establish sound strategic planning and effective implementation across the department, and at all levels, with efforts that can be sustained through leadership transitions.

---

<sup>11</sup>Pub. L. No. 111-383, Div. A, Tit. VIII, § 881, 124 Stat. 4137, 4306 (Jan. 7, 2011).

<sup>12</sup>Pub. L. No. 111-84, Div. A, Tit. X, § 1003, 123 Stat. 2190, 2439-2441 (Oct. 28, 2009).

---

  

---

Reconciling Intragovernmental  
Activity and Balances

We are encouraged by continuing congressional oversight of DOD's business transformation and financial management improvement efforts and the commitment of DOD's leaders to implementing sustained improvements in the department's ability to produce reliable, useful, and timely information for decision making and reporting. We will continue to monitor DOD's progress in addressing its financial management weaknesses and transforming its business operations.

Federal entities are unable to adequately account for and reconcile intragovernmental activity and balances. For both fiscal years 2010 and 2009, amounts reported by federal entity trading partners for certain intragovernmental accounts were not in agreement by significant amounts. Although OMB and Treasury require the CFOs of 35 significant federal entities to reconcile, on a quarterly basis, selected intragovernmental activity and balances with their trading partners, a substantial number of the entities did not adequately perform those reconciliations for fiscal years 2010 and 2009. As a result of these circumstances, the federal government's ability to determine the impact of the unreconciled differences between trading partners on the amounts reported in the accrual-based consolidated financial statements is significantly impaired.

GAO has identified and reported on numerous intragovernmental activities and balances issues and has made several recommendations to Treasury and OMB to address those issues. Treasury and OMB have generally taken or plan to take actions to address these recommendations. Treasury continues to take steps to help resolve material differences in intragovernmental activity and balances. For example, during fiscal year 2010, Treasury established additional focus groups, consisting of Treasury and agency personnel, to begin identifying and resolving certain reported material differences. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a strong commitment by federal entities to fully implement guidance regarding business rules for intragovernmental transactions issued by OMB and Treasury as well as continued strong leadership by OMB and Treasury.<sup>13</sup>

---

<sup>13</sup>On November 8, 2010, Treasury issued the Treasury Financial Manual (TFM) Bulletin No. 2011-04, *Intragovernmental Business Rules*, which rescinded and supersedes TFM Bulletin No. 2007-03, *Intragovernmental Business Rules* (October 31, 2007). This guidance is effective for fiscal year 2011 and has updated the previous guidance to include, among other things, a new *Intragovernmental Dispute Resolution Request Form* to be certified by federal entity CFOs and disputes to be resolved by Treasury's Deputy Assistant Secretary—Accounting Policy, Office of Fiscal Assistant Secretary.

---

## Preparing the Consolidated Financial Statements

While further progress was demonstrated in fiscal year 2010, the federal government continued to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited entity financial statements, properly balanced, and in conformity with GAAP.<sup>14</sup> For example,

- Treasury's process did not ensure that the information in certain of the accrual-based consolidated financial statements was fully consistent with the underlying information in 35 significant federal entities' audited financial statements and other financial data.
- To make the fiscal years 2010 and 2009 consolidated financial statements balance, Treasury recorded net increases of \$0.8 billion and \$17.4 billion, respectively, to net operating cost on the Statement of Operations and Changes in Net Position, which it labeled "Unmatched transactions and balances."<sup>15</sup> Treasury recorded an additional net \$3.8 billion and \$8 billion of unmatched transactions in the Statement of Net Cost for fiscal years 2010 and 2009, respectively. Treasury is unable to fully identify and quantify all components of these unreconciled activities.
- Treasury's reporting of certain financial information required by GAAP continues to be impaired, and will remain so until federal entities, such as DOD, can provide Treasury with complete and reliable information required to be reported in the consolidated financial statements.

A detailed discussion of additional control deficiencies regarding the process for preparing the consolidated financial statements can be found on pages 240 through 243 of the *Financial Report*.

During fiscal year 2010, Treasury, in coordination with OMB, continued implementing corrective action plans and made progress in addressing certain internal control deficiencies we have previously reported regarding the process for preparing the consolidated financial statements. Resolving

---

<sup>14</sup>Most of the issues we identified in fiscal year 2010 existed in fiscal year 2009, and many have existed for a number of years. Most recently, in July 2010, we reported the issues we identified to Treasury and OMB and provided recommendations for corrective action in GAO, *Management Report: Improvements Needed in Controls over the Preparation of the U.S. Consolidated Financial Statements*, GAO-10-757 (Washington, D.C.: July 30, 2010).

<sup>15</sup>Although Treasury was unable to determine how much of the unmatched transactions and balances, if any, relate to net operating cost, it reported this amount as a component of net operating cost in the consolidated financial statements.

---

some of these internal control deficiencies will be a difficult challenge and will require a strong commitment from Treasury and OMB as they continue to execute and implement their corrective action plans.

## Addressing Other Impediments

While not as significant as the major impediments noted above, financial management problems at the Department of Homeland Security (DHS) and the Department of Labor (Labor) also contributed to the disclaimer of opinion on the federal government's accrual-based consolidated financial statements for fiscal year 2010. About \$28 billion, or about 1 percent, of the federal government's reported total assets as of September 30, 2010, and approximately \$235 billion, or about 5 percent, of the federal government's reported net cost for fiscal year 2010 relate to these two agencies. The auditors for DHS and Labor reported that they were unable to provide opinions on the financial statements because they were not able to obtain sufficient evidential support for certain amounts presented in financial statements. For example,

- only selected DHS financial statements were subjected to audit, and the auditors stated that DHS was unable to provide sufficient evidence to support certain financial statements balances at the Coast Guard and Transportation Security Administration; and
- auditors for Labor reported that the department was unable to provide sufficient support for certain accounts in Labor's fiscal year 2010 financial statements.

The auditors for DHS and Labor made recommendations to address control deficiencies at the agencies, and management for these agencies generally expressed commitment to resolve the deficiencies. It will be important that management at each of these agencies remain committed to addressing noted control deficiencies and improving financial reporting.

## Significant Uncertainties Result in Disclaimer of Opinion on 2010 Statement of Social Insurance

Because of significant uncertainties (as discussed in Note 26 to the consolidated financial statements), primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2010 Statement of Social Insurance, we were unable to, and we did not, express an opinion on the 2010 Statement of Social Insurance.<sup>16</sup> The Statement of Social Insurance presents the actuarial present value of the federal

---

<sup>16</sup>About \$22.8 trillion, or 74 percent, of the federal government's reported total present value of future expenditures in excess of future revenue for 2010 relate to the Department of Health and Human Services' 2010 Statement of Social Insurance, which received a disclaimer of opinion.

---

government's estimated future revenue to be received from or on behalf of participants and estimated future expenditures to be paid to or on behalf of participants, based on benefit formulas in current law and using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs.<sup>17</sup>

The significant uncertainties, discussed in further detail in Note 26 to the consolidated financial statements, include:

- Medicare projections in the 2010 Statement of Social Insurance were based on full implementation of the provisions of the Patient Protection and Affordable Care Act (PPACA),<sup>18</sup> including a significant decrease in projected Medicare costs from the 2009 Statement of Social Insurance related to (1) reductions in physician payment rates totaling 30 percent over the next 3 years and (2) productivity improvements for most other categories of Medicare providers. However, there are significant uncertainties concerning the achievement of these projected decreases in Medicare costs.
- Management has noted that actual future costs for Medicare are likely to exceed those shown by the current-law projections presented in the 2010 Statement of Social Insurance due to the likelihood of modifications to the scheduled reductions.<sup>19</sup> The extent to which actual future costs exceed the projected current-law amounts due to changes to the physician payments and productivity adjustments depends on both the specific changes that might be legislated and on whether legislation would include other provisions to help offset such costs.
- Management has developed an illustrative alternative projection intended to provide additional context regarding the long-term

---

<sup>17</sup>The projection period used for the Social Security, Medicare, and Railroad Retirement social insurance programs is 75 years. For the Black Lung program, the projections are through 2040.

<sup>18</sup>Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

<sup>19</sup>Subsequent to the date of our report, the Medicare and Medicaid Extenders Act of 2010, Pub. L. No. 111-309, § 101 overrode the scheduled reductions in physician payments through December 2011 and reduced non-Medicare outlays by limiting a health insurance tax credit.

---

sustainability of the Medicare program and to illustrate the uncertainties in the Statement of Social Insurance projections. The present value of future estimated expenditures in excess of future estimated revenue for Medicare, included in the illustrative alternative projection, exceeds the \$22.8 trillion estimate in the 2010 Statement of Social Insurance by \$12.4 trillion.

---

## Effects of the Recent Economic Recession and Stabilization Efforts on the Federal Government's Financial Condition

The recent economic recession and the federal government's actions to stabilize financial markets and promote economic recovery continued to significantly affect the federal government's financial condition.

In December 2007, the United States entered what has turned out to be its deepest recession since the end of World War II. Gross domestic product (GDP) fell 4.1 percent from the beginning of the recession through the second quarter of 2009, which marked the recession's end. Since the end of the recession, GDP has grown slowly and unemployment remains at a high level.

As of September 30, 2010, the federal government's actions to stabilize the financial markets and to promote economic recovery resulted in assets of over \$400 billion, which is net of about \$75 billion in valuation losses. In addition, the federal government reported incurring significant liabilities and related net cost resulting from these actions. Although the federal government has received positive returns from investments in certain large financial institutions, it continues to report significant costs overall related to these actions. Because the valuation of the related assets and liabilities is based on assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions, actual results may be materially different from the reported amounts.

Actions taken to stabilize financial markets—including aid to the automotive industry—increased borrowing and added to federal debt held by the public. The revenue decreases and spending increases enacted in the American Recovery and Reinvestment Act of 2009 also added to borrowing and federal debt held by the public. Federal debt held by the public increased from 40 percent of GDP as of September 30, 2008, to 62

---

percent as of September 30, 2010.<sup>20</sup> The economic downturn and the nature and magnitude of the actions taken to stabilize the financial markets and to promote economic recovery will continue to shape the federal government's near-term budget and debt outlook. While deficits are projected to decrease as federal support for states and the financial sector winds down and the economy recovers, the increased debt and related interest costs will remain.

The ultimate cost of the federal government's actions to stabilize the financial markets and promote economic recovery will not be known for some time as these uncertainties are resolved and further federal government actions are taken in fiscal year 2011 and later. Looking ahead, it will be important for the federal government to continue to determine the most expeditious manner in which to bring closure to its financial stabilization initiatives while optimizing its investment returns.

---

## Long-Term Fiscal Challenges

The 2010 *Financial Report* includes the first sustainability statement required under new financial reporting standards.<sup>21</sup> This statement presents comprehensive long-term fiscal projections for the U.S. government, expanding on similar information presented in recent years' financial reports and consistent with the fiscal simulations that GAO has published since 1992. This enhanced reporting will hopefully increase public awareness and understanding of the long-term fiscal outlook: both its overall size and the major drivers of that outlook. Information on the imbalance between revenues and spending currently built into the structure of the budget can help stimulate public and policy debates and help policymakers make more informed decisions about the overall sustainability of government finances.

---

<sup>20</sup>Federal debt held by the public relative to GDP is a function of the federal government's fiscal policy as well as overall economic conditions. Congress and the President have enacted laws to establish a limit on the amount of federal debt that can be outstanding at one time. Federal debt subject to the limit includes both debt held by the public and debt held by government accounts (intragovernmental debt holdings). In February 2011, we reported on the debt limit in GAO, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203 (Washington, D.C.: Feb. 22, 2011).

<sup>21</sup>Under such standards, the new statement will be audited beginning in fiscal year 2013.

---

For more than a decade, GAO has been running fiscal simulations to tell more about this longer-term story. The Congressional Budget Office (CBO) has also published long-term simulations for many years.

The federal government faced large and growing structural deficits—and hence rising debt—before the instability in financial markets and the economic downturn. Under the projections included in the *Financial Report* and under the most recent CBO and GAO simulations using a range of assumptions, these structural deficits—driven on the spending side primarily by rising health care costs and known demographic trends—lead to continuing increases in federal debt held by the public as a share of GDP, which is unsustainable.

---

## Closing Comments

In closing, even though progress has been made in improving federal financial management activities and practices, much work remains given the federal government's long-term fiscal challenges and the need for the new Congress, the administration, and federal managers to have reliable, useful, and timely financial and performance information to effectively meet these challenges.

The recent economic recession and the federal government's actions to stabilize financial markets and promote economic recovery continued to significantly affect the federal government's financial condition. The accrual-based consolidated financial statements for fiscal year 2010 include, as they did for fiscal year 2009, substantial assets and liabilities resulting from these actions. The valuation of certain assets and liabilities is based on assumptions and estimates that are inherently subject to substantial uncertainty arising from the uniqueness of certain transactions and the likelihood of future changes in general economic, regulatory, and market conditions. As such, there will be differences between the estimated values as of September 30, 2010, and the actual results, and such differences may be material. These differences will also affect the ultimate cost of the federal government's market stabilization and economic recovery actions. Going forward, a great amount of attention will need to continue to be devoted to ensuring (1) that sufficient internal controls and transparency are established and maintained for all financial stabilization and economic recovery initiatives; and (2) that all related financial transactions are reported on time, accurately, and completely.

Further, sound decisions on the current and future direction of all vital federal government programs and policies are more difficult without reliable, useful, and timely financial and performance information. In this



---

regard, for DOD, the challenges are many. We are encouraged by DOD's efforts toward addressing its long-standing financial management weaknesses and its efforts to achieve auditability. Consistent and diligent top management oversight toward achieving financial management capabilities, including audit readiness, will be critical going forward. Moreover, the civilian CFO Act agencies must continue to strive toward routinely producing not only annual financial statements that can pass the scrutiny of a financial audit, but also quarterly financial statements and other meaningful financial and performance data to help guide decision makers on a day-to-day basis. Federal entities' improvement of financial management systems will be essential to achieve this goal.

Moreover, of utmost concern are the federal government's long-term fiscal challenges that result from large and growing structural deficits that are driven on the spending side primarily by rising health care costs and known demographic trends. This unsustainable path must be addressed soon by policymakers.

Finally, I want to emphasize the value of sustained congressional interest in these issues, as demonstrated by this Subcommittee's leadership. It will be key that, going forward, the appropriations, budget, authorizing, and oversight committees hold the top leadership of federal entities accountable for resolving the remaining problems and that they support improvement efforts.

---

Mr. Chairman and Ranking Member Towns, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the Subcommittee may have at this time.

---

## GAO Contacts and Acknowledgments

For further information regarding this testimony, please contact Jeanette M. Franzel, Managing Director, or Gary T. Engel, Director, Financial Management and Assurance, at (202) 512-2600. Key contributions to this testimony were also made by staff on the Consolidated Financial Statement audit team.

# Appendix I: Fiscal Year 2010 Audit Results

**Table 1: Chief Financial Officers (CFO) Act Agencies: Fiscal Year 2010 Audit Results and Principal Auditors**

<b>CFO Act agencies</b>	<b>Opinion rendered by agency auditor</b>	<b>Agencies' auditors reported material weaknesses or noncompliance<sup>a</sup></b>	<b>Principal auditor</b>
Agency for International Development	Unqualified	√	Office of Inspector General (OIG)
Agriculture	Unqualified	√	OIG
Commerce	Unqualified		KPMG LLP
Defense	Disclaimer	√	OIG
Education	Unqualified	√	Ernst & Young LLP
Energy	Unqualified		KPMG LLP
Environmental Protection Agency	Unqualified	√	OIG
General Services Administration	Unqualified		KPMG LLP
Health and Human Services	<sup>b</sup>	√	Ernst & Young LLP
Homeland Security	<sup>c</sup>	√	KPMG LLP
Housing and Urban Development	Unqualified	√	OIG
Interior	Unqualified	√	KPMG LLP
Justice	Unqualified		KPMG LLP
Labor	Disclaimer	√	KPMG LLP
National Aeronautics and Space Administration	<sup>d</sup>		Ernst & Young LLP
National Science Foundation	Unqualified		Clifton Gunderson LLP
Nuclear Regulatory Commission	Unqualified		Urbach Kahn & Werlin LLP
Office of Personnel Management	Unqualified	√	KPMG LLP
Small Business Administration	Unqualified	√	KPMG LLP
Social Security Administration	Unqualified		Grant Thornton LLP
State	Unqualified	√	Kearney & Company
Transportation	Unqualified		Clifton Gunderson LLP
Treasury	Unqualified	√	KPMG LLP
Veterans Affairs	Unqualified	√	Clifton Gunderson LLP

Source: GAO.

<sup>a</sup>Reported noncompliance with applicable laws and regulations and/or substantial noncompliance with one or more of the Federal Financial Management Improvement Act requirements.

<sup>b</sup>The auditors expressed an unqualified opinion on the Department of Health and Human Services' fiscal year 2010 accrual-based financial statements, but not on the department's 2010 Statement of Social Insurance. The auditors were unable to render an opinion on that financial statement.

<sup>c</sup>For fiscal year 2010, only the Consolidated Balance Sheet and the related Statement of Custodial Activity of the Department of Homeland Security were subject to audit; the auditors were unable to express an opinion on these two financial statements.

<sup>d</sup>The auditors of the National Aeronautics and Space Administration's fiscal year 2010 financial statements issued a qualified opinion because of the affect of certain matters related to property, plant, and equipment and operating materials and supplies balances.

---

---

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to [www.gao.gov](http://www.gao.gov) and select "E-mail Updates."

---

## Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Ralph Dawn, Managing Director, [dawnr@gao.gov](mailto:dawnr@gao.gov), (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, DC 20548

---

## Public Affairs

Chuck Young, Managing Director, [youngc1@gao.gov](mailto:youngc1@gao.gov), (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, DC 20548

