

ACCOUNTABILITY CHALLENGES IN THE 21ST CENTURY

International
Consortium on
Governmental
Financial Management

19TH ANNUAL
Conference and Training
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The Honorable David M. Walker
Comptroller General of the United States

May 2, 2005

Accountability Environment

- The credibility of auditing and financial reporting has suffered in the last several years as a result of the accountability failures in the provide sector.
- Forces that lead to the corporate scandals and audit failures includes:
 - Individual and corporate greed
 - Inadequate corporate governance systems
 - Ineffective regulation and oversight of the accounting and auditing profession
 - Inadequate accounting/reporting standards
 - Audit-related expectation gaps
 - Financial managers and advisors working to achieve certain reporting results and focusing on the legal form versus the economic substance of the transactions
 - Unreasonable and inappropriate executive compensation arrangements
 - 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 their independence
- While the recent failures have been concentrated in the private sector, the entire profession has been affected and steps need to be taken to modernize the profession and related standards and practices for the 21st Century.

How Do We Move Forward?

- Good governance and accountability are critical
 - in the private sector to promote efficiency and effectiveness in the capital and credit markets, and overall economic growth, both domestically and internationally
 - in the public sector for the effective and credible functioning of a healthy democracy, and in fulfilling the government's responsibility to citizens and taxpayers
 - in both sectors to support a healthy economy that provides economic opportunities and benefits to citizens
- Sorting out the needs and effective and appropriate governance and accountability mechanisms for different sectors and types of organizations and on an international scale will be critical

GAO's Work to Modernize the Accountability Profession

GAO is actively working to modernize and transform the accountability profession, both inside the government and in the private sector, and to lead by example in this area.

- Definition of success in financial management: clean opinion, no major weaknesses in controls or compliance, and financial systems that produce timely, accurate and useful information for management
- Opinion on system of internal control
- 2003 revision of *Government Auditing Standards*
- Creation of the U.S Auditing Standards Coordinating Forum (i.e., GAO, PCAOB, ASB)
- Coordination with accountability organizations around the world (e.g., INTOSAI)
- Modernization of the accounting/reporting and audit models
- Assure appropriate treatment of restatements by auditors and others
- Monitor implementation of the Sarbanes-Oxley Act, including providing suggestions for possible actions by the PCAOB and the SEC in connection with the internal control reporting requirements under Section 404
- Consider whether reform elements similar to those in Sarbanes-Oxley make sense for the federal government

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), but DOD is the key challenge
- 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
- More timely financial and performance reporting should not come at the price of less reliable reporting

Selected Federal Government Reporting Challenges

- **Financial and Performance Reporting**
 - long-range fiscal challenges (e.g., per capita burden, sustainability, intergenerational impact)
 - “trust funds” (e.g., restricted vs. unrestricted revenues, intra-governmental obligations)
 - DOD assets, liabilities, and contingencies
 - performance reporting
 - Summary annual report
- **Audit Reporting**
 - system of internal control
 - financial vs. performance vs. other information
 - Restatements
 - Beyond “going concern” opinions (e.g., broken business model)

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 and enhanced financial reporting
 - Enhanced performance and accountability reporting
 - Summary annual report
 - Audit/financial management committees
 - Auditor independence

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 that 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.

Selected Key Concepts

- **Public Servants:**

- Public servants hold a public trust and have an obligation to do what is in the collective best interest of all (i.e., greater good) versus what is in the narrow interest of a few (i.e., special interests).

- **SAIs, CPAs, CAs:**

- Certain accountability professionals are in the “trust business”. As a result, they should lead by example and do what is right versus what is arguably acceptable.

- **Corruption:**

- There should be zero tolerance for corruption although it will never be zero. The key question is: What happens when corruption exists and is exposed?

Three Key Elements for Success

Incentives

Transparency

Accountability

Contributing Elements

Government Examples

Incentives

- Rule of law
- Professional Civil Service
- Checks and balances

Transparency

- Financial disclosure
- Free press
- Due process

Accountability

- Oversight Mechanisms
- Enforcement of laws
- Independent judiciary

Contributing Elements

SAI Examples

Incentives

- Independence
- Resources

Transparency

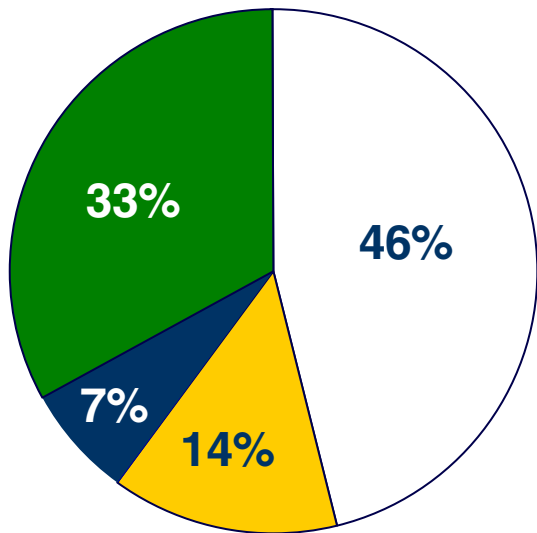
- Protocols
- Public reporting

Accountability

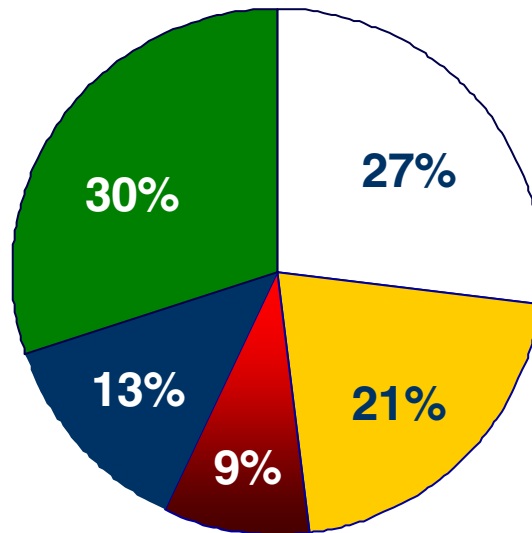
- Enforcement of access rights
- Peer review

Composition of Federal Spending

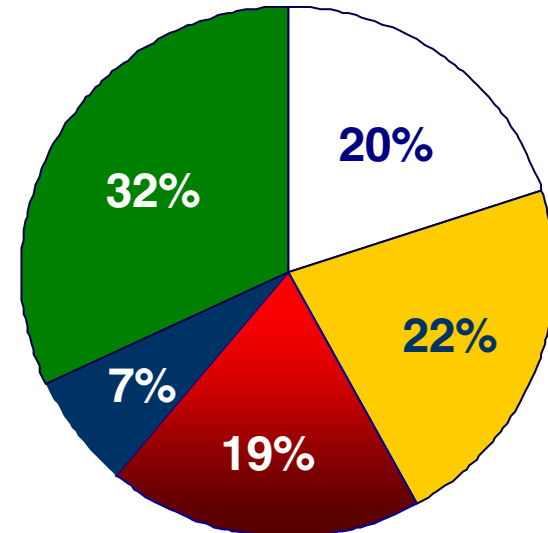
1964



1984



2004



□ Defense
■ Net interest

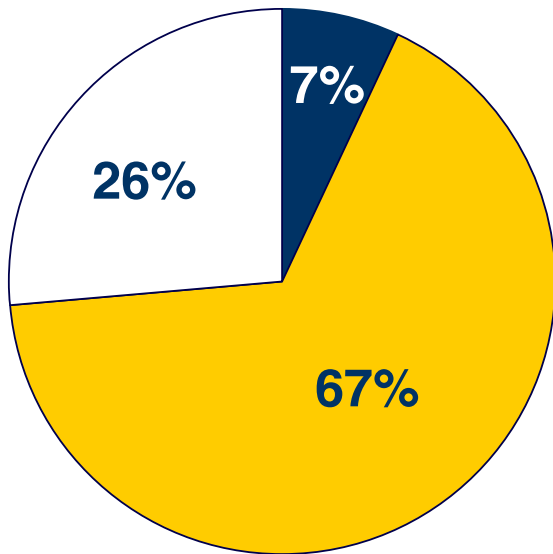
■ Social Security
■ All other spending

■ Medicare & Medicaid

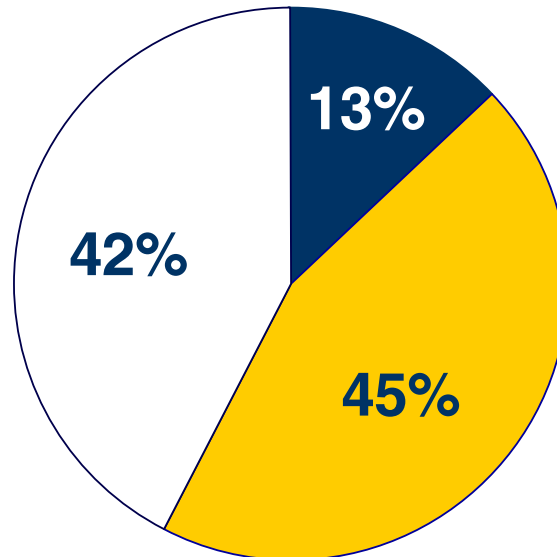
Source: Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs

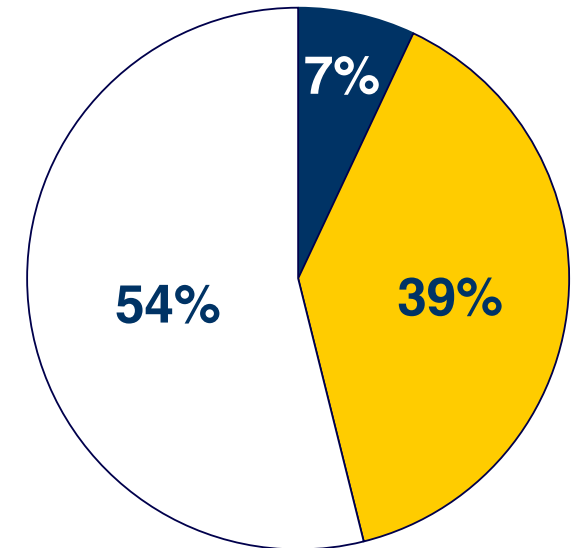
1964



1984



2004



 **Net Interest**

 **Discretionary**

 **Mandatory**

Source: Office of Management and Budget.

Fiscal Year 2004 Deficit Numbers

	\$ Billion	% of GDP
On-Budget Deficit	(567)	(4.9)
Off-Budget Surplus	155*	1.3
Unified Deficit	(412)	(3.6)

*Includes the \$151 billion Social Security surplus and a \$4 billion surplus for the Postal Service

[March 2005]

Selected Fiscal Exposures: Sources and Examples 2005^a

Type	Example (dollars in billions)
Explicit liabilities	Publicly held debt (\$4,297) Military and civilian pension and post-retirement health (\$3,059) Veterans benefits payable (\$925) Environmental and disposal liabilities (\$249) Loan guarantees (\$43)
Explicit financial commitments	Undelivered orders (\$596) Long-term leases (\$39)
Financial contingencies	Unadjudicated claims (\$4) Pension Benefit Guaranty Corporation (\$96) Other national insurance programs (\$1) Government corporations e.g., Ginnie Mae
Exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts (\$3,071) ^b Future Social Security benefit payments (\$4,017) ^c Future Medicare Part A benefit payments (\$8,561) ^c Future Medicare Part B benefit payments (\$12,384) ^c Future Medicare Part D benefit payments (\$8,686) ^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 2004, except Social Security and Medicare estimates, which are as of January 1, 2005.

^b This amount includes \$845 billion held by military and civilian pension and post-retirement health 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 (\$1,687 billion for Social Security, \$268 billion for Medicare Part A, and \$19 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 \$11.1 trillion, \$24.1 trillion for Medicare Part A, \$25.8 trillion for Medicare Part B, and \$18.2 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.

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 Multifaceted Approach to Close the Long-Term Fiscal Gap

Policy:

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending

Operations:

- Reassess and revise how the government does business (e.g., management, planning and operational issues)
- Consider who should provide government services (e.g., sourcing strategy)

21st Century Challenges Report

- Report was issued February 16
- Based on GAO's work for the Congress
- Provides framework and questions to assist in reexamining the base
- Covers entitlements & other mandatory spending, discretionary spending, and tax policy and programs

Twelve Reexamination Areas

MISSION AREAS

- Defense
- Education & Employment
- Financial Regulation & Housing
- Health Care
- Homeland Security
- International Affairs
- Natural Resources, Energy & Environment
- Retirement & Disability
- Science & Technology
- Transportation

CROSSCUTTING

- Improving Governance
- Reexamining the Tax System

Generic Reexamination Criteria and Sample Questions

Relevance of purpose and the federal role

Why did the federal government initiate this program and what was the government trying to accomplish?

Have there been significant changes in the country or the world that relate to the reason for initiating it?

Measuring success

Are there outcome-based measures? If not, why?

If there are outcome-based measures, how successful is it based on these measures?

Targeting benefits

Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

Affordability and cost effectiveness

Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?

Best practices

Is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission?

Illustrative 21st Century Questions

- Can intermodal solutions to the needs of modes such as freight, air, and passenger rail service be effectively carried out within the framework of the existing trust funds and other transportation programs or is another model needed?
- How should the historical allocation of resources across services and programs be changed to reflect the results of a forward-looking comprehensive threat/risk assessment as part of DOD's capabilities-based approach to determining defense needs?
- How should the federal government update its compensations systems to be more market-based and performance—oriented?
- Which tax incentives need to be reconsidered because they fail to achieve the objectives intended by the Congress, their costs outweigh their benefits, they duplicate other programs, or other more cost-effective means exist for achieving their objectives?
- Is the federal government effectively informed by a key national indicator system about the position and progress of the nation as a whole—both on an absolute and relative bases compared to other nations—as a guide to helping set agency and program goals and priorities?

Key National Indicators

- **WHAT:** A portfolio of economic, social, environmental and security related outcome-based statistics that could be used to help assess the nation's and other governmental jurisdictions' position and progress
- **WHO:** Many countries and several states and localities have already undertaken related initiatives (e.g., Australia, New Zealand, Canada, United Kingdom, Oregon, Washington, and Charlotte)
- **WHY:** Development of such a portfolio of indicators could have a number of possible benefits, including
 - Serving as a framework for related strategic planning efforts
 - Enhancing performance and accountability reporting
 - Informing public policy decisions, including much needed baseline reviews of existing government policies, programs, functions, and activities
 - Facilitating public education and debate as well as an informed electorate
- **WAY FORWARD:** Consortium of key players led by the National Academies domestically and related OECD efforts internationally

Trans **FORMATION**

Webster's definition

**An act, process, or instance of
change in structure appearance,
or character**

**A conversion, revolution,
makeover, alteration, or
renovation**

The Case for Change

- **The U.S. federal 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

GAO's High-Risk List

2005

High-Risk Areas	Designated High Risk
Addressing Challenges in Broad-based Transformations	
Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures	1997
Strategic Human Capital Management ^a	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook ^a	2001
Managing Federal Real Property ^a	2003
Implementing and Transforming the Department of Homeland Security	2003
Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security	2005
DOD Approach to Business Transformation ^a	2005
DOD Supply Chain Management (formerly Inventory Management)	1990
DOD Weapon Systems Acquisition	1990
DOD Business Systems Modernization	1995
DOD Financial Management	1995
DOD Support Infrastructure Management	1997
DOD Personnel Security Clearance Program	2005
Managing Federal Contracting More Effectively	
DOE Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992
Management of Interagency Contracting	2005
Assessing the Efficiency and Effectiveness of Tax Law Administration	
Enforcement of Tax Laws ^{a, b}	1990
IRS Business Systems Modernization ^c	1995
Modernizing and Safeguarding Insurance and Benefit Programs	
Medicare Program ^a	1990
HUD Single-Family Mortgage Insurance and Rental Housing Assistance Programs	1994
Medicaid Program ^a	2003
Modernizing Federal Disability Programs ^a	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program ^a	2003
Other	
FAA Air Traffic Control Modernization	1995

^a Legislation is likely to be necessary, as a supplement to actions by the executive branch, in order to effectively address this high-risk area.
^b Two high-risk areas—Collection of Unpaid Taxes and Earned Income Credit Noncompliance—have been consolidated to make this area.
^c The IRS Financial Management high-risk area has been incorporated into this high-risk area.

Transformation: A New Model for Government Organizations

Government organizations will need to:

- Become less hierarchical, process-oriented, stovepiped, and inwardly focused
- Become more partnership-based, results-oriented, integrated, and externally focused
- Achieve a better balance between results, customer, and employee focus
- Work better with other governmental organizations, non-governmental organizations, and the private sector, both domestically and internationally, to achieve results
- Focus on maximizing value, managing risk and enhancing responsiveness within current and expected resource levels

Keys to Making Change Happen

- Commitment and sustained leadership (e.g., leading by example and “tone at the top”)
- Demonstrated need for change (i.e., burning platform)
- Start at the top and with the new people (transformation takes 7+ years)
- Process matters (e.g., employee involvement) – Don’t fight a two-front war
- 15-percent rule
- Identifiable and measurable progress over time
- Communication, communication, communication
- Figure out what’s right versus what’s popular
- Patience, persistence, perseverance to pain before you prevail

Key Transformation Elements

- People
- Process
- Partnerships
- Technology
- Environment

The most important of the five is **PEOPLE** —
an agency's human capital.



Transformation is about
CREATING the future rather than
PERFECTING the past.
Effective **HUMAN CAPITAL**
strategy is key to any
SUCCESSFUL
transformation effort

GAO: Leading by Example

- Mission and vision clarification
- Core values: accountability, integrity, reliability
- Strategic planning
- Organizational realignment
- Definitions of success
- Multi-tasking and matrix management
- Procurement, contracting, and acquisition
- Human capital
- Information technology
- Knowledge management
- Financial management
- Client service/external agency relations and protocols
- Enhanced products and services
- Risk-based approach to engagements
- Constructive engagement with agencies
- Partnering with other accountability and “good government” organizations
- Peer reviews

GAO's Strategic Plan



SERVING THE CONGRESS AND THE NATION GAO'S STRATEGIC PLAN FRAMEWORK

MISSION

GAO exists to support the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government for the benefit of the American people.

THEMES



Long-Term Fiscal Imbalance

National Security

Global Interdependence

Changing Economy

Demographics

Science and Technology

Quality of Life

Governance

GOALS & OBJECTIVES



Provide Timely, Quality Service to the Congress and the Federal Government to ...
Address Current and Emerging Challenges to the Well-Being and Financial Security of the American People *related to ...*

- Health care needs and financing
- Education and protection of children
- Work opportunities and worker protection
- Retirement income security
- Effective system of justice
- Viable communities
- Natural resources use and environmental protection
- Physical infrastructure

Respond to Changing Security Threats and the Challenges of Global Interdependence *involving ...*

- Emerging threats
- Military capabilities and readiness
- Advancement of U.S. interests
- Global market forces

Help Transform the Federal Government's Role and How It Does Business to Meet 21st Century Challenges *by assessing ...*

- Roles in achieving federal objectives
- Government transformation
- Key management challenges and program risks
- Fiscal position and financing of the government

Maximize the Value of GAO by Being a Model Federal Agency and a World-Class Professional Services Organization *in the areas of ...*

- Client and customer satisfaction
- Strategic leadership
- Institutional knowledge and experience
- Process improvement
- Employer of choice

CORE VALUES

Accountability

Integrity

Reliability

INTOSAI's Strategic Plan



INTOSAI STRATEGIC PLAN 2005 - 2010 OVERVIEW

MISSION

INTOSAI is an autonomous, independent, professional, and nonpolitical organization established to provide mutual support; foster the exchange of ideas, knowledge, and experiences; act as a recognized voice of supreme audit institutions (SAIs) within the international community; and promote continuous improvement among diverse member SAIs.

VISION

Promote good government by enabling SAIs to help their respective governments improve performance, enhance transparency, ensure accountability, maintain credibility, fight corruption, promote public trust, and foster the efficient and effective receipt and use of public resources for the benefit of their peoples.

STRATEGIC GOALS

■ **Goal 1: Accountability and Professional Standards**

Promote strong, independent, and multidisciplinary SAIs by (1) encouraging SAIs to lead by example and (2) contributing to the development and adoption of appropriate and effective professional standards.

■ **Goal 2: Institutional Capacity Building**

Build the capabilities and professional capacities of SAIs through training, technical assistance, and other development activities.

■ **Goal 3: Knowledge Sharing and Knowledge Services**

Encourage SAI cooperation, collaboration, and continuous improvement through knowledge sharing, including providing benchmarks, conducting best practice studies, and performing research on issues of mutual interest and concern.

■ **Goal 4: Model International Organization**

Organize and govern INTOSAI in ways which promote economical, efficient, and effective working practices, timely decision-making, and effective governance practices while maintaining due regard for regional balance and the different models and approaches of member SAIs

CORE VALUES

INDEPENDENCE INTEGRITY PROFESSIONALISM CREDIBILITY
INCLUSIVENESS COOPERATION INNOVATION

Selected Success Measures

- Results
- Clients/customers
- People
- Partnerships

Annual Performance Measures

(1998 and 2004)

Performance measure	Actual	
	FY 1998	FY 2004*
Financial benefits (billions)	\$19.7	\$44
Other benefits	537	1197
Past recommendations implemented	69%	83%
Return on investment (ROI)	58:1	95:1
Financial benefits per employee (millions)	\$6.1	\$13.7
Timeliness	93%	97%

*All of the FY 2004 performance measures are records, except timeliness which tied the record set in FY 2003.

International Peer Review Team

- Australia
- Mexico
- Norway
- South Africa
- Canada
- Netherlands
- Sweden

Peer Review Results

- **Clean Opinion**
- **Global Good Practices**
 - Strategic planning process
 - Audit risk assessment
 - Agency Protocols
 - Use of experts
 - E.A.G.L.E
 - Report design
- **Other Observations**
 - Distinguishing between audit and non-audit services
 - Strengthening reporting
 - Reviewing the quality assurance system for further efficiencies
 - Streamlining the documentation requirements
 - Making the inspection program more efficient

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

Key Leadership Attributes For Success

- ***Courage***
- ***Integrity***
- ***Innovation***

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May 2, 2005