

*Managing The Cost
Of Government
Building An Effective
Financial Management
Structure*

Comptroller General of the United States

I think it an object of great importance . . . to simplify our system of finance, and to bring it within the comprehension of every member of Congress . . . the whole system [has been] involved in impenetrable fog. [T]here is a point . . . on which I should wish to keep my eye . . . a simplification of the form of accounts . . . so as to bring everything to a single centre[;] we might hope to see the finances of the Union as clear and intelligible as a merchant's books, so that every member of Congress, and every man of any mind in the Union, should be able to comprehend them to investigate abuses, and consequently to control them.

*Thomas Jefferson
April, 1802*

Preface

The situation lamented by Thomas Jefferson has worsened immeasurably. Federal finances are managed through an elaborate structure of decision processes and information systems. Many of these processes and systems, now obsolete, face ever-increasing difficulties in coping with the demands placed upon them.

The most visible evidence of difficulties is the enormous cost in time, energy, and public confidence involved in the annual search for consensus on the budget. Problems elsewhere in the structure are less visible but equally real:

- The processes by which we decide how much to spend, and for what purposes, are cumbersome, repetitive, and time-consuming.
- Controls over how federal money is spent are detailed and burdensome, but they are routinely found to be ineffective in preventing abuses.
- Budgeting, accounting, and management information systems often yield data that are unreliable, inconsistent, and all too often irrelevant.

The government must make a major effort to rebuild its financial management structure. Old computer systems must be replaced with more modern technology—a long, expensive process. At the same time, however, this updating creates the opportunity to build a structure that will serve the needs of government and the public in the last decade of the 20th century and beyond.

A modern structure for managing government finances will not cause the budget deficit to disappear, nor will it make difficult budget decisions easy. But it can ensure that congressional and executive branch officials receive timely, reliable, and consistent information with which to make those decisions.

This document and an accompanying, more detailed volume explain why we believe a major overhaul is needed; they discuss some of the most important elements of a new system. Many of these ideas have been suggested before. We now attempt to unite them in a single, comprehensive framework. This effort could not have succeeded without the generous assistance of a number of present and former government officials, as well as the accounting firms of Arthur Andersen & Co. and Coopers & Lybrand.

Building a more modern and effective financial management structure for the federal government is an ambitious goal, but it can be achieved if there is a broad consensus that the American taxpayer deserves no less.

Charles A. Bowsher
Comptroller General
of the United States

Overview

The shortcomings of the present federal financial management system are numerous and well-documented. This report emphasizes five problem areas that demonstrate dramatically our need to overhaul the system:

Major Problems *Lack of Cost Information*

Today's financial reports provide a flood of information. Yet there is little of the reliable cost data essential for effectively monitoring program execution, anticipating overruns, and providing a basis for future program and budget planning.

Lack of Reliable Information on Weapon Systems

Current project reporting systems are not tied to the accounting and budgeting systems. The reports, all too often, are incomplete, inconsistent and unreliable. Significant changes may be reported too late for remedial action to be taken.

Inadequate Disclosure of Costs and Liabilities

Major commitments of federal resources, such as retirement benefits, are only partially recognized in the budget. Other activities, such as the \$106.9 billion loan portfolio of the Federal Financing Bank, are entirely excluded from the budget totals.

Unstructured Planning for Capital Investment

The federal government plays a major role in determining the level of investment for public capital facilities. Yet these vitally important decisions are made in an uncoordinated fashion, and the government's overall approach to capital budgeting provides capital expenditures little visibility in the budget process.

Antiquated Financial Management Systems

The federal government is the largest and most complex operating organization in the world. Its basic approach to financial management, however, is obsolete and inefficient. Many federal systems employ outdated equipment and are not designed to provide the information needed by managers, policy officials and Congress.

Previous efforts to remedy these and other problems have been piecemeal and partial. Successful reform requires a comprehensive, integrated approach. It should be government-wide in scope, serving the needs of both Congress and the executive branch, by ensuring that consistent data are available across agency and department lines. The effort should stress four key elements:

Four Key Elements of Reform *Strengthened Accounting, Auditing, and Reporting*

Effective financial management must start with complete, reliable, consistent and timely information. Government financial systems must be designed to produce that information. Routine and special reports must be timely, useful and readily understandable, and the reliability of the information must be assured through effective auditing procedures.

Improved Planning and Programming

Many of the most pressing national issues cannot be adequately considered using a narrow, short-term focus. A modern financial management system should include a structured process for considering those issues, one that focuses attention on major issues, identifies alternative courses of action and analyzes their probable future consequences. The process must assure that the alternatives are

accurately and completely costed on the basis of data from the integrated accounting systems.

Streamlined Budget Process

To be effective, the federal budget process must be made more manageable, and integrated with the planning, programming and accounting phases of financial management. Reform is needed in both Congress and the executive branch. This effort should concentrate on eliminating unnecessary repetition, detail, and obstacles to action. The system and its operating procedures must be designed so that program managers, policy officials and Members of Congress can focus on the difficult budget choices that must be made.

Systematic Measurement of Performance

Effective management of resources requires examining the results of government activities as well as their costs. An integrated and disciplined financial management system that provides consistent data on cost and performance is essential to help both Congress and the executive branch assess the efficiency and effectiveness of government operations. Top appointive federal executives have relatively short tenures and are therefore especially dependent on reliable cost and performance reports to assure that resources are being used effectively.

Taken together, these elements form the conceptual foundation of a new financial management structure. Putting the new structure in place and making it work, however, will require much more:

**Reform Will Require
Investments in Systems,
Organizations and People**

System Development Efforts

New systems will have to be designed and installed, over a period of years, that consistently implement the concepts and take full advantage of the latest technology. Much of this effort can be accomplished with little additional cost by coordinating new and existing system development activities.

Organizational Changes

To operate the new structure efficiently, financial management responsibilities within the federal government may need adjustment.

Investments in People

To operate effectively, even the best-designed financial management system requires able, dedicated, well-trained people and continuity of leadership from skilled executives.

The potential benefits are substantial, but only if these efforts are part of a coordinated strategy of reform. This will require a sustained commitment over a number of years from both Congress and the executive branch. The basis for successful reform might best be established through a series of congressional hearings resulting in a bill or resolution setting forth the scope, objectives, leadership and timetable for the overall effort.

Cost Consciousness: Getting Full Value for the Taxpayers' Money

The federal government spends more than \$2 billion a day on everything from social security benefits and the B-1 bomber to paper clips and pencils. The lack of good cost information has complicated the task of managing government efficiently.

Financial Reports Do Not Clearly Show the Costs of Government Activities

Controlling the cost of government requires knowing what government services and programs cost and why. But today's financial reports do not paint a clear picture of those costs. They focus instead on obligations (when an item is ordered) and on outlays (when the bill is paid). Both are important, but neither is a consistently reliable measure of the resources being consumed (costs) in carrying out government programs.

Obligation-basis reporting is essential in monitoring the extent to which agencies are making commitments for future payments. Cash-basis reporting is essential in managing fiscal, debt, and credit policies. Cost-basis reporting is essential in determining the cost of units of delivered service.

In some cases, the timing difference between obligations, outlays, and costs can be large and very important. For an agency that manages large, multi-year contracts or handles large inventories, a system that reports costs (as well as obligations and outlays) will reveal important information about the operations of the agency that is otherwise unavailable.

Budgeting and Accounting Should Both Be Done on a Cost Basis

Budgeting and accounting should be done on the same basis, so that actual results can be measured against plans, but this is not now the case. Budgets are requested and justified in terms of programs and projects, such as infant health care or dams for flood control. Accounting and other financial reports, however, often focus on appropriations and categories of expenses such as travel or personnel, without relating them to the particular programs or projects for which the money was requested and approved.

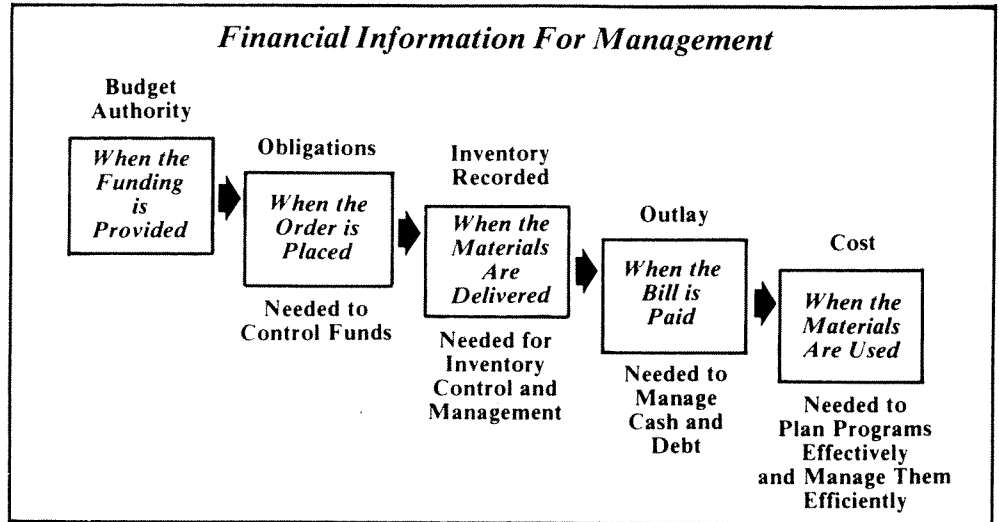
Illustration Of A Typical Budgeting/Accounting Mismatch:

<u>Budget System Reporting Categories</u>	<u>Accounting System Reporting Categories</u>
<ul style="list-style-type: none"> • Maintenance and operation of facilities • Contract services • Grants for state services • Civilian programs 	<ul style="list-style-type: none"> • Personnel compensation • Communications, utilities, rent and other • Other services • Supplies and materials

Costs Should Be Recorded and Reported Consistently Across the Government

Costs should be recorded and reported in a consistent manner across the government, but they currently are not. An integrated budget and accounting system that focused on costs could produce cost reports on such management responsibilities as operations (e.g., motor pools), organizations (e.g., the Public Health Service), programs or missions (e.g., child immunization), and projects (e.g., the Tellico Dam, the B-1 bomber). Such reports could compare the estimated and actual costs of operations, organizations, programs, and projects. Such a system could

also make it possible to compare the costs of operating such activities as motor pools agency by agency, and to know the costs for the government as a whole.



Integrated Cost-Based Budgeting and Accounting Has Already Been Implemented in Some State and Local Governments

Several state and local governments already have developed, to a far greater extent than the federal government, integrated budgeting and accounting systems that report costs. In some cases, the federal government has required this reform. New York City, for example, adopted an integrated budgeting and accounting system as a condition of federal assistance during the city's financial crisis of 1975.

Among the benefits to the federal government of adopting such a system would be:

Better Cost Information Permits Better Management of Government Activities

- The ability to compare planned with actual costs.
- Reliable project status reporting that focuses on costs, improving on the concept of the Defense Department's Selected Acquisition Reports for major weapon systems.
- If desired, the ability to establish user fees for government services that fully cover the cost of those services.
- The ability to compare costs of similar operations across the government.
- More accurate budget estimates based on actual past program and project costs.
- The ability to measure the input of cost and the output of performance.
- Greater assurance that financial transactions are not artificially moved from one fiscal year to another.
- Increased accountability for the management of public funds.

Consistent Information on the Cost of Major Weapon Systems

Good Financial Information on Major Weapon Systems Is Lacking

Although the Department of Defense is embarked on the largest peacetime program of weapons purchases in its history, it does not always provide complete and consistent information on the cost of these weapons. For example, the 64 major weapon systems included in the June 1983 Selected Acquisition Report (SAR) are estimated to cost almost \$600 billion. This figure does not include the cost of people, spare parts, and other support equipment necessary to operate and maintain the weapons.

Several recent examples demonstrate what happens when there is a lack of consistent and complete budget and accounting information to support both budget estimates and program management.

On the F/A-18 fighter plane, the Navy used budgetary practices that obscured from Congress a \$310 million cost increase. Funds provided for support equipment were used to pay for the plane itself. The Navy then asked Congress again for the money for the support equipment. In effect, the Navy budgeted the same support equipment twice. Good project reports on planned versus actual costs and accomplishments would have revealed the overrun much earlier.

The December 1982 SARs illustrate some of the problems in current project reporting for major weapon systems:

- The \$20.1 billion baseline SAR estimate for the B-1 bomber excludes more than \$1 billion in costs, such as flight simulators for pilot training, that are normally included in SAR program estimates for aircraft.
- The estimate for the Army's Bradley Fighting Vehicle showed a decrease of \$679 million in ammunition cost. This cost was subtracted because SARs do not include ammunition costs unless the ammunition is unique to a specific weapon system, and the Army had decided to buy the same ammunition for the Bradley and the Light Infantry Vehicle.
- Though they are built by the same contractor, two different inflation estimates were used for the Navy's Tomahawk Missile and the Air Force's Ground Launched Cruise Missile. Since the December SARs must tie to the President's budget, the budget requests for these two systems were not based on consistent information.

Inconsistencies in the December 1982 Selected Acquisition Report (SAR)

Current SAR Project Reports on the Costs of Major Weapon Systems Are Not:

- Tied to the accounting systems,
- Consistent from year to year,
- Consistent with other budget and accounting reports

The SARs are provided to Congress quarterly. They were first issued by the Defense Department in 1969 because its management systems, which focused on obligations, did not provide needed information on costs, production rates, and technical performance.

Though useful, the SARs have three major limitations. First, the SARs rely on contractor and other information that does not necessarily tie to the accounting systems of the Department of Defense and can be reconciled to the budget only in December. The experience of the Atomic Energy Commission (AEC) shows that this need not be the case. In cooperation with its contractors, the AEC developed contractor project reports that tied directly into the AEC's own accounting and budgeting system. These reports could then be used to monitor contractor performance and prepare consolidated statements on AEC programs to support future budget requests.

Second, information on the same weapon systems may be reported differently from one year to the next, and the changes are not always clearly explained. The SAR of December 31, 1982, for example, reported the Trident II submarine as a new weapon system even though the only difference between it and the Trident I was the type of missile it would carry. This had the effect of disrupting the historical data on what is essentially the same weapon system.

Finally, the information in the SARs is not consistent with that in other budget documents provided to Congress. According to the Congressional Budget Office, cost estimates in the December 31, 1982, SAR for 13 systems excluded at least \$40.8 billion in program costs reported elsewhere.

Continued dissatisfaction with the SARs led to the 1981 passage of the Nunn Amendment, which is designed to provide earlier notification of cost increases, in time to take remedial action.

Clear, Summary Project Reports Can Provide the Information Top Decisionmakers Need

Clear, summary project reports of the type displayed below would make it much easier for Members of Congress and executive branch officials to quickly determine the status of projects—civilian or military—and explore further the causes of any increased cost estimates and schedule slippages. They would have the information they need to see a project's expected cost, how this compares to previous estimates, how much money has been spent, and what it has been used for.

***A Sample Project Report
Construction Of A Strategic Missile Submarine***

Project Status As of 10/3/83

<i>Phases</i>	<i>Planned Cost</i>	<i>Actual Cost To Date</i>	<i>Estimate to Complete</i>	<i>Total Cost to Complete</i>	<i>Increase (+) Decrease (-) From Plan</i>	<i>Months Under (-) Over (+)</i>
<i>Research and Development</i>	16	20	0	20	+4	+2
<i>Testing and Evaluation</i>	4	3	0	3	-1	
<i>Design</i>	10	11	0	11	+1	+1
<i>Procurement</i>	70	10	65	75	+5	+2
	<u>100</u>	<u>44</u>	<u>65</u>	<u>109</u>	<u>+9</u>	

Funding Status As of 10/3/83

<i>Appropriation</i>				<i>Obligations</i>	
<i>Number</i>	<i>Description</i>	<i>Date</i>	<i>Amount</i>	<i>Amount</i>	<i>Unobligated</i>
XXXX	<i>Research and Development Testing and Evaluation (FY 82)</i>	10/81	20	20	0
XXXX	<i>Research and Development Testing and Evaluation (FY 82 Supplemental)</i>	2/82	3	3	0
XXXX	<i>Shipbuilding and Conversion (FY 83)</i>	10/82	10	10	0
XXXX	<i>Shipbuilding and Conversion (FY 83 Supplemental)</i>	4/83	1	1	0
XXXX	<i>Shipbuilding and Conversion (FY 84)</i>	10/83	70	35	35
	<i>Totals</i>		<u>104</u>	<u>69</u>	<u>35</u>
	<i>Current Estimate</i>		<u>109</u>		
	<i>Increase (+)</i>				
	<i>Decrease (-)</i>		<u>+5</u>		

Full Disclosure of Costs and Liabilities

Federal Costs and Liabilities Are Not Fully Disclosed in the Budget

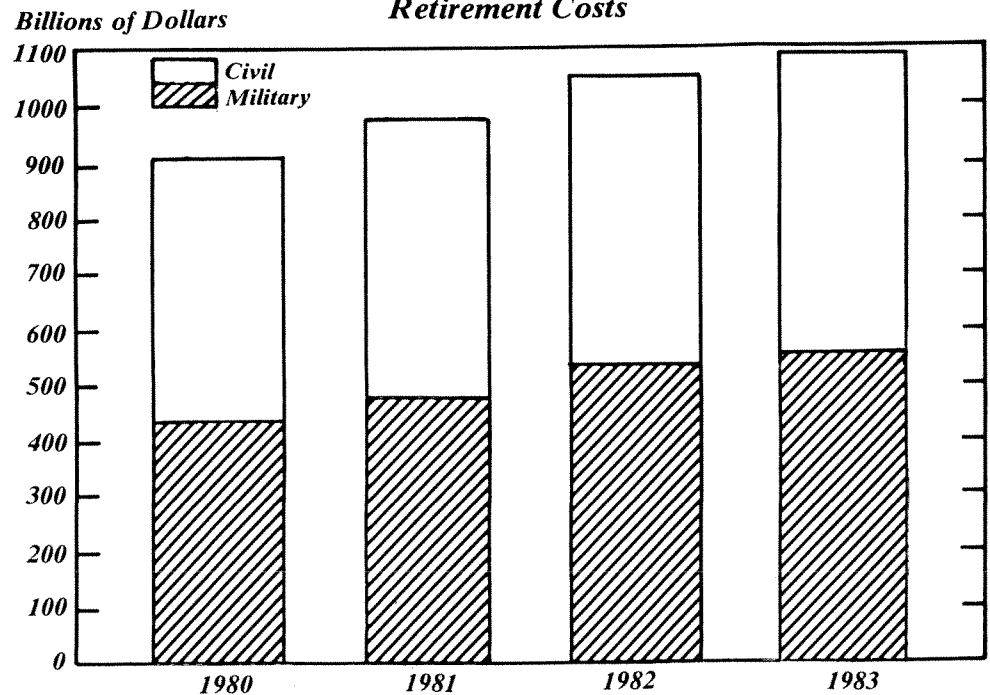
Today, the federal budget does not include all government activities, nor does it disclose all costs of those activities that do appear in the budget. In addition, financial reports do not fully disclose the government's financial commitments. These gaps make informed policy choices much more difficult.

The government's liability for retirement benefits represents a major commitment of future federal resources. A recent report estimated the unfunded portion of retirement benefits to be several hundred billion dollars. But the budget only partially recognizes retirement benefits being earned by today's civilian employees, while those of military personnel were not recognized at all until Congress recently changed the law.

Unfunded Retirement Liabilities Mortgage the Future

The costs and liabilities of retirement programs increase as a growing number of federal employees earn and receive retirement benefits. At the end of fiscal year 1983, for example, there were more retired (319,000) than active duty (300,000) military officers on the Defense Department payroll. To avoid the risk of inappropriately mortgaging the future, decisionmakers should recognize the long-term consequences of current benefits and any proposed changes to them.

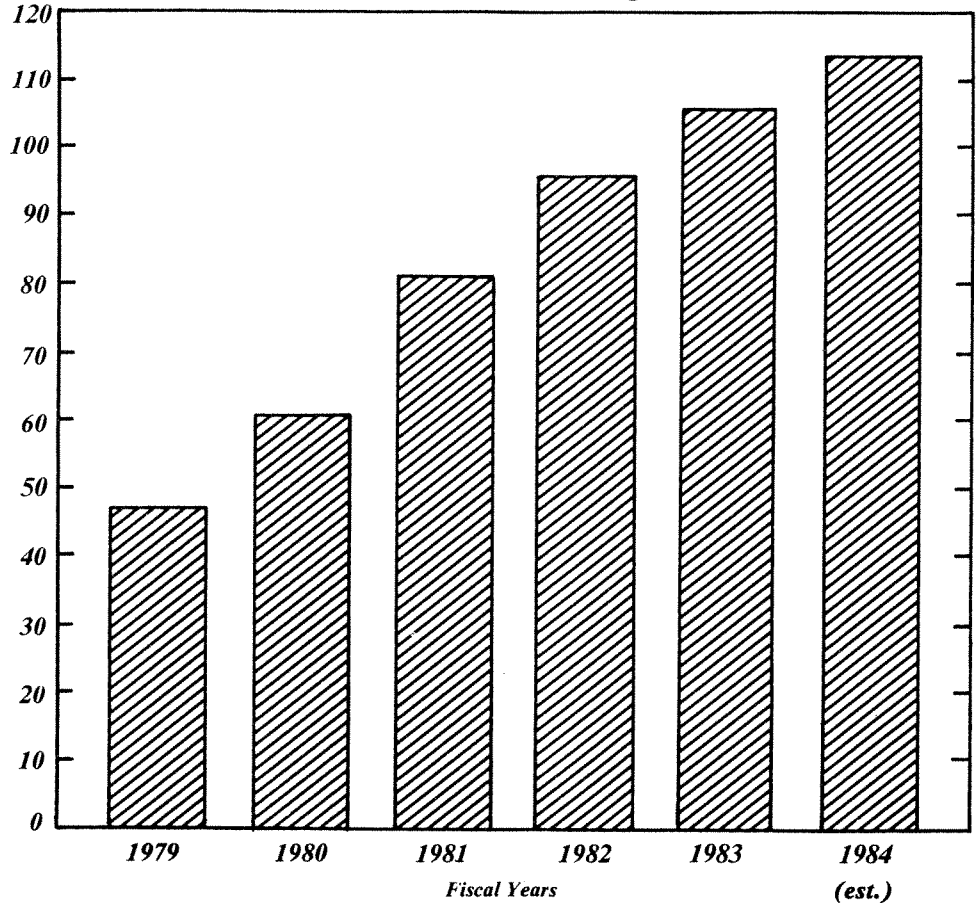
Total Unfunded Civil & Military Retirement Costs



Off-Budget Spending Undermines the Budget Process

Resource allocation decisions become more difficult when the budget does not fully recognize all of the government's activities. Among these is the Federal Financing Bank, which has \$106.9 billion in off-budget loans outstanding and issued some \$32 billion in new loans in fiscal year 1982. But the Federal Financing Bank is small in comparison to the Social Security retirement and disability funds. The new Social Security law recently passed by Congress will move these funds off-budget, beginning in 1993, dramatically reducing the comprehensiveness of the budget even further.

*Off-Budget Loans Held
By The Federal Financing Bank*



**Inadequate Disclosure
of Credit Program Costs
Can Mislead
Decisionmakers**

Costs of direct loans, such as loan write-offs and interest subsidies, are not routinely disclosed to decisionmakers. Anticipated write-offs, such as those for foreign military sales and many loan programs, are often not recognized in the budget or the accounting systems. The cost of interest subsidies is often buried as part of the interest on the public debt. Thus, decisionmakers may be misled into assuming that programs are less expensive than they are.

Loan guarantees are another case where the government's financial condition is not fully disclosed. Contingent liabilities should be accurately measured and incorporated into the government's financial reports.

Budget documents, financial statements, and reports received by Congress and the executive branch should fully disclose the financial position of the government, and reflect all costs of government activities.

Better Planning for Capital Investment Decisionmaking

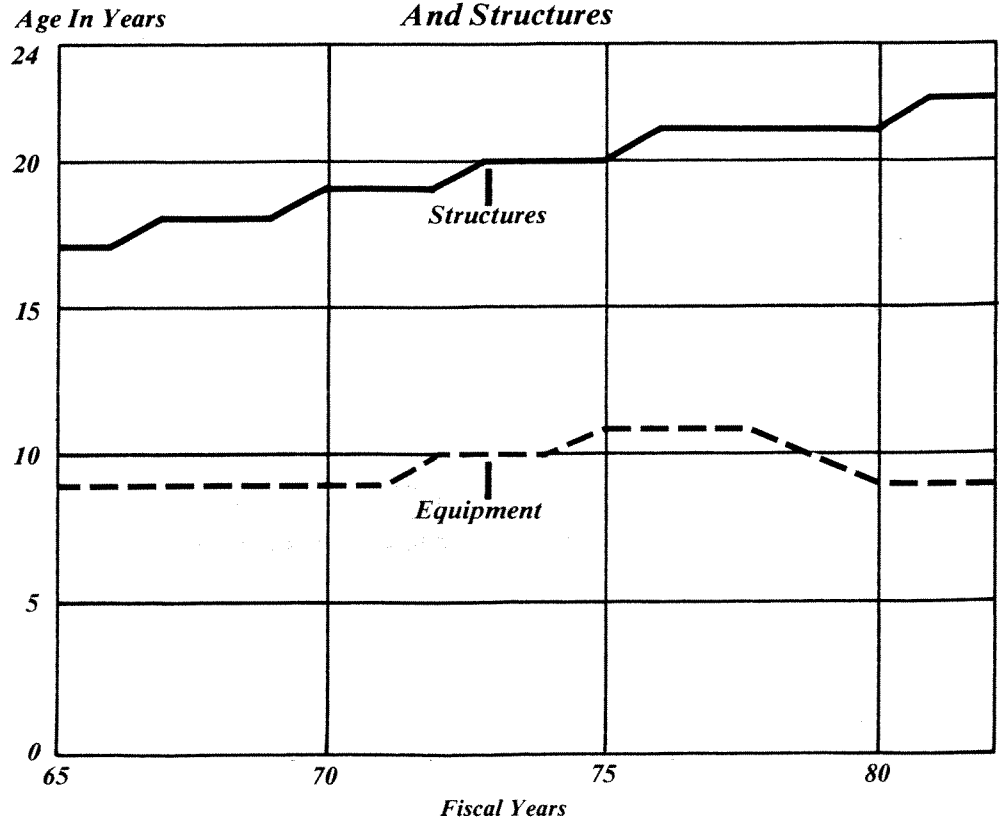
- Capital Investment:**
- Is widely dispersed,
 - Has little visibility,
 - Is not distinguished from current operations

The federal government is a major participant in developing and maintaining a wide array of public capital facilities. When it owns the facility, the federal government's involvement is direct. In other cases, the government is a source of financing for facilities owned by others. In recent years, as public concern about the deteriorating condition of many types of public facilities has grown, federal systems for planning, budgeting, and financing of capital assets have been criticized and debated by leaders of business and government alike.

Federal capital investment activity is managed through numerous agencies, programs, and funding sources. There is no structured approach to making capital investment decisions and no policy mechanism for assessing capital investment priorities for the government as a whole. The lack of visibility for investment decisions, coupled with a budget and accounting approach which treats capital spending as if it were the same as spending for current operations, creates what some consider to be a systematic bias against capital investment. The Congress has recognized the need for greater visibility for capital investment, and took a first step in that direction with passage of the Federal Capital Investment Program Information Act of 1984.

Business organizations and most state and local governments budget separately for operating and capital investment spending. The federal government's budget, however, should be as comprehensive as possible, reflecting the importance of the budget totals for economic policy purposes and the need to consider the full scope of government activities in the budget process.

Average Age of Federal Equipment And Structures



**Increased Visibility
Would Aid in Making
Capital Investment
Decisions**

The needed visibility of capital budgeting within the unified budget could be achieved by displaying capital investment activities separately. Thus, each major functional category in the budget (e.g., national defense, energy, agriculture) would include an operating component and a capital investment component.

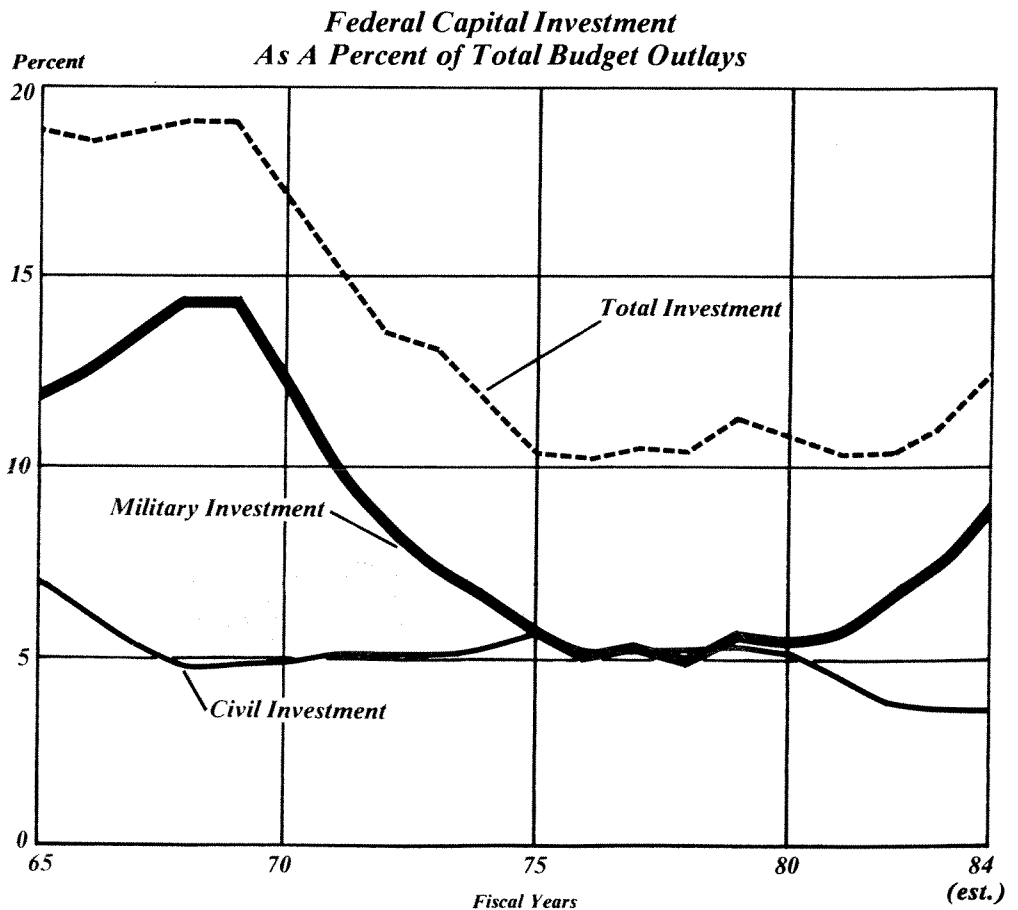
The capital component would include new investments in capital assets, whether acquired directly by the federal government or through loans and grants to state and local governments. The several capital components could be combined to represent the federal government's capital budget.

The operating component would include salaries, utilities, contracted services, and other expenses not related to investment, as well as depreciation expenses if applicable.

**Federal Capital
Investments Should
Be Displayed Separately
Within the Unified Budget**

This separation of capital and operating expenditures within the unified budget would

- elevate the visibility of capital investment decisions,
- facilitate the development of replacement planning, and
- allow a comparison of the long-term costs and benefits of capital investments across budget functions.



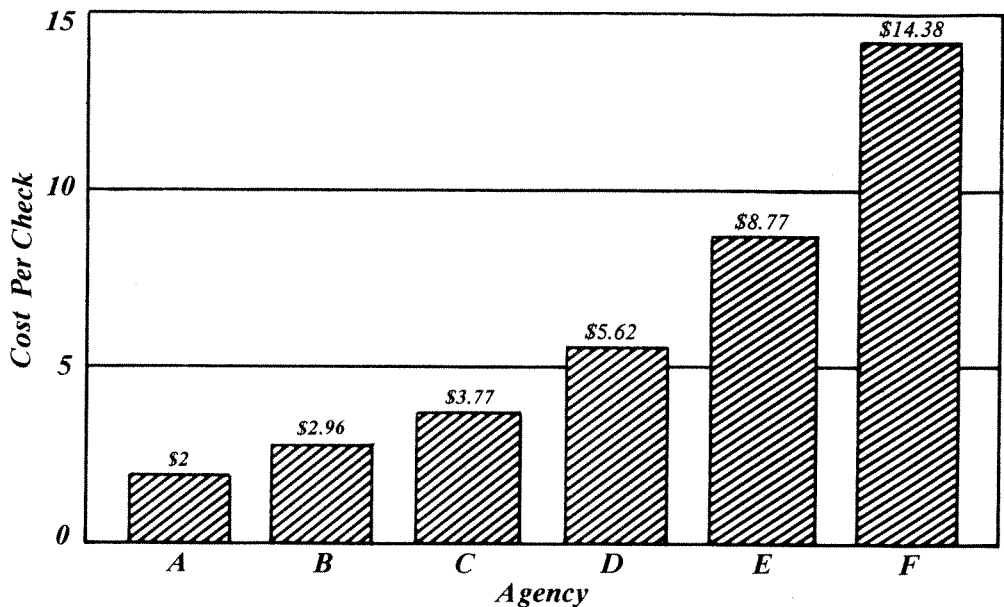
Streamlining and Modernizing Financial Management Systems

Many Federal Financial Management Systems Are Old, Inefficient and Inadequate

Federal decisionmakers are working with financial management systems that were designed for a bygone era. These often antiquated systems are characterized by gaps, inconsistencies, inefficiencies, and wide disparities in quality. According to a recent presidential study commission, much of the government's data processing technology is out-of-date, and senior officials of the government have no practical means of collecting summarized management information on a government-wide basis.

Current financial management systems are inefficient. The average cost to issue a federal payroll check currently varies from about \$2 to \$14 depending on what payroll system is used.

The Cost Of Processing Federal Payroll Checks Varies Widely



Efforts to Update these Systems Have Been Only Partially Successful

Agency efforts to update obsolete equipment for their financial management systems often do not take full advantage of improved technology. Frequently, agencies acquire new hardware without redesigning their systems to fully exploit the new equipment.

Some agencies (such as the Air Force, the Department of Agriculture, the Department of Commerce, and the Veterans Administration) have tried to modernize and consolidate their systems. But accomplishments are limited by the need to interact with antiquated systems elsewhere. For example, Veterans Administration payment tapes are flown from Illinois to Austin, Texas, and hand-delivered to Treasury where checks are prepared.

Building New Systems Will Require a Coordinated Approach and Long-Term Commitment

For years, GAO has been pointing to the need for modern financial management systems, but limited progress has been made. Building such systems will require a long-term commitment of leadership and resources, and a coordinated approach using a common conceptual framework.

There are two basic approaches to improving current systems. One is to redesign existing systems without altering the basic roles and missions of agencies involved

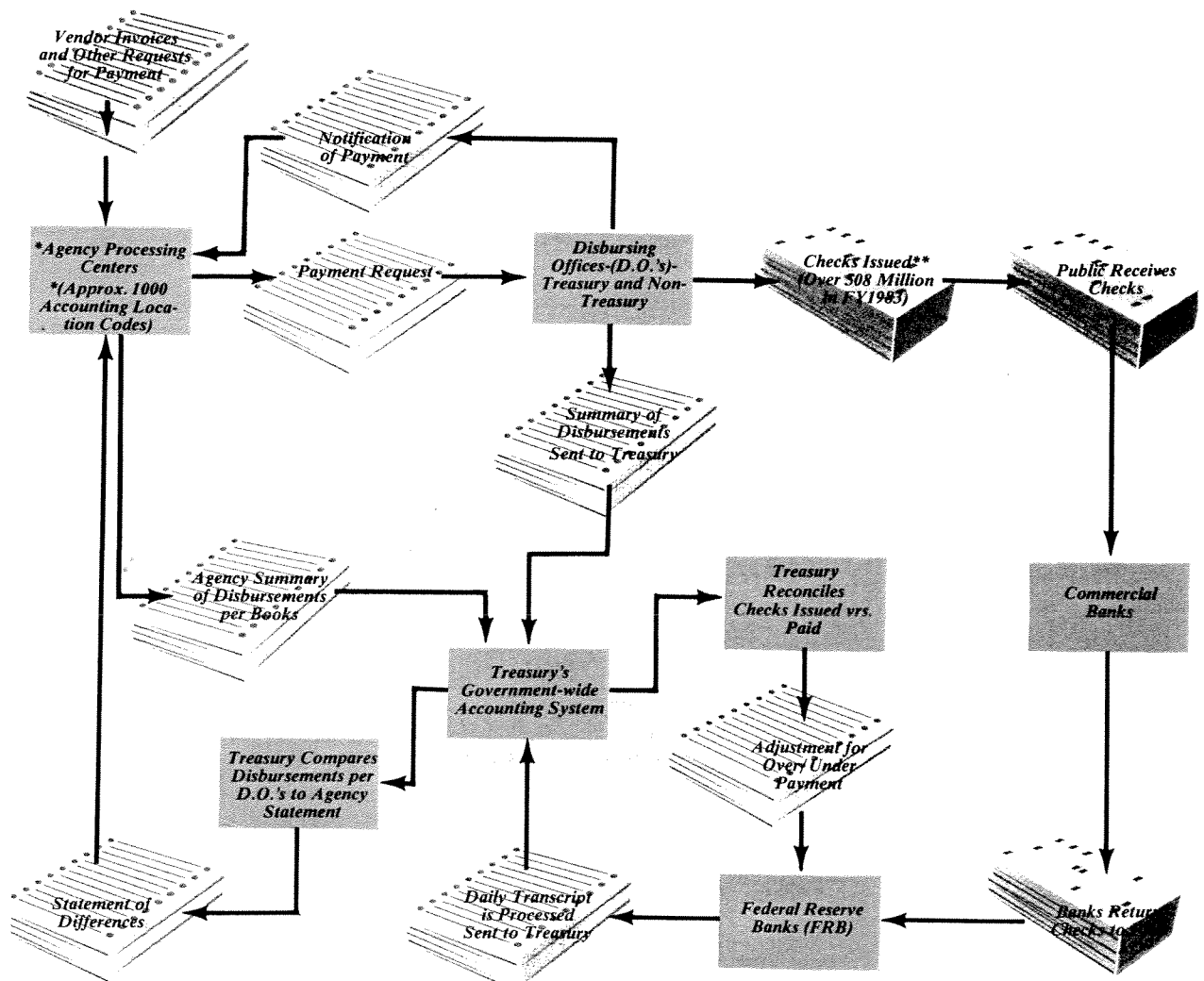
in federal financial management. This approach will yield new systems and equipment. But it will not achieve the most efficient operations.

A second approach might be to revise the basic structure of financial management by locating a few (e.g., 20 or so) processing centers in the cabinet departments and major agencies to handle both disbursements and financial accounting. Other federal agencies could share common systems for related activities, allowing substantial savings in development and operating costs. The result would be higher productivity in federal financial management operations and more timely, compatible, and reliable financial information.

**A Modern Approach
Would Yield Consistent
and Reliable Summary
Information for
Decisionmakers**

Consistent, comparable information from the individual agency systems should flow into a central system that is capable of routinely summarizing, consolidating, and reporting relevant information to top policymakers in the executive branch, Members of Congress, and the public on a timely basis.

*Current Disbursement Process Paper Flow
For Check Payments*



**This does not include approximately 150 million checks issued by other agencies. In addition to checks, Treasury made over 197 million payments through electronic funds transfer.

Strengthened Accounting, Auditing, and Reporting

Good Management Depends on Good Information

Effective management of the Nation's financial resources rests on a foundation of financial information derived, for the most part, from budgeting and accounting systems. The importance of good financial information underscores the need for well-designed integrated budgeting and accounting systems. Because current systems are not integrated, budgets are frequently developed without reliable information on what has occurred. This often leads to unrealistic budget planning and difficulty in controlling budget execution.

Reforms are needed to strengthen how the government accounts for financial resources and to improve the financial information used by Congress and the executive branch. The consistent application of comprehensive accounting principles and standards by all agencies would ensure comparability of financial data throughout the government. Then, financial data would reflect differences in fact, rather than differences in the accounting treatment of the same facts.

Improved Accounting Systems Can Provide Essential Information

Because federal accounting systems need to communicate more useful information to decisionmakers, they should encompass certain basic features:

- Costs and revenues should be displayed along several relevant dimensions, e.g., appropriation, organizational unit, program, and project.
- The obligation of funds, payment of bills, and the use of goods and services (costs) should all be recorded and reported.
- Performance information should be routinely integrated with accounting systems to help in assessing effectiveness and efficiency.

Consolidated Financial Statements Are an Additional Source of Information

Consistent, comparable data from integrated financial systems is essential for preparing government-wide financial statements. These statements can supplement other budgeting and accounting information by giving an overall picture of the financial health of the government that is not available elsewhere. They could also disclose the cumulative financial effect of decisions on the Nation's resources and provide early warning signals to policymakers.

Many organizations, such as publicly owned corporations, are required to present comprehensive financial reports to the public. Just as shareholders expect management to report the financial position of their companies, so taxpayers should hear about the financial position of their government. Many state and local governments are moving toward this practice, partially influenced by federal reporting requirements for Revenue Sharing and other programs.

The federal government is a unique entity, and its financial statements must adequately reflect that fact. Though requiring further development, the "prototype" financial reports prepared by the Treasury are a useful first step toward this goal.

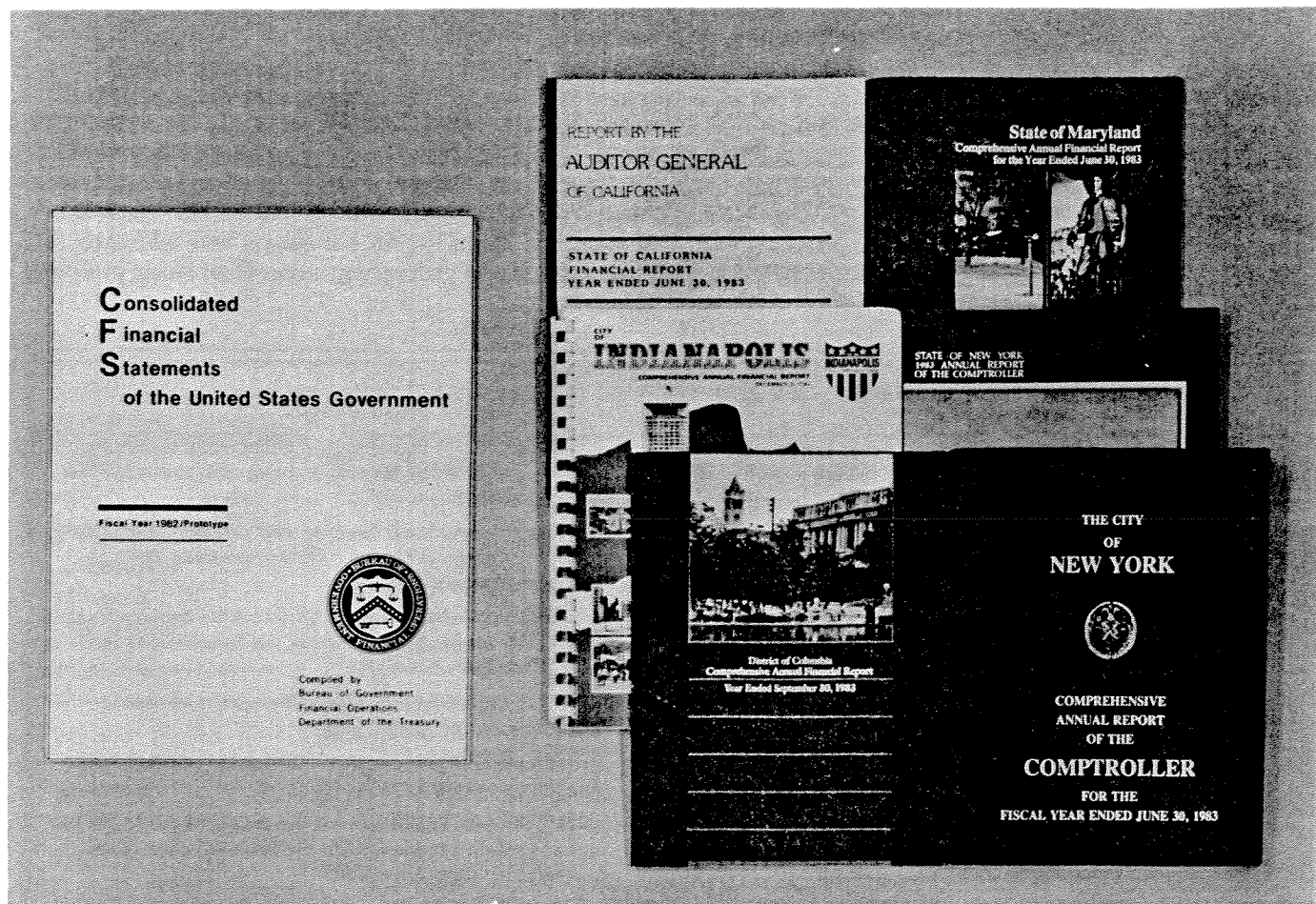
With the installation of modern integrated systems, and the adoption of comprehensive accounting principles and standards, agencies can efficiently provide the information for consolidated federal financial statements that can be annually audited.

Financial Reports Should Be Audited Annually to:

- Increase discipline,
- Enhance oversight,
- Help assure financial integrity

Auditing introduces discipline to the financial reporting process by confirming the accuracy and reliability of the information in financial statements. Financial auditing also enhances the oversight of programs, by providing a better basis for selecting areas for program audit and evaluation. Leadership in auditing federal financial statements rests with GAO, working with the Inspectors General, but the effort may well also require the involvement of independent public accountants.

Auditing is also essential to any program to strengthen internal controls. The Federal Manager's Financial Integrity Act of 1982 represents important progress. This act requires each executive agency to report annually on its compliance with internal control standards prescribed by the Comptroller General, and its plans for correcting any problems.



Improved Federal Planning and Programming

Improved Decisionmaking on Major Policy Issues Requires:

- Better information on past performance,
- Systematic consideration of alternatives, and
- Careful analysis of their long-term consequences

Sound financial management requires a process that focuses attention on major policy issues and alternatives and their probable future consequences. To be effective, the process needs information on the actual costs and benefits of prior decisions.

The federal government currently has few of the necessary pieces of such a process. Often, top management attention to policy or legislative issues is unstructured, divorced from actual experience, focused on individual programs, and concerned only with the next year or two.

But, increasingly, the major problems facing the Nation defy short-term, narrowly focused solutions. With rising health care costs and an aging population, for example, managing the costs of Medicare requires both a long-term strategy and consideration of the interaction of Medicare with other health programs such as Medicaid, and with private health insurance programs.

A Structured Planning and Programming Process Would Meet This Need

A structured planning and programming process can help identify solutions to major long-term problems such as financing health care. The cornerstone of this concept is the use of a formal, analytic process for considering the medium and long-term implications of current decisions. Efforts to develop a good planning and programming process for the government as a whole should build on the concepts developed over 20 years of experience with the Defense Department's Planning, Programming, and Budgeting System (PPBS).

Planning and Programming Should Be Integrated With Financial Management

Planning/programming, budgeting, and accounting are separate, but interdependent, phases of the financial management process. To be successful, a planning and programming structure must be an integral part of financial management decisionmaking, as it is in the Defense Department. When PPBS was tried by civilian agencies in the late 1960s, it failed in part because it was added to, and often competed with, existing systems and processes, rather than being built into

Effective Planning And Programming

Major Elements

- A Mechanism to identify, evaluate, and select realistic goals and strategies for addressing major issues.
- A multi-year view for those programs where sound choices cannot be made using the one-year budget horizon.
- A program structure that relates the costs of programs to the out-puts (results, benefits) produced or missions served.
- The ability to apply modern analytic techniques in assessing issues and alternatives.
- A means to aggregate program costs by major activity area and agency as well as government-wide.
- Feedback mechanisms that reliably, consistently, and systematically develop and provide useful program performance information and analyses to those who need it.

Major Benefits

- Assist officials to focus on the fundamental questions of what the government should be doing and how best to accomplish it.
- Encourage longer term thinking and permit more realistic multi-year financial planning for agencies and the government as a whole.
- Provide an essential analytic framework for decisionmaking and a better basis for evaluating the benefits and costs of alternatives.
- Facilitate choices among alternative goals, missions, strategies, and programs.
- Help assure that programs are affordable and balanced given national priorities.
- Enable officials to learn about the results of past decisions and apply this knowledge more effectively when future program decisions are made.

the basic structure of financial management. Budgeting, as the most formal, visible and independent financial management process, continued to dominate financial management decisionmaking.

Budgeting Often Fails to Make Good Use of Planning and Accounting Information

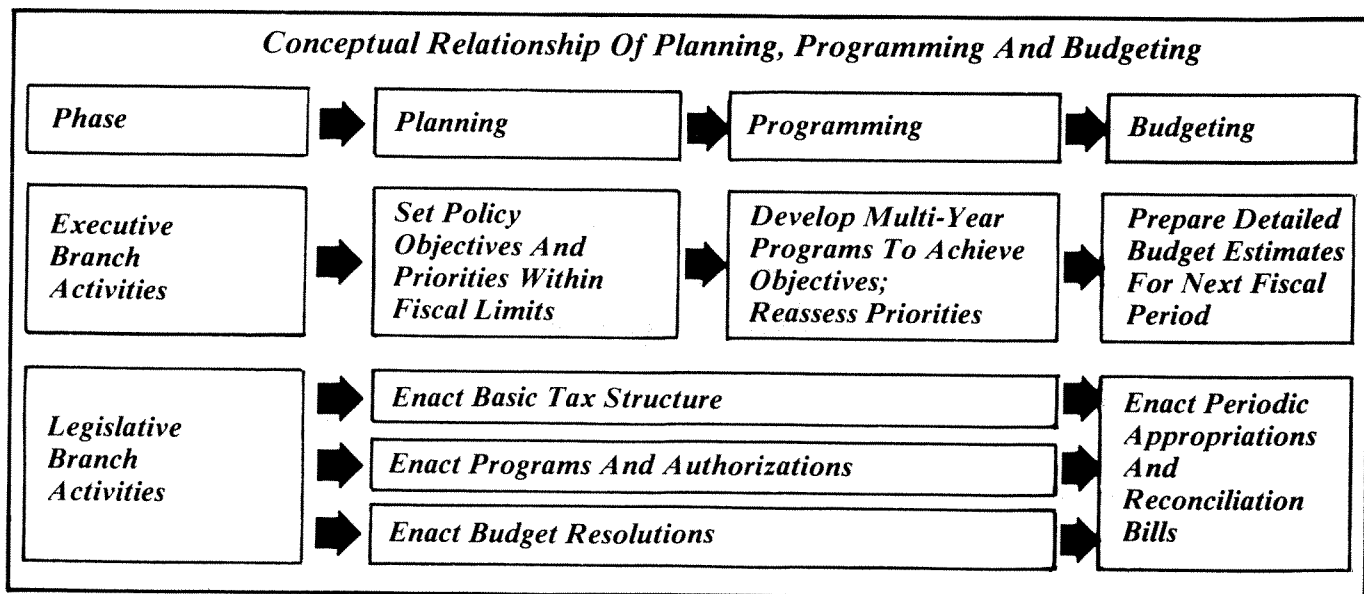
Today, in much of the government, budgeting remains the dominant financial management process and the focus of decisionmakers' attention. The budget process tends to operate as a separate system that ignores or "crowds out" information from both agency planning and program offices and the accounting system. Consequently, products developed in these two phases are not used well in the budgetary process. Yet sound budgeting and sound financial management depend both on the analysis of future trends and program needs (planning/programming) and on past performance (accounting). No single process should dominate.

An effective planning and programming process must of course be designed to meet the particular needs of each agency and program area. But the six major elements shown in the accompanying chart should always be present.

While originally developed for use in defense, structured planning and programming is useful in any area involving complex issues with multi-year implications. Housing policy, for example, involves complex interactions among diverse programs and the decisions entail major commitments of resources over many years.

Better Planning and Programming Would Reduce Some of the Pressures on the Budget Process

A well-developed, modern, government-wide structure of planning and programming would highlight the major policy and program options available to decisionmakers together with their likely benefits and costs. Making these decisions in a more systematic way would reduce some of the pressure on the budget process. It would also enable Congress, the President, and agency officials to focus their policy deliberations more systematically on the major issues facing the Nation.



Spotlighting National Policy Choices: Strengthening and Streamlining the Federal Budget Process

The Current Budget Process is Unduly Detailed, Repetitive, and Work-Intensive

Reliable, timely information is indispensable to an effective budget process, and we have highlighted some ways of improving that information. But equally important is a budget process that focuses the attention of decisionmakers on the available choices. The current budget processes of Congress and the executive branch are unduly detailed, repetitive, and work-intensive. These processes urgently need to be simplified and streamlined so that decisionmakers can more easily concentrate on the budget choices that confront them.

Past Budget Process Reforms Have Added to the Workload

Over the years, both Congress and the executive branch have made changes designed to improve their budget processes. The Congressional Budget and Impoundment Control Act of 1974 created an essential framework for Congress to set national priorities. But the act did this by adding to the existing machinery for authorization, appropriation, and tax legislation. Though it devotes an ever-greater proportion of its time to budget issues and the budget process, Congress in recent years has been unable to pass a budget and enact all appropriations laws before the beginning of the fiscal year.

Improvements tried in the executive branch—e.g., planning, programming, and budgeting (PPB); management by objective (MBO); zero-base budgeting (ZBB)—have also generally been added to existing systems and processes. As a result, both Congress and the executive branch are faced with burdensome processes marked by repetitious detail that obscures, rather than highlights, budget choices.

Budget execution, like budget preparation, has grown more detailed and complex. Managerial flexibility and efficiency is increasingly limited by the growing number of constraints on the uses of funds imposed by both Congress and executive branch officials.

Key Events In Executive Branch Budget Process

	March (or Earlier)	April/ May	June	July- Sept. 30	Oct./ Nov.	Dec/Jan.
	<i>Budget Policy Development</i>		<i>Preparation And Submission Of Agency Budgets To OMB</i>		<i>OMB & Presidential Review Decisions</i>	<i>Budget Prepared And Submitted To Congress</i>
<i>Agencies/ Departments</i>	<i>Reviews Major Programs & Budget Issues</i>	<i>Submits Projection of Future Needs to OMB</i>	<i>Issue Internal Budget Guidance</i>	<i>Prepare & Submit Budget To OMB For Review</i>	<i>Defend Budget To OMB, Revise To Meet President's Decisions</i>	<i>Final Agency Appeals To President</i>
<i>Office Of Management And Budget (OMB)</i>	<i>Develops Economic Assumptions, Fiscal Projections</i>	<i>Issues Policy Guidance Economic Assumptions</i>	<i>Issues Budget Planning, Targets to Agencies</i>	<i>Economic, Fiscal Assumptions Updated</i>	<i>Reviews Agency Budgets, Advises President, Reexamines Economic, Fiscal Assumptions</i>	<i>Final Review Of Economic, Fiscal Assumptions Budget Prepared For Congress</i>
<i>President</i>	<i>Discusses Budget Outlook/Policy With OMB & Others</i>		<i>Establishes Overall Budget Policy And Targets</i>		<i>Decides Agency Budgets, And Final Economic Fiscal Assumptions</i>	<i>Decides Final Appeal Revises And Approves Budget</i>

During this same time supplemental budget requests for the current budget year are prepared and sent to Congress and the current year's budget is being executed.

Recent Studies Suggest Simplifying the Federal Budget Process

There is growing recognition that the federal budget process must be simplified. Proposals for improving the congressional budget process have come from both within Congress and such outside groups as the Committee for Economic Development. They include selected changes in congressional organization and procedures; a biennial budget for part or all of the federal government; and the adoption of a single, omnibus budget, appropriations and tax bill. All these proposals have the common goal of reducing the number of layers in the congressional budget process and/or reducing the number of budget decisions that Congress must make each year.

Similar issues have been raised about the executive branch process as indicated by a recent report of the National Academy of Public Administration and continuing reform efforts within the Office of Management and Budget.

A Streamlined Budget Process Will Allow Decisionmakers to Focus More on Other Important Responsibilities

Proposals for reform in both Congress and the executive branch should be judged against the overriding objective of making the process more manageable and understandable. Members of Congress and top executive branch officials must be less encumbered with unnecessary detail so they can give more attention to major policy issues, the long-term consequences of current budgetary decisions, and the oversight and management of government programs and agencies.

Key Events In Legislative Branch Budget Process

	Jan. - Feb.	May 15	Sept. 15	Sept 25	Oct. 1		
Legislative Activity	President's Budget Submitted	First Budget Resolution Adopted	(Debt Ceiling Raised)*	Second Budget Resolution Adopted**	Reconciliation Bill Enacted	New Fiscal Year Begins	(Possible Continuing Resolution Enacted)*
Budget Committees	Hearings & Report First Budget Resolution	Work on Second Budget Resolution					
Authorizing Committees	Hearing, Views & Estimates Reports on Budget, Report Authorization Bills	Authorization Bills Enacted		Reconciliation			
Appropriation Committees	Hearings, Views & Estimates Reports on Budget, Work on Appropriation Bills	Appropriations Bills Enacted					
Tax Committees	Hearings, Views & Estimates Reports on Budget, Work on Possible Revenue Bills	Revenue Bills Enacted		Reconciliation			
Congress		Debate And Floor Votes	Debate And Floor Votes	Debate And Floor Votes	Debate And Floor Votes	Debate And Floor Votes	Debate And Floor Votes

*If necessary

**In recent years, reconciliation has occurred after the adoption of the first budget resolution.

Strengthening the Ability to Monitor and Evaluate Performance

It is Important, and Possible, to Measure How Well Government Employees and Programs Are Performing

Whether the goal is defending the nation or immunizing children against disease, government officials and the public need to know how well government is accomplishing its intended objectives. Assessing government accomplishments requires measuring employee and program performance. Though the size and complexity of the government make it difficult, developing effective performance measurement systems is clearly possible.

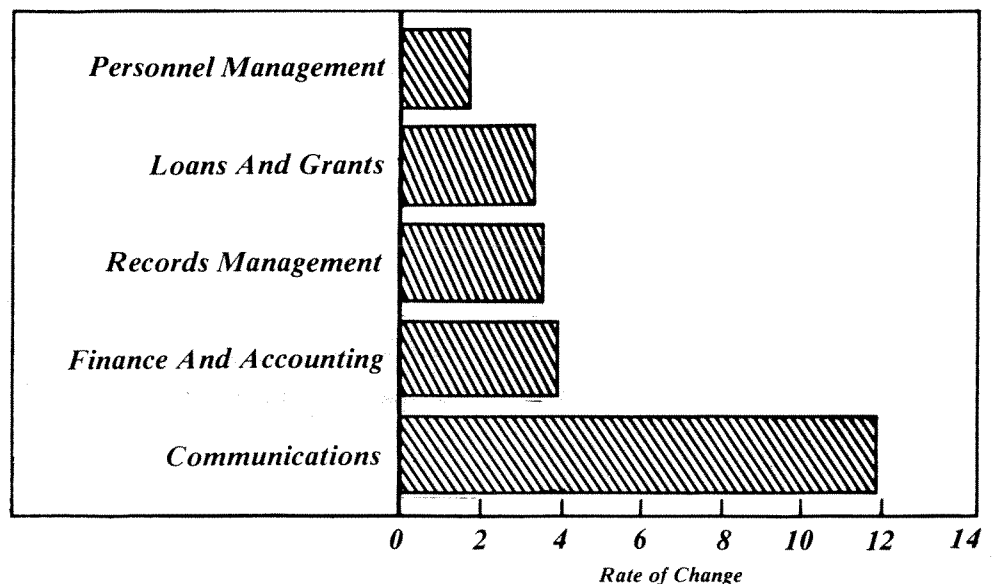
The work of nearly two-thirds of government employees, for example, can be measured by means of formal productivity measurement systems. For the remaining one-third, substantial time and effort may be required to develop reliable measures of performance. Indeed, there may be some government activities (such as basic research) for which quantitative measures are not feasible. Even in these cases, however, qualitative measures can usually be developed and used.

Effective Performance Measurement Systems Should Be an Integral Part of Financial Management

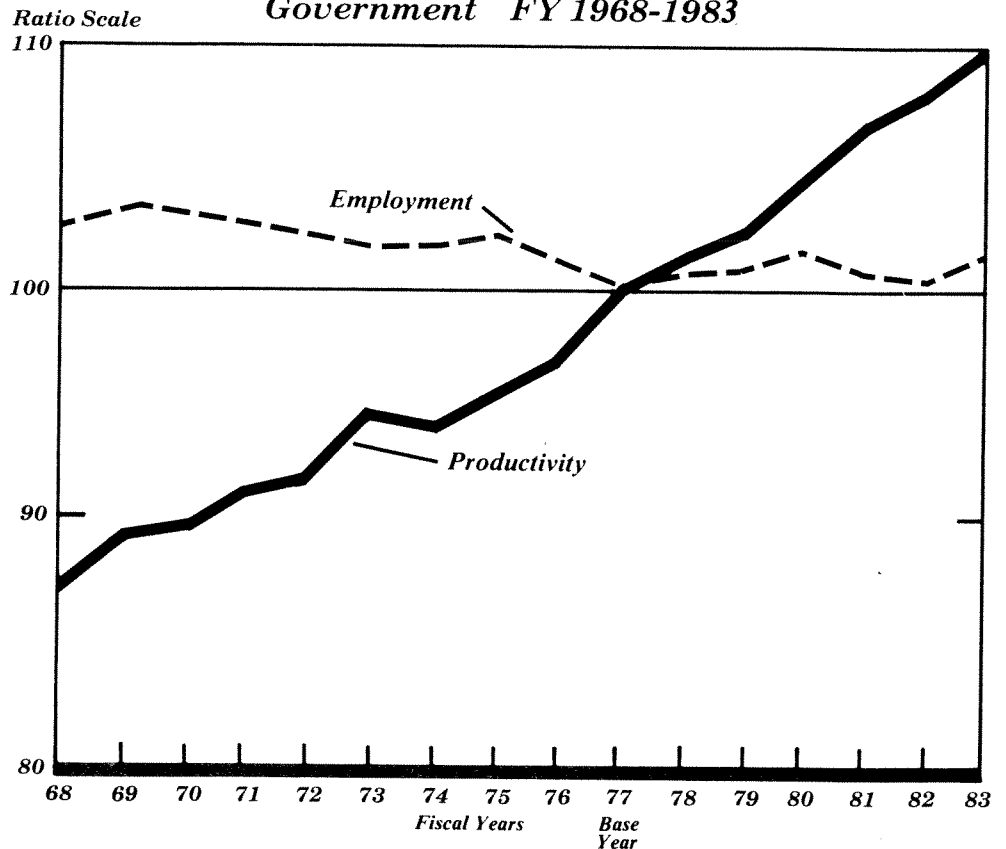
A well-developed financial management structure should include performance information that can be used for both day-to-day management and policy and budgeting decisions. An effective system of measuring program performance requires

- agreeing on objectives and relevant measures of accomplishment;
- systematically collecting reliable, consistent, and comparable information on costs and accomplishments;
- supplying that information routinely for use in management, planning, programming, and budgeting.

*Average Annual Rate Of Change In Productivity
By Selected Activities - 1967-1982*



Measured Productivity Trends For The Federal Government FY 1968-1983



Performance Data Can Answer Many Routine Questions of Decisionmakers

Strong performance monitoring systems can answer many routine questions about program performance. Consider, for instance, a program whose goal is to immunize children against certain childhood diseases (e.g., mumps, polio). A system of performance indicators would provide information on the level of resources and effort devoted to each program site, the number of eligible children being served, the number of immunizations administered, and the cost per immunization. The incidence of these diseases in children could also be monitored.

However, Special Studies Are Also Needed to Provide Important Additional Information for Decisionmaking

Even the best monitoring systems, however, cannot answer many important questions about program effects and policy alternatives. Carefully designed studies to determine the actual accomplishments of a program and to examine other complex issues are an essential part of a modern management structure. In our example, we may notice that there is an unexplained drop in immunizations and therefore need to undertake a special study to explore the reasons. A modern structure of financial management should include a systematic way to identify questions warranting special analysis of this type.

Such special studies can provide decisionmakers with important additional information about program performance. But it is equally important that these studies be designed so that their results can be integrated with the information produced by the regular performance and financial reports. The results can then be used to help identify both future resource and program needs, and ways of improving the routine performance measures in use.

Putting In Place A Modern Structure Of Financial Management

There is a growing recognition that federal financial management needs to be modernized. Many efforts are now underway to improve financial management systems and reporting, including projects in the Departments of State, Treasury, and Commerce, as well as the government-wide initiatives of "Reform '88." Congress is considering several proposals for reform as well. The challenge is to integrate these efforts into the broader strategy outlined in this report. This can lead to the creation of a more modern, efficient, responsive, and reliable financial management structure to support decisionmaking and management in both Congress and the executive branch.

Building a Modern Structure of Financial Management Will Require:

- Investments in systems and people,
- Organizational changes,
- Coordinated commitment, and
- Consensus

This report highlights the benefits that could be achieved through a modern structure of financial management. Many of them already exist in the integrated financial management systems of progressive state and local governments. We are convinced that such a structure can be built for the federal government, but it will not emerge by accident, nor can it be created through isolated efforts in a few agencies. Building the structure will require the design and installation of new systems over an extended period. Coordination of new and existing system development activities can yield major benefits at little additional cost. An equally important investment must be made in the people who implement and operate the systems. They must be recruited more carefully, trained more thoroughly, and offered a more attractive career path.

In addition, organizational realignments will be needed. Financial operations should be consolidated into more efficient units that use modern technology. Also, responsibilities for interagency policymaking should be clearly assigned.

Finally, all actions must be coordinated to serve the needs of the government as a whole. Because developing a new system is likely to overlap several presidential administrations, it will require firm commitment, clearly identified leadership responsibility, and continuity of purpose. These key ingredients, however, can only exist if supported by a broad and stable bipartisan consensus—including both Congress and the executive branch.

Discussion, Debate, and Congressional Hearings Are the First Steps

As the first step toward implementing a new financial management structure, we think that discussion and debate are necessary on the nature and extent of our financial management problems. We are confident that open discussion will lead to general agreement that these problems are widespread and serious, and that they warrant a broad rebuilding of the overall structure.

This agreement might best be achieved through a series of congressional hearings that build on prior congressional efforts to improve financial management, such as the 1921 Budget and Accounting Act, the 1950 Budget and Accounting Procedures Act, the Congressional Budget Act of 1974, and the 1982 Federal Manager's Financial Integrity Act. These hearings could result in the passage of a bill or resolution setting forth the objectives of the long-term rebuilding effort, identifying the leadership for the effort, and specifying an initial timetable. A comprehensive list of objectives might include:

- full disclosure of costs and financial commitments for all government activities;
- strengthened accounting, auditing and reporting, using consistently applied and comprehensive accounting principles and standards;

-
- consolidated financial statements for the federal government, audited annually;
 - a structured approach, such as planning and programming, for considering the long-term consequences of major policy choices;
 - a more manageable and understandable federal budget process;
 - cost-based budgeting and accounting;
 - greater visibility for capital investments within the unified budget;
 - reports for major projects showing planned versus actual costs and accomplishments;
 - performance information that is integrated with the financial management structure and reports.

**All Those Affected By
the New System Should
Participate in Designing It**

Organization and leadership of that effort will be critical. The effort may well be led by the General Accounting Office and the central financial management agencies—Treasury and OMB—through the Joint Financial Management Improvement Project. All those who will be affected by the new system, including Congress, Congressional Budget Office, and the operating departments and agencies, must have a strong voice in its design. The system must serve the needs of all participants.

*These Issues Are
Discussed Further In
Volume II—Conceptual Framework
GAO/AFMD-85-35-A*

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