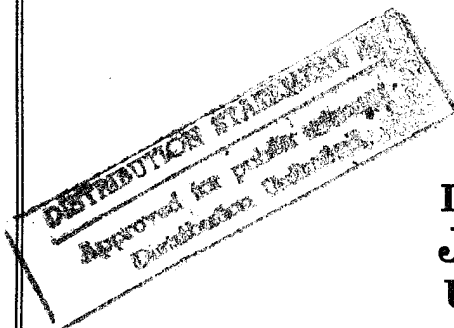


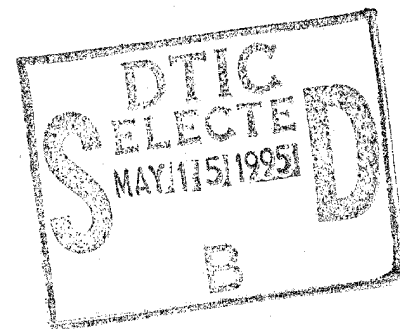
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**The Chief Financial Officers Act of 1990
Conserving Resources for Readiness and
National Security Through Better
Financial Management**



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THE CHIEF FINANCIAL OFFICERS ACT OF 1990

Conserving Resources for Readiness and National Security Through Better Financial Management

by
Lieutenant Colonel Joseph G. Dodd, Jr.

Abstract

Congress enacted the Chief Financial Officers (CFO) Act in November 1990 to improve financial management in the Federal Government. It requires 23 federal agencies, including DOD, to submit annual financial statements to the Office of Management and Budget.

The Secretary of Defense, William Perry, testified before Congress in 1995 that, "we need to reform our financial management. It is a mess, and it is costing us money we desperately need."

The military services waste billions of dollars each year because of poor financial management practices. DOD is taking a centralized, top-down, and long-term approach to meet the requirements of the CFO Act. It's not working. This approach doesn't include the leaders in the field in the solution. Therefore, the operators stationed throughout the world are unaware of the massive changes that need to occur and largely uninformed of the readiness benefits and savings that could arise.

We must improve our financial management practices. We can't afford to waste any of our defense dollars as resources continue to decline. The process of preparing auditable financial statements will provide our leaders with more reliable and accurate resource information which will improve their decisions and will lead to increased levels of readiness by the more efficient and effective use of federal funds.

Introduction

The Office of Management and Budget (OMB) and the Treasury Department oversee annual spending of an amount equal to 1/4th of the Gross Domestic Product (GDP). They manage a \$2 trillion cash flow, \$900 million (M) in annual contract payments, payroll and benefit systems for five million civilian and military personnel, and a budget with 1,962 separate accounts. The federal government operates approximately 253 separate financial management systems.¹ These systems should be efficient and effective with excellent internal controls to manage the taxpayers' dollars. This isn't the case.

Leon Panetta, Director of OMB from 1992-1994, stated that taxpayers have the right to expect that their tax dollars are managed as well as those of the best managed private organizations. Unfortunately, poor financial management has been tolerated in the past, and some federal agencies have suffered for years from poor attention to this matter.²

In 1981, Elmer Staats, Comptroller General of the United States, said that good financial management can help retain the public confidence and trust. He believed though that this topic was often very low on the list of priorities of many top government managers.

The current Comptroller General, Charles Bowsher, states that financial management in the federal government has long been practiced as a rather narrow function, involving many accountants and budget analysts,³ but few in senior leadership positions. This is especially apparent in the military. Most commanders don't understand, nor do they want to be burdened with financial management issues.

¹ L. R. Jones and Jerry L. McCaffery, "Federal Financial Management Reform and the Chief Financial Officers Act," *Public Budgeting and Finance*, Winter 1992, 78.

² Stephen Barr, "OMB Points Out Many Agencies' Failure to Deliver Reliable Financial Reports," *Washington Post*, 19 April 94, A13.

³ Jones and McCaffery, "Financial Management Reform," 77.

Congress passed the Chief Financial Officers (CFO) Act in November 1990 to improve financial management and internal controls in the federal government. The CFO Act may well be the most significant federal financial management reform since the adoption of the Budget and Accounting Act in 1921.

The Act holds great promise for improving financial management throughout the federal government. It mandates the publication of an agency CFO annual report which is a level of accountability reporting well beyond what has been previously achieved. This report compiles, in a single document, the department's financial results; the status of internal controls and management systems; and its success in achieving critical missions, goals, and objectives.⁴

By law, DOD and 22 other federal agencies must successfully implement the requirements of the CFO Act. More importantly though, the successful and strict accountability of increasingly scarce resources will provide our leaders with more reliable and accurate resource information which will improve their decisions and will lead to increased levels of readiness by the more efficient and effective use of federal funds.

This paper will discuss:

- the background which led Congress to implement the CFO Act
- the requirements of the Act
- how OSD and the military services have implemented the Act during the pilot period
- why it's essential that we improve our financial management practices
- recommendations for successful implementation of the requirements of the CFO Act

⁴ Dennis J. Duquette, CPA, and Alexis M. Stowe, CPA, "Enter the Era of Performance Measurement Reporting," *Government Accountants Journal*, Summer 1992, 19.

Financial Management Before the CFO Act

For 130 years, the federal government had no formal budgeting or accounting procedures. The 1921 Budget and Accounting Act began to centralize financial practices through the creation of the Bureau of the Budget and the General Accounting Office (GAO). But the unprecedented expenditures and expansion of the government during World War II reversed the process.

Congress legislated decentralized financial management by giving agency heads responsibility for their own accounting systems as part of the 1950 Budget and Accounting Procedures Act. The results have been:

- a proliferation of hundreds of accounting systems and standards
- fraud, waste, and abuse due to inattention to internal controls
- an inability to provide accurate or timely information that would benefit program management and managerial decision making

The Carter Administration began the first serious effort to modernize and integrate hundreds of disparate federal accounting systems. Presidents Reagan and Bush continued this program. Concurrently, Congress designed several legislative remedies to help agencies improve internal controls and stem abusive and illegal financial practices.⁵ These efforts were a good start, but they weren't enough. In the latter part of the 1980s, investigations uncovered several financial fiascos to include:

- the savings and loan debacle
- embezzlement and financial wrongdoing at Housing and Urban Development (HUD)
- abuses in the Pentagon procurement process

⁵ Mark L. Goldstein, "Chasing Wayward Billions," *Government Executive*, May 1991, 21.

In the HUD scandal, three separate Congressional committees learned that housing officials were putting close to \$6M in the pockets of prominent Republicans. The auditors learned that this illegal activity was possible because of obsolete financial management systems and practices HUD used to track the use of taxpayer dollars.⁶

Additionally, GAO and OMB studies in 1989 identified more than 75 different problems which posed potential federal liabilities reaching into the hundreds of billions of dollars. These included:

- The Internal Revenue Service had failed to collect approximately \$63 billion (B) in back taxes.
- The Federal Housing Administration had losses exceeding \$4B.
- DOD had approximately \$30B in unnecessary inventory.

As a result of these financial management oversight weaknesses, the House of Representatives and Senate Committees on Government Affairs concluded that the absence of timely, relevant, and comprehensive financial information and persistent internal control weaknesses compounded the difficulty of controlling government operations and costs.⁷ From its introduction in committee in September 1990 to 15 November 1990, the Congress took only three months to debate and enact Public Law 101-576, the Chief Financial Officers Act of 1990. The purposes of this Act are:

- bring more effective general and financial management practices to the federal government
- provide for improvement, in each agency of the federal government, of systems of accounting, financial management, and internal controls to assure the issuance of reliable financial information to deter fraud, waste, and abuse of government resources

⁶ Christine C. Lawrence, "New Chief Financial Officers Straddle Branches of Power," *Government and Commerce*, 17 August 1991, 2286.

⁷ Jones and McCaffery, "Financial Management Reform," 75, 81-83.

- provide for the production of complete, reliable, timely, and consistent financial information for use by leaders throughout the executive branch of the government and the Congress in the financing, management, and evaluation of federal programs.⁸

The Comptroller General believes that the CFO Act marks the beginning of what promises to be a new era not only in federal management and accountability, but also in efforts to gain financial control of government operations.⁹

Requirements of the CFO Act and Its Extension

CFO Act

Agency CFO. The Act establishes a CFO in 23 federal agencies. The CFO in DOD is the OSD Comptroller. The DOD CFO's requirements include:

- develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls, which:
 - complies with applicable accounting principles, standards, and internal control standards
 - provides for:
 - complete, reliable, consistent, and timely financial information
 - development and reporting of cost information
 - integration of accounting and budgeting information
 - systematic measurement of performance
- develop agency financial management budgets
- submit an annual report to the SECDEF and the OMB Director which includes:

⁸ _____, "Chief Financial Officers Act," Public Law 101-576, 101st Congress, 15 Nov 90, Section 102 (b).

⁹ Charles A. Bowsher, "The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform," GAO, Washington D. C., September 1991, 1.

- a description and analysis of the status of financial management in DOD
- DOD's annual financial statements
- DOD's audit report
- a summary of the reports on internal accounting and administrative control systems submitted to the President and Congress as required by the Federal Managers' Financial Integrity Act of 1982.¹⁰

Financial Statements. The Act requires DOD to submit the preceding fiscal year's (FY) financial statements for each revolving fund, trust fund, and commercial activity no later than 31 March. The financial statements must reflect:

- DOD's overall financial position (balance sheet)
- results of operations (equivalent of an income statement)
- a statement of cash flows or changes in financial position

Pilot Program. The CFO Act established a pilot program to test the viability of preparing and auditing financial statements for the entire operations of ten major organizations in the federal government. Congress required the Army to participate in the Act's pilot program for FYs 91 and 92. OMB extended the pilot program into FYs 1993, 1994, and 1995. The Air Force joined the pilot program for FYs 1993 - 1995.¹¹

Audits. The Act mandates that the required financial statements be audited in accordance with generally accepted government auditing standards (GAGAS) and that the head of the agency receive the audit report no later than 30 June of the succeeding fiscal year.¹²

¹⁰ "Chief Financial Officers Act," Section 205.

¹¹ "Chief Financial Officers Act," Section 303.

¹² "Chief Financial Officers Act," Section 304.

The Government Management Reform Act of 1994

On 9 June 1994, Congress passed Public Law 103-356, the Government Management Reform Act. The financial portion of the Act, Title IV, requires the 23 federal departments affected by the CFO Act to prepare and submit to OMB audited financial statements covering all accounts and associated activities of each office, bureau, and activity of the agency. The statements are due to OMB not later than 1 March 1997 and each year thereafter.¹³

Congress and OMB believe it's essential to continue the financial management improvement progress begun with the CFO Act. In DOD, the Army and Air Force have been involved with these financial management improvements since 1991 and 1993 respectively. But the Navy and the Defense Agencies haven't been required to submit audited financial statements for most of their activities.

Implementation of the CFO Act in DOD

How Are We Doing?

When presenting DOD's FY 1995 budget to Congress, the Secretary of Defense stated that "we need to reform our financial management. It is a mess, and it is costing us money we desperately need."

DOD officials recognize and have accepted that we can attain savings through improved financial management, and that these savings are essential to sustain sufficient combat power.¹⁴ But due to OSD's centralized, top-down approach to improving financial management, these officials haven't passed the word down the chain of command to the units in the field.

¹³ "Government Management Reform Act of 1994," Public Law 103-356, 103d Congress, Washington, D.C., 3415-3416.

¹⁴ Charles A. Bowsher, "CFO Act is Achieving Meaningful Progress," Testimony Before the Subcommittee on Legislation and National Security, Committee on Government Operations, House of Representatives, GAO/T-AIMD-94-149, 21 June 94, 9-10.

These subordinate Army, Air Force, Navy, and Marine units stationed throughout the world are generally unaware of the massive changes that need to occur to improve financial management in DOD, and they don't understand the savings and benefits that could arise from improved financial management practices.

The Department of Defense

DOD has been working with the requirements of the CFO Act since FY 1991. In its latest Financial Management 5-Year Plan, DOD's CFO lays out the department's "Blueprint for Reform" which includes:

- comply with statutory requirements
- reengineer DOD business and organizational practices
- standardize financial data, definitions, and concepts
- consolidate and reform DOD's finance and accounting systems
- align financial controls and management initiatives
- practice candor and engender confidence with the Congress and the U. S. taxpayer¹⁵

DOD has created a management oversight committee, the Senior Financial Management Oversight Council, which meets regularly to:

- address financial management deficiencies
- approve plans for proactive solutions to financial management weaknesses and deficiencies
- assign responsibility for correcting financial management problems
- monitor progress in reforming the Department's financial management

¹⁵ "Chief Financial Officer Financial Management 5-Year Plan" Department of Defense, Pentagon, Washington, D. C., 2 Nov 94, i-ii.

The Council is chaired by the Deputy Secretary of Defense. Its members include:

- Secretaries of the Military Departments
- Vice Chairman of the Joint Chiefs of Staff
- Undersecretary of Defense (Acquisition and Technology)
- DOD Comptroller/CFO
- DOD General Counsel
- Assistant Secretary of Defense (Command, Control, Communications, and Intelligence),
- Director of Defense Performance Review

The DOD Inspector General and the Director, Defense Finance and Accounting Service aren't members of the Council, but they attend the meetings.¹⁶

GAO hasn't published its findings on any of the FY 93 audit findings in DOD, and the Army and Air Force didn't submit their FY 94 financial statements until 1 March 1995. But in FY 1992, audits of DOD agencies uncovered 19 material weaknesses in accounting controls across DOD - shortcomings significant enough for a reasonable person to question the information provided by financial systems.¹⁷ This is even more significant when you consider that the audits covered only 58% of DOD's \$281.9B budget. The Government Management Reform Act will expand this to 100% for the FY 1996 financial statements.

Based on GAO's findings in the FY 1992 audit reports, DOD has a long way to go. When considered in their entirety, DOD's financial management problems are overwhelming. The more significant findings include:

- vacancies in top financial leadership positions

¹⁶ "CFO Financial Management 5-Year Plan," ii.

¹⁷ Materiality is defined by the Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*, as "the magnitude of an omission or misstatement that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement." AICPA Professional Standards, 1 June 1990, Volume I, 231-9.

- unclear financial accountabilities and responsibilities
- unreliable financial systems
- ongoing changes in programs and extensive downsizing
- high rates of noncompliance with internal controls and policies
- failure to retain certain financial records
- billions of dollars of undistributed and unmatched disbursements
- mischarges to appropriations
- millions of dollars of negative unliquidated obligations
- millions of dollars of duplicate, erroneous, and improper payments¹⁸

Two of DOD's initiatives to improve financial management are Corporate Information Management (CIM) and the Defense Finance and Accounting Service (DFAS).

Corporate Information Management (CIM). In October 1989, DOD established the Corporate Information Management initiative to:

- implement new or improved business methods in several functional areas, including financial management
- create more uniform practices for common functions
- improve and standardize DOD's automated information systems

Since CIM's inception in 1989, DOD has cited it as a primary solution to the numerous problems reported by the audits of DOD's accounting and other management information systems. GAO's reviews of CIM have shown that the effort has been plagued by a lack of top-down policy direction, as well as inadequate strategic planning and leadership changes.¹⁹ Nevertheless, in DOD's 1994 5-Year Financial Plan, five years after DOD took funds from the military services to develop CIM, DOD states that

¹⁸ Charles A. Bowsher, "DOD Has Not Responded Effectively to Serious, Long-standing Problems," Testimony Before the Governmental Affairs Committee, United States Senate, US General Accounting Office, GAO/T-AIMD-93-1, 1 July 1993, 24.

¹⁹ "DOD Has Not Responded Effectively," 7.

CIM will incrementally evolve into standard, fully integrated, multi-functional applications.²⁰

Defense Finance and Accounting Service (DFAS). In January 1991, OSD established a single organization, DFAS, to be primarily responsible for accounting activities throughout DOD. DFAS took control of most of the accounting operations previously conducted by the military services. However, based on the results of GAO, DOD IG, and military services' financial audits, better financial reporting hasn't yet resulted from the creation of DFAS. DOD organizations still can't prepare reasonably accurate financial statements, something that every organization with fiduciary responsibilities should be able to do as a matter of course.

Assessment of DOD's Activities

Centralization vs De-centralization. Over the last few years, DOD has centralized its approach to financial management by transferring much of the responsibility, authority, control, and resources for financial management operations and systems from the military services to OSD. DOD believes that this centralization will enhance financial management activities. In contrast, the GAO believes that these changes may limit the military services' ability to make changes and improvements in their financial operations.

GAO has also noted that with the establishment of DFAS and the centralization of financial management functions previously controlled by the military services, it has become vitally important for OSD and the military services to more clearly assign accountability and responsibility for internal controls, financial data accuracy, and financial reporting.

DOD considers DFAS the department's accounting firm, yet DFAS' actions more often resemble a bookkeeping operation. For example, even though DFAS now has

²⁰ "CFO 5-Year Plan," 3-13

control over most of the systems producing the military services' financial information - DFAS finance centers actually produce the services' financial statements - OSD requires the military services' senior managers to certify to the financial statements' overall reasonableness and accuracy. Since the service senior leaders aren't in control of the financial systems that generate the financial data or the financial statements, service leaders aren't in a position to certify their accuracy.²¹

Dual-Entry General Ledger Accounting System. Even with DFAS and CIM, none of the military services or DOD have standardized, transaction-based general ledger accounting systems. The lack of a dual-entry general ledger accounting system prevents the military services and DOD from developing reliable and accurate financial statements from the accounting systems. Financial managers use budget reports, equipment and facility management reports, physical counts, and estimates to determine entries into the financial statements.

Even though the Army revised its accounting policy and required the implementation of a standard general ledger by 1 October 1988, GAO's FY 1991 audit found that the general ledger information was so unreliable that the Army had to use alternative sources to prepare the financial statements. For example, the Army estimated it had \$78 billion worth of tactical equipment based on sources other than the general ledger.²²

The United States Navy

The Navy isn't one of the ten pilot agencies required by the CFO Act to prepare audited financial statements. However, they've been required to prepare audited financial statements for their segment of the Defense Business Operating Fund (DBOF)

²¹ "DOD Has Not Responded Effectively," 8-11.

²² GAO, "Immediate Actions Needed to Improve Army Financial Operations and Controls", Report to Congress, US General Accounting Office, GAO/AFMD-92-82, August 1992, 30.

and their Management and Trust Funds since FY 1991. Beginning in FY 1996, the Government Management Reform Act requires the Navy to submit audited financial statements for all of its activities.

The Navy understands that it will have to change its financial management practices so that it will be able to produce auditable financial statements.

Assessment of the U.S. Navy's Activities

The senior financial managers in the Navy have a plan for implementation of their program. Their first step is education. They conducted a two-day seminar in March 1995 with their financial managers from throughout the Navy to explain the requirements of the Chief Financial Officers and Government Management Reform Acts and to learn from the experiences of the Army and Air Force.

Navy financial managers realize that most of their organizational elements aren't familiar with the requirements of this legislation. They also realize that implementation of this program will require a cultural change since leaders and managers in the Navy, as well as the other military services, are accustomed to managing financial resources in terms of budget authority, commitments, obligations, spend what you have, and don't have anything left at the end of the year.²³

United States Air Force

Even though the CFO Act didn't require the Air Force to provide agency-wide, audited financial statements to DOD and OMB prior to FYs 1993-1995, it was the first military service that attempted to develop consolidated financial statements of sufficient accuracy and reliability to be considered auditable in the late 1980s. GAO audited the Air Force's 1988 financial statements. Their audit report discussed the weaknesses in

²³ Interview with A. Anthony Tisone, Director, Resource Allocation and Analysis, Office of the Comptroller of the Navy, 26 Jan 95.

the accounting systems, procedures, practices, and controls that prevented the GAO from expressing an opinion on these financial statements.

Since this 1988 audit, GAO has issued 12 additional reports which outline the problems and the actions that the Air Force and DOD need to take to meet the objectives of the CFO Act.²⁴ The persistent problems include:

- Accounting systems generate unreliable and inaccurate financial information which has little value for internal management or external reporting.
- Budgeting and accounting systems aren't integrated which causes inaccurate recording of billions of dollars of budgetary outlays.
- Reported valuations of weapons systems (aircraft and missiles) are materially misstated because the Air Force doesn't value the assets at actual costs as required by the DOD Accounting Manual. For example, in FY 90 the Air Force valued the B-1B Bomber fleet at \$14.5B. GAO found that the fleet was understated by about \$7B since the Air Force doesn't include the cost of materials it provided to contractors for the manufacture and assembly of the aircraft, and it doesn't include the cost of modifications made to in-service systems that increase the life or usefulness of the aircraft.
- Inventory systems don't correctly report either the quantities or values of high-dollar investment-item inventories at the Air Logistics Centers.
- The Air Force system of internal controls doesn't adequately safeguard all assets nor ensure that account balances and financial reports are reliable.

The Air Force Audit Agency couldn't complete their audit on the Air Force's FY1992 financial statements due to continued deficiencies in the accounting systems and

²⁴ GAO, "Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act," Report to Congress, GAO/AFMD-92-12, February 1992, 2.

internal controls. In a July 1993 GAO testimony, the Comptroller General expressed his disappointment that OSD and Air Force officials had displayed insufficient commitment and progress toward improving financial management deficiencies highlighted since 1988.²⁵

Assessment of the U.S. Air Force's Activities

Air Force officials are committed to improving their financial management systems. They understand the need for OSD centralized planning and direction, but believe that the execution and management of the financial and accounting systems should be decentralized. The Air Force knows its shortcomings and the requirements of the CFO Act, yet the senior financial managers also understand that their subordinate commands provide the input data to the systems and must be part of the solution.

Currently, the Air Force is using the Air Combat Command as a test-bed to determine how to best capture the accounting data and how this data can be transformed into useful management information for the operational commanders as well as the financial managers.²⁶

United States Army

The Army has participated in the CFO Act's pilot program since FY 1991. The GAO reported significant uncertainties regarding the FY 91 and 92 financial statements' completeness and accuracy. The FY 92 audit revealed that although the Army had made some improvements, a number of conditions similar to those reported for FY 91 still existed. For example:

- The GAO audit revealed \$4.9 billion of disbursements made by disbursing offices but not captured in the accounting records.

²⁵ "DOD Has Not Responded Effectively," 20-22.

²⁶ Interview with Mr. Netherley, Deputy Assistant Secretary, Plans, Systems, Analysis, Department of the Air Force, 26 January 1995.

- The Army's Facilities System, used at each installation, couldn't provide complete and accurate information on the quantity and type of Army structure and facilities
- The Army's equipment accountability system, the Continuing Balance System Expanded (CBSX), doesn't provide reliable information on the quantity, type, and location of \$53 billion in Army equipment. The FY 92 audit noted a discrepancy between CBSX and unit records of over 1.3 million individual pieces of equipment valued at over \$7 billion.

The Army learned the importance of accurate CBSX data during Desert Storm. Army leaders reported that inaccurate CBSX data hampered equipment distribution decisions. Reliable CBSX data clearly has an impact on readiness and warfighting and should be horizontally integrated with the Army's financial management system.

Assessment of the U.S. Army's Activities

Senior financial officials in the Army recognize that the Army's financial systems need improvement. As a result of the FY 91 audit, the Army established a special action group to oversee corrective action implementation. Likewise, the Army worked closely with GAO during the FY 92 and 93 audits to take corrective actions and to help ensure GAO auditors had access and cooperation necessary to complete the audit.

During interviews with officials at OMB, GAO, and DOD, the Army was singled out as showing leadership and initiative in addressing its financial management problems. But the Army, along with the rest of DOD, has a long way to go.²⁷

²⁷ "DOD Has Not Responded Effectively," 6,12-19,23.

Assessment by GAO and OMB

The Comptroller General is disheartened at DOD's overall progress. He believes that DOD's civilian and military leadership haven't taken the strong, decisive, and sustained actions required to significantly improve financial management. Even after several years of what should be considered devastating audit findings, DOD hasn't demonstrated that it's serious about resolving its financial management problems by aggressively developing and implementing effective corrective actions.

Likewise, a senior OMB official involved with implementation of the CFO Act - government-wide - is concerned with the slow financial reform at DOD. OMB must prepare the federal government's first set of financial statements for FY 1996 which will be audited by GAO and submitted to Congress in 1997. He believes that DOD could prevent the federal government from receiving an unqualified audit opinion because of senior leaders' reluctance to change and improve their financial management systems more quickly.²⁸

So What?

Why Should We Change?

Senior officials in OSD and the military services are aware of the requirements of the CFO Act. They know that they must prepare and submit audited financial statements. They also understand that the purpose of this act is to improve financial management in DOD and the federal government. Many of the senior officials know about these requirements either because their senior financial managers have told them or because they're required to participate in financial management oversight councils.

²⁸ Interview with Norwood Jackson, Chief, Financial Standards and Reporting Branch, Office of Management and Budget, 26 January 1995.

They know that improving financial management is important, and they understand that they're responsible for the stewardship of government funds. But they aren't taking widespread, decisive action to improve financial management in DOD.

When the leadership in OSD or the military services decide an issue is important and want to make changes, the leaders, soldiers, sailors, airmen, marines, and their families know about it. For example:

- When AIDS became a health threat in the mid-80s, DOD quickly instituted department-wide blood tests for all active duty members and screening for potential recruits.
- When we recognized that alcohol and drug abuse was a threat to readiness in the early 80s, we quickly began department-wide, random drug testing and the deglamorization of alcohol.
- When the Army Chief of Staff, General Edward C. Meyer, learned that Army commanders were confused about what their priorities were in 1981-1982, he made his "two glass-balls" video tape and required that all leaders, down to company commanders, see the tape within a very short time-period.

His message was simple, direct, and effective. We had two glass balls to keep in the air: training and maintenance. All of the others, such as reenlistment, blotter reports, and AWOL statistics would take care of themselves if we successfully managed training and maintenance.

We were told that in the near future, he would visit an Army post and ask a company commander what his priorities were. If he didn't answer training and maintenance, GEN Meyer would relieve the company commander, battalion commander, brigade commander, and division commander.

Rest assured, we all knew what the answer was. He didn't have to relieve anyone. And to this day, Army leaders in the field know that their two top priorities are training and maintenance.

So, why does it appear that DOD isn't being more aggressive in improving its financial management systems? Why aren't commanders in the field involved in these improvements? Possible reasons include:

- Senior leaders in the military services may not believe Congress is serious about demanding that DOD financial management systems be improved.

The CFO Act and the Government Management Reform Act originated in the Governmental Affairs Committee, not the Appropriations or Authorization Committees. Staff members from these committees may believe that the Governmental Affairs Committees are getting into their business. Currently, the Authorization and Appropriations Committees don't use the information from the audited financial statements to authorize or appropriate funds for the military services.

- Senior OSD officials, senior leaders in the military services, and most commanders in the field don't want the operators to be too concerned with financial management issues. The prevalent battle cry is "let the accountants fix it, and don't bother us, we're concerned about readiness." Most of the operators don't link the product of excellent financial management with readiness.
- DOD is taking a long-term view toward fixing the problems. These long-term solutions allow many DOD leaders to remain concerned with other, more pressing short-term concerns and causes them to lose their focus on improving financial management.

We Need to Improve Our Financial Management Systems Now!

We must improve our financial management practices. It's the law, it's good management practice, resources for defense are declining, and taxpayers should be able to trust our stewardship of their tax dollars.

It's the Law. The Appropriations and Authorization Committees may not currently use the audited financial statements to provide funds to the military services, but they may in the future. When they do, our financial statements must reflect that we're managing our funds well. If we don't, these committees could decide to reduce our funding until we improve our financial management systems and comply with the law.

Better Management Practices. Improved financial management practices and the process of preparing auditable financial statements will highlight where problems are. For example:

- This information will provide a clearer picture of DOD's true financial condition. It will give the services a more realistic portrayal of the costs they can expect to incur as a result of their activities. Defense leaders will receive more complete information on the costs and consequences of certain programs and activities.

Accurate and reliable financial information will allow the services to use the standard industry practicing of "benchmarking." Leaders will be able to identify the best practices of the most efficient and effective posts, divisions, ships, or wings; determine why they're functioning so well; and then adopt those practices in like entities.

- Accurate financial information will bring help pinpoint waste, mismanagement, and possible illegal acts and will highlight the gaps in safeguarding DOD assets.

For example, improved financial discipline will prevent people no longer serving in the Army from receiving over \$6M in payments because their names weren't removed from active duty payroll files.²⁹

- Reliable financial statements will allow decisionmakers to compare the cost of current operations versus the cost of operations under alternative force and organizational structures as we continue to downsize and learn to operate with less funding.³⁰

Decreasing Defense Budgets. Defense has been one of the primary billpayers to keep the annual deficit below \$300B in the last few years. As the Congress and the President drawdown the military to its post-Cold War strength, its percent of federal outlays and GDP continue to decline. Between FYs 95 and 99, OMB has projected that defense and the remainder of discretionary spending will remain relatively flat in current dollars while the mandatory entitlements and interest payments rise from 64.3% of outlays in FY 95 to 70.4% of outlays in FY 99 (See Table 1). Hence, automatic cost adjustments and interest payments on the national debt squeeze an additional 4% of outlays from defense and 2% from other discretionary spending in a short four years.

To maintain our ability to fight two nearly simultaneous major regional conflicts, be involved in peace-enforcement and humanitarian operations, and continue to recruit and keep quality people in the military services, we must be able to get the most out of our budgets. Likewise, as we continue to downsize, the decisionmakers need information on the cost of performing current operations vs the cost of operating under alternative force and organizational structures. However, based on information provided by DOD's

²⁹ Charles A. Bowsher, "GAO's Views on H. R. 3400 Management Initiatives", Testimony Before the Committee on Governmental Affairs, United States Senate, U.S. General Accounting Office, GAO/T-AIMD/GGD-94-97, 23 February 1994, 2-4.

³⁰ "Immediate Actions Needed to Improve Army Financial Operations and Controls", 31.

current financial management systems, the senior leaders don't have reliable cost information available to consider their alternatives.³¹

Table 1
(\$B FY 94 dollars)

	'95*	'96*	'97*	'98*	'99*
Defense	\$270.7	\$261.6	\$257.0	\$257.1	\$258.1
% Outlays	17.8%	16.4%	15.2%	14.5%	13.9%
% GDP	3.9%	3.5%	3.2%	3.1%	3.0%
Entitlements	\$763.7	\$826.6	\$909.7	\$988.3	\$1,051.3
% Outlays	50.3%	51.8%	53.8%	55.6%	56.7%
Net Interest	\$212.8	\$224.2	\$234.0	\$244.6	\$254.4
% Outlays	14.0%	14.0%	13.8%	13.8%	13.7%
Deficit	\$165.1	\$179.2	\$190.0	\$191.8	\$207.4
% Outlays	10.9%	11.2%	11.2%	10.8%	11.2%
% GDP	2.4%	2.4%	2.4%	2.3%	2.4%
Outlays	\$1,518.9	\$1,596.9	\$1,691.4	\$1,777.4	\$1,854.0
GDP	\$7,022.0	\$7,466.7	\$7,916.7	\$8,339.1	\$8,641.7

Source: Office Management & Budget (Feb '94 & July '94)

***Estimate**

High-Risk Investment. National defense is a public good. Taxpayers don't get to decide whether they want it or not. Yet most taxpayers would probably agree that national defense is important. But based on GAO's audits of DOD and the military services over the last three years, if DOD depended on investors for funding, analysts would assess DOD as a high-risk investment. Since the inception of the CFO Act, the auditors have issued disclaimers of opinion on the Army's and Air Force's financial statements.

³¹ "Immediate Actions Needed to Improve Army Financial Operations and Controls," 31.

Auditors can issue several types of opinions on financial statements in accordance with generally accepted accounting principles (GAAP). The best opinion is an unqualified, or clean, opinion and the worst is a disclaimer of opinion.

An unqualified opinion states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with GAAP.

A disclaimer of opinion states that the auditor doesn't express an opinion on the financial statements due to the inability to adequately conduct the audit and render an opinion for material reasons. These reasons could be because they couldn't:

- rely on the information from the financial management systems
- verify counts of equipment, inventory, or cash on hand
- verify if bills were paid or payments were received

Due to a disclaimer of opinion:

- If DOD was a corporation, state, or city and had to rely on the sale of bonds for financing, the bonds would be rated as junk bonds.
- If DOD was a publicly-held corporation and wanted to sell stocks on the New York Stock Exchange, the Securities and Exchange Commission would suspend the trading of DOD shares in the stock market.
- If DOD was a privately-held business that wanted a loan from a bank, the bank would disapprove the loan.

Taxpayers should expect, and Congress should demand that we improve our financial management systems and our stewardship of federal funds. The payoff for DOD will be better information for decision makers and better use of funds which will buy more readiness. Furthermore, potential savings could be used for other national security priorities such as health, education, or reduction of the annual deficit.

Recommendations

For the past several years, the GAO has been reporting how DOD and the military services can improve their financial operations and internal controls. GAO's continuing theme is that although DOD's financial management improvement projects, such as CIM and DFAS, represent long-term solutions to many of the problems, DOD and the military services can also take a number of short-term actions to improve their financial information. These include:

- emphasize the importance of following existing policies and procedures
- eliminate gaps in accounting policies that reduce the completeness of financial reporting
- expedite actions to bring service accounting policies in line with DOD, OMB, and Congressional policies and laws.³²

Additional recommendations are:

- *Get the Word Out to the Field.* Tell leaders that improved financial management practices directly affect readiness and enhance national security by preventing waste, generating savings that can be used for training and quality-of-life programs, and providing leaders with more reliable information for better decision making.
- *Establish an OSD Task Force.* Establish an action-officer task force with members from each of the services and DOD agencies that prepare audited financial statements. This group's charter would be to determine the milestones and requirements to successfully prepare financial statements that will receive an unqualified opinion for FY 1996 as required by law. This task

³² "Immediate Actions Needed to Improve Army Financial Operations and Controls," 35.

force will report regularly to the Senior Financial Management Oversight Council.

- *Establish Service Task Forces.* Establish similar task forces in each service and defense agency to determine the same milestones and requirements to meet the above objective.
- *Require the Defense Information Service Agency (DISA) and DFAS to Present Solutions to the Senior Financial Management Oversight Council.* DFAS and DISA need to present shorter-term solutions regarding what needs to be done to integrate the managerial information and financial management systems in the services and DOD. A standardized, dual-entry general ledger accounting system that will be used by all services, will include all necessary accounts, and will be the source for all financial statements and other required reporting must be part of this solution.

The current DFAS and CIM solutions will be completed too far in the future: 8-10 years from now. DFAS and DISA need to explore other commercial and government alternatives to be able to produce financial statements that will receive an unqualified opinion for FY 1996.

- *Establish a Test-Bed in Each Service.* Each service should establish a test-bed to determine how to horizontally integrate management and financial information systems. The purpose of integrating these systems would be to improve management information and facilitate preparation of financial statements.

The Air Force is already doing this with the Air Combat Command. The Army could do this as part of their Force XXI initiative at Fort Hood, Texas.

And the Navy could determine how to best do this as they prepare to meet the requirements of the CFO Act in the near future.

- *Encourage "Benchmarking" in Each Service.* As the financial statements become more reliable and accurate, the best practices in like units will be highlighted and can be shared service-wide, thereby reducing wasteful activities.
- *Establish OSD as the Executive Agent for Comptroller Selection, Training, and Management.* Officers and civilians would apply for selection into the program at the appropriate time in their career. OSD would insure that the mix would include line officers so that the resource management community will not lose touch with what's needed in the field.

When accepted into the program, OSD would send the officers and civilians to receive an MBA at the best business schools in the country or at business schools with programs set up by OSD. For example, the Army has the Army Comptroller Program at Syracuse University at which approximately 30 Army officers and civilians are trained as resource managers and receive an MBA in a 15-month program each year. OSD could expand this program and include all services, or it could keep the program and add others.

Afterwards, these resource managers would return to their service or to a joint assignment to work in a resource management position. While in these jobs, they would work for their service or a joint headquarters, but they would be an OSD asset. When this initial tour is completed, the officers could return to operational jobs in their services to remain competitive for command assignments. Throughout the rest of their career, they could move between

operational and resource management positions. And when they served in resource management positions, OSD would be responsible for their assignments in coordination with the respective military service.

OSD would be responsible for maintaining the resource management training and education programs, controlling assignments, requiring and monitoring continuing professional education, and encouraging further professional licensing as certified public accountants or certified management accountants to enhance their technical training and to gain legitimacy within and outside DOD.

This centralized selection, training, and management of resource managers would lead to DOD-wide understanding of financial management systems and would motivate resource managers to adopt a DOD-view in their service and joint financial management positions.

- *Develop Incentives For Outstanding Stewardship.* Currently, commanders and financial managers are successful if they get what they ask for in their budget submission and if they spend every dollar they receive. Commanders and their financial managers should be rewarded if they return funds to their higher headquarters, accomplish more with the same amount of funds they received the year before, or accomplish the same results with less resources. This requires the development of reliable, accurate, and meaningful performance measures as well as incentives.

We're probably not ready to give financial bonuses to commanders and their financial managers for saving money or working more efficiently, but we can provide other incentives. For example, the Army has the Community of Excellence Program. In this program, the most excellent post communities receive a large sum of money to use as the post commander deems best for

such things as a new facility or a new activity. Likewise, the DOD should award similar incentives to communities or units whose commander is able to accomplish all of his missions and returns funds to his higher headquarters.

We need to stop the practice of racing to spend all of our funds and shooting all of our ammunition by the end of the fiscal year to prove we needed and can use all of our resources.

- *Establish Longer Terms for CFOs.* CFOs should be professional financial managers and should be appointed for a ten-year term. The CFO should have a long-term view and should have the stability to see initiatives implemented and remain in the position to be held accountable.

Conclusion

The government is searching for every nickel it can find to shrink the deficit. Yet it's not taking aggressive steps to implement the requirements of the CFO Act. Through sound financial management practices, we can reap tens of billions of dollars in benefits *every year* thereby reducing the deficit, enhancing our national security, and giving the taxpayers more value for their dollar.

The legislation is in place, but the Appropriations and Authorization Committees aren't pressuring the various departments to comply with the requirements. Hence, several federal agencies are implementing sluggish, long-term initiatives while still receiving disclaimers of opinion on their financial statements.

Many of the federal agencies and Congress can blame bureaucratic inertia, political gridlock, and the inherent vagueness of the problem of waste as to why government financial management isn't improving. Additionally, the federal government doesn't have to answer to credit-rating agencies, which can pressure cities, states, and

corporations to toe the line or suffer the consequences of lower debt ratings and higher borrowing costs.³³

But it's perplexing that the defense establishment, where discipline is a noted virtue, part of the culture, and essential for combat is so poorly disciplined in its financial management operations. GAO notes that existing policies and procedures are often sufficiently sound to provide at least minimally adequate control and accounting. Yet high rates of non-compliance render the policies and procedures ineffective.³⁴

DOD has initiated several top-down, centrally managed initiatives to improve financial management and meet the requirements of the CFO Act. But financial management doesn't receive the attention it requires at the lower levels in the military services where more involvement could improve the management of financial resources.

Congress passed the CFO Act of 1990 and Government Management Reform Act of 1994 to improve financial management and internal controls in the federal government. DOD and 22 other federal agencies must provide audited financial statements for FY 1996 to OMB in early 1997. The law requires that we provide this information. As military professionals, we should lead the way and take pride in outstanding stewardship of public funds.

Also, we need to use the tools of financial management and learn to get the most out of the funds provided by the taxpayers. Audits over the last few years have shown that we can make better use of the billions of dollars we receive for national defense. As commanders and senior leaders learn to use financial statements in the same way that our commercial counterparts use them, we'll become better stewards of federal funds, and we'll be able to continue to provide high levels of national defense as the defense budget shrinks.

³³ P. Norman Roy, "To Shrink the Deficit, Watch the Books," *New York Times*, 22 August 1993.

³⁴ "DOD Has Not Responded Effectively," 24.

In a few years, an Army Division Commander should be able to review his unit's financial statements that recently received an unqualified opinion. The success story won't be the "clean" opinion, rather it will be the knowledge that the Division's management and internal control processes are working well. The integrated managerial and accounting systems will provide the Division Commander with reliable, timely, and accurate data which will allow him to make informed decisions regarding the best use of his resources.

We must act now though. Failure to improve our financial systems and meet the requirements of the CFO Act of 1990 and the Government Reform Act of 1994 will cause us to continue to waste government resources. We'll make decisions with incomplete and inaccurate information. We won't be able to provide the level of defense that we could potentially provide. We'll raise the ire of Congress and could receive less funding. And we'll let down the U.S. taxpayers who count on us to be professional stewards of the tax dollars they provide.

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