



Calhoun: The NPS Institutional Archive
DSpace Repository

Faculty and Researchers

Faculty and Researchers' Publications

2013

**Audited Financial Statements in the US
Federal Government: The Question of Policy
and Management Utility**

Brook, Douglas A.

Emerald Publishing Limited

Brook, Douglas A. "Audited financial statements in the US federal government: The question of policy and management utility." *Journal of Public Budgeting, Accounting & Financial Management* 25, no. 1 (2013): 135-157.

<http://hdl.handle.net/10945/57697>

This publication is a work of the U.S. Government as defined in Title 17, United States Code, Section 101. Copyright protection is not available for this work in the United States.

Downloaded from NPS Archive: Calhoun



Calhoun is the Naval Postgraduate School's public access digital repository for research materials and institutional publications created by the NPS community. Calhoun is named for Professor of Mathematics Guy K. Calhoun, NPS's first appointed -- and published -- scholarly author.

Dudley Knox Library / Naval Postgraduate School
411 Dyer Road / 1 University Circle
Monterey, California USA 93943

<http://www.nps.edu/library>

**AUDITED FINANCIAL STATEMENTS
IN THE US FEDERAL GOVERNMENT: THE QUESTION OF POLICY AND
MANAGEMENT UTILITY**

Douglas A. Brook*

ABSTRACT. The Chief Financial Officers Act and subsequent legislation require federal agencies to produce corporate-style financial statements. Arguments for financial statements drew on private sector analogies and suggested policy makers and managers would use the information to make better public policy and management decisions and improve accountability for financial management and program performance. Nearly all major government agencies have unqualified audit opinions and improvements in financial management are claimed. But benefits for policy making and management are not yet well understood. This paper examines the question by comparison with the private sector and by examining what agencies say about the uses and users of financial statement information. The emerging challenge in the evolution of federal financial reporting is to develop better government-specific analytical tools and other financial information for policy makers and managers.

INTRODUCTION

A major provision of the Chief Financial Officers Act of 1990 created a pilot program for selected agencies to produce corporate-style financial statements and subject them to independent audit. The Government Management Reform Act of 1994 expanded this financial statement requirement to major federal agencies, and mandated a consolidated financial statement for the U.S. Government. Later, the Accountability of Tax Dollars Act of 2002 expanded the financial statement requirement to all federal entities

** Douglas A. Brook, Ph. D., is Professor of Public Policy and Director of the Center for Defense Management Research at the Naval Postgraduate School. His research and teaching interests are in public budgeting and financial management.*

with budget authority in excess of \$25 million. Arguments made for corporate-style financial statements for the federal government drew heavily on private sector analogies and the idea that better management would result. For instance, the Grace Commission's Federal Management System Task Force asserted, "As in the private sector, it is the responsibility of central government, essentially the government's corporate headquarters, to see that more is achieved from the combined efforts of the departments than they are able to achieve independently [...]. It requires better information" (President's Private Sector Survey on Cost Control, 1983, p. 71). The Grace Commission report served as a precursor for the arguments that led eventually to adoption of the CFO Act (Haller, 1983).

The 20th anniversary of the CFO Act has recently passed. All departments and agencies are producing financial statements and 21 of the 24 major government agencies have achieved unqualified audit opinions, 2 have qualified opinions, and only one, the Department of Defense, remains disclaimed (Executive Office of the President, 2011). Previous research has explored the outcomes from the requirement to produce financial statements and has assessed the value derived from subjecting the statements to independent audit. The main results have been improved financial management as demonstrated by better internal controls and modernized integrated financial systems. Agencies that have achieved unqualified audit opinions report reputational benefits on matters of accountability and stewardship (Brook, 2010). Value is derived from the audit requirement itself as audits provide evidence of good financial management, force improvement in internal controls and financial management systems and processes, and reduce information risk by providing assurances about underlying financial information. (Brook 2011). The CFO Council (2011) found that implementation of the CFO act "has increased transparency, fostered accountability, established a government-wide financial management leadership structure, promoted new accounting and reporting standards, generated auditable financial statements, strengthened internal controls, improved financial management systems and enhanced performance information" (p. 1).

While advances have clearly been made inside the financial management domain the questions of who uses the financial statements and for what purposes remain to be examined.

Arguments for audited financial statements asserted that citizens, policy makers and managers would use the resulting information to make better public policy and public management decisions and to assure better accountability for the use of financial resources and the performance of government programs. One of the purposes stated in the CFO Act itself was to “Provide for the production of complete, reliable, timely and consistent information for use by the executive branch of the Government and the Congress in the financing, management and evaluation of Federal programs” (Section 102(b)). Then-Comptroller General David Walker argued, “Legislators, government officials, and the public want to know whether government services are being provided efficiently, effectively, economically, and in compliance with laws and regulations. They also want to know whether government programs are achieving their objectives and desired outcomes, and at what cost” (U.S. Government Accountability Office, 2003). The goals of the CFO Act and the Government Management Reform Act were “to create reliable, relevant financial and performance information for sound management decisions about programs, budgets and fiscal stewardship, all of which should lead to higher performance (Amos, et.al., 1997, p. 28). The GAO (1991) asserted, “Several of the CFO Act’s requirements aim to improve the financial information available to agency managers, the Congress and others.” This includes “accounting and financial systems which report cost information, [...] integration of accounting and budget information, [...] and the systematic measurement of performance” (p. 14).

At the beginning, Jones and McCaffery (1993) asserted, “[...] notwithstanding the experience of a few agencies with audited financial statements, their practical utility has not yet been proven [...] (p.71). This paper re-examines this issue by exploring the question of benefits for policy making, management and ultimately for accountability.

We explore the question of policy and management utility of audited financial statements. To the extent that the public sector analogy is valid, perhaps value can be extracted from government financial statements using private sector analytical techniques. To the extent that individual agencies have found way to use this new

financial information these best practices need to be identified and shared. And, to the extent that users and uses within the government are not found new ways of thinking about reporting financial information and extracting the value of government financial reporting may be required.

METHODOLOGY

To determine the extent to which audited financial statements are supporting the goals of policy making, management and accountability, we first consider the private sector analogy by identifying users and users and considering whether the analytical techniques applied to private sector financial statements are useful in a governmental context. Next we examined the FY 2011 performance and accountability and financial statement reports of the twenty-four major federal reporting agencies to see what they self-reported about the use and users of financial statement information. Then we conducted a small number of in-depth telephone and e-mail interviews with agency CFOs and deputy CFOs and with experts outside of the agencies to determine their views on the issue. In analyzing the current and potential uses and users of financial information, we found helpful the hierarchy of financial needs suggested by David (2002):

Budget Information- Perhaps the most important financial information for any federal official is the amount of money available for obligation or expenditure for his or her program, service or organization. Knowing the budget is the foundation of the hierarchy.

Status of Funds- The next layer of the hierarchy, and the emphasis of most federal financial efforts today, is knowing how much of the budgeted funds are available for obligation (or expenditure) at any time. This is typically known as the status of funds or budget execution and consumes significant attention and effort from federal policy, program and operating officials.

Financial Information- The next layer in the hierarchy is the financial information needed for day-to-day management, monitoring and decision-making, such as information on individual accounts, assets, liabilities, etc. The financial

information needs of the policy, program and operating official must be satisfied at the same time the information is gathered for financial statement purposes.

Cost Management Information- Federal managers recognize the value of cost information—details on how federal entities use resources to manage their organizations, programs, projects and services—and are demanding such information. Cost management represents a new way of thinking being embraced by many federal officials.

Cost/Performance Information- This is the top of the hierarchy, the intersection of cost with performance information. The relationship of program results with the cost of providing those results will be increasingly important in future policy, program and operating decision-making (David, 2002, p. 12).

FINANCIAL REPORTING

Three types of accounting are generally found in the federal government; budgetary, managerial, and financial. Budgetary accounting, perhaps the most common in government, accounts for the budgeting, receipt, obligation, and expenditure of annual appropriations. Managerial accounting provides current information—cost accounting data, for instance—to support managerial and policy decision making. Financial accounting, sometimes called proprietary accounting, provides historical information on the financial condition of the organization in accordance with certain accounting and auditing principles (Candrea, 2004). Of these three types of accounting, proprietary accounting and its associated financial statements represent the newest approach to reporting financial information in the federal government. The GASB explained that “The idea was [...] [to] bring the benefits of accrual accounting—full cost of service information and consolidated financial statements to government” (Government Accounting Standards Board, 2006, p. 30).

FINANCIAL STATEMENTS

Federal financial statements look very much like private sector models. Federal government financial statements contain four required reports, somewhat similar to the commercial sector:

- **Balance Sheet** provides a snapshot of the department's financial position at the end of the fiscal year, depicting assets, liabilities, and net position. Note that the accounting equation for the balance sheet differs between commercial and governmental balance sheets. The standard accounting equation for business entities is:

$$\text{Assets} = \text{Liabilities} + \text{Shareholder Equity}$$

It is changed for the federal government to:

$$\text{Assets} = \text{Liabilities} + \text{Net Position}$$

- **Statement of Net Cost** depicts the gross costs of operations for the period, minus any exchange revenues earned from its activities.
- **Statement of Changes in Net Position** presents the sum of operations since inception, plus unexpended appropriations at the end of the period.
- **Statement of Budgetary Resources** reports the use and availability of budgetary resources at the end of the period (U.S. Department of Defense, 2009).

The balance sheet mirrors the balance sheet in the commercial sector with "net position" replacing "shareholder equity" as the balancing entry. The balance sheet provides a financial snapshot of the enterprise. The statement of net cost provides a financial summary of operations for the reporting period. The Statement of Changes in Net Position and the Statement of Budgetary Resources are particularly governmental. Changes in net position reflect how net costs are financed through retained assets and available appropriations. The Statement of Budgetary Resources reports the source, use, and balances in budgetary resources, and is the only statement in the financial reports that is based on budgetary (cash-basis) accounting.

TESTING THE PRIVATE SECTOR ANALOGY: USES AND USERS OF FINANCIAL STATEMENTS

How is financial information from annual financial statements used, and by whom? In the business sector, users of audited financial

statements are largely external to the firm. The principal uses and users in the business sector can be grouped as follows:

- **For investment information.** Existing and potential investors and lenders, analysts, and rating agencies may use the information to assess financial condition and make decisions about financial participation.
- **For business decisions.** Existing and potential suppliers, customers, venture partners, competitors, and labor unions may use financial reports to assess the risks in doing business with the firm, to identify opportunities, and to benchmark their own performance.
- **To evaluate management.** Boards of directors, investors, and management itself may use audited financial reports as a tool to assess management performance and to compare performance with peer organizations.
- **To manage financial issues.** Boards of directors and management may use financial reports to identify issues of risk and opportunities based upon significant year-to-year changes, long term liabilities or cash position, or current annual payments on long-term debt, for instance.
- **To identify policy issues.** Policy analysts and advocates, politicians, and media interested in issues associated with the firm may use financial statements for information related to executive compensation, in , profit levels, etc. (Wang, 2010).

Use of financial statements by internal management in the business sector is secondary to use by external entities. Financial statements are generally not a primary source of information for operational management. Nevertheless, information in the financial statements is relevant for management. Assets, for instance, are resources with the potential for providing future financial benefits by generating future cash inflows or by reducing future cash outflows. Liabilities, on the other hand, are constraints on future activity that represent obligations to make future payments of some type, largely for benefits received in the past. Shareholders' equity is a residual claim that the owners have on assets not required to meet obligations or claims by creditors. The statement of cash flow indicates the ability of the firm to function smoothly and effectively by meeting its required short-term and long-term payment obligations.

Given that the majority of the users of audited financial statements in the commercial sector are external to the enterprise, what list of analogous potential uses and users can be identified for audited financial statements in federal agencies? For instance:

- **Investment Decisions.** Is it possible to think that Congress, the Office of Management and Budget (OMB), or taxpayers at large could make use of financial statements to make decisions about putting investments, in the form of additional appropriations, into a particular department or agency based on its audited financial report? What kind of budgetary and appropriations decisions would be influenced by audited financial reports? Can Congress be considered analogous to a board of directors, the OMB as investors, agency leaders as managers, and the media, taxpayers, and advocacy groups as external users?
- **Assessment Decisions.** Could Congress, the OMB, and agency leaders assess the performance of agency programs and management using the information in audited financial reports? How do audited financial statements reflect agency performance?
- **Identifying Financial Issues.** Can Congress, the OMB, and agency leaders use financial statements to identify issues such as long-term liabilities, stewardship over assets, and audit opinions as a proxy for good financial management systems and overall financial management? How can changes in net position be interpreted?
- **Policy Issues.** Do external users such as the media, interest groups, policy advocates, and internal policy makers in the agency and elsewhere in the government use financial reports to identify policy issues? What kinds of policy issues are reflected in audited financial statements?

The CFO Council (2011, p. 15) argues “Financial and budget-related information needs to service multiple stakeholders, including program managers; elected, appointed, and career officials in both the legislative and executive branches; the public; and other entities such as the media, private companies, and public interest groups.”

The OMB identified the four major users of federal financial reports to be citizens, Congress, executives, and program managers (Office of Management and Budget, 1993, para. 75). The GASB identified citizens and their elected representatives, such as

legislatures, other oversight organizations, and creditors, as the primary beneficiaries of the information in governmental financial reports (Government Accounting Standards Board, 2006, p. 5). The GASB conceptual framework “places priority on the informational needs of citizens and elected representatives, two constituencies not identified as users of business enterprise financial statements by the FASB” (Government Accounting Standards Board, 2006, p. 2). The FASAB, in slightly different words, viewed the audiences for the consolidated federal financial report as citizens, citizen intermediaries, Congress, federal executives, and program managers (Federal Accounting Standards Advisory Board, 1996). IBM’s government consultants saw the users of federal financial information as “senior leadership, program managers, financial managers and analysts, and claimed that financial information is used for stronger budget formulation and justification, improved cost management, enhanced compliance ... and more transparent fee-setting” (IBM Business Consulting Services, 2005). The intended users of federal financial information are both policy makers and government managers. For both groups “GASB says, ‘...reporting should provide information to assist users in (a) assessing accountability and (b) making economic, social, and political decisions.’ In other words, financial reporting is expected to support the exercise of public accountability and also economic, social, and political decision making” (Yamada, 2007, p. 5).

Users of government financial reports are interested in stewardship of public resources, where resources are spent, the costs of services and programs, and compliance. The GASB recognized that “The needs of users of financial reports of government and business enterprises differ [...] Government accounting and financial reporting standards aim to address the need for public accountability...” (Government Accounting Standards Board, 2006, p. 1).

Perhaps the theoretical users of government financial information make no use of the actual reports. An Association of Government Accountants (AGA) survey reported that some interviewees “pointed out that customers simply do not value, much less read, the information in financial statements” (Association of Government Accountants, 2005, p.18). Shortly after, another AGA survey found that, “many financial professionals do not think the types of financial

statements used by the private sector and required by the CFO Act are right for the federal government” (Association of Government Accountants, 2007, p. 10). But the GASB also argued that, “Creditors of both [the public and private sectors] are interested in the ability to repay debt but government creditors are focused on the ability to raise taxes and the competing demands for resources rather than on how earnings are generated” (Government Accounting Standards Board, 2006, p. 2).

And, finally, financial information is seen as needed by program managers for operational reasons:

With the emphasis on delivering results, program officials must assume their role as financial managers and finance officials must move into analysis, evaluation and value-added activities. With the advent of new information systems, transaction processing is becoming less important, and information analysis more important. Both program and finance officials must learn new skills and, in so doing, improve delivery of programs and services to taxpayers and customers” (David, 1997, p. 59).

Persistent claims are made that information associated with financial statements are, or should be, used by managers and policymakers: “...policy, program and operating officials (and their staffs) require timely, accurate, reliable, consistent and useful financial information for day-to-day operating, strategic, investment and policy decisions and actions” (David, 2002, p.11). If such claims have merit, who are turning out to be the users of financial statement information and what are their uses?

TESTING THE PRIVATE SECTOR ANALOGY: FINANCIAL ANALYSIS

In the business sector, analysts use data in financial reports to make certain evaluations of the firm, particularly by using ratio and time series analysis. Drawing on experience at the state and local government levels, Gauthier (2007) offers a set of purposes for public sector financial information:

[...] the approach taken to analyzing their financial statements must necessarily differ in important respects from the approach taken in the private sector. Local governments offer no equivalent to a business’s “bottom line.” Instead, users of

local government financial statements typically approach a government's finances from three different but complementary perspectives: near-term financing situation, financial position, and economic condition. These three perspectives correspond to the questions: Will the government be able to pay its bills on time? Is the government's financial health improving or deteriorating? And is it likely that today's financial position will improve or deteriorate? Assessments of a local government's near-term financing situation tend to focus on the fund financial statements. The government-wide financial statements provide the most useful information for assessing financial position [...]. (p. 11).

Ratio Analysis

Private sector analysts rely heavily on calculation of various mathematical ratios derived from information in financial statements. Return on assets (ROA), for instance, measures the use of assets to generate earnings independent of financing. Short-term liquidity risk, the risk associated with whether assets will be available to meet near-term liabilities, can be measured by the current ratio (current assets/current liabilities) and by the quick ratio (cash + receivables + marketable assets/current liabilities). Similarly, long-term solvency can be assessed through debt-to-equity ratios (total liabilities/total assets). Working capital, an indicator of the firm's ability to meet obligations and expand opportunities, is measured by deducting current liabilities from current assets (current assets - current liabilities). The debt-to-equity ratio (total liabilities/total shareholders' equity) is an indicator of the prudent use of debt. Debt-to-equity ratios in excess of 1.0, for instance, would mean that the debt exceeds the total investment level of the owners. Return on equity (ROE) (net income/average stockholder's equity), is the return on the shareholders' value in the firm. It can be compared with the return that might be available from investment choices.

For government, the current ratio, debt ratio, and debt-to-equity ratio merit a closer look.

- *Current ratio*: (current assets/current liabilities) measures short term liquidity by assessing the ability of the organization to meet demands for cash as they arise.

- *Debt ratio*: (total liabilities/total assets) indicates the ability of the organization to meet its liabilities with assets, and measures the proportion of assets financed by debt.
- *Debt to equity*: (total liabilities/stockholders equity or total liabilities/net position) measures liabilities against the organization's equity base.

An example of these ratios can be calculated for the Department of Defense. Using data in the FY 2010 DoD financial statements these ratios are calculated as:

$$\begin{aligned}\text{Current ratio: } & \sim \$522\text{b}/\$31\text{b} = 16.8 \\ \text{Debt ratio: } & \sim \$2.3\text{t}/\$1.9\text{t} = 1.21 \\ \text{Debt to equity: } & \sim \$2.3\text{t}/-\$.392\text{t} = -5.87\end{aligned}$$

From this, it might be concluded that the DoD has more than sufficient resources to meet daily demands, but that its longer term financial health is less strong. A positive current ratio may be good news for employees, vendors, or suppliers; there are resources available to pay them. But a negative debt-to-equity ratio may be less reassuring to investors (Congress, OMB, taxpayers), who might have to share the burden of future liabilities. The DoD could not retire its liabilities even if it devoted the entirety of its assets to that effort. Instead, it will require additional appropriations in the future to meet recognized liabilities. The financial report provides a glimpse of the extent of this problem: only \$441 billion or 21% of liabilities are currently covered by budgetary resources. \$1.6 trillion for liabilities such as military retirement and health benefits and environmental liabilities remains unfunded (U.S. Department of Defense, 2008, p. 9). A CFO at another agency similarly pointed out the visibility of long-term environmental liabilities on the balance sheet (personal communication with author April 9, 2012). This is the type of information that agency leadership, the OMB, and Congress, could and perhaps should address through a long-term plan to fund these liabilities.

Equity

In a commercial financial statement, one might look at shareholders' equity for useful information. Is there an analogous analysis that can be applied to net position in government financial statements? Net position represents cumulative results from

operations plus unexpended appropriations. The DoD financial statements include a statement of changes in net position. The DoD reports negative net positions: -\$476,881.1 million in 2008 and -\$546,635.4 million in 2007. What accounts for the negative net position? The DoD's negative net position derives from the unfunded liabilities in the Medicare-Eligible Retiree Health Fund and the Military Retirement Fund. This is useful information for investors (Congress), as investments (appropriations) into these funds would be required to reduce the DoD's unfunded liabilities and negative net position. Should elimination of negative net position be a financial goal for the DoD?

Considering both the question of uses and users and the question of analytical techniques it is apparent that the private sector analogy is of limited utility in the federal government. If that is the case, then attention must shift within the government to determine more government-appropriate uses and users.

GOVERNMENTAL USES AND USERS

The FY 2011 annual financial reports (AFR) of the twenty-four major CFO Act agencies were examined to see what the agencies self-reported about the uses and users of their financial statements. Many of the AFRs were silent on the issue. However, some did address the issue, largely in general, non-specific terms. For instance, the Agency for International Development reports "Preparing the Agency's financial statements creates the opportunity to improve financial management and provide accurate, reliable information that is useful for assessing performance and allocating resources" (AID 2011, p. 23). The Department of Education states "The Department consistently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operation" (Department of Education, 2011, p. 27).

The statements in the agency AFRs can be categorized by some common terminology. The major terminological themes include: informing management decision making, linkage to budgeting and resource allocation, assessing performance, promoting management accountability, and supporting other financial reports. The Department of Health and Human Services (2011) says, "The production of accurate and reliable financial information is necessary for making sound decisions, assessing performance, and allocating

resources” (p. I-18). Some agencies cite the processes involved in audited financial reporting as a key element. The Department of Labor (2011), for instance reports, “With [its] emphasis on internal controls accurate financial information delivery to key decision makers, and transparent and accountable reporting, the Department's stakeholders can be confident that resources are used efficiently and effectively” (p.24). Other agencies make reference to management reports based on financial information derived from the financial statements or from the related processes that produce more timely and accurate financial information. The Social Security Administration (2011) explains, “the [financial] statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records (p. 40-41). Similarly, USAID (2011) identifies such reports as “[...] quarterly financial statements, financial statements at the operating division or program level, budget execution reports, reports used to monitor specific activities, and reports used to monitor compliance with laws and regulations[...]” (p. 30).

Notwithstanding positive assertions about the uses and users of federal agency financial statements, there is at best slim evidence that the statements themselves are useful to policy makers and managers. Danny Werfel, comptroller of the Office of Management and Budget, has observed, “Neither the public nor the government decision makers appear to be looking at our standard reports, such as our balance sheets or our net operating costs” (Federal News Radio 2010). Interview data indicate that agency CFOs and financial managers also see only limited usefulness to the financial for the financial statements. One respondent said “Financial statements are not useful if you are trying to manage daily operations and are interested in the current status of your funds. However, financial statements can give you reference points for some high level historical financial information” (personal communication with author April 8, 2012).

But if a distinction is made between financial *statements* and financial *information*, there is some evidence for the usefulness for policy makers and managers. Agency CFOs report that they are preparing a variety of internal financial reports for policy makers and managers from data that underlie the financial statements. These reports reflect financial information that has been made more timely

and accurate because of the improved processes, systems and internal controls required for the financial statements. These reports include quarterly budget execution reviews, cost analyses, resource utilization analyses, resource management dashboards, trend analyses and other standard reports (personal communications with author April 8-12, 2012).

Thus, it remains doubtful that the financial statements themselves are used much by policy makers and managers. Similarly, development of government-specific techniques for analyzing financial statements for governmental users appears to remain unaddressed. But the timely and accurate financial information associated with the processes and practices of audited financial reporting may have increasing usefulness as new standard reports are developed for budgetary review, cost analysis, program evaluation and other purposes.

LOOKING AHEAD: IMPROVING USEFULNESS

GAO (2007) has urged a reevaluation of the federal financial reporting model to address these questions:

- What kind of information is most relevant and useful for a sovereign nation?
- Do traditional financial statements convey information in a transparent manner?
- What is the role of the balance sheet in the federal government reporting model?

OMB's comptroller has identified three objectives for federal financial reporting:

- Transparency in the nature of the government's finances
- Sustainability in the costs of operations
- Cost effectiveness of government programs (Werfel 2011)

To serve these goals three missions are identified;

- Transparency
- Internal controls
- Decision support (Werfel 2011)

Financial statements themselves may not be as important to some users as the underlying financial information that is derived from systems and processes that produce timely and accurate data. For instance "... [program managers] do not use annual financial statements for decision making. Program officials do care, however, about and need the information generated from the systems used to prepare the annual financial statements. Program officials must have reliable, consistent, useful, accurate and timely information from those same systems and need to know that the information is in compliance with applicable standards" (David 1997, p. 57).

Comparisons are being made to the reporting under the American Recovery and Reinvestment Act of 2009 which displayed a new speed and style of financial reporting, including the posting of recipient information on the *Recovery.gov* website. Two new approaches are being suggested for the publication of federal financial data: the "supermarket approach" whereby the government publishes raw data and allows users to generate the reports they need, and the "restaurant" approach" whereby the government produces the reports that it thinks the public and users want or need (AGA 2010).

AGA's Relmond Van Daniker advocates for 4-page Citizen Centric Reports which devote one page to each of the following topics: statement of financial stability/statement of financial position, results of operations, sustainability, and performance" (AGA 2010, p. 3).

And finally, OMB's Werfel argues for a larger role for agency CFOs beyond being mere compliance officers, "[...] what is the full vision of a CFO in the future beyond just clean audits and financial statements? It's an individual [...] who can identify the critical risks, financial risks and the critical business goals that the agency has. And [...] turn around and implement a data strategy to inform on those goals and risks" (IBM 2007, p. 1).

Returning then to David's (2002) hierarchy of needs it appears that some financial information associated with audited financial statements is currently useful for meeting some of these needs, while others seem less so but could be further developed:

- **Budget Information.** Some agencies are reporting links to budgetary matters and resource allocation decisions

- **Status of Funds.** The management of budget execution seems less associated with financial statement information and reporting but the Department of Defense has placed a high priority on achieving auditability for its Statement of Budgetary Resources because of its immediate relevance to budget formulation and execution (Hale 2011).
- **Financial Information.** Assertions by agencies that other reports are being generated from information used for financial statements suggest the financial information needs of the policy, program and operating official can be satisfied at the same time the information is gathered for financial statement purposes.
- **Cost Management Information.** Some agencies appear to suggest that they are able to extract details on how resources are used to manage their organizations, programs, projects and services from financial information associated with the financial statements.
- **Cost/Performance Information.** A few agencies indicate a relationship between financial information and performance evaluation.

An important concluding distinction must be made between the usefulness of financial statements and the usefulness of financial information associated with those statements. AGA recommends that “Research is needed to determine what kind of financial information is being sought by various groups (that is, the public, executive branch officials, legislative bodies, the press, and bond rating agencies)” (AGA 2010). The CFO Council (2011) has recommended “Congress should consider directing OMB, GAO and the Federal Accounting Standards Board [...] to evolve the financial reporting model by examining the entire process with an eye toward how to further improve and streamline current reporting requirements and to better meet the needs of all stakeholders” (p. 2). In the words of one senior Pentagon financial manager, “I am more encouraged than ever that we can take the balance sheet and make it highly informative to leadership so long as we interpret the data and not make them read the statements themselves” (e-mail to the author, April 22, 2010).

CONCLUSION

Twenty years after passage of the CFO Act, most agencies of the federal government have been able to produce annual financial

statements and achieve and sustain unqualified audit opinions. There is general recognition that the requirement to produce audited financial statements has driven improvements in financial management systems and processes and enhanced the quality and timeliness of financial information. Clean audit opinions serve as effective proxies for good financial management and, therefore, contribute to the overall goal of financial accountability. (Brook, 2010). There is also some evidence that audited financial statements have helped to reduce inefficiencies and improve mission-related purchasing power per appropriated dollar (U.S. Marine Corps, 2008). However making good and proper use of financial information associated with financial statements remains a challenge. Even the OMB seems now to recognize a less-than-dominant role for federal financial reporting. "Financial reporting is not the only source of information to support decision-making and accountability. Neither can financial reporting, by itself, ensure that the government operates as it should. "Financial reporting can, however, make a useful contribution toward those objectives" (Office of Management and Budget, 1993, para. 107).

This paper has examined the question of the utility of federal financial statements. While federal agencies have successfully developed the means to produce proprietary financial statements and receive, in most cases, unqualified audit opinions, the goal of using this information for policy making and management remains to be fully achieved. Our analysis suggests that the emerging challenge in the evolution of financial reporting in the federal government is to develop government-specific analytical tools and identify special reports and other information for policy makers and managers that can be drawn from the underlying data supporting the financial statements. Ultimately, the goals of accountability and stewardship predominate. Through audited financial statements, "Agencies assure Congress and the public that assets are being safeguarded, financial results are reported accurately and timely, and performance is measured accurately" (CFO Council, 2007, p.6).

ACKNOWLEDGEMENT

The author gratefully acknowledges the research support provided by Sarah Martin, MBA, and LCDR Rex Aman, research assistant and MBA student, respectively, at the Naval Postgraduate

School. Thanks also for the technical assistance from my colleagues in the NPS accounting faculty: Chong Wang, and Danny Matthews.

REFERENCES

- Amos, T. G., Paolillo, C.A. & Joseph, D.A. (1997). "Enhancing CFO, GMRA, and GPRA Implementation with Activity-Based Management. *The Government Accountants Journal*, 46 (1) 28-30.
- Association of Government Accountants. (2010). *Financial Reporting in a Dynamic, Digital World: An Overview of AGA's 2010 Executive Session*. Washington, DC: Author.
- Association of Government Accountants (2007). *Scoring Financial Management & Oversight Efforts*. Washington, DC: Grant Thornton, LLP.
- Association of Government Accountants (2006). *PAR: The Report We Hate to Love*. Washington, DC: Author.
- Association of Government Accountants (2005). *CFO Survey: Integrating Internal Control with Performance Management*. Washington, DC: Grant Thornton, LLP.
- Blann, S. W. (2010). "Auditor Independence in the Public Sector." *Government Finance Review*, 26 (4): 40-44.
- Brook, D. A. (2010). "Audited Financial Statements in the Federal Government: Intentions, Outcomes and On-Going Challenges for Managers and Policy-Making." *Journal of Public Budgeting, Accounting & Financial Management*, 22 (1): 52-83.
- Brook, D. A. (2011, Spring). "Exploring the Value of Financial Audits." *Journal of Government Financial Management*, 60 (1): 38-42.
- Candrea, P. J. (2004, Summer). "Accounting for Transformation." *Armed Forces Comptroller*, 49 (4): 7-13.
- Chief Financial Officers Council (CFO Council) and the Council of the Inspectors General on Integrity and Efficiency (2011). *The Chief Financial Officers Act of 1990 - 20 Years Later: Report to the Congress and the Comptroller General*. Washington, DC: Chief Financial Officers Council.

- Chief Financial Officers Council (2007). *Guide to the History and Activities of the CFO Council*. Washington, DC: Author.
- Collins, J. (2005). *Good to Great—What the Public Sector Can Learn From the Best Performing Businesses*. New York: HarperCollins.
- David, I. T. (1997). "The True Financial Managers in the Federal Government." *The Government Accountants Journal*, 46 (4): 57-59.
- David, I. T. (2002). "Financial information for Policy, Program and Operating Officials." *Journal of Government Financial Management*, 51 (1): 11-12.
- Defense Finance and Accounting Service (2008, December). *Fiscal Year 2008 Financial Report*: 32. Washington, DC: Author.
- Executive Office of the President, Office of Management and Budget (2010, April 14). *Testimony of Daniel I. Werfel Controller, Office of Management and Budget before the Subcommittee on Government Management, Organization, and Procurement House Committee on Oversight and Government Reform*. [On-line]. Available at www.whitehouse.gov/omb. [Retrieved March 9, 2011].
- Federal Accounting Standards Advisory Board (1996). *Overview of Federal Accounting Concepts and Standards: Reporting Relevant Financial Information, Report No. 1*. Washington, DC: FASAB.
- Federal News Radio (2010, August 18). "OMB's Werfel Sees Major Changes Coming." [On-line]. Available at www.federalnewsradio.com/?nid=697&sid=2030066 [Retrieved February 14, 2012].
- Fraser, L. M. & Ormiston, A. (2009). *Understanding Financial Statements* (9th ed.). Boston, MA: Prentice Hall.
- Gauthier, S. J. (2007, June). "Interpreting Local Government Financial Statements," *Government Finance Review*, 23 (3): 8-14.
- Glassman, J. K. (1998). "The Gang That Couldn't Keep its Books Straight." *On the Issues No. 9116* monograph. Washington, DC: American Enterprise Institute.
- Gore, A. (1993). *Reinventing Government: Creating a Government That Works Better and Costs Less*. Washington: US Government Printing Office.

- Government Accounting Standards Board (2006). *White Paper: Why Government Accounting and Financial Reporting Is—And Should Be—Different*: 6-9. [On-line]. Available at www.gasp.org/white_paper_mar_2006.html. [Retrieved October 30, 2007].
- Hale, R.F., & McGrath, E.A. (2011, July 28). "Statement before the U.S. House Armed Service Committee, Defense Financial Management and Auditability Reform Panel. Washington, DC: US Congress.
- Haller, E. J. (1983). "Wanted: A Chief Financial Officer for the Federal Government." *The Government Accountants Journal*, 32 (3): 32-36.
- IBM Center for the Business of Government. (2007, November 17). "Business of Government Hour." [On-line]. Available at <http://www.businessofgovernment.org/interview/danny-werfel-interview>. [Retrieved January 23, 2012].
- IBM Business Consulting Services (2005). *The CFO Act and Federal Financial Management: The End of the Beginning*. Washington, DC: Author.
- Jones, L. R. & McCaffery, J. L. (1993). "Implementation of the Federal Chief Financial Officers Act." *Public Budgeting & Finance*, 13 (9): 68-76.
- Knubel, J. A. (2009, Summer). "Contrasting Financial Management in the Public and Private Sectors." *Armed Forces Comptroller*, 54 (3): 43-48.
- Merrill-Lynch (n.d.). "How to Read a Financial Report." Monograph. New York: Author.
- Motley Fool. (2011). *Statement of Shareholders' Equity*. [On-line]. Available at http://wikifool.com/Statement_of_shareholders'_equity. [Retrieved February 18, 2011].
- Nikolai, L. A., Bazley, D., & Jones, J. P. (2006). *Intermediate Accounting* (11th ed.). Cincinnati, OH: South-Western College Publishers.
- Office of Management and Budget (1993). *Objectives of Federal Financial Reporting: Statement of Federal Financial Accounting Concepts, Number 1*. Washington, DC: Author.

- Osborne, D. & Gabler, T. (1993). *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector*. New York: Plume.
- President's Private Sector Survey on Cost Control (Grace Commission) (1983, Spring-Fall). *Report on Federal Management Systems*. [On-line]. Available at <http://hdl.handle.net/2027/mdp.39015015456778>. [Retrieved November 2, 2010].
- Social Security Administration (2011). *FY 2011 Annual Financial Report*. Washington, DC: Author.
- Steinberg, H. I. (1996, March). "The CFO Act: A Look at Federal Accountability." *Journal of Accountancy*, 181: 55-57.
- Stickney, C. P. (2001). *Financial Statement Analysis*. Mason, OH: Thompson Learning South-Western
- U.S. Agency for International Development (2011). *FY 2011 Annual Financial Report*. Washington DC: Author.
- U.S. Army, U.S. Army Corps of Engineers (2009). *Fiscal Year 2008 Financial Statement*. Washington, DC: Author.
- U.S. Department of Defense (2008, November 18). *Fiscal Year 2008 Agency Financial Report*. Washington, DC: Author.
- U.S. Department of Defense (2010). *Agency Financial Report for FY 2010*, Washington, DC: Author.
- U.S. Department of Defense, Office of the Inspector General. (2008). *Financial Statement Audit, Fiscal 2008: 27*. Washington, DC: Author.
- U.S. Department of Education (2011). *FY 2011 Annual Financial Report*. Washington, DC: Author.
- U.S. Department of Health and Human Services (2011). *FY 2011 Annual Financial Report*. Washington DC: Author.
- U.S. Department of Labor (2011). *FY 2011 Annual Financial Report*. Washington, DC: Author.
- U.S. General Accounting Office (1991). *The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform*. Washington, DC: Author.

- U.S. Government Accountability Office (2003). *Government Auditing Standards (2003 Revision)*. Washington, DC: Author.
- U.S. Government Accountability Office (GAO 2007). *Fiscal Year 2006 U.S. Government Financial Statement: Sustained Improvement in Federal Financial Management is Crucial to Addressing Our Nation's Accountability and Fiscal Stewardship Challenges*. Washington, DC: Author.
- U.S. Marine Corps (2008, September). *Value of United States Marine Corps Audit Readiness to the Warfighter*, monograph. Washington, DC: Author.
- U.S. Securities and Exchange Commission (2007). *Beginners' Guide to Financial Statements*. [On-line]. Available at <http://www.sec.gov/investor/pubs/begfinstmtguide.htm>. [Retrieved October 26, 2007].
- Wang, C. (2010, February 22). Unpublished e-mail communication with author. Monterey, CA: Naval Postgraduate School.
- Werfel, Danny I. (2011, June 23). Testimony before the Subcommittee on Technology, Information Policy, Intergovernmental Relations and Procurement Reform, U.S. Congress, Committee on Oversight and Government Reform.
- Yamada, Y. (2007, March). "Objectives of Financial Reporting and Their Problems in Governmental Accounting." *Government Auditing Review*, 14: 3-12.