



UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

# GAO Update: Accountability in Times of Financial and Fiscal Crisis

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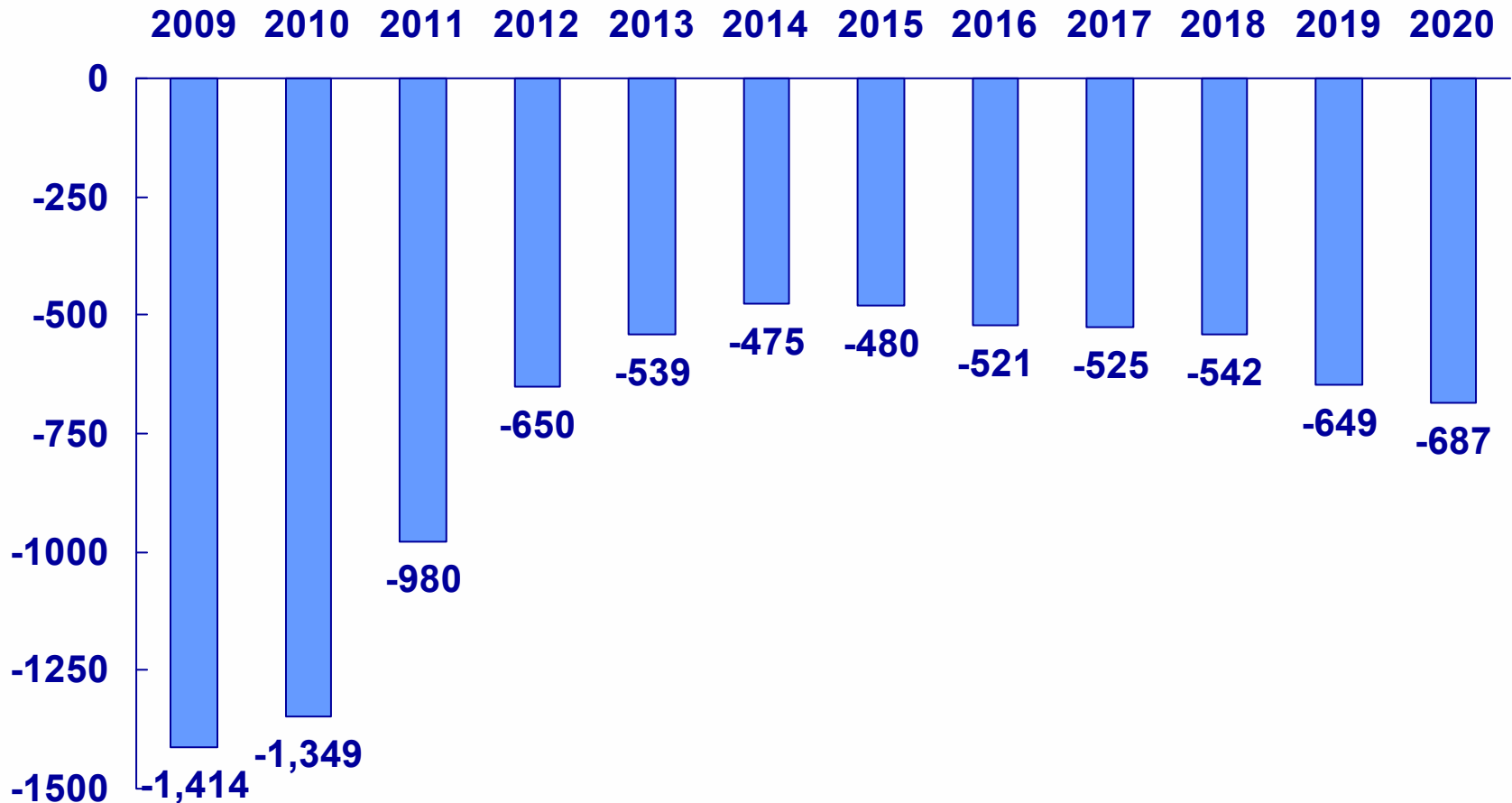


# What We Will Cover

- Current and Long-term Fiscal Outlook
- GAO Oversight of Recovery Act
- Financial System Crisis
- Disclaimer on the Consolidated Financial Statements
- Government Auditing Standards
- Current and Long-Term Challenges

# Near-Term Budget Outlook

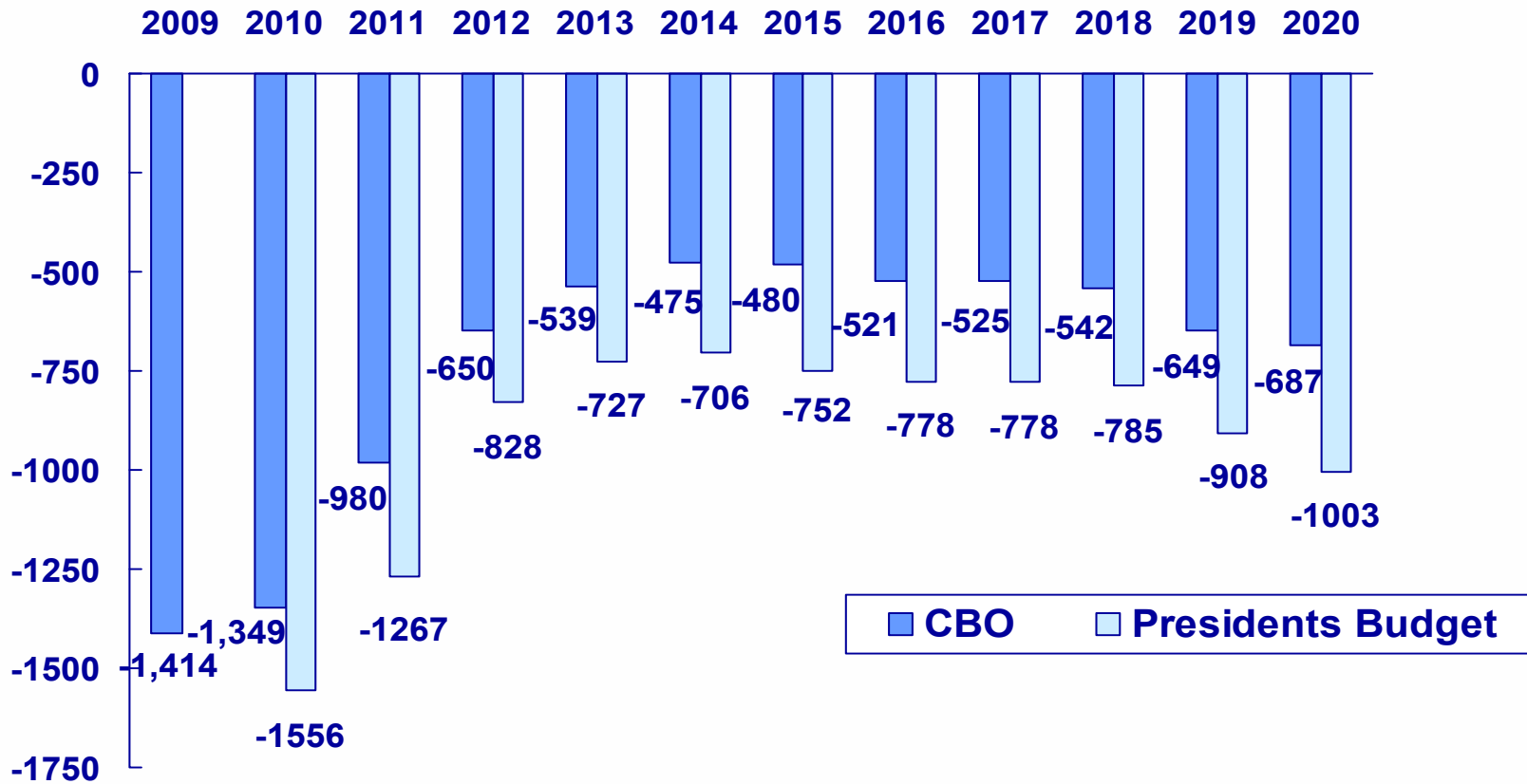
## Deficits Under CBO's January 2010 Baseline



Source: CBO's January 2010 Budget and Economic Outlook

# Near-Term Budget Outlook

## Deficits Under The President's Budget

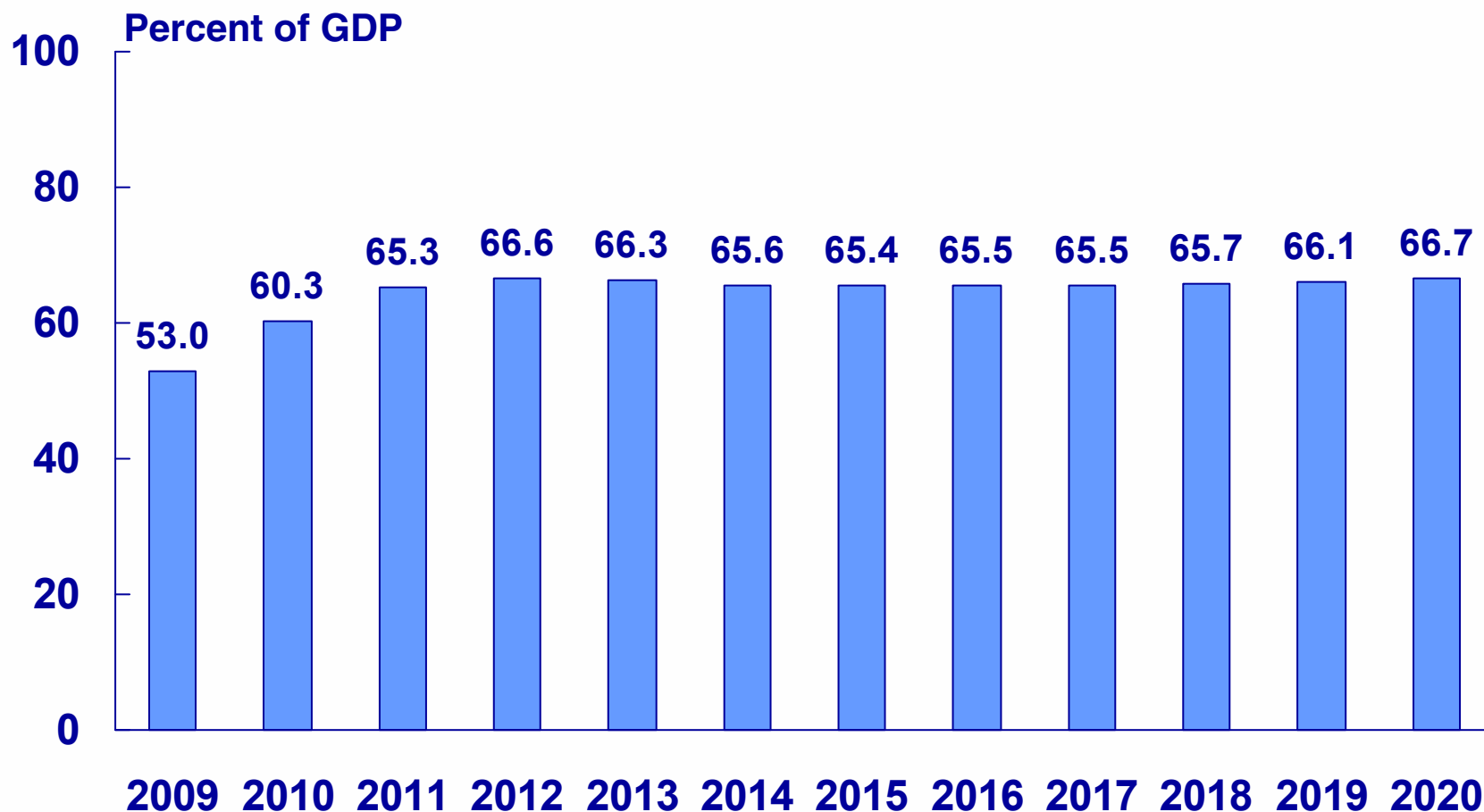


# Federal Debt Outlook

- Debt held by the public:
  - FY 2005 actual: \$4.6 trillion (37.5% of GDP)
  - FY 2008 actual: \$5.8 trillion (40.8% of GDP)
  - FY 2009 actual: \$7.6 trillion (53.8% of GDP)
  - FY 2010 projected: \$8.8 trillion (60.3% of GDP)
  - FY 2015 projected: \$12.1 trillion (65.4% of GDP)
  - FY 2020 projected: \$15.0 trillion (66.7% of GDP)

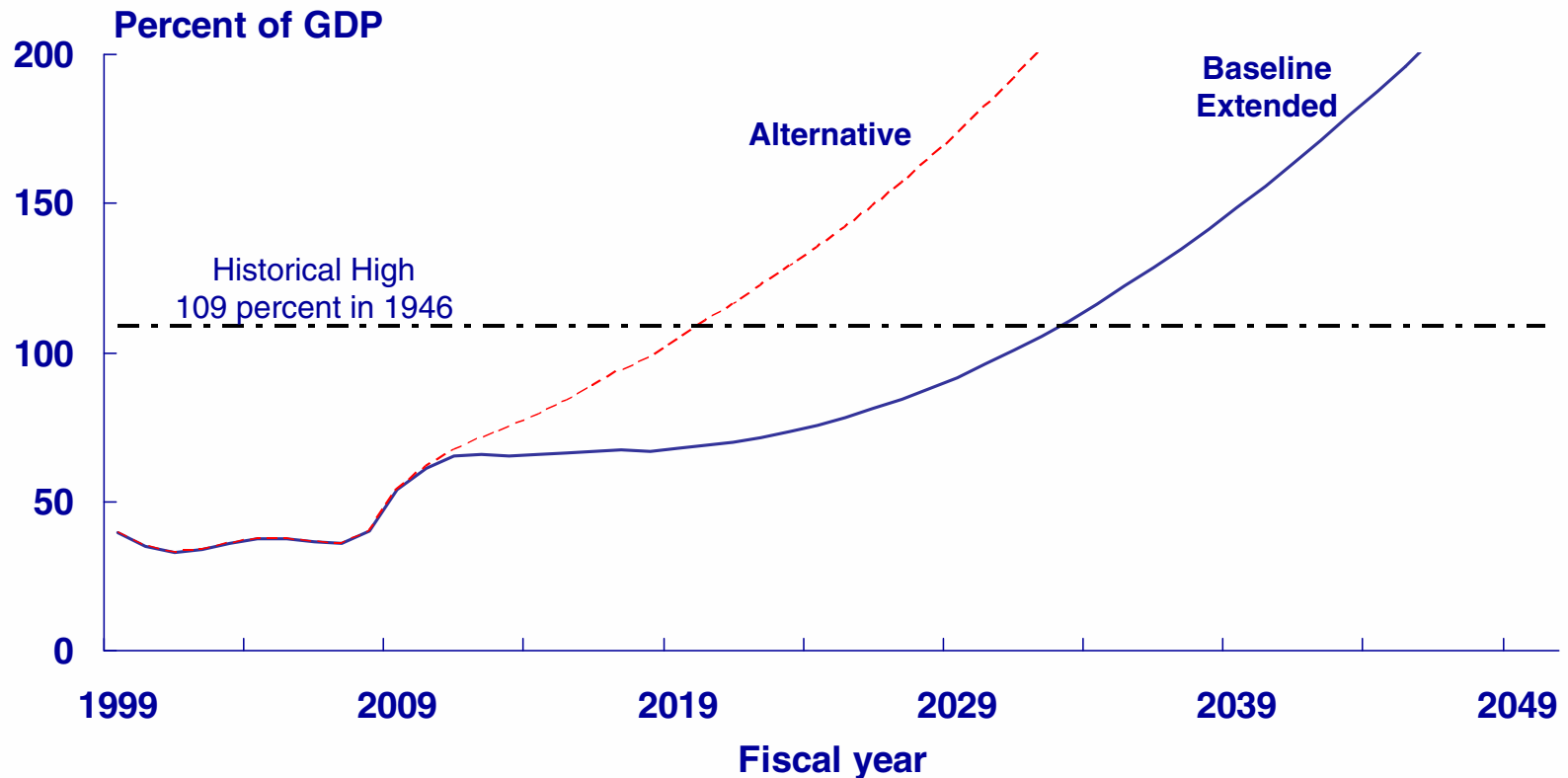
Note: Projected figures based on CBO January 2010 Update

# Debt Held by the Public Under CBO's January 2010 Baseline



Source: CBO's January 2010 Budget and Economic Outlook

# Debt Held by the Public Under GAO's Two Fiscal Policy Simulations

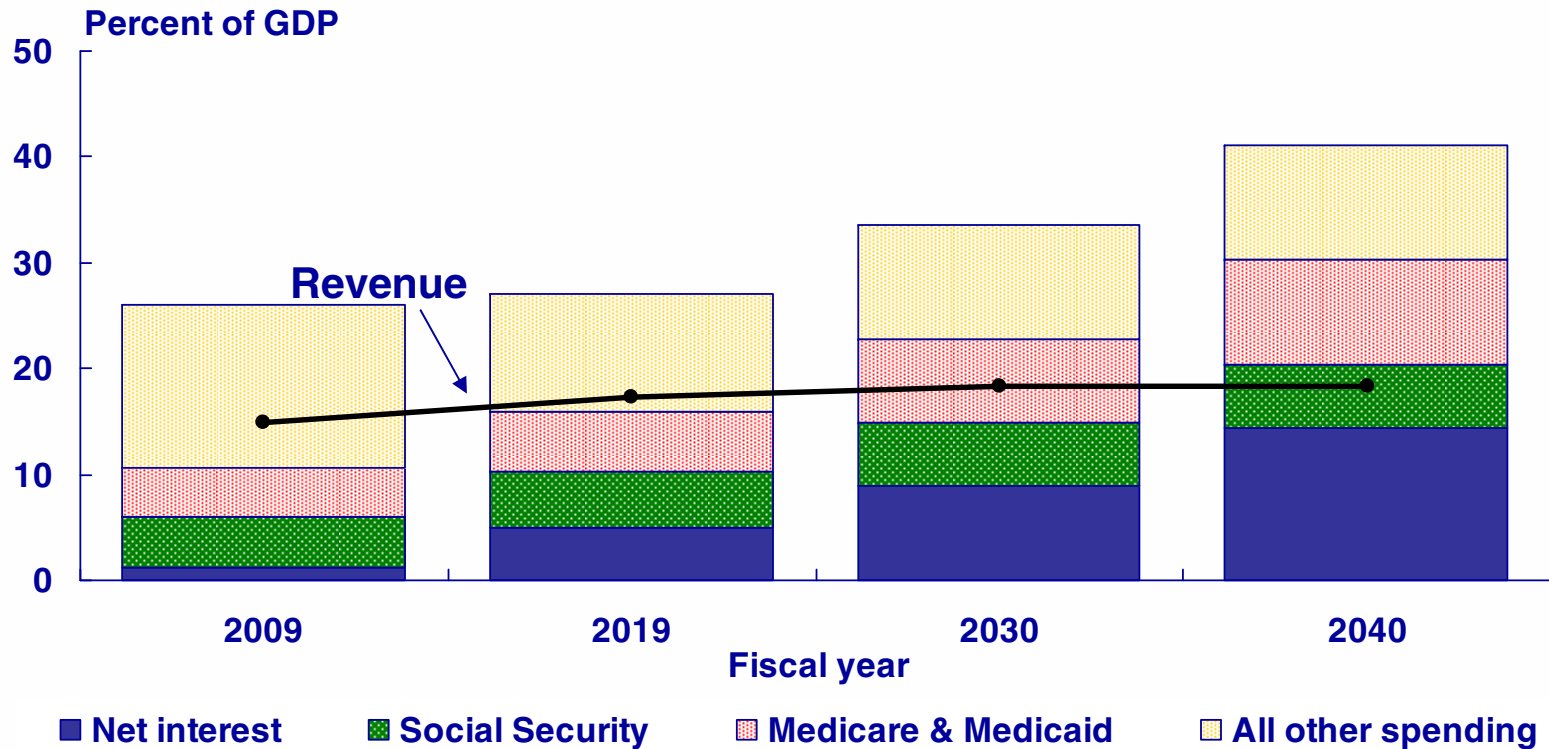


Source: GAO's Fall 2009 analysis based on the Trustees' assumptions for Social Security and Medicare.

Note: Note: Some of the increase in debt has been used to purchase financial assets as part of programs to stabilize financial markets and stimulate the economy. The value of these financial assets has not been subtracted from the total debt held by public in our simulations.

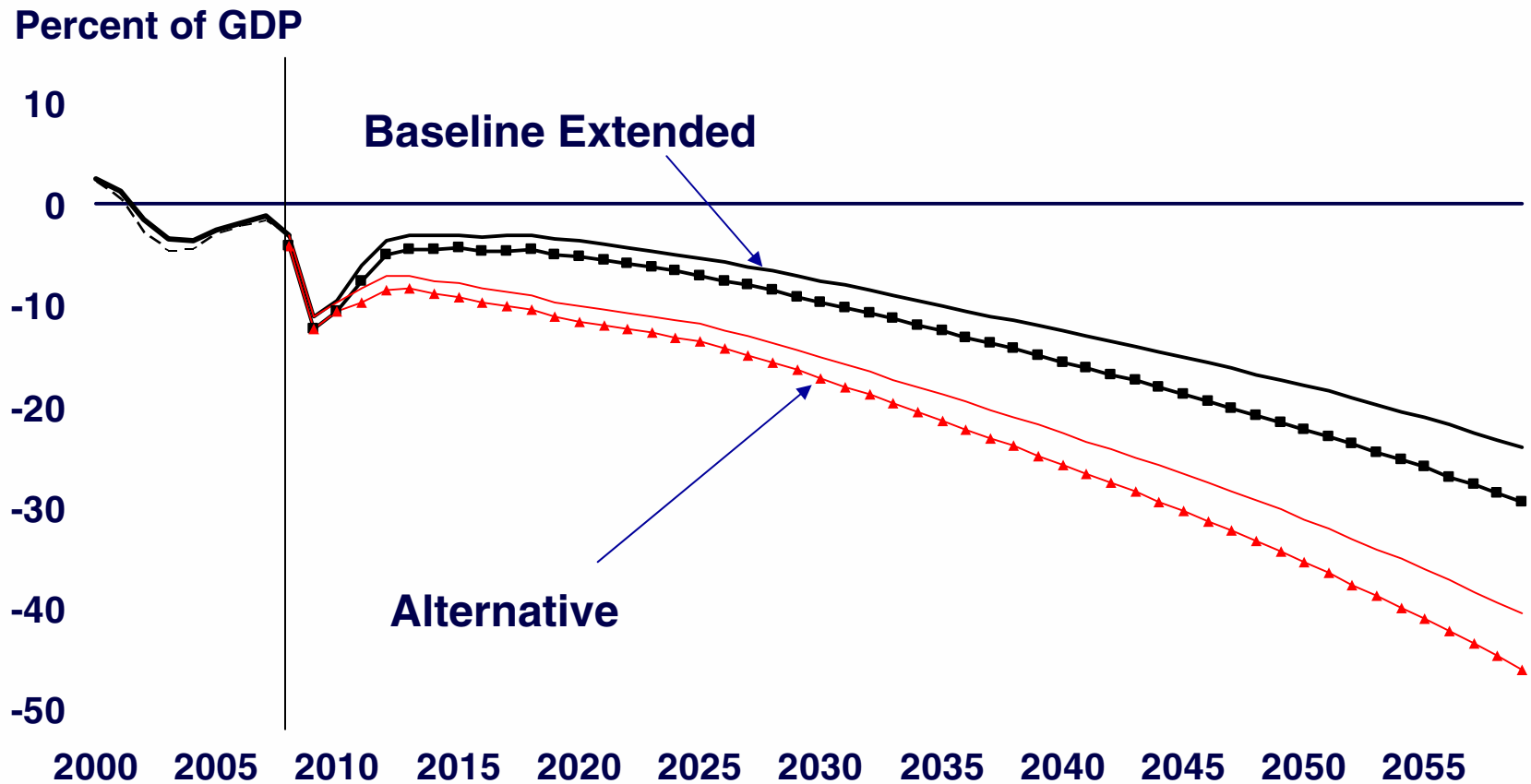
# Potential Fiscal Outcomes

## Revenues and Composition of Spending Under Alternative Simulation



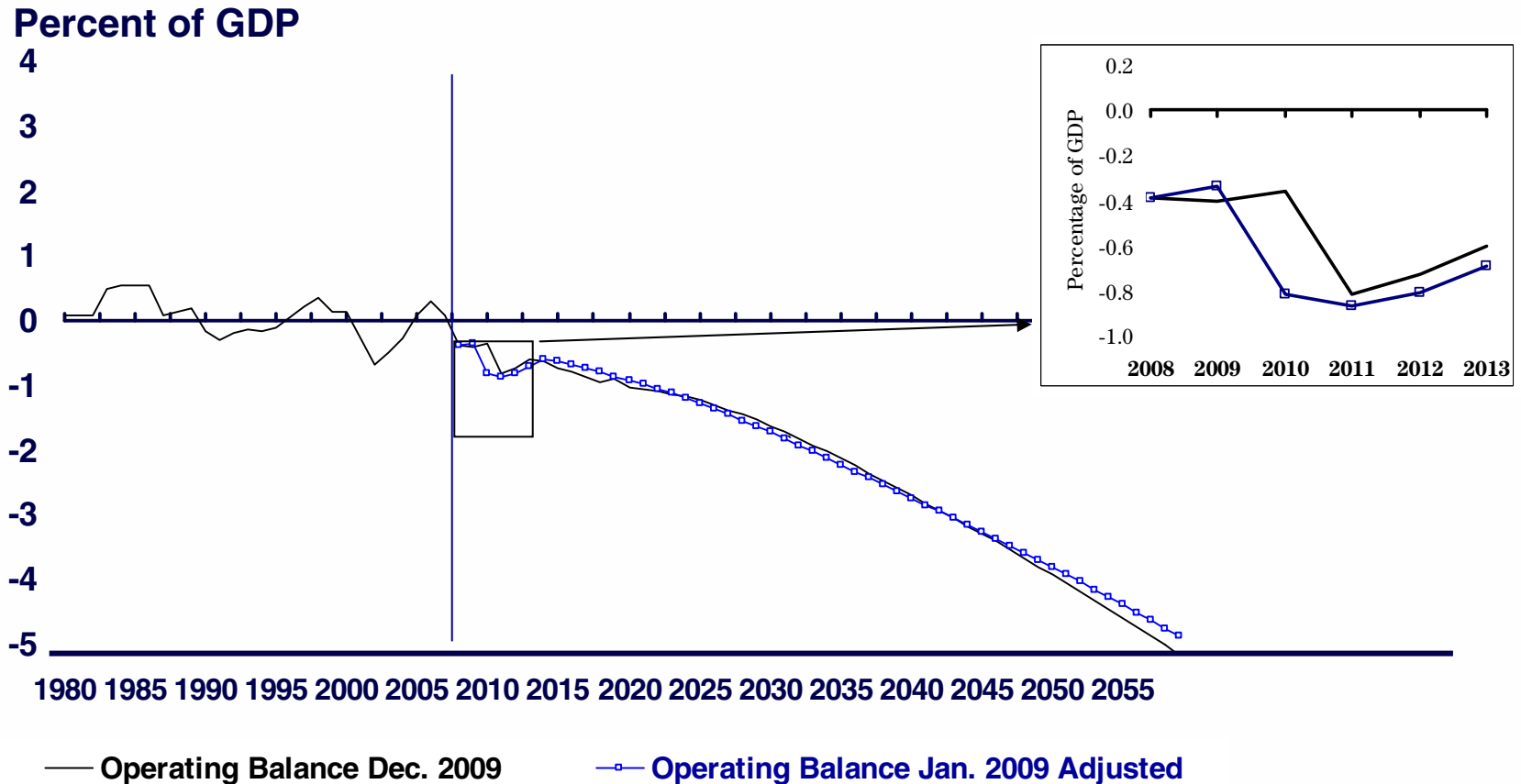
Source: GAO's Fall 2009 analysis based on the Trustees' assumptions for Social Security and Medicare.

# Federal and State/Local Surpluses and Deficits



Source: GAO Simulations, updated Dec. 2009

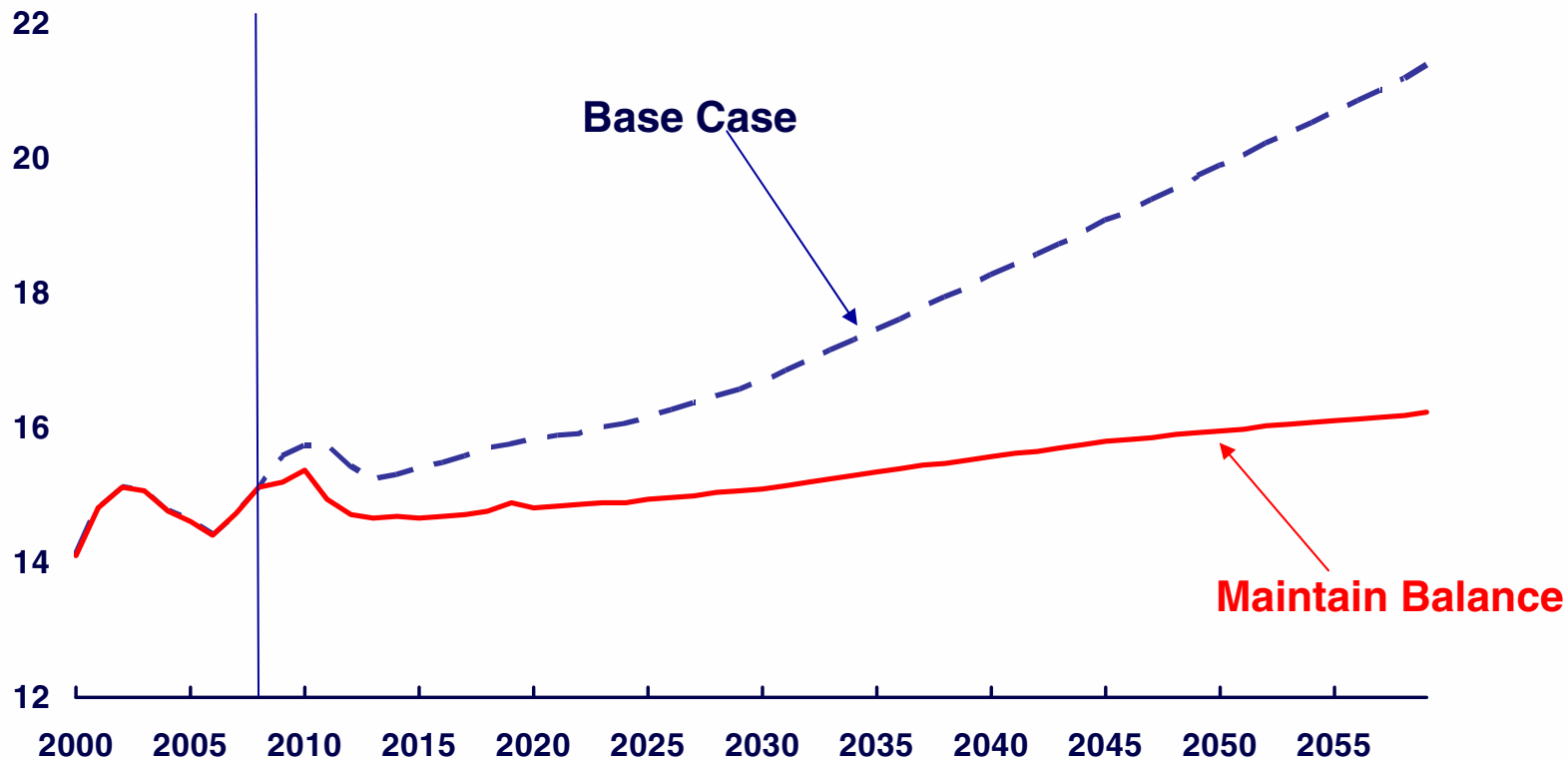
# State and Local Governments Face Short-Term Declines and Growing Long-Term Fiscal Challenges



Source: GAO Simulations, updated Dec. 2009 and January 2009 adjusted

# Extent of State and Local Government Action Required to Maintain Balance

State and Local Expenditures, as a Percent of GDP



Source: GAO Simulations, updated Dec. 2009

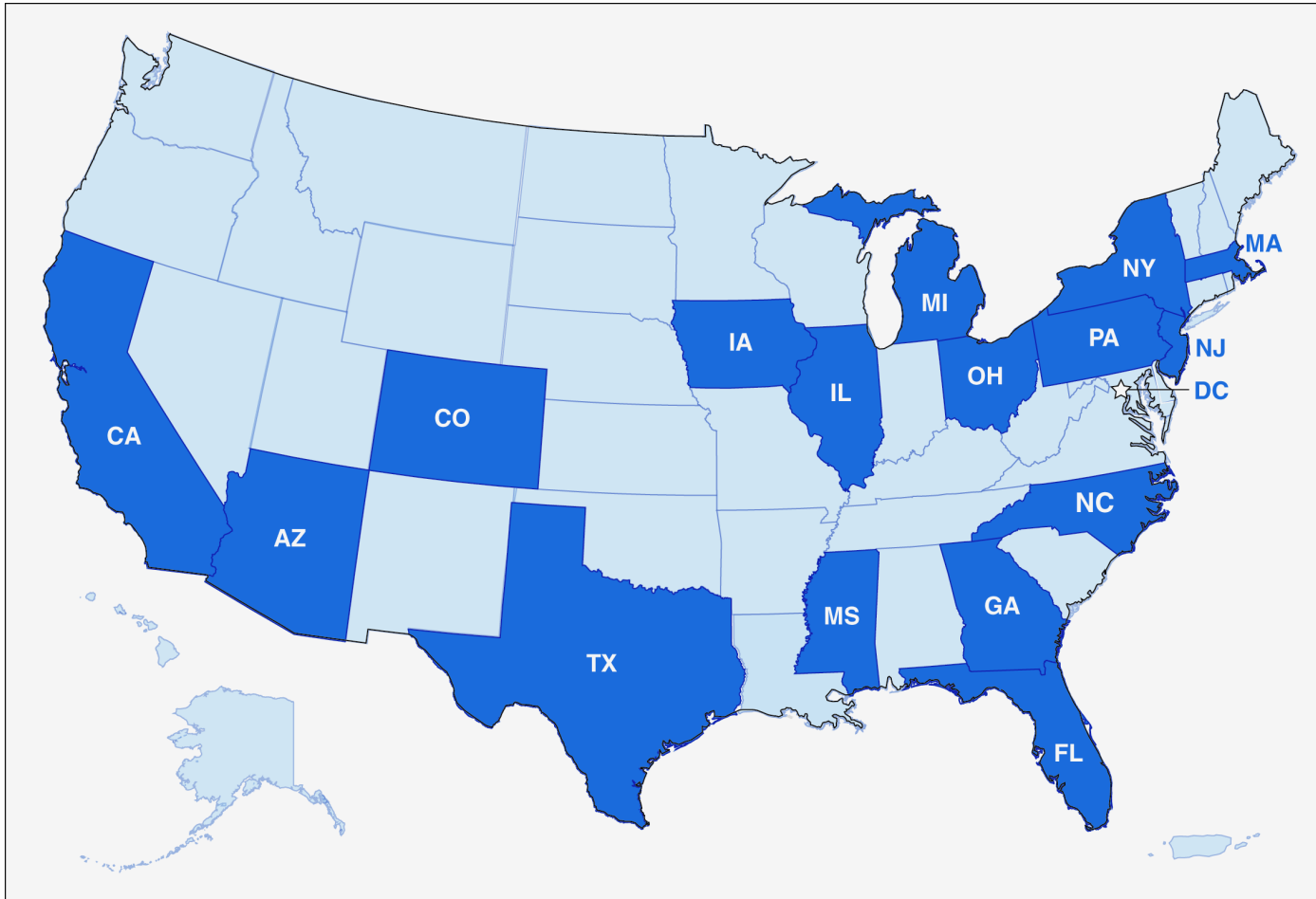
# American Recovery & Reinvestment Act

- Signed February 17, 2009
- Purposes:
  - preserve and create jobs and promote recovery
  - assist those most impacted by the recession
  - invest in science and health-care technology
  - invest in infrastructure
  - **stabilize state and local government budgets**
- Original Estimated Cost: \$787 Billion
- January 2010 Updated Estimate: \$862 Billion

# GAO's State and Local Reporting Strategy

- Recovery Act requires GAO to “conduct bimonthly reviews and prepare reports on such reviews on the use by **selected States and localities** of funds made available in this Act.”
- Strategy
  - *Longitudinal study* of 16 states and the District of Columbia
  - *Selection criteria* based on the stated purposes of the Recovery Act
  - *Additional states* added as other events dictate, including ongoing GAO work
  - *Localities* sampled within selected states
  - *GAO senior executives* to coordinate with each selected state

# GAO's Monitoring of Selected States



1. Arizona
2. California
3. Colorado
4. Florida
5. Georgia
6. Illinois
7. Iowa
8. Massachusetts
9. Michigan
10. Mississippi
11. New Jersey
12. New York
13. North Carolina
14. Ohio
15. Pennsylvania
16. Texas
17. Washington, D.C.

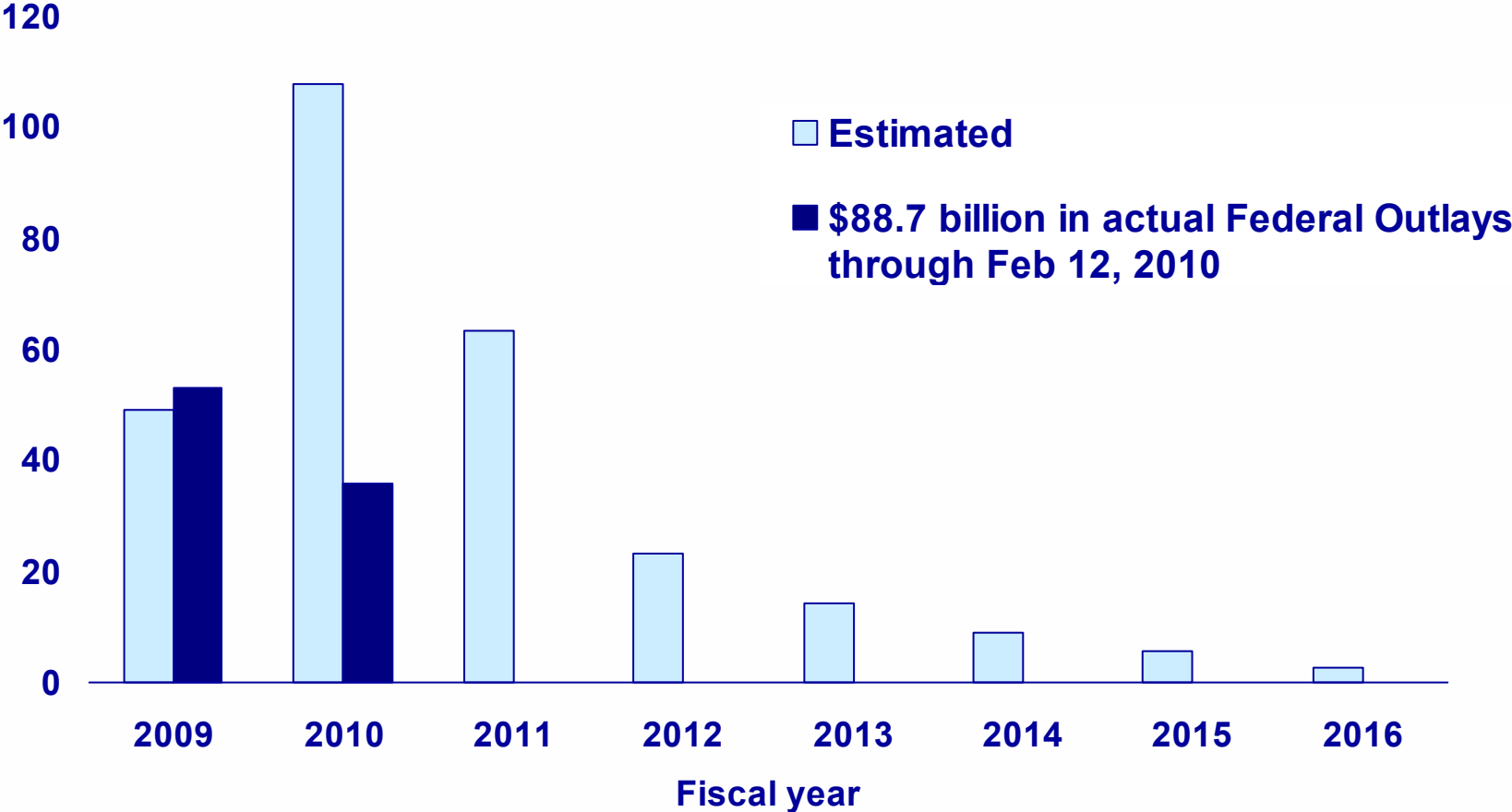
Source: GAO analysis.

# GAO's Reporting Objectives

1. States' and localities' use of funds
2. States' and localities' up-front safeguards and ongoing monitoring, audits, and evaluations
3. States' and localities' plans to evaluate the impact of funds

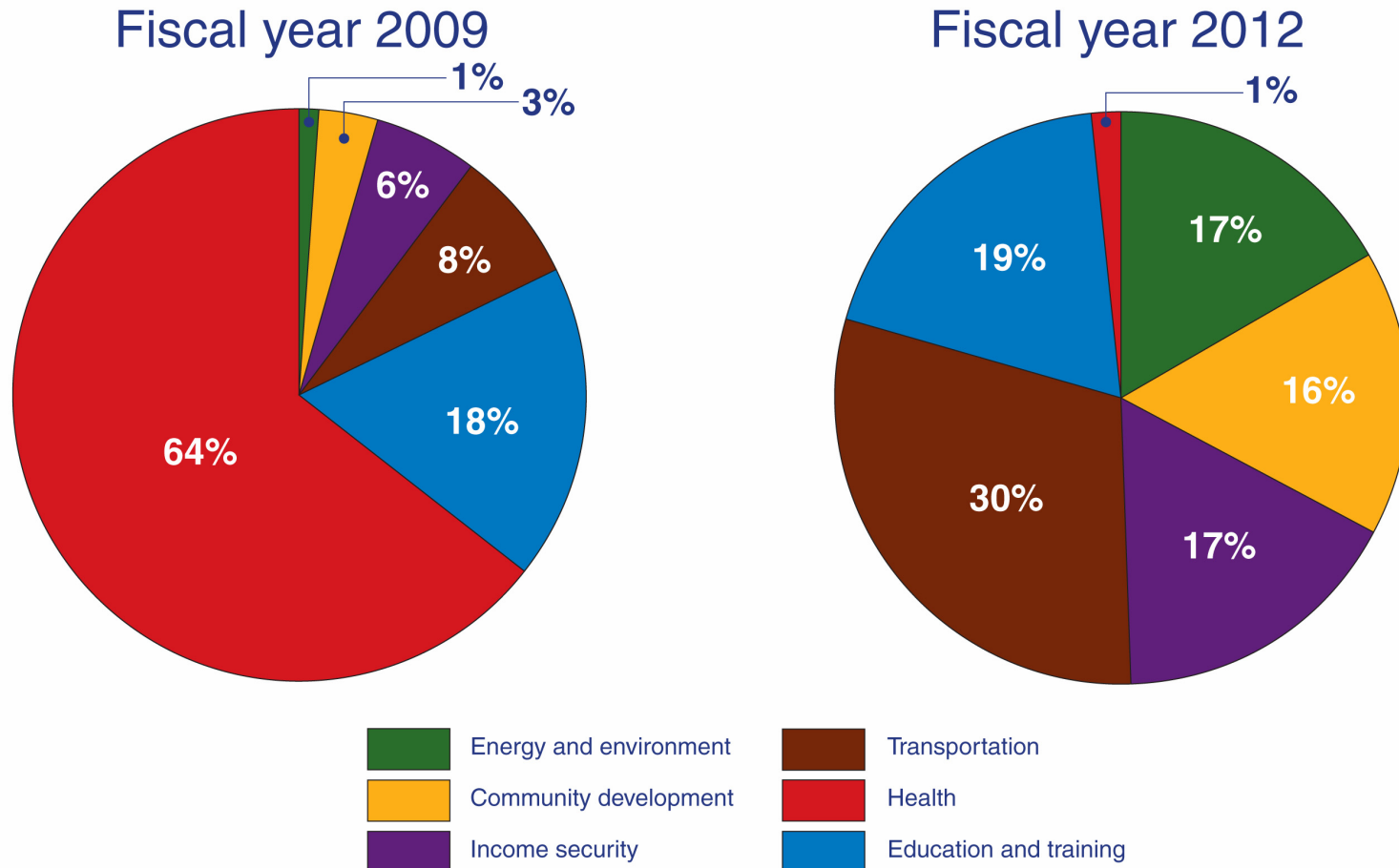
# Projected versus Actual Federal Outlays to States and Localities under the Recovery Act

Outlays in billions of dollars



Source: GAO analysis of data from CBO, Recovery.gov and Federal Funds Information for States.

# Composition of State and Local Recovery Act Funding, Fiscal Year 2009 versus Fiscal Year 2012



Source: GAO analysis of CBO and FFIS data.

# Recovery Act Oversight GAO Recommendations

## Accountability and Transparency

- Leverage Single Audit as an effective oversight tool
  - Earlier reporting on internal controls; focus on Recovery Act programs; relief for low-risk programs
  - Develop mechanisms to fund more timely, effective Single Audits
  - Take steps to enhance internal control pilot project
- Clarify accountability for recipient report data and federal review
- U.S. Department of Education review and assistance for developing state monitoring plans for the State Fiscal Stabilization Fund
- U.S. Department of Housing and Urban Development criteria for selecting housing agencies for on-site reviews, develop a plan for recapture and reallocation of funds prior to the obligation deadline
- U.S. Department of Transportation review of states' maintenance of effort requirements and state reporting requirements

# Recovery Act Oversight GAO Recommendations

## Communication and Guidance

- Addition of a master schedule for and centralized approach to providing federal Recovery Act program guidance
- More direct communication on funds flowing to each state Expedite consideration of states' alternative administrative cost reimbursement proposals
- Specify data quality, certification and approval requirements
- Clarify guidance on project selection in economically distressed areas
- Continue U.S. Department of Transportation outreach to state DOTs and transit agencies on reporting requirements
- Provide U.S. Department of Labor guidance on youth employment and training in green jobs and work readiness outcomes

# Recovery Act Oversight GAO Recommendations

## Reporting on Impact

- Provide examples of reporting on jobs created and retained
- Clarify new or existing program performance measures
- Work with federal agencies to educate state and local program officials on reporting
- The Director of OMB clarify what other program performance measures recipients are expected to report on to demonstrate the impact of Recovery Act funding.

# OMB Pilot Project: Interim Internal Control Reporting

- Single Audit Internal Control Project
  - Encourage auditors to identify and communicate significant deficiencies and material weaknesses for selected Recovery Act programs 3 months earlier than current 9-month timeframe
  - 16 states volunteered to participate
  - Coverage
    - about 16 percent of Recovery Act obligations
    - About 23 percent of Recovery Act outlays

# Single Audits: GAO Matter for Congressional Consideration

- GAO matter for Congressional consideration:
  - To the extent that appropriate adjustments to the Single Audit process are not accomplished, Congress should consider amending the Single Audit Act or enact new legislation that provides for more timely internal control reporting, as well as audit coverage for smaller Recovery Act programs with high risk.
  - To the extent that additional audit coverage is needed to achieve accountability over Recovery Act programs, Congress should consider mechanisms to provide additional resources to support those charged with carrying out the Single Audit and related audits.

# U.S. Government's Response to the Crisis in the Financial Markets

## Housing and Economic Recovery Act of 2008 (HERA)

- Established the Federal Housing Finance Agency (FHFA) to oversee the housing GSEs: Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System.

Treasury, pursuant to HERA, took steps to help ensure the solvency and liquidity of the GSEs, and instill confidence in their viability

- Preferred stock purchase agreements with Fannie and Freddie
- Established a line of credit for the GSEs, and
- Established a GSE mortgage backed security purchase program

# U.S. Government's Response to the Crisis in the Financial Markets

## Preferred Stock Purchase Program-- GSEs

- Started at \$100 billion each for Fannie and Freddie, then increased to \$200 billion, now unlimited.
- Fannie and Freddie had utilized \$95.6 billion under this program as of September 30, 2009.
- Treasury recorded a liability of \$91.9 billion for this program as of September 30, 2009.

## Mortgage Back Securities Purchase Program

- As of September 30, Treasury had purchased \$214.4 billion in agency MBS, and had received back \$36.2 billion in principal and interest.
- This program, and the GSE line of credit expired on December 31, 2009.

# U.S. Government's Response to the Crisis in the Financial Markets

- The Federal Reserve has been purchasing substantial amounts of Fannie and Freddie debt and securities, to support housing finance, housing markets, and the financial markets in general.
- Administration has stated that it will develop a policy on the future of the GSEs and the federal government's role in the mortgage market in early 2010.

# Troubled Asset Relief Program (TARP)

- On October 3, 2008, the Emergency Economic Stabilization Act of 2008 was signed into law.
- The act established the Office of Financial Stability (OFS) within the Department of the Treasury and created the TARP.
- The act provides Treasury with broad, flexible authorities to buy or guarantee up to \$700 billion in “troubled assets,” which include mortgages and mortgage-related instruments, and any other financial instrument whose purchase Treasury determines is needed to stabilize the financial markets.

# Status of Troubled Asset Relief Program Outstanding Balances

- As of February 26, 2010, Treasury had disbursed about \$378 billion of the almost \$700 billion in program funds, and had received repayments of about \$174 billion.
- A total of about \$202 billion remains outstanding (see table below).

## Status of TARP Funds as of February 26, 2010 (dollars in billions)

<b>Program</b>	<b>Outstanding Balance</b>
Capital Purchase Program	\$72.8
AIG	47.5
Targeted Investment Program	0.0
Term Asset-backed Securities Loan Facility	0.1
Automotive Industry Financing Program	76.3
Public Private Investment Program	5.5
<b>Totals</b>	<b>\$202.2</b>

# Status of Troubled Asset Relief Program

## Net Income (Cost)

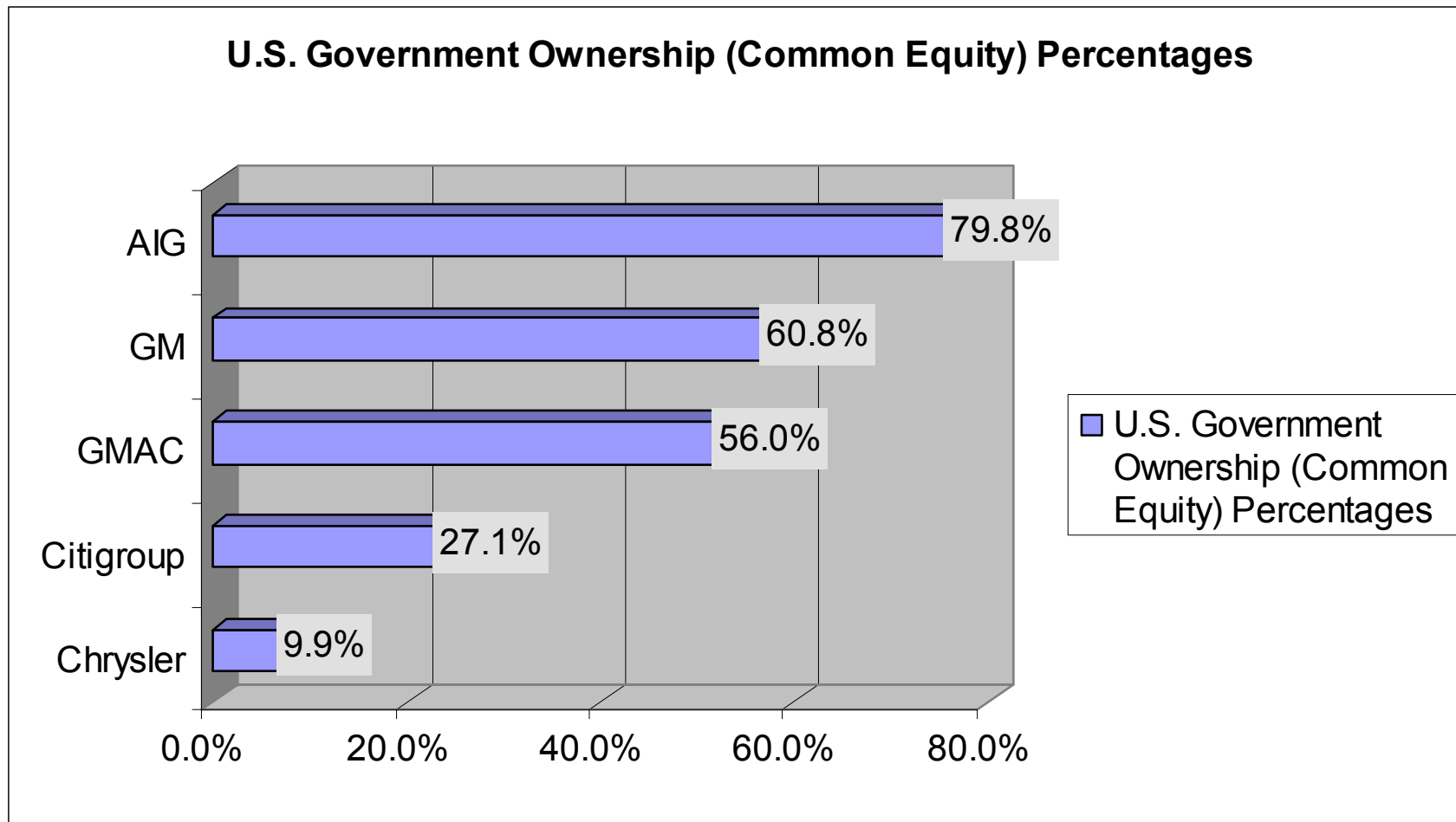
•For the period ended September 30, 2009, Treasury's Office of Financial Stability reported a total net cost of \$41.6 billion for current TARP assets.

**Net Income (Cost) by Program for the period ended Sept 30, 2009 (dollars in billions)**

<b>Program</b>	<b>Net Income (Cost)</b>
Capital Purchase Program	15.0
Targeted Investment Program	1.9
Asset Guarantee Program	2.2
Term Asset-backed Securities Loan Facility	0.3
AIG	(30.4)
Automotive Industry Financing Program	(30.4)
Home Affordable Modification Program	(0.0)*
Administrative Costs	(0.2)
<b>Totals</b>	<b>(41.6)</b>

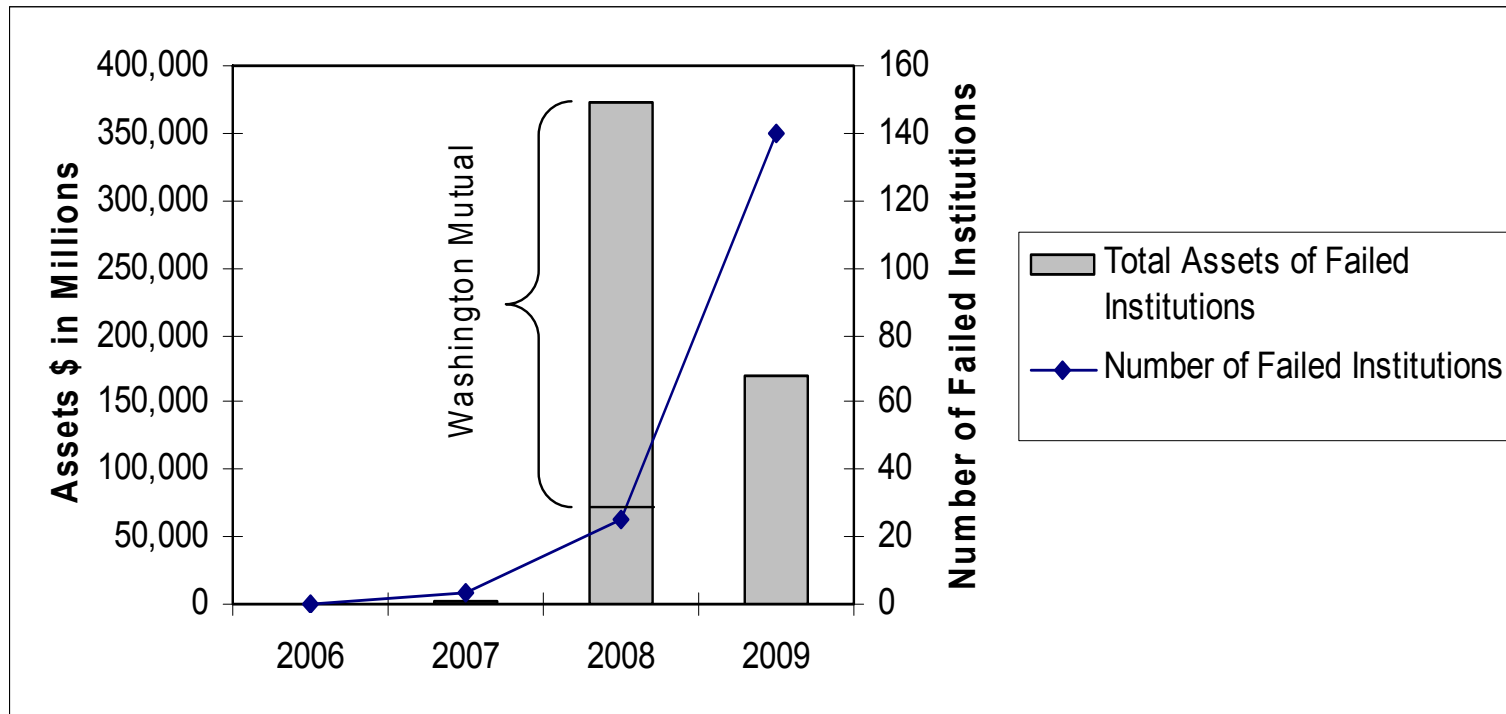
\*HAMP Net Cost for the period ended Sept 30, 2009, was about (\$2 million).

# Status of U.S. Government Ownership of Selected Companies



AIG, GM, and Chrysler – As of Sept. 30, 2009; GMAC and Citigroup – As of Dec. 31, 2009

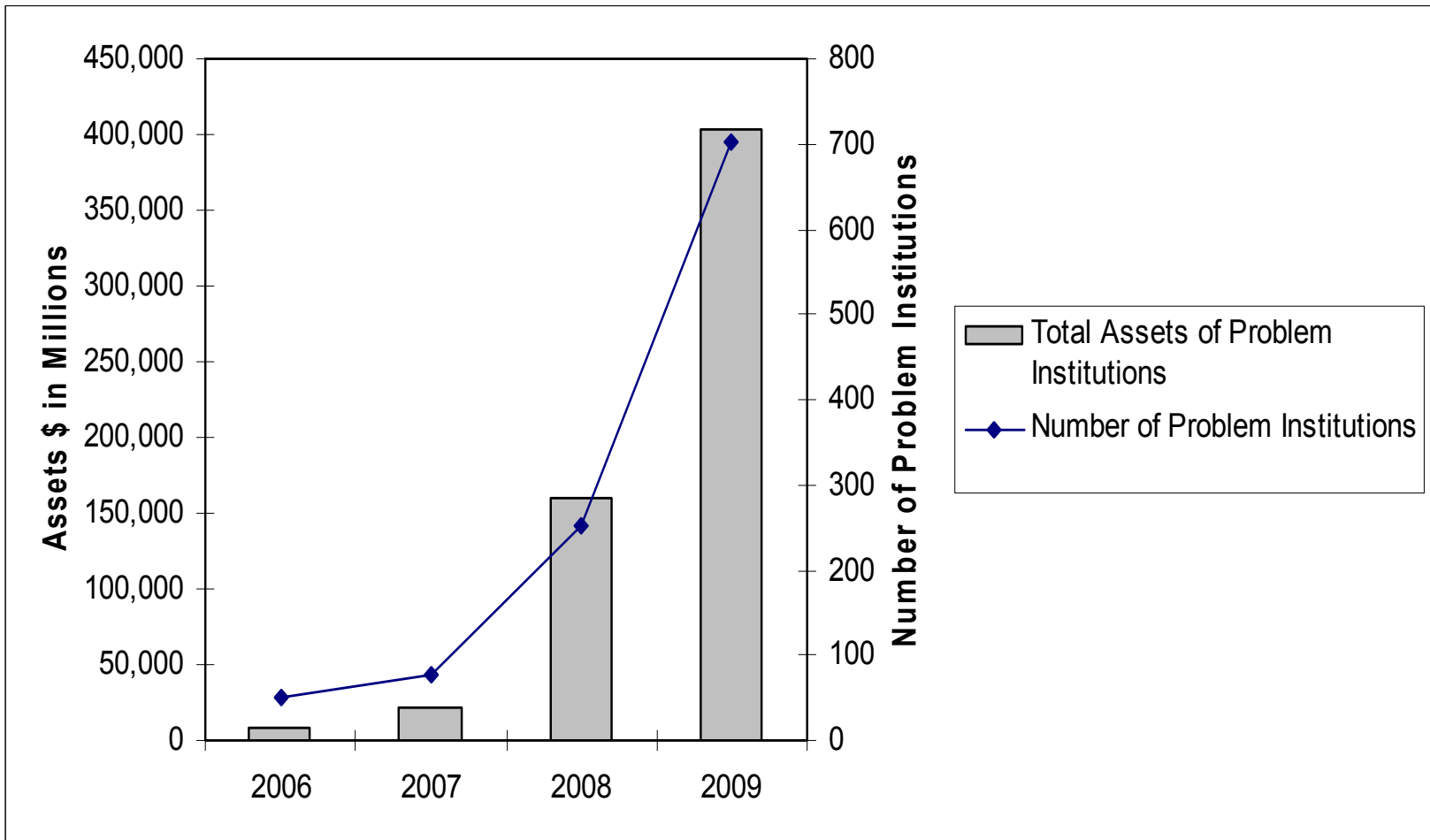
# FDIC Insured Banks: Total Assets/Number of Failed Institutions



- For 2010 (as of 2/26/2010), there were 22 failed institutions with total assets of approximately \$16 billion.
- In 2008, Washington Mutual Bank failed, which had total assets of approximately \$300 billion.

Source: FDIC

# Total Assets/Number of Problem Institutions

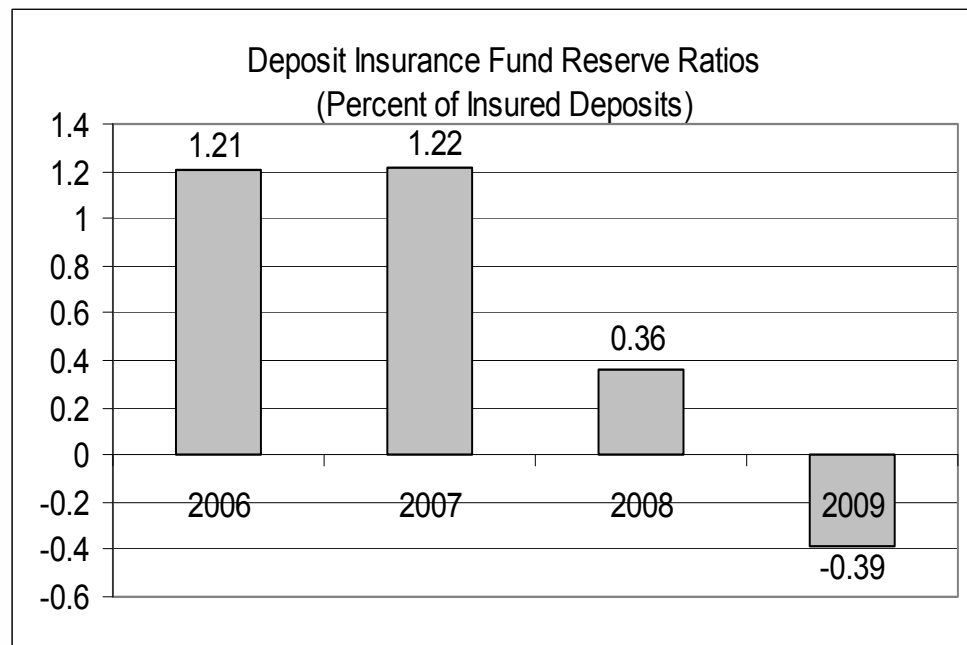


Source: FDIC

# Deposit Insurance Fund (DIF) Balance and Reserve Ratios

Deposit Insurance Fund Balance and Insured Deposits (\$ Millions)

	DIF Balance	DIF-Insured Deposits
2006	50,165	4,153,786
2007	52,413	4,292,221
2008	17,276	4,750,608
2009	-20,850	5,391,876



- Effective, January 1, 2007, the designated reserve ratio by law must be within a range of 1.15 percent to 1.50 percent. The designated reserve ratio is calculated by dividing the DIF fund balance by total amount of DIF insured deposits.

Source: FDIC

# MEASURES TO CONSERVE AND RESTORE THE DIF

## **Loss Share Agreements (as of December 31, 2009)**

- Number of loss share agreements: 93
- Covered assets under loss share agreements: over \$125 billion
- Projected loss share payment liability: over \$20 billion

## **Higher Premiums and Prepaid Assessments**

- In September 2009, the FDIC Board adopted a restoration plan to allow the DIF to return to a reserve ratio of 1.15 percent within eight years, as mandated by law.
- As part of the restoration plan, the FDIC Board adopted higher annual risk based assessment rates, effective January 1, 2011.
- The FDIC Board also required insured institutions to prepay 13 quarters worth of deposit insurance premiums, amounting to approximately \$46 billion (collected on December 30, 2009).

Source: FDIC

# Outdated Regulatory System

Risks posed by:

- Emergence of large, complex, and interconnected financial conglomerates
- Less-regulated entities are playing increasingly critical roles in the financial system
- New and complex products pose challenges to system stability and consumer protection

# For Crafting or Assessing Regulatory Reform Proposals: GAO Framework— 9 Essential Characteristics

- Clearly defined regulatory goals in statute
- Appropriately comprehensive
- Systemwide focus
- Flexible and adaptable
- Efficient and effective
- Consistent consumer and investor protections
- Regulators provided with independence, prominence, authority, and accountability
- Consistent financial oversight
- Minimal taxpayer exposure

# Financial Report of the U.S. Government, Fiscal Year 2009

- GAO disclaimer of opinion on the consolidated financial statements.
- Material weaknesses in financial reporting and other limitations on the scope of our work prevented us from expressing an opinion on the financial statements other than the 2009 and 2008 Statements of Social Insurance.

# Financial Report of the U.S. Government, Fiscal Year 2009

## **Major impediments prevent us from rendering an opinion on the consolidated financial statements:**

1. Serious financial management problems at the Department of Defense,
2. The federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and
3. The federal government's ineffective process for preparing the consolidated financial statements.

# Financial Report of the U.S. Government, Fiscal Year 2009

## **Additional material weaknesses involve the federal government's inability to:**

1. determine the full extent to which improper payments occur and implement the necessary actions to cost-effectively reduce improper payments,
2. identify and resolve information security control deficiencies and manage information security risks on an ongoing basis, and
3. effectively manage its tax collection activities.

# Financial Report of the U.S. Government, Fiscal Year 2009

Key figures from the financial statements (billions):

	2009	2008
<b>Net Operating Cost (deficit)</b>	<b>(1,255)</b>	<b>(1,009)</b>
<b>Net Position (Assets - Liabilities)</b>	<b>(11,457)</b>	<b>(10,203)</b>
<b>Social Insurance Responsibilities</b>		
Social Security	(7,677)	(6,555)
Medicare (Parts A, B, & D)	(38,107)	(36,312)
Other	<u>(94)</u>	<u>(95)</u>
<b>Total Social Responsibilities</b>	<b>(45,878)</b>	<b>(42,962)</b>

# Financial Report of the Government, FY 2009

Three main themes:

- Current deficits and debt levels
- The government's ongoing efforts to stimulate and facilitate economic recovery
- The government's capacity to sustain the funding and pay the benefits of key social programs, such as Social Security and Medicare

# Yellow Book: Revisions Under Consideration

- Independence
  - Independence assessment framework
  - Likely Eliminate the independence Q&As
- Financial Audits
  - Streamlining and converging with AICPA standards
- Attestation engagements
  - Define an audit as providing “reasonable assurance”
  - Eliminate Agreed-Upon Procedures and Review level attestation engagements
- Performance audits
  - No major revisions expected

# 2011 Yellow Book Projected Dates

## **June 2010:**

- Issue Exposure Draft of 2011 Revision

## **September 2010:**

- Comments due on Exposure Draft

## **June 2011:**

- Issue 2011 Revision of GAGAS

## **Advisory Council Observation:**

- Timeframe is ambitious but doable

# Short-Term and Long-Term Challenges

- The Government's immediate challenge is to continue to manage the many investments that have been made to stabilize and strengthen the nation's economy.
- However, the Government must also keep sight of the long-term fiscal imbalance resulting from the demands on the nation's social insurance programs, notably Medicare, Medicaid, and Social Security. The Government's fiscal policies for these programs as currently structured are not sustainable.

# Short-Term and Long-Term Challenges

- Without changes, spending for Medicare, Medicaid, and Social Security would permanently and dramatically increase the Government's budget deficit and debt leading to renewed financial and economic instability.
- Serious weaknesses exist in the current U.S. financial regulatory system, which, if not effectively addressed, may cause the system to fail to prevent similar or even worse crises in the future.
- Another concern is the failure or threatened viability of numerous financial institutions insured by FDIC, and the significant stress on the FDIC's Deposit Insurance Fund.

# Short-Term and Long-Term Challenges

- Fiscal Commission?
- Health Care Reform?
- Tax Laws?
- Fiscal Health of the States?
- Recovery Act, Part II?
- Jobs bills?
- Future of Fannie Mae and Freddie Mac?
- Federal Reserve Exiting the Housing Finance Markets?
- Financial Regulatory Reform?
- Economic Recovery?
- Long-term structural changes?

# Concluding Thoughts

**“If there is no struggle, there is no progress.”**

Frederick Douglass (1818 – 1895)

*American abolitionist, women's suffragist, editor, orator, author, statesman and reformer.*