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FINANCIAL MANAGEMENT

Challenges Facing DOD in Meeting the Goals of the Chief Financial Officers Act

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GAO/T-AIMD-96-1

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the Department of Defense's (DOD) efforts to implement the Chief Financial Officers (CFO) Act. This act has been instrumental in helping the Department understand the depth and magnitude of its financial management problems and start on a course towards corrective measures. Today, as you asked, we will highlight the results of financial audits since the passage of the CFO Act and provide our perspective on the major challenges facing the Department in meeting the act's objectives.

Achieving the reforms required by the CFO Act is essential because DOD needs accurate financial information and appropriate internal controls to effectively manage the Department's vast resources—over $1 trillion in assets, 3 million military and civilian personnel, and a budget of over $250 billion for fiscal year 1995. Unfortunately, the Department does not yet have adequate financial management processes in place to produce the information it needs to support its decision-making process. No military service or other major DOD component has been able to withstand the scrutiny of an independent financial statement audit.

As discussed in our high-risk series,[1] this failure has serious implications. Good financial management runs deeper than the ability to develop accurate financial records. It is being able to provide managers with clear visibility and control over inventories, being able to accurately project material needs, and being able to effectively balance scarce resources with critical needs. In short, effective financial management is essential to ensuring that DOD's resources are productively employed in meeting our nation's defense objectives.

The Department has recognized the seriousness of its financial management problems and the need to take action. Secretary Perry and Under Secretary Hamre, who serves as DOD's CFO, have been candid in their assessments of the status of current processes and practices. The Department's financial reform goals—presented in its February 1995 "Blueprint"—offer a good perspective of the corrective actions which must be taken. This approach represents an important first step in committing DOD to real action. However, very serious management challenges face the Department as it moves to make the blueprint a reality.

[1] High-Risk Series: An Overview (GAO/HR-95-1, February 1995).

Given the serious and pervasive nature of DOD's financial management problems, and the need for more immediate progress, the Department needs to consider additional steps to fix its long-standing weaknesses. As we testified in May 1995,[2] DOD needs to take several immediate actions to turn Secretary Perry's blueprint into substantive improvements, including (1) assessing the number and skill level of its financial management workforce and (2) establishing an outside board of experts to provide counsel, oversight, and perspective to reform efforts. In addition, we have questions about whether DOD's systems improvement strategy will produce the needed improvements in a timely manner and whether enough actions are planned to address the Department's deep-rooted organizational impediments to attaining meaningful change.

We are in the process of more closely examining these issues and DOD's other specific improvement strategies as requested by the Chairman of the Subcommittee on Defense, Senate Committee on Appropriations. We plan to provide our assessment and recommendations next spring. In the interim, we will continue to work with DOD in providing our views on ways to build upon its improvement efforts.

The following sections summarize the serious financial problems facing the Department, the actions it plans to take, and the difficult issues that it must address to overcome its problems.

CFO Act Audits Have Brought Greater Clarity to DOD's Financial Management Problems

The CFO Act requirements have served as an important catalyst for focusing attention on the financial problems facing the Department. The regular preparation of financial statements and independent audit opinions, in particular, is bringing greater clarity to the scope and depth of DOD's financial management problems and needed solutions. These annual public report cards also are generating increased pressure on DOD management to fix its long-standing problems.

GAO performed the initial financial audit of the Army general fund operations under the CFO Act pilot program, as well as an early assessment of the Air Force's ability to meet the act's requirements. Also, we will soon release the results of our review of the Navy's financial reporting. Throughout our audit work, we developed and maintained a close working relationship with the DOD Inspector General (IG) and the military services' audit agencies. They have assumed responsibility for the

[2]Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-146, May 23, 1995).

audits of the Air Force and Army general funds over the past few years and have had responsibility for audits of the Department's $80 billion Defense Business Operations Fund (DBOF) operations since 1992. I want to commend the DOD audit community for its continuing strong support of the CFO Act. We are particularly encouraged that the DOD Inspector General and the military services' audit organizations recently pledged substantial resources to meet the expanded requirement for an audit of DOD's fiscal year 1996 consolidated financial statements resulting from passage of the Government Management Reform Act of 1994 (GMRA).

Since 1990, we and the DOD auditors have made over 350 recommendations to help resolve the financial management weaknesses identified throughout the Department. These audits have consistently identified fundamental deficiencies in the Department's financial operations. A brief recap of the recurring issues identified by these audits follows.

- Serious problems in accounting for billions of dollars in annual disbursements. Without the proper matching of disbursements with obligations there is substantial risk that (1) fraudulent or erroneous payments may be made without being detected and (2) cumulative amounts of disbursements may exceed appropriated amounts and other legal limits. CFO Act audits have shown that DOD has paid billions of dollars without being able to determine exactly what was purchased. Also, financial audits of the Air Force and Army have shown that existing controls could not be relied on to ensure that DOD did not spend more than it was authorized—a basic fund control responsibility.[3] Similar problems were disclosed in our recent review of the Navy.

  As of August 1995, DOD reported that its problem disbursements totaled about $28 billion. Of this amount, $16 billion, or 58 percent, of the problem disbursements had remained unresolved for at least 180 days. As we discuss later in this statement, DOD is taking steps to begin to address this issue.

  Also, we recently reported that DOD could not rely on its own financial data to detect errors in payments made to contractors. For example, in one case, a $7.5 million overpayment was outstanding for 8 years and

[3]Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990); Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, December 22, 1993); and Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DOD's General Fund Financial Statements (DOD Inspector General Report No. 95-301, August 29, 1995).

might not have been recovered if the contractor had not notified DOD of the overpayment. When such overpayments were identified, DOD did not always properly try to recover those overpayments, costing the government millions of dollars in additional interest.[4]

- Not identifying and disclosing future government costs. Financial audits have reported that DOD has not properly reported billions of dollars in potential future liabilities. Most of these future costs are associated with outstanding legal obligations, or with environmental cleanup costs at military installations, including bases that have been or will be closed.

  This problem was found in both the Army's and Air Force's financial statements. For example, a fiscal year 1994 Army Audit Agency report disclosed that the Army did not properly report an estimated $21 billion in potential future costs the government may incur for the cost of environmental cleanup.[5] The Air Force Audit Agency's fiscal year 1994 financial audit of the Air Force also identified almost $28 billion of previously undisclosed contingent liabilities for items such as contract appeals and civil law and litigation claims.[6]

- Breakdowns in the Department's ability to protect its assets from fraud, waste, and abuse. CFO Act audits have highlighted continuing problems in overseeing DOD's multibillion dollar investment in government furnished property and equipment in the hands of contractors, real property, and inventory and equipment. For example, our report[7] on Army real property disclosed instances in which real property maintenance requirements for some installations were understated, while other installations' requirements were overstated. In March 1995, the Army Audit Agency continued to report[8] on breakdowns in the process to ensure the accuracy of accounting for the Army's reported $30 billion investment in real property. The same report indicated that the Army did not have accurate records for its reported $8.5 billion investment in government furnished property in the hands of contractors. As a result, relying on contractors'

[4]DOD Procurement: Millions in Contract Payment Errors Not Detected and Resolved Promptly (GAO/NSIAD-96-8, October 6, 1995).

[5]Audit of the Army's Principal Statements, Fiscal Years 1994 and 1993, Audit Opinion (HQ 95-451, March 23, 1995).

[6]Review of Contingent Liabilities, FY 1994 Air Force Financial Statements (94053037, May 1, 1995).

[7]Financial Management: Army Real Property Accounting and Reporting Weaknesses Impede Management Decision-making (GAO/AIMD-94-9, November 2, 1993).

[8]Audit of the Army's Principal Financial Statements, Fiscal Years 1994 and 1993, Audit Opinion (HQ 95-451, March 23, 1995).

reporting of government furnished property in their possession, the Army increased its accounting records by $5.6 billion for fiscal year 1994.

- Continuing problems in reliably reporting on the cost of its operations. Reliable cost information is necessary for the Congress to make sound budget decisions and is a key to achieving the Department's goal of reducing the cost of its operations. However, financial audits have demonstrated DOD's inability to accurately record and report costs. For example, we reported that the life cycle support costs reported to decisionmakers in DOD and the Congress for modifications to the Blackhawk and Chinook helicopters were understated by at least $3.6 billion.[9]

Reliable cost information is also vital for DBOF to operate as intended on a break-even basis. However, the amount of DBOF's net operating results for fiscal year 1994 differed by an estimated $4.4 billion between its financial and budgetary reports. As a result, it was unclear if DBOF operated at a gain or a loss, or whether it "broke even."

Beginning in fiscal year 1996, the Navy's general fund operations, for the first time, will be subject to audit under the expansion of the CFO Act requirements enacted by GMRA. We reviewed the Navy's fiscal year 1994 financial reports as a measure of the Navy's current ability to prepare reliable financial statements. In our soon-to-be-issued report, we conclude that, to an even greater extent than the other military services, the Navy is plagued by troublesome financial management deficiencies involving billions of dollars.

We found that the Navy's financial reports were of little value in assessing its operations or the execution of its stewardship responsibilities. We identified substantial misstatements in almost all of the Navy's major accounts and $225 billion in errors in the Navy's fiscal year 1994 financial reports. For example, our findings included the following.

- As of August 31, 1995, the Navy's problem disbursements had grown to $18.6 billion and accounted for 67 percent of DOD's total problem disbursements.
- DOD has reported to the Congress and the President that from October 1992 through July 1995, the Navy had 15 violations of the Antideficiency Act totaling about $87 million.

[9]Financial Management: Reliability of Weapon System Cost Reports Is Highly Questionable (GAO/AIMD-94-10, October 28, 1993).

- Navy and DOD managers did not have sufficiently reliable information to know whether, in fiscal year 1994, Navy's DBOF activities operated at a gain or a loss, or whether they broke even as intended. Of the $80 billion in revenue for fiscal year 1994, the Navy's DBOF activities accounted for $23 billion. Further, since the inception of DBOF in fiscal year 1992, the DOD Inspector General has not been able to render a favorable audit opinion on DBOF's financial statements.[10]
- Navy managers did not consider all excess inventory in their budgetary and procurement decision-making. For example, not all of Navy's excess inventories of about $400 million accumulated from the overhaul and decommissioning of ships and submarines were considered in developing its fiscal year 1996 budget request. As a result, we reported that the Navy's fiscal year 1996 budget request could be reduced by $38 million.[11]

We found the Navy's financial reporting problems could be attributed in part to the long-standing failure to instill discipline in its financial operations and follow basic procedures. For example, rudimentary controls, such as ensuring the conduct of periodic physical inventories, reconciling related accounts and records, documenting adjustments, and reviewing abnormal account balances, were not routinely carried out.

We also found flaws in Navy and DOD controls relied on to secure their vast automated data processing operations. For example, we identified weaknesses in restricting access to sensitive data and in ensuring continuity of computer operations in the event of a catastrophe or other emergency. Such deficiencies increase DOD's exposure to security breaches that could result in the loss of assets or leaks of sensitive information, such as payroll data.

The Navy, along with DOD, has not taken full advantage of the 5 years since the CFO Act's passage, or the lessons learned from the experiences of the other services in preparing financial statements. They must now "play catch up" and earnestly counteract these serious problems through measures that will lead to successfully preparing reliable financial statements on the Navy's operations within the next year. Our planned reporting on our Navy work will detail recommendations to the Secretaries of Defense and the Navy to help correct the problems we identified.

[10]Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994 (Report No. 95-294, August 18, 1995).

[11]1996 DOD Budget: Potential Reduction to Operations and Maintenance Program (GAO/NSIAD-95-200BR, September 26, 1995).

DOD's Progress in Meeting the CFO Act Objectives

In laying out his "Blueprint" for reforming the Department's financial management operations in February 1995, Secretary Perry took a first step towards resolving the Department's long-standing problems. The following five areas were key elements of that blueprint: (1) consolidate finance and accounting operations, (2) consolidate finance and accounting systems, (3) establish pre-validation for disbursements, (4) reengineer DOD business practices, and (5) strengthen internal controls. DOD has cited the Defense Finance and Accounting Service's (DFAS) "Business Plan" as the mechanism on which it will rely to implement the blueprint.

A summary of DOD's improvement initiatives in the blueprint's five key areas follows.

- Consolidate Finance and Accounting Operations. In May 1994, DOD announced plans to consolidate over 300 defense accounting offices in 5 large existing finance centers[12] and 20 new sites called operating locations during the next 5 to 7 years. The plan, which is expected to reduce DOD finance and accounting personnel from 46,000 to 23,000, is aimed at streamlining DOD's financial operations and setting the stage for future process enhancements.

  We see DOD's plans to consolidate and reduce personnel as a necessary step toward a more effective and efficient finance and accounting service. However, as discussed in our September 1995 report, we have concerns with DOD's planned consolidation efforts.[13] For example, DOD decided to open 20 new operating locations without first determining what finance and accounting functions they would perform or if 20 was the right number to support its operations. In response to the report, DOD has committed to reevaluate the number of locations and personnel required to perform finance and accounting functions by November 30, 1995. Further, starting December 15, 1995, and annually thereafter, DOD has agreed to reassess its site-selection decisions and report its findings to the Secretary of Defense.

- Consolidate Finance and Accounting Systems. DOD has acknowledged that its financial management systems are antiquated and cannot be relied upon to provide DOD management and the Congress with accurate and reliable financial information for use in decision-making. To date, a

[12]DOD's five large centers are located in Columbus, Ohio; Cleveland, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri.

[13]DOD Infrastructure: DOD's Planned Finance and Accounting Structure Is Not Well Justified (GAO/NSIAD-95-127, September 18, 1995).

number of standard systems have been selected, including those used for civilian pay, military retiree and annuitant pay, military pay, transportation payments, debt management, and contractor payments. The implementation of these standard systems is expected to reduce DOD's cost of operating redundant systems. To illustrate, 3 years ago, DOD had 18 separate military payroll systems; today, there are 11. By 1996, DOD hopes to reduce the number of systems to two or three. While DOD has made progress in reducing the number of payment systems, as discussed later, we have concerns with the overall strategy and timing of DOD's other systems improvement efforts.

- DOD Disbursements. DOD recognizes that it has a serious problem of not being able to properly match disbursements with obligations. In attempting to correct this problem, DOD is taking steps to implement the legislative mandate limiting the funds that may be disbursed before the proposed payments are prematched to the obligation data in the official accounting systems. This initiative should help ensure that the (1) disbursements are properly matched to the corresponding obligations and (2) obligations and disbursements data are recorded accurately in the accounting records. As discussed later, DOD has not yet been able to fully implement this initiative.
- Reengineer Business Practices. DOD has recognized that its financial management structure consists of many organizations with each having their own processes. These often duplicative processes have produced business practices that were complex, slow, and error-prone. For example, we have reported that DOD's administrative travel processes were extremely complicated.[14] DOD has recognized that it could save hundreds of millions of dollars yearly by reengineering its travel processes and has such efforts under way.

  As discussed in our May 1995 testimony, the potential for savings in other areas may be even greater. While DOD's mission is unique, many of its support functions, such as payroll/personnel, are similar to those carried out in the private sector and could be modeled on industry best practices. DOD is now planning to evaluate the potential for reengineering a number of these areas.

- Strengthen Internal Controls. Strong internal controls are critical to effectively controlling and accounting for the estimated $1 trillion in DOD assets worldwide. Secretary Perry has directed that senior managers play a more active role in identifying, reporting, and correcting poor controls.

[14]Travel Process Reengineering: DOD Faces Challenges in Using Industry Practices to Reduce Costs (GAO/AIMD/NSIAD-95-90, March 2, 1995).

We endorse the thrust of DOD's efforts in this area. In the past, we were critical of DOD's failure to acknowledge its fundamental internal control deficiencies in its Federal Managers' Financial Integrity Act reporting. However, more recently, we have been encouraged by DOD's more complete and realistic reporting on its internal control weaknesses.

We support DOD's reform initiatives and recognize the difficult challenge it faces in realizing financial management improvements. However, as we testified in May 1995, DOD could take added steps to help increase the likelihood of turning Secretary Perry's blueprint into substantive improvements. We suggested that DOD (1) assess the number and skill level of its financial management workforce and (2) establish an outside board of experts to provide counsel, oversight, and perspective to reform efforts. As discussed in the following sections, we also are planning to closely examine DOD's overall strategy and timing of planned systems improvement efforts and its efforts to address deep-rooted organizational impediments to meaningful change.

DOD's Financial Management Systems Are Not Yet Capable of Providing Accurate Data

Accounting and financial systems are the backbone of any agency's financial management processes and operations. The CFO Act requires that agencies develop integrated systems—meaning budget and accounting systems—that provide reliable, timely, and consistent information necessary to conduct agency operations and produce reliable information on the cost and performance of those operations. DOD's financial systems are neither integrated nor do they provide reliable information.

DOD operates over 250 financial management systems that are largely incompatible. Only 8 percent of those systems are integrated, and only 9 percent have been designated as DOD-wide systems. Further, only three systems comply with the Comptroller General's accounting principles and standards.[15]

This situation causes real problems within the agency, as shown in the following examples.

- The problem of properly matching billions of dollars in disbursements is exacerbated by poor system performance. DOD has not yet fully implemented an automated process for validating invoices prior to

[15]Federal Financial Management Status Report & Five-Year Plan (Office of Management and Budget, July 1995).

disbursement. In order to comply with a legislative mandate to validate all disbursements over $5 million, the Department had to process most of the transactions manually. Nonstandard systems have also prevented DOD from implementing a new pre-validation threshold of $1 million at its largest contract-paying facility.

- Poor cost accounting systems limit the effectiveness of DBOF, which was established, in part, to help the Department run on a more businesslike basis. Accurate cost data are needed to properly analyze trends, make comparisons, and evaluate the performance of DBOF business activities. Many DOD business activities are inefficient, and accurate financial information is needed to help pinpoint where cost reductions are needed. However, DOD is experiencing difficulty obtaining such data because the cost accounting systems are fragmented, costly to maintain, and do not provide the cost information necessary for managers to better control costs. The DOD Inspector General has cited system deficiencies as one of the major obstacles to the preparation of statements that fairly present DBOF's financial position.[16]

Further, our analyses of DBOF's budgeting and financial reports have shown that they differ by billions of dollars for net operating results. DBOF's fiscal year 1993 budgeting and financial reports differed by $5.9 billion, whereas the fiscal year 1994 reports differed by $4.4 billion.[17] Credible cost data on operating results are essential because they are needed in setting the prices DBOF will charge its customers which, in turn, provide the basis for establishing customers' budget requests.

A key element of Secretary Perry's reform blueprint was the consolidation of financial management systems. Such action is expected to help eliminate duplication, enhance system performance, and save money. The Department is implementing this strategy by developing a standard financial accounting system for each service and by consolidating the current 80 DBOF systems into 17 standard systems.

However, we are concerned about the pace of needed systems improvements. The projected time frames for completion of these system development efforts are several years away. According to a recent DOD IG

[16]Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994 (Report No. 95-294, August 18, 1995).

[17]Defense Business Operations Fund: Improved Pricing Practices and Financial Reports Are Needed to Set Accurate Prices (GAO/AIMD-94-132, June 22, 1994).

report,[18] DFAS management has said long-term corrective actions, including the development of new accounting systems, will not be completed until September 1998. According to the DOD IG, until that date, general fund financial statements will remain unauditable. The report goes on to state that the DOD IG will not be able to render audit opinions on any of the military services' general fund operations until March 2000 at the earliest.

Historically, DOD has encountered difficulty in putting effective financial management systems into place. For example, in response to the first GAO audit of the Air Force in 1990,[19] DOD stated that its Corporate Information Management (CIM) initiative would be partly or wholly responsive to 17 of the 26 recommendations that were made. Unfortunately, we have reported that the overall objectives of CIM, which in part, was aimed at improving the standardization, quality, and consistency of data from DOD's multiple automated information systems, have not been achieved.[20] Because the needed systems improvements are still not in place, the accuracy and reliability of the data provided by the systems today remain questionable.

As part of our ongoing efforts to evaluate DOD's financial operations, we will be more closely examining DOD's current systems strategy. For instance, is the DOD strategy of reducing the number of accounting systems within each service—the interim migration approach—appropriate? Will DOD's planned investment of $200 million to enhance existing systems produce auditable financial statements that comply with applicable accounting standards and reporting requirements? Will the interim systems as designed be truly integrated?

We will also be evaluating DOD's underlying capability to successfully develop software and manage its contractors. Standard software engineering processes are critical to developing and enhancing systems in a timely and cost-effective manner. However, based on a DFAS self-assessment, we believe that it currently lacks the software engineering capability to provide assurance that systems enhancements can be effectively carried out, although it has begun improvement efforts.

[18]Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DOD General Fund Financial Statements (Report No. 95-301, August 29, 1995).

[19]Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990).

[20]Defense Management Initiatives: Limited Progress in Implementing Management Improvement Initiatives (GAO/T-AIMD-94-105, April 14, 1995).

We recently started an assessment of the software process improvement efforts of the Financial Systems Organization—the information technology arm of DFAS—and plan to develop detailed recommendations to assist in these efforts. We also plan to evaluate the software engineering capability of other DOD organizations providing software support to DFAS. For our evaluations, we are using the Capability Maturity Model developed by the Software Engineering Institute (located at Carnegie Mellon University). The model is used by DOD and the private sector to assess an organization's software engineering capability.

In addition, DOD needs to pursue short-term actions to improve the quality and reliability of the data in its current systems, such as (1) following and enforcing current accounting policies and procedures, (2) reviewing and analyzing its monthly reports to identify inaccuracies, and (3) taking action to correct the problems identified. These actions are not new or revolutionary, but rather fundamental internal control procedures. The Director of DFAS has recognized the need to reinforce these key procedures and issued a September 1, 1995, directive that called for all DFAS locations to place increased emphasis on adhering to established internal controls.

Establish Skilled Financial Management Workforce

Another key responsibility that the CFO Act assigned to agency CFOs is directing and upgrading the agency's financial management personnel, including enhancing their professional training. Well-qualified personnel with the knowledge and skills required to carry out existing systems operation and accounting procedures will be essential if DOD is to make marked strides toward improving its financial operations.

While we have not yet done any comprehensive assessment of the Department's financial personnel, recurring audit findings have highlighted problems relating to DOD personnel adhering to basic control requirements. For example, these audits have consistently found that DOD personnel did not carry out required supervisory reviews or reconciliations, nor did they properly document adjustments to financial records. In addition, both our financial audits and those of the DOD Inspector General have raised questions about the adequacy of DOD's financial management personnel, as shown in the following examples.

- Our 1993 review of the Army's financial operations disclosed that of its 84 top managers responsible for overseeing the work of over 1,500 personnel

at its central accounting location, only 7 had any professional certifications.[21]

- Our recent review of the Navy's financial operations disclosed that 31 percent of the positions at its central accounting facility were vacant. In addition, 30 percent of its mid- and senior-level positions were filled with personnel in a job series that requires no accounting education.
- The DOD IG's report on its summary of the major deficiencies that prevented the development of reliable DBOF financial statements identified personnel as a major problem.[22] For example, it highlighted inadequate training and shortages of support personnel as factors impeding effective DBOF transaction processing.

In May 1995, we testified[23] that ensuring that DOD has the appropriate number of staff with the requisite skills is a key to turning Secretary Perry's blueprint into substantive improvements. Unfortunately, DOD has not made enough progress in addressing these fundamental personnel issues. DOD needs to comprehensively assess the personnel levels, skills, and experience necessary to effectively carry out DOD's financial operations.

However, we are encouraged by the DOD CFO's recognition of the importance of professional development for the Department's financial management workforce. In August 1995, the DOD CFO established a Financial Management Community Executive Committee. The committee is chaired by the DOD CFO, and its members include the Director of DFAS and representatives from the military services' assistant secretaries for financial management. One of the committee's planned initiatives is to address the specific competency requirements for the Department's financial personnel. If successfully carried out, such initiatives may help strengthen the professional skills of DOD's financial management workforce.

Because of its importance to the overall success of DOD's reform efforts, we plan to take a closer look at DOD's financial management workforce needs. Specifically, we will be looking at whether additional actions may be needed in (1) ensuring that DOD has the appropriate number of staff

[21]Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, December 22, 1993).

[22]Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994 (Report No. 95-294, August 18, 1995).

[23]Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-146, May 23, 1995).

with the requisite skills required to successfully reform DOD's financial operations, (2) determining the appropriate training and experience requirements, and (3) developing and implementing plans to address future financial management needs.

Build an Effective Financial Management Organization Structure With Clear Accountability

One of the key objectives of the CFO Act is to establish a CFO in each agency with the authority to oversee all financial management activities. While DOD has established a Chief Financial Officer, we are concerned that DOD's CFO faces major long-standing organizational barriers that will be extremely difficult to overcome in making needed improvements. In presenting his blueprint for reforming DOD's financial management, Secretary Perry accurately stated that "DOD's manifold financial management failures reflect an antiquated bureaucratic organizational structure coping unsuccessfully with the complexities of modern government and business."

For example, since the creation of DFAS in 1991, DOD has had continuing problems in clarifying the relationship between DFAS and its customers—principally the military services. DFAS was created to serve as DOD's "Accounting Service," with its Director reporting to DOD's CFO. However, DOD faces significant organizational challenges, and accountability concerns remain. In our December 1993 report on the Army's financial operations, we pointed out that the effectiveness of the Army's financial management was impaired as a result of the lack of clearly delineated roles and responsibilities between DFAS and the military services. Most recently, in our review of the Navy, we found that DOD still had not yet clearly defined or strictly enforced accountability between the Navy and DFAS for the Navy's financial management and reporting operations, or for meeting the CFO Act's requirements.

The DOD CFO has issued a draft of a section of its financial management regulations setting out detailed proposed roles and responsibilities among the various DOD organizations involved in financial management. If effectively implemented, including establishing individual accountability, the draft policy may help address many of the failures to follow basic control procedures that we found. We have recently recommended that this draft document, issued for comment in February 1995, be finalized as soon as possible, and that a follow-up effort be established to ensure its effective implementation.

In addition, the responsibility for many of the actions that will be needed to bring about any major improvements in DOD's financial management resides with DOD's functional area managers, such as DOD's procurement, personnel, and logistics functions. The systems and procedures that are directed by these DOD functional managers currently are relied on to provide substantial portions of the data that is compiled in DOD's accounting systems and financial reports. However, these functional managers operate outside the DOD CFO's sphere of influence. Consequently, garnering the support and active involvement of these organizations will be another major challenge that the DOD CFO must address. Because overcoming these organizational impediments are a key to any fundamental improvements in DOD's financial management, we are also planning additional work to examine whether additional actions will be needed to help the DOD CFO achieve the goals of more effective and efficient integration.

Reforming DOD's financial management operations is one of the formidable challenges facing the government today. Secretary Perry's blueprint lays out an overall plan to help meet this challenge. DOD must now translate the plan into concrete actions that will move the Department forward and result in measurable progress. It is essential that DOD have a world-class financial operation in order to make sound resource allocation decisions and safeguard the American public's huge investment in defense.

As outlined in our May 1995 testimony, we continue to believe that DOD should consider establishing an independent, outside board of experts to provide counsel, oversight, and perspective to DOD's reform efforts. Such experts could provide valuable advice and expertise in all three of the challenging areas we have outlined today: systems development, personnel needs assessment, and organizational structure. We plan to continue working closely with the Department in its efforts to meet the goals of the CFO Act.

Mr. Chairman, this concludes my testimony. I will be happy to answer questions that you or Members of the Subcommittee may have.

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