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United States Government Accountability Office
Washington, DC 20548

May 27, 2010

Congressional Committees

Subject: Opportunities to Improve Controls over Department of Defense's Overseas Contingency Operations Cost Reporting

From September 2001 through January 2010, Congress provided about \$1.023 trillion in supplemental and annual appropriations in response to Department of Defense (DOD) requests for funding to support overseas contingency operations (OCO).¹ In March 2010, DOD reported obligations² of about \$825 billion attributed to OCO for the period September 2001 through January 2010.³ DOD uses available cost-related information,⁴ along with other financial information, to evaluate OCO trends, formulate OCO funding requests, and monitor the costs of overseas operations. In addition, Congress considers this information in its deliberations on DOD requests for additional OCO funding.

Our prior reviews have found the financial information in DOD's monthly OCO reports to be of questionable reliability.⁵ For example, we identified problems in DOD's processes for recording and reporting obligations, such as not including all OCO costs and the lack of a systematic process for ensuring that data are correctly entered into those systems.⁶ Consequently, we concluded DOD's reported OCO costs

¹Starting with the fiscal year 2009 supplemental budget request in April 2009, the administration has replaced the term, "Global War on Terrorism" with "Overseas Contingency Operations (OCO)."

²Obligations are a definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States.

³The approximately \$198 billion difference between DOD's appropriations and reported obligations can generally be attributed to the remaining unobligated balances of the following: annual fiscal year 2010 appropriations; multiyear procurement appropriations; military construction appropriations; and research, development, test, and evaluation appropriations; as well as to obligations for classified and other items, which DOD considers to be non-OCO related, that are not reported in DOD's OCO reports.

⁴For purposes of this report, cost-related means appropriations, obligations, and disbursements that DOD attributes to OCO.

⁵For more information see GAO, *Global War on Terrorism: DOD Needs to More Accurately Capture and Report the Costs of Operation Iraqi Freedom and Operation Enduring Freedom*, GAO-09-302 (Washington, D.C.: Mar. 17, 2009); *Global War on Terrorism: DOD Needs to Take Action to Encourage Fiscal Discipline and Optimize the Use of Tools Intended to Improve GWOT Cost Reporting*, GAO-08-68 (Washington, D.C.: Nov. 6, 2007); and *Global War on Terrorism: DOD Needs to Improve the Reliability of Cost Data and Provide Additional Guidance to Control Costs*, GAO-05-882 (Washington, D.C.: Sept. 21, 2005).

should be considered approximations. Based on our prior work, we made a number of recommendations to improve the reliability of OCO reported costs, with which DOD generally concurred.

Consistent with our recommendations, DOD has taken steps intended to improve OCO cost reliability, such as clarifying cost category definitions and requiring military services (Army, Navy, Air Force, and Marine Corps) and other DOD components to analyze variances in reported OCO costs. Further, in fiscal year 2009, DOD initiated the Contingency Operations Reporting and Analysis Service (CORAS), an automated system and database through which DOD intended to provide more transparent, accurate, and timely reporting on costs attributed to OCO. Prior to the CORAS initiative, DOD had relied on manual procedures for accumulating data and reporting on costs attributed to OCO from the military services. With CORAS, the intent was to (1) eliminate such manual practices where feasible and instead use automated processes to retrieve and accumulate key financial OCO data from the military services' financial systems using a DOD-wide database and (2) add the capability to report on OCO-related funding (appropriations) and disbursements, as well as obligations.

On December 18, 2009, we reported on the status of OCO funding and cost reporting.⁷ Among other things, we highlighted our preliminary observations related to DOD's internal controls for reliably reporting OCO costs. This letter presents our findings with respect to those preliminary observations along with related recommendations. The objective of our review, conducted under the authority of the Comptroller General to undertake work on his own initiative, was to determine whether DOD had adequately designed internal controls that, if implemented effectively, could enable DOD to provide more transparent and reliable cost-related data attributable to OCO.

To determine whether DOD had designed adequate internal controls over reporting of OCO cost-related data, we reviewed internal control criteria related to reliably reporting financial data as defined in GAO's *Standards for Internal Control in the Federal Government* and *Internal Control Standards: Internal Control Management and Evaluation Tool*.⁸ We also reviewed DOD's requirements and guidance on reporting OCO costs, including DOD Financial Management Regulation (FMR) 7000.14-R, Volume 12, Chapter 23 on OCO reporting and the Under Secretary of Defense, Comptroller's (DOD Comptroller) *Fiscal Year 2009 Instructions for Contingency Cost Reports*. We interviewed key officials from the Office of the Under Secretary of Defense (Comptroller), Defense Finance and Accounting Service (DFAS), and military services to understand the design of internal control activities over OCO processes and reporting, such as data validation, and to obtain any

⁶We and the DOD Office of Inspector General have also reported on the unreliability of DOD's underlying transaction data, including budgetary accounting, and the lack of reasonable assurance over DOD's compliance with legal limitations on the use of appropriated funds. See GAO, *DOD Financial Management: Improvements Are Needed in Antideficiency Act Controls and Investigations*, GAO-08-1063 (Washington, D.C.: Sept. 26, 2008) and Department of Defense Office of Inspector General, *Independent Auditor's Report on the DOD Agency-wide FY 2009 and FY 2008 Basic Financial Statements*, Report No. D-2010-016 (Arlington, Va.: Nov. 12, 2009).

⁷GAO, *Overseas Contingency Operations: Funding and Cost Reporting for the Department of Defense*, GAO-10-288R (Washington, D.C.: Dec. 18, 2009).

⁸GAO, *Internal Control Standards: Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: August 2001) and *Internal Control: Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

evidence that these activities were performed. We reviewed DOD and military service standard operating procedures and practices in comparison with federal and department standards and guidance to determine whether they contained key controls.

We conducted this performance audit from January 2010 to May 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary of Results

While DOD's new cost reporting system and database, CORAS, was intended to provide more transparent, accurate, and timely reporting on costs that DOD attributes to OCO, we found that the design of internal control for reviewing and reporting OCO data did not contain key internal control activities. Specifically, we found the following:

- In fiscal year 2009, the military services did not have clear, detailed written procedures for reviewing the reliability of OCO reported costs including steps for conducting and documenting validation activities such as reconciliations between CORAS data and OCO data in the services' official accounting systems;
- DOD's financial management regulation on accounting for contingency operations⁹ did not clearly define validation activities—such as reconciliations—require documentation of internal control activities, or require the DOD Comptroller to monitor the accuracy of OCO reported data; and
- DOD's implementation guidance for OCO reporting obscures the accuracy of current and prior-period OCO cost reporting by directing the military services to include, in the monthly data for the current period, adjustments for omissions and errors that occurred in prior periods.

We are recommending that DOD and the military services clarify their respective guidance on validating data in the OCO report, retaining documentation on validation activities, and reporting adjustments related to prior periods. DOD agreed with four recommendations and partially agreed with one as discussed in more detail later in this report.

Design of OCO Controls for Reviewing and Reporting OCO Data Missing Key Elements

For fiscal year 2009, as shown in table 1, none of the military services had fully developed clear, detailed written procedures on how to review OCO data to help assure reliability, such as (1) performing monthly data variance analysis activities—a DOD FMR requirement to review OCO obligation amounts that fluctuate beyond

⁹The DOD FMR 7000.14-R, Volume 12, Chapter 23, *Contingency Operations* (September 2007), states that each component will develop and publish a Standard Operating Procedure (SOP) or other supplemental guidance that will cover component-specific items for cost reporting and validating monthly reporting. At a minimum, the SOP should cover data sources, validation, and variance analysis.

established limits; (2) establishing criteria for “additional validation analysis” and performing this analysis monthly—a DOD FMR requirement—other than variance analysis, to verify that reported data are accurate; and (3) maintaining documentation of monthly variance and validation activities conducted—a key internal control activity. While the Army, Marine Corps, and Air Force had written procedures requiring monthly data variance analysis, they did not clearly specify the “additional validation analysis” steps required for all appropriations. Navy’s written procedures did not identify required monthly data variance analysis or “additional validation analysis” activities. Also, none of the services’ written procedures required maintaining documentation of the internal controls performed.

Table 1: Comparison of Military Services’ Fiscal Year 2009 Written OCO Procedures with Key Internal Control Elements

	Army	Navy	Marine Corps	Air Force
Key internal control elements				
Perform monthly data variance analysis activities	●	○	●	●
Define and perform “additional validation analysis” monthly, such as reconciliation of CORAS data with official OCO accounting data	◐	○	○	◐
Maintain documentation of “additional validation analysis” performed	○	○	○	○

- Incorporates the key element to a large extent
- ◐ Incorporates the key element to some extent
- Incorporates the key element to little or no extent

Source: GAO analysis.

For fiscal year 2010, the Army and Marine Corps issued new OCO standard operating procedures in February 2010 and November 2009 respectively. Although the Army procedures contained a high-level description of reconciliation activities, neither contained clearly detailed steps necessary to perform the reconciliation nor required documentation of the results of validation activities. However, in April 2010, the Army provided us with informal desk procedures that contain detailed reconciliation steps. Navy and Air Force officials told us that they plan to issue new OCO standard operating procedures during fiscal year 2010.

We also identified deficiencies in the DOD FMR regarding the internal control policy on budgeting and accounting for contingency operations. The FMR requires each service, in its standard operating procedures, to include steps for validating OCO reported costs as an accurate and fair representation of ongoing OCO activities. As part of the validation, the FMR requires variance analysis and “additional validation analysis.” The FMR does not (1) explain the type of tasks required for “additional validation analysis”—such as specifically requiring reconciliation and (2) require the military services to retain documentation of the performance of internal control activities such as variance analysis and data validation. In addition, the DOD FMR does not require the DOD Comptroller to prepare a standard operating procedure covering its OCO monitoring activities. Internal control standards provide that internal controls should be documented and all documentation should be properly managed, maintained, and readily available for examination. Without detailed guidance that clearly defines conducting and documenting service-level variance analysis and validation activities and DOD-level monitoring, there is an increased risk

that internal control activities will not be performed, will be performed inconsistently across the military services, or will not continue to be performed when key employees leave, which can lead to unreliable reporting of OCO data.

While not routinely documented, according to DOD Comptroller staff and military services officials “additional validation analysis” was performed to help verify the accuracy of reported OCO costs in CORAS. For example, DOD Comptroller staff told us they carried out reasonableness checks of the OCO data reported by the military services but did not retain documentary evidence of their reviews. Army officials told us that they carried out reconciliations of accounting system data and the CORAS data. For example, Army officials informed us that their data reconciliations disclosed a difference of about \$3 billion in OCO obligations retrieved by CORAS and OCO obligations recorded in its accounting systems, as of July 31, 2009, which they used to adjust the CORAS data. They also told us that they worked with DFAS to improve the CORAS data retrieval process for fiscal year 2010. At Navy, officials told us they have an effort underway to determine whether Navy accounting data are being properly coded for OCO. Air Force and Marine Corps officials told us that they reconcile CORAS to accounting data to some extent.

We also found that the DOD Comptroller’s guidance to the services for compiling data for the OCO report directs them to include, in the current reporting period, adjustments for omitted or incorrect OCO transactions in previously issued OCO reports. This guidance, by not requiring separate reporting of costs attributable to other periods, obscures the current monthly obligation amounts and thus diminishes the transparency of the reported data. For example, on the July 2009 OCO report, the Army reported, but did not explain, monthly obligations of a negative \$196 million for fiscal year 2009 Army National Guard military personnel appropriations. According to Army officials, this amount represented \$46.7 million of July 2009 obligations and a negative \$242.7 million of corrections for errors or omissions related to prior months’ reporting. Clearly reporting the actual monthly obligations would provide more useful information for monitoring month-to-month financial activity related to actual OCO operations in a specific month.

Conclusions

While DOD, by implementing CORAS, has taken steps to improve the framework for OCO reporting, further actions are needed to improve the reliability and transparency of OCO reports. The services and DOD lack sufficient internal control requirements in their guidance and regulations. Development, documentation, and effective implementation of internal controls are key factors in improving accountability and financial reporting. Without complete guidance and regulations, that require documentation, there is an increased risk that monthly data validation and monitoring activities will not be performed, will be performed inconsistently, or will not continue to be performed when key employees leave, which can lead to unreliable reporting of OCO data. In addition, Congress does not have assurance that the monthly OCO reports truly represent that month’s costs because DOD consolidates corrections for prior periods with current month activity.

Recommendations for Executive Action

We recommend the Secretary of Defense direct the Under Secretary of Defense (Comptroller), in coordination with the military service secretaries (as appropriate), to take the following five actions:

- revise the Army procedures to include specific steps required to retain documentation of the activities performed and related results;
- revise the Marine Corps and Air Force procedures to include specific steps required to validate data in the OCO report including reconciliations and retain documentation of the activities performed and related results;
- establish Navy procedures to include specific steps required to validate data in the OCO report including variance analysis and reconciliations, and retain documentation of the activities performed and related results;
- revise DOD requirements in FMR 7000.14-R, Volume 12, Chapter 23, *Contingency Operations*, to provide clear, detailed guidance on (1) conducting reconciliations and other validations and (2) documenting military service-level reviews and DOD Comptroller-level reviews; and
- revise DOD Comptroller guidance to provide clear, detailed steps for identifying and separately disclosing adjustments related to prior-period omissions or errors in current month reporting.

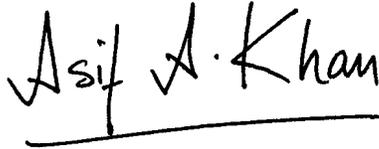
Agency Comments and Our Evaluation

In written comments on a draft of this report, reprinted in full in enclosure I, DOD agreed with four of our five recommendations and partially agreed with our fifth recommendation. DOD also stated it has taken action to address our recommendations.

In agreeing with our first four recommendations, DOD stated it is in the process of revising the FMR 7000.14-R, Volume 12, Chapter 23, *Contingency Operations*, to include requiring components to document reconciliations, reviews, and validations for monthly cost-of-war reporting. DOD partially agreed with our fifth recommendation that it revise DOD Comptroller guidance to provide clear, detailed steps for identifying and separately disclosing adjustments related to prior-period omissions or errors in current-month reporting. DOD noted that it issued guidance for fiscal year 2010 dated August 19, 2009, that requires all components to provide footnote disclosure for any adjustment related to prior-period omissions or errors in current-month reporting processes. In addition, DOD stated that it will explore the possibility of separating current-month obligations and prior-period omissions or errors in the monthly cost-of-war reports. However, as discussed in our draft report, not requiring separate reporting of costs attributable to other periods obscures the current monthly obligation amounts and thus diminishes the transparency of the reported data. Consequently, we continue to believe DOD should require separate disclosure of prior-period omissions and errors from current period amounts in its monthly cost-of-war reports. Such a separate disclosure would assist Congress in more readily identifying DOD's monthly OCO costs.

We are sending copies of this report to interested congressional committees; the Secretary of Defense; and the Under Secretary of Defense (Comptroller). In addition, the report will also be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9095 or khana@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in enclosure II.

A handwritten signature in black ink that reads "Asif A. Khan". The signature is written in a cursive style and is underlined with a single horizontal line.

Asif A. Khan
Director
Financial Management and Assurance

Enclosures

List of Committees

The Honorable Carl Levin
Chairman
The Honorable John McCain
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Ranking Member
Subcommittee on Defense
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House of Representatives

The Honorable Norman D. Dicks
Chairman
The Honorable C.W. Bill Young
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Enclosure I: Comments from the Department of Defense



COMPTROLLER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

MAY 10 2010

Mr. Asif Khan
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street N.W.
Washington, DC 20548

Dear Mr. Khan:

Enclosed is the Department of Defense (DoD) response to the Government Accountability Office (GAO) Draft Report GAO-10-562R, "Opportunities to Improve Controls over Department of Defense's Overseas Contingency Operations Cost Reporting" dated April 20, 2010. The Department concurs with the first four recommendations for executive action and partially concurs with the last recommendation, and has taken action to address them. Thank you for the opportunity to provide the Department's response to GAO's recommendations.

Sincerely,

A handwritten signature in cursive script that reads "Robert F. Hale".

Robert F. Hale

Enclosure:
As stated



GAO DRAFT REPORT DATED APRIL 20, 2010
GAO-10-562R (GAO CODE 197090)

“OPPORTUNITIES TO IMPROVE CONTROLS OVER DEPARTMENT
OF DEFENSE’S OVERSEAS CONTINGENCY OPERATIONS COST
REPORTING”

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to revise the Army procedures to include specific steps required to retain documentation of the activities performed and related results. (p. 10/GAO Draft Report)

DOD RESPONSE: Concur. The Department is in the process of revising the Financial Management Regulation 7000.14-R Volume 12, Chapter 23, *Contingency Operations*, to require components to document reconciliations and reviews for monthly Cost of War reporting.

RECOMMENDATION 2: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to revise the Marine Corps, and Air Force procedures to include specific steps required to validate data in the overseas contingency operations (OCO) report including reconciliations and retain documentation of the activities performed and related results. (p. 10/GAO Draft Report)

DOD RESPONSE: Concur. The Department is in the process of revising the Financial Management Regulation 7000.14-R Volume 12, Chapter 23, *Contingency Operations*, to require components to document reconciliations and reviews for monthly Cost of War reporting.

RECOMMENDATION 3: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to establish Navy procedures to include specific steps required to validate data in the OCO report including variance analysis and reconciliations, and retain documentation of the activities performed and related results. (p. 10/GAO Draft Report)

DOD RESPONSE: Concur. The Department is in the process of revising the Financial Management Regulation 7000.14-R Volume 12, Chapter 23, *Contingency Operations*, to require components to document reconciliations and reviews for monthly Cost of War reporting.

RECOMMENDATION 4: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to revise DoD requirements in Financial Management Regulation 7000.14-R Volume 12, chapter 23, *Contingency Operations*, to provide clear, detailed guidance on (1) conducting reconciliations and other validations and (2) documenting military service reviews and DoD Comptroller-level reviews. (p. 10/GAO Draft Report)

DOD RESPONSE: Concur. The Department is in the process of revising the Financial Management Regulation 7000.14-R Volume 12, Chapter 23, *Contingency Operations*, to require components to document reconciliations and provide details on validations for monthly Cost of War reporting.

RECOMMENDATION 5: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to revise DoD comptroller guidance to provide clear, detailed steps for identifying and separately disclosing adjustments related to prior-period omissions or errors in current month reporting. (p. 10/GAO Draft Report)

DOD RESPONSE: Partially Concur. The Department already has established guidance titled "Fiscal Year (FY) 2010 Instructions for Contingency Operations Cost Reports" dated August 19, 2009, which requires all Components to provide footnotes for any adjustments related to prior-period omissions or errors in current month reporting. However, the Department will explore the possibility of separating current month obligations and prior-period omissions or errors in the monthly Cost of War reports.

Attachment
Page 2 of 2

Enclosure II: GAO Contact and Staff Acknowledgments

GAO Contact

Asif A. Khan (202) 512-9095 or khana@gao.gov

Acknowledgements

In addition to the contact above, Mary Ellen Chervenik, Assistant Director; Maxine Hattery; Sheila D. M. Miller; James Moses; and Laura Pacheco made key contributions to this report.

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