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DEPARTMENT OF DEFENSE

Status of Financial Management Weaknesses and Progress Toward Reform

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Financial Management and Assurance

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Highlights

Highlights of GAO-03-931T, a testimony to the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

DEPARTMENT OF DEFENSE

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Why GAO Did This Study

As seen again in Iraq, the excellence of our military forces is unparalleled. This same level of excellence is not yet evident in the Department of Defense's (DOD) financial management and other business areas, impeding DOD's ability to provide complete, reliable, and timely information to the Congress, DOD managers, and other decision makers. The Subcommittee asked GAO to testify on the status of DOD's financial management and business process reform efforts. Specifically, GAO was asked to provide an overview of the long-standing financial management weaknesses facing DOD and a summary of the underlying causes of DOD's financial management challenges. In addition, GAO's testimony focused on (1) key actions necessary to correct DOD's financial management problems and (2) the progress DOD is making toward business process reform.

www.gao.gov/cgi-bin/getrpt?GAO-03-931T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory D. Kutz at (202) 512-9095 or kutzg@gao.gov.

What GAO Found

Overhauling DOD's financial management represents a major challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. Of the 25 areas on GAO's governmentwide "high risk" list, 6 are DOD program areas, and the department shares responsibility for 3 other high-risk areas that are governmentwide in scope. Key financial management weaknesses include the lack of effective and efficient asset management and accountability; unreliable estimates of environmental and disposal liabilities; lack of accurate budget and cost information; nonintegrated and proliferating financial management systems; and fundamental flaws in DOD's overall control environment.

GAO has identified four underlying causes for DOD's inability to resolve its long-standing financial management problems:

- a lack of sustained top-level leadership and management accountability for correcting problems;
- deeply embedded cultural resistance to change, including military service parochialism and stovepiped operations;
- a lack of results-oriented goals and performance measures and monitoring; and
- inadequate incentives for seeking change.

The following are elements that GAO has identified as key to a successful approach to financial management and business process reform:

- addressing financial management challenges as part of a comprehensive, integrated, DOD-wide business reform;
- providing for sustained leadership by the Secretary of Defense and resource control to implement needed financial management reforms;
- establishing clear lines of responsibility, authority, and accountability for such reform tied to the Secretary;
- incorporating results-oriented performance measures and monitoring tied to financial management reforms;
- providing appropriate incentives or consequences for action or inaction;
- establishing and implementing an enterprise architecture to guide and direct financial management modernization investments; and
- ensuring effective executive and congressional oversight and monitoring.

DOD has taken positive steps in many of these key areas. For example, the Secretary of Defense has included improving DOD's financial management as one of his top 10 priorities, and DOD has already taken a number of actions under its Business Transformation Program, including its efforts to develop an enterprise architecture to guide operational and technological changes. However, these are beginning steps and formidable challenges remain in each of the key reform areas.

Dear Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to discuss the status of financial management and business process reform efforts at the Department of Defense (DOD). DOD faces financial and related management problems that are pervasive, complex, long standing, and deeply rooted in virtually all business operations throughout the department. These problems have impeded the department's ability to provide complete, reliable, and timely business operations information to the Congress, DOD managers, and other decision makers. In addition, DOD's financial management weaknesses have resulted in the failure of the department, its military services, and its major components from passing the test of an independent financial audit and are a significant obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. Overhauling DOD's financial management represents a major challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. Of the 25 areas on GAO's governmentwide "high risk" list, 6 are DOD program areas, and the department shares responsibility for 3 other high-risk areas that are government wide in scope.[1] Central to effectively addressing DOD's financial management problems will be understanding that these 9 areas are interrelated and cannot be addressed in an isolated, stovepiped, or piecemeal fashion. While Secretary of Defense Rumsfeld has initiated a program to transform DOD's business processes, including establishing a new management structure to oversee reform efforts, DOD has not yet developed an overarching plan tying key reform efforts together in an integrated program.

DOD's size, structure, and diversity of activities increase the difficulty and complexity of reform efforts. For example, DOD is the nation's largest employer, with

- 1.4 million men and women currently on active duty,
- 1.2 million serving in the Reserve and Guard components, and

[1] U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003). The nine interrelated high-risk areas that represent the greatest challenge to DOD's development of world-class business operations to support its forces are: contract management, financial management, human capital, information security, infrastructure management, inventory management, real property, systems modernization, and weapon system acquisition.

- 675,000 civilians.

DOD operates more than 600,000 individual buildings and structures located at more than 6,000 different locations and using more than 30 million acres. For fiscal year 2002, DOD expended approximately $371 billion to operate and maintain about 250,000 vehicles, over 15,000 aircraft, more than 1,000 oceangoing vessels, and some 550 public utility systems.[2]

DOD's financial management problems are the result of long-standing deficiencies related to its systems, processes, and people. Therefore, to be successful, reform efforts will need to address all three factors. In recognition of the far-reaching nature of DOD's financial management problems, on September 10, 2001, Secretary Rumsfeld announced a broad, top-priority initiative intended to "transform the way the department works and what it works on." This new broad-based business transformation initiative, led by DOD's Senior Executive Council and the Business Initiative Council, incorporates a number of defense reform initiatives begun under previous administrations but also encompasses additional fundamental business reform proposals. In announcing his initiative, Secretary Rumsfeld recognized that transformation would be difficult and expected that needed changes would take 8 or more years to complete.

As we have seen again in Iraq, the excellence of our military forces is unparalleled. This same level of excellence is not yet evident in the department's financial management and other business areas. This is particularly problematic because effective financial and related management operations are critical to achieving the department's mission in a reasonably economical, efficient, and effective manner and to providing reliable, timely financial information on a routine basis to support management decision making at all levels throughout DOD. Transforming DOD's business operations would free up resources that could be used to enhance readiness, improve the quality of life for our troops and their families, and reduce the gap between "wants" and available funding in connection with major weapon systems. In fact, Secretary Rumsfeld has estimated that successful business process reform could save DOD 5 percent of its budget or $20 billion a year.

[2] *Department of Defense*, *Performance and Accountability Report*: Fiscal Year 2002 (Washington, D.C.: January 2003).

Today, I will focus mainly on the key actions necessary to correct DOD's financial management problems and the progress DOD is making toward business process reform. But first, I want to provide you with an overview of the long-standing financial management weaknesses facing DOD—as highlighted by the results of audit work performed over the past few years—and a summary of the underlying causes of DOD's financial management challenges. My statement is based on previous GAO reports as well as on our review of DOD Inspector General (IG) reports and recent DOD reports and studies.

Long-standing Financial Management Weaknesses

DOD continues to confront pervasive, decades-old financial management problems related to its systems, processes (including internal controls), and people (human capital). These problems have (1) resulted in a lack of reliable information needed to make sound decisions and report the status of DOD's activities through financial and other reports, (2) hindered its operational efficiency, (3) impacted mission performance, and (4) left the department vulnerable to fraud, waste, and abuse.

DOD's serious financial management and related business systems problems led us in 1995 to put both DOD financial management and systems modernization on our list of high-risk[3] areas in the federal government, a designation that continues today.[4] As discussed in the results of our audit of the fiscal year 2002 Financial Statements of the U.S. Government,[5] DOD's financial management deficiencies, taken together, continue to represent one of the largest obstacles to achieving an unqualified opinion on the U.S. government's consolidated financial statements. To date, none of the military services or major DOD components has passed the test of an independent financial audit because

[3] GAO has designated government operations and programs as "high risk" because of either their greater vulnerabilities to waste, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness.

[4] U.S. General Accounting Office, *High-Risk Series: An Overview*, GAO/HR-95-1 (Washington, D.C.: February 1995); *High-Risk Series: Defense Financial Management*, GAO/HR-97-3 (Washington, D.C.: February 1997); *High-Risk Series: An Update*, GAO-01-263 (Washington, D.C.: January 2001); and *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003).

[5] U.S. General Accounting Office, *Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform*, GAO-03-572T (Washington, D.C.: Apr. 8, 2003).

of pervasive weaknesses in financial management systems, processes, and controls. These weaknesses not only hamper the department's ability to produce timely and accurate financial management information but also impact mission performance and make mission costs unnecessarily high. Ineffective asset accountability and the lack of effective controls continue to adversely affect visibility over its estimated $1 trillion investment in inventories and property, plant, and equipment (including weapon systems and other property). Such information is key to meeting military objectives and readiness goals. Further, unreliable cost and budget information related to a reported $700 billion of liabilities, particularly $59 billion of reported environmental liabilities, and about $380 billion of reported costs negatively affects DOD's ability to effectively project funding needs, maintain adequate funds control, reduce costs, and measure performance. DOD has invested, and continues to invest, significant resources—in terms of dollars, time, and people—in its systems without demonstrated improvement in its business operations and adequate management and oversight, thereby continuing to perpetuate a proliferation of systems that do not adequately address the department's needs. Finally, DOD's weak overall control environment has left the department vulnerable to fraud, waste, and abuse. As the results of the department's fiscal year 2002 financial audit and other audit work demonstrate, DOD continues to confront serious weaknesses in these areas.

Asset Management and Accountability

Of the $776 billion of inventory and related property and general property, plant, and equipment (PP&E)[6] assets reported by federal entities for fiscal year 2002, DOD is responsible for about half—approximately $146 billion in inventory and related property and $226 billion of general PP&E, comprised of $162 billion in real property (land, buildings, facilities, capital leases, and improvements to those assets); $37 billion in personal property (such as vehicles, equipment, telecommunications systems, computers, and software); and $27 billion in construction-in-progress, the largest amount of which belongs to the Corps of Engineers. While DOD is not presently required to report dollar values for its weapons systems and support PP&E used in the performance of military missions, such reporting will be required beginning October 1, 2002.[7] The amount subject to reporting will likely be significant considering that DOD has estimated an acquisition cost of over $64 billion for only three of its major weapons systems acquisition programs.

Effective and efficient asset management and accountability is crucial to DOD's defense of our national interests. While the department has undertaken several initiatives over the years to improve its asset management and accountability systems, processes, and controls, material weaknesses persist. As a result, DOD lacks reliable information about the quantity, location, condition, and value of inventory and property—including military equipment—critical to the department's ability to effectively meet military objectives and readiness goals. Ineffective and inefficient asset management and accountability leave the department vulnerable to fraud, waste, and abuse. Over the past 2 years, the DOD Inspector General (IG) and we have issued numerous reports detailing problems with asset management and accountability, including the following examples.

[6] Statement of Federal Financial Accounting Standards No. 6 states that general PP&E is any property, plant, and equipment used in providing goods and services.

[7] Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant and Equipment*, was issued on May 8, 2003, and is effective for periods beginning after September 30, 2002.

- DOD and its military services and units did not know how many Joint Service Lightweight Integrated Suit Technology (JSLIST)[8]—commonly referred to as "chem-bio suits"— they had, their condition, and where they were located.[9] This lack of visibility was due to several factors, including the use of nonstandard, nonintegrated, stovepiped systems. Nonintegrated systems are unable to share data across business applications and therefore, multiple manual data entries must be made into numerous stand-alone systems, which result in errors, add significantly to administrative costs, and generally exacerbate asset visibility problems. The methods used to control and maintain visibility over JSLIST ranged from stand-alone automated systems, to spreadsheet applications, to pen and paper, to nothing at all. For JSLIST, the result was that DOD was excessing and selling these suits on the Internet for pennies on the dollar, while at the same time procuring hundreds of thousands of new garments annually. Similarly, a few years ago, the Defense Logistics Agency (DLA) had problems identifying and removing from its inventory defective Battle Dress Overgarments (BDO)—the JSLIST predecessor. As a result, some of the defective suits were shipped to U.S. forces in high-threat areas. In a June 2000 testimony, the DOD IG pointed out that a physical count of BDOs could not locate 420,000 protective suits that were recorded in DLA's accountability database.

[8] JSLIST is a universal, lightweight, two-piece garment (coat and trousers) that when combined with footwear, gloves, and protective mask and breathing device, forms the war fighter's protective ensemble. Together the ensemble is to provide maximum protection to the war fighter against chemical and biological contaminants without negatively impacting the ability to perform mission tasks.

[9] U.S. General Accounting Office, *DOD Management: Examples of Inefficient and Ineffective Business Processes*, GAO-02-873T (Washington, D.C.: June 25, 2002).

- DOD lacked effective processes and controls to ensure that easily pilferable and sensitive items were properly recorded and safeguarded. For example, we found that the military services failed to record all of the pilferable and sensitive items acquired through purchase card transactions, including the Navy's failure to record a $757,000 purchase comprised of 430 computers, 213 flat panel monitors, and other computer hardware and software.[10] The Navy was unable to provide us with evidence confirming the location of 187 of those computers and 87 of the flat panel monitors. Similarly, in our recent review[11] of property controls at three military treatment facilities, we found that items such as a laptop computer, a Sony monitor, and a sterilizer were not recorded in the property records. We also found that numerous recorded items could not be located. Most of these were lower priced (under $5,000) or pilferable items such as a personal digital assistant, a cellular telephone, computer monitors, color printers, a handheld radio, and various pieces of medical equipment such as a stretcher, electric beds, and intravenous pumps.

Environmental and Disposal Liabilities

Under federal, state, and international law, DOD faces a major funding requirement associated with environmental cleanup and disposal resulting from prior and current operations and from the production of weapons systems. In its fiscal year 2002 financial statements, DOD reported an estimated liability of $59 billion to manage and clean up or contain a diverse population of environmental contamination comprised of

- $22 billion for closed and open sites where past and current waste disposal practices, leaks, spills, and other activities have created a risk to public health or the environment;

- $14 billion for closed, transferring, and active military ranges where contamination and unexploded ordnance create environmental hazards; and

[10] U.S. General Accounting Office, *Purchase Cards: Navy Is Vulnerable to Fraud and Abuse but Is Taking Action to Resolve Control Weaknesses*, GAO-02-1041 (Washington, D.C.: Sept. 27, 2002).

[11] U.S. General Accounting Office, *Military Treatment Facilities: Internal Control Activities Need Improvement*, GAO-03-168 (Washington, D.C.: Oct. 25, 2002).

- $23 billion for cleanup, demilitarization, and disposal of nuclear and non-nuclear weapons systems, chemical weapons, and munitions.

DOD's reported cost represents the current value of estimated future cash outlays that will need to be paid from appropriations; therefore, the Congress needs reliable information in order to plan how much and when to provide funding for cleanup activities. In past years, we and the DOD IG have repeatedly reported that the environmental liability amounts presented in DOD's financial statements were not reliable because the department did not have (1) sufficient guidance for identifying and categorizing cleanup activities whose costs must be included in the liability calculation, (2) complete inventories of the sites and weapons systems that will require cleanup or containment, and (3) valid cost estimating models that produce consistent and supportable liability estimates. These deficiencies were not systems related but rather resulted from inadequate policies and processes and a lack of leadership.

We have also issued individual reports on several environmental cleanup categories, including training ranges and on-going operations.[12] In those reports, we specifically cite weaknesses related to DOD's lack of complete site inventories, which means that the department's reported liability amount is likely understated. In line with our findings, the Air Force has recently confirmed that it is investigating possible radioactive waste buried at more than 80 former and current air bases around the country. According to the Air Force, it lost track of the waste burial sites because of poor record keeping and is now trying to identify and inspect the lands for safety concerns. Costs for cleaning up these sites are not currently included in the Air Force's reported liability amounts. In addition, incomplete identification of cleanup sites on installations that are currently being used by the military could have negative consequences for future base reutilization, alignment, and closure decisions.

Budget and Cost Information

DOD's appropriation for fiscal year 2002 represented 18 percent of the total U.S. budget and 48 percent of discretionary funds. For fiscal year 2002, DOD reported disbursing $347 billion to, among other things, make

[12] U.S. General Accounting Office, *Environmental Liabilities: DOD Training Range Cleanup Cost Estimates Are Likely Understated*, GAO-01-479 (Washington, D.C.: Apr. 11, 2001) and *Environmental Liabilities: Cleanup Costs From Certain DOD Operations Are Not Being Reported*, GAO-02-117 (Washington, D.C.: Dec. 14, 2001).

payments to 5.7 million military and civilian personnel and annuitants, process and pay 11.2 million contractor invoices, and make 7.3 million travel payments. The magnitude of the dollars and number of transactions involved makes it imperative that DOD maintain accurate fund balances and properly account for costs; however, DOD financial management systems and processes continue to be significant impediments to reporting complete and accurate information with respect to budgetary and disbursement activities.

Weaknesses in DOD's accounting for its funds include (1) the inability to reconcile its balances to Treasury's, a process similar in concept to individuals reconciling their checkbooks with their bank statements, (2) payment recording errors, including disbursements that are not properly matched to specific obligations recorded in the department's records, and (3) limited ability to track the use of funds appropriated for contingency purposes. For example,

- For fiscal year 2002, we found that DOD had at least $7.5 billion in unexplained differences between Treasury and DOD fund activity records. Many of these differences represent disbursements made and reported to Treasury that had not yet been properly matched to obligations and recorded in DOD accounting records. In addition to these unreconciled amounts, DOD identified and reported an additional $3.6 billion in payment recording errors. These include disbursements that DOD has specifically identified as containing erroneous or missing information and that cannot be properly recorded and charged against the correct, valid fund account. DOD records many of these payment problems in suspense accounts and made $1.6 billion in unsupported adjustments to its fund balances at the end of fiscal year 2002 to account for a portion of these payment recording errors. These adjustments did not resolve the related errors.

- In June 2001, we reported that DOD's financial systems could not adequately track and report on whether the $1.1 billion in earmarked funds that the Congress provided to DOD for spare parts and associated logistical support were actually used for their intended purpose.[13] The vast majority of the funds—92 percent—were transferred to the military services operation and maintenance accounts. Once transferred, the

[13] U.S. General Accounting Office, *Defense Inventory: Information on the Use of Spare Parts Funding Is Lacking*, GAO-01-472 (Washington, D.C.: June 11, 2001).

department could not separately track the use of the funds. As a result, DOD lost its ability to assure the Congress that the funds it received for spare parts purchases were used for, and only for, the designated purpose.

- In April 2003, we reported[14] that DOD was not able to separately track Emergency Response Funds provided under appropriations in fiscal years 2002 and 2003 ($20.5 billion). These funds were commingled in DOD's regular appropriations accounts with funds appropriated for other purposes. Because DOD's accounting system only captures data on total obligations and does not distinguish among original sources of funds, DOD is not able to identify those obligations that are funded from emergency response funds.

- In December 2000, we reported[15] that our review of DOD functions that were studied over the past 5 years for potential outsourcing under OMB Circular A-76 showed that while DOD reported that savings had occurred as a result of these studies, we could not determine the precise amount of any such savings because the department lacked actual cost data. Further, in March 2002, we testified[16] that while significant savings were being achieved, it has been difficult to determine the magnitude of those savings.

DOD's continuing inability to capture and report the full cost of its programs represents one of the most significant impediments facing the department. DOD does not have the systems and processes in place to capture the required cost information from the hundreds of millions of transactions it processes each year. Lacking complete and accurate overall life-cycle cost information for weapon systems impairs DOD's and congressional decision makers' ability to make fully informed judgments about which weapons, or how many, to buy. DOD has acknowledged that the lack of a cost accounting system is its largest impediment to controlling and managing weapon systems costs.

[14] U.S. General Accounting Office, *Defense Budget: Tracking of Emergency Response Funds for the War on Terrorism*, GAO-03-346 (Washington, D.C.: Apr. 30, 2003).

[15] U.S. General Accounting Office, *DOD Competitive Sourcing: Results of A-76 Studies Over the Past 5 Years*, GAO-01-20 *(Washington, D.C.: Dec. 7, 2000)*.

[16] U.S. General Accounting Office, *Competitive Sourcing: Challenges in Expanding A-76 Governmentwide*, GAO-02-498T (Washington, D.C.: Mar. 6, 2002).

An April 2001 report on the results of an independent study of DOD's financial operations commissioned by the Secretary of Defense concluded that DOD lacked the ability to routinely generate cost-based metrics to link financial management to DOD's goals.[17] For example, DOD's reporting under the Government Performance and Results Act of 1993 (GPRA)[18] often did not address the cost-based efficiency aspect of performance, making it difficult for DOD to fully assess the efficiency of its performance. DOD's most recent performance plan (fiscal year 2001) included 45 unclassified metrics but only a few of those contained efficiency measures based on costs.

Financial Management Systems

For fiscal year 2003, DOD estimated that it would spend approximately $18 billion[19] to operate, maintain, and develop business systems. Of that amount, $5.2 billion relates directly to business systems and the remaining $12.8 billion relates to the infrastructure that supports the systems. While funding system development and modernization activities is crucial, it is only part of the solution needed to improve DOD's current business systems and operating environment. Key ingredients to successful systems development and modernization include effective management and oversight of ongoing and planned investments.

However, in February 2003,[20] we reported that DOD had yet to establish the necessary departmental investment governance structure and process controls needed to adequately align ongoing investments with its architectural goals and direction. An effective governance structure should include

[17] Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change* (Washington, D.C.: Apr. 13, 2001).

[18] Government Performance and Results Act of 1993, Pub. L. 103-62, 107 Stat. 285, Aug. 3, 1993. Pertinent performance planning and reporting requirements have been codified, as amended, at 31 U.S.C. sections 1115 and 1116.

[19] U.S. General Accounting Office, *DOD Business Systems Modernization: Continued Investment in Key Accounting Systems Needs to be Justified*, GAO-03-465 (Washington, D.C.: Mar. 28, 2003).

[20] U.S. General Accounting Office, *DOD Business Systems Modernization: Improvements to Enterprise Architecture Development and Implementation Efforts Needed*, GAO-03-458 (Washington, D.C.: Feb. 28, 2003).

- a hierarchy of investment review boards composed of representatives from across the department who are assigned investment selection and control responsibilities based on project threshold criteria;

- a standard set of investment review and decision-making criteria for use by all boards, including criteria to ensure compliance and consistency with its newly developed enterprise architecture or "blueprint for reform"; and

- a specified, near term date by which ongoing investments have to be subject to this standard investment review process, and by which decisions should be made as to whether to proceed with each investment.

DOD's lack of effective oversight and process controls over IT investments perpetuates the existence of an incompatible, duplicative, and overly costly systems environment, which undermines its ability to optimally support mission performance. For example,

- In March 2003, we reported[21] that DOD did not effectively manage and oversee its planned investment of over $1 billion in four Defense Finance and Accounting Service (DFAS) systems modernization efforts. DOD invested approximately $316 million in these projects without first demonstrating that they would markedly improve the information needed for decision-making and financial reporting purposes. The DOD Comptroller terminated one of the four projects we reviewed after an investment of over $126 million, citing poor program performance and increasing costs. Investments in the other three projects continue despite the absence of the requisite analyses of costs, benefits, and risks to demonstrate that the projects will produce value commensurate with the cost being incurred.

- In March 2002, the DOD IG reported that DOD's Joint Total Asset Visibility Program (JTAV) system provided incomplete asset visibility to military commanders in chief (CINCs) and joint task force commanders.[22] Required capabilities were not developed before the

[21] GAO-03-465.

[22] DOD Inspector General, *Information Technology: Effectiveness of the Joint Total Asset Visibility Program;* Audit Report D-2002-057 (Arlington, Va.; Mar. 11, 2002).

program was placed into service, including asset and personnel visibility for the warfighter, accurate and timely source data, and data links to critical data in other DOD systems. As a result, CINCs and joint task force commanders did not have access, through the program, to all required data on the location, movement, status, and identity of military units, personnel, equipment, and supplies as intended.

- In June 2002, DOD reported[23] that shortcomings in existing nonintegrated personnel and pay systems caused delays in military payroll payments (some as much as 6 or more months after the event occurred) and resulted in errors (both under- and overpayments). DOD estimated that system input errors ranged from 5 to 15 percent and that these errors necessitated complex retroactive computations, data reconciliation and corrections, losses due to overpayments, debt processing, and costs to recoup overpayments.

- As of October 2002, DOD reported that its current business systems environment consisted of 1,731 systems and system acquisition projects (a number that has since risen to about 2,300 as DOD has identified additional systems). DOD reported that it had 374 systems to support civilian and military personnel matters, 335 systems to support finance and accounting functions, and 310 systems that produce information for management decision making.

As we have previously reported,[24] these numerous systems have evolved into the overly complex and error-prone operation that exists today, including (1) little standardization across DOD components, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, (4) manual data entry into multiple systems, and (5) a large number of data transactions and interfaces that combine to exacerbate the problems of data integrity. While the department recognizes the uncontrolled proliferation of systems and the need to eliminate as many systems as possible and to integrate and standardize those that remain, DOD components continue to receive and control their own IT investment funding.

[23] Department of Defense, *Report to Congress: Defense Integrated Military Human Resources System (Personnel and Pay)*, June 2002.

[24] U.S. General Accounting Office, *DOD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment*, GAO-02-784T (Washington, D.C.: June 4, 2002).

Weak Control Environment

Fundamental flaws in DOD's systems, processes, and overall control environment leave the department at risk of fraud, waste, and abuse. Over the past few years, we have reported numerous instances of breakdowns in—or lack of—internal control that have had serious economic and legal consequences for the department, including

- government travel card delinquency rates for the Army and the Navy that were nearly double those of federal civilian agencies;[25]
- pervasive purchase and travel card control breakdowns that resulted in numerous instances of potentially fraudulent, improper, and abusive transactions and increased DOD's vulnerability to theft and misuse of government property;[26]
- inadequate management and reporting on the funding associated with the Air Force's contracted depot maintenance that resulted in understating the dollar value of year-end carryover work by tens of millions of dollars;[27]
- adjustments to DOD's closed appropriations that resulted in about $615 million in adjustments that should not have been made, including $146 million that was illegal;[28]

[25] U.S. General Accounting Office, *Travel Cards: Control Weaknesses Leave Navy Vulnerable to Fraud and Abuse*, GAO-03-147 (Washington, D.C.: Dec. 23, 2002); *Air Force Management Has Reduced Delinquencies, but Improvements in Controls Are Needed*, GAO-03-298 (Washington, D.C.: Dec. 20, 2002); *Travel Cards: Control Weaknesses Leave Army Vulnerable to Potential Fraud and Abuse*, GAO-03-169 (Washington, D.C.: Oct. 11, 2002).

[26] U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave the Air Force Vulnerable to Fraud, Waste, and Abuse*, GAO-03-292 (Washington, D.C.: Dec. 20, 2002); *Purchase Cards: Navy Is Vulnerable to Fraud and Abuse but Is Taking Action to Resolve Control Weaknesses*, GAO-02-1041 (Washington, D.C.: Sept. 27, 2002); *Purchase Cards: Control Weaknesses Leave Army Vulnerable to Fraud, Waste, and Abuse*, GAO-02-732 (Washington, D.C.: June 27, 2002); *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-32 (Washington, D.C.: Nov. 30, 2001).

[27] U.S. General Accounting Office, *Air Force Depot Maintenance: Management Improvements Needed for Backlog of Funded Contract Maintenance Work*, GAO-02-623 (Washington, D.C.: June 20, 2002).

[28] U.S. General Accounting Office, *Canceled DOD Appropriations: $615 Million of Illegal or Otherwise Improper Adjustments*, GAO-01-697 (Washington, D.C.: July 26, 2001).

- hundreds of millions of dollars of over- and underpayments to contractors;[29] and

- lost opportunities to collect millions of dollars of reimbursements for services performed in military treatment facilities because not all patients with third party insurance coverage were identified or because those insurers were not billed.

In general, DOD does not have the necessary control processes and procedures in place to identify problem situations like the ones listed above. However, DOD usually takes action to try to correct and then prevent these problems once they have been identified by auditors.

Underlying Causes of Financial and Related Business Process Reform Challenges

In the past, DOD initiated a number of departmentwide reform initiatives to improve its financial operations as well as other key business support processes. While these initiatives produced some incremental improvements, they did not result in the fundamental reform necessary to resolve these long-standing management challenges. For example, in 1989, DOD began the Corporate Information Management (CIM) initiative, which was expected to save billions of dollars by streamlining operations and implementing standard information systems across the department to support common business operations. DOD intended CIM to reform all of its functional areas—including finance, procurement, material management, and human resources—through the consolidation, standardization, and integration of its numerous, duplicative information systems. DOD spent billions of dollars on this initiative with little sound analytical justification. Rather than relying on a rigorous decision-making process for information technology investments, as used in leading private and public organizations we studied, DOD made systems decisions without (1) appropriately analyzing cost, benefits, and technical risks, (2) establishing realistic project schedules, or (3) considering how business process improvements could affect information technology investments. For one effort alone, DOD spent about $700 million trying to develop and implement a single system for the material management business area—but this effort proved unsuccessful. After 8 years and about $20 billion in

[29] U.S. General Accounting Office, *DOD Contract Management: Overpayments Continue and Management and Accounting Issues Remain*, GAO-02-635 (Washington, D.C.: May 30, 2002).

expenditures, DOD abandoned the CIM initiative. However, some of the conditions that led to its defeat remain today.

We first identified underlying causes for the department's inability to resolve its long-standing financial management problems, as well as the other areas of its operations most vulnerable to waste, fraud, abuse, and mismanagement, in our May 1997 testimony.[30] We have continued to highlight in various testimonies what we believe are the underlying reasons for the department's inability to fundamentally reform its business operations. There are four underlying causes:

- a lack of sustained top-level leadership and management accountability for correcting problems;
- deeply embedded cultural resistance to change, including military service parochialism and stovepiped operations;
- a lack of results-oriented goals and performance measures and monitoring; and
- inadequate incentives for seeking change.

Lack of Leadership and Accountability

Historically, DOD has not routinely assigned accountability for performance to specific organizations or individuals who have sufficient authority to accomplish desired goals. For example, under the Chief Financial Officers Act (CFO) of 1990,[31] it is the responsibility of the agency CFO to establish the mission and vision for the agency's future financial management and to direct, manage, and provide oversight of financial management operations. However, at DOD, the Comptroller—who is by statute the department's CFO—has direct responsibility for only an estimated 20 percent of the data relied on to carry out the department's financial management operations. The other 80 percent comes from DOD's other business operations. In addition, DOD's past experience has suggested that top management has not had a proactive, consistent, and

[30]U.S. General Accounting Office, *DOD High-Risk Areas: Eliminating Underlying Causes Will Avoid Billions of Dollars in Waste*, GAO/T-NSIAD/AIMD-97-143 (Washington, D.C.: May 1, 1997).

[31]Chief Financial Officers Act of 1990, Pub. L. 101-576, 104 Stat. 2842, Nov. 15, 1990 (codified as amended in scattered sections of 31 U.S.C.).

continuing role in building capacity, integrating daily operations for achieving performance goals, and creating incentives. Major improvement initiatives must have the direct, active support and involvement of the Secretary and Deputy Secretary of Defense to ensure that daily activities throughout the department remain focused on achieving shared, agencywide outcomes and success. Furthermore, sustaining top management commitment to performance goals is a particular challenge for DOD because the average 1.7-year tenure of the department's top political appointees has served to hinder long-term planning and follow-through. Based on our survey of best practices of world-class financial management organizations,[32] strong executive leadership is essential to (1) making financial management an entitywide priority, (2) redefining the role of finance, (3) providing meaningful information to decision makers, and (4) building a team of people that delivers results.

Cultural Resistance and Parochialism

Cultural resistance to change, military service parochialism, and stovepiped operations have also played a significant role in impeding previous attempts to implement broad-based management reforms at DOD. The department has acknowledged that it confronts decades-old problems deeply grounded in the bureaucratic history and operating practices of a complex, multifaceted organization. For example, the effectiveness of the Defense Management Council, established in 1997 to help break down organizational stovepipes and overcome cultural resistance to change, was impaired because members were not able to put their individual military services' or DOD agencies' interests aside to focus on departmentwide approaches to long-standing problems.[33] DOD's stovepiped approach is most evident in its current financial management systems environment, which DOD recently estimated to include approximately 2,300 systems and system development projects—many of which were developed in piecemeal fashion and evolved to accommodate different organizations, each with its own policies and procedures.

[32] U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: Apr. 1, 2000).

[33] U.S. General Accounting Office, *Defense Management: Actions Needed to Sustain Reform Initiatives and Achieve Greater Results*, GAO/NSIAD-00-72 (Washington, D.C.: July 25, 2000).

Unclear Goals and Performance Measures

Lack of clear, linked goals and performance measures has handicapped DOD's past reform efforts. As a result, DOD managers lack straightforward road maps showing how their work contributes to attaining the department's strategic goals, and they risk operating autonomously rather than collectively. According to its fiscal year 2002 Performance and Accountability report, DOD is still in the process of developing measurable annual performance goals and objectives.

In our assessment of DOD's Fiscal Year 2000 Financial Management Improvement Plan[34]—its most recent plan—we found that it presented the military services' and DOD components' individual improvement initiatives for reforming financial management but did not clearly articulate how their individual efforts would result in a collective, integrated DOD-wide approach to financial management improvement. In addition, the product did not include performance measures that could be used to assess DOD's progress in resolving its financial management problems. As a result, the product was more a compilation of a data call than a strategic plan. Furthermore, while DOD plans to invest billions of dollars in modernizing its financial management systems, it currently does not have effective management governance and controls in place to guide and direct these investments. We will discuss DOD's work to develop an initial business enterprise architecture later in our testimony.

Lack of Incentives for Change

The final underlying cause of the department's long-standing inability to carry out needed fundamental reform has been the lack of incentives for making more than incremental change to existing "business-as-usual" processes, systems, and structures. Traditionally, DOD has focused on justifying its need for more funding rather than on the outcomes its programs have produced. DOD generally measures its performance by the amount of money spent, people employed, or number of tasks completed. Incentives for its decision makers to implement changed behavior have been minimal or nonexistent. Secretary Rumsfeld perhaps said it best in announcing his planned transformation at DOD: "There will be real consequences from, and real resistance to, fundamental change."

[34] U.S. General Accounting Office, *Financial Management: DOD Improvement Plan Needs Strategic Focus*, GAO-01-764 (Washington, D.C.: Aug. 15, 2001).

The lack of incentive has been most evident in the department's acquisition area. In DOD's culture, the success of a manager's career has depended more on moving programs and operations through the DOD process than on achieving better program outcomes. The fact that a given program may have cost more than estimated, taken longer to complete, and not generated results or performed as promised was secondary to fielding a new program. To effect real change, actions are needed to (1) break down parochialism and reward behaviors that meet DOD-wide and congressional goals, (2) develop incentives that motivate decision makers to initiate and implement efforts that are consistent with better program outcomes, including saying "no" or pulling the plug on a system or program that is failing, and (3) facilitate a congressional focus on results-oriented management, particularly with respect to resource-allocation decisions.

Keys to Fundamental Financial Management Reform and Progress to Date

Successful reform of DOD's fundamentally flawed financial management operations must simultaneously focus on its systems, processes, and people. While DOD has made some encouraging progress in addressing specific challenges, it is still in the very early stages of a departmentwide reform that will take many years to accomplish. As a result, it is not possible to predict when—or even whether—the effort will be successful.

Our experience has shown there are several key elements that collectively would enable the department to effectively address the underlying causes of its inability to resolve its long-standing financial management problems. For the most part, these elements, which should not be viewed as independent actions but rather a set of interrelated and interdependent actions, are consistent with those discussed in the department's April 2001 financial management transformation report.[35] These elements, which we believe are key to any successful approach to financial management reform, include

- addressing the department's financial management challenges as part of a comprehensive, integrated, DOD-wide business reform;
- providing for sustained leadership by the Secretary of Defense and resource control to implement needed financial management reforms;

[35]Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change*, (Washington, D.C.: Apr. 13, 2001).

- establishing clear lines of responsibility, authority, and accountability for such reform tied to the Secretary;
- incorporating results-oriented performance measures and monitoring tied to financial management reforms;
- providing appropriate incentives or consequences for action or inaction;
- establishing and implementing an enterprise architecture to guide and direct financial management modernization investments; and
- ensuring effective executive and congressional oversight and monitoring.

While DOD still has a long way to go, it has made serious efforts to address many of the key areas over the past 2 years. We will discuss each of the areas and provide examples of improvement actions—long-term and/or short-term—where relevant. Both long-term actions focused on the Secretary's envisioned business transformation and short-term actions focused on improvements within existing systems and processes are critical to forward movement.

Integrated Business Reform Strategy

As we previously reported,[36] establishing the right goal is essential for success. Central to effectively addressing DOD's financial management problems will be the recognition that they cannot be addressed in an isolated fashion separate from the other high-risk areas and management challenges facing the department. Further, successfully reforming the department's operations—which consist of people, business processes, and technology—will be critical if DOD is to effectively address the deep-rooted organizational emphasis on maintaining business-as-usual across the department. DOD has recently taken important steps to begin improving its people, processes, and systems.

We have reported[37] that many of DOD's financial management shortcomings were attributable in part to human capital issues. In April 2002, DOD published a departmentwide strategic plan for its civilian employees, which sets forth its vision to "design, develop and implement

[36] U.S. General Accounting Office, *Department of Defense: Progress in Financial Management Reform*, GAO/T-AIMD/NSIAD-00-163 (Washington, D.C.: May 9, 2000).

human resources policies, strategies, systems, and tools to ensure a mission-ready civilian workforce that is motivated to excel." Although a positive step, the plan needs further refinement to achieve the Secretary of Defense's transformation initiatives, including (1) integration of component-level plans with the department-level plan, (2) development of key elements, such as results-oriented performance measures, and (3) integration with military personnel planning and sourcing decisions.[38] Recently, DOD proposed a National Security Personnel System that would provide for wide-ranging changes in DOD's civilian personnel pay and performance management. While we strongly support the concept of modernizing and making more flexible federal human capital policies, we have warned that the appropriate infrastructure and adequate safeguards need to be in place for successful implementation and to prevent abuse.[39] In addition, in its fiscal year 2003 Defense Authorization Act, DOD sought and obtained authorization to prescribe certification and credential standards for its professional accounting positions and is currently drafting the relevant regulations. These are important steps in DOD's plans to develop a human capital investment strategy and plan.

The department recently renamed its Financial Management Modernization Program to the Business Management Modernization Program, a move that recognizes that financial management is a crosscutting issue that affects virtually all DOD business areas. For example, improving its financial management operations so that they can produce timely, reliable, and useful cost information is essential to effectively measure its progress towards achieving many key outcomes and goals across virtually the entire spectrum of DOD's business areas. At the same time, the department's financial management problems—and, most importantly, the keys to their resolution—are deeply rooted in and dependent upon developing solutions to a wide variety of management problems across DOD's various organizations and business areas. In line with this, DOD has designated

[37] U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-01-244 (Washington, D.C.: Jan.1, 2001).

[38] U.S. General Accounting Office, *DOD Personnel: DOD Actions Needed to Strengthen Civilian Human Capital Strategic Planning and Integration with Military Personnel and Sourcing Decisions*, GAO-03-475 (Washington, D.C.: Mar. 28, 2003).

[39] U.S. General Accounting Office, *Human Capital: DOD's Civilian Personnel Strategic Management and the Proposed National Security Personnel System*, GAO-03-493T (Washington, D.C.: May 12, 2003).

owners of seven key department business lines,[40] or domains, to transform the department's business operations and implement its enterprise architecture.

As we mentioned earlier, and it deserves emphasis, the department has reported that an estimated 80 percent of the data needed for sound financial management comes not from the Comptroller's operations but from its other business operations, such as its acquisition and logistics communities. DOD's vast array of costly, nonintegrated, duplicative, and inefficient financial management systems reflects its lack of an integrated approach to addressing management challenges. DOD has acknowledged that one of the reasons for the lack of clarity in its reporting under the Government Performance and Results Act has been that most of the program outcomes the department is striving to achieve are interrelated, while its management systems are not integrated. In fact, DOD is redefining its performance metrics and program outcomes as they relate to four risk areas: (1) force management, (2) operations, (3) future challenges, and (4) institutional.

Secretary of Defense Rumsfeld recognized the far-reaching nature of DOD's financial management problems and, on September 10, 2001, he announced a broad, top-priority initiative intended to "transform the way the department works and what it works on." This new broad-based business transformation program incorporates a number of defense reform initiatives begun under previous administrations but also encompasses additional fundamental business reform proposals. However, like defense reform initiatives begun under the previous administration, the transformation program has not yet developed an overarching plan tying all the individual reform efforts together. The development of an overarching plan could take on increased importance, particularly where initiatives are interrelated and up-front investments are required.

DOD has already taken a number of actions under its business transformation program. In this context, the Secretary established a number of top-level councils, committees, and boards, including the Senior Executive Council, the Business Initiative Council, and the Defense

[40]DOD's seven business process areas include: (1) acquisition/procurement, (2) finance, accounting operations, and financial management, (3) human resource management, (4) logistics, (5) strategic planning and budgeting, (6) installations and environment, and (7) technical infrastructure.

Business Practice Implementation Board. The Senior Executive Council was established to help guide efforts across the department to improve its business practices. This council—chaired by the Secretary of Defense, and with membership to include the Deputy Secretary, the military service secretaries, and the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L)—was established to function as the "board of directors" for the department. The Business Initiative Council—comprised of senior DOD and military service officials and headed by the Under Secretary of Defense for Acquisition, Technology and Logistics—was established to encourage the military services to explore new money-saving business practices to help offset funding requirements for transformation and other initiatives. The Defense Business Practice Implementation Board is an advisory board whose mission is to make recommendations to the Senior Executive Committee on strategies for implementing best business practices in matters relating to management, acquisition, production, logistics, personnel leadership, and the defense industrial base.

Our research of successful public and private sector organizations shows that such entities, comprised of enterprisewide executive leadership, provide valuable guidance and direction when pursuing integrated solutions to corporate problems. Inclusion of the department's top leadership could help to break down the cultural barriers to change and result in an integrated DOD approach for business reform.

Sustained Leadership and Resource Control

The department's successful Year 2000 effort illustrated, and our survey of leading financial management organizations[41] captured, the importance of strong leadership from top management. As we have stated many times before, strong, sustained executive leadership is critical to changing a deeply rooted corporate culture—such as the existing "business-as-usual" culture at DOD—and to successfully implementing financial management reform. For example, in the case of the Year 2000 computer challenge, the personal, active involvement of the Deputy Secretary of Defense played a key role in building entitywide support and focus. Given the long-standing and deeply entrenched nature of the department's financial management problems—combined with the numerous competing DOD organizations,

[41] GAO/AIMD-00-134.

each operating with varying, often parochial views and incentives—such visible, sustained top-level leadership will be critical.

In discussing their April 2001 report to the Secretary of Defense on transforming financial management,[42] the authors stated that, "unlike previous failed attempts to improve DOD's financial practices, there is a new push by DOD leadership to make this issue a priority." To demonstrate his commitment towards reforming the department, Secretary Rumsfeld designated improving financial management operations, which included not only finance and accounting but also such business areas as logistics, acquisition, and personnel management, as 1 of the department's top 10 priorities for reform.[43] While the commitment of the Secretary is vital to the success of any DOD-wide reform effort, strong, sustained executive leadership—over a number of years and administrations—will be key to changing a deeply rooted culture and to truly transforming DOD's business systems and operations so that the department can meet the mandate of the CFO Act and achieve the President's Management Agenda goal of improved financial management performance.

Additionally, the tenure of the department's top political appointees has generally been short in duration and as a result, it is sometimes difficult to maintain the focus and momentum that are needed to resolve the management challenges facing DOD. This is particularly evident with the postwar reconstruction of Iraq along with DOD's substantial commitment to the continuing war on terrorism. The resolution of the array of interrelated business system management challenges that DOD faces is likely to span several administrations. As we have proposed in previous congressional testimonies,[44] one option to address the continuity issue would be the establishment of the position of chief operating or

[42]Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change* (Washington, D.C.: Apr. 13, 2001).

[43]The Secretary's top ten priorities: successfully pursue the global war on terrorism, strengthen joint warfighting capabilities, transform the joint force, optimize intelligence capabilities, improve force manning, new concepts of global engagement, counter the proliferation of weapons of mass destruction, homeland security, streamline DOD business processes, and improve interagency processes, focus, and integration.

[44]U.S. General Accounting Office, *DOD Financial Management: Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform*, GAO-02-497T (Washington, D.C.: Mar. 6, 2002); U.S. General Accounting Office, *DOD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment*, GAO-02-784T (Washington, D.C.: June 4, 2002).

management officer. This position could be filled by an individual appointed for a set term of 5 to 7 years with the potential for reappointment. Such an individual should have a proven track record as a business process change agent for large, diverse organizations—experience necessary to spearhead business process transformation across the department and serve as an integrator for business reform.

Clear Lines of Responsibility and Accountability

Another key to reform is the establishment of clear lines of responsibility, decision-making authority, and resource control for actions across the department tied to the Secretary. As we previously reported,[45] such an accountability structure should emanate from the highest levels and include the secretary of each of the military services as well as heads of the department's various major business areas.

The Secretary of Defense has taken action to vest responsibility and accountability for financial management modernization with the DOD Comptroller. In October 2001, the DOD Comptroller established the Financial Management Modernization Executive[46] and Steering Committees as the governing bodies that oversee the activities related to the modernization effort. The Executive Committee is to advise the DOD Comptroller on the modernization effort and provide strategic direction, whereas the Steering Committee is to advise the Executive Committee on the program's performance and provide guidance to the program management office.

Results-oriented Performance

As discussed in our January 2003 report on DOD's major performance and accountability challenges,[47] establishing a results orientation is another key element of any approach to reform. Such an orientation should draw upon results that could be achieved through commercial best practices, including outsourcing and shared servicing concepts. Personnel

[45] GAO/NSIAD-00-72 and GAO-03-458.

[46]Effective December 28, 2001, Sec. 1009 of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, Pub. L. No. 107-107, 115 Stat. 1012, 1206 (codified at 10 U.S.C. Sec. 185), required the Secretary of Defense to establish a Financial Management Modernization Executive Committee.

[47]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-03-98 (Washington, D.C.: Jan. 1, 2003).

throughout the department must share the common goal of establishing financial management operations that not only produce financial statements that can withstand the test of an audit but more importantly, routinely generate useful, reliable, and timely financial information for day-to-day management purposes. To its credit, DOD has initiated a number of improvement actions to address accountability and financial information deficiencies.

- In its most recent performance and accountability report, DOD stated that it had (1) validated cost-estimating models used in calculating environmental liability costs, (2) developed a methodology for estimating liabilities associated with nuclear powered ships and submarines, and (3) issued improved guidance—for all areas except ongoing operations—to help components compile complete, accurate, and fully substantiated environmental liability data. In addition, DOD claimed that it is developing and maintaining supporting documentation and audit trails for 30,000 closed contamination sites, including open and closed installations and base reutilization and alignment sites.

- Through training and implementation of more efficient and effective processes, DOD is improving its fund accounting and disbursement activities. During fiscal year 2002, DOD improved its disbursement activity reporting and its procedures for reconciling its fund balance records with similar information maintained by the Department of Treasury. As a result, the number and amount of disbursement disparities between DOD's records and Treasury's records decreased from the previous year. DOD is taking the necessary first steps to identifying and eliminating payment recording problems.

- DOD's major components must now prepare quarterly financial statements along with extensive footnotes that explain any improper balances or significant variances from previous year quarterly statements. In addition, the midyear and end-of-year financial statements must be briefed to the DOD Comptroller by the service Assistant Secretary for Financial Management or the head of the defense agency. We have observed several of the midyear briefings and have noted that the practice of preparing and explaining interim financial statements is instilling discipline into DOD's financial reporting processes, which will help improve the reliability of DOD's financial data.

- DOD has begun to develop methodologies for valuing and depreciating the cost of its weapons systems and other equipment used to support its military operations. The department completed a similar effort to obtain a baseline for the majority of its real property assets in fiscal year 1999. These valuation efforts represent important steps toward obtaining cost data for management decision making and financial reporting. However, in order for the department to reap the full benefits of these and similar efforts, it must develop and implement efficient and effective systems, processes, and controls—consistent with its enterprise architecture—to sustain the calculated baselines and capture subsequent additions, modifications, and deletions of property assets.

Since the Secretary has established an overall business process transformation goal that will require a number of years to achieve, going forward it is especially critical for managers throughout the department to focus on specific metrics that, over time, collectively will translate to achieving this overall goal. It is important for the department to refocus its annual accountability reporting on this overall goal of fundamentally transforming the department's financial management systems and related business processes to include appropriate interim annual measures for tracking progress toward this goal.

In the short term, it is important to focus on actions that can be taken using existing systems and processes. It is critical to establish interim measures to both track performance against the department's overall transformation goals and facilitate near-term successes using existing systems and processes. The department has established an initial set of metrics intended to evaluate financial performance and it has seen improvements. For example,

- With respect to closed appropriation accounts, during the first 6 months of fiscal year 2002, DOD reported a reduction in the dollar value of adjustments to closed appropriation accounts of about 80 percent from the same 6-month period in fiscal year 2001.

- For DOD individually billed travel cards, the delinquency rate dropped from 8.9 percent in March 2002 to 5.7 percent in March 2003.

- From March 2001 through March 2003, DOD reduced its commercial pay backlogs (payment delinquencies) by 46 percent and its payment recording errors by 43 percent.

While DOD's metrics show significant improvements from 2001 to today, statistics for the last few months show that progress has slowed or even taken a step backward for payment recording errors and commercial pay backlogs. Our report on DOD's metrics program[48] included a caution that, without modern integrated systems and the streamlined processes they engender, reported progress may not be sustainable if workload is increased. It could be that DOD is experiencing problems accounting for the additional volume of transactions resulting from contingency funding and increased appropriations amounts.

We note that DOD is still formulating departmentwide performance goals and measures to align with the outcomes described in its strategic plan—the September 2001 Quadrennial Defense Review. We agree with the department's efforts to expand the use of appropriate metrics to guide its financial management reform efforts. However, it is important for DOD to synchronize its development of these metrics with it efforts to develop departmentwide goals and measures, including nonfinancial metrics, to ensure consistency.

Incentives and Consequences

Another key to breaking down the parochial interests and stovepiped approaches that have plagued previous reform efforts is establishing mechanisms to reward organizations and individuals for behaviors that comply with DOD-wide and congressional goals. Such mechanisms should be geared to providing appropriate incentives and penalties to motivate decision makers to initiate and implement efforts that result in fundamentally reformed financial management and other business support operations.

In addition, such incentives and consequences are essential if DOD is to break down the parochial interests that have plagued previous reform efforts. Incentives driving traditional ways of doing business, for example, must be changed, and cultural resistance to new approaches must be overcome. Simply put, DOD must convince people throughout the department that they must change from business-as-usual systems and practices or they are likely to face serious consequences, organizationally and personally.

[48]U.S. General Accounting Office, *Financial Management: DOD's Metrics Program Provides Focus for Improving Performance*, GAO-03-457 (Washington, D.C.: Mar. 28, 2003).

If people are to be held more accountable for achieving desired outcomes, then DOD must make sure that such outcomes are in fact, achievable. Along these lines, DOD has taken a positive step to reform its acquisition process by revising part of its acquisition regulations related to weapons systems. The revisions have focused primarily on (1) making sure technologies are demonstrated to a high level of maturity before beginning a weapon system program and (2) taking an evolutionary, or phased, approach to developing a system. Separating technology development from a weapons system development program would help curb incentives to over-promise the capabilities of a new weapon system and to rely on immature technologies. Also, an evolutionary approach to developing requirements and making improvements to a system's capabilities is different from the historical approach of trying to deliver all desired capabilities in one "big bang." In addition, it has been reported that DOD plans to begin using program cost estimates from the Office of the Secretary of Defense's Cost Analysis Improvement Group, rather than those prepared by the military services, which may lead to more realistic cost estimates when pricing programs.

Enterprise Architecture

Enterprise architecture development, implementation, and maintenance are a basic tenet of effective IT management. Used in concert with other IT management controls, an architecture can increase the chances for optimal mission performance. We have found that attempting to modernize operations and systems without an architecture leads to operational and systems duplication, lack of integration, and unnecessary expense. Our best practices research of successful public and private sector organizations has similarly identified enterprise architectures as essential to effective business and technology transformation.[49]

Following our May 2001 report,[50] the Secretary of Defense directed the development and implementation of a departmentwide enterprise architecture, and established a program to accomplish this. In doing so, the Secretary assigned responsibility for the program to the DOD

[49]U.S. General Accounting Office, *Executive Guide: Improving Mission Performance through Strategic Information Management and Technology*, GAO/AIMD-94-115 (Washington, D.C.: May 1, 1994).

[50]U.S. General Accounting Office, *Information Technology: Architecture Needed to Guide Modernization of DOD's Financial Operations*, GAO-01-525 (Washington, D.C.: May 17, 2001).

Comptroller, in coordination with the Under Secretary of Defense for AT&L and the DOD Chief Information Officer. To assist in overseeing and guiding the program, the DOD Comptroller established the Financial Management Modernization Executive Committee to oversee the architecture and systems modernization efforts, and the Financial Management Modernization Steering Committee to advise and guide the program. Efforts began in earnest in April 2002 when DOD hired a contractor to develop the department's enterprise architecture.

The Clinger-Cohen Act of 1996[51] requires major departments and agencies to develop, implement, and maintain an integrated architecture. As we previously reported,[52] such an architecture can help ensure that the department invests only in integrated business system solutions and, conversely, will help move resources away from non-value-added legacy business systems and nonintegrated business system development efforts. Without a complete enterprise architecture to guide information technology investments, and adequate oversight of IT investments to ensure compliance, DOD runs the serious risk that its investments will perpetuate the existing systems environment that suffers from systems duplication, limited interoperability, and unnecessarily costly operations and maintenance.

The fiscal year 2003 National Defense Authorization Act (the Act),[53] enacted on December 2, 2002, required DOD to develop by May 1, 2003, a financial management enterprise architecture and a transition plan for implementing the architecture that meet certain requirements. The Act also requires DOD to control expenditures for financial system improvements while the architecture and transition plan are being developed and after they are completed. According to DOD, the Comptroller approved the initial version of the department's business enterprise architecture in May 2003. Developing and implementing a business enterprise architecture for an organization as large and complex as DOD is a formidable challenge but it is key to achieving the Secretary's vision of relevant, reliable, and timely financial information needed to

[51]Clinger-Cohen Act of 1996, Pub. L. 104-106, Div. E, 110 Stat. 679, Feb. 10, 1996 (codified as amended at scattered sections of the U.S.C.).

[52] GAO/T-AIMD/NSIAD-00-163.

[53]Bob Stump National Defense Authorization Act for Fiscal Year 2003, Pub. L. 107-314, Sec. 1004, 116 Stat. 2458, 2629, Dec. 2, 2002.

support the department's vast operations. We plan to report on DOD's progress in developing its architecture and its transition efforts in the near future.

As part of its ongoing business system modernization effort and consistent with our past recommendations,[54] DOD is creating a repository of information about its existing systems environment. To accomplish this, DOD initiated an extensive effort to document its business systems currently relied upon to carry out financial management operations throughout the department. To date, the department has identified approximately 2,300 systems that support its business operations. In developing its systems inventory, DOD has recognized that financial management is broader than just accounting and finance systems. Rather, it includes the department's acquisition, budget formulation, inventory management, logistics, personnel, and property management systems.

DOD is investing billions of dollars in financial management solutions and business process reform. In moving forward with the implementation of its business enterprise architecture, DOD needs to ensure that the multitude of systems efforts currently underway are designed as an integral part of the architecture. The effort to implement the architecture will be further complicated as the department strives to develop multiple architectures across its various business areas and organizational components. In this regard, it is critical that DOD has the management structure and processes in place to effectively control the estimated $19 billion that will be spent on its business systems in fiscal year 2004. However, as we have previously reported,[55] the department has yet to establish the requisite investment governance structure and process controls needed to adequately align ongoing investments with its architectural goals and direction. To its credit, the department has recognized that it cannot continue with the proliferation of duplicative, nonstandard, and nonintegrated systems and is in the process of developing policies and procedures to obtain better visibility and accountability over its IT business system investments. A key to success will be DOD's ability to effectively manage and oversee its investments in systems. DOD can ill afford to invest billions of dollars in

[54] U.S. General Accounting Office, *Financial Management: Analysis of DOD's Inventory of Financial Management Systems Is Incomplete*, GAO/AIMD-97-39 (Washington, D.C.; Jan. 29, 1997); *Financial Management: DOD Improvement Plan Needs Strategic Focus*, GAO-01-764 (Washington, D.C.: Aug. 17, 2001).

[55] GAO-03-458.

systems that are not capable of providing DOD management and the Congress with more accurate, timely, and reliable information on the results of the department's business operations.

Monitoring and Oversight

Ensuring effective monitoring and oversight of progress will also be key to bringing about effective implementation of the department's financial management and related business process reform. We have previously testified[56] that periodic reporting of status information to department top management, the Office of Management and Budget, the Congress, and the audit community is another key lesson learned from the department's successful effort to address its Year 2000 challenge.

Previous submissions of the department's *Financial Management Improvement Plan* have simply been compilations of data call information on the stovepiped approaches to financial management improvements received from the various DOD components. It is our understanding that DOD plans to change its approach and anchor the plan in the enterprise architecture. If the department's future plans are upgraded to provide a departmentwide strategic view of the financial management challenges facing the department, along with planned corrective actions and milestones, these plans can serve as an effective tool not only to help guide and direct the department's financial management reform efforts, but also to help maintain oversight of the department's financial management operations. Going forward, this Subcommittee's oversight hearings, as well as the active interest and involvement of the defense appropriations and authorization committees, will continue to be key to effectively achieving and sustaining DOD's financial management and related business process reform milestones and goals.

In conclusion, we support Secretary Rumsfeld's vision for transforming the department's financial and business related operations. The continued leadership and support of the Secretary and other DOD top executives will be essential to successfully change the DOD culture that has over time perpetuated the status quo and been resistant to a transformation of the magnitude envisioned by the Secretary. As noted throughout this testimony, DOD is taking steps to begin transformation; however, the

[56] GAO-01-244.

events of September 11, 2001, the continuing war on terrorism, and the reconstruction of Iraq may dilute the focused attention and sustained action that are necessary to fully realize the Secretary's transformation goal, a situation that is understandable given the circumstances. At the same time, with waste and inefficiencies potentially costing $20 billion or more annually, true reform is needed to restore public confidence that taxpayer dollars are well spent in meeting our national defense objectives.

Mr. Chairman, this concludes my statement. I would be pleased to answer any questions you or other members of the Subcommittee may have at this time.

Contacts and Acknowledgments

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