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FINANCIAL MANAGEMENT

Analysis of DOD's First Biennial Financial Management Improvement Plan

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Management Division

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

The Honorable Floyd D. Spence
Chairman
The Honorable Ike Skelton
Ranking Minority Member
Committee on Armed Services
House of Representatives

Section 1008 of the National Defense Authorization Act for Fiscal Year 1998 (Public Law 105-85) required that the Secretary of Defense submit to the Congress a biennial strategic plan for the improvement of financial management within the Department of Defense (DOD). The plan is to be submitted not later than September 30 of each even-numbered year and is to address all aspects of financial management within DOD, including the finance systems, accounting systems, and data feeder systems that support its financial functions. Each plan is to include a statement of the Secretary of Defense's concept of operations for financial management. In addition, the act directed that the first plan include a discussion of 12 specific financial management topics. Section 912 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 (Public Law 105-261) required GAO to analyze DOD's Biennial Plan and discuss the extent to which it is a workable plan for addressing DOD's financial management problems.

DOD submitted its Biennial Plan to the Congress on October 26, 1998. Volume I of the Biennial Plan includes three main sections: the concept of operations, the current environment, and the transition plan intended to describe the department's goals for achieving the target financial management environment and to identify the strategies and corrective actions necessary to move through the transition. Volume II of the Plan provided information on the specific financial management improvement initiatives intended to implement the transition plan. To address the section 912 requirements, our objectives were to determine whether (1) the concept of operations included the critical elements necessary for

producing sustainable financial management improvement over the long term and (2) the transition plan provided a strategic-level "road map" from the current environment to DOD's planned future financial management environment. This report also includes a discussion of additional technical details that would be needed to determine whether implementation of the department's future financial management environment is practical, cost-effective, and feasible.

We are continuing to review the 12 specific financial management areas that DOD included in its first plan and will provide any observations concerning DOD's discussion of these topics at a later date. Further details on our scope and methodology are in appendix I.

Results in Brief

DOD's Biennial Plan represents a great deal of effort and provides a first-ever vision of the department's future financial management environment. In developing this overall concept of its envisioned financial management environment, DOD has taken an important first step in improving its financial management operations. The department's Biennial Plan also represents a significant landmark because it includes, for the first time, a discussion of the importance of the programmatic functions of personnel, acquisition, property management, and inventory management to the department's ability to support consistent, accurate information flows to all information users. In addition, DOD's Biennial Plan includes an impressive array of initiatives intended to move the department from its current state to its envisioned financial management environment.

If effectively implemented, the initiatives discussed should result in some improvements in DOD's financial management operations. However, the department's Biennial Plan lacks certain critical elements necessary for producing sustainable financial management improvement over the long term. Specifically, the Plan's discussion of how DOD's financial management operations will work in the future—its concept of operations—does not address (1) how its financial management operations will effectively support not only financial reporting but also asset accountability and control and (2) budget formulation.

In addition, the transition plan, while an ambitious statement of DOD's planned improvement efforts, has two important limitations: (1) links are not provided between the envisioned future operations and the over 200 planned improvement initiatives to determine whether the proposed transition will result in the target financial management environment and

(2) actions to ensure feeder systems' data integrity are not addressed—an acknowledged major deficiency in the current environment. Without identifying specific actions that will ensure feeder system data integrity, it is unclear whether the department will be able to effectively carry out not only its financial reporting, but also its other financial management responsibilities.

Finally, additional detailed information would be necessary to determine whether implementation of the department's future financial management environment is practical, cost-effective, and feasible. Such details are appropriately not included in the strategic financial management improvement plan that DOD was asked to provide. For example, a systems architecture—consisting of information such as the portfolio of desired systems, detailed information flows, and specific technical requirements—would not be expected as part of a strategic improvement plan. However, developing the architecture, and other additional detailed information, would be the next step toward achieving the department's target financial management environment. DOD officials have stated that they recognize that additional information will be necessary and that they are developing further details on these issues.

In commenting on a draft of this report, the Under Secretary of Defense (Comptroller) stated that DOD took issue with each of the report's major findings and with all of the recommendations. DOD stated that it appreciated the recognition that the report provides regarding the magnitude of the effort that the department expended in the preparation of the report and the challenges that the department will face in implementing its ambitious financial management reform initiatives. However, DOD disagreed that the Biennial Plan lacked critical elements and stated that parts of the report appear to reflect a lack of awareness of the department's actions for improving its financial management. In addition, DOD stated that the draft report contained misleading statements and used inflammatory language.

We disagree with DOD's comments. The department's comments reflect a basic disagreement with us over the role and definition of financial management and how this function should support various critical program functions. Our views on the scope and requirements of accounting, finance, and feeder systems are fully supported by the mandates and goals of the CFO Act of 1990 and the Federal Financial Management Improvement Act of 1996, as well as by OMB and JFMIP guidance, reports, and pronouncements. As shown in the report, most of

our responses to DOD's comments can be traced to this fundamental disagreement over the role of financial management in supporting the agency's operations.

Background

The primary objective of the Chief Financial Officers (CFO) Act of 1990 Public Law (101-576) is improving the financial management of federal agencies. Among the specific requirements of the CFO Act is that each agency CFO develop an integrated agency accounting and financial management system, including financial reporting and internal controls. Such systems are to comply with applicable principles and standards and provide complete, reliable, consistent, and timely information that is responsive to the agency's financial information needs. DOD's Financial Management Regulation[1] also specifies that the department's CFO is to develop and maintain an integrated DOD accounting and financial management system, including financial reporting and internal controls, that provides for the integration of accounting and budgeting information. In addition, the Joint Financial Management Improvement Program (JFMIP)[2] Framework for Federal Financial Management Systems states that the financial management system should not only support the basic accounting functions for accurately recording and reporting financial transactions, but must also be the vehicle for integrated budget, financial, and performance information that managers use to make decisions on their programs.

Further, the Federal Financial Management Improvement Act (FFMIA) of 1996 requires agencies to implement and maintain financial management systems that substantially comply with federal financial management systems requirements, applicable accounting standards, and the standard general ledger. The legislative history of FFMIA expressly refers to JFMIP requirements and Office of Management and Budget (OMB) Circular A-127 as sources of the financial management systems requirements.

JFMIP's Framework for Federal Financial Management Systems defined an agency's financial management operations to encompass the relationships among the program delivery financing function, the budget formulation/transaction tracking function, and the financial accountability

[1]DOD's Financial Management Regulation (volume I, chapter 1).

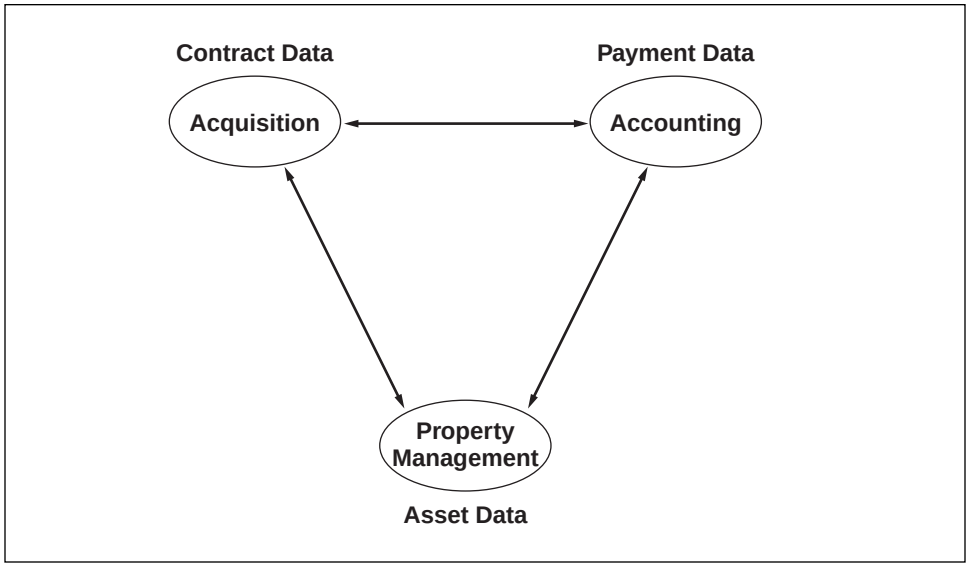
[2]JFMIP is a cooperative undertaking of the U.S. Department of the Treasury, the U.S. General Accounting Office, the Office of Management and Budget (OMB), and the Office of Personnel Management and was organized to improve governmentwide financial management. JFMIP's Framework for Federal Financial Management Systems (January 1995) defines the scope of an agency's financial management systems.

function. The integration of systems is a key element to achieving these functional relationships. OMB Circular A-127, Financial Management Systems, requires federal agencies to ". . . establish and maintain a single, integrated financial management system."

Benefits of a Single Integrated Financial Management System

A single integrated financial management system ensures that adequate financial controls are in place through the linkage of the budget formulation, financial accountability, and transaction processes. In addition, an integrated financial management system provides for improvements in efficiency, including reductions in the potential for errors and rework. Figure 1 is a simplified example of how a single integrated financial management system for asset acquisition can help achieve greater control and accountability.

Figure 1: Example of How Systems Integration Helps Achieve Greater Control



As shown in this example, integration would allow contract data to be entered initially by acquisition personnel when an asset was ordered. This information would be available to accounting personnel to record the obligation and property management to recognize that an asset is to be delivered. Upon asset receipt, property management personnel enter the asset in property management records. Those records are available for accounting personnel for payment purposes, for acquisition personnel to

monitor contract delivery, and for property management personnel to monitor program results and the use of budgetary resources. Under a single integrated financial management system, greater asset control and accountability is achieved because data associated with assets acquired are available simultaneously to accounting, property management, and acquisition personnel.

Alternatively, in the absence of a single integrated system, OMB Circular A-127 permits a unified set of financial systems that are planned for and managed together, operated in an integrated fashion, and linked together electronically in an efficient and effective manner to provide agencywide financial system support necessary to carry out an agency's mission and support its financial management needs. Under a unified integrated system, data reside in multiple systems that are linked by interfaces. Data integrity can be ensured by compensating controls, such as reconciliation. For example, if property management records do not include data on an asset for which the accounting records indicate payment has been made, the necessary steps can be taken to determine if the asset was in fact acquired and to determine its current location, or if the accounting records need to be corrected.

DOD's audited financial statements prepared under the CFO Act provide for an annual scorecard on the department's progress in resolving its financial management deficiencies. To date, DOD has not passed this test of its ability to produce reliable financial information. The most recent audits of DOD's financial statements identified pervasive weaknesses across virtually the full spectrum of the department's systems and controls, including material weaknesses in DOD's ability to

- maintain accountability and control over virtually every category of physical assets, including military equipment;
- account for the full cost of its operations and the extent of its liabilities; and
- properly record and reconcile disbursements, which has resulted in numerous erroneous and several fraudulent payments.

Correcting the department's long-standing systems' weaknesses will be critical if DOD is to resolve these serious financial management weaknesses. Until the department can successfully integrate its information systems, its ability to efficiently and effectively maintain accountability over its vast resources, prevent wasted resources, and achieve broader management reforms will continue to be impaired.

Concept of Operations Key to Improving Financial Management

Another key element of improving an agency's financial management is the development of a high-level description of how it carries out its financial management responsibilities—a concept of operations. The importance of this step was emphasized by the Congress in including this requirement in DOD's fiscal year 1998 authorization act.

A concept of operations defines how an entity's operations are (or will be) carried out. It includes a high-level description of the operations that must be performed and who must perform them. As we noted in a June 1997 letter,[3] for the concept of operations to be useful, it should encompass (1) all of DOD financial management, not just the finance and accounting functions performed by the Defense Finance and Accounting Service (DFAS), and (2) both current and future financial management operations to document how the department is working today and to obtain mutual agreement from all parties on how DOD will conduct its financial management operations in the future.

First Biennial Plan Important Step Toward Improving Financial Management

In developing its concept of operations as part of its Biennial Plan, DOD has taken an important step in improving its financial management operations. DOD has reported, for the first time, the importance of the programmatic functions of personnel, acquisition, property management, and inventory management to the department's ability to support consistent, accurate information flows to all information users. Specifically, the department's Biennial Plan recognizes that approximately 80 percent of its financial data is derived from program functions and identifies the integrity of these data as critical to the success of the future financial improvement efforts. Recognizing the root of the problem is the first step towards finding the appropriate solution.

DOD's Biennial Plan is an ambitious undertaking. The 1998 authorizing legislation requires that the department's Biennial Plan address all aspects of financial management. The Biennial Plan encompasses over 900 pages of text and provides information on over 200 separate financial management improvement initiatives. In addition, according to DOD, the Biennial Plan incorporates the department's response to the annual financial reporting requirements specified in other regulatory legislation, including the following:

- the CFO Act requirement for a CFO Five Year Plan,

[3]Financial Management: Comments on DFAS' Draft Federal Accounting Standards and Requirements (GAO/AIMD-97-108R, June 16, 1997).

- the Federal Financial Management Improvement Act requirement for a Remediation Plan for correcting systems deficiencies, and
- the Federal Managers' Financial Integrity Act requirement for a Statement of Assurance for the agency's financial management systems.

The DOD Inspector General, in the DOD financial statement audit report, must provide his opinion on whether the Biennial Plan satisfies the FFMIA requirements for a systems remediation plan. For the purposes of this analysis, we did not evaluate whether the plan meets the other legislative requirements.

Because of the range and amount of detailed information contained in the department's Biennial Plan, it is divided into two volumes. Volume I of the Biennial Plan includes an executive summary followed by three main sections on the concept of operations, the current environment, and the transition plan intended to describe the department's goals for achieving the target financial management environment and to identify the strategies and corrective actions necessary to move through the transition. A section on the 12 specific topics that are required to be addressed is also included. Volume II of the Plan provided information on the specific financial management improvement initiatives that, according to the department, are intended to implement the transition plan. The initiatives include improvements to existing systems, development of new systems, and studies to develop strategies and goals for specific problem areas.

DOD's Concept of Operations Missing Key Elements

In its Biennial Plan, DOD stated that the purpose of its concept of operations was to describe how the department will structure and manage financial operations in the future to be in compliance with applicable regulatory requirements.[4] The Biennial Plan further stated that the department will use this concept of operations to guide the evolution of its financial management policies, systems, functions, and improvement initiatives by specifying the target environment needed to meet regulatory requirements and produce auditable financial statements.

However, the concept of operations does not address two critical elements that are necessary for producing sustainable financial management improvement over the long term. Specifically, the concept of operations does not address (1) how its financial management operations effectively

[4]The regulatory requirements DOD referred to were the CFO Act, the Federal Managers' Financial Integrity Act of 1982, and FFMIA.

support not only financial reporting but also asset accountability and control, and (2) budget formulation.

First, the department's concept of operations does not clearly address the department's fundamental financial management responsibilities for asset accountability and control. DOD's concept of operations appears to focus primarily on financial reporting and the information needed from the program managers to prepare auditable financial statements. The flow of information among functional areas, such as how acquisition will provide information to property management is not clear. This flow of information helps promote accountability. Maintaining financial accountability over DOD's assets is an area of continuing concern because, in the current environment, the department must rely on fundamentally weak controls. DOD currently obtains the data needed by the department's accounting personnel for financial reporting from its property management systems after items are received and entered into those systems. There is no reconciliation of that information with acquisition and payment data. Without such reconciliations, DOD's ability to maintain effective asset accountability and control is impaired.

While acknowledging the importance of integration, the plan enumerates the costs and disadvantages of integration. These include (1) data structures would need to be standardized across integrated systems, (2) maintenance of shared data must be timely and well executed since many integrated systems may be affected, and (3) business processes, procedures, and practices must be modified commensurate with the integrated network. These could all be viewed as advantages of integration, and including them as disadvantages sends mixed messages on the department's intentions to integrate its systems. Defining the needed integrated relationships is vital to ensuring that adequate financial controls not only facilitate financial reporting, but also help maintain effective asset accountability. As stated, under an integrated system, DOD's accounting and logistic functions would obtain data on asset acquisitions from the department's acquisition community data. These data could then be reconciled with subsequent logistics records as the assets are placed in service at DOD locations around the world.

Second, the department's concept of its financial operations does not include the budget formulation processes. The DOD plan states that it intentionally excluded budget formulation because it is performed as part of the department's Planning, Programming, and Budgeting System (PPBS). However, budget formulation is one of the central processes involved in

any agency's financial management operations and must be included in the department's concept of operations to develop a fully integrated financial management system.

One of the primary goals of the CFO Act is to better integrate budget and accounting information. The CFO Act requires each agency CFO to monitor budget execution and to develop and maintain systems which integrate accounting and budget information. The integration of budget formulation with budget execution and accounting is necessary to help ensure that budgets consider financial implications and that policy decisions are based on sound financial information. Furthermore, JFMIP's Framework document identified the integration of budgeting and accounting as the first step to establishing a firm financial management information foundation. Such integration would provide a record of historical costs and performance data that is key to reliably estimating future costs.

Therefore, it is important for DOD to determine how actual cost and financial management data from other systems will flow to PPBS, which incorporates DOD's budget formulation systems and processes, and be used in the budget process. DOD stated in its Government Performance and Results Act Annual Performance Plan for Fiscal Year 1999 that it will use existing data systems and reports supporting the PPBS process to verify and validate performance information.[5] However, as discussed in a June 1998 report on the results of our review of DOD's Annual Performance Plan for Fiscal Year 1999, the DOD performance plan does not address known system deficiencies.[6] For example, we previously reported[7] that the weaknesses in the Army's systems used to account for and control major equipment items and real property, adversely affected its ability to make reliable budget requests for procurement and real property maintenance. However, because budget formulation is excluded from DOD's concept of operations, it does not discuss how PPBS will be supported by these systems and how known deficiencies will be addressed.

[5]The Government Performance and Results Act of 1993 requires each agency to prepare an annual performance plan covering each program activity set forth in the budget of the agency. The performance plan is to include a description of how the agency will verify and validate the reported information.

[6]Observations on DOD's Annual Performance Plan (GAO/NSIAD-98-188R, June 5, 1998).

[7]Financial Management: Army Real Property Accounting and Reporting Weaknesses Impede Management Decision-making (GAO/AIMD-94-9, November 2, 1993) and Army Logistics Systems: Opportunities to Improve the Accuracy of the Army's Major Equipment Item System (GAO/AIMD-98-17, January 23, 1998).

Transition Plan Does Not Provide a Road Map From the Current Environment to DOD's Future Financial Management System

The transition plan, while an ambitious statement of DOD's planned improvement efforts, has two important limitations: (1) clear links are not provided between the envisioned future operations and the numerous planned improvement initiatives to determine whether the proposed transition will result in the target financial management environment and (2) actions to ensure feeder systems' data integrity are not addressed.

Links Not Fully Described

A vital part of any transition plan is a description of how the specific initiatives in the plan bridge the gap between the current environment and the envisioned environment. Thus, describing how the current environment operates is an important step in being able to choose and implement the improvement initiatives. In other words, DOD needs to know where it stands now to help it map out how it will get to its final destination—improved financial management.

The plan's discussion of the current environment included key information such as (1) the roles and responsibilities of the Under Secretary of Defense (Comptroller), DFAS, military departments, the defense agencies and the DOD management oversight structure, (2) the operational structure of finance and accounting including DFAS functions, the military departments' and defense agencies' finance and accounting functions, and the DOD technical supporting structure, and (3) the status of impediments to auditable financial statements, including inadequate program feeder and core systems. In addition, Volume II of the department's Biennial Plan includes overview information on over 200 specific initiatives.

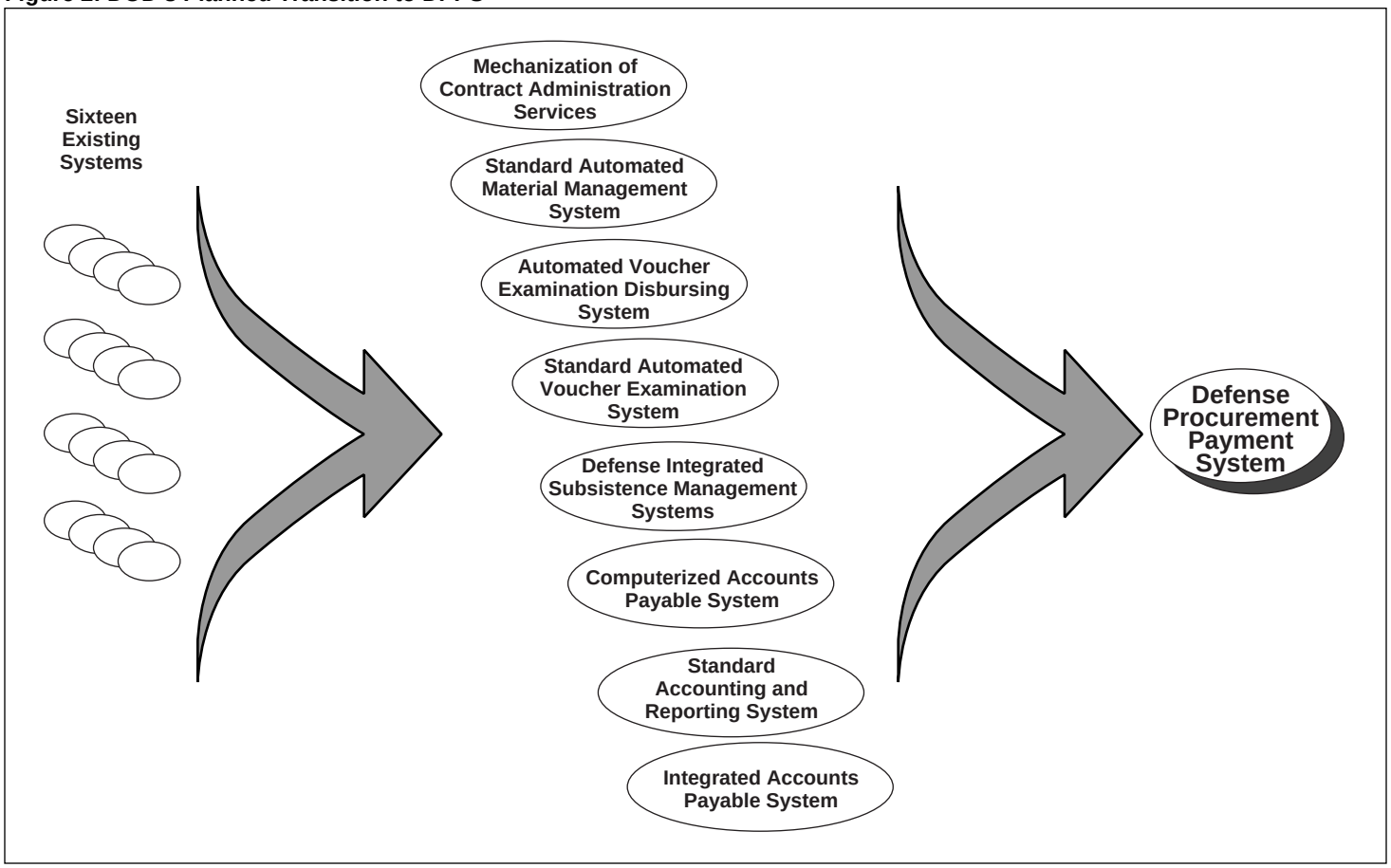
However, Volume II does not discuss how each of these discrete initiatives will contribute to DOD's ability to achieve its envisioned concept for its financial management operations. In addition, the transition plan generally does not provide a high-level description of how information currently flows from one function to another. While DOD's planned concept of operations and transition plan are organized by function, information by function on the current environment is generally not included. These omissions make it difficult to track from the current environment to the target financial management environment by function and to determine how the many initiatives included in the transition plan will move the department from the "as is" to the future. A clear link between the department's envisioned concept for its financial operations and each of

its specific initiatives by function will be essential if DOD is to ensure that each of these initiatives receives the proper priority attention and resources.

However, based on information included in the various sections of the Biennial Plan, we were able to identify one example of a specific function for which DOD depicted how it was planning to move from the current environment to the target environment. This type of high-level description of how the department plans to move from its current "as is" to the envisioned future financial environment could serve as a model for the department's other functional areas.

Specifically, the type of high-level "road map" provided in the plan for the transition from the department's "as is" contract payment function to its envisioned operation of that function is illustrated by excerpts from the plan shown in figures 2 through 4. Figure 2 illustrates the transition of the contract payment function to the target procurement payment system.

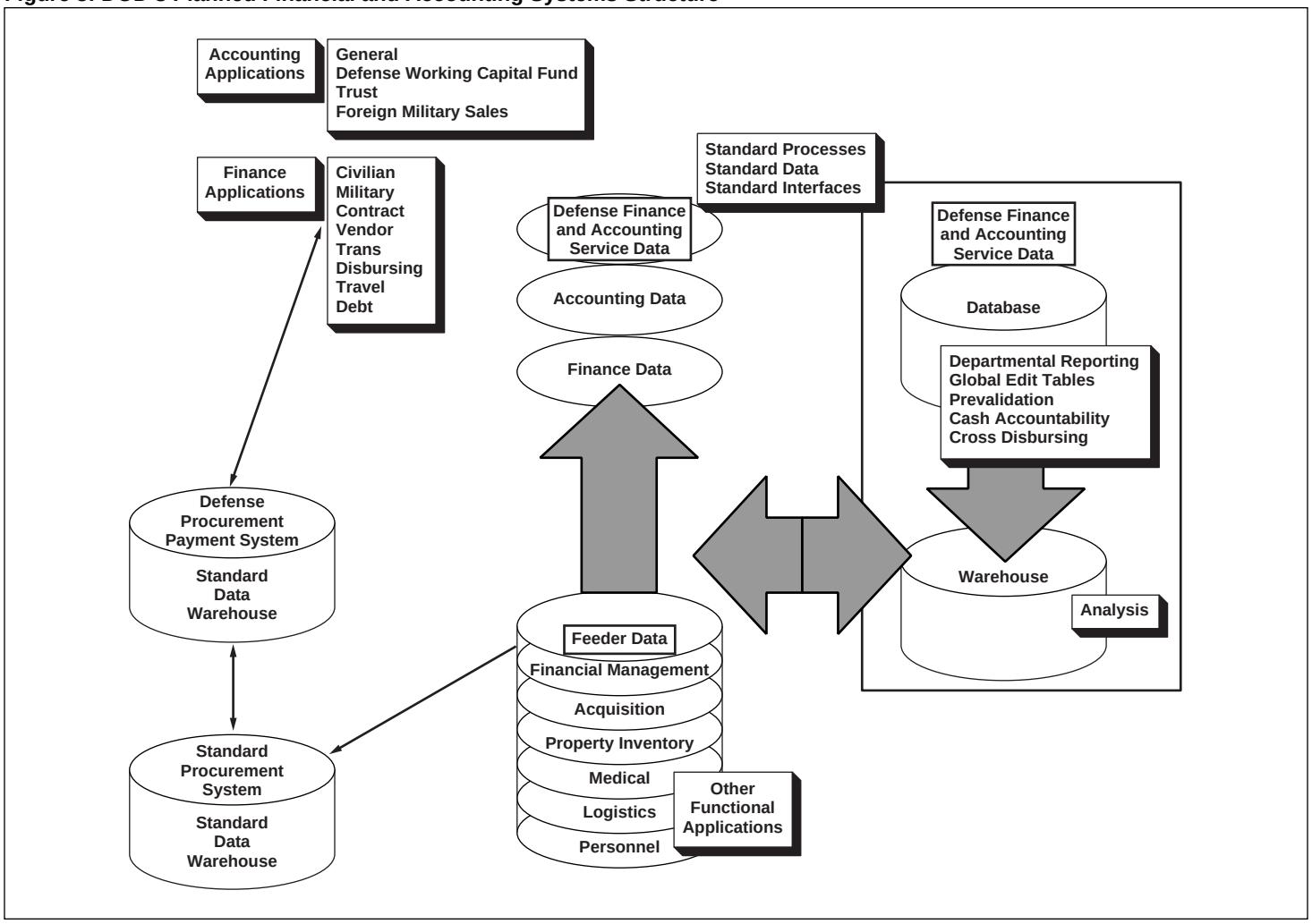
Figure 2: DOD's Planned Transition to DPPS



Source: DOD's Biennial Plan.

Figure 2 indicates that there are 16 existing systems supporting the contract payment function. The figure illustrates that DOD will move from the 16 existing systems to 8, and finally to a single contract payment system, the Defense Procurement Payment System (DPPS). Figure 3 shows DPPS as part of the target environment and illustrates how data from DPPS will become part of the DFAS database and will be available to run DFAS' accounting and finance applications.

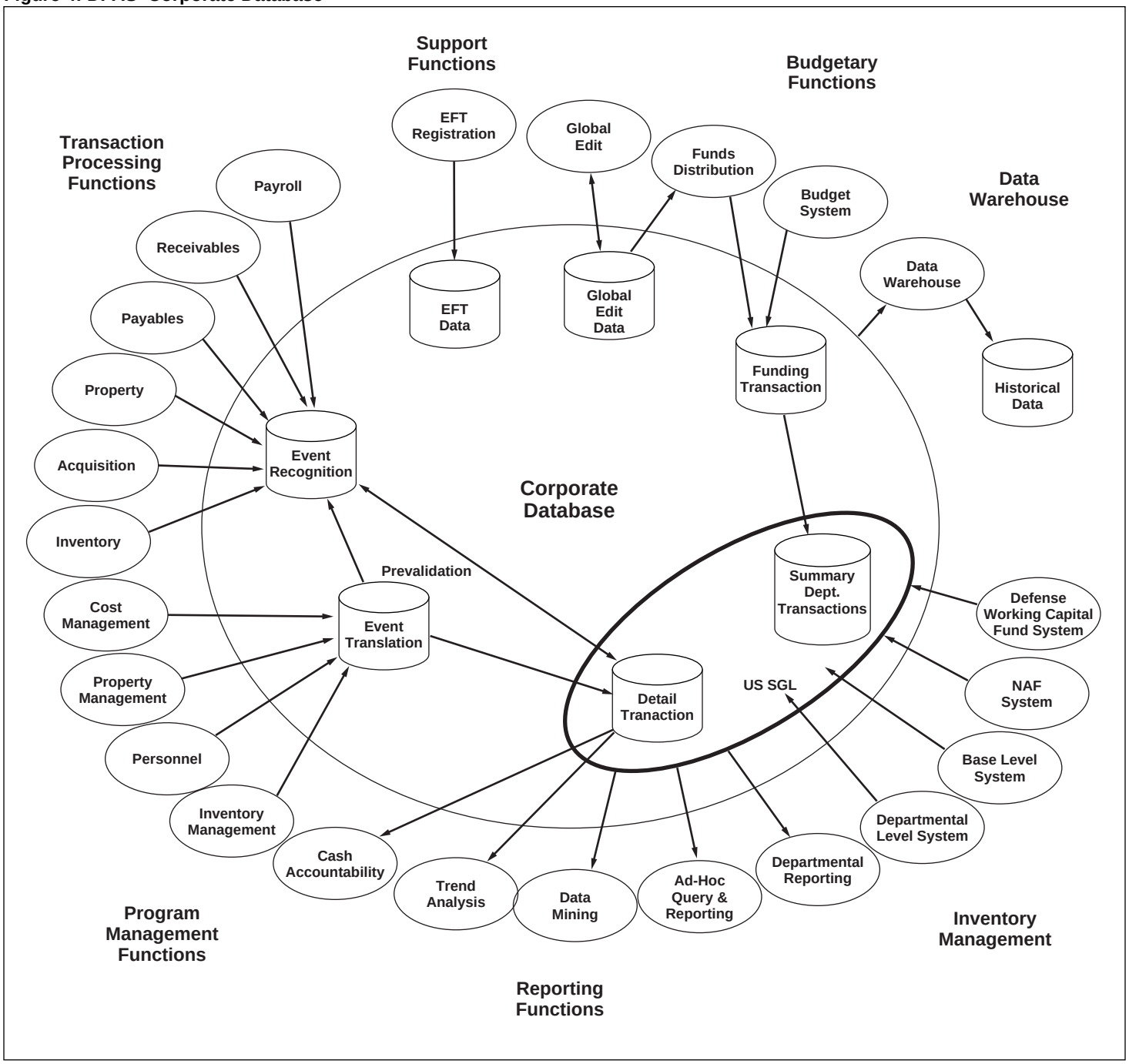
Figure 3: DOD's Planned Financial and Accounting Systems Structure



Source: DOD's Biennial Plan.

Figure 4, which is included in DOD's concept of operations, provides a different view of the planned financial and accounting structure illustrated in figure 3. This is one instance in the plan where users can follow a specific function from the current environment through the DFAS' planned financial and accounting system architecture to the DFAS' Corporate Database as illustrated and discussed in the concept of operations.

Figure 4: DFAS' Corporate Database



Source: DOD's Biennial Plan.

However, even for this one instance, the high-level information is lacking some key details. For example, the plan does not identify the 16 existing systems illustrated in figure 2, their owners, or where they operate. Therefore, we could not determine whether these systems are included in the inventory, although the plan acknowledges that it is critical that an accurate inventory be maintained of all feeder systems required to provide program data to DOD's financial management systems. The plan indicates that there are currently 109 finance and accounting systems and 83 feeder systems for a total of 192 DOD financial management systems. The plan states that the 109 finance and accounting systems will be reduced to 32 by fiscal year 2003. However, the transition plan does not provide a clear description of what systems will be eliminated and how—even at a high-level—nor does the plan discuss how the number of feeder systems will be reduced.

Actions Not Defined for Ensuring Data Integrity

DOD's transition plan acknowledges that it relies on feeder systems' data accuracy to ensure that the data ultimately used for financial management is accurate. Specifically, DOD stated:

> "As an estimated 80 percent of the data needed for financial management come from program systems, the use of modern, fully-integrated, and fully-interfaced program feeder systems is necessary for the Department to be able to provide its managers with the information they need to make informed decisions. The current use of a variety of non-integrated databases precludes the easy or reliable interfacing of information from program functional areas (i.e., personnel, acquisition, and logistics) with the Department's core finance and accounting systems."

The department has also acknowledged problems with the accuracy of data from these feeder systems. In addition, financial statement audit reports have confirmed significant problems with the accuracy of the data produced by the department's supporting logistical, budgetary, and program operating systems. However, the department's transition plan does not explicitly address how these acknowledged significant feeder system data integrity problems will be resolved. Ideally, data should be processed at the original point of entry in a manner to ensure that only accurate, complete data are entered into all systems that subsequently process that data. Without identifying specific actions that will ensure feeder system data integrity, it is unclear whether the department will be able to effectively carry out not only its financial reporting, but also its other financial management responsibilities.

Further Details Will Be Needed to Evaluate the Workability of DOD's Planned Financial Management Environment

Certain additional detailed information would be necessary to determine whether implementation of the department's future financial management environment is "workable"—that is, whether the planned environment is practical, cost-effective, and feasible. Such details are not within the scope of the high-level, strategic financial management improvement plan that DOD was asked to provide and we were asked to analyze. The additional, detailed information that would be necessary includes the systems architecture, which is comprised of logical and technical components. DOD officials have stated that they recognize that additional information will be necessary and that they are developing further details on these issues.

The Congress and OMB have recognized the importance of a systems architecture. For example, the Clinger-Cohen Act of 1996 requires that the department-level Chief Information Officers develop, maintain, and facilitate integrated system architectures. Also, in an October 25, 1996, memorandum, "Funding Information Systems Investments," the Director of OMB stated that "investments in major information systems proposed for funding in the President's budget should be consistent with Federal, agency, and bureau information architectures which: integrate agency work processes and information flows with technology to achieve the agency's strategic goals . . ."

As we have described in other reports,[8] the purpose of the logical architecture is to ensure that the systems meet the business needs of an organization. Therefore, the logical architecture should be further detailed information fleshing out DOD's concept for its financial management operations. For example, while the concept of operations may describe, at a high level, how acquisition must share information with accounting and logistics, the logical model would, among other things, describe the specific data and how the data will be manipulated. For each business function required to carry out the mission, it defines the specific information needed to perform the function, and describes the individual systems that produce the information. In addition, an essential element of the logical architecture is the definition of specific information flows. After the logical architecture is defined, DOD will have an understanding of both its portfolio of desired systems and how these systems will collectively carry out the department's objectives.

A technical architecture is necessary to detail specific information technology and communications standards and approaches that will be

[8]Strategic Information Planning: Framework for Designing and Developing System Architectures (GAO/IMTEC-92-51, June 1992) and Air Traffic Control: Complete and Enforced Architecture Needed for FAA Systems Modernization (GAO/AIMD-97-30, February 3, 1997).

used to build systems, including those that address critical hardware, software, communications, data management, security, and performance characteristics. The purpose of a technical architecture is to ensure that systems are interoperable, function together efficiently, and are cost-effective over their life cycles.

Conclusions

Until DOD amends its Biennial Plan to incorporate budget formulation and functional information sharing, the Congress will have little assurance that DOD's efforts to reform its acknowledged deficient financial operations are likely to be successful. Ensuring that accounting data are used to formulate budgets and that program information is shared among functional areas is a fundamental concept that underpins an effective financial management structure. Further, until DOD precisely documents its current environment, clearly links its initiatives to bridge the gap between its current environment and its concept of how it intends to operate in the future, and develops initiatives to address feeder systems' data accuracy problems, the Congress cannot be sure that DOD has a workable, clear transition plan to achieve its vision. Finally, further details will be needed to assess whether implementation of DOD's envisioned future concept for its financial management operations is practical, cost-effective, and feasible, including documentation of the logical and technical architectures that will support its future concept of operations.

Recommendations

In order to help ensure that DOD's first-ever Biennial Plan provides a sound foundation for fundamentally reforming the department's financial management operations, we recommend that the Secretary of Defense take the following immediate actions to develop and issue a supplemental plan.

- Revise the concept of operations to reflect, at a high level, the full range of the department's financial management operations, including its key asset accountability and budget formulation responsibilities.
- Describe how, at a high level, data will be shared among the various DOD functional areas to ensure that the benefits of full systems integration will be realized in accordance with relevant legislative requirements and JFMIP guidance.
- Clarify the role of each of the described initiatives in bridging the gap between the current environment and the envisioned future concept of operations.

- Identify the steps the department will take to ensure that it will build reliability into the data provided by its feeder systems.

Agency Comments and Our Evaluation

In commenting on a draft of this report, the Under Secretary of Defense (Comptroller) indicated that DOD took issue with each of the report's major findings and with all of the recommendations. The department's comments reflect a basic disagreement with us over the role and definition of financial management and how this function should support various critical program functions. Our views on the scope and requirements of accounting, finance, and feeder systems are fully supported by the mandates and goals of the CFO Act of 1990 and the Federal Financial Management Information Act of 1996, as well as by OMB and JFMIP guidance, reports, and pronouncements.

In its overall comments on a draft of this report, DOD stated that it appreciated the recognition that the report provides regarding the magnitude of the effort that the department expended in the preparation of the report and the challenges that the department will face in implementing its ambitious financial management reform initiatives. However, DOD disagreed that the Biennial Plan lacked critical elements and stated that parts of the report appear to reflect a lack of awareness of the Department's actions for improving its financial management. In addition, DOD stated that the draft report contained misleading statements and used inflammatory language.

We disagree with DOD's comments. As shown in the following discussion, most of our responses to them can be traced to this fundamental disagreement over the role of financial management in supporting the agency's operations. First, with respect to our concern that its plan lacks critical elements relative to asset accountability and control, or to budget formulation, DOD stated that the plan was explicitly limited to accounting and finance functions and that the department considers both asset accountability and budget formulation to be outside the scope of accounting and finance functions. DOD's response further stated that the department does not perform accountability for its nonfinancial resources through its finance and accounting systems and that to do so would, among other things, require an investment of hundreds of millions, perhaps billions, of dollars in new systems or system changes.

Moreover, the Under Secretary of Defense (Comptroller) in his opening statement stated that the plan "addresses both its financial systems and program feeder systems that originate and provide the majority of the financial source data." The Biennial Plan itself explicitly refers to feeder systems and includes initiatives that are intended to address the need for feeder systems to be fully integrated with accounting and finance systems. For example, the plan included information on initiatives to improve CBSX and REMIS—two systems that provide data on mission critical assets of the Army and Air Force, respectively. Because financial information in such systems includes data on units and condition of assets, those feeder systems must ensure data integrity and be easily reconciled with the accounting and finance systems.

Our concern is that the Biennial Plan does not explain how the feeder systems will meet accounting and internal control requirements, such as those related to asset accountability and budget formulation. Among the specific requirements of the CFO Act is that each agency CFO ensure that agency accounting and financial management systems include adequate financial reporting and internal controls. Such systems are to comply with applicable principles and standards and provide complete, reliable, consistent, and timely information that is responsive to the agency's financial information needs.

In addition, if the plan were limited to a narrow view of accounting and finance functions, it could not be used to meet additional regulatory requirements, as DOD intended. For example, FFMIA requires agencies to implement and maintain financial management systems that substantially comply with federal financial management systems requirements, applicable accounting standards, and the standard general ledger. FFMIA defines financial management systems to include the financial systems and financial portions of mixed systems[9] (feeder systems) necessary to support financial management. OMB reinforced these concepts in its June 1998 Federal Financial Management Status Report and Five-Year Plan, where it stated a goal of providing high quality financial information on federal government operations which fully supports financial and performance reporting. Further, the Authorization Act that mandated the plan explicitly required that it "address all aspects of financial management within the Department of Defense, including the finance systems, accounting systems, and data feeder systems of the Department that support financial functions of the Department."

[9]"Mixed system means an information system that supports both financial and nonfinancial functions of the Federal Government or components thereof." Federal Financial Management Improvement Act of 1996, Sec. 806 (6).

Further, our report outlines the potential benefits of modern systems in helping to achieve accountability, including the integration of logistics, accounting, and acquisition data. OMB Circular A-127, which prescribes policies and standards to be followed by executive departments and agencies in developing, operating, evaluating, and reporting on financial management systems, describes a unified set of financial systems as those that are "planned for and managed together, operated in an integrated fashion, and linked together electronically in an efficient and effective manner to provide agency-wide support necessary to carry out an agency's mission and support its financial management needs." Thus, OMB requires that a financial management improvement plan include efforts to address asset accountability.

Moreover, by DOD's own estimates, the logistics and other feeder systems necessary to properly account for and to ensure accountability over assets supply over 80 percent of the data used to support DOD's financial reporting and management. We agree fully with DOD's comment that commanders, not accountants, should remain responsible for the department's physical assets. Our point is that improved accuracy of feeder system data, with the benefits of controls incorporated into sound financial accounting and reporting, could assist commanders and program managers in fulfilling their asset accountability responsibilities. Systems improvements would not only help DOD comply with accounting and reporting requirements, but would also help provide better information and assurance to program managers to improve efficiency and strengthen accountability.

Regarding the costs of new systems or systems changes to meet financial management requirements, we asked DOD for support of its estimate of "hundreds of millions, perhaps billions, of dollars," but DOD indicated that the number is not supported by a documented cost estimate; but rather an informed approximation based on experience. In this regard, DOD is already spending huge sums to upgrade its feeder systems as well as its accounting and finance systems. For example, our analysis of DOD's fiscal year 1999 Information Technology Exhibits, which support the department's overall budget request, showed that DOD has requested a total of about $6 billion for fiscal years 1998 and 1999 to develop new or modify existing systems supporting functions that are likely to include feeder systems. Our point is that these ongoing efforts, with their large investments, should incorporate the requirements needed to achieve an integrated financial management system that meets legislative mandates and implementing guidance.

With regard to budget formulation, we did not say or imply the process used to formulate the budget was deficient or that any changes were needed in PPBS. Our focus was on the need to have that process supported by accurate and timely budget execution and accounting data. This will only happen if the systems are originally designed to include the requirement to link accounting data to support the budget formulation process. Because budget formulation is excluded from DOD's concept of operations, the plan does not address how the Department's Planning, Programming, and Budgeting System will be supported by existing systems, nor how known deficiencies in those systems will be addressed.

As stated in our report, such budgeting and accounting integration is called for by the CFO Act, DOD's regulations, JFMIP, and FFMIA. DOD's Financial Management Regulation mirrors the requirements in the CFO Act by specifying that the department's CFO is to develop and maintain an integrated DOD accounting and financial management system, including financial reporting and internal controls, that provides for the integration of accounting and budgeting information. JFMIP's Framework for Federal Financial Management Systems states that the financial management system should not only support the basic accounting functions for accurately recording and reporting financial transactions, but must also be the vehicle for integrated budget, financial, and performance information that managers use to make decisions on their programs. As stated previously, FFMIA requires that agencies implement and maintain financial management systems that substantially comply with federal financial management systems requirements.

The integration of budgeting and accounting is also a key tenet of OMB's efforts to improve financial management across government. Specifically, as part of its June 1998 Federal Financial Management Status Report and Five-Year Plan, OMB set out a vision of an environment where "Program and financial managers work in partnership to achieve the full integration of financial (finance, budget, and cost), program, and oversight information and processes." Supporting its overall vision, OMB set out a number of goals, including "Building a partnership to ensure the functioning together of information resource management, program management, and financial management, including budgeting." DOD's approach, however, unless broadened, will unfortunately ensure continued isolation of functional systems. The approach is inefficient, does not effectively utilize advances in technology, and misses opportunities to better support program managers.

Second, DOD stated that it does not agree that the Biennial Plan is critically flawed by the exclusion of a detailed discussion of the (1) links between the over 200 planned improvements and the envisioned future operations to determine whether the proposed transition plan will result in achievement of the target financial management environment and (2) actions to ensure feeder systems' data integrity. DOD stated that many of the initiatives are intended to improve the department's financial management in the interim period and others are geared more to the implementation of new processes or systems to replace outdated processes or noncompliant systems. The department stated that more details on each of the individual initiatives are in other documents that supported the initiative and should not be duplicated in the plan.

DOD's response to our draft report reinforces our point that the plan does not present an easily understood explanation of the transition from its current "as is" to the envisioned future financial environment. The catalog of initiatives in the plan does not indicate which initiatives are intended to be interim fixes and which are long-term efforts. The plan also does not indicate how those that are interim initiatives will fit in with the long-term initiatives. We have previously reported[10] on this issue in regard to DOD's technological initiatives identified as key elements of its efforts to improve the contract payment process. In that report, we stated that DOD had not defined how its short- and long-term initiatives, which were independently managed, would work in tandem. The relationship of such tasks or initiatives needs to be articulated clearly to provide a useful strategic vision. As we stated in our draft report, a vital part of any transition plan is a description of how the specific initiatives in the plan bridge the gap between the current environment and the envisioned environment.

Third, DOD stated that several characterizations in the report are subjective, misleading, and unnecessarily inflammatory. All of the statements DOD referred to are supported by the results of numerous audit reports produced by us and the DOD audit community. For example, DOD took exception to our statement that the most recent audits of DOD's financial statements identified material weaknesses in DOD's ability to maintain accountability and control over virtually every category of physical assets, including military equipment. The DOD Inspector General was unable to render an opinion on DOD's consolidated financial statements for fiscal years 1996 and 1997 as a result of these material

[10]Financial Management: Seven DOD Initiatives That Affect the Contract Payment Process (GAO/AIMD-98-40, January 30, 1998).

weaknesses. As we stated in our April 1998 testimony[11] on DOD's serious financial management problems, material financial management deficiencies identified at DOD, taken together, represent the single largest obstacle that must be effectively addressed to achieve an unqualified opinion on the U.S. government's consolidated financial statements. No major part of DOD has been able to pass the test of an independent audit. In the area of critical military weapons systems, we testified that for fiscal year 1997, the auditors found that DOD's logistical systems could not be relied upon to provide basic information, such as, for each asset category, how many exist, where they are located, and their value. We considered our draft report to be accurate, but we have carefully considered the department's comments regarding our characterizations and made wording revisions where appropriate.

Finally, DOD's comments are not fully responsive to our recommendations. Overall, DOD indicated that it did not believe that a supplemental plan was necessary because it was already working on detailed follow-on reports. We agree with the department that financial management is an ongoing process that requires continuous attention and updates. However, the items that we identified in our draft report that are currently not covered in the Biennial Plan are so critical to its viability that we continue to believe that the plan should be amended, especially in light of the need for the plan to support investments in systems initiatives.

We are sending copies of this report to the Secretary of Defense, the Under Secretary of Defense (Comptroller), and the Director of the Defense Finance and Accounting Service. We are also sending copies to the Director of the Office of Management and Budget and interested congressional committees and members. Copies will be available to others

[11]Department of Defense: Financial Audits Highlight Continuing Challenges to Correct Serious Financial Management Problems (GAO/T-AIMD/NSIAD-98-158, April 16, 1998).

upon request. If you or your offices have any questions concerning this report, please contact me at (202) 512-9095. Major contributors to this report are listed in appendix III.

Lisa G. Jacobson
Director, Defense Audits

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Abbreviations

CFO	chief financial officer
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
DPPS	Defense Procurement Payment System
FFMIA	Federal Financial Management Improvement Act
GAO	General Accounting Office
JFMIP	Joint Financial Management Improvement Program
OMB	Office of Management and Budget
PPBS	Planning, Programming, and Budgeting System

Objectives, Scope, and Methodology

To address the requirements of section 912 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 (Public Law 105-261), our objectives were to determine (1) whether DOD's concept of operations included the critical elements necessary for producing sustainable financial management improvement over the long term and (2) whether the transition plan provided a "road map" from the current environment to DOD's planned future financial management environment. This report also includes a discussion of additional technical details that would be needed to determine whether implementation of the department's future financial management environment is practical, cost-effective, and feasible.

To accomplish our objectives, we obtained the DOD Biennial Plan and compared its contents to the requirements of the National Defense Authorization Act of 1998 and to relevant laws, regulations and standards, and policy guidance documents to determine the plan's responsiveness to the act's requirements and the plan's workability. Specifically, we analyzed the plan's description of the Secretary of Defense's concept of how the department carries out its financial management operations. This analysis included whether the Secretary's concept covered all aspects of integrated financial management, including an integrated financial management system as defined by

- The Chief Financial Officers Act of 1990,
- The Federal Financial Management Improvement Act of 1996,
- The Clinger-Cohen Act of 1996,
- The JFMIP Framework for Federal Financial Management Systems (January 1995), and
- OMB Circular A-127, Financial Management Systems.

We also compared the Secretary's concept for the department's financial management operations with the essential elements of a concept of operations identified in our reports, Financial Management: Comments on DFAS' Draft Federal Accounting Standards and Requirements (GAO/AIMD-97-108R, June 16, 1997) and Strategic Information Planning: Framework for Designing and Developing System Architectures (GAO/IMTEC-92-51, June 1992).

We conducted our review from October 1998 to December 1998 in accordance with generally accepted government auditing standards.

We requested written comments on a draft of this report from the Under Secretary of Defense (Comptroller). These comments are presented and evaluated in the "Agency Comments and Our Evaluation" section and are reprinted in appendix II.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

UNDER SECRETARY OF DEFENSE
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COMPTROLLER

Mr. Gene L. Dodaro
Assistant Comptroller General
Accounting and Information
Management Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Dodaro:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "Financial Management: Analysis of DoD's First Biennial Financial Management Improvement Plan," (GAO Code 800425/918950, OSD Case 1726).

See comment 1.

The Department appreciates the recognition that the report provides regarding the magnitude of the effort that the Department expended in the preparation of the report, the recognition of the complexity of the formidable tasks that the Department has overcome to date, and the challenges that the Department will face in implementing its ambitious financial management reform initiatives. However, I am concerned that parts of the report appear to reflect a lack of awareness of the Department's past, current and planned actions for improving financial management within the Department. Additionally, as currently written, I believe that parts of the draft report contain misleading statements and, in some instances, unnecessarily use inflammatory language. Such statements detract from the progress made to date by focusing more attention on past problems than on current solutions. Such an approach does a disservice to serious readers of the report and needlessly confuses those who care about the matters involved or the additional actions required to improve financial management within the Department.

In summary, the draft report should be rewritten to properly characterize the Department's significant efforts to comply with the legislative mandate to produce a Biennial Plan. Moreover, the draft report should be revised to give the reader the proper perspective on the Department's ongoing efforts to modernize its finance and accounting operations. To do otherwise clearly paints an unbalanced, incorrect picture that does a disservice to the Department of Defense and the General Accounting Office itself.

Enclosed are more specific comments and a response to each recommendation contained in the report. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

William J. Lynn

Enclosures

GENERAL ACCOUNTING OFFICE DRAFT REPORT
"FINANCIAL MANAGEMENT: ANALYSIS OF DOD'S
FIRST BIENNIAL FINANCIAL MANAGEMENT IMPROVEMENT PLAN"
DATED DECEMBER 21, 1998
(GAO CODE 800425/918950,OSD CASE 1726)

DEPARTMENT OF DEFENSE COMMENTS
TO STATEMENTS MADE IN THE GAO DRAFT REPORT

Now on p. 2.

1. **GAO STATEMENT**: The GAO draft report, on page 3 and other references throughout the GAO draft report, states that the Department's Biennial Plan lacks critical elements necessary for producing sustainable financial management improvement over the long term and that the Plan's discussion of how the DoD's financial management operations will work in the future --its concept of operations--does not address (1) how its financial management operations will effectively support not only financial reporting, but also asset accountability and control and (2) budget formulation.

DOD COMMENTS: The above GAO referenced statements appear to be subjective and convey an apparent lack of awareness regarding the Department's ongoing and proposed actions as well as the Department's accountability and budget formulation processes.

See comment 1.

The Department does not agree that its plan lacks critical elements relative to asset accountability and control, or to budget formulation. The Department intentionally limited its Biennial Financial Management Improvement Plan to accounting and finance functions and considers both asset accountability and its budget formulation process to be outside the scope of accounting and finance functions. The fact that the plan addressed only accounting and finance matters explicitly was stated in the plan.

See comment 1.

The Department does not perform accountability for its nonfinancial resources through its finance and accounting systems. Instead, the Department performs accountability through various other systems. Accountability and accounting for financial resources is accomplished through the Department's financial management systems. However, while the Department's financial management systems perform accounting functions related to the Department's key assets, accountability for those assets--property and equipment, for example--is not accomplished through the Department's financial management systems. Instead, this accountability is achieved through property accountability, or other accountability, systems, depending on the items involved. Accordingly, the Concept of Operations appropriately addresses accounting for nonfinancial assets but, equally appropriately, excludes accountability requirements for nonfinancial assets. The Department strongly believes that its Commanders--not its accountants--should remain responsible (accountable) for planes, ships, tanks, and other physical assets entrusted to them. Encompassing accountability functions for nonfinancial assets within the Department's financial management systems would: (a) require a major (and undesirable) restructuring of responsibilities within the Department, (b) involve significant reengineering of various processes within the Department, (c) take a number of years to implement, and (d) require an investment of hundreds of millions, perhaps billions, of dollars in new systems

1 Enclosure 1

or system changes. Additionally, such actions would not likely offer additional benefits commensurate with the costs and efforts required.

See comment 1.

Additionally, the Department does not believe that major flaws exist in its budget formulation process. Nor does the Department believe that it was asked, or should be required, to significantly modify its budget formulation process. In fact, the Department believes that it has perhaps one of the better, if not the best, budget formulation process in the federal government.

See comment 2.

The Department's budget formulation process requires input from many different communities and sources within the Department. The Department's financial management systems are but one of the numerous sources of information used to formulate the Department's budget. The Department recognizes that more timely, accurate and reliable information from its accounting and finance systems could enhance the ability of managers to make more informed budget formulation decisions. However, the achievement of more timely, accurate and reliable information from the Department's accounting and finance systems--one of many input sources to the budget formulation process--does not involve, or require, changes in the Department's budget formulation process. Instead, it requires changes in the Department's financial management systems. Those changes--vice changes in the Department's budget formulation process--are addressed in the Department's Biennial Plan.

Now on p. 2.

2. **GAO STATEMENT**: The GAO draft report states on pages 4 and on other pages in the draft report that the transition plan has two critical flaws: (1) linkages are not provided between the envisioned future operations and the over 200 planned improvement initiatives to determine whether the proposed transition will result in the target financial management environment and (2) actions to ensure feeder systems' data integrity are not addressed--an acknowledged critical deficiency in the current environment.

See comment 1.

See comment 8.

DOD COMMENTS: The Department does not agree that the exclusion, from the Department's Biennial Plan, of a more detailed discussion of the matters mentioned above represent critical flaws in the Department's plans. Many of the Department's ongoing initiatives are intended to improve the Department's financial management process in the interim period while the Department is implementing new or improved financial management systems. Other initiatives are geared more to the implementation of new processes or systems to replace current outdated processes or noncompliant systems. The objective of each of these initiatives is stated in the various documents that approved or otherwise support the initiative. Duplication of that information in the Department's Biennial Financial Management Improvement Plan would have added a considerable number of pages to the report and diverted resources from more important actions such as actually implementing applicable improvements. The fact that this information was not duplicated in the Biennial Plan does not represent a critical flaw in the Department's efforts to improve its financial management processes.

See comment 3.

Through separate actions, some that predate the Department's 1998 Biennial Plan, the Department has undertaken various efforts to better ensure the integrity of financial information provided by its feeder systems. Additionally, the 1998 Biennial Plan explicitly states that this level of detail specifically was not addressed in the 1998 plan but will be considered for inclusion in the development of the 1999 Financial Management Improvement Plan.

2 Enclosure 1

Now on p. 6.

3. **GAO STATEMENT**: The GAO draft report, on page 9 and other references in the GAO draft report, states that pervasive weaknesses across virtually the full spectrum of the Department's systems and controls, including material weaknesses in DoD's ability to: (1) maintain accountability and control over virtually every category of physical assets, including military equipment; (2) account for the full cost of its operations and the extent of its liabilities; and (3) properly record and reconcile disbursements, which have resulted in numerous erroneous and several fraudulent payments.

DOD COMMENTS: The above referenced characterizations are subjective, misleading, and unnecessarily inflammatory. Further, such statements contribute little, if at all, towards a better understanding the matters involved or additional actions required to improve financial management within the Department. More importantly, they distract from efforts intended to improve financial management by focusing more attention on problems than on solutions.

See comment 1.

The Department takes exception to the implication that it is unable to "maintain accountability and control over virtually every category of physical assets, including military equipment." The Department recognizes that in a large organization the size of the Department of Defense, there may be some individuals who fail to keep some physical property records up to date at all times--a compliance, not a policy, system or process issue. The Department does not condone such practices and attempts to eliminate such undesirable habits when they become known through vigilant oversight through the Department's command structure. However, the Department believes that prior experience demonstrates that the Department exercises reasonable physical control over its assets. Characterizations of the nature noted above not only are unnecessarily inflammatory and fail to contribute to improvements in the Department's accountability efforts, but they also are a disservice and an injustice to the many military members and civilian personnel who safeguard the Department's military equipment and other physical assets.

See comment 4.

While the Department may not report its cost of operations in the manner desired by the GAO, or in a manner anticipated by certain new accounting standard setting bodies, such actions should not be equated to an inability to account for full costs. The Department does account for the use of all the financial resources entrusted to it. That the Department may not report all the details in precisely the manner desired by some, is not, and should not, be considered an inability to account for the cost of the Department's operations.

See comment 4.

Similarly, the primary liabilities for which the Department has been criticized are new requirements--environmental and disposal liabilities--not the more traditional accounting liabilities. These liabilities are merely estimates of potential future costs that the Department would incur when, or if, it disposes of items such as nuclear ships, weapons, etc., or when, or if, it is required to return a particular location (environment) to its natural state once it is no longer needed for military purposes. Such liabilities often are not amounts to be paid within the next few months or even years. Rather, these amounts typically are costs that might be incurred 10, 20, or 40 or more years in the future. While, under new requirements that only recently became effective, these amounts are required to be reported in financial statements; these amounts are not amounts that should be expected to be generated, automatically, by a financial management

system. Rather, these are amounts that must be estimated independently, on a case-by-case or site-by-site basis, by engineers and others.

See comment 5.

The Department does not pretend that all disbursements--without exception--are properly recorded and reconciled initially; however, it is significantly misleading to imply that the Department lacks the ability to properly record and reconcile disbursements. The Department disburses an estimated $288 billion a year. The vast majority of these individual disbursements are properly matched and recorded at the time of disbursement. The remaining amounts generally are properly recorded thereafter. However, it is important to clarify, from an accounting perspective, what is a proper disbursement. For example, suppose a DoD Component orders fifty different items on a single contract and creates separate obligations for each item (a common practice within the Department). Further, suppose that the contractor provides a single invoice for the total of the fifty different items provided, the total amount of the invoice is correct but the contractor did not identify separately the cost of each of the fifty items provided. If the Department paid the total amount, that might not be a proper disbursement from an accounting perspective because the disbursement must be recorded separately for each of the fifty items provided. Nevertheless, from a propriety perspective, the disbursement would be proper in that the Department was obligated to pay the contractor and the amount paid was the proper amount. While the Department, similar to many other large organizations, has experienced instances in which individuals have forged documents and committed other illegal acts in efforts to fraudulently obtain funds, the Department is not aware of any such fraud that is directly attributable to the Department's disbursing recording process.

Now on p. 16.

4. **GAO STATEMENT**: The GAO draft report states on page 25 that the Department's transition plan does not explicitly address how problems with the accuracy of data from feeder systems will be resolved.

See comment 1.

DOD COMMENTS: Again, the draft GAO report makes assertions that reflect a lack of understanding of the Department's ongoing initiatives and the Department's initial efforts to produce the first-ever Biennial Plan. As previously mentioned, the Biennial Plan explicitly states that the 1998 Plan was limited to primarily accounting and finance operations--not feeder systems. Moreover, the Department clearly understands that financial and nonfinancial systems need to be linked in the most optimum way to achieve reliable management and accounting information. Notwithstanding that implicit underlying requirement, the 1998 Biennial Plan, as well as future follow on Financial Management Improvement Plans, are not the appropriate vehicle to document in excruciating detail the plethora of data elements, programming and appropriate linkages necessary to achieve maximum integration and reliability among financial and nonfinancial systems. Such information is more suitable for systems documents such as functional design and detail design manuals. The Department will continue to work with acquisition, logistics, medical, and other communities to define the functionality necessary to obtain reliable and accurate management and accounting information from feeder, as well as financial, systems.

See comment 6.

Now on pp. 2 and 6 .

5. **GAO STATEMENT**: The GAO characterizes the Department's financial management as being in a "troubled state" (last line of the first paragraph in the "RESULTS IN BRIEF" section--page 3 of the draft report)" and alludes to " . . . serious financial management weaknesses" (page 9 of the draft report).

See comment 7.

DOD COMMENTS: The Department takes strong exception with the use of the phrase "troubled state" to describe the Department's financial management. The Department has acknowledged that it needs to improve its financial management operations. However, the Department's statements should not be misconstrued to mean that the Department is not paying the vast majority of its vendors in a timely and accurate manner. Nor should it be perceived to mean that the Department is not paying its salaried employees promptly and accurately. Nor should it be interpreted to mean that the Department tolerates fraud, waste and abuse. Quite the contrary; on the whole, the Department performs its financial management functions professionally, responsibly, and with high quality for which it receives little or no credit.

The above referenced characterizations are subjective, unnecessarily inflammatory and contribute little, if at all, towards better understanding the matters involved or additional actions required to improve financial management within the Department. The Department previously has acknowledged, on a number of occasions, that its financial management systems do not meet newly imposed accounting requirements. Further, the Department has acknowledged that its systems do not perform a number of functions as efficiently, or effectively, as the Department desires. As a result, the Department has undertaken a number of initiatives to improve financial management within the Department. Nevertheless, the Department believes that, taken as a whole, its financial management systems provide reasonable assurances that the Department's financial resources are properly safeguarded and accounted for. More importantly, inflammatory words such as "troubled state" and other sound bites of the nature noted above not only fail to contribute to solutions to improve the Department's financial operations, but actually distract from such efforts by creating unwarranted negative attention and focusing more attention on problems than on solutions.

See comment 7.

Now on p. 2.

6. **GAO STATEMENT**: The GAO draft report also states on page 3 that the Department's initiatives should result in some "incremental improvements" in DoD's financial management operations.

See comment 8.

DOD COMMENTS: Again, the Department takes strong exception with use of the phrase "incremental improvements." Incremental is often defined as one of a series of minute additions or a slight or imperceptible augmentation. More importantly, the use of the term incremental could, and probably would, be interpreted by readers of the final report in a similar manner. Nothing could be further from the truth. The Department's ongoing initiatives are expected to substantially--not incrementally--improve the Department's financial management operations.

5 Enclosure 1

GENERAL ACCOUNTING OFFICE DRAFT REPORT
"FINANCIAL MANAGEMENT: ANALYSIS OF DOD'S
FIRST BIENNIAL FINANCIAL MANAGEMENT IMPROVEMENT PLAN"
DATED DECEMBER 21, 1998
(GAO CODE 800425/918950, OSD CASE 1726)

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION

GAO RECOMMENDATION: In order to help ensure that the DoD's first-ever Biennial Plan provides a sound foundation for fundamentally reforming the Department's financial management operations, the Secretary of Defense take immediate actions to develop and issue a supplemental plan.

See comment 1.

See comment 3.

DOD RESPONSE: In a number of instances, the contents of the Department's 1998 Biennial Financial Management Improvement Plan already represents a compilation of other supplemental plans that existed prior to the publication of the Biennial Plan. The Department did not repeat the details of these preexisting supplemental plans in its Biennial Plan but, instead, in many instances, merely summarized those supplemental plans. The 1998 effort was planned to focus on the Concept of Operations and a high-level transition plan; the 1999 effort was planned to focus more on the details of transitioning to the Concept of Operations environment. From the time the Department commenced its efforts on the Biennial Plan, it intended to issue more detailed follow on reports; this is clearly stated in the Statement of the Under Secretary of Defense (Comptroller) section of the Biennial Plan. In pursuit of this objective, the Department never discontinued its seamless ongoing efforts to improve the first-ever Biennial Plan. Months before the completion of the 1998 plan, the Department embarked on additional efforts to perfect the Department's "blueprint" for financial management reform. Thus, the Department's team initially assembled to develop the 1998 plan continued unabated its work on the next phase of the plan immediately upon the release of the 1998 plan.

GAO RECOMMENDATION: Revise the concept of operations to reflect, at a high level, the full range of the Department's financial management operations, including its key asset accountability and budget formulation responsibilities.

See comment 1.

DOD RESPONSE: The Department limited its 1998 Financial Management Improvement Plan primarily to accounting and finance functions. This was explicitly stated in the plan. The Department does not achieve accountability for nonfinancial assets through its finance and accounting systems. Nor does the Department believe that it has major flaws in its budget formulation process. In fact, the Department believes that it has perhaps one of the better, if not the best, budget formulation process in the federal government.

See comment 1.

The Department does not perform accountability for its nonfinancial resources through its finance and accounting systems. Instead, the Department performs accountability through various other systems. Accountability and accounting for financial resources is accomplished

1 Enclosure 2

through the Department's financial management systems. However, while the Department's financial management systems perform accounting functions related to the Department's key assets, accountability for those assets--property and equipment, for example--is not accomplished through the Department's financial management systems. Instead, this accountability is achieved through property accountability, or other accountability systems, depending on the items involved. Accordingly, the Concept of Operations appropriately addresses accounting for nonfinancial assets but, equally appropriately, excludes accountability requirements for nonfinancial assets. The Department strongly believes that its Commanders--not its accountants--should remain responsible (accountable) for planes, ships, tanks, and other physical assets entrusted to them. Encompassing accountability functions for nonfinancial assets within the Department's financial management systems would: (a) require a major (and undesirable) restructuring of responsibilities within the Department, (b) involve significant reengineering of various processes within the Department, (c) take a number of years to implement, and (d) require an investment of hundreds of millions, perhaps billions, of dollars in new systems or system changes. Additionally, such actions would not likely offer additional benefits commensurate with the costs and efforts required.

See comment 1.

Additionally, the Department does not believe that major flaws exist in its budget formulation process. Nor does the Department believe that it was asked, or should be required, to significantly modify its budget formulation process. In fact, the Department believes that it has perhaps one of the better, if not the best, budget formulation process in the federal government. The Department's budget formulation process requires input from many different communities and sources within the Department. The Department's financial management systems are but one of the numerous sources of information used to formulate the Department's budget. The Department recognizes that more timely, accurate, and reliable information from its accounting and finance systems could enhance the ability of managers to make more informed budget formulation decisions. However, the achievement of more timely, accurate and reliable information from the Department's accounting and finance systems--one of many input sources to the budget formulation process--does not involve, or require, changes in the Department's budget formulation process. Instead, it requires changes in the Department's financial management systems. Those changes--vice changes in the Department's budget formulation process--are addressed in the Department's Biennial Plan.

GAO RECOMMENDATION: Describe how, at a high level, data will be shared among the various DoD functional areas to ensure that the benefits of full system integration will be realized in accordance with relevant legislative requirements and JFMIP guidance.

See comment 9.

DOD RESPONSE: The Department addressed, at a high level, data integration in its description of the Defense Finance and Accounting Service Corporate Database and Defense Finance and Accounting Service Corporate Data Warehouse in the Infrastructure section of the 1998 Concept of Operations. In the 1999 Financial Management Improvement Plan, where appropriate, the Department plans to expand upon the importance of data sharing by emphasizing the need for improved information utilization through better integration or interfacing of feeder systems and finance and accounting systems through the Corporate Database and Corporate Data Warehouse initiatives.

2 Enclosure 2

GAO RECOMMENDATION: Clarify the role of each of the described initiatives in bridging the gap between the current environment and the envisioned future concept of operations.

See comment 1.

DOD RESPONSE: Many of the Department's ongoing initiatives are intended to improve the Department's financial management process in the interim period while the Department is implementing new or improved financial management systems. Other initiatives are geared more to the implementation of new processes or systems to replace current outdated processes or noncompliant systems. The objective of each of these initiatives has been stated in the various documents prepared by the Department that approved or otherwise support the initiative. Duplication of that information in the Department's Financial Management Improvement Plan could have added a considerable number of pages to the report. The fact that this information was not duplicated in the 1998 Biennial Plan does not represent a flaw in the Department's efforts to improve its financial management processes. Nevertheless, the Department will review the benefits of repeating--in the 1999 Financial Management Improvement Plan--applicable linkages that exist between each of the initiatives addressed in the 1998 Biennial Plan and the Transition Plan.

GAO RECOMMENDATION: Identify the steps the Department will take to ensure that it will build reliability into the data provided by its feeder systems.

See comment 1.

See comment 6.

DOD RESPONSE: The 1998 Biennial Plan explicitly states that the plan was limited to primarily accounting and finance operations--not feeder systems. Moreover, the Department clearly understands that financial and nonfinancial systems need to be linked in the most optimum way to achieve reliable management and accounting information. Notwithstanding that implicit underlying requirement, the 1998 Biennial Plan, as well as future follow on Financial Management Improvement Plans, are not the appropriate vehicle to document in excruciating detail the plethora of data elements, programming and appropriate linkages necessary to achieve maximum integration and reliability among financial and nonfinancial systems. Such information is more suitable for systems documents such as functional design and detail design manuals. The Department will continue to work with acquisition, logistics, medical, and other communities to define the functionality necessary to obtain reliable and accurate management and accounting information from feeder, as well as financial, systems.

3 Enclosure 2

The following are GAO's comments on the Department of Defense's letter dated January 11, 1999.

GAO Comments

1. See the "Agency Comments and Our Evaluation" section of this report.

2. DOD's comments misstate our position. We did not say or imply that the process used to formulate the budget was deficient. Our focus was on the need to have that process supported by accurate and timely budget execution and accounting data. We believe that DOD's budget formulation process can only be as good as the information on which it is based. Audit reports by us and the DOD audit community have identified problems in the accuracy, reliability, and timeliness of that budgetary source information. For example, in our March 1998 report[1] on the implications of Navy audit results, we stated that the financial reporting errors disclosed by the Naval Audit Service affect the budget process because the same incomplete inventory data are used both for the financial statements and as the starting point for the Navy's process to develop budget requests for additional inventory. We have also reported[2] that inaccurate management information in the Army's Installation Facilities System resulted in unreliable budget requests. Further, this report stated that inadequate guidance and inconsistent reporting of information used in the budget development process added to the unreliability of the budget requests. In another example, we reported[3] that errors in CBSX—the system that provides worldwide asset visibility over the Army's reportable equipment items, including the Army's most critical war fighting equipment—directly affect whether too few or too many of these critical items are procured.

3. We could not find any explicit reference to a 1999 financial management improvement plan in the 1998 Biennial Plan. Further, we continue to believe that the 1998 plan was deficient in not addressing, at a high-level, how known data accuracy problems in feeder systems will be resolved.

4. DOD's inability to account for the full cost of its operations and the extent of its liabilities has been documented in numerous reports prepared by us and the DOD audit community. Further, DOD's inability to ensure that

[1]CFO Act Financial Audits: Programmatic and Budgetary Implications of Navy Financial Data Deficiencies (GAO/AIMD-98-56, March 16, 1998).

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

[3]Army Logistics Systems: Opportunities to Improve the Accuracy of the Army's Major Equipment Item System (GAO/AIMD-98-17, January 23, 1998).

the financial resources entrusted to it are used for the purpose intended by the Congress has been repeatedly documented in these reports, including our recent report, Financial Management: Problems in Accounting for Navy Transactions Impair Funds Control and Financial Reporting (GAO/AIMD-99-19, January 19, 1999). In addition, the "new" accounting requirements for the reporting of environmental and disposal liabilities were issued in 1995 and became effective for fiscal year 1997. Moreover, the Congress has required lifecycle environmental costs, including disposal costs, for major defense acquisition programs in DOD's fiscal year 1995 Authorization Act. As we reported in a series of recent reports[4] (with which the department concurred), DOD has the disposal cost information available to make these estimates for major weapons systems and other assets in a systematic manner, rather than on a case-by-case basis. To date, however, the department has only developed draft policy guidance for addressing these issues.

5. DOD's problems in properly accounting for its disbursements remain a serious problem, as we have reported in the past. For example, we reported that DOD's $18 billion total in problem disbursements as of May 31, 1996, was understated by at least $25 billion. We concluded that neither the Congress nor DOD management can rely on DOD's reported amount to determine the extent of problem disbursements or to monitor progress made in resolving them. Further, without adequate documentation to support its disbursements—one of the major factors contributing to its inability to resolve its problem disbursements, DOD cannot know the extent to which its payments are fraudulent and improper. In addition, our recent report and testimony[5] on several serious fraud incidents detail the ongoing control weaknesses over the department's disbursement processes that contributed to the embezzlement of millions of dollars from DOD.

6. As stated in our draft report, we believe that the Biennial Plan should identify specific actions that will ensure feeder system data integrity, rather than the specific details indicated in DOD's response. As we stated,

[4]Financial Management: Accounting Implications of DOD's Facilities Demolition Programs (GAO/AIMD-98-194R, August 28, 1998); Financial Management: DOD's Liability for Missile Disposal Can Be Estimated (GAO/AIMD-98-50R, January 7, 1998); Financial Management: DOD's Liability for the Disposal of Conventional Ammunition Can Be Estimated (GAO/AIMD-98-32, December 19, 1997); Financial Management: DOD's Liability for Aircraft Disposal Can Be Estimated (GAO/AIMD-98-9, November 20, 1997); and Financial Management: Factors to Consider in Estimating Environmental Liabilities for Removing Hazardous Material in Nuclear Submarines and Ships (GAO/AIMD-97-135R, August 7, 1997).

[5]Financial Management: Improvements Needed in Air Force Vendor Payment Systems and Controls (GAO/AIMD-98-274, September 28, 1998), Financial Management: Improvements Needed in Air Force Vendor Payment Systems and Controls (GAO/T-AIMD-98-308, September 28, 1998).

certain detailed information needed to determine whether the planned environment is practical, cost-effective, and feasible are not within the scope of the high-level strategic financial management plan that DOD was asked to provide and we were asked to analyze.

7. In the Biennial Plan, the department itself acknowledged that improving its financial management operations represents "a monumental challenge." As we stated in our April 1998 testimony,[6] no major part of DOD has been able to pass the test of an independent audit; auditors consistently have issued disclaimers of opinion because of pervasive weaknesses in DOD's financial management operations. Such problems led us in 1995 to put DOD financial management on our list of high-risk areas vulnerable to waste, fraud, abuse, and mismanagement.[7] This designation continued in our recent high-risk update.[8] While we consider our draft report to be accurate, we have carefully considered the department's comments regarding our characterizations and made wording revisions where appropriate.

Further, while DOD takes issue with focusing unwarranted negative attention on problems, we believe that fully identifying the problem and its context is the first and crucial step in properly implementing solutions that will work. For example, we have previously reported[9] that DOD did not develop adequate information to effectively diagnose the causes of problem disbursements, implement solutions, and evaluate progress.

8. We continue to believe that without addressing the critical flaws we have identified, the improvements that can be achieved will be limited relative to the department's total financial management operations, including asset accountability and budget formulation. While we consider our draft report to be accurate, we have carefully considered the department's comments regarding our characterizations and made wording revisions where appropriate.

9. The department's description of the DFAS Corporate Database and Corporate Data Warehouse does not explain, at a high-level, how

[6]Department of Defense: Financial Audits Highlight Continuing Challenges to Correct Serious Financial Management Problems (GAO/T-AIMD/NSIAD-98-158, April 16, 1998).

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

[8]High-Risk Series: An Update (GAO/HR-99-1, January 1999).

[9]Financial Management: Improved Management Needed for DOD Disbursement Process Reforms (GAO/AIMD-97-45, March 31, 1997).

information will be shared between functional areas such as acquisition and logistics. Such sharing is a critical element of a financial management system.

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