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CONGRESSIONAL REQUESTERS

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**FINANCIAL
MANAGEMENT**

**Status of the Defense
Business Operations
Fund**



**Accounting and Information
Management Division**

B-249045

March 9, 1994

Congressional Requesters

The National Defense Authorization Act for Fiscal Year 1994¹ directed the Secretary of Defense to submit to the congressional Defense committees a comprehensive management plan to improve the operations of the Defense Business Operations Fund by December 30, 1993, and to report on progress in implementing the plan by February 1, 1994. The act further requires that we evaluate and report on the Department of Defense's (DOD) progress. In a related matter, Senator Grassley requested that we evaluate the Fund's cash management practices. The purposes of this report are to (1) provide an update on the status of the Fund's operations, including those related to cash management, (2) describe DOD's progress in addressing identified problems through its comprehensive plan, and (3) discuss DOD's approach to managing the Fund.

We continue to support the Fund's concept. If the Fund is operated in an efficient and effective manner, it can contribute to a significant improvement in DOD operations. The Fund's primary goal is to focus the attention of all levels of management on the total costs of carrying out certain critical DOD business operations and the management of those costs. Better information on business operations should enable DOD management and the Congress to make more informed policy decisions as DOD continues to adapt to a much smaller force structure and a new world environment. Accomplishing these objectives will require DOD managers to become more conscious of operating costs and make fundamental improvements in how DOD conducts business.

The Fund is modeled after businesslike operations in that it maintains a contractual (buyer-seller) type of relationship with its customers, primarily the military services. It is estimated that in fiscal year 1994, the Fund will have revenue of about \$85 billion, which would make it one of the largest corporations in the world. However, unlike a private sector enterprise which has a profit motive, the Fund should operate on a break-even basis by recovering the costs incurred in conducting its operations. The Fund provides such essential goods and services as the (1) overhaul of ships, tanks, and aircraft and (2) sale of over 5 million types of vital inventory items such as landing gears for aircraft. Many of these are essential to maintaining the military readiness of our country's weapon systems.

¹Public Law 103-160, November 30, 1993.

Since the concept of the Fund was first put forth in February 1991, we have monitored and evaluated its implementation and operation. We have previously reported² that DOD has not achieved the Fund's objectives because

- policies critical to the Fund's operations either were not developed or needed to be revised;
- the Fund's financial reports were inaccurate; and
- the cost accounting systems were fragmented, costly to maintain, and did not provide the cost information necessary for managers to better control costs.

In addition, in an October 1993 letter (GAO/AIMD-94-7R) to the Deputy Secretary of Defense, we suggested that DOD appoint a Fund director under the auspices of the Deputy Secretary of Defense to provide the necessary management focus and resolve the problems confronting the Fund.

Results in Brief

On September 24, 1993, DOD approved the Defense Business Operations Fund Improvement Plan.³ The plan identifies dozens of actions and related tasks to be taken to improve the operations of the Fund, assigns responsibility, and establishes milestones for completing the actions and tasks. The plan addresses all known problems that have hindered the operations of the Fund. For example, the plan identifies the need for (1) policies and procedures governing the operations of the Fund, (2) improved financial reports, and (3) reliable financial systems to accumulate and report on the results of operations.

In its February 1, 1994, progress report, DOD stated that it had made significant progress in improving the operations of the Fund. We agree that DOD has made some progress. However, much work remains to be done since most of the actions and tasks aimed at correcting the more difficult fundamental problems with the Fund's policies, procedures, systems, and financial reports are scheduled to be completed by the end of fiscal year 1994 or in fiscal year 1995.

While correcting the Fund's fundamental problems, particularly the implementation of financial systems, will require a long-term effort, it is

²See Related GAO Products list in the back of this report.

³On January 4, 1994, DOD provided this plan to the congressional Defense committees in response to Public Law 103-160.

especially important for DOD to also pursue short-term, building block efforts to begin improving the accuracy of the Fund's financial information. Considering the past difficulties DOD has experienced in implementing the Fund, it is essential that every effort be made to stay on schedule to meet key milestone dates. We believe that completing the following short-term critical actions within the milestones prescribed by the plan will be key to DOD making future progress in resolving the Fund's problems and will build the foundation for further improvements:

- Complete all Fund policies by December 31, 1994.
- Select the systems to account for the Fund's resources by September 30, 1994, and begin implementing these systems by December 31, 1994.
- Impose greater discipline to improve the accuracy of the monthly financial reports that provide information on the profit/loss of each business area by December 31, 1994.

The problems confronting the Fund are symptomatic of DOD's overall financial management operations. In its January 1994 annual report to the President and the Congress, DOD acknowledged that in the past its top management considered accounting, business-type efficiency, and indirect support functions to be of secondary importance. The report further noted that the limited attention to improving financial management threatens our nation's combat forces because it creates problems that waste money that is needed more than ever to sustain sufficient military readiness. The report's recognition of the problems in financial management represents a marked change in DOD's management philosophy. This changed attitude is a step in the right direction and will contribute to the ultimate success of DOD's reform initiatives, such as the Defense Business Operations Fund.

Background

Over the past 2 years, congressional committees, the DOD Inspector General, the military services' audit agencies, and our reports have identified serious weaknesses in DOD's management and operation of the Fund—long-standing problems that were inherited from the old stock and industrial funds. A DOD-wide review of the Fund confirmed that these problems adversely affected the Fund's operations. These problems have resulted in DOD's inability to accurately account for, control, and report on the Fund's \$85 billion annual operation. Further, as part of DOD's annual assessment of its internal controls under the Federal Managers' Financial Integrity Act, the Defense Finance and Accounting Service (DFAS) reported the Fund's accounting and reporting as a material weakness in its fiscal

year 1993 annual statement of assurance on its operations to the Secretary of Defense.⁴

On April 20, 1993, the Secretary of Defense directed a comprehensive and detailed review of the Fund's operations. To accomplish this, DOD established a task force of 80 experts from varying levels of DOD operations and management with financial and functional experience to review the Fund. They concentrated on eight areas: (1) organization, (2) education and training, (3) budget, (4) accounting policy, (5) centralized system development, (6) financial management systems, (7) cash management, and (8) financial reporting. The task force issued a report containing its recommendations on July 30, 1993.

A Steering Committee of senior officials in the Office of the Secretary of Defense, the Army, the Navy, the Air Force, and DOD components reviewed the recommendations in the task force report, candidly discussed the problems hindering the Fund's implementation and operation, and identified the needed corrective actions. The Steering Committee also obtained the views of GAO, the Office of Management and Budget, the DOD Inspector General, and outside consultants on the problems hindering the Fund.

DOD endorsed the continuation of the Fund and developed the Defense Business Operations Fund Improvement Plan. On September 24, 1993, the Deputy Secretary of Defense and the secretaries of the Army, Navy, and Air Force approved the plan. This plan consists of 56 actions and 183 tasks aimed at improving the Fund's operations. In response to Public Law 103-160, DOD provided this plan to the congressional Defense committees on January 4, 1994, and reported on its progress in implementing the actions and tasks in the plan on February 1, 1994.

Scope and Methodology

To accomplish our objectives we reviewed the Fund plan that DOD approved on September 24, 1993, and DOD's February 1, 1994, progress report on the Fund. In reviewing the plan, we determined if (1) it addressed all known deficiencies identified by GAO, congressional committees, the DOD-wide review, the DOD Inspector General, and the military services' audit agencies and (2) specific actions were identified to correct each of the deficiencies. We met with DOD officials to (1) discuss

⁴As of March 1, 1994, the Secretary of Defense had not filed the DOD-wide report on internal controls that was due on December 31, 1993, under the Federal Managers' Financial Integrity Act. Therefore, we do not know if the Secretary also considers the Fund's accounting and reporting to be a material weakness for DOD as a whole.

the planned corrective actions and milestones for completing them and (2) determine if DOD was completing the corrective actions in accordance with the scheduled milestone dates. We also analyzed reports and interviewed DOD officials to determine the status of DOD's efforts in correcting the Fund's problems and DOD's approach to managing the Fund.

To evaluate DOD's management of the Fund's cash balance, we collected and analyzed financial information related to collections and disbursements. Our analysis of the disbursement data included determining the magnitude and causes of disbursements that had not been matched to corresponding obligations. Further, we evaluated actions being taken to improve the Fund's cash position through discussions with appropriate Office of the Secretary of Defense officials and the analysis of pertinent documentation.

We performed our work at the Office of the Secretary of Defense (Comptroller); the Departments of the Army, Navy, and Air Force; the Defense Logistics Agency; the DFAS headquarters; the Columbus, Denver, Cleveland, and Indianapolis DFAS Centers; and selected Fund business activities. Our review was performed from June 1993 through February 1994 in accordance with generally accepted government auditing standards.

We discussed the facts and conclusions in our report with cognizant DOD officials. Their comments have been incorporated where appropriate.

Persistent Problems Hinder Fund Operations

The Fund provides a mechanism through which DOD can adopt a businesslike approach for identifying and reducing its operating costs. However, to date, DOD has not achieved this objective. In April 1991, we pointed out that DOD did not have the framework in place to operate the Fund in an efficient and effective manner.

Today, almost 3 years later, many of the same fundamental problems continue to exist. DOD's ability to properly manage the Fund continues to be hindered because of its inability to (1) manage cash, (2) develop policies and procedures, (3) enhance financial systems, and (4) produce accurate financial reports on the results of operations. These problems, which DOD is now trying to address through the plan, are highlighted below and discussed in further detail in appendix I.

- Cash Management: Some problems affecting the Fund's operations are also causing difficulties in DOD's management of the Fund's cash balance. Successful operation of the Fund is critical to effective cash management. The Fund did not have sufficient cash to make a \$5.5 billion transfer directed by the National Defense Authorization Act for Fiscal Year 1993. To alleviate this situation, DOD began to advance bill customers in June 1993 for goods and services to be provided. If DOD had not advance billed, the Fund's cash balance would have been a negative \$1.6 billion as of January 31, 1994.

In addition, at least \$4.7 billion in Fund disbursements had not been matched with the corresponding obligations as of September 30, 1993. Unmatched disbursements put DOD at risk that erroneous payments may have been made without detection and that total disbursements may have exceeded the amount authorized by the Congress. A major cause of unmatched disbursements is the time it takes from making the payment to transmitting disbursement data to various DOD activities to recording the disbursement data against the proper obligations. This process can take from 1 to 6 months and, in some cases, is manually intensive. The problem with unmatched disbursements is not unique to the Fund; it also applies to DOD's overall financial operations.

- Fund Policies: DOD acknowledges that one of the most significant weaknesses of the Fund's implementation has been the development of policies and procedures. Some policies need to be developed, others need to be revised, and all need to be fully coordinated (for example, DOD's policy on recognizing revenue and billing customers for work performed). As a result of not having or enforcing the Fund's policies, DOD components are performing similar functions in different ways. For example, DOD reported that due to insufficient policy guidance, Fund managers were forced to make their own interpretation regarding how to report on the operations of their respective business areas. Until the Fund's policies are in place and followed, DOD cannot ensure that the Fund is operating in a consistent manner, and the Fund will continue to be faced with incomplete and inconsistent information.
- Financial Systems: DOD has acknowledged that the Fund's financial systems are inadequate. The Fund has 80 disparate, unlinked financial systems and approximately 200 ancillary systems that provide financial data. Consequently, accounting data are often not complete, timely, or useful. For example, the Fund's fiscal year 1993 financial information on the results of operations differed by \$6.1 billion from the data used in preparing the Fund's budget. These data should be the same. Systems that

produce credible cost data on the results of operations are essential. These data are considered in setting the prices the Fund will charge its customers. In turn, the prices should be used as a basis for establishing customers' budget requests.

- **Financial Reports:** DOD has acknowledged that the Fund's financial reports are inaccurate. Further, because the fiscal year 1992 year-end financial statements were incomplete and audit trails were inadequate, the DOD Inspector General was unable to express an opinion on the Fund's financial statements in performing the audit required by the Chief Financial Officers Act. Financial reports can be important tools to better determine, understand, explain, and justify the costs of operation. Accurate and reliable financial reports are critical for management to analyze trends, make comparisons among similar business areas (such as depot maintenance for the military services), and measure budget execution. Meaningful and reliable financial reports are also essential for the Congress and the Office of Management and Budget in exercising their oversight responsibilities.

DOD has stated, and we agree, that the full achievement of the Fund's objectives "hinges on standardized and modernized finance and accounting systems." DOD plans to select, from the existing Fund systems, those that will be used to account for the Fund's costs and resources by September 30, 1994, and to begin implementing these systems for the Fund's operations by December 31, 1994. Given DOD's history of difficulty in implementing systems, these time frames, though achievable, will have to be closely monitored.

DOD has cited the Corporate Information Management (CIM) initiative as the long-term solution to its system problems. CIM is intended to reduce or eliminate systems in the military services and DOD components that perform the same function. While CIM initially appeared to be a promising undertaking, it has had limited success to date in enhancing DOD's systems,⁵ and it will be several years before the Fund's systems are fully implemented. Given today's environment of budget reductions, DOD cannot afford to let this critical effort fail.

Given the pressing need for reliable data and the fact that the planned system improvement efforts will be a long-term venture, it is important for DOD to concurrently pursue short-term efforts to improve the quality of its financial information. During the course of our financial audits and in

⁵Financial Management: Defense Business Operations Fund Implementation Status (GAO/T-AFMD-92-8, April 30, 1992).

previous reports on the Fund, we have stressed the need for DOD to improve existing operations and not wait for the implementation of new systems. Operating improvements could be obtained under the present systems.

For example, the financial reports prepared during fiscal years 1992 and 1993 could have been improved if DOD had (1) exercised more discipline in following and enforcing existing policies and procedures, (2) routinely reviewed and analyzed its monthly reports to identify inaccuracies, and (3) taken the steps needed, such as providing additional guidance to field activities, to correct the identified problems. Our review of the Fund's monthly financial reports disclosed that the Navy supply management business area had a reported profit of \$23.1 billion as of May 1993. A review of the report by DFAS personnel would have shown that the reported profit was over five times greater than the reported revenue of \$4.3 billion and, therefore, in error. If DOD does not undertake the necessary short-term actions, the reports on the Fund's operations in fiscal years 1994 and 1995 may be no more reliable than those issued for fiscal years 1992 and 1993.

Plan Addresses Known Problems but Some Milestones Not Met

According to our analysis, DOD's September 1993 plan on the actions and tasks to improve Fund operations addresses known deficiencies. To correct the Fund's deficiencies, the plan identified 56 actions, subdivided into 183 specific tasks. The plan also identified the offices responsible for performing the tasks and the scheduled task completion dates. The actions are divided into four categories: (1) accountability and control, (2) Fund structure, (3) policy and procedures, and (4) financial systems.

In its February 1, 1994, progress report on the Fund, DOD stated that it had made significant progress in improving Fund operations. While we recognize that DOD has made some progress, (1) the progress report covers the first 3 months of a plan that will require several years to complete and (2) DOD completed only 18 of the 44 planned tasks covering the Fund's policies, procedures, and systems that were scheduled to be completed by December 31, 1993.

For the accountability and control and the Fund structure categories, DOD completed 10 of the 11 actions planned to be accomplished by December 31, 1993. For example, under the accountability and control category, DOD (1) established the Fund's Corporate Board, (2) identified specific DOD offices to be responsible for certain areas (for example, DFAS

assumed responsibility for the Fund's accounting procedures and systems), (3) decided that the Office of the Secretary of Defense should continue to be responsible for the cash Antideficiency Act⁶ controls, and (4) directed that explanations of budget/cost changes be provided within 30 days of issuing the initial annual operating budgets to Fund activities.

Within the policy and procedures and financial systems categories, DOD completed 6 of the 9 planned actions but only 18 of the 44 tasks by the December 31, 1993, milestone. Some tasks not completed include (1) developing Fund draft policy guidance on management headquarters cost, military personnel cost, economic analysis for capital projects, and adjustments to financial reports and (2) improving the monthly financial report which provides information on revenue, costs, and profit/loss. It is critical that all tasks be completed within the established time frames because undertaking many scheduled future tasks is contingent upon earlier tasks being completed promptly.

In our October 1993 letter to the Deputy Secretary of Defense, we expressed concern that DOD may not be able to meet the plan's milestones. DOD has not successfully completed past actions on schedule to correct the Fund's problems. For example, in May 1992, DOD issued the Defense Business Operations Fund Implementation Plan. This document indicated that all but one of the Fund's policies would be completed by September 1992. However, as discussed earlier, key policies, such as cash management, have yet to be finalized. In another case, the National Defense Authorization Act for Fiscal Year 1993 required DOD to develop performance measures and corresponding goals for each of the Fund's business areas by March 1, 1993. DOD has developed performance measures for the Fund but has just begun developing the required corresponding goals for some business areas, such as the Defense Logistics Agency's supply management and distribution depots.

Successful implementation of the Fund will require continued commitment from DOD's top management to ensure that the milestones in the plan are successfully met. We believe that completing the following critical actions within the milestones prescribed by the plan will be key to DOD's progress in resolving the Fund's problems:

⁶The Antideficiency Act, 31 U.S.C. 1341(a)(1), 1517, provides that no officer or employee of the government shall make or authorize an expenditure or obligation exceeding the amount of an appropriation or fund available for the expenditure or obligation.

- Complete all Fund policies by December 31, 1994. Subsequently, these policies need to be implemented in a uniform manner to help ensure that the Fund's business areas operate with standard policies and procedures.
- Select the systems to account for the Fund resources by September 30, 1994, and begin implementing these systems by December 31, 1994. The implementation of these systems, which is a long-term effort, will reduce the number of Fund systems and serve as the foundation for the implementation of a standard integrated system to improve the Fund's operations. Since DOD will have to continue to rely on existing systems and reports in the near term, it is imperative that DOD pursue short-term efforts to improve the accuracy and reliability of the financial data.
- Improve the accuracy of the monthly financial reports that provide information on the profit/loss of each business area by December 31, 1994.

Until the actions and tasks related to the policies, procedures, and systems categories are completed and fully implemented, DOD will not be in a position to identify the total cost of operations, and managers will continue to lack the data needed to reduce these costs.

Strong Leadership and Management Needed to Address Fund Problems

The Fund has been under the direction of the Office of the Comptroller since its inception. However, until recently, the Comptroller did not always have the DOD-wide support needed to effectively deal with and resolve the long-standing problems that the Fund inherited from the old stock and industrial funds and that have continued to impair the operations of the Fund. From the outset, DOD management underestimated the magnitude, complexity, and difficulty of operating an \$85 billion enterprise. DOD now recognizes the challenges it faces and the need to place priority on financial management improvements.

Because of the problems with the operation of the Fund, we suggested in our October 1993 letter to the Deputy Secretary of Defense that DOD appoint a Fund director. In response to that letter, DOD stated that it has an alternative management approach in place to resolve the problems with the Fund. Instead of a Fund manager, DOD has appointed the DOD Comptroller to oversee the implementation of the plan. The Comptroller chairs the Defense Business Operations Fund Corporate Board, which was established in December 1993. The Corporate Board is comprised of functional and financial senior executives, who represent the interests of the Fund and its customers—primarily the military services.

DOD's approach could resolve the problems with the Fund. However, it is very similar to the Fund Board the DOD Comptroller established when the Fund was created over 2 years ago. Successful implementation of the current board approach rests heavily upon many components of DOD working together without specific hierarchical direction from one manager with overall responsibility and authority for implementation. Including outside experts could provide some additional insights and perspective on resolving the Fund's problems.

The collaboration of the Comptroller and the Corporate Board is essential to ensuring that the plan is successfully executed and that the problems hindering the Fund's operations are corrected. Because the Fund involves several functional areas, the Fund's problems can only be corrected if these areas work in unison. The most critical areas involved are the various accounting, financial, logistical, and personnel systems that provide the information included on the Fund's financial reports.

Because this management approach is extremely difficult to manage, particularly in a highly structured entity as DOD, periodic assessments would enable the Secretary of Defense to determine whether the current management approach is resolving the Fund's problems within the time frames set forth in the plan. If not, DOD could reconsider the option of using a Fund director, as we previously suggested, to oversee the management of the Fund and the implementation of the plan.

Conclusions

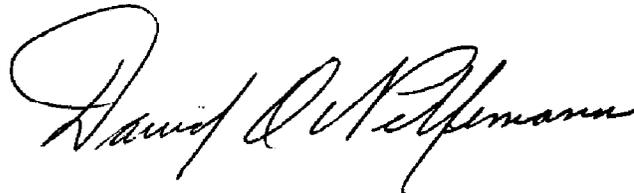
DOD has made progress in completing the actions and tasks in the plan. Most importantly, DOD has recognized the seriousness of the problems affecting the Fund. However, the key tasks aimed at improving the Fund's policies, procedures, and systems—which are crucial to satisfying the basic Fund objectives—are not scheduled to be completed until later this fiscal year or next fiscal year.

Until these actions are completed, especially the implementation of enhanced systems, the Fund will continue to be faced with operational problems. Antiquated systems and flawed data continue to seriously impair DOD's ability to obtain reliable data on the results of operations. Short-term efforts, such as improving the accuracy of the financial data in existing systems, must be given a high priority to improve the Fund's current operations.

DOD will not fully achieve the Fund's objectives until its systems are successfully upgraded. Implementing these systems will require a long-term commitment by DOD. In the past, DOD has had limited success in systems implementation, and many promises of management improvement that hinge on new systems have remained unfulfilled. The continued leadership and commitment of the Secretary of Defense and key DOD managers will be critical to the success of DOD's planned improvements.

We are sending copies of this report to the Secretary of Defense; the Director of the Office of Management and Budget; the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs and the House Committee on Government Operations; and other interested parties. We will make copies available to others upon request.

Please contact me at (202) 512-2666 if you or your staffs have any questions concerning this report. Major contributors to this report are listed in appendix II.



David O. Nellesmann
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List of Requesters

The Honorable Sam Nunn
Chairman

The Honorable Strom Thurmond
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Daniel K. Inouye
Chairman

The Honorable Ted Stevens
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Ronald V. Dellums
Chairman

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

The Honorable John P. Murtha
Chairman

The Honorable Joseph M. McDade
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

The Honorable Charles E. Grassley
United States Senate

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Abbreviations

CIM	Corporate Information Management
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense

Persistent Problems Hinder Fund Operations

In April 1991—5 months before the Fund began operations—we testified that DOD did not have the policies, procedures, and systems in place to operate the Fund in a businesslike manner. Today, after more than 2 years of operations, many of the problems discussed in our April 1991 testimony persist. Defense still faces major challenges in (1) managing the Fund's cash, (2) developing the Fund's policies, (3) developing and implementing an integrated financial management system, (4) producing accurate financial reports on the results of the Fund's operations, and (5) developing performance measures for the Fund.

Fund's Cash Management Problems Continue

Although we have testified and reported on many occasions that DOD needs to develop a cash management policy, DOD still has not done so. In general, an effective cash management policy would (1) prescribe the minimum and maximum amounts of cash needed to support the Fund's operations, (2) address those functions that affect the Fund's cash balance, such as billing customers, collecting accounts receivables, and paying contractors for items procured, (3) provide for cash forecasting, and (4) hold military services and DOD agencies accountable for cash outlay targets. DOD's plan identified several actions designed to remedy the cash management problems, including the development of comprehensive cash management policies and procedures by March 31, 1994.

Advance Billing Used to Alleviate Cash Shortage

Effective cash management is critical to the successful operation of the Fund because of the billions of dollars involved in collections and disbursements each year. DOD estimates that the Fund will collect and disburse over \$85 billion and \$83 billion, respectively, in fiscal year 1994. However, DOD continues to experience difficulties in effectively managing the Fund's cash.

Recognizing that the Fund's operations would not generate adequate cash to complete the transfers of \$5.5 billion as required by the National Defense Authorization Act for Fiscal Year 1993, the DOD Principal Deputy Comptroller directed in June 1993 that all depot maintenance and selected research and development activities advance bill customers for goods and services to be provided. DOD reported that approximately \$5.6 billion has been advance billed. If the Fund had not advance billed customers, the Fund's balance would have been a negative \$1.6 billion as of January 31, 1994. In our view, advance billing is more of a stopgap measure than a sound business practice. DOD plans to start eliminating the advance billing

during fiscal year 1994 and anticipates completely eliminating it during fiscal year 1995. However, a plan to accomplish this has not been finalized.

Restrictions on Procuring Inventory Could Generate Cash for the Fund

DOD had anticipated that restrictions imposed on replacing inventory sold to customers would improve the Fund's cash position since the Fund would purchase less inventory than it sold. For fiscal years 1993 and 1994, the Congress imposed a 65-percent limitation on the amount of inventory DOD could procure to replace inventory the Fund sold to customers. The restriction was aimed at reducing DOD inventory levels.

For fiscal year 1994, DOD estimated that the Fund's supply management and commissary business areas would have sales of approximately \$47 billion. However, various types of inventory items or operations—such as fuel, subsistence, and repair of repairable inventory—are exempted from the replacement limitation. Due to the exemptions, the 65-percent limitation only applies to about \$7 billion of the \$47 billion in sales. A DOD official told us that the 65-percent limitation could generate about \$1.5 billion to \$2 billion in cash each year. Although this inventory replacement limitation could help improve the Fund's cash balance, it will not resolve the Fund's cash shortage problem.

DOD Unable to Match \$4.7 Billion of Fund Disbursements With Obligations

Further inhibiting DOD's ability to effectively manage the Fund's cash balance is its failure to match disbursements with the corresponding obligations. Matching disbursements with related obligations is necessary to ensure that reliable information exists on the amount of operating funds available for obligation and expenditure. The inability to properly match disbursements with obligations puts DOD at a substantial risk that erroneous payments may have occurred without detection, cumulative amounts of disbursements may exceed legal limits, and the Fund's operating cash balance may be incorrectly stated.

Based on our review of available documentation, DOD had not matched at least \$4.7 billion in Fund disbursements with the corresponding obligations as of September 30, 1993. This amount, however, is understated. The following examples illustrate this point.

- Air Force installations record Fund disbursements in their accounting records even when the disbursements do not belong to them. The Air Force calls this practice "forced posting." Although these disbursements are not matched to the correct corresponding obligations, they are no

longer identified as unmatched. Because there is no obligation to record the disbursements against, forced posting creates at the installation level what are referred to as negative unliquidated obligations, which are tracked and researched as such by the installation. These unmatched disbursements are not reported to Fund managers at DFAS-Denver for control purposes. DFAS-Denver officials were unaware of the dollar value of unmatched disbursements caused by forced posting.

- Amounts reported by the Fund's business areas are netted as the data are "rolled up" for management reporting. The amounts, which are normally positive, are netted against negative amounts that occur because of data processing errors, duplicate payments, or clearing actions. This netting takes place from the lowest reporting level to the highest reporting level and results in incorrect amounts of unmatched disbursements being reported. For example, DFAS-Columbus accounts for nine Fund business areas. One of the business areas reported that it had \$498 million in unmatched disbursements as of September 30, 1993. However, by the time this amount was summarized with the other eight areas, the accumulated or total amount reported was \$296 million.

DOD officials informed us that a primary cause of unmatched disbursements is the time it takes to process disbursement transactions. Officials told us that the processing of disbursement transactions can take from 1 to 6 months. DOD's lengthy processing time is attributable to the flow of disbursement data and the manually intensive process used to record that data. DOD components routinely make disbursements on behalf of each other. Even within a given DOD component, such as the Air Force, one activity will make disbursements for another activity. To be recorded in DOD's accounting records, the disbursement data must flow from the activity making the disbursement (paying station) to the activity responsible for recording the disbursement and matching it to the related obligation (accountable station).

Further exacerbating the problem is the data flow used by the individual DOD components to get the disbursement data to their respective accountable stations for entry into the accounting records. For example, Air Force transactions flow from the paying station through DFAS-Denver to the Air Force accountable station. Navy disbursements flow essentially the same way, except the data flows through DFAS-Cleveland to the accountable station. The Army uses a more simplified flow: its disbursements flow from the paying station directly to the Army accountable station if the paying station is an Army activity or DFAS-Columbus. Disbursements made for the Army by the Air Force, Navy,

and non-DOD organizations flow through DFAS-Indianapolis to the Army accountable station.

Disbursement transaction processing time is lengthened because the recording of data is manually intensive. For example, at the end of fiscal year 1993, DFAS-Columbus had approximately 44,000 unprocessed transaction vouchers valued at \$454 million resulting from cross-disbursing activities.¹ DFAS-Columbus officials estimated that entering the unprocessed transactions into the system would equate to about 1 year's worth of work. DOD officials attribute the manual entry of data to the lack of integration and automated interfaces between the Fund's various systems.

DOD's failure to match disbursements with obligations applies not only to the Fund, but throughout DOD. Our past reports have shown that DOD components have historically had problems in matching disbursements with the corresponding obligations. Prompted by our report on the Navy's \$12 billion unmatched disbursements,² a DOD-wide review was initiated to address the unmatched disbursement problem. DOD acknowledged that the total amount of DOD disbursements not properly matched to obligations was about \$41 billion. Further, DFAS has recognized unmatched disbursements as a material weakness in its fiscal year 1993 annual statement of assurance to the Secretary of Defense.³

Critical Policies Not Developed

Over the past 3 years, we have pointed out that DOD has not developed the necessary policies to operate the Fund. DOD acknowledges that one of the most significant weaknesses of the Fund's implementation has been the lack of standard policies. Given the immense size, complexity, and scope of the Fund's \$85 billion in operations, the need for such policies is particularly acute. Fund managers have lacked the necessary guidance to execute the day-to-day operations of the Fund's various activities. This has resulted in problems related to budgeting, accounting, and reporting for the business areas of the Fund. For example, DOD reported that due to insufficient policy guidance, Fund managers were forced to make their

¹Cross-disbursing is a term used within DOD to refer to one DOD component or another federal agency, such as the Department of State, making disbursements on behalf of another DOD component.

²Financial Management: Navy Records Contain Billions of Dollars in Unmatched Disbursements (GAO/AFMD-93-21, June 9, 1993).

³As of March 1, 1994, the Secretary of Defense had not filed the DOD-wide report on internal controls that was due on December 31, 1993, under the Federal Managers' Financial Integrity Act. Therefore, we do not know if the Secretary also considers unmatched disbursements to be a material weakness for DOD as a whole.

own interpretations regarding how to report on the operations of their respective business areas. Consequently, the Fund's financial reports reflected the inconsistent application of policies across the business areas. DOD further reported that the lack of detailed procedural guidance contributed to numerous after-the-fact changes and retroactive adjustments to the reports.

DOD's plan includes tasks to develop and implement standard Fund policies and, as a result, DOD has two efforts currently underway. First, DOD is drafting Fund guidance, which will be included in the DOD Financial Management Regulation. The draft accounting guidance for the Fund consists of 14 chapters. According to the Fund's plan, DOD plans to (1) coordinate the draft guidance with the military services and DOD components by March 1994 and (2) implement the guidance by December 1994. Second, DOD established the Special Committee for Oversight of Policy Action, which is responsible for reviewing issues related to the Fund's policies. DOD plans on this group's work being completed by June 1994.

However, issuing the policies will be only the first step. The Fund's various field activities will need even more detailed procedures to implement these policies. For example, once DOD issues its revised revenue recognition policy, it will need to develop procedures on how the policy is to be implemented in a uniform manner throughout the Fund's business areas. In addition, a very substantial effort will be needed to train the people who will be implementing the policies. A major action in DOD's plan is aimed at ensuring proper implementation of policies and procedures through educating and training personnel on the conceptual framework of the Fund and the mechanics of its implementation. Once these policies are issued, some will require significant revisions to the supporting information systems. Until implementation of the new policies is achieved and changes are made to the systems, the benefits of the new policies will not be realized.

Fund Lacks Integrated Financial Management System

The Fund is supported by the same systems that existed under the old stock and industrial funds and, consequently, inherited the multiple problems of those systems. The Fund has 80 disparate, unlinked financial systems and approximately 200 ancillary systems that provide financial data. As a result, the Fund's accounting systems do not provide complete and accurate information on the results of its operations. These complex, serious, and long-standing problems adversely affect DOD's ability to

accurately account for, control, and manage billions of dollars of resources. DOD's plan acknowledged the serious problems with the Fund's systems.

The plan identifies numerous tasks aimed at improving the Fund's financial systems, such as using the DOD standard general ledger and developing a standard budget accounting and classification code. DOD plans to select the systems to account for the Fund's costs and resources by September 30, 1994, and to begin implementing these systems by December 31, 1994.

Developing and implementing systems that produce credible cost data is essential for successful Fund operation. Users of the cost data, such as Fund customers, must be assured that the cost data are accurate because the data will be used as the basis to bill them for the goods and services they receive. Also, the cost data must be accurate for congressional oversight and control over customers' budget requests.

Fund's Financial Reports Continue to Contain Inaccurate Information

We have previously reported that the Fund's financial reports contain billions of dollars of errors and cannot be relied on for decision-making purposes. The DOD Inspector General also reported that it could not render an opinion on the Fund's fiscal year 1992 financial statements because the data were not complete and accurate. DOD management needs accurate reports on the Fund's operation in order to properly analyze trends, make comparisons, measure budget execution, formulate budget requests, and set prices to charge.

DOD has acknowledged several times that the Fund's financial reports are inaccurate—in the Acting Comptroller's February 2, 1993, letter to the congressional Defense committees; in the Fund's task force report of July 30, 1993; in the Fund's September 24, 1993, plan; and in DOD's February 2, 1994, response to our October 1993 letter on the Fund's plan. The plan identifies a number of tasks aimed at improving the accuracy of the Fund's financial reports. Many of the tasks are not scheduled to be completed until later in fiscal year 1994 or in fiscal year 1995. If DOD management does not ensure that these tasks are completed as scheduled, the reliability of the financial reports will not improve in the foreseeable future.

Our brief and limited analysis of the fiscal year 1993 monthly financial reports disclosed numerous instances in which the reports were

inaccurate and of questionable use. The problems with these reports are similar to those we identified in the fiscal year 1992 reports. Some examples from the fiscal year 1993 reports follow.

- The Fund's fiscal year 1993 financial and budget reports reported amounts that differ by \$6.1 billion for net operating results. If the gains and losses in individual business areas are not netted, the gross difference is \$7.5 billion. The fiscal year 1993 net operating results are a key factor in setting the fiscal year 1995 prices the Fund will charge its customers. Since the financial reports should be the basis for preparing the budget reports, these vastly different amounts reported for the same item should not occur.
- The Fund's Monthly Report of Operations—the 1307 report—provides information on the revenues, costs, and profits/losses for each of the Fund's business areas. DOD has disclosed in the footnotes to the report that the report is not accurate. The footnotes also disclose some causes for the inaccuracies, such as the following: (1) guidance has not been provided on how to determine the amount of certain accounts and (2) the accounting systems have not been modified to accumulate and report the information needed for certain accounts. However, little or no action has taken place to resolve these problems.
- DOD managers are not receiving accurate financial data on the annual \$1 billion to \$2 billion capital asset program. The monthly 1307 financial report does not provide accurate capital asset information on the amount of (1) revenue earmarked for purchases of capital assets, (2) capital asset obligations, and (3) capital asset outlays. Our analysis of the fiscal years 1992 and 1993 accounting and budgeting reports shows that the Fund business areas only obligated about \$1.8 billion (58 percent) of the \$3.1 billion of the authority provided to them. Because the financial information is not accurate, it is extremely difficult, if not impossible, for DOD management and the Congress to ascertain if the capital asset program is being executed in accordance with the capital asset budget presented to the Congress. DOD officials have acknowledged that the Fund activities have not always executed the capital asset program. To try to resolve this problem, DOD specifically listed the capital asset projects authorized for execution in the fiscal year 1994 annual operating budgets issued to the Fund activities.

Further, DOD has not established, a capital asset subaccount, as required by the National Defense Authorization Act for Fiscal Year 1993. The act required that amounts charged for the depreciation of capital assets be credited to the subaccount. Moreover, these funds were to be available

only for the payment of capital assets for the Fund.⁴ Because no capital asset subaccount exists and the financial data on capital assets are inaccurate, DOD cannot determine the amount of cash that should be set aside in the subaccount. As a result, during fiscal year 1993, DOD had no assurance that funds available only to pay for capital assets were not improperly used to finance the day-to-day operating expenses of the Fund.

Performance Measures Have Been Developed for Fund's Business Areas

DOD included performance measures in the Fund's fiscal year 1994 annual operating budgets. The measures were developed using the criteria outlined in the Acting Comptroller's October 29, 1992, memorandum and data drawn from existing measures used in current programs. DOD has just begun developing the corresponding goals for some business areas, such as the Defense Logistics Agency supply management and distribution depots. One of the goals DOD plans to use is its ability to fill a customer's request for an inventory item without having to backorder the request. However, as of the end of January 1994, DOD had not received any actual execution data on the performance measures included in the annual operating budget.

Performance measurements are a valuable tool for managers because they provide information on an organization's performance. Managers can use the data that performance measures provide to help them account for past activities, manage current operations, or assess progress toward planned objectives. Well-designed measures that are timely, relevant, and accurate are important, but it is also important that the measures be used by decisionmakers. Performance measures will be used as a management tool only if management makes a commitment that supports their use.

⁴The National Defense Authorization Act for Fiscal Year 1994 deleted the requirement that these funds be available only for the payment of capital assets. DOD is still required to establish a capital asset subaccount.

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