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DOD BUSINESS  
TRANSFORMATION

Sustained Leadership  
Needed to Address  
Long-standing Financial  
and Business Management  
Problems

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# DOD BUSINESS TRANSFORMATION

## Sustained Leadership Needed to Address Long-standing Financial and Business Management Problems

Highlights of [GAO-05-723T](#), testimony before the Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

### Why GAO Did This Study

In July 2004, GAO testified before this Subcommittee on the impact and causes of financial and related business weaknesses on the Department of Defense's (DOD) operations and the status of DOD reform efforts. The report released today highlights that DOD still does not have management controls to ensure that its business systems investments are directed towards integrated corporate system solutions. GAO's reports continue to show that fundamental problems with DOD's financial management and related business operations result in substantial waste and inefficiency, adversely impact mission performance, and result in a lack of adequate accountability across all major business areas. Over the years, DOD leaders attempted to address these weaknesses and transform the department. For years, GAO has reported that DOD is challenged in its efforts to effect fundamental financial and business management reform and GAO's ongoing work continues to raise serious questions about DOD's chances of success.

The Subcommittee asked GAO to provide information on the (1) pervasive long-standing financial and business management weaknesses that affect DOD's efficiency, (2) cost of and control over the department's business systems investments, and (3) legislative actions needed to enhance the success of DOD's business transformation efforts.

[www.gao.gov/cgi-bin/getrpt?GAO-05-723T](http://www.gao.gov/cgi-bin/getrpt?GAO-05-723T).

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

### What GAO Found

Overhauling the financial management and business operations of one of the largest and most complex organizations in the world represents a daunting challenge. Eight DOD program areas, representing key business functions, are on GAO's high-risk list, and the department shares responsibility for six other governmentwide high-risk areas, meaning that DOD is fully or partially responsible for 14 of the 25 high-risk areas in the federal government. DOD's substantial financial and business management weaknesses adversely affect not only its ability to produce auditable financial information, but also to provide accurate, complete, and timely information for management and Congress to use in making informed decisions. Further, the lack of adequate accountability across all of DOD's major business areas results in billions of dollars in annual wasted resources in a time of increasing fiscal constraint and has a negative impact on mission performance.

#### Impact of Weaknesses in Human Capital Management, Internal Control, and Systems

Business	
Business area affected	Problem identified
Military pay	Injured and ill reserve component soldiers—who are entitled to extend their active duty service to receive medical treatment—have been inappropriately removed from active duty status causing significant gaps in their pay and medical benefits. The current stovepiped, nonintegrated personnel and pay systems are labor intensive and require extensive error-prone manual entry and reentry of data.
Logistics	DOD does not have the ability to provide timely, complete, or accurate information on the location, movement, status, or identity of its supplies, even though total asset visibility has been a departmentwide goal for over 30 years.
Systems	DOD lacks the management structure to effectively control billions of dollars being spent each year to operate, maintain, and modernize its reported 4,150 duplicative, nonintegrated business systems.

Source: GAO.

The department has recently taken several steps to address provisions of the fiscal year 2005 defense authorization act which are aimed at improving DOD's business systems management practices. For example, DOD has established the Defense Business Systems Management Committee to oversee its business systems modernization efforts. However, DOD's overall transformation efforts have not adequately addressed the key causes of past reform failures. Lessons learned from these previous reform attempts include the need for sustained leadership at the highest level and a strategic and integrated plan. The seriousness of DOD's weaknesses underscores the importance of no longer condoning the "status quo."

To improve the likelihood that DOD's transformation efforts will succeed, GAO proposes that business systems funding be appropriated to the approval authorities responsible for business systems investments. Additionally, GAO suggests that a senior management position be established to provide sustained leadership for DOD's overall business transformation. Absent this unified responsibility, authority, accountability, and control of funding, DOD's transformation efforts are likely to fail.

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Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be back before this Subcommittee to discuss business transformation efforts at the Department of Defense (DOD). At the outset, I would like to thank the Subcommittee for having this hearing and acknowledge the important role hearings such as this one serve in addressing DOD's business transformation challenges. DOD spends billions of dollars each year to sustain key business operations that support our forces, including systems and processes related to acquisition and contract management, financial management, supply chain management, support infrastructure management, human capital management, and other key areas. Recent and ongoing military operations in Afghanistan and Iraq and new homeland defense missions have led to higher demands on our forces in a time of growing fiscal challenges for our nation. In an effort to better manage DOD's resources, the Secretary of Defense has appropriately placed a high priority on transforming key business processes to improve their efficiency and effectiveness in supporting the department's military mission.

However, as discussed in the report<sup>1</sup> being released at this hearing and previous reports and testimonies, fundamental problems with DOD's financial management and related business operations continue to cause substantial waste and inefficiency, have an adverse impact on mission performance, and result in the lack of adequate transparency and appropriate accountability across all major business areas. Of the 25 areas on GAO's governmentwide high-risk list, 8 are DOD specific program areas related to key business functions, and the department shares responsibility for 6 other high-risk areas that are governmentwide in scope.<sup>2</sup> These problems preclude the department from producing reliable and timely information to make sound decisions and to accurately report on its trillions of dollars of assets and liabilities.

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<sup>1</sup>GAO, *DOD Business Systems Modernization: Billions Being Invested without Adequate Oversight*, [GAO-05-381](#) (Washington, D.C: Apr. 29, 2005).

<sup>2</sup>GAO, *High-Risk Series: An Update*, [GAO-05-207](#) (Washington, D.C.: January 2005). The eight specific DOD high-risk areas are (1) approach to business transformation, (2) business systems modernization, (3) contract management, (4) financial management, (5) personnel security clearance program, (6) supply chain management, (7) support infrastructure management, and (8) weapon systems acquisition. The six governmentwide high risk areas that include DOD are: (1) disability programs, (2) interagency contracting, (3) information systems and critical infrastructure, (4) information sharing for homeland security, (5) human capital, and (6) real property.

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Today, my testimony will focus on two of the high-risk areas—financial management and business systems modernization. Both of these areas have been designated as high-risk since 1995—a decade ago. In this regard, my testimony will provide our perspectives on the (1) pervasive long-standing financial and business management weaknesses that affect DOD’s efficiency, (2) cost of and control over the department’s business systems investments, and (3) legislative actions needed to enhance the success of DOD’s business transformation efforts—specifically, the central control of business systems investment funding and establishment of a chief management official. Implementation of these two suggestions would provide the sustained top-level leadership and accountability needed and thereby increase the likelihood of successful business transformation.

My statement is based upon the report<sup>3</sup> released today, as well as our previous reports and testimonies. Our work was performed in accordance with U.S. generally accepted government auditing standards.

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## Summary

DOD’s substantial long-standing management problems related to business operations and systems have adversely affected the economy, efficiency, and effectiveness of its operations; and, in some cases, impacted the morale of our fighting forces that are in harms way. These problems have left the department vulnerable to billions of dollars of fraud, waste, and abuse annually, at a time of increasing fiscal constraint and have resulted in a lack of adequate accountability across all major business areas. Additionally, our report released today describes other indicators of the department’s limited progress in transforming its business operations and systems. This year, we added DOD’s overall approach to business transformation to our high-risk list<sup>4</sup> because DOD lacks a strategic and integrated business transformation plan and because we have concerns over DOD’s lack of adequate management responsibility and accountability to achieve and sustain business reform on a broad, strategic, departmentwide, and integrated basis. The following examples indicate the magnitude and severity of the resulting problems.

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<sup>3</sup>GAO-05-381.

<sup>4</sup>GAO-05-207.

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- As we testified<sup>5</sup> before this Subcommittee on March 16, 2005, mobilized Army National Guard soldiers have experienced significant problems getting accurate, timely, and consistent reimbursement for out-of-pocket travel expenses. One of the primary causes for these problems is rooted in the paper-intensive process used by DOD to reimburse Army National Guard soldiers for their travel expenses.
  - DOD does not have the ability to provide timely or accurate information on the location, movement, status, or identity of its supplies. Although total asset visibility has been a departmentwide goal for over 30 years, DOD currently estimates that it will not achieve this goal until the year 2010.<sup>6</sup>
  - DOD's continued supply chain problems resulted in shortages of items in Iraq. As discussed in our April 2005, report, demands for items like vehicle track shoes, batteries, and tires exceeded their availability because the department did not have accurate or adequately funded Army war reserve requirements and had inaccurate forecasts of supply demands for the operation. Furthermore, the Army's funding approval process delayed the flow of funds to buy them. In addition, numerous problems, such as insufficient transportation, personnel, and equipment, as well as inadequate information systems, hindered DOD's ability to deliver the right items to the right place at the right time for the warfighter. Among the items the department had problems delivering were generators for assault amphibian vehicles, tires, and Meals Ready-to-Eat.<sup>7</sup>
  - DOD's stovepiped, duplicative, and nonintegrated systems environment contributes to these operational problems and costs the American taxpayers billions of dollars each year. For fiscal year 2005, the department requested approximately \$13 billion to operate, maintain,

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<sup>5</sup>GAO, *Army National Guard: Inefficient, Error-Prone Process Results in Travel Reimbursement Problems for Mobilized Soldiers*, [GAO-05-400T](#) (Washington, D.C.: Mar. 16, 2005).

<sup>6</sup>GAO, *Defense Inventory: Improvements Needed in DOD's Implementation of Its Long-Term Strategy for Total Asset Visibility of Its Inventory*, [GAO-05-15](#) (Washington, D.C.: Dec. 6, 2004).

<sup>7</sup>GAO, *Defense Logistics: Actions Needed to Improve the Availability of Critical Items during Current and Future Operations*, [GAO-05-275](#) (Washington, D.C.: Apr. 8, 2005).

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and modernize its reported 4,150 business systems—an increase of about 1,900 in the number of reported systems since last year.

Because of the department's flawed processes, we found that DOD is not in compliance with the National Defense Authorization Act for Fiscal Year 2003, which requires the DOD Comptroller to determine that system improvements with obligations exceeding \$1 million meet the criteria specified in the act. Based upon DOD's reported data, system improvements totaling about \$651 million of obligations over \$1 million were not reviewed by the DOD Comptroller before obligations were made since passage of the 2003 act. Further evidence of DOD's problems is the long-standing inability of any military service or major defense component to pass the test of an independent financial audit or provide timely reliable and complete information for DOD decision makers because of pervasive weaknesses in the department's financial management systems, operations, and controls.

The seriousness of DOD's business management weaknesses underscores the importance of no longer condoning "status quo" business operations at DOD. To improve the likelihood that the department's current business transformation efforts will be successful, we propose that those who are responsible for business systems modernization control the allocation and execution of funds for DOD business systems. Investments in the modernization of the department's business systems need to be directed towards integrated corporate system solutions to common DOD-wide problems, and not the perpetuation of the stovepiped, duplicative systems environment that exists today.

Additionally, due to the complexity and long-term nature of these transformation efforts, strong and sustained executive leadership is needed if DOD is to succeed. We believe one way to ensure this strong and sustained leadership over DOD's business management reform efforts would be to create a full-time, executive-level II position for a chief management official (CMO), who would serve as the Deputy Secretary of Defense for Management.<sup>8</sup> We believe that the new CMO position should be filled by an individual appointed by the President and confirmed by the Senate, for a set term of 7 years. Articulating the role and responsibilities of the position in statute and establishing a term that spans administrations

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<sup>8</sup>GAO, *Defense Management: Key Elements Needed to Successfully Transform DOD Business Operations*, GAO-05-629T (Washington, D.C.: Apr.28, 2005).

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underscores the importance of a professional, nonpartisan approach to this business management-oriented position. This position would serve as a strategic integrator to elevate and institutionalize the attention essential for addressing key stewardship responsibilities, such as strategic planning, enterprise architecture development and implementation, information technology (IT), and financial management, while facilitating the overall business management transformation within DOD. The CMO would not conduct the day-to-day management functions of the department; therefore, creating this position would not add an additional hierarchical layer to the department. Day-to-day management functions of the department would continue to be the responsibility of the undersecretaries of defense, the service secretaries, and others. Just as the CMO would need to focus full-time on business transformation, we believe that the day-to-day management functions are so demanding that it is difficult for these officials to maintain the oversight, focus, and momentum needed to implement and sustain needed reforms of DOD's overall business operations.

We are confident that transforming DOD's business operations and making them more efficient would free up resources that could be used to support the department's core mission, enhance readiness, and improve the quality of life for our troops and their families. It is worth noting that on April 14, 2005, a bill was introduced in the Senate that would require the establishment of a CMO that would be appointed by the President and confirmed by the Senate, for a set term of 7 years.<sup>9</sup>

In written comments on a draft of the report released today, DOD agreed with our four recommendations and briefly outlined its actions for addressing them.

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## Background

Because DOD is one of the largest and most complex organizations in the world, overhauling its business operations represents a huge management challenge. In fiscal year 2004, DOD reported that its operations involved \$1.2 trillion in assets, \$1.7 trillion in liabilities, over 3.3 million in military and civilian personnel, and over \$605 billion in net cost of operations. For fiscal year 2005, the department received an annual appropriation of about \$417 billion and was appropriated about \$76 billion for the global war on

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<sup>9</sup>S. 780, 109<sup>th</sup> Cong. (2005).

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terrorism. Execution of DOD's operations spans a wide range of defense organizations, including the military services and their respective major commands and functional activities, numerous large defense agencies and field activities, and various combatant and joint operational commands that are responsible for military operations for specific geographic regions or theaters of operation. To support DOD's operations, the department performs an assortment of interrelated and interdependent business processes, including logistics, procurement, health care, and financial management.

Transformation of DOD's business systems and operations is critical to the department providing Congress and DOD management with accurate and timely information for use in the decision-making process. This effort is an essential part of the Secretary of Defense's broad initiative to "transform the way the department works and what it works on." The Secretary of Defense has estimated that improving business operations of the department could save 5 percent of DOD's annual budget, which based on fiscal year 2005 appropriations, represents a savings of about \$25 billion.

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## **Pervasive Financial and Business Management Problems Affect DOD's Efficiency and Effectiveness**

For several years, we have reported that DOD faces a range of financial management and related business process challenges that are complex, long-standing, pervasive, and deeply rooted in virtually all business operations throughout the department. As the Comptroller General testified in April 2005,<sup>10</sup> DOD's financial management deficiencies, taken together, continue to represent a major impediment to achieving an unqualified opinion on the U.S. government's consolidated financial statements. To date, none of the military services has passed the test of an independent financial audit because of pervasive weaknesses in internal controls and processes and fundamentally flawed business systems.

In identifying improved financial performance as one of its five governmentwide initiatives, the President's Management Agenda recognized that without sound internal controls and accurate and timely financial and performance information, it is not possible to accomplish the President's agenda and secure the best performance and highest measure of accountability for the American people.

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<sup>10</sup>GAO-05-629T.



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## Pervasive Weaknesses Impact DOD Operations

Long-standing weaknesses in DOD's financial management and related business processes and systems have (1) resulted in a lack of reliable information needed to make sound decisions and report on the status of DOD activities, including accountability of assets, through financial and other reports to Congress and DOD decision makers; (2) hindered its operational efficiency; (3) adversely affected mission performance; and (4) left the department vulnerable to fraud, waste, and abuse, as the following examples illustrate.

- The current inefficient, paper-intensive, error-prone travel reimbursement process has resulted in inaccurate, delayed, and denied travel payments for mobilized Army Guard soldiers. We found a broad range of reimbursement problems that included disputed amounts for meals that we estimated to be as high as about \$6,000 for each of 76 soldiers in one case study that remained unpaid by the end of our review. Until DOD improves the antiquated process that requires Army Guard soldiers to accumulate, retain, and submit numerous paper documents, reimbursement problems and inefficiencies will likely continue. Of approximately 930,000 travel vouchers received between fiscal years 2002 and 2004, the Defense Finance and Accounting Service (DFAS) Contingency Travel Operations Office rejected and returned about 139,000 vouchers to soldiers for additional paper documentation or to correct other processing deficiencies. This repeated churning of vouchers frustrated soldiers and added to the volume of claims to be processed.<sup>11</sup>
- Injured and ill reserve component soldiers—who are entitled to extend their active duty service to receive medical treatment—have been inappropriately removed from active duty status in the automated systems that control pay and access to medical care. The current stovepiped, nonintegrated systems are labor-intensive and require extensive error-prone manual entry and reentry. Inadequate controls resulted in some soldiers experiencing significant gaps in their pay and medical benefits, causing hardships for the soldiers and their families. In addition, because these soldiers no longer had valid active duty orders, they did not have access to the commissary and post exchange—which allows soldiers and their families to purchase groceries and other goods at a discount. In one case we reviewed,

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<sup>11</sup>GAO-05-400T.

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during a 12-month period, while attempting to obtain care for injuries sustained from a helicopter crash in Afghanistan, one Special Forces soldier fell out of active duty status four times. During the times he was not recorded in the system as being on active duty, he was not paid and he and his family experienced delays in receiving medical treatment. In all, he missed payments for 10 pay periods—totaling \$11,924.<sup>12</sup>

- Ninety-four percent of mobilized Army National Guard and Reserve soldiers we investigated during two audits<sup>13</sup> had pay problems. These problems distracted soldiers from their missions, imposed financial hardships on their families, and may have a negative impact on retention. The processes and automated systems relied on to provide active duty payments to mobilized Army Guard and Reserve soldiers are so error-prone, cumbersome, and complex that neither DOD nor, more importantly, the soldiers themselves could be reasonably assured of timely and accurate payments. Some of the pay problems soldiers experienced often lingered unresolved for considerable lengths of time, some for over a year.
- DOD continues to lack visibility and control over the supplies and spare parts it owns. Therefore, it cannot monitor the responsiveness and effectiveness of the supply system to identify and eliminate choke points.<sup>14</sup> Currently, DOD does not have the ability to provide timely or accurate information on the location, movement, status, or identity of its supplies. Although total asset visibility has been a departmentwide goal for over 30 years, DOD estimates that it will not achieve this visibility until the year 2010. DOD may not meet this goal by 2010, however, unless it overcomes three significant impediments: (1) developing a comprehensive plan for achieving visibility, (2) building the necessary integration among its many inventory management information systems, and (3) correcting long-standing data accuracy and reliability problems within existing inventory management systems. A key to successful implementation of a comprehensive logistics strategy will be addressing

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<sup>12</sup>GAO, *Military Pay: Gaps in Pay and Benefits Create Financial Hardships for Injured Army National Guard and Reserve Soldiers*, [GAO-05-125](#) (Washington, D.C.: Feb. 17, 2005).

<sup>13</sup>GAO, *Military Pay: Army Reserve Soldiers Mobilized to Active Duty Experienced Significant Pay Problems*, [GAO-04-911](#) (Washington, D.C.: Aug. 20, 2004) and *Military Pay: Army National Guard Personnel Mobilized to Active Duty Experienced Significant Pay Problems*, [GAO-04-89](#) (Washington, D.C.: Nov. 13, 2003).

<sup>14</sup>GAO-05-629T.

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these initiatives as part of a comprehensive, integrated business transformation.

- The Defense Logistics Agency (DLA) and each of the military services experienced significant shortages of critical spare parts, even though more than half of DOD's reported inventory—about \$35 billion—exceeded current operating requirements. In many cases, these shortages contributed directly to equipment downtime, maintenance problems, and the services' failure to meet their supply availability goals. DOD, DLA, and the military services each lack strategic approaches and detailed plans that could help mitigate these critical spare parts shortages and guide their many initiatives aimed at improving inventory management.<sup>15</sup>
- The Navy did not know how much it spent on telecommunications and did not have detailed cost and inventory data needed to evaluate spending patterns and to leverage its buying power. At the four case study sites we audited, management oversight of telecommunication purchases did not provide reasonable assurance that requirements were met in the most cost-effective manner. For example, cell phone usage at three sites was not monitored to determine whether plan minutes met users' needs, resulting in overpayment for cell phone services. In addition, the Navy lacks specific policies and processes addressing the administration and management of calling cards. On one card alone, in a 3-month period, the Navy paid over \$17,000. Not until the vendor's fraud unit raised questions about more than \$11,000 in charges in a 6-day period was the card suspended.<sup>16</sup>
- Over the years, DOD recorded billions of dollars of disbursements and collections in suspense accounts because the proper appropriation accounts could not be identified and charged. Because documentation needed to resolve these payment recording problems could not be found after so many years, DOD requested and received authority to write-off certain aged suspense transactions. While DOD reported that it wrote off an absolute value of \$35 billion or a net value of \$629 million using the legislative authority, neither of these amounts accurately represents

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<sup>15</sup>GAO-05-207

<sup>16</sup>GAO, *Vendor Payments: Inadequate Management Oversight Hampers the Navy's Ability to Effectively Manage Its Telecommunication Program*, GAO-04-671 (Washington, D.C.: June 14, 2004).

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the true value of all the individual transactions that DOD had not correctly recorded in its financial records. Many of DOD's accounting systems and processes routinely offset individual disbursements, collections, adjustments, and correction entries against each other and, over time, amounts might even have been netted more than once. This netting and summarizing misstated the total value of the write-offs and made it impossible for DOD to identify what appropriations may have been under- or overcharged or to determine whether individual transactions were valid. At December 31, 2004, DOD reports showed that, even after the write-offs, more than \$1.3 billion (absolute value) remained in suspense accounts for longer than 60 days; however, DOD has acknowledged that its suspense reports are incomplete and inaccurate. In addition, DOD is still not performing effective reconciliations of its disbursement and collection activity. Similar to checkbook reconciliations, DOD needs to compare its records of monthly activity to Treasury's records and promptly research and correct any differences.<sup>17</sup>

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## Financial Improvement Initiative Lacks a Comprehensive and Integrated Plan and Effective Oversight and Monitoring Capabilities

In September 2004, we reported<sup>18</sup> that DOD had begun implementing a financial improvement initiative that included the goal of obtaining an unqualified audit opinion on its fiscal year 2007 consolidated financial statements but that the initiative lacked a clearly defined, integrated, well-documented, and realistic plan for improving DOD's financial management and thus achieving that goal. We also reported that DOD lacked effective oversight and accountability mechanisms to ensure that the mid-range financial improvement plans being developed by the military services and defense agencies in support of the initiative were adequately planned, implemented, and sustainable. Our report expressed concern that DOD's emphasis on obtaining a clean audit opinion for fiscal year 2007 could divert limited resources away from ongoing efforts to develop and implement the long-term systems and process changes needed to improve financial information and to efficiently and effectively manage DOD's business operations.

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<sup>17</sup>GAO, *DOD Problem Disbursements: Long-standing Accounting Weaknesses Result in Inaccurate Records and Substantial Write-offs*, [GAO-05-521](#) (Washington, D.C.: June 2, 2005).

<sup>18</sup>GAO, *Financial Management: Further Actions Are Needed to Establish Framework to Guide Audit Opinion and Business Management Improvement Efforts at DOD*, [GAO-04-910R](#) (Washington, D.C.: Sept. 20, 2004).

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In the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005,<sup>19</sup> Congress placed a limitation on the use of operations and maintenance funds for continued preparation or implementation of DOD's mid-range financial improvement plan. Use of such funds for the mid-range plan is prohibited until the Secretary of Defense submits to the congressional defense committees a report containing the following: (1) a determination that DOD's business enterprise architecture (BEA) and the transition plan for implementing the BEA have been developed, (2) an explanation of the manner in which fiscal year 2005 operations and maintenance funds will be used by DOD components to prepare or implement the mid-range financial improvement plan, and (3) an estimate of future year costs for each of the military services and defense agencies to prepare and implement the mid-range financial improvement plan. As of the end of May 2005, DOD has not yet provided the defense committees with the required report.

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## Ineffective Management Oversight and Control over Business System Investments

Until DOD has complete, reliable information on the costs and number of business systems operating within the department, its ability to effectively control the money it spends on these systems will be limited. DOD's fiscal year 2005 budget request for its business systems was \$13.3 billion, which, on its face, is about \$6 billion, or 29 percent, less than its fiscal year 2004 budget request. However, we found that this decrease can be attributed to DOD's reclassification of some business systems to national security systems, not to a reduction in spending on its systems. While some of the reclassifications appeared reasonable, our analysis showed that others were questionable or inconsistencies exist, which hinder DOD's ability to develop a definitive business systems inventory. At the same time the amount of requested business system funding declined, the reported number of business systems increased by about 1,900—from 2,274 in April 2003 to 4,150 in February 2005.

Furthermore, given that DOD does not know how many business systems it has, it is not surprising that the department continues to lack effective management oversight and control over business systems investments. Since February 2003, the domains have been given the responsibility to oversee the department's business systems investments, yet the billions of dollars spent each year continue to be spread among the military services

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<sup>19</sup>Pub. L. No. 108-375, § 352.

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and defense agencies, enabling the numerous DOD components to continue to develop stovepiped, parochial solutions to the department's long-standing financial management and business operation challenges. Additionally, based upon data reported to us by the military services and DOD components, obligations totaling at least \$243 million were made for systems modernizations in fiscal year 2004 that were not referred to the DOD Comptroller for the required review, as specified in the fiscal year 2003 defense authorization act.<sup>20</sup>

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### Fiscal Year 2005 Budget Request for DOD's Business Systems Environment Is \$13.3 Billion

For fiscal year 2005, DOD requested approximately \$28.7 billion<sup>21</sup> in IT funding to support a wide range of military operations as well as DOD business systems operations. Of the \$28.7 billion, our analysis showed that about \$13.3 billion was for business applications and related infrastructure. Of the \$13.3 billion, our analysis of the budget request disclosed that about \$8.4 billion was for infrastructure and related costs. Business applications include activities that support the business functions of the department, such as personnel, health, travel, acquisition, finance and accounting, and logistics. The remaining \$15.4 billion was classified as being for national security systems. Of that amount, our analysis ascertained that about \$7.5 billion was for infrastructure and related costs.

Of the \$13.3 billion, \$10.7 billion was for the operation and maintenance of the existing systems and \$2.6 billion was for the modernization of existing systems, the development of new systems,<sup>22</sup> or both. Table 1 shows the distribution, by DOD component, of the reported \$13.3 billion between current services and modernization funding.

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<sup>20</sup>Bob Stump National Defense Authorization Act for Fiscal Year 2003, Pub. L. No. 107-314, § 1004(d), 116 Stat. 2458, 2629 (Dec. 2, 2002).

<sup>21</sup>DOD categorizes its funding request as follows: business systems—\$5 billion; national security systems—\$7.8 billion; shared infrastructure and information assurance activities—\$14.8 billion; and related technical activities—\$1.1 billion.

<sup>22</sup>According to the department's definition in its Financial Management Regulation, development/modernization/enhancement include (1) new applications and infrastructure capabilities that are planned and under development; (2) any change or modification to existing applications and infrastructure capabilities which is intended to result in improved capabilities or performance of the activity, including (a) all modifications to existing operational software (other than corrective software maintenance) and (b) expansion of capabilities to new users; (3) changes mandated by Congress or the Office of the Secretary of Defense; and (4) personnel costs for project management.

**Table 1: Distribution of DOD's \$13.3 Billion IT Budget Request for Fiscal Year 2005 for Business Systems and Related Infrastructure**

Dollars in millions

Component	Current services	Development/ modernization	Total
Navy	\$3,278	\$206	<b>\$3,484</b>
Air Force	2,630	726	<b>\$3,356</b>
Army	1,780	607	<b>\$2,387</b>
TRICARE Management Agency (TRICARE)	803	255	<b>\$1,058</b>
DLA	602	179	<b>\$781</b>
DFAS	407	59	<b>\$466</b>
Defense Information Systems Agency	157	34	<b>\$191</b>
Other DOD components	1,074	566	<b>\$1,640</b>
<b>Total</b>	<b>\$10,731</b>	<b>\$2,632</b>	<b>\$13,363</b>

Source: GAO analysis of DOD information.

Note: Based on information DOD reported in its fiscal year 2005 IT budget request.

## Reclassification Limits Oversight of Business Systems

Incorrect system classification hinders the department's efforts to improve its control and accountability over its business systems investments. Our comparison of the fiscal years 2004 and 2005 budget requests disclosed that DOD reclassified 56 systems in the fiscal year 2005 budget request from business systems to national security systems, which are not subject to the same level of investment control. The net effect of the reclassifications was a decrease of approximately \$6 billion in the fiscal year 2005 budget request for business systems and related infrastructure. The reported amount declined from about \$19 billion in fiscal year 2004 to over \$13 billion in fiscal year 2005.

In some cases, we found that the reclassification appeared reasonable. The reclassification of the Defense Information System Network initiative as a national security system appeared reasonable since it provides a secure telecommunication network—voice, data, and video—to the President, the Secretary of Defense, the Joint Chiefs of Staff, and military personnel in the field. However, our analysis of the 56 systems also identified instances for which reclassification was questionable. For example, Base Level Communication Infrastructure—initiative number 254—for several DOD entities was shown as a national security system in the fiscal year 2005

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budget request. Our review of the fiscal year 2005 budget found that within the Air Force, there were numerous other initiatives entitled Base Level Communication Infrastructure that were classified as business systems, not national security systems. The nomenclature describing these different initiatives was the same. Therefore, it was difficult to ascertain why certain initiatives were classified as national security systems while others, with the same name, were classified as business systems.

In another example, this is the first year in which the Navy enterprise resource planning (ERP) effort was listed in the budget and incorrectly classified as a national security system. Its forerunners, four pilot ERP projects, have been classified as business systems since their inception. DOD officials were not able to provide a valid explanation as to why the program was classified as a national security program. For the fiscal year 2006 budget request, the Navy has requested that the DOD CIO reclassify the program from a national security system to a business system. Improper classification diminishes Congress's ability to effectively monitor and oversee the billions of dollars spent annually to maintain, operate, and modernize the department's business systems environment.

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### DOD Reports Significant Increase in the Number of Existing Business Systems

The department's reported number of business systems continues to rise, and DOD does not yet have reasonable assurance that the currently reported number of business systems is complete. As of February 2005, DOD reported that its business systems inventory consisted of 4,150 systems, which is an increase of approximately 1,900 reported business systems since April 2003. Table 2 presents a comparison of the April 2003 and February 2005 reported business systems inventories by domain.



**Table 2: Comparison of DOD Business Systems Inventories by Domain**

Domain	April 2003	February 2005	Difference
Acquisition	143	179	36
Financial management	752	600	(152)
Human resources	665	713	48
Installations and environment	128	473	345
Logistics	565	2,005	1,440
Enterprise information environment	21	40	19
No domain <sup>a</sup>	0	140	140
<b>Total</b>	<b>2,274</b>	<b>4,150</b>	<b>1,876</b>

Source: GAO analysis.

Note: Based on analysis of Business Management Modernization Program (BMMP) reported inventory of business systems as of April 2003 and February 2005.

<sup>a</sup>A specific domain was not assigned to these systems.

The largest increase is due to the logistics domain increasing its reported inventory of business systems from 565 in April 2003 to the current 2,005. We reported<sup>23</sup> in May 2004 that the logistics domain had validated about 1,900 business systems but had not yet entered most of them into the BMMP systems inventory. Logistics domain officials informed us that they completed that process and this increase was the result.

Table 3 shows the distribution of the 4,150 business systems among the components and domains.

<sup>23</sup>GAO, *DOD Business Systems Modernization: Billions Continue to Be Invested with Inadequate Management Oversight and Accountability*, [GAO-04-615](#) (Washington, D.C.: May 27, 2004).

**Table 3: Reported DOD Business Systems by Domain and Component**

Domain	Air Force	Army	Navy	DFAS	Other defense agencies	Multiple owner	Not determined	Total
Acquisition	20	16	122	2	15	2	2	179
Financial management	41	88	233	93	59	15	71	600
Human resources	84	332	151	30	65	26	25	713
Installations and environment	36	63	259	1	12	6	96	473
Logistics	166	193	1,512	4	76	39	15	2,005
Enterprise information environment	4	17	10	0	8	0	1	40
No domain	18	18	66	13	18	2	5	140
<b>Total</b>	<b>369</b>	<b>727</b>	<b>2,353</b>	<b>143</b>	<b>253</b>	<b>90</b>	<b>215</b>	<b>4,150</b>

Source: GAO analysis.

Note: Based on analysis of BMMP reported business system inventory as of February 2005.

The table shows the stovepiped, duplicative nature of DOD’s business systems. For example, there are 713 human resources systems across all components whose reported funding for fiscal year 2005 includes approximately \$223 million for modernization and over \$656 million for operation and maintenance. According to DOD officials, the Defense Integrated Military Human Resources System (DIMHRS)<sup>24</sup> is intended to totally or partially replace 113 of these systems. We were informed that the remaining 600 human resources systems are to be reviewed in the context of DOD’s BEA, as it is developed.

In discussing the increase in the number of reported systems, some of the domains stated that funding for many of the systems are not included in the IT budget request. They said that some of these systems were likely developed at the local level and financed by the operation and maintenance funds received at that location and therefore were not captured and reported as part of the department’s annual IT budget request. Financing business systems in this manner rather than within the IT budget results in Congress and DOD management not being aware of the total amount being

<sup>24</sup>DIMHRS is a major IT program that is to provide an integrated personnel and pay system for all components of the military services.

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spent to operate, maintain, and modernize the department's business systems.

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## DOD Lacks Reasonable Assurance That It Is in Compliance with Statutory Investment Management Controls

We found that DOD is not in compliance with the fiscal year 2003 defense authorization act, which requires that all financial system improvements with obligations exceeding \$1 million be reviewed by the DOD Comptroller. Based upon the reported obligational data provided to us by the military services and the defense agencies for fiscal year 2004, we identified 30 modernizations with obligations totaling about \$243 million that were not submitted for the required review. Because DOD lacks a systematic means to identify the systems that were subject to the requirements of the fiscal year 2003 defense authorization act, there is no certainty that the information provided to us accurately identified all systems improvements with obligations greater than \$1 million during the fiscal year. BMMP officials stated that the domains were responsible for working with the components to make sure that business systems with obligations for modernizations greater than \$1 million were submitted for review as required. In essence, compliance was achieved via the "honor system," which relied on systems owners coming forward and requesting approval. However, the approach did not work. During fiscal year 2004, the number of systems reviewed was small when compared to the potential number of systems that appeared to meet the obligation threshold identified in the fiscal year 2004 budget request. We analyzed the DOD IT budget request for fiscal year 2004 and identified over 200 systems in the budget that could involve modernizations with obligations of funds that exceed the \$1 million threshold. However, BMMP officials confirmed that only 46 systems were reviewed, of which 38 were approved as of September 30, 2004. The remaining 8 systems were either withdrawn by the component/domain or were returned to the component/domain because the system package submitted for review lacked some of the required supporting documentation, such as the review by the Office of Program Analysis and Evaluation, if necessary.

In an attempt to substantiate that financial system improvements with over \$1 million in obligations had in fact been reviewed by the DOD Comptroller, as provided for in the fiscal year 2003 act, we requested that DOD entities provide us with a list of obligations (by system) greater than \$1 million for modernizations for fiscal year 2004. We compared the reported obligational data to the system approval data reported to us by BMMP officials. Based upon this comparison and as shown in table 4, DOD provided data showed that 30 business systems with obligations totaling

about \$243 million in fiscal year 2004 for modernizations were not reviewed by the DOD Comptroller.

**Table 4: Identification of Business Systems Modernizations by DOD Component That Did Not Have DOD Comptroller Review as Required by the Fiscal Year 2003 National Defense Authorization Act**

Dollars in millions

Component	Number of systems not reviewed	Fiscal year 2004 obligations
Army	2	\$40.5
Navy	10	92.8
Air Force	11	79.1
DLA	3	9.8
U.S. Transportation Command	1	1.1
DFAS	1	2.6
TRICARE	2	16.6
<b>Total</b>	<b>30</b>	<b>\$242.5</b>

Source: GAO analysis of DOD reported information.

Examples of DOD business systems modernizations with obligations in excess of \$1 million included in table 4 that were not submitted to the DOD Comptroller include the following.

- DFAS obligated about \$3 million in fiscal year 2004 for the DFAS Corporate Database/DFAS Corporate Warehouse (DCD/DCW). In fiscal year 2003, DFAS obligated approximately \$19 million for DCD/DCW without submitting it to the DOD Comptroller for review. Additionally, we reported in May 2004<sup>25</sup> that DFAS had yet to complete an economic analysis justifying that continued investment in DCD/DCW would result in tangible improvements in the department's operations. The department has acknowledged that DCD/DCW will not result in tangible savings to DOD. Continued investment is being based upon intangible savings of man-hour reductions by DFAS.

<sup>25</sup>GAO, *DOD Business Systems Modernization: Limited Progress in Development of Business Enterprise Architecture and Oversight of Information Technology Investments*, GAO-04-731R (Washington, D.C.: May 17, 2004).

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- The Army obligated over \$34 million for its Logistics Modernization Program (LMP) in fiscal year 2004. In fiscal year 2003, the Army obligated over \$52 million without the prerequisite review being performed by the DOD Comptroller. We have previously reported<sup>26</sup> that LMP experienced significant problems once it became operational at the first deployment site.

Cumulatively, since passage of the fiscal year 2003 defense authorization act in December 2002 through the end of fiscal year 2004, based upon information reported to us, the military services and defense components obligated about \$651 million for business systems modernizations without the required review by the DOD Comptroller. While this amount is significant, it is not complete or accurate because it does not include any fiscal year 2005 obligations that occurred prior to the enactment of the fiscal year 2005 defense authorization act on October 28, 2004.

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## Congress Acts to Improve DOD's Control and Accountability over Business Systems Investments

The statutory requirements enacted as part of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005<sup>27</sup> are aimed at improving the department's business systems management practices. The act directs DOD to put in place a definite management structure that is responsible for the control and accountability over business systems investments by establishing a hierarchy of investment review boards from across the department and directs that the boards use a standard set of investment review and decision-making criteria to ensure compliance and consistency with the BEA.

DOD has taken several steps to address provisions of the fiscal year 2005 defense authorization act. On March 19, 2005, the Deputy Secretary of Defense delegated the authority for the review, approval, and oversight of the planning, design, acquisition, development, operation, maintenance, and modernization of defense business systems to the designated approval

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<sup>26</sup>GAO-04-615.

<sup>27</sup>Pub. L. No. 108-375, § 332.

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authority for each business area.<sup>28</sup> Additionally on March 24, 2005, the Deputy Secretary of Defense directed the transfer of program management, oversight, and support responsibilities regarding DOD business transformation efforts from the Office of the Under Secretary of Defense, (Comptroller), to the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics. According to the directive, this transfer of functions and responsibilities will allow the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics to establish the level of activity necessary to support and coordinate activities of the newly established Defense Business Systems Management Committee (DBSMC). As required by the act, DBSMC, with representation including the Deputy Secretary of Defense, the designated approval authorities, secretaries of the military services, and heads of the defense agencies, is the highest ranking governance body responsible for overseeing DOD business systems modernization efforts.

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## Suggestions for Legislative Consideration

I would like to reiterate two suggestions for legislative consideration that I discussed in my July 2004 testimony,<sup>29</sup> which I believe could further improve the likelihood of successful business transformation at DOD. Most of the key elements necessary for successful transformation could be achieved under the current legislative framework; however, addressing sustained and focused leadership for DOD business transformation and funding control will require additional legislation. These suggestions include the appropriation of business system funding to the approval authorities responsible and accountable for business systems investments under provisions enacted by the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005,<sup>30</sup> and the creation of a CMO.

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<sup>28</sup>Approval authorities include the Under Secretary of Defense for Acquisition, Technology and Logistics; the Under Secretary of Defense (Comptroller); the Under Secretary of Defense for Personnel and Readiness; and the Assistant Secretary of Defense for Networks and Information Integration/Chief Information Officer of the Department of Defense. These approval authorities are responsible for the review, approval, and oversight of business systems and must establish investment review processes for systems under their cognizance.

<sup>29</sup>GAO, *Department of Defense: Long-standing Problems Continue to Impede Financial and Business Management Transformation*, [GAO-04-907T](#) (Washington, D.C.: July 7, 2004).

<sup>30</sup>See 10 U.S.C. §2222(f).

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## Central Control over Business Systems Investment Funds Is Crucial

DOD's current business systems investment process, in which system funding is controlled by DOD components, has contributed to the evolution of an overly complex and error-prone information technology environment containing duplicative, nonintegrated, and stovepiped systems. We have made numerous recommendations to DOD to improve the management oversight and control of its business systems investments. However, as previously discussed, a provision of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, established specific management oversight and accountability with the "owners" of the various core business mission areas. This legislation defines the scope of the various business areas (e.g., acquisition, finance, logistics, and etc.), and established functional approval authority and responsibility for management of the portfolio of business systems with the relevant under secretary of defense for the departmental core business mission areas and the Assistant Secretary of Defense for Networks and Information Integration (information technology infrastructure). For example, the Under Secretary of Defense for Acquisition, Technology and Logistics is now responsible and accountable for any defense business system intended to support acquisition activities, logistics activities, or installations and environment activities for DOD.

This legislation also requires that the responsible approval authorities establish a hierarchy of investment review boards, the highest level being DBSMC, with DOD-wide representation, including the military services and defense agencies. The boards are responsible for reviewing and approving investments to develop, operate, maintain, and modernize business systems for their business-area portfolio, including ensuring that investments are consistent with DOD's BEA.

Although this recently enacted legislation clearly defines the roles and responsibilities of business systems investment approval authorities, control over the budgeting for and execution of funding for business systems investment activities remains at the DOD component level. As a result, DOD continues to have little or no assurance that its business systems investment money is being spent in an economical, efficient, and effective manner. Given that DOD spends billions on business systems and related infrastructure each year, we believe it is critical that those responsible for business systems improvements control the allocation and execution of funds for DOD business systems. However, implementation may require review of the various statutory authorities for the military services and other DOD components. Control over business systems investment funds would improve the capacity of DOD's designated

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approval authorities to fulfill their responsibilities and gain transparency over DOD investments, and minimize the parochial approach to systems development that exists today.

In addition, to improve coordination and integration activities, we suggest that all approval authorities coordinate their business systems modernization efforts with a CMO who would chair the DBSMC. Cognizant business area approval authorities would also be required to report to Congress through a CMO and the Secretary of Defense on applicable business systems that are not compliant with review requirements and to include a summary justification for noncompliance.

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## Chief Management Official Is Essential for Sustained Leadership of Business Management Reform

As DOD embarks on large-scale business transformation efforts, we believe that the complexity and long-term nature of these efforts requires the development of an executive position capable of providing strong and sustained change management leadership across the department—and over a number of years and various administrations. One way to ensure such leadership would be to create by legislation a full-time executive-level II position for a CMO, who would serve as the Deputy Secretary of Defense for Management. This position would elevate, integrate, and institutionalize the high-level attention essential for ensuring that a strategic business transformation plan—as well as the business policies, procedures, systems, and processes that are necessary for successfully implementing and sustaining overall business transformation efforts within DOD—are implemented and sustained. An executive-level II position for a CMO would provide this individual with the necessary institutional clout to overcome service parochialism and entrenched organizational silos, which in our opinion need to be streamlined below the service secretaries and other levels.

The CMO would function as a change agent, while other DOD officials would still be responsible for managing their daily business operations. The position would divide and institutionalize the current functions of the Deputy Secretary of Defense into a Deputy Secretary who, as the alter ego of the Secretary, would focus on policy-related issues such as military transformation, and a Deputy Secretary of Defense for Management, the CMO, who would be responsible and accountable for the overall business transformation effort and would serve full-time as the strategic integrator of DOD's business transformation efforts by, for example, developing and implementing a strategic and integrated plan for business transformation efforts. The CMO would not conduct the day-to-day management functions



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of the department; therefore, creating this position would not add an additional hierarchical layer to the department. Day-to-day management functions of the department would continue to be the responsibility of the undersecretaries of defense, the service secretaries, and others. Just as the CMO would need to focus full-time on business transformation, we believe that the day-to-day management functions are so demanding that it is difficult for these officials to maintain the oversight, focus, and momentum needed to implement and sustain needed reforms of DOD's overall business operations. This is particularly evident given the demands that the Iraq and Afghanistan postwar reconstruction activities and the continuing war on terrorism have placed on current leaders. Likewise, the breadth and complexity of the problems and their overall level within the department preclude the under secretaries, such as the DOD Comptroller, from asserting the necessary authority over selected players and business areas while continuing to fulfill their other responsibilities.

If created, we believe that the new CMO position could be filled by an individual appointed by the President and confirmed by the Senate, for a set term of 7 years. As prior GAO work examining the experiences of major change management initiatives in large private and public sector organizations has shown, it can often take at least 5 to 7 years until such initiatives are fully implemented and the related cultures are transformed in a sustainable way. Articulating the roles and responsibilities of the position in statute would also help to create unambiguous expectations and underscore Congress's desire to follow a professional, nonpartisan, sustainable, and institutional approach to the position. In that regard, an individual appointed to the CMO position should have a proven track record as a business process change agent in large, complex, and diverse organizations—experience necessary to spearhead business process transformation across DOD.

Furthermore, to improve coordination and integration activities, we suggest that all business systems modernization approval authorities designated in the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 coordinate their efforts with the CMO, who would chair the DBSMC that DOD recently established to comply with the act. We also suggest that cognizant business area approval authorities would also be required to report to Congress through the CMO and the Secretary of Defense on applicable business systems that are not compliant with review requirements and include a summary justification for noncompliance. In addition, the CMO would enter into an annual performance agreement with the Secretary that sets forth measurable individual goals linked to overall

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organizational goals in connection with the department's business transformation efforts. Measurable progress toward achieving agreed-upon goals should be a basis for determining the level of compensation earned, including any related bonus. In addition, the CMO's achievements and compensation should be reported to Congress each year. As previously noted, on April 14, 2005, a bill was introduced in the Senate that requires the establishment of a CMO who would be appointed by the President and confirmed by the Senate, for a set term of 7 years.<sup>31</sup>

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## Conclusion

DOD lacks the efficient and effective financial management and related business operations, including processes and systems, to support the war fighter, DOD management, and Congress. With a large and growing fiscal imbalance facing our nation, achieving tens of billions of dollars of annual savings through successful DOD transformation is increasingly important. Recent legislation pertaining to defense business systems, enterprise architecture, accountability, and modernization, if properly implemented, should improve oversight and control over DOD's significant system investment activities. However, DOD's transformation efforts to date have not adequately addressed key underlying causes of past reform failures. Reforming DOD's business operations is a monumental challenge and many well-intentioned efforts have failed over the last several decades. Lessons learned from these previous reform attempts include the need for sustained and focused leadership at the highest level. This leadership could be provided through the establishment of a CMO. Absent this leadership, authority, and control of funding, the current transformation efforts are likely to fail.

I commend the Subcommittee for holding this hearing and I encourage you to use this vehicle, on an annual basis, as a catalyst for long overdue business transformation at DOD. Mr. Chairman, this concludes my statement.

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## Contacts and Acknowledgments

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<sup>31</sup>S. 780, 109<sup>th</sup> Cong. (2005).

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