

February 1997

Defense Financial Management





**United States
General Accounting Office
Washington, D.C. 20548**

**Comptroller General
of the United States**

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The President of the Senate

The Speaker of the House of Representatives

In 1990, the General Accounting Office began a special effort to review and report on the federal program areas its work identified as high risk because of vulnerabilities to waste, fraud, abuse, and mismanagement. This effort, which was supported by the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight, brought a much-needed focus on problems that were costing the government billions of dollars.

In December 1992, GAO issued a series of reports on the fundamental causes of problems in high-risk areas, and in a second series in February 1995, it reported on the status of efforts to improve those areas. This, GAO's third series of reports, provides the current status of designated high-risk areas.

This report describes GAO's concerns about the Department of Defense's inability to put in place the financial management operations and controls required to produce the information it needs to ensure adequate accountability and support decision-making. It focuses on the need for the Department to transform candid acknowledgements of problems in six critical areas into comprehensive, realistic corrective actions.

Copies of this report series are being sent to the President, the congressional leadership, all other Members of the Congress, the Director of the Office of Management and Budget, and the heads of major departments and agencies.

A handwritten signature in black ink, reading "James F. Hinchman". The signature is written in a cursive style with a large initial "J" and a long horizontal stroke at the end.

James F. Hinchman
Acting Comptroller General
of the United States

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Overview

The Department of Defense needs accurate financial information and appropriate internal controls to effectively manage the Department's vast resources—over \$1 trillion in assets, 3 million military and civilian personnel, and a budget of an estimated \$250 billion for fiscal year 1997. However, long-standing, serious weaknesses in the Department's financial operations continue not only to severely limit the reliability of DOD's financial information, but also have resulted in wasted resources, and undermined the Department's ability to carry out its stewardship responsibilities. GAO and DOD auditors doing financial audits under the Chief Financial Officers Act have made hundreds of recommendations to help resolve these weaknesses.

The Department has candidly acknowledged its manifold weaknesses and has a number of initiatives underway to address them. However, much remains to be done, and full corrective action will take more sustained, concerted efforts by DOD top officials.

The Problem

Defense's financial management systems, practices, and procedures continue to be hampered by significant weaknesses. The Department does not yet have adequate

financial management processes in place to produce the information it needs to ensure adequate accountability and to support its decision-making process. No military service or other major DOD component has been able to withstand the scrutiny of an independent financial statement audit. This situation is one of the worst in government and is the product of years of neglect.

The Department has acknowledged that it is struggling to overcome decades-old financial management problems. Its annual reports to the President and the Congress have highlighted a series of financial management problems confronting DOD, including billions of dollars in disbursements not matched to specific obligations, overpayments to Defense contractors, Anti-Deficiency Act violations, and issuance of paychecks to soldiers after their discharge. The Department concluded that its systems and practices required a major overhaul.

The financial management weaknesses that the Department must overcome fall into six areas:

- the lack of an overall integrated financial management system structure,

- no reliable means of accumulating actual cost data to account for and manage resources,
- continuing problems in accurately accounting for billions of dollars in disbursements,
- the critical need to upgrade its financial management workforce and organization,
- breakdowns in rudimentary required financial control procedures, and
- antiquated bureaucratic practices that underscore the need for progress in reengineering business practices.

Progress Made

Since 1990, we and the DOD auditors have made over 400 recommendations aimed at correcting the Department's most pressing financial management weaknesses. The past few years have been marked by DOD's financial management leadership, under the direction of the Department's Chief Financial Officer (CFO), recognizing the importance of tackling the broad range of problems in this area. The Department's "blueprint" for reforming financial management represents an important first step towards resolving DOD's long-standing problems. Through his 5-Year Plan, the CFO has also put in place a vision statement to guide the Department's reform efforts. As a

result, the importance of greater financial accountability is now clearer throughout the Department.

To support its blueprint and CFO vision, the Department has begun a number of initiatives intended to address its long-standing financial management weaknesses. For example, DOD is working on several fronts to resolve its problems in accounting for disbursements. Other initiatives include a set of projects intended to standardize selected financial systems, and another set of projects directed at DOD-wide data standardization including implementing the U.S. Government Standard General Ledger, a basic requirement.

Outlook for the Future

DOD still has a long way to go to meet the challenges of managing its vast and complex operations with greater accountability and efficiency demanded by the Congress and the American public. The reforms mandated by the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, and the Federal Financial Management Improvement Act of 1996 serve as important catalysts for focusing attention on the financial problems facing the Department.

The requirements for audited annual DOD financial statements beginning with fiscal year 1996 have generated increased pressure on DOD management to fix its long-standing financial problems. These audits have already resulted in a number of specific recommendations for interim improvements. In addition, we have work ongoing or planned to identify further opportunities for improvement.

Signs of DOD top leadership emphasis on and commitment to resolving the Department's financial management problems are encouraging. It is now critical that DOD take the next steps in transforming these candid acknowledgements of problems into comprehensive, realistic action to effectively bring about their resolution.

However, the Department must effectively address challenges in the six critical areas highlighted in audit reports—systems, cost accounting, disbursements, personnel, internal controls, and business processes—if its envisioned financial management reforms are to realize meaningful financial management improvements. It will take a focused, sustained effort for DOD to fully resolve these challenges.

Background

The massive scope of DOD's operations is unparalleled in either the private or public sectors. The challenges that DOD faces in managing such a huge and complex organization are compounded by its long-standing financial management weaknesses. We added this area to our high-risk list in 1995.¹ As the agency responsible for about 50 percent of the government's discretionary spending, DOD's financial management problems result in a lack of accountability over a substantial portion of the government's resources. These problems have also led to inaccurate information being provided to the Congress and the inefficient use and waste of resources.

Correction of DOD's widespread and severe financial management problems is also critical to the resolution of the department's other high-risk areas included in this series. (See reports HR 97-4, 97-5, 97-6, and 97-7.)

Resolving these long-standing problems with millions of dollars in erroneous contract payments, weapon system cost overruns, excessive inventories, and unwieldy infrastructures will be greatly aided by reliable financial management information.

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

For example, better information on the quantity and location of items would help prevent inventory managers from procuring additional items at one location that are already on hand at another DOD location.

**Legislation
Provides a
Framework for
Improvement**

**Key Legislation for DOD's
Financial Reform Efforts**

Chief Financial Officers Act of 1990

Government Management Reform
Act of 1994 (GMRA)

Federal Financial Management
Improvement Act of 1996

The CFO Act charges agency CFOs with (1) directing, managing, and providing policy guidance and oversight of all agency financial management personnel, activities, and operations, (2) developing and maintaining integrated accounting and financial management systems, (3) implementing agency asset management systems, including systems for cash management, (4) monitoring the financial execution of the agency budget in relation to actual expenditures, and (5) overseeing the recruitment, selection, and training of

personnel to carry out agency financial management functions.

GMRA made the CFO Act's requirement of annual audited financial statements permanent and expanded it to include virtually the entire executive branch. Under this legislative mandate, DOD is to annually prepare and have audited DOD-wide and component—including Army, Navy, and Air Force—financial statements, beginning with fiscal year 1996. These audited statements will provide for an annual public scorecard to measure agencies' progress in resolving financial management deficiencies.

In addition, the Federal Financial Management Improvement Act of 1996 provides a legislative mandate to implement and maintain financial management systems that substantially comply with federal systems requirements, applicable federal accounting standards, and the standard general ledger. As discussed in the following section, the act's provisions will have a significant impact on DOD because (1) few of its systems meet federal financial management systems requirements and (2) DOD has not yet comprehensively identified and assessed all of its financial management systems.

The act also noted that the Federal Accounting Standards Advisory Board (FASAB), established in 1990, has made substantial progress toward developing and recommending a comprehensive set of accounting concepts and standards for the federal government.² The act states, “When the accounting concepts and standards developed by [FASAB] are incorporated into Federal financial management systems, agencies will be able to provide cost and financial information that will assist the Congress and financial managers to evaluate the cost and performance of Federal programs and activities. . . .”

If properly implemented, these standards will provide the impetus not only for the Department to improve its financial management operations and reporting, but also to strengthen its ability to meet critical mission objectives because more accurate information will be provided to decisionmakers. However, to bring about the kind of fundamental changes in financial management envisioned by the Congress in enacting these reforms will require a focused

²FASAB recommends accounting standards, and the Office of Management and Budget (OMB), and Treasury, and GAO decide whether to adopt the recommended standards; if they are adopted, the standards are published by OMB and GAO and become effective.

Background

effort to use the Department's resources efficiently and the full support of DOD's leadership. Only in this way will sorely needed financial management improvements be achieved in a reasonable time frame.

Financial Audits Provide Focus and Improved Basis for Measuring Progress

Financial audit reports have continued to provide a clearer picture of DOD's financial position and provide a basis for measuring progress. These reports have highlighted significant deficiencies across the spectrum of DOD's financial management and reporting operations. None of the financial statements prepared by the military services or major DOD components have yet been able to withstand the scrutiny of a financial statement audit. As a result of these deficiencies, the DOD Inspector General has stated that auditable financial statements for the Department would not be likely until the next century.

While it may take several more years until the Department can expect an acceptable audit opinion, if used effectively, the results of the CFO Act financial statement audits can help focus reform efforts and establish priorities so that the time frame needed to correct DOD's major problems can be minimized. The Congress and the American public should expect to see the problems identified by the auditors in these annual reports diminish over time.

The deficiencies identified in auditors' reports have prevented DOD managers from obtaining reliable financial information

needed for sound decision-making. These reported deficiencies identified in the DOD audit community¹ reports and in our own financial audits and reviews of Air Force, Army, Navy, and the Defense Business Operations Fund fell into six common areas.

Six Areas Presenting Greatest Challenges

- Integrating accounting and financial management systems
 - Accumulating accurate cost information
 - Resolving problem disbursements
 - Upgrading financial management workforce and organization
 - Strengthening internal controls
 - Reengineering business practices
-

Auditors' reports have also pinpointed actions to help resolve DOD's continuing problems in these areas. Since 1990, we and the DOD auditors have made over 400 recommendations to help provide focus and perspective on the most pressing financial management weaknesses facing the Department.

¹The DOD audit community includes not only the DOD Inspector General, but the Army, Air Force, and Naval audit services.

DOD's leadership has recognized the financial management problems highlighted in the audited financial statements and has taken seriously the need to bring about their resolution. The Department's February 1995 "blueprint" for reforming its financial management operations represents an important first step towards resolving the Department's long-standing problems. The action areas specified in the blueprint are closely linked to the six problem areas identified in recent financial audits and reports. As a result, DOD financial managers are beginning to act based on a better understanding of the implications of the lack of reliable financial information on their overall accountability and the effective management of critical mission operations.

However, the Department's long-standing weaknesses are the product of decades of neglect. Identifying and implementing solutions will require a sustained, long-term commitment and focus on priorities.

To support its blueprint and CFO vision statement, the Department has undertaken a number of initiatives intended to improve financial management. The following sections outline DOD's reform initiatives in the six key problem areas identified by GAO

and DOD auditors. We also (1) identify additional actions the Department must consider if it is to realize genuine reform and meet the basic goals of the CFO Act and other management mandates and (2) provide an overview of our ongoing work in each of these areas to identify future suggestions for improvement.

Integrate Accounting and Financial Management Systems

Audit reports have repeatedly pointed out that DOD's existing accounting and financial management systems are not integrated and lack a standard general ledger. An integrated, general ledger controlled system is necessary to provide oversight and control to ensure accurate and complete accounting for DOD's resources. Under an integrated system structure, DOD's accounting, finance, logistics, personnel, and budgetary systems would be closely tied together. However, DOD has acknowledged that its operations are constrained by the military services operating unique systems, many of which are incompatible.

An example of the effect of DOD's nonintegrated systems is in the inventory management area. Specifically, auditors reported that, at least in part as a result of the lack of integration between DOD's

accounting and logistics systems, DOD purchased unneeded materials and DOD management and oversight officials lacked complete information on the costs incurred to acquire and operate weapon systems. Effectively addressing these systems integration deficiencies will necessitate the development of unified actions bringing together the organizational support and commitment of the Department's logistics, personnel, and budget components, as well as its financial organizations.

In describing the goals of the Department's October 1995 5-Year Plan, the DOD CFO stated that "In terms of payback for the department, the most important goal is the consolidation of, and improvements to, its finance and accounting systems." DOD has recognized that of the 249 financial systems included in its required annual reporting, only 5 conformed with governmentwide standards for financial systems. One of DOD's principal initiatives in this area has consisted of identifying financial management systems in the Department's inventory, modifying them to meet departmentwide requirements,

and consolidating them as migration or interim migration² systems.

Auditors have made numerous specific recommendations over the past few years to improve DOD's financial systems operations and the reliability of the financial information they produce. For example, as a result of our review of the Navy's financial reporting, we recommended (1) the use of standard data elements, such as object class codes, because we found that existing systems capabilities were not used to their full potential in controlling, managing, and reporting on the Navy's operations and (2) a series of actions needed to develop an overall system architecture to effectively guide the enhancement efforts for the system selected to perform the Navy's general fund accounting.

DOD established a Defense Accounting System Program Management Office (PMO) in April 1996 to provide centralized management control and oversight for all Defense Finance and Accounting Service

²DOD's system migration strategy involves, for each DOD function, (1) selecting one of each military service's systems currently in operation (i.e., legacy systems), (2) implementing that system across the service (i.e., an interim migratory system), (3) selecting the "best" of the services' systems to serve as the DOD system (i.e., a migratory system), and (4) enhancing the migration system until it meets all applicable requirements to become DOD's target system.

(DFAS) accounting systems. The PMO is intended to manage the reduction of existing accounting systems in accordance with DFAS goals and objectives. For example, the PMO is overseeing modifications to the Army Corps of Engineers Financial Management System (CEFMS), which was selected to become the general funds accounting migratory system for the Army and Air Force.

We are encouraged that the Department has established an office to help provide focus for its system improvement efforts. We will be looking closely at whether the strategy pursued by the PMO will enable the Department to put an integrated system structure in place.

In addition to the specific recommendations we made previously, we believe that efforts to improve DOD's financial systems must be based on a comprehensive understanding of all systems currently relied on to carry out the Department's financial operations—including those managed by DFAS and those operated by the military services. In addition, a comprehensive inventory is especially important in light of the enhanced systems requirements included in the Federal Financial Management Improvement Act of 1996.

We recently reported that DOD's inventory of financial management systems recognized in its annual reporting did not include all DOD systems used to carry out the Department's financial operations. DOD's reporting excluded hundreds of "mixed" financial systems—systems including both financial and programmatic elements—from the inventory of the systems. Because many of these mixed systems are relied on to record, accumulate, classify, and report financial information, it is critical that they are recognized in the Department's system inventory.

Once a complete inventory is established, the Department will be better able to define its target system architecture, including all system interfaces and data flows. With this target structure in place, DOD can more effectively prioritize system improvements, identify data requirements, and begin integration. In this regard, we are currently evaluating whether there are additional actions DOD can take to improve its capability to successfully develop application software used in carrying out the Department's financial operations.

We are also assessing possible actions DOD can take to improve its ability to produce

reliable information for the Department's substantial investment in property and other equipment. For example, we have ongoing reviews of specific general ledger or mixed system applications such as the Defense Property Accountability System (DPAS), the Air Force's Reliability and Maintainability Information System (REMIS), and the Army's Continuing Balance System-Expanded (CBSX).

Accumulate Accurate Cost Data

DOD has acknowledged, and the CFO Act financial statement audits have confirmed, fundamental problems with the Department's ability to accumulate reliable cost information. The Department's annual report to the President and the Congress in February 1996 acknowledged that inaccurate and incomplete cost accounting information was a Department-wide problem. Auditors' reports have confirmed that DOD does not have accurate cost data for almost all of its noncash assets, such as inventories, equipment, aircraft, and missiles, nor can the Department accumulate reliable information on the cost of its business activities and critical operations, such as the costs associated with maintaining its weapon systems in a high state of readiness.

For example, our review of the Navy's financial operations disclosed that billions of dollars associated with building aircraft and missiles and modernizing weapons systems were not included in the Navy's financial reports. It is critical that managers have accurate information on actual operating and capital costs to consider when making decisions to replace or upgrade weapons systems. In addition, in analyzing DOD's most recent round of base closure and realignment recommendations, we found that the quality of existing cost data limited their usefulness. Specifically, the existing data could not be relied on to provide decisionmakers with the actual costs or savings associated with alternative base closure and realignment options.

Not unmindful of the need for such information, the Department has taken action intended to improve its financial operations in this area. One of the major initiatives the Department undertook to improve its cost accounting capabilities was the establishment of the Defense Business Operations Fund.

This Fund, with estimated annual revenues of about \$75 billion, was established in October 1991 by consolidating nine existing

industrial and stock funds and five other activities operated throughout DOD. The Fund's primary goal was to focus attention on the total costs of carrying out certain critical DOD business operations—many of which are essential to maintaining weapon system readiness—and to help manage those costs more effectively. The Fund was intended to operate on a break-even basis by recovering the current costs incurred in conducting its operations.

However, since its inception, the Fund was plagued with implementation problems. We made a number of recommendations intended to help improve the Fund's operations and financial reporting.

In recognition of the Fund's implementation problems resulting from the lack of clear delineation of responsibility for managing Fund activities, in December 1996, the Department's CFO announced the Fund's elimination. In its place, he established four working capital funds.³ The CFO has stressed his intention that these working capital funds retain the essential purposes for which the Fund was established, such as increasing

³Working capital funds were established for the Army, Navy, and Air Force. In addition, the CFO established a Defense-wide working capital fund, and also stated that there may be a fifth working capital fund established for the commissary area.

visibility for the total cost of the Department's support structure.

However, these new working capital funds have also inherited their predecessor's operational and financial reporting problems. We will continue to monitor the Department's business activities carried out through these working capital funds and have efforts underway to identify opportunities for improvements in the area of pricing these funds' goods and services.

**Resolve Problem
Disbursements**

Auditor reports have served to highlight the scope and severity of the problems the Department must resolve if it is to accurately and promptly account for all its disbursements. Auditors reported that billions of dollars in disbursements could not be promptly or accurately matched with related obligations, and identified the Department's inability to ensure that disbursements were charged to the correct appropriation.

Until these problems are corrected, DOD's ability to detect and correct illegal acts, and ensure that funds are spent as directed by the Congress will continue to be impaired. Because of the large amount of funds DOD

obligates and disburses each year, resolving its disbursement problems is critical to improving its financial management operations.

The Department has recognized this as a major area of concern and is working hard to reduce current problem disbursements. In accordance with its blueprint, the Department developed a prevalidation policy and in July 1995, began matching disbursements to obligations, prior to payment, for payments of \$5 million or more. The threshold amount was reduced to \$1 million by October 1995 for all but DOD's primary location for contract payments. However, even at this location, DOD recently reduced the prevalidation threshold to \$4 million, and plans further reduction of that threshold.

The Department has many other short-term initiatives and long-term plans to reduce its problem disbursements. The scope of these efforts ranges from processing changes that affect one type of payment at a single location to complete system redesigns.

DOD's short-term initiatives focus primarily on stemming the tide of additional problem disbursements, which appears to be a

reasonable approach. However, the Department also needs to supplement this approach with an effort to determine what factors are contributing most significantly to the problem and the extent to which its numerous initiatives will improve these significant problem areas. In this way, DOD can best ensure that its resources are properly allocated to the initiatives with the greatest potential payoff. For example, are the resources allocated to preventing new problem disbursements appropriate if they take away from the resources that could be used to resolve existing problem transactions? DOD must be able to ensure that such trade-offs are worthwhile and will yield the most cost-effective and efficient solutions on a project-by-project basis.

DOD's long-term efforts to resolve problem disbursements include greater use of emerging technologies, such as shared data warehousing and electronic data management. DOD also has long-term plans to develop the Defense Procurement Payment System and the Standard Procurement System. These efforts are all in the early stages of development.

As of May 1996, DOD reported that its problem disbursements totaled about

\$18 billion. DOD officials have stated that they believe the Department has reduced its problem disbursements. In particular, they cited negative unliquidated obligations and unmatched disbursements as areas in which the Department has made substantial progress.

However, our preliminary work on DOD's reporting of problem disbursement data indicates that reported amounts are substantially understated and raises concerns over whether DOD has sufficient, reliable information to determine the extent to which disbursement problems have been reduced. Also, lacking basic quantitative data on the sources and causes of problem disbursements, DOD cannot reliably determine whether (1) its short-term initiatives best utilize its resources to stem the flow of problems and attain accountability, (2) its long-term initiatives are properly aimed at addressing the problems, and (3) the scope and size of DOD's disbursement problems are being reduced.

We have several ongoing reviews directed at identifying opportunities for additional corrective actions. For example, we are reviewing problem disbursement issues

involving progress payments, problem contracts, and transactions by others.

**Upgrade
Financial
Management
Workforce and
Organization**

DOD also faces a considerable challenge if it is to meet the CFO Act objectives of putting in place a quality, professional financial management workforce with clear organizational, as well as individual, responsibilities and accountability. DOD has acknowledged that, no matter how skilled its financial personnel, its manifold financial failures reflect a large, complex, antiquated bureaucratic organization structure. For example, the Department has stated that a dozen organizations are involved in making a single progress payment on a complex weapon system.

Auditors have reported that financial personnel deficiencies, such as the lack of accounting experience or competencies, and inadequate training, have diminished their effectiveness. For example, we recently found that at DFAS operating locations—the heart of DOD’s “Accounting Firm” with overall responsibility to account for the Department’s \$250 billion annual budget—only about 58 percent of the key managers had more than the minimum number of accounting hours necessary to be

classified as an accountant in the federal government. In addition, only 6 of 107 key managers were CPAs, and about 60 percent of the 107 managers did not have enough hours in accounting to sit for the CPA exam in many states.

As discussed in the following section, one of the common problems found repeatedly throughout prior financial audits has been DFAS and military service personnel not following rudimentary required control procedures. Without focused efforts to ensure that the Department has a skilled, professional workforce in place, it is unlikely that the needed improvements can be made and sustained.

DOD has not yet established any continuing professional education requirements for its financial workforce. Well-qualified personnel with demonstrated knowledge and technical skills acquired through a broad base of experience and continuing professional training will be essential if the Department is to effectively keep pace with emerging technologies and developments in financial management.

Our reports issued over the past few years also have included several other

recommendations for actions that the Department could take to improve financial personnel and organization. Specifically:

- In our May 1995 testimony, we recommended that DOD (1) determine the appropriate number of staff with the requisite skills to ensure that the Department's blueprint for financial reform will be successfully implemented and (2) establish an independent, outside board of experts to provide counsel, oversight, and perspective to DOD's reform efforts.
- In our March 1996 report on the Navy, we concluded that greater emphasis was needed on determining the skills, experience, and number of personnel needed to effectively address the fundamental weaknesses we found. We recommended that staffing issues be addressed, such as filling financial management vacancies, upgrading the experience of financial managers, and using contractors, as necessary, to improve financial management operations. We pointed out that implementing these recommendations at the DFAS Cleveland Center—the DFAS location with overall responsibility for Navy's accounting and financial reporting—was particularly important because of the substantial effort

that will be required to correct the serious deficiencies we found at that location.

- In July 1996, we reported on opportunities to better focus hiring practices at DFAS operating locations. We suggested that DFAS enhance its hiring criteria to include (1) demonstrated experience in successfully implementing accounting or finance systems and (2) demonstrated technical competency in accounting.

DFAS has already acted on our recommendations to fill vacancies and obtain additional contractor support at its DFAS Cleveland location. DFAS has also recently begun developing several major programs to ensure the professionalism of its financial management workforce.

First, DFAS is developing a program to improve the technical and managerial competencies for 5 percent of its workforce selected competitively on an annual basis. Under this program, individual development plans formulated for the program's selectees will guide the attainment of identified training, education, and rotational assignments, or professional certifications, such as a Certified Public Accountant. Second, DFAS is developing a "Cornerstone Program," which is intended to improve

managerial competencies and broaden the perspectives of all DFAS employees in GS grades 12 through 15. Third, it is expanding its existing Career Intern Program—the primary source for hiring entry-level personnel. This program focuses on providing on-the-job training through a series of rotational assignments.

To tie these programs together, DFAS is in the process of developing a “DFAS Career Development System” which will identify competencies obtained through training, education, organizational assignments, and self-development initiatives. These actions, if implemented promptly and effectively should enhance the capabilities of the staff and result in improved financial management practices. Adequate priority and resources must be dedicated to this area to ensure that these plans become a reality.

DFAS has also moved to supplement its financial management organization with outside contractors. For example, DFAS entered into a contract with a large accounting firm to examine the Department’s overall accounting structure, and another to help guide and direct the Department’s “catch up” efforts to prepare credible Navy financial reports in the near

term. To ensure that this contract support is effective, DOD must ensure that its contractors receive adequate information to provide informed advice, and, of course, must provide the necessary attention and resources to assess and implement contractors' recommendations.

To further assist DOD in focusing its reform efforts, our ongoing work in this area includes a review of the qualifications and experience of DOD financial management personnel and a benchmarking study of the qualifications and experience of private and public sector financial management personnel. We are also identifying leading private and public sector organizations' best practices in financial management—that is, changes in organizational practices, processes, personnel or systems that have led to greater productivity and reduced costs.

**Strengthen
Internal Controls**

The Department is also faced with a considerable challenge in its efforts to strengthen internal controls. Currently, required control procedures were either not in place, or were not followed, for critical reconciliations, physical counts of inventories, documentation supporting

reported amounts, and reviews and edits of abnormal balances. In its February 1996 annual reporting required by the Federal Managers' Financial Integrity Act (FMFIA), the Department acknowledged 33 material weaknesses that crossed a broad spectrum of its operations.

Adherence to these basic financial controls is necessary to ensure that DOD's assets are properly safeguarded against unauthorized acquisition, use, or disposition. In addition, disciplined adherence to key internal control policies and procedures could, in the short term, help mitigate the weaknesses created by DOD's lack of an integrated financial management system.

Audits identified many instances in which the Department's inability to ensure that rudimentary control procedures were followed adversely affected program operations. For example, auditors reported that additional validation of existing real property records was required to support the Department's base closure and realignment decisions and millions of dollars in unauthorized military payroll payments were made because required reconciliation procedures were not followed. Audit reports also disclosed that pervasive weaknesses in

the Department's general computer controls placed DOD at risk of improper modification, theft, inappropriate disclosure, or destruction of sensitive personnel, payroll, disbursement, or inventory information.

Strengthening the Department's internal controls will be critical if it is to effectively control and account for DOD's estimated \$1 trillion investment in assets worldwide. The following were among the recent recommendations we made for improving the Department's controls.

- In our May 1995 testimony, we recommended that DOD clean up the existing data in the financial systems and place special emphasis on ensuring that basic accounting policies and procedures are followed to improve data accuracy in the current systems while new systems are under development.
- In our March 1996 report, we recommended that DOD place high priority on implementing basic financial controls, such as conducting periodic physical inventories of equipment and property, reconciling accounts, and analyzing abnormal balances or fluctuations in accounts. In addition, we recommended that the Department improve the data in existing systems, and supplement existing

policies and procedures by better pinpointing individual accountability for carrying out assigned responsibilities.

- We also issued a September 1996 report⁴ that recommended a series of actions needed to strengthen general computer controls over DOD's processing of sensitive personnel, payroll, disbursement, and inventory data. Specifically, we recommended that the DOD Chief Information Officer develop and implement a comprehensive DOD-wide computer security management program. Further, we recommended that such policies and procedures should (1) limit computer system access authorizations to only those who need access to perform their work, (2) require that sensitive data files and critical production programs be identified and access to them be monitored, (3) strengthen security software standards in critical areas, (4) control physical security at computer facilities, and (5) provide for completing and testing disaster recovery plans.

The Department has struggled to put in place the necessary support throughout its vast financial operations to ensure disciplined

⁴Because of the sensitivity of the issues involved, distribution of this report was limited to recipients requiring this report for official use.

adherence to rudimentary required controls and, recently, to improve general computer controls. We are concerned that the Department's annual reporting under FMFIA may provide an overly optimistic impression of the nature and extent of its control weaknesses. Specifically, while acknowledging material control weaknesses, DOD's most recent annual report concludes that sufficient compensating controls are in place. This assertion is not consistent with the results of our financial audits.

Nonetheless, over the past few years, we have seen encouraging signs that some of DOD's top leaders have made a commitment to improving adherence to established control procedures. For example, DOD leadership directed that senior managers throughout the Department play a more active role in identifying, reporting, and correcting poor controls.

Given the large worldwide network of people and organizations relied on to carry out the Department's financial operations, improvements in this area represent a considerable challenge. In this regard, DOD is incorporating DOD component regulations into a single Department-wide DOD Financial Management Regulation. This effort is

intended to simplify control requirements by eliminating over 70,000 pages of regulations.

In addition, in September 1995, the Director of the Defense Finance and Accounting Service issued “lessons learned” guidance to his center directors requesting their personal involvement in preventing a repetition of previous years’ errors. We believe this guidance gets to the heart of DOD’s financial management problems and outlines control techniques that, if implemented, could have detected or prevented many of the deficiencies auditors observed. The results of the fiscal year 1996 audits, expected to be issued in March 1997, will provide a barometer to gauge the effectiveness of this directive.

Continuing and building upon DOD leaders’ recent public statements emphasizing the importance of following rudimentary controls will be critical if the Department is to realize meaningful, sustained improvements in its financial operations. Since it will be at least several more years before planned system development and improvement efforts are in place, it will be imperative for the Department to place special emphasis on improving controls in

existing systems so that decisionmakers have credible financial data in the interim.

**Reengineer
Business
Practices**

DOD's financial management operations are plagued with duplicative processes and business practices that are complex, slow, and error-prone. For example, we reported that before the Department decided to reengineer its travel processes, they were extremely complicated with over 700 processing centers and 1,300 pages of regulations, and required the traveler to go through some 40 steps to get travel authorization and reimbursement.

In describing conditions that led to its blueprint for reforming the Department's financial management, DOD leadership provided an excellent overview of the challenges facing DOD in this area. Specifically, the overview acknowledged that the Department confronts decades-old problems deeply grounded in the bureaucratic history and operating practices of a complex, multifaceted organization, and that many of these practices were developed piecemeal over a period of decades and evolved to accommodate different organizations, each with its own policies and procedures.

To its credit, DOD's blueprint set out reengineering the Department's business processes as one of the key elements of its proposed financial reform. Also, the DOD CFO's October 1995 vision statement recognized business process reengineering, along with system standardization and consolidation of operations, as the underpinnings of financial management improvement in the Department.

In DOD's efforts to reengineer its travel practices, the Department has taken a broad approach to reengineering—one not bounded by existing processes and organizations. This approach, while not yet completed, holds out the promise for dramatic improvement over existing practices, and potential savings of hundreds of millions of dollars.

Unfortunately, other DOD initiatives intended to "reengineer" other functional business areas have focused largely on greater use of technology within existing processes and organizations. Consequently, while these initiatives may improve existing practices, they will have little chance of radically improving the current processes that the Department has acknowledged are cumbersome and bureaucratic.

We have ongoing work to identify specific actions to improve the likelihood of successfully reengineering the Department's practices in the travel and disbursement areas. Successfully reengineering the Department's business processes is critical if DOD is to effectively address deep-rooted organizational emphasis on maintaining "business as usual" across the Department.

Related GAO Products

Financial Management: DOD Inventory of Financial Management Systems Is Incomplete (GAO/AIMD-97-29, Jan. 31, 1997).

DOD Accounting Systems: Efforts to Improve System for Navy Need Overall Structure (GAO/AIMD-96-99, Sept. 30, 1996).

Navy Financial Management: Improved Management of Operating Materials and Supplies Could Yield Significant Savings (GAO/AIMD-96-94, Aug. 16, 1996).

Correspondence to the Under Secretary of Defense (Comptroller) on financial management personnel qualifications (July 18, 1996).

CFO Act Financial Audits: Navy Plant Property Accounting and Reporting Is Unreliable (GAO/AIMD-96-65, July 8, 1996).

Financial Management: DOD Needs to Lower the Disbursement Prevalidation Threshold (GAO/AIMD-96-82, June 11, 1996).

Information Security: Computer Attacks at Department of Defense Pose Increasing Risks (GAO/AIMD-96-84, May 22, 1996).

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(GAO/AIMD-96-53R, Apr. 12, 1996).

Defense Business Operations Fund: DOD Is Experiencing Difficulty in Managing the Fund's Cash (GAO/AIMD-96-54, Apr. 10, 1996).

CFO Act Financial Audits: Increased Attention Must Be Given to Preparing Navy's Financial Reports (GAO/AIMD-96-7, Mar. 27, 1996).

Financial Management: Challenges Facing DOD in Meeting the Goals of the Chief Financial Officers Act (GAO/T-AIMD-96-1, Nov. 14, 1995).

Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-146, May 23, 1995).

Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-143, May 16, 1995).

Financial Management: Control Weaknesses Increase Risk of Improper Navy Civilian Payroll Payments (GAO/AIMD-95-73, May 8, 1995).

Related GAO Products

Travel Process Reengineering: DOD Faces Challenges in Using Industry Practices to Reduce Costs (GAO/AIMD/NSIAD-95-90, Mar. 2, 1995).

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