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THE DEPARTMENT OF DEFENSE: WHAT IS BEING DONE TO RESOLVE LONGSTANDING FINANCIAL MANAGEMENT PROBLEMS?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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THE DEPARTMENT OF DEFENSE: WHAT IS BEING DONE TO RESOLVE LONGSTANDING FINANCIAL MANAGEMENT PROBLEMS?

WEDNESDAY, MARCH 20, 2002

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 1 p.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn and Schakowsky.

Staff present: J. Russell George, staff director and chief counsel; Bonnie Heald, deputy staff director; Rosa Harris, professional staffmember and GAO detailee; Earl Pierce, professional staff member; Justin Paulhamus, clerk; David McMillen, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. HORN. I think everybody is here. We have Mr. Kutz, Mr. Hite, Mr. Warren, Ms. Jonas, Mr. Bloom, Mr. Ritchie, and Mr. Lieberman. OK. If you don't mind, we'll have you rise and raise your right hand.

[Witnesses sworn.]

Mr. HORN. The clerk will note that they've all affirmed.

We will start with my opening statement, but we will have to recess in a little while because two more votes have popped-up on the floor.

A quorum being present, this hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

We are here today to continue our examination of the progress executive branch departments and agencies in the Federal Government are making toward providing timely and useful information. Encouragingly, an increasing number of agencies were able to produce clean, auditable financial statements and made marked improvements in their financial management systems. However, this progress was often achieved through difficult and costly efforts. Despite that progress, the failures of the few agencies continue to tarnish the overall record of the executive branch.

The Department of Defense still cannot adequately account for the billions of tax dollars it spends. For example, the Department has issued more than 230,000 purchase cards to employees who use the card to buy $1.8 billion worth of goods and services last year,

yet a recent General Accounting Office audit of only 300 accounts found numerous cases in which the Government-guaranteed credit card had been inappropriately or fraudulently used.

For the sixth consecutive year, the Department's Inspector General has been unable to render an opinion on the reliability of the Department's financial statements. For fiscal year 2001, to Office of Inspector General limited its internal control review to examining the status of the corrective actions relating to material weaknesses that had been reported in prior audits.

In addition, for fiscal year 2001 the Inspector General did not test for compliance with the Federal Financial Management Improvement act of 1996, but relied on the Department's acknowledgement that many of its systems do not comply with the act.

For the last 5 years, the Department of Defense received the unacceptable grade of "F" on the subcommittee's financial management report card, which is one of the primary reasons the Federal Government is unable to prepare auditable financial statements. The Department of Defense's financial management and feeder systems simply cannot provide adequate evidence to support various material amounts on the financial statements.

The Department of Defense relies on non-integrated systems that are prone to errors. The GAO—the General Accounting Office—has reported that the Department of Defense's financial management systems reform will take years to complete.

For fiscal year 2001, alone, the Department of Defense reported total information technology investments of almost $23 billion. Despite the billions invested in modernizing its financial management systems, the Department does not have a plan in place to guide and direct these investments.

In today's hearings we will focus on what the Department of Defense is going to do to resolve these longstanding issues. I welcome today's witnesses and look forward to working with you to ensure financial accountability throughout the Federal Government.

I might add that Secretary Rumsfeld made it very clear yesterday that he won't tolerate what has happened in terms of the purchase cards and that he intends to do something about it. I'm glad that Secretary Jonas is here too.

We will now start with—well, I'm going to check to see if I need to go vote. Yes, we have about 6 minutes, so have a rest.

[Recess.]

Mr. HORN. The Nation has been saved. We stopped a motion that allowed us to be out and not still work. Sorry for going over there and holding you all up, but we will now start with Gregory Kutz, the Director of Financial Management and Assurance, U.S. General Accounting Office.

STATEMENTS OF GREGORY D. KUTZ, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY RANDOLPH C. HITE, DIRECTOR, INFORMATION TECHNOLOGY SYSTEMS, U.S. GENERAL ACCOUNTING OFFICE; AND DAVID R. WARREN, DIRECTOR, DEFENSE CAPABILITIES AND MANAGEMENT, U.S. GENERAL ACCOUNTING OFFICE

Mr. KUTZ. Mr. Chairman, it is a pleasure to be here to discuss financial management at the Department of Defense. The recent successes of our forces in Afghanistan has again demonstrated that our military forces are second to none; however, the same level of excellence is not evident in many of DOD's processes, including financial management.

DOD's financial management problems date back decades, and previous attempts at reform have largely proven unsuccessful. Problems with DOD financial management go far beyond its accounting and finance systems and processes. DOD's network of business systems was not designed, but rather has evolved into an overly complex and error-prone operation, with little standardization across the Department, multiple systems performing the same tasks, the same data stored in multiple systems, and significant manual data entry. Some of the systems in operation today date back to 1950's and 1960's technology.

Past reform efforts have not succeeded, despite good intentions, and the conditions that led to those reform initiatives remain largely unchanged. As a result, the DOD has fundamentally flawed financial management systems and a weak overall internal control environment.

My testimony has two parts: first, the root causes of DOD's inability to effectively reform its business operations, and, second, the keys to successful reform.

First, we believe the underlying causes of the chronic financial and business reform challenges include: lack of sustained top-level leadership and accountability; cultural resistance to change, including service parochialism; lack of results-oriented goals and performance measures; and inadequate incentives for seeking change.

Let me briefly touch on two of these—the challenges relating to leadership and culture.

In our Executive Guide on World-Class Financial Management, the leading organizations we surveyed, including General Electric, Boeing, and Pfizer, identified leadership as the most important factor in making cultural change and establishing effective financial management. DOD's past experience has suggested that top management has not had a proactive, consistent, and continuing role in leading financial management reform.

Sustaining top management commitment to performance goals is a particular challenge for DOD. In the past, the Department's top political appointees' average tenure of 1.7 years has served to hinder long-term reform efforts.

Cultural resistance to change and military service parochialism have also played a significant role in impeding previous reform efforts. I testified before this subcommittee last week on the culture at a Navy unit in San Diego that dismissed the need for internal controls and allowed abusive usage of Government purchase cards.

All parts of DOD will need to put aside their parochial interests and focus on Department-wide approaches to financial management reform.

My second point relates to the key elements necessary for successful reform. My written statement discusses seven elements necessary for reform. I will touch on two of those seven now.

First, the financial management challenges must be addressed as part of a comprehensive, integrated, DOD-wide business process reform and improvement strategy cannot be developed in a vacuum.

Financial management is a cross-cutting issue that affects all of an organization's business processes. Currently, DOD has six of the twenty-two agency-specific high-risk areas in the Federal Government, including systems modernization and inventory management. In addition, our two Government-wide high-risk areas, human capital strategy and computer security, are also relevant to DOD. These inter-related management challenges must be addressed using an integrated, enterprise-wide approach.

Second, establishing and implementing an enterprise-wide financial management architecture will be essential for the Department to effectively manage its modernization effort. The Clinger-Cohen Act requires agencies to develop, implement, and maintain an integrated systems architecture. Such an architecture can help ensure that the Department invests only in integrated, enterprise-wide business system solutions. Building systems without an architecture is like building a house without a blueprint.

And the stakes are high. For fiscal year 2001, DOD reported total information technology investment of about $23 billion. Without an architecture, DOD risks spending billions of dollars that will only result in perpetuating the existing complex, stovepipe, and high-maintenance systems environment.

In summary, we support Secretary Rumsfeld's vision for transforming the Department's full range of business processes. The benefits of business reform are substantial. The Secretary estimated that DOD could save 5 percent of its budget, which would be $15 to $18 billion annually, through successful business reform.

Today the momentum exists for reform, but the real question remains: Will this momentum continue to exist tomorrow, next year, and throughout the years to make the necessary cultural, systems, human capital, and other key changes necessary a reality.

For our part, we will continue to work constructively with the Department and the Congress on these reform issues.

Mr. Chairman, this concludes my testimony. I have Randy Hite and Dave Warren with me to answer questions.

Mr. HORN. We thank you very much.

[The prepared statement of Mr. Kutz follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Governmental Reform

For Release on Delivery
Expected at 1 p.m. Wednesday,
March 20, 2002

DOD FINANCIAL MANAGEMENT

Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform

Statement of Gregory D. Kutz
Director, Financial Management and Assurance

GAO-02-537T

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here to discuss financial management at the Department of Defense (DOD). Today, DOD faces financial management problems that are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. DOD's financial management deficiencies, taken together, represent the single largest obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. To date, none of the military services or major DOD components have passed the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls.

Overhauling financial management represents a major management challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. Previous administrations over the past several decades have tried to address these problems in various ways but have largely been unsuccessful. In this regard, on September 10, 2001, Secretary of Defense Rumsfeld announced a broad initiative intended to "transform the way the department works and what it works on" which he estimated could save 5 percent of DOD's budget—or an estimated $15 to $18 billion annually. The Secretary recognized that transformation would be difficult and expected the needed changes would take 8 or more years to complete.

The President's *Management Agenda* includes improved financial management performance as one of his five governmentwide management goals. In addition, in August 2001, the Principals of the Joint Financial Management Improvement Program—the Secretary of the Treasury, the Director of the Office of Management and Budget, the Director of the Office of Personnel Management, and the Comptroller General—began a series of quarterly meetings that marked the first time all four of the Principals had gathered together in over 10 years. To date, these sessions have resulted in substantive deliberations and agreements focused on key issues such as better defining measures for financial management success. These measures include being able to routinely provide timely, reliable, and useful financial information and having no material internal control weaknesses. Success on these measures will be a significant challenge to DOD. The principals have invited Defense Comptroller Zakheim to their upcoming April 2002 meeting to discuss the department's transformation effort and to begin a constructive engagement with DOD on this important initiative.

With the events of September 11, and the federal government's short- and long-term budget challenges, it is more important than ever that DOD effectively transform its business processes to ensure that it gets the most from every dollar spent. The department must be able to effectively carry out its stewardship responsibilities for the funding it receives and for the vast amount of equipment and inventories used in support of military operations. Even before the events of September 11, increased globalization, changing security threats, and rapid technological advances were prompting fundamental changes in the environment in which DOD operates. These trends place a premium on increasing strategic planning, enhancing results

orientation, ensuring effective accountability, maintaining transparency, and using integrated approaches. Six of the 22 areas on GAO's governmentwide "high-risk" list are DOD program areas, and DOD shares responsibility for 2 other high-risk areas that are governmentwide in scope.[1] Central to effectively addressing DOD's financial management problems will be the understanding that these eight areas are interrelated and cannot be addressed in an isolated, stovepiped, or piecemeal fashion.

The recent success of our forces in Afghanistan has again demonstrated the unparalleled excellence of our military forces. This same level of excellence is not yet evident in the department's financial management and other business processes. This is particularly problematic because effective financial management operations are critical to achieving the department's mission in a reasonably economical, efficient, and effective manner and to providing reliable, timely financial information on a routine basis to support management decision-making at all levels throughout DOD. This level of excellence will also be critical in order to enhance overall transparency and accountability. Success in this area will serve to freeup resources that can be redeployed to enhance readiness, improve the quality of life for our troops and their families, and reduce the gap between wants and available funding in connection with major weapon systems.

Today, I will provide my perspectives on (1) how Defense got where it is today and the underlying causes of the department's longstanding inability to effectively reform its financial management and other business systems and processes and (2) the keys to successfully carrying out the Secretary's business process transformation and DOD's plans and actions to date. Last summer, the Comptroller General shared with Secretary Rumsfeld and Comptroller Zakheim a business transformation paper. This paper provided an overview of GAO's views on the current challenges facing the department, the keys to effective reform, and detailed one option for addressing these challenges.

LONG-STANDING FINANCIAL MANAGEMENT PROBLEMS AND ATTEMPTS AT REFORM

History is a good teacher. To solve the problems of today, it is instructive to look to the past. The problems with the department's financial management operations date back decades, and previous attempts at reform have largely proven unsuccessful. These problems adversely affect DOD's ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget (such as for health care, weapon systems, and environmental liabilities), measure performance, maintain funds control, prevent fraud, and address pressing management issues.

In this regard, I would like to briefly highlight three of our recent products that exemplify the adverse impact of DOD's reliance on fundamentally flawed financial management systems and processes and a weak overall internal control environment.

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[1]U.S. General Accounting Office, *High-Risk Series: An Update,* GAO-01-263 (Washington, D.C.: Jan. 2001).

- In a testimony before your subcommittee last week,[2] we highlighted continuing problems with internal controls over approximately $64 million in fiscal year 2001 purchase card transactions involving two Navy activities. Consistent with our testimony last July[3] on fiscal year 2000 purchase card transactions at these locations, our follow-up review demonstrated that continuing control problems left these Navy activities vulnerable to fraudulent, improper, and abusive purchases and theft and misuse of government property. We are currently auditing purchase card usage across the department.

- In a testimony before your Subcommittee in July 2001, we reported[4] that DOD did not have adequate systems, controls, and managerial attention to ensure that $2.7 billion of adjustments to closed appropriations were legal and otherwise proper. Our review of $2.2 billion of these adjustments found that about $615 million of them should not have been made, including about $146 million that were illegal.

- In June 2001, we reported[5] that DOD's current financial systems could not adequately track and report on whether the $1.1 billion in earmarked funds that the Congress provided to DOD for spare parts and associated logistical support were actually used for the intended purpose. The vast majority of the funds—92 percent—were transferred to the military services operation and maintenance accounts. We found that once these funds were transferred, DOD lost its ability to assure the Congress that the funds it received for spare parts purchases were used for, and only for, that purpose.

Problems with the department's financial management operations go far beyond its accounting and finance systems and processes. The department continues to rely on a far-flung, complex network of finance, logistics, personnel, acquisition, and other management information systems—80 percent of which are not under the control of the DOD Comptroller—to gather the financial data needed to support day-to-day management decisionmaking. This network was not designed to be, but rather has evolved into, the overly complex and error-prone operation that exists today, including (1) little standardization across DOD components, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, (4) manual data entry into multiple systems, and (5) a large number of data translations and interfaces that combine to exacerbate problems with data integrity. DOD has determined, for example, that efforts to reconcile a single contract involving 162 payments resulted in an estimated 15,000 adjustments.

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[2]U.S. General Accounting Office, *Purchase Cards: Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-504T (Washington, D.C.: Mar. 13, 2002).
[3]U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-01-995T (Washington, D.C.: July 30, 2001).
[4]U.S. General Accounting Office, *Canceled DOD Appropriations: $615 Million of Illegal or Otherwise Improper Adjustments*, GAO-01-994T (Washington, D.C.: July 26, 2001).
[5]U.S. General Accounting Office, *Defense Inventory: Information on the Use of Spare Parts Funding Is Lacking*, GAO-01-472 (Washington, D.C.: June 11, 2001).

Many of the department's business processes in operation today are mired in old, inefficient processes and legacy systems, some of which go back to the 1950s and 1960s. For example, while implemented in 1968, the department still relies on the Mechanization of Contract Administration Services (MOCAS) system to process a substantial portion of the contract payment transactions for all DOD organizations. In fiscal year 2001, MOCAS processed an estimated $78 billion in contract payments. Past efforts to replace MOCAS have failed. Most recently, in 1994, DOD began acquiring the Standard Procurement System (SPS) to replace the contract administration functions currently performed by MOCAS. However, our July 2001 and February 2002 reporting[6] on DOD's $3.7 billion investment in SPS showed that this substantial investment was not economically justified and raised questions as to whether further investment in SPS was justified. For the foreseeable future, DOD will continue to be saddled with MOCAS.

Moving to the 1970s, we, the Defense Inspector General, and the military service audit organizations, issued numerous reports detailing serious problems with the department's financial management operations. For example, between 1975 and 1981, we issued more than 75 reports documenting serious problems with DOD's existing cost, property, fund control, and payroll accounting systems. In the 1980s, we found that despite the billions of dollars invested in individual systems, these efforts, too, fell far short of the mark, with extensive schedule delays and cost overruns. For example, in 1989, our report[7] on eight major DOD system development efforts—including two major accounting systems--under way at that time, showed that system development cost estimates doubled, two of the eight efforts were abandoned, and the remaining six efforts experienced delays of from 3 to 7 years.

Beginning in the 1990s, following passage of the Chief Financial Officers (CFO) Act of 1990, there was a recognition in DOD that broad-based financial management reform was needed. Over the past 12 years, the department has initiated several departmentwide reform initiatives intended to fundamentally reform its financial operations as well as other key business support processes, including the Corporate Information Management initiative, the Defense Business Operations Fund, and the Defense Reform Initiative. These efforts, which I will highlight today, have proven to be unsuccessful despite good intentions and significant effort. The conditions that led to these previous attempts at reform remain largely unchanged today.

Corporate Information Management. The Corporate Information Management (CIM), initiative, begun in 1989, was expected to save billions of dollars by streamlining operations and implementing standard information systems. CIM was expected to reform all DOD's functional areas--including finance, procurement, material management, and human resources--through consolidating, standardizing, and integrating information systems. DOD also expected CIM to replace approximately 2,000 duplicative systems. Over the years, we have made numerous recommendations to improve CIM's management, but these recommendations were largely not addressed. Instead, DOD spent billions of dollars with little sound analytical justification. We

[6]U.S. General Accounting Office, *DOD Systems Modernization: Continued Investment in the Standard Procurement System Has Not Been Justified*, GAO-01-682 (Washington, D.C.: July 31, 2001) and *DOD's Standard Procurement System: Continued Investment Has Yet to Be Justified,* GAO-02-392T (Washington, D.C.: Feb. 7, 2002).
[7]U.S. General Accounting Office, *Automated Information Systems: Schedule Delays and Cost Overruns Plague DOD Systems,* GAO/IMTEC-89-36 (Washington, D.C.: May 10, 1989).

reported in 1997,[8] that 8 years after beginning CIM, and spending about $20 billion on the initiative, expected savings had yet to materialize. The initiative was eventually abandoned.

Defense Business Operations Fund. In October 1991, DOD established a new entity, the Defense Business Operations Fund by consolidating nine existing industrial and stock funds and five other activities operated throughout DOD. Through this consolidation, the fund was intended to bring greater visibility and management to the overall cost of carrying out certain critical DOD business operations. However, from its inception, the fund was plagued by management problems. In 1996, DOD announced the fund's elimination. In its place, DOD established four working capital funds. These new working capital funds inherited their predecessor's operational and financial reporting problems.

Defense Reform Initiative (DRI). In announcing the DRI program in November 1997, the then Secretary of Defense stated that his goal was "to ignite a revolution in business affairs." DRI represented a set of proposed actions aimed at improving the effectiveness and efficiency of DOD's business operations, particularly in areas that have been long-standing problems—including financial management. In July 2000, we reported[9] that while DRI got off to a good start and made progress in implementing many of the component initiatives, it did not meet expected time frames and goals, and the extent to which savings from these initiatives will be realized is yet to be determined. GAO is currently examining the extent to which DRI efforts begun under the previous administration are continuing.

The past has clearly taught us that addressing DOD's serious financial management problems will not be easy. Early in his tenure, Secretary Rumsfeld commissioned a new study of the department's financial management operations. The report on the results of the study, *Transforming Department of Defense Financial Management: A Strategy for Change,* was issued on April 13, 2001. The report recognized that the department will have to undergo "a radical financial management transformation" and that it would take more than a decade to achieve. The report concluded that many studies and interviews with current and former leaders in DOD point to the same problems and frustrations, and that repeated audit reports verify systemic problems illustrating the need for radical transformation in order to achieve success. Secretary Rumsfeld further confirmed the need for a fundamental transformation of DOD in his "top-down" Quadrennial Defense Review. Specifically, his September 30, 2001, *Quadrennial Defense Review Report* concluded that the department must transform its outdated support structure, including decades-old financial systems that are not well interconnected. The report summed up the challenge well in stating: "While America's businesses have streamlined and adopted new business models to react to fast-moving changes in markets and technologies, the Defense Department has lagged behind without an overarching strategy to improve its business practices."

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[8]U.S. General Accounting Office, *High-Risk Series: Information Management and Technology,* GAO/HR-97-9 (Washington, D.C.: Feb. 1997).
[9]U.S. General Accounting Office, *Defense Management: Actions Needed to Sustain Reform Initiatives and Achieve Greater Results,* GAO/NSIAD-00-72 (Washington, D.C.: July 25, 2000).

UNDERLYING CAUSES OF FINANCIAL AND
RELATED BUSINESS PROCESS REFORM CHALLENGES

As part of our constructive engagement approach with DOD, the Comptroller General met with Secretary Rumsfeld last summer to provide our perspectives on the underlying causes of the problems that have impeded past reform efforts at the department and to discuss options for addressing these challenges. There are four underlying causes

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

Lack of Leadership and Accountability

Historically, DOD has not routinely assigned accountability for performance to specific organizations or individuals that have sufficient authority to accomplish desired goals. For example, under the CFO Act, it is the responsibility of agency CFOs to establish the mission and vision for the agency's future financial management. However, at DOD, the Comptroller—who is by statute the department's CFO---has direct responsibility for only an estimated 20 percent of the data relied on to carry out the department's financial management operations. The department has learned through its efforts to meet the Year 2000 computing challenge that to be successful, major improvement initiatives must have the direct, active support and involvement of the Secretary and Deputy Secretary of Defense. In the Year 2000 case, the then Deputy Secretary of Defense was personally and substantially involved and played a major role in the department's success. Such top-level support and attention helps ensure that daily activities throughout the department remain focused on achieving shared, agencywide outcomes. A central finding from our report on our survey of best practices of world-class financial management organizations---Boeing; Chase Manhattan Bank; General Electric; Pfizer; Hewlett-Packard; Owens Corning; and the states of Massachusetts, Texas, and Virginia—was that clear, strong executive leadership was essential to (1) making financial management an entitywide priority, (2) redefining the role of finance, (3) providing meaningful information to decisionmakers, and (4) building a team of people that deliver results.[10]

DOD past experience has suggested that top management has not had a proactive, consistent, and continuing role in building capacity, integrating daily operations for achieving performance

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

goals, and creating incentives. Sustaining top management commitment to performance goals is a particular challenge for DOD. In the past, the average 1.7--year tenure of the department's top political appointees has served to hinder long-term planning and follow-through.

Cultural Resistance and Parochialism

Cultural resistance to change and military service parochialism have also played a significant role in impeding previous attempts to implement broad-based management reforms at DOD. The department has acknowledged that it confronts decades-old problems deeply grounded in the bureaucratic history and operating practices of a complex, multifaceted organization, and that many of these practices were developed piecemeal and evolved to accommodate different organizations, each with its own policies and procedures.

For example, as discussed in our July 2000 report,[11] the department encountered resistance to developing departmentwide solutions under the then Secretary's broad-based DRI.[12] In 1997, the department established a Defense Management Council—including high-level representatives from each of the military services and other senior executives in the Office of the Secretary of Defense—which was intended to serve as the "board of directors" to help break down organizational stovepipes and overcome cultural resistance to changes called for under DRI. However, we found that the council's effectiveness was impaired because members were not able to put their individual military services' or DOD agencies' interests aside to focus on department-wide approaches to long-standing problems.

We have also seen an inability to put aside parochial views. Cultural resistance to change has impeded reforms not only in financial management, but also in other business areas, such as weapon system acquisition and inventory management. For example, as we reported[13] last year, while the individual military services conduct considerable analyses justifying major acquisitions, these analyses can be narrowly focused and do not consider joint acquisitions with the other services. In the inventory management area, DOD's culture has supported buying and storing multiple layers of inventory rather than managing with just the amount of stock needed.

Unclear Goals and Performance Measures

Further, DOD's past reform efforts have been handicapped by the lack of clear, linked goals and performance measures. As a result, DOD managers lack straightforward road maps showing how their work contributes to attaining the department's strategic goals, and they risk operating autonomously rather than collectively. In some cases, DOD had not yet developed appropriate strategic goals, and in other cases, its strategic goals and objectives were not linked to those of the military services and defense agencies.

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[11]GAO/NSIAD-00-72 .

[12]Announced by the Secretary of Defense in 1997, DRI represents a set of actions aimed at reforming the department's major business processes and support operations.

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

As part of our assessment of *DOD's Fiscal Year 2000 Financial Management Improvement Plan*, we reported[14] that, for the most part, the plan represented the military services' and Defense components' stovepiped approaches to reforming financial management and did not clearly articulate how these various efforts would collectively result in an integrated DOD-wide approach to financial management improvement. In addition, we reported that the department's plan did not include performance measures that could be used to assess DOD's progress in resolving its financial management problems. DOD officials have informed us that they are now working to revise the department's approach to this plan so that future years' updates will reflect a more strategic, departmentwide vision and provide a more effective tool for financial management reform.

As it moves to modernize its systems, the department faces a formidable challenge in responding to technological advances that are changing traditional approaches to business management. For fiscal year 2001, DOD's reported total information technology investments of almost $23 billion supporting a wide range of military operations as well as DOD business functions. As we have reported,[15] while DOD plans to invest billions of dollars in modernizing its financial management and other business support systems, it does not yet have an overall blueprint—or enterprise architecture—in place to guide and direct these investments. As we recently testified,[16] our review of practices at leading organizations showed they were able to make sure their business systems addressed corporate—rather than individual business unit—objectives by using enterprise architectures to guide and constrain investments. Consistent with our recommendation, DOD is now working to develop a financial management enterprise architecture, which is a very positive development.

Lack of Incentives for Change

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

This lack of incentive has perhaps been most evident in the department's acquisition area. In DOD's culture, the success of a manager's career has depended more on moving programs and operations through the DOD process rather than on achieving better program outcomes. The fact that a given program may have cost more than estimated, taken longer to complete, and not

[14]U.S. General Accounting Office, *Financial Management: DOD Improvement Plan Needs Strategic Focus,* GAO-01-764 (Washington D.C.: Aug. 17, 2001).
[15]U.S. General Accounting Office, *Information Technology: Architecture Needed to Guide Modernization of DOD's Financial Operations,* GAO-01-525 (Washington, D.C.: May 17, 2001).
[16]U.S. General Accounting Office, *Defense Acquisitions: DOD Faces Challenges in Implementing Best Practices,* GAO-02-469T (Washington, D.C.: Feb. 27, 2002).

generated results or performed as promised was secondary to fielding a new program. To effect real change, actions are needed to (1) break down parochialism and reward behaviors that meet DOD-wide and congressional goals; (2) develop incentives that motivate decisionmakers to initiate and implement efforts that are consistent with better program outcomes, including saying "no" or pulling the plug on a system or program that is failing; and (3) facilitate a congressional focus on results-oriented management, particularly with respect to resource allocation decisions.

KEYS TO FUNDAMENTAL DOD FINANCIAL MANAGEMENT REFORM

As we testified before your Subcommittee last May,[17] our experience has shown there are several key elements that, collectively would enable the department to effectively address the underlying causes of its inability to resolve its long-standing financial management problems. These elements, which are key to any successful approach to financial management reform, include

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

Actions on many of the key areas central to successfully achieving desired financial management and related business process transformation goals —particularly those that rely on longer term systems improvements—will take a number of years to fully implement. Secretary Rumsfeld has estimated that his envisioned transformation may take 8 or more years to complete. Consequently, both long-term actions focused on the Secretary's envisioned business transformation and short-term actions focused on improvements within existing systems and processes will be critical going forward. Short-term actions in particular will be critical if the department is to achieve the greatest possible accountability over existing resources and more

[17]U.S. General Accounting Office, *DOD Financial Management: Integrated Approach, Accountability, and Incentives Are Keys to Effective Reform,* GAO-01-681T (Washington, D.C.: May 8, 2001).

reliable data for day-to-day decisionmaking while longer-term systems and business process reengineering efforts are under way.

Beginning with the Secretary's recognition of a need for a fundamental transformation of the department's business processes, and building on some of the work begun under past administrations, DOD has taken a number of positive steps in many of these key areas. At the same time, the challenges remaining in each of these key areas are daunting.

Integrated Business Process Reform Strategy

As we have reported in the past,[18] establishing the right goal is essential for success. Central to effectively addressing DOD's financial management problems will be the recognition that they cannot be addressed in an isolated, stovepiped, or piecemeal fashion separate from the other high-risk areas facing the department.[19] Successfully reengineering the department's processes supporting its financial management and other business support operations will be critical if DOD is to effectively address the deep-rooted organizational emphasis on maintaining business-as-usual across the department.

Financial management is a crosscutting issue that affects virtually all of DOD's business areas. For example, improving its financial management operations so that they can produce timely, reliable, and useful cost information will be essential if the department is to effectively measure its progress toward achieving many key outcomes and goals across virtually the entire spectrum of DOD's business operations. At the same time, the department's financial management problems—and, most importantly, the keys to their resolution---are deeply rooted in and dependent upon developing solutions to a wide variety of management problems across DOD's various organizations and business areas. For example, we have reported[20] that many of DOD's financial management shortcomings were attributable in part to human capital issues. The department does not yet have a strategy in place for improving its financial management human capital. This is especially critical in connection with DOD's civilian workforce, since DOD has generally done a much better job in conjunction with human capital planning for its military personnel. In addition, DOD's civilian personnel face a variety of size, shape, skills, and succession-planning challenges that need to be addressed.

As I mentioned earlier, and it bears repetition, the department has reported that an estimated 80 percent of the data needed for sound financial management comes from its other business operations, such as its acquisition and logistics communities. DOD's vast array of costly, nonintegrated, duplicative, and inefficient financial management systems is reflective of its lack

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

[19]The eight interrelated high-risk areas that represent the greatest challenge to DOD's developing world-class business operations supporting its forces are: financial management, human capital, information security, systems modernization, weapon system acquisition, contract management, infrastructure management, and inventory management.

[20]GAO-01-244.

of an enterprisewide, integrated approach to addressing management challenges. DOD has acknowledged that one of the reasons for the lack of clarity in its reporting under the Government Performance and Results Act has been that most of the program outcomes the department is striving to achieve are interrelated, while its management systems are not integrated.

As I discussed previously, the Secretary of Defense has made the fundamental transformation of business practices throughout the department a top priority. In this context, the Secretary established a number of top-level committees, councils, and boards, including the Senior Executive Committee, Business Initiative Council, and Defense Business Practices Implementation Board. The Senior Executive Committee was established to help guide efforts across the department to improve its business practices. This committee--chaired by the Secretary of Defense, and with membership to include the Deputy Secretary, the military service secretaries, and the Under Secretary of Defense for Acquisition, Logistics and Technology--was established to function as the board of directors for the department. The Business Initiative Council--comprising the military service secretaries and headed by the Under Secretary of Defense for Acquisition, Technology and Logistics--was established to encourage the military services to explore new money saving business practices to help offset funding requirements for transformation and other initiatives. The Secretary also established the Defense Business Practices Implementation Board, composed of business leaders from the private sector. The board is intended to tap outside expertise to advise the department on its efforts to improve business practices.

Active Leadership and Resource Control

The department's successful Year 2000 effort illustrated, and our survey of leading financial management organizations[21] captured, the importance of strong leadership from top management. As we have stated many times before, strong, sustained executive leadership is critical to changing a deeply rooted corporate culture—such as the existing "business as usual" culture at DOD--and to successfully implementing financial management reform. As I mentioned earlier, the personal, active involvement of the Deputy Secretary of Defense played a key role in building entitywide support and focus for the department's Year 2000 initiatives. Given the long-standing and deeply entrenched nature of the department's financial management problems--combined with the numerous competing DOD organizations, each operating with varying, often parochial views and incentives--such visible, sustained top-level leadership will be critical.

In discussing their April 2001 report to the Secretary of Defense on transforming financial management,[22] the authors stated that, "unlike previous failed attempts to improve DOD's financial practices, there is a new push by DOD leadership to make this issue a priority." With respect to the key area of investment control, the Secretary took action to set aside $100 million for financial modernization. Strong, sustained executive leadership—over a number of years and

[21]GAO/AIMD-00-134.
[22]Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change,* (Washington, D.C.: Apr. 13, 2001).

administrations—will be key to changing a deeply rooted culture. In addition, given that significant investments in information systems and related processes have historically occurred in a largely decentralized manner throughout the department, additional actions will likely be required to implement a centralized IT investment control strategy. For example, in our May 2001 report,[23] we recommended that DOD take action to establish centralized control over transformation investments to ensure that funding is provided for only those proposed investments in systems and business processes that are consistent with the department's overall business process transformation strategy.

Clear Lines of Responsibility and Accountability

Last summer, when the Comptroller General met with Secretary Rumsfeld, he stressed the importance of establishing clear lines of responsibility, decision-making authority, and resource control for actions across the department tied to the Secretary as a key to reform. As we previously reported,[24] such an accountability structure should emanate from the highest levels and include the secretary of each of the military services as well as heads of the department's various major business areas.

The Secretary of Defense has taken action to vest responsibility and accountability for financial management modernization with the DOD Comptroller. In October 2001, the DOD Comptroller established the Financial Management Modernization Executive and Steering Committees as the governing bodies that oversee the activities related to this modernization effort and also established a supporting working group to provide day-to-day guidance and direction in these efforts. DOD reports that the executive and steering committees met for the first time in January 2002.

It is clear to us that the Comptroller has the full support of the Secretary and that the Secretary is committed to making meaningful change. To make this work, it is important that the Comptroller have sufficient authority to bring about the full, effective participation of the military services and business process owners across the department. The Comptroller has direct control of 20 percent of the data needed for sound financial management and has historically had limited ability to control information technology investments across the department. Addressing issues such as centralization of authority for information systems investments and continuity of leadership are critical to successful business process transformation.

In addition to DOD, a number of other federal departments and agencies are facing an array of interrelated business system management challenges for which resolution is likely to require a number of years, challenges that could span administrations. One option that may have merit would be the establishment of chief operating officers, who could be appointed for a set term of 5 to 7 years with the potential for reappointment. These individuals should have a proven track record as a business process change agents for large, diverse organizations and would spearhead business process transformation across the department or agency.

Results-Oriented Performance

[23]GAO-01-525.
[24]GAO/NSIAD-00-72.

As discussed in our January 2001 report on DOD's major performance and accountability challenges, [25] establishing a results orientation is another key element of any approach to reform. Such an orientation should draw upon results that could be achieved through commercial best practices, including outsourcing and shared servicing concepts. Personnel throughout the department must share the common goal of establishing financial management operations that not only produce financial statements that can withstand the test of an audit but, more importantly, routinely generate useful, reliable, and timely financial information for day-to-day management purposes.

In addition, we have previously testified[26] that DOD's financial management improvement efforts should be measured against an overall goal of effectively supporting DOD's basic business processes, including appropriately considering related business process system interrelationships, rather than determining system-by-system compliance. Such a results-oriented focus is also consistent with an important lesson learned from the department's Year 2000 experience. DOD's initial Year 2000 focus was geared toward ensuring compliance on a system-by-system basis and did not appropriately consider the interrelationships of systems and business areas across the department. It was not until the department, under the direction of the then Deputy Secretary, shifted to a core mission and function review approach that it was able to achieve the desired result of greatly reducing its Year 2000 risk.

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

In the short term, it is important to focus on actions that can be taken using existing systems and processes. It is critical to establish interim measures to both track performance against the department's overall transformation goals and facilitate near- term successes using existing systems and processes. The department has established an initial set of metrics intended to evaluate financial performance, and it reports that it has seen improvements. For example, with respect to closed appropriation accounts, DOD reported during the first 4 months of fiscal year 2002 a reduction in the dollar value of adjustments to closed appropriation accounts of about 51 percent from the same 4-month period in fiscal year 2001. Other existing metrics concern cash and funds management, contract and vendor payments, and disbursement accounting. DOD also reported that it is working to develop these metrics into higher-level measures more appropriate for senior management. We agree with the department's efforts to expand the use of appropriate metrics to guide its financial management reform efforts.

Incentives and Consequences

[25] GAO-01-244.
[26] GAO/T-AIMD/NSIAD-00-163.

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

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

Enterprise Architecture

Establishing and implementing an enterprisewide financial management architecture is essential for the department to effectively manage its large, complex system modernization effort now under way. The Clinger-Cohen Act requires agencies to develop, implement, and maintain an integrated system architecture. As we previously reported,[27] such an architecture can help ensure that the department invests only in integrated, enterprisewide business system solutions and, conversely, will help move resources away from non-value-added legacy business systems and nonintegrated business system development efforts. In addition, without an architecture, DOD runs the serious risk that its system efforts will perpetuate the existing system environment that suffers from systems duplication, limited interoperability, and unnecessarily costly operations and maintenance. In our May 2001 report,[28] we pointed out that DOD lacks a financial management enterprise architecture to guide and constrain the billions of dollars it plans to spend to modernize its financial management operations and systems.

DOD has reported that it is in the process of contracting for the development of a DOD-wide financial management enterprise architecture to "achieve the Secretary's vision of relevant, reliable and timely financial information needed to support informed decision-making." Consistent with our previous recommendations in this area, DOD has begun an extensive effort to document the department's current as-is financial management architecture by inventorying systems now relied on to carry out financial management operations throughout the department. DOD has identified 674 top-level systems and at least 997 associated interfaces thus far and estimates that this inventory could include up to 1,000 systems when completed.

While DOD's beginning efforts at developing a financial management enterprise architecture are off to a good start, the challenges yet confronting the department in its efforts to fully develop, implement, and maintain a DOD-wide financial management enterprise architecture are unprecedented. Our May 2001 report[29] details a series of recommended actions directed at ensuring DOD employs recognized best practices for enterprise architecture management. This

[27] GAO/T-AIMD/NSIAD-00-163.
[28] GAO-01-525.
[29] GAO-01-525.

effort will be further complicated as the department strives to develop multiple enterprise architectures across its various business areas. For example, in June 2001, we recommended[30] that DOD develop an enterprise architecture for its logistics operations. As I discussed previously, an integrated reform strategy is critical. In this context, it is essential that DOD closely coordinate and integrate the development and implementation of these, as well as other, architectures. By following this integrated approach and our previous recommendations, DOD will be in the best position to avoid the serious risk that, after spending billions of dollars on systems modernization, it will perpetuate the existing systems environment that suffers from duplication of systems, limited interoperability, and unnecessarily costly operations and maintenance.

Monitoring and Oversight

Ensuring effective monitoring and oversight of progress will also be a key to bringing about effective implementation of the department's financial management and related business process reform. We have previously testified[31] that periodic reporting of status information to department top management, the Office of Management and Budget (OMB), the Congress, and the audit community is another key lesson learned from the department's successful effort to address its Year 2000 challenge.

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

Given the size, complexity, and deeply engrained nature of the financial management problems facing DOD, heroic end-of-the year efforts relied on by some agencies to develop auditable financial statement balances are not feasible at DOD. Instead, a sustained focus on the underlying problems impeding the development of reliable financial data throughout the department will be necessary and is the best course of action. In this context, the Congress recently enacted the fiscal year 2002 National Defense Authorization Act, which contains provisions that will provide a framework for redirecting the department's resources from the preparation and audit of financial statements, which are acknowledged by DOD leadership to be unauditable, to the improvement of DOD's financial management systems and financial management policies, procedures, and internal controls. Under this new legislation, the department will also be required to report to the Congress on how resources have been redirected

[30]U.S. General Accounting Office, *Information Technology: DLA Should Strengthen Business Systems Modernization Architecture and Investment Activities,* GAO-01-631 (Washington, D.C.: June 29, 2001).
[31]GAO-01-244.

and the progress that has been achieved. This reporting will provide an important vehicle for the Congress to use in assessing whether DOD is using its available resources to best bring about the development of timely and reliable financial information for daily decision making and transform its financial management as envisioned by the Secretary of Defense.

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In conclusion, we support Secretary Rumsfeld's vision for transforming the department's full range of business processes. Substantial personal involvement by the Secretary and other DOD top executives will be essential for success to change the DOD culture that has over time perpetuated the status quo and been resistant to a transformation of the magnitude envisioned by the Secretary. Comptroller Zakheim, as the Secretary's leader for financial management modernization, will need to have the ability to make the tough choices on systems, processes, and personnel, and to control spending for new systems across the department, especially where new systems development is involved. Processes will have to be reengineered, and hierarchical, process-oriented, stovepiped, and internally focused approaches will have to be put aside. The past has taught us that well-intentioned initiatives will only succeed if there are the right incentives, transparency, and accountability mechanisms in place.

The events of September 11 and other funding and asset accountability issues associated with the war on terrorism, at least in the short term, may dilute the focused attention and sustained action that are necessary to fully realize the Secretary's transformation goal, which is understandable given the circumstances. At the same time, the demand for increased Defense spending, when combined with the government's long-range fiscal challenges, means that solutions to DOD's business systems problems are even more important. As the Secretary has noted, billions of dollars of resources could be freed up for national defense priorities by eliminating waste and inefficiencies in DOD's existing business processes. Only time will tell if the Secretary's current transformation efforts will come to fruition. Others have attempted well-intentioned reform efforts in the past. Today, the momentum exists for reform. But, the real question remains, will this momentum continue to exist tomorrow, next year, and throughout the years to make the necessary cultural, systems, human capital, and other key changes a reality? For our part, we will continue to work constructively with the department and the Congress in this important area.

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

CONTACTS AND
ACKNOWLEDGEMENTS

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-9095 or *kutzg@gao.gov*. Other key contributors to this testimony include Jack Brock, Geoffrey Frank, Randolph Hite, Jeffrey Jacobson, Darby Smith, and David Warren.

Mr. HORN. We now have Tina W. Jonas, Deputy Under Secretary for Defense, Financial Management, Department of Defense. When we were voting recently, I met with Mr. Lewis and said you were going to turn the Department around, and he said, "Absolutely."

Ms. JONAS. We are trying mightily.

STATEMENTS OF TINA W. JONAS, DEPUTY UNDER SECRETARY FOR DEFENSE, FINANCIAL MANAGEMENT, DEPARTMENT OF DEFENSE, ACCOMPANIED BY THOMAS R. BLOOM, DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE, DEPARTMENT OF DEFENSE; AND DE W. RITCHIE, JR., ACTING DEPUTY CHIEF FINANCIAL OFFICER, DEPARTMENT OF DEFENSE

Ms. JONAS. Thank you, Mr. Chairman and members of the committee. I am pleased to be here to give you an update on the Department's financial management reform program. I wish to reaffirm the commitment to financial management reform that we made to you last year. Our goal for financial management reform is profound and far-reaching. We intend to provide the Department's decisionmakers with financial data that is reliable, relevant, and timely so that they, in turn, can carefully and efficiently manage and account for taxpayer funds.

You cannot change anything unless you get your arms around the problem, and we are beginning to get our arms around the extent of our problem. We are taking five basic steps to achieve successful financial reform. We are rebuilding our financial management infrastructure to include renovating our information systems and business processes. We are improving the quality of the processes we use to prepare financial statements, and we are developing and using performance measures to target areas for improvement. We are also ensuring that components safeguard their assets from fraud, waste, and abuse, and we are developing procedures to build and maintain a highly motivated professional financial work force.

Our first step is building a robust financial management infrastructure. Our program targets two primary causes of the Department's extensive problems. These are the uncontrolled proliferation of antiquated and stand-alone financial management systems and the inefficient business processes that they support.

It is important to note that our financial systems were developed to support the budget appropriations process, but, unfortunately, they do not generate the type of financial information necessary for the Department's decisionmakers and they do not incorporate standard accounting principles as required by law. We intend to fix this.

The proliferation of systems can be seen in the inventory diagram here. There's a board over there, and it's on the screen, Mr. Chairman, that represents over 673 financial and what they call "feeder systems"—in other words, systems that produce data that is relevant or necessary for financial reporting.

The slide or the chart, aside from it, is the chart that GAO used last year when I came to see you. They thought that spider chart—I call that the spider chart—was a problem. The work we have been doing has identified and validated that mess. There are 1,500 different what they call "interfaces." So, I think very explicitly and

graphically that shows you the extent of the Department's problem. I was informed by my team this morning that we have discovered another 200 systems.

So many of the things that we are dealing with, all the problems in reporting—the inability to get financial statements on time—stem from that mess, and it is going to be a very difficult task to try to clean-it-up, but we are going to get to that.

We are modernizing our business processes so that we can produce financial information. We are eliminating as many systems as possible and integrating standards and standardizing those that remain. We are creating an enterprise architecture that will serve as a plan of action linking systems and business processes in a comprehensive and integrated fashion.

These processes are now isolated from each other across functional areas. The functional areas, as I mentioned earlier, these include healthcare, inventory, and other areas.

Our enterprise architecture will also outline Department-wide financial management standards and prescribe stringent internal controls.

We expect to complete this architecture by March 2003, and we will be looking toward six pilot sites and prototyping the system by 2004.

Just as a note here, we will be briefing the Deputy Secretary tomorrow and the service Secretaries on the status of our plan, so the Secretary gets routine briefs on where we are. Essentially, what I am describing for you, Mr. Chairman, is the approach that Greg has just discussed with you on an enterprise architecture—that is, creating a blueprint that will guide our financial investments in the future and will hopefully get us to a point where we're not spending so much money on inefficient processes.

In addition to developing a robust financial infrastructure, we are addressing many of the Department's most intractable financial problems, including those that prevent the Department from receiving a clean audit opinion. For example, we are working to change the way the Department accounts for ships, tanks, aircraft, and other military equipment, and we want to give our managers and the public a clear view of the full cost associated with these items.

We are developing more accurate methods to estimate our environmental liabilities so that we know what it costs to clean them up.

We are improving our ability to estimate retiree healthcare costs. Our enhanced healthcare program will help us to budget for future healthcare costs more accurately. Our goal is to improve the quality of healthcare for our retirees.

We are also balancing our checkbook with the U.S. Treasury, so knowing exactly how much money we have in our Treasury accounts helps to ensure that we spend only the funds appropriated to us by Congress.

And, fifth, we have made considerable progress in documenting adjustments to our books, thus improving audit trails.

Another area, Secretary Rumsfeld has stated—known to state that if we cannot measure it, we cannot manage it. We have begun

to use performance measures to target areas for improvement, and our data shows that we are making progress.

For instance, we are doing a better job of paying our bills on time. From April 2001, to October 2001, we reduced the backlog of commercial payments by 41 percent. This improves our business relationships and reduces wasteful interest payments. For example, when I came in I realized—I started to ask for performance data, and they suggested that we were spending $40 million a year on interest payments. That's something that is just untenable, so we're using performance measures to understand. We brought that down, I think, by at least $12 million over the past year.

We are also trying to do a better job of accurately recording payments so that we know the status of our funds. We decreased our payment recording errors by 44 percent between January, 2001, and October 2001. We have also reduced our travel card payment delinquencies by 34 percent between January, 2001, and December, 2001, for cards held by individuals, and during the same period of time we reduced delinquencies related to cards held by DOD organizations by 86 percent.

We are trying to demonstrate to the Congress and to others that we want to measure our progress and understand where we are, particularly in the travel card area. This is very critical, and Dr. Zakheim—I get monthly briefings on where we are, and we're trying to drive the numbers to an acceptable level.

We are also aggressively collecting money that contractors owe us, overpayments. We have identified over $53 million worth of overpayments, and we have collected as much as $31 million so far, and we continue to seek to get the rest of the returns on that, on those overpayments.

Concurrent with our review of policies and procedures we are making enforcement of internal controls a top priority, and we are looking very closely at our overall internal controls program, with a specific focus on credit cards.

Mr. Chairman, since I was here last week and we discussed this a little bit, the Secretary has put together a task force. That task force has met on a routine basis, and Tom is part of that task force. He may have the actual hours committed to that. But we are looking exactly at what has been done, what has not been done, what administrative remedies we have, what we must do for proper control. Don Zakheim has personally spoken to the acting IG, and we're going to invite Justice on the task force, so we hope to have some solid answers for this. I guarantee you the Secretary is personally involved in this.

You asked me last week whether or not the service Secretaries have been discussed—this has been discussed with the service Secretaries. I guarantee you it has. So hopefully we will make some progress in those areas.

I covered—Monday the Secretary had asked Dr. Zakheim to meet with the senior leadership and he did so, and I just mentioned the task force that we are involved with.

So, Mr. Chairman, we are also, just as a final note—and I don't want to give it short shrift, but we're also—we had a human capital work group. The financial work force is critical. I think Greg has talked about this many times, David Walker has talked about

it. We're serious about improving the financial management work force and the credentials of that work force, and we may be seeking legislation on some particular matters associated with that.

Thank you, Mr. Chairman. I appreciate the opportunity to testify.

[The prepared statement of Ms. Jonas follows:]

Statement of Tina Jonas
Deputy Under Secretary of Defense (Financial Management)
Before the House Government Reform Committee
Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations
March 20, 2002

Mr. Chairman and members of the Committee, I am pleased to be here to discuss financial management within the Department of Defense and to give you an update on the Department's financial management reform program.

CONTINUING LEADERSHIP COMMITMENT

I wish to reiterate the commitment to financial management reform that we made to you last year. Indeed, transforming the Department's financial practices continues to be a very high priority for the Secretary and the Comptroller.

Our goal for financial management reform is profound and far-reaching. We intend to provide the Department's decision-makers with financial data that is reliable, relevant, and timely so that they, in turn, can carefully and efficiently manage and account for taxpayers' funds.

You cannot change anything unless you can get your arms around the problem, and we are getting our arms around the problem. We are taking five basic steps to achieve successful financial management reform. We are:

1. Rebuilding our financial management infrastructure, to include renovating our information systems and business processes;
2. Improving the quality of the processes we use to prepare financial statements;
3. Developing and using performance measures to target areas for improvement;
4. Ensuring that Components safeguard their assets from fraud, waste and abuse; and

5. Developing procedures to build and maintain a highly-motivated and professional financial workforce.

BUILDING A FINANCIAL INFRASTRUCTURE

Our first step toward financial reform is building a robust financial management infrastructure. In this sense, our program goes far beyond our past efforts to reform financial management. Our program targets two of the primary root causes of the Department's problems:

- The uncontrolled proliferation of antiquated and standalone financial management systems, and
- The inefficient business processes that they support.

It is important to note that our financial systems and processes were developed to support the budget and appropriations process. Therefore, they unfortunately do not generate the type of financial information that meets the needs of the Department's decision-makers. And, they do not incorporate standard accounting requirements as required by the Federal Financial Management Improvement Act of 1996. We intend to fix that.

The proliferation of systems can be seen in our inventory diagram. This schematic illustrates the complexity of the systems that produce most of the Department's financial management information. This diagram is itself the product of a major effort of several months. It documents, for the first time, the Department's "As-Is" inventory--a vital element for change.

There are no less than 673 systems in our inventory. The majority of these systems manage personnel, logistics, health care and other non-financial functions. Because they generate financial data, they are as important to financial management reform as accounting systems. ***(of 673 systems, 532 are feeders, or 73 percent of total systems.)***

Just to let you know what's what,

COLOR	SYSTEM
Gray	Accounting
Red	Finance
Yellow	Financial Reporting
Blue/Gray	Personnel and Pay
Black	Property Management
Purple	Budget Formulation
Brown	Inventory
Green	Management Information
Magenta	Acquisition
Dark Green	Cost Management
Orange	Travel
Light Green	Non-DoD

In addition, in October 2001 Dr. Zakheim instituted tighter controls over the development and fielding of management information systems to slow investments in systems that do not conform to our modernization effort. We cannot afford to waste resources implementing stovepipe systems that do not talk to each other.

We are transforming our old financial management infrastructure. We are doing this by:

- modernizing the business processes that produce our financial information;
- eliminating as many systems as possible; and
- integrating and standardizing those that remain.

We are creating an Enterprise Architecture that will serve as a plan of action linking systems and business processes in a comprehensive and integrated fashion. These processes are now isolated from each other, across the functional areas I mentioned earlier: logistics, health care, accounting, finance, and others. Our Enterprise Architecture will also outline Department-wide financial management standards and prescribe stringent internal controls. We expect to finish the architecture by March 2003. We will then begin testing--or "prototyping"--the solution we developed in our architecture in early 2004.

IMPROVING FINANCIAL STATEMENTS

In addition to developing a robust financial infrastructure, we are addressing many of the Department's most intractable financial problems, including those that prevent the Department from receiving a "clean" audit opinion on its financial statements. We are already making progress in several key areas. For example:

1. We are working with the Federal Accounting Standards Advisory Board to change the way the Department accounts for ships, tanks, aircraft, and other military equipment. We want to record their full costs in our accounts and show those costs on our balance sheet. This will give our managers, and the public, a clearer view of the total costs associated with these items.
2. We are developing more accurate methods to estimate our environmental liabilities. These new methods will help the Department report reliable estimates for its clean-up costs.
3. We are improving our ability to estimate retiree health care costs. Our enhanced quality control program will enable us to budget for future health care costs more accurately. Our goal is to improve the quality of health care for our retirees.

4. We are balancing our checkbook with the U.S. Treasury. Knowing how much money we have in our Treasury accounts helps to ensure that we spend only the funds appropriated to us by Congress.
5. We have made considerable progress documenting adjustments to our books, thus improving audit trails. The Defense Finance and Accounting Service (DFAS) added management reviews, upgraded documentation requirements, and introduced additional reconciliation requirements. These improved procedures have reduced our adjustments by half, and we intend to achieve further reductions.

MEASURING PERFORMANCE

Thirdly, Secretary Rumsfeld stated that if we cannot measure our performance then we cannot improve it. We are using performance measures to target areas for improvement. Our data shows that we have been successful in several areas already:

1. We are doing a better job of paying bills on time. From April 2001 to October 2001, we reduced the backlog of commercial payments by 41 percent. This improves our business relationships and reduces wasteful interest payments.
2. We are doing a better job of accurately recording payments. We decreased our payment recording errors by 44 percent between January 2001 and October 2001. The elements of this reduction include:
   - A 48 percent reduction in the dollar value of our unmatched transactions,
   - A 78 percent reduction in the dollar value of our transactions not obligated, and
   - A 57 percent reduction in the dollar value of transactions requiring additional research.

To continue this progress, the Comptroller recently issued revised policy directing the Department to reduce unreconciled balances by recording obligations for payments that are over 120 days old. The previous target was 180 days. This gives managers more timely and accurate information on how much they have remaining in their budgets. We expect that with the use of established performance metrics we will be able to measure the impact of this new policy on problem disbursements.

3. We reduced travel card payment delinquencies. We increased management oversight of travel cards, which resulted in a 34 percent reduction between January 2001 and December 2001 in payment delinquencies for cards held by individuals. During the same time period, we reduced delinquencies related to cards held by DoD organizations by 86 percent. This demonstrates greater fiscal responsibility and reduces the cost of the card.
4. We are aggressively collecting money that contractors owe us. The Defense Contract Audit Agency (DCAA) and Defense Finance and Accounting Service (DFAS) are working together to identify and collect contract overpayments. To date, our auditors have found overpayments of $53 million, with over $31 million of the overpayments already returned to the government. We are working to recover the balance. DCAA finished audits of contractor overpayments at 46 major contractors and is completing audits at 124 others.

IMPROVING INTERNAL CONTROLS

Concurrent with our review of policies and procedures, we are making enforcement of internal controls a top priority. We are looking very closely at our overall internal control program, with specific focus on credit cards.

The Under Secretary of Defense (Comptroller) and the Under Secretary Of Defense (Acquisition, Technology and Logistics) issued a joint memorandum on March 12, 2002,

directing all DoD components to ensure compliance with published purchase card internal controls.

On Monday, the Secretary asked Dr. Zakheim to investigate credit card abuse in the Department. That afternoon, Dr. Zakheim met with the Department's senior leaders to address recent allegations of credit card misuse.

A working group is currently conducting a comprehensive review of the policies, procedures, and legislation governing the use of the card. The working group will recommend revised policies and procedures, and if necessary, propose legislative changes to end the abuses.

We are also aggressively pursuing all available administrative and criminal remedies for credit card fraud. We are working with the Department's Inspector General and the Service Audit Agencies to improve program policies and procedures, enhance management oversight, and verify that Component corrective actions actually have been implemented.

TRANSFORMING OUR WORKFORCE

Lastly, successful transformation of the Department's finances requires one additional ingredient: a highly motivated and professional financial workforce. Secretary Rumsfeld has spoken repeatedly of the need to improve the professional qualifications and skills of the Department's workforce.

We formed a financial management human capital workgroup to create a detailed plan to bolster the talent and experience of our financial workforce. The workgroup is developing incentives that encourage personnel to attain recognized professional credentials, such as Certified Public Accountant. The Defense Finance and Accounting Service and Defense Contract Audit Agency, the Department's two major financial agencies, are both members of the workgroup. This is the first time that these two agencies have worked together in this kind of

endeavor. We are integrating the proposals developed by this group into our overall transformation initiative. The workgroup will be reporting its recommendations and findings by April 2002.

CLOSING

In conclusion, I want to reiterate that Secretary Rumsfeld and his senior leadership are determined to transform financial management within the Department of Defense. We are using transformation techniques that are novel to the Department. We have set an aggressive schedule and are resolved to meet it.

I would like to thank this committee for its interest in our modernization program. As with any major undertaking in the Department, we will need continued support from the Congress--to include approval of our Fiscal Year 2003 budget request for Financial Management Modernization.

We will also continue our strong partnership with the General Accounting Office, the Office of Management and Budget, and the Department's Inspector General. Together, we can create the world-class financial management infrastructure that will be needed to revitalize and transform America's defense posture.

Thank you, Mr. Chairman

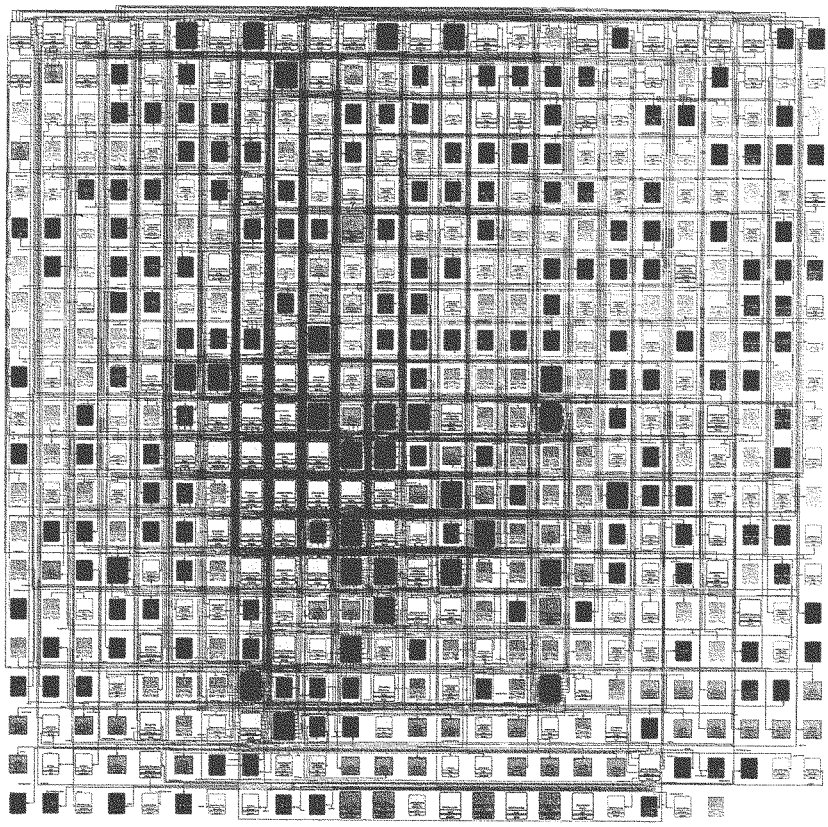
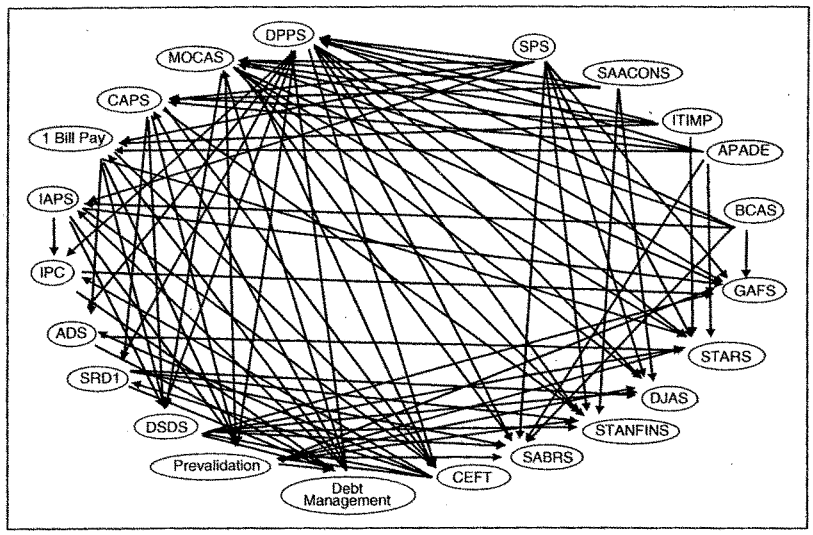


Figure 4: DOD's Current Systems Environment for the Contract and Vendor Payment Process



Source: DOD.

Transactions must be recorded using a complex line of accounting that accumulates appropriation, budget, and management information that varies by military service and fund type. An error in any one character in such a line of code can delay payment processing or affect the reliability of data used to support management and budget decisions.

Further, through the Year 2000 experience, DOD has learned that its goal of systems improvement initiatives should be improving end-to-end business processes. Lessons learned from the Year 2000 effort also stressed the importance of strong leadership from top leaders in making any goal—such as financial management and systems improvements—an entitywide priority. DOD's

Mr. HORN. Well, that's a good report, and we're glad to hear about what is happening. I look forward to the conclusions and summaries of the task forces that cut across the services, because if we don't do it down there it will never get done at the top, and it should be standard at the top. I think you are there to do it and we will work with you.

Now, Mr. Bloom and Mr. Ritchie, I assume are here for questions, or do they have something?

Mr. BLOOM. Yes, for questions.

Mr. HORN. OK. So our last presenter is Robert J. Lieberman, Deputy Inspector General, Department of Defense.

STATEMENT OF ROBERT J. LIEBERMAN, DEPUTY INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. LIEBERMAN. Thank you, Mr. Chairman.

My written statement addresses the results of our audits of the Department of Defense year-end financial statements for fiscal year 2001. It also summarizes the most significant of our many audit reports on financial management issues over the past year. Two of those reports, in March 2001, and January 2002, discuss the crucial efforts to modernize the vast array of information systems that generate financial data and to achieve compliance with new accounting standards. For several years we have reported and testified that these system development and modernization projects are high-risk because of historically fragmented management and the poor DOD track record for information technology system acquisition and control.

Since 1999, we have been advocating the application of the successful Year 2000 conversion management techniques to the task of revamping these systems. We've also stressed that the primary focus needs to be on generating useful financial information, not just clean audit opinions.

I am pleased to report today that the Department's new approach is very much along the lines that we have been suggesting. Therefore, we are very supportive of this effort, beginning with the major and difficult initiative to develop a comprehensive financial system architecture.

I would be remiss, though, not to warn that there are undeniable risks. Specifically, development of the architecture could take longer than anticipated, the end product might leave numerous issues that are hard to resolve, the cost to implement the architecture might be prohibitively expensive, or the DOD might lack the discipline over time to make system program managers conform to the architecture.

Nevertheless, the Department has taken a major step forward by accepting the premise that the financial management improvement effort needs to be treated as a program in its own right, with all the management controls that a very large Government program should have. Those include a master plan, well-defined management accountability, full visibility in the budget, regular performance reporting, and robust audit coverage. We believe that the DOD is making a good faith effort to create a strong management structure for this effort.

We look forward to assisting with timely and useful audit advice, just as we did during the Year 2000 conversion.

Likewise, we welcome the emphasis in the President's management initiatives on controlling erroneous payments. As the Department of Defense pursues the goal of greatly improved financial reporting, we must also keep focused on the need for better controls in many facets of its day-to-day finance operations and closely related purchasing activities such as the use of Government credit cards.

As mentioned in my written statements, there have been 382 audits of the purchase card program and 31 audits of the travel card program. More reports on them, as well as the aviation card program, are in the pipeline. In fact, we plan to issue a major IG report with numerous recommendations for improvement to the purchase card program later this month.

Moreover, numerous criminal investigations involving credit card misuse are in progress, as well as proactive investigative research efforts intended to identify abuses of credit card privileges. The Defense Criminal Investigative Service, which is part of the Office of the Inspector General, currently has 17 open cases involving misuse of Government credit cards. Cooperation from senior DOD managers on this subject has been exemplary, and we welcome the latest initiatives.

Everyone agrees that much more need to be done to improve local level management controls. I will close by noting that, despite unacceptably weak controls at some DOD activities, particularly in the Navy, it is wrong to assume that there is little peril for individuals who abuse their Government credit card privileges. Recent criminal convictions illustrate that abusers of Government credit cards actually take considerable risk. To underscore that point, my written statement includes a list of examples of recently closed cases on felony frauds involving the misuse of DOD credit cards.

Again, thank you for soliciting our views in this matter. That concludes my summary.

[The prepared statement of Mr. Lieberman follows:]

HOLD FOR RELEASE
EXPECTED 1:00 P.M.
MARCH 20, 2002

STATEMENT

OF

ROBERT J. LIEBERMAN

DEPUTY INSPECTOR GENERAL

DEPARTMENT OF DEFENSE

TO THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL MANAGEMENT AND INTERGOVERNMENTAL RELATIONS

HOUSE GOVERNMENT REFORM COMMITTEE

ON

DEFENSE FINANCIAL MANAGEMENT

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to provide the views of the Office of the Inspector General, Department of Defense, on financial management, which surely ranks as one of the Department's most difficult management improvement challenges. I would like to begin with a brief recounting of recent audit results.

Opinions on Financial Statements for FY 2001

In terms of audit opinions on the reliability of DoD year-end financial statements, I am unable to report progress for the DoD-wide or major component funds. As in previous years, we issued an unqualified (clean) opinion for the Military Retirement Fund's statements. Disclaimers of opinion were necessary for all other major funds, however, because of serious deficiencies in the reporting systems and other internal control problems. A few DoD organizations, whose funds are not large enough to require separate reporting to OMB, have made progress, but the impact is primarily symbolic.

Measuring progress toward compliance with the Chief Financial Officers Act and related statutes has been extremely difficult, because the Government has lacked any metrics except audit opinions on year-end financial statements. I am greatly encouraged by the widespread support expressed for our concept of applying Year 2000 conversion-type metrics to the financial system improvement projects. As soon as the ongoing effort to develop a comprehensive systems architecture has laid the groundwork, we can begin assessing the progress of each system development or modification effort that is needed to achieve compliance with the new Federal Accounting Standards.

Other Recent Audit Results

Although the annual audit opinions may continue to attract more attention than most individual audit reports, the DoD progress in addressing the specific findings and recommendations in those reports will be a critical factor in how much financial management improvement actually occurs.

Now to bring the most important of these financial management audit findings to your attention. Their variety illustrates the breadth of the DoD financial management challenge.

-- We reported in March 2001 that the DoD Financial Management Improvement Plan, submitted to Congress in January 2001, was incomplete and did not ensure that the Department would correct financial system deficiencies and attain an integrated financial management system structure. In addition, the Plan erroneously indicated that 12 critical systems were compliant with Federal Financial Management Improvement Act requirements. The Plan was little more than a compilation of unvalidated inputs from various organizations. Its $3.7 billion cost estimate for systems replacement or improvement was clearly understated and unreliable. (Report D-2001-085)

-- We reported in May 2001 that the Defense Finance and Accounting Service needed to be more efficient and aggressive in collecting debt from large contractors. We identified 148 cases worth $12.6 million where action was needed. The List of Contractors Indebted to the United States, which is a tool used by disbursing officers to offset contractor debts, included numerous invalid debts and other erroneous data that reduced its usefulness. (Report D-2001-114)

-- In June 2001, we reported that DoD had successfully adapted a commercial automated payment system for DoD freight payment purposes. This enabled the Department to move away from untimely, paper-based, poorly controlled and labor intensive processes for 1.25 million payments per year. However, additional measures were warranted to take full advantage of the system's capabilities and achieve optimum streamlining without undue risk. (Report D-2001-148)

-- In August 2001, we reported that the DoD had failed to develop a standardized cost accounting system for managing the life cycle costs of weapon systems. DoD reports that various acquisition reform goals had been met by establishing such a system were wrong. (Report D-2001-164)

-- The DoD agreed with Congress in August 1998 to implement a new policy to decrease the risk of progress payments being charged to the wrong accounts. We reported in September 2001 that implementation had

been poorly managed and the new policy was ineffectual. (Report D-2001-188)

-- We reported in November 2001 that DoD financial management systems were not integrated and could not share data without expensive and inefficient crosswalks. Nevertheless, the Department had been moving ahead with the Defense Finance and Accounting Service Corporate Database and other projects with insufficient assurance that a truly integrated set of systems would result. (Report D-2002-014)

-- The DoD plans to transition from the existing contractor payment system, the archaic Mechanization of Contract Administration Services (MOCAS) system, to the new Defense Procurement Payment System by FY 2003. To ensure a smooth transition, it is important to close as many contracts that have been completed, but not closed out, as possible. In December 2001, we reported that DoD had a six year backlog of contract closure actions and needed to accelerate the process. In addition, there were weaknesses in the closure process itself, insufficient resources earmarked for the task and untimely contractor input. Cumulatively, these problems increased the risk to an orderly transition. (Report D-2002-027)

-- From FY 1996 through FY 2001, 382 General Accounting Office and DoD audit reports addressed a wide range of management control issues in the DoD Purchase Card Program. The Army and Air Force had particularly thorough internal audit coverage. Those audit results were summarized in a December 2001 Inspector General, DoD, report. Auditors documented numerous instances of misuse of the cards, lack of oversight and accountability, splitting purchases to avoid oversight, failure to segregate duties and inadequate training. (Report D-2002-029)

-- In January 2002, we reported that most DoD components initially had done little to implement the DoD Financial and Feeder Systems Compliance Process, which had been inaugurated in January 2001 to apply the proven management techniques of the Year 2000 conversion program to financial systems improvement. Progress in mapping the flow of financial data and compiling an inventory of systems had been disappointingly slow, despite the fact that such research was supposed to have been done earlier for a variety of reasons, including identification of security vulnerabilities, contingency planning, and systems architecture development. However, DoD management initiatives during FY 2001 and the guidance provided by

the National Defense Authorization Act for FY 2002 had established the groundwork for a more successful effort. (Report D-2002-044)

-- In March 2002, we reported that the two versions of the Computerized Accounts Payable System, used for Army and Defense agency payments, lacked effective controls to detect and correct improperly supported or erroneous payments to contractors. (Report D-2002-056)

-- Earlier this week, we issued a summary report on 31 DoD internal audit reports on the DoD Travel Card Program. A wide range of problems, similar to those in the DoD Purchase Card Program, were identified. The report recounts the actions taken by the Under Secretary of Defense (Acquisition, Technology and Logistics) and the Under Secretary of Defense (Comptroller) between June 2001 and March 2002 to strengthen both the Travel Card and Purchase Card Programs. (Report D-2002-065)

The full text of our reports is available on-line at www.dodig.osd.mil.

Responding to Congressional Direction

Section 1008 of the National Defense Authorization Act for FY 2002 directs the Inspector General, DoD, to perform only the minimum audit procedures required by auditing standards for year-end financial statements that management acknowledges to be unreliable. The Act also directs us to redirect any audit resources freed up by that limitation to more useful audits, especially in the financial systems improvement area.

We strongly agree with the rationale behind Section 1008. Due to overall resource constraints, it would be impossible to provide audit support in the crucial systems improvement area if we were forced to expend resources on labor intensive efforts to audit the convoluted workarounds and poorly documented transactions that currently characterize most major DoD financial statements. We have long advocated focusing primary attention on the system problems that are at the core of the DoD financial reporting problems. By rejecting the notion that financial statements compiled by special efforts, which bypass or override official accounting systems, are worth their high cost or constitute progress, Section 1008 has reintroduced an appropriate sense of proportion.

DoD Financial Management Initiatives

The initiatives announced by DoD over the past year appear to be highly compatible with the course mandated by Section 1008. In reports and testimony over the past several years, including my testimony to you last May 8, we had expressed concerns that the cost of the Chief Financial Officers Act compliance effort was unknown, performance measures were lacking, there was no sense of consistently strong central leadership and there was no assurance that managers would get more useful financial information, even if year-end financial statements eventually received favorable audit opinions. The Department is being responsive to those concerns.

We believe that the effort to establish a comprehensive financial system architecture is a necessary and long overdue step. There are undeniable risks--development of the architecture could take much longer than anticipated, the end product might leave numerous unresolved issues, the cost to implement the architecture might be prohibitively expensive or the DoD might lack the discipline to make system program managers conform to the architecture. Nevertheless, the Department has taken a major step forward by accepting the premise that the financial management improvement effort needs to be treated as a program, with all of the management controls that a very large program should have. Those include a master plan, well defined management accountability, full visibility in the budget, regular performance reporting and robust audit coverage. We believe that the DoD is making a good faith effort to create a strong management structure for the systems improvement effort. We look forward to assisting with timely and useful audit advice, just as we did during the Year 2000 conversion.

Likewise, we welcome the emphasis in the President's Management Initiatives on controlling erroneous payments. The DoD has worked hard to improve the efficiency of its disbursement operations; however, this is another area where the inadequacy of current systems is the core problem. As the Department pursues the goal of greatly improved financial reporting, it must also keep focused on the need for better controls in many facets of its day-to-day finance operations and closely related purchasing activities, such as the use of government credit cards.

During your recent hearings on abuses of DoD credit cards, you have expressed appropriate concern about the continued risk of fraud and abuse in that area. I would like to close my statement by assuring you that the DoD audit and investigative communities are heavily engaged in helping the Department to reduce its vulnerability to credit card misuse. In addition to the previously mentioned summary reports on over 400 audits, we recently completed another major audit on the Purchase Card Program. We plan to issue a report by March 31. There will be additional audit reports issued later this year. Moreover, several criminal investigations involving credit card misuse are in progress, as well as proactive investigative research efforts intended to identify abuses of credit card privileges. Cooperation from DoD managers has been exemplary, although everyone agrees that much more needs to be done to improve local level management controls. Several recent criminal convictions illustrate that abusers of Government credit cards take considerable risk. I have attached to this statement a list of examples of recently closed Defense Criminal Investigative Service cases on frauds involving the misuse of DoD credit cards.

Again, thank you for soliciting our views on these matters.

Attachment

Examples of Defense Criminal Investigative Service Cases on Credit Card Fraud

- David M. White pled guilty to placing fraudulent charges against 13 Government credit cards. He was sentenced in U.S. District Court, Panama City, Florida, to 18 months incarceration, $262,840 in restitution and other fees and 36 months supervised release.

- John L. Henson, Jr., pled guilty to using a Government credit card to buy a television for personal use. He was terminated from DoD employment and sentenced in Federal Court in the Eastern District of Texas to a $3,000 fine and $1,400 restitution.

- Lionel G. Green pled guilty to a one count criminal information charging him with theft using a Government credit card. He was sentenced in U.S. District Court, Eastern District of Virginia, to 4 months imprisonment, 4 months home detention, 3 years probation and $61,465 in restitution and other fees.

- Jerome D. Phillips pled guilty to conspiracy in a fraudulent scheme involving the misuse of a purchase card while assigned to the Joint Staff Supply Service. He was sentenced in U.S. District Court, Eastern District of Virginia, to serve a jail term of 12 months and one day, 24 months probation, and restitution and other fees of $120,100.

- Johnny L. Bailey, formerly assigned to the Joint Staff Supply Service, pled guilty to conspiracy to defraud the Government using his official purchase card. He was sentenced in U.S. District Court, Eastern District of Virginia, to 2 years probation, restitution and other fees of $70,100 and 6 months of electronic monitoring.

- Tyrone X. Celey, Sr., pled guilty to bribing Joint Staff Supply Service employees to make credit card purchases from his office supplies company. He was sentenced in U.S. District Court, Eastern District of Virginia, to 27 months of incarceration, 36 months of supervised release, and $400,200 in restitution and other fees.

- Former Master Sergeant Bobby Gilchrist, also a figure in the Joint Staff Supply Service case, pled guilty to one count of money laundering, bribery and conspiracy. He conspired with contractors to defraud the DoD by accepting cash payments for making both otherwise legitimate and bogus purchases from them, using his and other employees' credit cards. He was sentenced in U.S. District Court, Eastern District of Virginia, to 41 months in prison, 3 years of supervised release, and $400,300 in restitution and other fees.

- Carla F. Armstrong pled guilty to six counts of theft and other charges related to misuse of her Government credit card. She was sentenced in Federal Court, Southern District of Indiana, to 3 years of supervised probation, including 4 months of home confinement, and $10,945 in restitution and other fees.

- Tommie Ray Briley pled guilty to stealing Government property by using his official credit card to buy hardware items and selling them to a second party for cash. He was sentenced in U.S. District Court, Eastern District of Texas, to 3 years probation and $26,378 in restitution and other fees.

- Quintin A. Swann pled guilty to charges related to fraudulent use of his Government credit card while employed in the Office of the Assistant Secretary of the Army (Financial Management and Comptroller). He was sentenced in U.S. District Court, Eastern District of Virginia, to 14 months imprisonment, 3 years of supervised release and $90,200 in restitution and other fees.

- Susan E. Johnson and James E. Johnson, Navy employees, pled guilty to charges related to the purchase of a motorcycle and other items for their own use, misusing a Government credit card to do so. Susan E. Johnson was sentenced in U.S. District Court, Eastern District of Virginia, to 5 years probation and fines totalling $1,025. James E. Johnson was sentenced to 6 months home confinement, 3 years probation and $13,279 in restitution.

Press releases on indictments, convictions, sentences and civil settlements stemming from Defense Criminal Investigative Service cases are available at www.dodig.osd.mil. Many of these cases are joint efforts with other Federal and DoD law enforcement agencies, as explained in the individual press releases, when applicable.

Mr. HORN. Well, thank you very much. I appreciate the one-pager of examples of Defense Criminal Investigative Service cases on credit card fraud. How many of those had some sort of sanction? Were any of them let off by either the U.S. Attorney or the particular judge, or what?

Mr. LIEBERMAN. On that particular list, every single example is a conviction and a sentence. Some of the sentences are not particularly heavy, but that is the way the criminal justice system works, and, of course, the Department of Defense has nothing to say about the sentencing.

Mr. HORN. I see some of the others actually had imprisonment.

Mr. LIEBERMAN. Yes, sir.

Mr. HORN. Yes.

Mr. LIEBERMAN. And for white collar offenses like that, in all these cases first-time white collar offenders, some of those are considered heavy sentences in those parts of the country.

Mr. HORN. I now yield to the ranking member, Ms. Schakowsky, for her statement.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. Here we go again, and I'm glad that we are. We are here today because once again the Department of Defense has failed to produce a set of books that could be audited. Unfortunately, this isn't news. It actually should be news. I wish there were more attention to this fact. Even though the Defense Department is responsible for half the total discretionary spending of the Federal Government, over $300 billion, they don't have enough respect for the American public to keep a clean set of books.

This is Enron accounting ten times worse. I find this particularly disturbing because the men and women who put their lives on the line for this country are not the ones responsible for these failures. It's the military bureaucrats at the Pentagon and around the country who keep the books.

If they're failing the American public in this way, I wonder in what other ways they are failing those men and women who are putting their lives on the line.

In 1995, the GAO put the Defense Department financial management on the high-risk list. One of the issues raised then by the GAO was the failure of the Department to protect its assets from fraud, waste, and abuse. Last week, we saw just how vulnerable the Department is to fraud in the area of purchase cards, which has been discussed already. Millions of dollars in personal items, trips, and even plastic surgery were charged to Government-issued credit cards. The financial mismanagement continues at the Pentagon.

Seven years ago the GAO reported that the Defense Department was unable to reliably report on the cost of its operations—7 years ago. Today that remains a problem. Seven years ago the GAO reported that the Defense Department was not properly reporting billions of dollars of future liabilities associated with environmental liabilities. Today, that remains a problem. Seven years ago the GAO reported the Defense Department was unable to protect its assets from fraud, waste, and abuse, and today that remains a problem.

Twelve years ago the GAO reported that the Defense Department's inventory management was a high-risk for failure, and today that remains a problem. Twelve years ago the GAO reported that the weapons system acquisition was a high-risk for failure. Today that remains a problem.

The list goes on and on, and we've heard lots of talk and we have not seen any progress.

As I pointed out last week, the problems, in my view, is not systems or training or organization, and Mr. Kutz mentioned that today. The word I am looking for is the culture at the Department of Defense.

The mission of the Department is critical to our safety and welfare; unfortunately, the bureaucracy has taken the importance of that mission and turned it into impudence.

These failures to account for the cost of programs to properly identify environmental costs, protect against fraud, are not just the dry, arcane stuff of accounting, these are examples of how the Department abuses the public trust, wastes billions of dollars, and in the process asks for more.

Today we will hear again—we are hearing again how the Department is going to correct these problems, and I have to say that, frankly, I see no reason to believe those responses at this moment. Last July we were told that the credit card issue would be addressed; instead, it was business as usual, fraud, waste, and abuse. And why should we not expect the same today? That's really the nature of the questions that I want to be asking. Why should we have any confidence in this?

I think that these questions ought to be the central part of the debate when we look at the $48 billion increase, the $400 billion Defense budget that is being asked for. Why should we expect that these problems won't be there next year and next year and next year?

Thank you, Mr. Chairman.

[The prepared statement of Hon. Janice D. Schakowsky follows:]

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STATEMENT OF THE HONORABLE JAN SCHAKOWSKY
AT THE HEARING ON
DOD FINANCIAL MANAGEMENT

MARCH 20, 2000

Thank you Mr. Chairman for holding this hearing. We are here today because once again, the Department of Defense has failed to produce a set of books that could be audited. Unfortunately, this isn't news. Even though the Defense Department is responsible for half of the total discretionary spending of the federal government, over $300 billion, they don't have enough respect for the American public to keep a clean set of books. This is Enron accounting, ten times worse.

I find this particularly disturbing because the men and women who put their lives on the line for this country are not the ones responsible for these failures. It is the military bureaucrats at the Pentagon and around the country who keep the books. If they are failing the American public in this way, I wonder in what other ways they are failing those men and women who are putting their lives on the line.

In 1995, the GAO put the Defense Department financial management on the high risk list. One of the issues raised then by the GAO was the failure of the department to protect its assets from fraud, waste, and abuse. Last week we saw just how vulnerable the Department is to fraud in the area of purchase cards. Millions of dollars in personal items, trips, and even plastic surgery were charged to government issued credit cards.

The financial mismanagement continues at the Pentagon. Seven years ago the GAO reported that the Defense Department was unable to reliably report on the costs of its operations. Today that remains a problem.

Seven years ago, the GAO reported that the Defense Department was not properly reporting billions of dollars of future liabilities associated with environmental liabilities. Today that remains a problem.

Seven years ago, the GAO reported that the Defense Department was unable to protect its assets from fraud, waste, and abuse. Today that remains a problem.

Twelve years ago, the GAO reported that the Defense Department's inventory management was a high risk for failure. Today that remains a problem.

Twelve yeas ago, the GAO reported that the weapon system acquisition was a high risk for failure. Today that remains a problem. Unfortunately, the list goes on and on.

We have heard lots of talk, but we have not seen any progress.

As I pointed out last week, the problem is not systems or training or organization. It is the culture at the Department of Defense. The mission of the department is critical to our safety and welfare. Unfortunately, the bureaucracy has taken the importance of that mission and turned it into impudence. These failures to account for the cost of programs; to properly identify environmental costs; to protect against fraud are not just the dry arcane stuff of accounting. These are examples of how the Department abuses the public trust, wastes billions of dollars, and in the process ask for more.

Today we will hear again how the Department is going to correct these problems. Frankly, I see no reason to believe those responses. Last July we were told that the credit card issue would be addressed. Instead, we got business as usual – fraud, waste and abuse. Why should we not expect the same today?

$400 billion Defense Budget
$48 billion increase

Mr. HORN. If you'd like to use the 10-minutes now for questions, I'll yield 10 minutes to you.

Ms. SCHAKOWSKY. Thank you.

Mr. Lieberman, in a recent report your office criticized the Department. I can't get past this number—$1.2 trillion in Department-level accounting entries which were unsupported because of documentation problems or improper because the entries were illogical or did not follow generally accepted accounting principles.

How can this happen?

Mr. LIEBERMAN. The number you're referring to was in our report last year on year-end financial statements for fiscal year 2000. The direct answer to your question is that, because those systems outlined on those two different charts they are incapable of generating accurate reports, the Department has to go through a convoluted series of procedures, work-arounds that are both inefficient and just simply don't work in terms of leaving an inadequate audit trail.

Ms. SCHAKOWSKY. This is so obvious, though.

Mr. LIEBERMAN. Yes.

Ms. SCHAKOWSKY. It is so obvious to everyone. Were you waiting for this subcommittee to act or to raise questions? I mean, anybody could look at that and say that. So why wasn't something done earlier, and why has it still not happened, even when repeatedly that has been pointed out by you and others?

Mr. LIEBERMAN. Yes, ma'am. That was pointed out when the Chief Financial Officers Act was passed. I remember hearings with this committee when it was called "Government Operations," and we were saying back then the Department will have to completely revamp its information systems in order to do this, and that is a monumental effort, requiring a lot of intensive management attention, which, frankly, I don't think the problem got throughout the decade of the 1990's.

Ms. SCHAKOWSKY. And why is that?

Mr. LIEBERMAN. A combination of the Department having other priorities and the Congress having very on-again/off-again interest from year to year on how much progress was being made.

Ms. SCHAKOWSKY. Accumulating over time to $1.2 trillion in such transactions that we just can't adequately account for or sensibly, logically account for.

Mr. LIEBERMAN. When we first started doing these year-end financial statement audits, we did not try to quantify the value of the unsupported transactions. We only actually tried to do that starting 2 or 3 years ago. So I don't know what the number was when DOD first started, but it would have been astronomical, because what that number tells you is the systems are incapable of doing the kind of job that a corporation's systems can do when they put together an auditable financial statement.

Ms. SCHAKOWSKY. But it is not as if these systems and processes are beyond our grasp. It is not that we didn't know there was a problem. It is not that we didn't know that the problem was of astronomical proportion. It's just there was no will to do that.

Mr. LIEBERMAN. I won't argue with your statement, ma'am, because I have said many of the same things.

Ms. SCHAKOWSKY. Yes.

Mr. LIEBERMAN. I think, in addition to a lack of will, it has been a matter of organization. The way the Department is organized, all those different systems belong to many different organizations within the Department. There is nobody at the Assistant Secretary level who owns all of them. And getting the different parties involved to focus on the particular challenge of improving financial management reporting has proven to be very, very difficult because those other managers had their own priorities and there wasn't strong enough central leadership.

The problem here is no tougher than the Year 2000 problem that I alluded to earlier. I know Chairman Horn probably remembers well that he had hearings when we all sat here and said, "Gee, the Department just discovered another few hundred systems." We were still doing that well into the fall of 1999. But there was very strong and sustained central management interest, and everybody in the Department ended up marching in the same direction. It took 2 years of many a critical audit report and many a nasty meeting, but then Deputy Secretary Hamry kept pounding on people to get over the finish line and they did, and it was a successful conclusion to an enormous management challenge.

This one hasn't had quite the sex appeal that one did. What is going on and how much is being spent has always been somewhat of an unknown. There was never one place you could go to to say, "How much are we spending on this this year?" The numbers simply didn't exist, incredibly, when you think about it, because we're talking a multi-billion-dollar government program. But there was not a program structure with someone in charge, a clear roadmap, as Ms. Jonas is talking about. You've got to have a roadmap of where you want to go and then set milestones and expect people to report where they are against those milestones. Over the years we never had any of that. We always had just a vague notion that we were moving forward.

And a lot of money was spent during the 1990's. It's not that there hasn't been a lot of activity. Unfortunately, it has not been efficiently focused.

Ms. SCHAKOWSKY. I think there is actually a lot of—you put it "sex appeal" to this issue. If the American people really—if this message really got out, even just the credit card aspect, which I think is a small part of it, I think that there would be a lot of interest. People would be very upset if we were successful in really—I think the Department has been lucky, actually, that this is not widely known among the American people, who would feel very betrayed, I think, if that got out.

Let me ask you this. Our colleague, Representative Kucinich, has proposed the following language be added to our budget views: "Except for funds to be used directly for homeland security, the subcommittee opposes any increase in the Department of Defense budget unless the Department passes a test of an independent audit."

I'd like to get your reaction to this proposal, and overall why—and, Ms. Jonas, feel free to answer this—why we shouldn't take some sort of direct action instead of just these hopeful kind of hearings.

Ms. JONAS. Well, and I appreciate that because the spirit of the Congressman's legislation I personally would agree with. The problems I was describing earlier and the practicality—when I first got into this job, I asked some very fundamental questions. We have known that systems, in general, have been a problem, but it has never been clearly defined to the point where you could start to resolve the problem, so one of the basic questions I asked was: What's the extent of the problem? Nobody could tell me. I asked how much we were spending on these systems. Nobody could tell me.

So for several months we have had a good task force of people, which is now part of the structure of the Comptroller's Office, investigating, looking at this very carefully. This diagram is not just a posterboard. That represents a huge amount of data. It tells us every little linkage that we have, and we needed to have that in order to fix it.

We must get to a point where the systems will routinely provide the type of information that the Congress deserves. It absolutely deserves it. I think everybody at this table would agree with the sentiments expressed here, your sentiments that it is inexcusable. So we must get to that.

I think we have—I don't have it with me, but we do have our schedule and our program plan laid out. I'd like to submit that for the record, if that's all right, so that you can see what progress we expect to make and, you know, how we are measuring yourselves, if that's all right.

Mr. HORN. Without objection, that will be in the record.

[The information referred to follows:]

Milestone	Start	Finish
Award Contract		March 2002
Develop To Be Architecture	March 2002	March 2003
Validate To Be at Representative Business Areas	March 2003	November 2003
Acquire Software Solution(s)	November 2003	March 2004
Deploy Solution to Prototype Sites	March 2004	March 2005
Conduct Operational Tests & Evaluations	March 2005	June 2005
Perform Compliance Assessments	March 2005	June 2005
Deploy Defense Wide Solution	June 2005	Sept 2007

Mr. HORN. The clerk should get copies here.

Ms. SCHAKOWSKY. OK. The Secretary is adamant and we are very hopeful with his leadership we can get this raised to the level. I've known John Hamry for years, and John tried very mightily and did a great job on the 2002—the 2000 problem. We need that kind of sustained leadership. That is why we've set up an executive committee to deal with this and a steering group at my level to work through these issues. It is the only way to get the problem solved.

So we have got a lot of work to do. It is huge. But your basic question, we should be able to comply with that law and we intend to try to get there as soon as we possibly can.

Mr. HORN. Let me pursue some of these issues. When the National Security Act brought in not only the CIA but the National Security Council and certainly the Department of Defense under the Truman administration, implemented in part by the Eisenhower administration, and Secretary Forrestal as we all know, had difficulties, and he probably just didn't know what he was in for. He had been a very able Secretary of the Navy, but once you got into the complexity and the services are fighting with each other, and his successor, as I remember Louis Johnson, decided that, "Well, I'll just give them each one-third of the budget." That's what it was, and so it was submitted to Congress in that way.

Now, when we got into the systems bit, the computer systems versus the accounting system, obviously computers used for the accounting system, but the first Secretary should have said, "Folks, we're going to have one accounting system and we're going to have it for the services and we're going to have it for the overall Department of Defense." Nobody did that.

I'm curious, Mr. Lieberman—you could probably write a great memoir on this, and that is, when Mel Laird was Secretary of Defense and David Packard of Hewlitt Packard, he was a brilliant student at Stanford in the early 1930's, and he came back here and he was one tough hombre in terms of being Deputy Secretary. Now, he also wanted to turn that place around, and I'm just curious, were you there when he was there?

Mr. LIEBERMAN. Yes, I was. I was afraid for a minute you were going to ask me if I was there when Forrestal was there. I don't go back quite that far.

Mr. HORN. And I wasn't going to ask you about General Grant, either. [Laughter.]

General Grant was for a Department of Education. We've now got one. It took about a century, but things are going good.

So tell me about—did David Packard, who was an industrialist and knows what it is to have a very tough-minded central group and getting the things done, so I'd be curious what he did or didn't do.

Mr. LIEBERMAN. As I recall, his primary focus was on weapons system acquisition.

Mr. HORN. Yes.

Mr. LIEBERMAN. Trying to make sure that the different systems being bought by the different services didn't duplicate each other, and hammering out a lot of very difficult budget issues. In his day, the Defense Department budget was not growing and there was

great difficulty in modernizing the forces. So I don't remember him being an active player in financial management, frankly. The first time I remember a concerted effort to try to get a handle on this financial management system problem was really in the ill-fated corporate information management initiative, which was launched under Secretary Cheney's deputy, Don Atwood, and it just did not have the support within the Department at the time and sort of petered out by the mid 1990's.

Mr. HORN. Well, I got into the Y2K bit, and Mr. Hamre, as you suggest, really threw his heart into it and tried to get things done. And, as I remember, it started with 149 accounting systems, and when I said that, the next hearing a couple of hundred more, just as you found, were there, and they kept coming out. Nobody could ever get their handle on that. Of course, as Secretary Forrestal said, as I noted, they should have had one and his successor should have stuck with one unless there was something wrong with it and make sure that it is integrated and related with all the services.

So that's one of your problems that you face, Madam Secretary, and we've got to get the type of things that executives need before them if they are going to know what the options are.

What else is needed over there? Heaven knows we give them a lot of money.

Ms. JONAS. Well, I really think the sustained support of the Congress. We recognize, you know, this is a culture problem, and to the extent that we can have the support of the Congress—OMB has been very good. You know, they have a watchful eye over us, as does the GAO and the IG, but we need to demonstrate to the culture that this is unacceptable, and changing culture is a very difficult job. I mean, we cannot, you know—a system—this isn't all just a system issue. Systems are a really good part of that, but we also have to do—Tom Bloom has been here. He is changing his culture, DFAS, quite a bit, retraining people, making sure that people understand that certain mistakes are unacceptable. He did a great job on cleaning-up the canceled accounts issue. At one time there were 162 of those accounts that were illegal. He worked on that problem and has completely cleaned-it-up, and I'll let him give you the stats on it. But it is the sustained attention of management and letting the people know that it's not acceptable.

Mr. HORN. Mr. Bloom, want to comment on that?

Mr. BLOOM. It's clearly a cultural issue, as Ms. Jonas mentioned. It is also a human capital issue. We're working those issues hard. We need to get the right folks with the right training in the jobs as we're changing the culture, as well as getting a handle on the systems, and we need to take these issues as seriously as we have.

Ms. Jonas mentioned the canceled account issue that we talked about last July—which, by the way, was one of the worst days of my career to have to come up here and look you all in the face and say, "Look, we screwed up. We need to fix this." But we took that and we changed the systems. We got the training for the people. We've worked very hard on the culture.

I can't tell you that we'll never have another one. I'd like to think that we'll never have another one. But we have worked so hard to change the culture and the systems and the human capital. That's the kind of effort overall that needs to be done.

Mr. HORN. I'd be curious about the Office of Personnel Management and how helpful they are to a department, and what's the kind of flexibility that you have to get that capital, human capital? Are you able to do it within the Department of Defense, or do you have to beg at the OPM?

I was in the Eisenhower administration, and our person in administration who should have been working for the Department never worked for him. He simply said, "Gee, I've got to do something with the U.S. Civil Service Commission." That was just bunk, frankly, but they were so regulatory that they weren't—they didn't have any vision of human capital. And we puttered along with that until OPM was created, and I think the ballots are still out on OPM, and they ought to be where they can.

Looking at the various issues that you have faced and to get them down at your level as an agency and not an all-executive branch, then they ought to be letting everyone. I did that in a rather complicated system in California, and the personnel people just went after us. You couldn't believe it. And it's because they don't have a broad vision. But, by George, the trustees did. And it took me 5 years to do it, but the fact is we had a flexible scale so that we could get the people that we needed and we could go between 10,000 and 110,000 and have contracts every 6 months to see what are you going to accomplish.

Mr. KUTZ. Mr. Chairman, it's interesting right now. The environment we're in with human capital in the financial area is actually quite good. We've seen that, you know, with the dotcom bomb and the people that are available out there looking for a stable job, challenging work, the kind of work that we do at GAO, for example, is quite appealing to people. We've had pretty good success the last year in the financial management area. In the past it was very difficult to compete with the Pricewaterhouses and the other firms out there, but now even they don't look so attractive with what's happening with Arthur Andersen. So we've found that the environment right now is quite good, actually, to hire good financial management people from either the dotcom companies or right off of campuses, so this is a unique opportunity to fill the ranks with some good young people for succession planning and for, you know, places like GAO and DOD for the future leaders of the financial organizations.

Mr. HORN. I think when you're out in the States, and all 50 of them, that if you have a chance you ought to be talking to students that are in business school, public administration school, and undergrads as well as grad students and all that if we are going to recruit people, because it is a terrific opportunity.

Mr. BLOOM. Mr. Chairman, over this last year we've really seized on that opportunity with the economy, and every one of my executives now, as part of their performance plan, is to visit a college and university, get to know the professors, get to know the kids, get to know the graduate students and recruit. We look at this as a unique opportunity.

In the Department of Defense, particularly in financial management, we had a 10-year hiatus essentially on hiring. It is tough to find a 29-year-old in financial management in the Department of

Defense. We just hadn't been hiring them. And we have a unique opportunity now, and at DFAS we are really grasping.

Mr. HORN. Well, I'm delighted to hear that.

Mr. LIEBERMAN. Mr. Chairman, could I add something on that?

Mr. HORN. Yes. Let me just get one point here on this. With all that fine work, it might help if you sent Members of Congress that want to be on campuses, want to say good things about the Department of Defense, and so forth, I'd love to have a kit which I can have some decent figures and know what's happening now. The services have always been very good about educating their people, and master's and Ph.D's and all the rest of them.

Go ahead on that, Mr. Lieberman.

Mr. LIEBERMAN. I can't tell you how much we appreciate your interest in this question. The entire Civil Service faces a crisis right now because it is an aging work force. In the Office of the IG, we are in the process of hiring a lot of young people, and I'm pleased to be able to tell you we've had excellent luck over the last few years. I have some of our junior auditors sitting here in the back row——

Mr. HORN. They're smiling.

Mr. LIEBERMAN [continuing]. Thinking they were going to sit in the shadows.

Mr. HORN. They're smiling and saying, "We need a raise," right?

Mr. LIEBERMAN. They are smiling. And they're excellent, and we're very pleased that we've had good luck recruiting. Even though we are not competitive salary-wise head-up with private industry in a lot of cases, we can offer intrinsically interesting work and good working conditions, and I think anything that can be done to spread that word by public officials would really be for the best.

Mr. HORN. See, that's the kind of thing, when Members of Congress, Senate and House, have a weekly column in many places, and that's one way to get it out to all the little towns in America, as well as the big towns in America.

Well, let me pursue a few questions right now. Let me ask, Mr. Kutz, the Department of Defense received approximately $100 million in fiscal year 2002 and has requested $96 million for fiscal year 2003 to transform its financial management operations. Over the years, the Department has undertaken various efforts to streamline operations within the Department. The success rate, however, has been less than admirable.

In your opinion, what does the Department of Defense need to do to ensure that the current effort does not continue wasting significant resources on marginal improvements, at best? Have you separated out, as a critic, the degree to which certain things should be done and certain things are being done?

Mr. KUTZ. I guess I would go back to the several items that were mentioned earlier, the sustained leadership issue and the cultural transformations needed to get this done.

The systems that you see up there I think are a symptom of the lack of sustained leadership and of a culture that allows or encourages even everybody to kind of do their own thing, to build their own system, even if someone else has a system that could do the

same thing. That's how you get something like the computer chip and the spider chart over there as to developing systems.

So I really believe that the leadership and the culture—we laid out in our written statement the seven key elements to reform, but it seems to me that the culture is going to be the most difficult one for the leadership here to really address and to get people to change the way they're doing things.

I mean, if you look over time, people probably are hoping they can wait this group out and maybe this phase will pass and they can wait until the next group comes in, and that's the reality of what not only DOD faces but other agencies face that have difficulty having sustained leadership over time.

Mr. HORN. With Mr. Kutz, I'm going to have the ranking person here, Ms. Schakowsky, for 10 minutes on going through and seeing some of these things just like I have.

Ms. SCHAKOWSKY. Mr. Kutz, at every hearing we're told that the solutions to these problems lie, when they get solved, 5 to 10 years down the road, but as we've seen from the purchase card fiasco, what happens is the deck chairs get rearranged so fast that it is hard to hold anybody really accountable 6 months later, so I'm wondering how we address that, and if you believe, you really believe, that it is possible to solve these problems, and if you want to make any predictions about that, given the current promises, the current personnel, etc.

Mr. KUTZ. Right. I mean, we're not in a position to predict at this point. I think we would need to see several years of looking over the long-term, this being, if you did it the right way, a five, ten, possibly longer year type of solution until there are specific markers set out there that we can see being achieved year by year.

If you have another hearing next year and you see that they have met their goal of having the enterprise architecture done, developed, and in place and are moving on to step two, then I think you can start to say, "OK, we're seeing some progress here." But until you really see the long-term plan and have markers every year that they need to meet and they can come up and testify before this subcommittee and others saying either we did or didn't meet these markers, that's how you can start projecting.

If you get 2 to 3 years into a seven-to 10-year planning, you see that you are making progress, then you can start to have some confidence that maybe this is going to take 7 years.

Ms. SCHAKOWSKY. And what happens if the marker isn't met, you know, because that's what happens all the time.

Mr. KUTZ. Exactly. I mean, right now there are no consequences, necessarily, and that's why I think Secretary Rumsfeld has said that there are going to be personal consequences for people who are responsible, someone that you can point to and say, "You are the person who is actually responsible." I think Ms. Jonas will probably elaborate on that, but that is I think what is the new culture they're trying to establish there, that someone actually is held accountable if they don't meet that marker.

Ms. SCHAKOWSKY. And so that person gets fired and then there's a new person and then we have a hearing, and that person says, "Well, I just got here and I have all these new ideas and now here

is what we're going to do." That's what I'm talking about. We rearrange the deck chairs and we never get to the end of it.

Ms. Jonas, did you want to comment?

Ms. JONAS. I can really appreciate your comments, but I will tell you, from my own standpoint, Secretary Rumsfeld really is the kind of Secretary who drags people in and says, "What have you done for me lately? What has this system done for me lately? Have you met your markers?" That type of leadership, you know, is filtering down. It's gradual.

If he decided to leave tomorrow, would the culture continue? I don't know. But we need to continue to show that we are accountable, that we intend on meeting deadlines, even simple things like meeting deadlines from memos.

You know, the Department is used to just delaying everything because there is no cost in their mind to delaying everything. There's a huge cost to delaying things. You know, you said in your discussion during my testimony that 10 years have gone by, what's happened since the enactment of the law. Well, nobody sees that there is a problem that we've delayed.

Some of the systems there represented we discovered were costing us $3 to $4 billion. Nobody had made them visible. You know, there's so much that needs to be done to bring this into the light, let everybody see what is being spent, and make people accountable, meet deadlines, meet milestones.

One of the reasons we went with a program management technique, which is something that is used in the acquisition side of the house, is because there is routine and regular senior-level review at milestones. Those systems were never developed with the acquisition discipline in mind, so nobody has ever seen that they're being really developed. It is an undisciplined process.

Ms. SCHAKOWSKY. Yes, it is an undisciplined process, that's for sure, but it is not as if we didn't know, in many instances, that a billion here, a billion there was being—it was either unaccounted for or slipping through the cracks. So it's not just shedding light. A lot of light has been shed over the years.

Let me ask Mr. Lieberman a question. Maybe you've said this in other ways. If you agree with the Department's new financial management plans, and then if your office has been given appropriate responsibilities in these plans, and, if not, if you think that your office should have additional responsibilities.

Mr. LIEBERMAN. Yes, I do very much support the plan. We had been calling for the exact same things that are in the plan now for some time, and there had been movement in those directions, but nothing put into place as concrete as what is going on now, so we are very pleased with that.

Part of the scheme here, once the architecture is put together and systems managers know exactly what it is they're supposed to do, is that then we can begin auditing each one of these system development efforts to provide independent verification that they actually are making progress and doing what they are supposed to be doing, rather than going off on a tangent and creating kind of mushy result that has occurred in prior years.

So we expect that to be a heavy audit requirement for us. It is challenging in terms of resources and priorities because people

want us to do a lot of other things, too, but we're going to step up to that as best we can and put very high priority on it.

The Department also, I think, is very receptive to audit support in other areas like credit cards. We're going to be issuing a report next week on the purchase card program that has lots of recommendations for changes in procedures in the program, and I expect either total concurrence with that or something close to it.

Ms. SCHAKOWSKY. I wanted to ask you, I think there is another side to the whole purchase card issue than that has been suggested, and that is the whole issue of vendor fraud, where there is—anybody want to comment on that?

Mr. KUTZ. I certainly can. That is an issue that we see. If you have an environment—again, a weak control environment where people are not reviewing the monthly credit card bill, you are vulnerable to vendors peppering your account with inappropriate charges, and we have several investigations that we are going to followup on out in San Diego, based on the work we did for the hearing last week, that we're going to look into that issue. But yes, the Department is vulnerable to vendors hitting their accounts for inappropriate charges or work that wasn't done, and if nobody is looking at the bill the Government is going to pay the bill and not receive the services.

Ms. SCHAKOWSKY. I just can't emphasize enough how absolutely unacceptable this would be to ordinary Americans who—you know, Ms. Jonas, you talk about balancing a checkbook as if that would be such a fabulous achievement for the Department, which it would be, but families in this country do it every single month, and it is unthinkable that they would proceed year to year to year without doing that, and I think there is this basic assumption that we are doing that here.

So these really modest goals I think, common-sense goals that are regularly being violated is just—I'm speechless. Thank you.

Mr. HORN. I've never seen a Member of Congress speechless. [Laughter.]

But on a Wednesday afternoon—don't forget, we're not going to be around tomorrow.

Anyhow, let's get back a little bit to Secretary Jonas. Is there anything else you have to say to what Mr. Kutz has said in terms of getting a comprehensive, integrated strategy for reengineering all of the Department's business processes? What actions have you taken or do you plan to take to ensure a comprehensive, integrated approach to reform? And obviously that's part of the culture and the toughest job is the culture, and the only way you change that is you stay around there and you don't run down the halls and say, "How did I ever get into this? I'm going back to Congress."

If you're in there and they know you're in there for 5 years, it will change.

Ms. JONAS. I appreciate your comments, Mr. Chairman. I will tell you I have been working about 14-hour days at least 6 days a week on this job, so——

Mr. HORN. We're used to it up here.

Ms. JONAS [continuing]. I do wonder sometimes what did I get myself into.

Mr. HORN. We're used to it up here.

Ms. JONAS. Just one comment to the point on vendor issues. We are developing, as I mentioned in my testimony, and have available to us some very detailed performance metrics that we're using, and I alluded to the overpayments, which is a sore issue, and using DCAA and Defense Audit Agency and DFAS together, working very aggressively to look at some of these contracts to identify overpayments—in other words, what are we owed, and let's get it back, at a minimum, so that we're not asking Congress for additional appropriations if we don't need it. So let's get the money back from the contractors that is owed us. Let's be out there, be aggressive.

I will be showing the SEC, which is the Senior Executive Committee that the Secretary has, our metrics, so they'll see. Their sustained leadership there will help.

I agree with much of what has been said here. I agree, Ms. Schakowsky, with your statement it is incredible. What I have found out since I have been over there has been truly incredible. We just have to stick with it. It is a hard job. It's going to get harder. We just must stay with it so that we can demonstrate good stewardship.

The one good thing about working for Secretary Rumsfeld is we know that we have his support.

Mr. HORN. The Secretary of Defense has stated it will take 8 years or more to complete the planned financial management reform at the Department. Do you agree with that time table?

Ms. JONAS. It will take quite a while. What we do anticipate is by 2004 being able to prototype this system, and we would probably pick—I don't want to be too forward-leaning—when we finish our architecture, that will tell us very specifically what we should do and how we should proceed. As Greg alluded to, it is the equivalent of a blueprint for building a house. But I would say within various functional areas, perhaps healthcare—I mean, healthcare is costing us $20 billion in the Department. That is a key area. It is one that the Secretary is intensely interested in. We could get more efficient in that area. We may prototype the system in that area.

But we don't know for sure. It will take several years, however.

Mr. HORN. Yes, because otherwise it will be 2009 and none of you will be around. There will be a new administration, since there is a term limit for Presidents at 8 years. A lot of the bureaucrats say, "Well, this crowd will go, just like the last crowd," and so forth, so that's the cynical that you have to really cut right through to it.

In your testimony you stated the Department of Defense has created an enterprise architecture that is expected to be complete in March, 2003, and you're saying you'd like to at least get it at 2004. Anything else on that point?

Ms. JONAS. Just to clarify. The blueprint will be accomplished within a year. We would be prototyping in 2004, so that's a—there's a distinction there.

Mr. HORN. OK. What specifically controls does the Department have in place to eliminate overpayments to contractors? We passed a law on that, so what's happening?

Ms. JONAS. I think, as I alluded to, one of the things that Dr. Zakheim did—and, Tom, you may want to pipe in here—was to get the Defense Contract Audit Agency engaged in reviewing some of

these outstanding contracts and, you know, get aggressive on that matter, and DFAS is cooperating with them—Tom, you might want to address this—but really move out aggressively on these overpayments.

Some of our—you know, these systems are very difficult to reconcile. That causes problems in the contract process. Contractors are anxious to get paid. We don't want to pay interest. But at the same time we have to be just as aggressive in getting what is owed to us as they are about getting the money that is owed to them.

Mr. BLOOM. And there is work being done on the back end, as Ms. Jonas mentioned, but we are also doing a fair amount of work on the front end to make sure we don't make the screw-ups to begin with, and we've—I've got a cell of folks dedicated to this. They're actually out in California. They work with a system that we've developed called "Predator," where we can—before we make payments we take certain edit areas, certain edit functions, and we have been able to capture an awful lot of potential duplicate payments.

Most of the time we make a duplicate payment it is just because of a mistake. Either a contractor has billed us twice and we haven't caught that, or, you know, maybe we copied an invoice twice, and Predator has gone a long way. We still have a ways to go, but Predator has gone a long way to eliminate a lot of those duplicate payments.

Mr. HORN. Now, one of the places we used to have—and I haven't heard much about now—and I'd just be curious—Columbus, Ohio, the facility there. On the Y2K bit we found that $1 million went off to one, and he said, "Hey, I didn't have anything. Oh, well, must be right," so the person put it in the bank, lived off the interest, and then sent it back. So I don't think that's apocryphal. But what has happened in that place—and it is clear that they were using GS–1s, for heaven's sake, which I thought went out with the first World War, so they didn't have the people there that could make judgments. So what is happening?

Mr. BLOOM. Columbus actually has been a success story in the last year. We've changed leadership totally. I think you had the opportunity last July to meet JoAnn Boutelle, and JoAnn has done some great things there, along with three or four other new members of the team, and she has changed the attitude, she has changed the culture. She does not tolerate mistakes. She is hard but fair, and she is working on getting the people trained.

Again, I go back to the training. Ms. Boutelle is a big proponent of——

Mr. HORN. Spell it out for us so she gets due credit in this hearing.

Mr. BLOOM. I believe it is B-O-U-T-E-L-L-E. And that's JoAnn.

Mr. HORN. OK. Well, there ought to be awards for people like that.

Mr. BLOOM. We try to take as good care of her as we can, sir.

Mr. HORN. OK. So do we have another question or so on Mr. Lieberman, I think? Go ahead.

Ms. SCHAKOWSKY. Has anybody put a dollar figure to waste, fraud, and abuse? We talked about a billion on purchase cards. Has there ever been a total on that amount?

Mr. LIEBERMAN. No. Well, we can tell you things like how much money has been recovered from investigations, but if your question is how much waste, fraud, and abuse is going on, we don't know.

Ms. SCHAKOWSKY. Well, we estimated on the purchase cards in terms of—oh, I see what you're saying, because that is what has been discovered and recovered.

Mr. LIEBERMAN. Right. And even the excellent GAO work at those two Navy sites is fine in its own right, but there are many different parts of the Department, so it remains to be seen just how widespread the problem is.

Mr. KUTZ. Well, as Mr. Lieberman said, you can quantify what you know, but with fraud the issue is there's a lot of fraud that we don't know about. Again, it gets back to the control environment at DOD. The weaker the control environment, the more fraud that's likely taking place that nobody ever catches. A lot of the investigative cases that do get prosecuted, as Mr. Lieberman said, some are caught through the system and some are just caught because someone talks, but there are as many or more that never get caught, so fraud is always something that's very, very difficult to quantify.

Ms. SCHAKOWSKY. So in that context, though, then how does someone self-confidently propose a $48 billion increase in a budget where we know about billions of dollars of fraud that has occurred—fraud, waste, and abuse that has occurred? I just think the Department is on such weak footing to ask for such a large increase. How do you? What do you say? If the American people say, "Wait a minute. Look at all this. Look at this mess, this spider web." What's the answer to that? Anybody?

Ms. JONAS. I think one of the traditional means the Department has used to understand what its request should be—I'm a former budgeteer—has been what we spent in the prior years, and I know that doesn't tell you what things actually cost, it tells you what you've spent. And the difference between the systems that we're proposing to create that give true accountability, give cost accounting, give the Secretary an understanding how efficient we are, they don't exist. They're based on appropriations laws and appropriation accounting, which basically tells you by quarter how much you've obligated and——

Ms. SCHAKOWSKY. I understand that, but when we're asking for an increase that, in and of itself, is larger than the total defense budget of any other nation on the globe, then it seems to me that, given the context in which this money is used, that it's a pretty hard case to make, I think.

Mr. HORN. Any comments on that?

[No response.]

Mr. HORN. If not, this will be the last couple of questions, although I'd like each of you to tell us something that we were too dumb to ask you. We always give you an out.

In your testimony, Mr. Lieberman, you stated that the fiscal year 2002 National Defense Authorization Act directs the Inspector General to perform only the minimum audit procedures required by auditing standards for year-end financial statements that management acknowledges that they are unreliable. The act also directs

you to redirect resources freed up by that limitation to more useful audits.

So the question is: What changes have you made to redirect your audit resources from auditing statement balances to identifying needed improvements in the Department's systems and internal controls?

Mr. LIEBERMAN. We had already cut back a lot of our transaction testing on related year-end financial statements in anticipation of that legislation, so we're not talking about a massive shift in resources here.

In addition to that legislation, the Intelligence Committees gave us extra financial statement audit work to do vis-a-vis the Defense Intelligence Agencies, so some of those resources are going sideways into that area.

But what that legislation helps us avoid doing is wasting any audit resources telling everybody what they already know—that these statements are unauditable. The thinking was if management admits the statements are unauditable, there's no point in the auditors having to prove that's so. We thoroughly support that direction, which will help us focus our resources toward looking at how these systems are doing rather than just fooling around belaboring the obvious in terms of the problems with the existing statements.

Mr. HORN. You heard about the Secretary of Defense that certain things will take 8 or more years. Do you agree with that time table, and does that mean we should not expect to see an opinion on the Department's financial statements until 2009, although Secretary Jonas has said there's a performance point along the way?

Mr. LIEBERMAN. Well, that entirely depends on how sweeping a change the new architecture mandates, and then how much money the Department and the Congress are going to be willing to spend each year to implement that architecture. So I don't know whether we're talking about a plan that is going to end up being logically phased over 2 years, 5 years, 8 years. Any of those things are possible, depending on how many resources you throw at the problem.

All I can say is that history tells us that it's very dangerous to make an optimistic estimate on this, because systems development projects inevitably take quite a bit longer than anybody forecasts upfront.

Mr. HORN. Now, do any of you have anything else you'd like to get on the record?

Mr. KUTZ. Mr. Chairman, I would say one thing. In the past the Department had really focused its goals on getting a clean opinion on the financial statements, and they've really kind of gone away from that as the goal, because that's a misleading goal. I mean, you can get a clean opinion and not have good information to manage on a day-to-day basis. They are really—their goal is more now to have good financial management information to manage the organization.

As happens in the private sector, the goal is not a clean opinion. The goal is to have real-time data on a day-to-day basis to make decisions. That clean opinion falls out from that. It just happens. It isn't something that each year Johnson and Johnson and Exxon and Mobil are saying, "What kind of opinion are we going to get?"

It's, "We close the books in a day or two, we get the report to the shareholders, and we're done." So I think that they've focused more on the longer-term and actually real change rather than trying to take this mass computer chip and the spider chart and trying to gin-up financial statements from it.

DOD is so large that there is no way, I don't think, to go through the heroic measures that would be necessary and it would be a waste of taxpayer money to do so, so, I mean, I would give them credit that they have got their priorities straight and they've really scaled back on that and they're trying to make longer-term, lasting changes.

Mr. HORN. Any other points anybody wants to make?

Ms. JONAS. Just to quantify what Greg has said, Mr. Chairman, we spent—in 2001 the Department spent about $52 million to prepare and audit our financial statements, and, based on new legislation that we got from the Congress last year and pursuant to what Bob was talking about, this year we will be able to save $24 million because we don't have to go through the machinations. We really are interested in getting at the root cause of the problem and not trying to act as if we can come up with a clean audit that would be respectable. We really want to get at the problem, get the good, timely information to our decisionmakers so that they can become efficient and we can—as Greg said, you know, clean statements are just a product—an important product, but are not years worth of and millions of dollars worth of work.

Mr. HORN. Well, thank you. All of you have contributed quite a bit to our further understanding of what is the major Department within the executive branch.

I now want to thank those that prepared this hearing: J. Russell George, staff director and chief counsel; Bonnie Heald is deputy staff director; Rosa Harris to my left and your right is professional staff on detail from the General Accounting Office; Earl Pierce, professional staff; our faithful clerk, Justin Paulhamus; and the minority, Mr. Dave McMillen, professional staff; Jean Gosa, minority clerk; and the court reporter, Joan Trumps.

We now thank you all, and we have to go to vote.

[Whereupon, at 2:43 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

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