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FINANCIAL MANAGEMENT AT THE DEPARTMENT OF DEFENSE

HEARING

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

AUGUST 3, 2006

Available via http://www.access.gpo.gov/congress/senate

Printed for the use of the Committee on Homeland Security and Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE

29–762 PDF WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
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FINANCIAL MANAGEMENT AT THE DEPARTMENT OF DEFENSE

THURSDAY, AUGUST 3, 2006

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:30 p.m., in room SD–342, Dirksen Senate Office Building, Hon. Tom Coburn, Chairman of the Subcommittee, presiding.

Present: Senators Coburn and Carper.

OPENING STATEMENT OF CHAIRMAN COBURN

Chairman COBURN. Today's hearing of the Federal Financial Management, Government Information, and International Security Subcommittee of the Homeland Security and Governmental Affairs Committee will come to order.

I want to thank all our witnesses for being here, the work you have put into it plus the work that you are doing in every area, whether it is at DOD or IG or with General Walker and his staff and the wonderful work they do to help us get things realigned.

On September 10, 2001, the day before the terrorist attacks that shook our Nation, Secretary of Defense Donald Rumsfeld stated the following: "Financial management efforts at the Pentagon are not just about money or waste. In the end, it is really about a matter of life and death, ultimately, every American's life and death. Our job is defending America, and if we cannot change the way we do business, then we cannot do our job well and we must."

I don't think it could be said any better. The U.S. Department of Defense fiscal year 2006 budget was more than the combined defense spending of the rest of the world. We are currently debating the proposed $441.2 billion budget for DOD on the Senate floor right now, plus another $120 billion that will have come through supplementals and add-ons to total $513 billion in this next fiscal year. The baseline amount reflects a 7 percent increase over 2006, a 48 percent increase over 2001, without including war supplementals.

It is difficult for most of us to wrap our hands around a budget that big. Our budget for defense will be higher than at any time in our history in real dollars, even including World War II. We must secure America—that is not negotiable—whatever it costs. But do we really know what it costs? When we don't know how we

are spending that money and we don't know whether it is being managed well, we don't know what areas of the budget are really necessary for the Nation's defense and what areas aren't.

We had Secretary Rumsfeld this morning before the Armed Services Committee and he made a valid point, is the very things that the Defense Department wants to do, the Congress won't let them, and the very things they don't want to do in terms of earmarks, some $20 billion, the Congress is making them do.

There is quite a bit of evidence that the amounts that are lost to payment errors, waste, fraud, abuse, and duplication could be in excess of tens of billions of dollars each year. When you consider that seven of nine advanced weapon programs today are over budget and behind schedule, something is very wrong.

The most glaring problem has been the Department's inability to produce auditable financial statements. In other words, they can't undergo an audit, much less pass one. If DOD were a privately-owned company, it would have been bankrupt long ago. There is good movement, I am proud to say, within the DOD in trying to address that. In 2004, the Department set the goal of undergoing a full audit by the year 2007. Unfortunately, that deadline has not been met, and in fact, it has been moved fairly far out, to 2016. That is 10 years from today.

Americans are being asked to wait a full 10 years before their dollars are tracked well enough for the Department to hold an audit, and that seems to be the new objective of financial managers, is to get to a place where we can actually have an audit, and that is a laudable goal. Don't get me wrong. Undergoing an audit is real and measurable progress. The President inherited a Department in financial disarray and many hard-working folks have been making slow but steady progress on the goals of having audited financial statements.

I have had individual conversations with your Comptroller. I think the ideas and the plans and the institutional plans of change are ongoing. I am pleased that the Government Accountability Office (GAO) and Office of Management and Budget (OMB) believe that the goal is realistic and can be met. Just being able to get a financial audit of all the components of the Department will be a marked improvement over what we have today.

Over the past 5 years, GAO has made a series of recommendations to DOD, which they are in the process of implementing, and I want to recognize them and thank them for that process. They deserve to be commended for their work. The financial audit and improvement readiness plan to incrementally move the Department to an auditable state by 2015 and the standard financial information structure to categorize DOD financial information are two key elements driving this plan for financial management improvement. They are both promising steps. They will require, however, vigorous oversight to see that these plans are on track and receiving the attention necessary within DOD and that these efforts yield the results that we want them to.

This Subcommittee is going to be watching closely and asking for regular updates every 3 to 5 months. Quite frankly, 2016 is not good enough for the American taxpayer. When we call on the Defense Department to do things that we think are unimaginable and

they do it in terms of defending this country, they demonstrate the leadership qualities and characteristics that make them as good as they are. We need to apply those same characteristics, those same leadership traits, to getting the Department's financial management under control.

This drive to improve the financial management controls in DOD will not happen without sustained leadership—every day, every week, every month. It is essential to obtaining the outlined results, the benchmarks, and meeting the goals the Department has set.

GAO has recommended the position of a Chief Management Officer be established within the Department of Defense to keep the business transformation intact as a new administration is ushered in. I am interested to hear more about the role and function of such a position within DOD to see how this organizational change will help maintain continuity during times of administrative transition.

GAO has also been reporting to Congress that DOD is at the top of its high-risk list for years. Of the 26 high-risk areas, 14 are at DOD. While sustained leadership at the agency is critical to achieving success with financial management improvement, continued oversight by Congress is just as important.

And as the Secretary's quote reminds us, none of this is trivial and none of it is optional. The financial management of the world's largest and most competent military force affects not only the stewardship of taxpayer dollars, but the safety and well-being of the real men and women on the battlefield, the security of our civilian population at home and abroad, and indeed, the freedom and peace of the world. Beyond these life and death issues, there are fundamental issues of respect in how we treat our sons and daughters in harm's way every day.

During this time of war, GAO reported that our battle-wounded soldiers were hounded by debt collectors for debt they incurred on no fault of their own. In fact, GAO found as many as 73 percent of the reported debts were caused by overpayments of pay allowances, pay calculation errors, or erroneous leave payments.

Every dollar wasted or misspent is a dollar we won't spend preparing and equipping our warfighters. Recently, Lt. Gen. Steven Baum, the top National Guard General, said that two-thirds of the active Army brigades are not rated ready for war. Army officials, analysts, and some of my colleagues have complained that there just isn't enough money to complete the personnel training and equipment repairs and replacement that must be done when units return home after deploying to Iraq and Afghanistan. And we heard this morning that, in fact, part of the problem with that is underfunding from the 302(b), earmarks that take away, and not allowing the Defense Department to do the things that they think will create efficiencies and economy of scale.

If there is one agency in the government where corners can be cut, it is not the DOD, and we are not suggesting that with this hearing today. If there is one agency where we should ensure an abundance of resources, it is DOD. My colleagues know that, and perhaps that explains why so much money has rolled out the door to DOD with so little oversight. That same desire to give our armed forces whatever they need may be what has hampered us from following what we do give them.

It is not enough just to write blank checks to DOD without effective oversight, call ourselves patriots, and go home. It is a perverse world when we can roll out the types of appropriations, both through regular order and emergency war supplementals, and still hear complaints of equipment and training for warfighters that the Department can't afford. It is time for Congress to match the level of its abundant provision of resources of the American taxpayers' money with an intensity and frequency of financial oversight. The safety and protection of our country should be our top priority. I have a hard time, however, justifying continued multiple emergency war supplementals for the Department when we don't know exactly what that money is buying, and neither does the Department of Defense.

I would like to stress that this hearing is not a policy debate about whether or not U.S. troops should be present in Afghanistan or Iraq. We are there and we must win. We must be prepared to win the next time, as well, and the time after that. The Department of Defense has adopted a motto, and it is a good one. "Check it. What gets checked, gets done."

Senator Carper and I are committed to Congressional checking.

We thank each of our witnesses for appearing today before this Subcommittee.

[The prepared statement of Chairman Coburn follows:]

PREPARED STATEMENT OF SENATOR COBURN

On September 10, 2001—the day before the terrorist attacks that shook our Nation—Secretary of Defense Donald Rumsfeld stated that, ". . . financial management efforts at the Pentagon are not just about money or waste . . . in the end, it is really a matter of life and death—ultimately every American's . . ." Secretary Rumsfeld continued: "Our job is defending America, and if we cannot change the way we do business, then we cannot do our job well, and we must."

The U.S. Department of Defense fiscal year 2006 budget was more than the combined defense spending of the rest of the world. We are currently debating a proposed $441.2 billion dollar budget for DOD on the Senate floor right now. This, of course, does not include money the Department receives through supplemental appropriations to pay for the Iraq war. This amount reflects a 7 percent increase over 2006 and a 48 percent increase over 2001—again, and that doesn't even include war expenses.

It's difficult for most of us to wrap our heads around a budget that big. Let's put it in more tangible terms: U.S. defense spending will exceed $513 billion next year, the highest amount at any time since World War II. It also exceeds the rest of the world's military spending—combined.

We must secure America—that's not negotiable—whatever it costs. But do we really know what it costs? When we don't know how we're spending that money, and if it's being managed well, we have no idea what areas of the budget are really necessary for the Nation's defense and what areas aren't. And there's quite a bit of evidence that the amounts lost to payment errors, waste, fraud, and abuse each year could be in the tens of billions.

The most glaring problem has been the Department's inability to produce auditable financial statements—in other words, they can't undergo an audit, much less pass one. If DOD were a privately-owned company, it would have been bankrupt long ago. In 2004, the Department set the goal of undergoing a full audit by 2007. That deadline has not been met, and in fact, has been moved to the year 2016. That's 10 years from today. Americans are being asked to wait a full 10 years before their dollars are tracked well enough for the Department to fail an audit. And that seems to be the new objective of financial managers at DOD—to get to a place where DOD can actually fail an audit. Passing the audit is a pipedream for some future date beyond 2016.

Don't get me wrong. I understand that merely undergoing an audit is real and measurable progress. The President inherited a Department in financial disarray, and many hardworking folks have been making slow but steady progress. I am

pleased that the Government Accountability Office and the Office of Management and Budget believe that goal is realistic and can be met. Just being able to get a financial audit of all components of the Department will be a measurable improvement.

Over the past 5 years, GAO has made a series of recommendations to DOD, which they are in the process of implementing. They deserve to be commended for their work so far. The Financial Improvement and Audit Readiness (FIAR) Plan to incrementally move the Department to an auditable state by 2016 and the Standard Financial Information Structure (SFIS) to categorize DOD financial information are two key elements driving this plan for financial management improvement. These are both promising steps. We still need, however, rigorous oversight to see that these plans are on track and receiving the attention necessary within DOD, and that these efforts yield the intended results. This Subcommittee will be watching closely, and asking for regular updates every few months.

DOD's plans to improve the financial management of our defense system will not happen without sustained leadership. Leadership is essential to obtaining outlined results, benchmarks, and meeting the goals the Department has set. GAO has recommended the position of Chief Management Officer be established within the Department of Defense to keep the business transformation intact as a new Administration is ushered in. I am interested to hear more about the role and function of such a position within DOD to see how this organizational change could help maintain continuity during times of transition.

GAO has been reporting to Congress that DOD is at the top of its "High-risk" list for years. Of the 26 "high-risk" areas, 14 are at DOD. While sustained leadership at the agency is critical to achieving success with financial management improvement at DOD, continued oversight by Congress is just as important. And as the Secretary's quote reminds us, none of this is trivial or optional. The financial management of the world's largest and most competent military force affects not only the stewardship of taxpayer dollars, but the safety and well being of real men and women on the battlefield, the security of our civilian population at home and abroad, and indeed the freedom and peace of the world.

Beyond these life and death issues, there are fundamental issues of respect and how we treat our sons and daughters in harm's way every day. During this time of war, GAO reported that our battle-wounded soldiers were hounded by debt collectors for debt they incurred by no fault of their own. In fact, GAO found that as many as 73 percent of the reported debts were caused by overpayments of pay allowances, pay calculation errors, and erroneous leave payments.

Every dollar wasted or misspent is a dollar we don't spend preparing and equipping our warfighters. Recently, Lt. Gen. H. Steven Blum, the top National Guard General, said that two-thirds of the active Army's brigades are not rated "ready for war." Army officials, analysts and some of my colleagues have complained that there just isn't enough money to complete the personnel training and equipment repairs and replacement that must be done when units return home after deploying to Iraq or Afghanistan.

If there is one agency in the government where corners can be cut, it is not DOD. If there is one agency where we should ensure an abundance of resources—it is DOD. My colleagues know this, and that perhaps explains why so much money has rolled out the door to DOD with so little oversight. That same desire to give our armed forces whatever they need may be what has hampered us from following what we do give them. It is not enough just to write blank checks to DOD without effective oversight, call ourselves patriots and go home. It is a perverse world when we can roll out the types of appropriations—both through regular order, and emergency war supplements—and still hear complaints of equipment and training of warfighters that the Department can't afford.

It is time for Congress to match the level of its abundant provision of resources with an intensity and frequency of financial oversight. The safety and protection of our country should be our top priority; however, I have a hard time justifying continued multiple emergency war supplementals for the Department when we don't know exactly what that money is buying, and neither does the Department.

I would like to stress that this hearing is not a policy debate about whether or not U.S. troops should be present in Afghanistan or Iraq: We're there and we must win. We must be prepared to win next time, and the time after that. The Department of Defense has an adopted motto: "Check it. What gets checked, get done."

Senator Carper and I are committed to some Congressional "checking." Thank you to each of our witnesses for appearing before the Subcommittee today.

Chairman COBURN. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thanks, Mr. Chairman. Normally, I don't say this about opening statements that other people give, but that was a good statement.

Chairman COBURN. Thank you.

Senator CARPER. I am delighted that we are here and I thank you for scheduling this hearing and our witnesses for joining us today at this time.

I read not long ago that we spend more money in the Department of Defense on our military than all the other countries combined. I sort of come at this as a guy who has spent a lot of his life in the military, in the Navy as a Naval flight officer on active duty and later in the Reserves for many years, so having served in a war, hot war, cold war, and now having some idea and some real special personal feeling as to the importance of the Armed Forces. As governor, I got to be Commander in Chief of the Delaware National Guard, so I bring that experience to this table. This is a great affection for those who wear the uniform and great respect.

I also know that we are spending a whole lot more money than we have in the government, and General Walker is going to probably share a little bit of that with us here today. We have to find ways to reduce the deficit. We had a real good hearing this week on the kind of abuses that are going on in terms of tax shelters. It was another Subcommittee of our Committee that held that hearing and hopefully can help us narrow that tax gap that the Chairman and I talked a fair amount about. There is no silver bullet here. Some of the money that we need to narrow the deficit is going to be in the tax gap and others from a wide variety of different kinds of programs, domestic and defense.

But I want to talk a little bit today before we turn it over to General Walker, acknowledging that the Department of Defense is a very large organization, a very complex organization with a critical mission. Its success or its lack of success in carrying out that mission is a matter of life and death to the men and women who serve in our military today, and frankly, for all of us who are sitting here today.

Unfortunately, the Department's ability to effectively carry out its mission is threatened by a number of longstanding, ongoing management problems that the Chairman has alluded to. Eight of the 26 problem areas highlighted on GAO's high-risk list are within the Department of Defense. Six others on the list are government-wide problems that also apply to the Department of Defense.

There have been hearings held in the past on a number of DOD problem areas. I am pleased that this Subcommittee will now be spending some time examining those basic financial management failures at the Department, failures that have kept DOD's financial management on the high-risk list now for more than a decade.

The Department of Defense and most of its components have essentially been deemed unauditable. The thousands of business systems scattered throughout the Department don't talk to one another and simply can't produce timely, accurate financial data. This has led to an unacceptable situation, a situation where decision-makers within the Department and also here within Congress don't

have a clear picture of what the Department has, what it needs, and how it spends its money.

The murky nature of the Department's finances is, according to GAO, the single largest obstacle to achieving overall qualified audit opinions on the Federal Government's consolidated financial statements. It also creates an environment that invites waste, fraud, and abuse, and abuse of the taxpayers' trust. No Secretary of Defense, no matter how determined or how accomplished he or she might be, can be as effective as they need to be facing these kinds of problems.

I understand that the Department of Defense has made some progress in recent months laying out a road map for how to address these problems and I hope we can continue to pay close attention to the Department's efforts to ensure that the milestones are met and the goals remain in sight. Like you, Mr. Chairman, the idea of waiting until 2016 when we were hoping 2007, that is just not acceptable. I like to say, if it isn't perfect, make it better. We also like to say in my office, we can do better than that. With respect to the timeline, we can do better than that. We need to do better than that.

Thank you, Mr. Chairman.

Chairman COBURN. Thank you, Senator Carper.

Before us now is the Hon. David Walker. He is well known to this Subcommittee. I don't know if he has testified before more Subcommittees than this one, but we are up in the running with him. We appreciate him being here.

He became Comptroller General in 1998, a 15-year term. He dare not leave before that term is up. I will get you if you do. We will come back after you. We are very pleased you are here. We are very proud of the dedicated work that you and all the people who work with you give in assisting this Subcommittee and the rest of Congress an honest look at problems that we are facing. Please give us your statement.

General WALKER. Do you want to swear me in?

Chairman COBURN. I don't think you need to be sworn in.

General WALKER. Thank you very much. I would rather be sworn in than sworn at.

Senator CARPER. Can we vote on that?

Chairman COBURN. Do you want him sworn in?

Senator CARPER. No. [Laughter.]

TESTIMONY OF HON. DAVID M. WALKER,[1] COMPTROLLER GENERAL, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. WALKER. Thank you very much. You can trust what I tell you, whether I am sworn in or not. Thank you for your kind comments about GAO and our staff. We have an outstanding staff.

It is a pleasure to be back before this Subcommittee to talk about the Defense transformation efforts on the business side. I want to commend this Subcommittee, you, Mr. Chairman, and Senator Carper, for your dedication and commitment to oversight. Frankly, there are not enough committees and Subcommittees in Congress

[1] The prepared statement of Mr. Walker appears in the Appendix on page 33.

that are doing oversight and this Subcommittee is a clear exception.

As has been mentioned by the Chairman as well as Senator Carper, 14 of GAO's 26 high-risk areas relate directly or indirectly to the Department of Defense. We are No. 1 in the world in fighting and winning in armed conflicts. We do not deserve a passing grade on economy, efficiency, transparency, and accountability, and that needs to change.

You are right, Mr. Chairman, that Secretary Rumsfeld basically noted the importance of business transformation on September 10, 2001. We all know the tragic events of September 11, 2001, and as a result, not as much progress has been made in this area as everybody would like. But, we are seeing signs that things are starting to change.

It is important to keep in mind that this is not about audited financial statements. I mean, clearly, in the end, DOD has a responsibility to achieve a clean opinion on its audited financial statements. That is an indicator, but it is not an end in and of itself. What is important that we have sound internal controls coupled with timely, accurate and useful financial and management information in order to make informed decisions on a day-to-day basis, and to make sure that we are maximizing economy, efficiency, and effectiveness and we are providing for appropriate transparency and accountability to the American people.

The simple fact of the matter is, because of decades-old problems with internal controls, with financial management information systems, and selected other issues, the Defense Department wastes billions of dollars every year. That is money that we cannot afford to waste at any time, especially at a time when we are running large and imprudent budget deficits. These deficits are only going to get worse when the baby boomers start to retire in the next few years unless we end up changing our path.

I will note that DOD has shown increased commitment to trying to take on some of these challenges within the last year and there are a number of steps that it has taken that are encouraging and they represent improvements over their past efforts.

I would note for the record, however, that I have not heard that 2016 date before. I can tell you that while I thought that the 2007 date to achieve an audited financial statement for the DOD was ridiculously optimistic and not credible on its face, the 2016 date is likewise not credible on its face. I would suggest 2012 at the absolute latest. I would like to see their plan showing how they are going to try to get there. We ought to be able to get there.

Quite frankly, in all fairness, one of the reasons I mentioned that date is that it is the last fiscal year in which I will be Comptroller General and have an opportunity to express an opinion on the consolidated financial statements of the U.S. Government. You can take it to the bank, there will not be an opinion on the consolidated financial statements of the U.S. Government until there is one at DOD. There won't be, because DOD is just too big from the standpoint of the balance sheet and the statement of net cost of operations of the Federal Government.

Some examples of some positive things that have happened of late are the issuance of the FIAR Plan, or the Financial Improve-

ment and Audit Readiness Plan. The plan is clearly a much more logical and pragmatic approach to trying to look at different line items in different entities, which is what we have been suggesting for a while. Namely, that DOD try to hit some singles and doubles before they go for the fence, and I think the new plan is clearly an improvement in approach.

In addition, the Standard Financial Information Structure, the SFIS, represents a more pragmatic approach with regard to financial management information, and the enterprise architecture is clearly superior to the prior approach that they were taking.

The creation of the DBSMC, the Defense Business System Management Committee—there are more acronyms than you can count over at the Defense Department—as a means to oversee the overall business transformation effort was also a positive step. The creation of the Business Transformation Agency, otherwise known as BTA, in order to support that effort obviously is a positive step.

There are a number of things that we think will be essential in order for the Department to achieve sustainable success in business transformation. I will mention two. One, they need a strategic and integrated business transformation plan. They don't have it right now.

Two, it is not a panacea, but it is essential. They will need a Chief Management Officer at the right level, for the right period of time, and doing the right things to provide continuity within administrations and between administrations to deal with these many challenges that are years in the making and will take years to successfully address.

I am pleased to note that the Defense Business Board has recommended the creation of a Chief Management Official. I am also pleased to note that McKinsey, one of the world's most respected global consulting firms, has also recommended it. I am hopeful that the FFRDC entity that is going to conduct an additional study that is going to come out later this year will also recommend it. As you know, GAO has recommended it for at least 2 years.

Last thing, given the fact that we are in a real but undeclared global war on terrorism, it is time for us to declare war on waste. It is long overdue and the time to do it is now.

Thank you, Mr. Chairman.

Chairman COBURN. Thank you, General Walker.

I think Senator Carper and I feel like we have declared the war on waste. That is what we have been doing the last 18 months up here, and we are on our 44th or 45th hearing. Most of it has to do with waste, fraud, abuse, and inefficiencies.

You are uncomfortable with this 2016 because you think it can be achieved sooner, and——

Mr. WALKER. I haven't seen the 2016 date. That was news to me. But I do think it can be achieved sooner.

Chairman COBURN. Would you talk for a minute about the information systems problems that the Defense Department has in terms of even if they wanted to do it sooner, because they have, what, 70 or 80 different management information systems and all these different programs and different computers that don't talk to one another, describe for us and also for the American public the size and extent of this problem. It would just seem to most people,

if you just look at this, well, just put in new systems everywhere and make them all talk to each other and you can do this. Can you comment on that for me, if you would?

Mr. WALKER. The Department of Defense, as you properly pointed out, is one of the largest, most complex, and arguably most important entities on the face of the earth. It has over 3,000 legacy and non-integrated financial and other management information systems that have accumulated over decades.

In many cases, for a single transaction for a purchase or acquisition or other type of activity, there are multiple entries that have to be made into different systems in order to record that transaction rather than a single entry into an integrated information system. In some cases, there is a 16-digit code that has to go for each transaction, irrespective of the size of the transaction.

We have a situation where you have thousands of outdated systems that don't talk with each other that have accumulated over the years and trying to reconcile those numbers is a nightmare. We need to kill, discontinue, all non-essential, all non-stay-in-business information systems. We need to kill them. We need to free up that money and redeploy that money to create a more positive future, creating more modern and integrated information systems. It will take time. It will take money. But it clearly can be done before, in my view, 2016.

Mr. Chairman, last week another event that occurred that is important was the kick-off of the Check It Campaign, which deals with internal controls. The Department recognizes the importance of sound controls as well as appropriate systems. I was there at that event, at the request of Deputy Secretary Gordon England, in order to show the importance and commitment to that. It is going to take years, but we can do it a lot quicker than 2016.

Chairman COBURN. Let us talk for a minute about the CMO position. We had testimony yesterday in front of us in terms of Iraq and Special Investigative—SIGIR, I think it was——

Mr. WALKER. Stuart Bowen.

Chairman COBURN. Yes, Stuart Bowen, who has done a wonderful job over there looking at things. The problem is he is looking at it after it happened. We have made several recommendations on Hurricane Katrina, Senator Carper and myself and Senator Obama, about having a Chief Financial Officer watch the store, and we have seen billions wasted because we didn't have anybody watching the store.

In your mind, is there progress being made at the Defense Department to look at this realistically, to put somebody in such a position and give them the authority as well as the position to make management decisions in terms of the organization?

Mr. WALKER. Senator, as you probably know, the Congress required as a matter of law that the Department of Defense conduct two studies on the concept of a Chief Management Official and to report the results of those two independent studies by the end of this calendar year.

Chairman COBURN. I would just note for the record that by law, they are supposed to be reporting improper payments throughout the Pentagon, as well, and they don't.

Mr. WALKER. The good news here, Senator, is that the first study has already been completed by the Defense Business Board and they did recommend the creation of a Chief Management Official at level two that would be a principal Under Secretary of Management to focus on the business transformation process, that would have statutory qualification requirements, a 5-year term appointment, and presumably a performance-based contract. So basically, their recommendation is very consistent with what GAO has recommended, minor differences, but intellectually very consistent.

McKinsey within the last 2 weeks came out with a study noting the need for chief management officials or chief operating officers in a number of Federal departments and agencies around the government.

It is my understanding that IDA is doing a study now. I met with representatives from IDA for about an hour and a half about 10 days ago. They are doing their independent study. It is my understanding they are going to make some recommendations. They are also going to talk about a short-term versus long-term approach and they expect to meet their statutory deadline.

Chairman COBURN. Why do we need another study? I mean, that sounds like what the government does usually. We study things to death, but we don't get any action. Why do we need another study on whether or not we need a chief——

Mr. WALKER. I don't think we need a study. I will tell you why I think we got a study. We were very clear that this was needed. The Department did not embrace that recommendation. Therefore, the Congress decided, well, let us get a couple more views, because the Department didn't want to do it, we were recommending that it be done, and it was a way to try to get additional information. It shouldn't have been necessary, but nonetheless, it is going to happen. I am cautiously optimistic that both will end up recommending this position. I continue to believe today, more than ever, that it is an essential element to sustainable progress in business transformation within DOD.

Chairman COBURN. Thank you. Senator Carper.

Senator CARPER. Thanks, Mr. Chairman.

Mr. Walker, again, it is great to have you before our Subcommittee today. When you were testifying, during your statement, General Walker, I wrote down that 2007 is not achievable, and if 2016 is not soon enough, what time line makes sense? You, reading my mind, responded no later than 2012. I think you said 2012 at the latest.

Mr. WALKER. In fairness, I haven't ended up independently going down and taking the building block approach to get there, but if this country can send a man to the moon and return them in less than 9 years, we ought to be able to get our act together in this area in at least 6 years.

Senator CARPER. How do we make 2012 or 2011 or some other year a reality rather than just a target? How do we go about making it reality? And if you would, talk about what you can do, if you will, through GAO——

Mr. WALKER. Absolutely.

Senator CARPER [continuing]. And what we can do through our oversight role. Later on, I am going to come back and say, what can the Administration do? What can the Executive Branch do?

Mr. WALKER. Well, first, if you want to achieve a challenging and complex objective, you must have a plan. If you don't have a plan, you will have no prayer. Or stated differently, that may be the only thing you have, is a prayer.

There is an approach now to develop a plan, which I mentioned, which is good. The conceptual approach to it is much better. It is taking specific line items, specific entities, taking a building block approach, providing for accountability to specific parties as to what they need to be doing by when in order to achieve that objective.

I will need to take a look at it to see how they got to 2016. As I said, that is a new date to me. It seems too far out. In my view, I would like to see how they got to it.

You also need, to have accountability. Who is going to be responsible for what? You need to make sure that they are held accountable, that they are rewarded for meeting dates and that they are held accountable if they don't end up meeting dates.

The Congress needs to continue to provide for appropriate oversight. It needs to provide enough resources to get the job done, reasonable flexibility with appropriate transparency and accountability to make sure that people are doing what needs to be done within the time frame.

With regard to us, we can continue to work with them on a constructive basis to give them our views as to what we think are the most important issues and what possibly might be the best way forward, but ultimately DOD management needs to make that judgment, if you will.

I think OMB needs to hold DOD more accountable than they have in the past in these areas, and hopefully that will happen. I also think that it may be necessary, although I have not made a decision on this and I would want to coordinate this with the Department of Defense, with the Inspector General for the Department of Defense, and other appropriate parties, for us to have to assume more responsibility for the audit of the Department of Defense.

Senator CARPER. So you are going to maybe——

Mr. WALKER. It may be possible that we, GAO, may have to directly assume more responsibility for the financial statement audit of the Department of Defense, and let me tell you what I mean by that. We have not made a decision, and I would need to consult with a variety of parties. It is too early to make that decision. Under law, we have the authority to audit any entity that we say we think it is appropriate that we audit because of either confidentiality, because of complexity, because of materiality or whatever.

In the case of the Department of Defense, it is the last linchpin in order to achieve an opinion on the consolidated financial statements. We have to make sure that gets done and we have to make sure that it gets done the right way in order for us to be comfortable to express an opinion on the consolidated financial statements.

Furthermore, whether the Inspector General does it or whether we do it, it is going to require a tremendous amount of resources

across several organizations and it is going to require contractor resources, too, from independent public accounting firms. Unfortunately, it appears that most of the major independent public accounting firms are doing so much work in the Department of Defense that they themselves couldn't assume responsibility for the audit and be deemed to be independent.

Therefore, I think, we need to work out an approach, a coordinated approach as to who is going to be on the point. All three of us are going to have to be involved. By that, I mean the IG, us, and outside auditors. But, who is going to be on the point, who is going to do what, over what relative time frame, in order to achieve the end objective? That is something that we are going to need to begin conversations on, and that is obviously also relevant with regard to whatever a realistic date may or may not be for achieving an opinion on DOD's financials.

Senator CARPER. I was wondering, listening to you testify and the back-and-forth between you and our Chairman, if there are any models in this country, business models, government models in this country or around the world that we could look to to provide some road map, if you will, to getting our arms around the financial, really our business situation in the Department of Defense?

Mr. WALKER. It is interesting that you ask that question, Senator Carper. I mean, you didn't know I was going to say what I said and I didn't know you were going to ask this question.

Senator CARPER. This shows that he has been before the Subcommittee a whole lot of times.

Mr. WALKER. Yes, that is right. We are familiar with each other, I guess. But one of the things we are doing with increasing frequency at GAO is recognizing the reality, that while the United States may be No. 1 in many things, we are not No. 1 in everything. We have things to teach others, but we also have things to learn from others.

One of the things that I have been doing is working with my counterparts around the world. As you know, we are on the Board of Directors for auditor generals around the world and head of strategic planning. One of the things I have recently done is look at this financial management area and find out what other countries have done to try to address some similar challenges.

Interestingly, the country of Brazil has a modern and integrated financial management system for their entire Federal Government. We are not talking about that. We are just talking about the Department of Defense, which is probably bigger than the entire Brazilian government if we looked at the numbers. If Brazil can do it, we can do it.

Senator CARPER. You are not the first person who has said that in the last week or two. I have said, if Brazil can do it, we can do it, and that was with respect to declaring energy dependence and achieving the goal within 15 years.

Mr. WALKER. If they can do it, we can do it.

And second, with regard to the United Kingdom, I was recently in London meeting with officials of the Ministry of Defence, and within the last 5 years or so, they have gotten their financial management act together. I think for 3 years in a row, they have achieved a clean opinion on their financial statement audit. Fur-

thermore, they have also made progress on reconciling program planning with budgeting, not just in the current year, but for the out years, which is something that we need to do, as well.

Now, we are a lot larger. We are a lot more complex. We have a lot more important role in the world, arguably, but there are lessons to be learned from others and I think it is important that we learn them.

Senator CARPER. Mr. Chairman, will there be another round of questions?

Chairman COBURN. No, go on and I will wrap up.

Senator CARPER. Go ahead. I want to just figure out one of these question that I want to ask.

Chairman COBURN. In December of this last year, the Department of Defense issued the BEA and an ETP for modernizing their business processes and supporting information technology processes and assets. What it really is is a blueprint for modernizing the business operations, one, and their business information systems and their management information systems while ETP provides a road map and management tool that sequences the business systems, investments in the areas of personnel, logistics, real property, acquisition, purchasing, and financial management. Do you think the ETP goes far enough in achieving what they need to do to get a hold on this?

Mr. WALKER. First, let me say that I think the approach they are taking now is vastly superior to the approach that they were taking before. I would like to provide some more detailed information for the record. But I clearly think it is vastly superior to what they were doing before. I would like to consult with some of my information technology specialists to provide you more detail for the record, if I can, Mr. Chairman.

INFORMATION PROVIDED FOR THE RECORD BY MR. WALKER

As we reported in May of this year, the department has taken steps over the last one year to further comply with the requirements specified in the Fiscal Year 2006 National Defense Authorization Act and related guidance. The Act's requirements were consistent with our recommendations for developing a business enterprise architecture and associated enterprise transition plan, and establishing and implementing effective information technology (IT) business system investment management structures and processes. As part of DOD's incremental strategy for developing and implementing its architecture, transition plan, and tiered accountability framework for managing business systems, DOD has improved its overall approach to business systems modernization. On March 15, 2006, DOD released a minor update to its business enterprise architecture, developed an updated enterprise transition plan, and issued its annual report to Congress describing steps taken to address the Act's requirements, among other things.

The updated architecture and transition plan, as well as the report and related documentation, reflect steps taken to address a number of the areas that we previously reported as falling short of the Act's requirements and related guidance. While this progress better positions the department to address the business systems modernization high-risk area, many challenges remain relative to improving the architecture, implementing its tiered accountability investment approach, and actually acquiring and implementing modernized business systems on time and within budget that provide promised capabilities and benefits.

The enterprise transition plan now includes an initiative aimed at identifying capability gaps between the current and target architectural environments, and DOD continues to validate the inventory of ongoing IT investments that formed the basis for the prior version of the transition plan. Further, the plan provides information on progress on major investments—including key accomplishments and milestones attained, and more information about the termination of legacy systems. However, it still does not identify, among other things, all legacy systems that will not be part

of the target architecture, and it does not include system investment information for all the department's agencies and combatant commands. Once missing content is added and all planned investments are validated by capability gap analyses, the department will be better positioned to sequentially manage the migration and disposition of existing business processes and systems—and the introduction of new ones.

Chairman COBURN. Thank you. Senator Carper.

Senator CARPER. Thanks. I think in your testimony, your written testimony, you criticized the Department of Defense for lacking a comprehensive department-wide plan for transforming itself. Let me just ask, what is lacking in the Department's current strategy that you would like to see taken up in this plan?

Mr. WALKER. First, as you noted, Senator Carper, they have, directly or indirectly, 14 of 26 high-risk agencies—high-risk areas government-wide and you need to start with that. Those aren't the only things that need to be addressed with regard to business transformation, but they are arguably the most important things that need to be addressed with regard to business transformation.

You need to have a strategic and integrated plan for how you are going to end up addressing all these different areas. Quite frankly, many, if not most of them, are interrelated. A decision you make in one area can have a ripple effect with regard to decisions in others.

Furthermore, you have too many layers, too many players, too many hardened silos within the Department of Defense. There is so much hierarchy and so much process orientation there, all the more reason why you need to have somebody on the point, who has got a plan, who is responsible and accountable, whose is matrixing both with the different under secretaries as well as the service secretaries, uniformed and non-uniformed key players to make progress on all these different fronts in a strategic and integrated fashion. That doesn't exist to the extent that it needs to exist.

Now, they have made progress. They have individual plans. The approaches that they are taking on those individual plans in most cases are much better than the approaches they were taking before. There is also more accountability being provided for.

But the two big points that I said they need to do, they need this strategic and integrated business transformation plan that deals with all these areas, and they need a Chief Management Official, because these problems aren't going to come close to getting solved by the end of this Administration and it is going to take years of sustained attention to get us to where we need to be and we need to recognize that reality.

Senator CARPER. Give us just some idea of the profile of the Chief Management Official——

Mr. WALKER. Sure.

Senator CARPER [continuing]. You mentioned and where might we be looking for him or her.

Mr. WALKER. First, let me say we are not talking about something that is novel. Let me go back to the other question you asked about can we learn something from other countries. The answer is yes.

Now, we don't have a parliamentary system, but in many parliamentary systems of government, they have something called either a permanent secretary, or a general secretary. They are the

chief operating officers for the departments and agencies in government and they have a lot fewer political appointees in the executive branch than we do. I would argue that is all the more reason why you need a Chief Management Official or Chief Operating Officer because it means you are going to get a lot more turnover at the top because we have a lot more political appointees.

We are talking about a proven professional, who will be a political appointee, subject to Senate confirmation. Hopefully, there will be statutory qualification requirements. The person should have a proven track record of success, ideally both in the private sector as well as the public sector. They would commit, hopefully, if everything goes well, to a 7-year term. They would have performance standards, and performance-based compensation. They would be responsible for assuring that this strategic and integrated plan was developed and properly implemented.

Importantly, they would not be another layer that people would have to deal with on a recurring basis. In other words, they would be focused solely on achieving business transformation, not trying to manage day-to-day operations, not trying to deal with the normal things that the under secretary and comptroller or under secretary for AT&L, or others have to deal with, just the business transformation part.

This has worked in other countries. It can work here, and I would argue we need it worse here than they did because we have a lot more turnover and a lot more political appointees in leadership positions, and a lot more money and risk at stake than they do.

Chairman COBURN. So it is your opinion that DOD today does not have that comprehensive, integrated business management information system? They don't have that plan?

Mr. WALKER. Let me clarify. The plan that I am talking about is beyond business information systems. In other words, you have business information systems, you have financial management, you have acquisition reforms, and you have human capital reforms. There are a number of different areas on our high-risk list.

Chairman COBURN. So it is total transformation.

Mr. WALKER. Correct. A total business transformation plan.

Chairman COBURN. But you would agree that they are on their way to putting some of these other systems——

Mr. WALKER. Absolutely. They are making progress and they have plans for many, if not most, of the sub-elements. We are working constructively with the Office of Management and Budget and trying to make sure that every department and agency in government has an action plan for getting off of GAO's high-risk list eventually. Some are going to take longer than others, obviously.

Senator CARPER. Mr. Chairman, you and I have talked with General Walker about our oversight role. This Subcommittee under your leadership has done, I think, a remarkable job in terms of performing or attempting to perform an oversight role. We have a lot of other committees in the House and Senate that don't take those responsibilities as seriously, and one of the ideas we have kicked around to better enable committees to meet their oversight responsibilities, to enable the Congress to meet its oversight responsibility, would be to look at a 2-year budget process or a biennial

budget, where 1 year you are basically doing the budget and the second year you focus a bit more on oversight, not one exclusively over the other. Would you just give us your thought on our idea?

Mr. WALKER. First, I think there is conceptual merit to biennial budgeting. As you know, there are States that have biennial budgets. At this same point in time, I don't think they are a panacea. The assumption is that if you only have to do the budget every 2 years, that you would use the time that was made available from not having to do the budget 1 year out of two to do more oversight. I don't know whether or not that would occur, but clearly to the extent that time is a problem, that would free up some time.

Furthermore, lately, we have been running at least one supplemental a year. So one of the questions you have to ask yourself is, what do you do if something happens and you have an unanticipated event, maybe a really true emergency rather than an "emergency"? Well, then that is what the supplemental process is supposed to be for. Unfortunately, as the Chairman mentioned before, we have got too many things running through the supplemental process right now that, frankly, we need to move into the base. In terms of forcing more trade-offs, you are getting more transparency and accountability than historically has been the case.

Senator CARPER. Thank you very much. Thanks for your service and for the great resources you provide in your team that you bring.

Mr. WALKER. My pleasure.

Chairman COBURN. General Walker, thank you so much.

Mr. WALKER. Thank you.

Chairman COBURN. Our next panel, first is Jack Patterson, Principal Deputy Under Secretary at the Department of Defense. He is directly responsible for advising and assisting the Comptroller with oversight of the DOD financial management policy, financial management systems, and business modernization programs.

Accompanying Mr. Patterson is Teresa McKay, Deputy Chief Financial Officer at the U.S. Department of Defense. She is the principal advisor to the Comptroller for accounting and financial matters.

Thomas Gimble is the Acting Inspector General for the Department of Defense. As the Acting Inspector General, Mr. Gimble is charged by law to report directly to the Secretary of Defense on matters relating to the prevention of fraud, waste, and abuse in programs and operations of the Department.

Let me welcome each of you. We will recognize Mr. Patterson first and we will go in the order in which we introduced you. Mr. Patterson.

TESTIMONY OF J. DAVID PATTERSON,[1] PRINCIPAL DEPUTY UNDER SECRETARY OF DEFENSE (COMPTROLLER), U.S. DEPARTMENT OF DEFENSE

Mr. PATTERSON. Mr. Chairman, Senator Carper, thank you for the opportunity to update you on the progress the Department has made in business transformation and financial management. And

[1] The prepared statement of Mr. Patterson appears in the Appendix on page 59.

by way of the opportunity to meet with you, we also recognize that we have an opportunity to inform the American people.

As stewards of the resources entrusted to us for the defense of the Nation, we take our responsibility to the American taxpayer very seriously. We also strive to never lose sight of the fact that everything we do, every dollar we manage, every contract we fund, affects the men and women in uniform who put their lives on the line every single day.

This has been the case since the Administration first took office, the words of Secretary Rumsfeld said on September 10, and we appreciate very much that you put them up because, in fact, they are the vision that all of us must look to in our daily business in the Department. Since that time the Secretary made that statement, Mr. Chairman, we have been working to make this vision a reality.

The challenges the Department faces are not insignificant. Beginning with the sheer size of the enterprise, which you have alluded to this afternoon, with more than 600,000 buildings and structures in over 146 countries around the globe, the Department's assets and liabilities alone exceed those of Wal-Mart, Exxon, Ford, and IBM combined. Add to that an employment roster that includes 1.4 million active-duty men and women, 740,000 civilians, 860,000 Guard and Reserve members, two million retirees and their families, and an operating budget in excess of $400 billion.

Add that together and you have some idea of the sheer volume of the financial information and data that the Department manages daily, not to mention the difficulty in consistently capturing that information and preparing that data so that it can be analyzed and communicated to Congress as well as the decisionmakers in the Department. That data, to be usable, depends on common business system solutions. Indeed, for decades, there were no such common solutions, only a wide variety of different systems and processes unable to talk to one another, and consequently, unable to produce consistent, complete, timely information.

In 2001, the Department embarked on an ambitious plan to bring the Department of Defense into the 21st Century. After 4 years of work and preparation, in 2005, two comprehensive and integrated plans for financial improvement and business systems modernization were launched. As you have heard, they are the Enterprise Transition Plan and the Financial Improvement and Audit Readiness Plan.

The Enterprise Transition Plan is a step-by-step plan that consolidates DOD's many different business systems and focuses resources to minimize redundancy and reduce overhead. It also details the schedules, milestones, and costs for 98 key transformational programs and initiatives across the Department.

The Financial Improvement and Audit Readiness Plan, or something we refer to as the FIAR Plan, focuses the Department's efforts on improving business processes and internal management controls. The FIAR Plan unites DOD's functional and financial operations and comprehensively guides the effort to incrementally eliminate material weaknesses to achieve an independently verified and clean audit opinion.

I have asked Deputy Chief Financial Officer Terri McKay to join me this afternoon, and following my brief remarks, she will speak

to you about the Department's progress in improving financial management and audit readiness.

The second part of our plan, improving business systems and processes, is equally important and the key to future and continuing success. Like good financial management, effective business systems and processes also support the clean audit opinions and the internal management controls that help eliminate material weaknesses. In this respect, the Department has made clear and measurable progress in modernizing and consolidating DOD business systems and operations as well as improving accuracy, reliability, and timeliness.

There are numerous examples of where we have made progress, and if you would allow me, I would just like to enumerate a few. Unsupported accounting entries have been reduced by 86 percent, or $1.98 trillion, from fiscal year 1999 to 2005. Delinquent debts receivable have been reduced by 42 percent, or $1.1 billion, from fiscal year 2004 to 2005. Fully 95 percent of all vendor payments are now done electronically, as compared with 86 percent in 2001, realizing a savings of $6 million. And since 2001, process efficiencies at the Defense Finance and Accounting Service have resulted in a cost savings of approximately $238 million, all while improving productivity and service to the warfighter.

Mr. Chairman, the challenges we face in accomplishing our goals are many and the task is still far from complete by any measure, but I believe the Department of Defense has made a clear and measurable progress in improving business systems and financial management of the Nation's largest and most complex Department, and that progress will continue.

I thank you again for the opportunity to share these accomplishments with you, and on behalf of the Department, I thank the Subcommittee for its very strong support for these important efforts, and most importantly, for your continued strong support of the men and women who are out there doing the Nation's business in the global war against terror.

Chairman COBURN. Thank you. Ms. McKay.

TESTIMONY OF TERESA McKAY, DEPUTY CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF DEFENSE

Ms. MCKAY. Mr. Chairman, Senator Carper, thank you for this opportunity to discuss the Department's financial management improvement effort. As the Deputy Chief Financial Officer for the last 2 years, it has been my privilege to oversee this undertaking with the help of a dedicated staff of financial management professionals. Indeed, well over half of my immediate staff have professional certifications.

As the Deputy Chief Financial Officer, I have three primary responsibilities in this area: To establish policy for accounting, finance, and internal control functions throughout the Department; to oversee periodic financial reporting, including quarterly financial statements; and to develop and execute a systematic plan for financial management improvement and audit readiness, and we are doing this.

The Financial Improvement and Audit Readiness, or FIAR Plan, released in December 2005, charts a course to sound financial man-

agement by improving internal controls, resolving material weaknesses, and advancing the Department's fiscal stewardship. The plan also details a path for integrating the Financial Management Improvement Plans of the military services and components and confirming those improvements with favorable audits.

Employing an incremental methodology to achieving audit readiness, we focused our initial efforts on four high-impact areas that represent a significant portion of the Department's assets and liabilities, military equipment, real property, health care liabilities, and environmental liabilities. Fund balance with Treasury is also a priority. Each focus area includes specific milestones for achieving a successful audit, and during the last 6 months, 64 percent of those milestones have been met.

To give you a couple of quick examples of the progress that has been made, in the area of military equipment, which represents 27 percent of the value of all DOD assets, an initial baseline valuation for all military equipment programs, everything from combat vehicles to ships to aircraft, has now been established. This value was reported in the Department's third quarter fiscal year 2006 financial statements. This achievement is especially significant because the Department has never before had an accurate valuation of its military equipment.

In the area of environmental liabilities, the initial inventory and estimate for 97 percent of all environmental liabilities have now been completed. Calculating the value of this important category of liabilities will enable the Department to precisely identify the amount and the timing of funding requirements necessary to resolve environmental issues.

The military components are also making good progress toward independent audit opinions. For example, the U.S. Army Corps of Engineers is currently undergoing an audit of its fiscal year 2006 financial statements and the Marine Corps expects to be ready for a full audit of their financial statements in fiscal year 2007.

Clean audits for the military components confirm the reliability of the financial information and demonstrate the Department's commitment to accurate and timely reporting using a publicly recognized standard, and that commitment is producing results.

Four years ago, it took the Department 5 months to produce a single set of financial statements, and we did it once a year. Today, we are able to produce statements every quarter and publish end-of-year financial statements in 45 days. This is not, however, reporting for reporting's sake alone. Rather, we are using the information to better manage business operations.

For example, through the analysis performed on the quarterly financial statements, we are able to identify monies owed to the various components of the Department and emphasize collection efforts. Efforts thus far have reduced the amount owed to the various components by over $1 billion in the last year.

This information is also used to reduce the cycle time of collections owed to the Department. This effort is especially critical to our working capital funds' cash management efforts.

So while the FIAR Plan is designed to produce steady, incremental progress toward a clean audit opinion that will take years

to accomplish, the effort itself is yielding valuable benefits in other important areas, so I believe we are making real progress.

Mr. Chairman, as Mr. Patterson has said, we take our responsibilities seriously, our responsibility to be good stewards of the resources entrusted to us by the American people, and especially our responsibility to do all we can to support the brave men and women of America's armed forces who are fighting to defend our freedom and our future. Thank you, Mr. Chairman, and I am happy to answer any questions that you may have.

Senator COBURN. Thanks you. Inspector General Gimble.

TESTIMONY OF THOMAS F. GIMBLE,[1] ACTING INSPECTOR GENERAL, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. GIMBLE. Mr. Chairman, Senator Carper, thank you for the opportunity to discuss the financial management challenges that the Department of Defense continues to face and the progress that the Department has made in addressing the challenges and achieving business process modernization goals established by the 2001 Quadrennial Defense Review.

The Department's financial statements are the most extensive, complex, and diverse financial statements in the government. As we have reported in prior testimony, the Department faces financial management problems that are longstanding, pervasive, and deeply rooted in virtually all operations. Those financial problems continue to impede the Department's ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. The problems have also prevented the Department from receiving an unqualified opinion on its financial statements.

We are encouraged, however, by the framework the Department has established to address those problems. The framework consists of the Enterprise Transition Plan, which addresses the business process modernization goals established in the 2001 QDR and the Financial Improvement and Audit Readiness Plan. This framework provides the direction for the Department's financial improvement efforts and can be a mechanism for holding the Department's managers accountable for correcting specific weaknesses and for meeting milestones. More importantly, it provides a mechanism for measuring success.

The challenge to the Department managers is to continue to fortify and refine the framework. Further, within the framework, there must be a sustained effort to identify, monitor, and correct internal control and system weaknesses. The Department must continue to recognize that financial improvement is an ongoing effort that needs sustained management attention and accountability at all levels.

In order for the Department to achieve results in the financial management area, the Department must exercise rigor and continued management focus in executing the Enterprise Transition Plan, the FIAR, and the assessments of internal controls over financial reporting under OMB Circular A–123.

[1] The prepared statement of Mr. Gimble appears in the Appendix on page 71.

Not only does the Department need to focus on financial management improvement efforts on known deficiencies, it also needs to continue developing corrective action plans for the financial management challenges identified during the course of business and while implementing the programs mentioned above. Known balance sheet line item deficiencies include fund balance with Treasury; inventory; operating materials and supplies; property, plant, and equipment. Government-furnished material; contractor-required materials, environmental liabilities; accounts payable and accounts receivable. Other known deficiencies that are not specifically associated with balance sheet line items include financial management systems, intragovernmental eliminations, unsupported accounting entries, the statement of net cost, and the statement of financing.

In addition, we believe the quality of existing financial data in the systems is still a major challenge that the Department faces. Although the Department has had some successes in establishing the framework to execute financial improvement and audit readiness initiatives, continued focus and commitment by management are needed to successfully execute all the improvement initiatives. Management must continue to identify and correct pervasive weaknesses that have impaired the Department's ability to achieve auditable financial statements, and more importantly, to provide reliable, accurate, and timely data for decisionmaking.

Our Inspector General financial auditors are active in the financial management improvement process and auditors serve as advisors on the Financial Improvement and Readiness Committee and all the DOD audit component committees. Auditors also perform financial-related audits focusing on internal control and compliance with laws and regulations. We make recommendations to improve the efficiencies in those areas. We have made over 500 separate recommendations in the last 2 years.

The auditors also review assertion packages prepared by the financial managers and serve as contracting officer representatives on contracts to audit financial statements, line items, or financial management systems.

Mr. Chairman and Senator Carper, that concludes my statement. I would be happy to address any questions you might have.

Chairman COBURN. I thank each of you.

Mr. Patterson, I got the difference between what General Walker was talking about and the components that you all have put in place. You put the accounting and financial controls, are starting to put those into place. But he is talking about an integrated and transformational management plan that will use the tools that you are putting into place now. And so basically what he is saying is you are doing the right thing, but you are not doing the overall thing.

I just would like your comments. Before I went to medical school, I was a manufacturing manager and we used management information systems to tell us how to make decisions about how we ran plants and what to invest in and what not to. I just wonder, if we had this integrated, strategic and integrated business transformational plan, would seven of the nine major weapons systems now be behind and over-budget, and not small amounts of over-

budget, 40 and 50 percent over budget for the American taxpayer. I am just wondering what your comments are. And I am not trying to lay blame on anybody.

General Walker made a significant difference in terms of what the overall picture has to be, and you all are implementing a significant component of that. I just wonder what your comments are on his thought that you have got to move to the next level, the bigger level, to where you are really managing it at every aspect, using the financial tools that you all are developing, you and Ms. McKay, but how do you take those tools and then turn them into management tools? And where is the overall plan at the Department of Defense to get to what he was talking about?

Mr. PATTERSON. I think that General Walker does have a good point, and we obviously consult with the GAO on a regular basis. I think that where we believe we are making progress is, in fact, to build one brick on top of the other, and I take your point that you do need to have a vision of where you want to go. I think the Department is, in fact, doing that. With the Enterprise Transition Plan, with the FIAR Plan, and with the Business Transformation Agency as an implementor, if you will, as well as the Defense Business Management Systems Committee, which I sit on on occasion, we are, in fact, bringing together all of the disparate, different ideas, all of the different systems and attempting to do precisely what General Walker is talking about.

But these kinds of things, when you start out to do them, it is easy to say it is hard to do, and what we are finding is that it is very complex to take the systems that have previously been very unique, very tailored to specific needs and now start to build systems that talk to one another, not necessarily totally integrated, but at least turn out reports that are usable for decisionmakers so that those people who have to make decisions, those people who use the analysis, like the Congress, are able to have a common set of business solutions that can be used for decisionmaking. And that is really the goal here, is to have a common set of business solutions that people can use, particularly in leadership positions, to make the decisions so important to the business of the government.

Chairman COBURN. Would you agree that the American people should be suspect about the management when seven of nine—I am talking billions, hundreds of billions of dollars in weapons systems—are over budget and behind schedule? There has got to be something. It can't be just poor planning. There has got to be something about the management of that. Some of it is culture in terms of the defense industry, I understand that. They think they can milk the thing along. But it has to be management and the techniques of management and the business plan that has allowed us to get to that level. Would you agree with that?

Mr. PATTERSON. I would. I would say that what we have found in a study that I was a part of during the summer is that there are a number of components that all come together to cause the kind of circumstances, and I agree, programs are over cost, they are behind schedule, and they are not performing, and that is not where we want the Department of Defense to be.

There are things that the current Secretary and Deputy Secretary are doing that have great promise. Using the studies and

the conclusions to recent studies—the CSIS study, Goldwater II, the study that I mentioned that I was on—and taking from these studies the good recommendations, we are now starting to put these recommendations into a plan and implement them.

Chairman COBURN. Do you think it is a good idea to have a Chief Management Official in place? You don't have to answer that if you don't want to, if you think that causes you problems at the Pentagon.

Mr. PATTERSON. No, it doesn't. I mean, what we have done, and I think it is to Secretary England's great credit that he has asked the Defense Business Board to look at this very seriously. They have. They have concluded that a CMO would benefit the Department and now it is a matter of how do you, understanding the culture, as you have pointed out so clearly, how do you start to put those kinds of disciplines into this behemoth we call the Department of Defense of the United States.

Chairman COBURN. It is kind of like having a mentor with authority in your life. You voluntarily give authority to your mentors and they exercise that authority to improve you. That is what we are really talking about, is having this overall plan where we get a hold of everything.

Talk to me about 2016 and why you all have moved—I understand 2007 wasn't realistic, but I have to give some credence to what——

Mr. PATTERSON. Well, I am going to give you the broad-brush view and then I am going to turn that question over to my expert. But effectively, when we put together the FIAR Plan, we established boundaries, time boundaries. But truthfully, what we propose is an event-driven process, not a time-driven process. So as we find that we can do things much more quickly, we will accomplish them and get them behind us and move on to the next thing.

But with that as kind of an umbrella statement, I would like to turn it over to Ms. McKay, who actually——

Chairman COBURN. Fine. It is kind of like me asking my dad when I was a teenager for $100 when I only wanted $10, because I knew he wouldn't give me $100, but by the time I got down to $10, I could pretty sure bet I was going to get the $10. I think there is merit to an event-driven system, but the fact is—you are talking 9 years from now—before we can have systems which you all say you can present adequate financial data that you would say could get blessed by an auditor.

Quite frankly, I have looked at a lot of areas in the Defense Department, and to me, my advice is don't give us a date if you are not going to go date-driven. Give us an event-driven. But the point is, then let us hold you accountable for achieving the events and asking questions, why haven't you gotten to the next stage on time, rather than give us something that is truly unrealistic, because you just said, we are not going to do it based on dates. We are going to do it based on events.

That is part of the problem. It is gaming it. What this Subcommittee wants to do is we want to find out real facts, what the real problems are, what the situation behind them is, and what can we do, both Senator Carper and myself, to implement things in the Senate that makes this easier for you, that gives you the tools.

How do you replace all these computer systems that are running on RPG or Cobol? I mean, how do you do that and how do you do that in a system where you get the information you want? What do you need and how do we do that?

It is fine for Ms. McKay to answer that, but the point is, if the date is meaningless, the date should be said that the date is meaningless. You don't mean the date.

Mr. PATTERSON. When I say event-driven, I mean that we are going to beat that date by some significant number of years, and——

Chairman COBURN. All the more reason not to give us that date, then.

Ms. MCKAY. We didn't explicitly give anybody that date. Where I believe that date is coming from is as we develop the FIAR Plan and put the building blocks in place, some of those tracks are more detailed than other tracks.

Chairman COBURN. Right.

Ms. MCKAY. The 2016 is the long pole in the tent in an area that, quite frankly, we don't know a lot of details about yet. What we do know is a notional system implementation date and we know that we are dependent on that system implementation to resolve that particular issue.

So, in fact, the intent of the FIAR Plan is to do just what you suggested, to give you the events and ask us to be accountable for achieving those events, and that is the intent. But we have to put some targets there as we build these action plans, and so that is where those dates come from. The area in question here is the valuation of the Department's inventory and operating materials and supplies. That is an area that has not been a focus area of the FIAR Plan to date. We have just recently added that and would include a more detailed action plan on how to resolve that issue in the version that would be published in September.

So again, the 2016 date isn't something that was explicitly stated by any of us, but rather I think maybe an assumption made based on some GANT charts that are displayed in the plan.

Chairman COBURN. Let me talk about one other area real quick, and Mr. Gimble, if you would comment on this. Senator Ensign held a hearing a couple months ago on contract bonus performance payments. And my question is not to make a big deal of that. It is something we certainly don't want to happen if people aren't performing, and the fact is a lot of bonus payments over the last 4 years have been paid for non-performance.

Where is the management system in what you are setting up that is going to keep that from happening in the future so that we are not paying performance bonuses for people who haven't achieved the performance ratings under their contract? Mr. Gimble, if you would comment on how that happens, and what you see needing to happen in terms of management information systems so we are not doing it.

And this is $6 billion. This isn't small change. One of the things that was heard at that hearing is if we didn't spend the money, we were going to lose it, and that is exactly the wrong answer to tell the Congress of the United States and the people of this country, simply because we have this budget cycle problem and we are

afraid we are not going to fund things. This honesty, we have got to get back. What do you really need? We want to give you what you really need, but we don't want to play the game of just spending money that you don't need to spend because you will feel like you are going to get penalized next year if you haven't spent it. We ought to be rewarding people for not spending money rather than rewarding them for spending it.

So, Mr. Gimble, if you would answer that first, and then I will give both of you an opportunity to answer. It is not to beat up on anyone. It has happened. What we want to do is keep it from happening in the future.

Mr. GIMBLE. Mr. Chairman, the idea of having a central management information system that makes that not happen, I am not sure that is the right answer. I think, in my view, the answer would be that we need to hold the program offices accountable. When they write contracts and put in the provisions and the metrics that have to be met, they need to hold the contractors accountable to meeting those or not pay that bonus, and I think that is really the issue.

Chairman COBURN. So you are saying this is pure management. This isn't management information system, this is just pure management.

Mr. GIMBLE. I think, largely, it is, because obviously, you need to have some management information systems within the contract management arena, but the real issue of those bonuses, of a performance bonus being paid without being deserved, I think that is a management issue more so than a system issue.

Chairman COBURN. OK. Thank you. Mr. Patterson.

Mr. PATTERSON. Well, we found exactly the same thing, and when we did our study of the large major defense acquisition programs, what we couldn't find is a thread that linked the Contractor Performance Assessment Reports to the award fees. I mean, you would have a company that is red and they got 92 percent award fees. How did that happen?

What we also believe is that chronologically, they are not linked. And sometimes you can fix things mechanically, just simply having a CPAR come out followed by the assessment of the award fee immediately afterwards so that the two are linked, if for no other reason, they are linked chronologically.

But the point is that this is a management issue, not a systems issue. This is purely a management issue and these kinds of things can be fixed.

Chairman COBURN. OK, and that goes back to what Mr. Walker was talking about, is having an overall long-term plan for setting in a management structure using the information systems that you all are so—you have done a great job. I have no criticism. It has moved a long ways. There is no question about it. But utilizing those tools with a vision of how we want to manage the Defense Department.

How about giving me the next two events that you all are looking for to accomplish so that we can follow that? What are the next two events, Ms. McKay, in terms of event-driven things that we should be looking for as milestones for you all to accomplish?

Ms. MCKAY. I would say to you that the goals that we are working toward that are described in detail in the FIAR Plan today get us to a level of auditability in 2009, where we would have 79 percent of our liabilities auditable and, don't quote me on this, but it is in the vicinity of 64 percent of our assets.

And then the other shorter-term thing that I would say is as we continue to execute and monitor those specific milestones in the four focus areas that we have described in detail today, we are continuing the planning process in the additional significant areas of additional asset and liability categories so that we will have a better understanding of what it takes to resolve those deficiencies and pull in the system solutions, take a look at can we accelerate some of those system solutions once we have a better understanding of that.

Chairman COBURN. If the Defense Department doesn't have a strategic and integrated business transformation plan that has the vision for that, will that change what you decide without that vision and that transformation plan in there that you are looking to? In other words, you are going to use these marks of where you need to go, but you are going to be doing it without an overall transformation plan and business plan, how you run it.

In other words, the key is really not the—I was interviewed once when I graduated from college. I had a degree in accounting and production management. And I was interviewed by the now-defunct Arthur Andersen who said, why do you want to do this? And I said, because you can do anything you want with numbers. It is exactly the opposite of what everybody believes. You can do whatever you want with numbers. You can use them as a tool. You can do lots of things with numbers.

Without an overall transformational plan as you all go along, let us say if we get the plan 3 years from now, that is going to impact some of the things you all do. So would you not agree with that, that is going to have an impact on what decisions you make in terms of trying to run this? Are you going to be running two parallel tracks again, which is what we are trying to get away from?

Mr. PATTERSON. I think what I would say to that is we believe that the Enterprise Transition Plan, in combination with the Business Transformation Agency, the Defense Business Management Systems Committee, as well as the FIAR Plan, that most of us sit on all of those committees——

Chairman COBURN. So you are involved in creating those transitional plans——

Mr. PATTERSON [continuing]. So we are involved in——

Chairman COBURN. OK.

Mr. PATTERSON. And, if you will, it is a human integration, and we all work very closely together to see that these initiatives are successful.

But your challenge is well taken. If we find that, as we go back and we review these things, that we haven't done what I have just said that we were going to do, we will report back and tell you how we are going to fix that.

Chairman COBURN. One last little note. We are going to have another one of these hearings in 3 to 5 months on this same issue. What are the things that we should be expecting from you? What

are the milestones that you hope to achieve in the next 3 to 5 months? Do you want to go on record with that so we can hold you accountable for it?

Ms. MCKAY. Well, again, we are going to have a good view of what it takes to resolve some additional significant categories of assets and liabilities, so we would be able to give you some projections on when we would be able to be auditable there. And I would say that the current milestones that are described in the plan, we would be able to report to you on our completion of—our success in completing those.

Chairman COBURN. Thank you. Senator Carper.

Senator CARPER. We have talked a fair amount today about information systems, about inventory systems, and financial management systems. We have not talked a lot about the people that we hire to really develop and to run those systems. I would like for us to focus on that for a bit if we could.

In the military, when you have folks in uniform that are assigned to different jobs—at least in my experience in Naval aviation was, and we have a big Air Force base in Dover, Delaware—and folks, a lot of times will cycle out there, and sometimes the very senior will go into a job in the Pentagon for a while, I don't remember a lot of men or women who look forward to tours at the Pentagon. We wanted to be running squadrons or running ships, not sitting at a desk. We had a lot of good people and a lot of able people, but that is not what they wanted to do.

How do we go about making sure that we get the right people with the right set of talents and skill sets in some of these key positions, get them to stay there long enough so that they can learn the job, and not just learn the job, but be able to make a real difference? How do we go about doing that?

Mr. PATTERSON. I think you have hit upon a really important point, and actually, I did cycle out of Dover Air Force Base as the Deputy Ops Group Commander into the IG at the Pentagon.

Senator CARPER. When were you at Dover?

Mr. PATTERSON. I was there from 1990 until 1992.

Senator CARPER. Good for you.

Mr. PATTERSON. I was there during Desert Storm, Desert Shield, and——

Senator CARPER. Do you recall who the Wing Commander was there? Was it Bill Welzer?

Mr. PATTERSON. Yes, Mike Moffatt and Bill Welzer followed him.

Senator CARPER. Good.

Mr. PATTERSON. But, as I was going to say, it is very difficult. I mean, it is a difficult thing. It is a high-rent area to come to. It is a culture shock when you walk through the building, and if you are a Wing Commander, you leave your white-topped car out in North Parking and they truck you in. It is an unusual place where the people who have the most information and who have the actual money are at the lowest rung in the hierarchy, so if you think you are going to make a big difference and you are going to change how Western civilization views our Defense Department, you are probably going to be shocked.

But at the same time, I think that the Department offers such incredible opportunities. I mean, honestly, where can a major come

to a corporation and write a paper that, in fact, changes the way we think about defense?

So it is a difficult prospect that you offer, but nonetheless, we must be doing something right, because as I go through the Pentagon, we have absolutely marvelous people doing superb work under extraordinarily difficult circumstances, and so I would offer to you that it is hard to fill individual places, but as you look at the folks that we have working for us, you can be proud of them.

Senator CARPER. Ms. McKay.

Ms. MCKAY. Well, I would echo that and maybe talk more specifically about the financial management career field. It is a tight market today and the Washington area itself is very competitive. We have been very fortunate in the Pentagon in filling positions with people who have professional credentials. It is something that we emphasize. The majority, almost all of my staff, my immediate staff have either a professional certification and/or an advanced degree. We do have some special hiring authority that we have been able to capitalize on that has brought some well-qualified people to us. We have some special pay authority that we have been able to leverage from time to time. So we have a tool kit and we try to use every tool that we can find in it to find the right people, but I will tell you, as we exist today, we have a group of the finest professionals that I have ever worked with.

Senator CARPER. Our colleague, Senator Voinovich, who serves on this Subcommittee with us, is a fellow who focuses a lot on human resources and having to make the right investments in human capital so you have the right person in the right job, the kind of tools that they need to do their jobs better. Give us some advice on what the Legislative Branch needs to do to better ensure that we do have the right people and the right skill sets?

Mr. PATTERSON. Well, since you asked that question, I think that one of the things that you can review or assess is what would be by any stretch a byzantine, difficult, arduous approach to getting a political appointee into a job of importance. It is unbelievable——

Senator CARPER. Should some of those political appointees, should they not be political jobs, if you will, or——

Mr. PATTERSON. No, I think that there are more constructive and, in fact, more valid ways of bringing people on into these jobs of very high responsibility. I mean, CEOs of Fortune 500 companies do not go through anything like an under secretary goes through to be confirmed in that job. Not that you shouldn't be very, very careful about who is chosen, but the way in which—the methodology, the road to that success is far more difficult than it needs to be.

Senator CARPER. OK, thanks. Ms. McKay, I am going to ask you if you have any thoughts on this, as well.

Ms. MCKAY. I believe we have the authority that we need to operate within the environment that we are in. We are in the process of implementing some legislation that was provided a couple of years ago that allows the Secretary to designate specific positions as requiring professional certifications. That was helpful. And we expect to have implementing guidance on that published within the next couple of months. I think we have what we need.

Senator CARPER. Mr. Gimble, any thoughts?

Mr. GIMBLE. I think we have what we need in terms of the ability to do it. It is a kind of a funding issue. Also, it goes back to the, if you are talking about the auditing and accounting world, it is very competitive, and let me just give you—I am certified in the State of Texas, and this is kind of dated information, but I think that it demonstrates something.

My State Board said that in 1990, they had 8,000 candidates sit for the CPA exam. In 2000, 10 years later, they had 3,000 to sit for the exam. So then we open up a whole big area in the auditing world of government financial statements, which is in addition, too. So the competition for the talent out there is extremely tight and tough and we have a hard time, frankly, competing with that to some extent. But we also serve as a training ground for the private sector when we are contracting those out. So it is a challenge and a balancing act.

Do we have the ability to hire the people? We get really good people, we do. Sometimes we retain them, sometimes we are not able to because they get better offers in the private sector. But I think that it is a challenge.

And I think the other challenge that we have, particularly on the career side of the house, is the baby boomers really are beginning to retire. Thankfully, we have gotten a little option where we can do the rehired annuitant and attract some of that talent back in on a case-by-case basis, and that is really important for us. So I would say we probably have the tools. Is it challenging? Always, it is.

Senator CARPER. OK. I want to talk about an intersection and the intersection is the responsibilities of Inspector Generals, OMB, GAO, the Congress through its oversight responsibilities. My sense is we try to focus and encourage better financial management, better control. I am not so sure that we work in a synergistic type of way.

How might we better harness our shared goals to get a better result, realizing that the IG is sort of an independent free agent out there, the folks within the Department are Executive Branch? You have OMB sort of saying grace over all of you, and then there are a whole bunch of us in the House and the Senate, Democrats and Republicans, and some have different priorities other than oversight, as I said earlier. How do we get better on sort of pulling together rather than maybe pushing us apart?

Ms. MCKAY. I think some of the things that we are already doing are bringing us to that end. Certainly, we have the IG as advisors on many of our boards. As Mr. Gimble mentioned, someone from the IG Office sits on all of the audit committees of the components and on the various committees that we have to provide oversight to the operations that we have underway. We meet regularly with OMB to describe our progress to them, make sure that they understand the approach that we are taking. Similarly, we meet regularly with the Government Accountability Office for the same reason. We seek their advice. We accept their advice and try to move forward with that.

With regard to the Congress, I think hearings like this and meetings with the staff can further the communication channels so that

we both understand what each other's objectives are and where they converge.

Senator CARPER. Thank you. Are you all aware of any resistance within the Department of Defense to some of the initiatives that are underway? All of us have been in parts of organizations where we have been faced with change, and change is not always easy, but it is necessary and certainly necessary in this case to change the culture and to institutionalize some of the improved management processes that are currently being developed.

Mr. PATTERSON. Change is always hard, and in cultures that are entrenched, it is even harder. But it is a manager's responsibility to adopt leadership to go within their particular organization and bring the people along, make them part of your solution. It is not easy. It is easy to sit down and write books and say it. It is not easy to do it.

But what I have found in my experience is that you start from the bottom and socialize the idea, and quite frankly, the people who know the most about the organization and how it should work generally are at the lower ranks, and you had better start listening to them because they have the ideas at how it works, where the tires reach pavement. If you start there and start to move it up the chain and get everybody as a part of your solution, as opposed to being part of the problem, I think that although it sounds Pollyanna-ish, it does work, and I think that is how a good manager goes about that. If you have difficult things to move within the oversight world, you had better get to the staff early and get the idea starting to bubble up, because that is where I think you are going to be most successful.

Senator CARPER. Ms. McKay.

Ms. MCKAY. I absolutely agree, and I would like to give you a couple of examples. A couple of the areas that we have had the most success in executing against this FIAR Plan, environmental liabilities and the military equipment valuation, that would not have happened had we not partnered with the functional communities. We have been hand-in-hand working on these areas for several years now. It actually predates the actual formal plan.

And so if you look at that model of the functional community and the financial community understanding each other's objectives and where those come together and how we can move forward in tandem rather than separately, we have taken that success and we have applied it to the other areas. We are in the process—we have partnered with both the folks over in the real property area and the health care liability area and are starting to see movement in those areas, as well, for the same reason.

Senator CARPER. Mr. Gimble.

Mr. GIMBLE. I think that we have historically worked very well with GAO from the IG standpoint. Also, what has not been mentioned very much is the services each have very capable audit components and we have all partnered—we realize it is a big job, a big task, and I think we have been very good at working collectively together to achieve the progress that we are making.

Another thing, I think this is just a personal observation, having been in the area for a lot of years, is that I recall when we first started back in the 1990s looking at this, I would go up to some

of the meetings and it would be the auditors' statement, and my position was, the statement belongs to you, the manager, and we have the opinion. That is the clear break in responsibilities. And for a number of years, it wasn't that clear.

Currently, now, it is very clear that management owns the statements. We can advise on ways to improve the statements and so forth and we do that. Ms. McKay and I had a discussion yesterday that went kind of like this, "well, I don't think that we agree on these all the time." And I said, "well, really, I think it is a healthy thing to have a little bit of contention between the oversight community and the management, but at the end of the day, you need to work together to move it forward."

So I think we really do that, since the turn of the century, I think there has really been a lot of progress made in that area.

Senator CARPER. Let me just say again, thank you all for being here. This is important stuff, as you know, not just for the dollars and cents that are involved, but really for the folks that are out on the point carrying the battle for all of us. Thank you.

Chairman COBURN. First of all, I want to congratulate you on the good work that you have done thus far. I want to encourage you to keep doing it. We are going to have several questions for the record that we would like responses within 2 weeks, if we could.

Mr. Patterson, my understanding is under the FIAR Plan, you are at 64 percent, and I think I heard 2009 to be at 100 percent. I guess my question is, is 2009 a hard date or can we expect 2007 or 2008? You don't have to answer that, but we are going to submit that question to you because that is the kind of milestones we want to see you get to.

The other thing I would say is I had a meeting with Secretary Rumsfeld before I came to this meeting, a personal one-on-one meeting, and I am committed to help the Pentagon do what it wants to do to get things right and to be good stewards of the country's money. I think he has got fine people working for him and the cooperation—we are going to have better cooperation and it is going to grow and we are going to do more things to give you the tools.

So one of the questions we are going to be asking you is what do you need that you don't have now to accomplish what you need in terms of management to get the information systems up and develop this overall strategic and integrated management plan so that we can be there sooner and we can be there at less cost?

So I want to thank each of you for being here.

Mr. PATTERSON. Thank you, Mr. Chairman.

Chairman COBURN. The hearing is adjourned. Thank you all.

[Whereupon, at 4:09 p.m., the Subcommittee was adjourned.]

APPENDIX

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

For Release on Delivery
Expected at 2:30 p.m. EDT
Thursday, August 3, 2006

DEPARTMENT OF DEFENSE

Sustained Leadership Is Critical to Effective Financial and Business Management Transformation

Statement of David M. Walker
Comptroller General of the United States

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Highlights

Highlights of GAO-06-1006T, a testimony before the Subcommittee on Federal Financial Management, Government Information and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

The Department of Defense (DOD) bears sole responsibility for eight DOD-specific high-risk areas and shares responsibility for six governmentwide high-risk areas. These high-risk areas reflect the pervasive weaknesses that cut across all of DOD's major business operations. Several of the high-risk areas are inter-related, including, but not limited to, financial management, business systems modernization, and DOD's overall approach to business transformation. Billions of dollars provided to DOD are wasted each year because of ineffective performance and inadequate accountability. DOD has taken some positive steps to successfully transform its business operations and address these high-risk areas, but huge challenges remain.

This testimony discusses (1) pervasive, long-standing financial and business management weaknesses that affect DOD's efficiency; (2) some examples that highlight a need for improved business systems development and implementation oversight; (3) DOD's key initiatives to improve financial management, related business processes, and systems; and (4) actions needed to enhance the success of DOD's financial and business transformation efforts.

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To view the full product, click on the link above. For more information, contact McCoy Williams at (202) 512-9095 or williamsm1@gao.gov.

August 3, 2006

DEPARTMENT OF DEFENSE

Sustained Leadership Is Critical to Effective Financial and Business Management Transformation

What GAO Found

DOD's pervasive financial and business management problems adversely affect the economy, efficiency, and effectiveness of its operations, and have resulted in a lack of adequate accountability across all major business areas. These problems have left the department vulnerable to billions of dollars of fraud, waste, and abuse annually, at a time of increasing fiscal constraint. Further evidence of DOD's problems is the long-standing inability of any military service or major defense component to pass the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls. The following examples indicate the magnitude and severity of the problems.

Illustrative Weaknesses in DOD's Financial Management and Business Operations

Business area	Problem identified
Military personnel	Hundreds of separated battle-injured soldiers were pursued for collection of military debts incurred through no fault of their own. Overpayment of pay and allowances (entitlements), pay calculation errors, and erroneous leave payments caused 73 percent of the reported debts.
Inventory	The Army had not maintained accurate accountability over inventory shipped to repair contractors.
Financial management	DOD's processes for recording and reporting costs for the Global War on Terrorism were inadequate, raising significant concerns about the overall reliability of DOD's reported cost data.

Source: GAO.

To support its business operations, DOD invests billions of dollars each year to operate, maintain, and modernize its business systems. But despite this significant annual investment, GAO has continued to identify business system projects that have failed to be implemented on time, within budget, and with the promised capability. For example, in January 2006, GAO reported on problems with the implementation of the Defense Travel System—a project that was initiated in September 1998.

DOD's many high-risk challenges are years in the making and will take time to effectively address. Top management has demonstrated a commitment to transforming the department's business processes. In December 2005, DOD issued its Financial Improvement and Audit Readiness Plan to guide its financial management improvement efforts. Also, DOD has developed an initial Standard Financial Information Structure, which is DOD's enterprisewide data standard for categorizing financial information. Because of the complexity and long-term nature of DOD transformation efforts, GAO would like to reiterate two missing critical elements that need to be in place if DOD's transformation efforts are to be successful. First, DOD should develop and implement a comprehensive, integrated, and enterprisewide business transformation plan. Second, GAO continues to support the creation of a chief management officer, with the right skills and at the right level within the department, to provide the needed sustained leadership to oversee the department's overall business transformation process.

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here to discuss key aspects of business transformation efforts at the Department of Defense (DOD). At the outset, I would like to thank the Subcommittee for having this hearing and acknowledge the important role hearings such as this one serve. The involvement of this Subcommittee is critical to ultimately ensuring public confidence in DOD as a steward that is accountable for its finances. DOD continues to confront pervasive, decades-old financial management and business problems related to its systems, processes (including internal controls), and people (human capital). Of the 26 areas on GAO's governmentwide "high-risk" list, 8 are DOD program areas, and the department shares responsibility for 6 other high-risk areas that are governmentwide in scope.[1] These problems serve to, among other things, preclude the department from producing accurate, reliable, and timely information with which to make sound decisions and accurately report on its trillions of dollars of assets and liabilities. Further, DOD's financial management deficiencies continue to represent the single largest obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. In an effort to better manage DOD's resources, the Secretary of Defense has appropriately placed a high priority on transforming key business processes to improve their efficiency and effectiveness in supporting the department's military mission.

As per your request, my testimony will touch on three of the high-risk areas—financial management, business systems modernization, and DOD's overall approach to business transformation. I will provide perspectives on (1) some of the pervasive, long-standing financial and business management weaknesses that affect DOD's efficiency; (2) some examples that highlight a need for improved business systems development and implementation oversight; (3) DOD's key initiatives to improve financial management, related business processes, and systems; and (4) actions needed to enhance the success of DOD's financial and

[1] GAO, *GAO's High-Risk Program*, GAO-06-497T (Washington, D.C.: Mar. 15, 2006). DOD bears responsibility for the following eight high-risk areas: (1) DOD's overall approach to business transformation, (2) business systems modernization, (3) financial management, (4) the personnel security clearance process, (5) supply chain management, (6) support infrastructure management, (7) weapon systems acquisition, and (8) contract management. The department shares responsibility for the following six governmentwide high-risk areas: (1) disability programs, (2) interagency contracting, (3) information systems and critical infrastructure, (4) information sharing for homeland security, (5) human capital, and (6) real property.

business transformation efforts. My statement is based on our previous reports and testimonies. Our work was performed in accordance with generally accepted government auditing standards.

Summary

DOD's pervasive financial and business management problems adversely affect the economy, efficiency, and effectiveness of its operations, and have resulted in a lack of adequate accountability across all major business areas. These problems have left the department vulnerable to billions of dollars of fraud, waste, and abuse annually, at a time of increasing fiscal constraint. Further evidence of DOD's problems is the long-standing inability of any military service or major defense component to pass the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls. The following examples indicate the magnitude and severity of the problems.

- We found that hundreds of separated battle-injured soldiers were pursued for collection of military debts incurred through no fault of their own, including 74 soldiers whose debts had been reported to credit bureaus, private collection agencies, and the Treasury Offset Program. Overpayment of pay and allowances (entitlements), pay calculation errors, and erroneous leave payments caused 73 percent of the reported debts.[2]

- We found numerous problems with DOD's processes for recording and reporting costs for the Global War on Terrorism (GWOT), raising significant concerns about the overall reliability of DOD's reported cost data. As noted in our September 2005 report, neither DOD nor Congress know how much the war was costing and how appropriated funds were spent, or have historical data useful in considering future funding needs.[3] In at least one case, the reported costs may have been materially overstated. Specifically, DOD's reported obligations for mobilized Army reservists in fiscal year 2004 were based primarily on estimates rather than actual information and differed from related payroll information by as much as $2.1 billion, or 30 percent of the

[2] GAO, *Military Pay: Hundreds of Battle-Injured GWOT Soldiers Have Struggled to Resolve Military Debts*, GAO-06-494 (Washington, D.C.: Apr. 27, 2006).

[3] GAO, *Global War on Terrorism: DOD Needs to Improve the Reliability of Cost Data and Provide Additional Guidance to Control Costs*, GAO-05-882 (Washington, D.C.: Sept. 21, 2005).

amount DOD reported in its cost report.

Additionally, the department invests billions of dollars each year to operate, maintain, and modernize its business systems. But despite this significant annual investment, the department has been continually confronted with the difficult task of implementing business systems on time, within budget, and with the promised capability. For example, in December 2005,[4] we reported that the Army had not economically justified its investment in the Transportation Coordinators' Automated Information for Movement System (TC-AIMS) II, on the basis of reliable estimates of costs and benefits. TC-AIMS II was intended to be the single integrated system to automate transportation management function areas for the military services. As noted in our report, the most recent economic justification included cost and benefit estimates based on all four military services using the system. However, the Air Force and the Marine Corps have stated that they do not intend to use TC-AMIS II. Even with costs and benefits for all four services included, the analysis showed a marginal return on investment; that is, for each dollar spent on the system, slightly less than one dollar of benefit would be returned. The Army estimates the total life cycle cost of TC-AIMS II to be $1.7 billion over 25 years, including $569 million for acquisition and $1.2 billion for operation and maintenance. The Army reports that it has spent approximately $751 million on TC-AIMS II since its inception in 1995.

This example and others highlight the need for improved oversight of the billions of dollars DOD invests annually in the operation, maintenance, and modernization of its business systems. Further, in the past the department has also struggled with developing a business enterprise architecture to guide its business system development efforts. We reported in July 2005, that DOD, after almost 4 years and investing approximately $318 million, the architecture was not sufficient to effectively guide and constrain ongoing and planned systems investments.[5] To its credit, DOD has recognized these weaknesses and taken actions to improve its management control and accountability over business system investments.

[4] GAO, *DOD Systems Modernization: Uncertain Joint Use and Marginal Expected Value of Military Asset Deployment System Warrant Reassessment of Planned Investment*, GAO-06-171 (Washington, D.C.: Dec. 15, 2005).

[5] GAO, *DOD Business Systems Modernization: Long-standing Weaknesses in Enterprise Architecture Development Need to Be Addressed*, GAO-05-702 (Washington, D.C.: July 22, 2005).

Successful reform of DOD's fundamentally flawed financial and business management operations must simultaneously focus on its systems, processes, and people. DOD's top management has demonstrated a commitment to transforming the department and has launched key initiatives to improve its financial management processes and related business systems. For example, in December 2005, DOD issued its Financial Improvement and Audit Readiness (FIAR) Plan, to guide financial improvement and financial audit efforts within the department. Also, DOD has developed an initial Standard Financial Information Structure (SFIS), which is DOD's enterprisewide data standard for categorizing financial information. While DOD has made some encouraging progress in addressing specific challenges, it is still in the very early stages of a departmentwide reform that will take many years to accomplish.

DOD continues to make progress in several areas in its overall business transformation efforts. For example, DOD established the Defense Business System Management Committee (DBMSC) as DOD's primary transformation leadership and oversight mechanism, and created the Business Transformation Agency (BTA) to support the DBSMC. However, I believe that DOD still lacks several key elements that are needed to ensure a successful and sustainable transformation effort. In this regard, I would like to reiterate two critical elements needed if DOD is to succeed. First, as we have previously recommended, DOD should develop and implement an integrated and strategic business transformation plan. The lack of a comprehensive, integrated, enterprisewide action plan linked with performance goals, objectives, and rewards has been a continuing weakness in DOD's business management transformation. Second, we continue to support the creation of a chief management officer (CMO) at the right level of the organization to provide the sustained leadership needed to achieve a successful and sustainable transformation effort. The CMO would serve as a strategic integrator to elevate and institutionalize the attention essential for addressing key stewardship responsibilities, such as strategic planning, enterprise architecture development and implementation, business systems, and financial management, while facilitating the overall business management transformation within DOD.

Background

DOD is a massive and complex organization. Overhauling its business operations will take years to accomplish and represents a huge management challenge. In fiscal year 2005, the department reported that its operations involved $1.3 trillion in assets and $1.9 trillion in liabilities, more than 2.9 million military and civilian personnel, and $635 billion in

net cost of operations. For fiscal year 2005, the department was appropriated approximately $525 billion.[6]

Large differences between the net cost of operations and amounts appropriated for any given fiscal year are not unusual in DOD. For the most part, they are attributed to timing differences. For example, net cost is calculated using an accrual basis of accounting (revenues and expenses are recorded when earned and owed, respectively) whereas appropriations are recorded on a cash basis (revenues and expenses are recorded when cash is received or paid.) Using the accrual basis versus the cash basis can result in DOD's reporting of revenues and expenses in different periods. For instance, DOD may have received in 2005 an appropriation for the acquisition of a weapon system but may not incur expenses or make payments from the appropriation until several years later. Also, DOD's net cost of operations includes non-cash expenses, such as depreciation related to buildings and equipment that will not require cash outlays until several years after the funds were appropriated. In addition, the department's recording of expenses related to environmental cleanups and pension and retiree health cost liabilities can occur many years before the appropriations to fund payment of those liabilities are received.

Execution of DOD's operations spans a wide range of defense organizations, including the military services and their respective major commands and functional activities, numerous large defense agencies and field activities, and various combatant and joint operational commands that are responsible for military operations for specific geographic regions or theaters of operation. To support DOD's operations, the department performs an assortment of interrelated and interdependent business functions—using more than 3,700 business systems—related to major business areas such as weapon systems management, supply chain management, procurement, health care management, and financial management. The ability of these systems to operate as intended affects the lives of our warfighters both on and off the battlefield. For fiscal year 2006, Congress appropriated approximately $16 billion to DOD to operate, maintain, and modernize these business systems, and for fiscal year 2007, DOD has requested another $16 billion for this purpose.

[6] Of the fiscal year 2005 appropriation, approximately $78 billion was for the Global War on Terrorism and tsunami and hurricane relief efforts and about $39 billion was for permanent indefinite appropriations for retiree pensions and health care.

To assist DOD in addressing its modernization management challenges, Congress included provisions in the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 [7] that were consistent with our recommendations for establishing and implementing effective business system investment management structures and processes. During the past year, DOD has embarked on a series of efforts to transform its business operations and further comply with the act. In February 2005, DOD chartered the DBSMC to oversee transformation. As the senior most governing body overseeing business transformation, the DBSMC consists of senior leaders who meet monthly under the personal direction of the Deputy Secretary of Defense to set business transformation priorities and recommend policies and procedures required to attain DOD-wide interoperability of business systems and processes.

In October 2005, DOD also established the BTA that is intended to advance DOD-wide business transformation efforts in general, but particularly with regard to business systems modernization. DOD believes it can better address agencywide business transformation—which includes planning, management, organizational structures, and processes related to all key business areas—by first transforming business operations that support the warfighter while also enabling financial accountability across DOD. The BTA reports directly to the vice chair of the DBSMC—the Under Secretary of Defense for Acquisition, Technology and Logistics—and includes an acquisition executive who is responsible for 28 DOD-wide business projects, programs, systems, and initiatives. The BTA is responsible for integrating and supporting the work of the Office of the Secretary of Defense principal staff assistants, some of whom function as the approval authorities and who chair the business system investment review boards (IRB). The IRBs serve as the oversight and investment decision-making bodies for those business capabilities that support activities in their designated areas of responsibility.

[7] Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. No. 108-375, § 332, 118 Stat. 1811, 1851-1856 (Oct. 28, 2004) (codified in part at 10 U.S.C. § 2222).

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

Since the first GAO report on the financial statement audit of a major DOD component over 16 years ago,[8] we have repeatedly reported that weaknesses in business management systems, processes, and internal controls not only adversely affect the reliability of reported financial data, but also the management of DOD operations. In March 2006,[9] I testified that DOD's financial management deficiencies, taken together, continue to represent the single largest obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. These issues were also discussed in the latest consolidated financial audit report.[10] To date, none of the military services or major DOD components has passed the test of an independent financial audit because of pervasive weaknesses in internal control and processes and fundamentally flawed business systems.

DOD's financial management problems are pervasive, complex, long-standing, deeply rooted in virtually all of its business operations, and challenging to resolve. The nature and severity of DOD's financial management, business operations, and system deficiencies not only affect financial reporting, but also impede the ability of DOD managers to receive the full range of information needed to effectively manage day-to-day operations. Such weaknesses have adversely affected the ability of DOD to control costs, ensure basic accountability, anticipate future costs and claims on the budget, measure performance, maintain funds control, and prevent fraud, as the following examples illustrate.

- We found that hundreds of separated battle-injured soldiers were pursued for collection of military debts incurred through no fault of their own, including 74 soldiers whose debts had been reported to credit bureaus, private collection agencies, and the Treasury Offset Program. Overpayment of pay and allowances (entitlements), pay calculation errors, and erroneous leave payments caused 73 percent of

[8] GAO, *Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources*, GAO/AFMD-90-23 (Washington, D.C.: Feb. 23, 1990).

[9] GAO, *Fiscal Year 2005 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Financial Condition and Long-term Fiscal Imbalance*, GAO-06-406T (Washington, D.C.: Mar. 1, 2006).

[10] Department of the Treasury, *2005 Financial Report of the United States Government* (Washington, D.C.: Dec. 15, 2005).

the reported debts.[11]

- We identified numerous problems with DOD's processes for recording and reporting costs for the Global War on Terrorism raising significant concerns about the overall reliability of DOD's reported cost data. As discussed in our September 2005 report, neither DOD nor Congress know how much the war was costing and how appropriated funds were spent, or have historical data useful in considering future funding needs. [12] In at least one case, the reported costs may have been materially overstated. Specifically, DOD's reported obligations for mobilized Army reservists in fiscal year 2004 were based primarily on estimates rather than actual information and differed from related payroll information by as much as $2.1 billion, or 30 percent of the amount DOD reported in its cost report.

- In March 2006, we reported that DOD's policies and procedures for determining, reporting, and documenting cost estimates associated with environmental cleanup or containment activities were not consistently followed. Further, none of the military services had adequate controls in place to help ensure that all identified contaminated sites were included in their environmental liability cost estimates. DOD's reported liability of $64 billion is primarily for the cleanup of hazardous wastes at training ranges, military bases, and former defense sites; disposal of nuclear ships and submarines; and disposal of chemical weapons. These weaknesses not only affected the reliability of DOD's environmental liability estimate, but also that of the federal government as a whole. Uncertainties in environmental liabilities could materially affect the ultimate cost and timing of cleanup activities.[13]

- In December 2005, we reported that the Army had not maintained accurate accountability over inventory shipped to repair contractors, thereby placing these assets at risk of loss or theft. Although DOD policy requires the military services to confirm receipt of all assets shipped to contractors, we found that the Army did not consistently record shipment receipts in its inventory management systems. In an

[11] GAO-06-494.

[12] GAO-05-882.

[13] GAO, *Environmental Liabilities: Long-Term Fiscal Planning Hampered by Control Weaknesses and Uncertainties in the Federal Government's Estimates*, GAO-06-427 (Washington, D.C.: Mar. 31, 2006).

analysis of fiscal year 2004 shipment data obtained from two Army inventory control points, we could not reconcile shipment records with receipt records for 42 percent of the unclassified secondary repair item shipments, with a value of $481.7 million, or for 37 percent of the classified secondary repair item shipments, with a value of $8.1 million. These weaknesses in the Army's ability to account for inventory shipped to repair contractors increase the risk of undetected loss or theft because the Army cannot ensure control over assets after they have been shipped from its supply system. Moreover, inaccurate and incomplete receipt records diminish asset visibility and can distort on-hand inventory balances, leading to unnecessary procurement of items.[14]

- Over the years, DOD recorded billions of dollars of disbursements and collections in suspense accounts because the proper appropriation accounts could not be identified and charged. Because documentation needed to resolve these payment recording problems could not be found after so many years, DOD requested and received authority to write off certain aged suspense transactions. While DOD reported that it wrote off an absolute value of $35 billion or a net value of $629 million using the legislative authority, neither of these amounts accurately represents the true value of all the individual transactions that DOD had not correctly recorded in its financial records. Many of DOD's accounting systems and processes routinely offset individual disbursements, collections, adjustments, and correction entries against each other and, over time, amounts might even have been netted more than once. This netting and summarizing misstated the total value of the write-offs and made it impossible for DOD to identify what appropriations may have been under- or overcharged or to determine whether individual transactions were valid.[15]

- In May 2006, we reported that some DOD inventory management centers had not followed DOD-wide and individual policies and procedures to ensure they were retaining the right amount of contingency retention inventory. While policies require the centers to (1) use category codes to describe why they are retaining items in contingency inventory, (2) hold only those items needed to meet

[14] GAO, *Defense Inventory: Army Needs to Strengthen Internal Controls for Items Shipped to Repair Contractors*, GAO-06-209 (Washington, D.C.: Dec. 13, 2005).

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

current and future needs, and (3) perform annual reviews of their contingency inventory decisions, one or more centers had not followed these policies. For example, the Army's Aviation and Missile Command was not properly assigning category codes that described the reasons they were holding items in contingency inventory because the inventory system was not programmed to use the codes. We found that items valued at $193 million did not have codes to identify the reasons why they were being held, and therefore we were unable to determine the items' contingency retention category. We also found that some inventory centers have held items such as gears, motors, and electronic switches, even though there have been no requests for some of them by the services in over 10 years. By not following policies for managing contingency inventory, DOD's centers may be retaining items that are needlessly consuming warehouse space, and they are unable to know if their inventories most appropriately support current and future operational needs.[16]

- In June 2006, we reported that the military services had not consistently implemented DOD's revised policy in calculating carryover.[17] Instead, the military services used different methodologies for calculating the reported actual amount of carryover and the allowable amount of carryover since DOD changed its carryover policy in December 2002. Specifically, (1) the military services did not consistently calculate the allowable amount of carryover that was reported in their fiscal year 2004, 2005, and 2006 budgets because they used different tables (both provided by DOD) that contained different outlay rates for the same appropriation; (2) the Air Force did not follow DOD's regulation on calculating carryover for its depot maintenance activity group, which affected the amount of allowable carryover and actual carryover by tens of millions of dollars as well as whether the actual amount of carryover exceeded the allowable amount as reported in the fiscal year 2004, 2005, and 2006 budgets; and (3) the Army depot maintenance and ordnance activity groups' actual carryover was understated in fiscal years 2002 and 2003 because carryover associated with prior year orders was not included in the carryover calculation as required. As a result, year-end carryover data provided to decision

[16] GAO, *Defense Inventory: Actions Needed to Improve Inventory Retention Management*, GAO-06-512 (Washington, D.C.: May 25, 2006).

[17] Carryover is the dollar value of work that has been ordered and funded (obligated) by customers but not completed by working capital fund activities at the end of the fiscal year. Carryover consists of both the unfinished portion of work started but not completed as well as requested work that has not yet commenced.

makers who review and use the data for budgeting were erroneous and not comparable across the three military services.[18]

Improved Oversight of DOD Business Systems Needed

The department is provided billions of dollars annually to operate, maintain, and modernize its stovepiped, duplicative, legacy business systems. Despite this significant investment, the department is severely challenged in implementing business systems on time, within budget, and with the promised capability. The Clinger-Cohen Act of 1996[19] and Office of Management and Budget guidance provide an effective framework for information technology (IT) investment management. They emphasize the need to have investment management processes and information to help ensure that IT projects are being implemented at acceptable costs and within reasonable and expected time frames and that they are contributing to tangible, observable improvements in mission performance. Effective project management and oversight will be critical to the department's success in transforming its business management systems and operations. Many of the problems related to DOD's inability to effectively implement its business systems on time, within budget, and with the promised capability can be attributed to its failure to implement the disciplined processes[20] necessary to reduce the risks associated with these projects to acceptable levels.[21] Disciplined processes have been shown to reduce the risks associated with software development and acquisition efforts and are fundamental to successful systems acquisition. While the department invests billions of dollars annually in its business systems, the following examples highlight the continuing problem faced by the department in successfully implementing business systems.

- *Logistics Modernization Program* (LMP). In May 2004, we first reported our concerns with the requirements management and testing

[18] GAO, *Defense Working Capital Fund: Military Services Did Not Calculate and Report Carryover Amounts Correctly*, GAO-06-530 (Washington, D.C.: June 27, 2006).

[19] Pub. L. No. 104-106, div. E, 110 Stat. 186, 679 (Feb. 10, 1996).

[20] Disciplined processes include a wide range of activities, including project planning and management, requirements management, risk management, quality assurance, and testing.

[21] Acceptable levels refer to the fact that any systems acquisition effort will have risks and will suffer the adverse consequences associated with defects in the processes. However, effective implementation of disciplined processes reduces the possibility of the potential risks actually occurring and prevents significant defects from materially affecting the cost, timeliness, and performance of the project.

processes used by the Army in the implementation of LMP and the problems being encountered after it became operational in July 2003.[22] At the time of our initial report, the Army decided that future deployments would not occur until it had reasonable assurance that the system would operate as expected for a given deployment. However, as we reported in June 2005, the Army's inability to effectively address the requirements management and testing problems hampered its ability to field LMP to other locations.[23] Our analysis disclosed that LMP could not properly recognize revenue or bill customers. Furthermore, data conversion problems resulted in general ledger account balances not being properly converted when LMP became operational in July 2003. These differences remained unresolved almost 18 months later. These weaknesses adversely affected the Army's ability to set the prices for the work performed at the Tobyhanna Army Depot. In addition, data conversion problems resulted in excess items being ordered and shipped to Tobyhanna. As noted in our June 2005 report, three truckloads of locking washers (for bolts) were mistakenly ordered and received and subsequently returned because of data conversion problems. At the request of the Chairman and Ranking Minority Member of the Subcommittee on Readiness and Management Support, Senate Committee on Armed Services, we have initiated an audit of the Army's efforts to achieve financial management visibility over its assets. One aspect of this audit will be to ascertain the Army's progress in resolving the previously identified problems with LMP.

- *Navy Enterprise Resource Planning (ERP).* We reported in September 2005 that the Navy had invested approximately $1 billion in four pilot ERP efforts, without marked improvement in its day-to-day operations.[24] The four pilots were limited in scope and were not intended to be a corporate solution for resolving any of the Navy's long-standing financial and business management problems. The lack of a coordinated effort among the pilots led to a duplication of efforts in implementing many business functions and resulted in ERP solutions

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

[23] GAO, *Army Depot Maintenance: Ineffective Oversight of Depot Maintenance Operations and System Implementation Efforts*, GAO-05-441 (Washington, D.C.: June 30, 2005).

[24] GAO, *DOD Business Systems Modernization: Navy ERP Adherence to Best Business Practices Critical to Avoid Past Failures*, GAO-05-858 (Washington, D.C.: Sept. 29, 2005).

that carry out similar functions in different ways from one another. In essence, the pilots resulted in four more DOD stovepiped systems that did not enhance DOD's overall efficiency and resulted in $1 billion being largely wasted. While the current Navy ERP effort has the potential to address some of the Navy's financial management weaknesses, its planned functionality will not provide an all-inclusive, end-to-end corporate solution for the Navy. For example, the scope of the ERP project does not provide for real-time asset visibility of shipboard inventory. Asset visibility has been and continues to be a long-standing problem within the department. Furthermore, the project has a long way to go, with a current estimated completion date of 2011, at an estimated cost of $800 million.

- *Defense Travel System (DTS)*. As we reported in January 2006,[25] DTS continues to face implementation challenges, particularly with respect to testing key functionality to ensure that the system will perform as intended. Our analysis of selected requirements for one key area disclosed that system testing was not effective in ensuring that the promised capability was delivered as intended. For example, we found that DOD did not have reasonable assurance that flight information was properly displayed.[26] This problem was not detected prior to deployment of DTS because DOD did not properly test the system interfaces through which the data are accessed for display. As a result, those travelers using the system may not have received accurate information on available flights, which could have resulted in higher travel costs. Our report also identified key challenges facing DTS in becoming DOD's standard travel system, including the development of needed interfaces and underutilization of DTS at sites where it has been deployed. While DTS has developed 36 interfaces with various DOD business systems, it will have to develop interfaces with at least 18 additional business systems—not a trivial task. Additionally, the continued use of the existing legacy travel systems at locations where DTS is already deployed results in underutilization of DTS and affects the savings that DTS was planned to achieve.

- *Naval Tactical Command Support System (NTCSS)*. The Navy initiated the NTCSS program in 1995 to enhance the combat readiness

[25] GAO, *DOD Business Transformation: Defense Travel System Continues to Face Implementation Challenges*, GAO-06-18 (Washington, D.C.: Jan. 18, 2006).

[26] Flight information includes items such as departure and arrival times, airports, and the cost of the airline ticket.

of ships, submarines, and aircraft. To accomplish this, NTCSS was to provide unit commanding officers and crews with information about maintenance activities, parts inventories, finances, technical manuals and drawings, and personnel. According to the Navy, it spent approximately $1.1 billion for NTCSS from its inception through fiscal year 2005 and expects to spend another $348 million from fiscal years 2006 through 2009, for a total of approximately $1.45 billion. As discussed in our December 2005 report,[27] the Navy has not economically justified its ongoing and planned investment in NTCSS on the basis of reliable estimates of future costs and benefits. The most recent economic justification's cost estimates were not reliably derived, and return on investment was not properly calculated. In addition, independent reviews of the economic justification to determine its reliability did not occur, and the Navy has not measured whether already deployed and operating components of the system are producing expected value.

- *TC-AIMS II.* In December 2005, we reported that the Army had not economically justified its investment in TC-AIMS II on the basis of reliable estimates of costs and benefits. TC-AIMS II was intended to be the single integrated system to automate transportation management function areas for the military services.[28] As noted in our report, the most recent economic justification included cost and benefit estimates predicated on all four military services using the system. However, the Air Force and the Marine Corps have stated that they do not intend to use TC-AMIS II. Even with costs and benefits for all four services included, the analysis showed a marginal return on investment; that is, for each dollar spent on the system, slightly less than one dollar of benefit would be returned. The Army estimates the total life cycle cost of TC-AIMS II to be $1.7 billion over 25 years, including $569 million for acquisition and $1.2 billion for operation and maintenance. The Army reports that it has spent approximately $751 million on TC-AIMS II since its inception in 1995.

To effectively and efficiently modernize its nonintegrated and duplicative business operations and systems, it is essential for DOD to develop and use a well-defined business enterprise architecture. In July 2001, the

[27] GAO, *DOD Systems Modernization: Planned Investment in the Navy Tactical Command Support System Needs to Be Reassessed*, GAO-06-215 (Washington, D.C.: Dec. 5, 2005).

[28] GAO-06-171.

department initiated a business management modernization program to, among other things, develop the architecture. We have previously reported on DOD's long-standing architecture management weaknesses.[29] Despite spending almost 4 years and about $318 million, the architecture did not provide sufficient content and utility to effectively guide and constrain ongoing and planned business systems investments. DOD recognized the weaknesses that needed to be addressed and assigned a new business transformation leadership team in 2005. More specifically, as previously noted, in October 2005, DOD established BTA to advance DOD-wide business transformation efforts in general, but particularly with regard to business systems modernization.

DOD's Key Initiatives to Improve Financial Management Processes and Business Systems

DOD's complex and pervasive weaknesses cannot be fixed with short-term solutions, but require ongoing and sustained top management attention and resources. DOD's top management has demonstrated a commitment to transforming the department and has launched key initiatives to improve its financial management processes and related business systems, as well as made important progress in complying with legislation pertaining to its business systems modernization and financial management improvement efforts. For example, we reported in May 2006[30] that DOD released an update to its business enterprise architecture on March 15, 2006, developed an updated enterprise transition plan, and issued its annual report to Congress describing steps taken and planned with regard to business transformation, among other things. These steps address several of the missing elements we previously identified relative to the legislative provisions concerning the architecture, transition plan, budgetary reporting of business system investments, and investment review. Further, we testified[31] that in December 2005 DOD had issued its FIAR Plan, a major component of its business transformation strategy, to guide financial management improvement and audit efforts within the department. In addition, DOD developed SFIS that will be its enterprisewide data standard for categorizing financial information to support financial management and reporting functions. While this progress better positions the department to address the business systems

[29] GAO-05-702.

[30] GAO, *Business Systems Modernization: DOD Continues to Improve Institutional Approach, but Further Steps Needed*, GAO-06-658. (Washington, D.C.: May 15, 2006).

[31] GAO-06-406T.

modernization and financial management high-risk areas, significant challenges remain, particularly in implementing its tiered accountability investment approach.

DOD Issued Its Financial Improvement and Audit Readiness Plan

A major component of DOD's business transformation strategy is its FIAR Plan, issued in December 2005. The FIAR Plan was issued pursuant to section 376 of the National Defense Authorization Act for Fiscal Year 2006,[32] which for fiscal year 2006 limited DOD's ability to obligate or expend funds for financial improvement activities until the department submitted a comprehensive and integrated financial management improvement plan to congressional defense committees that (1) described specific actions to be taken to correct deficiencies that impair the department's ability to prepare timely, reliable, and complete financial management information; and (2) systematically tied such actions to process and control improvements and business systems modernization efforts described in the business enterprise architecture and transition plan. Further, section 376 required a written determination that each financial management improvement activity undertaken be (1) consistent with the financial management improvement plan and (2) likely to improve internal controls or otherwise result in sustained improvement in DOD's ability to produce timely, reliable, and complete financial management information. The act also required that each written determination be submitted to the congressional defense committees.

The FIAR Plan is intended to provide DOD components with a road map for achieving the following objectives: (1) resolving problems affecting the accuracy, reliability, and timeliness of financial information, and (2) obtaining clean financial statement audit opinions. Similar to the Financial Improvement Initiative, an earlier DOD improvement effort, the FIAR Plan uses an incremental approach to structure its process for examining operations, diagnosing problems, planning corrective actions, and preparing for audit. However, unlike the previous initiative, the FIAR Plan does not establish a specific target date for achieving a clean audit opinion on the departmentwide financial statements. Target dates under the prior plan were not credible. Rather, the FIAR Plan recognizes that it will take several years before DOD is able to implement the systems, processes, and other changes necessary to fully address its financial management weaknesses. This plan is an important and positive step that will help key

[32] Pub. L. No. 109-163, § 376, 119 Stat. 3136, 3213 (Jan. 6, 2006).

department personnel to better understand and address its financial management deficiencies.

As outlined in its FIAR Plan, DOD has established business rules and an oversight structure to guide improvement activities and audit preparation efforts. In December 2005, the U.S. Army Corps of Engineers, Civil Works, became the first major DOD component to assert, under DOD's new process and business rules, that its fiscal year 2006 financial statement information was reliable. An independent public accounting firm has been hired to perform this component's financial statement audit, under the oversight and direction of the DOD Inspector General. However, the effectiveness of DOD's FIAR Plan, as well as the department's leadership and business rules, in addressing DOD's financial management deficiencies will be ultimately measured by the department's ability to provide timely, reliable, accurate, and useful information for day-to-day management and decision making.

DOD Developed an Initial Standard Financial Information Structure

Another key initiative is SFIS, which is DOD's enterprisewide data standard for categorizing financial information to support financial management and reporting functions. DOD has recently completed phase I of the SFIS initiative, which focused on standardizing general ledger and external financial reporting requirements. SFIS includes a standard accounting classification structure that can allow DOD to standardize financial data elements necessary to support budgeting, accounting, cost management, and external reporting; it also incorporates many of the Department of the Treasury's U. S. Standard General Ledger attributes. Additional SFIS efforts remain under way, and the department plans to further define key data elements, such as those relating to the planning, programming, and budgeting business process area.

DOD intends to implement SFIS using three approaches. One approach requires legacy accounting systems to submit detail-level accounting transactions that are to be converted to SFIS-equivalent data elements. The second approach applies to business feeder systems and will require incorporation of SFIS data elements within systems that create the business transactions. Lastly, accounting systems under development, including new enterprise resource planning systems, are required to have the ability to receive SFIS data as part of source transactions and generate appropriate general ledger entries in accordance with the U.S. Standard General Ledger.

DOD Efforts to Control Business Systems Investments

To help improve the department's control and accountability over its business systems investments, provisions in the fiscal year 2005 national defense authorization act directed DOD to put in place a specifically defined structure that is responsible and accountable for controlling business systems investments to ensure compliance and consistency with the business enterprise architecture. More specifically, the act directs the Secretary of Defense to delegate responsibility for review, approval, and oversight of the planning, design, acquisition, deployment, operation, maintenance, and modernization of defense business systems to designated approval authorities or "owners" of certain business missions.[33] DOD has satisfied this requirement under the act. On March 19, 2005, the Deputy Secretary of Defense issued a memorandum that delegated the authority in accordance with the criteria specified in the act, as described above. Our research and evaluation of agencies' investment management practices have shown that clear assignment of senior executive investment management responsibilities and accountabilities is crucial to having an effective institutional approach to IT investment management.[34]

The fiscal year 2005 national defense authorization act also required DOD to establish investment review structures and processes, including a hierarchy of IRBs, each with representation from across the department, and a standard set of investment review and decision-making criteria for these boards to use to ensure compliance and consistency with DOD's business enterprise architecture. In this regard, the act required the establishment of the DBSMC—which serves as the highest ranking governance body for business system modernization activities within the department. As of April 2006, DOD identified 3,717 business systems and assigned responsibility for these systems to IRBs. Table 1 shows the systems by the responsible IRB and component.

[33] Approval authorities, including the Under Secretary of Defense for Acquisition, Technology and Logistics; the Under Secretary of Defense (Comptroller); the Under Secretary of Defense for Personnel and Readiness; the Assistant Secretary of Defense for Networks and Information Integration/Chief Information Officer of the Department of Defense; and the Deputy Secretary of Defense or an Under Secretary of Defense, as designated by the Secretary of Defense, are responsible for the review, approval, and oversight of business systems and must establish investment review processes for systems under their cognizance.

[34] GAO, *Information Technology Investment Management: A Framework for Assessing and Improving Process Maturity*, GAO-04-394G (Washington, D.C.: March 2004).

Table 1: DOD Systems by Investment Review Board and Component

Investment Review Board	Air Force	Army	Navy	Defense Finance and Accounting Service	Other defense agencies	Total
Financial Management	67	161	148	72	35	483
Human Resources Management	164	320	174	20	114	792
Weapon System Life Cycle Management and Materiel Supply and Service Management	780	730	406	1	168	2,085
Real Property and Installations Life Cycle Management	71	122	44	0	17	254
Other	65	0	26	0	12	103
Total	**1,147**	**1,333**	**798**	**93**	**346**	**3,717**

Source: GAO analysis of DOD data.

A key element of the department's approach to reviewing and approving business systems investments is the use of what it refers to as tiered accountability. DOD's tiered accountability approach involves an investment control process that begins at the component level and works its way through a hierarchy of review and approval authorities, depending on the size and significance of the investment. Military service officials emphasized that the success of the process depends on them performing a thorough analysis of each business system before it is submitted for higher-level review and approval. Through this process, the department reported in March 2006 that 226 business systems, representing about $3.6 billion in modernization investment funding, had been approved by the DBSMC—the department's highest-ranking approval body for business systems. According to the department's March 2006 report, this process also identified more than 290 systems for phaseout or elimination and approximately 40 business systems for which the requested funding was reduced and the funding availability periods were shortened to fewer than the number of years requested. For example, one business system investment that has been eliminated is the Forward Compatible Payroll (FCP) system. In reviewing the program status, the IRB determined that FCP would duplicate the functionality contained in the Defense Integrated Military Human Resources System, and it was unnecessary to continue investing in both systems. According to the department's fiscal year 2007 IT budget request, approximately $33 million was sought for fiscal year 2007 and about $31 million was estimated for fiscal year 2008 for FCP. Eliminating this duplicative system will enable DOD to use this funding for other priorities. The funding of multiple systems that perform the same function is one reason the department has thousands of business systems. Identifying and eliminating duplicative systems helps optimize mission

performance and accountability and supports the department's transformation goals.

Furthermore, based on information provided by BTA program officials, there was a reduction of funding and the number of years that funding will be available for 14 Army business systems, 8 Air Force business systems, and 8 Navy business systems. For example, the Army's Future Combat Systems Advanced Collaborative Environment program requested funding of $100 million for fiscal years 2006 to 2011, but the amount approved was reduced to approximately $51 million for fiscal years 2006 to 2008. Similarly, Navy's Military Sealift Command Human Resources Management System requested funding of about $19 million for fiscal years 2006 to 2011, but the amount approved was approximately $2 million for the first 6 months of fiscal year 2006. According to Navy officials, this system initiative will be reviewed to ascertain whether it has some of the same functionality as the Defense Civilian Personnel Data System. Funding system initiatives for shorter time periods can help reduce the financial risk by providing additional opportunities for monitoring a project's progress against established milestones and help ensure that the investment is properly aligned with the architecture and the department's overall goals and objectives.

Besides limiting funding as part of the investment review and approval process, this process is also resulting in conditions being placed on system investments. These conditions identify specific actions to be taken and when the actions must be completed. For example, in the case of the Army's LMP initiative, one of the noted conditions was that the Army had to address the issues discussed in our previous reports.[35] In our May 2004 report, we recommended that the department establish a mechanism that provides for tracking all business systems modernization conditional approvals to provide reasonable assurance that all specific actions are completed on time.[36] The department's action is consistent with the intent of our recommendations.

Notwithstanding the department's efforts to control its business system investments, formidable challenges remain. In particular, the reviews of those business systems that have modernization funding of less than $1 million, which represent the majority of the department's reported 3,717

[35] GAO-04-615 and GAO-05-441.

[36] GAO-04-615.

business systems, are only now being started on an annual basis. The extent to which the review structures and processes will be applied to the department's 3,717 business systems is still evolving. Given the large number of systems involved, it is important that an efficient system review and approval process be effectively implemented for all systems. As indicated in table 1, there are numerous systems across the department in the same functional area. Such large numbers of systems indicate a real possibility for eliminating unnecessary duplication and avoiding unnecessary spending on the department's multiple business systems.

Key Elements Needed to Guide DOD Transformation Efforts

While DOD's recent efforts represent positive steps toward improving financial management and changing DOD's business systems environment, the department still lacks key elements that are needed to ensure a successful and sustainable business transformation effort. We reiterate two major elements necessary for successful business transformation: (1) a comprehensive, integrated, and enterprisewide business transformation plan and (2) a CMO with the right skills and at the right level of the department for providing the sustained leadership needed to achieve a successful and sustainable transformation effort.

Comprehensive, Integrated, and Enterprisewide Business Transformation Plan Not Developed

Although some progress has been made in business transformation planning, DOD still has not developed a comprehensive, integrated, and enterprisewide strategy or action plan for managing its overall business transformation effort. The lack of a comprehensive, integrated, enterprisewide action plan linked with performance goals, objectives, and rewards has been a continuing weakness in DOD's business management transformation.

Since 1999, GAO has recommended a comprehensive, integrated strategy and action plan for reforming DOD's major business operations and support activities.[37] DOD's efforts to plan and organize itself to achieve business transformation are continuing to evolve. Critical to the success of these efforts will be top management attention and structures that focus on transformation from a broad perspective and a clear, comprehensive, integrated, and enterprisewide plan that at a summary level, addresses all of the department's major business areas. This strategic plan should cover

[37] GAO, *Defense Reform Initiative: Organization, Status, and Challenges*, GAO/NSIAD-99-87 (Washington, D.C.: Apr. 21, 1999).

all of DOD's key business functions; contain results-oriented goals, measures, and expectations that link institutional, unit, and individual performance goals and expectations to promote accountability; identify people with needed skills, knowledge, experience, responsibility, and authority to implement the plan; and establish an effective process and related tools for implementation. Such an integrated business transformation plan would be instrumental in establishing investment priorities and guiding the department's key resource decisions.

DOD's leadership has recognized the need to transform the department's business operations. DOD released a major update to its business enterprise architecture in September 2005 and developed an updated transition plan in March 2006 for modernizing its business processes and supporting IT assets. The business enterprise architecture provides a foundational blueprint for modernizing business operations, information, and systems, while the enterprise transition plan provides a road map and management tool that sequences business systems investments in the areas of personnel, logistics, real property, acquisition, purchasing, and financial requirements.

However, while the enterprise transition plan is an important step toward developing a strategic plan for the department's overall business transformation efforts, it is still focused primarily on business systems. Business transformation is much broader; it encompasses areas such as support infrastructure, human capital, financial management, planning and budgeting, and supply chain management. DOD officials acknowledge that the enterprise transition plan may not have all of the elements of an overarching business transformation plan as we envision it. However, they consider the plan to be evolving.

Sustained Leadership Is Needed

DOD continues to lack the sustained leadership at the right level to achieve successful and lasting transformation. We have testified on the need for a CMO on numerous occasions.[38] Because of the complexity and

[38] GAO, *Department of Defense: Long-standing Problems Continue to Impede Financial and Business Management Transformation*, GAO-04-907T (Washington, D.C.: July 7, 2004); *Department of Defense: Financial and Business Management Transformation Hindered by Long-standing Problems*, GAO-04-941T, (Washington, D.C.: July 8, 2004); *Department of Defense: Further Actions Are Needed to Effectively Address Business Management Problems and Overcome Key Business Transformation Challenges*, GAO-05-140T (Washington, D.C.: Nov. 18, 2004); and *DOD's High-Risk Areas: Successful Business Transformation Requires Sound Strategic Planning and Sustained Leadership*, GAO-05-520T (Washington, D.C.: Apr. 13, 2005).

long-term nature of DOD's business transformation efforts, we reiterate the need for a CMO to provide sustained leadership and maintain momentum. Without formally designating responsibility and accountability for results, choosing among competing demands for scarce resources and resolving differences in priorities between various DOD organizations will be difficult and could impede DOD's ability to transform in an efficient, effective, and reasonably timely manner. In addition, it may be particularly difficult for DOD to sustain transformation progress when key personnel changes occur. The National Defense Authorization Act for Fiscal Year 2006[39] directs the department to study the feasibility of a CMO position in DOD. In this regard, the Institute for Defense Analysis has initiated a study and the results are due by December 2006. Further, in May 2006, the Defense Business Board recommended the creation of a Principal Under Secretary of Defense, with a 5 year term appointment, to serve as CMO. Additionally, in July 2006, a major global consulting firm recommended the concept of a chief operating officer be instituted in many federal agencies as the means to help achieve the transformation that many agencies have undertaken.[40]

To provide for senior-level leadership, the CMO would serve as the strategic, enterprisewide integrator of DOD's overall efforts to transform its business operations. The CMO would be an executive level II appointment, with a tenure of 5 to7 years and serve as the Deputy Secretary or Principal Under Secretary of Defense for Management. This position would elevate integrate, and institutionalize the attention essential for addressing key stewardship responsibilities, such as strategic planning, enterprise architecture development and implementation, IT management, financial management reform, and human capital reform while facilitating the overall business management transformation effort within DOD. It is important to note that theCMO would not assume the responsibilities of the undersecretaries of defense, the service secretaries, or other DOD officials for the day-to-day management of the department. Rather, the CMO would be responsible and accountable for planning, integrating, and executing the overall business transformation effort. The

[39] National Defense Authorization Act for Fiscal Year 2006, Pub. L. No. 109-163, § 907, 119 Stat. 3136, 3403 (Jan. 6, 2006).

[40] Tony Danker, Thomas Dohrmann, Nancy Killefer, and Lenny Mendonca, *How can American government meet its productivity challenge?* (Washington, D.C.: McKinsey & Company, 2006).

CMO also would develop and implement a strategic plan for the overall business transformational efforts.

The Secretary of Defense, Deputy Secretary of Defense, and other senior leaders have clearly shown a commitment to business transformation and addressing deficiencies in the department's business operations. During the past year, DOD has taken additional steps to address certain provisions and requirements of the fiscal year 2005 national defense authorization act, including establishing the DBSMC as DOD's primary transformation leadership and oversight mechanism, and creating the BTA to support the DBSMC, a decision-making body. However, these organizations do not provide the sustained leadership needed to successfully achieve business transformation. The DBSMC's representatives consist of political appointees whose terms expire when administrations change. Furthermore, it is important to remember that committees do not lead, people do. Thus, DOD still needs to designate a person to provide sustained leadership and have overall responsibility and accountability for this effort.

Conclusion

DOD continues to face two formidable challenges. Externally, it must combat the global war on terrorism, and internally, it must address the long-standing problems of fraud, waste, and abuse. Pervasive, decades-old management problems related to its business operations affect all of DOD's major business areas. While DOD has taken several positive steps to address these problems, our previous work has uncovered a persistent pattern among DOD's reform initiatives that limits their overall impact on the department. These initiatives have not been fully implemented in a timely fashion because of the absence of comprehensive, integrated strategic planning; inadequate transparency and accountability; and the lack of sustained leadership. In this time of growing fiscal constraints, every dollar that DOD can save through improved economy and efficiency of its operations is important to the well-being of our nation and the legitimate needs of our warfighters. Until DOD resolves the numerous problems and inefficiencies in its business operations, billions of dollars will continue to be wasted every year. Furthermore, without strong and sustained leadership, both within and across administrations, DOD will likely continue to have difficulties in maintaining the oversight, focus, and momentum needed to implement and sustain the needed reforms to its business operations. In this regard, I would like to reiterate the need for a CMO to serve as the strategic and enterprisewide integrator to oversee the overall transformation of the department's business operations.

Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I would be happy to answer any questions you may have at this time.

Testimony

of

J. David Patterson
Principal Deputy Under Secretary of Defense (Comptroller)

before the

Senate Homeland Security and Governmental Affairs Committee

Subcommittee on Federal Financial Management, Government Information and International Security

August 3, 2006

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Mr. Chairman, Members of the Committee, thank you for the opportunity to update you on the progress the Department has made in business transformation and financial management – and through you, the American people.

As stewards of the resources entrusted to us for the defense of the Nation, we take our responsibilities to the American taxpayer seriously. We also strive to never lose sight of the fact that everything we do – every dollar we manage, every contract we fund – affects the men and women in uniform who put their lives on the line every day to protect our freedom.

Secretary's Message

Indeed, more than anything else, the Department's business transformation and financial management efforts are about supporting the warfighters who defend the Nation.

This has been the case since the Administration took office. As Secretary Rumsfeld said on September 10, 2001 when he announced this campaign to transform the Pentagon bureaucracy, "This is not just about money or waste... In the end," the Secretary said, "it is really a matter of life and death – ultimately, every American's ..."

"Our job," the Secretary said, "is defending America, and if we cannot change the way we do business, then we cannot do our job well, and we must."

2001 QDR GOALS

In the first year of Secretary Rumsfeld's tenure, the 2001 Quadrennial Defense Review was released. The QDR challenged the Department to

modernize its approach to business operations and information, especially with regard to enabling the Department's financial and non-financial operations to work together effectively – which was not then the case.

To correct this deficiency, the QDR called for the creation of a DOD-wide blueprint, or architecture, to guide the development of enterprise-level processes and systems throughout the Department of Defense. The QDR also prescribed periodic consultation with the U.S. Comptroller-General for better insight and support, and improved coordination with Congress regarding financial management oversight activities.

Since that time, Mr. Chairman, we have been working to make these goals a reality.

Meeting the Challenge

The challenges the Department faced were not insignificant – beginning with the sheer size of the enterprise. With more than 600,000 buildings and structures in over 146 countries around the globe, the Department's assets and liabilities alone exceed those of WalMart, Exxon, Ford and IBM combined.

Add to that an employment roster that includes 1.4 million active duty men and women, 740,000 civilians, 860,000 Guard and Reserve, 2 million retirees and families, and an operating budget in excess of $400 billion, and you have some idea of the sheer volume of financial information, not to mention the difficulty in consistently capturing that information and uniformly applying solutions.

Indeed, for decades there were no uniform solutions, only a wide variety of disparate systems and processes unable to talk to one another, and thus unable to produce accurate, complete or timely information.

Agenda for Change

In 2001, the Department embarked upon an ambitious plan to bring the Department of Defense into the 21st century. After four years of work and preparation, two comprehensive and integrated plans for financial improvement and business systems modernization were launched in 2005: The Enterprise Transition Plan (ETP); and The Financial Improvement and Audit Readiness Plan (FIAR).

The Enterprise Transition Plan (ETP) consolidates DoD's many disparate business systems and focuses resources to minimize redundancy and reduce overhead. The Enterprise Transition Plan also details the schedules, milestones, and costs for 98 key transformational programs and initiatives across the Department.

The Financial Improvement and Audit Readiness Plan, or "FIAR" Plan, focuses the Department's efforts on improving business processes and internal controls. It unites DoD's functional and financial operations and comprehensively guides the effort to incrementally resolve material weaknesses to achieve an independently verified, or "clean," audit opinion.

Together, the Enterprise Transition Plan and the Financial Improvement and Audit Readiness Plan are reducing the cost of operations, increasing speed and efficiency, improving internal controls and financial accountability, and most

importantly, positively impacting our primary mission: supporting the warfighters who defend the Nation.

Improving Financial Management and Audit Readiness

Employing an incremental methodology to achieving audit readiness, the FIAR Plan focused its initial efforts on four high-impact areas that represent a significant portion of the Department's assets and liabilities: Military Equipment, Real Property, Medicare-Eligible Retiree Health Care Fund, and Environmental Liabilities. Fund Balance with Treasury is also a priority.

The goal is to produce an independently verified opinion of 73 percent of the Department's assets and 80 percent of its liabilities by 2010.

Each focus area includes specific milestones for achieving a successful audit, and during the last six months, 64 percent of these milestones have been met.

Military Equipment

In the area of Military Equipment – which represents fully 27 percent of all DoD assets – an auditable baseline valuation for 100 percent of all Military Equipment programs – everything from combat vehicles to ships to aircraft – has now been established, and was included in the Department's third quarter fiscal year 2006 financial statement.

This is especially significant because the Department has never before had an accurate valuation of its military equipment. This work also lays the

foundation for the development of depreciation schedules for the Department's largest category of assets.

Fund Balance With Treasury

Also, for the first time in its history, the Air Force Fund Balance with Treasury – which represents five percent of all DoD assets – is now ready for audit, meeting its target goal for 2006.

Real Property

In the area of Real Property, long-standing issues regarding the best way to value real property assets have now been resolved, and the process of identifying and accurately reporting real property is moving forward. This process allows us to fully understand the cost of operating facilities, and also improves our ability to negotiate contracts and identify savings associated with the Base Realignment and Closure process.

Environmental Liabilities

In the area of environmental liabilities, an initial inventory and estimate for 97 percent of all environmental liabilities have now been completed for Navy nuclear-powered vessels, the Defense Environmental Restoration Program, Base Realignment and Closure, and the Chemical Weapons Program. In addition to calculating the value of this important category of liabilities, this work will enable the Department to better identify the amount and timing of funding requirements necessary to resolve environmental issues.

Medicare-Eligible Retiree Health Care Fund Liabilities

In the area of health care liabilities, a new system that will provide an improved capability to manage the cost of this increasingly expensive liability is expected to be in place within the next two years.

Component Progress

In addition to the four focus areas of the DoD balance sheet, the military components are making good progress toward independent audit opinions. For example, the U.S. Army Corps of Engineers is currently undergoing an audit of *its* FY 2006 financial statements, and the Marine Corps expects to be ready for a full audit of their financial statements in FY 2007.

Clean audits for the military components confirm both the reliability of financial information and demonstrate the Department's commitment to accurate reporting.

Improving Business Systems and Processes

Effective business systems and processes also support "clean" audit opinions and the internal controls that help eliminate material weaknesses.

In this respect, the Department has made clear and measurable progress in modernizing and consolidating DoD business systems and operations, and improving the accuracy, reliability and timeliness of information.

Specifically, the major milestones for improved financial visibility, as outlined in the Enterprise Transition Plan, are being achieved on schedule. These milestones include implementation of the Standard Financial Information Structure (SFIS), which will allow all DoD financial systems to speak the same language, and facilitate more accurate compilation and reporting of financial information.

Other enterprise-level financial management initiatives and programs are also proceeding on schedule and reviewed monthly by the Deputy Secretary of Defense and the Defense Business Systems Management Committee (DBSMC).

As noted in the Department's March report to Congress, the Department has achieved 74 percent of the six-month milestones identified in the Enterprise Transition Plan, and is proactively resetting the remaining 26 percent to ensure that those milestones are achieved in the next six months.

Additionally, the Department has certified over 200 systems modernization efforts, each valued at $1 million or more, to ensure compliance with the Enterprise Transition Plan and the Business Enterprise Architecture. An update to the Enterprise Transition Plan will be published in September.

So, I feel good about our progress. And it's not just the Department saying that. Our recent success in business systems modernization was affirmed by the Government Accountability Office in two consecutive reports (November and May), which cited important progress in this area, and by the Office of Management and Budget, which elevated the Department's progress rating from yellow to green.

Indeed, there are numerous examples of how the Department is improving its business processes and systems. For example:

- Since 2001, process efficiencies at the Defense Finance and Accounting Service have resulted in manpower cost savings of approximately $238 million – all while improving productivity and service to the warfighter.

  As new automated systems are implemented, and the Base Realignment and Closure process is completed, manpower costs will decrease by an additional 45 percent, with a projected annual savings of $357 million.

- Past due individual travel accounts have been reduced from 18.4% in 2001 to an all-time low of 3.2 percent -- which results in increased public credibility and improved negotiating power for new card service contracts.

- Fully 95 percent of all vendor payments are now done electronically, as compared with 86 percent in 2001, realizing a savings of $6 million.

- Delinquent debts receivable have been reduced by 42 percent – or $1.1 billion – from FY 2004 to FY 2005.

- Likewise, unsupported accounting entries have been reduced by 86 percent, or $1.98 trillion, from FY 1999 to FY 2005.

- Late payment penalties have continued to decrease from $343 per million dollars of payments in 2001 to $127 per million in 2006 – a 63 percent improvement that has avoided $140 million in interest payments.

- We have also steadily reduced the amount of overpayment to vendors, which has resulted in a reduction of approximately $39 million of improper payments.

These are just some of the ways, improved business processes and systems are making a difference at the Department of Defense. Of course, the most important improvement has been the clear and comprehensive process for change outlined in the Enterprise Transition Plan and the Financial Improvement and Audit Readiness Plan.

Looking forward, the September 2006 FIAR Plan will include four new focus areas for financial management improvement: Accounts Payable, Accounts Receivable, Inventory, and Operating Material and Supplies. A special initiative *focusing on* improvements to Military Pay will also be addressed.

All in all, since the 2001 QDR was released, $16 billion has been spent on business systems modernization -- $12.6 billion at the Component level, and $3.4 billion at the enterprise level – in my view a wise investment for the return we have already realized, as well as for what we can expect in the years ahead.

Responsibility and Accountability

The responsibility for improved financial management and business modernization rests with every employee of the Department of Defense. Because personal integrity, responsibility, and competence permeate all financial

improvement efforts, every person is responsible for safeguarding assets, ensuring compliance, and maintaining effectiveness. And, starting at the top, all are responsible for identifying and resolving problems in operations and compliance.

Indeed, the Deputy Secretary of Defense has designated financial improvement to be a Department-wide priority, and personally ensures that DoD senior leadership stay committed and informed.

To manage the FIAR Plan, and ensure that DoD-wide financial improvement efforts are fully integrated with other transformation activities across the Department, the Office of the Under Secretary of Defense (Comptroller) established the FIAR Committee and the FIAR Directorate, its program management office.

The FIAR Committee leads the process for establishing and monitoring FIAR Plan priorities. Chaired by the Deputy Chief Financial Officer, the Committee includes executive-level representatives of the Military Departments, the Defense Logistics Agency, the Business Transformation Agency, and the Defense Finance and Accounting Service. The Inspector General, DoD acts as an adviser to the FIAR Committee. This collaborative management structure reinforces business integration.

But, the Department is not alone in providing oversight. The President's Management Agenda requires federal agencies to improve financial performance, and the Office of Management Budget monitors this progress against metrics on which DoD reports quarterly.

Reporting began in December 2005 for the first quarter of FY 2006. Regular DoD progress reviews, and key milestone controls, ensure that the financial improvement metrics reported are reliable and based on strict internal management objectives.

Mr. Chairman, the challenges we have faced in this endeavor have been many, and the task is still far from complete, but I believe the Department of Defense has made clear and measurable progress in improving the business systems and financial management of the Nation's largest and most complex department – and that that progress will continue.

Mr. Chairman, I thank you again for the opportunity to share these accomplishments with you, and on behalf of Department of Defense, I thank the Committee for its support for these important efforts, and most importantly, for their continued strong support of the men and women of America's Armed Forces and their families.

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[2,287 words; 16.5 minutes]

August 3, 2006

HOLD FOR RELEASE
EXPECTED 2:30 p.m.

Statement
of
Thomas F. Gimble
Acting Inspector General
Office of the Inspector General
Department of Defense

before the

Subcommittee on Federal Financial Management,
Government Information and International Security
Senate Committee on Homeland Security and
Governmental Affairs

on

"Financial Management at the Department of Defense"

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to discuss, first, the financial management challenges that the Department of Defense continues to face; and second, the progress that the Department has made in addressing the challenges and achieving the goals established in the 2001 Quadrennial Defense Review (QDR).

The Department's financial statements are the most extensive, complex, and diverse financial statements in the Government. As we reported in prior testimony,[1] the Department faces financial management problems that are long standing, pervasive, and deeply rooted in virtually all operations. Those financial management problems continue to impede the Department's ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. The problems have also prevented the Department from receiving an unqualified opinion on its financial statements.

We are encouraged, however, by the framework the Department has established to address those problems. This framework can provide direction to the Department's financial improvement efforts and can be the mechanism for holding the Department's managers accountable for correcting specific weaknesses and for meeting milestones. More importantly, it provides a mechanism for measuring success.

The challenge to Department managers is to continue to fortify and refine the framework. However, they also must maintain a sustained effort and focus within the framework to identify, monitor and correct internal control and systems weaknesses. The Department's financial improvement effort must be focused on implementing the corrective actions needed throughout the Department to improve financial management. Ongoing Office of Inspector General audit work is described in the Attachment.

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[1] Department of Defense Office of the Inspector General Report Number D-2004-105-T, "Statement of Francis E. Reardon, Deputy Inspector General for Auditing Office of the Inspector General Department of Defense before the subcommittee on Financial Management, the Budget and International Security Senate Committee on Governmental Affairs on 'Department of Defense FY 2003 Financial Statements'" July 8, 2004.

Opinions on Financial Statements for FY 2005

The Fiscal Year 2005, DoD Agency-Wide Principal Financial Statements reported $1.3 trillion in assets, $1.9 trillion in liabilities, and $635 billion in Net Cost of Operations. We issued a disclaimer of opinion for the statements because numerous deficiencies continue to exist related to the quality of data, adequacy of reporting systems, and reliability of internal controls.

Nine DoD Components are required by the Office of Management and Budget (OMB) to prepare and obtain an audit opinion on their FY 2005 financial statements. Only the Military Retirement Fund received an unqualified opinion. The Medicare-Eligible Health Care Fund received a qualified opinion. All the others, including the agency-wide financial statements, received a disclaimer of opinion, as they have every year in the past.

DoD's financial management problems are so significant that they constitute the single largest and most challenging impediment to the U.S Government's ability to obtain an opinion on its consolidated financial statements. In its March 3, 2006, Executive Branch Management Scorecard, OMB assessed the status of the department's financial performance as "Red," or "Unsatisfactory." The weaknesses that affect the auditability of the financial statements also impact other DoD programs and operations and contribute to waste, mismanagement, and inefficient use of DoD resources. These weaknesses affect the safeguarding of assets and proper use of funds and impair the prevention and identification of fraud, waste, and abuse.

Internal Control Deficiencies

Issues of reliability, integrity, timeliness, and auditability of financial data continue to impede our ability to render an opinion on the financial statements. We have reported those weaknesses to the Department and have also made recommendations to correct those weaknesses. The Department's progress in addressing the specific findings and recommendations made in individual audit reports will be a critical factor in determining how much financial management improvement occurs. We have identified reportable conditions in Accounts Payable, Accounts Receivable, and Contingent Legal Liabilities.

We also have identified the following list of current material internal control weaknesses.

1. Financial Management Systems
2. Fund Balance with Treasury
3. Inventory
4. Operating Materials and Supplies
5. Property, Plant and Equipment
6. Government-Furnished Material and Contractor-Acquired Material
7. Environmental Liabilities
8. Intragovernmental Eliminations
9. Accounting Entries
10. Statement of Net Cost
11. Statement of Financing

These weaknesses affect the quality of the data that DoD managers at all levels use and rely on for decision-making. Poor data quality impairs management's ability to: make informed decisions, manage programs and funds efficiently, effectively meet objectives, comply with laws and statutory and regulatory requirements, and provide sufficient and timely support to the warfighter.

DoD management has acknowledged these financial weaknesses. However, DoD financial management is decentralized. The Under Secretary of Defense (Comptroller)/Chief Financial Officer has overall responsibility for financial management. However, the Assistant Secretaries of the various Military Departments (Financial Management and Comptroller) and the Chief Financial Executives (or other named positions) have the primary responsibility within their Components. Thus, it is difficult for the Department to oversee the implementation of DoD OIG recommendations for corrective action.

The DoD OIG makes recommendations to the lowest level of management that has the authority or ability to perform the corrective action. Normally this level of authority resides in the Commander, Director, or the Under Secretary- or Assistant Secretary-level rather than the actual Division or Directorate which would implement the recommendation. We make a great number of recommendations to the Defense Finance and Accounting Service because they own most of the major financial accounting and management systems within DoD; however, we make recommendations to the Under Secretary of Defense (Comptroller)/Chief Financial Officer when policy issues need to be addressed or we see a need for DoD-Wide actions guided by top management. The DoD OIG performs follow-up procedures to determine whether management accepts and implements our recommendations.

Challenges

In the past, DoD did not have a specific, coordinated organizational structure or plan to identify, coordinate, and monitor the corrective actions and key milestone dates for the previously identified financial management weaknesses. Additionally, DoD did not have a structure to identify additional weaknesses or hold managers accountable for implementing corrective actions and meeting key milestones. These elements are fundamental to successfully implementing financial management improvements in an organization as complex and decentralized as DoD. Specifically, the following elements and actions are key to improving the Department's financial management.

- **Create** an environment that fully supports clean financial reporting. The financial managers need buy-in from senior management and personnel in the field offices in order to successfully implement the corrective action plans.
- Maintain a significant level of continued review to **identify** all of the material financial management and reporting deficiencies, internal control weaknesses, and quality of data issues.
- **Develop** corrective action plans that will adequately correct the deficiencies and result in financial reporting in accordance with generally accepted accounting principles (GAAP).

- **Implement** the corrective action plans that address the system, control, reporting, or quality of data weakness.

The most significant financial management challenge facing the Department is the ability of the individual DoD financial managers to sustain their focus and efforts on those key elements. However, they must successfully implement all four elements because eliminating even one poses a significant risk that DoD will not achieve improved financial management processes and systems and earn favorable audit results.

Another significant financial management challenge for the Department is unreliable financial data from legacy systems. Unless the data's completeness and accuracy are properly verified before being carried forward to the new systems, the data will continue to be unreliable and may contaminate summary data in future enterprise systems.

Progress

The Department's overall business systems modernization effort encompasses all facets of DoD operations, including the area of financial management. Specifically, in that area, the Department has made progress by establishing a framework to direct and hold managers accountable for the Department's financial improvement efforts. The framework, called the Financial Improvement and Audit Readiness (FIAR) improvement initiative, comprises a directorate that is responsible for centrally coordinating the initiative; a regularly updated, written plan with stated objectives and milestones; a defined process with protocols for making decisions; a tool for tracking progress; and oversight groups consisting of participants from across DoD to guide the decision making process.

The Department's financial managers are developing and updating corrective action plans in the FIAR plan, refining the Department's roadmap to correct deficiencies and achieve proper financial reporting. Success of the FIAR plan rests with each financial manager's efforts to identify all major financial management problems, and develop corresponding action plans, and fully implement the corrective actions. Failure on the part of the

financial managers to succeed in any of these elements will prevent the respective reporting entity from achieving favorable audit results.

The FIAR plan categorizes the financial management challenges faced by the Department into three broad categories: those that heavily depend on systems solutions; those that depend primarily on process solutions; and those that depend on both systems and process solutions. The FIAR plan focuses on the process solutions that DoD financial managers identify, develop, and implement to correct financial reporting deficiencies or internal control weaknesses. The DoD OIG has primarily focused its audit efforts on the FIAR improvement initiative.

On the other hand, the Enterprise Transition Plan (ETP) addresses systems solutions. The September 2001 QDR reported that one element of the Department's goal to "Revitalizing the DoD Establishment" is to "Modernize the DoD-wide approach to business information." In that section, the Departments stated that:

> DoD will create a Department-wide blueprint (enterprise architecture) that will prescribe how the Department's financial and non-financial feeder systems and management processes will interact. This architecture will guide the development of enterprise-level processes and systems throughout DoD.

The Department has made progress toward achieving that goal by establishing the Business Transformation Agency and developing the business enterprise architecture and the Enterprise Transition Plan. The Government Accountability Office (GAO) has been fully engaged in auditing the Enterprise Transition Plan. GAO's most recent report "Business Systems Modernization: DoD Continues to Improve Institutional Approach, but Further Steps Needed," (Report No. GAO-06-658) May 2006, discusses the additional steps the Department should take in the Enterprise Transition Plan.

Since the 2001 QDR, the Department has spent funds on the systems infrastructure relating to the Enterprise Transition Plan. According to the GAO report just cited, the

Department will receive approximately $15.5 billion in FY 2006, and requested $16 billion for FY 2007, to operate, maintain, and modernize its business systems.

Successes

In the area of financial management, the DoD OIG considers the following DoD financial management efforts to be successes: implementation of integrated organizational structures and processes to address financial management improvement, assignment of accountability to DoD managers, DoD improvement initiatives at the entity and line item level, and self assessment of controls over financial reporting related to OMB Circular A-123. Although the DoD OIG anticipates that DoD will need to make refinements in these areas, the DoD OIG considers these to be critical steps in establishing a culture/ingrained structure that will enable DoD managers to identify internal control weaknesses and effectively plan for resolution of those weaknesses and that will hold DoD managers accountable for improving internal controls over financial reporting. Further, these steps should result in a financial management structure that can provide accurate, relevant, and timely financial management information for decision-making.

We fully support the Department's goal to implement internal controls that will result in sustained improvements in its ability to produce timely, reliable, and complete financial management information. To that end, DoD needs to continue the development of comprehensive, integrated plans that will lead to improved systems and internal control. We are quick to add that we recognize that there are many variables affecting the execution of DoD improvement initiatives, such as specific Components' ability to make corrective actions and meet the projected milestones. The DoD OIG will continue to provide input to the DoD managers on these initiatives as requested, or as part of the DoD OIG's advisory role on the DoD committees that support these initiatives.

Organizational Structure and Processes. DoD established the FIAR Directorate of the Office of the Under Secretary of Defense (Comptroller) to manage the DoD-wide financial management improvement efforts and to integrate those efforts with transformation activities across DoD. The FIAR Directorate is also responsible for the development and update of the FIAR Plan which establishes a DoD-wide strategy and

systematic, incremental approach for improving financial and business operations. The FIAR Plan prioritizes DoD financial improvement efforts and is fully integrated with the ETP initiative that is being coordinated by the Business Transformation Agency. As part of the FIAR initiative, DoD formed an Executive Steering Committee (ESC) to provide oversight, and established the FIAR Committee, FIAR Subcommittee, and Senior Assessment Team (SAT) to provide leadership for developing the structure and priorities of the FIAR planning process. The FIAR Committee also develops strategies and plans for expanding, managing, and overseeing the FIAR Plan and oversees the process for management's assertion on internal control over financial reporting. The DoD OIG acts as an advisor to the ESC, FIAR Committee and SAT.

In addition to the organizational structure, the Under Secretary of Defense (Comptroller) designed the FIAR Plan and business rules to provide an organized process for examining its operations, diagnosing problems, planning corrective actions, and preparing for audit. The FIAR Plan identifies focus areas for improvement and the key milestone plans for taking corrective actions and eventually achieving auditable areas. The business rules outline five standard steps[2] that each Component must follow when planning financial management improvements.

Accountability. DoD has taken steps to make accountability an important component of the DoD financial improvement initiatives. Under the FIAR improvement initiative, DoD managers are assigned responsibility for specific corrective actions and senior DoD leaders monitor progress regularly to determine whether projected milestones are met. Specifically, the Deputy Chief Financial Officer reviews the status of the FIAR Plan Priorities monthly and the Under Secretary of Defense (Comptroller)/Chief Financial Officer conducts quarterly reviews that require the Military Department Assistant Secretaries for Financial Management/Comptroller and the Assistant Deputy for Programs and Resources of the U.S. Marine Corps to present their overall progress, issues, and accomplishments.

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[2] The five steps are: discovery and correction; validation; assertion; assessment; and audit. The steps are discussed in detail on pages 10 and 11 of the December 2005 Defense Financial Improvement and Audit Readiness Plan.

Improvement Initiatives. DoD has implemented improvement initiatives at the DoD level and at the entity and line item level. The FIAR Plan identifies the following focus areas for improvement: Military Equipment, Real Property, Medicare-Eligible Retiree Health Care Fund, and Environmental Liabilities. Additionally, individual DoD entities, such as USACE, have implemented financial improvement initiatives. Since FY 2000, DoD OIG, U.S. Government Accountability Office, and Army Audit Agency have issued numerous reports discussing deficiencies related to the U.S. Army Corps of Engineers (USACE) balance sheet.

In October 2004, DoD OIG announced an audit to determine the progress USACE made in taking corrective actions that were recommended in previous audit reports. Based on the DoD OIG audit work, USACE conducted a workshop in May 2005 to discuss a "Get Well" plan and continued to take corrective actions. As a result of those efforts, the USACE asserted that their financial statements were ready for audit and the Executive Steering Committee, which includes representatives from OSD and DOD OIG, approved the audit in March 2006. The contract for audit was awarded in April 2006. The audit work began in May 2006 and the audit report should be completed in November 2006. The DoD OIG is providing oversight of those audit efforts.

The Air Force implemented a financial improvement initiative over Fund Balance With Treasury and asserted that the line item was ready for audit. It is now in the process of awarding a contract. The Air Force has also asserted that cash and other monetary assets is ready for audit.

Self Assessment. Another important step to success in financial management is DoD's implementation of OMB Circular A-123 Revised, "Management's Responsibility for Internal Control, Appendix A: Internal Control Over Financial Reporting," December 21, 2004. The requirements of OMB Circular A-123 Revised were effective beginning with Fiscal Year 2006. Under the new requirements included in Appendix A, managers must assess, document, test, and report on the effectiveness of internal controls over financial reporting. Appendix A also requires an annual report, which DoD will publish in the DoD Performance and Accountability Report.

In response to the new Appendix A requirements, DoD established written guidelines and processes for assessing internal control over financial reporting. DoD included the requirements for assessing internal control over financial reporting in the DoD "Fiscal Year (FY) 2006 Guidance for the Preparation of the Statement of Assurance," November 8, 2005. DoD plans an incremental approach to assessing internal controls over financial reporting, which has been approved by OMB. For FY 2006, the DoD plan included 31 financial reporting entities and 8 focus areas (Fund Balance with Treasury, Investments, Real Property, Military Equipment, Federal Employment Compensation Act (FECA) Liability, Environmental Liabilities, Health Care, and Appropriations Received). DoD also established a Senior Assessment Team to provide oversight and guidance to the managers that will be performing the assessments.

This new requirement for managers to perform a self assessment of the controls over financial reporting and provide assurance on the effectiveness of those controls should go a long way in establishing an ongoing formal process by which managers will identify control weaknesses, identify corrective actions and milestones, and be held accountable for resolution of those weaknesses. This formalized process should result in DoD managers focusing on the identification and resolution of financial related internal control weaknesses which will lead to improved accountability and reporting within DoD.

Conclusion

The Department must recognize that financial improvement is an ongoing effort that needs sustained management attention and accountability at all levels. In order for the Department to achieve results in the financial management area, the Department must exercise rigor and continued management focus in executing the Enterprise Transition Plan, FIAR plan, and assessments of internal controls over financial reporting under OMB A-123. Not only does the Department need to focus financial management improvement efforts on the known deficiencies, but it also needs to continue developing corrective action plans for financial management challenges identified during the course of business and while implementing the programs discussed above.

The FIAR plan is the Department's roadmap to correct deficiencies and achieve proper financial reporting. The known deficiencies include: financial management systems; fund balance with Treasury; inventory; operating materials and supplies; property, plant, and equipment; government-furnished material and contractor-acquired material; environmental liabilities; intragovernmental eliminations; accounting entries; accounts payable; accounts receivable; Statement of Net Cost; and Statement of Financing. In addition, we believe that the quality of existing financial data is a major challenge that the Department faces.

The Department's financial managers have to scrub their financial reporting processes to ensure that they have identified all of the major deficiencies and internal control weaknesses in order to achieve financial reporting success. Although the Department has some successes in establishing the framework to execute financial improvement and audit readiness initiatives, continued focus and commitment by management are needed to successfully execute the financial improvement initiative. Management must continue to execute the initiative with rigor and aggressively take steps to identify and correct the pervasive weaknesses that have impaired the Department's ability to achieve auditable financial statements, and more importantly, to provide reliable, accurate and timely data for decision making.

CHARRTS No.: SG-03-001
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #1

Question. Can you please explain the purpose of the Business Enterprise Architecture (BEA) and the Enterprise Transition Plan (ETP). What are they, and how are they related?

Answer. The BEA provides the architectural framework for an information infrastructure for the DoD, including business rules, requirements, data standards, system interface requirements, and the depiction of policies and procedures. This framework is provided through a set of DoD Architecture Framework (DoDAF) products, including Operational, Technical, System, and All View products.

The BEA was developed under the DoD tiered accountability concept reflecting key Enterprise Priorities within Business Missions. Through this concept, a DoD Component is responsible for defining an enterprise architecture associated with their own tier of responsibility, while complying with the policy and BEA at the DoD Enterprise level. Within the DoD Business Mission Area, the BEA and Component Enterprise Architectures provide required guidance as part of a federated approach. Additionally, the BEA is aligned with the Federal Enterprise Architecture (FEA) and other external architectures.

The Enterprise Transition Plan is designed to guide and track the transformation of the DoD Business Mission Area (BMA) by:

- Describing what DoD is trying to achieve and how we will know when we get there;
- Providing milestones to realize Business Capabilities;
- Identifying tangible benefits for each investment; and
- Establishing a Program Baseline against which to measure progress and support program management discipline.

The ETP addresses the six Business Priorities at the DoD Enterprise level and contains transformation plans for the three Military Departments and three of the Defense Agencies/COCOMs.

The ETP complies with FY05 NDAA requirements for a transition plan to implement the Business Enterprise Architecture. The ETP presents the acquisition strategy for new systems and lists all systems that are part of the BEA, as well as all systems that have more than $10 million in planned investment (Investment Review Board Tier 1 and Tier 2). The ETP contains a termination schedule for legacy systems that will be replaced by systems in the target BEA environment. This plan contains time-phased milestones, performance metrics, and resource needs for new and existing systems that will be part of the BEA. Consistent with tiered accountability, systems that are outside the current scope and organizational span of the BEA are managed within Component Transition Plans.

CHARRTS No.: SG-03-002
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #2

Question. GAO reports and testimonies present examples demonstrating consequences of DoD's failure to improve its business processes and related systems. In fact, of the 26 areas on GAO's governmentwide "high-risk" list, 8 are DoD program areas, and the Department shares responsibility for 6 other high-risk areas that are governmentwide in scope. These problems prevent the department from producing accurate, reliable, and timely information with which to make sound decisions and accurately report on its trillions of dollars of assets and liabilities.

Answer. The Deputy Secretary of Defense asked the Under Secretary of Defense for Acquisition, Technology and Logistics, Ken Krieg, to aggressively track the High Risk Areas under the department's purview including: (1) Weapons Systems Acquisition; (2) Contract Management and Interagency Contracting; (3) Supply Chain Management; (4) Support Infrastructure Management and Managing Federal Real Property; (5) Business Systems Modernization; and (6) Financial Management. Over a year ago, the respective Department leads, in collaboration with both the Office of Management and Budget (OMB) and GAO staff, developed plans and identified appropriate milestones and metrics to reduce risks in these areas critical to DoD. Mr. Krieg provided those plans to Office of Management and Budget (OMB) and GAO last fall. Since that time, he has conducted periodic reviews to track the progress on each High Risk Area goal and milestone and provide the Deputy Secretary with updates on our progress. Simultaneously, he has provided updated status/progress information to OMB and GAO leaders. GAO has voiced our high level focus and associated initiatives are demonstrating tangible progress in several High Risk areas.

CHARRTS No.: SG-03-003
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #3

Question. What specific challenges does DoD face with regard to transforming its business processes, including financial management?

Answer. The Department of Defense (DoD) is perhaps the largest and most complex organization in the world. It manages more than twice the budget of the world's largest corporation, employs more people than the population of a third of the world's countries, provides medical care for as many patients as the largest health management organization, and carries five hundred times the number of inventory items as the world's largest commercial retail operation. The sheer size of the Department reflects the magnitude of its mission and the broad responsibilities it has for maintaining national defense. This mission, however, also demands that the Department be as nimble, adaptive, flexible, and accountable as any organization in the world. The Department must ensure that the right capabilities, resources and materiel are delivered rapidly and reliably to our warfighters: what they need, where they need it, when they need it, anywhere in the world. Reconciling the apparent contradiction between size and flexibility – between complexity and adaptability – is the challenge of Defense business transformation.

Over the past four years, the Department's emphasis on overall DoD transformation has yielded substantial improvements in the Department's business operations. For example, DoD's logistics and supply chain has achieved significant increases in materiel availability and major reductions in lead times. Process improvement initiatives in aviation repair depots have reduced work-in-process inventory, thus increasing the depots' speed and efficiency. Active transportation cost management has saved millions of dollars in the process for moving people and materiel across the world. DoD financial statements that once took over five months to produce are now being produced with better quality in less than 45 days. The Department of Defense is now working to further advance these accomplishments at a Department-wide level across five Core Business Missions (CBMs). Ultimately, Defense business transformation is being driven by a series of strategic objectives, each of which illustrates a different aspect of the overall transformation challenge. The four key objectives of the Department's business transformation efforts are to:

- Provide support for the joint warfighting capability;
- Enable rapid access to information for strategic decisions;
- Reduce the cost of Defense business operations; and
- Improve financial stewardship to the American people.

These objectives help shape DoD's priorities and serve as checkpoints by which to assess the efficacy of our transformation efforts over the long term.

CHARRTS No.: SG-03-004
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #4

Question. GAO reported in September 2005 and the Comptroller General recently testified on concerns with DoD's data reliability and cost reporting of the Global War on Terrorism (GWOT). GAO's prior work has found numerous problems with DoD's processes for recording and reporting costs for GWOT, including longstanding deficiencies in DoD's financial management systems and business processes, the use of estimates instead of actual costs, and the lack of adequate supporting documentation. DoD's Deputy Comptroller testified at a July 18, 2005 hearing before the National Security, Emerging Threats and International Relations Subcommittee, Committee on Government Reform that the GWOT costs are accurate and reliable.

Answer. The Department established a Cost of War Task Force on March 21, 2006 with staff from all of the Components involved in reporting GWOT costs. The purpose is to improve the accuracy, reliability and timeliness of the reports. The USD (Comptroller) issued two sets of guidance to the Department's components to improve the accuracy of GWOT cost reports. The first guidance issued on March 3, 2006 directed the components to provide written proof that management review of cost data had occurred. The second issued on June 13, 2006 refined the cost of war variance analysis and methodology. The variance analysis guidance requires the Components to document all alternate data sources and to establish standardized auditable processes. The improvement in the accuracy of military personnel costs is a direct result of this effort as noted in the most recent Government Accountability Office report on the adequacy of FY 2006 funding for the Global War on Terrorism (GAO Code 350801).

CHARRTS No.: SG-03-005
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #5

Question. Since 2001, Congress has appropriated nearly $430 billion to DoD and other government agencies for military and diplomatic efforts in support of the Global War on Terror. How is DoD recording and reporting the costs associated with the Global War on Terror?

Answer. The DoD Components record the costs associated with the Global War on Terrorism in their respective financial management systems. Monthly, the DoD Components extract the associated costs from the automated systems and prepare the cost and analysis reports for submission to the Defense Finance and Accounting Service (DFAS). The DoD Components are required to validate the data, provide the sources of data if it does not come from the automated system, provide footnotes to explain any variances, and to sign an affirmation statement attesting to the accuracy of the information. The DFAS consolidates the reports, reviews the variance analysis to ensure the Components provide footnotes where applicable, and confirms submission of all affirmation statements. The DFAS then submits the reports to the Office of the Under Secretary of Defense (Comptroller) for final approval and release to the Government Accountability Office.

CHARRTS No.: SG-03-006
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #6

Question. The June 2001 Quadrennial Defense Review outlined specific actions DoD should take to improve financial management. What progress has the DoD made towards achieving these financial management goals?

Answer. The Department recognizes its responsibility to the American people to manage resources carefully as it executes its mission to support the joint warfighter. DoD's financial statements are tools to help manage operational performance and demonstrate accountability to the American people and compliance with federal accountability laws and regulations.

Effective financial management depends on information that is accurate, reliable, and timely. The Department has developed a comprehensive Financial Improvement and Audit Readiness (FIAR) Plan that provides a DoD-wide strategy and systematic approach for making improvements to financial and business operations within the Components while prioritizing and synchronizing efforts to achieve an unqualified, or clean, audit opinion. The FIAR Plan charts a course to sound financial management by improving internal controls, resolving material weaknesses, and advancing the Department's fiscal stewardship. Deployment of the business systems detailed in the ETP will drive the Department's ability to achieve a clean audit. For example, the deployment of the Capital Asset Management System-Military Equipment (CAMS-ME) will impact the Department's ability to achieve favorable audit results for military equipment. By improving DoD's audit readiness, the Department is helping to satisfy its responsibility for stewardship of the resources provided by the American taxpayer.

Improving the effectiveness and efficiency of business processes and systems across the Department will also result in improved support to our nation's warfighters. DoD's Military Pay Improvement Action (MPIA) Plan, for example, leverages the long-term Defense Integrated Military Human Resources System (DIMHRS) implementation strategy, while improving the current Defense Joint Military Pay System to ensure that Soldiers are paid properly. Additionally, DoD has established a Wounded-in-Action (WIA) Pay Account Management effort to address near-term DoD problems in paying wounded warfighters accurately and on-time. Improving pay accuracy is critical to satisfying our responsibility and accountability to the men and women in our Armed Forces.

CHARRTS No.: SG-03-007
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #7

Congress included provisions in the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 that required DoD to take steps aimed toward addressing business systems modernization management challenges, including those related to establishing effective business systems investment management processes and structures.

Question. Please provide examples as to how the structure and processes DoD established improved DoD's business systems development and implementation efforts, as well as DoD's business processes and financial management.

Answer. The Department provided the following details in the March 15, 2006 Annual Report to the Congressional Defense Committees on the Status of the Department of Defense's Business Transformation Efforts:

As of February 17, 2006, the Defense Business Systems Management Committee (DBSMC) has approved 226 systems recommended by the Investment review Boards (IRBs). These systems represent approximately $3.6 billion in modernization investment funding. The following table shows a breakout of the total number of systems certified, by Component and IRB. The table does not count multiple certifications for the same system.

Systems Certified by Component and IRB

Component	FM IRB*	HRM IRB*	RPILM IRB*	WSLM & MSSM IRB*	Total
	Certified to Date	Certified to Date	Certified to Date	Certified to Date	Certified to Date
Army	4	23	10	11	48
Navy	4	10	4	26	44
Air Force	7	14	3	20	44
Joint Staff	0	1	0	0	1
OSD	1	3	0	9	13
USTRANSCOM	2	0	0	11	13
DECA	0	4	0	0	4
DISA	2	0	0	1	3
DFAS	12	8	0	0	20
DLA	1	0	1	16	18
TMA	0	17	0	0	17
DTIC	0	0	0	1	1
DHRA	0	0	0	0	0
Total	33	80	18	95	226

*FM- Financial Management
*HRM – Human Resources Management

*RPILM – Real Property & Installations Lifecycle Management
*WSLM &MSSM – Weapon Systems Lifecycle Management & Materiel Supply and Services Management

The IRB/DBSMC certification process has resulted in closer scrutiny of investment spending at every level of the Department. Components, in particular, have been very aggressive in "self-policing" their IT investment spending activities. Knowing that the IRBs are evaluating similar systems with a view towards global solutions, Components are required to present investment recommendations that include a valid and well documented business case. In some cases, investment decisions have been delayed until detailed justification could be provided. In others, programs have been cancelled or merged with programs sponsored by other Components. The DBSMC has not granted any waivers (national security or otherwise) to any business systems for proposed modernization investments, largely due to Components carefully vetting systems before submitting them to the IRBs.

At the IRB level, two systems to date have had their funding request denied: Intragovernmental Transactions (IGT) and Forward Compatible Payroll (FCP). The Financial Management IRB determined that approving funding for an IGT system was premature, as additional analysis was still needed. FCP termination was based on the decision of the DBSMC to support DIMHRS as the Department's enterprise solution for Military Pay. In addition, the IRBs continue to ensure that they have all the necessary information before making a certification recommendation to the DBSMC, often limiting requested funding to more closely monitor progress towards execution. IRBs often require systems to meet specific certification conditions, as a means to ensure that systems are constantly communicating their progress back to the appropriate IRB. Moreover, because of the investment review process, the Services collectively identified over 290 systems for phase-out/elimination. None of these systems were submitted for IRB certification, as they did not require funding for modernization in excess of $1 million in FY06. Going forward, the IRBs will be conducting certification and annual reviews throughout the year organized in logical groupings of business capabilities, thus achieving a portfolio view of business system investments across the Department.

CHARRTS No.: SG-03-008
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #8

Question. What steps are DoD management taking to ensure that the institutional management capabilities and controls are reflected in how each and every business system investment is managed?

Answer. The DoD investment review process plays a vital role in delivering the flexibility and responsiveness required across the Department's warfighting operations. This process ensures that all business systems activities within the OSD and Component organizations: (1) support the joint warfighting capability by applying innovations and best practices from leading companies as well as from our joint forces; (2) provide better information for strategic decisions through access to actionable management information by continued migration to a net-centric environment; and (3) reduce the cost of business operations by providing timely, reliable and accurate financial information to drive a "cost-conscious" decision-making process. These improvements in business system investment activities support the improvement of financial stewardship to the American people.

The Department has established four Investment Review Boards (IRBs), which are aligned to the five Core Business Missions. These Boards are responsible for assessing modernization investments relative to their impact on end-to-end business process improvements that support warfighter needs. Board membership spans the entire Department, including OSD, the Services and Defense Agencies. IRBs evaluate each individual modernization proposal to ensure proper cross-DoD integration, avoid duplication of capabilities, and ensure compliance with the BEA and ETP. Based on these factors, IRBs make a certification recommendation to their respective Certification Authority (at the Principal Staff Assistant level). Upon certification, the modernization proposal is submitted to the DBSMC for final approval.

This process is critical to achieving better and more efficient business operations for the Department. IRBs enhance cost savings and simplify information exchange by prioritizing and controlling investments across OSD and the Components, and reducing system redundancies.

CHARRTS No.: SG-03-009
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #9

Question. What progress has DoD achieved in implementing its tiered accountability process?

Answer. Tiered accountability has been institutionalized across the Department of Defense at two levels:

- Governance – structures, policies and procedures required to provide oversight of IT business systems investments
- Architecture and Systems – ensuring that all system development activities, whether Component- or Enterprise-driven, are consistent with DoD standards for integration and interoperability.

From a governance perspective, DoD has fully adopted a governance structure that implements tiered accountability. The Defense Business Systems Management Committee (DBSMC), chaired by the Deputy Secretary of Defense, now manages the "corporate" or Enterprise-level requirements and each Component (Military Department, Defense Agency, DoD Field Activity, and Combatant Command) manages its own unique mission support requirements. In 2005, the Deputy Secretary of Defense directed the establishment of the Defense Business Transformation Agency (BTA) as the entity responsible for executing Enterprise-level business transformation. In practical terms, this means that the BTA, the Under Secretaries of Defense (i.e., Principal Staff Assistants, or PSAs), and the Components together identify those activities that must be executed collectively to enable joint business support to the Department's warfighting mission.

During its most recent audit of DoD Business Transformation activities, GAO's Financial Management Assurance team thoroughly examined this governance structure, with a specific eye towards understanding how Component governance activities integrated with the DoD-wide bodies; DBSMC and Investment Review Boards (IRBs). This engagement tested whether tiered accountability was working from a governance perspective. GAO concurred with the Department's approach and closed all outstanding GAO recommendations related to the structure and functioning of these bodies.

Tiered Accountability is implemented at the architecture and systems level through federation. The federated architecture for DoD's Business Mission Area (BMA) consists of the Business Enterprise Architecture (BEA) supplemented by the business architectures of the various DoD Components and program architectures of the many IT systems supporting DoD business operations. The BEA is a thin-layer architecture detailing enterprise-wide architecture centered around the Department's business enterprise priorities. The BEA has been developed and is evolving to guide decision-makers in discovering gaps in existing business capabilities

across DoD and identifying solutions to meet them. As a component of the overall DoD Federated EA, the BEA inherits and implements numerous DoD-wide IT rules, policies and procedures from the Global Information Grid (GIG).

The Department recognizes that gaining visibility across the various business architectures is an essential step in enabling decision-makers to identify gaps in needed business capabilities as well as gaps in delivery of previously identified and architected capability needs. Additionally, within the BMA there is the additional requirement imposed by the FY05 NDAA to assess compliance of all business systems before obligating funds in excess of $1 million. This requires the additional ability to assess the compliance of program and/or component architectures with the BEA. The BMA is addressing these needs through a variety of means fully described in the BMA Federation Strategy and Roadmap.

CHARRTS No.: SG-03-010
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #10

Question. What assurance can DoD give that the services are identifying and reporting all business system investments to the designated approval authorities as required under the legislation and what steps are the department taking to ensure compliance?

Answer. Over the past 18 months, the Investment Review Boards (IRBs) have worked closely with the Components to determine both the full roster of systems that require certification and when these systems would require funding. For FY06 funding, this allowed us to ensure all systems requiring immediate funding would go through the investment review process prior to the beginning of the fiscal year. Other systems were scheduled over the next few months. The same practice has held true for FY07 funding.

During the course of the fiscal year, systems that have received additional or new FY06 funding have been added to the list. In these cases, Components have been forthcoming in explaining the mission need of the new requirement and presenting the related strategy to the appropriate IRB.

Each IT business system is responsible for ensuring that it is in compliance with the NDAA in terms of not obligating funds prior to certification and approval. The Component CIO organizations closely monitor the activities of their program managers to ensure their compliance. To monitor Component compliance, the IRBs use the DoD IT budget as a guide to identifying a candidate list of systems that require certification and work with the Components to verify and modify this list as appropriate. Ultimately, the Components have the necessary visibility to their internal system activities to determine the full roster of systems requiring certification and ensure they come forward at the proper time. We are unaware of any obligation of funds without certification.

It should be noted that this process was examined extensively by GAO during their more recent audit of DoD Business Transformation activities (GAO 06-658). GAO found the Department's actions towards identifying all business systems investments requiring NDAA certification to be adequate and appropriate and, in fact, closed all open recommendations related to the identification and reporting of business systems investments.

CHARRTS No.: SG-03-011
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #11

Question. How will the tiered accountability concept help provide the Congress reasonable assurance that future business systems will be implemented on time, within budget, and with the promised capabilities?

Answer. The Department's business transformation efforts rely on the organizational strengths of the individual Services and Defense Agencies. This is an important distinction because it recognizes that, while the Secretary of Defense sets the tone from the top, each of the Components has its own way of doing business, its own natural constituencies, and its own appropriations. Components are responsible not only for executing their individually assigned missions, but also for ensuring that joint operations run smoothly, and that information flows freely across the enterprise so DoD can function as a cohesive whole.

Major corporations have headquarters organizations that set standards for their business units. Chief among these standards is a common business data framework that allows corporations to interoperate and present a common face to customers. By harnessing information assets and leveraging networked business services, corporate executives have daily visibility into constantly changing customer orders and sales, and therefore, can link changes in demand to production and inventory management. This also enables corporations to share information with suppliers and manage the timing and quantity of replenishment.

DoD is taking a similar approach, employing industry best practices to quickly build out enterprise-wide functionality, which includes data standards, business rules, specific systems, and an associated integration layer of interfaces for the Components. These standards, which are established through joint cooperation, represent the "rules of engagement" to which all DoD Components must adhere. Thus, while the Department is not dictating how to transform, it is ensuring that each Component's transformational program increases the Department's ability to reap the benefits of improved information exchange across organizational boundaries.

This type of integration will drive the Department down the path to interoperability and accelerate the Services' transformation efforts as the Department transitions to a more joint operation. Over time, the DoD Enterprise layer is expected to evolve, bringing increasing levels of interoperability and transparency across DoD. Operationally, the Department is implementing this approach by:

- Dividing the planning and management of strategic systems and initiatives, as appropriate, between DoD-level and Component-level enterprises;
- Establishing common capabilities, clear data standards, and enterprise-wide systems; and,

- Establishing a tiered process for control and accountability over IT investments for both DoD-level and Component-level business systems modernization.

In addition to their role in achieving BEP objectives, the Component's internal business transformation efforts are a critical part of DoD's overall effort. The Services and the Defense Agencies are pursuing their modernization plans to share data, eliminate duplicative or isolated business systems, and provide a "single point of presence" for users to get information. Component priorities are reflected in the individual Component business transformation plans (see Chapters 5-11 of the Enterprise Transition Plan (ETP).

Using this tiered accountability approach, transformation can occur simultaneously throughout DoD with consistency of focus by taking maximum advantage of the Department's leadership structure.

CHARRTS No.: SG-03-012
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #12

The DoD Inspector General has been reporting for years that DoD cannot produce timely, accurate, and reliable financial information and, therefore, cannot produce financial statements that can be audited. DOD issued its Financial Improvement and Audit Readiness (FIAR) Plan, which is intended to provide a roadmap to guide the department's efforts to improve its financial management, obtain an audit opinion, and get DoD financial management off GAO's high-risk list.

Question. Recent private sector accounting and financial management debacles, such as Enron and WorldCom, clearly reveal the risk of overemphasizing financial statements and clean audit opinions. What actions has DoD taken to mitigate this risk in its FIAR Plan?

Answer. Congress passed the Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley Act) legislation in response to private sector debacles. The Office of Management and Budget (OMB) initiated similar requirements for federal agencies when it published Circular A-123, "Management's Responsibility for Internal Control," Appendix A, "Internal Control Over Financial Reporting" (*hereafter referred to as Appendix A*) requirements.

Appendix A requires an annual Statement of Assurance on the effectiveness of internal controls over financial reporting within an organization's key business processes. These requirements align with the Department's business rules for financial improvement including the first phase called Discovery and Correction. During Discovery and Correction, Components identify obstacles to a favorable audit opinion and develop steps to overcome the obstacles. Moreover, Appendix A requirements for testing controls and issuing a Statement of Assurance align with the "Validation" and "Assertion" business rules. Compliance with Appendix A often meets FIAR Plan key milestones and vice versa. In addition to Appendix A and the business rules, the Federal Managers' Financial Integrity Act Annual Statement of Assurance requires well-defined plans designed to correct weaknesses identified during the assessment and testing.

CHARRTS No.: SG-03-013
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #13

Question. Section 1008 of the National Defense Authorization Act for fiscal year 2002 requires the department to minimize resources spent to prepare for and audit unreliable information. Can you explain how the department will know whether sufficient work has been performed to identify, understand, and address deficiencies not previously identified by auditors and to enable it to prepare timely, accurate and useful information for decision making and reporting?

Answer. The Department created a rigorous business rules process, which complies with Section 1008, to ensure that we have identified and corrected deficiencies and to demonstrate due diligence when determining that we are ready for an audit.

The business rules process consists of five phases:

- Discovery and Correction – Identify, examine, and resolve problems.
- Validation – Evaluate audit readiness and ensure that fixes are adequate.
- Assertion – Review the work that has been done, test for sustainability, and assert audit readiness.
- Assessment – IG, DoD evaluates audit readiness.
- Audit.

The business rules are designed to uncover problems including those not previously identified by an auditor. Any DoD entity preparing for audit must complete each phase, and completion and readiness is verified. Because the phases are consistently applied, corrective actions build on solutions available and identified solutions are integrated throughout the Department. By ensuring that audit readiness has been achieved and capturing common problems and solutions, the Department minimizes the expenditure of resources.

CHARRTS No.: SG-03-014
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #14

We understand that DoD has had a number of costly initiatives over the years focused on valuing its assets for financial reporting purposes. Some of these initiatives were performed before the department or the military services took actions to ensure that they had the business processes and systems to sustain baseline valuations. As a result, the initiatives failed. It is our understanding that you expect to have valuation amounts for your military equipment assets by the end of this calendar year.

Question. Can you give us an estimate of how much this endeavor cost the department?

Answer. The objective was to have a reportable military equipment value by the end of this fiscal year. We exceeded this objective and have reported military equipment values, computed using our valuation methodology, in the FY 2006 third quarter financial statements. This methodology, which values military equipment based on detailed program by program assessments, has been discussed with the DoD IG, GAO, Federal Accounting Standards Advisory Board, and the Office of Management and Budget.

Completion of this baseline value was a major accomplishment. However, the Department needed a methodology for updating this value to reflect acquisitions, retirements and depreciation. A new system, the Capital Asset Management System for Military Equipment (CAMS-ME) was developed to meet this requirement.

CAMS-ME is a system that captures program expenditures through an automated link to the accounting system and asset additions and retirements/losses through an internet link that is used by acquisition program managers. CAMS-ME uses these inputs to compute the impact of the changes on the military equipment baseline and to develop amounts to be reported.

The processes that were created to support the baseline valuation will be used in the future as part of the property modules in Service Enterprise Resource Planning (ERP) systems. CAMS-ME can also be used in the Navy's ERP and possibly the Army's ERP.

To this point, it has cost approximately $30 million to implement this endeavor,

CHARRTS No.: SG-03-015
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #15

Question. How has DoD incorporated lessons learned from prior valuation efforts, such as the one attempted for real property assets, into its military equipment valuation effort?

Answer. The Department applied several lessons from prior efforts. First, we recognized that a focused, coordinated and cooperative effort was required. One of the very positive lessons learned from prior efforts such as the valuation of Real Property was that establishing a central focal point that had overall responsibility for managing the effort increased the probability of success. Second, we recognized that a system for updating the military equipment values, which was automated to the maximum extent possible, was a requirement. Finally, we recognized that coordination between the initiatives was needed. The individuals working the Military Equipment and Real Property valuation efforts have been working together to share lessons learned and to ensure that policies developed are consistent.

CHARRTS No.: SG-03-016
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #16

Question. Does DoD currently have the systems and processes needed to sustain baseline military equipment valuation amounts? If not, why didn't you address the systems and processes issues before attempting valuation?

Answer. Yes. The Department has developed a new system, the Capital Asset Management System for Military Equipment (CAMS-ME), to maintain the ME values, and we have established processes to update the values for new programs and new procurements.

CHARRTS No.: SG-03-017
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #17

Question. When the contractor delivers a valuation amount for the department to use in its fiscal year 2007 financial statements, will DoD finally have the data needed by program managers and other decision makers (including the Congress) to manage and oversee major weapons system acquisition programs?

Answer. The values developed for fiscal year 2007 will be useful for decision makers to manage and oversee acquisition programs and their utility will continue to improve over time as process improvements are implemented.

CHARRTS No.: SG-03-018
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #18

Question. If this initial effort is not intended to improve the data used by program managers and other DoD decision makers to fulfill their management and oversight responsibilities, what have we gained from our money?

Answer. It was necessary to establish the military equipment baseline valuation to comply with the Chief Financial Officers Act of 1990 and the President's Management Agenda goal of Improved Financial Performance. This data will also be useful to management and its usefulness will improve over time as the systems and processes are refined.

CHARRTS No.: SG-03-019
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #19

DoD has spent tens of billions of dollars over decades to transform its business operations. Despite many well-intentioned efforts, transformation has largely failed. GAO has previously testified that the lack of sustained leadership is a key underlying cause of DOD_s inability to resolve its long-standing financial and business management problems. To help address these issues and oversee and manage the ongoing transformation effort, GAO has proposed that the position of Chief Management Official be established.

Question. What is the status of the legislative mandate for DoD to study the feasibility of a chief management official position within the department?

Answer. Sec. 907 of the FY06 NDAA offered the Secretary the opportunity to "select one or two FFRDCs" to study the feasibility and advisability of establishing a Deputy Secretary of Defense for Management. We could only afford to do one and selected IDA. We also asked the Defense Business Board to look at this issue; so, in effect, got our second look for 'free'.

DBB gave us their recommendations in May. IDA is scheduled to report 1 November. A report to Congress is due 1 December.

CHARRTS No.: SG-03-022
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #22

Question. Have you been able to review the SIGIR's latest report on Lessons Learned in contracting and procurement?

Answer. Yes. We review all SIGIR reports. The Special Inspector General for Iraq Reconstruction (SIGIR) is part of the U.S. government's continuing effort to improve the management of our reconstruction programs and improve accountability.

Our response is that when we see a potential problem, we investigate it and we hold those responsible for wrongdoing accountable. The SIGIR as well as the DoD IG, and the Defense Contract Audit Agency are central to that process.

As for the lessons learned report, it is important to note that the progress that was made in the reconstruction program is noteworthy. As the SIGIR has said, "... the positive results achieved in the reconstruction program are impressive."

It is important to emphasize that US reconstruction projects laid the groundwork for the future development. Longer term system repairs and upgrades to Iraq's dilapidated infrastructure are still required throughout Iraq.

CHARRTS No.: SG-03-023
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #23

Question. One of the SIGIR's "lessons learned" states that a single unified contracting entity should be designated to coordinate all contracting activity in theater. I was glad to see that included. After Hurricane Katrina, I introduced a bill that would have appointed a special Chief Financial Officer for Hurricane relief activities. Unfortunately, this proposal was struck down-both by Congress and the White House. But perhaps if this central figure with accountability for hurricane activities had been in place we wouldn't have seen the waste, fraud and downright criminal behavior that has recently come to light. I believe the same can be said about Iraq. I'd like to get your opinion on appointing a special Chief Financial Officer or Comptroller for large military operations in order to reduce these types of contracting failures in the future?

Answer. I do not support appointing a special CFO or Comptroller for each large military operation because every organization that would be responsible for a large operations already has a CFO and Comptroller. Each Combatant Commander has a CFO or Comptroller -- as does each Military Service and each major operating agency likely to have a central role in the operation. Appointing a special CFO or Comptroller could complicate and disrupt the clear and strong lines of responsibility that already exist in the Department of Defense.

CHARRTS No.: SG-03-024
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #24

I understand that the President's Management Agenda requires federal agencies to improve financial performance, and the Office of Management and Budget monitors this progress against metrics on which DoD reports on a quarterly basis.

Question. When did reporting begin for reporting financial performance at the Department of Defense for the first quarter of fiscal year 2006?

Answer. The Department's Financial Improvement and Audit Readiness (FIAR) plan, released in December 2005, describes specific corrective actions to be taken, by Fiscal Year (FY)/quarter, to correct material weaknesses in financial management, improve internal controls, prepare for auditability, and produce more reliable, accurate, and complete financial data that can be used to improve key management decisions.

The FIAR Plan contains Key Milestones that predict the completion of critical tasks for specific Focus Areas. Reporting on the number of Key Milestones completed began in the first quarter of FY 2006. The Department reports this progress to the Office of Management and Budget (OMB) on a quarterly basis. OMB has scored the department "GREEN" for progress made in improving financial management in each of the first three quarters of FY 2006.

CHARRTS No.: SG-03-025
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #25

Question. Are there progress reviews or key milestone controls in place at DoD to ensure that financial improvement metrics reported are reliable and based on strict internal management objectives? In other words, what types of standards and metrics exist to measure progress made in the FIAR Plan, and overall financial management improvement?

Answer. Yes. The FIAR Plan progress is reported quarterly to the Deputy Secretary of Defense and Secretaries of the Military Departments at Defense Business System Management Committee meetings. Progress is reported monthly to the Under Secretary of Defense (Comptroller) and Deputy CFO. The Deputy CFO conducts monthly progress reviews on each of the Plan focus and priority areas with representatives from the appropriate functional organization. Direction from these reviews is documented in the web-based tool used to manage the Plan.

The Department has institutionalized processes and controls that ensure the accuracy of FIAR Plan progress metrics and that the objectives found in the FIAR Plan are being achieved. Monthly, the Components report on the status of their key milestones for the current and subsequent quarter. For missed milestones or milestones for which progress is lagging the Components report both the reason for delays and their corrective actions

CHARRTS No.: SG-03-026
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #26

Mr. Patterson, you state on page 4 of your testimony that Each focus area (within the FIAR Plan) includes specific milestones for achieving successful audit and during this last six months, 64 percent of these milestones have been met.

Question. Can you please explain to me how you measure this?

Answer. To clarify, the FIAR Plan contains individual key milestone plans for each focus area. For each Military Department and the Defense Logistics Agency (DLA), the key milestone plans show corrective actions (e.g., changes to policies, processes, and controls), deployment of new systems, independent validation, management assertions, assessments, and audits. The Department monitors, through a formal monthly reporting process, the progress of each Military Department and DLA for milestones due for completion during the current and next quarter.

When milestones are behind schedule or not completed, the accountable entity explains why and what steps are being taken to complete the milestone. All milestones continue to be tracked and progress monitored until successfully completed.

CHARRTS No.: SG-03-027
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #27

In briefings, DoD has been confident that they would be able to provide adequate risk assessments for all other activities and programs that are required to be risk assessed under statute, should the Subcommittee request any

Question. Can you please tell me how DoD complies with the Improper Payment Information Act?

Answer. The Department reviews programs and activities in accordance with Office of Management and Budget guidance. In each program the Department statistically samples payments using the random sample methodology prescribed by OMB (statistically random sample of sufficient size to yield an estimate with a 90 percent confidence internal) of which the Department meets or exceeds the random sample methodology. The results of the statistical random sample is then projected across the population. The Department has categorized the improper payments into the following categories:

- Military Pay,
- Civilian Pay,
- Retired Pay,
- Military Health,
- Travel, and
- Commercial Pay.

In fiscal year 2004 the Department deemed one program, Military Pay, susceptible to high risk. The Military Retirement and Military Health Benefits programs were identified previously in OMB Circular A-11, Section 57 as susceptible to erroneous payments.

CHARRTS No.: SG-03-028
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #28

Question. How much in resources-both time and dollars-would you say the Department uses to focus on this important process?

Answer. The Department spends an estimated $2,105,974 and 36.5 work years in support of the Improper Payments Information Act (IPIA) for personnel readily identifiable involved in identifying/collecting improper payments. Each work-year is calculated at 2,080 hours per employee x 52 weeks. The figures above are not all inclusive but are an estimate on how much the Department spends in resources and dollars in support of the IPIA. These figures do not include the figures for the Military Health which is primarily made up of the TRICARE Management Activity which incorporates management control processes into the other work performed to ensure compliance, appropriate contract performance and the appropriate expenditure of government funds.

CHARRTS No.: SG-03-029
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #29

Question. How many, and which senior-level management positions are vacant in the OSD Comptroller's office?

Answer. There are four senior level management vacancies:

Deputy, Chief Financial Officer (DCFO)
Assistant Deputy Chief Financial Officer (ADCFO)
Deputy Director for Program and Financial Control
Associate Director for Investment (Ground, Sea, and Other Programs)

CHARRTS No.: SG-03-030
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #30

Question. When do you anticipate being able to fill each position, and with whom?

Answer. Interviews to fill the positions of Deputy Director for Program and Financial Control and Associate Director for Investment began during the week of September 18, 2006.

Job announcements for the DCFO closed on September 30; the announcement for the ADCFO position will close on September 30. We will consider all candidates who apply who are certified as best qualified to fill both positions.

We expect to fill all of these key positions within the month; however, the basic requirement is to acquire the best and brightest leaders despite significant competition with the private sector for human resources and caps on federal compensation.

CHARRTS No.: SG-03-031
Senate Committee on Governmental Affairs
Hearing Date: August 03, 2006
Subject: Financial Management at the Department of Defense
Witness: Mr. Patterson
Senator: Senator Coburn
Question: #31

Question. The Subcommittee plans on inviting the DoD Comptroller back to testify in about five months. Please provide the Subcommittee with key milestones that DoD plans to accomplish by January 1, 2007 so that we can hold the Department accountable to meeting the financial management improvement benchmarks it has set for itself.

Answer. The Department will publish an update of its Financial Improvement and Audit Readiness (FIAR) Plan as of September 30, 2006, in October 2006. After publication the updated Plan will be provided to Congress. The Plan will set forth the key milestones we anticipate achieving by January 1, 2007 and beyond. Some of the key milestones we will include in the updated Plan are presented below.

- Complete an audit of the US Army Corps of Engineers Civil Works financial statements.
- Coordinate with the military services a plan to fund military medical treatment facilities based on market rates rather than estimated health care costs.
- The Navy will submit a management assertion that the Environmental Liabilities estimate for its Nuclear and Conventional Ships is ready for audit.
- The Army will complete process and system changes enabling it to confirm that real property assets exist and ensure that all related transactions have been included in its real property baseline.

In addition to publishing its FIAR Plan update, the Department will publish its FY 2006 Performance and Accountability Report by November 15, 2006.

Department of Defense, Office of the Inspector General

Answers to Questions for the Record
Financial Management at the Department of Defense

1. Could you please tell the Subcommittee what you believe is the most critical aspect of financial management improvement that DoD is in the process of doing?

The most critical aspect of DoD financial management improvement is the development and refinement of an integrated framework that DoD can use to manage both financial process and systems improvements. DoD has invested heavily over the past few years on modernizing their business and accounting systems. If the new architecture is not deployed soon, DoD's business enterprise investments may be questioned.

DoD has established organizational structures and plans as part of the business transformation efforts that will allow DoD to consider and integrate both process and systems improvements incrementally. The Business Transformation Agency (BTA) coordinates overall financial improvement efforts for the DoD and is responsible for maintaining and updating the Business Enterprise Architecture (BEA) and the Enterprise Transition Plan (ETP). Additionally, the Financial Improvement and Audit Readiness Directorate within the Office of the Under Secretary of Defense (Comptroller) is responsible for the Financial Improvement and Audit Readiness (FIAR) Plan.

We have previously reported that systems modernization is a fundamental element if DoD is to improve financial management. This requires careful and extensive coordination between the managers of the BTA and personnel responsible for the FIAR Plan. The FIAR Plan provides an organizational framework to identify areas that need improvement and to assign responsibility for achieving those improvements. It is also important that the ETP, which serves as the plan for implementing the BEA, be fully integrated in the periodic updates to the FIAR Plan. This framework can provide direction to the Department's financial improvement efforts and can be the mechanism for holding the Department's managers accountable for correcting specific weaknesses and for meeting milestones. The framework can also provide a mechanism for measuring success. Further, a significant management challenge that DoD is addressing in the financial improvement and systems modernization effort is unreliable financial data from legacy systems. Unless the completeness and accuracy of data in the legacy systems are properly verified before being carried forward to the new systems, the data will continue to be unreliable and may contaminate summary data in future enterprise systems. The quality of existing financial data is a major challenge that the Department faces.

2. Do you believe that the FIAR Plan adequately addresses the major financial weaknesses at the Department? What is missing?

The FIAR Plan is definitely a good start in identifying and correcting known weaknesses. The FIAR Plan provides a structure that DoD can use to adequately address the major financial weaknesses as financial improvement efforts progress. However, because the FIAR Plan uses an incremental approach, it does not currently contain plans or milestones to address all of the material weaknesses that we have previously reported.

Department of Defense, Office of the Inspector General

Answers to Questions for the Record
Financial Management at the Department of Defense

Also, the solutions included in the FIAR Plan for correcting known material weaknesses and improving financial management need to be better defined. There may also be other major financial weaknesses that have not yet been identified by auditors that will need to be addressed by the FIAR Plan. As a result, DoD organizations should focus their efforts on identifying and correcting weaknesses and validating corrective actions and put less emphasis on obtaining audit opinions. Further, the FIAR Plan currently only addresses improvements for the balance sheet and does not address other financial statement areas such as budgetary accounts. The FIAR Plan should also include metrics that adequately measure progress.

3. DoD is reporting improper payments for three different programs:

Military Retirement Fund:	**$49.3 million**
Military Health Benefits:	**$150 million**
Military Pay (just began reporting last November):	**$432 million**

DoD is proud that they are reporting for Military Pay, because even though it doesn't meet the 2.5% and $10 million threshold, they believe it is essential to see that our soldiers are paid. I agree.

In briefings, DoD has been confident that they would be able to provide adequate risk assessments for all other activities and programs that are required to be risk assessed under statute, should the Subcommittee request any.

> **a) Can you please tell me how, and to what degree, DoD is complying with the Improper Payments Information Act?**

In October 2005, the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD(C)/CFO) issued a memorandum requesting improper payment information for the following offices in DoD:

- Secretaries of the Military Departments
- Chairman of the Joint Chiefs of Staff
- Under Secretaries of Defense
- General Counsel of the Department of Defense
- Director, Operational Test and Evaluation
- Inspector General of the Department of Defense
- Commander, U.S. Special Operation Command
- Commander, U.S. Transportation Command
- Director, Administration and Management
- Directors of the Defense Agencies
- Directors of the DoD Field Activities

Department of Defense, Office of the Inspector General

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Financial Management at the Department of Defense

Each office was asked to provide to the Defense Finance and Accounting Service (DFAS) information on improper payments associated with programs and activities they managed. The intent of that data-call was to determine the Department's highest risk areas for making improper payments. After the surveys were completed and returned to DFAS, DFAS personnel summarized the data, and OUSD(C)/CFO personnel reported the Department's improper payment information in its DoD PAR.

We audited the survey process in FY 2005, and we are auditing a revised process the Department is using to report improper payments in FY 2006. We have issued two reports to date on the revised process. In August 2005, we reported[1] that the Department improved its process for reviewing programs and activities and identifying and reporting on those programs susceptible to making significant erroneous payments. The report stated that DoD used an improved data-call to estimate approximately $977.5 million in erroneous payments associated with its FY 2004 operations. Additionally, DoD identified the military pay activity as being at high risk for erroneous payments. DoD did not complete its preliminary estimates or identify the high risk areas until January 2005. As a result, the amount of erroneous payments DoD reported in its FY 2004 PAR was understated, and DoD did not report the newly identified high-risk area related to erroneous payments. DoD needed to continue to improve the process of gathering and analyzing data to develop an accurate baseline from which it can measure progress in reducing the likelihood of erroneous payments.

In June 2006, we reported[2] that although they reported $22.5 million in improper payments related to the procurement of fuel in FY 2005, DFAS Columbus and the Defense Energy Support Center (DESC) did not have adequate control processes in place to provide assurance that the amount reported was accurate. The DFAS Columbus and the DESC had not begun the contract reconciliation process on approximately 3,421 fuel contracts which is required to be completed before closeout, a process that provides the information needed to determine whether fuel payments are accurate. As a result, DFAS Columbus inappropriately reported to the Under Secretary of Defense (Comptroller)/Chief Financial Officer that DoD was at low risk for making improper fuel payments. DFAS Columbus and the Defense Energy Support Center needed to close contracts to improve the baseline of improper payments related to fuel and permit management to determine the causes of improper payments and to find ways to reduce the amounts. We also reported that DFAS Columbus inaccurately reported that it corrected a material weakness related to the identification of improper payments on commercial and vendor pay contracts during FY 2005. DFAS Columbus needed to report the material weakness on the identification of improper commercial and vendor payments in its Annual Statement of Assurance and assign a medium-risk rating to the

[1]DoD IG Report No. D-2005-100, "Identification and Reporting of DoD Erroneous Payments," August 17, 2005.
[2]DoD IG Report No. D-2006-094, "Improper Payments for Defense Fuel," June 29, 2006.

fuel payments process. Additionally, DFAS Columbus and the Defense Energy Support Center needed to report a material weakness related to the problems with the closing of fuel contracts. The DoD generally concurred and was taking action to correct these deficiencies.

Additional Comments. DoD has attempted to recover some of its improper payments through the use of Recovery Audits. The annual reporting requirements for Improper Payments and Recovery Audits fall under the same OMB guidance. The OMB guidance indicates that a Recovery Audit is not an audit in the traditional sense but a control activity designed to ensure the integrity of contract payments. DoD recovered a total of $107.3 million in improper payments in FY 2005 using Recovery Audits: $103.7 million by DFAS efforts and $3.6 million by recovery audit contractors.

We issued an audit report in August 2005[3] that described problems with the DoD process of administering and managing the Recovery Audit Program. We reported that DoD implemented cost-effective recovery audit programs in two of its Defense Working Capital Fund Business areas and in one Defense General Fund Business area. DoD used contract firms in those areas over an 8-year period to perform audits that recovered approximately $34 million. Additionally, DoD used its internal review staff to perform recovery audits and DoD successfully recovered $48.2 million. Although the program has been successful, DoD did not expand its Recovery Audit Program to other business areas, citing their lack of suitability. We concluded that further study of other areas in DoD is needed. Activities that appear to be good candidates, including activities funded with General Fund Appropriations, were never studied, and the use of Recovery Audits in the area of contract administration was not adequately explored. Additionally, DoD needed to fully report the success of its internal recovery audit efforts in its FY 2004 PAR. We concluded that the FY 2004 PAR understated the Recovery Audit results by at least $27.1 million. The DoD has responded by updating its Financial Management Regulations and by designating a manager to oversee the Recovery Audit Program.

b) How much in resources—both time and dollars—would you say the Department uses to focus on this important process?

Currently, personnel from OUSD(C)/CFO coordinate and report improper payment information for the Department using information from the improper payment survey. The FY 2006 improper payment survey requested FY 2005 information from the offices described above. We do not have data about the time and resources used by the Department for this important process.

[3]DoD IG Report No. D-2005-101, "DoD Audit Recovery Program," August 17, 2005.

Department of Defense, Office of the Inspector General

Answers to Questions for the Record
Financial Management at the Department of Defense

4. I understand that DoD IG is currently doing work on Improper Payment Information Act Compliance at the Department.

a) Could you share with the Subcommittee what you have found, and are finding?

In March 2006, we announced an audit[4] of the improper payment information reported in the FY 2005 DoD PAR. Specifically, we are reviewing the FY 2005 DoD PAR for compliance with OMB reporting guidance, completeness and usefulness of information reported, and the availability of supporting documentation for the information reported on improper payments. We have provided status briefings regarding the lack of a clear and readily available audit trail for the improper payment information reported in the FY 2005 DoD PAR. However, the audit is still in the field work phase and we have not published a conclusion on DoD compliance with the OMB reporting guidance on improper payments or the completeness and usefulness of the improper payment information.

We are discussing with OUSD(C)/CFO and DFAS the newly issued OMB Circular A-123, Appendix C, August 2006, which contains guidance on improper payment reporting and is applicable for FY 2006 DoD PAR reporting. We are also reviewing the FY 2006 improper payment survey to evaluate DoD's compliance with the newly issued guidance for FY 2006 DoD PAR reporting.

5. Can you please share with us some of the key successes that DoD has seen in the area of financial management?

In addition to the financial management successes discussed in the August 3, 2006, testimony, DoD has seen the following key successes in financial management:

- Development of the FIAR Plan that is periodically submitted to Congress to report the status of financial improvement initiatives.
- Establishment of Audit Committees to discuss audit readiness and approaches.
- Compilation of the quarterly and annual financial statements under accelerated reporting due dates established by the Office of Management and Budget which required the financial statements to be compiled within 45 days after the end of the accounting period.
- And, over the past 5 years, the U.S. Army Corps of Engineers (USACE) has worked to improve internal controls and move toward an opinion. By working

[4]DoD IG Project No. D2006-D000FJ-0156.000, "Audit of the Identification and Reporting of Erroneous Payments in the DoD," March 16, 2006.

closely with the audit community USACE has been able to correct most of the deficiencies. In December 2005, USACE asserted that the financial statements were ready for audit. An independent public accounting firm is currently performing the audit. We expect the results of the audit late November 2006.

6. How have the past five years been different from DoD's prioritization of financial management in the 1980's and 1990's?

In the past five years DoD has made significant progress on implementing an integrated approach and organizational framework to systems modernization and improved financial management through the efforts of the BEA and the use of the ETP and the FIAR Plan.

Prior to the 1990s, DoD focused primarily on funds control and not on producing financial management data and financial statement reporting. In the past, DoD allowed components to independently develop finance and accounting systems that resulted in poor interoperability between those systems and with non-financial systems. However, statutory requirements passed during the 1990s, such as the Chief Financial Officers (CFO) Act of 1990, the Government Management Reform Act of 1994, and the Federal Financial Management Improvement Act of 1996, formalized the requirements for providing financial statements and improving financial systems. The Acts established reporting requirements that emphasized complete, reliable, timely, and consistent financial data and transaction driven systems that could generate financial statements that complied with the U.S. Standard General Ledger. Further, the establishment of the Federal Accounting Standards Advisory Board and issuance of federal accounting standards provided additional formalized requirements that DoD would need to meet. Those statutory and accounting requirements provided the impetus and focus for DoD to improve financial reporting and systems.

In response to the new statutory and accounting requirements, DoD implemented various financial improvement efforts during the 1990s. However, these efforts made little progress toward achieving improved financial management data and financial statement reporting. During testimony in the 1990s and 2000, the DoD OIG reported concerns over DoD's financial improvement efforts. In April 1998 testimony, the DoD OIG reported that cooperation between major DoD organizations and systems owners, and commitment of DoD managers to the goal of CFO Act compliance were vital to systems modernization and improved financial reporting. Additionally, the DoD OIG reported disappointment over the Department's financial improvement efforts because the DoD Senior Financial Management Oversight Council, which was described as the capstone of the DoD financial management reform organization structure in the Chief Financial Officer's Five Year Plan, had not met in over a year and had not discussed compliance with the CFO Act in four years. Further, the DoD OIG reported that leaders of many non-finance functional areas did not appear to be actively engaged in the improvement process. The DoD OIG also reported concerns over the "excessive complexity of DoD

accounting" and cautioned that that there would be "tremendous complexity, workload, and vulnerability to errors unless we also reengineer the accounting structure itself."

In May 2000 testimony, the DoD OIG raised concerns that DoD could not identify the status of the financial management improvement efforts, the amount of work that remained, the amount of risk that existed in meeting goals and schedules, and the cost incurred or funds needed in the future. The DoD OIG also observed that DoD did not consistently update or analyze the data that was compiled for the financial management improvement plans and did not use the information for daily program management or oversight. The DoD OIG recommended that the "Department needs to determine how best to collate and share available information, establish any additional metrics needed and require sufficient internal reporting to enable the CFO Act compliance effort to be managed, monitored and controlled as a well integrated program."

However, DoD has recently made progress in prioritizing financial management initiatives by establishing the BTA and developing the BEA, the ETP and the FIAR Plan. With continued pressures from the audit community (Government Accountability Office [GAO] and DoD OIG) and Congress, DoD has responded by requiring all levels of DoD to implement practices and actively participate in providing financial data. The GAO has been fully engaged in auditing the ETP. A recent GAO report[5] discussed the additional steps the Department should take in the ETP. The DoD OIG has primarily focused its efforts on advising DoD managers who are preparing and implementing the FIAR Plan.

7. Do you believe that the current organizational structure for financial management at the Department will allow DoD to meet its financial management goals?

DoD should be able to meet its financial management goals under the current organizational framework for systems and financial management improvement. This framework is comprised of the BTA, the BEA, the ETP and the FIAR Plan. However, as I stated in my testimony before this Subcommittee on August 3, 2006, the challenge to DoD managers is to continue to fortify and refine the framework. For the framework to be successful, DoD managers must maintain a sustained effort and focus within the financial management improvement framework to identify, monitor, and correct internal control and systems weaknesses. DoD must aggressively and rigorously sustain and pursue the financial improvement efforts within the established business transformation framework in order for DoD to meets its financial management goals. The Department's effort must be focused on implementing the corrective actions needed throughout DoD to improve financial management. DoD must coordinate and maintain consistency between the plans and efforts. Further, DoD needs to continue to move toward a common business enterprise where all systems are capable of exchanging business events and

[5]GAO Report No. GAO-06-658, "Business Systems Modernization: DoD Continues to Improve Institutional Approach, but Further Steps Needed," May 15, 2006.

transactions. We agree with the conclusions GAO reached in its recent report:[6] "a well-defined enterprise architecture is an essential tool for leveraging information technology (IT) in the transformation of business and mission operations."

8. Are there any enhancements you would recommend?

Although DoD has achieved some key successes in the area of financial management, there are still significant improvements that DoD must make before DoD can claim that successful management practices are in place. We would recommend the following enhancements to the financial improvement and audit readiness initiative:

- Metrics - The FIAR Plan should include metrics that adequately measure progress, such as, the percentage of key milestones that have been accelerated, delayed, added or deleted; the percentage of milestones completed for all reporting periods included in the FIAR Plan (for example, more than milestones completed for a quarter); or, the percentage of milestones that were met in certain categories (that is, milestones related to policy or systems implementation). Additional metrics will provide the users of the FIAR Plan with a more complete and accurate understanding of the progress DoD has made in implementing the corrective actions identified in the FIAR Plan. Additionally, the metrics reported in the FIAR Plan should fairly present the status of corrective actions in relation to the entire period of the plan.

- Focus - The focus of the FIAR Plan is directed at achieving auditability as measured by a "clean opinion." The Department should be focused on becoming auditable and producing timely, reliable and complete financial management data for decision-making and that will support the DoD managers in accomplishing their mission.

- Scope - The scope of the FIAR Plan should be expanded to provide more comprehensive coverage and identify improvement initiatives to:
    - include the other five financial statements required under the CFO Act, in addition to the balance sheet.
    - achieve the ultimate goal of obtaining unqualified opinions at the financial statement level for individual components and for DoD as a whole.

- DoD financial management is still too fragmented to successfully meet its goals. There are too many unique systems and procedures among the Military Departments and Defense agencies. Standardization must continue to be a key goal. Additionally, Congress, the President and the DoD need to consider appointing DoD Financial Managers for longer terms to help stabilize financial

[6]No. GAO-06-831, "Enterprise Architecture Leadership Remains Key to Establishing and Leveraging Architectures for Organizational Transformation," August 14, 2006.

management within DoD. Continual changes in DoD key positions cause continual changes in the DoD financial management focus. GAO also acknowledges that sustained executive leadership is a key requirement for departments and agencies to ultimately realize the benefits of enterprise architecture.

- DoD needs to continue developing comprehensive, integrated plans that will lead to improved systems and controls within the Department. In the March 15, 2006, Annual Report to Congress on the status of DoD business transformation efforts,[7] the Department recognized the need to identify dependencies within and between the various business transformation programs and plans.

[7] Required by the Ronald W. Reagan National Defense Authorization Act for FY 2005 (Public Law 108-375).

ATTACHMENT

Summary of Other DoD OIG Work

Overview of Financial Management Work

The following is a summary of the work the DoD OIG has done in the financial management area:

- CFO Act Audits - We issued disclaimer opinion reports, and related reports on internal control and compliance with laws and regulations, on the FY 2005 DoD Agency-Wide Financial Statements and seven other Component financial statements whose audits are required by OMB. In addition, DoD OIG issued an unqualified opinion on the FY 2005 Military Retirement Fund financial statements and a qualified opinion on the FY 2005 Medicare-Eligible Retiree Health Care Fund financial statements. The DoD OIG cited the following material internal control weaknesses in the DoD Agency-wide report: financial management systems; fund balance with Treasury; inventory; operating materials and supplies; property, plant, and equipment; government-furnished material and contractor-acquired material; environmental liabilities; intragovernmental eliminations; accounting entries; Statement of Net Cost; and Statement of Financing. DoD OIG also issued reports on the FY 2005 DoD Agency-wide special purpose financial statements and the FY 2005 intragovernmental agreed-upon procedures required by OMB.

- Line-item work - We have audit teams dedicated to the following material line items on the DoD Agency-Wide balance sheet: Fund Balance with Treasury; General Property, Plant, and Equipment; Military Equipment; Inventory; Operation Materials and Supplies; Environmental Liabilities; and Accounts Payable. These teams are subject matter experts and track the Department's progress of correcting deficiencies. They are responsible for the audit and attestation work performed on these line items.

- Information Systems Audits - The DoD OIG performed six Statements on Auditing Standards 70/88 audits of DoD systems in FY 2005 and plan to audit additional systems in FY 2006. In performing our examinations, we test the design and operating effectiveness of the controls in operation. In FY 2005, we found that the controls in place to ensure compliance with DoD information assurance policies appeared to be suitably designed, but our tests of the design and operating effectiveness indicated inconsistencies in the adherence to DoD policies. Specifically, we found design control weaknesses regarding access controls in the areas of user and access rights, physical and logical controls to detect unauthorized access, and audit trails. Additionally, tests of operating effectiveness identified primary deficiencies in authorization, completeness, change controls, and configuration management.

- Compliance Audits - In addition to the compliance work we perform during our annual financial statement audits of DoD agency-wide and Component financial statements, we perform several stand-alone compliance audits. In FY 2006, we are auditing the Department's compliance with the Federal Manager's Financial Integrity Act, Prompt Pay Act, Antideficiency Act, Government Performance and Results Act, and the Improper Payment Act.

- Intelligence Agency Financial Statement Audits - The Senate Select Committee on Intelligence currently requires audit opinions on the FY 2007 Defense Intelligence Agency, National Security Agency, and National Geospatial-Intelligence Agency financial statements. In anticipation of this requirement, during the past several years, we have conducted and are continuing to perform financial-related audits on the financial data and operations of these intelligence agencies.

- Other - The DoD OIG Data Mining Directorate, DFAS, and the DCIS have teamed together to identify DoD freight transportation payment systems that are vulnerable to fraud and other abuse. PowerTrack, an Internet-based freight payment system, is the DoD's primary method for paying for freight transportation and has streamlined the payment process by electronically allowing carriers to bill shippers for payment. DoD OIG health care audit resources focused on an audit of controls over payments made to overseas health care providers. Additionally the DoD OIG initiated an audit of the Third Party Collection Program to evaluate the implementation of itemized outpatient billing.

Current Audit Projects

We are currently working on a number of audit projects that should provide assessments, conclusions and recommendations related to financial management within DoD. For example:

- Financial Management of supplemental funds and relief efforts related to Hurricane Katrina.

- Several audits related to DoD Components' management of funds on outgoing and incoming military interdepartmental purchase requests (MIPRs) (to include organizations such as Defense Intelligence Agency, National Geospatial-Intelligence Agency, Marine Corps, Army, Missile Defense Agency, U.S. Special Operations Command).

- Controls over identifying, disclosing, and correcting abnormal balances and compilation of the financial statements for Other Defense Organizations.

- Several audits of DoD systems to determine their compliance with financial accounting requirements and other internal control and regulatory

requirements. (Systems include Integrated Accounts Payable System, DFAS Corporate Database/Warehouse, Army Corps of Engineers Financial Management System, Defense Travel System, Defense Civilian Pay System, Military Sealift Command Financial Management System , Army General Fund Enterprise Business System,

- DoD Compliance with the Federal Managers' Financial Integrity Act of 1982
- DoD Garnishment Program
- Internal Controls and Management of Purchase Card Program
- Controls Over Prevalidation of DoD Commercial Payments
- Military Pay Accounting Operations & Controls Over Air Force Military Pay and Allowances
- Internal Controls Over Inventory Stored at DLA Distribution Depots
- Controls Over Army Cash and other Monetary Assets.
- Budget Execution Operations at DFAS
- Air Force Vendor Pay Disbursement Cycle
- Processes and Procedures for Recognizing and Reporting Accounts Payable.
- Agreed-Upon Procedures on the Air Force General Fund Balance with Treasury Line Item.
- Limited Scope Audits to Provide a Disclaimer Opinion on the Following FY 2006 Financial Statements: DoD-Wide; and Army, Navy and Air Force General and Working Capital Funds.
- Full Scope Audits to Provide an Opinion on the Following FY 2006 Financial Statements: Military Retirement Fund, Medicare Eligible Retiree Health Care Fund, and Army Corps of Engineers.

Planned Audit Projects

In addition to on-going audits, we have several additional audits planned during the next 12 to 15 months. For example:

- Financial Management of International Military Educational Training Funds

- Audits of Defense Intelligence Agencies' Financial Statements as Required by the Senate Select Committee on Intelligence
- Identification and Reporting of Improper Payments in DoD
- Military Personnel Receiving Housing Allowances
- DoD Emergency Response Fund
- DoD Purchases through the Veteran's Administration
- Air Force Fund Balance With Treasury, Cash and Other Monetary Assets
- Reliability of Contingent Liabilities for the Defense Logistics Agency
- Several audits of DoD Systems to Determine Their Compliance with Financial Accounting Requirements and Other Internal Control and Regulatory Requirements (Standard Accounting and Reporting System,
- FY 2006 Obligations for the DoD Counterdrug Program
- Controls Over Out of Country Payments
- Financial Reporting for Nonappropriated Funds

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