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IMPROVING FINANCIAL AND BUSINESS MANAGEMENT AT THE DEPARTMENT OF DEFENSE

HEARING

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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IMPROVING FINANCIAL AND BUSINESS MANAGEMENT AT THE DEPARTMENT OF DEFENSE

TUESDAY, OCTOBER 16, 2007

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

The Subcommittee met, pursuant to notice, at 3:19 p.m., in Room SD–342, Dirksen Senate Office Building, Hon. Thomas R. Carper, Chairman of the Subcommittee, presiding.

Present: Senators Carper, McCaskill, and Coburn.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Welcome, one and all. The Subcommittee will come to order. Dr. Coburn and I were talking and it looks like we are going to start voting. We are working on one of our 13 appropriations bills, the Commerce-Justice appropriations bill, and they have an amendment at 3:30. We are probably doing amendments about every 15 minutes after that. It will make this a long hearing. No, hopefully it won't be that often, but it will seem that way, I am sure.

I am grateful my colleague here is with us, Dr. Coburn. We are going to be joined by some others on our Subcommittee later. Senator McCaskill is presiding right now. As soon as she can get someone to relieve her, she will be over to join us and some others will, too.

I think it was the day before September 11, 2001, former Secretary of Defense Donald Rumsfeld, with whom and for whom some of you have worked, gave a blunt and accurate assessment of one of our greatest adversaries while speaking to Pentagon employees and this is what he said, "The topic today is an adversary that poses a serious threat to the security of the United States," and he went on to say, "the adversary is closer to home. It is the Pentagon bureaucracy, not the people, but the processes; not the civilians, but the systems; not the men and women in uniform, but the uniformity of thought and action that we too often impose upon them."

Unfortunately, some 6 years later, those words are as true today as they were back then and our hearing today will focus on this adversary. Specifically, we will discuss how to continue to improve

financial and business management at the Department of Defense, focusing on both the progress made by the Department in the area of business transformation as well as on the monumental challenges that the Department continues to face.

I am told that the Department of Defense is one of the largest, most complex entities in the world. It employs nearly 1.4 million people on active duty, roughly 825,000 in the Reserve and National Guard, and nearly 720,000 civilians. Its fiscal year 2006 financial statements included $1.4 trillion in assets and nearly $2 trillion in liabilities.

To support DOD's operations, the Department performs an assortment of interrelated and interdependent business functions using almost 3,000 business systems. For fiscal year 2007, the Department of Defense spent approximately $4.5 billion to operate, maintain, and modernize these business systems, including their infrastructure. The ability of these systems to operate as intended affects the lives of our war fighters both on and off the field.

While the Department of Defense has long been acknowledged for its premier war fighting capabilities, the dismal state of its financial and business management practices leave the Department vulnerable to waste, fraud, and abuse.

We all share the same objective, and that is to try to figure out how the Department of Defense can successfully transform its financial management and business systems. The questions I hope will be addressed today are the following ones.

The Department recently assigned Chief Management Officer duties to the current Deputy Secretary of Defense. One of the questions that I have is, is this action sufficient?

Since 1999, the GAO has urged the Department to develop a strategic enterprise-wide business transformation plan. Why has this plan not yet been developed?

Given the personnel turnover that will happen between now and January 2009, how will the Department ensure that progress is sustained?

And finally, how can Congress play a constructive role in charting the best path forward for the Department?

The Department of Defense has needed a Chief Management Officer who puts taxpayers first and is committed to sound financial and business management and transparency. Some of us, including the Comptroller General, have been pushing for this change literally for years. In fact, along with Senators Ensign, Voinovich, and Akaka, I joined them in cosponsoring legislation to establish in the Department of Defense, a Deputy Secretary of Defense for Management, who would serve as a Chief Management Officer.

Now, certainly, Deputy Secretary of Defense Gordon England, for whom I have enormous respect, has ably served in this capacity unofficially even while tackling the challenges of being at the Department itself. Furthermore, Secretary Gates took a step in the right direction when in a September 18, 2007, DOD Directive he expanded Secretary England's official role to include serving as Chief Management Officer, as we know.

But a number of others, and certainly myself, and that includes GAO, the Institute for Defense Analysis, and the Defense Business Board, do not believe this action is sufficient. I believe this addi-

tional title will not necessarily result in the kind of meaningful reform that we are looking for. Only a full-time, term-based senior management official will be able to provide focus and sustained leadership over DOD's business transformation.

Sound financial and business management is critical to the success of the Department. It is the foundation of any organization, any program, or any activity. The Department of Defense has one of, if not the most, important missions of any U.S. Government agency, and that is to protect and secure our homeland. Waste and mismanagement undermine that very important mission. Anything that weakens the Department weakens its ability to respond quickly and effectively to meet the real threats that our country continues to face.

As elected Members of Congress, we have an obligation to the United States of America and to our people to ensure that their dollars are being used as effectively and as efficiently as possible. To date, the war in Iraq has cost us just over a half-trillion dollars and the meter is still running. Since 2003, we have passed eight supplemental bills for Iraq and Afghanistan. We will soon consider another $150 to $190 billion. The deficit this year is forecasted at roughly $160 billion, and although that is a little better than last year, it is not great.

At home, we are faced with huge growing fiscal imbalances due at least in part to our aging population and skyrocketing health care costs. This is not the time to be frivolous with our hard-earned money. But we know that there is never a time to be frivolous with the hard-earned money of the people of our country.

Congressional oversight is imperative to make sure that Federal agencies like the Department of Defense step up to the plate, confront the waste of precious taxpayers' dollars, and take immediate corrective action so that more of our dollars support the real mission of the Department of Defense, and that is protecting Americans and our national interest both here and abroad.

Dr. Coburn.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. Senator Carper, thank you for having this hearing. It is our biggest expenditure, the Department of Defense. That is where we have the most money.

I was glad you alluded to former Secretary Rumsfeld's statements. I am anxious to hear how things have changed since then. As I have studied and prepared for this hearing, I am not sure large quantities of measurable change have, in fact, happened.

My primary concern pertaining to DOD's financial management is the goal for DOD to become audit-capable. Whether they pass or fail the audit, you have to become audit-capable first, and the fact that we are not anywhere closer to that now than we were when I came to the Senate is simply unacceptable.

DOD continues to play the key role, with 15 programs or activities on GAO's 2007 high-risk list. Six of them have been on the list for at least 10 years, some dating as far back as 1990. The DOD contracting continues to be unaccountable. I want to restate that word, unaccountable, unmeasurable, not manageable. It still is unaccountable. It is plagued with longstanding problems and it has

been on the high-risk list for 15 years, almost three Administrations.

There have been numerous initiatives and strategies that have been implemented, but there still hasn't been any demonstrable progress in the key areas, or there hasn't been any significant metrics that I am aware of or benchmarks to gauge the progress of new standards and guidelines.

I am almost to the point where I agree with David Walker that there ought to be a permanent position at DOD called the Chief Management Officer. I know that is not in the framework. I know it is not there. But I am wondering how long—6 years from now, we will continue to sit at a hearing like this and still have 15 to 20 programs on the high-risk list, still not have metrics, and still not measure things?

And this is not meant to reflect on any of you gentlemen. I am not talking about you personally. I am talking about the leadership above you that has to be there to make this happen. The efforts have to be held accountable, and that is part of the reason that we are having this hearing. I hope that there are clear milestones and firm commitments in both planning, financial planning as well as purchasing planning, that I haven't seen.

What I am hoping that will come out of this hearing is a commitment from the Defense Department to sit down with this Subcommittee and the GAO on a regular basis to try to hash some of this out. To me, I think we are kind of like we are on a paddleboat and we are going against the current. We haven't lost any, but I am not sure we have made any headway. As we continue to change things and change techniques and change strategies, I am not sure we are any closer to the goal. So I look forward to hearing that.

I want to thank Comptroller Walker for his work and analysis and I thank each of you all for the input and the effort that you are—this is a daunting task. If it was easy, you would have already fixed it, I am sure. But the fact is, the frustration level and the financial consequences to not having an audited financial statement, to not having procurement under control, is, in fact, costing lives. And more importantly, it is costing the future of the next two generations of Americans because this is the largest expenditure that we have and if we can't get this right, we can't get any of it right.

So I look forward to your testimony and I am hopeful that we can start a dialogue with both Chairman Carper and myself and really get some benchmarks for you all in terms of the implementation of this.

The other thing that I worry about, as your staff and you have so ably pointed out and I know you are going to bring up, is there going to be an Administration change coming up in 2009? Are we going to see another great big setback? Are we going to start all over again? I want some assurance today that the things that are in place are going to continue to move forward rather than we are going to change it again and change the goal. What are we, at 2016 now, I believe, is when we said we can have an auditable financial statement? That is not acceptable anywhere else in this country and it shouldn't be acceptable here. Thank you.

Senator CARPER. Let me go ahead and take a minute or two and introduce our witnesses. Again, welcome to each of you.

We are going to lead off today with our Comptroller General, General David Walker. I said to General Walker before we started that I am glad we don't have to pay him on a piecemeal basis for every time that he testifies. Otherwise, you would run this deficit up even more than it has. He said he would like to go to work on a commission basis, I think is what he said. But it is not going to happen anytime soon.

He is currently serving his ninth year of a 15-year term. Part of me says it would be nice to have a 15-year term, but I am not sure sometimes. But General Walker has been a vocal advocate of ensuring fiscal stewardship in the Federal Government. We are grateful for your service and for that of the team that you lead.

J. David Patterson is the Principal Deputy Under Secretary of Defense, the Comptroller. As the Principal Deputy, he is directly responsible for advising and assisting the Under Secretary of Defense as Comptroller for oversight of DOD's financial management activities. His responsibilities also include developing and implementing DOD financial policy, financial management systems, and business modernization programs.

Mr. Patterson served in the Air Force, I am told, from 1970 to 1973 and retired at the rank of Colonel. During that time, he held responsible leadership and management positions with assignment at the Air Wing level as—are you ready for this, Dr. Coburn—a C–5A aircraft commander. Were you the wing commander for a wing that included C–5s?

Mr. PATTERSON. I was the deputy forward air controller at Dover.

Senator CARPER. At Dover? Good for you. Welcome, a special welcome.

Next, we have Paul Brinkley—welcome, Mr. Brinkley—Deputy Under Secretary of Defense for Business Transformation at the Department of Defense. Mr. Brinkley leads business management modernization for the Department of Defense. Prior to assuming his current role, Mr. Brinkley served as Senior Vice President of Customer Advocacy and Chief Information Officer for the JDS Uniphase Corporation. I hear from my staff that you have been doing great economic development work over there in Iraq and we commend you for that and say welcome.

Last, we are glad to have Dr. Dov Zakheim with us today, currently a Vice President at Booz Allen Hamilton. Dov was appointed to be the Under Secretary of Defense and Comptroller from 2001 to 2004. I think his tenure there began as my tenure here in the U.S. Senate started. I remember fondly the opportunities we had to work together and we are delighted that you could be with us today. Dr. Zakheim is a member of the Defense Business Board and the Council on Foreign Relations. He has taught at the National War College, at Yeshiva University and Columbia University to name but a few. We are delighted to see you and thank you for coming today.

I don't know if we started a vote or not. Could somebody——

Senator COBURN. Yes, we have.

Senator CARPER. Have we? OK.

Senator COBURN. Let me just add something. It takes a lot of courage for Booz Allen Hamilton to allow you to come and testify here. They are a contractor at the Defense Department and I want

to thank them for their courage. Input into our government is the thing that we need and we value, and when people are intimidated to not do that because of the fear that they might not have the next contract, we all lose. So I want to thank your employer for that, Dov.

Mr. ZAKHEIM. Thank you. I am speaking in my own personal capacity, but I am glad to be here.

Senator CARPER. Dr. Coburn, do you want to just——

Senator COBURN. Do you want me to go vote? We have got three.

Senator CARPER. In a row? Let us just get started and then we will take a break.

General Walker, you are on. Welcome.

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

Mr. WALKER. Chairman Carper, Dr. Coburn, it is a pleasure to be back before the Subcommittee again to talk about this time the Department of Defense's efforts to transform its business operations and what further action is needed to maintain continuity of effort, to change the status quo, and to achieve sustainable success.

As has already been mentioned, DOD represents 15 of 27 high-risk areas on our latest list. Eight are DOD-specific. Seven are government-wide challenges.

As you all know, in addition to representing the largest single domestic agency as far as spending—discretionary agency, I should say, for spending, our Nation is already running deficits and they are going to get a lot worse in the future because of the retirement of the baby boomers of the generation, absent reforms.

Every dollar of waste is a dollar we don't have to meet a need, and every dollar of waste is an additional dollar of debt with compound interest that our kids and grandkids are going to have to pay off. We should have zero tolerance for waste at any time, but especially at a time of deficits and facing a period of sustained deficits and debt burdens that lie before us absent meaningful reforms.

Transformation takes a long time to make happen, even in the private sector. And clearly, the senior leadership at DOD is committed to transformation and there are a lot of good people working very hard in order to try to achieve success. Progress has been made at differing rates in these 15 different areas, but candidly, there are a number of critical things that have to be done that have not been done, and I am here to tell you unless and until they are done, we will never be successful.

We have to have a single integrated, comprehensive, strategic business transformation plan that goes beyond systems, that deals with all 15 high-risk areas, a comprehensive strategic and integrated plan with key metrics and milestones and with assigned accountability and responsibility for achieving results. We don't have it.

Second, we need a Chief Management Official, a full-time job, not a part-time job, with a term appointment, with responsibility and authority to develop, implement, and oversee that plan, to work in

[1] The prepared statement of Mr. Walker appears in the Appendix on page 38.

partnership with others who would provide continuity both within and between Administrations. GAO, the Defense Business Board, and IDA have all recommended a new full-time position with a term appointment.

The recent action to appoint Deputy Secretary Gordon England as the CMO, in my view, is form, not substance, and let me be clear here. I have tremendous respect for Secretary England. He is an extremely capable individual, and this has nothing to do with him as an individual. In fact, what we need to start doing is look beyond individuals and recognize that we have got an institutional problem that cries out for institutional and sustainable solutions, and that is not what is being done.

The only outlier in this debate is the Department of Defense. That is the only outlier in the debate about what we need to do to move this thing forward, and frankly, I am growing more frustrated as time goes on, not because of these good people here. These are very capable, dedicated people who are making a difference because the status quo is not going to achieve sustainable success, and the sooner the Congress recognizes that and the sooner that the Executive Branch acts, the better off we will all be.

I will be happy to answer any questions you may have after hearing from my co-panelists.

Senator CARPER. Thank you, General Walker.

From a General to a Colonel. David Patterson, please proceed. You are recognized for 6 minutes. If you want to summarize your testimony, that would be fine. Your entire statement will be entered into the record. Please proceed.

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

Mr. PATTERSON. Thank you very much, Mr. Chairman, Dr. Coburn. Again, it is a great privilege to be here to talk to this Subcommittee and discuss the progress that I believe we have made in the Department in improving our business and financial management and preparing the Department for an independent audit.

We are always happy to bring the Subcommittee up to date and to clarify any questions you may have about the Department's modernization efforts. Indeed, before I finish today, I would hope that I would leave you with a better understanding of what I consider to be the three most important considerations on this topic.

First, to your point, Chairman Carper, the size and the scope of the Department of Defense is indeed a great challenge. But to address that challenge, we are making progress in the Department along a sound plan for success. And the DOD's strong commitment to wise stewardship with our resources, sustained business and financial modernization, and a solid leadership support.

To the first point, the size and scope of our challenge, we often hear it asked with some astonishment, how can it possibly be that the Department of Defense has never been independently audited? Well, on its face, it seems like a simple question and a relatively

[1] The prepared statement of Mr. Patterson appears in the Appendix on page 81.

straightforward task. In an organization as large as the Department of Defense, the task is anything but simple.

To put it in perspective, the Department of Defense is not only the largest department in the Federal Government, but the largest and most complex organization in the entire world. With an annual budget nearly twice the annual revenues of Wal-Mart and assets three times the size of Wal-Mart, IBM, and ExxonMobil combined, it is also the largest entity in the world ever to consider being audited end to end.

And again to your point, Chairman Carper, we are also a global enterprise with 600,000 facilities in 163 countries around the globe, over five million inventory items, and $3.4 trillion in assets and liabilities.

Now, before the Chief Financial Officers Act of 1990, the Department of Defense operated under a very simple system. We received appropriations from Congress and tracked expenditures to ensure their proper execution. Business processes were slow, business operations inefficient, and because systems that had evolved over decades were incompatible across a spectrum of the agencies and components, information was inaccurate and incomplete. The result: Inaccurate inventories, material weaknesses, and an inability to obtain a clean audit.

So that is the first point. The Department of Defense is a huge organization, a huge enterprise that for decades has utilized an outmoded collection of disparate systems incompatible with each other in a modern systems world.

The second I would like to bring to your attention is the progress in light of that challenge that we have made toward a sound path for success. In 2005, a detailed plan was launched to modernize DOD financial management and prepare the Department for audit. Today, that plan is producing measurable results, transforming the way we do business, improving process, and reducing costs and making the Department more accountable.

In 2001, only two Department of Defense entities were auditable, the Defense Finance and Accounting Service and the Military Retirement Fund. Today, seven Defense enterprises are auditable, whose combined assets and liabilities comprise 15 percent of the Department's total assets and 49 percent of its total liabilities, and they all have clean audit opinions. By the end of fiscal year 2009, we expect to have nearly 40 percent of DOD assets and 90 percent of the liabilities, or nine of our financial enterprises, with clean audit opinions.

So we have the largest enterprise in the world, but thanks to a solid plan that is working, we will have gone from two auditable entities in 2001 to nine Department entities, or 90 percent of our liabilities and nearly 40 percent of our assets being auditable by the end of next fiscal year. And I might add just in passing that those seven auditable agencies that we have today have a combined value of assets and liabilities twice the next largest government agency, Health and Human Services.

So that brings me to my third point, and I would like to leave with you a very strong understanding that the Department of Defense, the heads of our agencies, and military leaders are absolutely committed to wise stewardship of resources and sustained

modernization that supports not a bureaucracy, but the mission and the brave fighting men and women who put their lives on the line every day to accomplish that mission.

So we have the largest and most complex organization. We have a plan to achieve success. And we have an organization, and more importantly a senior leadership that is absolutely committed to achieving that success.

So, Mr. Chairman, thank you again for allowing us to come and talk to you. I look forward to your questions.

Senator CARPER. Thank you, Colonel Patterson.

We are going to take a little break here. We have a series of three votes. We are going to get there for the end of the first one, vote two more times, and be back probably in about 20 minutes. We will get back as quickly as we can.

The hearing will stand in recess and we will return shortly. Thank you.

[Recess.]

Senator CARPER. The hearing will come to order. I am delighted that you are all still here. Thank you. I apologize for the interruption.

Mr. Brinkley, you are next in line, so please feel free to proceed. I am going to ask you to summarize in about 6 minutes and we will enter your full statement into the record. You are recognized. Thank you.

TESTIMONY OF PAUL BRINKLEY,[1] DEPUTY UNDER SECRETARY OF DEFENSE FOR BUSINESS TRANSFORMATION, U.S. DEPARTMENT OF DEFENSE

Mr. BRINKLEY. Thank you, sir. Chairman Carper, Senator Coburn, Members of the Subcommittee, it is my honor to appear here today to discuss Defense business transformation and its associated governance.

As the largest industrial organization in the world, the size and complexity of the Department of Defense combined with its singular mission present unique challenges not faced by other entities undergoing transformational change. The Department's mission requires that its business operations adapt to meet new challenges not faced by other organizations undergoing transformation. The Department must be able to react with precision and speed to support our Armed Forces. Despite these challenges, I believe the progress the Department has made at all levels under the leadership of Deputy Secretary of Defense Gordon England over the past 3 years has been remarkable.

Fundamentally, business transformation requires a number of things, including a sound enterprise-level strategy for transforming business processes and the culture that our people work within, leadership commitment, and a strong investment, management, and governance structure to ensure alignment to that strategy.

Over the last 3 years, the Deputy Secretary of Defense has led our transformation efforts, devoting extensive time and energy to the effort to improve the Department's business operations. In many ways, Secretary England has been acting in the capacity of

[1] The prepared statement of Mr. Brinkley appears in the Appendix on page 86.

Chief Management Officer throughout his tenure, most notably in his role as the Chairman of the Deputy's Advisory Working Group and the Defense Business Systems Management Committee (DBSMC), the overarching governance board for the Department's business activities.

Since its inception in 2005, the DBSMC, in concert with functionally aligned investment review boards, has served as the governance structure that guides transformation activities of the business areas of the Department, such as finance, acquisition, personnel management, and logistics. Authorized by the fiscal year 2005 National Defense Authorization Act and reiterated in the DBSMC charter, the DBSMC has responsibility for approving business systems modernizations over $1 million, the Business Enterprise Architecture for the Department of Defense, and the Enterprise Transition Plan, a comprehensive, milestone-based plan that lays out, in 6-month increments, measurable progress that the entire Department has opened up to scrutiny and measures itself on 6-month increments in published reports to the Congress. This gives the DBSMC statutory oversight and control of spending to ensure alignment to Department-wide objectives, the key to our success to date.

The DBSMC charter extends the authority of the DBSMC beyond statutory requirements to include responsibility for ensuring the strategic direction of the Department's business operations are aligned with the rest of the DOD and for measuring and reporting the progress of our business transformation efforts. With this expanded focus, the DBSMC has become an integral driving force behind the Department's adoption of continuous process improvement and Lean Six Sigma methodologies. The Department's shared focus on enterprise resource planning system and process deployments, and the requirement to change longstanding business practices necessary for these ERP projects to succeed. In each of these areas, the DBSMC has provided invaluable top-level direction for the business transformation efforts of the Department.

As you mentioned, the Deputy Secretary's role in business transformation was recently codified in a September 18, 2007 directive issued by the Secretary of Defense designating the Deputy Secretary of Defense as the Chief Management Officer (CMO) of the Department. This ensures that the Department's top leadership will continue to make business transformation a top priority.

The directive formally institutes into departmental policy the Deputy Secretary's responsibilities as the CMO. As CMO, the Deputy Secretary shall ensure Department-wide capability to carry out the strategic plan of the DOD in support of national security objectives; ensure that the core business missions of the Department are optimally aligned to support the Department's war fighting mission; establish performance goals and measures for improving and evaluating overall economy, efficiency, and effectiveness, and to monitor and measure the progress of the Department; and finally, to develop and maintain the Department's Department-wide strategic plan for business reform.

The official designation of the Deputy Secretary of Defense as the CMO affords the President and the Secretary of Defense necessary flexibility to implement an integrated management team that can

quickly meet the changing requirements of business transformation and positively affect outcomes while formally instituting accountability at the top levels of the Department for the future of our transformation activities.

Finally, I want to highlight a few points. The Department under Secretary England's leadership, we have successfully established the Business Transformation Agency in 2005. This organization provides an accountable entity for all DOD-wide business and system improvement efforts, staffed by the best and brightest career civil servants along with highly-qualified experts hired from private industry, bringing best practices to the business of government.

We have developed and continue to evolve the Business Enterprise Architecture and its associated federation strategy. Biannually, we do publish the Enterprise Transition Plan, which serves as our business transformation strategic road map.

We are implementing the Department-wide adoption of continuous process improvement principles and implementing Lean Six Sigma, as I mentioned, and we are improving the acquisition and fielding process for information systems, the development of what we call the Business Capability Lifecycle (BCL). This BCL process will help resolve longstanding challenges that have impacted the delivery of business capabilities in a timely manner. Under process rules, initial operating capability of an IT program must be reached within 12 to 18 months of the contract award or else the business case will not be approved for funding. This shifts the entire mentality of how we invest in business systems within the Department of Defense.

There are over 20 DOD-wide systems programs that are critical to the DOD and its interoperability that have directly benefitted from this transformation approach. Using a similar approach, programs like the Defense Travel System (DTS) and Defense Integrated Military Human Resources System (DIMHRS) have been restructured and are on a path to deliver longstanding value to the Department of Defense.

Finally, I have two last points I want to make that I think we lose sight of. Some of the most effective and rewarding work the business transformation effort is involved in is in the midst of our fighting forces in Iraq, working to ensure business processes that directly support military operations in the field are agile and that they are aligned to war fighting needs.

Three years ago, the business mission of the Department and the war fighting mission were viewed as very separate activities. In three short years, that mentality has changed. The effect of our business operations on stability operations in the war fighting arena are now widely understood and seamlessly linked. In considering any changes to organizational structure, it is critical that we not structurally recreate a boundary between these two mission areas.

Finally, regarding sustaining our effort, we have taken several steps to ensure our progress is sustained. Transformation of an entity this size cannot be achieved in a single Presidential term. It took Lou Gerstner 10 years to transform IBM into the global competitor it is today, as an example. By establishing a culture of measured 6-month incremental improvements, published and clear-

ly articulated in our transition plan, by establishing the new entity within government, the BTA, staffed with career and business professionals, and creating a sense of direct customer focus by engaging with our war fighters, we believe the Department now has the tools needed to help ensure continued progress and to avoid lost momentum in a change of Administration.

Thank you, and I look forward to your questions.

Senator CARPER. Mr. Brinkley, you are recognized. Please proceed. Thank you.

TESTIMONY OF DOV S. ZAKHEIM,[1] FORMER UNDER SECRETARY OF DEFENSE (COMPTROLLER), U.S. DEPARTMENT OF DEFENSE

Mr. ZAKHEIM. Thank you, Mr. Chairman and Senator Coburn. It is a privilege to be here before you today to discuss ways to improve financial management in the Department of Defense, and as I said to Senator Coburn earlier, I am speaking in a personal capacity.

When I appeared in 2001 before the Senate Armed Services Committee at the hearing for my confirmation as Under Secretary of Defense, I told the Members of the Committee that I considered being CFO as important as being Comptroller. The fact is that financial management traditionally has been a backwater at DOD and that is for two reasons. The first is because the Department's primary task is to support the military's mission, to fight and win the Nation's wars. So everything else, and particularly everything that can be categorized as back office, tends to be subordinated to this essential task.

The second reason is that while the Under Secretary of Defense (Comptroller) is also the Chief Financial Officer, the CFO role has traditionally been subordinated to that of Comptroller, because as Comptroller, it is the Under Secretary of Defense's responsibility to formulate the budget and secure its passage through the Congress. This activity is naturally critical to the ongoing functioning of the Department while financial management is seen as an ancillary exercise. As one of my predecessors put it to me just as I was taking on the job, "as long as you can get your budget submitted on time, you have done your job." He never mentioned CFO at all.

This situation, by the way, is exactly the reverse of what goes on in the private sector. In most corporations, it is the Comptroller who is subordinated to the CFO. Budget preparation is just one financial task and hardly the most important at most private firms. It is a lot more important to know how the money actually is spent and managed throughout the year, what DOD terms "budget execution." But it is noteworthy that only in 2002–2003 did the Department of Defense formally include execution as part of what is now called the planning, programming, budgeting, and execution process.

This focus on the budget is a natural outgrowth of the Department's relationship with the Congress. It is by means of the budget that the Congress exercises its control over the DOD program. In the private sector, shifting funds from one division to another is a

[1] The prepared statement of Mr. Zakheim appears in the Appendix on page 97.

routine matter. For DOD, those actions are strictly regulated by the Armed Services and Appropriations Committees as well as, in some cases, the Intelligence Committee. There are severe, and in my view excessively low, limits on reprogramming funds. Reprogrammings of any significance require prior Congressional approval, normally from the four defense-related committees. The combination of Congressional practice and rules with the culture of a Department whose top priority is war fighting poses a fundamental challenge to any effort to improve the Department's ability to improve upon the management of its business finances and all of its business management operations.

Nevertheless, the last 7 years have witnessed considerable progress in the financial management arena and that of business management. DOD is realizing the objectives that result from sound financial and business management. You have heard details from my former colleagues who are sitting alongside me. But as in other aspects of DOD activity, business transformation remains and must remain an ongoing effort.

In addition, the Department continues to face major hurdles well beyond those created by Congressional limitations and execution management. That is understood. So improving financial management is going to be a painstaking process. There is no quick fix or panacea that is going to change the situation overnight.

Beyond those actions already taken to improve the situation over that which prevailed in the 1990s, I would suggest the following. None of these are particularly original ideas.

First, Congress should reconsider its reprogramming ceilings. These should be raised to 5 percent of the baseline budget so as to give the Department's financial managers the ability to execute budgets more efficiently. Congress would still retain prior approval to satisfy its oversight role.

Second, I believe the Department should ensure that the Business Transformation Agency be led by a three-star general or flag officer or the civilian equivalent, and that the agency report directly to the Department's Chief Management Officer, currently the Deputy Secretary of Defense. While I currently see no need for legislation to codify such a relationship, that may have to be considered in the future.

Finally, since I am running out of time, I would like to address this question of a Chief Management Officer. In my view, the Department should have one with the rank of a principal under secretary who would hold office for a fixed term. I stated this view during my final appearance before the Congress when I was still Comptroller, when I sat alongside Comptroller General David Walker, with whom I agreed then and with whom I still agree.

I recognize, and you have heard this before and I am in complete agreement, that the Department currently has a strong CMO. In my opinion, Deputy Secretary Gordon England is the most capable senior manager the Department has had in decades. But Secretary England's term expires with that of the Administration. He hasn't indicated that he wants to serve another 20 years. There is no guarantee that his successor will bring the same managerial background to the job as, by the way, did Secretary Rumsfeld, who in many ways was his own CMO. Moreover, the post of CMO should

be one that is for a fixed term, perhaps 5 years. Nevertheless, a way needs to be found that the CMO should serve at the pleasure of the Secretary and Deputy to whom he or she would report.

Some say it is going to be exceedingly difficult to find a top manager willing to take the job. They point to the fact that Congress has imposed increasingly onerous financial and reporting burdens on those who otherwise would be willing to serve the Nation in a senior capacity. Clearly, the Congress is going to have to do its part. It is going to have to ease restrictions to the point where senior people would be prepared to leave industry and finance to serve as CMO without, for example, putting their pensions at risk. Otherwise, the right people will never be available and the CMO concept for DOD will remain just that, just a concept.

Again, I appreciate the opportunity to testify before this Subcommittee and I am prepared to respond to questions the Members might put to me. Thank you.

Senator CARPER. Dr. Zakheim, thanks very much for your testimony.

We have been joined by Senator McCaskill. I understand you choose not to offer an opening statement, is that correct?

Senator MCCASKILL. No. I just have questions.

Senator CARPER. OK. Well, you will have them. Thank you for joining us today.

Dr. Zakheim, very briefly restate your four points right at the end.

Mr. ZAKHEIM. The four points about CMO or generally?

Senator CARPER. The last four points that you made.

Mr. ZAKHEIM. What I said, first of all, is the——

Senator CARPER. Starting with reprogramming ceilings——

Mr. ZAKHEIM. Yes. Reprogramming ceilings are just far too low.

The second point that I made was that the Business Transformation Agency needs to be permanently linked at a high level to the Deputy Secretary and the Secretary and to the CMO if there is one. In this case, it is still the Deputy Secretary.

And then I made several other points in my written statement, but finally I did address the question of the CMO. I believe it should be someone with a fixed term, preferably 5 years, a principal under secretary, that is to say outranking the other under secretaries, reporting to the Secretary and the Deputy, obviously having to work with them, but if this person is a technocrat, it shouldn't be that much of a problem.

Finally, that Congress needs to take action to ensure that the reporting requirements that make it so difficult for people to get through the confirmation process are made a little easier. You are just not going to get Wall Street bankers and industrial tycoons who really know this domain well to come in, go out or come back into government. It is not so much the salaries. They don't care about the salaries. They are serving their country. It is the agony of the process. Why should they want to do that? Congress just has to ease up, I think.

Senator CARPER. I remember being nominated by former President Clinton when I was Governor of Delaware to serve on the Amtrak Board of Directors and going through the process itself, just

the paperwork alone was enough to, as much as I wanted to do it, I almost said a couple of times, that is it. I am not going to do this.

Let us just go with the last point that Dr. Zakheim mentioned and that is the issue of whether we ought to have basically a Chief Management Officer. Is this somebody who should serve a set number of terms, somebody who would not be part of the team, if you will, appointed by a President? I know Messrs. Patterson and Brinkley have different perspectives, but let us just go back to you on that point.

One of the things that the Secretary has done, I think, is by executive order or by direction he has said that Gordon England, Deputy Secretary, who is, I think we all acknowledge, very talented and valuable leader, he ought to be the CMO. Is that action sufficient? That is one question. The second is how is this designation any different from some of the previous arrangements that we have had?

Mr. WALKER. First, the action is not sufficient. It is largely a status-quo scenario. I have great respect and admiration for Gordon England. He is an extremely capable professional. But the simple fact of the matter is, Secretary England is G–O–N–E on January 20, 2009, gone, and we don't know who the next Deputy Secretary is going to be. We have no idea what their background is going to be. We have no idea what their interest is going to be. There is no statutory requirement for the Deputy Secretary to have the kind of qualifications that would lead to sustainable success with regard to business transformations. If you look at recent deputy secretaries, some have had backgrounds that would lend them towards being successful and some have had backgrounds that would not lead them to be successful in that role.

And so as I have said before, I think there is agreement between the Defense Business Board, IDA, and GAO that there is a need for a new position as a full-time job with a term appointment and certain other elements. There is agreement on that, and I think it is essential.

Senator CARPER. One of the statements, it maybe came from Secretary England, but someone, I think, has indicated that CMO position that meets GAO's recommendations and the recommendations of Dr. Zakheim will interfere with future Presidents' and Secretaries of Defense's ability to create their own management team. Would you just respond to that?

Mr. WALKER. Clearly, there has to be a basis that if there are irreconcilable differences between the CMO and the Secretary or potentially the Deputy Secretary, depending on the reporting relationships, then there has got to be a mechanism in place to be able to deal with that, and one way you could deal with that is to have some type of a reporting requirement to the Congress where they could end up proposing to take an action to end somebody's term before the end of that term for specified reasons and just advise the Congress.

But I think one of the things we have to keep in mind is that by getting somebody to agree on the front end to serve a specified period of time, with the right type of qualification requirements and with the potential to be reappointed if they do a good job, that sends a powerful signal within the organization, as well, that you

can't underestimate because I have been a Presidential appointee of Ronald Reagan, George Herbert Walker Bush, and William Jefferson Clinton, and my prior positions have been at the pleasure of the President until this current one.

The fact is that PAS-es, by definition, are temporary help. I mean, they are only going to be there for a temporary period of time if you serve at the pleasure of the President, and the kind of things that we are talking about needing to get done here—that these gentlemen are making a very meaningful contribution towards, I might add—they are going to take a long time.

Senator CARPER. I just want to turn to Mr. Brinkley, if we could, to follow up on this question. I know you and, I think, Mr. Patterson have a different take on this, but there is concern about if we don't allow the President to appoint the CMO as part of his or her team, that it is going to interfere with their ability to create a management team to their liking. I just wonder, why does the Department hold this position if the CMO is supposed to be nonpartisan and focused solely on business transformation.

Mr. BRINKLEY. I can only offer observations. The sense the Department has is that a new Secretary coming into the Department with a management agenda aligned to the Administration's managerial priorities should have as much freedom as possible to take the people that he has available and build the team that he believes best aligns to his management style and his management discipline, and the more statutory structure you build in place—a private sector analogy would be you hire a new CEO into a major corporation. He needs to be able to build his team. He needs to be able to organize.

So anywhere that you have a statutorily-defined structure, you reduce the flexibility of the CEO of the organization to organize effectively, and so I believe there is a natural resistance within the Executive Branch of government to efforts to legislate and put in statute things that hinder the ability of the accountable individual because it will be the Secretary of Defense held accountable for execution within the Executive Branch, there is a resistance to having statutory structures imposed. And so I believe that is the source of the concern that the Department has about having a position this senior defined in a way that is not—having this statutorily put into place.

Senator CARPER. Dr. Zakheim, would you just comment on that, please?

Mr. ZAKHEIM. It seems to me that, first of all, as you said, Senator, we are talking about a technocrat here. We have lots of people who have served as technocrats inside the Department of Defense under a variety of Secretaries. Let me give you two.

The late Doc Cook, David O. Cook, who was called the "Mayor of the Pentagon." He had lots of power. Some people said he had more power than the Secretary. When he swore me in, he told me the Bible that he used was the same one he had sworn in Don Rumsfeld 25 years earlier in the same job. He always was the Secretary's purse man, whoever the Secretary was.

Another example, and he should be alive and well, is Andy Marshall, who has been serving as the head of Net Assessment in the Department of Defense since he was appointed by Secretay Jim

Schlessinger, Mr. Rumsfeld's predecessor the first time Mr. Rumsfeld was Secretary, which was a couple of years ago.

So it is quite possible for somebody who is technically brilliant at what they do to serve as the Secretary and the Deputy Secretary, and obviously, as David Walker said, there has to be some leeway that they have to serve at the pleasure of the top two people. In other words, if there is a fundamental personality disagreement that is paralyzing the Department, you can't turn around to the Secretary and the Deputy and say, well, you are stuck with this individual. That wouldn't work, either.

Senator CARPER. General Walker.

Mr. WALKER. Very quickly, Mr. Chairman. First, look, there is a balancing of interest here that we have to keep in mind. On one hand, any President or any Secretary would like to have total discretion to pick whoever they want and remove whomever they want. That is understandable. That is human nature.

On the other side of the coin, we have an institutional need. You have to balance the two. What is more important, to meet the institutional need irrespective of who the President and the Secretary is, or to meet the individual want based upon who that is.

The other thing is, is this is not a new issue. The Commissioner of Social Security and the Commissioner of the Internal Revenue Service are Presidential appointments with Senate confirmation with significant responsibilities and they have term appointments.

Senator CARPER. Have they always been that way?

Mr. WALKER. They have been that way for a number of years. I mean, we are not crossing the rubicon here, and those jobs are at least equivalent in level of responsibility as this one.

Senator CARPER. All right. Good. Thanks. Dr. Coburn.

Senator COBURN. Thank you. Let me just go back for a minute. General Walker, last year's appropriation had $9 billion in earmarks in the Defense Department, something like 12,000 earmarks, which we are trying to get a handle on now with the Defense Department on how the money was spent. You are talking about progress being made. I just want to make it clear. Is there any interference in the progress of managing the Defense Department when we have 12,000 earmarks out there laid out for things that they have to do that are non-competitively bid that have to happen?

Mr. WALKER. I think earmarks are a problem. I think not all earmarks are equal. Some earmarks, frankly, represent waste. I recently was asked by the House to come up with a definition of waste and some examples, and my definition was basically on the following lines. When the taxpayers as a whole do not receive reasonable value for money because of an inappropriate act or omission by a party that has discretion over government resources, that is waste. That can happen by Executive Branch officials, by Legislative Branch officials, by contractors or grantees. One example I gave was inappropriate earmarks that are not based upon value and risk, where we would not be doing it but for the earmark.

But as you know, Dr. Coburn, an earmark by itself doesn't increase government spending, but if you have got constrained resources, the fact that you are telling somebody how to spend the money when you are going to have tighter and tighter budgets

causes other problems and it serves to undercut the integrity of the process and the credibility of the Congress in the eyes of the American people.

Senator COBURN. General Patterson, you went from two to seven. You expect to be nine entities in 2009. How many total entities are there in the Defense Department?

Mr. PATTERSON. There are roughly 15.

Senator COBURN. Fifteen?

Mr. PATTERSON. Fifteen, yes.

Senator COBURN. In your report, this report, you list the DOD reporting entities. It is 15 percent of assets, 49 percent of liabilities. What percentage of net operating expenditures is that?

Mr. PATTERSON. We don't audit net operating expenditures. That is an appropriation and we don't audit—and as I understand it, we don't intend to audit net operating expenditures.

Senator COBURN. What percentage of the Defense Department is it?

Mr. PATTERSON. Well, it is about $152 billion in O&M, which is operations and maintenance, of a roughly $460 billion——

Senator COBURN. So it is about 30 percent?

Mr. PATTERSON. Yes, sir, that is about right.

Senator COBURN. OK. So we have 30 percent of the Pentagon or the DOD now auditable, correct?

Mr. PATTERSON. That is correct. But sir, if I could explain——

Senator COBURN. OK.

Mr. PATTERSON [continuing]. I don't want to leave the wrong impression. Within the O&M account, you have a number of other things—civilian personnel, you have the contractors, you have services, you have maintenance, and depot maintenance. You have a variety of things within it, all of which are accountable line items in a budget. Those are the things within the services and the various agencies that we would look at for auditing.

Senator COBURN. OK. But as a percentage of the DOD, that is what my point is, we are up to about 30 percent where we were at 5 percent before.

Mr. PATTERSON. I couldn't attest to that sir, I mean——

Senator COBURN. Well, it is about 30 percent of the DOD budget?

Mr. PATTERSON. Yes, sir.

Senator COBURN. That is my point. But none of the Army isn't in there, right?

Mr. PATTERSON. Yes, sir, it is. The Army is in operating and maintenance accounts, of course.

Senator COBURN. I am talking about auditing.

Mr. PATTERSON. Oh, I am sorry.

Senator COBURN. The Army isn't in there. The Air Force isn't in there. The Marines and Navy are not in there.

Mr. PATTERSON. That is correct.

Senator COBURN. So this 70 percent would include the services.

Mr. PATTERSON. The 90 percent on liabilities and 40 percent in assets would include, when we get to that point, the Marine Corps, it would include the Corps of Engineers and the Army, it would include the Defense Information Systems Agency, and it would include the Medicare fund that we have.

Senator COBURN. When you get there.

Mr. PATTERSON. When we get there in—correct.

Mr. WALKER. Dr. Coburn, the answer to your question, I think, is yes. The 70 percent of net operating costs that have not been audited yet include the services.

Senator COBURN. OK. Paul, you are in a appointed position, correct? So unless you are reappointed, everything you are doing now at the Business Transformation Agency is going to have a jump start with the next Administration?

Mr. BRINKLEY. We have staffed an SES-level director of the BTA that reports to my office. My office is a political appointment, a non-Senate-confirmed political appointment that supports that Deputy Secretary of Defense's business transformation objectives. My role will be replaced no later—no earlier—maybe no later—than January 20, 2009.

Senator COBURN. OK. And so understanding the political nature of this, if you were asked to serve no matter what the next Administration, would you give that a consideration? We are not going to hold you to it—— [Laughter.]

Mr. BRINKLEY. I don't want to be on the spot here——

Senator COBURN. This is a great point. Look at our problem. We have somebody fairly effective, or highly effective at what they are doing now, and because we are going to have an election, we are going to gut that. That is the whole point. The point is, we don't have the ability to put great managers in and keep them there. Go to the point of David Walker or Dov Zakheim.

Give me, Mr. Zakheim, if you will, give me some examples of where the military or DOD could have used a higher reprogramming, or some examples where we were wasting or not being able to effectively do things because we have so much—such a limitation on reprogramming.

Mr. ZAKHEIM. You are asking me to think back 3 or 4 years. We have had cases, as I recall, where we needed to move money into faster spending accounts. I will give you an example of where it would have been nice to be able to reprogram a lot of money quickly.

Up-armored Humvees, we moved the money eventually. We had to move mountains on the Hill to make that happen. There shouldn't have been anything requiring that kind of work. There were kids out there getting killed. It is that sort of thing, or the body armor, where it needs to be left to the discretion of the managers.

Again, as you heard from Dave Patterson and Paul Brinkley, we know generally where the money is, and nobody is running off to the Swiss banks with the DOD budget. The real question is, do the managers of that budget today, who are executing the budget, have the ability to move money around to where it needs to be spent urgently. The answer is "no", 99 percent of the time, and that just makes no sense in any context, including the government.

Senator COBURN. So your position is if you had a 5 percent limit, still reportable——

Mr. ZAKHEIM. Yes.

Senator COBURN [continuing]. You still had to come and get clearance——

Mr. ZAKHEIM. Absolutely.

Senator COBURN [continuing]. That would give the flexibility?

Mr. ZAKHEIM. Sure, because then you——

Senator COBURN. What kind of resistance, when you talk to appropriators, do you get on that?

Mr. ZAKHEIM. Well, it is not just the appropriators. I mean, we have to get the authorizers to agree and you have to get the Intelligence Committees, when it is their budgets, as well. The staffers feel that this is the way they control, and I can understand that. I agree that Congress needs to maintain oversight. But it seems to me that as long as you still have the prior approval requirement, you are maintaining that control.

Senator COBURN. Do you think there is adequate oversight in Congress of the Department of Defense?

Mr. ZAKHEIM. Very often, the Congress seems to be looking for the key under the lamp post, because you get oversight that verges on or actually is like micromanagement. In other cases you don't get it at all, and it seems to me that what you really need is a dialogue between responsible leaders on both sides of the river, where both sides have the country's interest at heart. There just hasn't been that kind of a dialogue to say, "Look, how do we straighten this out?" In fact, we are still functioning in the realm of financial management and budgeting as if we were living in the 1960s.

If you permit me to relate an anecdote about this. Around the time I took over as Comptroller, I bumped into Robert McNamara and we got to talking about the planning, programming, and budgeting process because there wasn't execution even as part of that process. And McNamara said to me, "You have got to be kidding. This is what I was dealing with 40 years ago."

Now, think about that. We are still functioning in many ways, because of the interplay between Congress and the Pentagon, the same way we were at the height of the Cold War. Something has got to give here.

Senator COBURN. Earlier, you alluded to the fact that you, or maybe Mr. Brinkley, I don't know which, that you have a management structure and that in the private sector, we have a business plan, we have auditing, we have financial controls, we have benchmarks, we have metrics, and we have reassessment all the time of what we are doing. The point was made is that their primary thing is to defend the country, and so therefore this is second. I will put forward to you is you can't defend the country unless you have the other first.

Mr. ZAKHEIM. I don't disagree. I am just saying that there is a culture here that exists, and when you think about it, these are folks who are laying their lives on the line every day. Many of them are coming home pretty badly beaten up, if they come home alive, and so naturally when the requirement comes, when I want to pull some people off to do some of this anolytical management activity, the military is going to say, "Well, wait a minute. We are short of people out in the field."

Senator COBURN. Yes.

Mr. ZAKHEIM. You have this tremendous tension there. It is not just money resources, it is human resources, maybe even more so human resources. It is very understandable, and that is why I

think you can't really start pointing fingers at anybody and blame anyone. We have a system that just needs to be revisited.

Senator COBURN. All right. Thank you, Mr. Chairman.

Senator CARPER. I think we are about to start another vote. If we do, I am going to ask Dr. Coburn if he would be willing to go over and vote and then just come back and, while I vote, chair the hearing.

Senator McCaskill, welcome. We are glad you are here.

OPENING STATEMENT OF SENATOR MCCASKILL

Senator MCCASKILL. Thank you. I have, as usual, like 14 different things I would like to pursue with this particular group, but let me for a minute focus on contracting.

Clearly, we are going to be contracting in the future forever, and clearly, DOD and the various branches have done a miserable job of contracting in this conflict. Whether it is LOG CAP, whether it is reconstruction funds, there has been a lack of definitization. There has been a lack of oversight. There has been a lack of monitoring. There has been a lack of competitive bidding. And we have example after example after example.

We have had several references to the private sector. I have got to tell you, and I think, Mr. Brinkley, you mentioned a CEO and having the ability to organize. Somebody would have been fired in a private business over the way these contracts have been overseen. Someone would have been held accountable, not necessarily maybe the CEO, but I guarantee you the Board of Directors, if all the information had come forward about literally—I had actually the contracting people at LOG CAP in Iraq, when they put up the bar graph of LOG CAP going from $20 billion to $15 billion to $12 billion. When I asked them what caused the difference, I actually had this woman say to me in Baghdad it was a fluke, a $5 billion fluke that the contract went down that much.

Now, what I would ask of you, Mr. Brinkley, any of you, and Mr. Walker and all of you, is don't we need to either have a Reserve component for conflicts that are contracting specialists, or more importantly, don't we need to engrain contract oversight in military training? I had a general say to me over there, I don't care if it costs $10 billion or $15 billion. I wanted it yesterday and I wanted to make sure there was ice cream in the mess hall. It didn't make any difference to me. And he was kind of offended that I was trying to drill down on this.

And ultimately, this comes back to a level of trust. Congress is going to continue to overreact and over-regulate because they don't trust that the military is going to be responsible, and the military is going to run around and do whatever they can to go around the regulations because they need what they need when they need it. And it doesn't appear to me that this dog is going to ever catch his tail, because it hasn't for 40 or 50 years.

What do we do about the contracting piece to provide some measure of accountability? Can we demote someone? Can we promote someone? More importantly, can we fire someone?

Mr. BRINKLEY. I will answer the first two questions and comment on the rest. Your points, and it was good to hear the focus on the root cause of what exactly has transpired, the idea of a Reserve

component for contracting, I have seen firsthand, and I will give you an anecdote from the private sector.

The company I worked for before I came to DOD bought about a billion dollars worth of materiel all over the world, just $1 billion, right. It seemed like big money at the time. We had a large staff of engineers and contracting, procurement experts, we called them, contracting experts who managed those supply relationships, ensured that product was delivered on time. It was key to our ability to ship a product to our customer.

Now, compare and contrast within government. The scale of the spending to support our mission in Iraq and the number of people we have doing a phenomenally good job—I am in awe of how our contracting officers are able to manage the scale of the spending they oversee.

We do need to look at, in my opinion, and I know that this has been acknowledged and people are looking at how to do this, Joint Forces Command is looking at a contracting, a scalable Reserve component for contracting, but we do need, if we anticipate future conflict that requires us to contract at this level, and also to ensure that the economic effect of our contracting is being applied to support the economic stabilization missions that we have in places like Iraq, that we ensure that we create a contracting corps that has the expertise not just in contracting in peacetime, but also contracting in times of conflict when a general is going to pound the table and he is going to want his forces to have the very best they can get and you get overwhelmed with the natural desire to support immediately the needs of the force and to balance that trade against your ability to adhere to contract regulations and rules and have systems and processes that support that mission.

That is a very important area that we must focus on going forward, and there are some bright folks who are looking at how we structure the contracting community to do that in the future.

Senator MCCASKILL. Yes, Me. Walker.

Mr. WALKER. Senator, on pages 40 and 41 of my testimony, which is Appendix 1,[1] there are 15 longstanding systemic structural problems within the Defense Department with regard to acquisition and contracting that need to be addressed. You're tough on another issue, and that is when you have a conflict or another type of contingency, for example, Hurricane Katrina. To the extent that you have systemic weaknesses that have not been addressed, they are exacerbated and multiplied when you have a contingency operation, whether that be in Iraq, which is a military operation, or whether that be Hurricane Katrina, which is a natural disaster.

And yes, one of the challenges on the 15 is the capacity and the capability, both in numbers as well as skills and knowledge, to get the job done, and I think we do need to consider having some type of Reserve for contingency operations, but we also need to make sure we have enough for just day-to-day ongoing operations and I question whether we do.

Senator MCCASKILL. Mr. Patterson, I have a letter from a constituent who used to work at KBR. He is retired Navy and he left in November 2006. His job at KBR was a subcontract close-out spe-

[1] Appendix 1 appears in the Appendix on page 81.

cialist. His job was basically an auditing function to look at the contracts and find if there had been errors, omissions, and money that was paid inappropriately.

He found a number of problems, and when he left in November 2006, he not only talked to KBR about it, he also talked to DCAA about it, the Defense Contract Audit Agency. It is $50 million. He hasn't heard a word. So he sent me all the documentation and it is pretty obvious, and this is the other issue. At some point in time, it is like Monopoly money. Who cares about $50 million? I mean, we have got billions that are out there.

Who is responsible within the Comptroller's Office to take obviously very credible—this is the work we paid for, by the way. This is somebody who we paid for, found this money that we are owed, and nothing has happened and it has been almost a year. I mean, not a word. So he recently forwarded it to me because he figured out that I am talking about this stuff a lot out here and figured I was interested, and I am.

I would certainly appreciate, first of all, your response about how successful have we been at getting money back that was paid that shouldn't have been paid? I know that lack of definitization of the contracts is a big problem, but this is definitely definitized, and this was not a cost-plus. This is a firm fixed price subcontract.

And so this is a situation where there is $50 million here ripe for the picking and nobody seems interested in picking it. Multiply that times thousands of contracts. We are talking real money.

Mr. BRINKLEY. Well, I certainly appreciate that, and I will be more than happy—if you ask, who is responsible, it is the Comptroller and myself. I will ensure that you get an answer back on that particular incident.

Senator MCCASKILL. And I would like to know how many of these there are. How many auditors have we paid to find money that we are owed and how successful have we been at getting that money back?

Mr. BRINKLEY. Well, to that particular point, we have done 33,800 audits through the Defense Contract Audit Agency (DCAA) throughout the entire Department of Defense. We have recovered $1.2 billion from vendors that were overpaid incorrectly. We have a very high incidence of—the percentage of improper payments is extremely low in a very large organization.

But to your point, we take it very seriously, particularly with regard to what is going on in the theater. We have Defense Finance and Accounting Service (DFAS) representatives who are in theater. We have DCAA, as you point out, in theater and looking at all of the contracts. The KBR has been a particularly important company for us to look at because it has had such high visibility.

So I can assure you that the Department of Defense takes its contracting responsibilities extremely seriously, and when we find that there are areas where we find discrepancies, we send teams to immediately work through those things. We have sent people to jail, as you well know, because they have defrauded the government.

Senator MCCASKILL. And there are going to be, unfortunately, in a heartbreaking way, there are going to be a lot more that go to jail——

Mr. BRINKLEY. Absolutely.

Senator MCCASKILL [continuing]. Because we are a long way from done, and I think the American people, when they realize that for the first time, really, we have had men and women who, unlike the 99.9 percent of the men and women who step forward and across the line for us, have stolen millions and millions and millions of dollars, and it is a dramatic failure of the Department of Defense. I appreciate you take it seriously that this has been a complete breakdown of appropriate financial accountability.

Mr. WALKER. Senator McCaskill, we have a report coming out on improper payments dealing with the Defense Department within 2 weeks that I would commend to you.

Senator MCCASKILL. OK, and I will read it in depth and hopefully I can get back and ask some more questions after I go vote.

Senator CARPER. We are going to take a quick recess. Dr. Coburn will be back momentarily and resume the hearing. But until he returns, we will just be in recess for a few minutes.

[Recess.]

Senator COBURN [presiding]. Well, we will start again, if we may.

General Patterson, in 2006, the DOD spent $300 billion on contracts, 71 percent of the entire Federal Government's contract work. Many of these contracts were time and materials, one of the riskiest contract types for the government because they could be awarded quickly and labor hours or categories can be adjusted if the requirements are unclear or the funding is uncertain. DOD's management of contracts have been on the GAO's high-risk list since 1992, 15 years. Why in contracting has this not been resolved in 15 years?

Mr. PATTERSON. Well, I can't account for the years prior to my coming to the Department of Defense, but I can——

Senator COBURN. Well, what are your thoughts about it?

Mr. PATTERSON. I think that we use too many time and materials contracts. Within 2 weeks of my taking the job, I came in and found out that the logistics management program had a $1.3 billion time and materials contract that looked as though it had no end and we simply refused to fund it because that is ridiculous.

I have a very negative reaction to people who use time and materials contracts because they can't figure out how to justify the individual elements of what they want to do and we have to get to a point where we apply structure and discipline to the way in which we use the taxpayers' dollars. To simply go in and say, well, I don't know exactly what I want to do, so I guess a time and materials, or an Indefinite Delivery/Indefinite Quantity (IDIQ) contract, is the way I should go.

Particularly odious to us has been the interagency contracting, and we have gone a long way to eliminate the abuses that have taken place——

Senator COBURN. Explain what that is, interagency.

Mr. PATTERSON. As you know, you have GSA and NASA, the Treasury, they all have open contracts, IDIQ contracts. They all have them. Well, when something is very urgent and there is an open contract that is open in that category, it is perfectly reasonable to sign a MPR over to another agency because you need to get something very quickly.

Well, what we found was that wasn't the case at all. People were having Multi Interagency Procurement Requests (MIPR) signed over to the GSA or the Department of the Interior that said things like office equipment. I can't tell whether that is urgent or not. So consequently, we have taken very strong steps to eliminate that as a potential area for fraud, waste, and abuse. The Department of Defense IG has identified 640 potential ADAs. Of those, we have done a cursory review and found that, effectively, it is people using the wrong appropriation or doing something else. It is simply an administrative error. But there are some that we are taking action on, and 90 of those are now for official review by the Department of Defense General Counsel.

Senator COBURN. What percentage of contracts at DOD are fixed price?

Mr. PATTERSON. I couldn't tell you right off the top of my head.

Senator COBURN. Would that seem to be an important number for us as we look at this?

Mr. PATTERSON. I am not sure that it is, because the exigencies of what you want to purchase drive you to make a determination as to whether or not you will use a fixed-price contract or a cost-plus contract. If you know very clearly what the bounds are of what you want to buy and how long you are going to purchase it for and the cost of that is very well known, then a fixed price is perfectly reasonable.

Senator COBURN. Let me give you a little example. We had the Air Force and Lockheed here on the C–5 problems and the Nunn-McCurdy breach that was just filed about the time we were having that hearing.

Mr. PATTERSON. Yes, sir.

Senator COBURN. You can have all sorts of fixed-price contracts in the private sector where you say, if we buy this many, it is this price. If we buy this many over this time, it is this price. If we buy this many over an extended period of time, it is this price.

I guess what I am going towards is it seems like we are not sharing some of the risk with the suppliers of the Defense Department. All the risk is being placed on the American public because we go cost-plus for a limited fixed-price contract. What is wrong with contracting the way the private sector does? How many contracts are you aware of that the private sector does that 70 percent are cost-plus? Mr. Brinkley, would you want to answer that?

Mr. BRINKLEY. I think the motive in that, and I am not sure it is applicable anymore given all the consolidation that has taken place, but I think the desire for cost-plus and the motives that drove that and continue to drive that, in the private sector, you can always find another customer. In government, you win a big government contract, you do cost-plus, and in the event that you lose that contract, you have the ability to ramp down your cost structure as opposed to just instantly facing a bankruptcy situation. So I think the structural definition or why we got into cost-plus was lent to that. Now whether in a globalized defense environment that is still a motive or not, I think may be worth looking at in terms of whether that structure and those motives that drove the creation of that still make sense.

Mr. ZAKHEIM. There is something else, too. If you look at shipbuilding, in the 1970s, there were huge cost overruns on fixed-price contracts, so the decision was made to go to cost-plus because that way, you accounted for a lot of front-end research. You don't have formal R&D accounts as much in the shipbuilding account, but it is basically front-end R&D for the first ship. It is very difficult to predict a fixed price on research and development, and so they moved to cost-plus. Then there was a swing back to fixed price because then no one was happy with cost-plus. Then they realized why they had gone away from fixed price in the first place.

So to some extent because—and this is what Mr. Brinkley was talking about—because of the peculiar nature of a lot of, of a monopsony environment, there is only one buyer here, it is much more difficult to say there is a cookie cutter answer, whether it is for cost-plus or fixed price, or for that matter, as Mr. Patterson said, in some cases, time and materials also is legitimate.

I think maybe having a better sense of what is the most appropriate, we have some distance to go there, but I don't think you can just have a meat ax approach to a particular kind of contract.

Senator COBURN. Mr. Patterson, I am going to go to you in just a second because I think a lot of our problems with these contracts is a lack of oversight in the contracts. In other words, the contract is out there and we don't have the oversight. That brings me up to another problem which I would like both Mr. Brinkley and Mr. Patterson to address. It is my understanding that we have a real shortage of contract purchase managers. What are we doing to address that? What are we doing to train for that? What are we doing to get those people in, get them the experience so that we have them on board?

Mr. PATTERSON. I think there is something that we can do in the near term, and we are, and that is to train people within the individual units on very rudimentary statement of work, purchase order. A lot of the problems that we have are at the very lowest level and they don't amount to a great deal of money, but they continue to be problems. We have a dearth of qualified contracting officers, that is true, and I would attribute that to the zeal at which we reduced the number of professional government employees in the 1990s. We went from 550,000 in the acquisition world, down to something less than 300,000 in a matter of 7 years. We basically took the very guts out of the talented pool of professionals that did this kind of thing.

Now, I am not saying that if we got them all back that everything would be wonderful again, but at least it is symptomatic, I think, of what you are getting at, and that is a lack of contracting officials to do the work.

Senator COBURN. Are there certain regulations that should be waived in terms of hiring to help solve this problem?

Mr. PATTERSON. I think there just needs to be a very strong, enthusiastic management emphasis on bringing back qualified and skilled government employees.

Senator COBURN. Where do you get those?

Mr. PATTERSON. You get them from the private sector. I would start out—the Congress gave us the authority to bring back IPAs

and highly-qualified experts. We need to use that authority more liberally.

Senator COBURN. General Walker.

Mr. WALKER. Well, first, I think training clearly is an issue, especially—including for our deployed forces. They need to have more training with regard to some of the basic issues of contracting that they are responsible for executing and they don't necessarily have that type of training.

Second, cost-plus contracts are a problem to the extent that they are used in circumstances where they shouldn't be, but they are only one of many challenges that we have. And I come back to page 40 and 41 of my testimony where I lay out a number of them. I mean, part of the problem is that we know we have a want. The want may or may not be a need. We may or may not have defined it clearly enough. And then we ask a contractor to go out and try to work on a want, or even if it is a need that is not clearly defined, and we do it on a cost-plus basis with inadequate training, with inadequate risk sharing between the taxpayer and the contractor, with inadequate oversight. You get a combination and a compounding of problems of which cost-plus is only one element.

Mr. PATTERSON. And to follow up on what Dr. Zakheim said, I think that what we are missing here is we are missing a set of clear standards that drive you to make decisions on whether or not you are going to use a cost-plus incentive fee, a fixed price. We don't have those kinds of standards whereby we would be driven one place or the other. We also live in a world of extraordinary vagaries in terms of what the next year will bring in terms of budgetary authority.

Senator COBURN. I am going to go back to the Lockheed——

Mr. PATTERSON. OK.

Senator COBURN. We have a contract that by the Air Force's assessment has a Nunn-McCurdy breach because it looks like the costs are going to be—why accept that contract in the first place? Why not say, Lockheed, if you want this business, you are going to have to share a good portion of the risk and here is what we will commit to, and you take, based on what an appropriations plan is and an authorization plan is, and the only out for Lockheed would be is that we are not going to ever fund this again. And ask Lockheed to quote on the basis of those parameters.

We don't do that. We say, well, here is the way it works, and so therefore that is the only way we are going to contract. Well, the fact is, we could change to a different paradigm in defense contracting if we said, look, you get a bunch of gravy but you're going to take a bunch of risk. We have a defense contracting business, I believe, in this country that doesn't have much risk. We have conditioned them to low risk and they make billions of dollars off the Federal Government every year, and it is time that their contracting reflected them taking some of the risk.

So I am asking, why can't you change the paradigm under which you buy, and maybe shipbuilding is an exception, but in Lockheed, we did all the steps. Now the question is, the real question is does the Air Force want the C–5 or not. That is the real question. It is not whether or not we are going to buy it or whether or not there

is going to be a contract. It is whether or not the generals really want it.

Mr. PATTERSON. Well, aside from your last question, the fact is, you are exactly right. We can modify contracts. We can write contracts to get the very best advantage for the government. But we are also responsible for getting cost schedule and performance, and what I believe and what I think we found when we did the Defense Acquisition Performance Assessment a couple or 3 years ago is that what we are missing here is stability in programs.

The C–5 program, for example, starts in 2007 and doesn't finish until 2021 for 108 airplanes. In the 1950s, we bought 535 Boeing 707s for air refueling. That price, I guarantee you, stayed fairly consistent over the 5 years in which those airplanes were purchased.

What we need to understand, and to your point, we need to revamp the way in which we consider contracts. They can't be what I refer to, and it is unfair, I realize that, but it appears as though what we say is we need it faster, better, cheaper. The contractors say, outstanding. We can make it faster, better, cheaper, no matter how long it takes or how much it costs. And we say, where do we sign? We have to change that fundamental way of thinking in order to get a better deal for the American taxpayer, and I can guarantee you that we are committed to doing that.

Senator COBURN. Well, I think General Walker's point is the reason we have trouble bidding contracts on research is because we oftentimes don't know what we want.

Mr. PATTERSON. We have no idea.

Senator COBURN. And so why are we letting contracts when we don't know what we want? That is management. That is the thing that Mr. Brinkley has brought to this, is this has to be clarified. What is your intent? What is your need? And is it a real need, and that is where upper management has to make those decisions. Where are the standards for cost-plus versus fixed-price contracting in the Pentagon? Is there a set of standards that people have to follow?

In other words, the Secretary says, here is when you will make a decision fixed price versus cost-plus. Are there standards within the Pentagon, or is there just freedom to do whatever you want?

Mr. PATTERSON. Well, I think to your immediate question, and I am somewhat embarrassed, I have not seen those standards——

Senator COBURN. So why not? Where are the standards that should drive the management of purchasing things that say, here are the circumstances in which it should be correct to use a cost-plus contract. Here are the circumstances when it is not. Where is the management tools? Mr. Walker.

Mr. WALKER. Well, first, there is something in the Federal Acquisition Regulations (FAR), that lays out guidance. To what extent has that been communicated and to what extent is that being followed?

Senator COBURN. And where is the follow-up to see if it is correctly followed?

Mr. WALKER. Right.

Mr. PATTERSON. But I think to General Walker's point that it is guidance, and there is nothing that tells us if these conditions, A,

B, C, exist, then you have the conditions necessary for a fixed-price contract. If other conditions exist, then you will choose some other way of contracting. I think that very specificity needs to be part of the way we do our business in the Department of Defense.

There may have been in the past people, as I mentioned, who knew this stuff intuitively and it wasn't necessary to come to this, what I refer to as the rules of acquisition. But in the absence of that skilled labor, I am coming to the point where I believe we need a strong set of rules.

Senator COBURN. Is that in the planning?

Mr. PATTERSON. The planning. I provided what I consider to be a reasonable set of rules to the acquisition community. But it is a process and we will talk about it and we will come to some accommodation because, quite frankly, I mean, as much as I would like to think so, I don't have the inside track on everything that takes place. But I do know from my experience both in government and in the corporate world that you need discipline and structure if you are ever going to achieve cost, schedule, and performance as you expect to have it.

Senator COBURN. It is called line management. Here is your area of accountability. Step up to it. You step over, you are in trouble, but if you don't come up to it, you are in trouble, and that is the kind of management techniques that we need.

Mr. Brinkley, do you have any comment on that?

Mr. BRINKLEY. I just want to reinforce. I mean, Federal Acquisition Regulations and to be Defense Acquisition Workforce Improvement Act (DAWIA) certified as an acquisition professional requires you to learn those guidelines, and they are guidelines. I have witnessed myself courageous contracting and acquisition professionals put in place fixed firm price agreements for large programs that almost immediately then went off the rails, and the pressures then that they felt because now their whole program was at risk given all of the issues that General Walker pointed out in terms of the up-front requirements definition that was not well crafted. And so I know that the pressure on a contracting professional or an acquisition professional is to use the most flexible vehicle possible in the absence of that up-front requirements definition discipline that exists.

Senator COBURN. That makes a lot of sense. When was the last time the Pentagon sued a contractor for non-performance based on a fixed-price contract?

[No response.]

Senator COBURN. There is the problem. The fact is, if we haven't, that means we have been contracting poorly. There should have been people taking enough risk that some didn't perform and we aren't holding them accountable. Most of these are very wealthy companies that do the big contracts for the Pentagon, and so with risk comes reward. I have no problem with them making a lot of money off of our purchasing, but they also ought to have to carry a lot of risk and I don't see that risk in our contracting and that is a big problem and one of the reasons the costs are so great. If it goes off the rails, why isn't the contractor on the hook? And that is my point. We are on the hook, you and I as taxpayers, not the contractor.

Mr. Chairman.

Senator CARPER [presiding]. Mr. Brinkley, do you head the Business Transformation Agency?

Mr. BRINKLEY. The Business Transformation Agency reports through my office within the Department, within the Office of the Secretary of Defense.

Senator CARPER. All right. That is the way it looks today. Help me figure out who is included under the Defense Business System Management Committee. Does that include the Deputy Secretary?

Mr. BRINKLEY. That would be chaired by the Deputy Secretary. It includes all of the Service Secretaries, the heads of the Defense agencies, as well as the under secretaries in the business mission area of the Department, so the Comptroller, AT&L, personnel, and readiness.

Senator CARPER. All right. Fair enough. And then we have the Principal Staff Assistants. These would be the Comptroller, the Under Secretary of Defense for Acquisition Technology and Logistics, and then the Under Secretary for Personnel and Readiness, right?

Mr. BRINKLEY. Correct.

Senator CARPER. OK. Let us move ahead to January 2009. I don't think any of us know who is going to be the next President, but there is strong suspicion that there will be some changes, as there normally is at the end of an Administration after 8 years. What our staff has done is they color-coded these different boxes with red, which suggests majority turnover, beige, which is sort of partial turnover, and yellow, which is relatively no turnover. I don't know if that is a vote of confidence in you, Mr. Brinkley, or not, but we don't have much turnover at all expected at the Business Transformation Agency.

But up here, a lot of turnover from among the senior governing body. Among the Principal Staff Assistants, we have a fair amount of turnover. Here, we have some turnover at the Investment Review Board and relatively little down here below.

Mr. Brinkley, with this much turnover at the Department, especially at some of the higher levels up here, how do you think the next Administration will continue the transformation efforts that have begun?

Mr. BRINKLEY. So this is something we have thought about since the very beginning, and early on, we did some research on this problem, and I counted up nine times since 1960 that bright people came into the Department of Defense and launched efforts to modernize the Pentagon's business operations, and they all follow a trajectory: A head of steam, a vision, a strategy, some talented people come in, establish some momentum, a change of Administration, start over. That is a problem.

Senator CARPER. Have there been nine changes? How many changes in Administration since 1960?

Mr. BRINKLEY. You would have to count. I guess I have to do the math.

Senator CARPER. You said nine times.

Mr. BRINKLEY. I counted nine times since 1960 we have attempted to do a business modernization——

Do some quick math. Anyway, so the question is whether it is turnover of individuals, turnover of Administrations, that is a concern. So we have taken tangible steps to address this. Some of this is codified into statute and none of that structure existed prior to the efforts we have had underway for the past 3 years, building on what Dr. Zakheim launched back in 2001.

We believe that establishing the civilian agency, Business Transformation Agency, we moved all of the people who were part of that political structure into a civilian organization. That organization in yellow there will not see turnover in the transition. It is a Defense agency. It is directed by David Fisher, a gentleman from the private sector who has come in at the SES level. He is the BTA's Director. I am a political appointee within the Office of the Under Secretary for AT&L in the middle there. I will turn over.

But we also believe that there are a series of other steps we have taken to mitigate the risk of a loss of momentum. We publish, and sometimes I think we take this lightly, but it was a monumental achievement to publish for the entire Department of Defense our transition plan, and in some of the testimony earlier, people claim that such a plan doesn't exist or it is not complete enough and we will probably continue to debate that forever, whether it is comprehensive enough or not. But that plan lays out 6-month milestones, which was a change in thinking for the Department, that we publish and we measure ourselves to, and we make clear to you and we make clear to the public. And we hit about 70 to 80 percent of those milestones every 6 months. The ones we miss, we put in place recovery plans for.

There are milestones in that plan that go out well past this Administration, 2012, 2013. Those are things that the Congress can hold the next Administration accountable to. And if the next Administration decides they think some of those are bad ideas, political—Democratic or Republican supply chain, right, or a Democratic or Republican accounting system, if they can identify things like that and they want to stop or redirect, well, then they can do that, but they do it in a way that is transparent and that you can hold them accountable to, and that is a very powerful tool that has been placed in your hands as an overseeing body to hold the Department of Defense accountable not to lose momentum, and I think that is important.

So those are tangible steps. The structure that you have defined, that is in statute. The Congress put that structure into place, the DBSMC, these Investment Review Boards were put into place in the 2005 National Defense Authorization Act. The next Administration can't just wipe that structure out. It must place new leaders into those key roles and they must assume their responsibilities.

So there are things that are continuity that have never existed before, that are necessary steps to create continuity beyond Administrations. What you have to decide is are they sufficient. I know Mr. Walker doesn't believe they are sufficient. There are people who argue passionately that this is good progress but not sufficient. That is above my pay grade. But I do think we have taken steps for the first time to see this work.

My worst nightmare is to wake up back in California in March 2009 and read in the paper that all the work we have done has

been washed away and that we are going to start over—because I know what will happen. A few months later, we will start again, right, because the need for this isn't going to go away.

Senator CARPER. General Walker, you are raising your hand?

Mr. WALKER. First, there have been nine Administrations since 1960, all right.

Senator CARPER. All right.

Mr. WALKER. Second—and some were two-term Presidents. Second, there is a plan for systems. There is not a comprehensive integrated strategic business transformation plan that deals with all 15 high-risk areas with metrics and milestones. There has never been one.

Senator CARPER. Why do you suppose that is?

Mr. WALKER. Because there is nobody in charge. You can't run a country by committee. You can't run an agency by committee. Now, don't get me wrong. I think the DBSMC is a very positive thing, and let me reinforce, I think that Gordon England is one of the most talented executives that the Defense Department has ever seen, all right. But there is going to be massive turnover. It is a reality. It is not a theory, it is a reality.

Now, one of the things, and I will just mention this briefly, that I think we need to think about as a country is how many political appointees should we have? How deep should they go? How many of them should be Presidential appointees with Senate confirmation? How many of them ought to be Presidential appointees?

And of the ones that are Presidential appointees with Senate confirmation, I think we have to recognize the reality that there are three kinds of positions. There are policy positions, which clearly ought to serve at the pleasure of the President because they are executing the President's policy. There are operational and management positions which are different where you ought to have statutory qualification requirements and maybe a term appointment. And then there are independent adjudicatory and oversight positions, like Comptroller General, IGs, judges, where not only do you need the right kind of qualifications and potentially a term, but you also need independence. You need people who are independent.

We have one-size-fits-all approaches in government and we need to kind of step back and fundamentally reassess that.

Senator CARPER. All right. Thank you. Mr. Zakheim.

Mr. ZAKHEIM. Obviously, you have pointed to a very serious problem. Let us play a mind game and say that the next Deputy Secretary of Defense, who still would be CMO, is someone who is not interested in management. We have had some of those. How effectively do you think that individual will run that committee that he or she will chair? The committee then will become useless.

What does that do? It totally undermines the Business Transformation Agency because now the head of the agency, who by the way stays on, as I understand it, now doesn't really have any real reporting chain because the head of that agency has to deal with three quarrelling barons, the Comptroller—again note Comptroller is in the title, it is not CFO in the title. It is very interesting. So the Comptroller—you may have a Comptroller that is only inter-

ested in the budget and not even interested in financial management. We have had some of those.

And so it would be the Comptroller, the Acquisition Under Secretary, and the Personnel Readiness. How do you expect the business transformation person to deal with all three of those if there is a weak chairman of that business management committee at the top? It just doesn't work. It doesn't work in business and it won't work in government.

So I feel that you have to have, in effect, a parallel to what we have already done. I mean, the fact is the Defense Department has a permanent managerial person, namely the head of the Business Transformation Agency. I believe that person has got a term, That person is seen as a technocrat, as an expert. Well, if that is the case, the same model ought to apply to a CMO, as I said in my testimony, and I would have the head of the Business Transformation Agency report directly to that CMO to get out from under competing baronies who are all legitimately claiming resources, but you just can't satisfy everybody.

Senator CARPER. All right. Thank you. Colonel Patterson, if you want to say anything on this one, feel free. Otherwise, I have another question for you. Do you want to opine on this briefly?

Mr. PATTERSON. Well, obviously, I support the Deputy Secretary of Defense and the position that he has taken on this. I would also mention the fact that one of our responsibilities and that we take very carefully and very—it is an important responsibility, and that is we hire good managers. That is our responsibility. We vet them. Sometimes we are not perfect. But we are accountable for what happens to them and what happens on their watch. And so I would tell you that we take that very seriously and that is our responsibility, is to hire good managers. Good managers are people and sometimes we don't make the right choice.

But to pick up on what Dr. Zakheim said, I think it is an extraordinarily important point, and it was the point that when you asked me the last time I was here, you said, what could we do for you, and I said you could help eliminate the byzantine labyrinthine process by which good people are systematically eliminated from being candidates for these important jobs, and I can't stress that enough.

Senator CARPER. I remember you saying that. It is good that you are staying on message.

Mr. PATTERSON. Thank you, sir.

Senator CARPER. Let me move on to Mr. Walker for a quick question. We will come right back to you for my last question. General, how do challenges in DOD's business operations affect the war fighters?

Mr. WALKER. Well, first, I would say that there are three Ms in the Department. Mission is No. 1, and it should be, and it should be in every department and agency. Money is No. 2. Get the money, spend the money. And management is No. 3. Now, don't get me wrong. I am not trying to downplay what has been accomplished because a considerable amount has been accomplished. And I think to be fair, you have to analyze things based upon where do things stand now, what type of progress is being made, and then how do you benchmark it against a comparable organization. You

need to look at all three to be fair and to provide contextual sophistication. Progress has been made.

To the extent that we have inefficient and ineffective business processes, several things happen. One, we waste a lot of money. And if we waste a lot of money, when the crunch comes, and the crunch will come, including for the Department of Defense, we won't be able to acquire some things that we need.

Second, we may not have good accounting over what we have in deciding what we are going to buy. We may not have an ability to deliver things that we do have, and we know where they are, as effectively as we should. And so I can give you more and more examples, but there are consequences to the war fighter and those consequences are anywhere from short-term tactical to longer-range strategic implications, not just for the war fighter, but quite frankly, for our national security.

Senator CARPER. Say those three Ms one more time.

Mr. WALKER. OK. Those three Ms are mission, money, and management.

Senator CARPER. All right. Thank you.

Mr. Patterson, one more question for you and that is it for the questions I want to ask here today. But GAO has previously reported that it has found, I think, numerous problems with DOD's process for recording and reporting costs for ongoing operations related to the Global War on Terrorism, raising significant questions about the reliability of DOD's reported costs and its future requirements. Are the steps that DOD has previously taken regarding reliability having an impact in improving its reported Global War on Terrorism costs?

Mr. PATTERSON. Yes, sir, I believe they have.

Senator CARPER. Would you talk about that a little bit?

Mr. PATTERSON. Yes, sir. I would be happy to. Because it is so visible and we have a responsibility to be very accurate about the cost of this war, we have established a senior executive working group that I am a co-chair and the lead chair with the Director of the Defense Finance and Accounting System. And to this day, our processes and improvements have brought us to a point where we believe and we can show that 92 percent of all of the costs that we identify are costs that come from an accounting system, so that you can trace it back to an established accounting system.

Only 8 percent of the costs of the Global War on Terror are attributed to modeling or estimating, and more modeling than estimating. We are attempting in every way possible to start to eliminate completely estimates and use actual costs in our Global War on Terror reporting and we are coming very close. I believe that the GAO in their latest accounting of the way in which we do things have given us credit for the fact that we are making progress in that area.

Senator CARPER. Is there anything to what he just said there, General Walker? Are you here to back him up?

Mr. WALKER. They are making progress and I have been asked to be briefed on this matter and I have yet to be briefed on it, but I am scheduled to be briefed on it in the near future and I will be happy to report back to this Subcommittee when I am.

Senator CARPER. Thank you. I said that would be my last question, but I want to go back to Mr. Brinkley, one thing we have not really gotten into. I understand one of the things that you focus on deals with how do we help foster economic development and job creation within Iraq. It is an important subject, real important, actually. I would be interested in your telling us how we are doing. Are we doing any better? What are some of our lessons learned?

Mr. BRINKLEY. To synthesize quickly on this, Iraq has a $35 to $40 billion gross domestic product (GDP), most of that generated with oil sales.

Senator CARPER. Is that both before and after the war?

Mr. BRINKLEY. I think it has grown a bit in terms of the price of oil has gone up. Therefore, GDP has grown since 2003. Now, it was an industrial economy prior to 2003. Under U.N. sanctions, they were not allowed to import anything other than what they could smuggle in. They had a large industrial base. We are bringing DOD's industrial expertise to bear to get that industrial base up and running again. It provided employment for, the World Bank estimates, about half-a-million people in Iraq. That served as the core engine of the Iraqi economy, and so where we can bring business expertise from the Department of Defense to bear to restore industrial operations in Iraq, we are doing that.

The way we are doing that is we are spending, as you know, well in excess of $10 billion a month in Iraq. Now, you are spending over $10 billion a month in Iraq to sustain our troop presence, acquiring a wide variety of goods and things that are necessary to sustain our presence there. That can be a huge economic stimulus to that country. So this area of contracting, not just how we do it transparently and more effectively so that the Congress and the American people have confidence in where their dollars are going, but also so that the war fighting community can wield our spending as a tool of economic policy in Iraq to help stabilize and restore employment and normalcy in areas.

As General Petraeus establishes a security footprint, we follow with rapid economic reconstruction and development by restoring employment and the industrial base there. That is what we are working on today, and we have made significant progress and anticipate significant ongoing progress in that effort.

Senator CARPER. How do you measure your progress?

Mr. BRINKLEY. Progress is measured in multiple levels. First and foremost is the efforts we have in partnership with Joint Contracting Command for Iraq-Afghanistan. Major General Darryl Scott under MNF–I Command has—we have registered over 5,000 Iraqi companies, private companies, that are currently receiving almost $400 million a month in U.S. Government contracts for goods and services to sustain our forces. Four-hundred-million dollars a month is a significant economic stimulus in the Iraqi economy, and these were goods that were not being imported from America but were being purchased in the region to support our mission. So this is not removing economic stimulus from home, but actually channeling regional economic stimulus into the place where we need it most, Iraq.

The other measurement is in our restarting of factories. Up until September of this year, we brought back online 17 industrial oper-

ations in Iraq that restored sustained employment to over 5,000 Iraqis. We will impact 30 more factories between now and January. Unlike construction or some of the other jobs, programs that we have underway in Iraq, a manufacturing job is a sustained employment that has a multiplier effect on the economy in Iraq, and so in partnership and in support of MNF–I Command objectives, we believe this is a key element to helping continue the stabilization we see starting to take hold in areas in Iraq today.

Senator CARPER. Dr. Zakheim.

Mr. ZAKHEIM. Yes. I was just going to say as the one non-member of any part of the government, I am reasonably objective, I think. Paul Brinkley has done a remarkable job out there. He has paid a very high personal cost. He spends most of his time in what is now the garden spot of the world. He has been developing U.S. investments in Iraq, which is good for our businesses and good for the Iraqis, as well as what he has talked about. And fundamentally, if we are going to turn that place around, and now I am biased because I am an economist, it is only going to be done by turning the economy around. And so the gentleman to the right of me has done a remarkable job in that regard.

Senator CARPER. Mr. Brinkley, are you going to let him get away with saying that about you?

Mr. BRINKLEY. Yes. [Laughter.]

Senator CARPER. All right. Dr. Coburn, any closing words?

Senator COBURN. No, I am fine.

Senator CARPER. We appreciate each of you being here. We appreciate your current service to our country and your previous service. Dr. Zakheim, it is great to see you again.

Your testimony has been valuable, but I think our questions have been of value to us and I hope to some of you.

One request that I asked Mr. Patterson before was what can we do to be of help, and he has again reminded us of one of the things that we can do to be of help and we will try to be helpful there. Go ahead.

Senator COBURN. I just wanted you to know that I elevated his rank while you were gone to General. [Laughter.]

Mr. PATTERSON. And consequently, my answers to you were much better. [Laughter.]

Senator CARPER. That is not always the case. [Laughter.]

We have field hearings. That would be a field promotion.

This hearing record is going to be open for a couple of weeks for any additional statements that our colleagues might have and questions. To the extent that you receive those, we would appreciate your promptly responding to them.

Thank you for bearing with us today through all these votes, and again, we appreciate very much your presence and testimony. Thank you so much.

The hearing is adjourned.

[Whereupon, at 5:58 p.m., the Subcommittee was adjourned.]

APPENDIX

PREPARED STATEMENT OF SENATOR VOINOVICH

Senator Carper and Senator Coburn, thank you for holding this important hearing to address the business management and financial challenges facing the Department of Defense. Improvements in these areas are essential to ensuring that the Department manages its people, systems, and programs in an efficient manner.

Since 2005, as Chairman and now Ranking Member of the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, I have held hearings on the Department's GAO high-risk areas; three on DOD supply chain management and one on the Department's transformation efforts.

My interests in this area is three fold. First, the Government Accountability Office designated eight areas within the Department as high-risk for waste, fraud, abuse, and mismanagement. In addition, there are seven government-wide high-risk areas for which DOD shares responsibility. Many of these problem areas have been on GAO's list since 1990. These high-risk areas, and the resources and management efforts they consume, diminish the ability of the Department to perform its missions effectively.

Second, the men and women serving abroad and fighting for our freedom deserve the best support possible from their government. Finally, the American taxpayer deserves a Department that is transparent and held accountable for every penny it spends. With a budget of well over $400 billion, the Department must be a good steward of the taxpayers' money.

As I have noted in the past, former Secretary of Defense Donald Rumsfeld once estimated that the Department wastes 5 percent of its budget—more than $20 billion a year at current budget levels—on redundant or outdated business practices. Based on my experience, I believe the actual number is much higher.

I have been extremely pleased with the work Mr. Brinkley and the Business Transformation Agency have been able to accomplish in such a short period of time. By developing and issuing the Enterprise Transition Plan every 6 months, BTA has been able to monitor the Department's transformation. Mr. Brinkley, I look forward to hearing how you plan to institutionalize BTA's transformation plan.

Regardless of the progress, the Department will never see true transformation until they have a Chief Management Officer dedicated solely to management. While I applaud the decision of Secretary Gates to name a Chief Management Officer, the designation of the existing Deputy Secretary does not get the job done. After all, there are only 24 hours in a day, and Gordon England is already responsible for a multitude of tasks. I think Comptroller General Walker will agree with me that we need a dedicated senior level official whose full-time job is focused on management.

True transformation is driven by committed leadership and must stand the test of time. With the coming transition to a new Administration, we need to ensure that progress continues. I look forward to hearing from our witnesses today.

Thank you, Senator Carper.

United States Government Accountability Office

GAO

Testimony

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

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DEFENSE BUSINESS TRANSFORMATION

A Full-time Chief Management Officer with a Term Appointment Is Needed at DOD to Maintain Continuity of Effort and Achieve Sustainable Success

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

GAO-08-132T

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Highlights

Highlights of GAO-08-132T, a testimony before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

The Department of Defense (DOD) continues to face significant challenges in resolving its many long-standing business challenges. DOD is solely responsible for eight high-risk areas and shares responsibility for another seven governmentwide areas on GAO's high-risk list. GAO designated DOD's approach to business transformation as high risk in 2005 because (1) DOD's improvement efforts were fragmented, (2) DOD lacked an enterprisewide and integrated business transformation plan, and (3) DOD had not appointed a senior official at the right level with an adequate amount of time and appropriate authority to be responsible for overall business transformation efforts. A recent DOD directive designated the current Deputy Secretary of Defense as DOD's chief management officer (CMO). Successful overall business transformation, however, will require full-time leadership that is focused solely on the integration and execution of these efforts, over the long term, to resolve pervasive weaknesses that have left DOD vulnerable to waste, fraud, and abuse at a time of increasing fiscal constraint.

This testimony is based on previous and ongoing GAO work and discusses (1) the impact of DOD's long-standing business challenges on DOD and the warfighter, and (2) the progress DOD has made and actions needed to achieve sustainable success in its business transformation efforts. This testimony also provides an update on DOD-specific high-risk areas.

To view the full product, including the scope and methodology, click on GAO-08-132T. For more information, contact Sharon Pickup, at (202) 512-9619 or pickups@gao.gov.

October 16, 2007

DEFENSE BUSINESS TRANSFORMATION

A Full-time Chief Management Officer with a Term Appointment Is Needed at DOD to Maintain Continuity of Effort and Achieve Sustainable Success

What GAO Found

The persistence and magnitude of DOD's business transformation challenges highlight the fact that the status quo is unacceptable and that, without focused and sustained leadership to guide the overall business transformation effort, the department will continue to waste billions of dollars annually. Within DOD, business transformation is broad, encompassing people, planning, processes, organizational structures, and technology. DOD's pervasive and long-standing business weaknesses adversely affect the department's economy, efficiency, and effectiveness, and have resulted in a lack of adequate accountability across all of its major business areas. Ultimately, these weaknesses affect the department's ability to support the warfighter, including the availability of equipment and weapon systems, the cost and performance of contractors supporting the warfighter, and the assessment of resource requirements.

Illustrative Weaknesses in DOD's Business Operations

Business area	Impact on department and warfighter
Weapon Systems Acquisition	Weapon development problems have delayed deliveries to the warfighter by several years on average. It is a predictable phenomenon that can be remedied with better knowledge at key decision points. However, standing in the way is a range of long-standing challenges Congress will have to address.
Contract Management	While DOD relies heavily on contractors to undertake major reconstruction projects and provide support to the military, ineffective contract design, management, and oversight leads to increased costs and poor outcomes.
Financial Management	Unreliable cost information affects DOD's ability to assess resource requirements, control costs, assess performance, evaluate programs, and set appropriate fees to recover costs where required.

Source: GAO.

DOD's senior leadership has shown a commitment to transforming the department's business operations. Two critical actions, among others, however, are still needed to change the status quo. DOD has yet to establish (1) a strategic planning process that results in a comprehensive, integrated, and enterprisewide plan or set of plans to help guide transformation, and (2) a senior official who can provide full-time attention and sustained leadership to transformation. Broad-based consensus exists among GAO and others that DOD needs a full-time and term-based senior management official to provide focused and sustained leadership over its overall business transformation efforts, both within and across administrations. Also, various legislative proposals call for senior-level attention to these efforts. While DOD recently assigned CMO duties to the current Deputy Secretary of Defense, this does not ensure full-time attention or continuity of leadership. GAO continues to believe a CMO position should be codified in statute as a separate position, at the right level, and with the appropriate term in office. In the absence of a CMO with these characteristics, and an enterprisewide plan to guide business transformation efforts, it is highly unlikely that DOD will ever get the most out of every taxpayer dollar it invests to better support the warfighter in times of growing fiscal constraint.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be before this Subcommittee to discuss the status of the Department of Defense's (DOD) efforts to transform its business operations and why further action is needed to maintain continuity of effort, change the status quo, and achieve sustainable success. Since the first financial statement audit of a major DOD component was attempted almost 20 years ago, we have reported that weaknesses in business operations not only adversely affect the reliability of reported financial data, but also the economy, efficiency, and effectiveness of DOD's operations. In fact, DOD continues to dominate our list of high-risk programs designated as vulnerable to waste, fraud, and abuse of funds, bearing responsibility, in whole or in part, for 15 of 27 high-risk areas.[1] Eight of these areas are specific to DOD and include DOD's overall approach to business transformation, as well as business systems modernization, financial management, the personnel security clearance process, supply chain management, support infrastructure management, weapon systems acquisition, and contract management. Collectively, these high-risk areas relate to DOD's major business operations which directly support the warfighters, including how they are paid, the benefits provided to their families, and the availability and condition of equipment they use both on and off the battlefield.

Given the current security environment and growing longer-range fiscal imbalance facing our nation, DOD, like other federal agencies, will increasingly compete for resources in a fiscally constrained environment in the future. Commitments are clearly growing both abroad, with our involvement in ongoing operations in Iraq and Afghanistan, as well as at home, with efforts to provide homeland security. However, our nation is threatened not only by external security threats, but also from within by large and growing fiscal imbalances over time due primarily to our aging population and rising health care costs. Absent policy changes to cope with rising health care costs and known demographic trends, a growing imbalance between expected federal spending and revenues will mean escalating and ultimately unsustainable federal deficits and debt levels. As I have stated previously, our nation is on an imprudent and unsustainable fiscal path. Given this scenario, DOD cannot afford to continue on the course of reduced efficiencies, ineffective performance, and inadequate accountability in connection with its business operations. With its annual

[1]GAO, *High-Risk Series: An Update*, GAO-07-310 (Washington, D.C.: Jan. 31, 2007).

base budget approaching $500 billion, along with total reported obligations of about $462 billion to support ongoing operations and activities related to the global war on terrorism since the September 11th attacks through July 2007, the department has clearly been given stewardship over unprecedented amounts of taxpayer money. DOD must do more to get the most from every dollar it is given.

Transformation in any organization is a long-term process, especially in an organization as large and as complex as DOD. I continue to believe that DOD's senior leadership has shown a commitment to address long-standing weaknesses and transform its business operations. Congress, under the leadership of this Subcommittee and others, has conducted oversight, passed legislation, and codified many of our prior recommendations, particularly with respect to DOD's modernization of its business systems.[2] Since then, DOD has devoted substantial resources and made important progress toward establishing key transformation entities and processes to guide business activities. DOD's current approach is clearly superior to its prior approach; however, progress has been inconsistent and a number of challenges remain. Most importantly, DOD has not taken what could be considered one of the single most critical steps, which is to provide the full-time attention and sustained leadership needed to guide business transformation efforts. To that end, DOD needs a chief management officer (CMO), codified in statute as a separate position, at the right level, and with the adequate amount of time and appropriate authority to be responsible and accountable for its business transformation efforts.[3] As I will discuss later, DOD recently assigned chief management officer duties specifically to the current Deputy Secretary of Defense, and therefore it appears these responsibilities will expire when that individual leaves the department. In my view, subsuming the duties within the other responsibilities of the current Deputy Secretary essentially represents the status quo and will not provide the continuity of effort and full-time focus that is necessary to effectively further achieve and sustain success in connection with DOD's overall business transformation effort.

[2]Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. No. 108-375, § 332 (2004) (codified in part at 10 U.S.C. §§ 186 and 2222).

[3]GAO, *Defense Business Transformation: Achieving Success Requires a Chief Management Officer to Provide Focus and Sustained Leadership*, GAO-07-1072 (Washington, D.C.: Sept. 5, 2007).

Our work shows that DOD will continue to face difficulty in achieving better outcomes in its business operations and ultimately optimizing support to the warfighter until it adopts a better leadership approach to guide its business transformation efforts. My testimony today will touch on the various high-risk areas for which DOD is responsible, paying special attention to the department's overall approach to business transformation. I will provide perspectives on (1) the impact DOD's pervasive and long-standing business challenges have on the department and the warfighter, and (2) the progress DOD has made and the actions needed to achieve sustainable success in its business transformation efforts. I will also provide an update on remaining DOD-specific high-risk areas that highlight the need for continued attention.

My statement is based on our previous reports and testimonies, as well as some of our current, ongoing efforts. Our work was performed in accordance with generally accepted government auditing standards.

Summary

DOD spends billions of dollars to sustain key business operations intended to support the warfighter, including systems and processes related to financial management, weapon systems acquisition, the supply chain, support infrastructure, and contract management. We have reported for years on pervasive and long-standing weaknesses in these areas that adversely affect the economy, efficiency, and effectiveness of the department, result in the lack of accountability and substantial waste, and impede efforts to effectively support the warfighter. Specific illustrative examples of these problems include the following:

- *Financial management.* Continuing weaknesses in DOD's ability to properly record transactions and reconcile its disbursement activities have adversely impacted the reliability of DOD's reported cost data. Unreliable cost information affects DOD's ability to assess resource requirements, control and reduce costs, assess performance, evaluate programs, and set appropriate fees to recover costs where required.

- *Weapon systems acquisition.* DOD's planned investment in new weapons has doubled from $750 billion in 2001 to $1.5 trillion today. Yet, the problems remain the same: development time typically grows by 20 percent and development costs typically grow by 30 percent reducing qualities and delaying delivery to the warfighter. It is a fixable problem that will, among other things, require a commitment to following a knowledge-based approach to major systems design, development, and production.

- *Supply chain management.* U.S. ground forces experienced shortages of critical supply items, such as tires and body armor, while the Air Force simultaneously invested billions of dollars on inventory that was not needed for requirements.

- *Contract management.* While DOD relies extensively on contractors to undertake major reconstruction projects and provide logistical support to the military, ineffective contract design, management, and oversight leads to increased costs and poor contract outcomes.

Overall, these long-standing weaknesses in DOD's business areas have (1) resulted in a lack of reliable information needed to make sound decisions and report accurately on its operations; (2) hindered operational efficiency; (3) adversely affected mission performance; and (4) left the department vulnerable to significant amounts of fraud, waste, abuse, and mismanagement.

Transforming DOD's business operations is an absolute necessity in the context of an increasingly demanding security environment and the pressures of our nation's long-term fiscal outlook. Further, the current deployment of tens of thousands of servicemembers, civilians, and contractor personnel to support ongoing operations overseas provides an even greater sense of urgency for the department to aggressively address weaknesses in its business operations and achieve transformation goals in the near and long term. DOD's senior leadership has demonstrated a commitment to transforming the department's business operations, and has taken many steps in the last few years to further this effort. For example, DOD has made progress in creating transformational entities to guide its efforts, such as the Defense Business Systems Management Committee and the Business Transformation Agency, as well as the development of plans and other tools. However, two critical actions, among others, are still needed to put DOD on a sustainable path to success. DOD has yet to establish (1) a strategic planning process that results in a comprehensive, integrated, and enterprisewide plan or set of plans to help guide transformation and (2) a senior official who can provide full-time attention and sustained leadership to the overall business transformation effort. Broad-based consensus exists among GAO and others that DOD needs a full-time and term-based senior management official to provide focused and sustained leadership over business transformation efforts, although differing views exist concerning specific characteristics of the position. Various legislative proposals before the Congress call for senior-level attention to business transformation, and we continue to believe a CMO at DOD should be codified in statute as a

separate position, at the right level, and with the appropriate term in office to provide full-time focus and sustained leadership over the long term, both within and across administrations. While DOD has recently designated the current Deputy Secretary of Defense as the department's CMO and assigned related duties to this individual, this step essentially perpetuates the status quo and does not ensure full-time attention and continuity of leadership. In the absence of a CMO with an appropriate term who can provide focused attention and a comprehensive, integrated, and enterprisewide plan to guide its transformation efforts, it is highly unlikely that DOD will ever get the most out of every dollar it invests to better support the warfighter in times of growing fiscal constraints.

In addition to DOD's overall approach to business transformation, ensuring effective transformation of other areas within DOD that we have identified as high-risk will require continued attention and sustained leadership over a number of years to be successful. For example, DOD continues to be challenged in its efforts to transform its financial management systems which are nonintegrated, stovepiped, and not capable of providing decision makers with accurate and reliable information, thus adversely affecting the department's ability to control costs, ensure basic accountability, anticipate future costs, and measure performance. Further, while progress has been made in DOD's business systems modernization efforts, DOD has not fully defined and consistently implemented the full range of management controls needed to effectively and efficiently ensure that its business systems investments are the right solutions for addressing its business needs. While DOD has made some progress in addressing its supply chain management problems, the department faces many significant challenges in successfully implementing its changes and measuring performance. In the area of weapon systems acquisition, recurring problems with cost overruns and scheduled delays have resulted in a reduction on return on investment at a time when the nation's fiscal imbalance is growing. Furthermore, our work has found that DOD is unable to ensure that it is using sound business practices to acquire the goods and services needed to meet the warfighters' needs, creating unnecessary risks and paying higher prices than justified, and its long-standing problems with contract design, management, and oversight have become more prominent as DOD's reliance on contractors to provide services continues to grow.

Background

DOD is one of the largest and most complex organizations in the world. Overhauling its business operations will take many years to accomplish and represents a huge and possibly unprecedented management challenge. 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 thousands of 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.

To address long-standing management problems, we began our high-risk series in 1990 to identify and help resolve serious weaknesses in areas that involve substantial resources and provide critical services to the public. Historically, high-risk areas have been designated because of traditional vulnerabilities related to their greater susceptibility to fraud, waste, abuse, and mismanagement. As our high-risk program has evolved, we have increasingly used the high-risk designation to draw attention to areas associated with broad-based transformation needed to achieve greater economy, efficiency, effectiveness, accountability, and sustainability of selected key government programs and operations. DOD has continued to dominate the high-risk list, bearing responsibility, in whole or in part, for 15 of our 27 high-risk areas. Of the 15 high-risk areas, the 8 DOD-specific high-risk areas cut across all of DOD's major business areas. Table 1 lists the 8 DOD-specific high-risk areas and the year in which each area was designated as high risk. In addition, DOD shares responsibility for 7 governmentwide high-risk areas.[4]

[4]See GAO-07-1072. DOD shares responsibility for the following seven governmentwide high-risk areas: (1) disability programs, (2) ensuring the effective protection of technologies critical to U.S. national security interests, (3) interagency contracting, (4) information systems and critical infrastructure, (5) information-sharing for homeland security, (6) human capital management, and (7) real property management.

Table 1: Years When Specific DOD Areas on GAO's 2007 High-Risk List Were First Designated as High Risk

DOD Area	Year designated as high risk
DOD approach to business transformation	2005
DOD personnel security clearance program	2005
DOD support infrastructure management	1997
DOD business systems modernization	1995
DOD financial management	1995
DOD contract management	1992
DOD supply chain management	1990
DOD weapon systems acquisition	1990

Source: GAO.

GAO designated DOD's approach to business transformation as high risk in 2005 because (1) DOD's improvement efforts were fragmented, (2) DOD lacked an enterprisewide and integrated business transformation plan, and (3) DOD had not appointed a senior official at the right level with an adequate amount of time and appropriate authority to be responsible for overall business transformation efforts. Collectively, these high-risk areas relate to DOD's major business operations, which directly support the warfighter, including how servicemembers get paid, the benefits provided to their families, and the availability of and condition of the equipment they use both on and off the battlefield.

DOD's Pervasive and Long-standing Financial Management and Business Weaknesses Affect the Department's Efficiency and Effectiveness and Ultimately Impact DOD's Ability to Support the Warfighter

The persistence and magnitude of DOD's business transformation challenges underscore the fact that the status quo is unacceptable, and without focused and sustained leadership to guide business transformation, the department will continue to waste billions of dollars every year. Within DOD, business transformation is broad, encompassing people, planning, processes, organizational structures, and technology in all of DOD's major business areas. DOD spends billions of dollars to sustain key business operations intended to support the warfighter. DOD's pervasive and long-standing weaknesses in its financial management and business operations adversely affect the economy, efficiency, and effectiveness of DOD's operations, and have resulted in a lack of adequate accountability across all the department's major business areas. Every dollar that DOD could save through improved economy and efficiency of its operations is important to the fiscal well-being of our nation, and ultimately can be used to support the needs of the warfighter. DOD's high-risk areas have real world implications for our men and women in uniform, including how the future needs of ongoing operations are estimated, the availability and condition of the equipment they use both on and off the battlefield, and the performance of contractors paid to provide logistical support to servicemembers in theater, as the following examples illustrate:

- *Financial management.* Continuing material weaknesses in DOD's business processes, systems, and controls have adversely affected the reliability of the department's reported financial information and the department's ability to manage its operations. To its credit, the department initiated the "Check It" Campaign in July 2006 to raise awareness throughout the department on the importance of effective internal management controls. However, until the impact of this campaign and other efforts, including its financial improvement and audit readiness (FIAR) effort, begin to significantly transform and improve DOD's business operations, the department will continue to suffer weaknesses in the reliability and usefulness of its management information as illustrated by the examples below.

  - The lack of reliable asset information, including cost, location, and condition, necessary to effectively (1) safeguard assets from physical deterioration, theft, or loss; (2) account for the acquisition and disposal of these assets; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs, or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.

- DOD's inability to estimate with assurance key components of its environmental and disposal liabilities and support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. Problems in accounting for liabilities affect the determination of the full cost of DOD's current operations and the extent of its liabilities. Also, improperly stated environmental and disposal liabilities and weak internal control supporting the process for their estimation affect the department's ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities.

- Continuing weaknesses in DOD's ability to properly record transactions and reconcile its disbursement activities have adversely impacted the reliability of DOD's reported cost data. Unreliable cost information affects DOD's ability to control and reduce costs, assess performance, evaluate programs, and set appropriate fees to recover costs where required. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by DOD for inclusion in The Budget of the United States Government concerning obligations and outlays. Further, inadequacies in DOD's systems and processes for recording and reporting obligation data related to ongoing operations in support of the global war on terrorism have contributed to uncertainty regarding the reliability of reported costs. Our reviews found a number of problems, including long-standing deficiencies in DOD's financial management and business systems, incorrectly categorized or omitted obligations, and the reporting of large amounts of obligations in miscellaneous "other" categories.[5] Without transparent and accurate cost reporting, neither DOD nor Congress can reliably know how much the war is costing, examine details on how funds are spent, or have historical data useful in considering future needs. DOD has taken positive steps in response to our recommendations intended to improve the reliability and accuracy of its cost reports, and therefore cost reporting continues to evolve.

[5]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) and *Global War on Terrorism: Fiscal Year 2006 Obligation Rates Are Within Funding Levels and Significant Multiyear Procurement Funds Will Likely Remain Available for Use in Fiscal Year 2007*, GAO-07-76 (Washington, D.C.: Nov. 13, 2006).

- These financial management problems continue to be exacerbated by the department's inability to implement business systems with the desired capability. For example, the Army's Logistics Modernization Program has been beset with problems virtually since its initial implementation in July 2003. For instance, as we reported in July 2007, the program cannot accurately recognize revenue and bill customers, and its inability to implement effective business processes has adversely affected the reliability of its financial reports.[6]

- *Weapon systems acquisition.* DOD weapon system programs typically take longer to field and cost more to buy than planned, placing additional demands on available funding. For example, we reviewed 27 weapon programs that were in the research, development, test and evaluation phase and noted that since development began the costs had increased by almost $35 billion, or 33.5 percent, over the first full estimate. The same programs have also experienced an increase in the time needed to develop capabilities. The consequence of cost and acquisition cycle time growth is often manifested in a reduction of the buying power of the defense dollar. As costs rise and key schedule milestones are delayed, programs are sometimes forced to reduce quantities, resulting in a reduction in buying power and a reduction in capability delivered to the warfighter. It is a predictable and recurring phenomenon that can be remedied with more attention to separating wants from needs and better knowledge at key decision points. With a weapon investment portfolio of $1.5 trillion, DOD cannot settle for the same kind of outcomes it has gotten in the past.

- *Supply chain management.* Systemic deficiencies in DOD's supply support for U.S. ground forces have led to critical supply shortages during war operations. At the outset of Operation Iraqi Freedom and periodically throughout the campaign, DOD has experienced difficulties in providing U.S. ground forces with critical items such as tires, body armor, and Meals-Ready-to-Eat.[7] In addition, our review of the Air Force's inventory management practices found problems that hindered its ability to efficiently and effectively maintain its spare parts inventory for military equipment.[8] For example, we found that from fiscal years 2002 through

[6]GAO, *DOD Business Transformation: Lack of an Integrated Strategy Puts the Army's Asset Visibility System Investments at Risk*, GAO-07-860 (Washington, D.C.: July 27, 2007).

[7]GAO, *Securing, Stabilizing, and Rebuilding Iraq: Key Issues for Congressional Oversight*, GAO-07-308SP (Washington, D.C.: Jan. 9, 2007).

[8]GAO, *Defense Inventory: Opportunities Exist to Save Billions by Reducing Air Force's Unneeded Spare Parts Inventory*, GAO-07-232 (Washington, D.C.: Apr. 27, 2007).

2005, an average of 52 percent ($1.3 billion) of the Air Force's secondary on-order inventory was not needed to support on-order requirements. Furthermore, we also reported that the Army plans to invest about $5 billion over the next several years to develop and implement business systems to better track inventory items without a clear, integrated strategy, Armywide enterprise architecture, or concept of operations to guide this investment. Challenges remain in coordinating and consolidating distribution and supply support in theater, which could lead to similar types of supply problems experienced in Operation Iraqi Freedom in future military operations.

- *Contract management.* DOD has relied extensively on contractors to undertake major reconstruction and logistical support to its troops in Iraq. Service contracts have grown by nearly 80 percent in a decade, both at home and abroad. In some cases, contractors have begun work without the key terms and conditions of contracts, including projected costs, being defined within required time frames. Problems with poor planning, insufficient leadership and guidance, inadequate numbers of trained contracting personnel, and limited oversight contribute to ineffective contract management controls.[9] For example, a program official for the Logistics Civil Augmentation Program (LOGCAP)—DOD's largest support contract—noted that if adequate staffing had been in place, the Army could have realized substantial savings through more effective reviews of new requirements.[10] Furthermore, we recently found that sole-source contracts for security contractors on installations were found to be 25 percent higher than past contracts awarded competitively.[11] In addition, DOD does not have a sufficient number of oversight personnel, in deployed locations and elsewhere, which precludes its ability to obtain reasonable assurance that contractors are meeting contract requirements efficiently and effectively at each location where work is being performed. For example, officials responsible for contracting with the Multi-National Force—Iraq (MNF-I) stated that they did not have enough contract oversight personnel and quality assurance representatives to allow MNF-I to reduce the Army's use of the LOGCAP contract by awarding more sustainment contracts for base operations support in Iraq.[12] Further, a lack

[9]GAO-07-308SP.

[10]GAO, *Defense Acquisitions: Improved Management and Oversight Needed to Better Control DOD's Acquisition of Services*, GAO-07-832T (Washington, D.C.: May 10, 2007).

[11]GAO-07-832T.

of training for military commanders hinders their ability to adequately plan for the use of contractor support and inhibits the ability of contract oversight personnel to manage and oversee contracts and contractors who support deployed forces.

As these examples point out, weaknesses in DOD's business operations span most of the department's major business areas and negatively impact the department's efficiency and effectiveness and affect its ability to support the warfighter. Overall, these long-standing weaknesses in DOD's business areas have (1) resulted in a lack of reliable information needed to make sound decisions and report accurately on its operations; (2) hindered its operational efficiency; (3) adversely affected mission performance; and (4) left the department vulnerable to fraud, waste, abuse, and mismanagement.

DOD Has Made Progress in Addressing Its Business Transformation Efforts, but Critical Actions are Needed to Provide Comprehensive, Integrated, and Strategic Planning and Focused and Sustained Leadership

Due to the impact of the department's business weaknesses on both the department and the warfighter, DOD's leaders have demonstrated a commitment to making the department's business transformation a priority and have made progress in establishing a management framework for these efforts. For example, the Deputy Secretary of Defense has overseen the establishment of various management entities and the creation of plans and tools to help guide business transformation at DOD. However, our analysis has shown that these efforts are largely focused on business systems modernization and that ongoing efforts across the department's business areas are not adequately integrated. Furthermore, key characteristics of the management framework have yet to be institutionalized or defined in directives. In addition, DOD lacks two crucial features that are integral to successful organizational transformation—(1) a strategic planning process that results in a comprehensive, integrated, and enterprisewide plan or interconnected plans, and (2) a senior leader who is responsible and accountable for business transformation and who can provide full-time focus and sustained leadership.

[12]GAO, *Military Operations: High-Level DOD Action Needed to Address Long-standing Problems with Management and Oversight of Contractors Supporting Deployed Forces*, GAO-07-145 (Washington, D.C.: Dec. 18, 2006).

DOD Has Made Progress in Addressing Its Business Transformation Challenges

DOD's senior leadership has shown commitment to transforming the department's business operations, and DOD has taken a number of positive steps to begin this effort. In fact, because of the impact of the department's business operations on its warfighters, DOD recognizes the need to continue working toward transformation of its business operations and provide transparency in this process. The department has devoted substantial resources and made important progress toward establishing key management structures and processes to guide business systems investment activities, particularly at the departmentwide level, in response to congressional legislation that codified many of our prior recommendations related to DOD business systems modernization and financial management.[13]

Specifically, DOD has made progress in establishing a management framework for business transformation by creating various governance and management entities and developing plans and tools to help guide transformation. In the past few years, DOD has established the Defense Business Systems Management Committee, investment review boards, and the Business Transformation Agency to manage and guide business systems modernization. The Defense Business Systems Management Committee and investment review boards were statutorily required by the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 to review and approve the obligation of funds for defense business systems modernization, depending on the cost and scope of the system in review. The Business Transformation Agency was created to support the top-level management body, the Defense Business Systems Management Committee, and to advance DOD-wide business transformation efforts.

Additionally, DOD has developed a number of tools and plans to enable these management entities to help guide business systems modernization efforts. The tools and plans include the business enterprise architecture and the enterprise transition plan. The business enterprise architecture is a tool or blueprint intended to guide and constrain investments in DOD organizations and systems as they relate to business operations. It provides a thin layer of corporate policies, capabilities, standards, and rules and focuses on providing tangible outcomes for a limited set of enterprise-level (DOD-wide) priorities. The enterprise transition plan is currently considered the highest level plan for DOD business

[13]Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. No. 108-375, § 332 (2004) (codified in part at 10 U.S.C. §§ 186 and 2222).

transformation. According to DOD, the enterprise transition plan is intended to summarize all levels of transition planning information (milestones, metrics, resource needs, and system migrations) as an integrated product for communicating and monitoring progress, resulting in a consistent framework for setting priorities and evaluating plans, programs, and investments.

Our analysis of these tools, plans, and meeting minutes of the various transformational management entities shows that these efforts are largely focused on business systems modernization, and that this framework has yet to be expanded to encompass all of the elements of the overall business transformation. Furthermore, DOD has not clearly defined or institutionalized in directives the interrelationships, roles and responsibilities, or accountability for the various entities that comprise its management framework for overall business transformation. For example, opinions differ within DOD as to which senior governance body will serve as the primary body responsible for overall business transformation. Some officials stated that the Defense Business Systems Management Committee would serve as the senior-most governance entity, while others stated that the Deputy's Advisory Working Group, a group that provides departmentwide strategic direction on various issues, should function as the primary decision-making body for business transformation. Additionally, opinions differ between the two entities regarding the definition of DOD's key business areas, with the Defense Business Systems Management Committee and the Business Transformation Agency using a broader definition of business processes than that of the Deputy Advisory Working Group and its supporting organizations. Until such differences are resolved and the department institutionalizes a management framework that spans all aspects of business transformation, DOD will not be able to integrate related initiatives into a sustainable, enterprisewide approach and to resolve weaknesses in business operations.

Critical Actions Are Needed to Provide Comprehensive, Integrated, and Strategic Planning and Focused and Sustained Leadership for DOD's Overall Business Transformation Efforts

As we have testified and reported for years, a successful, integrated, departmentwide approach to addressing DOD's overall business transformation requires two critical elements: a comprehensive, integrated, and enterprisewide plan and an individual capable of providing full-time focus and sustained leadership both within and across administrations, dedicated solely to the integration and execution of the overall business transformation effort.

DOD Lacks a Strategic Planning Process That Results in a Comprehensive, Integrated, and Enterprisewide Plan or Set of Plans

DOD continues to lack a comprehensive, integrated, and enterprisewide plan or set of linked plans for business transformation that is supported by a comprehensive planning process, and guides and unifies its business transformation efforts. Our prior work has shown that this type of plan should help set strategic direction for overall business transformation efforts and all key business functions; prioritize initiatives and resources; and monitor progress through the establishment of performance goals, objectives, and rewards.[14] Furthermore, an integrated business transformation plan would be instrumental in establishing investment priorities and guiding the department's key resource decisions.

While various plans exist for different business areas, DOD's various business-related plans are not yet integrated to include consistent reporting of goals, measures, and expectations across institutional, unit, and individual program levels. Our analysis shows that plan alignment and integration currently focuses on data consistency among plans, meaning that plans are reviewed for errors and inconsistencies in reported information, but there is a lack of consistency in goals and measurements among plans. For example, our analysis of the March 2007 enterprise transition plan showed that the goals and objectives in that plan were not clearly linked to the goals and objectives in the most recent Quadrennial Defense Review, which is DOD's highest-level strategic plan. Additionally, the enterprise transition plan is not based on a strategic planning process. For example, it does not provide a complete assessment of DOD's

[14]See for example, GAO-07-1072; GAO, *Defense Business Transformation: A Comprehensive Plan, Integrated Efforts, and Sustained Leadership Are Needed to Assure Success*, GAO-07-229T (Washington, D.C.: Nov. 16, 2006); *Department of Defense: Sustained Leadership Is Critical to Effective Financial and Business Management Transformation*, GAO-06-1006T (Washington, D.C.: Aug. 3, 2006); 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).

progress in overall transformation efforts aside from business systems modernization. The plan also does not contain results-oriented goals and measures that assess overall business transformation. Other entities such as the Institute for Defense Analyses, the Defense Science Board, and the Defense Business Board have similarly reported the need for DOD to develop an enterprisewide plan to link strategies across the department for transforming all business areas and thus report similar findings as our analysis. DOD officials recognize that the department does not have an integrated plan in place, although they have stated that their intention is to expand the scope of the enterprise transition plan to become a more robust enterprisewide planning document and to evolve this plan into the centerpiece strategic document. DOD updates the enterprise transition plan twice a year, once in March as part of DOD's annual report to Congress and once in September, and DOD has stated the department's goal is to evolve the plan to that of a comprehensive, top-level planning document for all business functions. DOD released the most recent enterprise transition plan update on September 28, 2007, and we will continue to monitor developments in this effort.

DOD Lacks a Full-time and Term-based Senior Management Official to Provide Focus and Sustained Leadership for the Overall Business Transformation Effort

DOD has not established a full-time and term-based leadership position dedicated solely to the business transformation effort. We have long advocated the importance of establishing CMO positions in government agencies, including DOD, and have previously reported and testified on the key characteristics of the position necessary for success.[15] In our view, transforming DOD's business operations is necessary for DOD to resolve its weaknesses in the designated high-risk areas, and to ensure the department has sustained leadership to guide its business transformation efforts. Specifically, because of the complexity and long-term nature of business transformation, DOD needs a CMO with significant authority, experience, and a term that would provide sustained leadership and the time to integrate its overall business transformation efforts. Without formally designating responsibility and accountability for results, reconciling competing priorities among various organizations and prioritizing investments will be difficult and could impede the department's progress in addressing deficiencies in key business areas.

Furthermore, a broad-based consensus exists among GAO and others that the status quo is unacceptable and that DOD needs a full-time and term-based senior management official to provide focused and sustained

[15]See for example GAO-07-1072, GAO-07-310, GAO-07-229T, and GAO-06-1006T.

leadership for its overall business transformation efforts, although differing views exist concerning the specifics of the position, such as term limit and the level of the position within the department. Congress directed DOD to commission studies of the feasibility and advisability of establishing a deputy secretary of defense for management to oversee the department's business transformation process. As part of this effort, the Defense Business Board and the Institute for Defense Analyses both supported the need for a senior executive to be responsible for DOD's overall business transformation efforts.[16] Additionally, this matter is now before Congress as it prepares to deliberate on pending legislation that calls for statutorily establishing a CMO at DOD. Both the current House and Senate versions of the Fiscal Year 2008 Defense Authorization legislation contain provisions for assigning responsibility for DOD's business transformation efforts to a senior-level position within the department, although the versions differ in certain details. The Senate version calls for the Deputy Secretary of Defense to take on the additional duties of the CMO position while also establishing a Deputy CMO position at the Executive Level III; the House version would require the Secretary of Defense to assign CMO duties to a senior official at or above the under secretary level.

DOD has recently taken action on the issue of establishing a CMO position at DOD; however, we believe this action does not go far enough to change the status quo and ensure sustainable success. We recognize the commitment and elevated attention that the Deputy Secretary of Defense and other senior leaders have clearly shown in addressing deficiencies in the department's business operations. For example, the Deputy Secretary has overseen the creation of various business-related entities, such as the Defense Business Systems Management Committee and the Business Transformation Agency, and has been closely involved in monthly meetings of both the Defense Business Systems Management Committee and the Deputy's Advisory Working Group, a group that provides departmentwide strategic direction on various issues. Most recently, DOD issued a directive on September 18, 2007, that assigned CMO responsibilities to the current Deputy Secretary of Defense.[17] In our view, subsuming the duties within the responsibilities of the individual currently

[16]Defense Business Board, *Governance-Alignment and Configuration of Business Activities Task Group Report* (Washington, D.C.: May 31, 2006) and Institute for Defense Analyses, *Does DOD Need a Chief Management Officer?* (Alexandria, Va.: Dec. 2006).

[17]DOD Directive 5105.02, *Deputy Secretary of Defense* (Sept. 18, 2007).

serving as the Deputy Secretary represents the status quo and will not provide full-time attention or continuity as administrations change. While the Deputy Secretary may be at the right level, the substantial demands of the position make it exceedingly difficult for the incumbent to maintain the focus, oversight, and momentum needed to resolve business operational weaknesses, including the high-risk areas. Furthermore, the assignment of CMO duties to an individual with a limited term in the position does not ensure continuity of effort or that sustained success will be ensured both within and across administrations.

In the interest of the department and the American taxpayers, we maintain that the department needs a separate, full-time CMO position over the long term in order to devote the needed focus and continuity of effort to transform its key business operations and avoid billions more in waste each year. Therefore, we continue to believe that the CMO position at DOD should be:

- Codified in statute as a separate and full-time position. The CMO should be a separate position from the Deputy Secretary of Defense in order to provide full-time attention to business transformation. The CMO would be responsible and accountable for planning, integrating, and executing DOD's overall business transformation effort. The CMO also would develop and implement a strategic plan for overall business transformation. It should become a permanent position to ensure continuity of business transformation efforts, with the specific duties authorized in statute.

- Designated as an Executive Level II appointment. The CMO should be at Executive Level II and report directly to the Secretary of Defense so that the individual in this position has the stature needed to successfully address integration challenges, adjudicate disputes, and monitor progress on overall business transformation across defense organizations.

- Subject to an extended term appointment. The CMO's appointment could span administrations to ensure transformation efforts are sustained across administrations. Because business transformation is a long-term and complex process, a term of at least 5 to 7 years is recommended to provide sustained leadership and accountability.

In the absence of a CMO with these characteristics to focus solely on the integration and execution of business transformation efforts, and an enterprisewide plan to guide these efforts, it is highly unlikely that DOD will ever resolve its pervasive weaknesses and get the most out of every

dollar it invests in these times of growing fiscal constraint to better support the warfighter. Transforming DOD's business operations is an absolute necessity in the context of an increasingly demanding security environment and the pressures of our nation's long-term fiscal outlook. Further, the current deployment of tens of thousands of servicemembers, civilians, and contractor personnel to support ongoing operations provides an even greater sense of urgency for the department to aggressively address weaknesses in its business operations and achieve transformation goals in the near and long term.

DOD-Specific High-Risk Areas Highlight the Need for Further Change and Transformation in the Department

I would like to discuss the remaining seven programs and activities within DOD that have been designated as high risk. Some of these areas have remained on the high-risk list for nearly 20 years and have continued to be a challenge for DOD, while others have newly emerged as a challenge for the department in more recent years. The remaining high-risk areas include DOD's financial management, business systems modernization, personnel security clearance program, support infrastructure management, supply chain management, weapon systems acquisition, and contract management. Each area was added to our high-risk list due to weaknesses that make DOD more vulnerable to waste, fraud, and abuse. DOD has made progress in addressing each of these areas, but serious challenges remain that will require continued attention and sustained leadership over a number of years to achieve success.

DOD Financial Management

DOD's pervasive financial and related business management and system deficiencies adversely affect its ability to assess resource requirements; control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; prevent and detect fraud, waste, and abuse; and address pressing management issues. Therefore, we first designated DOD financial management as high risk in 1995.

A major component of DOD's business transformation effort is the defense Financial Improvement and Audit Readiness (FIAR) Plan, initially issued in December 2005 and updated periodically pursuant to section 376 of the National Defense Authorization Act for Fiscal Year 2006.[18] Section 376 limited DOD's ability to obligate or expend funds for fiscal year 2006 on

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

financial improvement activities until the department submitted a comprehensive and integrated financial management improvement plan to the congressional defense committees. Section 376 required the plan to (1) describe 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 tie these actions to process and control improvements and business systems modernization efforts described in the business enterprise architecture and transition plan. The John Warner National Defense Authorization Act for Fiscal Year 2007 continued to limit DOD's ability to obligate or expend funds for financial management improvement activities until the Secretary of Defense submits a determination to the committees that the activities are consistent with the plans required by section 376.[19]

DOD intends the FIAR Plan to provide DOD components with a framework for resolving problems affecting the accuracy, reliability, and timeliness of financial information, and obtaining clean financial statement audit opinions. In its June 2007 FIAR Plan update, DOD introduced a change in its audit strategy in which it moved from a line item approach to a segment approach for addressing its financial management weaknesses and achieving auditability. According to the limited information provided in the June update, DOD has loosely defined a segment as a business process (Civilian Pay), financial statement line item (Cash and Other Monetary Assets), group of related financial statement line items (Fund Balance with Treasury, Accounts Payable, and Accounts Receivable), or a sub-line (Military Equipment). According to DOD officials, the FIAR Plan and the enterprise transition plan are key efforts in improving financial information for decision makers and obtaining unqualified (clean) audit opinions on their annual financial statements. According to the DOD FIAR Director, the September 2007 FIAR Plan update, which the department intends to release by mid-October 2007, and the March 2008 update of the FIAR Plan, are expected to provide more details on DOD's new audit strategy and respective changes in its business rules and oversight process for ensuring that its goals are achieved. We cannot comment on specific changes in DOD's audit strategy until we have had an opportunity to review these more substantive updates of the FIAR Plan.

We will continue to monitor DOD's efforts to transform its business operations and address its financial management deficiencies as part of

[19]Pub. L. No. 109-364, § 321, 120 Stat. 2083 (2006).

our continuing DOD business enterprise architecture work and our oversight of DOD's financial statement audit.

Furthermore, the department invests billions of dollars annually to operate, maintain, and modernize its over 2,900 business systems, including financial management systems. Despite this significant investment, the department is severely challenged in implementing business systems on time, within budget, and with the promised capability. As previously reported,[20] many of the department's business systems are nonintegrated, stovepiped, and not capable of providing department management and Congress with accurate and reliable information on DOD's day-to-day operations. Effective process improvement and information technology investment 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 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.

DOD Business Systems Modernization

DOD is still not where it needs to be in managing its departmentwide business systems modernization. Until DOD fully defines and consistently implements the full range of business systems modernization management controls (institutional and program-specific), it will be not be positioned to effectively and efficiently ensure that its business systems and information technology services investments are the right solutions for addressing its business needs, that they are being managed to produce expected capabilities efficiently and cost effectively, and that business stakeholders are satisfied.

For decades, DOD has been challenged in modernizing the thousands of timeworn business systems. We designated DOD's business systems modernization program as high risk in 1995. Since then, we have made

[20]GAO-06-1006T and GAO-07-229T.

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

scores of recommendations aimed at strengthening DOD's institutional approach to modernizing its business systems, and reducing the risks associated with key business system investments. In addition, in recent legislation, Congress included provisions that are consistent with our recommendations, such as in the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005. In response, the department has taken, or is taking, actions to implement both our recommendations and the legislative requirements, and as a result has made progress in establishing corporate management controls, such as its evolving business enterprise architecture (BEA), corporate investment management structures and processes, increased business system life-cycle management discipline on its largest business system investments, and leveraging highly skilled staff on its largest business system investments.

However, much more remains to be accomplished to address this high-risk area, particularly with respect to ensuring that effective corporate approaches and controls are extended to and employed within each of DOD's component organizations (military departments and defense agencies). To this end, our recent work has highlighted challenges that the department still faces in "federating" (i.e., extending) its corporate BEA to its component organizations' architectures, as well as in establishing institutional structures and processes for selecting, controlling, and evaluating business systems investments within each component organization. Beyond this, making sure that effective system acquisition management controls are actually implemented on each and every business system investment also remains a formidable challenge, as our recent reports on management weaknesses associated with individual programs have disclosed.[22] Among other things, these reports have identified program-level weaknesses relative to architecture alignment, economic justification, and performance management.

[22]See for example, GAO-07-860; *DOD Needs to Ensure That Navy Marine Corps Intranet Program Is Meeting Goals and Satisfying Customers*, GAO-07-51 (Washington, D.C.: Dec. 8, 2006); *Defense Travel System: Reported Savings Questionable and Implementation Challenges Remain*, GAO-06-980 (Washington, D.C.: Sept. 26, 2006); *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); and *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).

More specifically, we recently reported[23] that DOD has continued to take steps to comply with legislative requirements and related guidance pertaining to its business systems modernization high-risk area, and that these steps addressed several of the missing elements that we previously identified relative to, for example, its BEA, enterprise transition plan, business system investment management, and business systems budgetary disclosure. However, we reported that additional steps were still needed to fully comply with legislative requirements and relevant guidance.

- The latest version of the BEA does a good job of defining DOD-wide corporate policies, capabilities, rules, and standards, which are essential to meeting the act's requirements. However, this version had yet to be augmented by the DOD component organizations' subsidiary architectures, which are also necessary to meeting statutory requirements and the department's goal of having a federated family of architectures. Compounding this are our reports showing the military departments' architecture programs were not mature and the strategy that the department had developed for federating its BEA needed more definition to be executable.[24] To address these limitations, we made recommendations aimed at ensuring that DOD's federated BEA provides a more sufficient frame of reference to optimally guide and constrain DOD-wide system investments. DOD agreed with these recommendations and has since taken some actions, such as developing an updated draft of its federation strategy, which according to DOD officials, addresses our recommendations but has yet to be released.

- The March 2007 enterprise transition plan continued to identify more systems and initiatives that are to fill business capability gaps and address DOD-wide and component business priorities, and it continues to provide a range of information for each system and initiative in the plan (e.g., budget information, performance metrics, and milestones). However, this version still does not include system investment information for all the defense agencies and combatant commands. Moreover, the plan does not sequence the planned investments based on a range of relevant factors,

[23]GAO, *DOD Business Systems Modernization: Progress Continues to Be Made in Establishing Corporate Management Controls, but Further Steps Are Needed*, GAO-07-733 (Washington, D.C.: May 14, 2007).

[24]GAO, *Business Systems Modernization: Strategy for Evolving DOD's Business Enterprise Architecture Offers a Conceptual Approach, but Execution Details Are Needed*, GAO-07-451 (Washington, D.C.: Apr. 16, 2007); and *Enterprise Architecture: Leadership Remains Key to Establishing and Leveraging Architectures for Organizational Transformation*, GAO-06-831 (Washington, D.C.: Aug. 14, 2006).

such as technology opportunities, marketplace trends, institutional system development and acquisition capabilities, legacy and new system dependencies and life expectancies, and the projected value of competing investments. According to DOD officials, they intend to address such limitations in future versions of the transition plan as part of their plans for addressing our prior recommendations.[25] DOD recently released its September 2007 version of the plan which, according to DOD, continues to provide time-phased milestones, performance metrics, and statement of resource needs for new and existing systems that are part of the BEA and component architectures, and includes a schedule for terminating old systems and replacing them with newer, improved enterprise solutions. We have yet to review the updated transition plan.

- The department has established and has begun to implement legislatively directed investment review structures and processes.[26] However, it has yet to do so in a manner that is fully consistent with relevant guidance.[27] Specifically, the department has yet to fully define a range of policies and procedures needed to effectively execute both project-level and portfolio-based information technology investment management practices. For example, while DOD has established an enterprisewide information technology investment board that is responsible for defining and implementing its business systems investment governance process, it has not fully defined the policies and procedures needed for oversight of and visibility into operations and maintenance-focused investments. Accordingly, we made recommendations aimed at improving the department's ability to better manage the billions of dollars it invests annually in its business systems. DOD largely agreed with these recommendations and has since undertaken several initiatives to strengthen business system investment management. For example, it has drafted and intends to shortly begin implementing a new Business Capability Lifecycle approach that is intended to consolidate management of business system requirements, acquisition, and compliance with architecture disciplines into a single governance process. Further, it has established an Enterprise Integration directorate in the Business Transformation Agency to support the implementation of Enterprise

[25]See GAO-07-733.

[26]Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. No. 108-375, § 332 (2004) (codified in part at 10 U.S.C. § 2222).

[27]GAO, *Business Systems Modernization: DOD Needs to Fully Define Policies and Procedures for Institutionally Managing Investments*, GAO-07-538 (Washington, D.C.: May 11, 2007).

Resource Planning systems by ensuring that best practices are leveraged and BEA-related business rules and standards are adopted.

- The department has continued to review and approve business systems as directed in legislation. As of March 2007, the department reported that its senior investment review body had approved 285 such systems. However, the military departments reported that their review and approval processes were still evolving and that additional work was needed for them to mature. Because of the importance of the military departments' investment management structures and processes, we have ongoing work to determine their maturity.

Beyond having a well-defined federated architecture for the business mission area and business systems investment management policies and procedures across the department, the more formidable challenge facing DOD is how well it can implement these and other acquisition management controls for each and every business system investment and information technology services outsourcing program. In this regard, we have continued to identify program-specific weaknesses.

Most recently, for example, we reported that the Army's approach for investing about $5 billion over the next several years in its General Fund Enterprise Business System, Global Combat Support System-Army Field/Tactical,[28] and Logistics Modernization Program did not include alignment with Army enterprise architecture or use of a portfolio-based business system investment review process. [29] Moreover, we reported that the Army did not have reliable processes, such as an independent verification and validation function, or analyses, such as economic analyses, to support its management of these programs. We concluded that until the Army adopts a business system investment management approach that provides for reviewing groups of systems and making enterprise decisions on how these groups will collectively interoperate to provide a desired capability, it runs the risk of investing significant resources in business systems that do not provide the desired functionality and efficiency.

We also reported that the Navy's approach for investing in both system and information technology services, such as the Naval Tactical Command

[28]Field/tactical refers to Army units that are deployable to locations around the world, such as Iraq or Afghanistan.

[29]GAO-07-860.

Support System (NTCSS)[30] and Navy Marine Corps Intranet (NMCI),[31] did not include effective program performance management. For NTCSS, we reported that, for example, earned value management, which is a means for determining and disclosing actual performance against budget and schedule estimates, and revising estimates based on performance to date, had not been implemented effectively. We also reported that complete and current reporting of NTCSS progress and problems in meeting cost, schedule, and performance goals had not occurred, leaving oversight entities without the information needed to mitigate risks, address problems, and take corrective action. We concluded that without this information, the Navy cannot determine whether NTCSS, as it was defined and was being developed, was the right solution to meet its strategic business and technological needs. For NMCI, we reported that performance management practices, to include measurement of progress against strategic program goals and reporting to key decision makers on performance against strategic goals and other important program aspects, such as examining service-level agreement satisfaction from multiple vantage points and ensuring customer satisfaction, had not been adequate. We concluded that without a full and accurate picture of program performance, the risk of inadequately informing important NMCI investment management decisions was increased.

DOD Personnel Security Clearance Program

We first designated DOD's personnel security clearance program as a high-risk area in January 2005. The designation followed about 20 years of our reports documenting delays in determining clearance eligibility and other clearance-related challenges. The type of information accessed by individuals with clearances and the scope of DOD's clearance program are two factors to consider in understanding the risk present in this area. For example, personnel with clearances can gain access to classified information that could cause damage to U.S. national defense and foreign relations through unauthorized disclosure. In our 1999 report, we noted that the damage had included intelligence personnel being killed, critical information being compromised, and U.S. military forces being put at risk.[32] Furthermore, problems with DOD's program have effects outside of

[30]GAO-06-215.

[31]GAO-07-51.

[32]GAO, *DOD Personnel: Inadequate Personnel Security Investigations Pose National Security Risks*, GAO/NSIAD-00-12 (Washington, D.C.: Oct. 27, 1999).

the department. DOD is responsible for about 2.5 million security clearances issued to servicemembers, DOD civilians, and industry personnel who work on contracts for DOD and 23 other federal agencies.

Our reports have documented a wide variety of problems present in DOD's clearance program. Some of the problems that we noted in our 2007 high-risk report included (1) DOD's consistently inaccurate projections of clearance requests and their negative effects on workload planning and funding, (2) incomplete and delayed investigative reports from the Office of Personnel Management (OPM)—DOD's primary provider of clearance investigations, and (3) DOD personnel (namely, adjudicators) granting clearance eligibility despite data missing from the investigative reports used to make such determinations. While some of those findings were reported on data which are now over 1 ½ years old, our May 2007 testimony noted that problems continue to exist such as OPM not fully counting all of days required for investigations and limited information being provided to Congress on reinvestigations for clearance updating. Delays in determining initial clearance eligibility can increase the cost of performing classified work, and delays in updating clearances may increase the risk to national security. Additionally, incomplete investigative or adjudicative reports could undermine governmentwide efforts to achieve clearance reciprocity (e.g., an agency accepting a clearance awarded by another agency).

High-level attention has been focused on improving the personnel security clearance processes in DOD and governmentwide. Since June 2005, the Office of Management and Budget's (OMB) Deputy Director of Management has been responsible for improving the governmentwide processes. During that time, OMB has overseen, among other things, the issuance of reciprocity standards, the growth of OPM's investigative workforce, and greater use of OPM's automated clearance-application system. An August 9, 2007, memorandum from the Deputy Secretary of Defense indicates that DOD's clearance program is drawing attention at the highest levels of the department. Specifically, streamlining security clearance processes is one of the 25 DOD transformation priorities identified in the memorandum. Another indication of high-level involvement in addressing clearance problems is a memorandum of agreement that seeks to develop, in phases, a reformed DOD and intelligence community security clearance process that allows granting high-assurance security clearances in the least time at the lowest reasonable cost. While the Office of Director of National Intelligence and the Office of the Under Secretary of Defense posted a request for information on the Federal Business Opportunities' website for August 7

through September 4, 2007, the request indicated that they plan to deliver "a transformed, modernized, and reciprocal security clearance process that is universally applicable" to DOD, the intelligence community, and other U.S. government agencies no later than December 31, 2008.

DOD Support Infrastructure Management

Since 1997, we have identified DOD's management of its support infrastructure as a high-risk area because infrastructure costs continue to consume a larger than necessary portion of its budget. We have frequently reported in recent years on the long-term challenges DOD faces in managing its portfolio of facilities, halting the degradation of facilities, and reducing unneeded infrastructure to free up funds to better maintain enduring facilities and meet other needs. DOD officials have likewise been concerned for several years that much of the department's infrastructure is outdated, inadequately maintained, and that DOD has more infrastructure than needed, which affects its ability to devote more funds to weapon systems modernization and other needs the department deems critical. Inefficient management practices and outdated business processes also have contributed to the problem.

While DOD has made progress and expects to continue making improvements in its support infrastructure management, DOD officials recognize they must achieve greater efficiencies. To its credit, the department has continued to give high-level emphasis to reforming its support operations and infrastructure, including continued efforts to reduce excess infrastructure, promote transformation, and foster jointness through the base realignment and closure (BRAC) process. Also, DOD is updating its Defense Installations Strategic Plan to better address infrastructure issues, and has revised its installations readiness reporting to better measure facility conditions, established core real property inventory data requirements to better support the needs of real property asset management, and continued to modify its suite of analytical tools to better forecast funding requirements for the sustainment and restoration of facilities. It also has achieved efficiencies through demolishing unneeded buildings at military installations and privatizing military family housing.

Our work examining DOD's management of its facilities infrastructure shows that much work remains for DOD to fully rationalize and transform its support infrastructure to improve operations, achieve efficiencies, and allow it to concentrate its resources on the most critical needs. For example, we have reported that the cleanup of environmental contamination on unneeded property resulting from prior BRAC rounds

has been a key impediment to the transfer of these properties and could be an issue in the transfer and reuse of unneeded property resulting from the 2005 BRAC round.[33] Impediments to transfer continue to be related primarily to a variety of interrelated environmental cleanup issues, including limited technology to address unexploded ordnance and protracted negotiations on compliance with environmental regulations. We have also recently reported that projected savings from past BRAC rounds have been significantly overstated.[34] During recent visits to installations in the United States and overseas, service officials continue to report inadequate funding to provide base operations support and maintain their facilities. They express concern that unless this is addressed, future upkeep and repair of many new facilities to be constructed as a result of BRAC, overseas rebasing, and the Army's move to the modular brigade structure will suffer and the facilities' condition and base services will deteriorate. We have also found that DOD's outline of its strategic plan for addressing this high-risk area had a number of weaknesses and warranted further clarification and specification. For example, DOD's outline does not identify DOD's short- and long-term goals or the desired end state for its facilities infrastructure—information critical for a meaningful plan. Instead, the outline focuses on completing administrative actions and producing paper products, and it does not describe how the completion of these actions and products will directly affect DOD infrastructure, including major support functions, and ultimately meet DOD's short- and long-term goals. We will continue to meet with OMB and DOD officials to discuss the department's efforts in addressing this high-risk area.

Through future work examining DOD's strategic plan for this area and through our monitoring of DOD base realignment and closures, overseas rebasing, and the sustainment and operations of military installations and facilities, we will be able to determine what other work needs to be done to assist DOD in its efforts to improve the management of its support infrastructure. As demands on the military continue to change and increase, organizations throughout DOD will need to continue

[33]GAO, *Military Base Closures: Opportunities Exist to Improve Environmental Cleanup Cost Reporting and to Expedite Transfer of Unneeded Property*, GAO-07-166 (Washington, D.C.: Jan. 30, 2007).

[34]GAO, *Military Base Closures: Projected Savings from Fleet Readiness Centers Likely Overstated and Actions Needed to Track Actual Savings and Overcome Certain Challenges*, GAO-07-304 (Washington, D.C.: June 29, 2007).

reengineering their business processes and striving for greater operational effectiveness and efficiency. Having a comprehensive, long-range plan for its infrastructure that addresses facility requirements, recapitalization, and maintenance and repair will help DOD provide adequate resources to meet these requirements and improve facility conditions and base services.

DOD Supply Chain Management

The availability of spare parts and other critical supply items that are procured and delivered through DOD's supply chain network affects the readiness and capabilities of U.S. military forces, and can affect the success of a mission. Moreover, the investment of resources in the supply chain is substantial, amounting to more than $150 billion a year according to DOD, and supply inventory levels have grown by 35 percent from $63.3 billion in fiscal year 2001 to $85.6 billion in fiscal year 2006. While DOD has taken a number of positive steps toward improving its supply chain management, it has continued to experience weaknesses in its ability to provide efficient and effective supply support to the warfighter. Consequently, the department has been unable to consistently meet its goal of delivering the "right items to the right place at the right time" to support the deployment and sustainment of military forces. As a result of weaknesses in DOD's management of supply inventories and responsiveness to warfighter requirements, supply chain management has been on our high-risk list since 1990. Our prior work over the last several years has identified three focus areas that are critical to resolving supply chain management problems: requirements forecasting, asset visibility, and materiel distribution.

Beginning in 2005, DOD developed a plan to address long-term systemic weaknesses in supply chain management. Since the January 2007 update of the high-risk series, DOD has made progress in developing and implementing supply chain management improvement initiatives in its supply chain management plan. However, the long-term time frames for many of these initiatives present challenges to the department in sustaining progress toward substantially completing their implementation. The plan also lacks outcome-focused performance measures for many individual initiatives as well as its three focus areas: requirements forecasting, asset visibility, and materiel distribution. Together, these weaknesses limit DOD's ability to fully demonstrate the results it hopes to achieve through its plan.

Our recent work has also identified problems related to the three focus areas in DOD's plan. In the requirements area, for example, the military services are experiencing difficulties estimating acquisition lead times to

acquire spare parts for equipment and weapon systems, hindering their ability to efficiently and effectively maintain spare parts inventories for military equipment. In March 2007, we reported that 44 percent of the services' lead time estimates varied either earlier or later than the actual lead times by at least 90 days. Overestimates and underestimates of acquisition lead time contribute to inefficient use of funds and potential shortages or excesses of spare parts. Challenges in the asset visibility area include the lack of interoperability among information technology systems, problems with container management, and inconsistent application of radio frequency identification technology, all of which make it difficult to obtain timely and accurate information on assets in theater. In the materiel distribution area, challenges remain in coordinating and consolidating distribution and supply support within a theater. Furthermore, we recently reviewed DOD's joint theater logistics initiative, which is aimed at improving the ability of a joint force commander to direct various logistics functions, including distribution and supply support activities. Our work raises concerns as to whether DOD can effectively implement this initiative without reexamining fundamental aspects of its logistics governance and strategy. In this respect, joint theater logistics may serve as a microcosm of some of the challenges DOD faces in resolving supply chain management problems.

DOD Weapon Systems Acquisition

For more than a decade, we have identified DOD's acquisition of major weapon systems as high risk. The weapon acquisitions process continues to produce systems that are the best in the world but cost more than first promised, take longer to field than first promised, and do less than first promised. Weapon acquisitions are demanding a larger share of the DOD budget at a time when the nation's fiscal imbalance is growing. DOD has doubled its planned investment in new weapon systems from approximately $750 billion in 2001 to almost $1.5 trillion in 2007. During the same period, the government's total liabilities and unfunded commitments have increased from about $20 trillion to about $50 trillion. In this context, DOD simply must maximize its return on investment to provide needed capabilities to the warfighter and to provide the best value to the taxpayer. We have found that knowledge at key decision points is critical in the development of new weapon systems if they are to meet their promised costs, schedules, and capabilities—in other words, using a knowledge-based approach to acquisitions. The link between knowledge and cost is real and predictable. It provides three choices for decision makers: (1) accept the status quo, (2) require demonstrations of high knowledge levels before approving individual programs, or (3) increase cost estimates to accurately reflect consequences of insufficient

knowledge. With over $880 billion remaining to invest in the current portfolio of major systems, the status quo is both unacceptable and unsustainable.

The inability to deliver new weapon systems at promised times and costs has significant consequences for both the taxpayer and the warfighter. When time and costs increase, quantities often decrease to compensate. The result is the warfighter gets less capability than planned and the taxpayer's dollar does not go as far. For example, table 2 depicts the following programs that experienced both cost increases and quantity decreases:

Table 2: Examples of Reduced Buying Power (constant 2007 dollars)

Programs	Initial estimate	Initial quantity	Latest estimate	Latest quantity	Percentage of unit cost increase
Future Combat Systems	$85.5 billion	15 systems	$131.7 billion	15 systems	54.1
V-22 Osprey Aircraft	$36.9 billion	913 aircraft	$50.0 billion	458 aircraft	170.2
Evolved Expendable Launch Vehicle	$16.0 billion	181 vehicles	$28.6 billion	138 vehicles	134.7
Expeditionary Fighting Vehicle	$8.4 billion	1,025 vehicles	$13.2 billion	593 vehicles	171

Source: GAO.

DOD knows what to do to achieve more successful outcomes but finds it difficult to apply the necessary discipline and controls or assign much-needed accountability. DOD has written into policy an approach that emphasizes attaining a certain level of knowledge at critical junctures before managers agree to invest more money in the next phase of weapon system development. This knowledge-based approach should result in evolutionary—that is incremental, manageable, and predictable—development and inserts several controls to help managers gauge progress in meeting cost, schedule, and performance goals. However, as we reported in our March 2007 report on selected DOD weapon systems, DOD has not been employing the knowledge-based approach, proceeds with lower levels of knowledge at critical junctures, and attains key elements of product knowledge later in development than specified in DOD policy. In particular, the department accepts high levels of technology risk at the start of major acquisition programs. DOD's acquisition community often

takes on responsibility for technology development and product development concurrently. Without mature technologies at the outset, a program will almost certainly incur cost and schedule problems. Without mature technologies, it is difficult to know whether the product being designed and produced will deliver the desired capabilities or, alternatively, if the design allows enough space for technology integration. Our work has shown that very few DOD programs start with mature technologies.

We continue to annually assess DOD's weapon system acquisition programs, and the breadth of our work gives us insights into a broad range of programs as well as the overall direction of weapon system acquisitions. In examining our defense work, we have observed 15 systemic acquisition challenges facing DOD—which we have included as appendix I to my statement. DOD is depending on the weapons currently under development to transform military operations for the 21st century. As we have recently reported, the complexity of DOD's transformational efforts is especially evident in the development of several megasystems or major weapon systems that depend on the integration of multiple systems—some of which are developed as separate programs—to achieve desired capabilities.[35] This strategy often requires interdependent programs to be developed concurrently and to be closely synchronized and managed, as they may, for example, depend on integrated architectures and common standards as a foundation for interoperability. If dependent systems are not available when needed, then a program could face cost increases, schedule delays, or reduced capabilities. Furthermore, the larger scope of development associated with these megasystems produces a much greater fiscal impact when cost and schedule estimates increase.

The current fiscal environment also presents challenges for DOD's plans to transform military operations. As the nation begins to address long-term fiscal imbalances, DOD is likely to encounter considerable pressure to reduce its investment in new weapons. Within DOD's own budget, investment in new weapon systems competes with funds needed to replace equipment and sustain military operations in Iraq and Afghanistan. The nation's long-term fiscal imbalances also will likely place pressure on DOD's planned investment in major weapon systems. As entitlement programs like Social Security, Medicare, and Medicaid consume a growing

[35]GAO, *Defense Acquisitions: Assessments of Selected Weapon Programs*, GAO-07-406SP (Washington, D.C.: Mar. 30, 2007).

percentage of available resources, discretionary programs—including defense—face competition for the increasingly scarce remaining funds. Sustaining real, top-line budget increases in any discretionary program will be difficult in this constrained resource environment. DOD budget projections conform to this tightening framework by offsetting growth in procurement spending with reductions in research and development, personnel, and other accounts. The minimal real increases projected in defense spending through fiscal year 2011 depend on these offsets. However, these projections do not reflect recent experience, nor do they take into account higher than anticipated cost growth and schedule delays, which can compound the fiscal impact and affordability of DOD's planned investment.

Program approvals in DOD have also shown a decided lack of restraint. DOD's requirements process generates more demand for new programs than fiscal resources can support. DOD compounds the problem by approving so many highly complex and interdependent programs. Once too many programs are approved, the budgeting process must broker trades to stay within realistic funding levels, Because programs are funded annually and departmentwide, cross-portfolio priorities have not been established, competition for funding continues over time, forcing programs to view success as the ability to secure the next funding increment rather than delivering capabilities when and as promised. DOD recognizes this dilemma and has embraced best practices in its policies, instilled more discipline in requirements setting, strengthened training for program managers, and reorganized offices that support and oversee programs. However, this intention has not been fully implemented and it has not had a material effect on weapon system programs. To translate policy into better programs, several additional elements are essential, including having a sound business case for each program that focuses on real needs and embodies best practices, sound business arrangements, and clear lines of responsibility and accountability.

DOD Contract Management

DOD's management of its contracts has been on our high-risk list since 1992. Our work has found that DOD is unable to ensure that it is using sound business practices to acquire the goods and services needed to meet warfighters' needs, creating unnecessary risks of paying higher prices than justified. DOD's long-standing problems with contract management have become more prominent as DOD's reliance on contractors to provide services continues to grow.

Recently, I have been quite vocal about the large and growing long-range structural deficits the federal government faces. Given this fiscal reality, it is imperative that DOD gets the best return it can on not only major weapon systems, but also on its investments in goods and services. In our recent testimony we noted that within the federal government, DOD is the largest purchaser of a variety of goods and services.[36] In fiscal year 2006 DOD spent about $297 billion, or 71 percent of the more than $400 billion spent by the federal government, on goods and services to equip and support the military forces, but is not able to ensure it is using sound business practices to acquire the goods and services needed to meet the warfighters' needs.

In November 2006, we reported that DOD's approach to managing service acquisitions has tended to be reactive and has not fully addressed the key factors for success at either the strategic or transactional level.[37] At the strategic level, DOD has yet to set the direction or vision for what it needs, determine how to go about meeting those needs, capture the knowledge to enable more informed decisions, or assess the resources it has to ensure departmentwide goals and objectives are achieved. Actions at the transactional level continue to focus primarily on awarding contracts and do not always ensure that user needs are translated into well-defined requirements or that postcontract award activities result in expected performance. In June 2007, we reported that DOD used time-and-materials contracts, one of the riskiest contract types for the government because they could be awarded quickly and labor hours or categories can be adjusted if requirements are unclear or funding uncertain.[38] Even though these contracts call for appropriate government monitoring of contractor performance, there were wide discrepancies in the rigor with which monitoring was performed and most of the contract files we reviewed did not include documented monitoring plans. DOD also used undefinitized contract actions (UCA) to rapidly fill urgent needs. While this is permitted in a variety of circumstances, we reported in June 2007 that DOD did not meet the definitization time frame requirement of 180 days after award on

[36]GAO, *Federal Acquisitions and Contracting: Systemic Challenges Need Attention*, GAO-07-1098T (Washington, D.C.: July 17, 2007).

[37]GAO, *Defense Acquisitions: Tailored Approach Needed to Improve Service Acquisition Outcomes*, GAO-07-20 (Washington, D.C.: Nov. 9, 2006).

[38]GAO, *Defense Contracting: Improved Insight and Controls Needed over DOD's Time-and-Materials Contracts*, GAO-07-273 (Washington, D.C.: June 29, 2007).

60 percent of the 77 UCAs we reviewed.[39] Since DOD tends to obligate the maximum amount of funding permitted—up to 50 percent of the not-to-exceed amount—immediately at award of UCAs, contractors may have little incentive to quickly submit proposals. Lack of timely negotiations contributed significantly to DOD's decision on how to address $221 million in questioned costs on the $2.5 billion Restore Iraqi Oil contract.[40] All 10 task orders for this contract were negotiated more than 180 days after the work commenced. As a result, the contractor had incurred almost all its costs at the time of negotiations, which influenced DOD's decision to pay nearly all of the questioned costs.

Additionally, DOD management and oversight of contractors continues to be problematic for two reasons: inadequate numbers of trained contract oversight personnel and second, insufficient training for those officials responsible for contract oversight.

On multiple occasions, we and others have reported on the challenges caused by DOD's lack of contract management and oversight personnel. For example, in our June 2004 report on Iraq contract award procedures, we found that inadequate acquisition workforce resources presented challenges to several agencies involved in Iraq reconstruction efforts and, at times, resulted in inadequate oversight of contractor activities.[41] Similarly, in 2004, we reported that administrative contracting officers from the Defense Contract Management Agency, who were responsible for monitoring the LOGCAP contract in Iraq, believe that they needed an increase in the number of qualified staff to fully meet their oversight mission.[42] In an April 2005 report, we found that DOD, faced with an urgent need for interrogation and other services in support of military operations in Iraq, turned to the Department of the Interior for contract assistance. However, numerous breakdowns occurred in the issuance and

[39]GAO, *Defense Contracting: Use of Undefinitized Contract Actions Understated and Definitization Time Frames Often Not Met*, GAO-07-559 (Washington. D.C.: June 19, 2007).

[40]GAO, *Defense Contract Management: DOD's Lack of Adherence to Key Contracting Principles on Iraq Oil Contracts Put Government Interests at Risk*, GAO-07-839 (Washington, D.C.: July 31, 2007).

[41]GAO, *Rebuilding Iraq: Fiscal year 2003 Contract Award Procedures and Management Challenges*, GAO-04-605 (Washington, D.C.: June 1, 2004).

[42]GAO, *Military Operations: DOD's Extensive Use of Logistics Support Contracts Requires Strengthened* Oversight, GAO-04-854 (Washington, D.C.: July 19, 2004).

administration of the orders for these services, including inadequate oversight of contractor performance.[43]

More recently, in December 2006 we reported that DOD does not have sufficient numbers of contractor oversight personnel at deployed locations, which limits its ability to obtain reasonable assurance that contractors are meeting contract requirements efficiently and effectively.[44] For example, an Army official acknowledged that the Army is struggling to find the capacity and expertise to provide the contracting support needed in Iraq. In addition, officials responsible for contracting with MNF-I stated that they did not have enough contract oversight personnel and quality assurance representatives to allow MNF-I to reduce the Army's use of the LOGCAP contract by awarding more sustainment contracts for base operations support in Iraq. Additionally, a Defense Contract Management Agency official responsible for overseeing the LOGCAP contractor's performance at 27 installations in Iraq told us he was unable to personally visit all 27 locations himself during his 6-month tour in Iraq. As a result, he was unable to determine the extent to which the contractor was meeting the contract's requirements at each of those 27 sites. Moreover, he only had one quality assurance representative to assist him. The official told us that in order to properly oversee this contract, he should have had at least three quality assurance representatives assisting him. The contracting officer's representative for an intelligence support contract in Iraq told us he was also unable to visit all of the locations that he was responsible for overseeing. At the locations he did visit he was able to work with the contractor to improve its efficiency. However, because he was not able to visit all of the locations at which the contractor provided services in Iraq, he was unable to duplicate those efficiencies at all of the locations in Iraq where the contractor provided support.

Since the mid-1990s, our work has shown the need for better pre-deployment training for military commanders and contract oversight personnel on the use of contractor support. Training is essential for military commanders because of their responsibility for identifying and validating requirements to be addressed by the contractor. In addition, commanders are responsible for evaluating the contractor's performance and ensuring the contract is used economically and efficiently. Similarly,

[43]GAO, *Interagency Contracting: Problems with DOD's and Interior's to Support Military Operations*, GAO-05-201 (Washington, D.C.: Apr. 29, 2005).

[44]GAO-07-145.

training is essential for DOD contract oversight personnel who monitor contractor performance for the contracting officer.

As we reported in 2003, military commanders and contract management and oversight personnel we met in the Balkans and throughout Southwest Asia frequently cited the need for better preparatory training.[45] Additionally, in our 2004 review of logistics support contracts, we reported that many individuals using logistics support contracts such as LOGCAP were unaware that they had any contract management or oversight roles.[46] Army customers stated that they knew nothing about LOGCAP before their deployment and that they had received no pre-deployment training on their roles and responsibilities in ensuring that the contract was used economically and efficiently. In July 2005 and again in June 2006, we reported that military units did not receive any training on private security contractors in Iraq and the military's roles and responsibilities regarding private security contractors.[47]

In our December 2006 report, we noted that many officials responsible for contract management and oversight in Iraq stated that they received little or no training on the use of contractors prior to their deployment, which led to confusion over their roles and responsibilities.[48] For example, in several instances, military commanders attempted to direct (or ran the risk of directing) a contractor to perform work even though commanders are not authorized to do so. Such cases can result in increased costs to the government.

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

[45]GAO, *Military Operations: Contractors Provide Vital Services to Deployed Forces but Are Not Adequately Addressed in DOD Plans*, GAO-03-695 (Washington, D.C.: June 24, 2003).

[46]GAO-04-854.

[47]GAO, *Rebuilding Iraq: Actions Needed to Improve the Use of Private Security Providers*, GAO-05-737 (Washington, D.C.: July 28, 2005) and *Rebuilding Iraq: Actions Still Needed to Improve the Use of Private Security Providers*, GAO-06-865T (Washington, D.C.: June 13, 2006).

[48]GAO-07-145.

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Appendix I: Systemic Acquisition Challenges at the Department of Defense

1. Service budgets are allocated largely according to top line historical percentages rather than Defense-wide strategic assessments and current and likely resource limitations.

2. Capabilities and requirements are based primarily on individual service wants versus collective Defense needs (i.e., based on current and expected future threats) that are both affordable and sustainable over time.

3. Defense consistently overpromises and underdelivers in connection with major weapons, information, and other systems (i.e., capabilities, costs, quantities, and schedule).

4. Defense often employs a "plug and pray approach" when costs escalate (i.e., divide total funding dollars by cost per copy, plug in the number that can be purchased, then pray that Congress will provide more funding to buy more quantities).

5. Congress sometimes forces the department to buy items (e.g., weapon systems) and provide services (e.g., additional health care for non-active beneficiaries, such as active duty members' dependents and military retirees and their dependents) that the department does not want and we cannot afford.

6. DOD tries to develop high-risk technologies after programs start instead of setting up funding, organizations, and processes to conduct high-risk technology development activities in low-cost environments, (i.e., technology development is not separated from product development). Program decisions to move into design and production are made without adequate standards or knowledge.

7. Program requirements are often set at unrealistic levels, then changed frequently as recognition sets in that they cannot be achieved. As a result, too much time passes, threats may change, or members of the user and acquisition communities may simply change their mind. The resulting program instability causes cost escalation, schedule delays, smaller quantities, and reduced contractor accountability.

8. Contracts, especially service contracts, often do not have definitive or realistic requirements at the outset in order to control costs and facilitate accountability.

9. Contracts typically do not accurately reflect the complexity of projects or appropriately allocate risk between the contractors and the taxpayers (e.g., cost plus, cancellation charges).

10. Key program staff rotate too frequently, thus promoting myopia and reducing accountability (i.e., tours based on time versus key milestones). Additionally, the revolving door between industry and the department presents potential conflicts of interest.

11. The acquisition workforce faces serious challenges (e.g., size, skills, knowledge, and succession planning).

12. Incentive and award fees are often paid based on contractor attitudes and efforts versus positive results (i.e., cost, quality, and schedule).

13. Inadequate oversight is being conducted by both the department and Congress, which results in little to no accountability for recurring and systemic problems.

14. Some individual program and funding decisions made within the department and by Congress serve to undercut sound policies.

15. Lack of a professional, term-based Chief Management Officer at the department serves to slow progress on defense transformation and reduce the chance of success in the acquisitions/contracting and other key business areas.

Testimony of

Mr. 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

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Mr. Chairman, Senator Coburn, Members of the Subcommittee, thank you for the opportunity to discuss the progress the Department has made in improving its business and financial management, and preparing the Department for independent audit.

We are always happy to bring the Committee up-to-date, and to clarify any questions you may have about the Department's modernization efforts.

Indeed, before I finish today, I hope to leave you with a better understanding of what I consider to be the three most important aspects of these issues: 1) The size and complexity of the challenge we face; 2) The progress the Department has made along a sound plan for success; and 3) DoD's strong commitment to wise stewardship of resources; sustained business and financial modernization, and solid leadership support.

First, the size and scope of the challenge. We often hear it asked – with some astonishment – how it can possibly be that the Department of Defense has never been independently audited.

While on its face, it seems like a simple question – and a relatively straightforward task – in an organization as large as the Department of Defense the task in anything but simple. So, I'd like to take just a moment to provide some perspective on the magnitude of the challenge we face, for without that it is impossible to appreciate the significance of the achievements that have been made.

For example, not only is the Department of Defense the largest department in federal government, it is the largest and most complex organization in the world. When compared to the world's largest corporations, the Department's annual budget is nearly twice the annual revenues of Wal-Mart. Our assets – three times the size of Wal-Mart, IBM and Exxon Mobil combined. And we are the largest entity in the world ever to be audited end-to-end.

The Department of Defense is also a global enterprise, with 600,000 buildings and structures in more than 5,000 locations and 163 countries around the globe. It has: 5,624 IT systems; 5.2 million inventory items, $3.4 trillion in Assets and Liabilities and, including the global war on terror, an annual operating budget of more than half a trillion dollars.

In the last year alone DoD processed over 145 million pay transactions and 14 million commercial invoices; paid out $424 billion in payroll; managed $21 billion in foreign military sales; and maintained 57 million general ledger accounts – which makes us the largest financial entity in the world.

We also tracked hundreds of DoD appropriations, and submitted more than 42,000 pages of budget justification to the Congress.

Now, before the Chief Financial Officers Act of 1990, the Department of Defense operated under a very simple system: We received appropriations from Congress, and tracked expenditures to ensure the proper execution of those funds. Business processes were slow; business operations, inefficient; and because systems that had evolved over decades were incompatible across the spectrum of agencies and Components, information was incomplete and untimely. The result: inaccurate inventories, material weaknesses, and an inability to obtain clean audit opinion.

So that's the first point. The Department of Defense is a huge enterprise that, for decades, utilized an outmoded collection of disparate systems incompatible with each other or the modern world. The second is the progress we are making along a sound path for success.

In 2005, a detailed plan was launched to modernize and transform DoD financial management and prepare the Department for audit. Today, that plan is producing measurable results: transforming the way we do business; improving processes and reducing costs; and making the Department more accountable.

To just cite a few examples of the way we are transforming the way we do business, today 94 percent of all commercial payments are processed electronically; overpayments and late penalties have been reduced; and more than $1.2 billion in overdue amounts have been recovered. And we are implementing a single standard financial language across the Department that will enable us to consistently manage costs, value assets, forecast future needs, develop historical trends, move toward performance-based budgeting, and make better trade-off decisions. Since 2001, just these few examples alone have saved the taxpayers nearly $1.3 billion.

And we continue to get even more efficient. For example, in FY 2006, DCAA audits on contracts valued at $346 billion saved the Department $2.3 billion – which works out to a savings of $5.20 for every DCAA dollar spent. This year, I just learned, DCAA audits on contracts valued at $358 billion have saved the Department $2.4 billion – or $5.30 for every DCAA dollar spent. That's a return on our investment of 530 percent.

As for making the Department more accountable, in 2001, only two entities in the Department [DFAS and the Military Retirement Fund] were auditable. Today, seven Defense entities – whose combined assets and liabilities comprise 15 percent of the Department's total assets and 49 percent of its total liabilities – have clean audit opinions.

How does that compare to the rest of the government? Well, together, the combined assets and liabilities of just those seven entities are larger than all the assets and liabilities of HHS – the largest federal department with a clean audit opinion. And by the end FY 2009, we expect that fully 39 percent of DoD assets and 90 percent of liabilities will have clean audit opinions.

So, 1) DoD is the largest and most complex organization in the world, and the largest entity ever to be audited end-to-end. 2) Thanks to a solid plan to completely transform decades of dysfunctional financial management, we will have gone from two auditable entities in 2001 to 90 percent of all liabilities and nearly 40 percent of all assets being auditable by the end of the next fiscal year. Which brings me to the third point I'd like to leave with you: We are committed to wise stewardship of resources, solid leadership support, and sustained modernization.

Every DoD official – from the Secretary of Defense, to agency heads, to military leaders – is committed to business and financial transformation. And because we have a solid plan in place that is producing clear, measurable results, that modernization will continue until the job is done and the Department fully auditable.

So, three points: 1) We are largest and most complex organization in the world; 2) We have a solid plan for success and it's working; and 3) We are committed to sustained modernization and

wise stewardship of resources that support, not the bureaucracy, but our mission, and the brave men and women who put their lives on the line every day to carry it out.

Mr. Chairman, thank you again for the opportunity to be with you today; I look forward to your questions.

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Mr. Paul A. Brinkley
Deputy Under Secretary of Defense
for Business Transformation

Before

THE UNITED STATES SENATE

COMMITTEE ON HOMELAND SECURITY

GOVERNMENT AFFAIRS (SUBCOMMITTEE ON

FEDERAL FINANCIAL MANAGEMENT)

October 16, 2007

Chairman Carper, Senator Coburn, Members of the Subcommittee, thank you for this opportunity to provide information on the progress and direction of Defense Business Transformation.

Our Nation faces diverse challenges and greater uncertainty about the future global security environment than ever before. The Department's mission requires that its business operations adapt to meet these challenges and react with precision and speed to support our Armed Forces. The Department is currently engaged in a massive effort to transform the way it does business and fulfill its commitment to the American people to deliver enhanced defense business capabilities effectively and efficiently.

Over the past few years, DoD has built the foundation for improving and modernizing its business operations by engaging its leadership through the establishment of the Defense Business System Management Committee (DBSMC) and Investment Review Board (IRB) structure, standing up the Business Transformation Agency (BTA), developing the Business Enterprise Architecture (BEA) and its associated Federation Strategy, adopting Continuous Process Improvement principles and implementing Lean Six Sigma methodologies, and by issuing the Enterprise Transition Plan (ETP). More broadly, the Department has focused on five key areas, which together, are critical to the successful execution of our business transformation endeavor: Strategy, Process, Culture, Information, and Technology. Using this framework over the past two and a half years, Gordon England has made business transformation a central focus of his tenure as Deputy Secretary of Defense, devoting extensive time and energy to the effort to improve the business operations of the Department. The Deputy Secretary's role in business transformation was recently codified in a September 18, 2007 directive, issued by the Secretary of Defense, ensuring that the Department's top leadership will continue to make business transformation a top priority. We have made significant progress in our efforts, and I would like to take this opportunity to review with you our major successes and recent accomplishments.

Chief Management Officer

I am pleased to announce that per a September 18, 2007 directive issued by the Secretary of Defense, Deputy Secretary of Defense Gordon England has been officially designated as DoD's Chief Management Officer (CMO). As Deputy Secretary, Secretary England has worked tirelessly to improve the Department's business operations. In many ways, Secretary England had been acting in the capacity of CMO throughout his tenure, most notably in his role as the Chair of the Deputy's Advisory Working Group (DAWG) and the Defense Business System Management Committee (DBSMC), the overarching governance board for the Department's business activities. The directive formally institutes into Department policy the Deputy Secretary's responsibilities as the CMO. As CMO, the Deputy Secretary shall: 1) ensure Department-wide capability to carry out the strategic plan of the DoD in support of national security objectives; 2) ensure the core business missions of the Department are optimally aligned to support the Department's warfighting mission; 3) establish performance goals and measures for improving and evaluating overall economy, efficiency and effectiveness and monitor and measure the progress of the Department; and 4) develop and maintain a Department-wide strategic plan for business reform. The official designation of the Deputy Secretary of Defense as the CMO affords the President and Secretary of Defense the necessary flexibility to implement an integrated management team that can quickly meet the changing requirements of business transformation and positively affect outcomes, while formally instituting accountability at the top levels of the Department for the future of our transformation activities.

Defense Business Systems Management Committee (DBSMC)

Since its inception in 2005, the DBSMC, in concert with the IRBs, has served as the governance structure that guides the transformation activities of the business areas of the Department, such as finance, acquisition, etc. As authorized by the FY05 National Defense Authorization Act and reiterated in the DBSMC Charter, the DBSMC has responsibility for

approving: business systems IT modernizations over $1M, the Business Enterprise Architecture (BEA), and the Enterprise Transition Plan (ETP). This gives the DBSMC oversight and control of the BMA's enabler to transformation – material solutions.

Additionally, the DBSMC Charter extends the authority of the DBSMC beyond statutory requirements to include responsibility for ensuring that the strategic direction of the Department's business operations are aligned with the rest of DoD and for measuring and reporting the progress of the BMA's transformation. The DBSMC has also been an integral driving force behind the Department's adoption of Continuous Process Improvement (CPI) / Lean Six Sigma (LSS) methodology and the Department's shared focus on Enterprise Resource Planning (ERP) strategy. The DBSMC has provided invaluable top level direction for the business transformation efforts of the Department.

Controlling/Managing Investments

The DBSMC/IRB investment review process provides a framework for effective investment decision-making that ensures alignment with the enterprise standards and focuses on the needs and priorities of the Warfighter.

The DBSMC has overseen the development and implementation of the Business Capability Lifecycle (BCL), which, when fully implemented, will serve as the acquisition process for all Major Automated Information Systems (MAIS) level systems. The BCL will help resolve long-standing challenges that have impacted the delivery of business capabilities in a timely, well-informed manner – fragmented governance and reporting, a need for better-defined requirements and more robust upfront solution analysis, and a need for continual access to comprehensive information to enhance visibility for all process stakeholders. Under BCL process rules, initial operational capability of a program must be reached within 12-18 months of the contract award or the business case will not be approved.

The DBSMC/IRB governance structure has produced significant improvement across a broad range of business systems, including two major enterprise-level programs – the Defense Travel System (DTS) and the Defense Integrated Military Human Resources System (DIMHRS). Based in large part on the significant upgrade performed this year to the reservation module within DTS, usage of the tool has increased dramatically. This year, there has been a ~75% increase in vouchers processed monthly basis over last year. The next phase of the program will add additional types of travel to the tool's capability, which will further increase usage. We are also preparing to make the use of DTS mandatory for all trip types that the tool has the capability to handle. Finally, we will more closely align DTS with the government-wide travel system, e-Travel, to capture government-wide travel data that can then be used to make more effective strategic sourcing decisions. Under the direct leadership of the DBSMC, the DIMHRS program has achieved effective governance to keep the program on track for initial operating capability for the Army by October, 2008.

Business Enterprise Architecture (BEA)

The BEA has allowed us to establish clear benchmarks for the alignment of business systems to the Department's future business environment. It has also allowed us to make important and measurable progress, as acknowledged by recent Government Accountability Office (GAO) reports.

As we continue to evolve the BEA, a key objective is to produce an architecture that can be harnessed as an executive decision-making mechanism while simultaneously supporting the implementation of information technology systems and services. The recently released *Concept of Operations for Business Enterprise Architecture (BEA) Requirements* addresses this objective by 1) outlining a further maturation of the Department's architecture development approach that addresses both top-down strategic requirements and bottom-up tactical requirements, and 2) expanding the governance process to encourage users and stakeholders to shape architecture form and content. This approach is already drawing from

new sources of requirements, better evaluating the priority of requirements, and providing improved governance for the BEA development cycle.

When BEA 5.0 is released in March 2008, it will help achieve interoperable, efficient, transparent business operations by including and integrating data standards, required business rules and system interface requirements for the enterprise systems and ERP target programs.

Defense Agencies Initiative (DAI)

The Defense Agencies Initiative (DAI) is a significant initiative within the Department's overall effort to modernize the Defense Agencies' financial management processes including streamlining financial management capabilities, eliminating material weaknesses, and achieving financial statement auditability for the Agencies and field activities across the DoD. The DAI implementation approach is to deploy a standardized system solution that effectively addresses the requirements in the Federal Financial Management Improvement Act (FFMIA), OMB Circular-A-127, and the BEA, by leveraging the out-of-the-box capabilities of the selected Commercial Off-the-Shelf product. The benefits of DAI include a single Financial System Integration Office certified solution[1]; common business processes and data standards; access to real-time financial data transactions; significantly reduced data reconciliation requirements; enhanced analysis and decision support capabilities; standardized line of accounting with the use of Standard Financial Information Structure (SFIS); and use of United States Standard General Ledger (USSGL) Chart of Accounts to resolve DoD material weaknesses and deficiencies.

Capitalizing on the business acumen of twenty-eight Defense Agencies and/or Field Activities, DAI will implement a compliant business solution with common business processes and data standards for the following business functions within budget execution requirements: procure to pay; order to fulfill; acquire to retire; budget to report; cost

accounting; grants accounting; time and attendance; and re-sales accounting. Each Defense Agency is committed to leveraging its resources and talents to build an integrated system that supports standardized processes and proves that the DoD is capable of using a single architecture and foundation to support multiple, diverse components.

Continuous Process Improvement (CPI) / Lean Six Sigma (LSS)

Lean Six Sigma (LSS) is an important part of the Department's Continuous Process Improvement (CPI) effort. A disciplined improvement methodology, LSS has been endorsed by DoD leadership as the means by which the Department will become more efficient in its operations and more effective in its support of the warfighter. By focusing on becoming a "lean" organization, the DoD will eliminate waste, improve quality and put its resources and capital to the best use in meeting the goals in the Enterprise Transition Plan. On April 30, 2007, the Deputy Secretary of Defense instructed the Office of the Deputy Under Secretary of Defense-Business Transformation to create a DoD CPI/LSS Program Office to drive DoD-wide CPI/LSS activities. We have worked with the Defense Acquisition University to create a Green Belt and Black Belt training infrastructure, are tracking training and project metrics from all OSD and Component organizations, and are in various stages on selected DoD-wide projects.

One of the most ambitious process improvement projects that has been undertaken to date is an end-to-end reform of the government-wide security clearance process. DoD is working in close cooperation with the Director of National Intelligence, the Office of Management and Budget, and the Office of Personnel Management on this effort. The interagency team has been charged with creating a new clearance process that is fair, flexible and adaptive, managed and highly automated end-to-end, reciprocal, and delivering timely, high-assurance security clearances at the lowest reasonable cost by December, 2008. The team has completed the first phase of its work.

Enterprise Transition Plan (ETP)

The ETP reflects the strategic and tactical partnership between the Enterprise- and Component- levels by providing a big picture view of defense business transformation efforts at every level within the business mission area. Two weeks ago we released the September 30, 2007 ETP, once again delivering on our commitment to Congress to update this plan every six months since its initial delivery in September 2005. With the publication of the September 2005 ETP, the Department, for the first time, provided its internal and external stakeholders a comprehensive view of the systems and initiatives that will transform the largest business entity in the world. The plan continues to mature and communicates our transformation plans, and provides senior management with a tool for monitoring progress against those plans. Significant milestones in the ETP are shown in 6, 12, and 18 month increments. For example, our most recent publication reflected success on over 83% of the Enterprise milestones detailed in the first version of the ETP. The ETP has also been expanded to include the progress of the Department's CPI/LSS efforts.

Accountability

While the DBSMC/IRB governance structure provides direction and oversight at the Enterprise-level, with participation from the Components, we would be remiss if we failed to acknowledge the dedication and commitment the Components have demonstrated in their own transformation. In partnership with the Components, the Department has taken major strides in business transformation at all levels. The Department has tried to create an environment in which each level of the DoD organizational structure, Component, Enterprise, or other, can focus on those requirements specific to their level, with oversight and assistance provided by the Office of Business Transformation and the Business Transformation Agency. This system of multi-layered accountability encompasses the broad area of policy setting; the detailed establishment of process and data standards; as well as the ultimate execution of business operations.

Business Transformation Agency Agile and Accountable Workforce

True transformation requires visionary leaders and an agile, collaborative and accountable workforce that embraces change and achieves results. In the span of less than two years, the BTA has gained a significant robust and organic capability to manage and oversee the Department's transformation efforts. In February 2006, the first permanent BTA Director was selected, providing a constancy of leadership and a focus for Enterprise wide decision making across the Department. And, using the Congressional special hiring authority for highly qualified experts (HQEs), BTA has created a complementary workforce composed of career civilians, term-appointed civilians, military members and contractors who have collectively contributed to our continuing progress in assuring standardization and mitigating the risk associated with large business systems implementations across the DoD. We appreciate Congress' recognition of the need to develop a multi-dimensional workforce and the continued support for hiring HQEs as an integral part of maintaining transformation momentum.

Working Relationship with the Government Accountability Office (GAO) and the Office of Management and Budget (OMB)

DoD regularly and proactively engages with GAO and OMB to communicate its progress and achievements in defense business transformation. GAO has acknowledged the Department's progress in several reports over the past two years and both organizations continue to be constructive partners in our overall transformation efforts. GAO's May report, entitled "DOD Business Systems Modernization: Progress Continues to Be Made in Establishing Corporate Management Controls but Further Steps are Needed" (GAO-07-733) was the most positive NDAA Compliance report the Department has received to date, and contained a single new recommendation and officially closed 10 others. GAO stated the following:

> Given the demonstrated commitment of DOD leadership to improving its business systems modernization efforts and its recent responsiveness to our prior recommendations, we are optimistic concerning the likelihood that the department will continue to make progress on these fronts.

The Department has also been in regular dialogue with OMB regarding a number of transformation initiatives. In both the effort to align DTS and e-Travel and the initiative to reform the Security Clearance process, described previously in this testimony, DoD and OMB are working closely together to bring increased capabilities to the entire Federal government. In other cases, OMB is helping DoD leverage lessons learned from similar initiatives across the Federal space.

We continue to welcome GAO and OMB's insight, as well as that of all our government partners, as we work together to accomplish our transformation priorities and achieve our shared goals.

Conclusion

We are pleased with our progress in our business transformation efforts and that this progress has been recognized by our oversight bodies. However, aligning the strategy, controls, people, processes, and technology to truly effect enterprise-wide change in an organization as large and complex as the Department of Defense is an enormous undertaking, which has also been recognized by GAO and OMB. The challenges that business transformation faces should not be underestimated. We believe though, that our persistent focus on accelerating the pace of change the Department will continue to make steady and significant progress, achieving tangible results and positive business outcomes.

We appreciate and value the support of Congress over the last several years as we have established new governance and discipline in our business transformation efforts. We are anxious to demonstrate that this support will reap benefits for both the taxpayers who fund our efforts and for the Warfighters who defend this nation. Mr. Chairman, we thank you and the members of the subcommittee for your continued support.

[1] The Financial Systems Integration Office was formerly known as the Joint Financial Management Improvement Program staff office. FSIO has responsibility for core financial systems requirements development, testing and product certification for the Executive Branch.

IMPROVING FINANCIAL AND BUSINESS MANAGEMENT AT THE DEPARTMENT OF DEFENSE

DOV S. ZAKHEIM

TESTIMONY BEFORE
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, FEDERAL SERVICES
AND INTERNATIONAL SECURITY
OF THE
THE SENATE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS

OCTOBER 16, 2007

Mr. Chairman, Senator Coburn, members of the subcommittee, it is a privilege to appear before you today to discuss ways to improve financial management in the Department of Defense. When I appeared in 2001 before the Senate Armed Services Committee at the hearing for my confirmation as Under Secretary of Defense, I assured the members of the committee that I considered my responsibility as the Department's Chief Financial Officer to be as important as that of Comptroller. I tried my best to carry out that promise and I hope that I did.

Financial management has traditionally been a backwater at the DOD, despite a trend toward greater transparency and accountability that began a quarter-century ago with the passage of the 1982 federal managers' financial integrity act—the first of its kind since 1950-- and that intensified with the 1990 chief financial officers' act. There are two major reasons why financial management has remained a challenge for the Department.

First, the Department's primary task is to support the military's mission—to fight and win the nation's wars. All other activities, and particularly activities that can be categorized as "back office," are subordinated to this essential task. Financial management falls into the category of "back office" activities. Human and material resources that are required to provide and sustain a level of accountability and transparency that would meet commercial standards inevitably are seen as coming at the expense of the need to organize, train and equip military forces. Needless to say, if seen as a direct competitor with military operations, financial management inevitably will lose out.

Second, while the Under Secretary of Defense (Comptroller) is also Chief Financial Officer, the CFO role historically has been subordinated to that of the comptroller. In the latter role, it is the Under Secretary of Defense's responsibility to formulate the Department's budget and secure its passage through the Congress. The latter activity is naturally critical to the ongoing functioning of the Department, whereas financial management is seen as an ancillary activity. As one of my predecessors put it to me just as I was about to take over as comptroller and CFO, "as long as you can get your budget submitted on time, you've done your job." He never even mentioned financial management.

It is noteworthy that this situation is exactly the reverse of that which obtains in the private sector. In most corporations, it is the comptroller who is subordinated to the CFO. Budget preparation is but one financial task, and hardly the most important, of most private firms. Far more important is how the money actually is spent and managed throughout the year—what DOD terms "budget execution." Yet until early in the first bush administration, the Defense Department's resource management

system did not even account for execution. It was termed planning, programming and budgeting, or ppb, as it had been since the days of Robert McNamara. The focus was on the "front end" of the system that is the formulation of requirements and their funding by the Congress. Only in 2002-2003 did the Department of Defense formally include execution as part of what is now the PPBE process.

The focus on the budget is a natural outgrowth of the Department's relationship with the Congress. Budget formulation, its presentation to the Congress, and its defense on Capitol Hill has become a year-round affair, primarily because of reliance on emergency supplemental budgets. Moreover, it is by means of the budget that the Congress exercises its control over the DOD program. In the private sector, shifting funds from one division to another is a routine matter. For DOD, those actions are strictly regulated by the armed services and appropriations committees (as well, as, in some cases, the intelligence committees). There are severe, and in my view, excessively low limits, on the re-programming of funds, and re-programmings of any significance require prior congressional approval, normally from the four defense-related committees. The combination of congressional practice and rules with the culture of a department whose top priority is warfighting poses a fundamental challenge to any effort to improve the Department's ability to improve upon the management of its finances and indeed, all of its business management operations.

Nevertheless, the last seven years have witnessed considerable progress in the financial management arena and of realizing the objectives that result from sound financial management. These objectives include not merely obtaining transparent financial statements and unqualified audit opinions, colloquially referred to as "clean audits." Equally important are the ability to track expenditures and program performance quickly, to redirect funds in the most efficient manner, and ultimately . To improve program management and program results.

In this regard, since 2001, the Department has made progress across a variety of fronts, whether in terms of cleaning up outstanding problem disbursements, providing more meaningful financial statements, improving business systems, or, more generally, transforming the DOD business enterprise. These developments are the direct result of both greater top level attention, beginning with a series of reforms initiated by Secretary Donald Rumsfeld, and, ironically in light of the restrictions I just mentioned, the bipartisan support of the Congress.

Permit me briefly to review some of these developments. Early in 2001, Secretary Rumsfeld asked Stephen Friedman, the former CEO of Goldman Sachs, to evaluate the current state of the DOD financial management system. Friedman's study conveyed a dismal picture, and recommended that both the comptroller, and, more importantly, the Secretary himself, devote time and attention to cleaning up the

financial mess. Throughout 2001 and into 2002, Secretary Rumsfeld issued a series of memoranda that empowered the comptroller to approve the acquisition of enterprise resource planning (erp) systems, to create a business board of outside experts, and, most importantly, to create a financial management modernization office. The mission of this office was to reduce and coordinate the vast number of overlapping, duplicative and non-interoperable business systems that made it impossible for management to have a top level view of business operations. To that end it undertook to develop a single financial management architecture that would link the disparate systems functioning throughout DOD.

Trial and error demonstrated that no single architecture could capture all of the Department's financial activities. Moreover, it became clear that since financial management itself accounted for but 20 per cent. of the Department's transactions, what was really needed was to transform the management of all of the Department's business, whether in terms of human, materiel, or financial resources.

As in other aspects of DOD activity, business transformation remains—and must remain—an ongoing effort. Nevertheless, the Department now has a functioning business transformation agency—the lineal descendant of the financial management modernization office—that affords a vehicle for centralized business reform. The Department now has an enterprise transition plan (etp) that describes a systematic approach for the transformation of business operations within the DOD. The original and unwieldy financial management architecture has evolved into focused business enterprise architecture.

Other developments have included the reduction of what in 1999 was $2.3 trillion worth of problem disbursements to less than 18 per cent. Of that amount, or just over $405 billion as of fiscal year 2006. Billons of dollars of both assets and liabilities have been added to financial statements, while several individual agencies have obtained unqualified—or "clean"—audits. Acquisition programs now review life cycle costs, including operations and maintenance costs, the so-called "tail" of any program, as a matter of course. Moreover, in fiscal year 2006, the Department for the first time managed to obtain an audit opinion for its department-wide financial statements and those of its nine reporting agencies. This represented a truly signal accomplishment. Finally, as I indicated earlier, the program process now accords equal importance to "e"—budget execution.

Of course the Department continues to face major hurdles well beyond those created by congressional limitations on execution management. Most DOD agencies still cannot obtain an unqualified audit. Financial statements still do not reveal all departmental activity. The Department needs to refine its top level "dashboard" metrics for managing its business.

Major acquisition programs still result in both delays and serious cost overruns. The Department still is forced to make decisions about both individual programs and programmatic trade-offs without having reliable and up-to-date performance and financial information indeed, it is arguable that our cumbersome acquisition process has not served our combat forces well as they prosecute their missions in Iraq, Afghanistan and elsewhere.

Transforming DOD's business and financial operations will remain a painstaking process. There is no quick fix, or panacea that can change the situation overnight. Beyond those actions already taken to improve the situation over that which prevailed in the 1990s, I would suggest the following—none of which are particularly original ideas.

First, the Congress should reconsider its reprogramming ceilings. These should be raised to 5 per cent. Of the baseline budget, so as to give the Department's financial managers the ability to execute budgets more efficiently. Congress would still retain prior approval, so as to satisfy its oversight role.

Second, the Department should ensure that the business transformation agency be led by a three-star general or flag officer, or the civilian equivalent, and that the agency report directly to the Department's Chief Management Officer, currently the Deputy Secretary of Defense. While I currently see no need for legislation to codify such a relationship, the Congress may need to consider it at some future time.

Third, the Department should increase the use of program performance data in the requirements process. Decisions taken at that early stage have an enormous impact on what will be fielded for our troops in the years ahead, how well those systems perform and how much they will cost the taxpayer.

Fourth, the Department needs to improve its ability to sort financial data in multiple ways, not just by budget account or service. The Department requires more accessible cost data by military base and by command.

Fifth, given the size of recent emergency supplementals, the Department needs to work even more closely with the Congress to continue improving the tracking and execution of supplemental funds.

Finally, the Department must have a Chief Management Officer, with the rank of Principal Under Secretary, who would hold office for a fixed term. I stated this view during my final appearance before the Congress as comptroller, when I sat

alongside comptroller general David Walker, with whom I agreed then and with whom I still agree. I recognize that the Department currently has a strong CMO; Deputy Secretary Gordon England, is, in my opinion, the most capable senior manager the Department has had in decades. But Secretary England's term expires with that of the Administration, and there is no guarantee that his successor will bring the same managerial background to the job, as, by the way, did Secretary Rumsfeld, who in many ways was his own CMO. Moreover, the post of CMO should be one that is for a fixed term, perhaps five years. Nevertheless he or she should serve at the pleasure of the Secretary and Deputy Secretary, to whom he/she would report.

Some argue that it will be exceedingly difficult to find a top manager willing to take the job. They point to the fact that the Congress has imposed increasingly onerous financial and reporting burdens on those who otherwise would be willing to serve the nation in a senior capacity. Clearly, the Congress will have to do its part. It will have to ease restrictions to the point that senior people would be prepared to leave industry to serve as CMO without, for example, putting their pensions at risk. Otherwise, the right people will never be available, and the CMO concept for DOD will remain just that, merely a concept.

Let me reiterate that I appreciate the opportunity to testify before this subcommittee, and I am prepared to respond to questions the members might put to me.

Thank you.