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**DEPARTMENT OF
DEFENSE**

**Progress in Financial
Management Reform**

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G A O

Accountability * Integrity * Reliability

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to discuss the status of financial management at the Department of Defense (DOD). This is the third year that we have participated in such a hearing before this Subcommittee, and we believe that your sustained commitment to financial management reform governmentwide and at DOD, in particular, has resulted in the steady improvement we have seen across government. At the same time, as we testified¹ before the Subcommittee on March 31, 2000, on the results of our review of the fiscal year 1999 *Financial Report of the U.S. Government*, significant financial systems weaknesses, problems with fundamental recordkeeping and financial reporting, incomplete documentation, and weak internal controls, including computer controls, continue to prevent the government from accurately reporting a significant portion of its assets, liabilities, and costs. Material financial management deficiencies identified at DOD, taken together, continue to represent the single largest obstacle that must be effectively addressed to achieve an unqualified opinion on the U.S. government's consolidated financial statements. DOD's vast operations—with an estimated \$1 trillion in assets, nearly \$1 trillion in reported liabilities and a reported net cost of operations of \$378 billion in fiscal year 1999—have a tremendous impact on the government's consolidated reporting.

To date, no major part of DOD has yet been able to pass the test of an independent audit; auditors consistently have issued disclaimers of opinion because of pervasive weaknesses in DOD's financial management systems, operations, and controls. Such problems led us in 1995 to put DOD financial management on our list of high-risk areas vulnerable to waste, fraud, abuse, and mismanagement, a designation that continued in last year's update.² Lacking such key controls and information not only hampers the department's ability to produce timely and accurate financial information, but also significantly impairs efforts to improve the economy and efficiency of its operations. Ineffective asset accountability and control adversely affect DOD's visibility over weapon systems and inventory, and unreliable cost and budget information affects DOD's ability to effectively measure performance, reduce costs, and maintain adequate funds control. We have worked closely and constructively with

¹*Auditing the Nation's Finances: Fiscal Year 1999 Results Continue to Highlight Major Issues Needing Resolution* (GAO/T-AIMD-00-137, Mar. 31, 2000).

²*High-Risk Series: An Overview* (GAO/HR-95-1, Feb. 1995), *High-Risk Series: Defense Financial Management* (GAO/HR-97-3, Feb. 1997), and *Major Management Challenges and Program Risks: A Governmentwide Perspective* (GAO/OCG-99-1, Jan. 1999).

the DOD Inspector General (IG) and the military service audit agencies to help provide further clarification of the scope and magnitude of the department's problems and recommendations to correct them.

DOD has made genuine progress in many areas throughout the department, both larger steps forward and smaller incremental improvements. We have seen a strong commitment by the DOD Comptroller and his counterparts in the military services to addressing long-standing, deeply rooted problems. For example, significant areas of improvement include (1) increased accountability over property, plant, and equipment, (2) more complete reporting of environmental and disposal liabilities, (3) increased understanding and documentation of the Fund Balance With Treasury reconciliation process, and (4) development of a detailed concept of operations included in the department's *Financial Management Improvement Plan*. At the same time, DOD has a long way to go. Major problems remain—problems that are pervasive, deeply rooted, and complex in nature. My testimony today outlines DOD's most difficult financial management challenges and describes the initiatives that are in place or planned to address many of them. These challenges include DOD's inability to

- properly account for and report (1) billions of dollars of inventory and property, plant, and equipment and (2) national defense assets, primarily weapon systems and support equipment;
- estimate and report material amounts of environmental and disposal liabilities and their related costs;
- determine the liability associated with post-retirement health benefits for military employees;
- accurately report the net costs of its operations and produce accurate budget data; and
- provide adequate controls over sensitive computer information.

DOD has hundreds of initiatives under way to address these key challenges, with many of the planned fixes designed to result in a one-time, year-end number for financial statement purposes. However, achieving an unqualified or "clean" financial audit opinion, while an important milestone, is not the final goal and must be accomplished through real improvements in the underlying financial management systems and operations that affect DOD's ability to manage its day-to-day activities effectively. The substantial efforts needed to work around DOD's serious systems and control weaknesses to derive year-end balances will

not produce the timely and reliable financial and performance information DOD needs to manage its operations every day.

To achieve what the Comptroller General has referred to as the “end game”—systems and processes that routinely generate good financial information for management purposes—will require a major systems and reengineering effort. In this regard, the lessons learned from DOD’s Year 2000 experience can prove to be a valuable teacher. Specifically, the successful Year 2000 effort demonstrated that DOD can resolve complex, entitywide problems through top management leadership working across functional lines. Similarly, our *Executive Guide: Creating Value Through World-class Financial Management*³ notes that building a sound financial management organization begins with leadership that clearly defines and communicates the organization’s mission and vision for the future. Finally, I will discuss actions DOD is taking to address training its personnel and the importance of having a strong human capital investment strategy.

Control and Accountability Over Assets Impaired

As discussed in our recent report on the fiscal year 1999 consolidated financial statements, the federal government—one of the world’s largest holders of physical assets—does not have accurate information about the amount of assets held to support its domestic and global operations. Material weaknesses in DOD’s ability to carry out its stewardship responsibilities over an estimated \$1 trillion in physical assets—ranging from enormous inventories of ammunition, stockpile materials, and other military items to buildings and facilities to multimillion dollar weapons systems—were a major factor in the federal government’s inability to account for and report on its assets. The following sections discuss DOD’s problems and ongoing improvement efforts in accounting for inventory and related property; property, plant, and equipment; and national defense assets.

Accountability Over Inventory and Related Property Remains a Concern

DOD inventory includes ammunition (such as machine gun cartridges, mines, and grenades), repairable items (such as navigational computers, landing gear, and hydraulic pumps), consumables (such as clothing, bolts, and medical supplies), and national defense stockpile materials (such as industrial diamonds, rubber, and beryllium). In its fiscal year 1999 financial statements, DOD reported \$128 billion in inventory and related property. The sheer volume of DOD’s on-hand inventories impedes the department’s efforts to accumulate and report accurate inventory data. We

³GAO/AIMD-00-134, Apr. 2000.

reported⁴ in our January 1999 high-risk report on defense inventory management that the department needs to avoid burdening its supply system with large unneeded inventories. For example, our analysis of DOD data as of September 30, 1999, showed that 58 percent of on-hand items, or an estimated \$36.9 billion of DOD's reported secondary inventory, exceeded requirements.

DOD's inability to account for and control its huge investment in inventories effectively has been an area of major concern for many years. Audit results for fiscal year 1999 again demonstrate that DOD does not know the actual amount and value of inventory for which it is responsible due to three critical deficiencies: (1) physical controls over inventory are inadequate, (2) DOD does not capture all inventories in its records, and (3) reported inventory values are questionable. DOD recognizes the seriousness of this problem and has a number of initiatives under way to address these issues, as well as several broad initiatives intended to simplify the complicated processes it currently uses to account for inventory.

Physical Controls Over Inventory

We, the DOD Inspector General, and the audit services have repeatedly reported on weak controls over DOD supply inventory. The Defense Logistics Agency's (DLA) distribution depots store approximately 75 percent of DOD's consumable and repairable items. DLA is responsible for conducting physical counts of inventory in its depots and measuring and ensuring inventory record accuracy. In June 1999, we reported on significant control weaknesses in DLA's inventory count process that affected the integrity of the physical counts and the reliability of the reported inventory record accuracy.⁵ Specifically, 14 DLA distribution depots we visited had reported accuracy rates below DLA's goal of 95 percent and error rates of up to 28 percent, with only 2 depots having accuracy rates above 90 percent. Similar weaknesses continue. During the fourth quarter of fiscal year 1999, only two of DLA's 20 distribution depots reported accuracy rates above 90 percent, and overall accuracy was reported at 83 percent, with error rates ranging from 6 percent to 28 percent.

DLA has a number of initiatives under way to address the inventory accuracy issue. For example, during 1999, DLA initiated the development of a statistical sampling plan to measure the dollar accuracy of DLA-

⁴ *Major Management Challenges and Program Risks: Department of Defense* (GAO/OCG-99-4, Jan. 1999).

⁵ *Financial Management: Better Controls Essential to Improve the Reliability of DOD's Depot Inventory Records* (GAO/AIMD-99-132, June 28, 1999).

owned inventory. DLA is working with us and the DOD audit community in the design, implementation, and execution of the plan. After refining the plan to address any problems encountered in applying this approach to valuing DLA inventories, DOD plans to expand the statistical sampling plan to include the valuation of the assets it stores for the military services. Further, section 347 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 requires the secretary of each military department to set up a schedule to implement best commercial inventory practices for secondary supply items by 2003. The statute defines commercial best practices as including those that will enable the military departments to reduce inventory levels while improving responsiveness to user needs. While not specifically initiated to address this new requirement, DLA's recent contract with the University of Arkansas to examine private sector business practices, including obtaining data on performing and controlling physical counts, should help the department identify and implement commercial best practices in this area.

Physical control weaknesses have also been reported for military service locations that hold inventory. For example, for fiscal years 1997 and 1998, Navy auditors reported 23 percent and 14 percent error rates, respectively, for the Supply Fund storage locations they visited. Because of these poor results and acknowledgment by Navy management that better results could not be expected for fiscal year 1999, Navy auditors limited their tests for the fiscal year 1999 audit. The Naval Audit Service performed limited physical inventory counts at nine selected non-Supply Fund locations to determine if internal controls were in place and functioning well enough to be relied upon to provide accurate and complete inventory records. Results at seven of the nine locations visited indicated that controls were not in place or were not functioning as designed. For example, three of the locations visited had error rates in excess of 10 percent.

Control weaknesses over inventory can lead to inaccurate reported balances, which could affect supply responsiveness and purchase decisions, and result in a loss of accountability. For example, during a December 1999 visit to one Army ammunition depot, we found weak internal controls over self-contained, ready-to-fire, handheld rockets, a sensitive item requiring strict controls and serial number accountability. As detailed in our recently issued report,⁶ we and depot personnel identified 835 quantity and location discrepancies associated with 3,272 rocket and launcher units contained in two storage igloos. The depot had more items on hand than shown in its records because of control

⁶*DOD Inventory: Weaknesses in Controls Over Category I Rockets* (GAO/AIMD-00-62R, Apr. 13, 2000).

weaknesses over receipt of items, and, in some cases, the records had location errors. Depot management responded immediately to our findings, and the depot subsequently accounted for and corrected the inventory records of all the rocket and launcher units. Regarding this problem, we identified potentially systemic weaknesses in controls and lack of compliance with federal accounting standards and inventory system requirements and made recommendations to the Army to establish and verify operating procedures to help ensure that systemic weaknesses are corrected.

Inventory Visibility

Over the years, we have reported billions of dollars of materials that were not “visible” to managers—that is, they were not captured in DOD’s central visibility records and therefore managers did not know they existed and could not ensure accountability. These kinds of omissions adversely affected the department’s financial reporting and its reporting to the Congress on inventory reductions. Further, the lack of complete visibility over inventories increases the risk that responsible inventory item managers may request funds to obtain additional, unnecessary items that may be on-hand but not reported. Recent audit results indicate that these problems continue. Examples of these visibility issues include the following.

- In recent years, we and the audit services have reported weak controls over inventory in transit. For example, the Air Force Audit Agency (AFAA) reported⁷ in 1998 that the Air Force did not accurately account for inventory items being shipped from one location to another and did not know the value of this inventory. In addition, the Army Audit Agency reported⁸ for fiscal year 1999 that the Army could not determine the value of in-transit inventory and that audit trails did not exist. We reported⁹ in 1999 that the Navy had not followed established internal control procedures to notify inventory managers of inventory shipments or receipts and instead had reported these items as lost during shipment. As a result, the Navy lost visibility of \$3 billion of in-transit inventory over the past 3 years. In our February 2000 follow-up report, we reported¹⁰ that the

⁷ *Compliance with Federal Financial Accounting Standards Numbers 1 and 3* (AFAA Project 97068017, Sept. 15, 1998).

⁸ *Army Working Capital Fund Principal Financial Statements for Fiscal Year 1999: Auditors Report* (Army Audit Agency Report No. AA-00-177, Feb. 10, 2000).

⁹ *Defense Inventory: Navy’s Procedures for Controlling In-Transit Items Are Not Being Followed* (GAO/NSIAD-99-61, Mar. 31, 1999).

¹⁰ *Department of the Navy: Breakdown of In-Transit Inventory Process Leaves It Vulnerable to Fraud* (GAO/OSI/NSIAD-00-61, Feb. 2, 2000).

majority of the items that the Navy reported as lost were delivered and that there was no evidence of theft in the shipments we reviewed. However, we also found that the inventory process was vulnerable and that Navy may have made procurements during this period for some of these items on hand but not visible to item managers. For example, a commercial repair facility in Singapore received 3 shipments of 67 generators (valued at \$593,620) for Navy aircraft that were written off in fiscal year 1997 as an in-transit loss. In October 1999, the Navy purchased 88 generators (valued at \$1.2 million) and initiated purchase orders for an additional 145 generators (valued at \$1.9 million) Among other items not visible to inventory managers were classified and sensitive items, such as aircraft guided-missile launchers, and unclassified items, such as cockpit video recorders.

On September 14, 1999, the department submitted a plan to the Congress containing 18 proposed actions, performance measures, and implementation schedules. DOD's overall objective is to achieve 100 percent visibility of inventory in transit at all times. As discussed in our February 2000 report on the results of our analysis of DOD's plan,¹¹ DOD's proposed actions in this area represent a necessary first step to improvement, but the plan does not adequately address how the department will overcome underlying weaknesses that have led to the lack of control over inventory shipments. In any case, the department's efforts to implement the plan are ongoing and are expected to take several years to complete.

- The Naval Audit Service reported¹² that the Navy did not include material turned into stores in its fiscal 1999 financial statements because the inventory was not processed promptly and therefore had not been recorded in the inventory system. At one distribution depot, the Navy had a backlog of materials turned into that depot of an estimated 122,000 line items as of September 30, 1999. This represented a backlog of approximately 10 months, according to the Deputy Commander of the depot. These items were not recorded in any inventory record and were therefore not visible to the item managers for management and planning. This backlog could result in the Navy purchasing items that it does not need because item managers do not have information on all items that are already on hand.

¹¹*Defense Inventory: Plan to Improve Management of Shipped Inventory Should Be Strengthened* (GAO/NSIAD-00-39, Feb. 22, 2000).

¹²*Fiscal Year 1999 Consolidated Financial Statements of the Department of the Navy Working Capital Fund* (Naval Audit Service Report No. N2000-0019, Feb. 14, 2000).

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- In its fiscal year 1999 financial reporting, the Navy included for the first time, several key categories of inventory, such as sponsor-owned material¹³ valued at \$5.5 billion and inventory items at redistribution sites valued at \$600 million. At the same time, deficient logistics systems continue to impair the Navy's ability both to maintain visibility and prepare reliable financial reports for these assets effectively. For example, one command could only estimate a value for its sponsor-owned inventory because it did not have a system in place to capture and report this material. The command's estimate of \$2 billion represented over a third of the Navy's reported \$5.5 billion of sponsor-owned material. Further, while the Navy's inclusion of several key inventory categories has substantially improved the completeness of its inventory reporting, not all categories of Navy inventory are yet included. Specifically, Navy auditors reported in February 2000¹⁴ that the Navy's fiscal year 1999 reporting omitted \$9.2 billion of shipboard inventories because logistical systems could not fully support the required accounting methodology. Lacking effective financial management systems that can provide the information needed to produce financial reports, various Navy commands rely on data calls and error-prone manual reentry of inventory data. For example, one Navy command did not report any inventory. However, after a follow-up review by Navy auditors, the command reported inventory of \$550 million. During fiscal year 1999, the Navy began an effort to identify and evaluate the logistics systems used to account for and control its inventories. The Navy established a working group of senior Navy financial and program managers and audit community representatives to address this issue. To start, the working group is focused on evaluating existing systems to identify opportunities to consolidate and substantially reduce the number of systems. In the next phase, the group is to work on improving the asset visibility and financial reporting capabilities of the remaining systems.
 - Air Force auditors could not verify the accuracy of \$2.9 billion in inventory in the hands of contractors.¹⁵ The Air Force extracted that amount from the Contract Property Management System for financial reporting. However, the auditors could not determine whether the \$2.9 billion of inventory shown in the system was reliable because the system did not provide a sufficient audit trail.

¹³The Navy defines sponsor-owned materials as items outside of the supply fund that support weapon systems and equipment.

¹⁴*Fiscal Year 1999 Department of the Navy Principal Statements for Fiscal Year 1999* (Naval Audit Service Report No. N2000-0018, Feb. 10, 2000).

¹⁵*Opinion on Fiscal Year 1999 Air Force Consolidated Financial Statements* (Air Force Audit Agency Report No. 9953002, Feb. 9, 2000).

DOD is making efforts to improve its inventory management and ability to report reliable inventory levels to the Congress and in financial statements. DOD's Total Asset Visibility initiative is designed among other things to, link inventory information systems to improve asset visibility and provide the capability for inventory redistribution among DOD components. Our recent work has shown that DOD has made limited progress in achieving departmentwide asset visibility. Specifically, we reported the Department's implementation plan for its Total Asset Visibility initiative did not address DOD-wide problems with systems critical to the initiative's successful implementation.¹⁶ The Secretary of Defense's 2000 *Annual Report to the President and the Congress* incorporated a Total Asset Visibility goal of 90 percent. The longer term Total Asset Visibility goal is 100 percent visibility by 2004.

Inventory Valuation

DOD has long-standing problems accumulating and reporting the full costs associated with working capital fund operations that provide goods and services in support of the military services, its primary customers. The foundation for achieving the goals of these business-type funds is accurate cost data, which are critical for management to operate efficiently, measure performance, and maintain national defense readiness.

Federal accounting standards require inventories to be valued based on historical costs or a method that approximates historical costs. Valuation is of particular importance to capture the cost of operations in DOD working capital funds, which in turn is critical to the usefulness of related performance measures. DOD working capital funds charge their customers for the support operations provided, including administrative and overhead costs. Every dollar that the military services spend inefficiently on DOD working capital fund purchases results in fewer resources available for other defense spending priorities. Simply stated, working capital fund overcharges could result in the military services using more Operations and Maintenance appropriations in the current year than anticipated; undercharges could result in unanticipated future pricing increases and additional funding requests.

DOD systems do not capture the information needed to report historical cost. Instead, inventory records and accounting transactions are maintained at a latest acquisition cost or a standard selling price. Because systems do not capture historical costs, DOD working capital funds have attempted to estimate historical cost through the use of a spreadsheet

¹⁶ *Defense Inventory: DOD Could Improve Total Asset Visibility Initiative With Results Act Framework* (GAO/NSIAD-99-40, Apr. 18, 1999).

application. This methodology takes general ledger data at standard price values or latest acquisition values and revalues the general ledger data to estimated historical costs. This methodology is dependent, therefore, on accurate general ledger data. Auditors have previously reported that the logistical systems and general ledger systems are not integrated. As a result, large adjustments are necessary to bring general ledger records into agreement with logistical records. For example, for fiscal year 1999, the Navy recorded \$1.5 billion, the Army recorded \$3.8 billion, and the Air Force recorded \$15.5 billion in adjustments to bring general ledger records into agreement with logistical records. To illustrate the magnitude of these adjustments, the Air Force Supply Fund revenue for the year was only \$10.2 billion.

Further, the Naval Audit Service reported¹⁷ that an error in the valuation methodology in 1998 resulted in overstating the cost of goods sold by \$1.2 billion. The Navy was unable to correct this error in applying the methodology in 1999. Moreover, even if general ledger data are accurate, the valuation methodology may lack the necessary precision to produce a reliable estimate of cost of goods sold. For example, the Navy methodology revalued inventory from \$34 billion (selling price) to \$16 billion (historical cost estimate). A 5-percent error in this estimate would result in a misstatement of \$900 million in the Navy's Supply Fund reported net operating loss of \$976 million and reported inventory of \$15.8 billion for fiscal year 1999.

Army auditors reported¹⁸ for fiscal year 1998 that they were unable to audit the Army's application of the methodology because there was insufficient documentation to support the calculation. Further, Army auditors reported that inventory balances at year-end improperly included inventory losses of \$5.1 billion and inventory gains of \$4.5 billion. Such gains and losses should be recognized in the net cost of operations in the period in which they occurred. In fiscal year 1999, Army auditors reported¹⁹ that these problems continued to exist and that removing these period costs are necessary before an accurate estimate of historical cost can be developed.

¹⁷ *Department of the Navy Working Capital Fund, Inventory Records and Valuation* (Naval Audit Service Report No. N2000-0014, Dec. 30, 1999).

¹⁸ *Army Working Capital Fund FY 98 Financial Statements, Inventory Allowance Accounts* (Army Audit Agency Report No. AA 00-63, Nov. 17, 1999).

¹⁹ *Army Working Capital Fund, Principal Financial Statements for Fiscal Year 1999* (Army Audit Agency Report No. AA 00-177, Feb. 10, 2000).

Further complicating the inventory valuation issue, inventory levels reported to the Congress are reported at latest acquisition cost. Although latest acquisition cost data may be important for budget projection and purchase decisions, this information may not be appropriate for performance measurement. Latest acquisition cost can substantially differ from the cost paid for the item. To illustrate how this occurs, assume a military service had 10 items that cost \$10 each, so each item would be valued at \$10, or at \$100 in total. However, if the service then purchased 1 new item at \$25, all 11 items would be valued based upon the latest purchase price of \$25, or \$275 in total. The Commander of Air Force Materiel Command recently testified that such valuation practices distort DOD's progress toward reducing inventory levels. The Commander stated the following.

“Each year, inventories of old spare parts were increased in value to reflect their latest acquisition price (the normal commercial practice is to deflate, not inflate, the value of long term assets). Many supply managers who faithfully disposed of unneeded inventory were surprised at the end of the year to see their total inventory value increase. As a result, they were subject to great pressure to further reduce inventory levels. . . .The new spares were needed but funding restrictions prevented purchase of these parts for several years.”²⁰

Overall, the effect of increasing prices can be demonstrated by noting that the Air Force's \$32.6 billion of inventory at latest acquisition cost is revalued to \$18.3 billion to reflect estimated historical costs.

Accurate inventory cost data are also important to measuring operational performance. A key performance measure is net operating results, the difference between revenue and expenses related to that revenue. Net operating results are an important factor in setting prices charged to customers. Navy management has acknowledged that due to unreliable inventory cost data, the reported net operating results for the supply fund are unreliable and cannot be used in the price-setting process. Several initiatives are ongoing to address inventory valuation issues, as noted in the following section.

Broad Simplification Initiatives

In addition to the specific initiatives discussed previously, DOD has a number of broad-based initiatives that are intended to simplify its

²⁰Statement of General George T. Babbitt, USAF, Commander, Air Force Materiel Command, Before the Subcommittee on Military Readiness, Committee on Armed Services, House of Representatives, October 7, 1999.

complicated processes for accounting for inventory. Initiatives such as these, if effectively implemented, could help achieve the kind of wide-ranging process changes throughout the department that will result in long-term improvements in this area.

- The Air Force has begun an initiative to revise current inventory systems to capture historical costs. Senior Air Force financial management officials believe that historical cost data by inventory item provide the best information by which to manage the supply fund business. A working group of Navy senior financial and logistical managers is also considering the benefits of moving to a historical cost system.
- One impediment to valuing inventory at historical cost is establishing a beginning value for DOD inventory. Much of DOD inventory has been on hand for many years, and supporting documents may not be available within DOD systems. We are currently working with DOD officials to evaluate procurement data available within DOD and other sources to address this issue.
- The Air Force is considering the adoption of private sector practices to account for repairables, which represent the majority of supply fund inventory. The Air Force had a contractor review DOD inventory accounting and valuation processes versus those of the private sector. The contractor concluded that adoption of private sector practices, including the use of historical cost, would simplify accounting transactions. For example, under DOD's current accounting procedures, logistical actions, such as transfers of inventory between locations, changes in condition code, and turn-in of an asset for repair, result in adjustments to the financial systems. Under private sector practices, the same transactions would be recorded in the logistical systems but not in the financial systems because they have no impact on inventory valuation. The contractor estimated that adoption of such private sector accounting practices would eliminate 155 million general ledger transactions currently processed by the Air Force. This is an estimated 78 percent reduction over current Air Force accounting practices for these types of logistical actions.
- The Army has initiated an effort to consolidate supply fund inventory into a single stock fund. The Single Stock Fund initiative will integrate separately managed wholesale and retail stock fund inventories into a single Army stock fund. By October 2000, stock-funded supplies owned and managed by installations—currently retail stock fund—are expected to become wholesale assets to be managed by the Army Material Command. This initiative is intended to improve the acquisition and distribution of supply items by eliminating numerous inefficiencies, such

as duplicative levels of stock and several automated systems managing the same inventory, and a lack of central item manager visibility over inventory at Army bases and installations. Further, this initiative will eliminate multiple points of sale and credit, billings, and general ledgers, thus reducing the number of accounting transactions. Army financial managers expect significant dollar savings to result from this initiative, although program officials have not yet estimated those savings.

- Similarly, in an effort to improve visibility and financial management of inventory, the Navy changed ownership of over \$2 billion of shipboard repairables from general fund commands to the supply fund during 1998 and 1999. This change provides central visibility and transaction-based reporting of this inventory.

General PP&E Amounts Are Still Unreliable But Efforts Are Underway to Address Deficiencies

DOD is responsible for almost one-half of the government's reported general property, plant, and equipment (PP&E).²¹ For fiscal year 1999, DOD reported a gross value of about \$208 billion of general property assets, including \$151 billion in real property (land, buildings, facilities, capital leases, and improvements to those assets), \$35 billion in personal property (such as computer software, computer mainframes, and equipment), and \$22 billion in construction-in-progress. For the past 2 years, we have testified before this Subcommittee concerning Defense financial management and have detailed numerous problems that affected DOD's ability to value and account for real and personal property, including property in the possession of contractors. Unless DOD knows the actual (historical) costs of its facilities and equipment, the department cannot properly depreciate and assign costs to the programs and activities that benefit from use of those assets. Further, until its systems can accurately account for the existence and movement of general property, DOD cannot know the location and condition of those assets or safeguard them from physical deterioration, theft, or loss.

To address accountability and financial reporting issues, DOD has begun several initiatives over the past year. Due to the department's enormous size and complexity, however, most of its PP&E initiatives are still in

²¹Statement of Federal Financial Accounting Standards No. 6 states that general PP&E is any property, plant, and equipment used in providing goods and services. It typically has one or more of the following characteristics: (1) it could be used for alternative purposes (e.g., by other federal programs, state, or local governments, or nongovernmental entities) but is used to produce goods or services, or to support the mission of the entity, (2) it is used in business-type activities, or (3) it is used in activities whose costs can be compared to those of other entities performing similar activities (e.g., federal hospital services in comparison to other hospitals).

process and have not yet fully affected its operations or the reliability of amounts reported.

Real Property

DOD's real property represented more than 70 percent of its reported PP&E for fiscal year 1999. Last year, DOD took a step forward to address one of its long-standing PP&E problems, the valuation of its beginning real property balances. Specifically, the department obtained contractor assistance in validating its recorded real property amounts (or recommending ways to develop auditable values), compiling reported PP&E data, and helping to maintain accurate property records. The contractor sampled and surveyed nearly 1,300 real properties, estimated a current replacement cost for each, deflated that cost back to the property's acquisition date, and compared the deflated replacement cost to the cost recorded in DOD's property database. All major DOD components except for the Corps of Engineers were included in this effort.

The contractor has finished its work and reported the results of its validation effort.²² Because we and the DOD audit community have not yet completed our reviews of the contractor's work, we cannot address the methodology or conclusions at this time. It is our understanding that the valuation effort has provided results at a DOD and servicewide level (Army, Navy, and Air Force) but not at lower levels that are used for reporting, such as the Army Working Capital Fund or DLA. Therefore, the results may not support determining the cost of many DOD activities or the calculation of user fees and other reimbursable charges.

As agreed, the contractor's valuation effort was limited to real property on DOD's books at September 30, 1998. Therefore, in order to evaluate the reliability of recorded values at September 30, 1999, DOD auditors needed to test real property transactions—additions, deletions, and modifications—that occurred during that fiscal year. Having valuation results as of September 30, 1998, will not be useful to DOD if it cannot maintain a reliable balance going forward. Component audit tests showed that DOD continues to lack the necessary systems and processes to ensure that its real property assets are promptly and properly recorded in real property databases. For example, auditors found the following deficiencies.

- Real property transactions are not promptly recorded. As reported, Army auditors reviewed about \$408 million in real property addition, deletion,

²² *Department of Defense Real Property Validation Phase II, Accuracy Test Results* (PWC Contract No. GS23F-8126H, Delivery Order MDA 210-99-F-001, Task 2.2, Deliverable 2.3, Dec. 9, 1999).

and modification transactions recorded during fiscal year 1999 and determined that \$113 million of those transactions should have been posted in prior fiscal years. Army auditors also identified \$43 million in unrecorded real property transactions.²³ Air Force auditors identified backlogs of unprocessed real property transactions totaling approximately \$781 million at 46 of the 99 locations audited.²⁴ In addition, Air Force auditors found that real property constructed under multi-facility construction contracts was not always recorded until construction was completed on all facilities under the contract. Navy auditors also found that real property assets were not being recorded when construction was completed. Because Navy activities did not consider contracts complete for purposes of removing assets from construction-in-progress until the final payment was made, auditors found over \$55 million of unrecorded new construction or improvement costs at two locations.

Navy auditors also found that Base Realignment and Closure (BRAC) funded property transactions were not always recorded in Navy databases. While costs associated with closing activities should be expensed, some costs incurred to realign activities should be capitalized, such as new construction or major improvements. Navy auditors identified millions of dollars of newly constructed or improved assets paid for by BRAC funds that were not captured in the Navy's accountability and financial reporting databases. For example, the \$4.3 million renovation costs associated with a building that the Naval Audit Service moved into in June 1999 and \$18.4 million in capital improvements at the Naval Facilities Engineering Command (NAVFAC) headquarters building were not recorded in the Navy's database.

- Sufficient controls over processing and reporting real property amounts did not exist. For example, Navy auditors found that reconciliations between accountability and financial reporting systems are not always performed. Navy auditors identified over \$10 million in discrepancies between the Navy working capital fund accountability and financial reporting records at one location and noted a more than \$13 million difference at another location. Air Force auditors found that acquisition costs reported by the Air Force for fiscal year 1999 were overstated by \$3.4 billion due to compilation errors related to the costs of buildings and other structures at 15 installations. In addition, Air Force auditors could

²³ *Army's General Fund Principal Financial Statements for Fiscal Year 1999, Summary Audit Report* (Army Audit Agency Report No. AA 00-168, Feb. 9, 2000).

²⁴ *Opinion on Fiscal Year 1999 Consolidated Financial Statements* (Air Force Audit Agency Report No. 99053002, Feb. 9, 2000).

not obtain supporting documentation for about \$1.8 billion of the Air Force's \$2.8 billion of construction-in-progress amounts reported for fiscal year 1999.

DOD must quickly address the problems that the auditors identified during their fiscal year 1999 testing related to backlogs and the proper recording, reconciling, and reporting of new property transactions. Until DOD has the systems and processes in place to maintain accurate, up-to-date property records, any valuation baseline will not be sustainable and accountability for real property will not be ensured.

Personal Property

As discussed in our testimony last year, the most important issue related to personal property is the accuracy of the underlying accountability records. DOD's draft accountability regulations support this position and require that all assets valued at \$2,500 or more be in property databases for accountability purposes. Also in line with this, the DOD Comptroller and the military services have redirected their personal property efforts to first ensure the accuracy and sustainability of personal property databases before attempting to address any valuation issues. The audit community and the Office of Management and Budget have agreed to and support this approach as prudent and consistent with the goals of the Chief Financial Officers Act.

DOD and the military services have recognized that major changes, such as implementation of standard automated systems and operating procedures, are necessary to ensure accountability and financial control of personal property. To move toward these goals, the military services general fund activities, which are responsible for most personal property reported by DOD, have begun implementing short-term initiatives over the past year, such as performing or testing personal property inventories, providing training to personnel responsible for maintaining the data, and developing procedures and controls to ensure the reliability of future transaction processing.

For example, the Department of the Navy has been working to ensure the reliability of its personal property records by standardizing its personal property processes and procedures and actively implementing the Defense Property Accountability System (DPAS) at locations worldwide. Over the past year, the Marine Corps has performed and reconciled the results of wall-to-wall physical inventories of assets valued at \$2,500 or more and has fully implemented DPAS at 30 sites. The benefits of the wall-to-wall inventories are easily understood when you consider that at one location alone, the number of assets recorded in the accountability database increased by over 35 percent, which added 478 items to the originally

reported 1,375 items, while the dollar amount increased by 28 percent, or about \$700,000 more than the beginning value of \$2.4 million. The Navy's efforts to conduct inventories and implement DPAS at Navy sites are still ongoing.

The Army and Air Force general fund activities are also beginning to focus on accountability. The Army has begun to implement DPAS to report its personal property. However, during fiscal year 1999, it temporarily suspended implementation of DPAS at some of its major installations due to problems encountered in converting logistical data from existing databases. As a result, as it had for fiscal year 1998, the Army relied on data calls to obtain information on equipment balances for financial reporting because it had no central system. Although the percentage of units responding to the Army's data calls increased from 78 percent for fiscal year 1998 to approximately 97 percent for fiscal year 1999, only \$857 million was reported for equipment—an over \$800 million decrease from the prior year.²⁵ Army officials were unable to explain this 48 percent decrease. To address these problems, the Army remains committed to DPAS and hopes to complete its implementation at general fund sites by the end of fiscal year 2000. They have also hired a contractor to test the accuracy of the assets reported in DPAS.

Rather than implement DPAS, the Air Force has chosen to modify its three personal property systems, the primary one being the Air Force Equipment Management System (AFEMS), to meet accountability and reporting requirements for assets that individually equal or exceed DOD's financial reporting capitalization threshold of \$100,000. Over the past year, the Air Force has added data fields to AFEMS to establish detailed records for these higher valued assets. Also, during fiscal year 1999, Air Force activities verified the existence of assets recorded in AFEMS that were valued at \$100,000 or more. Assets in AFEMS that were less than DOD's \$100,000 capitalization threshold, but exceeded DOD's \$2,500 accountability threshold, were not included in this verification effort. As of March 2000, personal property assets that did not meet DOD's \$100,000 financial reporting threshold accounted for over 99 percent of the total number of personal property assets recorded in AFEMS and approximately 45 percent (or \$6.4 billion) of the total reported personal property value. Many of these assets are "pooled" in AFEMS rather than controlled at a serial number level, which may impede any efforts to ensure that assets below \$100,000 are recorded in the database for

²⁵ *Army's General Fund Principal Financial Statements for Fiscal Year 1999, Summary Audit Report* (Army Audit Agency Report No. AA 00-168, Feb. 9, 2000).

visibility and accountability purposes. Air Force officials have indicated they have initiated a change in their systems and processes to eliminate these pools and provide individual accountability for items over \$2,500. In addition, they have hired contractors to validate that the existing assets are properly reflected in AFEMS.

Although issues such as DOD's capitalization threshold, depreciation periods, and systems integration do not affect current personal property efforts as long as those efforts focus on accountability consistent with DOD regulations, they do affect financial control and reporting for both real and personal property. To begin addressing some of these issues, DOD hired contractors to advise the department on appropriate capitalization thresholds and depreciation periods for real and personal property. The contractors have issued their reports concurring with DOD's current \$100,000 threshold for financial reporting and depreciation periods, but they noted that the databases they analyzed may not have been appropriate, complete, and accurate. For example, as we previously discussed, the Marine Corps' wall-to-wall inventories have identified significant numbers of assets not included in their personal property databases. In addition, the databases that were analyzed may not have included approximately \$20 billion of personal property held by contractors—an amount that was not reported in DOD's financial statements but which represents more than half the gross value for personal property that was reported for fiscal year 1999. The contractors also recommended that if adjustments are made to the underlying databases or if data integrity is improved, DOD should reevaluate the study's results. We have not yet reviewed the contractors' work but we agree that the limitations they cite could directly affect the materiality and appropriateness of the recommended capitalization threshold and the effect of the current depreciation periods. To ensure that the contractors' recommendations are appropriate, DOD needs to evaluate the accuracy of the databases that were used and analyze the full impact of property excluded from the study.

Although each of the services has various short-term initiatives to improve accountability, long-term sustainability and efficiency require systems integration—acquisition and payment systems must be linked with property accountability systems. The Navy, recognizing the usefulness of system interfaces to maintain accountability and financial control, has established a working group with DOD's DPAS office to begin developing electronic interfaces in accordance with the financial management systems requirements of the Federal Financial Management Improvement

Act of 1996.²⁶ The Army also has efforts under way and systems under development to provide needed interfaces. The Air Force has asked audit personnel to review its property systems under development and ensure that required integration is considered during development. To support these efforts, DOD has established a Property System Implementation Steering Committee, chaired by the Director of Acquisition Resources and Analysis, to emphasize property issues affecting the department and begin addressing those issues.

Problems Persist With Data and Reporting on National Defense Assets

Beginning with fiscal year 1998, DOD was required by federal accounting standards to report its national defense assets²⁷ in a stewardship report, which is treated as required supplementary information in its financial statements, rather than on its balance sheet. The reported cost of this equipment in fiscal year 1997—the last year for which such information was reported on its balance sheet—was more than \$600 billion. In its fiscal year 1999 financial report, DOD did not report on its national defense assets in accordance with accounting standards. Instead of reporting total costs of these assets as required by the standards, DOD reported quantities only for major weapons systems and real property, and yearly disbursements for items bought with procurement funds. This reporting is based in part on proposed amendments to the accounting standards, but the amendments were not passed when voted on in October 1999. In addition, DOD continues to experience problems in accumulating and reporting accurate information on its national defense equipment, as well as foreign sales activity related to these assets. The military services have made some improvements on these issues and are continuing to work toward more reliable logistical data for these assets.

Incomplete Data and Financial Reporting

Information on national defense assets remains a concern because, for fiscal year 1999, (1) it is incomplete and (2) activity during the year is not properly recorded.

The national defense asset quantities reported for fiscal year 1999 are incomplete primarily for two reasons. First, DOD policy instructed the services to report only certain categories of national defense assets and

²⁶The Federal Financial Management Improvement Act of 1996 provides a legislative mandate to implement and maintain financial management systems that substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the *U.S. Standard General Ledger*.

²⁷National defense assets consist of weapons systems, weapons systems support equipment, mission support equipment, and weapons systems support real property.

specifically excluded two of the major categories—support principal end items,²⁸ such as aircraft engines and radars, and mission support equipment,²⁹ such as nontactical vehicles and cryptographic systems. As a result, thousands of different types of support equipment costing billions of dollars were not reported anywhere in DOD's financial report. For example, the Army reported quantities for only 279 types of equipment out of more than 1,600 types. Unreported items include

- Army communication equipment with an estimated value of \$5.7 billion,
- Navy aircraft engines with an estimated value of \$7.6 billion, and
- over 2,300 Air Force electronics systems pods that attach to aircraft, with costs ranging from over \$1 million to \$5 million each.

Second, some items may not have been reported because they are not recorded in any centralized asset visibility system. Because the services cannot identify all of their assets through a centralized system, each service had to supplement its automated data with manual procedures to collect the information. For example, the Army again conducted an Army-wide data call as it had in fiscal year 1998 to capture items not reported in its centralized systems. Items identified as a result of this data call that were not included in the Army's centralized systems included 56 airplanes, 32 tanks, and 36 Javelin command-launch units. The Air Force had to use manual procedures to compile its missile data from a number of different systems and to try to avoid double counting and/or omissions. The Navy had to obtain data on ballistic missiles from inventory control personnel who maintain local spreadsheets on the missiles at two Navy facilities. The use of manual procedures, such as data calls, results in less reliable information because it is dependent on individuals responding promptly and accurately. For example, only 78 percent of Army units responded to a data call in time for its fiscal year 1998 reporting. Although this percentage increased to 97 percent for fiscal year 1999, the reliability of the information from the data call was not tested. Furthermore, the necessity for manual procedures prevents DOD from having visibility over all of its assets and the day-to-day information needed to effectively manage its

²⁸Support principal end items are items acquired to support weapons systems and may ultimately be incorporated in weapons systems.

²⁹Mission support equipment is deployable equipment that (1) is essential to the effective operation of a weapon system or is used by the military services to carry out their military missions, (2) has an indeterminate or unpredictable useful life, and (3) is at very high risk of being destroyed or becoming prematurely obsolete.

operations. For example, DOD's lessons learned studies from Operation Desert Storm highlighted combat support problems associated with tracking the status and location of personnel and supplies. As previously mentioned, DOD has a goal of 100 percent visibility over its assets by 2004.

The services have historically been unable to maintain information on additions and deletions for most of their national defense assets. While some progress has been made toward improving this data, auditors found that much of it was still unreliable for fiscal year 1999. Reliable information on additions and deletions is an important internal control to ensure accountability over assets. Without integrated accounting, acquisition, and logistics systems to provide accounting controls over asset balances, this control is even more important. For example, acquisition personnel should be able to review information on additions to ensure that all assets acquired are reported in logistics systems. If such a control is not in place, DOD cannot have assurance that all items purchased are received and properly recorded.

Further, since October 1998, we have issued four reports identifying internal control weaknesses in DOD's foreign military sales program that includes sales of national defense assets and services to eligible foreign countries. Most recently, on May 3, 2000, we reported³⁰ that the Air Force did not have adequate controls over its foreign military sales to ensure that foreign customers were properly charged. Specifically, our analysis of data contained in the Defense Finance and Accounting Service's Defense Integrated Financial System as of July 1999, indicated that the Air Force might not have charged FMS customer trust fund accounts for \$540 million of delivered goods and services.

In performing a detailed review of \$96.5 million of these transactions, we found that the Air Force was able to reconcile about \$20.9 million. However, of the remaining \$75.6 million, the Air Force had either

- failed to charge customer accounts (\$5.1 million, 22 transactions);
- made errors, such as incorrectly estimating delivery prices (\$44 million, 11 transactions); or

³⁰ *Foreign Military Sales: Air Force Controls Over the FMS Program Need Improvement* (GAO/AIMD-00-101, May 3, 2000).

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- could not explain differences between the recorded value of delivered goods and services and corresponding value of changes to customer accounts. (\$26.5 million or 19 transactions).

Improvement Initiatives

Each military service has taken some actions to improve its national defense asset data. Some of these actions are short-term solutions, while others are intended to provide longer term, permanent improvements in the way the data are maintained. For example, the Navy is currently taking a servicewide inventory of all of its aircraft engines to improve its data for these assets. While this might result in accurate data for a given point in time, longer term—both with respect to the design of the systems and to basic transaction processing—logistics system changes are needed to ensure that the data remain accurate. An ongoing, longer-term improvement effort involves a new working group that is trying to improve ship and boat data. The group is developing new software and has developed new guidance for managing ship and boat information, including guidance for an annual inventory validation and for boat disposals. In another effort intended to improve all of the Navy's national defense asset data, the Navy has hired a contractor to evaluate its systems, methods, processes, and procedures used to account for its national defense assets.

The Army has made several short-term improvements in its national defense asset information and is also developing a long-term solution. Most of the short-term efforts stemmed from lessons learned during the fiscal year 1998 financial reporting process. For example, the Army improved its method for determining which assets should be reported as national defense, and it gained a better understanding of the types of information available in its myriad logistics systems. These lessons learned should help it develop needed systems improvements in the future, including the development of its Logistics Integrated Database (LIDB), which is intended to eventually replace and/or integrate many of its existing logistics systems. Army logistics officials have commented that the efforts taken to comply with the reporting requirements for national defense assets have been very beneficial to the Army because the process has resulted in more accurate property records which are used for procurement and deployment decisions.

The Air Force acknowledged that it was not able to identify all of its national defense assets for fiscal year 1999, but it is working to improve several of its logistics systems. It has reported that it is developing interfaces for all of its munitions systems so that manual procedures will not be necessary in the future to develop accurate missile data. It also

expects to have complete, reliable information on all of its electronics systems pods in one logistics system by the end of this fiscal year.

Each of the services also made some progress toward improving information on additions and deletions activity during the year. For example, according to Air Force auditors, the Air Force now has accurate additions and deletions for its aircraft engines. The Army has considered a number of different options for tracking additions and deletions to its equipment, and while it does not yet have a solution in place, Army officials expect to have a plan to incorporate this information into their new Logistics Integrated Database by June 30, 2000. The Navy has developed new forms to better document additions and deletions for its boats and new procedures for documenting the transfer or disposal of aircraft engines.

In addition to the services' individual efforts, DOD is continuing to undertake initiatives to improve departmentwide asset visibility and tracking. The department's Global Combat Support System (GCSS) strategy—its approach to providing the technological base needed to rapidly deploy support to the warfighter—incorporates a number of such initiatives. For example, its Total Asset Visibility (TAV) initiative is intended to provide department-level access to timely and accurate information on the status, location, and movement of all assets, including national defense assets.

Because of the recognized problems with national defense asset information, and the lack of an audit requirement for these assets, the audit community in the past year focused on supporting and reviewing improvement efforts, rather than conducting any significant tests of data and systems. Under the National Defense Authorization Act for Fiscal Year 2000, the DOD Inspector General is required to review national defense asset data submitted to the Congress for fiscal year 1999. Such a review should help determine the success of DOD's improvement efforts so far, as well as identify those areas requiring further improvement.

Improvements in Environmental/Disposal Liability Reporting But Additional Issues Need to Be Addressed

DOD has taken important steps to implement the federal accounting standards³¹ requiring recognition and reporting of liabilities associated with environmental cleanup and disposal. The department issued accounting policy³² consistent with these standards and has begun implementing those policies for nuclear weapons systems and training ranges, in addition to efforts already taken to address environmental restoration and chemical weapons disposal. In addition, working groups comprised of officials from the responsible DOD functional areas (such as Comptroller, Environmental Security, and Acquisition, Technology, and Logistics) and the audit community have been established.

DOD still faces significant challenges in this area. Specifically, (1) all potential liabilities were not considered, (2) estimates need to be refined to ensure that assumptions and methodologies are consistently applied, and (3) support for the basis of reported estimates continues to be inadequate. To ensure that the reported amounts of environmental and disposal liabilities are complete and reliable, adequately reflecting DOD's obligation to clean up and dispose of hazardous and other wastes, DOD will need to address these issues. While DOD has made great progress toward developing more complete estimates of these costs, until these efforts are complete, the Congress will not know the full extent of future resource requirements necessary to fund cleanup and disposal efforts based on current laws and policies.

DOD reported approximately \$80 billion in estimated liabilities in its fiscal year 1999 financial statements, including for the first time approximately \$34 billion for training range cleanup and nearly \$11 billion for disposal of nuclear-powered aircraft carriers and submarines. For fiscal year 1998, only \$34 billion was reported for estimated environmental liabilities. The time frame in which the fiscal year 1999 estimates were developed did not permit the audit community to perform adequate audit procedures to determine their reasonableness. DOD's failure to report these costs in prior years was among the most significant deficiencies that we previously reported to this Subcommittee.

³¹Statements of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government* and No. 6, *Accounting for Property, Plant, and Equipment*.

³²DOD Financial Management Regulation, volume 4, chapter 13, *Accrued Environmental and Nonenvironmental Disposal Cost Liabilities* and chapter 14, *Accrued Environmental Restoration (Cleanup) Liabilities*.

Potential Liabilities Not Considered in Current Year Estimate

To date, DOD has focused on those liabilities expected to involve the largest amounts (nuclear weapons systems and training ranges). Going forward, DOD will need to address estimates for other weapons systems and conventional munitions. DOD needs to analyze the potential liability for disposing of these types of items and determine whether these estimates would be significant and thus need to be reported. If so, it will need to develop methodologies to support such estimates. Further, DOD has just begun to consider the significance of costs associated with the ultimate disposition of ongoing operations.

The Congress has also recognized the potential for significant costs associated with disposal. The National Defense Authorization Act for Fiscal Year 1995³³ required that the Secretary of Defense analyze the environmental costs of major defense acquisitions as part of the life-cycle costs of the programs. However, recent IG audits of several major weapons systems programs, including the Black Hawk helicopter and F-15 aircraft, have found that life-cycle cost estimates did not include costs for demilitarization, disposal, and associated cleanup.³⁴ These disposal cost estimates are important to consider before proceeding with a major acquisition because this information can contribute to the ongoing dialogue on funding comparable weapons systems. Compliance with the Fiscal Year 1995 Defense Authorization Act would also provide data critical to ensuring more complete and reliable financial statement reporting. In addition, the Senate Committee on Appropriations has required that DOD develop disposal cost estimates for munitions.³⁵

DOD must also ensure consistent application of methods and assumptions regarding aircraft disposal cost estimates. The Navy's financial statements included an initial estimate of \$331 million in fiscal year 1999 for disposal of fixed-wing and rotary-wing aircraft. However, although it reported twice as many aircraft as the Navy, the Air Force has not yet reported environmental and disposal liabilities for these weapons systems.

We are working with the department to identify other weapons systems that might have significant cleanup and disposal liabilities and approaches for estimating those liabilities. For example, the department's costs to

³³Public Law 103-337, Oct. 5, 1994.

³⁴*Hazardous Material Management for the Black Hawk Helicopter Program* (DOD IG Report No. 99-242, Aug. 23, 1999) and *Hazardous Material Management for the F-15 Aircraft Program* (DOD IG Report No. 00-012, Oct. 15, 1999).

³⁵*Report on the Fiscal Year 1995 Defense Appropriations Bill* (Senate Committee on Appropriations, Senate Report 103-321, July 29, 1994).

dispose of conventionally powered ships would be at least \$2.4 billion, based on applying the Navy's estimated average cost of \$500 per ton of displacement used to estimate disposal costs for its inactive fleet. In addition, we previously estimated that the conventional munitions disposal liability for Army alone could exceed \$1 billion.³⁶

With regard to ongoing operations, costs of cleaning up and disposing of assets used in these operations may be significant. Significant environmental and disposal costs are to be recognized over the life of the related assets to capture the full cost of operations. We are working with DOD to assess whether operations, such as landfills and utilities (including wastewater treatment and power generation facilities), will ultimately have significant environmental costs associated with closure. For example, Edwards Air Force Base officials provided us with a landfill closure cost estimate of approximately \$8 million. In addition, post-closure maintenance costs, such as monitoring in excess of \$200,000 annually for 30 years, are not included in this estimate. To provide some perspective on the potential scope of these operations, the Army alone reported 65 landfills that, based on the Air Force estimated cost data, could cost nearly \$1 billion to close and monitor.

Further, environmental and disposal costs must also be considered in the department's plans to analyze its more than 2,000 utility systems for privatization. If these costs prove significant to DOD, they should be considered in any cost-benefit analyses developed by the department in deciding to retain or privatize these functions.

Cleanup and Disposal Cost Estimates Need to Be Refined

Information on the estimated training range cleanup costs was not available in sufficient time prior to the statutory release date of the financial statements to enable the audit community to perform adequate work to determine the reasonableness of reported estimates. However, we were able to perform a limited analysis of DOD's first-time effort to develop complete cleanup cost estimates for training ranges. We previously testified on the significance of the department's unreported liability for training range cleanup, including removal and/or containment of unexploded ordnance and remediation of chemical contamination. DOD took initial steps to address this deficiency in fiscal year 1999 by reporting approximately \$34 billion for cleanup of training ranges, accounting for

³⁶ *Financial Management: DOD's Liability for the Disposal of Conventional Ammunition Can Be Estimated* (GAO/AIMD-98-32, Dec. 19, 1997).

over 40 percent of its total reported environmental/disposal liabilities, which we view as an important step forward.

The training range cleanup liability is comprised primarily of cost estimates for active, inactive, and closed Navy/Marine Corps ranges of approximately \$31 billion. The Navy reported this to be a minimum estimate based on assumptions of “low” contamination and cleanup/remediation to “limited public access” levels, for uses such as livestock grazing or wildlife preservation but not for human habitation. Based on these assumptions, the Navy used a cost factor of \$10,000 per acre. Although the Army also has significant exposure for training range cleanup liabilities, it reported only \$2.4 billion for ranges on formerly used defense sites and closed ranges on active installations. The Army assumed one closed training range per base for the active installations. However, because the Army has not developed a complete range inventory nor recorded any liability for active or inactive ranges, this approach may have significantly understated its liability. To illustrate the potential magnitude of Army training range cleanup, applying the cost factor used by the Navy to estimated range acreage of the Army’s National Training Center at Ft. Irwin, California, would result in a cleanup cost estimate of approximately \$4 billion for that installation alone.

DOD has cited the lack of guidance on the scope of range cleanup requirements as an impediment to reporting the cost of cleaning up the ranges. In this regard, DOD has been working with the Environmental Protection Agency (EPA) for several years to finalize the Range Rule that will provide a framework for developing an inventory of ranges and assessing the level of cleanup required.³⁷ After finalizing this rule, DOD will need to develop specific implementation guidance to ensure consistent application across the military services. This guidance will need to address the assumptions to be applied in estimating cleanup costs, including those related to risk levels and cleanup thresholds.

Cost estimates should also be refined for changes in cleanup/disposal schedules. For example, DOD reported a liability of approximately \$8.9 billion in its fiscal year 1999 financial statements for chemical weapons disposal. Initial estimates to comply with the United Nations-sponsored Chemical Weapons Convention were based on a 2007

³⁷On March 7, 2000, DOD and the Environmental Protection Agency issued Interim Final Management Principles to address ongoing range response actions until the final version of the Range Rule is promulgated.

completion date. However, we recently reported³⁸ that while 90 percent of the stockpile could be destroyed by the 2007 deadline, schedule slippages associated with the remaining 10 percent are likely to occur because of additional time required to validate, certify, and obtain approval of technologies to dispose of the remaining stockpile of chemical weapons. These schedule slippages will likely result in additional program costs. Historically, schedule delays have been found to increase direct costs such as labor, emergency preparedness, and program management.

Support for the Basis of Estimates Remains Inadequate

Last year the DOD IG reported³⁹ that the basis of estimates for significant recorded liabilities—primarily those related to restoration (cleanup) of sites contaminated from prior operations—was not adequately supported, and those problems persist. Service auditors continue to find that significant portions of the reported restoration liabilities lack adequate support for the basis of cost estimates. To address this deficiency, the Deputy Under Secretary of Defense (Environmental Security) issued a policy requiring that the basis of cost estimates be properly documented.⁴⁰ While this step is critical to resolving this issue, implementation issues remain, such as ensuring that the appropriate personnel receive the guidance and are properly trained on its implementation. For example, the Army Audit Agency found that the guidance was not properly disseminated to project managers and others preparing project cost estimates.⁴¹

Progress in Estimating Military Post-Retirement Health Care Liability

DOD provides health care benefits to military retirees and their families through its own military treatment facilities (MTF) and by using civilian providers. Each year, the DOD Office of Actuary and its contractors develop an estimate of DOD's future liability for providing these benefits. At September 30, 1999, the expected cost for future retiree health care benefits was estimated at \$196 billion.

³⁸ *Chemical Weapons Disposal: Improvements Needed in Program Accountability and Financial Management* (GAO/NSIAD-00-80, May 8, 2000).

³⁹ *Data Supporting the DOD Environmental Line Item Liability on the FY 1998 Financial Statements* (DOD IG Report No. 99-209, July 9, 1999).

⁴⁰ *Supplemental Management Guidance for the Defense Environmental Restoration Program* (DOD Deputy Under Secretary of Defense (Environmental Security) Aug. 1999).

⁴¹ *Army's General Fund Principal Financial Statements for Fiscal Year 1999: Financial Reporting of Liabilities* (Army Audit Agency Report No. AA 00-220, Apr. 21, 2000).

In last year's testimony, we reported that DOD's estimated retiree health benefits liability was unreliable because DOD did not have accurate and complete cost data on which to base its calculation, used old and incomplete historical claims data, and relied on unsupported clinic workload data related to outpatient visits. Although these problems still exist, the Office of Actuary and Office of Health Affairs have made meaningful progress in improving the processes and underlying data on which the liability estimate is based. For example, the liability reported in fiscal year 1998 was based on 1994 claims data—a 4-year lag—while the 1999 liability was based on 1997 data—a 2-year lag. Moreover, the 1998 liability used outpatient claims data from only 15 of 121 MTFs while the 1999 liability had outpatient information for all MTFs. Better and more complete data resulted in a \$37.5 billion decrease, nearly 17 percent, in DOD's estimated liability for retiree health benefits. These kinds of improvements in claims and workload data will also benefit DOD's ability to manage its health care programs, make health care-related decisions, such as whether to outsource certain medical treatments or provide them in MTFs, and evaluate legislative options regarding benefit changes.⁴²

To help focus improvement efforts, the Office of Actuary recently conducted a thorough analysis of the various factors that affect the magnitude and reliability of its actuarial estimate. The analysis identified assumptions regarding future interest rates and medical trends, program withdrawal and death rates, and measures of current cost and services provided as the key drivers of the future cost of health care benefits. This type of analysis is important because it shows that, for example, if current MTF costs change by only 1 percent, DOD's future liability will change by more than a billion dollars.

Despite the sensitivity of the liability to current costs, DOD has had to use obligations in its calculation and for making many program decisions because it does not have actual cost information for its MTFs. However, budget obligations do not reflect the full cost of providing health care because they do not include, among other things, civilian employee retirement benefits that are paid directly out of the Civil Service Retirement and Disability Fund rather than by DOD or depreciation costs for medical facilities and equipment. In addition, health program budget obligations attributable to wartime readiness are not distinguishable from

⁴²In recent testimony before the House Subcommittee on Military Personnel, we discussed several legislative proposals that have been introduced to expand and enhance military health benefits for older retirees. See *Defense Health Care: Observations on Proposed Benefit Expansion and Overcoming TRICARE Obstacles* (GAO/T-HEHS/NSIAD-00-129, Mar. 15, 2000).

those associated with peacetime care.⁴³ Consistent with our prior advice, DOD now agrees that full cost should be used to estimate the retirement health benefits liability and plans to do so for fiscal year 2000. To this end, representatives from Health Affairs, the Comptroller's Office, Office of Actuary, DOD Inspector General and GAO have established a Full Cost Working Group, which has begun addressing the completeness and accuracy of recorded costs as well as determining the portion of health care costs associated with retirees. In addition to improving the liability estimate, DOD needs reliable cost data to properly allocate health care resources, decide whether to outsource certain services, set third-party billing and interagency cost rates, and benchmark its health care delivery system with those of other providers.

The proper allocation and growth rate of pharmacy costs are other factors that could have a significant impact on future retiree health care costs. For purposes of calculating the liability, DOD has been making the assumption that its patient population uses pharmacy resources equally; however, preliminary evidence suggests that retirees use more outpatient pharmacy resources than nonretirees. Furthermore, pharmacy costs are increasing at a faster rate than other medical costs, yet DOD has been applying the same medical trend rate to all outpatient costs. We estimated that DOD pharmacy costs increased 13 percent from 1995 through 1997, while its overall health care costs increased 2 percent for that period.⁴⁴ DOD is currently analyzing the effect of separately estimating the pharmaceutical component of the health benefits liability. This analysis will be even more important if legislation currently being proposed, which includes increased pharmacy benefits for retirees eligible for Medicare, is enacted.⁴⁵

DOD and its auditors have identified other needed improvements in patient care and demographic data. DOD has been using examples of blatant data errors, such as negative costs for some surgery clinics and obstetrics services provided to male patients, to stress to its own staff and to health care contractors the importance of its improvement efforts.

⁴³Wartime readiness refers to maintaining the health of service members and treating wartime casualties, whereas peacetime care refers to providing for the health care needs of the families of active-duty members, retirees, and their families and survivors.

⁴⁴*Defense Health Care: Fully Integrated Pharmacy System Would Improve Service and Cost-Effectiveness* (GAO/HEHS-98-176, June 12, 1998).

⁴⁵Proposed legislation to expand Medicare-eligible uniformed services retirees' eligibility for certain Defense pharmacy programs was introduced in the Senate on January 27, 2000, as S.2013, the "Honoring Health Care Commitments to Servicemembers Past and Present Act of 2000."

Similarly, the DOD IG⁴⁶ has reported that workload data are problematic—medical services cannot be validated either because medical records are not readily available or outpatient visits are not adequately documented. The DOD IG also reported that MTF outpatient visits are often double counted and that many telephone consultations have been incorrectly counted as visits, perhaps due to the lack of standardized appointment types. An accurate count of patient visits by clinic and type is necessary for DOD to make the proper allocations of medical personnel, supplies, and funding.

To address access and workload shortcomings, DOD recently issued a letter directing MTFs to ensure that medical records are readily available and has begun moving toward standardized appointment types and to electronic patient records that would be accessible by all MTFs. DOD also established a Data Quality Integrated Program Team, which is currently considering other data quality improvements. In addition, DOD has developed procedures for reconciling financial, workload, and labor hours to the data sources. When fully and effectively implemented, these procedures should improve the reliability of underlying data used in managing DOD's health care programs.

DOD Net Cost Information Is Unreliable

Our audit of the U.S. government's consolidated financial statements for fiscal year 1999 found that the government was unable to support significant portions of the \$1.8 trillion reported as the total net cost of government operations. Federal accounting standards require federal agencies to accumulate and report on the full costs of their activities.⁴⁷ DOD, which represents \$378 billion of the \$1.8 trillion, was not able to support its reported net costs. Although we have seen some improvements in DOD's ability to produce reliable financial information, as noted throughout this testimony, capturing and accurately reporting the full cost of its programs remains one of the most significant challenges DOD faces.

DOD needs reliable systems and processes to appropriately capture the required cost information from the hundreds of millions of transactions it processes each year. To do so, DOD must perform the basic accounting

⁴⁶Data Supporting the FY 1998 DOD Military Retirement Health Benefits Liability Estimate (DOD IG Report No. 99-127, Apr. 7, 1999).

⁴⁷Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards*, requires accumulating the full cost associated with an entity's output through appropriate costing methodologies or cost-finding techniques.

activities of entering these transactions into systems that conform to established systems requirements, properly classifying transactions, analyzing data processed in its systems, and reporting in accordance with requirements. As discussed later, this will require properly trained personnel, simplified processes, systems supporting operational and accounting needs, and a disciplined approach for accomplishing these steps.

Because it does not have the systems and processes in place to reliably accumulate costs, DOD is unable to account for several significant costs of its operations, as discussed in this testimony. Specifically, the accuracy of the department's reported operating costs was affected by DOD's inability to

- properly value and capitalize its facilities and equipment,
- properly account for and value its inventory,
- identify the full extent of its environmental and disposal liability,
- determine its liability associated with post-retirement health care for military personnel, and
- complete the reconciliation of its records with those of the Department of the Treasury.

In addition, DOD did not have adequate managerial cost accounting systems in place to collect, process, and report its \$378 billion in total reported fiscal year 1999 net operating costs by program area consistent with federal accounting standards.⁴⁸ Instead it used budget classifications such as military construction, procurement, and research and development to present its cost data. In general, the data DOD reported in its financial statements represented disbursement data for those budgetary accounts, adjusted for estimated asset purchases and accruals. For financial reports other than the financial statements, DOD typically uses obligation data as a substitute for cost. As discussed later in this testimony, DOD budget data are also unreliable.

⁴⁸Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards* (July 31, 1995) and *Internal Controls and Compliance With Laws and Regulations for the DOD Agency-Wide Financial Statements for FY 1999* (DOD IG Report No. D-2000-091, Feb. 25, 2000).

To manage DOD's programs effectively and efficiently, its managers need reliable cost information. This information is necessary to (1) evaluate programs, such as by measuring actual results of management's actions against expected savings or determining the effect of long-term liabilities created by current programs, (2) make economic choices, such as whether to outsource specific activities and how to improve efficiency through technology choices, (3) control costs for its weapons systems and business activities funded through the working capital funds, and (4) measure performance.

The lack of reliable, cost-based information hampers DOD in each of these areas as illustrated by the following examples.

- DOD is unable to provide actual data to fully account for the costs associated with functions studied for potential outsourcing under OMB Circular A-76. We recently reported on a long-standing concern over how accurately DOD's in-house cost estimates used in A-76 competitions reflect actual costs.⁴⁹
- DOD has acknowledged that its Defense Reform Initiative efforts have been hampered by limited visibility into true ownership costs of its weapons systems. Specifically, the department cited inconsistent methods used by the military services to capture support cost data and failure to include certain costs as limiting the utility of existing weapons system cost data. DOD has also acknowledged that the lack of a cost accounting system is the single largest impediment to controlling and managing weapon systems costs, including costs of acquiring, managing, and disposing of weapon systems.
- DOD has long-standing problems accumulating and reporting the full costs associated with its working capital fund operations, which provide goods and services in support of the military services. Cost is a key performance indicator to assess the efficiency of working capital fund operations. For example, we recently reported⁵⁰ that the Air Force's Air Mobility Command—which operated using a working capital fund—lacked accurate cost information needed to set rates to charge its customers and assess the economy and efficiency of its operations. We separately reported that Air Force depot maintenance officials acknowledged that

⁴⁹*DOD Competitive Sourcing: Lessons Learned System Could Enhance A-76 Study Process* (GAO/NSIAD-99-152, July 21, 1999).

⁵⁰*Defense Transportation: More Reliable Information Key to Managing Airlift Services More Efficiently* (GAO/NSIAD-00-6, Mar. 6, 2000).

they lack all the data needed to effectively manage their material costs.⁵¹ As a result, DOD is unable to reliably assess the economy and efficiency of its business-like activities financed with working capital funds.

Reliability of Budget Data Impaired

In its financial statements, DOD is required to report the activity in and status of its budget accounts. The Statement of Budgetary Resources, one of the basic financial statements, presents information, such as outlays and obligated and unobligated balances, at the end of the year. This statement also should reconcile to Fund Balance with Treasury accounts, which represent DOD's balances available for disbursement. In addition, DOD's outlays should agree with the activity in these Treasury accounts for the year.

DOD auditors were unable to complete their audits of the Statements of Budgetary Resources because they found that obligated balances were not correct, disbursements were not properly recorded, and Fund Balances with Treasury remained unreliable. In addition to the specific improvement initiatives referred to in this section, the ultimate resolution of DOD's long-standing problems in maintaining reliable budgetary data will depend on the process improvements, enhanced training, and systems efforts discussed later in this testimony.

Obligated Balances Were Incorrect and Unsupported

In their testing of obligated balances, auditors found evidence of unsupported obligations and poor internal controls over obligations, as illustrated by the following examples.

- The Army Audit Agency found⁵² that internal controls over the recording of obligations were not adequate to ensure that amounts reported in the Army's General Fund Statement of Budgetary Resources for fiscal year 1999 were accurate. In a sample of 60 transactions, the auditors found that 21 could not be supported.
- For fiscal year 1999, audit results⁵³ show that the Air Force Working Capital Fund had \$211 million of obligations out of approximately

⁵¹ *Air Force Depot Maintenance: Analysis of Its Financial Operations* (GAO/AIMD/NSIAD-00-38, Dec. 10, 1999).

⁵² *Army's General Fund Principal Financial Statements for Fiscal Year 1999, Financial Reporting of Budgetary Resources* (U.S. Army Audit Agency Report No. AA 00-223, Apr. 28, 2000).

⁵³ *Opinion on Fiscal Year 1999 Air Force Working Capital Fund Financial Statements* (Air Force Audit Agency Report No. 99068011, Feb. 9, 2000).

\$1 billion tested, that is 700 out of 2,526 transactions that were incorrect, inadequately supported, or not supported. In addition, Air Force's general fund audit continued to identify inaccurate or unsupported obligated balances as of September 30, 1999. Specifically, Air Force auditors identified an estimated \$1.3 billion in inaccurate or unsupported obligated balances. However, this represents a significant improvement over the prior year when an estimated \$4 billion in obligated balances were inaccurate or unsupported.

- In addition to auditors' reports, the Department of the Navy identified its unliquidated and invalid obligations as a material management control weakness in its fiscal year 1999 annual assurance statement issued pursuant to the Federal Managers' Financial Integrity Act.⁵⁴ For example, the Navy reported that within the Operation and Maintenance-Navy appropriation, some activities were not verifying that only valid obligations were entered into the accounting system. As a result, funding may have been available but not used. In addition, the Navy had more than \$1 billion in expired budget authority that was allowed to cancel at the end of fiscal year 1999, including more than \$750 million that had been obligated but not disbursed. According to Treasury data, at the end of fiscal year 1999, the department had \$3.8 billion in expired budget authority that canceled.

Further, major Navy commands were deobligating funds from subordinate commands without the subordinate's knowledge and approval. As a result, valid obligations could have been deobligated. These procedures demonstrate a lack of adequate internal controls over the obligation process, which is intended to ensure that liabilities are recognized against available funding and that overspending does not occur.

Disbursements Not Properly Recorded

Problem disbursements—disbursements that are not properly matched to specific obligations recorded in the department's records—continue to impede the department's efforts to improve its budgetary data. This situation can misstate DOD's reported obligated balances, undermining this important budgetary control. For example, when disbursements are not matched to specific obligations, an understatement of obligations and an overdisbursement of an account can occur. This situation occurs if the disbursement is for an item for which an obligation has not been recorded

⁵⁴The Federal Managers' Financial Integrity Act of 1982 requires federal agencies to annually assess controls and report on internal control and accounting system deficiencies, along with the status of related corrective actions.

or if the amount of the recorded obligation is less than the recorded disbursement. Obligations are also understated in the case of in-transits, in which a disbursement has been made but documentation is insufficient to determine how the transaction should be recorded in the accounting records.

The DOD Comptroller's Office stated in the fiscal year 1999 financial statements that the elimination of problem disbursements is one of the department's highest financial management priorities. DOD has reported progress in resolving problem disbursements. As of September 30, 1999, DOD reported⁵⁵ \$10.5 billion in problem disbursements, including in-transits, as compared with about \$17.3 billion in problem disbursements reported at the end of fiscal year 1998.

Of the \$10.5 billion, DOD reported that about \$1.5 billion were problem unmatched disbursements and negative unliquidated obligations (NULOs)⁵⁶ over 180 days old. DOD's problem disbursement policy requires that obligations be recorded for amounts paid that are unmatched to a recorded obligation or exceed recorded obligated balances after 180 days. However, the policy makes an exception if sufficient funds are not available for obligation. In that case, DOD's policy permits the department to delay recording an obligation or adjustment until the funds cancel—up to 5 years after expiration of the account. DOD believes that by delaying the recording of the obligation, funds will become available—for example, through de-obligation—thus permitting the obligation to be recorded without incurring a potential Antideficiency Act violation⁵⁷ and ensuing investigation. If DOD had recorded this \$1.5 billion after the transactions remained unmatched for 180 days, the related account balances would have reflected potential Antideficiency Act violations and required an investigation and report to the Congress.

An agency may not avoid the requirements of the Antideficiency Act, including its reporting requirements, by failing to record obligations or to investigate potential violations. To ensure sound funds control and

⁵⁵Defense Finance and Accounting Service reports to the DOD Comptroller on problem disbursements and in-transits as of September 30, 1999.

⁵⁶Negative unliquidated obligations (NULOs) are disbursements that have been received and posted to specific obligations by the accounting station, but the recorded disbursements exceed the recorded obligations.

⁵⁷The Antideficiency Act provides that an officer or employee of the United States Government may not "make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund" or enter into a contract or other obligation for payment of money "before an appropriation is made." (31 U.S.C. 1341 (a)).

compliance with the Antideficiency Act, an agency's fund control system must record transactions as they occur. We and the DOD IG have previously reported⁵⁸ on this issue and recommended that DOD revise its problem disbursement policies and procedures to ensure that accurate and reliable balances are maintained.

Finally, due to improper and unsupported DOD payments, such as the problem disbursement issues previously discussed, the true magnitude of DOD's payment problems is unknown. For example, our work continues to identify problems with overpayments and erroneous payments to contractors. For fiscal years 1994 through 1999, defense contractors returned over \$5.3 billion to the DFAS Columbus Center, including \$675 million during fiscal year 1999, due to contract administration actions and payment processing errors.

Frequent Adjustments Affect Reliability

DOD frequently adjusts recorded payments to record the payment to another appropriation account, including to canceled appropriations. These adjustments raise questions about the reliability of amounts reported as obligated and available for disbursement. In March 2000, we reported⁵⁹ that about one of every two dollars in fiscal year 1997 contract payment transactions processed was for adjustments to previously recorded disbursement transactions. Although DOD reported that the number of adjustments has declined, it remains significant. During fiscal year 1999, DFAS data showed that almost one of every three dollars in contract payment transactions was for adjustments to previously recorded payments—\$51 billion in adjustments out of \$157 billion in transactions. These adjustments were often made to original entries that were recorded years earlier. Many of the adjustments selected during our review were made to canceled accounts.

In the National Defense Authorization Act for Fiscal Year 1991, the Congress changed the government's account closing procedures. The intent of the changes was to impose the discipline of the Antideficiency Act and the bona fide needs rule⁶⁰ to expired appropriations and to ensure

⁵⁸ *Financial Management: Problems in Accounting for Navy Transactions Impair Funds Control and Financial Reporting* (GAO/AIMD-99-19, Jan. 19, 1999) and *Recording Obligations in Official Accounting Records* (DOD IG Report No. D-2000-030, Nov. 4, 1999).

⁵⁹ *Financial Management: Differences in Army and Air Force Disbursing and Accounting Records* (GAO/AIMD-00-20, Mar. 7, 2000).

⁶⁰ The bona fide needs rule, based on 31 U.S.C. 1502(a), requires that agencies use appropriations available for obligation for a limited period of time to meet the legitimate needs of the agency arising during that period of time.

that expired appropriations do not remain open on the government's books indefinitely. Under the account closing law, 31 U.S.C. 1551-1558, agencies must continue to account for the obligated and unobligated balances of their appropriations for 5 years after the expiration of their period of availability. At the end of 5 years, appropriation balances, both obligated and unobligated, are canceled. After that time, they are no longer available for obligation, obligation adjustment, or expenditure for any purposes.⁶¹ Because these accounts are no longer available for disbursement, they are not reported as part of DOD's Fund Balance with Treasury or in the department's Status of Funds reports to OMB or the Congress.

Subsequent to the amendment of the account closing law, DOD requested that Treasury reopen hundreds of closed accounts to permit the posting of adjustments. Treasury asked us whether it had authority to correct reporting or accounting errors in closed accounts. In 1993, we determined that Treasury had authority to correct these errors.⁶² However, our decision emphasized that "Treasury's authority to correct the accounts relates only to obvious clerical errors such as misplaced decimals, transposed digits, or transcribing errors that result in inadvertent cancellations of budget authority, and is not meant to serve as a palliative for deficiencies in DOD's accounting systems."⁶³ The decision also concluded that Treasury may adjust canceled appropriations to record disbursements that were in fact made before the cancellation. However, Treasury can make these adjustments only if DOD can establish that a disbursement was a liquidation of a valid obligation, recorded or unrecorded, that was properly chargeable against a closed account.⁶⁴

Adjusting disbursements previously recorded to current or expired accounts by moving those transactions to canceled accounts can change balances available for obligation in the current accounts or obligated balances in expired accounts. Since the 1991 account closing law was enacted, DOD has requested that Treasury reopen 333 closed accounts, restoring a total of \$26 billion. These accounts remained open as of

⁶¹Obligation adjustments and liquidations (expenditures) that an agency would otherwise have charged against the expired appropriation are, at this point in time, chargeable against a current appropriation for the same purpose, but only to the extent of the lesser of 1 percent of the current appropriation or unexpended balance of the closed account (31 U.S.C. 1553(b)).

⁶²72 Comp. Gen. 343 (1993).

⁶³72 Comp. Gen. at 346 (1993).

⁶⁴72 Comp. Gen. at 347 (1993).

September 30, 1999. By comparison, all other federal agencies combined have requested that Treasury reopen 21 closed accounts, restoring a total of \$5 million. According to Treasury's records, DOD made \$576 million in net adjustments to canceled accounts in fiscal year 1999. DOD has indicated that it has controls in place to ensure that adjustments to canceled accounts are proper. We expect to begin a review in this area to ensure that DOD's adjustments to closed accounts comply with the account closing law and the 1993 Comptroller General decision.

Fund Balance With Treasury Remains Unreliable

Although an agency is responsible for determining and maintaining its available fund balance, Treasury also has information about activity in the agency's account, and Treasury's and the agency's records must be periodically reconciled to determine the actual amount of funds available. Although DOD has made some improvements in its accountability over these funds, the amount of funds available at DOD remains questionable because significant differences between DOD and Treasury's records remain and items in suspense accounts may or may not reflect DOD activity.

DOD made the reduction of differences a high priority in its short-term improvement plans last year. DFAS began standardizing the reconciliation procedures and adjusting the differences. This effort resulted in a drop in the absolute value of unresolved differences from \$9.6 billion at September 30, 1998, to \$7.3 billion at September 30, 1999. In addition, some DOD components have significantly improved the process and reduced the amount of unreconciled differences. The Army's Corps of Engineers, Civil Works, formed special teams to research and resolve differences identified by Treasury on a monthly basis. The efforts of these special teams resulted in a substantial reduction in unreconciled differences. For example, the absolute value of unreconciled differences for the Corps of Engineers at September 30, 1999, was \$64 million—down from \$423 million on September 30, 1998.

Although some of these unreconciled differences may be due to the timing of transaction processing at Treasury versus DOD, an aging of the difference demonstrates that reconciliation issues remain. For example, although \$4.8 billion of the absolute difference is less than 60 days old, \$1.2 billion is 60 days to 1 year old, and \$1.3 billion is over 1 year old. Differences over 60 days old are generally not expected to be attributable to timing.

At least some of the decrease in the total differences can be attributed to the practice of some DFAS center staff to routinely adjust their records

each month to match those at Treasury without first identifying whether the adjustment is proper. This practice results in fewer differences on the reports but does not necessarily mean that the reconciliation process has actually improved or that the causes of the differences have been addressed and resolved. For example, one Army disbursing station recorded \$608 million in differences to a suspense account.⁶⁵ These differences were ultimately charged to Operations and Maintenance at year-end to avoid showing this amount on the Statement of Differences.

Finally, DOD records show that an estimated \$1.6 billion of transactions held in suspense accounts at the end of fiscal year 1999 have not been properly reported to Treasury and may also affect the fund balance with Treasury amount. DOD reported \$823 million in suspense accounts at the end of fiscal year 1998. Until suspense account transactions are posted to the proper appropriation account, the department will have little assurance that it has a right to the collections, that adjustments are valid, and that the disbursements do not exceed appropriated amounts. Moreover, the reported amounts in suspense accounts represent the offsetting (netting) of collections and adjustments against disbursements, thus understating the magnitude of the unrecorded amounts in suspense accounts.

Computer Security Weaknesses Continue to Undermine Financial Management and Other Operations

DOD relies on a vast and complex computerized information infrastructure to support virtually all aspects of its operations, including strategic and tactical operations, weaponry, intelligence, and security. This reliance extends to its business operations that support the department, including financial management. In recent years, internal and external evaluations have identified weaknesses in information security that could seriously jeopardize DOD's operations and compromise the confidentiality, integrity, or availability of sensitive information, including data that are recorded in or transmitted by the department's financial management systems. In September 1996, we issued a report with limited distribution that identified pervasive information security weaknesses in DOD. We reported that DOD lacked a departmentwide information security program to comprehensively address the general control weaknesses we had identified.

While not unmindful of the computer security weaknesses of its financial management and other critical computer system operations, until recently,

⁶⁵A suspense account is a temporary holding account for problem transactions—for example, those rejected because of system edit controls.

the department has necessarily focused its efforts on preparing its computer infrastructure for the Year 2000. However, with that challenge successfully addressed, DOD can now turn even greater attention to countering cyber threats and protecting its information systems in support of both warfighting and its financial management and other business missions.

In some areas, the Year 2000 effort has laid a foundation for long-term improvement in the way federal agencies view, manage, and protect computer systems supporting critical missions. Among the lessons learned were the importance of understanding the significance of computer-supported operations and the extensive dependence agencies have on computers. This dependence has heightened DOD's exposure and vulnerability to a rapidly growing number of sophisticated internal and external cyber threats. As such, DOD reports that it is firmly embarked on improving its overall information assurance posture. For example, we recently reported to the Special Committee on the Year 2000 Technology Problem⁶⁶ that DOD expects funding for computer-network defense to increase significantly for fiscal years 2001 through 2005. DOD reports that this funding is in support of its efforts to improve computer security capabilities and to manage and strengthen its information assurance posture.

As laid out in our 1998 Executive Guide⁶⁷ on information security management, establishing and effectively implementing a computer security program should establish a process and assign responsibilities for systematically (1) assessing risk, (2) developing and implementing effective security policies and controls, (3) promoting security awareness, (4) monitoring the appropriateness and effectiveness of these policies and related controls, and (5) providing feedback to managers who may then make needed adjustments. In February 1997, we included information security in our list of government program areas at high risk for waste, fraud, abuse, and mismanagement, a designation that continued in last year's update.⁶⁸

⁶⁶ *Computer Security: Reported Appropriations and Obligations for Four Major Initiatives* (GAO/AIMD-00-92R, Feb. 28, 2000).

⁶⁷ *Executive Guide: Information Security Management—Learning From Leading Organizations* (GAO/AIMD-98-68, May 1, 1998).

⁶⁸ *High-Risk Series: Information Management and Technology* (GAO/HR-97-9, Feb. 1997); *High-Risk Series: An Update* (GAO/HR-99-1, Jan. 1999); and *Major Management Challenges and Program Risks: Department of Defense* (GAO/OCG-99-4, Jan. 1999).

Although many factors contribute to these weaknesses, audits by GAO and Inspectors General have found that an underlying cause of weak information security is poor management of security programs. In August 1999, we reported⁶⁹ that serious weaknesses in DOD's information security—at both the department and component levels—continued to provide hackers and hundreds of thousands of authorized users the opportunity to modify, steal, inappropriately disclose, and destroy sensitive data. Moreover, they endanger other important DOD-wide functions, such as weapons and supercomputer research, logistics, procurement, personnel management, and military health. In fact, attackers have stolen, modified, and destroyed both data and software at DOD. They have installed “back doors” that circumvented normal system protection and allowed attackers unauthorized future access. They have also shut down and crashed entire systems and networks.

In particular, we found that DOD lacked adequate (1) controls over access to sensitive systems and data, (2) controls over software development and changes, (3) segregation of duties, (4) system software controls, and (5) continuity of service plans. For example, we found that users were granted access to computer resources that exceeded what they required to carry out their job responsibilities, including sensitive system privileges for which they had no need. In addition, we found that personnel were still being assigned both systems programming and security administration duties. This dual assignment would enable users for example, to modify payroll records or shipping records to generate unauthorized payments or misdirect inventory shipments and to suppress the related system audit data to avoid detection.

At the time of our 1999 review, in response to our recommendations, DOD was developing but had not yet implemented a departmentwide security program—known as the Defense-wide Information Assurance Program (DIAP). DIAP planning documents, which incorporate at a high level most of the best practices associated with information security management, indicate that DOD recognizes and is attempting to establish the departmentwide structure needed to manage the complex information security risks associated with its heavy reliance on computer systems. Also, in December 1998, a newly created Joint Task Force for Computer Network Defense began coordinating and directing the defense of DOD computer systems and networks against strategic attack. Its functions include (1) situation monitoring and assessment, (2) directing DOD

⁶⁹*DOD Information Security: Serious Weaknesses Continue to Place Defense Operations at Risk* (GAO/AIMD-99-107, Aug. 26, 1999).

actions to stop attacks, contain damage, restore functionality, and provide feedback to users, (3) coordinating DOD defensive actions with other government agencies and private organizations, as appropriate, (4) participating in joint training exercises, and (5) developing contingency plans and techniques. We currently have a review under way to determine how well these improvements are being implemented and whether they are being effectively coordinated.

We also made recommendations in our earlier reports aimed at ensuring that information security programs of the military departments and Defense agencies were consistent with the departmentwide security program. This recommendation came partly as a result of persistent general control weaknesses at many military installations, including unauthorized access to sensitive information and weak controls over key automated data processing operations used to support accounting and operational systems. Our recently completed general and application control review of one DOD component's key financial management system identified similar weaknesses.

Preliminary results of this review identified serious weaknesses in access controls and systems software. For example, we gained access to sensitive information through a file that was publicly available over the Internet. Without valid user authentication, we gained access to employees' social security numbers, addresses, and pay information, as well as budget, expenditure, and procurement information on projects. This component is taking corrective actions consistent with DOD's overall information assurance initiatives.

Integrated Financial Management System Using Year 2000 Approach

Establishing an integrated financial management system—including both automated and manual processes—will be key to reforming DOD's financial management operations. DOD has acknowledged that its present system has long-standing inadequacies and does not, for the most part, comply with federal system standards. DOD has set out an integrated financial management system goal. Further, the department is now well-positioned to adapt the lessons learned from addressing the Year 2000 issue and our recently issued survey of the best practices of world-class financial management organizations⁷⁰ and to use the information technology investment criteria included in the Clinger-Cohen Act of 1996.

⁷⁰*Executive Guide: Creating Value Through World-class Financial Management* (GAO/AIMD-00-134, Apr. 2000).

Integrated Financial Management System Needed

Establishing an integrated system is central to the framework for financial reforms set out by the Congress in the Chief Financial Officers (CFO) Act of 1990 and the Federal Financial Management Improvement Act (FFMIA) of 1996. Specifically, among the requirements of the CFO Act is that each agency CFO develop an integrated agency accounting and financial management system. Further, FFMIA provided a legislative mandate to implement and maintain financial management systems that substantially comply with federal financial management systems requirements, including the requirement that federal agencies establish and maintain a single, integrated financial management system.⁷¹

The department faces a significant challenge in integrating its financial management systems because of its size and complexity and the condition of its current financial management operations. DOD is not only responsible for an estimated \$1 trillion in assets and liabilities, but also for providing financial management support to personnel on an estimated 500 bases in 137 countries and territories throughout the world. DOD has also estimated that it makes \$24 billion in monthly disbursements, and that in any given fiscal year, the department may have as many as 500 or more active appropriations. Each service operates unique, nonstandard financial processes and systems. In describing the scope of its challenge in this area, DOD recognized that it will not be possible to reverse decades-old problems overnight.

DOD submitted its first *Financial Management Improvement Plan* to the Congress on October 26, 1998. We reported⁷² that DOD's plan represented a great deal of effort and provided a first-ever vision of the department's future financial management environment. In developing this overall concept of its envisioned financial management environment, DOD took an important first step in improving its financial management operations. DOD's 1999 update to its *Financial Management Improvement Plan* set out an integrated financial management system as the long-term solution for establishing effective financial management. As part of its 1999 plan, DOD reported that it relies on an inventory of 168 systems to carry out its financial management responsibilities. This financial management systems inventory includes 98 finance and accounting systems and 70 critical

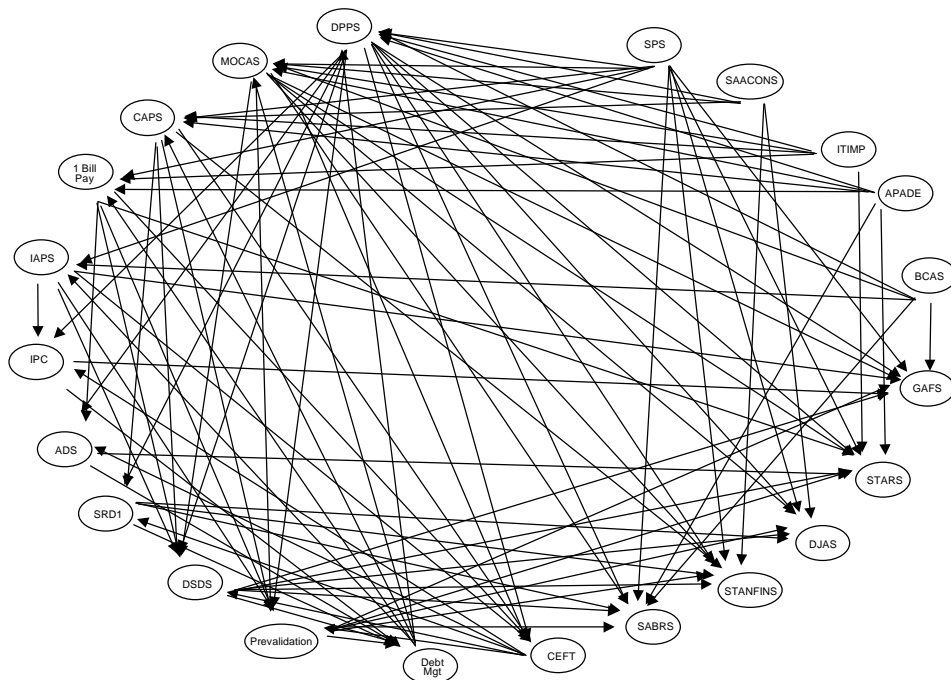
⁷¹Office of Management and Budget Circular A-127 defines an integrated financial management system as a unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls, and data necessary to carry out financial management functions of an agency, manage financial operations of an agency, and report on an agency's financial status to central agencies, Congress, and the public.

⁷²*Financial Management: Analysis of DOD's First Biennial Financial Management Improvement Plan* (GAO/AIMD-99-44, Jan. 29, 1999).

feeder systems—systems owned and operated by functional communities throughout DOD, such as personnel, acquisition, property management, and inventory management. The inclusion of feeder systems in the department's inventory of financial management systems is a significant landmark because of the importance of the programmatic functions to the department's ability to carry out not only its financial reporting but also its asset accountability responsibilities. The department has reported that an estimated 80 percent of the data needed for sound financial management comes from these feeder systems. However, DOD has also acknowledged that overall, its financial management systems do not comply with the FFMIA federal financial management systems requirements.

DOD presently lacks the integrated, transaction-driven, double entry accounting systems that are necessary to properly control assets and accumulate costs. As a result, millions of transactions must be keyed and rekeyed into the vast number of systems involved in a given business process. To illustrate the degree of difficulty that DOD faces in managing these complex systems, the following figure shows for one business area—contract and vendor payments—the number of systems involved and their relationship to one another.

Figure 1: DOD's Current Systems Environment for the Contract and Vendor Payment Process



Source: Department of Defense.

In addition to the 22 financial systems involved in the contract payment process that are shown in figure 1, DFAS has identified many other critical acquisition systems used in the contract payment process that are not shown on this diagram. To further complicate the processing of these transactions, each transaction must be recorded using a nonstandard, complex line of accounting that accumulates appropriation, budget, and management information for contract payments. Moreover, the line of accounting code structure differs by service and fund type. For example, the following line of accounting is used for the Army's Operations and Maintenance appropriation.

2162020573106325796.BD26FBQSUPCA200GRE12340109003AB22WORNAAS34030

Because DOD's payment and accounting processes are complex, and generally involve separate functions carried out by separate offices using different systems, the line of accounting must be manually entered multiple times, which compounds the likelihood of errors. An error in any one character in such a line of code can delay payment processing or affect the reliability of data used to support management and budget

decisions. In either case, time-consuming research must then be conducted by DOD staff or by contractor personnel to identify and correct the error. Over a period of 3 years, one DOD payment center spent \$28.6 million for a contractor to research such errors.

The combination of nonintegrated systems, extremely complex coding of transactions, and poor business processes have resulted in billions of dollars of adjustments to correct transactions processed for functions such as inventory and contract payments. As stated previously, during fiscal year 1999, almost one of every three dollars in contract payment transactions was made to adjust a previously recorded transaction. In addition, the DOD IG found that \$7.6 trillion of adjustments to DOD's accounting transactions were required last year to prepare DOD's financial statements.

DOD Adopts Year 2000 Approach

As we testified last year, DOD has a unique opportunity to capitalize on the valuable lessons it has learned in addressing the Year 2000 issue and apply them to its efforts to reform financial management. The Year 2000 approach is based on managing projects as critical investments and uses a structured five-phase process, including awareness, assessment, renovation, validation, and implementation. Each phase represents a major program activity or segment that includes (1) specific milestones, (2) independent validation and verification of system compliance, and (3) periodic reporting on the status of technology projects. During the department's Year 2000 effort, DOD followed this structured approach and (1) established interim dates or milestones for each significant aspect of the project, (2) used auditors to provide independent verification and validation of systems compliance, and (3) periodically reported the status of its efforts to OMB, the Congress, and the audit community.

To successfully adapt this structured, disciplined process to DOD's current financial management improvement initiatives, DOD must ensure that the lessons learned in addressing the Year 2000 effort and from our financial management best practices survey are effectively applied. In this regard, two important lessons should be drawn from the Year 2000 experience—the importance of (1) focusing on process improvement instead of systems compliance and (2) strong leadership at the highest levels of the department to ensure the reform effort becomes an entitywide priority.

End-to-End Business Process Focus

Establishing the right goal is essential for success. Initially, DOD's Year 2000 focus was on information technology and systems compliance. This process was geared toward ensuring compliance system by system and did not appropriately consider the interrelationship of all systems within a

given business process. However, DOD eventually shifted to a core mission and function approach and greatly reduced its Year 2000 risk through a series of risk mitigation measures including 123 major process end-to-end evaluations. Through the Year 2000 experience, DOD has learned that the goal of systems improvement initiatives should be improving end-to-end business processes, not systems compliance.

This concept is also consistent with provisions of the Clinger-Cohen Act of 1996 and related system and software engineering best practices, which provide federal agencies with a framework for effectively managing large, complex system modernization efforts. This framework is designed to help agencies establish the information technology management capability and controls necessary to effectively build modernized systems. For example, the act requires agency chief information officers to develop and maintain an integrated system architecture. Such an architecture can guide and constrain information system investments, providing a systematic means to preclude inconsistent system design and development decisions and the resulting suboptimal performance and added cost associated with incompatible systems. The act also requires agencies to establish effective information technology investment management processes whereby (1) alternative solutions are identified, (2) reliable estimates of project costs and benefits are developed, and (3) major projects are structured into a series of smaller increments to ensure that each constitutes a wise investment.

The financial management concept of operations included in DOD's *Financial Management Improvement Plan* should fit into the overall system architecture for the department developed under the provisions of the Clinger-Cohen Act. In addition, the goal of DOD's *Financial Management Improvement Plan* should be to improve DOD's business processes in order to provide better information to decisionmakers and ensure greater control and accountability over the department's assets. However, we reported last year,⁷³ the vision and goals the department established in its *Financial Management Improvement Plan* fell short of achieving basic financial management accountability and control and did not position DOD to adopt financial management best practices in the future.

Although the 1999 improvement plan includes more detailed information on the department's hundreds of improvement initiatives, the fundamental

⁷³*Financial Management: Analysis of DOD's First Biennial Financial Management Improvement Plan* (GAO/AIMD-99-44, Jan. 29, 1999).

challenges we highlighted last year remain. Specifically, a significant effort will be needed to ensure that future plans address (1) how financial management operations will effectively support not only financial reporting but also asset accountability and control, (2) how financial management ties to budget formulation, (3) how the planned and ongoing improvement initiatives will result in the target financial management environment, and (4) how feeder systems' data integrity will be improved—an acknowledged major deficiency in the current environment.

For example, to effectively support accountability and control, DOD's plan needs to define each of its business processes and discuss the interrelationships among the functional areas and related systems. To illustrate, the plan should address the entire business process for property from acquisition to disposal and the interrelationships among the functional areas of acquisition, property management, and property accounting.

The department recently announced its intent to develop a "Y2K like" approach for tracking and reporting the CFO compliance of its financial management systems, including critical feeder systems. However, the department currently has hundreds of individual initiatives aimed at improving financial management, many of which were begun prior to the decision that a Year 2000 approach would be used for financial management reform. These decentralized, individual efforts must now be brought under the disciplined structure envisioned by the Clinger-Cohen Act and used previously during the department's Year 2000 effort. Doing so will ensure that further investments in these initiatives will be consistent with Clinger-Cohen Act investment criteria and that the department's financial management reform efforts focus on entire business processes and needed process improvements.

Because of the extraordinarily short time frames involved for the Year 2000 effort, the department rarely had the opportunity to evaluate alternatives such as eliminating systems and reengineering related processes. DOD has established a goal of September 30, 2003, for completing its financial management systems improvement effort. This time frame provides a greater opportunity to consider all available alternatives, including reengineering business processes in conjunction with the implementation of new technology, which was envisioned by the Clinger-Cohen Act.

Strong Department-Level Leadership

Lessons learned from the Year 2000 effort and from our survey of leading financial management organizations also stressed the importance of strong leadership from top leaders. Both these efforts pointed to the critical role

of strong leadership in making any goal—such as financial management and systems improvements—an entitywide priority. As we have testified many times before, strong, sustained executive leadership is critical to changing the culture and successfully reforming financial management at DOD. Although it is the responsibility of the DOD Comptroller, under the CFO Act, to establish the mission and vision for the future of DOD financial management, the department has learned through its Year 2000 effort that major initiatives that cut across DOD components must have the leadership of the Secretary and Deputy Secretary of Defense to succeed. In addition, our best practices work has shown that chief executives similarly need to periodically assess investments in major projects in order to prioritize projects and make sound funding decisions.

Improving DOD financial management is a managerial, as well as technical, challenge. The personal involvement of the Deputy Secretary played an important role in building entitywide support for Year 2000 initiatives by linking these improvements to the warfighting mission. To energize DOD, the Secretary of Defense directed the DOD leadership to treat Year 2000 as a readiness issue. This turning point ensured that all DOD components understood the need for cooperation to achieve success in preparing for Year 2000 and it galvanized preparedness efforts.

Similarly, to gain DOD-wide support for financial management systems initiatives, DOD's top leadership must link the improvement of financial management to DOD's mission. For example, DOD stated in its Defense Reform Initiative that improved business practices will eventually provide a major source of funding for weapon system modernization. This can occur through reductions in the cost of performing these activities as well as through efficiencies gained through better information. To ensure that this mission objective is realized will require top leadership involvement to reinforce the relationship between good financial management and improved mission performance. To build this support across the organization, many leading organizations have developed education programs that provide financial managers a better understanding of the business problems and nonfinancial managers an appreciation of the value of financial information to improved decision-making. As discussed below, DOD is taking these first steps in providing training to its financial personnel, and DOD officials have recently stated that their next annual financial management improvement plan will begin to address the need for financial management training for nonfinancial managers.

Strategic Human Capital Investment Integral to Reform

An integral part of financial and information management is building, maintaining, and marshaling the human capital needed to achieve results. While DOD has several initiatives underway directed at improving the competencies and professionalism of its financial management workforce, it has not yet embraced a strategic approach to improving its financial management human capital. Our recently issued guide on the results of our survey of the best practices of recognized world-class financial management organizations shows that a strategic approach to human capital is essential to reaching and maintaining maximum performance.

DOD's 1999 *Financial Management Improvement Plan* recognized the key role of financial management training in ensuring that the department has a qualified and competent workforce. The DOD Comptroller recently issued a memorandum to the department's financial management community emphasizing the importance of professional training and certification in helping to ensure that its financial managers are well-qualified professionals. Consistent with this recent emphasis, the department has begun several initiatives aimed at improving the professionalism of its financial management workforce. For example, DFAS contracted to have government financial manager training developed by the Association of Government Accountants provided to several thousand of its employees over the next 5 years. This training is aimed at enhancing participants' knowledge of financial management and can then be used to prepare for a standardized exam to obtain a professional certification, such as the Certified Government Financial Manager (CGFM)⁷⁴—a designation being encouraged by DOD management.

In another initiative, undertaken in conjunction with the American Society of Military Comptrollers, the department reports that it expects to have its own examination-based certification program for a defense financial manager in place in the near future. The department has contracted with the USDA Graduate School—a continuing education institution—to provide financial management training to an estimated 2,000 DOD financial personnel in fiscal year 2000 and thousands more over the next 5 years. The department reports that this training will be directed at helping participants to develop sufficient knowledge so that they can demonstrate competencies in governmentwide accounting and financial management systems requirements as they are applied in the DOD financial management environment.

⁷⁴The Certified Government Financial Manager (CGFM) is a government financial manager professional certification awarded by the Association of Government Accountants.

The department is faced with a considerable challenge if it is to improve its financial management human capital to the performance-based level of financial management personnel operating as partners in the management of world-class organizations. While DOD's financial personnel are now struggling to effectively carry out day-to-day transaction processing, personnel in world-class financial management organizations are providing analysis and insight about the financial implications of program decisions and the impact of those decisions on agency performance goals and objectives. To help agencies better implement performance-based management, we have identified common principles that underlie the human capital strategies and practices of leading private sector organizations.⁷⁵ Further, we have issued a human capital self-assessment checklist for agency leaders to use in taking practical steps to improve their human capital practices.⁷⁶

In closing, as we have noted throughout this testimony, DOD continues to make incremental improvements to its financial management systems and operations. At the same time, the department has a long way to go to address the remaining problems. Overhauling DOD's financial systems, processes, and controls and ensuring that personnel throughout the department share the common goal of improving DOD financial management, will require sustained commitment from the highest levels of DOD leadership—a commitment that must extend to the next administration.

Mr. Chairman, this concludes my statement. We will be glad to answer any questions you or the other Members of the Subcommittee may have at this time.

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⁷⁵ *Human Capital: Key Principles From Nine Private Sector Organizations* (GAO/GGD-00-28, Jan. 31, 2000).

⁷⁶ *Human Capital: A Self-Assessment Checklist for Agency Leaders* (GAO/GGD-99-179, Sept. 1999).

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