

# THE DEPARTMENT OF DEFENSE'S FINANCIAL MANAGEMENT PROBLEMS

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## HEARING BEFORE THE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY OF THE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES ONE HUNDRED FOURTH CONGRESS FIRST SESSION

NOVEMBER 14, 1995

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# CONTENTS

Hearing held on November 15, 1995 .....	Page 1
Statement of:	
Dodaro, Gene L., Assistant Comptroller General, Accounting and Information Division, U.S. General Accounting Office; and G. Edward DeSeve, Controller, Office of Federal Financial Management, Office of Management and Budget .....	38
Hamre, John J., Comptroller, Department of Defense, accompanied by Alvin Tucker, Deputy Chief Financial Officer; Richard Keevey, Director, Defense Finance and Accounting Service .....	9
Hill, Eleanor J., Inspector General, Department of Defense .....	94
McCoy, Helen T., Assistant Secretary of the Army, Financial Management and Comptroller; Deborah P. Christie, Assistant Secretary of the Navy, Financial Management and Comptroller; and Robert F. Hale, Assistant Secretary of the Air Force, Financial Management and Comptroller .....	67
Letters, statements, etc., submitted for the record by:	
Christie, Deborah P., Assistant Secretary of the Navy, prepared statement of .....	76
DeSeve, G. Edward, Controller, Office of Federal Financial Management, Office of Management and Budget, prepared statement of .....	51
Dodaro, Gene L., Assistant Comptroller General, Accounting and Information Management Division, prepared statement of .....	40
Hale, Robert F., Assistant Secretary of the Air Force, (Financial Management and Comptroller), prepared statement of .....	83
Hill, Eleanor J., Inspector General, Department of Defense, prepared statement of .....	98
Horn, Hon. Stephen, a Representative in Congress from the State of California, letter dated May 22, 1995 .....	5
Maloney, Hon. Carolyn B., a Representative in Congress from the State of New York, prepared statement of .....	4
McCoy, Helen T., Assistant Secretary of the Army, prepared statement of .....	69
Tucker, Alvin, Deputy Chief Financial Officer, Department of Defense, prepared statement of .....	13



# THE DEPARTMENT OF DEFENSE'S FINANCIAL MANAGEMENT PROBLEMS

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TUESDAY, NOVEMBER 14, 1995

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,  
INFORMATION, AND TECHNOLOGY,  
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 2 p.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Scarborough, and Maloney.

Staff present: J. Russell George, staff director; Anna Gowans Miller, professional staff member; Andrew G. Richardson, clerk; Cherri Branson, minority professional staff; and Jean Gosa, minority staff assistant.

Mr. HORN. A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order.

This afternoon we will examine financial management practices at the Department of Defense. Recent articles in the national press and other hearings on Capitol Hill have highlighted serious shortcomings in the Defense Department's financial management systems. These are not recent; they go back 40, 45 years to the founding of the department and its expansion.

The systems are antiquated. They do not communicate with each other. They make it difficult for the staff of the Department of Defense to accurately complete their work. The systems are not designed to produce the kind of financial information that financial audits require, let alone sufficient financial information for management of that vast department.

However, instead of making changes, the Department of Defense has claimed that changes could, ironically, given what is occurring today, require a system-wide shutdown and would be too expensive to implement. Yet they continue to operate with systems that cannot even accommodate double-entry bookkeeping, which every mom and pop store in America can manage.

Well, such stories demand change. For example, last May 14, the Washington Post reported that, in the past 10 years, the Department of Defense had spent \$15 billion that it could not account for. The General Accounting Office reported, as of August 31, the true figure was nearly double that amount. The Post cited overpayments to contractors including one problem that took years to resolve.

A company in Van Nuys, CA, wrote to the Defense Finance and Accounting Center in Columbus, OH, asking for \$3.4 million which it was due pursuant to a Navy contract. "Oh, no, the center officials told the Navy contractor. We actually owe you \$11.1 million under the contract, and here is your check."

That was 1992. It took until last month for the center to remedy this gross error, to request that the overpayment be returned. If a corner store operated that way, it would soon be out of business. I hope we hear some better news than stories like this, this afternoon. With shrinking budgets, strong financial management is needed more than ever to make sure every dollar works to maintain the effectiveness of our Nation's armed forces.

Today's session will focus on steps the Department of Defense is taking to strengthen its management control. Specifically, we will examine the department's compliance thus far with two laws designed to restore fiscal accountability: the Chief Financial Officers or CFO Act of 1990 and the Government Management Reform Act of 1994. The second law, GMRA, which is the Government Management Reform Act, I believe, requires the Department of Defense and other executive branch agencies to produce auditable financial statements beginning with fiscal year 1997.

Recent reports by the General Accounting Office and Office of Management and Budget identified problems and recommended changes to the Defense Department's financial management systems. In this hearing, we intend to review the DOD's progress in implementing those recommendations.

Our witnesses today come from the Office of the Secretary of Defense, the military services, the General Accounting Office, and the Office of Management and Budget. Dr. John Hamre, the Department of Defense Under Secretary/Comptroller/Chief Financial Officer, will set the stage for us on panel one. And I am conscious of the time; Dr. Hamre is going to have to leave here about 20 of or 15 minutes of 2 to make other commitments.

Then he will be followed by his principal deputy in the financial management area. Then Gene Dodaro of the General Accounting Office and Ed DeSeve of OMB will summarize their agencies' reports on Defense's problems. Next, the Army, Navy, and Air Force Assistant Secretaries for Financial Management, and the DOD Comptroller will update us on their services' recovery plans. We will conclude with an overall assessment by the Department of Defense Inspector General, Eleanor Hill.

Ladies and gentleman, we thank you all for joining us. We do have a tradition on this committee that we swear in all witnesses. And we also have the rule that if there is a written statement—and I know some of you have it; some of you don't—by prearrangement, that statement is inserted in the record after we introduce you. We would like you to summarize in 5 minutes the written statement, and then we will have more time for questions.

So if you will all stand and raise your right hands.

[Witnesses sworn.]

Mr. HORN. Note to the clerk that all three witnesses affirmed.

Dr. Hamre, we welcome you here today. We realize this is not your problem over the years. On the other hand, you're going to be the one who is going to solve the problem.

Mr. HAMRE. Sir, thank you very much, Mr. Chairman. No, you're actually right; it is my problem.

Mr. HORN. Excuse me a minute. Our distinguished ranking minority member has an opening statement. I should have asked.

Mrs. MALONEY. Thank you very much, Mr. Chairman.

This is certainly a very important hearing. In our national discussion of Federal spending, the role of proper accounting, record-keeping, and other "nuts and bolts" aspects of financial management are often overlooked. They were overlooked dramatically, in this case, with the Department of Defense.

I would just like to ask that my opening statement be made part of the record. It mirrors many of the things that you said. It outlines the two laws that Congress passed and the steps that the Department of Defense is taking to adhere to them, some of which are impressive. On the other hand, the reading the material—and I congratulate you on calling this hearing—and also press reports, in the Washington Post, "Defense Department, billions go astray, often without a trace," really curled my hair, reading about this.

I just want to note that I find it almost believable that the report listed in 1994, the annual report of Congress, the report listed accounting problems totaling billions of dollars, including \$19 billion in unmatched disbursements; in other words, checks written but not matched to specific equipment and services.

At the very least, I would like to know from this hearing why—I mean, you know, the most simple business manager in a small business, when you get an invoice, you match it to the bill before you pay it. I was reading in some of the reports that sometimes the offices are separated. You are paying bills in offices that are separate from where you are receiving the invoices. That seems to me like standard eighth grade intelligence to figure out that you match these two.

And I don't understand why the Department of Defense hasn't done this, when I must note for the record that, when we are facing these severe cutbacks in government, in every single area—the only area that grew was \$8 billion to the Defense Department, \$8 billion, more than what the Defense Department wanted. But I feel that you should have had, at the very least, an accounting of the one budget that has increased in this Congress, not been cut.

I want to mention also, they noted \$7 billion in negative, unliquidated obligations, money spent for goods and services which exceeded the amount appropriated by Congress for a particular project. In particular, the GAO found that, during a 6-month period in 1993, \$305 million of the \$751 million, or about 78 percent of checks processed in the main Defense Finance and Accounting Service, represented overpayments by the government. So I certainly would like to hear what your overpayment procedures are and why we are having such a huge amount spent in overpayments.

In any event, I look forward to what you have to say. And last, I would like to know why you are not following general accounting principles. I think that that would simplify it for the audits; it would simplify it for Congress; and it would certainly keep a better track of the citizen taxpayer dollars. You know, to have \$19 billion

lost, to have tremendous overpayments in a 6-month period of time—anyway.

[The prepared statement of Hon. Carolyn B. Maloney follows:]

PREPARED STATEMENT OF HON. CAROLYN B. MALONEY, A REPRESENTATIVE IN  
CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, this is an important hearing. In our national discussion of Federal spending, the role of proper accounting, record keeping and other “nuts and bolts” aspects of financial management are often overlooked. However, I question whether this is an “essential” hearing. The Federal government shut down last night at midnight, and only essential Federal government employees are working and collecting a paycheck today. In my district alone, thousands of Federal workers have been idled and my staff has been reduced by over half. It seems to me that all of our time would be better spent in trying to resolve the current budget impasse, rather than spending four hours on an oversight hearing.

But since I won't win that argument, let me address the issues at hand. The Department of Defense receives half of all Federal money not spent on entitlements. Its fiscal 1995 budget is \$260 billion. It sends out an average of \$35 million an hour in checks for military and civilian employees from its main financing office. Approximately \$380 billion flows from the military to the private sector each year.

Within the Defense Department different organizations use different and often inconsistent operating and accounting approaches to do similar tasks. Additionally, the acquisition and accounting practices are not based on computerized or centralized files. Essentially, the system is based on tracking transactions through a manually produced paper maze involving contracts, invoices, payment orders and cancelled checks. Each manual step in this out-dated process increases the chance of error within any given transaction.

The Department of Defense has embarked on a massive effort to implement standardized accounting practices and resolve the questions which arose as a result of previous accounting practices. The Department has undertaken a major consolidation of payroll and contracting offices; initiated over 100 investigations into individual managers or agencies for violations of the Anti-deficiency Act; frozen 23 major accounts and stopped payment on invoices of over 1000 contractors with questionable practices; and prohibited payments over \$5 million unless supported by valid contract and accounting records.

Despite its current efforts, the Department of Defense has a long way to go. Compliance with the Chief Financial Officers Act, and the requirements of the Government Management Reform Act and Government Performance and Results Act will increase the pressure to establish a standardized accounting and financial management system with stringent financial controls.

Thank you Mr. Chairman.

Mr. HORN. The gentlewoman's statement will be put in the record as if read.

At this point, since you will probably offer it anyhow, I want in the record the letter the Under Secretary wrote to the Hon. C.W. Bill Young, chairman of the Subcommittee on National Security of the House Committee on Appropriations, which is a very full letter on this situation.

And Dr. Hamre accepts responsibility for it, even though, as I said earlier, this goes back probably before he was born. You look sort of young to me. Everybody looks pretty young to me.

[The letter referred to follows:]





UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON DC 20301-1100



6

MAY 22 1995

Honorable C. W. Bill Young  
Chairman, Subcommittee on National Security  
Committee on Appropriations  
House of Representatives  
Washington, DC 20515

Dear Mr. Chairman:

On May 14, 1995, the Washington Post printed a startling article about the condition of our finance and accounting operations in the Department of Defense. I feel it is necessary to write you about this article because it implies that the Department's finance and accounting systems are so flawed and error prone that you can't trust the budget we have submitted to you. That is flatly not the case, as I explain below.

Let me say at the outset that we do have serious problems in our finance and accounting operations. Secretary Perry has given me very specific direction to get our house in order, and as I hope this letter will show, we are making good progress. No one is hiding our problems and I am very willing to review them in any detail you desire. But it is essential that these problems be placed in a proper context. I feel that the Post article failed to do that. Since you undoubtedly will hear from your constituents about the problems, I must take this means to provide you that context.

First, our accounting problems can be separated from the makeup and quality of the annual Defense budget. While we have serious accounting problems, our budget is based on best estimates of future needs and expected costs. Further, it is based on the obligation of funds, over which there is strict oversight. Those obligations reflect the award of contracts for goods and services. There has been very little dispute about the accounting for obligations, i.e., for what is on contract. Likewise, we have in place an elaborate system to determine whether goods or services have been delivered. Rather, our problems have concerned the matching of expenditures to obligations, which are an important part of accounting, but a less relevant factor in the development of budgets or the measurement of budget execution.

When I arrived, I learned that the Department had serious problems in matching obligations and disbursements. These were not the makings of my predecessor. These problems, in varying degrees go back 50 years to the founding of the Department.



Indeed, had it not been for Secretary Cheney's pathbreaking decision to combine the various finance and accounting offices around the Department into a consolidated Defense Finance and Accounting Service, our problems would be dramatically worse, and we would not be in a position to attack these problems now.

In the fall of 1993, Secretary Perry (then as Deputy Secretary) directed us to cut our problems in half within a year. In the process, we learned the problems were even bigger than we thought. The following chart summarizes the status and progress we have made. (GAO criticized us for understating the problem earlier this year, so I am using the most all-encompassing definition called for by GAO in these comparisons.) The three measures are disbursements not matched to any obligation, disbursements that exceed obligations (negative unliquidated obligations), and disbursements that are in process now.

Category of Disbursements	(Dollars in Billions)		
	6/93	6/94	3/95
Unmatched Disbursements	23.0	14.4	13.3
Negative Unliquidated Obligations	8.8	7.3	5.9
In-Transit Disbursements	<u>16.9</u>	<u>13.6</u>	<u>9.6</u>
Total	48.7	35.3	28.8

As you can see, over a 21-month period we have reduced the total problem from \$48.7 billion down to \$28.8 billion. That is a 41 percent reduction, and I am very proud of that. We have had thousands of people working very hard to make progress. In some areas the progress has been nothing short of stunning. The Army has reduced its problem disbursements by nearly 60 percent during this period. This is an incredible achievement, made possible only by exceptional efforts. Unfortunately, we still are left with a large number of problem disbursements which we must resolve.

I should point out, however, that these problem disbursements occurred during the past 10 years during which we disbursed over \$2.5 trillion. This means our problem disbursements total approximately 1 percent of total disbursements, and during the past 21 months we solved nearly \$20 billion of these problem disbursements and correctly matched our cancelled checks with their proper accounting records. I hope we will cut this in half during the next year.

So why are we making errors in the first place? In brief, we have flawed business practices that have built up over the past 40 years. When the Department was created, every organization developed its own accounting systems. When the DPAS was created, there were over 250 major accounting systems in operation. Some 30 years ago, the Department adopted a system where any one of the 300 plus finance offices can write a check on behalf of anyone else in the Department (cross disbursing). Although, we never write checks unless (1) there is a valid

contract and (2) the invoice is accompanied by an independent report from a government receiving activity indicating that we received the goods and services, this cross disbursing process resulted in a situation where checks were written for valid bills without checking first that there was a clear path back to the accounting record in one of those 250 accounting systems. The result was a business practice (and a culture) of "pay now, account for it later."

That has to stop. In March of last year, I issued directives suspending all payments from accounts "in the red." Since that time, we have held up over 20,000 payments to over 1,500 contractors. Today, we are still holding up 367 payments totaling \$19.2 million. We lowered the problem through the research efforts of the past year. Also at that time, I issued new guidelines for matching unmatched disbursements and "negative unliquidated obligations." That policy change has had a huge effect in reducing the problem.

The ultimate solution is to preclude payment until we have a clear match with the accounting record. We will start doing that in July. We will start slow, first with payments over \$5 million, dropping to all payments over \$1 million on October 1. Eventually we will drop that to zero. Because we process 2.5 million invoices a month, we can't insist on prevalidation immediately or we would freeze up all payments overnight.

The second serious allegation made in the Post article was that we were willy nilly paying contractors more than we owed them, and that often we didn't even know about it. That too is wrong. Here are the facts.

Contractor Overpayments  
(\$ in Millions)

FY 1993	792
FY 1994	294
FY 1995 (projected)	270

As you can see, back in FY 1993, we did pay contractors \$792 million more than we should have, but we did recover those overpayments. Since that time, we have devoted considerable effort to correcting these problems and have reduced the FY 1995 overpayment to \$137 million through March 1995. The projected FY 1995 level is roughly a 65 percent reduction, and again, I am very proud of that.

This too must be put in context. We made these overpayments at the Columbus DFAS Center which pays some \$90 billion annually. We disburse \$35 million an hour at the Columbus Center. This means, we overpay contractors about .3 of 1 percent, or in other words, they get it right 99.7 percent of the time. I don't excuse our mistakes, and we are working to correct them. But I have to ask that you put this in perspective.

Now you may ask (as did GAO) how do you know the problem isn't worse? Indeed, the figures above represent just what the contractors have returned. How much more haven't they returned?

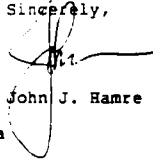
There could well be more that we don't know about. By law it is a criminal penalty for contractors to hold onto money when they know they have been overpaid. And every contract is audited before it is closed and that is usually when we catch overpayments that have occurred.

I am not making excuses for poor behavior. We have to get better. The problem already has been reduced by 65 percent in the past two years and we will continue to work on it until we get it totally corrected. But please remember we still have a 99.7 percent success rate.

Let me conclude by saying that there have been countless calls for "holding someone accountable" for this mess. I ask you to hold me accountable. The bulk of our problems are the product of innocent mistakes inside a very complex system where typographical errors produce thousands of mismatched records that require subsequent research. Some 46,000 people work in this area (the average grade is a GS-7) and they are working hard overcoming the limitations of the overly complicated system we have given them. We are fundamentally overhauling our business practices in this area--cutting by 90 percent the number of offices, cutting by over 80 percent the number of finance systems, cutting by half the number of people in the field, and so forth. Hold me responsible for progress. We are making progress, and I hope to earn your confidence.

Please let me know if I can provide additional information or insights into this important area.

Sincerely,



John J. Hamre

cc: Honorable John P. Murtha  
Ranking Democrat

Mr. HORN. OK. Proceed.

**STATEMENT OF JOHN J. HAMRE, COMPTROLLER, DEPARTMENT OF DEFENSE, ACCOMPANIED BY ALVIN TUCKER, DEPUTY CHIEF FINANCIAL OFFICER; AND RICHARD KEEVEY, DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE**

Mr. HAMRE. Mr. Chairman, thank you very much. You are gracious to invite. I might say, as I look around this room, you have 98 percent of all of the financial management talent in the Department of Defense and in the General Accounting Office that focuses on it. So it's a testament, I think, to the importance that we give to you and to this committee that we want to deal with these serious issues. And I personally appreciate very much your courtesy in inviting me and then also including in the record important documents that I think fill out that record.

I have asked to join me today, Mr. Tucker, who was originally going to be our witness, and he has a prepared statement, and I know we would like to add that to the record. And I would also like to introduce Mr. Richard Keevey, who is the Director of the Defense Finance and Accounting Service. I frequently say DFAS is more than a four-letter word, although that's usually what I only hear are four-letter words about it. And if there are any questions about DFAS, we would be delighted to answer them. I know he would be glad to.

Sir, I got to the department a little over 2 years ago, and I remember a very important hearing that I attended that Senator John Glenn had on your counterpart committee in the Senate on problems in financial management. And I must say I never really focused on it during the 11 years that I worked in the Congress, focused on Defense issues. I never worried about how we did finance and accounting for the Department of Defense. And I was startled at some of the things I heard.

My immediate reaction, as I think most Americans' are, is how they could be such a bunch of bums? You know, why would they be so stupid to do things that way? Why would people be so wicked to let these problems get out of control? And as I got over to the office, and my first reaction was just to crash a lot of heads, and we're going to certainly straighten this out, and I found out it was a much bigger, more complicated problem. It would be an easy answer if it was just slothful people or wicked people wanting to do bad things.

That isn't the case at all. Indeed, I found a department that was working very hard, trying to overcome the systemic problems that existed. So I set about saying, what are really the deeper, underlying causes of this problem? How did we get into this fix? Because the examples that Mrs. Maloney read, they are a little out of context with the truth, but nonetheless it is true, we had, when I got to the department—we didn't even aggregate it at the time—over \$50 billion of problem disbursements. How did we get into this fix?

So let me go through a bit of that as context for what follows. I think the first thing I've got to say is, we're dealing with a department and 200 years of business practices which are not adequate for today's form of business. I tell the analogy—I've given this to Secretary Perry—that when I got a review of our programs,

I reported about my predecessor back 200 years ago, who was John Warren, who was the second officer ever appointed by the Continental Congress. He was the paymaster general.

And after 6 months in the job, he wrote back to the Continental Congress and said, "I can't do my job," said, "There are 13 separate payroll systems. The uniforms aren't uniform. I mean, nothing is common." I reported to Dr. Perry, "We've made great progress. In 210 years, we have only added 5 more payroll systems, even though we've added 37 more states to the union."

When I got there, we had 18 payroll systems for civilians only. We had 18 military payroll systems. That reflects, frankly, a very important underlying reality. The Department of Defense, even though it was created 50 years ago, really constitutes a thin veneer over the business practices that built up, in some cases, over 200 years. And we designed a system where individual organizations developed their own finance and accounting operations, all of which were designed to report vertically to the boss; none of which were designed to interoperate with other organs in the government.

So we confront a department that has, today, over 230 accounting systems. Back 5 years ago, we had over 66 finance systems. And we are gradually going through the process of scoping this down, reducing the number, as a fallout to the consolidation that was started by the Department 5 years ago. If there is a hero, in my mind, it is Don Atwood, who was the Deputy Secretary of Defense, God rest his soul, he died a year ago.

Don Atwood was the Deputy Secretary of Defense under Dick Cheney. He came from industry. He was a senior executive in General Motors, and he said, "I can't believe we're doing business like this in the Department of Defense." And it was Don Atwood who created the Defense Finance and Accounting Service and said, "We've got to start bringing these things together. We've got to reduce the number of accounting systems and disbursing systems. We've got to introduce modern accounting methods."

He started us on the path. If it weren't for his efforts, we would be nowhere right now, and thank goodness he got us going.

Now, what have we done in the last 5 years? And I've got to say, it's hard to appreciate the scope of the problems. I'm clearly going well over my allotted time, if I may. Sir, first let me share with you the magnitude of the department and what it does. Every month we process 10 million payroll checks. Every month we process 2.5 million invoices. We process about 700,000 travel vouchers a month. We process 5,000 death notices a month. It's a gigantic operation.

It is also an operation that is spread to hither and yon. Four years ago, when DFAS was created, there were over 300 accounting stations and 300 disbursing stations. Any one of these disbursing stations could write a check on somebody else's account. It doesn't make a lot of sense, but that was the business practice at the time, 5 years ago. We are gradually going through very profound changes.

This last year alone, we closed nearly 80 accounting stations. We are consolidating so that we will only have 26 locations in the future that will do finance and accounting. We have consolidated our payroll systems. For example, we had four separate retiree and an-

nuitant systems, and we have reduced them now so that there is a single system being operated, I think, quite effectively, in two locations: one for annuitants, and one for retirees. We are consolidating our payroll systems. We are down now from 18 civilian payrolls systems; I think we only have 6 now, and we will be out of those by the end of next year.

So we are making profound changes across the board. We have made less progress, frankly, in the area of accounting. Now why is this? If I might address a question that Mrs. Maloney raised, which is, why are we not using modern accounting methods? It's a good question. Virtually all of the systems that we have set up in the Department of Defense are designed to answer one of two questions: If you have to go to war, can you do it, and where are there problems? That's question No. 1. And question No. 2 is, did you spend the money the way Congress gave it to you, and did you follow their guidelines?

That second question dominates our world in finance and accounting. And during the 1940's, and the 1950's, and the 1960's, and the 1970's, and the 1980's, we did all of that through the finance systems in the department; that is, disbursing systems that spent money. And our entire system revolved around accountability by keeping track of how we spent the dollars, recorded in the finance systems, not in our accounting systems. And we never had a closed circuit between our disbursing systems and our accounting systems.

We need to change that. This is, frankly, at the core of the reform that got started with passage of the Chief Financial Officers Act. We are on the way to doing that, but we are a long way away from getting that done. We have made some progress, not bad progress, but some progress in the area of consolidating our general accounting systems. We have made less progress in the area of our industrial fund accounting systems. And there it's because most of them are integrated into the business management systems that exist for those organizations, such as our depots and supply systems.

We have a plan to fix that. It's a long-term plan that's going to take us years, and it's going to take a lot of money. And there is some controversy about that. One of the questions you will want to ask later in this hearing, of Eleanor Hill, is, do we need to go the route that we're currently going on? We may not need to, and there is some discussion inside the department about that.

Another question is, how much of this should we do inside the government? Maybe we should contract out for some of it, to leapfrog this step and not necessarily improve our systems and then try to operate them as a government. Maybe we ought to contract it out. These are all issues that are on the table and things that we ought to explore.

Now, what can we promise you? What have we done so far, and what can we promise you? As I said, when I got to the office and when Rich Kievey came to the job, we had approximately \$50 billion of problem disbursements. May I say, these weren't checks written where we had no idea what we spent them on. We don't write the check until we have a receiving report that said we received the goods and services, and then we write the check. But

they weren't properly matched up against the underlying accounting record.

May I use an analogy, because this is a very complicated thing, to explain how this works. Let's pretend that I am a rich uncle, and I have 10 nephews and nieces. And because I have all the money and my brothers and sisters don't have any money, I offer to send them all to college, and I'm going to pay all their bills. But I'm no dummy, and I say, well, before I do that, I'm going to sit down with each of those kids and work out, in advance, a budget.

And my nephew John, he's a bright kid; he wants to go to Princeton. I worked out, here's his tuition, and here's however much for room and board, for all these different things, and I've worked that out with him, and then I give him a stack of blank checks. And I do that with each of my 10 nieces and nephews.

That's really how we do it in the Department of Defense. All of the program managers, we work out in advance what they are going to spend on something, and then we give them blank checks. They start spending money, and then we match up those checks, when they come in, back from the bank, with what did we agree in advance with their budget.

Now, let's say that I got a tuition check back from Princeton, and my agreement with my nephew John was that he was going to spend \$13,000, and it came in \$13,500. That \$500 is a negative unliquidated obligation, a NULO. It isn't a bad payment; but it's one that differs from our underlying accounting record, and we have to go back and research it and find out was it right or not right. And we had about \$10 billion of those, accumulated over a period of about 10 years, that we had to resolve.

Mr. HORN. \$10 million or \$10 billion?

Mr. TUCKER. \$10 billion, sir, big numbers.

Mr. HORN. I heard \$10 million.

Mr. TUCKER. I'm sorry. I'm just trying to confuse you. No, I apologize. In this case it was about \$10 billion, and we were off. And we had to resolve each one of those.

Now, let's say that my niece Mary Ann, I worked this out as well with her. And all of a sudden a check comes in from the Red Horse Saloon, and I said, "Well, wait a minute. I never worked out a deal with my niece, with her little budget, that she could spend any money at the Red Horse Saloon. What's going on here?" OK. It wasn't in my accounting records at all.

That's an unmatched disbursement. It's a check that was written. Now, I find out after the fact that she could buy a used economics textbook from a guy who was a bartender. She went there on Saturday night; he wanted cash; she wrote a check, and she got her book. Now, it might be a perfectly legitimate expenditure, but we have to research it after the fact. Now, we had about \$14 billion worth of those in that category.

We have been working these off. Then we had a large number of what are called "in transits," which had not yet formally been posted into the accounting record. Altogether, these various accounts, we had \$51 billion, as of June 1993. During the last 2 years, the department has made a lot of progress, and we've got the number down, as of September, to \$20.5 billion. So it's gone down



from \$50 billion to \$20 billion, and we still have a way to go, obviously.

Now, during this time, we've also put some policies in place that say, "You've got 180 days to work this out. And if you can't find the obligation during a 180-day period worth of research, you've got to now post an obligation against it." So we're trying to close that loop between our accounting systems and our finance systems. We've got a long way to go, but we are making progress as a department.

Now, how close are we to complying with the Chief Financial Officers Act, with auditable finance statements? That's a question that you need to ask the Assistant Secretary for Financial Management for the services that are here, and you have all of the chief principal leaders for the services here today.

It's an uneven picture, and we're a long way away, but we are making progress. Will we have certified statements without disclaimers tomorrow? Heck no. We're a way away from that, but we are making progress. We need to do better, and I would suggest that you direct that question to the assistant secretaries that are coming in the next panel. We're making some progress, sir.

Sir, let me end with that. And I would like to answer your questions. I've got two people who are much more expert in details than I, who might be able to answer things that you have specifically. And some of the charges that were made previously, for example, in the Post article, the facts weren't wrong; the context was totally off. So I would like to clarify that. Maybe my letter will do that, that was put in the record. I would be glad to answer any questions, sir.

[The prepared statement of Mr. Tucker follows:]

PREPARED STATEMENT OF ALVIN TUCKER, DEPUTY CHIEF FINANCIAL OFFICER,  
DEPARTMENT OF DEFENSE

Mr. Chairman and members of the Committee.

Thank you for the opportunity to discuss with you financial management in the Department of Defense (DoD) and the Department's efforts to implement the Government Management Act. I would like to address those issues you expressed interest in when inviting the Department to testify before this subcommittee.

ELIMINATING PROBLEM DISBURSEMENTS

First, I would like to discuss the issue of problem disbursements within the Department of Defense. Problem disbursements in DoD financial operations occur when an expenditure is not reconciled with official accounting records. On May 5, 1995, and June 30, 1995, Dr. Hamre, the Under Secretary Of Defense (Comptroller) and Chief Financial Officer advised Congressman Clinger of the actions the Department had recently taken and those the Department would take to resolve problem disbursements. I would like to speak specifically to two areas, Unmatched Disbursements and Contractor Overpayments.

*Unmatched Disbursements.* The Department of Defense aggressively is pursuing the matching of its old disbursements to proper obligations. In order to be successful in these efforts, the Department must be able to correct its records when an error is found. Thus, if a disbursement initially is charged to the incorrect obligation or appropriation, the Department must be able to correct that error and charge the proper obligation or appropriation. Such corrections are not difficult when only current or expired appropriations are involved. However, a substantial portion of the Department's obligations that have not yet been matched to the proper obligation involve appropriations that have been canceled. Thus, it is imperative that, for disbursements made before the cancellation of an appropriation, the Department be able to make corrections involving appropriations that have been canceled.

With the concurrence of the Department's Inspector General and the Office of General Counsel, Dr. Hamre approved policies and procedures for making corrections to DoD's canceled appropriations. These policies and procedures are consistent with the provisions of the closing accounts legislation. While they permit corrections in canceled appropriations to transactions that occurred before an appropriation was canceled, they do not permit new disbursements to be made from canceled appropriations. Consistent with the closing accounts legislation, disbursements after the cancellation of an appropriation must be charged to an appropriation current at the time of the disbursement.

To prevent future cases of unmatched disbursements, the Department is working toward requiring that every disbursement be matched to an obligation before actual payment is made. We can't fix the problem just by correcting the mistakes after they have been made. Instead, we have to go back to basic principles and not make the mistake in the first place. We now require the validation of proposed payments with the corresponding obligation data in official accounting systems prior to making payments. Since July 1995, DoD has required such validations for all payments over \$5 million. Beginning October 1, 1995, that threshold dropped to include all payments over \$1 million for all DoD activities with the exception of payments made by the DFAS Columbus Center. We expect to begin lowering the dollar threshold at the Columbus Center in later in FY 1996. Since the implementation of this policy, DFAS has successfully prevalidated over 1,100 invoices at a gross value of \$7.4 billion. As of November 5, only eight invoices are being held until we have found a satisfactory match to the accounting records.

Because systems are not in place to automatically prevalidate payments, much of the work must still be done manually. While the significant number of manual transactions will continue to hinder the Department's progress until automated systems are in place, the Department remains confident that the aggressive automation program underway will reduce the likelihood of unmatched disbursements.

*Contractor Overpayments.* Overpayments to DoD contractors constitute another area that is receiving intense management attention. In addition to the pre-validation process I have described, DFAS's Columbus Center has instituted a number of measures and internal controls to minimize the volume of overpayments occurring at this paying office. For example, the Center's Internal Review Office now conducts post payments reviews of all payments in excess of \$1 million to readily identify any potential overpayments. This ensures that requisite receivables can be established along with the issuance of demand letters. In addition, each of the payment entitlement operating divisions are continuously reviewing a sample of all \$1 million payments before the disbursement is made.

In late August, the Columbus Center sent letters to the contract community served by this center requesting that they return expeditiously, all overpayments that they discover. In addition, this letter served to advise the contracting community that the Defense Contract Audit Agency will be adding a step to its review of contractor billing systems to evaluate the adequacy of contractors' controls for identifying and notifying the Government of any overpayments.

We have also instituted a new procedure to expedite the delivery of demand letters to the contractors once the contracts have been reconciled. In addition, we have sent letters to the top 550 contractors requesting that they immediately return any identified overpayments. These actions will enable us to identify and collect overpayments to contractors more expeditiously.

On the system side, the Columbus Center is also in the process of developing programming changes to the entitlement system that will prevent payments if the disbursements made on a contract exceed available obligations.

#### FINANCIAL MANAGEMENT REFORM

In the early 1990's Department of Defense leaders initiated several important financial management improvements. When the Clinton Administration took office in 1993, the new DoD leadership directed a review of these initiatives and made major adjustments to increase their likelihood of success. More importantly, the leaders also concluded that the Department's financial management failures were more fundamental and entrenched than previously recognized. They therefore undertook a comprehensive diagnosis of financial management problems and causes, then launched new policies and far-reaching reforms to set things right. As a result the Department is now embarked upon the most comprehensive reform of financial management systems and practices in its history.

Planned reforms aim to streamline and redesign DoD financial processes and organizations, in order to make them optimally effective and to cut costs. Reforms also seek to ensure that the Department's financial management fulfills the needs of its

leaders, meets statutory requirements, minimizes inefficiency and fraud, and provides superlative customer service.

#### PROBLEM AND CAUSES

Since its formation in 1947, the Department of Defense has had a decentralized mode of operations. Reflecting that reality, the three military departments and the major defense agencies have, until recent reforms began, always managed their own budget, finance, and accounting systems. They developed their own processes and business practices, geared to their particular mission and with little need to achieve compatibility with other DoD operations. As defense missions became more complicated and DoD organizations were required to interact more with each other, their incompatibility and lack of standardization took a toll. Rather than redesigning its organization or standardizing its multitude of systems, the Department developed increasingly complex business practices to link the systems.

Illustrative of this situation, it traditionally has taken about a hundred paper transactions among as many as a dozen DoD organizations to make a progress payment toward the acquisition of a complex weapon system. Moreover, after the payment has been made, the final accounting for that payment typically has required considerable time and effort to complete—resulting in the accumulation of problem disbursements.

Such complexity left DoD financial systems prone to error or to demands that could not be met with the systems, personnel, or time available. No matter how good the people operating the systems, problems were almost inevitable. Moreover, there was an inherent inefficiency to having scores of incompatible organizations performing virtually identical functions. There was only one pay schedule for military people and one for DoD civilians; yet DoD had dozens of different pay systems.

#### REFORM INITIATIVES AND PROGRESS TO DATE

Highlighted below are the major Department of Defense initiatives for financial management reform:

##### *DFAS and the Consolidation of Financial Management Operations*

Since its activation in January 1991, the Defense Finance and Accounting Service (DFAS) has been the Department's pivotal agent for financial management reform. Through FY 1995 DFAS has achieved budget savings of \$314 million.

DoD's financial management systems are of two types: (1) finance systems for processing payments to DoD personnel/organizations and to private contractors; and (2) accounting systems, for accumulating and recording operating and capital expenses—as well as appropriations, revenues, and other receipts. Before DFAS was established, the Department had some 250 finance and accounting systems.

Before consolidation began, the Department's many financial management systems operated from over 300 field activities or sites. DFAS is now streamlining these down to five DFAS Centers and 21 Operating Locations. As of October 1995, over 100 financial management activities had been closed. Another 94 will be shut down in FY 1996, and all remaining closures will be completed by FY 1999. This consolidation of operations, along with the consolidation of systems detailed below, will: eliminate redundancy and unnecessary management layers, facilitate standardization, improve and speed up operations and service to customers, increase workforce productivity, facilitate expanded use of innovative technology, and enhance the financial management support of DoD decision makers.

In its financial management reform, the Department is reaching beyond its organizational confines to find the best way of doing business. For example, DFAS has initiated DoD-private sector cost comparisons in the functional areas of logistics and administrative support of its facilities, debt and claims management, and vendor pay in support of the Defense Commissary Agency. The objective is to determine how best to provide the most cost effective financial management services. For some functions, that may mean contracting out to the private sector. For example, in two business areas—printing/publications and base operations for the Navy—DoD plans to switch to commercial off-the-shelf accounting systems.

##### *Consolidation of Finance Systems*

As reform is carried out, finance and accounting operations have to continue to operate. People must be paid, and accounts kept current. Because of this and other considerations, the consolidation of financial management systems generally is being carried out in stages. The first step is to designate certain of the existing financial management systems as "migratory" systems, into which all existing systems can be consolidated without serious difficulty. In preparing these designated systems for their expanded role, the Department adapts the best features of existing

systems, corrects reasonably correctable deficiencies, improves processing and reporting capabilities as much as possible, and seeks cost savings.

The next step then is to develop optimum follow-on systems, drawing on lessons from the migratory ones and taking full advantage of the latest technology. The future transition to these optimum systems will be at a pace determined by the money and technologies available for such a transition, and other circumstances.

The consolidation of DoD finance systems is well underway, with the implementation of six migratory finance proceeding rapidly:

- By 1997, the Defense Civilian Payroll System (DCPS) will be fully implemented, replacing 27 payroll systems. The DCPS will handle the pay of all DoD civilians, now numbering about 830,000. As of September 1995, about half of the DoD civilian work force was under DCPS, and 222 payroll offices had been eliminated.

- By 1999, the Defense Joint Military Pay System (DJMS) will be fully implemented, consolidating the original 22 systems down to 2: DJMS for the Army, Navy, and Air Force; and the Marine Corps Total Force System for that service. The DJMS will support the 2.5 million people on active duty and in the Reserve Components.

- The Defense Transportation Payment System (DTPS) is being implemented to consolidate and standardize all DoD transportation payments. It currently processes payments for the shipment of some household goods and freight. In FY 1996, DFAS will improve the DTPS's use of electronic data exchange and other aspects of it. DTPS improvements are expected to save about \$21 million per year.

- The Defense Retiree and Annuitant System was fully implemented in FY 1995 and is now managing over 2 million accounts. When DFAS was created, retirees and annuitants were being paid from four sites, using 8 systems handling fewer than 2500 accounts per employee. We now have one system operating at just 2 sites. The DRAS enables us to handle 3400 accounts per employee, operate with 247 fewer workers, and save over \$10 million annually.

- The Defense Debt Management System became operational in 1993. It standardizes the collection of debts from military and civilian personnel not on active DFAS payroll systems, as well as delinquent contractor payments. It replaced 5 distinct systems operated by DoD components.

#### *Consolidation of Accounting Systems*

The Department continues to work hard to eliminate as many as 100 accounting systems. At least as important also are our ongoing improvements to the remaining systems—to make them more compliant with the Chief Financial Officers Act and capable of providing accurate, timely, and auditable financial statements.

In the general accounting area, migratory systems have been selected along the lines of the three military departments. We have already gone from 91 general fund accounting systems in 1991 to 77 in 1995. We anticipate a further reduction to 53 systems by 1998. Again, these migratory systems are continuously being improved to make them more accurate, timely, and compliant with the CFO Act. We also are working to improve greatly the link between accounting systems and the non-financial systems that handle logistics, procurement, and contracting.

In the functional area of business operations, the Defense Business Operation Fund (DBOF) Corporate Board has approved 18 migratory accounting systems, to handle the consolidation of the current 77 systems. We expect these DBOF migratory systems to be operational beginning in February 1998.

#### *Reengineering Business Practices*

A critical component of DoD's financial management reform is the reengineering of its business practices, i.e., the procedures by which it functions. The goal is to make DoD business practices simpler, more efficient, and less prone to error. The Department recognizes that even the very best finance or accounting system cannot compensate for inherent flaws in the processes that they service. Reengineering is being achieved by the revision of existing policies and procedures and the increased standardization, consolidation, and compatibility of existing systems.

In advancing the consolidation of DoD financial operations, DFAS is achieving a significant reengineering of the associated business practices. The organizational structure of DFAS's five centers and 21 Operating Locations is designed to facilitate standardization and streamlining, improve accountability, reduce data incompatibility, and improve customer service. Substantial reengineering also was achieved in the development of the new payroll/payment systems.

Electronic commerce/electronic data interchange (EC/EDT) technology is a major tool in DoD's reengineering effort to promote the paperless exchange of financial information, thereby saving time and money. DFAS is spearheading the widespread adoption of EC/EDI for DoD financial operations. For example, EDI is currently

used to process invoices in the Standard Automated Material Management System. In addition, we are implementing EDI for payment notification to vendors and the direct input of data into accounting systems.

During 1995, DFAS reengineered all processes by which the Department garnishes the pay of employees for child support, alimony, commercial debt, and divisions of retired pay. The new processes will be implemented in FY 1996. In FY 1997 and 1998, DFAS will introduce and integrate EDI, imaging, and artificial intelligence technologies into the processes. These changes are expected to increase dramatically the efficiency of DoD garnishment operations, plus reduce their cost significantly.

#### *Travel Reengineering*

Another important reengineering effort is simplifying the process for temporary duty (TDY) travel by DoD civilian and military personnel. The goal is to eliminate many of the steps now required to initiate travel, process a voucher, and receive payment. A new paperless system will meet the needs of travelers, support mission requirements, and save as much as \$100 million annually. The Department will rely on the private sector for all services except the obligation and approval of funds, final accounting, and random audit.

Features of the reengineered TDY system include:

- Simple policies, and entitlements, focused on mission requirements and respectful of the integrity of travelers and commanders.
- Single trip document to serve as travel order, voucher, and itinerary record.
- Maximum use of government travel credit cards, to eliminate cash advances.
- One-stop shopping for travel arrangements.
- Simplified accounting to enable supervisors to track their travel budgets.
- Random and exception-based audits, vice 100 percent audits.

#### *Standardization of Data*

The standardization of financial management data throughout the Department is crucial to reform. It facilitates the consolidation of financial management systems, enables the sharing of data and greater compatibility between financial management and non-financial management systems, and supports the reengineering of business practices.

Until recent consolidation efforts began, DoD finance and accounting systems managed some 100,000 data elements. Detailed data modeling has indicated that DoD financial operations eventually could be conducted with fewer than 800 carefully designed standard data elements. As of June 1995, we have adopted 540 standard financial management data elements. Additional elements are likely to be added in the future.

Also supporting reform is an ambitious effort to standardize and share acquisition data. This will greatly improve the interactions between DoD procurement systems and the financial management systems that process and account for payments for procurement.

To foster standardization beyond just data, the Department is consolidating financial policy and procedures into a single 15-volume DoD Financial Management Regulation. This will replace a myriad of existing regulations and will clarify and expand upon many financial management procedures.

#### *Eliminating Problem Disbursements*

Although I have previously discussed the importance of financial management reform in eliminating Problem Disbursements within the Department of Defense, I would like to reemphasize an important point—the Department was faced with a choice—should we spend large sums of money and devote a substantial amount of work-years researching these old files, or should we devote our limited resources and personnel to fixing the underlying problems with our finance and accounting systems? The Department has decided it isn't worth going back to try to reconstruct all of the old records that are incomplete and in some cases no longer exist, instead, we plan to focus on getting the more recent records straight and fix the underlying causes of the problem.

#### *Computer Security and Fraud Detection*

In June 1994 the Department established Operation Mongoose to detect fraud and reduce the vulnerability of its computer networks to intrusion. The program is jointly sponsored by the USD (Comptroller), USD (Personnel and Readiness), and the DoD Inspector General. Data matches from multiple sources are used to identify potentially fraudulent payments to individuals or contractors. Payments can be monitored and validated from the civilian, military, retired and annuitant, vendor, and

transportation pay systems. Besides data matches, Mongoose uses face-to-face interviews to verify retiree/annuitant claims.

Past incidences of fraud generally were made possible by deficiencies in our financial management systems and inadequate internal controls. Therefore fraud investigations have been used to identify and change practices that permitted the wrongdoing.

#### *Management Incentives*

A fundamental aim of DoD reform is to more effectively use financial controls to support desirable management incentives. For example, a key goal of the DBOF initiative has been to guide management decisions toward genuine cost consciousness, by prescribing that all relevant data be included in the costs affecting those decisions.

To encourage greater cost effectiveness, the Department is devising ways to track budget expenditures relative to their associated outcomes, as required by the Chief Financial Officers Act and the Government Performance and Results Act.

#### AUDIT SCHEDULE

Mr. Chairman, the Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Inspector General, DoD, have consulted and we are in agreement with their audit strategy to perform audits which comply with Office of Management and Budget requirements in support of the Government Management Reform and Chief Financial Officers Acts.

I understand that the Inspector General has been invited to testify and will provide much more detail concerning that office's anticipated audit coverage. I will only reiterate that our respective offices have discussed those plans and we are in agreement with their plans and projections.

#### CORRECTIVE ACTION PLANS

The overarching problem preventing a qualified or unqualified opinion on the Department's financial statements is that the accounting systems which support the financial statements do not have an integrated general ledger or produce account-oriented transaction files. Lacking a complete general ledger, the reported value for fixed assets in the financial statements is derived from systems designed to manage or physically account for those items. These management systems do not often interface with the accounting systems and too often do not contain complete or reliable financial information. Moreover, the accounting systems often do not generate transaction files supporting the assets accounts past the budgetary phase of the acquisition process. The Department has several initiatives directed at improving the internal control and accounting procedural deficiencies identified in the audit of its FY 1993 and FY 1994 financial statements. Some of the more significant deficiencies include:

- The use of a variety of non-integrated data bases. These separate data bases preclude the easy or reliable integration or interfacing of information from other (non-financial) functional areas—such as personnel, acquisition and logistics—with the Department's finance and accounting systems.
- Current finance and accounting systems often are not sufficiently flexible to respond rapidly to changing customer bases, legislative changes, contingency operations, management initiatives, requirements from other government central agencies, or other changes.
- Finance and accounting systems often do not include automated indicators that measure, or are linked to, costs, performance measurements, or other output measurements.
- Finance and accounting systems lack a single standard transaction driven general ledger—an essential ingredient for sound reliable financial reports.

In addition to the above, inadequate internal controls and undocumented audit trails have contributed to unreliable financial data and exacerbated significant procedural and systemic deficiencies. Weaknesses include the Department's difficulties with:

- verifying and reconciling cash,
- consistently valuing and reconciling physical inventories to financial account balances
- accurately reporting the value of property, plant and equipment, and
- reporting amounts in a consistent and timely manner.

This is due largely, but not entirely, to long standing systems problems. The continuing system problems remain a serious challenge to the Department—and realistically will require a number of years to correct. However, these audits also have

shown that some actions, short of substantive system changes, can be taken to improve operations. Ongoing initiatives to redress current system deficiencies are:

*Senior Financial Management Oversight Council.* This Council, chaired by the Deputy Secretary of Defense, meets on a regular basis to address existing and emerging financial management weaknesses and deficiencies, to approve plans for proactive solutions to financial management weaknesses and deficiencies, to assign responsibility for correcting financial management problems, and to monitor progress in reforming the Department's financial management. The Council includes the Secretaries of the Military Departments, the Vice Chairman of the Joint Chiefs of Staff, the Under Secretary of Defense (Acquisition and Technology), the USD ((Comptroller)/Chief Financial Officer (Executive Secretary), the DoD General Counsel, the Assistant Secretary of Defense (Command, Control, Communications and Intelligence) and the Director of the Defense Performance Review. The Inspector General, in order to avoid a conflict of interest, is not a member of the Council but serves as an observer, and at the request of the Chair, provides support to the Council. The Director, DFAS also attends the Council meetings. In short, the Council provides the necessary framework and clout to focus attention on problem areas and exert pressure to make things happen.

*Improvement of the Federal Managers' Financial Integrity Act Process.* A recent initiative by the Secretary of Defense places an even greater emphasis on sound internal controls and the correction of control weaknesses. Office of the Secretary of Defense (OSD) senior managers have been tasked to play a more active role in the identification, reporting and correction of internal control weaknesses. Previously, these responsibilities were primarily those of the various individual DoD Components and many senior OSD managers played little or no active role in this process. However, new roles and responsibilities require senior OSD managers, in addition to the DoD Components, to identify major systemic and other weakness and internal control problems within the functional area under their purview when such weaknesses or problems have not been reported by a Military Department or other DoD Component. This responsibility encompasses both those weakness or problems that may be unique to one DoD Component, as well as those that may be common to, or affect, all or multiple Components. Once such weaknesses or problems are identified, OSD managers also are responsible for requesting, and ensuring, that the affected DoD Component(s) take responsibility for reporting the weakness or problem in the DoD Annual Statement of Assurance and taking appropriate actions to eliminate the weakness or correct the problem. For those issues that impact more than one Component, applicable OSD functional managers are responsible for working with the affected DoD organizations to provide a single reporting of the systemic weakness or problem, and overseeing a joint effort to address and resolve it.

*Establishment of an Acquisition and Financial Management Panel.* A senior level panel, the Acquisition and Financial Management Panel, was established to identify and develop a course of action to correct systemic problems that cause problem disbursements. The panel is co-chaired by the USD (Comptroller) and the Principal Deputy Under Secretary of Defense for Acquisition and Technology. The panel also includes the Under Secretaries of the Army, Navy and Air Force, as well as the Director, DFAS and the Director of the Defense Contract Management Command. The purpose of the panel is to design, and oversee, a long-term solution to the problem of unmatched disbursements and the lack of interconnectivity between finance and acquisition systems.

Because this issue is so critical, a working group was formed by the panel to provide short-term improvement recommendations aimed at resolving the causes of unmatched disbursements. The working group prepared a report that identifies a strategy for implementing needed systemic improvements. One focus is on expanded use of standardized Electronic Data Interchange transaction formats to transmit contract data between systems. This will greatly reduce manual data entry, improve timeliness and ensure consistency between the contract administration, payment and accounting systems. Another focus is on improving the payment computation and validation processes. Work has begun already on a number of the high priority actions needed to resolve existing deficiencies.

*Financial Management Steering Committee.* This Committee oversees the development of functional requirements, facilitates implementation of product and policy recommendations, and addresses other issues involving financial management systems and practices outside the Defense Business Operations Fund. The Committee is chaired by the USD(C)/CFO and includes the Assistant Secretaries for Financial Management and Comptroller in the Military Departments, Comptroller of the Defense Logistics Agency, and a senior official from the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence). This Committee has focused on such issues as compliance with internal controls, policies

and procedures, the selection of non-DBOF (i.e. appropriated fund) accounting systems, the need for a standard budget and accounting code architecture, travel re-engineering, and the implementation of a Defense Property Accountability System.

*Defense Business Operations Fund Corporate Board.* The Board monitors implementation and operation of the Fund, including policies, rates, cash flow analysis and criteria for inclusion of business areas in the Fund. To assist it in its task, the Board has established separate subcommittees to address areas such as cost reductions, policies and performance. Each of these subcommittees are specifically tasked to bring to the Corporate Board proposed solutions to specific problems, or to provide recommendations for improvement.

The Department also is making advancements in remedying inadequate accounting support for the Defense Business Operations Fund. The Department has identified system requirements for supporting the Defense Business Operations Fund, and determined which existing systems best support those requirements. This will allow DoD to migrate to fewer Defense Business Operations Fund systems, and reduce related systems costs.

*Reduction, Clarification and Reissuance of Policies.* Numerous nonstandard financial management policies had been promulgated in the past within the Department. This condition existed because, in part at least, when the Office of the USD (Comptroller) issued policy guidance, that guidance was not always widely disseminated by the various DoD Components. Instead, the DoD Components frequently interpreted the guidance and published internal implementing procedures. Too often, the Components' interpretation and implementing procedures resulted in the inconsistent application of DoD policy. In response to this situation, the Department has commenced an effort to issue the "DoD Financial Management Regulation" for use on a DoD wide basis. The regulation, which includes both policies and implementing procedures, promulgates guidance involving the Department's appropriated funds, its Defense Business Operations Fund, as well as its other funds, and replaces a myriad of existing USD (Comptroller) policy guidance, clarifies existing guidance where appropriate, and includes additional guidance as needed. In conjunction with the resolution of Component unique system issues, separate financial management policy and procedural issuances of the DoD Components are being eliminated and incorporated into the Regulation as appropriate. This effort is eliminating some 70,000 pages of sometimes conflicting guidance and providing the Department with a sound basis for achieving standard policies and procedures.

#### STATUS OF UPGRADING FINANCIAL SYSTEMS

DFAS, in coordination with the Defense Logistics Agency (DLA) are developing systems to replace the current contract administration and payment entitlement system for Contract Administrated Service (CAS) contracts. The current system, the Mechanization of Contract Administration Services (MOCAS), is to be replaced by a new system. The finance module that will be deployed will be called the Defense Procurement Payment System (DPPS) and will handle the entitlement functions for the CAS and vendor type payments. In addition, DFAS and DLA are collaborating in the establishment of a single, shared data base which will serve as a repository for procurement and financial related data. This data will be used to perform the acquisition, contract administration and finance and accounting missions more efficiently and accurately. The initial module of this data base is to be deployed in 1996.

In the area of General Accounting, DFAS Centers and their components have identified interim migratory systems. As these systems become operational, DFAS will be able to improve markedly its accountability and reporting capabilities, and save resources by using fewer systems and consolidating its accounting operations. These interim migratory systems will incorporate a standard general ledger, standard budget and accounting classification code, key accounting requirements, Federal Managers' Financial Integrity Act requirements, audit report recommendations and comply with the CFO Act. We will also ensure that our upgraded systems interface and support systems-such as those for logistics, procurement, and contracting. The DFAS has instituted a Strategic Business Plan concept containing detailed Tactical Plans of Actions and Milestones for each system to adequately address and access progress toward our goal.

#### ABILITY TO PRODUCE AUDITABLE STATEMENTS

The GAO and DoDIG have been auditing DoD financial systems and reports for decades, so we believe there is no question that DoD financial data is auditable. Historically the financial information was used to report on budget execution as well as for budget justification use; and DoD has produced the necessary reports year



after year. However, the systems were not developed over the decades to produce financial statements patterned after the private sector annual reporting requirements.

Essentially the over 250 legacy systems developed over the past 30 plus years were designed to respond to Executive and Legislative Branch requirements and to direct DoD's management focus toward budget execution reporting. DoD Components independently developed their own version of systems to meet financial reporting needs. The requirement to produce private sector type financial statements, using the existing budget execution reporting orientated systems, is easier said than done. To achieve the financial statement requirements means DoD must make radical changes to financial management systems. We strongly support the direction and benefits to be gained, but want to be up-front on how difficult this change will be. The changes impact our policy, procedures, systems, training, and our DoD personnel and managers.

Nevertheless DoD continues to work hard to improve the quality of financial statements each year and to disclose more useful information in the CFO annual reports. While we are focusing our efforts to implement compliant accounting systems we are working in parallel to resolve audit recommendations in policy and procedures areas. Our objective is to improve the policy and procedures so when compliant accounting systems are implemented we will be able to obtain favorable audit opinions.

To improve the quality and auditability of CFO financial statements, DoD must continue to focus on the business transactions that create the millions of accounting entries each month that must be classified, posted, and accumulated up from installation level customer accounting records to departmental level accounting systems. The standardizing of accounting policy and regulations across DoD, the re-engineering of business practices, the use of Electronic Commerce/Electronic Data Interface (EC/EDI), implementing standard financial statements and footnotes, and work toward a standard Budget Accounting Classification Code will improve the efficiency and quality of financial management support, reports, and auditability of transactions.

Re-engineering DoD business practices is critical to DoD's financial reform. Business practices need to be more efficient because of the huge volume of accounting transactions performed to support our world-wide customers. DFAS's focus on the use of Electronic Commerce/Electronic Data Interface is a piece of the improvement effort to bring the efficiency of current technology to bear on the contract payment, disbursing and accounting processes.

The accuracy of the Department's reported asset account balances is a continuing audit finding. DoD is working to improve the procurement, logistics, and property functional reporting used in the Departments financial statements.

DoD continues to make progress in the quality of CFO reports as improvements in procedures, clarification and expansion of guidance, and the knowledge and experience of auditors, accountants, and customers has grown.

#### CONTINUING IMPLEMENTATION OF THE CFO ACT

DoD is expanding the scope of CFO reports and beginning with the FY 1996 CFO reports, DoD will be reporting on 100% of the Department's entities and appropriations/funds. A total of nine DoD CFO annual reports will be published and audit opinions rendered.

For Fiscal Year 1996 DoD's Navy CFO report will cover 100% of the Navy General Funds. DFAS and Navy have established a joint team to plan and prepare the FY 1996 Navy General Funds CFO report. The detailed Plan of Action and Milestones (POA&M) for this requirement is being carried out to produce financial statements that comply with OMB/DoD Form and Content guidance and provide Navy Managers useful financial information. DFAS and Navy are learning from the earlier efforts of the Army and Air Force who have been reporting on 100% of their funds for the past few years.

In FY 1996 DoD will also include financial information covering 100% of the Defense Agencies/Defense-Wide General Funds. In the past CFO reports were prepared only for some of the Defense Agencies/Defense-Wide trust and revolving accounts.

DoD will also prepare, starting in FY 1996, a DoD-Wide CFO report consolidating all DoD funds. This CFO report will include Army, Navy, Air Force, the Defense Business Operations Fund, the DoD Military Retirement Trust Fund, the National Defense Stockpile Transaction Fund, the U.S. Army Corps of Engineers, the Defense Security Assistance Agency, and Other Defense Organizations.

Before financial reforms began in 1990 the DoD problems seemed intractable. The Department's financial management troubles reflect the divergent procedures imple-

mented by various Components. DoD is taking action to standardize procedures for the treatment of financial information and is standardizing the Chief Financial Officers Act financial statements and footnotes. The standardizing of CFO statements for FY 1995 reports is being driven by the Department's preparation for the DoD-Wide consolidated financial statement that will be prepared and audit opinion rendered starting in FY 1996.

DoD is committed to providing audited financial statements by March 1st each year. To achieve this requirement DOD's Components, auditors, and accountants are working together and making the CFO reports better each year. We will continue to focus our efforts for implementation of compliant accounting systems and the development and use of better business process procedures and guidance.

#### UNQUALIFIED OPINIONS ON FINANCIAL STATEMENTS

We have a long way to go to obtain unqualified opinions on all DoD CFO reports, but we are taking aggressive action to reach that goal. At DoD we are committed to improving the financial reports that reflect our responsibility and accountability for the resources entrusted to us to carry out the Department's mission.

DoD continues to improve the CFO accounting policy and procedures used to collect and present fairly entity financial information. DFAS and the DoD Components are correcting policy and procedure shortcomings identified in audit recommendations.

Although a disclaimer opinion has been given for most DoD CFO reports, DoD has received favorable opinions on some of the DoD appropriation trust fund CFO reports. i.e. Voluntary Incentive Trust Fund, National Security Education Trust Fund, and the DoD Military Retirement Trust Fund.

The Department will continue to improve the quality of CFO reports so when transaction driven general ledger accounting systems are implemented we can obtain favorable audit opinions. The DFAS will continue to work to improve the quality of financial information presented in the CFO annual reports. DFAS and our customers are taking action to improve the accuracy of asset valuation for real property, personal property, inventories, and equipment. Improvement in the disclosure of contingent liabilities is another area we are working to improve.

DoD is working with the Federal Accounting Standards Advisory Board to establish and implement accounting standards to address the diverse, and sometimes unique Federal Government requirements.

Auditors have noted the progress DoD has made in some policy and procedures areas over the past few years. Improved presentation of financial statement data, footnote disclosures, reconciling pay and personnel records to increase accuracy of payroll data, DoD efforts to address the DoD-wide problem of mismatched disbursements.

DoD strongly supports financial management reform. We intend to provide accurate and useful information to the Congress. The Department has identified our financial problem areas and is working hard to correct those deficiencies.

#### CONSOLIDATION OF ACCOUNTING SYSTEMS

The Defense Finance and Accounting Service (DFAS) is streamlining its operations by consolidating over 300 offices into no more than 5 Centers and 21 Operating Locations (OPLOCs). The process began in Fiscal Year (FY) 1991 with the creation of DFAS which resulted in the capitalization of six large Military Service and Defense Agency finance centers. In an effort to achieve efficiencies and early savings, one of the six centers was disestablished in FY 1992, with its functions transferred to the other Centers. During FY 1993, over 300 field finance and accounting activities were transferred to DFAS from the Military Departments and Defense Agencies. In FY 1994, the Deputy Secretary of Defense selected the five DFAS centers and 21 new Operating Locations as the consolidation sites. By the end of FY 1995, 14 of the 21 new operating locations had been opened and one-third (110) of the field activities had been closed, with their functions transferred to one of the consolidation sites. Eighty more field activities have been announced for consolidation during FY 1996, and the remainder will be closed by FY 1999. When consolidation is completed, savings of over \$120 million per year is expected.

In the financial systems area, DFAS has made significant progress toward the consolidation and standardization of finance systems and operations. We have selected and modified major military pay, retired and annuitant pay, civilian pay, debt management, contract payment, and transportation payment finance systems to meet Department-wide requirements and are implementing them as migratory systems for use throughout DoD. In 1991, 82 finance systems were in use in these areas, we are now down to 42 and by 1998, DFAS will have reduced the number

of finance system to 20. The major systems are: The Defense Joint Military Pay System; Marine Corps Total Force System; Defense Retiree and Annuitant Pay System; Defense Civilian Pay System; Defense Business Management System; Defense Debt Management System; Mechanization of Contract Administration Services System; and the Defense Transportation Payment System.

In the Defense Business Operations Fund (DBOF) area, DFAS developed a two phase migratory strategy which was approved by the DBOF Corporate Board in February 1994. The strategy provides an interim phase that consolidates DBOF accounting systems along component and/or business area lines, converts key legacy systems into interim migratory systems, maintains current operations during the transition period and achieves compliance with the accounting and reporting objectives of the Federal Managers Financial Improvement Act (FMFIA) and Chief Financial Officers (CFO) Act. The interim phase accommodates existing unique capabilities of current component operations and structures. The approach permits a more aggressive simultaneous migrations and consolidations of systems by select DFAS Centers, while maintaining existing management information system requirements. The second phase of the system migration strategy is the transition from the interim to the ultimate migratory systems.

We are in the final phase of completing cost or economic analyses of the recommended interim migratory systems. Concurrent with the completion of the analyses, we are developing Strategic Business and Tactical Plans that detail the enhancement and deployment initiatives for each system. Actions to improve and deploy the systems are being authorized on the recommended systems based on the approval of the cost or economic analysis. Because of the need to complete the analysis before investing in the system, most enhancement and deployment actions are just beginning. Additionally, we are in the process of procuring Commercial-Off-The-Shelf (COTS) software to support two DBOF business areas. Both procurements are scheduled to be awarded in FY 1996.

We believe the strategy we are following is the best solution for DBOF. We are executing the strategy aggressively but relooking at our plans when appropriate to ensure the job is done right.

In the General Funds area, DoD is committed to, and has undertaken, a major effort toward consolidating and improving accounting systems. In 1991, there were 91 major general accounting systems. Many of these systems were obsolete, unreliable and were not integrated with other DoD financial and non-financial systems. DFAS identified interim migratory systems along component lines. These interim migratory systems will enable DFAS to eliminate 14 general accounting systems by the end of 1995 and an additional 24 systems by the end of 1998, as shown below:

#### General Accounting Systems

FUNCTION	1991	1995	1998
Installation level .....	49	39	23
Departmental .....	20	16	8
Security Assistance .....	8	8	8
Non-Appropriated Funds .....	10	10	10
Trust Funds .....	4	4	4
<b>TOTAL .....</b>	<b>91</b>	<b>77</b>	<b>53</b>

Selected investments in migratory systems will be made to incorporate the U.S. Government Standard General ledger, Standard Budget and Accounting Classification Code, and other limited improvements to redress deficiencies in the systems. DFAS will also ensure that the upgraded systems interface and link to support systems such as logistics procurement, and contracting. This strategy requires enhancements to fewer systems which saves DoD resources. Fewer systems also supports DFAS's long-term plans for consolidation of accounting functions.

A further reduction in the number of accounting systems below the projected 53 general accounting systems will depend on the number of legacy systems and the type of systems being reduced. Some legacy systems can be easily consolidated into an interim migratory system. Whereas some legacy systems support, to a great degree, systems such as logistics, procurement, and contracting. The conversion of these mixed systems is more problematic.

## CLOSING

DoD's Financial management reform actions constitute an ambitious agenda and your continued support of the Department of Defense's efforts to eliminate its financial management deficiencies is essential and very much appreciated. We are very proud of the pace of our progress so far and expect to continue on as expeditiously as possible.

Mr. HORN. The letter is in the record, as will be the Post articles, and I'm going to ask some questions about these.

Mr. HAMRE. Yes, sir.

Mr. HORN. So my first one is on the second page of your letter, just to double check the obvious. You say, "during the past 21 months, we solved \$20 billion of these problem disbursements, correctly matched our canceled checks with their proper accounting records." Now, does that include the purchase order of the delivery item in question, matching that again?

Mr. HAMRE. Yes, sir. As I mentioned, there are two checks that are going on: There is first the matching to the delivery of the good or service, and that's required before we write the check in the first place. You have to have a receiving report from a government official, either at the destination or at the factory, before we can write the check. That we already had.

What we didn't have was a clear match against the accounting records, a second step, a step that you want to do. I mean, it's a basic internal control feature. We didn't do that in the past, and we're going to have to move to that. We're going to do that increasingly, through a series of prevalidation requirements that Congress has imposed on us, which we think are a good idea.

Mr. HORN. You mentioned you're thinking of maybe contracting out some of these functions.

Mr. HAMRE. Yes, sir.

Mr. HORN. Should there be an outside random sample audit taken of various parts of DOD? What's your thinking on that, in terms of how you're going to go about getting yourself into a regular annual audit and financial statement?

Mr. HAMRE. Sir, I think I would—first of all, I have an auditor, and that's the Inspector General. So I feel I have audit oversight, an independent organization responding to the Congress, independent from the executive branch. Ask Eleanor Hill that question. I personally feel I've got more than enough audit oversight between that and the General Accounting Office. Let me say, we are working closely with both, trying to get at these problems.

Mr. HORN. In the Washington Post story on this situation, dated May 14, 1995, this paragraph appeared. And I realize you don't represent the Treasury, but I would like your reaction to it. "The U.S. Treasury has always paid the bills, even when there was no money in a given project's account, because it assumes any error was unintentional and someday would be corrected, said Pentagon officials and Inspector General investigators."

Is that basically still the Treasury policy with the Pentagon?

Mr. HAMRE. Sir, we have changed our policy. Prior to April 1, 1994, we had a practice where we would write checks even on accounts that were in the red. We changed that. So we froze payments on accounts where there was no balance, as of April 1, 1994.

I get monthly reports from Rich on those accounts which are still frozen. So we're not doing that.

We have also imposed requirements, at the same time, on requiring a match to the obligation record, at the same time, and establishing a new obligation, if you can't match it within a 180-day period. So the answer is no, the Treasury will not continue to honor a check if it's against an account that's "in the red," because our disbursing systems don't allow us even to disburse them.

Mr. HORN. We can ask the Inspector General, which I will ask, although she might not have been there at that time, did they ever pick up any of this situation? That is what I do hope the Inspector General will get into, because it seems to me some of this could have been caught by accurate audit ahead of time by the Inspector General and others.

Mr. HAMRE. Sir, may I just say, though, I think you will find a very consistent record on the part of the Inspector General and the General Accounting Office, pointing out these problems over years. But please do ask them. I think that they were highlighting it, and we just weren't attentive enough to it.

Mr. HORN. Yes, well, at that point, I think they should have nailed you—your predecessors—on that.

Now, according to you and Mr. Rau—this is again the Washington Post—a number of cases are under investigation for possible violations of the Antideficiency Act, a law that governs how congressionally appropriated money must be spent. When I was in the Eisenhower administration, we did take that act very seriously. And I'm just curious about the cases that might have been violations. What's happened; what's the status of those?

Mr. HAMRE. Sir, there are, right now, probably a little over 50 pending cases of pending Antideficiency investigations. Some of them go back a long time. This is an area where the department has—we've tried to focus during the last 2 years. I think we've made a concerted effort to get on top of the Antideficiency investigation cases. We take it very seriously.

I find it probably the most fearful lever that we have is to give people what we call 1517 legal liability; that is, handing Antideficiency limits to fund holders. They pay close attention to that. We do have violations. Sometimes they are small and very unintended. A person buys a computer with O&M dollars, and they were not supposed to use O&M dollars, little things. And then we've had some larger and more serious cases. I think, right now, we have about 50 of them pending.

Mr. HORN. I notice here that—this sort of tickled me, because having run a State university, I went through the same problem, which was how the old boys did know how to balance the books. Somehow they moved money around, and they always seemed to be balanced. And I note that this paragraph that you noted, "The services allowed such money mingling to go on partly because of the complexity of the yearly congressional appropriations process. 'People want to find an easier way to get the job done,' he said. 'They are trying to get some flexibility in a very cumbersome system.'" And I can certainly agree with you on that.

And then it came, "You're frustrated by it, but in the past they just waited until people retired. It was the old boy network cover-

ing up for people." I take it we're now beyond the old boy network, that we've got to actually see if the money is there before it's used to balance?

Mr. HAMRE. Yes, sir. And since I'm the senior old boy, I've got to make sure we don't do it that way.

Mr. HORN. OK. And then—well, some of these I can save for your deputy there.

Mr. HAMRE. Yes, of course.

Mr. HORN. But let's see. Yes, here on this part of the Post story, which I wasn't clear on, "Charles Coffee, Director of the Columbus Center, said the problem took so long to solve because some of the contract records were missing. Not asking for the overpayment to be returned 'was a bad decision,' he said." Now, I take it that Columbus situation has been straightened out?

Mr. HAMRE. It's getting better. We're not out of the woods yet in Columbus. May I explain what happened? We had, prior to 1990, the department had 10 locations around the country that made contract payments. Performance was, I think I would be charitable to say, uneven. In some cases, it was downright poor. And, again, attribute to Don Atwood, to Sean O'Keefe, my predecessor, to John Sheikopf and others, for having made the hard choice, we have to bring them together.

We probably weren't as careful in consolidating our contract payment operations back then as we should have been. And so we moved them all to Columbus, OH, and, in some cases, lots of records were lost or missing. They may not have been there originally. As I said, some of the operations were fairly flawed.

So we have been spending the last 4 years, frankly, trying to reconcile contracts where the original documentation is gone. That's been a painful thing. We actually hired a private accounting firm to help us do that. We should have most of the contract reconciliation—the outstanding contracts that need reconciliation done by the end of March of next year.

That is a major factor in why we overpaid, because if the underlying record wasn't correct, and you didn't have invoices and payments against invoices recorded, you could run the chance of overpaying. And we did overpay. Back in 1993, we overpaid by about \$750 million, that's \$750 million in an office that pays about \$35 million an hour. So the percentage is small, but, in our business, small percents add up to big numbers.

Mr. HORN. Are we giving a bonus to people in terms of how many checks they turn out per hour, and this kind of thing? Is there any incentive that's being given that really is meaning you go too fast; you don't have time to check; the idea is, just get it out of there? It seems to me that can be counterproductive, and I was just curious what the Columbus Center system is.

Mr. KEEVEY. No, we don't.

Mr. HORN. The other is, the level of education to understand the contracts against which you're checking.

Mr. KEEVEY. That's a problem. That's correct.

Mr. HORN. And that bothered me, if you've got GS-3s. Is that correct?

Mr. KEEVEY. These are very, very detailed, complicated contracts. Some of them literally take up half of a floor of a room. And

many of the people who are making payments against these contracts are account clerks or very junior level accountants.

Mr. HORN. Does that make sense?

Mr. KEEVEY. That is a problem. What we're doing is try to work with the contract acquisition community to try to simplify the contracts, specifically as it has to do with the finance components of it. For example, a simple thing as to consolidate and put in one place of the contract, or some kind of cover sheet, the critical financial data that an account clerk needs to look against. That is not the practice at the moment; that has not been the practice in the past and, frankly, needs to be corrected.

Mr. HORN. Well, are you on the way to correcting that? When will it be corrected? It seems to me that's a major problem.

Mr. KEEVEY. Yes. I think, in all honesty, the correction to that aspect that I just spoke to, that is, simplifying the contracts, has not been fleshed out in the correct detail with the acquisition and contract yet. I would say we're at least a year away before that would be completed. In the meantime, what we need to do and what we're working on is to develop technology which we had that we would check, before we make a payment above a certain amount, with the underlying accounting system, before we make the payment out the door.

This begs the question as to the competency of the clerk, but at least—we didn't do this in the past; we will do this in the future—that is, check the accounting record before we make the payment out, a sort of basic check that one would think that one would normally do, but had not been the practice.

Mr. HORN. I yield to the ranking minority member the remainder of the time. I'm going to go vote and then be able to come back and preside.

Mrs. MALONEY [presiding]. I'm going to have to leave in 5 minutes to go vote, too.

Since 1990, GAO has made over 350 recommendations to resolve DOD's financial crisis? How many of these 350 recommendations have been implemented?

Mr. HAMRE. Maybe you can give me the list of the 350. I'll be glad to give you a response for the record, Mrs. Maloney. I don't know.

Mrs. MALONEY. No. 1, they recommended to you in 1990 that there were serious problems in accounting for billions of dollars in annual disbursements. And they stated that without the proper matching, the fact that they were in separate offices and not matched up at one point or at one time, electronically or any other way, they stated that there were a lot of areas for fraudulent or erroneous payments. They certified, through audits and others, the CFO audit, that DOD had paid billions of dollars without even being able to determine exactly what was purchased.

I just have to say that, in this Congress, every other day there's a speech on the floor attacking welfare fraud, Medicaid fraud, Medicare fraud. But the amount of fraud that's documented in this GAO report.

Mr. HAMRE. I don't think it's documented. I think it's asserted.

Mrs. MALONEY. Well, the CFO audit that they cite.

Mr. HAMRE. I think it's asserted; I don't think it's documented. I'll be glad to go through that.

Mrs. MALONEY. That they allege. That they allege.

Mr. HAMRE. OK. That's very different.

Mrs. MALONEY. Is far greater than any that has been mentioned in these other programs. So the No. 1 recommendation was, why aren't you putting together the payments and accounting for billions of dollars in the annual disbursements? Why don't you put them together? When you get the bill, you pay the bill?

Mr. HAMRE. I thought I explained we did do that.

Mrs. MALONEY. You are doing it?

Mr. HAMRE. Yeah. I thought I explained that.

Mr. HORN. You are doing it?

Mr. HAMRE. Yes. We cannot make a payment until we have a receiving report.

Mrs. MALONEY. When did you start doing that?

Mr. HAMRE. We've been doing that all the time.

Mrs. MALONEY. Well, earlier, in one of the reports, they said that there was \$17 billion.

Mr. HAMRE. They weren't matched to the accounting record. Do you remember my analogy when I got in the bill?

Mrs. MALONEY. OK. They recommended that you match it to the accounting record.

Mr. HAMRE. Yes, and we do agree with that totally.

Mrs. MALONEY. You agree with that?

Mr. HAMRE. Oh, absolutely.

Mrs. MALONEY. And they recommended that in 1990, and why hasn't that been implemented?

Mr. HAMRE. Well, I didn't get there until 1993.

Mrs. MALONEY. By all accounts, everyone says you're doing an excellent job. I'm just saying, why aren't we doing that now?

Mr. HAMRE. Well, I think we're doing it now where we can. On the prematch to the accounting record, we're doing it at the \$5-million disbursement right now. We would like to drop that as soon as we can. Now, for small vendor payment, it's being done in some of the systems already; for example, STARS which is an accounting system used by the Navy. At the vendor payment level of installation, there is a prematch basis for that already. I think the CAP system in the Army is, as well.

But in the aggregate, we had so many problems.

Mrs. MALONEY. If it is being done, then how did we "lose \$17 billion" that's not matched?

Mr. HAMRE. I don't think we lost it. I think what it was is the disbursement.

Mrs. MALONEY. Well, how come we can't account for it?

Mr. HAMRE. We can account for it, but, unfortunately, we've got a pile of canceled checks and not a clear record back to the accounting station. And we've been researching those. We resolve about a billion dollars a month; we clear it up.

Mrs. MALONEY. But from now on you're going to have it all together, into the accounting system, so that we'll have a clear record?

Mr. HAMRE. Ma'am, lots of things are going on simultaneously. We had, as I said, back in 1990, there were 300 places in the coun-



try that would write checks on other people's accounts, I mean, and not check in advance, and that was a problem. We are shrinking.

Mrs. MALONEY. Even if they were writing checks—first of all, I would start right ahead that you don't write checks unless you check, and have the accounting principles, and put it into the centralized accounting system.

Mr. HAMRE. And we absolutely agree with you.

Mrs. MALONEY. I think that that's a minor requirement. Even if you're at 300 different stations, or even 1,000 different stations, you, at the very least, can accomplish that, it seems to me.

Mr. HAMRE. As I said, when you talk about that number of locations and our volume of transactions, 2.5 million invoices a month.

Mrs. MALONEY. All you have to do is tell them, "You don't pay it until you match it with your invoice, until it's put into the central recordkeeping accounting."

Mr. HAMRE. OK. Again, we match it with the invoice, but if I were to hold up—if a payment is made in an Air Force accounting station on a Navy account, it takes about 180 days to clear the accounting record. Now, you're telling me I've got to say to a contractor, "I'm not going to pay you for 180 days, until I get the electrons worked out and I get it validated against the underlying accounting record." I mean, the Prompt Payment Act says we pay in 30 days or start paying interest penalty payments.

So, as long as we have a receiving report that says we received the goods and services, we pay that bill. Now, that's not the ideal. In the long run, we want the system you have described very much.

Mrs. MALONEY. Now, earlier you said that they match only for expenditures over \$1 million?

Mr. HAMRE. Over \$5 million.

Mrs. MALONEY. Over \$5 million.

Mr. HAMRE. This is at the Columbus Contract Payment Center.

Mrs. MALONEY. OK. What about the volume of transactions under \$5 million. There are a huge number; right?

Mr. HAMRE. Oh, absolutely. Yes, absolutely.

Mrs. MALONEY. Well, I could go through, there are 350: not identifying and disclosing future government cost; not having an inventory of equipment. These are basic recommendations. No. 4, inability to accurately record and report costs. Just for the record, I would like to request that you respond to the 350 recommendations in writing, exactly what you have done.

Mr. HAMRE. Sure.

Mrs. MALONEY. So that we can start looking at it. And one thing that I would like in writing, because I just don't understand why it's not being done, is why we don't follow general accounting principles. And I'm going to tell you a brief story.

I'm a New York City resident. We had a financial crisis in 1977. We went bankrupt. The mayor had one set of books; the comptroller had another; the city council had another. It was a complete mess. They said they couldn't be part of one central accounting system; it was too complicated.

Well, the Federal Government said to us, "We're not going to bail you out unless you change your accounting systems, you go to general accounting systems." And guess what, overnight they went to

general accounting systems—we haven't had a problem since—jointly shared with the comptroller and the mayor.

And I don't see why we couldn't do this now, a general accounting system, jointly shared with all the important areas of our national defense.

I've got to go vote. I do appreciate your efforts to correct this, and I do appreciate the strong work of our military leaders. We have the strongest country on earth, and, really, the first purpose of government is to protect its citizens. My father, my grandfather, my brother, they all served in the military, and I'm proud of the military.

But I think what you are telling us today is a disgrace to the American fighting men and women who have given their lives, put their lives on the line to defend this country, and we can't, in Washington, or Ohio, or wherever it is, do general accounting and keep the books straight. And you've given a bad name to the military.

I've got to go vote. I'm sorry, but I'm rather upset by this.

[Recess.]

Mr. HORN. Thank you very much for bearing with us while we had two votes on the floor of the House. I think we want to prove we are essential and not go away today. So here we are, and thank you all for coming.

Now, I missed what you might have told Mrs. Maloney, and I'm not sure quite where we are here on this panel. What I'm interested in, let me just go through a few questions that might help get to this, because I am very concerned about whether you will be able to have a balance sheet in fiscal year 1997.

Are you optimistic that you can make sufficient corrections in the Department of Defense, in terms of processes and all the rest of it, perhaps go through improved training of people in the various disbursement centers; as you said, simplification of contracts, in some way, so they can easily check it off? I don't see how, frankly, they do it, if they are Grade 3s, unless they have had extensive training. So that worries me.

How about it, Mr. Keevey?

Mr. KEEVEY. I think there's a distinction between those kinds of problems in payment and matching records, et cetera, vis-a-vis presenting certified financial statements at a certain point in time. They require, that is, the latter, preparing certified financial statements, a lot better improvements to our accounting systems. We have a plan to do that. I think that plan will not be completed by fiscal 1997. I hope to be able to say by fiscal 1997, by a lot of other hard work and effort, we will present much better financial statements than we are now doing.

But I think the ultimate answer can only be, when we have better underlying systems. The systems were not developed, from day one, to produce financial statements under what we would call generally accepted accounting principles. They were basically developed to handle appropriation accounting.

The concept of generally accepted accounting principles was foreign to the Federal Government until fiscal 1990, under the CFO Act. Therefore, the underlying systems that keep track of that were just not designed that way. They pale in comparison to what is nec-

essary to handle inventory, fixed assets, which is a lot of the problems highlighted by the General Accounting Office, which we fall far short of. I think that will be the biggest stumbling block to correcting the balance sheet presentation.

But I think we are making and can make improvements related to the kinds of things that you talked about earlier: unmatched disbursements, negative unliquidated obligations. I think we have reduced them a lot. We have some short-term actions in line to reduce it even more: the idea of prevalidating before we make payment; the development of shared data bases so that, for example, when one enters contract data into the contract system, it is also entered into the accounting system at the same time. That is not now the practice, and that's why we have so much of these disconnects.

So I think we have a plan. I don't think we're going to get there where somebody will walk in the door and say, "Yup, we'll give you a check mark that, yes, you have financial statements that are certifiable," but we're not oblivious to the problem.

Mr. HORN. We all remember the old line whenever you use computers: "Garbage in; garbage out." And, obviously, the first question here is to get a system that makes sense, whether that's just common accounting practice or whatever. How far along are you on getting the system that makes some sense? Have we closed all the loopholes and everything else in that system?

Mr. KEEVEY. Well, we have multiple systems at the moment; too many systems.

Mr. HORN. Right.

Mr. KEEVEY. Our strategy is to get rid of a lot of them and to beef up the ones that we choose to be the ones that will service us for the next few years. For example, in the Navy environment—I don't know exactly how many—they may have 50 or 40-some. Our strategy is to get down to one or two, so that we don't have these mismatches and convoluted details, on the ship different than what's on shore, et cetera.

So we're putting money and improvements on one of the systems within the Navy environment, to build that up so it is capable, much more capable than is now being done, to handle detailed, better accounting records. And we're following that same practice in the Army and in the Marine Corps and the Air Force. We're making better progress in some areas than in other areas.

Mr. HORN. As you try to consolidate and eliminate some, is it possible that we're going to get to a year where we're just going to say, "Hey, there's no way we can dump this data into this new system and try to make some sense out of it," and just start, from that fiscal year, to do it right? What's your thinking on that?

Mr. KEEVEY. Well, I think that's what it will be. Once we get the system, it will be good for that year on. And I don't know whether we will be able, for example, from a strict accounting point of view, begin with the correct balances in all aspects of the balance sheet, if that was your point.

Mr. HORN. Yes. I guess my concern is what do we do about fraud and abuse under the condition that, when we finally get consolidation, we will say, "OK. October 1, when the fiscal year begins, we're

going to start using this system," or whatever. Or are you thinking of a mid-year use of the system, to warm up, or what's your plan?

Mr. KEEVEY. Well, we are doing some interim, if you will, improvements and interim iterations of financial statements, et cetera. I think the best way to have a system in place that will produce statements at the end that meet criteria would be at the beginning of a fiscal year.

Mr. HORN. Right.

Mr. KEEVEY. But I think there's another aspect that you raised, which I think is sort of independent of financial statement presentation, and that is fraud kinds of things.

Mr. HORN. Right.

Mr. KEEVEY. Under whatever system we're now working in, I mean, we strive to have systems improved to prevent fraud. For example, when somebody submits an invoice, we do a lot of checking against other criteria to make sure that this hasn't been a duplicate payment, or that somebody is not putting an invoice through that hasn't been approved for payment, et cetera. So we can do that now, and we strive to do that now, even though the basic accounting systems that are used to produce financial statements may not be up to snuff.

Having said that, we still have situations where someone will put through an inappropriate invoice or we make a duplicate payment. But I would hasten to say that I think that might happen even if we had a perfect system.

Mr. HORN. Well, I take it, you and your subordinates have looked at the normal checks one has, where at least two people need to do something.

Mr. KEEVEY. That's correct.

Mr. HORN. So you've got a conspiracy at that point, if something is going awry.

Mr. KEEVEY. Yes.

Mr. HORN. You've got that worked out at this point, I take it.

Mr. KEEVEY. I think pretty well. That's not to say that I can sit here and tell you that there is no fraud that ever occurs through an accounting system; that is not true. Even if we had the best of systems, somebody is going to figure out a way to get through. But our chore is to try to prevent that as much as possible.

In addition to that, we started a new fraud detection protection. We call it "Project Mongoose," where we're trying to develop a series of data base matches, so that, presumably, if we don't catch somebody through on the preaudit, by matching accounting systems on various other systems, we can catch fraud after the fact.

We have, for example, bumped up a lot of our payroll systems against our retirement and annuitant systems to make sure people aren't on both systems, et cetera. And we're developing some templates to try to go in and see what are the aberrations in there that would lead us to suspect that somebody is making some attempt at abuse and fraud, and we hope to do some correction of that after the fact. That's in addition to the normal preaudit within an accounting system.

Mr. HORN. Right. Now, what about the training of the staff as you consolidate, and what about the need, if any, for a newer type

of technology, software, and so forth? Where are we on figuring that one out?

Mr. KEEVEY. That's been a challenge too. For example, when we reduced these 300 accounting offices out there down to the 21. Last year we did about 50 of them, or 60, I forget which. When we closed down accounting offices and moved them into the new centers, a lot of the people didn't go with the work, so we had to hire up new people. We had a lot of training that needed to be accomplished. We have a program laid down to do that.

By the same token, we found that to be a problem, because we didn't have staff up sufficiently at first, so we ran into some difficulties in the short run. But I think we're strengthened by our first experience under the consolidation aspects, and we will increase training as we open up these new centers.

We have other problems related to training, just general accounting expertise. Especially in this downsizing of the government, we have to be careful that, when we rehire or maintain certain staff, we get the correct expertise in these areas to do that. So I think we're conscious of the problem. We've experienced some difficulties in our consolidation because of the drawdown of staff and the moving around of locations, but I think we're up to that task.

Mr. HORN. Were there any other centers besides the Columbus Center that had the difficulties in overpayments and this kind of thing?

Mr. KEEVEY. That's the major center, because Columbus is the center that pays our major contracts, our weapons systems. They pay about \$90 billion out of the one system there, and that, therefore, is the center that you would most likely find these huge numbers.

Mr. HORN. So when you compare centers, there isn't anything proportionately wrong?

Mr. KEEVEY. No.

Mr. HORN. The proportions are about the same, in terms of overpayments, with other centers?

Mr. KEEVEY. They are very, very small. In fact, the overpayment issue that is talked about in the various reports that reviewed DOD center on the Columbus Center and center on weapon system payment contracts, where we have made overpayments principally because of what Dr. Hamre alluded to, contracts that are not reconciled. We have a contract writing system out there. Data is not entered into that system the same way it's entered into the accounts payable system or the accounting system, and therefore there are disconnects which lead to some overpayments.

I should point out that we have made a lot of improvements, I think, reduced the contract overpayments which was identified at about \$800 million in fiscal 1993. The year of the close, we had contract overpayments of about \$250 million. So we're reducing the amount—still not acceptable—but I think making progress.

And in most instances—I should say “most,” because I don't know with certitude—we get the payments back. It's not like we have paid the money out and will not get it back. We will correct that, either by investigation during the time that we we're doing it or when a contract closes out. Most of the time this is money ahead of what it should be.

Mr. HORN. Who gets the interest in the interim?

Mr. KEEVEY. We lose that interest.

Mr. HORN. You lose it.

Mr. KEEVEY. Yes, sir.

Mr. HORN. And the person that got the overpayment can keep it.

Mr. KEEVEY. That's correct.

Mr. HORN. You're more liberal than the IRS.

Mr. KEEVEY. They are required, that is, the contractor, to pay us back, but they may not always be aware themselves.

Mr. HORN. Well, let me ask you, as we move toward that object of 1997, late 1996, 1997, as we move toward that, of getting a balance sheet, your testimony stated that you're making progress. You've just reaffirmed that you're making progress. And I guess I'm interested in how we're measuring that progress. We've had a whole series of hearings here on benchmarks and how do you establish them in relation to goals of a particular organization.

Do you feel that you're getting unqualified, clean audit opinions at this point? How much of your operation could you say you would get a clean opinion in?

Mr. KEEVEY. Hardly any.

Mr. TUCKER. A few of the trust funds, sir, military retirement trust funds.

Mr. HORN. The trust funds you have got them?

Mr. TUCKER. Some of the other smaller trust funds that are mostly securities of some sort that are held from the Treasury, we have clean opinions on.

Mr. HORN. As I'm looking down here, the Navy is still substantial; no audits performed, I take it, on some of these.

Mr. KEEVEY. No, they haven't undergone an audit yet.

Mr. HORN. Yes, since they aren't a pilot, presumably.

Mr. KEEVEY. Say again, sir?

Mr. HORN. They are not a pilot program, as is the Army and Air Force.

Mr. KEEVEY. Yes. The GAO has done a report on the financial statement of the Navy, but that was not a statement that was set up for a pilot audit. We will be going into that for the 1996 statement.

Mr. HORN. Mr. Tucker, as I understand, you stated in your testimony that DOD has received favorable opinions on some of the DOD appropriation trust fund CFO reports; namely, the Voluntary Incentive Trust Fund, the National Security Education Trust Fund, and the DOD Military Retirement Trust Fund. In which years did any of those funds really get favorable opinions?

Mr. TUCKER. I think in all but 1 year they got favorable opinions. They are mainly Treasury securities with a few operating expenses associated with them.

Mr. HORN. As I look at this thing, I think only one of them did; is that correct? Fiscal year 1994 did. The second got a qualified, and the third was not audited. I'm going to put in the record at the point the reporting on fiscal years 1991, 1993, and 1992, DOD financial statements.

I guess what I would just like to know from both of you, in your respective areas, and then we will close this out, if you had a scale of 1 to 10, with 10 being clean audits, the balance sheet can go for-

ward, all this, over the next 3 years, where do you think we are now? Are we at a 3, or a 4, or a 5, or a 1; 1 being the worst of the scale? Where would you say we are?

Mr. KEEVEY. I would say we're at a 3.

Mr. HORN. You're at a 3.

Mr. KEEVEY. And I answer it in the context of, a true balance sheet audit requires a lot of sophistication with regard to inventory and fixed assets, which we are a long way off from correcting. I think we have a much stronger chance, in the next couple years, to correct other aspects of what is integral to a balance sheet, other than fixed assets and inventory—accounts receivable, accounts payable, fund balances, things of that nature, that I think we will make giant steps toward correcting; again, with a lot of help from improvements to our accounting systems.

Mr. HORN. How do you feel about it, Mr. Tucker?

Mr. TUCKER. I would agree with that. I think—I hope that we are pretty realistic now, both the GAO and the IG and ourselves. We know this is a difficult road, but it's one that we're committed to. We will reach the end of this journey in time. We're still at a 3, I would certainly agree.

Mr. HORN. Do you have any further questions?

Mrs. MALONEY. I do have further questions, and I'm going to submit them in writing so that we can get on to the other panels, so that we can hear them. But I do want to just mention one question that I related in my opening statement, and it concerns the Prompt Payment Act, which requires DOD to pay interest on valid invoices that are paid late. Many people have talked about this; however, the GAO found that, during a 6-month period in fiscal year 1993, 78 percent of checks processed in the main Defense Finance and Accounting Service represented overpayments—overpayments by the government.

So not only are we having problems just giving an accounting of where the dollars are; we are having a problem with overpayment. The GAO also found the department does not have an adequate system to recover overpayments. And I would like to ask you some questions on that. What specific initiatives have you put in place in management to improve overpayments? What are your procedures?

Mr. KEEVEY. We talked a little bit about that when you were out. The problem, in 1993, I think was an order of magnitude of about \$800 million, mostly because we have a lot of contracts that are unreconciled. We have an accounts payable system where data is entered into it separately than it's entered into our accounting system. And when we come to make payments, the systems are not in synch, and therefore it leads to contract overpayments.

Mrs. MALONEY. What are you doing to correct that, to put them in synch?

Mr. KEEVEY. What Dr. Hamre indicated, we're spending a lot of time getting the contracts reconciled so that the accounts payable system and the accounting systems are in synch. We're spending a lot of extra time in supervisory review of individual payments over a certain dollar amount, that there is extraordinary review, if you will, before a payment is made due to a contract.

Mrs. MALONEY. Over the \$5 million, but what percentage are under the \$5 million in your payments? I would think it's huge.

Mr. KEEVEY. Well, that's a little bit different than a contract overpayment. Now you've wandered into the problems related to unmatched disbursements and NULOs.

Mrs. MALONEY. You said you had more oversight for the larger payments; isn't that what you said? I thought that's what you said.

Mr. KEEVEY. OK. I just want to make sure we're switching out of contract. We now pay, under the Columbus environment, if you will, where we pay our major weapons systems contracts, any payment that's over \$5 million we match to the underlying accounting system, which we heretofore did not do. For all the other accounting systems, we match for every payment over \$1 million.

Mrs. MALONEY. Not today, but could you get us in writing what the numbers are? I would like to know, in contract dollars, how much is spent under the \$5 million extra oversight level and under the \$1 million extra oversight level. I just know that, in Federal contracting of the \$200 billion that the Federal Government contracts annually, the large percentage of it is under \$1 million. I was just wondering if, in the military, it's the same.

Mr. KEEVEY. Well, we pay \$90 billion a year on contract payments. And we can give you some stratification of payments that are individually submitted as an invoice over \$5 million and those that are under \$5 million. We can get that.

Mrs. MALONEY. What could Congress do to help you achieve this?

Mr. HORN. Let me just say, that answer will be put in the record at this point, without objection.

Mr. KEEVEY. Yes, sir. OK.

Mrs. MALONEY. What could we do to assist you in resolving these problems? Do you need more money allocated to do this, or what do we need to do to help you solve these problems?

Mr. KEEVEY. I don't think more money at the moment is the problem. I think it's attention to the problem.

Mrs. MALONEY. So you have the resources to get the job done?

Mr. KEEVEY. Yes. I mean, there has to be a continual series of these resources year after year. I mean, this is a multiyear plan that has to be undertaken to solve these problems. They won't be overcome overnight. A lot of the more glaring errors have been reduced and mitigated significantly. If we were sitting here 3 years ago, we would be talking about \$50 billion of unmatched disbursements. We're talking about 60 percent less than that now and a plan laid out where we are, on a daily basis, minimizing that potential to increase because of the matching that we're doing that heretofore was not done.

What we need to do is persist on to make those continual improvements and improve the accounting systems, which is the long-range solution.

Mrs. MALONEY. How long do you think it will take you before you are able to match your overpayments with the actual amount that is owed? Is it a year, 2 years; how long?

Mr. KEEVEY. I think, until we have the accounting systems corrected, which will probably not be until at least fiscal 1998, will we have accounting systems that can produce financial statements. In the shorter term, what we're trying to do is develop some interim



technology that will limit that problem; that is, of making overpayments and of making unmatched disbursements and NULOs. I would say that that problem is being addressed every day.

Mrs. MALONEY. Why can't we move to general standard accounting practices?

Mr. KEEVEY. You alluded to that earlier.

Mrs. MALONEY. Yes.

Mr. KEEVEY. State and local governments, for many years, prepared financial statements under generally accepted accounting principles. The Federal Government never had that criteria or interest. Not until the CFO Act was passed was there a requirement to prepare financial statements. The Federal Government budget structure, particularly the Department of Defense, was based upon systems that only worried about appropriation accounting, obligation accounting, not developed to prepare financial statements to meet generally accepted accounting principles.

What we have underway now is a program to produce financial statements that meet generally accepted accounting principles. The systems were simply not designed to accomplish that. And I think that's probably true in most Federal agencies.

Mrs. MALONEY. OK. But your systems comply with the Comptroller General's accounting principles. My basic question is, you're telling me that States and cities comply with it, but the Federal Government never has.

Mr. KEEVEY. That's correct. There was never a requirement to do so until the CFO Act.

Mrs. MALONEY. OK. I understand completely that you have not been required to do so. Due to mismanagement—I call this mismanagement, overpayments, missing or unaccounted money, this is mismanagement. My question to you is maybe we should require general accounting principles.

Mr. KEEVEY. We do.

Mrs. MALONEY. Not the same standard general accounting principles that are the accepted ones for the private sector, for New York City, and New York State. You're operating under different accounting principles.

Mr. TUCKER. When the CFO Act was passed, it was recognized that—and I think it was put into the GMRA—it was recognized that the Federal Government needed somewhat different accounting standards. I sit on the Federal Accounting Standards Advisory Board. We are developing standards for the government, accounting standards for the government, that are being approved by OMB, GAO, and the Treasury.

We will have somewhat different standards for the Federal Government than the general accounting standards that apply to business, for instance. And there are different standards also that apply to State and local government. So we need our own standards.

Mrs. MALONEY. OK. I would like to request in writing why your standards have to be different. The GAO reports that there are only three financial management systems that comply with the Comptroller General's accounting principles and standards. If these are merely generally accepted accounting principles, why can't every service comply immediately.

See, I don't understand. I understand that you have a different system. My question is, why do you have to have a different system? Why can't you move simply to the accounting system that is accepted and used and understood so easily by accountants and auditors? When you read the audit report, they said they had a hard time trying to figure out what was going on. They still don't even know, because your recordkeeping apparatus is unique.

My question is, why does it have to be unique? I can understand that if you have security expenditures for defense that you don't want anyone to know about; it's under intelligence; it's off in a different category. But the whole procurement of the Department of Defense, a lot of which are just everyday supplies, why those cannot be brought into the same system that three management systems already have.

I don't want to belabor the point, but I would like to ask that you get back to the chairman and myself with that in writing, why you can't follow it. I think it's a simple question, and I'm getting answers that aren't answering my questions. So maybe if I ask to get it in writing and you have time to think about it and tell me the unique situations that you may face, so that we can look at it and try to figure out why this problem is taking place. We cannot afford to waste billions or mismanage billions of dollars.

Mr. HORN. Do you have some further questions?

Mrs. MALONEY. Thank you. I have many more, but I will put them in writing, because the chairman has several other panels.

Mr. HORN. Let me just ask one last question. Do you feel, in either of your respective areas, that you have strong resistance to this change from some parts of the Department of Defense, some of the services?

Mr. TUCKER. Well, I have to say that I think Dr. Hamre has been a very, very strong supporter. He has brought along with him not only the Secretary of Defense, who strongly supports our initiative, but he has brought along his colleagues in the various functional areas, acquisition and technology, R&D, procurement. The problems are difficult, but he has brought the people to the table who can help us solve them.

Mr. HORN. Very good. Any comment on that, Mr. Keevey?

Mr. KEEVEY. No. I agree.

Mr. HORN. Thank you both for coming. Your written testimony will be put in the record. That's automatic with all witnesses.

Panel two, the members from the General Accounting Office.

[Witnesses sworn.]

Mr. HORN. Both witness affirmed.

I take it, Mr. Dodaro, you will begin, as befits the Assistant Comptroller General. So welcome.

**STATEMENT OF GENE L. DODARO, ASSISTANT COMPTROLLER GENERAL, ACCOUNTING AND INFORMATION DIVISION, U.S. GENERAL ACCOUNTING OFFICE; AND G. EDWARD DeSEVE, CONTROLLER, OFFICER OF FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET**

Mr. DODARO. Good afternoon, Mr. Chairman, Mrs. Maloney.

I am pleased to be here today to discuss financial management at DOD. As you heard today, the department has some serious fi-

nancial management problems, and these problems span virtually all major aspects of their accounting operations. It is essential that they successfully tackle this issue. The department cannot currently provide adequate accountability over the public's huge investment in our national defense. This not only, as pointed out today, undermines their credibility, but it is also taking money and draining resources away from military readiness.

DOD is going to be severely challenged to make these needed improvements, however. As a result of this long history of neglect, their financial management structure, their systems, their processes, the work force need a major overhaul. Moreover, the magnitude of the problems go beyond accounting boundaries. Basic business practices, in areas such as procurement and inventory management, need to be revamped, as well.

As you have heard this morning, both the Secretary and Dr. Hamre are very candid and they are openly recognizing the seriousness of the problem. They've got many actions underway to fix some of the problems in the areas of unmatched disbursements, contractor overpayments, consolidating financial operations and systems, and reengineering their business practices.

We think these are all good steps, and they are in the right direction, and we're supportive of the thrust of those actions. However, there are concerns that we have in three areas, which we are in the process of more closely examining. The first involves revamping their accounting systems. Much of their improvement strategy hinges on redesigning the accounting systems, but their track record in producing good systems is not good, and many planned improvements are years away.

Issues we plan to explore include the schedule for developing systems without first reaching agreements on standard data elements and accounting requirements, the planned phased approach to developing a DOD-wide accounting system, and the need to address the limited software development capabilities within the Defense Finance and Accounting Service to provide quality systems on time and within budget.

Another critical area is upgrading the quality of DOD's financial management work force. This area has suffered greatly from the historic low priority given accounting in the department. Adequate training and skill development have been stifled.

Much of DOD's performance problems lie in carrying out existing procedures. Financial audits have consistently pointed this out. We are encouraged, however, by recent DOD actions to address this issue, but we plan to further work to identify additional opportunities for improvement. We also believe that a complete assessment of DOD's gaps in needed skills is essential to achieve meaningful results.

The final key barrier to improvement lies in the DOD structure itself. Within the financial management area there needs to be greater clarity between the Defense Finance and Accounting Service responsibilities and those of the military service departments. There are efforts being made to clarify this, but it's been a problem since DFAS was established in 1991, and we think that needs to be fixed.

Additionally, as pointed out today, solutions to a lot of these problems lies in DOD's business practices that result in payment and accounting problems, and we believe there needs to be a lot of cooperation within DOD in order to address these problems.

We plan to continue working with DOD to help find solutions to these problems. We believe their efforts, however, would be enhanced by the introduction of a first-rate group of outside experts. We made this recommendation last spring. These would be experienced chief executive officers, CFOs, information technology experts that have a proven track record in large-scale improvement efforts in the private sector. People have done this and accomplished this.

We believe DOD has extraordinary problems that require seeking some extraordinary solutions. An outside group of people could bring some creativity and perhaps more timely solutions to their problems.

In closing, let me underscore the value of the CFO Act in making needed improvements in DOD. CFO implementation has been absolutely critical to the progress that we've made to date, and the act's goals provide a valuable way to measure DOD's progress. Continued oversight by this subcommittee is very important to effectively ensure that the act is implemented in DOD.

I will be glad to answer questions later.

[The prepared statement of Mr. Dodaro follows:]

PREPARED STATEMENT OF GENE L. DODARO, ASSISTANT COMPTROLLER GENERAL,  
ACCOUNTING AND INFORMATION MANAGEMENT DIVISION

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the Department of Defense's (DOD) efforts to implement the Chief Financial Officers (CFO) Act. This act has been instrumental in helping the Department understand the depth and magnitude of its financial management problems and start on a course towards corrective measures. Today, as you asked, we will highlight the results of financial audits since the passage of the CFO Act and provide our perspective on the major challenges facing the Department in meeting the act's objectives.

Achieving the reforms required by the CFO Act is essential because DOD needs accurate financial information and appropriate internal controls to effectively manage the Department's vast resources—over \$1 trillion in assets, 3 million military and civilian personnel, and a budget of over \$250 billion for fiscal year 1995. Unfortunately, the Department does not yet have adequate financial management processes in place to produce the information it needs to support its decision-making process. No military service or other major DOD component has been able to withstand the scrutiny of an independent financial statement audit.

As discussed in our high-risk series,<sup>1</sup> this failure has serious implications. Good financial management runs deeper than the ability to develop accurate financial records. It is being able to provide managers with clear visibility and control over inventories, being able to accurately project material needs, and being able to effectively balance scarce resources with critical needs. In short, effective financial management is essential to ensuring that DOD's resources are productively employed in meeting our nation's defense objectives.

The Department has recognized the seriousness of its financial management problems and the need to take action. Secretary Perry and Under Secretary Hamre, who serves as DOD's CFO, have been candid in their assessments of the status of current processes and practices. The Department's financial reform goals—presented in its February 1995 "Blueprint"—offer a good perspective of the corrective actions which must be taken. This approach represents an important first step in committing DOD to real action. However, very serious management challenges face the Department as it moves to make the blueprint a reality.

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

Given the serious and pervasive nature of DOD's financial management problems, and the need for more immediate progress, the Department needs to consider additional steps to fix its long-standing weaknesses. As we testified in May 1995<sup>2</sup>, DOD needs to take several immediate actions to turn Secretary Perry's blueprint into substantive improvements, including (1) assessing the number and skill level of its financial management workforce and (2) establishing an outside board of experts to provide counsel, oversight, and perspective to reform efforts. In addition, we have questions about whether DOD's systems improvement strategy will produce the needed improvements in a timely manner and whether enough actions are planned to address the Department's deep-rooted organizational impediments to attaining meaningful change.

We are in the process of more closely examining these issues and DOD's other specific improvement strategies as requested by the Chairman of the Subcommittee on Defense, Senate Committee on Appropriations. We plan to provide our assessment and recommendations next spring. In the interim, we will continue to work with DOD in providing our views on ways to build upon its improvement efforts.

The following sections summarize the serious financial problems facing the Department, the actions it plans to take, and the difficult issues that it must address to overcome its problems.

#### CFO ACT AUDITS HAVE BROUGHT GREATER CLARITY TO DOD'S FINANCIAL MANAGEMENT PROBLEMS

The CFO Act requirements have served as an important catalyst for focusing attention on the financial problems facing the Department.

The regular preparation of financial statements and independent audit opinions, in particular, are bringing greater clarity to the scope and depth of DOD's financial management problems and needed solutions. These annual public report cards also are generating increased pressure on DOD management to fix its long-standing problems.

GAO performed the initial financial audit of the Army general fund operations under the CFO Act pilot program, as well as an early assessment of the Air Force's ability to meet the act's requirements. Also, we will soon release the results of our review of the Navy's financial reporting. Throughout our audit work, we developed and maintained a close working relationship with the DOD Inspector General (IG) and the military services' audit agencies. They have assumed responsibility for the audits of the Air Force and Army general funds over the past few years and have had responsibility for audits of the Department's \$80 billion Defense Business Operations Fund (DBOF) operations since 1992. I want to commend the DOD audit community for its continuing strong support of the CFO Act. We are particularly encouraged that the DOD Inspector General and the military services' audit organizations recently pledged substantial resources to meet the expanded requirement for an audit of DOD's fiscal year 1996 consolidated financial statements resulting from passage of the Government Management Reform Act of 1994 (GMRA).

Since 1990, we and the DOD auditors have made over 350 recommendations to help resolve the financial management weaknesses identified throughout the Department. These audits have consistently identified fundamental deficiencies in the Department's financial operations. A brief recap of the recurring issues identified by these audits follows.

- Serious problems in accounting for billions of dollars in annual disbursements. Without the proper matching of disbursements with obligations there is substantial risk that (1) fraudulent or erroneous payments may be made without being detected and (2) cumulative amounts of disbursements may exceed appropriated amounts and other legal limits. CFO Act audits have shown that DOD has paid billions of dollars without being able to determine exactly what was purchased. Also, financial audits of the Air Force and Army have shown that existing controls could not be relied on to ensure that DOD did not spend more than it was authorized—a basic fund control responsibility.<sup>3</sup> Similar problems were disclosed in our recent review of the Navy.

As of August 1995, DOD reported that its problem disbursements totaled about \$28 billion. Of this amount, \$16 billion, or 58 percent, of the problem dis-

<sup>2</sup>Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-146, May 23, 1995).

<sup>3</sup>Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990); Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, December 22, 1993); and Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DOD's General Fund Financial Statements (DOD Inspector General Report No. 95-301, August 29, 1995).

bursements had remained unresolved for at least 180 days. As we discuss later in this statement, DOD is taking steps to begin to address this issue.

Also, we recently reported that DOD could not rely on its own financial data to detect errors in payments made to contractors. For example, in one case, a \$7.5 million overpayment was outstanding for 8 years and might not have been recovered if the contractor had not notified DOD of the overpayment. When such overpayments were identified, DOD did not always properly try to recover those overpayments, costing the government millions of dollars in additional interest.<sup>4</sup>

- Not identifying and disclosing future Government costs. Financial audits have reported that DOD has not properly reported billions of dollars in potential future liabilities. Most of these future costs are associated with outstanding legal obligations, or with environmental cleanup costs at military installations, including bases that have been or will be closed.

This problem was found in both the Army's and Air Force's financial statements. For example, a fiscal year 1994 Army Audit Agency report disclosed that the Army did not properly report an estimated \$21 billion in potential future costs the government may incur for the cost of environmental cleanup.<sup>5</sup> The Air Force Audit Agency's fiscal year 1994 financial audit of the Air Force also identified almost \$28 billion of previously undisclosed contingent liabilities for items such as contract appeals and civil law and litigation claims.<sup>6</sup>

- Breakdowns in the Department's ability to protect its assets from fraud, waste, and abuse. CFO Act audits have highlighted continuing problems in overseeing DOD's multi-billion dollar investment in government furnished property and equipment in the hands of contractors, real property, and inventory and equipment. For example, our report<sup>7</sup> on Army real property disclosed instances in which real property maintenance requirements for some installations were understated, while other installations' requirements were overstated. In March 1995, the Army Audit Agency continued to report<sup>8</sup> on breakdowns in the process to ensure the accuracy of accounting for the Army's reported \$30 billion investment in real property. The same report indicated that the Army did not have accurate records for its reported \$8.5 billion investment in government furnished property in the hands of contractors. As a result, relying on contractors' reporting of government furnished property in their possession, the Army increased its accounting records by \$5.6 billion for fiscal year 1994.

- Continuing Problems in reliably reporting on the cost of its operations. Reliable cost information is necessary for the Congress to make sound budget decisions and is a key to achieving the Department's goal of reducing the cost of its operations. However, financial audits have demonstrated DOD's inability to accurately record and report costs. For example, we reported that the life cycle support costs reported to decisionmakers in DOD and the Congress for modifications to the Blackhawk and Chinook helicopters were understated by at least \$3.6 billion.<sup>9</sup>

Reliable cost information is also vital for DBOF to operate as intended on a break-even basis. However, the amount of DBOF's net operating results for fiscal year 1994 differed by an estimated \$4.4 billion between its financial and budgetary reports. As a result, it was unclear if DBOF operated at a gain or a loss, or whether it "broke even."

Beginning in fiscal year 1996, the Navy's general fund operations, for the first time, will be subject to audit under the expansion of the CFO Act requirements enacted by GMRA. We reviewed the Navy's fiscal year 1994 financial reports as a measure of the Navy's current ability to prepare reliable financial statements. In our soon-to-be-issued report, we conclude that, to an even greater extent than the other military services, the Navy is plagued by troublesome financial management deficiencies involving billions of dollars.

<sup>4</sup> DoD Procurement: Millions in Contract Payment Errors Not Detected and Resolved Promptly (GAO/NSIAD-96-8, October 6, 1995).

<sup>5</sup> Audit of the Army's Principal Statements, Fiscal Years 1994 and 1993, Audit Opinion (HQ 95-451, March 23, 1995).

<sup>6</sup> Review of Contingent Liabilities, FY 1994 Air Force Financial Statements (94053037, May 1, 1995).

<sup>7</sup> Financial Management: Army Real Property Accounting and Reporting Weaknesses Impede Management Decision-making (GAO/AIMD-94-9, November 2, 1993).

<sup>8</sup> Audit of the Army's Principal Financial Statements, Fiscal Years 1994 and 1993, Audit Opinion (HQ 95-451, March 23, 1995).

<sup>9</sup> Financial Management: Reliability of Weapon System Cost Reports Is Highly Questionable (GAO/AIMD-94-10, October 28, 1993).

We found that the Navy's financial reports were of little value in assessing its operations or the execution of its stewardship responsibilities. We identified substantial misstatements in almost all of the Navy's major accounts and \$225 billion in errors in the Navy's fiscal year 1994 financial reports. For example, our findings included the following.

- As of August 31, 1995, the Navy's problem disbursements had grown to \$18.6 billion and accounted for 67 percent of DOD's total problem disbursements.
- DOD has reported to the Congress and the President that from October 1992 through July 1995, the Navy had 15 violations of the Antideficiency Act totaling about \$87 million.
- Navy and DOD managers did not have sufficiently reliable information to know whether, in fiscal year 1994, Navy's DBOF activities operated at a gain or a loss, or whether they broke even as intended. Of the \$80 billion in revenue for fiscal year 1994, the Navy's DBOF activities accounted for \$23 billion. Further, since the inception of DBOF in fiscal year 1992, the DOD Inspector General has not been able to render a favorable audit opinion on DBOF's financial statements.<sup>10</sup>
- Navy managers did not consider all excess inventory in their budgetary and procurement decision-making. For example, not all of Navy's excess inventories of about \$400 million accumulated from the overhaul and decommissioning of ships and submarines were considered in developing its fiscal year 1996 budget request. As a result, we reported that the Navy's fiscal year 1996 budget request could be reduced by \$38 million.<sup>11</sup>

We found the Navy's financial reporting problems could be attributed in part to the long-standing failure to instill discipline in its financial operations and follow basic procedures. For example, rudimentary controls, such as ensuring the conduct of periodic physical inventories, reconciling related accounts and records, documenting adjustments, and reviewing abnormal account balances, were not routinely carried out.

We also found flaws in Navy and DOD controls relied on to secure their vast automated data processing operations. For example, we identified weaknesses in restricting access to sensitive data and in ensuring continuity of computer operations in the event of a catastrophe or other emergency. Such deficiencies increase DOD's exposure to security breaches that could result in the loss of assets or leaks of sensitive information, such as payroll data.

The Navy, along with DOD, has not taken full advantage of the 5 years since the CFO Act's passage, or the lessons learned from the experiences of the other services in preparing financial statements. They must now "play catch up" and earnestly counteract these serious problems through measures that will lead to successfully preparing reliable financial statements on the Navy's operations within the next year. Our planned reporting on our Navy work will detail recommendations to the Secretaries of Defense and the Navy to help correct the problems we identified.

#### DOD'S PROGRESS IN MEETING THE CFO ACT OBJECTIVES

In laying out his "Blueprint" for reforming the Department's financial management operations in February 1995, Secretary Perry took a first step towards resolving the Department's long-standing problems. The following five areas were key elements of that blueprint: (1) consolidate finance and accounting operations, (2) consolidate finance and accounting systems, (3) establish pre-validation for disbursements, (4) reengineer DOD business practices, and (5) strengthen internal controls. DOD has cited the Defense Finance and Accounting Service's (DFAS) "Business Plan" as the mechanism on which it will rely to implement the blueprint.

A summary of DOD's improvement initiatives in the blueprint's five key areas follows.

- Consolidate Finance and Accounting Operations. In May 1994, DOD announced plans to consolidate over 300 defense accounting offices in 5 large existing finance centers<sup>12</sup> and 20 new sites called operating locations during the next 5 to 7 years. The plan, which is expected to reduce DOD finance and accounting personnel from 46,000 to 23,000, is aimed at streamlining DOD's financial operations and setting the stage for future process enhancements.

<sup>10</sup> Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994 (Report No. 95-294, August 18, 1995).

<sup>11</sup> 1996 DOD Budget: Potential Reduction to Operations and Maintenance Program (GAO/NSIAD-95-200BR, September 26, 1995).

<sup>12</sup> DOD's five large centers are located in Columbus, Ohio; Cleveland, Ohio; Denver, Colorado; Indianapolis, Indiana; and Kansas City, Missouri.

We see DOD's plans to consolidate and reduce personnel as a necessary step toward a more effective and efficient finance and accounting service. However, as discussed in our September 1995 report, we have concerns with DOD's planned consolidation efforts.<sup>13</sup> For example, DOD decided to open 20 new operating locations without first determining what finance and accounting functions they would perform or if 20 was the right number to support its operations. In response to the report, DOD has committed to reevaluate the number of locations and personnel required to perform finance and accounting functions by November 30, 1995. Further, starting December 15, 1995, and annually thereafter, DOD has agreed to reassess its site-selection decisions and report its findings to the Secretary of Defense.

- **Consolidate Finance and Accounting Systems.** DOD has acknowledged that its financial management systems are antiquated and cannot be relied upon to provide DOD management and the Congress with accurate and reliable financial information for use in decision-making. To date, a number of standard systems have been selected, including those used for civilian pay, military retiree and annuitant pay, military pay, transportation payments, debt management, and contractor payments. The implementation of these standard systems is expected to reduce DOD's cost of operating redundant systems. To illustrate, 3 years ago, DOD had 18 separate military payroll systems; today, there are 11. By 1996, DOD hopes to reduce the number of systems to two or three. While DOD has made progress in reducing the number of payment systems, as discussed later, we have concerns with the overall strategy and timing of DOD's other systems improvement efforts.

- **DOD Disbursements.** DOD recognizes that it has a serious problem of not being able to properly match disbursements with obligations. In attempting to correct this problem, DOD is taking steps to implement the legislative mandate limiting the funds that may be disbursed before the proposed payments are prematched to the obligation data in the official accounting systems. This initiative should help ensure that the (1) disbursements are properly matched to the corresponding obligations and (2) obligations and disbursements data are recorded accurately in the accounting records. As discussed later, DOD has not yet been able to fully implement this initiative.

- **Reengineer Business Practices.** DOD has recognized that its financial management structure consists of many organizations with each having their own processes. These often duplicative processes have produced business practices that were complex, slow, and error-prone. For example, we have reported that DOD's administrative travel processes were extremely complicated.<sup>14</sup> DOD has recognized that it could save hundreds of millions of dollars yearly by reengineering its travel processes and has such efforts under way.

As discussed in our May 1995 testimony, the potential for savings in other areas may be even greater. While DOD's mission is unique, many of its support functions, such as payroll/personnel, are similar to those carried out in the private sector and could be modeled on industry best practices. DOD is now planning to evaluate the potential for reengineering a number of these areas.

- **Strengthen Internal Controls.** Strong internal controls are critical to effectively controlling and accounting for the estimated \$1 trillion in DOD assets worldwide. Secretary Perry has directed that senior managers play a more active role in identifying, reporting, and correcting poor controls. We endorse the thrust of DOD's efforts in this area. In the past, we were critical of DOD's failure to acknowledge its fundamental internal control deficiencies in its Federal Managers' Financial Integrity Act reporting. However, more recently, we have been encouraged by DOD's more complete and realistic reporting on its internal control weaknesses.

We support DOD's reform initiatives and recognize the difficult challenge it faces in realizing financial management improvements. However, as we testified in May 1995, DOD could take added steps to help increase the likelihood of turning Secretary Perry's blueprint into substantive improvements. We suggested that DOD (1) assess the number and skill level of its financial management workforce and (2) establish an outside board of experts to provide counsel, oversight, and perspective to reform efforts. As discussed in the following sections, we also are planning to closely examine DOD's overall strategy and timing of planned systems improvement efforts

<sup>13</sup> DoD Infrastructure: DOD's Planned Finance and Accounting Structure Is Not Well Justified (GAO/NSIAD-95-127, September 18, 1995).

<sup>14</sup> Travel Process Reengineering: DOD Faces Challenges in Using Industry Practices to Reduce Costs (GAO/AMD/NSIAD-95-90, March 2, 1995).



and its efforts to address deep-rooted organizational impediments to meaningful change.

#### DOD'S FINANCIAL MANAGEMENT SYSTEMS ARE NOT YET CAPABLE OF PROVIDING ACCURATE DATA

Accounting and financial systems are the backbone of any agency's financial management processes and operations. The CFO Act requires that agencies develop integrated systems—meaning budget and accounting systems—that provide reliable, timely, and consistent information necessary to conduct agency operations and produce reliable information on the cost and performance of those operations. DOD's financial systems are neither integrated nor do they provide reliable information.

DOD operates over 250 financial management systems that are largely incompatible. Only 8 percent of those systems are integrated, and only 9 percent have been designated as DOD-wide systems. Further, only three systems comply with the Comptroller General's accounting principles and standards.<sup>15</sup>

This situation causes real problems within the agency, as shown in the following examples.

- The problem of properly matching billions of dollars in disbursements is exacerbated by poor system performance. DOD has not yet fully implemented an automated process for validating invoices prior to disbursement. In order to comply with a legislative mandate to validate all disbursements over \$5 million, the Department had to process most of the transactions manually. Nonstandard systems have also prevented DOD from implementing a new prevalidation threshold of \$1 million at its largest contract-paying facility.
- Poor cost accounting systems limit the effectiveness of DBOF, which was established, in part, to help the Department run on a more businesslike basis. Accurate cost data are needed to properly analyze trends, make comparisons, and evaluate the performance of DBOF business activities. Many DOD business activities are inefficient, and accurate financial information is needed to help pinpoint where cost reductions are needed. However, DOD is experiencing difficulty obtaining such data because the cost accounting systems are fragmented, costly to maintain, and do not provide the cost information necessary for managers to better control costs. The DOD Inspector General has cited system deficiencies as one of the major obstacles to the preparation of statements that fairly present DBOF's financial position.<sup>16</sup>

Further, our analyses of DBOF's budgeting and financial reports have shown that they differ by billions of dollars for net operating results. DBOF's fiscal year 1993 budgeting and financial reports differed by \$5.9 billion, whereas the fiscal year 1994 reports differed by \$4.4 billion.<sup>17</sup> Credible cost data on operating results are essential because they are needed in setting the prices DBOF will charge its customers which, in turn, provide the basis for establishing customers' budget requests.

A key element of Secretary's Perry's reform blueprint was the consolidation of financial management systems. Such action is expected to help eliminate duplication, enhance system performance, and save money. The Department is implementing this strategy by developing a standard financial accounting system for each service and by consolidating the current 80 DBOF systems into 17 standard systems.

However, we are concerned about the pace of needed systems improvements. The projected time frames for completion of these system development efforts are several years away. According to a recent DOD IG report,<sup>18</sup> DFAS management has said long-term corrective actions, including the development of new accounting systems, will not be completed until September 1998. According to the DOD IG, until that date, general fund financial statements will remain unauditable. The report goes on to state that the DOD IG will not be able to render audit opinions on any of the military services' general fund operations until March 2000 at the earliest.

Historically, DOD has encountered difficulty in putting effective financial management systems into place. For example, in response to the first GAO audit of the Air

<sup>15</sup> Federal Financial Management Status Report & Five-Year Plan (Office of Management and Budget, July 1995).

<sup>16</sup> Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994 (Report No. 95-294, August 18, 1995).

<sup>17</sup> Defense Business Operations Fund: Improved Pricing Practices and Financial Reports Are Needed to Set Accurate Prices (GAO/AIMD-94-132, June 22, 1994).

<sup>18</sup> Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DOD General Fund Financial Statements (Report No. 95-301, August 29, 1995).

Force in 1990,<sup>19</sup> DOD stated that its Corporate Information Management (CIM) initiative would be partly or wholly responsive to 17 of the 26 recommendations that were made. Unfortunately, we have reported that the overall objectives of CIM, which in part, was aimed at improving the standardization, quality, and consistency of data from DOD's multiple automated information systems, have not been achieved.<sup>20</sup> Because the needed systems improvements are still not in place, the accuracy and reliability of the data provided by the systems today remain questionable.

As part of our ongoing efforts to evaluate DOD's financial operations, we will be more closely examining DOD's current systems strategy. For instance, is the DOD strategy of reducing the number of accounting systems within each service—the interim migration approach—appropriate? Will DOD's planned investment of \$200 million to enhance existing systems produce auditable financial statements that comply with applicable accounting standards and reporting requirements? Will the interim systems as designed be truly integrated?

We will also be evaluating DOD's underlying capability to successfully develop software and manage its contractors. Standard software engineering processes are critical to developing and enhancing systems in a timely and cost-effective manner. However, based on a DFAS self-assessment, we believe that it currently lacks the software engineering capability to provide assurance that systems enhancements can be effectively carried out, although it has begun improvement efforts.

We recently started an assessment of the software process improvement efforts of the Financial Systems Organization—the information technology arm of DFAS—and plan to develop detailed recommendations to assist in these efforts. We also plan to evaluate the software engineering capability of other DOD organizations providing software support to DFAS. For our evaluations, we are using the Capability Maturity Model developed by the Software Engineering Institute (located at Carnegie Mellon University). The model is used by DOD and the private sector to assess an organization's software engineering capability.

In addition, DOD needs to pursue short-term actions to improve the quality and reliability of the data in its current systems, such as (1) following and enforcing current accounting policies and procedures, (2) reviewing and analyzing its monthly reports to identify inaccuracies, and (3) taking action to correct the problems identified. These actions are not new or revolutionary, but rather fundamental internal control procedures. The Director of DFAS has recognized the need to reinforce these key procedures and issued a September 1, 1995, directive that called for all DFAS locations to place increased emphasis on adhering to established internal controls.

#### ESTABLISH SKILLED FINANCIAL MANAGEMENT WORKFORCE

Another key responsibility that the CFO Act assigned to agency CFOs is directing and upgrading the agency's financial management personnel, including enhancing their professional training. Well-qualified personnel with the knowledge and skills required to carry out existing systems operation and accounting procedures will be essential if DOD is to make marked strides toward improving its financial operations.

While we have not yet done any comprehensive assessment of the Department's financial personnel, recurring audit findings have highlighted problems relating to DOD personnel adhering to basic control requirements. For example, these audits have consistently found that DOD personnel did not carry out required supervisory reviews or reconciliations, nor did they properly document adjustments to financial records. In addition, both our financial audits and those of the DOD Inspector General have raised questions about the adequacy of DOD's financial management personnel, as shown in the following examples.

- Our 1993 review of the Army's financial operations disclosed that of its 84 top managers responsible for overseeing the work of over 1,500 personnel at its central accounting location, only 7 had any professional certifications.<sup>21</sup>
- Our recent review of the Navy's financial operations disclosed that 31 percent of the positions at its central accounting facility were vacant. In addition, 30 percent of its mid- and senior-level positions were filled with personnel in a job series that requires no accounting education.

<sup>19</sup>Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990).

<sup>20</sup>Defense Management Initiatives: Limited Progress in Implementing Management Improvement Initiatives (GAO/T-AIMD-94-105, April 14, 1995).

<sup>21</sup>Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, December 22, 1993).

The DOD IG's report on its summary of the major deficiencies that prevented the development of reliable DBOF financial statements identified personnel as a major problem.<sup>22</sup> For example, it highlighted inadequate training and shortages of support personnel as factors impeding effective DBOF transaction processing.

In May 1995, we testified<sup>23</sup> that ensuring that DOD has the appropriate number of staff with the requisite skills is a key to turning Secretary Perry's blueprint into substantive improvements. Unfortunately, DOD has not made enough progress in addressing these fundamental personnel issues. DOD needs to comprehensively assess the personnel levels, skills, and experience necessary to effectively carry out DOD's financial operations.

However, we are encouraged by the DOD CFO's recognition of the importance of professional development for the Department's financial management workforce. In August 1995, the DOD CFO established a Financial Management Community Executive Committee. The committee is chaired by the DOD CFO, and its members include the Director of DFAS and representatives from the military services' assistant secretaries for financial management. One of the committee's planned initiatives is to address the specific competency requirements for the Department's financial personnel. If successfully carried out, such initiatives may help strengthen the professional skills of DOD's financial management workforce.

Because of its importance to the overall success of DOD's reform efforts, we plan to take a closer look at DOD's financial management workforce needs. Specifically, we will be looking at whether additional actions may be needed in (1) ensuring that DOD has the appropriate number of staff with the requisite skills required to successfully reform DOD's financial operations, (2) determining the appropriate training and experience requirements, and (3) developing and implementing plans to address future financial management needs.

#### BUILD AN EFFECTIVE FINANCIAL MANAGEMENT ORGANIZATION STRUCTURE WITH CLEAR ACCOUNTABILITY

One of the key objectives of the CFO Act is to establish a CFO in each agency with the authority to oversee all financial management activities. While DOD has established a Chief Financial Officer, we are concerned that DOD's CFO faces major long-standing organizational barriers that will be extremely difficult to overcome in making needed improvements. In presenting his blueprint for reforming DOD's financial management, Secretary Perry accurately stated that "DOD's manifold financial management failures reflect an antiquated bureaucratic organizational structure coping unsuccessfully with the complexities of modern government and business."

For example, since the creation of DFAS in 1991, DOD has had continuing problems in clarifying the relationship between DFAS and its customers—principally the military services. DFAS was created to serve as DOD's "Accounting Service," with its Director reporting to DOD's CFO. However, DOD faces significant organizational challenges, and accountability concerns remain. In our December 1993 report on the Army's financial operations, we pointed out that the effectiveness of the Army's financial management was impaired as a result of the lack of clearly delineated roles and responsibilities between DFAS and the military services. Most recently, in our review of the Navy, we found that DOD still had not yet clearly defined or strictly enforced accountability between the Navy and DFAS for the Navy's financial management and reporting operations, or for meeting the CFO Act's requirements.

The DOD CFO has issued a draft of a section of its financial management regulations setting out detailed proposed roles and responsibilities among the various DOD organizations involved in financial management. If effectively implemented, including establishing individual accountability, the draft policy may help address many of the failures to follow basic control procedures that we found. We have recently recommended that this draft document, issued for comment in February 1995, be finalized as soon as possible, and that a follow-up effort be established to ensure its effective implementation.

In addition, the responsibility for many of the actions that will be needed to bring about any major improvements in DOD's financial management resides with DOD's functional area managers, such as DOD's procurement, personnel, and logistics functions. The systems and procedures that are directed by these DOD functional managers currently are relied on to provide substantial portions of the data that is

<sup>22</sup> Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994 (Report No. 95-294, August 18, 1995).

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

compiled in DOD's accounting systems and financial reports. However, these functional managers operate outside the DOD CFO's sphere of influence. Consequently, garnering the support and active involvement of these organizations will be another major challenge that the DOD CFO must address. Because overcoming these organizational impediments are a key to any fundamental improvements in DOD's financial management, we are also planning additional work to examine whether additional actions will be needed to help the DOD CFO achieve the goals of more effective and efficient integration.

Reforming DOD's financial management operations is one of the formidable challenges facing the government today. Secretary Perry's blueprint lays out an overall plan to help meet this challenge. DOD must now translate the plan into concrete actions that will move the Department forward and result in measurable progress. It is essential that DOD have a world-class financial operation in order to make sound resource allocation decisions and safeguard the American public's huge investment in defense.

As outlined in our May 1995 testimony, we continue to believe that DOD should consider establishing an independent, outside board of experts to provide counsel, oversight, and perspective to DOD's reform efforts. Such experts could provide valuable advice and expertise in all three of the challenging areas we have outlined today: systems development, personnel needs assessment, and organizational structure. We plan to continue working closely with the Department in its efforts to meet the goals of the CFO Act.

Mr. Chairman, this concludes my testimony. I will be happy to answer questions that you or Members of the Subcommittee may have.

Mr. HORN. Right. Now we will call on Mr. DeSeve.

Mr. DESEVE. Thank you very much, Mr. Chairman.

I would like to summarize the statement that I have submitted for the record. Often, in a system of government built on checks and balances, disagreements are perpetuated to promote a particular objective or point of view. The objective of improved financial management in the Defense Department is not the subject of such disagreements.

The testimony you have heard so far today, and will hear later, all points to the need for commonly arrived-at solutions. An important byproduct of the Chief Financial Officers Act and its successor, the Government Management Reform Act, is the establishment of a clear and common goal for success, an auditable financial statement, with an unqualified opinion from the auditor.

This goal, in itself, represents a capstone to the process of achieving it. In this case, the process may be more important than the product. Why? To produce an auditable financial statement, transactions must be properly executed and recorded. The systems used to receive the data, classify it, transmit it, and report it must be complete and efficient. The process by which cash and contracts are handled must meet high standards of integrity.

These and many other requirements are inherent in the concept of auditability and producing an unqualified opinion. Time and time again, throughout the government, the audit process has uncovered weaknesses and prompted solutions. In a recent survey conducted by Coopers & Lybrand, on behalf of the Association of Government Accountants, all 26 of the Inspector Generals' offices responding to the survey indicated that they believed that internal controls had improved as a result of CFO Act implementation, including auditing of financial statements.

As Assistant Comptroller General Gene Dodaro has noted, recent audits in the Defense Department have identified serious problems in accounting for billions of dollars in annual disbursements: the need to report, fully, future liabilities; properly accounting for prop-

erty and equipment to guard against waste and fraud; accurate cost information that is not always available to support decision-making; and inventories, which must be integrated with other financial and operating systems to minimize duplication and waste.

Let me just digress for a second. Those five things are the hurdles that must be overcome in order to for the specifications, first, to have a statement that is auditable at all, and then, finally, ultimately to get the Holy Grail of the clean opinion. Those are the five to keep your eyes on as you go forward.

Now, what has OMB been doing to help the Department of Defense? First, I would like to talk about Mrs. Maloney's earlier question, and that is the question of accounting standards. Trying to do accounting without accounting standards is like free verse; that is, trying to play tennis without a net. You can't do it.

But let's put a couple of things in context so that Mrs. Maloney's question can get a better answer. No. 1, until 1994, when the GMRA was passed, 1 year ago, the Defense Department was not required by this Congress to comply with what we call generally accepted accounting principles throughout government; that is, State and local government as well as in commercial activities. So it was a year ago that—I'm not making an apology; I just want to give you a context—it was a year ago when the standards were put in place.

Standards for the Federal Government do not currently exist. What has OMB been doing? Since 1990, along with GAO and Treasury, we've been developing those standards. They are almost finished. I'm told by the people who are working on them, that in the spring of the year, all of the standards will be in place. Many of them are in place now; for example, entity and display. You have to decide what buckets or what categories to put things in. And the Defense Department has complied very nicely. They have organized their own financial statements to be in exact accordance with entity and display.

Cost accounting principles are now available to us. We're waiting on revenue principles. But some very thorny questions lie in the weeds. What do you do about liabilities in Defense for environment clean-up? How do you count those on the balance sheet? What does that future liability look like? It's a problem that DOD shares with others. So there are problems within the inherent nature of government accounting.

And we will be happy, Mrs. Maloney, to spend some time, if you would like it, to go over some of the FASAB standards and the challenges that the Defense Department has facing them.

However, all of that said—we're not trying to apologize for the department—there's a bigger problem. Let's go to New York City for the moment. The last time I looked, New York City was about a \$25-billion-a-year operation. By any standard, it's as big as a Federal department. The Defense Department is about 10 times as big as New York City. It's about \$250 billion a year, but still a magnitude that you can contemplate. It's spread all over the Nation and has different requirements, but still something you can think about.

What forced New York City, as you correctly said, to begin producing audited financial statements that could have a clean opinion

on them was the Federal Government, but it was also the credit markets. The credit markets said, "We're not going to lend you any more money."

Before the Federal Government was asked, Chemical Bank was asked, and others were asked, to lend money to New York. And they said to New York, as every other State and locality, "We're not going to give you any money unless you've got, according to generally accepted accounting principles, a clean financial statement. Sorry. No statement; no money." So there was a market test.

The Federal Government, as a whole, has never had a market test. We use the full faith and credit of the Federal Government to borrow. We've never had, for the Federal Government, and were never required to until this Congress passed, last year, GMRA, to have an audited governmentwide financial statement. So the standard simply wasn't there. We simply never asked the Defense Department.

A good friend of mine, Morgan Kinghorn, who was the CFO at IRS, was asked the same question. Why are these IRS financial statements so terrible? And Morgan said, "Well, they were never designed to be audited." Well, that gave rise to a great humorous column by Dave Barry, the humorist, who talked about not paying his taxes this year because his tax return was never designed to be audited.

We can only appreciate the magnitude of the task, No. 1; the fact that it's never been asked to be done before, No. 2; and No. 3, the absence of market pressure. I don't want to sound like a market theorist in any way, but that lack of pressure focuses the attention more diffusely in the Defense Department than it does in New York, which needs to borrow in the credit markets on their underlying financial statement. So we would like to spend some time talking about that.

I don't want to go into a lot more detail other than to say that Gene, Gerry Murphy, and I have visited each of the departments covered by the CFO Act, recently. And we asked them questions about their auditability: can they produce an income statement; can they produce a balance sheet; do they have underlying systems that, with or without manual intervention, can produce those documents. We then said, what unique problems do you have? We found one agency where, over at least 17 years, they had never reconciled one of their major funds.

Now, the question is, do you start back in year one and take every shoe box, every cardboard file box out, in every office in that agency—and this is not the Defense Department—and reconcile each of those documents? Or do you try to do some testing and find some practical ways to find that opening balance, and then go forward from there? We're discussing and debating that question now.

What do you do with property, valuation of property? The State Department has a very difficult time valuing the Embassy in Tokyo. It sits on several acres of ground in the middle of downtown Tokyo. So there are a lot of audit issues that go beyond simply dealing with waste, fraud, and abuse. And I don't mean to be—how shall I say it—I don't mean to be obfuscating on the issue in the Defense Department. I associate myself with the Big Five that

Gene has identified, but think that we all have to move forward and recognize where we need to go.

Systems are something we've talked a lot about today, and I will be happy to answer any questions on those. OMB is making sure, where we can, that adequate standards exist and that resources are available.

I would be happy to answer any questions that you have.

[The prepared statement of Mr. DeSeve follows:]

PREPARED STATEMENT OF G. EDWARD DESEVE, CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

INTRODUCTION: THE UNIFIED CHALLENGE

Often in a system of government built on checks and balances, disagreements are perpetuated to promote a particular objective or point of view.

The objective of improved financial management in the Defense Department is not the subject of such disagreements. The testimony you have heard so far today and will hear later all points to the need for commonly arrived at solutions.

An important by-product of the Chief Financial Officers (CFOs) Act and its successor the Government Management Reform Act (GMRA) is the establishment of a clear and common goal for success: an auditable financial statement with an unqualified opinion from the auditor. This goal in itself represents a capstone to the process of achieving it. In this case the process may be more important than the product.

Why? To produce an auditable financial statement, transactions must be properly executed and recorded; the systems used to receive the data, classify it, transmit and report it must be complete and efficient; the process by which cash and contracts are handled must meet high standards of integrity.

These and many other requirements are inherent in the concept of auditability and producing an unqualified opinion. Time and time again throughout the government, the audit process has uncovered weaknesses and prompted solutions.

In a recent survey conducted by Coopers and Lybrand on behalf of the Association of Government Accountants, all 26 of the Inspectors General offices responding to the survey indicated that they believed that internal controls had improved as a result of CFOs Act implementation.

As Assistant Comptroller General Gene Dodaro has noted, recent audits in the Defense Department have identified the following:

- Serious problems in accounting for billions of dollars in annual disbursement. Disbursements must be matched to prevent fraudulent or erroneous payments and to assure that appropriations are not exceeded.
- The need to report future liabilities fully and clearly.
- Properly accounting for real property and equipment to guard against fraud and waste.
- Accurate cost information is not always available to support decision making.
- Inventories must be integrated with other financial and operating systems to minimize duplication and waste.

Given these audit concerns, it is incumbent on all of us to assist the Department in finding solutions not just in identifying the problems. None of us can be considered to have completed our tasks until the financial management of the Department meets the standard of integrity established by producing an audited financial statement that can assure Congress and the general public that the Department is on the path to an unqualified opinion. This is the unified challenge that we face.

THE OMB ROLE IN ASSISTING DOD

Just as GAO's role is primarily that of auditor, OMB's role is primarily that of policy setter. Together with Treasury, who receives and records information government wide, OMB and GAO have been providing various forms of assistance to DOD.

The recognition that the CFO Act would require Federal accounting standards led to the Memorandum of Understanding among OMB, GAO, and Treasury that established the Federal Accounting Standards Advisory Board (FASAB).

DOD has been an active participant in FASAB and its needs and views have shaped the Board's deliberations. DOD took cognizance of the Board's standard, "Entity and Display" and applied its criteria in identifying components that would prepare separate stand-alone financial statements in addition to the agency-wide statements required by GMRA. Entity and Display suggests that an agency should

consider preparing separate stand-alone financial statements for its sub-organizations that conduct very visible or critical activities with a high level of public interest. Using this criteria, DOD indicated that starting with FY1996, it will prepare separate stand-alone financial statements for the individual military services and the Defense Business Operations Fund (DBOF).

GMRA extended DOD's audit coverage from its revolving funds, trust funds, substantial commercial functions, and organization-wide pilots (Army and Air Force) to the entire Department. The new requirements of GMRA also include the need to produce a departmentwide statement by March 1, 1997 and to transmit information for the government-wide statement by March 31, 1998. These new requirements gave rise to a major program of assistance by GAO, Treasury, and OMB.

As I noted earlier, the new standard for success—the audited financial statement with a clean opinion—gives all of us a common goal. To assist DOD and others in meeting this goal, Gene Dodaro, Fiscal Assistant Secretary of the Treasury, Gerry Murphy and I, along with our staffs, visited the Inspectors General and Chief Financial Officers in each agency.

Our purpose was:

- To offer assistance in meeting challenges unique to a department or agency. For example, one agency has never reconciled one of its funds. The question of the practicality of attempting to find and reconcile very old records was discussed and is being examined by the agency and the central agencies to find a practical solution that addresses the problem in a comprehensive manner.
- To create interagency task forces to deal with common problems. The Defense Department is not the only agency that has difficulty accurately recording its environmental liabilities. A task force has been formed to deal with this issue in a consistent manner throughout the government that will give DOD assurance that its own efforts will satisfy accounting and audit requirements.
- To inform the agencies of the importance of statutory deadlines and to indicate that no waivers would be given by OMB. The process of granting waivers has been interpreted by some as a reason to postpone action toward compliance. This has caused unnecessary delays.

The central agencies will continue to work with DOD through FASAB; individually as part of the audit or policy setting process; in the task forces to assure that its unique needs are considered; and to help in finding practical solutions to problems.

#### THE ROLE OF FINANCIAL SYSTEMS

Throughout the Federal government, the creation of reliable integrated financial management systems is the number one financial management priority. This is reflected in two recent publications. The first is the 1995 Federal Financial Status Report and Five-Year Plan, which was transmitted by OMB Director Alice Rivlin to Congress in July. For the first time, the five year plan reflected the jointly stated priorities of the statutory Chief Financial Officers (CFO) Council and OMB.

In making financial systems its highest priority, the CFO Council said,

“Improving financial management systems is the CFO Council's number one priority, in part because good financial systems are required to support so many other areas. For example, financial statements and performance reporting depend on financial management systems to provide accurate, useful data. Similarly, electronic commerce depends on changes to business processes supported by financial management systems.”

The second publication was the previously referred to Association of Government Accountants/Coopers and Lybrand report. 35.4% of the financial managers responding to the survey stated that lack of integrated financial management systems was the greatest barrier to implementation of the CFOs Act. This was by far the greatest barrier cited and twice as important as the next category.

The Defense Department has acknowledged this priority in its 1994 Chief Financial Officer Financial Management Five-Year Plan. In his letter of transmittal, Comptroller and Under Secretary John Hamre states,

“We acknowledge the need to accelerate the pace of improvements in departmental operations and systems, and as a result, are undertaking aggressive actions to comply with the Chief Financial Officers Act.”

The pace of change in financial systems technology will require a continual reevaluation by the Department of its strategy. OMB has reviewed the Department's current systems strategy as part of its annual systems briefings. Discussions will



continue during the preparation of the President's Budget regarding the strategy and the resources needed to implement it.

An important part of Undersecretary Hamre's Blueprint for Reform is the standardization of data, definitions and concepts. As noted in Deputy CFO Tucker's testimony,

"Until recent consolidation efforts began, DOD finance and accounting systems managed some 100,000 data elements. Detailed data modeling has indicated that DOD financial operations eventually could be conducted with fewer than 800 carefully designed standard data elements. As of June 1995, we have adopted 540 standard financial management data elements. Additional elements are likely to be added in the future."

DOD is moving towards meeting the requirements of OMB Circular A-127, recognizing that consistently recording financial events is key to producing reliable financial information. Data standardization is a significant step towards improving the consistency of data entered in a system. These elements will serve as the basis to all accounting and financial systems. Efforts are underway to implement the Standard General Ledger (SGL) across the department as new systems are implemented or old systems are upgraded. Currently only 24% of the systems have the SGL place. DOD also is moving towards source data entry to support consistent recording of financial events. This means that information on a financial event is entered at a single source and is provided to other systems without reentry by electronic means.

To consolidate its financial operations, Defense established the Defense Financial and Automation Service (DFAS) organization in 1991. Under the DFAS approach, the number of financial centers is expected to be reduced from over 300 to 26 by 1998. Although Defense will recognize savings from operating fewer financial centers, the optimum benefits of streamlining financial operations will not be recognized until financial processes and the architecture of systems which support them are restructured to eliminate redundant and out-dated practices. This requires continuing a buy-in by top management down through the staff levels and must cross functional boundaries into areas such as procurement and logistics.

OMB has expressed some concern with DOD's interim standard system approach. This approach has focused upon selecting the best of the systems supporting each of the functional areas. Unfortunately, the best systems may be inadequate to meet financial management needs and may require significant and costly upgrades. OMB has recommended in the past that DOD look outside of its current financial management structure for system solutions. Possible alternatives include Commercial Off-The-Shelf Software (COTS), out-sourcing, cross-servicing, and adoption of systems from other agencies.

Although most of the publicity has focused on system problems, DOD has had some successes. Defense has reduced the number of civilian payroll systems from 18 in 1991 to 14 and expects to further reduce this number to one by FY 1997. DOD civilian payroll systems are successfully servicing other agencies, including the Executive Office of the President (EXOP). DOD has successfully implemented the interim systems for retiree/annuitant, debt management, and contract payments and has migration plans for implementing the interim target system for most of the other functional areas. The number of DOD accounting systems has declined from 270 in 1993 to 249 in 1995.

Defense still has long-term financial problems which must be dealt with. The current target systems are interim systems. The Department is still a long way from achieving integrated financial management systems as required by OMB policy. Plans for some functional areas need additional time for implementation. These include major areas, such as DBOF support and general appropriation accounting. The planned systems reduction for these areas is shown below:

	1991	1995	1998
General Fund .....	88	83	42
Business Fund .....	82	80	17
Total .....	170	163	59

Much work remains before Defense systems meet the current financial management system requirements outlined in OMB Circular A-127. For example, the Department reports that only 35% of its systems meet reporting requirements, and 36% comply with departmental data standards.

## PROGRESS IN PRODUCING AUDITABLE FINANCIAL STATEMENTS

As noted above, the production of auditable financial statements is a key indicator of the health of an agency's financial management.

The Army and Air Force have made significant progress in their efforts to produce auditable financial statements. The Navy will be required to produce a service-wide financial statement for the first time for FY 1996.

As highlighted in the audit of the Army's 1994 consolidated financial statements, significant progress has been made in many areas, including:

- improving the process and controls related to the preparation of the financial statements.
- implementing record retention policies which ensure the existence of appropriate audit trails.
- developing interfaces between Army personnel and payroll systems and ensuring reconciliation of military payroll amounts.

The Army Auditor General pointed out that although the Army is working energetically to solve its financial management problems, the Army's financial managers concentrate most of their attention on fund control and ensuring that they obligate all available funds. As a result, even with the limited capabilities of the existing accounting systems, the Army suffers from a lack of meaningful cost information.

The Air Force Audit Agency, in its report on the Air Force's 1994 consolidated financial statements, recognized progress made by the Air Force in a number of areas, including:

- coordinating system development efforts with the DFAS, particularly in areas where the two organizations' systems will need to interface.
- developing a plan to preclude unmatched disbursements and eliminate existing mismatches.
- improving controls cover the obligations process and reducing obligation discrepancies between the Air Force and DFAS.

## SUMMARY

The Department of Defense has been candid in admitting its challenges in the financial management area. They have identified the need for aggressive action on a continuing basis to implement the changes that the Department contemplates.

OMB stands ready to provide assistance in evaluating strategic direction and accomplishing specific milestones. In the Report of the Commission on Roles and Missions of the Armed Forces, dated May 24, 1995, two recommendations were made which should be noted here. The first:

- "The Department's decision-making information support framework—the Future Years Defense Plan—is too 'input' oriented. We recommend a mission/output-oriented information framework to better enable the assessment of forces and capabilities to perform missions derived from the National Security Strategy. The new framework would include improved metrics for measuring and tracking performance."

Improvements to Defense financial information process will increase the efficiency and integrity of the "decision-making information support framework" mentioned above. The progress toward mission-oriented budgeting will help maximize the use of ever more scarce resources, and so must be pursued. For these reasons, coupled with continued stakeholder assurance that, as stated in the Roles and Missions Report states, "America has the best and most capable military forces in the world," the improvements in integrity of financial management systems cannot be an issue. Good financial management will provide Congress and the general public valuable information about what they are getting for what they are spending.

The second recommendation from the Report is consistent with GAO's recommendation regarding a board of experts:

- "We recommend establishing a board of directors for each defense agency and major field activity. These boards should include customer representatives and be supported by expert consultants to promote adoption of innovative management practices. Their purview should extend beyond financial accounting matters to address the full range of customer needs."

While I agree with the Roles and Missions Commission on the need for such a Board in the financial management area, the focus should be on delivering activities and services which are geared toward meeting the needs of the customer. The melding of financial information and customer service, regardless of the vehicle, is good financial management. OMB would look forward to supporting this effort.

Mr. HORN. Well, we have a few to ask. No. 1, going back at least 40 years, as I remember, the U.S. Government Organization Man-

ual used to note that the Bureau of the Budget, the predecessor of OMB, had some responsibility with regard to standards, in conjunction with the General Accounting Office, in terms of what departments and independent agencies did in their accounting processes.

What went wrong, when, in the sense, did this happen when we moved from the Department of War and the Department of the Navy into the national military establishment, in 1947, and then the Department of Defense in 1949? Where did this thing get off the track?

Mr. DESEVE. Let me go back and separate the question into two parts. One is the question of standards.

Mr. HORN. Right.

Mr. DESEVE. The standards issued by GAO, the standards issued by OMB, compliant with law, because the first thing, in any audit, you look for is compliance with laws and regulations, took the laws for appropriation accounting, as the Congress passed them, related to the appropriation account and the ability to calculate the obligations and the outlays, and so on, and said, "Here's how you do that." Congress never asked, until last year, for a full accrual set, if you will, of accounting, certainly on an agency and consolidated basis.

That's what we're doing now. That's the process that we're going through in producing the standards with FASAB, under the joint memorandum of understanding. And we will followup, at OMB, with what we call Form and Content, telling them how to put their financial statements together, and finally the audit bulletins that we put out. GAO has a similar process, as well.

So we're really trying to respond to the way Congress has asked that accounting be done. And we couldn't applaud more the standards set out in GMRA. We think they are terrific—and the CFO Act—we think they are terrific.

Mr. HORN. I would have thought, though, when you had some standards developed—granted, they might not result in the full balance sheet, but if you did it right from the beginning, in terms of processes, I would think it would have been a much easier conversion, given the rise of the tremendous number of expenditures of Defense.

As I remember, in 1949, Louie Johnson had a \$3-billion budget, just before the Korean War, \$1 billion for each service, which is, you know, the thoughtful thinking of the Secretary of Defense at that time.

Mr. DODARO. Mr. Chairman, just to give our historical perspective here a bit, really a lot of the foundation for some of what we're talking about today was laid in 1950, in the Budgeting and Accounting Act. And following that process, GAO did promulgate some accounting standards and principles for the Federal Government. The problem was, they weren't viewed as a consensus set of standards, although a lot of agencies did put them into their own policies and procedures, and many agencies now do have some accounting principles and standards that they follow.

We are now talking about coming up with a set of accounting principles and standards that people can agree upon, that are relevant to decisionmakers, and really move us into a new age of Federal reporting that is much more timely and will meet user needs.

The problem—and your question of where we went wrong—was that, No. 1, the Treasury Department has for years accepted reports from agencies that are known to be inaccurate. We have not put in place the independent financial audit mechanism to require agencies to answer questions and subject their accounting practices to some degree of scrutiny.

In my opinion, that was the major flaw: no one was checking to see whether or not the standards that were being promulgated, or that the agencies had themselves, were indeed followed. In fact, a big finding out of almost all the financial audits done in the CFO Act now, basically say the agencies are not following their existing procedures. They are not doing basic reconciliations with Treasury. They are not reviewing accounts. They are making adjustments to their accounting records without adequate documentation. They are not conducting physical inventories.

I would like to make it clear, and hope we don't get sidetracked. I think the policies and procedures are important, but they are in place. We're talking about the basic problems of compliance and discipline in executing those operations.

Mr. HORN. Well, it's very well stated, but if you have the policies and procedures, I guess I don't understand why the old Bureau of the Budget, and now OMB, has not cracked down on those departments that weren't following the procedures issued by a unit of the Executive Office of the President.

I mean, I'm reminded of what President Truman said when General Eisenhower was about to become President. He said, "He's going to give an order to somebody around here, and he will think it's carried out, because he's been in the Army, and he will find, 6 months later, nobody has done anything."

Well, it sounds like, 40 years later, nobody has done anything until the 1990 Act, the 1994 Act. And all I can say is, I remember, before the Second World War, GAO used to do audits of agencies. And we've gone through that before.

Mr. DODARO. That's right.

Mr. HORN. Now you're off in the glorious program analysis, all of which I favor, but maybe Sam Rayburn was right when he didn't want you to do it, and it didn't happen while he was alive. And maybe we need somebody that gets into the basic auditing. Now, is that what we're thinking of in terms of these financial statements?

Mr. DODARO. Yes.

Mr. DESEVE. Yes.

Mr. HORN. And we will turn it over to private auditors?

Mr. DODARO. No.

Mr. DESEVE. No.

Mr. HORN. You see, the Congress had never been audited since 1789. The Speaker said, "We're going to have an audit. We want to see what's going on around here." It cost a few million. On the other hand, everything was looked over. We all, in our offices, every Member, have a stack that high of the audit.

Mr. DODARO. Well, the structure that is in place now with the CFO Act relies on the Inspectors General to either do the audits or to arrange to have the audits done for the 24 largest departments and agencies, and requires GAO to be the auditor for the

governmentwide financial statements. We are working very closely with the Inspector General community, and with OMB and Treasury, as they prepare the statements. Treasury has the primary responsibility. And we're working with the IGs to get the audits done.

So you will have regular audits now, beginning with fiscal year 1996, for all 24 agencies, and you will have audit opinions. So it won't be just the pilot agencies that were first selected under the 1990 Act. And then, beginning in 1997, you will have a governmentwide set of financial statements which GAO will audit.

So we are continuing to do our audit responsibilities. We're auditing IRS, for example, for the fourth straight year now. We're going to start the first audit ever of the Bureau of the Public Debt, Treasury's Financial Management Service. And I think a lot of these audits that we're going to do of the central accounting operations of the government will get at some of the issues about why these reports have been accepted from the agencies that have been inaccurate.

Mr. HORN. Now, will the Department of Defense be prepared to meet that test?

Mr. DODARO. They plan to prepare financial statements for 1996.

Mr. HORN. It will be prepared, but it isn't going to meet your test; right?

Mr. DODARO. Right. Eleanor Hill is coming up next. She will be the person primarily auditing DOD's set of financial statements. And they are predicting that, because of all the problems we've talked about today with Defense, that it will probably be more toward the year 2000 before the department gets a financial audit opinion. And she can point out those problems to you.

A lot of the problems revolve around the systems areas that we've talked about and not complying with some of the existing procedures. The work force issues that I pointed out, all these issues really need to be addressed.

Mr. HORN. To your knowledge, has any member of the financial management group, anywhere in the Federal Government, ever been sanctioned, reprimanded, or anything else, for violating the Antideficiency Act?

Mr. DODARO. Yes. As a matter of fact, this forthcoming report we have on the Department of the Navy, indicates.

Mr. HORN. Going to name names and take numbers?

Mr. DODARO. Well, they have identified the people, and there were disciplinary actions taken against the individuals where they concluded that there were violations put in place. The act, as you point out, has nowhere near been enforced as much as it probably could have been. And now, through the financial auditing that's done, more things are coming to light than there were before. But the issues are being better surfaced now, and I think there's a lot of attention.

I think the other thing, in addition to the CFO Act, that's driving a lot of this attention now is the serious budgetary problems that we have in the agencies, which we did not have in the 1960's and 1970's. As the government agencies grew, we added more programs, and we had a lot of resources, so nobody really paid a lot of attention to how we were using existing resources. That's now changing, and I think much for the better.

Mr. HORN. Well, really, GAO gave up on doing financial audits, didn't it, on even a spot-check basis?

Mr. DODARO. Well, basically, from the time we turned over the accounting systems to the agencies and examining each individual voucher, where we used to have about 14,000 people doing that, we did not do a lot of financial auditing until the 1980's. And then we started with the General Services Administration, the Veterans Department. All the agencies that were under the pilot program in the CFO Act, GAO started with these agencies.

So I would say we've been under a regular basis now of doing financial audits of selected departments and agencies for the better part of the last decade.

Mr. HORN. How would you rank the various military services' progress in complying with the CFO Act?

Mr. DODARO. My views on that are, the Department of the Army, I think, has shown a good commitment. I think they are making some steady progress, as noted by the Army audit and the DODIG in their last audit report this year. We did the audits of the Army for the first two fiscal years, under the act, and now have turned them over to the DODIG and the Army Audit Agency. I think the Army, they have had top-level commitment, and I would have to give them the highest marks of the services.

Mr. HORN. OK. Are they at the B, B-plus, or A-minus level?

Mr. DODARO. Giving grades are always difficult.

Mr. HORN. Giving them is easier than taking them.

Mr. DODARO. I would say they are at the C, C-plus level, and improving. I think the real test will be which military service gets a clean audit opinion. Also, to DOD's credit, they have identified and, under the act, they will not only have a DOD-wide financial statement and audit opinion, but they are going to have audits done of individual components of DOD. So the Army, Navy, Air Force will all have individual audit opinions.

I think the Navy probably has the longest way to go. They were not under the pilot program. I think they need to give some renewed emphasis to their operations.

Mr. HORN. What is your grade for their operations?

Mr. DODARO. It's lower than the Army's.

Mr. DESEVE. Mr. Chairman, I think there's an absolute standard.

Mr. HORN. How much lower?

Mr. DESEVE. I think there's an absolute standard we can apply.

Mr. HORN. Can they go to a community college to make up, or what?

Mr. DESEVE. I think there's a standard that we can apply that's a very simple standard. One, can the department prepare financial statements which do not have a disclaimer of opinion; that is, they are auditable? Let's call that grade one.

Mr. HORN. OK.

Mr. DESEVE. At the moment, the Navy has not done that. We won't know until 1996 whether they are capable of doing it and subjecting themselves to the outside test. They may have done it internally, and you should certainly ask them that, but we haven't worked with those yet. They are still working on their first merit badge, No. 1, that is producing statements, subjecting the state-

ments to audit. And they haven't been required to. We're not trying to assert that they have.

The Army has shown that they can produce auditable statements. So they have done their No. 1 grade. Gene talks about them being at a No. 2; that is, there are some audit exceptions. They don't have a clean opinion. So they are between a one and a three at this point. That's why he used the grade C.

The Navy hasn't taken the first test yet. They haven't gone for that merit badge yet. And maybe they could produce it tomorrow; we don't know, but they haven't done that yet. So we can't give them a grade in that regard.

Mr. HORN. So the Air Force, I take it, is No. 2? Under the GAO grading system, where does that rank them?

Mr. DESEVE. It's actually the OMB grading system.

Mr. DODARO. That's right. Yes.

Mr. DESEVE. It's a No. 2.

Mr. DODARO. Yes, I think Ed's right. We're in that position.

Mr. HORN. You're moving off letters and into numbers. OK. So, in other words, a C-plus in your university equals a one. What's an A get in your university?

Mr. DESEVE. That's the unqualified opinion.

Mr. DODARO. That's right.

Mr. DESEVE. And, of course, there are gradations. I think of one agency where there are three components. Two of the components have unqualified opinions, as components. The third could have an unqualified opinion, but for really a problem in legislation, where the law is written in such a way that it's very difficult to verify the spending that goes on in the agency, it's a tough problem that they've got to solve. They are probably at a 2-plus, where another agency who has produced financial statements but has a whole slew of problems would be at a 2-minus.

I think the Air Force and the Army are both right in the middle, striving to see who gets to be first. We're really waiting to see. Gene and I are waiting to see that.

Mr. DODARO. Right.

Mr. DESEVE. I will buy dinner for four financial managers of the first service, at the restaurant of their choice, in Washington, DC.

Mr. HORN. He's under oath, folks. Make sure he comes through.

Well, I'm going to yield to somebody who knows about grading systems from the 1960's, the distinguished representative, and ranking minority member, from New York.

Mr. DESEVE. When she was in high school; that's right.

Mrs. MALONEY. Thank you, Mr. Chairman.

In your testimony, you said that to solve the payment and accounting problems is going to depend greatly on DOD and GAO cooperation. The Assistant Comptroller General noted and identified several problems, and you outlined five in your testimony, on pages 2 and 3.

Mr. DESEVE. Right.

Mrs. MALONEY. So I would like to ask you, what has DOD done to solve the No. 1 problem you talk about, accounting for billions of dollars in annual disbursements? And have they cooperated with you? Have they worked with you, as you said was necessary, in your testimony?

Mr. DESEVE. Yes, they have. Again, we would like to see everything done tomorrow. We would all love to solve this problem tomorrow. I think Rich Keever testified that moving from \$50 million to \$20 million in unmatched disbursement is certainly a good step. Consolidating their accounting centers into fewer locations is a good step. They still need to train their people.

Mrs. MALONEY. But they still have 250 locations; right?

Mr. DESEVE. I would rather have them answer that. I don't know what the current number is.

Mrs. MALONEY. Is that correct, 250 locations?

Mr. DODARO. I believe that's accurate, but I'm not sure. They are consolidating every year. I think the biggest step that they have made is starting now to prevalidate on those large payments of \$5 million or more, as they mentioned. That is having a positive effect. Now, they have to do most of that manually, but it has also pointed out where they have some problems. Most of the problems that they have in matching that revolve around having to revisit either contract modifications or additional obligational authority.

So I think they have started in the right direction in putting in place a requirement that they always had, really, but didn't follow, which was matching the payment to the obligation before payment was made. So they are starting to institutionalize that. There are two other areas that they really need to move on. One is to streamline the contract procurement process, and they are trying to do that now. And I think that's central to doing this.

Mr. HORN. Now, in the testimony earlier, in the first panel, they said that it would take them 1 year to come up with a simplified form for their contract, a one-pager. Now, I don't understand why it takes 1 year. I would like to ask Hon. Ed DeSeve if he would submit to the committee.

Mr. DESEVE. DeSeve.

Mr. HORN. DeSeve. Excuse me. Mr. DeSeve, if you would submit to the committee a suggested, streamlined, one-page contract management form. Not that it's the be-all or end-all, just your ideas. Not that you spend a lot of time on it, just one afternoon, when you finish work, just put down your ideas, you know.

Mr. DESEVE. We don't finish work at OMB till late in the evening, Mrs. Maloney.

Mr. HORN. I just don't understand why it takes a year to come up with a simplified form. I really believe that, if I spent some time on it, I could come up with a simplified form in a week, or at least a work sheet from which we could try to consult with other people and make better.

Mr. DESEVE. I'll be happy to do that. I would like to work with my colleague, Dr. Steven Kellman, who has been actively involved in this area with DOD, from the OMB Office of Federal Procurement Policy.

Mrs. MALONEY. I know. He's done a fantastic job. In fact, we worked with him on a procurement bill that had measures to help the personnel and upgrade the personnel, and to streamline it and make it more cost-effective.

So you mentioned they need to streamline the contracting. What was the second point?



Mr. DODARO. Right. The second one was really automating their systems to have a lot of this done automatically. Given the volume of transactions that they have, that's the only way they are really going to get at this issue.

There are two dimensions on the streamlining, just to clarify: one is getting the simplified document that Mr. Keevey talked about for their payment process now; second, is changing the payment process itself and getting to more standardized and less complex accounting codes. Some of the accounting codes they have could be 40, 50 digits, if not more. So, given the number of contracts.

Mrs. MALONEY. Mr. Dodaro, then could I request that for the committee you submit—take their remaining accounting codes—how many do they have now?

Mr. DODARO. Well, they've got different codes for different services.

Mrs. MALONEY. But they have a total of about how many, about 3,000, or how many do they have?

Mr. DODARO. I'd have to go back and check, in terms of the numbers of codes. But I was just talking about one payment.

Mrs. MALONEY. I'd like to know how many codes they have now. And if GAO could make some recommendations of simplifying those codes and folding them into workable codes, maybe that would be helpful for us to look at, and maybe it would be helpful to them. But I can understand, if you have so many codes, ways that you feel that you could compress them and make them more manageable I think would be very helpful.

Mr. DODARO. One thing they are working on, too, which we think is very important, is to have a standard set of budgetary and accounting codes for the Department of Defense, which they do not now currently have.

Mrs. MALONEY. OK. Standardized?

Mr. DODARO. A standard set of budget and accounting code classifications, and they are working on that now.

Mrs. MALONEY. Could you submit sort of a draft of what you think it should be, from GAO?

Mr. DODARO. We would be happy to look into that.

Mrs. MALONEY. Thank you very much.

Mr. HORN. All those exhibits will go at the relevant place in the record.

Mrs. MALONEY. OK. Now, I'd like to go back to your testimony when you said one of the reasons that New York City was able to solve their problem and move quickly, within 1 year, to general accounting codes, was that they not only had the Federal Government demanding it but they had a market test, that they had to do it. Why can't we just have a market test on DOD, that they have to do it, and move to these standard procedures?

Mr. DESEVE. I think what you've done, in passing GMRA and the CFO Act, is to put that market test in place for the first time.

Mrs. MALONEY. So you think that that's sufficient?

Mr. DESEVE. I think it is, because I think it has now raised the cognizance within the department. If you read, for example, the roles and missions report, it's clear there that moving in that direction is very important to the department, to reduce the cost of what they do, and also to improve the integrity of what they are doing.

I think that that standard that you have set is very important and very key there.

Mr. DODARO. I think one of the other things, Mrs. Maloney, if I might add, would be another good test is to have the Congress, particularly the appropriations committees, have more regular oversight using the financial audit reports and asking questions, in terms of determining that. We have had some interest on the Senate side. The Senate subcommittee focused on the Defense issue, and they plan to have regular hearings.

But I think the more committees, particularly those that have control over resource decisions that can get involved, in addition to this committee, or working in conjunction with this subcommittee, I think that will help apply some additional pressure for quicker change.

Mrs. MALONEY. I agree. In your GAO report, you said that there are only three financial management systems that comply with the Comptroller General's accounting principles and standards. What are the three financial systems that comply now?

Mr. DODARO. Those primarily are civilian pay systems. I can submit for the record the three specific systems, but most of them are involved with the pay systems.

Mrs. MALONEY. Civilian pay systems. OK. Why can't every—if we're able to get these to comply with general accounting systems, why can't every service comply immediately or comply within a year?

Mr. DODARO. Part of the problem I think they have at Defense is the vast number of systems that they have.

Mrs. MALONEY. You mean the codes?

Mr. DODARO. Well, no—the codes are a problem—the sheer number of systems. They have 250 different systems, by their count, that they have, accounting systems. Each one is different. Many of them are old. Many of them do not contain the elements of a standard general ledger requirement that has been put in place.

Mrs. MALONEY. It sounds to me that, if you have 250 different systems, you don't want people to know what you're doing. I mean, if you wanted to figure a system that made it so difficult that you couldn't audit, that you couldn't get a hold on what was happening—I mean, that is an absolute program for disaster.

Why couldn't we—now, I keep asking this question because—it may sound like a simple question, but I haven't gotten an appropriate answer. Why couldn't we just merely say to all 250 systems, "Guess what, we're changing your system. We're going to general accounting systems. All of you have to comply within a year or two, and let's go. And here's the standard, and let's change it"? Why couldn't we do that?

Mr. DODARO. I think the department is trying to get there, but it's taking them a while in order to move in that direction. I mean, there's no question you could move, and that's the direction they need to move into. I think they better than I can explain the complexities of trying to get there. You have a lot of different systems set up for different purposes. They clearly need to have more standardization, smaller systems. They have done it in the payroll area first. They are trying to move in the other direction.

Part of the problem is reaching agreement within DOD on what the system should be, No. 1, and that has been a bit of a difficult area. Right now they are trying to go to one system for each service.

Mrs. MALONEY. Why should they have a different system for each service? That's just going to make it more difficult to compare productivity, cost-effectiveness, and protect taxpayers' dollars for the uses they are expected to be spent on.

Mr. DODARO. Well, we've got some questions about the strategy that DOD is pursuing. And I don't want to pretend that I'm defending DOD strategy to make their financial systems improvements. I'm just pointing out what they are planning to do. We're planning to look at their strategy in more detail and also look at their capability to develop software, which we've got some concerns about, as well.

One is, what system do you want to put in place? And No. 2, what capacity do you have to deliver that? We have questions about both, and we're looking at those issues.

Mrs. MALONEY. Could you and Mr. DeSeve's department, OMB, possibly come up with a proposed system that might take care of the Air Force, the Army, and the Navy? After all, we're not talking about what they are doing to defend the country; we're talking about how they procure and handle their books, their accounting. I don't see one reason why they have to have different accounting systems, and I don't understand why they need 250.

In fact, the chairman and I, earlier, we did have one bill attached to the reconciliation bill that I think was a fine bill to save taxpayers money, and that was to improve the collections. We worked very closely with OMB and with Treasury, and with really all the departments in government, to centralize collections with ways to bring the money into the government. Everybody said you couldn't do it. We devised a system, and we did it.

What I would like to respectfully request, because I'm very interested in this, because I personally feel that the cuts that we're having in certain areas—I won't go into them, but education and others—that if we managed our other systems better, then we would have more dollars for police officers and teachers and other things we need. And certainly we shouldn't be wasting taxpayers dollars through mismanagement.

I think we could probably save a lot of money if we moved into the computer age in the accounting systems of the Department of Defense. Computer systems can contain a lot of information, to go back to Mr. DeSeve's example of New York City being a \$25-billion budget. It's really a \$31-billion budget. But computer systems, once you have a standard, it doesn't matter whether it's \$25 billion or \$250 billion, if you're putting it into a computer system that can manage it.

Maybe what we should have been doing, Mr. Chairman, instead of spending \$8 billion on weapons systems that even the Pentagon says they don't want, and the Joint Chiefs of Staff said they didn't want, and the President doesn't want, maybe investing in a centralized computer system that is jointly managed by the three services, so that you know who is being paid for what, for how much, and whether there is an overpayment.

We should be able to computerize that and have that information ready so that we can manage our contracts better and see where—answer really the five questions that you outlined that were the five major problems in the system. I don't see why we can't do that.

Mr. DODARO. We don't disagree.

Mrs. MALONEY. You don't disagree.

Mr. DESEVE. I am going to disagree with Gene. Gene and I don't normally disagree. OK. The real question is the capacity of any organization to undertake change and how long it takes. The idea of a single integrated financial management system is one that—and I will send you a copy of OMB Circular A-127, which beautifully espouses how to design and develop such a system. I will give you a copy of the financial framework document that explains how to get to it, and a copy of the core document which shows what it looks like. And there are agencies out there who are doing it now and doing it very well.

The question is, in an organization where accounting is, frankly, not, as it would be in a bank, mission-critical, I'm not suggesting that it doesn't play a very important role in the Defense Department, but the criticality of it is less than it would be, for example, in a banking institution.

To put the pace of change that you suggest, 1 or 2 years, into the creation of a centralized system where no tradition—and you go back to the Key West agreement, and so on, in the Defense Department—no tradition of agreement exists—read the roles and missions report that now Deputy Secretary White prepared last May—still issues about fighting force capabilities and trying to integrate those. To create that single system I think would be terribly disruptive to the Defense Department in the near term.

I didn't want to have on the record that lack of concern. I wanted to register my concern about the pace of change in that circumstance.

Mrs. MALONEY. OK. What I was talking about is not critical defense measures or the fighting forces; I'm talking about an accounting system. Now, I certainly defer to the generals and admirals on the strategies of where our fighting forces should be and how they are trained. I'm just saying the accounting system of paying the personnel and paying for the uniforms, I mean, it ain't that big a deal.

I mean, we have computer systems. We have standard practices. And I'm not talking about interfering with the defense of the country; I'm just saying we should have good accounting principles. And maybe it takes 5 years to do it, but we should start going down a plan that makes sense. From what I'm hearing from your testimony, we now have 250 different prototypes out there, and now they are talking about consolidating, in the very least, into three different prototypes. We're not talking about the strategies on the beaches or the plains; we're talking about an accounting system.

Mr. DESEVE. Yes, we are. Mrs. Maloney, we are talking about those strategies. One of the critiques that GAO presents of the accounting system in the Defense Department is that it is incapable of managing its inventory, that during Desert Storm, because the accounting system couldn't tell them how many things they had in a warehouse, they had to go out and buy new things.

The logistics system, the inventory system are integrally tied together. And to make changes in those systems, ultimately—the civilian pay system, the military pay system are accounting systems. If the troops aren't paid properly, the troops won't function well. To change systems rapidly runs the risk of the inability to meet the mission of the department. That's my point about mission criticality.

So I'm simply saying that the pace of change and the vision that we all have for a single integrated financial management system is one we have to be very careful of in implementation. We would like to see the Defense Department move faster. We continually encourage. I just offered a dinner for four to the first service that gets an unqualified opinion. It's going to cost me several hundred dollars, probably. They eat a lot in the services, I'm told. I don't know; I've never had dinner with them.

My point is that we've got to be careful of the pace of change. We've got to push them to move faster.

Mrs. MALONEY. I understand your point, and I'm not talking about extraordinary circumstances as in time of war. I can certainly understand that we have to move quickly, do whatever we have to do to win. But the GAO report did not talk about Desert Storm. What the GAO report talked about was day-to-day management and the fact that certain policies, even when you're not in war—thank God we haven't been in war for many years—that the management steps are not there.

What concerns me, what I'm hearing from the testimony, is that I'm hearing a reluctance in the Department of Defense to move forward. I mean, you told me yourself they want three different systems, at least, for the three different military establishments. That didn't make any sense to me. When you're buying paper clips; you're buying paper clips. Why do you have a different system for the Navy than you have for the Army?

Mr. DESEVE. Why does General Electric have a different system, within GE, for GE Credit Corp. and the Large Steam Turbine Generator Division? Because in organizing their business, they have made strategic decisions about how their business will function. That's the reason.

Mrs. MALONEY. OK. My point is, there are certain functions within the Army, Navy, and Air Force that are the same, paying their personnel. So I think that that should be the same. Now, if you have a Star Wars system that's got to be billed differently than any other system, possibly, but I would like to see that in writing. I mean, you know, procurement is procurement. Paying bills is paying bills.

Whether they have a turbo system in GE or paying their personnel, they have general accounting principles that they are following with that, and I can assure you they are not doing overpayments. And I can assure you that they know where their dollars are going. And maybe we should try to do the same thing with the government.

You were saying it's not critical. Maybe it should be critical that we have better management of our taxpayers dollars, and we should have the same attitude toward tax dollars as we have for other things. Maybe we wouldn't be overspending our budgets or

maybe we wouldn't have a situation where we don't know where our dollars are.

But, in any event, I look forward to reading all the reports that you talked about, the strategic plan for implementing a centralized system that you said that you had and the steps that you felt you needed to go forward. I sincerely would like to read it. I understand we're going to be here over the weekend. It sounds like good weekend reading material. So if you get it to my office, I'd love to read it.

Thank you.

Mr. DESEVE. Sure will.

Mr. HORN. Earlier, I asked the other panel about the resistance that would be found in reorganizations. To what degree have either one of you or your staff members asked some of the people in these various accounting centers, where change is going to be made by consolidation of systems, as to what their concerns are, what their fears are?

Having gone through computerization, modernization, technological change in an institution I once ran, I am well aware that people have legitimate worries, rumors are rife, about, will I have a job at the end of this wonderful consolidated system? And they aren't really thinking about the mission of the Department of Defense or the mission of the university; they are thinking about them, which is normal human behavior.

Now, to what extent have those feelings been assuaged, in your judgment, as people that look in on the scene and try to see what's going on? What do you think?

Mr. DODARO. Mr. Chairman, I think that's a very good question.

Mr. HORN. Have I got a very good answer coming?

Mr. DODARO. Well, we have not done any systematic collection of opinions. Definitely, the consolidation of the accounting functions is creating change in the work force, as was pointed out. Many of the people who were in some of the closed facilities, for example, when the DFAS moved its Navy facilities to Cleveland from Arlington, did not go along there. So it is creating some challenges for them to hire up the people. There are some concerns, obviously, in some of those areas that we've come across with people.

As we pointed out in our testimony, training, upgrading the skill level of the work force is a critical issue. So I think that whole issue is one that needs to be managed very carefully. Managing change is difficult.

Mr. HORN. Well, that's right. And if it's handled right, people are enthusiastic about it. And if people can be retrained for other jobs somewhere, they wouldn't worry that much about what's going to happen. But let's face it, you and I know, in any human organization, change is the major inhibitor to making what you think is a rational organization. Since few organizations have rationality at the end of the pipeline, maybe it's too much for us all to expect.

But accounting is one of the ones where you know whether they did it or they didn't do it. And we would welcome any suggestions you have as to what Congress ought to be doing. That's why I've asked about the hardware and the software. But it seems to me they have probably got the funds over there, that if they want to solve the problem, they can focus on it. Now, they put about \$200

million into it last year, as I remember; is that about right, in terms of the accounting system and upgrading?

Mr. DODARO. Yes. They have plans, I think, to spend \$200 million.

Mr. HORN. But they haven't done that yet?

Mr. DODARO. They have spent some money. I'm not sure.

Mr. HORN. We will ask the following panel.

Well, we thank you for your time and appreciate your coming back here. It's always good to hear from you. And I'm fascinated as to where you're going to order that dinner; is it McDonald's?

Mr. DESEVE. No, no. We will let the first department decide.

Mr. HORN. We want to give incentives to assistant secretaries.

Mr. DESEVE. The only stipulation is, it has to be while I'm still the Controller at OMB.

Mr. HORN. I think there's going to be a fast resignation if they do it.

Mr. DESEVE. No, sir. No, sir.

Mr. HORN. OK. Panel three: Assistant Secretary of the Army, Assistant Secretary of the Navy, Assistant Secretary of the Air Force. We won't line you up by one, two, or three, we will just do it as we have it in the schedule.

OK. If you would raise your right hands.

[Witnesses sworn.]

Mr. HORN. All three witnesses affirmed.

Now, you know the procedure. In terms of written statements, we will file those. We would like you to summarize in 5 minutes, if possible. I know often, after I've said that in other hearings, people continue to read from page 1. But I will tell you, we read it; the staff reads it. We all look at your written statement, but we just like to have you talking from the heart, looking at us and telling us what the problem is and what are we going to do about it. So don't worry about sticking to the script. And that way we often hear things that make us pay attention.

So, Secretary McCoy, if you will begin.

**STATEMENT OF HELEN T. McCOY, ASSISTANT SECRETARY OF THE ARMY, FINANCIAL MANAGEMENT AND COMPTROLLER; DEBORAH P. CHRISTIE, ASSISTANT SECRETARY OF THE NAVY, FINANCIAL MANAGEMENT AND COMPTROLLER; AND ROBERT F. HALE, ASSISTANT SECRETARY OF THE AIR FORCE, FINANCIAL MANAGEMENT AND COMPTROLLER**

Ms. McCoy. Thank you, Mr. Chairman, Mrs. Maloney.

I appreciate your invitation to present my views on financial management in the Department of the Army and our progress in implementing the Chief Financial Officers Act. As you know, I do have a written statement, and I thank you for entering it into the record.

The subject of this hearing is "Department of Defense Financial Management Problems." My colleagues and I certainly agree that there are many problems. However, there is also a great deal of good news, and I welcome the opportunity to share with this committee some of the notable improvements we have made in Army financial management and stewardship.

Since fiscal year 1991, the Army has prepared agency-wide audited financial statements as a pilot under the Chief Financial Officers Act. As the committee is well aware, each year our auditors have been unable to express an opinion on the reliability of our statements. Looking back over 4 years of reporting experience, the greatest lesson we have learned is that the CFO Act is not just about financial statements and audits. They are the means to an end, and that end is the integration of functional and financial management, not only in systems and data, but in all aspects of day-to-day operations.

The Army has derived another major benefit from our experience as a CFO pilot, and that is our recognition of the differences between systemic and management problems, between problems which require DOD-wide efforts and will take years to resolve, and those for which we in the Army can and must take responsibility.

That recognition led to our forming strong partnerships with functional proponents throughout the Army to resolve internal problems. And I believe we have been very aggressive in finding new and improved ways of doing business with the tools and resources that are available to us today.

One of the most immediate outcomes of our early CFO audits was a restructuring of our management control process, an area in which the committee has expressed interest. In our first audit, the General Accounting Office found that the Army had a good management control framework, but commanders and managers in the field often simply were not using it. Our own assessment confirmed the GAO's findings and pointed out a number of specific problems.

Our new process, which became effective 1 October 1994, reduces workload and promotes ownership and accountability, by limiting required evaluations to key management controls, by giving commanders and managers greater flexibility in conducting evaluations, and by raising the level of responsibility for certifying evaluations.

The final thrust of our management control approach is education. We are incorporating the management control message into the full range of Army training and education programs, from orientations for new brigadier generals and senior executive service members, to courses for new managers and first-line supervisors, and a wide range of soldier schools.

As I noted earlier, the Army financial management community has formed strong partnerships with functional proponents, not only to improve our systems interface capabilities, but in a variety of reengineering efforts. Among our success stories is the Army Joint Reconciliation Program, which combines the financial skills of accounting and budget personnel with the expertise of acquisition specialists, logisticians, auditors, and legal staff to analyze problem disbursements.

During last fiscal year, joint reconciliation reduced unmatched disbursements by 51 percent, reduced negative unliquidated obligations by 70 percent, and reduced contingent liabilities associated with canceling year appropriations by 96 percent. We also implemented a new program to streamline and expedite the administrative and legal review process for open Antideficiency Act violation



cases. This led to our reducing the number of open cases by 85 percent.

One of our most critical partnerships is with the logistics community, and we are working together to improve the processes to requisition and account for supplies. We will identify a best business process by the end of this month and revise and standardize our policies and procedures, as necessary, to include an interface between key supply and accounting systems.

In a joint effort with the Assistant Secretary of the Army for Manpower and Reserve Affairs, a business process reengineering team is working to integrate the military pay and personnel systems. Final recommendations are scheduled for January 1996. In the interim, we have initiated systems changes to place a total of 93 pay-related events into the military personnel system over the next 24 months.

On August 10, we implemented a new mandatory requirement for unit commanders to certify the status of all soldiers in their units on the monthly finance report. This will enable us to identify any ghost accounts and to correct soldiers' entitlements and allowances. On November 1, we began testing a new checklist and separation procedure for soldiers leaving the Army. Today, one out of four soldiers separates owing money, usually as a result of an overpayment or for lost or damaged property.

I am proud of achievements such as these and of the Army's demonstrated commitment to the letter and the spirit of the Chief Financial Officers Act. I have intentionally presented a good news story here today, but that does not mean that I do not take very seriously the many continuing problems in Army financial management. Rather, it is the very seriousness with which we face our problems that I find most encouraging.

Thank you.

[The prepared statement of Ms. McCoy follows:]

#### PREPARED STATEMENT OF HELEN T. MCCOY, ASSISTANT SECRETARY OF THE ARMY

Mr. Chairman, I appreciate your invitation to appear today to present my views on financial management in the Department of the Army and our progress in implementing the Chief Financial Officers (CFO) Act.

Your invitation noted the subject of this hearing as "Department of Defense financial management problems." My colleagues and I certainly agree with you that there are many problems. However, there is also a great deal of good news, and I welcome the opportunity to share with this committee some of the notable improvements we have made in Army financial management and stewardship.

#### THE ARMY AS A CFO ACT PILOT

Since Fiscal Year (FY) 1991, the Army has prepared agency-wide audited financial statements as a pilot under the Chief Financial Officers (CFO) Act. As the committee is well aware, our auditors—the General Accounting Office for the FY 1991 and FY 1992 reports, and the US Army Audit Agency for FY 1993 and FY 1994—have been unable to express an opinion on the reliability of our financial statements. The overarching problem preventing a qualified or unqualified opinion is that the accounting systems which support the statements do not have an integrated general ledger or produce account-oriented transaction files. Without a complete general ledger, we must use systems that were designed to manage and physically account for Army assets to derive the value of those assets. The management systems do not interface with our accounting systems, nor do they meet requirements for generating reliable, auditable financial information.

While the audit opinions for FY 1992, FY 1993, and FY 1994 each noted significant progress from the previous year's reporting, until our systems can produce the information necessary to test the reliability of financial statement data, our auditors

will continue to be unable to express an opinion. We have been working with the DoD Comptroller, the Defense Finance and Accounting Service, and the other Military Departments for some time to bring about the necessary comprehensive reforms of our financial management systems and processes. We believe a great deal of progress has been made, but it will take years to achieve the streamlined and reliable systems that are our goal.

Although the state of our accounting systems is the single greatest factor cited in the wait opinions, other negative findings proved to be within the Army's ability to resolve. Audits of the first Army financial statements, and the associated hearings and media reports, were often—and in some cases, justifiably—harsh in their criticism of the Army as a steward of public resources. The Army responded by getting back to the basics, by bringing together key financial and program management personnel to resolve problems one by one. We have been and continue to be involved in a number of disciplined efforts to improve our management practices, ensure fiscal responsibility, and promote sound stewardship—actions that will not end, even when we do have integrated functional and financial management systems.

We are now preparing our financial report for Fiscal Year 1995—our last year as a pilot before full implementation of CFO reporting under the Government Management Reform Act of 1994. Looking back over the four years of reporting experience—and to the future, as we prepare to support consolidated DoD financial reporting—we in the Army have learned that the CFO Act is not just about preparing financial statements, or even audits. The statements and audits are the means to an end—and that end is the integration of financial and functional information, not only in systems and data, but in all aspects of our day-to-day management.

Without doubt, the single greatest benefit the Army has derived from its experience as a CFO Act pilot is our recognition and acknowledgment of the differences between systemic and management problems—between problems which require DoD-wide efforts and will take years to resolve, and those which we in the Army can, and must, take immediate responsibility for. We have formed strong partnerships with functional proponents throughout the Army to resolve internal problems with how we safeguard and account for the assets entrusted to us. I believe we have been very aggressive in our efforts to find new and improved ways of doing business with the tools and resources that are available to us today.

#### MANAGEMENT CONTROLS

One of the most immediate outcomes of our first audits under the CFO Act audit was the restructuring of our management control process. The GAO auditors found that, although the Army had a good management control policy and program framework, commanders and managers in the field often simply were not using it. In response, we initiated a self-assessment of our management control policy and process, including feedback sessions with Army managers and an independent assessment by a private accounting firm. This self-assessment confirmed the GAO's findings and pointed out several specific problems with the process—too much centralization, too little flexibility for commanders and managers, and little sense of "ownership." The checklists that were used to evaluate controls were excessive in number and length, confusing in format and style, and filled with minor procedural requirements.

Based on this self-assessment, we developed a restructured management control process that became effective on October 1, 1994. The new process reduces workload and promotes ownership and accountability by limiting required evaluations to key management controls, by providing maximum flexibility to commanders and managers in conducting evaluations, and by raising the level of responsibility for certifying evaluations. Our new process encourages the use of existing review mechanisms—as does the new Office of Management and Budget (OMB) Circular A-123 ("Management Accountability and Control," June 21, 1995)—thereby eliminating redundant efforts and embedding management control evaluations in routine management processes.

I believe our revised approach to management controls and compliance with the Federal Managers' Financial Integrity Act is the strongest in DoD. It is based on the fundamental philosophy that all commanders and managers have inherent responsibility for management controls—for ensuring that operations are effective and that resources are protected and used appropriately. Our process supports fulfilling that responsibility by providing a process for conducting detailed evaluations of key management controls and for reporting material weaknesses in management controls.

To provide effective oversight of this process, the Army Audit Agency routinely assesses the effectiveness of management controls in the course of every audit and ex-

explicitly addresses management control deficiencies in its reports. In addition, the Agency conducts an annual audit of the management control process itself, resulting in an independent assessment from the Auditor General to the Secretary of the Army. Finally, our Senior Level Steering Group—a crossfunctional, general officer-level oversight council—conducts a final “corporate” review of the Secretary’s annual Statement of Assurance before it is submitted for his approval and signature.

The most critical element in making the management control process work is leadership. The Army’s senior leadership has consistently stressed the importance of effective management controls and sound stewardship of public resources. The Secretary of the Army, the Under Secretary, and the Chief of Staff have issued a series of letters to our field commanders and the headquarters staff requiring their active involvement in the management control process and stressing effective controls as a means to successful mission accomplishment. Field commanders and headquarters principals, in turn, have issued their own directives emphasizing the importance of management controls.

The final thrust of our management control approach is education. We have implemented an Army-wide education and training effort to ensure personnel throughout the Army understand the Army’s process and their role in it. We have developed training materials, such as briefing packages and a videotape, to provide Army commands and activities with an in-house training capability. We developed a handbook for all management control administrators, and initiated an annual Army Management Control Conference. Our staff provides management control instruction in Introductory, Intermediate and Senior Auditor courses.

Our efforts to incorporate the management control message into the curriculum of Army schools cover a wide range of educational programs. At present, this instruction is included in: orientations for new Brigadier Generals and Senior Executive Service members; the Command and General Staff Officers Course; the Army War College; the Garrison Commanders’ Course; the Army Management Staff College; a variety of senior financial management training programs, and correspondence courses for new managers and first-line supervisors. In addition, we are working to incorporate management control instruction in a wide range of soldier schools, to include the Officer and Warrant Officer Basic and Advanced courses, the Advanced Non-Commissioned Officer and First Sergeant courses, and the Combined Arms and Services Staff School. Finally, in a joint effort with the US Department of Agriculture (USDA) Graduate School, we developed a one-day management control course for managers. This course was made available Army-wide beginning in March 1995, and is conducted on-site by the USDA Graduate School on a reimbursable basis.

#### PARTNERSHIPS AND PROGRESS

As I noted earlier, the Army financial management community has formed strong and lasting partnerships with functional proponents in the Army and throughout the Department of Defense. We are working together to improve not only our systems interface capabilities, but in a variety of business process reengineering efforts.

#### THE ARMY JOINT RECONCILIATION PROGRAM

Among our greatest success stories is the Army Joint Reconciliation Program, which combines the financial skills of accounting and budget personnel with the expertise of acquisition specialists, logisticians, auditors, and legal staffs in creating horizontal teams to analyze problem disbursements—payments that do not match the obligations on the books. These are of major concern within the Defense Department because if they are not resolved in a timely manner, current year dollars must be used to pay bills from previous years. During FY 1995, joint reconciliation:

- Reduced “absolute value” unmatched disbursements (UMDs—payments for which there are no matching corresponding obligations on the books) from \$750 million on June 30, 1994, to \$368 million on September 30, 1995—a reduction of 51 percent.
- Reduced “absolute value” negative unliquidated obligations (NULOs—payments that exceed the obligation amounts reserved) from \$500 million on June 30, 1994 to \$148 million on September 30, 1995—a reduction of 70 percent.
- Reduced contingent liabilities associated with the canceling year appropriations from \$539 million on October 1, 1994 to \$23 million on September 30, 1995—a reduction of 96 percent.

Our Major Commands report that their experience with the Joint Reconciliation Program has led to improvements in their execution of current year obligation authority. Most important, it has precluded current year funds being diverted from essential expenditures in support of military readiness.

## DOD ACQUISITION AND FINANCIAL MANAGEMENT REVIEW TEAM

Army acquisition and financial management personnel have been working with the Office of the Under Secretary of Defense for Acquisition and Technology, the Office of the Under Secretary of Defense (Comptroller), the Defense Finance and Accounting Service, the Defense Information Systems Agency, and the Navy and Air Force to eliminate problem disbursements. The DoD Acquisition and Financial Management Review Team recommended a total of 48 mid- and long-term improvements to eliminate problem disbursements and to implement approved policy changes, system updates, and electronic interfaces to support this effort. Electronic data interchange (EDI) is the single most important application that will lead to success in this overall effort. The electronic transfer of information from contract writing systems to contract payment systems is a critical component of the long-term solution to problem disbursements.

## SUPPLY REQUISITION AND ACCOUNTING

Working with the Deputy Chief of Staff for Logistics, we are conducting a business process review of the existing logistics and financial processes to requisition and account for supplies. By the end of this month, we will identify a best business process, and we will revise and standardize our policies and procedures. This will include the interface of the logistic communities supply system with the finance and accounting system.

## MILITARY PAY AND PERSONNEL SYSTEMS

In a joint effort with the Assistant Secretary of the Army for Manpower and Reserve Affairs and the Soldier Support Institute, a personnel finance business process reengineering team is reviewing military personnel and pay, with the goal of integrating the pay and personnel systems. Final recommendations are scheduled for January 1996. In the interim, systems changes to place a total of 93 pay related events into the Army military personnel system are scheduled for completion over the next 24 months. These changes will provide for an interface between the personnel and pay systems.

## UNIT COMMANDERS FINANCE REPORT

Through our joint efforts with the Deputy Chief of Staff for Personnel, on August 10, 1995, we implemented a mandatory requirement for unit commanders to review the monthly Finance Report and return a certified copy to finance (within 5-10 days), certifying the accountability and status of all soldiers in the unit. This action will assist commanders and the finance and personnel communities to identify any "ghost" accounts and correct soldiers' entitlements and allowances in a timely manner.

## INITIATIVE TO REDUCE OUT OF SERVICE DEBT

Today, one out of four soldiers separates from active duty owing the Army—as a result of such things as overpayment of pay, allowances, leave, bonuses, transportation costs, or travel advances, or for liability for lost or damaged government property. In too many instances, we out-process a soldier and pay a final settlement before all relevant data is available. The debt is more difficult to collect after the soldier separates and, in many cases, the cost to collect the debt may exceed the amount to be recovered. To compensate for this late data collection, a new separation checklist and procedures have been developed that focus on debt avoidance by requiring a more rigorous, standardized installation clearance process. Soldiers processing a completed checklist will receive 100 percent of all monies due at separation. Soldiers processing an incomplete checklist will receive 55 percent of final pay, pending verification of outstanding debts. Army wide testing of this new separation checklist policy and procedures began on November 1, 1995.

## ANTI-DEFICIENCY ACT VIOLATION CASES

We have implemented a program to reduce the number of open Anti-Deficiency Act (ADA) violation cases. This included communicating the importance of expedited processing of ADA cases by Major Commands, increasing emphasis on attending fiscal law courses, and coordinating with the Office of the Army General Counsel to streamline the administrative and legal review process and expedite final approval. Our efforts have resulted in reducing the number of open Army ADA violation cases from 33 to 5—an 85 percent reduction.

## CONSOLIDATION OF ARMY FINANCE AND ACCOUNTING SUPPORT

We have worked diligently with the Defense Finance and Accounting Service, their operating locations, installation Commanders, and supporting Defense Accounting Offices to review detailed procedures associated with consolidation and transfer of financial operations and services to designated DFAS operating locations (OPLOCs). To date, the process has proceeded well. Working together, we are ensuring that adequate management controls are in place at the losing and gaining activities.

## THE ARMY COMMITMENT

I am proud of the Army's demonstrated commitment to the letter, and the spirit, of the Chief Financial Officers Act. Even more important, "CFO" is becoming our way of doing business in the Army, and the impact of our efforts is expanding beyond the forums of internal federal management. Earlier this year, we were deeply gratified when The Comptroller General testified before the Senate Subcommittee on Defense, Committee on Appropriations, that "... Army's proactive approach to implementing the COO Act has been noteworthy ... its top leadership made strong, visible, commitments to addressing the Act's objectives. This momentum continues today. The Army's advice is now sought by other DoD components seeking to upgrade their financial reporting capabilities." I can assure you that commitment remains stronger than ever.

The Army is equally committed to implementation of the Government Performance and Results Act, and to the framework it offers for the meaningful integration of financial and program performance information. We have been incorporating readiness-related program performance measures into our annual financial statements since FY 1993, and we continue working to identify and report more meaningful and objective measures. We are especially committed to ensuring that we focus these initial efforts on core Army missions in support of readiness and sustainability.

To that end, we have implemented a new performance assessment process within Department of the Army headquarters. The Quarterly Army Performance Review provides both a mechanism and a forum for assessing Army mission accomplishment. It provides the Secretary of the Army and senior Army leaders a corporate view of performance and the status of major Army programs, systems, projects, and issues of special interest to Army leaders, the Department of Defense, or Congress.

## CONCLUSION

I would like to assure the members of this Committee that I have intentionally presented a "good news" story today, but that does not mean that I do not take very seriously the many continuing problems in Defense and Army financial management. Rather, it is the very seriousness with which we face those problems that I find the most encouraging. As a direct result of our experiences as a CFO Act pilot, we have recognized that sound financial management and stewardship transcend any individual organization, functional area, or system. Within the Army, we are breaking down the traditional stovepipe barriers between functional and financial managers, and working together to fix our problems and to improve every aspect of our stewardship. I believe our efforts to make "CFO" our way of doing business have paid great dividends already, and I have cited a number of success stories today. Mr. Chairman, you have my assurance, and that of Secretary West, that we will continue to demonstrate our commitment to implement both the letter and the spirit of the law, and to improve Army stewardship of the resources entrusted to us.

Mr. HORN. Thank you very much, Madam Secretary.  
Secretary Christie.

Ms. CHRISTIE. Mr. Chairman, Mrs. Maloney, as earlier witnesses have pointed out, there are some very serious problems in virtually every aspect of financial management in the Department of the Navy and the parts of the Defense Finance and Accounting Service that support us. So I welcome this opportunity today to tell you what we are doing to try and solve these serious problems and when our efforts might bear fruit.

As you requested, I will just try to hit, in this presentation, the highlights of the four areas that I consider perhaps to be absolutely

key to success. My written statement provides more details on these and talks about several others, as well.

The first area is the way the Department of the Navy is organized for financial management. When I speak about the Department of the Navy, I am including the Marine Corps, because that comes under my purview, as well. From the very beginning, our Secretary, John Dalton, made responsible stewardship a major theme of his tenure. It's 1 of his top 10 priorities for the next 2 years. And he specifically charged me, when I came on board, with trying to get our financial house in order.

There are several organizational steps we've taken to do that. Right off, we selected a career professional to be my principal deputy. What is remarkable about that is that the other two military departments have had a career professional to provide that continuity of leadership and experience for a long time, and the Navy had not done that. It had relied on military officers who tended to rotate through fairly frequently. So we felt it was important to get professionalism and continuity at the top.

We also established an Office of Financial Operations to pull together people from several locations who had bits and pieces of this problem and make sure that we had one person who was responsible for getting that. It reports directly to me and my principal deputy. They have initiated a Department of the Navy-wide effort to reengineer all of our financial management business processes, from beginning with the budget preparation right down through account closing.

We have also taken steps to more closely involve our acquisition community. As previous speakers have noted, a lot of our problems arise during the execution of procurement contracts, and it's important that they be more closely involved in the financial management process.

And, finally, we are beginning to take steps to produce our general funds financial statements. I want to elaborate a little bit on this one, because this is a very important point, and we do, as people have pointed out, have a very long way to go in this regard.

When I came on board 19 months ago, the department and the Defense Finance and Accounting Service were putting a lot of energy into financial reports for our Defense business operations functions. We have been preparing CFO statements for that part of our business for I guess 3 years now. And, in fact, of our \$70-billion budget, \$22 billion flows through that part. So we're not a complete stranger to the CFO Act requirements for financial statements.

We have actually made quite a bit of progress here, and I think I gave your staffs a copy of a report from the Naval Audit Service that does formal audits on these statements every year about what progress we have made. We were not, however, putting similar efforts into financial statements for general funds. We weren't a pilot project, and we had not really gotten started in that regard.

Based on the experience we had in trying to correct current financial statements for DBOF, it was apparent to us that it would be a very significant effort to try and correct the accuracy of current statements. So we have put our highest priority in trying to

figure out what systemic changes we need to make them right in the long run, and getting those underway.

We're not as far along as we would like. We in DFAS have a plan of action which I will have to admit we are somewhat behind on, but we do have working groups in each major area of information, educating people about the requirement, identifying sources of data, and making sure that there are clear lines of responsibility.

Just as soon as we in DFAS have completed CFO statements for DBOF for this year, which should be sometime in December or early January, we're going to start doing a prototype CFO statement for our general funds. It will be a learning experience for us. It will help us identify weaknesses in data and other corrective actions that we may need to take that we haven't started already.

A second key area is the consolidation and standardization of accounting operations. We are served by two centers: DFAS Cleveland and Kansas City. They have already stood up the five operating locations into which our accounting is going to be consolidated. And by the end of this fiscal year we will have more than two-thirds of former Navy and Marine Corps accounting sites already consolidated, and the full consolidation should be completed by the end of fiscal year 1997.

This is really important, because DFAS has found that most people don't want to move with their jobs. You have to hire new people; you have to train them. So this is one of those circumstances where things do sometimes get worse before they get better. We are seeing now, in some of the new centers that have been stood up, an improvement there, and I'm really convinced this is the right thing to do in the long run. So we're looking forward to getting this part of that problem behind us.

Another important piece is the consolidation of our accounting systems. If I can run down some quick data here, when DFAS was established, we had 50 general fund accounting systems. We're down to 38 now, which is the good news, and by the end of fiscal year 1998, we're going to be down to two: one for the Navy; one for the Marine Corps. Will we get to one eventually? We might very well. I really subscribe to what OMB said, that it's going to be a great leap forward to get ourselves down to two.

We did some looking at what it would cost to upgrade some of these very old systems, and the moneys ranged from maybe a few million dollars to as much as \$10 million or \$20 million per system. Clearly, it would not have been economically sound to modify 50 different systems at that price. So I think we're doing the right thing, which is to get down to one or two and make them work properly. There's a similar situation in our DBOF accounting. We started with 34 systems; today we're down to 29. And we think, eventually, we will get down to 8, or possibly even 6.

The final area is to make sure we have good data in those systems. DFAS provides the data on disbursements, but we are still responsible for obligations, reimbursable transactions, inventory, plant, property and equipment, contingent liabilities, lots and lots of things.

Many of these sources of data are in other communities; they are not directly from financial management. Fortunately, those other communities are also modernizing and upgrading their systems.

This will be a great help to us in both complying with data requirements and having an automated way to feed those data to the accounting systems.

But systems alone don't do the job. You have to rely on individuals, as people have noted, and you have to rely on your management control. We do have lots of audit reports which suggest that there are management control problems, generally that people aren't complying with the procedures that are there, not that the procedures themselves, if followed, wouldn't be sufficient.

My impression here is that people really do want to do a good job. As John Hamre said, this is not a case of evil people who are trying to pull something over. It's a case of people who want to do a good job, working under very difficult conditions. Frequently, these are very labor-intensive processes, and people have staffing restrictions which make it hard for them to comply when there's a labor-intensive process.

Modern systems will help, but I think we need other ways of measuring and following up and doing that sort of thing. So another thing my Office of Financial Operations is going to be doing is trying to find out and sort of look at our whole management control process and see how we need to change it to make it more responsive.

Well, these problems didn't happen overnight, and they are not going to get solved quickly, but we hope we have corrective action in each of the areas that has been identified for solution. We will need your support for investments. This will take investment dollars both in software and hardware, and we appreciate your understanding for how long it's going to take.

Thank you.

[The prepared statement of Ms. Christie follows:]

PREPARED STATEMENT OF DEBORAH P. CHRISTIE, ASSISTANT SECRETARY OF THE NAVY

Mr. Chairman and Members of the Committee:

The last five years have seen a "sea state change" in the financial management environment throughout the Department of Defense (DOD) and the Department of the Navy (DON).

**Legislative:** The Chief Financial Officers' (CFO) Act of 1990 and the Government Management Reform Act (GMRA) of 1994 require comprehensive action to improve federal financial management and placed new reporting requirements on all federal agencies. Earlier, the Defense Authorization Act of 1990 also required a significant change in the way DOD managed funds and programs.

**Organizational:** Within DOD, responsibility for most disbursing and accounting operations has been assigned to the Defense Finance and Accounting Service (DFAS), which was established in January 1991. DFAS was given the mission of physically consolidating most of DOD's disbursing and accounting operations, standardizing policies and business practices, and developing and deploying standard financial systems. In doing so, DFAS is expected to significantly reduce the cost of operations and the numbers of people involved.

**Management Priority:** Finally, the Department of Defense has placed new emphasis on following sound financial management practices, including a significant effort to eliminate errors in our accounting systems that have accumulated over decades.

Serious problems exist in many facets of DON financial management. As I hope to show, the DON and DFAS now have responsive improvement plans well under way. The DON is improving its organization for financial management. DFAS is well along in the consolidation of financial management services. The centerpiece of our joint efforts is the selection, upgrading, and deployment of compliant financial systems. The final essential ingredient is the provision of accurate data through modern feeder systems and a system of internal controls to ensure their proper use. Unfortunately, we have not yet reached a point where Congress and the public can



see the results of our efforts in terms of accurate and auditable financial statements, and we still are dependent on many error-prone processes and systems. Therefore, I welcome this opportunity to apprise you of the status of actions being undertaken by the DON and DFAS and our forecast of when their results should be visible to you.

#### PRIORITIES

Making these changes requires an investment of resources—both people and funds—by the DON and DFAS. As we try to make progress in all areas simultaneously, both organizations have had to set clear priorities for the use of their limited resources.

First priority for financial managers throughout the DON must be execution of the ongoing program. This is essential to the day-to-day operations and readiness of our forces and to their long-term recapitalization. Most DON Comptroller organizations were staffed for this function alone. Recent changes in law and policy have made this a more demanding task and require staffs to acquire new knowledge and skills.

Second priority is correction of errors in our accounting system. We must do this both to ensure that our funds are being spent appropriately and to avoid encumbering the funds needed to execute the ongoing program. We are meeting this challenge primarily with extra effort (overtime) from existing staffs and contractor support.

Third priority is making the systemic changes necessary to comply with government-wide financial management standards and reporting requirements. This requires changes in policies, procedures, and systems in the DON and in DFAS. It also requires a long-term investment in the tools required by DON and DFAS activities to do their jobs correctly and efficiently. This work is being done primarily by my immediate staff and DFAS.

Fourth priority has been reviewing and correcting the financial reports that are being generated from existing systems. This has been accorded a lower priority because—unlike priorities two and three, which make a permanent improvement with recurring effects—it provides primarily a one-time improvement.

When I came on board 19 months ago, the DON and DFAS were putting significant energies into improving reports for the DON's Defense Business Operating Fund (DBOF) operations. As a result of significant effort by the Naval Audit Service (NAS), DON comptroller staffs, and DFAS, CFO financial statements for the DON's DBOF operations have improved each year since we began to prepare them in FY92. I have provided your staff an analysis by the NAS of our progress. These efforts not only helped us identify the systemic problems we had to eliminate but also improved the accuracy of the reports themselves. As I alluded to above, significant further improvement in those reports is unlikely, however, until the underlying problems are eliminated.

Similar efforts were not being put into financial statements for general funds, although the Departments of the Army and Air Force have been actively involved in this as part of the CFO pilot project. As the General Accounting Office (GAO) has reported, significant errors have existed in financial statements prepared for DON general funds in the past—specifically the SF 220 reports required by the Department of the Treasury. These errors stem both from errors in the data (such as plant, property, and equipment) provided to DFAS by the DON, from the inability of current accounting systems to provide information required by CFO Act financial reports, and from errors in accounting data. Based on our experience with correcting DBOF financial statements, a considerable effort would be needed to improve the accuracy of current general funds statements. Within available manpower, such an effort could only come at the expense of efforts to improve the situation in the long term. In March of last year, my staff and our DFAS Centers initiated efforts to prepare to produce the CFO financial statements for our general funds that will be required by the GMRA for FY96 and beyond. Thus we have accorded priority to curing the disease, not treating the symptoms.

#### STEPS FOR IMPROVEMENT

Of the many activities that will improve DON financial operations, there are four that I consider to be key: organizing the DON for the task, consolidating finance and accounting services in DFAS, standardizing and upgrading accounting systems, and improving feeder systems and the quality of the data they contain.

1. DON Organization for Financial Management. Shortly before I came on board the DON had changed the position of Principal Deputy Assistant Secretary of the Navy (PDASN) for Financial Management from a military to a career position to ensure continuity of leadership expertise at the top of the financial management

chain. From the beginning, Secretary of the Navy Dalton has made responsible stewardship a major theme of his tenure, and he charged me with getting our fiscal house in order. It rapidly became apparent to the PDASN and me that our staff was not well organized to manage all the change that was taking place. The staff element with primary responsibility for oversight of financial operations was much too small for the task at hand; responsibility for related functions was fragmented; and there was some duplication of effort. Thus we established an Office of Financial Operations within our staff, consolidating and modestly expanding staffs that were responsible for pieces of the problem. This new organization is responsible for financial management policy and procedures; Departmental level funds control; CFO and other external reports; development, in coordination with DFAS, of a family of systems to meet DFAS and DON requirements; and oversight of the Department's internal management control program.

One of the PDASN's highest priorities has been leading a DON-wide effort to re-engineer financial management procedures from budget preparation through account closing. Increased requirements and pressure to downsize make it imperative that we have the most efficient organization possible. Individuals from headquarters to the field are involved in the effort. They are looking both at quick fixes (such as eliminating exhibits no longer required or sharing best practices among organizations) and at those that will take longer because they require more fundamental process changes and investment in the system improvements that facilitate them.

Another necessary step is to ensure that people throughout the organization understand policies and procedures and what is expected of them. To this end, we have begun a thorough review and consolidation of policies and procedures. Publication of a single DOD Financial Management Regulation is enabling us to cancel many DON directives, instructions, and letters. Where it is necessary for us to supplement DOD regulations, we plan a single document. Our intent is to develop a handbook for financial managers that will spell out clearly what actions are expected of them throughout the life of an appropriation.

We also have taken steps to more closely involve the acquisition community in solving financial management problems. Many of these problems arise during the execution of acquisition programs. Necessary steps include ensuring that acquisition managers understand financial management requirements, better communication between the two communities about funding requirements and availabilities, and electronic interfaces for timely and accurate transmissions of data. Actions are underway in each area.

Finally, as I noted earlier, the DON and DFAS are preparing to produce general fund financial statements. This involves (1) identifying what data are required and where it is maintained, (2) educating those involved about the requirement, and (3) enhancing interim migratory accounting systems. After we have completed CFO financial statements for DON DBOF operations for FY95, we plan to prepare prototype CFO statements for DON general funds. This will help us identify weaknesses in data and reporting processes so that we can make corrections (or, at least, initiate corrective action) before we have to prepare statements for FY96.

2. **DFAS Consolidation.** The DFAS Cleveland and Kansas City centers provide finance and accounting services to the Navy and Marine Corps respectively. All five operating locations (OPLOCs) subordinate to Cleveland have been established. Each of these OPLOCs formerly was a major Navy accounting activity. Of the remaining former Navy accounting sites (now DFAS accounting offices), the work of 25 percent has been consolidated into these OPLOCs already, and, by the end of FY96, about 75 percent of consolidations will be completed. All the Marine Corps accounting functions will be consolidated into the Kansas City Center. To date the work of about 30 percent of former Marine Corps accounting sites has been moved, and, by the end of FY96, about 70 percent of consolidations will be completed.

DFAS has found that most individuals do not follow their jobs to the OPLOCs as these geographic consolidations occur. Thus this consolidation is resulting in a considerable loss of expertise. This loss is particularly a problem with the older accounting systems, which frequently use old technology and are not well documented. The bright side to this picture is that consolidation of the Navy's general fund accounting activities will be largely completed by the end of FY96. In combination with the deployment and enhancement of standard general funds accounting systems, which I will describe next, this means that we should turn the corner soon and begin to see a marked improvement in products.

3. **Systems Modernization.** The center piece of our efforts is the standardization and upgrading of accounting systems.

During the 1980s, the Navy attempted to develop two standard accounting systems: one for general funds and one for revolving funds. As is all too often the case with major automated information systems, these programs fell behind schedule and

cost estimates grew to the point that both systems were canceled. Shortly thereafter, under the Corporate Information Management Initiative (CIM), DOD decided to pursue standard systems across the entire Department of Defense and a moratorium was placed on the development or modernization of Service-unique systems pending the selection of standard systems. As a result, we are living with technology and systems from the 70s and 80s that are ill-suited to the demands of the current environment.

When DFAS was established in January 1991, the DON had 50 systems officially inventoried for its general funds and 34 systems for its DBOF operations. In addition to these inventoried systems, the DON had over 20 supporting systems. These accounting and reporting systems use several different general ledgers, but none used the new government standard general ledger. These systems are predominantly "transaction driven" for a number of financial categories such as payables, but they are deficient in other areas such as plant, property, and equipment.

a. General Funds. For Navy general funds, we have selected the existing Standard Accounting and Reporting System (STARS) as our interim migratory system. In its final configuration, the system will have departmental (STARS-DR), headquarters (STARS-HQ), and field (STARS-FL) accounting modules.

STARS-HQ is resident at all major acquisition commands. STARS-FL is now deployed at 93 percent of the Navy's shore locations and deployment will be completed by the end of 1996. We also hope to have built the interfaces necessary for our operating force components to use STARS-FL by October 1996. The STARS-HQ and STARS-FL modules have an on-line bill paying module called STARS-ONE PAY, which includes the capability to "prevalidate" invoices (i.e., to locate a matching obligation record before making the payment). The changes necessary to bring existing software of the STARS-HQ and STARS-FL modules into compliance with government-wide accounting standards are scheduled to be completed early in 1997.

Development of STARS-DA is scheduled to be completed by April 1996. We also are upgrading the DON Centralized Expenditure Reporting System (CERPS), which will improve accuracy, reduce processing costs, and shorten cycle time for reporting of expenditures. The redesign is planned to be completed by the summer of 1999. These activities will provide the Navy a fully compliant set of general fund accounting systems.

Exhibit 1 shows the plan for consolidation of Navy general fund accounting systems. As it shows, we have reduced from 50 systems in FY92 to 38 today and expect to have only two systems (STARS and CERPS) by FY98.

General Fund  
System Consolidation Strategy Summary

	Fiscal year end 1992	Fiscal year end 1993	Fiscal year end 1994	Fiscal year end 1995	Fiscal year end 1996	Fiscal year end 1997	Fiscal year end 1998	Fiscal year end 1999
Systems Consolidated .....		5	1	6	13	15	8	0
Systems Remaining .....	50	45	44	38	25	10	2	2

Marine Corps general funds accounting is done primarily in the Standard Accounting, Budgeting, and Reporting system (SABRS) and the Headquarters Accounting System (HAS). SABRS has been selected as the Marine Corps' interim migratory system. When upgraded and fully deployed in August of 1997, SABRS will subsume the functions of HAS and replace six other legacy systems.

b. DBOF Systems. Selection of DBOF accounting systems has been under the purview of the DBOF Corporate Board. The Board initially decided on a strategy of standardization on the best system in each business area in each Service before moving to one or a very few systems DBOF-wide. This strategy was thought to be more feasible than moving directly to one or a very few systems due to the significant differences that existed in business practices among the Services. For the reasons described below, this has taken longer than initially expected.

As candidates for these "interim migration" systems were evaluated, most were found to require major functional upgrades to meet minimum requirements. In addition, many of the systems with the best functional scores used very old technology requiring us to consider technical as well as functional upgrades. In two Navy business areas, the candidates were so poor that the Board directed a subsequent investigation of the suitability of commercial-off-the-shelf (COTS) systems, many of which have been designed to meet government-wide accounting standards.

Progress toward standard systems has been further complicated by the time required to determine the cost of deployment. The cost can differ at each site depend-

ing on the number of interfaces that must be established with feeder systems and the suitability of the hardware suite at the site. Site-by-site surveys have been necessary.

Finally, it is essential that plans for accounting systems be coordinated with plans for the systems with which they must interface in the acquisition, logistics, and personnel communities. Each of these communities also are modernizing their systems, and we must ensure that we retain electronic interfaces (or establish them where they do not now exist).

On the bright side, however, taking the time to study the problem thoroughly had led us to conclude that we can use the same system in several business areas. Thus where the initial Board decision would have resulted in ten systems in DON DBOF business areas, we now believe as few as six may be adequate to meet our needs.

Exhibit 2 shows the plan for consolidation of DON DBOF accounting systems. As it shows, we have reduced from 34 in FY92 to 29 today, and we eventually will have at most eight systems (possibly only six). Although preliminary estimates are that deployment will not be completed until 1999, we are working with DFAS to investigate ways to accelerate deployment.

Defense Business Operations Fund  
System Consolidation Strategy Summary

	Fiscal Year 1992	Fiscal Year 1993	Fiscal Year 1994	Fiscal Year 1995	Fiscal Year 1996	Fiscal Year 1997	Fiscal Year 1998	Fiscal Year 1999	Fiscal Year 2000
Systems Consolidated .....		1	1	3	0	6	6	9	0
Systems Remaining .....	34	33	32	29	29	23	17	8	8

4. Feeder Systems and Data. Financial statements can only be as good as the data in our accounting systems. Thus deployment of compliant systems alone is only part of the solution. While DFAS is the source of most data on disbursements, the DON is responsible for the entry of obligation data; still makes some payments; generates the data on most reimbursable transactions and receivables; and is responsible for maintaining and providing data on inventory, on plant, property, and equipment, and on contingent liabilities in areas such as contracts and environmental cleanup. Fortunately, a number of actions already are underway that will improve the accuracy of data that originates within the DON and permit us to transmit it electronically to DFAS.

The acquisition community is developing a DOD Standard Procurement System (SPS). SPS will include contract writing and modification and contract management functions. It will draw from a data base into which we also can electronically link financial management systems. This will permit data to be entered only once and used by both the acquisition and financial management communities, eliminating many of the sources of error in current systems. We plan to begin deployment of SPS at DON activities in FY98.

DFAS has selected the Defense Property Accounting System (DPAS) to be the DOD standard for maintaining plant, property, and equipment (PPE) records. The Navy is now conducting a pilot test of DPAS at the Fleet Industrial Supply Center in Norfolk. In as many cases as possible we will attempt to deploy DPAS along with new accounting systems to minimize the number of interfaces that must be built to non-standard PPE systems. We also will insist on a cleanup of existing PPE data as DPAS is deployed at individual sites.

One of the changes the DON and DFAS are making to reduce the incidence of problem disbursements is implementing prevalidation for reimbursable orders with DBOF activities. We have developed the software necessary for DBOF sites to access STARS records to "prevalidate" an order before billing it. This capability has been successfully implemented at six Naval Aviation Depots, the Naval Air Warfare Center Aircraft Division, and the Naval Research Laboratory. Deployment should be completed at the remaining 24 DBOF sites by June of 1996.

The Navy is developing a Navy Single Integrated Personnel System (NSIPS) for field-level data entry and query for personnel data for all active, reserve, and retired personnel. This system will provide the interface with the DOD standard military pay system to implement the principle that personnel events should drive pay.

Systems by themselves do not ensure accurate data, however. For that we must rely on individuals and our system of internal management controls. Numerous internal and external audits have identified control deficiencies, but these usually result from a failure to follow established procedures not from a lack of them. We need to understand why this is happening and what we can do to improve the situation.

My overall impression is that people want to do the right thing but frequently are hampered by labor intensive processes. The systems described above certainly will facilitate compliance, but there undoubtedly are other steps we can take. Therefore, I have tasked my Office of Financial Operations to initiate a business process re-engineering effort on the entire DON internal management control process.

#### CONCLUSION

In my confirmation hearing, I was asked what I thought reasonably could be accomplished in the three years then remaining in this Presidential term. I responded that I would be satisfied if we had developed a plan for improvement and begun to implement it. I still believe this is a realistic assessment of the situation.

The DON and DFAS now have improvement plans well under way in every major area of financial management. For its part, the DON is improving its organization for financial management. DFAS is well along in the consolidation of financial management services for the DON. The centerpiece of our joint efforts is the selection, upgrading, and deployment of compliant financial systems, where we are further along than I had hoped. The final essential ingredient is the provision of accurate data through modern feeder systems and a system of internal controls to ensure their proper use. Here, a number of process and system improvements are underway that will facilitate the provision of timely and accurate information. The result of these efforts will be sound financial information for internal decision-making and external reporting.

We need your support for the improvements we must make, and appreciate your understanding of the time it will take to complete them.

Mr. HORN. Assistant Secretary Hale.

Mr. HALE. Mr. Chairman, Mrs. Maloney, I appreciate the chance to testify also.

I am, like all of my colleagues, firmly committed to improving financial management in the Air Force. You asked me to speak from the heart, so I will. One of the major reasons I want to do that is, I'm very concerned about the crisis of confidence in the Federal Government and its employees.

You can see it in public opinion polls, which show that fewer than one in eight Americans have a great deal of confidence in their government. And I can see it in my own family. I have two teenage sons, and I have a great deal of difficulty persuading Scott and Michael that we are reasonable stewards of the public's money, even though I view that as one of my major jobs.

I don't expect that this one thing will solve that problem, by any means. It's a lot larger than financial management, for sure, but I think it's a contribution I can make, and so I'm firmly committed to trying.

So what am I doing? A lot of the same things you've heard about. I will hit a few of the highlights. We, in the Air Force, didn't have, in my view, an organization that provided a focal point for financial management reform. I have created a small group on my staff to do that. I brought along two of them today, kept them off furlough, for a short period at least, so they could be here, because, in my mind, their contributions are very important.

We have established a senior oversight group. We call it the Financial Improvement Policy Council. It's trying to do some of what Helen is already doing in the Army, get senior Air Force leaders aware of what we're doing, because we need their participation. And we have sought outside advice, affiliated ourselves with the Financial Executive Institute, which is a group of CFOs from private corporations, and I've found their advice already very helpful.

So much for organizational issues. Let me talk a bit about the substance of reform efforts in the Air Force. In my view, the key

area of reform involves systems, and let me take a shot at why this is so hard and will take time. We've got about 80 accounting systems. We need to get them down, Mrs. Maloney, but I would share Debbie's feeling that if we try to go to one for the whole DOD, we've got to crawl before we walk, in my view. We need to reduce the number, but I think that we probably have to take the interim step of fixing some in each service.

I've got 80 of those. I've got more than 100 of what I call feeder systems. They are part of acquisition, logistics, personnel systems, but they feed financial data in. In every one of those cases, we've got to go and modify the—first figure out what they are, and I haven't even identified them all on the feeder side—then go and get a contractor to modify the computer code to put in what's called a transaction-driven general ledger, which is required for auditable statements.

And, also, we are required to get rid of these accounting errors that we have. The term meant nothing to me 18 months ago, so I will take just a moment and say what it is. Essentially, right now, what we've got is a system, if you put data in system A, even though system B depends on it, we often have to manually reenter the data, because they are not tied together. That creates errors. It creates separate sets of books that we then have to reconcile, and that's where you get some of these large errors.

We need to have a transaction-driven system so, when you enter data in system A, it automatically updates system B where that's appropriate. That's not easy to do. It's networking computer systems and revising what is often an antiquated code, and it's why it's going to take time and a fair amount of money.

We have a plan to do that. DFAS has got the lead in a number of the areas, but the Air Force is actively assisting them where we can. Their success is our success. In some of the cases, particularly these feeder systems, it will be our responsibility, and we are probably least far along with regard to those feeder systems. We are really trying to bite off a piece of that apple, and identified some, in our case, the plant, property and equipment ones, that we can come up with a plan to fix them and seek the resources.

All of that is going to take time. We're several years away, at least, I think, from having that done. In the meantime, there are some short-term efforts that we need to undertake. We have been actively working with DFAS to reduce these problem disbursements and have had some notable success, particularly in the negative unliquidated obligations category; they are down more than 70 percent in the last 15 months. We've got to work more on the unmatched disbursements and especially the in-transit category.

We also had way too many open Antideficiency violations, and I've got to tell you the Air Force, in my view, wasn't consistent in discipline on those. Eighteen months ago, we had 80 open Antideficiency cases; we're down to 28. We had 43 cases where the investigation started at least 2 years ago; we got that down to 8.

It needs to go lower, but I think we've made substantial progress. And working with our lawyers, both the military and civilian side, I think we are getting more consistent discipline. There have been a number of letters of reprimand and admonishments in connection with those Antideficiency violations.

We're also working with DFAS to try to improve the quality of the CFO reports. DFAS has been very helpful to us in instituting monthly reconciliations and training programs to try to correct some of these errors in the reports. We are trying to do a better job of including performance measures, because that is a key aspect, if these are ever to be useful.

Frankly, I think I could put a 1-800 number right now in the Air Force CFO reports and say, I'll give you 50 bucks if you call it, and it wouldn't cost me a dime. They are not used right now in the services. We need to find ways, and we've been experimenting with our work and with our wing commanders and are continuing an effort to make them more useful. We manage by budgets, not by CFO reports, at the moment.

I have highlighted a few key initiatives. I think they are moving us toward this goal of full compliance, eventually, with the CFO Act and GMRA. Eventually, they will also improve the data available to our field commanders, and that is at least as important to me. I think the initiatives are important, and they certainly will continue to receive my attention, but, as both my colleagues have said, we're a long way off. If a journey of a thousand miles begins with a single step, we're beyond the first step, but the finish line is still quite distant.

So with your help and perhaps your prodding, we will complete that journey as soon as we can. And that's all I have to say. I will be glad to answer any questions.

[The prepared statement of Mr. Hale follows:]

PREPARED STATEMENT OF ROBERT F. HALE, ASSISTANT SECRETARY OF THE AIR FORCE, (FINANCIAL MANAGEMENT AND COMPTROLLER)

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to testify regarding the status of Air Force financial management and our efforts to comply with the Chief Financial Officers (CFO) Act and the Government Management Reform Act (GMRA). I place a high priority on improving financial management in the Air Force, and the Secretary of the Air Force fully supports my commitment. Indeed, in a letter written last year the Secretary stated that: "I am firmly committed to the goal of reforming financial management systems in the Air Force."

There are several reasons why the Air Force must place a high priority on reform of its financial management systems. We need financial management reform to provide better information, both to our field commanders and senior leaders. As this Subcommittee knows well, we also need financial reform to comply with the CFO Act and GMRA. Finally, we need to improve our financial management processes in order to correct flawed practices such as disbursing funds from accounts that do not have available obligational authority or paying contractors that have not billed us. These financial "horror stories" erode the public's confidence in us as good stewards of their resources.

We have underway a number of initiatives designed to improve our financial management and move toward full compliance with the CFO Act and GMRA. In this statement I will describe the efforts we have undertaken, document our progress to date, and indicate further actions we plan to take. The Chairman's letter requesting my testimony raised a number of specific questions, and I will answer them in the context of this discussion of our reform agenda.

ORGANIZING FOR REFORM

One of the first things we did within the Air Force was to organize for financial reform. That organization effort began with my own staff. We established a small group of people to oversee our financial management reform efforts, designating them the Financial Systems and Reporting Directorate (SAFFMPS). Many other organizations within the Air Force are involved in reform efforts, but now we have a single focal point at our headquarters.

We also created an organization designed to provide better coordination of the reform effort among senior Air Force leaders. At the Secretary's direction, last year I set up the Financial Improvement Policy Council (FIPC), which I chair, to inform senior Air Force leaders about developing initiatives and issues and insure full coordination of financial improvement efforts. The FIPC also provides a forum for informing the Defense Finance and Accounting Service (DFAS) of our initiatives. The FIPC has met several times to discuss such issues as changes in systems for the defense business operations fund (DBOF), which affects other functional areas such as logistics. We have also used the FIPC to coordinate our efforts to improve our implementation of the Federal Managers Fiscal Integrity Act (FMFIA).

The Air Force also participates actively in groups set up by the Office of the Secretary of Defense (OSD) to coordinate reform efforts. I am a member and regularly attend meetings of the DBOF Corporate Board as well as the Financial Management Steering Committee. I also support the Secretary of the Air Force in her responsibilities as a member of the Senior Financial Management Oversight Council. This group, chaired by the Deputy Secretary of Defense, provides visibility for financial reform efforts at the highest levels of the Department of Defense.

In addition to making changes within the Air Force, we have gone outside to seek ideas and assistance. Shortly after assuming my current position, I met with Mr. Bowsher, the Comptroller General, to discuss issues and approaches to financial management improvement. At his suggestion, we reached out to the corporate community by seeking ideas from the Financial Executives Institute (FEI). The advice provided by FEI's Committee on Government Liaison, and particularly by Mr. Ted Sheridan who heads this committee, is proving most helpful in improving our CFO Report. We have also tapped the expertise of Electronic Data Systems (EDS) and Coopers and Lybrand for analysis in the areas of systems certification and performance indicators.

It is important to note that the Air Force is not undertaking financial reform in isolation. Our reform effort depends on interrelated and cooperative efforts by several organizations within DoD. In his capacity as DoD's Chief Financial Officer, Dr. Hamre, the Under Secretary of Defense, Comptroller (USD(C)), provides overall guidance and leadership for financial reform. His efforts have been invaluable. Dr. Hamre has been a leader in keeping financial reform at the forefront of DoD's agenda and in insuring that difficult reforms are actually accomplished. We also depend heavily on the services of the Defense Finance and Accounting Service (DFAS). DFAS not only provides all our accounting services; it is also responsible for making many of the improvements in our financial systems.

#### IMPROVING FINANCIAL SYSTEMS

Improving our financial systems is key to financial management reform. We need better systems in order to provide the information necessary to execute Air Force programs properly and to provide proper oversight and reporting of financial activities. Perhaps even more important to this hearing, flaws in our current systems are also the key reason why we do not have auditable financial statements and so cannot now comply with the CFO Act.

Air Force financial systems fall into two basic categories: those systems that record, process, and report financial data and those that primarily serve other functional activities—such as logistics, civil engineering, and personnel—but also provide financial information. Most of the systems in both categories have flaws that prevent compliance with today's accounting standards. Most lack a double-entry general ledger accounting system, which precludes meeting current accounting standards. Most of the systems are also not "transaction-driven." Transaction-driven systems insure that, where appropriate, data entered into one system automatically updates other systems. If systems are not transaction driven, information entered into one system does not automatically update other systems. Thus, much of the data related to accounting and finance must be reentered, and this leads to errors that show up in our financial statements.

Because of the size and complexities of these systems, and the substantial cost to change or replace them, it will be years before we can accomplish all the improvements necessary to produce fully auditable statements. Nevertheless, we are making a start. The nature of our approach varies according to the type of system, as does the organization that is in charge. For some types of systems, the Air Force will take the lead in improving systems. For most systems, DFAS is primarily responsible for system improvements, with the Air Force playing an active role in support.

Defense Business Operations Fund (DBOF) systems. DFAS has taken the lead in evaluating systems for use in the DBOF. Based on that evaluation, the DBOF Cor-



porate Board has selected the systems that will be improved for most functional areas. DFAS is now actively working to begin improvements on the chosen systems.

The Air Force has fully supported these DFAS efforts and will continue to do so. Financial management personnel at Air Force headquarters and field-level activities, along with personnel from other functional areas, actively participated in the functional evaluation of the DBOF candidate systems. Candidates were evaluated for DBOF Wholesale and Retail Supply, Depot Maintenance, and Transportation business areas. Likewise, Air Force software design activities participated in the technical evaluation of the existing systems. The Air Force Cost Analysis Agency further supported this effort with detailed cost estimates for systems implementation. We have also used the FIPC organization discussed above to keep senior Air Force leaders informed of DFAS efforts to improve these systems.

DFAS is now developing plans to improve the systems that have been chosen. DFAS has indicated that it hopes to complete the revisions to all DBOF systems by FY 2001.

General funds accounting systems. General funds accounting systems include most of the accounting systems outside of the DBOF business areas. These systems provide information to Air Force entities ranging from headquarters to all our bases. In 1991, DFAS assumed systems management responsibility for general funds accounting systems. As a first step toward improving the data available from these systems and meeting audit standards, the Denver Center of DFAS has completed the conceptual design for an interim system called (GL/FC). GL/FC will be a modular system that provides double entry, general ledger accounting capability that is transaction driven. It will also provide the capability for on-line verification of fund availability. DFAS Denver is now beginning the design work for GL/FC.

The Air Force actively supports the GL/FC effort. Air Force personnel are working regularly with personnel at DFAS Denver to insure that GL/FC meets our customer needs and to assist in the design effort in any way that we can. We are also making our field personnel aware of the development efforts so that, when the time comes to field a new system, the fielding can be done quickly. To that end, we recently invited the Director of DFAS Denver to discuss this system at our worldwide financial management conference.

Feeder financial systems. Feeder systems are systems in other functional areas—such as logistics, civil engineering, or personnel—that provide financial data to our accounting and finance systems. These feeder systems must be improved before we can achieve auditable financial statements.

The first step is to identify the feeder systems. An ongoing survey effort, financed jointly by DFAS Denver and the Air Force, is investigating all Air Force functional systems that interface with our finance and accounting systems. This effort is well along and should be complete by the end of January 1996. We expect that this survey will identify more than 100 of these feeder systems. In most cases, the Air Force will be responsible for making necessary changes to these systems to comply with accounting and FMFIA standards.

Because of the number of systems that are involved, we have decided to focus first on Property, Plant, Equipment (PPE) and Inventory systems. In addition to failing to meet financial standards, these systems have frequently been cited in audits as failing to meet FMFIA standards for reliable inventory control. We are working now with DFAS to get better and more complete certification criteria. Next, with input from the system managers and Air Force auditors, we will build a complete catalog of the known system deficiencies in these PPE systems. Interim survey results will be briefed to the FIPC later this month as a means of informing senior leaders in the functional areas that own these feeder systems of our plans and to coordinate any required actions.

We have also begun working with a contractor to structure a master plan for improving the plant, property, and equipment systems. Our goal is to have a plan and cost estimates by next spring. We can then seek necessary funding to begin the improvements and develop a detailed schedule.

Financial systems within procurement systems. DoD procurement systems also feed financial data to our accounting and finance systems. Efforts to improve these procurement systems deserve special mention because procurement systems deficiencies contribute to serious financial management problems, such as payments that are sometimes made to contractors who have not billed us.

OSD is taking the lead in developing a new Standard Procurement System (SPS) that will be designed to solve these problems. SPS will include a financial module. The Air Force is currently examining the costs and benefits associated with SPS to insure that it will meet our needs.

We also continue to work with OSD and DFAS to make interim improvements in the financial portions of our procurement systems. In early 1995, for example, we

asked DFAS to delay the transfer of Air Force payment files from an Air Force system to an the interim system. We did so to preclude serious deterioration in financial management and contract execution control and to allay major contractor dissatisfaction with the payment process. During the moratorium, the required systems modifications were accomplished and problems were averted.

In sum, we are undertaking efforts to improve a wide variety of our financial management systems and feeder systems. I believe we are making important progress. I recognize, however, that we have a long way to go and that we need to continue to look for ways to speed up the process.

#### IMPROVING ACCOUNTING AND REPORTING

System improvements are the key to achieving fundamental improvements in financial management. While those improvements are being made, we are taking other steps to realize near-term improvements. These efforts to improve our accounting and reporting fall into several categories.

**Improving the CFO Report.** Our CFO reports will not be fully auditable until our financial systems are improved, but in the meantime we can enhance the utility of the CFO reports by improving our use of performance measures. We are working with other Air Force functional communities to identify existing performance measures that would enhance the supplemental financial information section in the CFO report as well as the overview section of the report. We are reviewing measures that are presently a part of our budget submission. In addition, we are looking for ways to utilize the performance measures chosen for the Government Performance and Results Act (GPRA), including those developed for the DoD-level GPRA report and those being developed at our three GPRA pilot projects at wing level. To supplement this effort, we are working with Coopers and Lybrand to identify new performance measures based on their experience with the measures used in the private sector and other government agencies. We expect their efforts will identify additional new factors that can be incorporated into the fiscal year 1995 CFO statements and anticipate that additional factors can be developed and incorporated into the fiscal year 1996 statements.

We are also supporting the Denver Center of DFAS in efforts to improve the quality of data in Air Force CFO reports. Better accounting systems will be required to minimize data errors, but DFAS Denver is pursuing other steps as well. These steps include emphasizing monthly reconciliations, continuing manual reviews, and training personnel to reduce errors in the data. We are also working with the private sector through the Financial Executives Institute to improve our CFO reporting in the important area of contingent liabilities.

In addition, we have begun experiments to make the financial information in the CFO report more useful and meaningful to both field commanders and financial managers. If managers made more use of the report, data quality would improve. Greater use of CFO data would also improve our efforts to integrate financial planning and accountability into day-to-day operations.

We began our efforts to increase the utility of the CFO report by asking several wing commanders at our Air Combat Command whether portions of the CFO Report could be made useful to them on a day-to-day basis. Personnel from the Air Force Auditor General as well as DFAS were involved in this project. After examining several approaches, we concluded that wing commanders feel they are already getting the information they need to manage and do not currently want additional CFO data.

We are now pursuing alternative approaches to making the CFO reports more useful. We are considering changes in the format of the headquarters-level report that would make it more meaningful to our managers. Our logistics community has expressed interest in reviewing our CFO data to assess the day-to-day operations of DBOF activities.

**Reducing problem disbursements.** Problem disbursements include categories such as negative unliquidated obligations (NULOs), in which DoD is essentially writing checks on accounts that are in the red. Such actions are of concern because they erode public confidence in us as good stewards of public funds.

The USD Comptroller has taken the lead in pushing for reductions in problem disbursements, and his efforts are bearing fruit within the Air Force. We have made great progress in reducing negative unliquidated obligations (NULOs).<sup>1</sup> As the graph shows, NULOs have been reduced by more than 70% during the past 15 months.

<sup>1</sup> A NULO is a financial disbursement that appears to exceed the related obligation.

Air Force NULOs  
(In Millions)

	30-Jun-94	30-Jun-95	30-Sep-95
\$2,500 .....		\$669	\$613

This excellent progress reflects much hard work on the part of DFAS Denver as well as extensive cooperation and work on the part of Air Force Materiel Command and Air Force Headquarters personnel.

While we are making significant progress on NULOs, we must continue to work on other categories of problem disbursements including Unmatched Disbursements (UMD)<sup>2</sup> and In-Transit transactions.<sup>3</sup> We must also support efforts to improve the systems that contribute to these problems.

Reducing the number of open antideficiency cases. Antideficiency cases involve the potential overobligation of appropriated funds. In recent years the Air Force has had too many antideficiency cases. As recently as March of 1994, we had 80 open cases. As the graph shows, we have reduced the open cases to 28 and are working hard to achieve further reductions.

Open Antideficiency Act Cases

	1-Apr-94	1-Oct-94	31-Oct-95
Open Cases .....	80	64	28

Moreover, some of our antideficiency cases were not being reviewed quickly enough. A year ago, for example, we had 43 open antideficiency cases in which the investigation began before January 1994. We have now reduced the number of badly overdue cases to 8 and hope soon to resolve all of these vintage cases. This progress reflects hard work by my own staff at headquarters as well as efforts at our major commands, particularly the Air Force Materiel Command.

We are also reducing the number of new antideficiency cases that are being opened. As recently as fiscal year 1993, we opened 55 new antideficiency cases. That number fell to 23 cases in fiscal year 1994 and to 18 cases in fiscal year 1995. So far in fiscal year 1996, we have had no new cases.

Our efforts to minimize antideficiency violations also include stepped up training. We are offering training courses at several of our financial centers, particularly those that are heavily involved in procurement actions. We are also working with USD(C) to develop a training course for those assigned to investigate antideficiency violations.

Improving FMFIA compliance. The Chairman's letter asked about efforts to improve internal controls. We have an initiative underway to focus and improve our compliance with FMFIA. This responds to direction from the Secretary of the Air Force to have Air Force commanders "take a personal interest in overseeing the requirements of the Federal Managers' Financial Integrity Act."

The Air Force Auditor General has taken the lead in this important project. We want to insure that our efforts at compliance involve not only identifying weaknesses but also taking actions to correct them.

In the fiscal year 1994 version of the DoD FMFIA Report to the President, Secretary Perry outlined six major internal control weaknesses that adversely impact DoD operations. These systemic weaknesses encompassed the areas of financial data maintenance; financial records maintenance for inventory and property; total asset visibility; acquisition reform; information systems security; environmental deficiencies; and the third party collection program. The Air Force is working to eliminate the weaknesses identified in each category. In conjunction with functional representatives responsible for managing each of the major categories of weaknesses, we are cataloging each known internal control weakness, determining actions underway to correct the weakness, assessing progress to date, and identifying further improvements required to resolve the weakness.

But, we also realize that we cannot do everything at once. Therefore, at the meeting of our Financial Improvement Policy Council last January, we agreed to con-

<sup>2</sup> A UMD is a financial disbursement received by an accountable station that does not match an obligation at the detail level.

<sup>3</sup> An in-transit disbursement is a financial disbursement that has been sent to an accountable station for matching, but not yet received.

centrate our initial efforts in the critical areas of inventory management, automated data processing (ADP) security, and internal controls within our recently established financial services offices.

In the inventory management area, the Air Force Audit Agency is working in concert with our senior logistics official. The Agency has completed an in-depth compilation of those internal control weaknesses associated with inventory management that have been identified in audit reports, inspections, and internal management reviews. The auditors and the logistics community then documented improvements completed or underway to resolve the weaknesses and finally outlined future actions still needed. Senior logistics officials are actively working to achieve the changes needed in each area.

In a process similar to the inventory review, Air Force Audit Agency auditors worked with senior ADP officials to identify and catalog weaknesses in computer security identified in audits, inspections, and internal management reviews. The effort identified eight categories of weaknesses in system development and system operations that require both Air Force and DoD attention. This effort also outlined extensive actions currently underway and pointed out further actions required.

Finally, to address financial management controls at Air Force installations after DFAS consolidation efforts were completed, we participated in a joint working conference with DFAS to outline controls and procedures needed at DFAS operating locations and Air Force financial services offices. We asked Air Force auditors to participate in this effort. Now that we have implemented the new procedures, we have asked the Air Force Audit Agency to review internal controls in actual practice at our offices to ensure they are adequate. Specifically, the review will address cash verification procedures, emergency payment, certification of funds, vendor payment, and guidance provided to the financial services offices.

Streamlining financial management efforts. At the same time we are carrying out major initiatives to improve financial management, we are also involved in efforts to streamline the financial management process. One of the most prominent of these streamlining efforts is the consolidation of all base-level defense accounting offices, which are now run by DFAS, into centralized operating locations (known as "OPLOCS"). So far 17 Air Force bases have transferred their accounting operations to the new OPLOCS; another 20 bases are scheduled to consolidate to OPLOCS through the second half of FY 1996.

We are experiencing some "growing pains" as the OPLOCS are being set up. Many of the personnel at the OPLOCS are inexperienced, and communications problems have sometimes occurred. As a result, there have been adverse effects on service. For example, vendor payments have sometimes been late, resulting in complaints from vendors and sharp increases in interest payments and lost discounts.

DFAS has instituted a number of changes aimed at solving the problems. Among these changes are increases in temporary hires, changes in procedures, and more efforts to clean up the data bases at facilities that are about to be consolidated to an operating location. The Air Force also needs to be sure that it adheres closely to standard accounting procedures in order to assist in this consolidation.

We are working closely with DFAS and monitoring this transition carefully. Both DFAS and the Air Force remain confident that we will complete the consolidation successfully.

#### SUMMARY

I believe that the Air Force, with strong leadership from USD(C) and important help from DFAS, has made significant progress in financial management reform over the last year and a half. We now have a group on my staff responsible for financial reform efforts, a plan for system improvements, and active efforts to improve the CFO Report. We have significantly reduced problem disbursements and antideficiency violations, and we are working to improve FMFIA compliance.

While I am pleased that we have made progress, I also realize that we have a long way to go—especially in our efforts to improve our systems. It is said that a journey of a thousand miles begins with a single step. We are well beyond the first step, but the finish line for financial management reform is still far off in the distance. With the support of this Subcommittee and the Congress, we will complete the journey just as quickly as we can.

Mr. HORN. Thank you very much.

Let me ask each of you the same question: As you have tried to consolidate, to get new systems involved, and generally looked at the problem areas that we are here discussing, what has been your

major problem that you have discovered? Let's start with you, Ms. McCoy. And did it surprise you?

Ms. MCCOY. No, and I think we've talked about it quite a bit here today, and it's our systems or our lack of systems to do the job that we now find we have to do. All of our systems were developed, some as far back as the 1970's, some maybe in the 1980's, and we also moved along a path where we had financial systems and we had functional systems, and never did the two talk to each other.

We are just beginning to try to get the functional side—and I think we've made a lot of progress—to understand that financial information should be a byproduct of their systems. We haven't gotten there yet, but that, in my view, is the biggest problem that we have faced.

Mr. HORN. How about you, Secretary Christie?

Ms. CHRISTIE. Similarly, I think—maybe two challenges. One is this—I have a slogan this year: "Financial management, it's not just for comptrollers anymore."

We've really got to be sure that everyone in the logistics and personnel and acquisition communities understands that they have a role to play here, and they have not, to date, had that awareness. So we have a real consciousness raising effort here. It's not an unwillingness. I have found, when we have gone to people and said, "Look, there is this problem," they have really been quite willing to help. So it's partly an education problem on our part.

The second one is people. All of us are being pressure to downsize. All of my comptroller shops throughout the Navy have been pushed to downsize in recent years. So we really have to find ways to be as efficient as we possibly can in our processes and to automate as much of it as we can, so that people can do all of the things that they need to do to be responsible financial managers. And I think that's probably the second biggest challenge here.

Mr. HORN. OK. Thank you.

Mr. Hale.

Mr. HALE. Well, you asked about surprise. I will confess, most of my career I've spent around Defense, but it's almost all been with the budget, mostly with Congress, actually. I was amazed at how many problems we have with our accounting systems, and they are antiquated, and they don't work very well, as you see from the results.

In terms of challenges, I think Debbie and Helen have said them pretty well. We're trying to do this while we're downsizing. We don't have a lot of resources to throw at it. They are large in number, often controlled by other parts of the services. All of that means we have to get them all on our side, and it takes time. They've got their own priorities. Meanwhile, of course, we need to manage a budget that is pretty dynamic of itself these days. So this effort can't consume all of our time. It's probably a good deal less than half of my personal time. The budget and other aspects of financial management consume a lot of it.

So there are lots of challenges, but I do feel good about the progress we're making. We're in the right direction, and we're going at a reasonable pace.

Mr. HORN. Thank you.

Mrs. Maloney.

Mrs. MALONEY. Thank you, Mr. Chairman.

I want like to ask each of you to submit in writing, because the day is getting long, if you were to automate your systems and were able to modernize them—I asked some of the previous panels this, and they said there was no more money needed. But what I'm hearing from you, you need to automate it and upgrade it, and certainly bring it into the computer age.

Could you submit to the record, I mean, just a dream list of the tools that you feel that you need to get the job done, and even in personnel, the people that you need to help you pull this together. Maybe we need Congress to send some type of directive. If we can send a directive that you are to spend \$8 billion more on defense weapons that the Defense Department says you don't need, maybe we can also send a directive that a certain amount of money is to be spent in your departments so that you can track where these dollars are going and the overpayments, and everything, and bring it into a system.

I would like to see it personally. I would just like to read it and see what you think you need to do. And technology is changing so quickly. I just know, in my own office, we had a computer system, and now they are telling me it's antiquated, you know. There are all these new types of systems.

I would like to ask Secretary Hale, you mentioned that there were 80 different types of accounting systems now in the Air Force and that you were trying to consolidate them down a little bit. I would like to ask you if you could find time, at some point in the next couple of weeks, to come by and just talk to me about them.

Mr. HALE. I would be glad to.

Mrs. MALONEY. I don't want to belabor the point now, but to me it just doesn't make sense that we need so many different accounting systems, but maybe I need to learn more about it.

Are there some systems that you could possibly integrate into one? For example, in the GAO report, they mentioned that some had gone to standard accounting practices, I believe it was in payroll, three. So I assume it's the three in your different departments.

Mr. HALE. No.

Mrs. MALONEY. It's not?

Mr. HALE. No. The finance area is a real success story where we are heading to single systems. It's DFAS that's doing it, but I think that is a real success story, and they are coming close to being auditable. That's a real plus, and we ought to give credit where credit is due. I think they've done a good job.

Mrs. MALONEY. I was really very impressed with Secretary McCoy's testimony and the really successes that you've had in Army. What I just would like for anyone to respond to is, why can't Army's experiences under the CFO pilot be duplicated and applied to the other services? I just open that out.

Ms. CHRISTIE. I think they can. We are, in some ways, emulating the Army model, both with our career professionals and an Office of Financial Operations. And I'm looking very hard at the way they have organized the different communities. We started late, and so we have some catching up to do here.

Mr. HALE. The same thing here. I mean, we are basically copying a lot of what they have done with the CFO report. But let me ask Helen to comment on something, and I think I know the answer. The Army has the same fundamental system problems. They are also getting, I believe—correct me if I'm wrong—disclaimers on their statements, because they don't have transaction-driven general ledgers, the same system problems we all have. Fair?

Ms. MCCOY. Yes, that's a fair assessment.

Mr. HALE. Not to take away at all from what they have done.

Ms. MCCOY. And we did start earlier. After our first CFO audit, the Army formed what was called a senior level steering group. It was a group of all the three-stars and senior SESers in the headquarters, from all the functional areas, because, quite frankly, it was an eye-opener for us. We brought in a group from the private sector, the Private Sector Council, and got advice from them over a 2-year period. So we have been at this a little longer than they have, and it's paying off, finally.

Mrs. MALONEY. Well, thank you very much. I would be interested in hearing from you what you think you need to get the job done.

Mr. HORN. Let me just ask one closing question that interests me, with procurement, and I wonder if it applied to accounting. It seems to me you have a lot of similar recruitment problems, pay problems, upward mobility problems in some of these areas, where you're handling very important things, but it tends to become routinized. And there's a question as to how much creativity one really feels they are getting out of that.

Should we be thinking of a unified financial service in the Department of Defense? Now, I realize you represent the three service departments that still, despite unification pleas, go at each other almost as much as they go at the enemy, and maybe not just on the football field. And I understand all that. But the question would be, in terms of some basic support services, that was put very well, if you don't pay the troops on time, you've got a morale problem. George Washington wrote a number of letters to Congress about that very problem, the Continental Congress.

So do we need a financial service where we truly recognize the talent that it takes to run one of these systems, and where we have people that can make those contractual judgments, and we're not paying them at a very low grade for what is a very responsible job? Granted, it's automated, but judgment is still called for.

I will start with Secretary McCoy.

Ms. MCCOY. A couple of comments. First of all, the comment about there being very low grades and decisions having to be made. In my dream list or dream world, if you would, I would like to take that decisionmaker away from the low-graded individual and make it automated.

Mr. HORN. Do you want to elaborate on that? I think I know what you mean, but I just want it to be very, very clear.

Ms. MCCOY. Well, I think, in today's environment, with the technology that is available to us, you can have rule-based systems, you have artificial intelligence, there are so many tools available that the individual, particularly in that kind of operation, doesn't necessarily have to make decisions. Of course, it depends on contracts being written clearly. If it has to do with a requisition, the requisition

tion has to be written clearly and understandably, and all of those things. So it's more than just the financial operations. Again, we are a byproduct of what everybody else does, if you will.

In direct response to a finance service, I'm not sure that that would be the answer, quite frankly. We have recognized a need for additional training, if you will, and we have undertaken some efforts to provide that training. Granted, all of the downsizing, the consolidations have had an impact on our work force, but I don't think that, once we get to that end state in terms of automation, that we will need the number of people that we even have today. But, again, we have to get there.

But I really don't believe that a finance service, if you will, in the sense that you're thinking of it, if I'm not mistaken, would necessarily help us today. We know the problems. It's a matter of getting the time, of getting the dollars, and, in some cases, getting agreement, quite frankly, on what the solutions are.

Mr. HORN. Well, that's, I think, well said. I was sort of surprised when you didn't mention the people problems at the head of the list of problems, when I asked the first question, because, I think, usually, when we run into one of these situations, it might be people problems in getting there, but it's also, for sure, people problems getting out of where you are and trying to go somewhere else.

Ms. MCCOY. Yes. And our joint reconciliation effort is a prime example of that. It's very labor-intensive, but we have been willing to put forth the effort, and the people have been willing to do the work. What we're promising them is, hopefully, one day soon, you won't have to do this manually.

Mr. HORN. Yes. But we need to have some future, and some maybe alternative jobs, and maybe ways to get, say, from accounting into purchasing, or whatever it is.

Ms. MCCOY. Yes.

Mr. HORN. I would love to see a little more cross-fertilization. We've mentioned it to a number of people in the Pentagon about the senior executive service. It seems to me we ought to have people moving around a little more and get them out of the Pentagon into other departments, and get them out of other departments into the Pentagon. I mean, if you're a general manager; you're a general manager. There are certain skills there. And people in the executive service who have a lot of talent ought to have an opportunity to pursue those on an upward mobility basis.

Secretary Christie, some thoughts on this?

Ms. CHRISTIE. Yes. Of course, in a way, with the creation of DFAS, we did start a centralized activity, but as long as the money flows to the service secretaries and they have the responsibility for managing the obligation of those funds and making these financial statements, we're going to need some people who are our own.

And, of course, in the Navy, we have financial transactions going on on ships at sea, so we have, inevitably, a certain component of the financial community that will have to be specific to the services. Other people have the same problem when they are in a deployed situation.

I'm sorry John Hamre is not here, because he has been very interested and very concerned about the career development. We had a whole offsite for a day where we all got together and talked about



career development issues, and now have a formal committee set up to look at these kinds of problems. How do I get a trained accountant, for example, in the future, when all the junior level accounting positions are in DFAS, if I need a managerial level trained accountant, at some point, to replace the people who are in those jobs now?

So we are concerned about this problem, and I agree with you, I've been thinking about some more deliberate career rotation between the business and financial management community and acquisition, for example, in the comptroller community, to try and foster better communications and better understanding of the requirements.

Mr. HORN. Are the personnel offices you all have to clear through receptive to doing something, or do personnel people do what sometimes I think personnel people do?

Ms. CHRISTIE. I haven't detected any problems in that regard.

Mr. HORN. Have you had any problems in the Army?

Ms. MCCOY. No. I believe they would be receptive. They, too, are looking for ways to help their customers.

Mr. HORN. Good for them. Progress has been made in 25 years. Secretary Hale.

Mr. HALE. I think, on the accounting side, I would agree with what has been said. I think we're all concerned about growing those people. Let me be real clear, though, and I think this would be true for my colleagues, as well, I have about 11,000 people in the Air Force who are preparing, defending, and executing our budgets at the bases, at the major commands, and a few of them here at headquarters.

I think those people, by and large, are quite well trained. We have an extensive program of entry level training, of mid-career training. We run a training school, a joint training school, professional military comptrollers school at Maxwell Air Force Base. There are a variety of courses other than those three basic ones that these people go to. I'm very impressed by their capability in the Air Force and the ones I've met in the other services, as well.

So I think, on the financial management side, we've been focusing on the accounting side, and I understand that's the focus of the hearing, but recognize we have an important job to take the money you appropriate and be sure—one, we've got to tell you what we want it for and defend it; two, then we've got to be sure it's properly executed. I think we do that fairly well. And the systems we have were designed, as you've heard, to keep track of that, and I think they worked fairly well for that purpose.

So that's the reason why I would say this is not—the systems problems aren't, fundamentally, creating fraud and waste, because we are keeping track of the money that you appropriate. What we aren't doing a good job at is functioning like a business and looking at our past accounting data and relating that to performance. There we've got a long way to go. But on the financial management side, I think the Air Force people are very well trained.

Mr. HORN. Well, any other problems you think we ought to know to educate us, that we were too stupid to ask you? Speaking only for myself. The ranking minority member is never stupid.

Mr. HALE. I think you've asked very good questions.

Mr. HORN. OK. So if you have some, let us know. We would be glad to help.

Well, we get down to the final panel, the very patient Inspector General of Defense, with two of her deputies, so please come forward.

Ms. HILL. It's just me.

Mr. HORN. Have they gone?

Ms. HILL. They have been furloughed.

Mr. HORN. Oh, they have been furloughed. OK. You're telling me the Inspector General's Office is nonessential in the judgment of the Department of Defense?

Ms. HILL. Not completely, no.

Mr. HORN. OK.

[Witness sworn.]

Mr. HORN. The Inspector General has affirmed.

You know the ground rules. We put your statement in, and then we would love to have you summarize it.

#### **STATEMENT OF ELEANOR J. HILL, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE**

Ms. HILL. Thank you, Mr. Chairman.

I am very pleased to be here. As you alluded to, I had planned on bringing with me our two, I should say, in-house experts on DOD financial management, Mr. Lieberman, who is the Assistant Inspector General for Auditing, and Mr. Rau, the Assistant Inspector General for Policy and Oversight. However, they were both furloughed, in accordance with the government shutdown plans earlier today.

So I will try my best to give you our assessment of the situation at the Department of Defense, with the caveat that I am not, by trade, an accountant. I am, instead, a prosecutor and an investigator, formerly. But I have talked at length to our auditors, and they have spent a great deal of time on this issue.

I do want to put the statement in the record and just touch on a few points that I've listened to as you've asked questions of the other witnesses.

First of all, I absolutely share your frustration at the state of financial management in the Department. I have been at the Department about 9 months now, and I have to admit that one of the first things that I started to notice a pattern on, when I started reviewing the audit reports that were coming across my desk back in the spring, after I got there, was that there was a very consistent pattern in our reports of finding significant, not just minor problems, but significant problems in the finance and accounting systems at DOD.

I was frankly, at least at first, horrified to see that we were issuing disclaimers and unable to provide opinions on financial statements that we were required to audit under the Chief Financial Officers Act. Having been there now 9 months, I can tell you I'm becoming a little more accustomed to it, but I'm still not very happy about it; I'm still very frustrated by it, as I know, Mr. Hamre and the other witnesses are, and as you are, certainly.

Let me just tell you, briefly, a few points, and then I will try to answer any questions you may have. First of all, where are we, in terms of our assessment of what is happening right now?

First of all, the sad truth is that the DOD audit community, which really consists of not only our office, the Inspector General's Office, but also, as I think you know, each of the services has an auditor general, and they have significant audit resources. Together with the Army, Air Force, and Navy auditing communities, we are charged with conducting many of the CFO audits. The sad truth is, together we have been unable to give opinions on the largest DOD funds that are required to be audited under the Chief Financial Officers Act.

The second piece of bad news, if you would, is that we have been very candid and consistent on our opinion that, given current circumstances, and given what is now going on, the efforts that are now being made, but being realistic about it, we have estimated to GAO and the other agencies involved in the ongoing financial statement effort that we do not think that that situation is really going to change considerably until, at the earliest, 1999 or the year 2000, which is beyond the 1997 date in the statute.

The next point, I would say, and our statement reflects it, there has been some movement in the department in a positive direction, which you've heard at length about today. I don't need to go into that in great detail. It's in the statement. We have seen some good efforts. We think there are a lot of people working very hard on this in the department, but, unfortunately, given the situation and given also what they have inherited, I think it's fair to say they do have a long way to go.

Overall, when we look at our reports, and my conversations with our auditors and people who have done this for years and years and years, I think, really, we think the needs, the most critical needs, really break down, I would say, into about five areas, some of which have been touched on; all of which, I think, at one point or another have been at least alluded to today.

First of all, and I think we probably might even put this at the top of the list, is the problem with the data. Yes, there is a problem with systems, which is second on our list. But before you even get to coordinating the systems, what our audits are consistently finding is that the data going into those systems is, No. 1, not standardized.

In other words, you have different definitions. You are comparing apples and oranges between different systems, and you cannot easily make the transition into one system, when different services and different parts of the department are defining things different ways. So it's not standardized data.

No. 2, we are finding, in many, many instances, the data is not accurate. One example, Mr. Hamre, back in 1994, when he first looked at the unmatched disbursements issue and started issuing directives on that, which we worked with him on some of those directives and tried to give him our best advice on how to do that or address that problem, he asked us to look at some Antideficiency issues, situations where he thought, based on the evidence, it appeared there might be violations.

I can tell you that, at least in three of those, and some of them are still ongoing—several of them we had to refer back for additional information, because we didn't have enough information, which is another data problem—but in three of them we found that, in fact, there was no Antideficiency violation. What had happened was, the information was wrong; the data was wrong. The data in the accounting records was not even accurate.

So whereas it appeared there was a deficiency, when you really went back and went to all the different entities involved, which takes a lot of work and a lot of time, you found out the data wasn't accurate. So it was another data problem. So they really need to emphasize standardizing the data and also making sure that it's accurate. And that goes to systems and to people.

Second, and you've heard this many times today, and I won't overplay this, the systems problem. We agree completely that they need to emphasize and speed up, to the degree they can, the move to consolidate the systems. I think the department ultimately wants to get to the point of a single system, and this gets to the issue of whether we need to have service systems or one DOD-wide system. I think our people believe we need to have one DOD-wide system, but we are certainly a long way off. But that needs to be worked on.

Third, when you develop those systems, at the same time, the department needs to develop good processes and be aware of what the processes they are going to be using are, because if you don't do that in conjunction with developing the systems, you're not going to have any assurance that, when you ultimately get the systems, they are going to be able to perform under the processes you've set out. So that needs to be coordinated.

Fourth, the people problem. This is a twofold problem: One, we agree with GAO. They need enhanced training efforts. People need to be advised, and I think the department is trying to do that. But, again, they need to strengthen their efforts to improve training; and second, not only training, but to give their people very clear guidance and direction, and consistent guidance and direction on what they should do.

Fifth, and this is something I think Secretary Christie alluded to, this is not an issue that can just be handled by the Comptroller, Mr. Hamre, and the people in the finance area. Part of the problem, the big problem with the information and the data, much of that information is generated outside the finance and accounting area. It comes from other components within the department, and until those components really emphasize the same problems and the need to address this, we're not going to have a system that works.

So I think all of those are important. We've tried to focus on those. I can tell you that we're spending, I think, 700 audit work years just looking at finance and accounting issues, which I'm told is the largest commitment of audit resources in DOD ever, on a single issue. So we're trying to prioritize it.

I also would say that we have ongoing at least maybe four or five projects that relate to this area. We're not finished; we're still in the draft stage. But some of them have to do with some of the issues GAO had talked about, as far as looking at the systems they

are using, the migratory system of approach to change the accounting systems. We are now looking at whether we think that's the best way to do it, if there are other ways to do it. We have some concerns, but, again, that work is ongoing and hopefully will be finished very soon.

I will be glad to try and answer any questions you may have.

[The prepared statement of Ms. Hill follows:]

Ms. Eleanor J. Hill

Inspector General

Department of Defense

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss financial management in the Department of Defense. I am accompanied today by Mr. Robert J. Lieberman, the Assistant Inspector General for Auditing and Mr. Russell A. Rau, the Assistant Inspector General for Policy and Oversight. The principal focus of my remarks will be an overall assessment of the Department's ability to improve its finance and accounting operations and to comply with the Chief Financial Officers Act and the Government Management Reform Act. We would also like to share with the Committee what measures have been taken to make financial management reform a top DoD audit priority and to devise more efficient and effective audit approaches in this critical area.

DEJA VU

In preparing for this hearing, Mr. Chairman, my staff brought an interesting historical note to my attention. It seems that, in 1779, the Continental Congress purchased thousands of preprinted pro forma ledger pages for use by Army commissary officers. The intent was to create an audit trail to facilitate Congressional oversight. Quartermaster Jacob Greene balked, complaining that his purchasers could not be expected to itemize expenditures or provide delivery certifications from suppliers. The Quartermaster claimed the paperwork required by the Treasury Board was unreasonable. He further stated that the Quartermaster

Department could not be run like the "plain business of the common storekeeper." Simply put, here we are 216 years later in the computer age and we still cannot supply Congress with an acceptable accounting of expenditures.

#### FINANCIAL REPORTING

The Chief Financial Officers Act of 1990 required preparation and audit of financial statements of revolving funds, trust funds and commercial-like functions throughout the Federal government. Additionally, the Departments of the Army and Air Force were designated under the Act as pilot programs, requiring preparation and audit of financial statements for the general funds of those Services. The Government Management Reform Act of 1994 expands the requirement for providing audited financial statements to all DoD funds for FY 1996.

As you know, the Department of Defense is massive in size, encompassing a wide array of organizational entities and activities. Unfortunately, the Department's current process for preparing financial statements necessarily involves gathering data from hundreds of accounting and non-accounting systems that are not integrated, not compatible, and not designed for financial statement purposes. In some cases, the systems are not even automated, but are based on manual record keeping. The Department will be able to achieve sound financial reporting practices only after the number of multiple automated systems are

drastically reduced and the systems are redesigned and modernized. The fewer systems and the less manual intervention to produce accounting data, the more accurate and timely the data should become.

The financial statement data for the vast majority of DoD funds remain essentially not in condition for audit. In accounting terms, the current situation can best be described as a general lack of effective internal management controls. Consequently, we and the Service audit organizations were unable to give audit opinions on the financial statements for the largest DoD funds covered by CFO Act requirements for FY 1994. Those funds included the Army and Air Force general funds (combined assets of \$612.9 billion reported); and the Defense Business Operations Fund (DBOF) (\$102.6 billion in assets reported). A complete listing of the audit opinions issued or disclaimed is at Attachment 1 to this statement.

#### GENERAL FUNDS

In August 1995, we provided two special summary reports to DoD management, the Office of Management and Budget, and the Congress discussing the major deficiencies that prevented the auditors from rendering opinions on the Army and Air Force general funds and the Defense Business Operations Fund.



The audits of the Army and Air Force general fund FY 1994 financial statements disclosed 81 specific deficiencies in the overall areas of systems, asset reporting, disbursements and collections, and contingent liabilities.

The most fundamental problem is that accounting systems supporting Army and Air Force general funds do not compile and report reliable and auditable information. Those systems can not produce an audit trail of information from occurrence of a transaction through recognition in the accounting records at various levels and ultimately to the general fund financial statements. Because of the accounting systems' inadequacies, auditors could not obtain sufficient evidence or apply other auditing procedures to satisfy themselves as to the fairness of the financial statements. Until the Defense Finance and Accounting Service (DFAS) implements accounting systems with integrated, double-entry, transaction-driven general ledgers to compile and report information, auditors will be impeded in determining whether valid transactions are properly recorded, processed, and summarized. This presents a significant scope limitation to the auditors and will likely continue to cause us to disclaim opinions on the general fund financial statements for the next several years. Also, this almost certainly includes the Navy general fund statements, which will be prepared and audited for the first time for FY 1996. The Navy has recognized the problems that it faces and cancelled plans to formulate general fund statements for FY 1995.

DEFENSE BUSINESS OPERATIONS FUND

The Defense Business Operations Fund (DBOF) is the primary vehicle for financing DoD support activities such as supply, maintenance, transportation, finance, and information processing. We have reported 120 specific DBOF financial management deficiencies such as poor audit trails, unsupported and unverified transactions, and lack of guidance. These deficiencies prevented the timely development, reliable presentation, and effective use of the financial statements. The scope of the problem is evident from the fact that auditors recommended \$53.6 billion in adjustments to the DBOF FY 1994 financial statements and supporting accounting records. The systems and internal controls for preparing DBOF financial statements are clearly not in place and it appears that several years of sustained effort will be needed to turn the situation around. We recommend, however, that DoD should put priority on the following measures:

- o implement the DoD Standard General Ledger in all interim migratory, migratory, and new accounting systems;
- o improve documentation and audit trails;
- o implement reasonableness and analytical edit checks for internal control;

- o develop and provide accounting guidance, ensure distribution to all users, and follow up to ensure consistent implementation;

- o improve accounting for property, plant and equipment;

- o develop and improve documentation on critical accounting processes to assist personnel in preparing financial information.

Also, we believe that by focusing on the control environment and procedures as part of the internal control structure, management can address many of the problems identified, and should not await implementation of major new systems to do so. It is our understanding that the DoD Chief Financial Officer agrees with that advice.

We intend to provide similar summary reports on both the general fund and DBOF areas annually. We feel that the comprehensive listing of audit results in such reports will be helpful in "scoring" progress.

#### FINANCE AND ACCOUNTING OPERATIONS

It has often been said, but bears periodic repeating, that perhaps the greatest value of the requirement for audited financial statements in the Government sector lies in the discipline that it imposes on Government financial managers.

By and large, the same types of system problems and internal control weaknesses that hamper preparation of annual financial statements also impair the efficiency of day to day operations. Therefore the Chief Financial Officers Act led directly to increased attention being given to problems in DoD funds control, payroll and vendor payments. The consolidation of DoD finance and accounting activities into the Defense Finance and Accounting Service also brought the full extent of formerly dispersed and poorly understood problems into much sharper focus.

In addition to the inability to produce auditable financial statements, the Department's antiquated systems and business practices have led to considerable vulnerability to fraud, computer tampering, Antideficiency Act violations, and erroneous payments to both contractors and DoD personnel. Several of our numerous recent audit reports addressing those types of problems are summarized in Attachment 2.

#### NEW INITIATIVES

Turning the DoD financial management situation around is one of our top priorities, as manifested by the planned commitment of about 700 combined DoDIG, Army, Navy and Air Force auditor workyears annually to the finance and accounting area, mostly to perform financial statement audits, by FY 1996. Details are at Attachment 3. This is the largest continuing commitment of DoD internal audit resources to a single management area ever.

Because my office is expected to downsize by about 33 percent from FY 1994 to FY 2001, this means that DoDIG audit resources for the acquisition, logistics, construction, military health care, foreign military sales, communications and environmental areas could be reduced by nearly one half. To cope with the realities of downsizing and to ensure the best possible audit coverage in the finance and accounting area, we have taken a number of initiatives, some of which include:

- o Establishing a more formal DoD audit management structure with well documented processes to ensure good coordination between the DoDIG, Army, Navy and Air Force financial audits.

- o Taking a leading role on the Government-wide Audited Financial Statement Task Force, which is a joint effort by the Office of Management and Budget, Treasury, General Accounting Office, IG community and Chief Financial Officer community to plan for implementing the Government Management Reform Act.

- o Establishing resident DoDIG audit offices at four of the five DFAS Centers.

- o Developing a risk assessment plan to focus audit assessments of automated system controls and reliability on the most critical DoD systems, with emphasis on new, standard systems.

o Consulting with the Private Sector Council, an advisory group of representatives from public accounting firms, and adapting private sector practices in our overall audit approach, with principal focus on meaningful "corporate level" audit opinions. We will also study the merits of contracting for financial statement audits, although it appears there would be considerable problems in outsourcing as long as most systems remain fundamentally not in condition to audit.

o Agreeing with the Office of Management and Budget and Chief Financial Officer, DoD, on a logical and meaningful reporting structure for financial statements, starting with the statements for FY 1996. While many dozen DoD components will work with DFAS to prepare financial statements and their individual component internal control systems will be audited, the principal reporting entities will be as follows:

Department of Defense Consolidating Statements (DoD IG Opinion)

Army General Fund (Army Audit Agency Opinion)

Navy General Fund (Naval Audit Service Opinion)

Air Force General Fund (Air Force Audit Agency Opinion)

Defense Business Operations Fund (DoD IG Opinion)

DoD Military Retirement Trust Fund (DoD IG Opinion)

National Defense Stockpile Transaction Fund (DoD IG Opinion)

Corps of Engineers, Civil Works (Army Audit Agency Opinion)

Defense Security Assistance Agency (DoD IG Opinion)

MEASURING PROGRESS

Mr. Chairman, we recognize the frustration that understandably occurs when Government agencies continually assert that it will take several years to fix fundamental management problems. At the present time, the DoD faces such criticism on many fronts. The Secretary of Defense acknowledges that drastic improvement is needed not only in finance and accounting, but also in the equally huge, complex, controversial and troubled procurement and logistics sectors. It is important to keep in mind that the Department has been engaged for about five years in fundamentally reengineering its management processes and the thousands of automated or manual systems that support those processes. In every area, this is a long term challenge and readily usable and meaningful metrics for measuring progress can be hard to develop. Certainly the annual audit opinions on year end financial statements are one indicator. For the next few years, however, it is unlikely that there will be a dramatic turnaround from mostly disclaimers to clean opinions. In fact, we have candidly reported that we do not foresee such a turnaround happening until the statements for FY 1999, at the earliest.

During the next few years, it will be important to focus on the detailed audit findings on internal control weaknesses to ascertain if progress is being made. We now have a good baseline in terms of what problems exist in most major DoD organizations and funds. The extent of internal control problems in the Navy general fund and those Defense Agencies that are not financed through the DBOF is not yet fully known, because they were not initially covered under the Chief Financial Officers Act. This year we are working on those areas. Thus far it appears that the types of problems being encountered are similar to those already found elsewhere in the Department. The full cataloging of the internal control weaknesses will be essentially complete as we report out on the ongoing audit work and the financial statements prepared for FY 1996. This is not to say that most of the needed DoD corrective actions have to be slowed up or deferred until those previously unaudited areas are covered.

Among the positive developments since the Deputy Inspector General testified on this subject before this Subcommittee last year are the following:

- o Task forces have been formed to revamp the DoD travel and transportation management processes. Those efforts could have tremendous positive impact, since 730,000 travel vouchers and 340,000 transportation bills are processed monthly using obsolete, cumbersome and labor intensive procedures. We are



participating actively on those task forces and doing related audits.

o. The Department is also pressing forward with task forces on computer security, debt avoidance, computer matching (Project Mongoose) and Electronic Commerce/Electronic Data Interchange (EC/EDI). The OIG is supporting each of those efforts too. There are great opportunities for streamlining DoD operations by adopting commercial business practices, using credit cards for the millions of small purchases made annually throughout the Department. Innovations like that would serve both to reduce procurement lead times and cut DoD administrative burden, including finance and accounting paperwork.

o The Under Secretary of Defense (Comptroller) issued excellent guidance in a number of crucial areas, including standards for Antideficiency Act violation investigations, Defense Business Operations Fund procedures, prevalidation of obligations before disbursements are made and handling problem disbursements that cannot be reconciled.

o We are beginning to see progress in both systems and site consolidation, as well as data element standardization. We are currently auditing the development strategy and design efforts for certain key systems, including the Defense Civilian Payroll System, Defense Joint Military Pay System and Corps of Engineers

Financial Management System. We will report our findings to DoD and the Congress later this year.

o In reaction to previous DoDIG audit findings, the Defense Federal Acquisition Regulation Supplement was amended in July 1995 to require contracting officers to ensure that future contracts clearly identify the accounting classification reference numbers which apply to each contract line or subline item. In addition, contract modifications which obligate or deobligate funds shall identify the related accounting changes for each contract line or subline to enable appropriate payment. Those changes and other requirements related to contract form are intended to provide clear billing instructions to the disbursing offices. When fully implemented, the new rule will improve financial control over future DoD contracts with multiple lines and different funding sources, provide for progress payments that more accurately reflect actual performance of work, and make prevalidation of disbursements easier. It is a very positive sign that the DoD acquisition community finally is actively engaged in helping to address the longstanding problems with vendor payments, many of which originate with confusing contract structure and wording or a lack of good instructions to the paying offices.

CONCLUSION

In summary, Mr. Chairman, we are putting top priority on auditing DoD finance and accounting operations, and we will continue to emphasize this area even in the face of significant downsizing of the DoD audit community. We also will continue making every effort to keep this Subcommittee informed of our efforts.

This concludes my statement and we would be happy to answer any questions.

## FY 1994 CFO Audit Opinions

Title	Audit Organization	Opinion
Voluntary Separation Incentive Trust Fund Financial Statements for FY 1994	OIG, DoD	Unqualified
National Security Education Trust Fund Financial Statements for FY 1994	OIG, DoD	Qualified
Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994	OIG, DoD	Disclaimer
Defense Business Operations Fund Consolidated Statement of Financial Position for FY 1994	OIG, DoD	Disclaimer
Army's Principal Financial Statements for Fiscal Years 1994 and 1993	Army	Disclaimer
Fiscal Year 1994 Principal Financial Statements of the Navy General Gift Fund	Navy	Qualified
FY 1994 Principal Financial Statements of the Office of Naval Records and History Fund	Navy	Qualified
Opinion on FY 1994 Air Force Consolidated Financial Statements	Air Force	Disclaimer

(Attachment 1)

Examples of Audit Reports Issued since  
July 1, 1994 on DoD Financial Management

AUTOMATED SYSTEMS

Report No. 95-270, "Corrective Actions on System and Software  
Security Deficiencies," June 30, 1995

Management requested followup audits to track DoD progress in improving the security of automated financial systems.

The Financial Systems Activities in Pensacola, Florida, and Denver, Colorado, had begun actions in response to previous audit findings on computer security and had improved controls over access to critical computer systems, software changes, and quality assurance procedures; however, seven of the eight recommendations to the Defense Finance and Accounting Service in previous audit reports were not yet fully implemented. The corrective actions were continuing.

The Defense Finance and Accounting Service and the Defense Information Systems Agency concurred with all of the findings and recommendations. Report No. 95-263 (below) addressed similar followup issues at other sites.

Report No. 95-263, "Controls Over Operating System and Security  
Software, and Other General Controls for Computer Systems  
Supporting the Defense Finance and Accounting Service,"  
June 29, 1995.

Previous audit reports showed that opportunities existed for improving computer security at the Defense Finance and Accounting Service, the Defense Information Systems Agency and the Defense Logistics Agency. Controls over sensitive features of the operating systems needed improvements. As a result, application programs and data such as pay records could be added, modified or deleted without detection.

The followup audit indicated the Defense Finance and Accounting Service, the Defense Information Systems Agency and the Defense Logistics Agency have made commendable efforts to implement prior recommendations. However, additional corrective actions were required in some areas. Verification was performed on 87 of 123 prior recommendations. Of the 87 prior recommendations, adequate corrective actions were taken on 67 recommendations (77 percent) and additional corrective action was required on 20 (23 percent).

(Attachment 2)

Although significant improvements had been made, some additional improvements were required in security software and environmental controls. Because of these weaknesses, knowledgeable users could gain unauthorized system access to manipulate or destroy records.

The Defense Finance and Accounting Service and its Financial Systems Activity Denver generally concurred.

Report No. 95-046, "Data Input Controls for Mechanization of Contract Administration Services System," November 30, 1994

Controls over automated data input for the Mechanization Contract Administration Services (MOCAS) system at the DFAS Columbus Center to pay contractors were not adequate. Specifically, MOCAS accepted invalid data in 57 of the 484 automated input fields tested. Edit tables available from the Military Departments which could significantly improve the accuracy of MOCAS were not being used. As a result, the risk of negative unliquidated obligations, unmatched disbursements, and incorrect or duplicated payments was very high. At the time of our review in April 1994, there were 2,779 contracts with negative balances of \$1.07 billion.

Management concurred with the finding and issued guidance to improve internal operating procedures. However, despite the hiring of additional personnel, contracts with negative balances actually increased. As of June 1995, the DFAS Columbus Center reported 2,857 contracts with negative balances totaling \$1.5 billion. The June 1995 numbers include contracts for additional paying activities and a change in procedures for reporting cancellation of yearend funds.

PAYROLL

Report No. 95-244, "Processing and Distribution of Combined Federal Campaign Payroll Deductions for Military Personnel," June 21, 1995

The audit was conducted at the request of the Office of Personnel Management. Payroll deductions for the Combined Federal Campaign were not always processed and distributed as requested by Service members. Specifically:

- o Three Defense Finance and Accounting Service Centers distributed at least \$582,428 in allotment payments to Combined Federal Campaigns in which Service members did not participate. Our results were based on problems reported to the Defense Finance and Accounting Service Centers in FY 1994 and a judgmental review of a limited number of pledge cards at three payroll offices and three central receipt and accounting points.

Therefore, additional allotment payments may have been sent to other than the appropriate donation recipient. In addition, \$22,280 was sent to central receipt and accounting points that were not authorized to participate in the Campaign.

- o The Centers did not send detailed supporting statements to the central receipt and accounting points as required by Office of Personnel Management and Department of the Treasury regulations. Without supporting statements, the central receipt and accounting points could not identify the number of employees, by Government agency, who contributed to the campaign, and could not verify payments received.

- o There were material management control weaknesses in processing pledge cards and maintaining the tables of address codes for the central receipt and accounting points in the military payroll systems.

The Defense Finance and Accounting Service is implementing procedural and system changes to strengthen controls over entering and maintaining the address codes of the central receipt and accounting points in the Defense Joint Military Pay System. One standard address table for central receipt and accounting points will be maintained in the military payroll system for all Services using the system. Also, the Defense Finance and Accounting Service will develop a standard report to accompany Combined Federal Campaign payments to the central receipt and accounting points.

Report No. 95-059, "Processes Used to Separate Military Personnel From Active Service," December 19, 1994

Excessive debts were incurred at separation of active duty personnel because of inaccurate and incomplete calculations of pay. The Air Force was doing an excellent job in personnel separations; however, at Army, Navy and Marine Corps activities 17 to 34 percent of separated personnel had outstanding debts. Post-separation debt collection is inefficient and costly, making preventative action imperative. The auditors estimated that about half of the debts were readily avoidable without impairing the separation process.

Management generally concurred with most findings and recommendations and subsequently established a Debt Management Task Force to aggressively pursue reduction in individual indebtedness. The Inspector General, DoD, plans to issue an audit report on the DFAS debt collection program by early December 1995.

VENDOR PAYMENTSReport No. 95-234, "Department of Defense Compliance With Federal Tax Reporting Requirements," June 14, 1995

Compliance by the DoD with Internal Revenue Service Form 1099 reporting requirements was poor. Ten of the 11 DoD paying offices reviewed, including the DFAS Columbus Center, were not obtaining the needed information, maintaining accurate records, or reporting payments for services obtained from noncorporate contractors and medical service corporations to the Internal Revenue Service. Failure to provide Form 1099 hampers IRS efforts to combat tax evasion.

Management concurred, stating that the Department proposes to achieve compliance via vendor registration for electronic contracting in DoD and expects to complete the process within two years.

Report No. 95-231, "Vendor Payments - Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995

The Defense Accounting Office (DAO) Pentagon made incorrect or improper payments, improperly certified vouchers, did not update the accounting system, and did not maintain acceptable supporting documents for obligations, accruals and disbursements. As a result, duplicate and erroneous payments of at least \$629,000 were made during FY 1993 and the first two quarters of FY 1994; vouchers valued at \$335,000 were not certified properly; transactions were not recorded in a timely manner; and obligation, accrual, and disbursement transactions totaling \$102 million of the \$107.9 million reviewed lacked supporting documentation. The inaccurate accounting system could not be relied on to make resource allocation decisions because of the potential for overobligation of funds.

The DAO Pentagon did not react to exception reports that identified accounting errors and failed to ensure the integrity of accounting information.

Certifying fund availability was not consistently performed. As a result, it was unclear who was the official responsible for certifying expenditure of funds.

Management agreed to improve accounting procedures, recoup duplicate payments, maintain adequate supporting documentation for accounting transactions and do more to implement the DoD Internal Management Control Program.



Report No. 95-240, "Progress Payments for the M1 Tank and Patriot Missile Programs," June 19, 1995

Progress payments were allocated accurately for the Patriot missile production contract, but were not always allocated accurately for the M1A2 research, development, test and evaluation contract. Specifically, 60 of 69 progress payments contained 98 erroneous charges. Of the 60, 39 progress payments contained foreign military sales requirements of \$49.5 million that were paid with DoD appropriations; 10 payments contained DoD requirements of \$4.9 million that were paid with foreign military sales funds; and 49 payments contained \$82 million of joint requirements that were not correctly allocated to either customer. The following conditions caused the misallocations:

- o Although the contractor billed by contract line item number, the paying offices disregarded this information, which resulted in erroneous charges to some DoD and foreign military sales funds.

- o The U.S. Army Tank-automotive and Armaments Command did not provide adequate guidance to allow paying offices to accurately allocate the charges for work billed to contract line item numbers that were funded by DoD and foreign military sales.

The U.S. Treasury incurred unnecessary interest from the time the erroneous charges were made until the time the charges should have been made. Foreign military sales customers may also have incurred interest because of premature charges.

Misallocation of progress payments or other disbursements within multiple line contracts is a very widespread problem. A report was issued on this particular contract because of questions raised regarding cash flow requirements for the foreign military sales customers. On a prospective basis, the DoD acquisition community has recognized the need to write contracts in a way that will better facilitate clear payment instructions and billings.

The Defense Finance and Accounting Service agreed to issue guidance for making payments on the basis of contract line item numbers or account classification reference numbers when the contractor's request for payment cites these numbers, and when payment on that basis meets the terms of the contract.

The Army Tank-automotive and Armaments Command issued payment instructions to the paying office and will continue to provide appropriate payment instructions to the Defense Finance and Accounting Service.

## FINANCIAL REPORTING

### Report No. 95-301, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements," August 29, 1995

Four major deficiencies prevent DoD from preparing auditable general fund financial statements. These deficiencies include a lack of modern systems designed to produce financial statements, inaccurately or improperly valued assets, inaccurately accounted for disbursements and collections, and undisclosed contingent liabilities. Numerous corrective actions, some long-term, are planned and ongoing to address these deficiencies.

Management agreed that the DoD lacks an integrated, double entry, transaction driven general ledger system; does not have adequate interfaces between financial and non-financial systems; and does not adequately record and reconcile "Fund Balance With Treasury" general ledger accounts to amounts reported by the Treasury. The Department will follow pending Federal Accounting Standards Advisory Board guidance on defining and reporting contingent liabilities.

### Report No. 95-294, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," August 18, 1995

Major DBOF accounting and financial management deficiencies, resulting in \$53.6 billion in auditor-recommended adjustments, prevented the timely development, reliable presentation, and effective use of the DBOF's financial statements. These deficiencies were grouped into the following major categories: accounting systems' characteristics; policy guidance; Property, Plant, and Equipment; inventory classification and classification of accounts; and personnel. Corrective actions totaling \$19.9 billion affecting the identified deficiencies had been implemented. The overall inability to produce financial statements has been caused by numerous unlinked financial accounting and nonfinancial systems that are unable to compile and report financial information. These systems were designed without consideration of accounting principles such as accrual-based accounting, or the DoD Standard General Ledger.

Management generally concurred, stating that, on balance, the report fairly presents conditions that existed within DBOF during the period of the audit.

OTHERReport No. 95-235, "The Financial Status of Army Expired Year Appropriations," June 14, 1995

The Army Materiel Command's prior year requirements were not always funded from the correct appropriations, and the balances in its financial records could not always be relied on for making financial decisions.

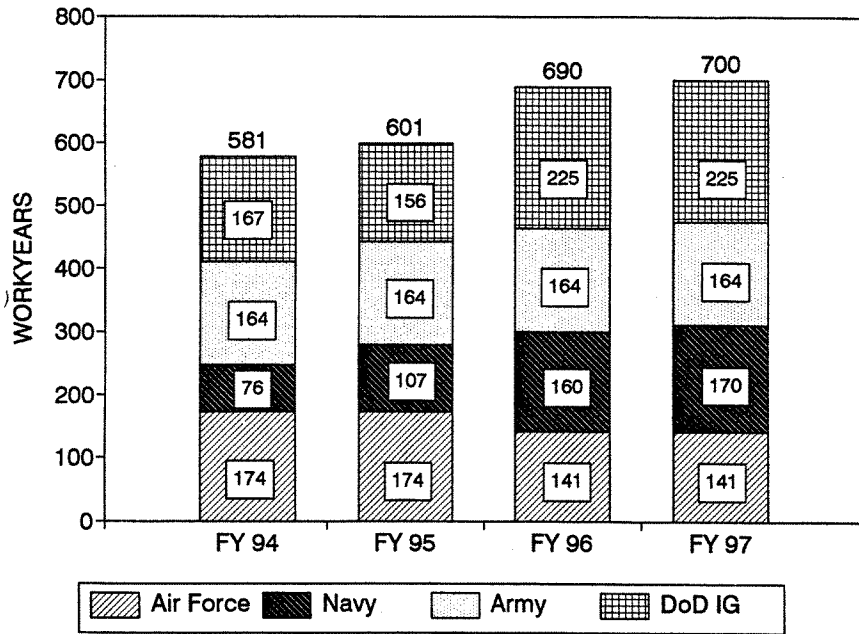
- o Progress payments to contractors and liquidations of previous payments were not necessarily recorded against the correct appropriations; as a result, appropriation balances were distorted, potential violations of the Antideficiency Act could have occurred, and overpayments to contractors were not recouped in a timely manner. About \$1.1 billion in unliquidated progress payments was recorded in January 1994 for Army contracts funded with expired appropriations. The balance was partially attributable to deficiencies in the recording and liquidation of progress payments, rather than to outstanding progress payments that were valid but not liquidated.

- o Contingent liabilities of at least \$29.7 million existed in programs funded in the expired procurement appropriations for Aircraft; Missiles; Weapons and Tracked Combat Vehicles; and Other Procurement items. Those liabilities were not adequately reflected in accounting records and could result in funding deficiencies and a potential violation of the Antideficiency Act in the Aircraft appropriation.

- o Army had about \$3.9 billion in unliquidated obligations charged to expired appropriations; however, the Army and the Defense Finance and Accounting Service were not effectively validating unliquidated obligation balances in expired appropriations.

Management generally agreed with the audit recommendations for corrective actions. Similar, but more extensive, problems had been noted previously in audits of Navy and Air Force expired accounts.

## CFO AUDIT WORKYEARS



Mr. HORN. Well, thank you. That's a very thorough and emphatic statement.

Let me ask you, in reviewing the reports of your auditors and maybe in just wandering around the building and talking to people, on the training side, what's your view of how the Inspector General's Office can help, in terms of sitting down with some of the key people that are responsible for that vast accounting network, using all these different systems? Do you think training is a problem here? I mean, do you detect that a lot of them have problems with recruitment, with the stability of the work force? Is it constant re-training that is needed? What's your sense of it.

Ms. HILL. I think there are a couple issues that my auditors tell me, and they, again, have done much more hands-on work on this than I have. First, certainly when they audited the DBOF, the Defense Business Operations Fund, the financial statement on that, one of the issues they raised there was the training of the individuals, and more emphasis on finance, accounting, and that sort of thing.

The other issue they have raised to me is that the downsizing that we are going through has had an impact. Obviously, as you downsize, you get less people to do the same amount of work, unless you eliminate some of that work and change what you're doing or the way you're doing it. The other aspect to the downsizing is that there have been a lot of senior people leaving. And that's a loss, not only of people, but of experience. And that's something that's hard to make up. So they have seen some evidence that that's had an impact and that that is a problem.

Our people, I know, have a lot of contact with all of the finance systems. They do a lot of work inside some of the financial centers. We have worked very closely with John Hamre's people. I know John from years ago when I worked in the Senate, and his people, before I came into the department, were working very closely with Derek Vander Schaaf, my deputy, and our staff. So, I mean, there's been a lot of back-and-forth interplay.

But, yes, we think training is a problem, a serious problem.

Mr. HORN. What else can the Defense Department do, right now, to get focused in on where we're headed, given the fact that there's a whole ream of testimony here that we're not going to make it by fiscal 1997, which everybody else is, presumably, going to make it? And we might even be at the end of the year, 7-year balanced budget, listening to things. 2002 no one has mentioned, but maybe that's where we will end up.

Ms. HILL. I think the bottom line and unfortunate truth is, there is really no quick fix to this. I don't see it. Our people don't see it. So it's not something that, no matter what they did today or tomorrow, you're probably not going to see an immediate turnaround.

We do think that the issues that I raised, those five points, are ones that they need to really emphasize and hit on continually. I think, also, the last one about getting the rest of the department in synch with this, they need to do that. We're seeing some evidence that's happening.

I mean, one positive thing that's happened on this unmatched disbursements issue, which is, you know, a terrible issue and it concerned a lot of people, and to the public, certainly, when they

hear about it, one thing that now has happened on that they have started, in the acquisition area, as opposed to the finance people, the contracting officers are now being required, when they put out these contracts, to include identifying information that matches these acquisition numbers to specific lines or sublines of contracts.

So, ideally, if that's complied with and it works, when the finance people get that, they will have the information there to match up these disbursements. Part of the problem now is, they don't have the information. No matter how long they spend on it, they don't have the accurate data in front of them. So those kinds of things they need to continue to do.

Mr. HORN. What can your office do? Now that you've had your series of audits, do you plan to do this on a yearly basis, or what else can the Inspector General do to stir the pot and keep people moving?

Ms. HILL. Well, obviously, we're going to continue to audit the financial statements that we are required to under the CFO Act, and work with GAO on the governmentwide effort on financial statements. That's something we will do, we are required to do by statute; we have assigned people to do that.

In addition, and in some ways I wish this hearing had been a couple months down the road, because I think we are working and we're going to continue to work on some issues as to is what we're doing now the best way to do this. And that goes back, Mr. Hamre alluded to it, and I mentioned it, the ongoing work we have on this whole process of getting new systems. Are we doing it the right way?

So I think our job is not only to keep looking at the financial statements, but part of our oversight mission is to see, are the ways we're addressing this problem in the department the best ways and most efficient ways? And we need to continue to look at that and pressure them, you know, to do things the best way, and maybe to raise with them alternatives.

I mean, I've raised some very kind of, you know, non-DOD questions to people. I get very frustrated, as Congresswoman Maloney has been, and I've said to people, "Well, you know, if you can't match up this disbursement to the right contract, because you don't have the information to identify which account this is supposed to be out of, well, just don't pay it."

But the response is—and then you get into these hard choices on policy here—you know, DOD doesn't sit in a vacuum. DOD not only affects the services and the military members; it affects huge parts of the economy, as far as contractors. I mean, are we to the point where we want to solve unmatched disbursements immediately so badly that we're going to not pay major defense contractors, because we don't have enough information to prevalidate those payments.

So, I mean, those are the kinds of choices that they get down to. And I think people probably need to start thinking about that, how far do we want to push them in either direction?

Mr. HORN. Getting back to training a minute, have you seen any evidence that the Office of Personnel Management, in the Executive Office of the President, is being helpful on improvement of

training in the Department of Defense, or is this strictly a Department of Defense function?

Ms. HILL. On that one I don't have much personal knowledge. I do know that DOD is trying to do some things. They have something they are calling the Defense Business Management University that they are in the process of setting up. That hasn't been sited yet, but they are developing a curriculum. But, honestly, I don't know that I have enough knowledge to really answer that, as to whether OPM has been heavily involved in that or not.

Mr. HORN. Well, ask your staff when you go back.

Ms. HILL. We can find out and get back to you.

Mr. HORN. We will file that and put it in the record at this point.

What would you suggest to improve the reliability of the financial information that is produced at these DFAS centers, especially the Columbus, OH, one?

Ms. HILL. Well, first of all, the systems have to get into place to produce not only accurate information but it has to be standardized information. I think, certainly, automation, as we've talked about and you've heard testimony about, would be very important, but, you know, that raises some other questions. And, again, I'm not a DOD expert yet, I've only been there a few months, but from what I understand there is a big move in the department to automate and to improve what they call the Corporate Information Management Initiative.

But that's not handled by the part of DOD that runs the finance system; that's handled by another component. So that raises questions of how much interface should they have. Second, I think that initiative is focusing on information, DOD-wide, by function. So that's how they are focusing on developing systems for information.

On the other hand, if you look at how we're developing the accounting systems, they are doing, at least in this migratory system, the initial cut, they are doing it by service-unique systems. The method that they are using is different, so that may create some problems.

So I think automation has great potential in this area, but it needs to be coordinated with what the department is doing, as a whole.

Mr. HORN. With these smaller systems that still exist, and they are in all the services, is anybody watching to see what kinds of purchases they are making, to upgrade that system when it ought to be folded into a more consolidated system? Or are we just spending millions of dollars still to keep this sort of rat trap moving?

Ms. HILL. You're talking about the accounting systems?

Mr. HORN. The accounting systems, and the technology to back it up, and the software, and all that. I can just see, nobody gets the message sometimes.

Ms. HILL. Well, I can tell you one concern we've got about some of these systems is, you know, as we're developing them, we're in a rush to get the systems in, but are we making sure that these systems have the right controls in them, controls against fraud, and vulnerabilities of that nature?

And some of that is being lost—maybe not lost, but at least it's not being emphasized as much, and our reports have shown that, because the push is to be able to come up here and tell the Con-

gress that we've got these systems in place. So people are rushing to try and do that, and they may, in the rush, not be doing it as thoroughly as we would like to. Now, the cost, there may be some of that that's sacrificed, too, in the rush to get a system in place and to meet the deadlines under the act on financial statements, which are going to turn on having those systems in place.

Mr. HORN. Very good.

Secretary Christie, you are welcome. You are still under oath.

Ms. CHRISTIE. I don't want to butt in, but we did one thing right. We did put a moratorium, when we decided to create DFAS and standardized systems, we put a moratorium on modernization of systems until we had selected which ones were going to be standard, because we did want to avoid exactly what you were answering, that spending tens of millions of dollars on 50 different systems.

Mr. HORN. Is that true of just the Navy or all services?

Ms. CHRISTIE. No, that's DOD-wide.

Mr. HORN. So that's DOD-wide.

Mr. HORN. That's DOD-wide, yes.

Mr. HORN. That's helpful.

Ms. HILL. I mean, I think what they are doing is picking out select systems that already existed, so we're really not bringing in new systems; we're taking existing systems and trying to improve them. Of course, that also raises a question, again, as an outsider, maybe we should have considered outside systems, I don't know, but that's where they are moving from.

Mr. HORN. I would think, and I guess since some of the Secretaries are still here, I would ask to what degree have we looked to private industry that has gone through this on, say, the merger of different companies, where you've got to integrate the controllership role and the financial management? To what extent has the Department of Defense gone out and asked advice?

Now, I heard earlier today, from Dr. Hamre, on the board of experts, and this kind of thing. But have we done it now? Because that isn't hard to get. There are some brilliant chief financial officers around the country, in various corporations. And as they have had mergers and acquisitions, they have faced exactly the problem that the Department of Defense is facing. So I was just curious, anybody tapping that brainpower? It's free; they won't charge you. They are glad to get to know you.

Secretary Hale.

Mr. HALE. Well, I think, at least to a limited extent, in the Air Force, we have sought outside guidance. Now, we haven't really established a full board of overseers. I do have the sense, Mr. Chairman, that we're going to have to jump into traffic on some of these, take a chance. We probably won't be perfect, but I fear that, if we sit around and look for the perfect solution or try to go immediately to one system, we will never get there, at least in our lifetimes.

I'm already concerned about how long it will take, even with these interim approaches. So I'm convinced that we ought to go forward with the interim approaches, get rid of as many old systems as we can, but it won't be just one when we're done, and try to fix them, lest my son be sitting here someday telling you that, "Gee,



you know, it will be 5 years before we have systems that will give you auditable statements."

Mr. HORN. That will be the hearing in 2025 that we plan already.

I yield to the ranking member from New York, and New York City, on this committee.

Mrs. MALONEY. Thank you very much.

Secretary Hill, I would like to ask you, you mentioned the problem with the prompt payment bill, that you have to pay within 30 days or interest starts accruing. Why couldn't we just, as we passed that bill, modify it and change that prompt payment bill, and say that you pay 30 days after you have verified that the bill is accurate; therefore, giving your personnel time to check the contract amount with the bill? Wouldn't that work?

Ms. HILL. Certainly, the Congress created that act and is free to change it. That would certainly give the department more time to do the verification process. I can foresee that you would have probably many contractors complaining that they weren't getting paid, which is the other side of this that I alluded to before. When I have raised this on occasion, "Well, just don't pay this stuff," the response is, "No. 1, we're going to have to pay interest under Prompt Payment, and, No. 2, you're going to have a lot of businesses, from the small businesses to the major contractors very upset because they may not get paid."

Mrs. MALONEY. Well, as the chairman mentioned, having sort of a joint public-private cooperation, you could notify the contractor you're having difficulty verifying their bill. I'm sure they will send a volunteer in immediately, you know, to try to help you figure out how to get the paperwork right and to verify it.

Mr. HORN. But the problem comes with the government side, on acquisition, when they wrote that contract, so the finance side can understand it. And when it gets down to push and shove, there are more contractors in our districts than there are finance officers and acquisition officers.

Ms. HILL. Probably true.

Mr. HORN. So I don't think that law is going to be changed. In fact, I get so irritated. We have a State law, also, in California. I get so irritated when I see some poor, struggling Hispanic contractor, who hasn't been paid in 6 months, it just sets me off. Because these people are working their hearts out, 18 hours a day, and they've got a cash-flow problem on paying their employees, and the check doesn't come from the Highway Department, or whatever.

Ms. HILL. I raised this. I had a similar discussion. My question was, "Well, is the problem that we don't get the information from the contractor, or are we not getting the right information from our acquisition people?" And I was told it's probably a little bit of both. So you've got a mix there.

Mrs. MALONEY. Well, I'm sure that they would work overtime to get you the proper information quickly.

Ms. HILL. You certainly would be giving them an incentive, whether it was either government or a contractor. We need to find some incentives.

Mrs. MALONEY. And I think that they have a stake in having our government well-run. They have an absolute stake in having our

government well-run. Maybe we should try to set up a meeting with the General Contracting Association on this and see how we can try to work that out.

Mr. HORN. You go right ahead and do that. I want to hear a report on it.

Mrs. MALONEY. OK. I will. I will. One of the things that you mentioned was the data problem, that the data comes to you in forms that aren't standardized and oftentimes it's not even accurate.

Ms. HILL. Right.

Mrs. MALONEY. If, by some chance, your staff returns from the furlough, and when my staff gets back from the furlough, I would like to meet with you, possibly, on proposed standardized data elements that would make this clear to understand.

Ms. HILL. We would be glad to do that, because that has been a finding in many, many, many of our audit reports, that the data was just not standardized.

Mrs. MALONEY. Now, one of the things that really annoys me, Mr. Chairman—and then I am going to be quiet—is that this is obviously a huge problem, which common sense tells you is not that difficult to solve. Now, if the contractors, in writing their contracts, can't make them clear enough so that the bill payers can figure out what's going on, or the contractor who is receiving the contract can't understand, I mean, something is very, very wrong.

Just common sense tells you that this can be corrected. And I think everybody has a stake in seeing it corrected, not only government, but I think the private contractors, and certainly the auditors. What has been outlined before us is a disaster, an absolute disaster that I don't have any confidence is going to be corrected, myself, quite frankly. And I don't see any reason why it can't be corrected.

That's all I have to say.

Mr. HORN. If the gentlelady would yield.

Mrs. MALONEY. Absolutely.

Mr. HORN. I'm just curious on the process. As I recall, a lot of these contracts are based on RFPs, where those have been designed by the services involved to get a certain type of procurement. Now, some of them might be from General Services and standard across all agencies, but it seems to me, as the gentlewoman from New York suggests, this is a manageable problem, if you bring together the acquisition people that are either writing that contract or approving the contract.

I don't look to a poor contractor that is busy getting widgets out, and they are quality widgets, to solve all the technical problems of what the Pentagon needs to know, to know, one, did they get what they ordered; and No. 2, what did they pay for it, and when did they pay for it? It seems to me those elements are what the financial people are looking for.

And I must say, I worry when I read some of the commentary on the Columbus Center, of how you've got to hunt through rooms filled with files to find the element. And we're expecting GS-3s to do it. Can't this be computerized and put into the system?

Ms. HILL. That's why, as we've said, it's very important that not just the finance part of DOD is aware of this.

Mr. HORN. Right. The contract part.

Ms. HILL. You have to have acquisition, logistics, all these other parts of the department have to be feeding into this process and working with us to get the system to where it works.

Mr. HORN. What concerns me is what we've seen at the FAA, we've seen it in a number of other agencies, and the Pentagon has been notorious for it, in their history, going back probably to Jefferson, is that we will have some huge, massive system develop because we've got unique needs. Their needs of purchasing aren't any more unique than the most complex electronic company in America. And it seems to me we're already doing this in the private sector, another reason to get their people to give some advice on how you do the job, if we fail to have that competency here.

It isn't a matter of our people are dumb; it's just sometimes the private sector has a little more freedom than government agencies do to go out and get the latest technology, the latest software.

Ms. HILL. I do know, certainly, on the audit side of it, not on the operations part, but on our audit side, with the service audit agencies and the IG's Office, we are increasing our contacts with the private sector and looking at their best practices in auditing, and that kind of thing, and seeing where we can use that in government. So there is certainly room for some exchange of ideas there, I think.

Mr. HORN. Well, good. Hopefully, that will also be encouraged by the Inspector General, you and your colleagues, across the government.

I want to thank you all for your patience today. We did have two votes. We thought we had a third coming up at 5 o'clock, but they must have sent all the floor staff home, or something.

So with that, I'm going to thank the people that put this hearing together.

For the majority, Russell George, staff director; Anna Miller, who is to my immediate left, the professional staff member specifically assigned to this. And I want to thank, in particular, since it's his almost last day working with us, and he comes from the Pentagon, Tony Polzak, legislative fellow, with the Department of the Army, who has been an invaluable addition to our staff, because he worked for nothing, for the last 9 months or so. And Andrew Richardson, our chief clerk; and the minority staff, Cherri Branson. And then our official reporter, Barbara Smith.

We thank you all for helping. With that, we thank you, and adjourn this session.

[Whereupon, at 5:35 p.m., the subcommittee adjourned.]

