

**WINNING THE WAR ON FINANCIAL MANAGE-
MENT—STATUS OF DEPARTMENT OF DEFENSE
REFORM EFFORTS**

HEARING

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY
AND FINANCIAL MANAGEMENT
OF THE
COMMITTEE ON
GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

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WINNING THE WAR ON FINANCIAL MANAGEMENT—STATUS OF DEPARTMENT OF DEFENSE REFORM EFFORTS

WEDNESDAY, JUNE 25, 2003

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

The subcommittee met, pursuant to notice, at 2:35 p.m., in room 2154, Rayburn House Office Building, Hon. Todd Russell Platts (chairman of the subcommittee) presiding.

Present: Representatives Blackburn and Towns.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Larry Brady, Kara Galles, and Tabettha Mueller, professional staff members; Amy Laudeman, clerk; Mark Stephenson, minority professional staff member; and Jean Gosa, minority clerk.

Mr. PLATTS. A quorum being present this hearing, the Subcommittee on Government Efficiency and Financial Management will come to order. Today's hearing is one in a series focusing on recently released audit opinions for Federal agencies. This year 21 of the 24 agencies mandated by the CFO Act to perform financial audits earned an unqualified or clean opinion. The Department of Defense [DOD], one of three entities not receiving a clean audit, will be the focus of today's hearing, and I would like to thank each of the witnesses for agreeing to testify here today and for your work leading up to your testimony today.

We are all very much aware that DOD is years away from earning an unqualified or clean opinion on its financial statements. The financial management challenges of DOD are unlike those of any other agency. In fact, they are unlike any entity in the world. With an annual budget of \$400 billion, DOD is almost twice as large as the biggest publicly held corporation. It is our country's largest employer. The consolidated statement of DOD encompasses 13 stand-alone financials, many of which are larger and more complex than the statements of other CFO Act agencies.

The good news is DOD has begun a complete restructuring of its financial management and business processes. Once completed, these reforms will likely result in savings between \$15 billion and \$30 billion, according to Business Executives for National Security. The saving of such substantial sums will greatly enhance DOD's ability to adequately fund and fulfill its primary mission, protecting the safety and security of America and its citizens. This trans-

formation will take years to complete, but it could also become a model for other agencies to follow.

The purpose of today's hearing is not to look back at DOD's problems of the past, but rather to focus on the reforms that have begun and, most importantly, to ensure that these reforms will be seen through to completion.

I am aware of the hundred of studies that have been done on DOD, and I'm also aware of the pressure on the Department to earn a clean opinion. But I want to repeat today what I have said in many of our previous hearings, a clean opinion is not an end in and of itself. A clean opinion should come as a benefit and as a result of sound financial management.

In order for DOD to accomplish its mission, managers must have access to timely, accurate and reliable information. Right now, DOD has over 2,300 individual financial management and business process systems. The systems infrastructure is hampered by a lack of functional and technical integration. Many of the systems are home-grown, built from the ground up to serve a particular purpose and have never intended to be integrated. These IT challenges and limitations have proven difficult to overcome.

No one knows these limitations better than the leaders at DOD. Commendably, Secretary Rumsfeld has made financial management a high priority and has reiterated that it's one of his top 10 priorities for the Department.

Changes are clearly underway. The Office of Comptroller developed the Business Management Modernization Program, and a major contract has been awarded to create a new Enterprise Architecture that will revolutionize the way things are done at DOD. Our job, in this subcommittee, is to provide oversight and support for these new efforts so that the work can continue until the job is done.

Today the subcommittee will hear from Mr. Greg Kutz, Director of Financial Management and Assurance at GAO; Mr. Larry Lanzillotta, Principal Deputy to the Comptroller at DOD; and Mr. Paul Granetto, Director of Auditing for the DOD Inspector General. Thank you each for agreeing to be with us here today, and I look forward to your testimonies. And I thank you for your extensive written testimonies that you provided to the committee.

I now yield to the gentleman from New York, Mr. Towns, for the purpose of making an opening statement.

[The prepared statement of Hon. Todd Russell Platts follows:]

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Opening Statement
Todd Russell Platts
June 25th, 2003

Today's hearing is one in a series focusing on audit opinions for Federal agencies that were released last February for FY2002. Twenty-one of the 24 agencies mandated by the CFO Act to audit financials earned an unqualified or "clean" opinion. Agencies that did not earn clean opinions have been invited to testify before the Subcommittee as part of our oversight on financial management. The Department of Defense will be the focus of today's hearing, and I'd like to thank the witnesses for agreeing to testify.

We're all very much aware that the Department of Defense is years away from earning an unqualified or "clean" opinion on its financial statements. The financial management challenges of DOD are unlike those of any other agency – in fact, they are unlike any entity in the world. With an annual budget of \$400 billion, DOD is almost twice as large as the biggest publicly held corporation. It is our country's largest employer. The consolidated statement for DOD encompasses at least twelve stand-alone financials, many of which are larger and more complex than the statements of other CFO Act agencies.

The good news is that DOD has begun a complete restructuring of its financial management and business processes. Once completed, these reforms will result in savings of between \$15 billion and \$30 billion dollars, according to the Business Executives for National Security. In fact, this may well be a conservative estimate. The transformation will take years to complete, but it could become a model for other agencies.

The purpose of today's hearing is not to look back at all of DOD's problems, but rather to focus on the reforms that have begun and, most importantly, to ensure that these reforms will be seen through to completion.

I am aware of the hundreds of studies that have been done on DOD, and I'm also aware of the pressure on the Department to earn a clean opinion. But I want to repeat

what I have said in many of our previous hearings. A clean opinion is not an end in itself. It should come as a benefit of sound financial management.

In order for DOD to accomplish its mission, managers must have access to timely, accurate and reliable financial information. Right now, over 2,300 individual systems process financial information. The infrastructure is hampered by a lack of functional and technical integration. Many of the systems are "home-grown" – built from the ground up to serve a particular purpose and not intended to be integrated. These IT challenges and limitations have proven difficult to overcome.

No one knows these limitations better than the leaders at DOD, and Secretary Rumsfeld has made financial management a high priority. In his speech on September 10, 2001, he said, "Our challenge is to transform not just the way we deter and defend but the way we conduct our daily business. Let's make no mistake: the modernization of the Department of Defense is a matter of some urgency. In fact, it could be said that it's a matter of life and death, ultimately, every American's."

Changes are underway. The Office of the Comptroller developed the Business Management Modernization Program, and a major contract has been awarded to create a new enterprise architecture that will revolutionize the way things are done at DOD. Our job in this Subcommittee is to provide oversight and support for these new programs so that the work can continue until the job is done.

To a certain extent, there is an irony with regard to DOD in that we have the finest military force in the history of the world, but the business structure is stuck in the middle of the 20th century. What is becoming abundantly clear is that we have no choice but to aggressively reform the financial management and business processes because of the billions and billions of tax dollars at stake.

Today the Subcommittee will hear from Mr. Greg Kutz, Director of Financial Management and Assurance at GAO; Mr. Larry Lanzillotta, Principal Deputy to the Comptroller at the Department of Defense; and Mr. Paul Granetto, Director of Auditing for the DOD Inspector General. Thank you for agreeing to testify today. I look forward to hearing from you.

Mr. TOWNS. Thank you very much, Mr. Chairman. Let me thank you for staying the course on this financial management issue.

The subcommittee recently had a hearing on the consolidated financial statements of the U.S. Government. It was clear from that hearing that while there has been some improvement in financial management at many Federal agencies, at others, serious problem still remains.

The Department of Defense is perhaps the worst agency, both because of the sheer magnitude of the amount of money involved and because of the complexity of its financial management problems.

The Defense Department receives approximately one half of the discretionary budget of the United States each year. Its annual budget is about \$380 billion. Its own assets value over \$1 trillion. It has about 3 million military and civilian employees. Because of the huge sum of money flowing through the Department, its financial management systems, practices, and procedures are hampered by critical weaknesses.

Since 1995, GAO has designated the financial management systems at DOD as high risk because they are vulnerable to waste, fraud and abuse. And again this year, as has been the case for at least the last 7 years, the Defense Inspector General could not provide an opinion on the agency's financial statements. None of the military services or major components has passed the test of an independent financial audit.

DOD cannot properly account for an estimated \$1 trillion of its assets holdings, including weapons systems and support equipment. It lacks complete and reliable information on its environmental liabilities, potentially understating by 10's of billions the reported \$59 billion liability. There are hundreds of millions of dollars of under and over-payments to contractors.

These are longstanding problems. We have had literally decades of reports from GAO and the Inspector General on the history of financial mismanagement at the Department. Approximately 8 years ago, in 1995 to be exact, the DOD Inspector General testified before Congress that a turnaround in the Pentagon's financial management practices might be expected by the year 2000. Well, 2000 is gone, 2001, 2002, and now we are into 2003, and the Department is saying it might have financial statements that can be audited by the middle of the decade.

This doesn't seem like progress to me, but there are some hopeful signs. Most important is the fact that the political leadership of the Department seems to recognize the seriousness of the problem and has developed a plan to address it with the Business Management Modernization Program. But plans are just plans. We have seen many such initiatives over the years. I am hopeful this one will be different from the others that we have heard and talked about.

On that note, Mr. Chairman, I yield back.

Mr. PLATTS. Thank you, Mr. Towns.

[The prepared statement of Hon. Edolphus Towns follows:]

Statement of Congressman Ed Towns
Subcommittee on Government Efficiency and Financial Management
Hearing on “Winning the War on Financial Management – Status of the
Department of Defense Reform

June 25, 2003

Thank you Mr. Chairman, and welcome to our witnesses.

The Subcommittee recently held a hearing on the consolidated financial statements of the United States Government. It was clear from that hearing that while there has been some improvement in financial management at many federal agencies, at others serious problems remain.

The Department of Defense is perhaps the worst such problem agency, both because of the sheer magnitude of the amount of money involved, and because of the complexity of its financial management problems.

The Defense Department receives approximately one-half of the discretionary budget of the United States each year. It's annual budget is about \$380 billion, it owns assets valued at over \$1 trillion, and has

about 3 million military and civilian employees. Despite, and maybe because of, the huge sums of money flowing through the department, its financial management systems, practices, and procedures are hampered by critical weaknesses.

Since 1995, GAO has designated the financial management systems at DoD as "high risk," because they are vulnerable to waste, fraud, and abuse. And again this year, as has been the case for at least the last seven, the Defense Inspector General could not provide an opinion on the agency's financial statements. None of the military services or major components has passed the test of an independent financial audit.

DOD cannot properly account for an estimated \$1 trillion dollars of its asset holdings, including weapon systems and support equipment. It lacks complete and reliable information on its environmental liabilities, potentially understating by 10's of billions the reported \$59 billion liability. There are hundreds of millions of dollars of under- and over-payments to contractors.

These are long-standing problems. We have had literally decades of reports from GAO and the Inspector General on the history of

financial mismanagement at the Department. Eight years ago, in 1995, the DoD Inspector General testified before Congress that a turnaround in the Pentagon's financial management practices might be expected by the year 2000. Well it's now 2003, and the Department is saying it might have financial statements that can be audited by the middle of the decade.

This doesn't seem like progress, but there are some hopeful signs. Most important is the fact that the political leadership of the Department seems to recognize the seriousness of the problem and has developed a plan to address it with the Business Management Modernization Program. But plans are just plans. We've seen many such initiatives over the years. I'm hopeful this one will be different.

Thank you Mr. Chairman.

Mr. PLATTS. I will proceed to our testimonies, and I would ask each of our witnesses, and any others who will be assisting you in your testimonies today, if you could stand and we will swear you in.

[Witnesses sworn.]

Mr. PLATTS. The clerk will reflect that all witnesses affirmed the oath, and we will now proceed directly to testimonies.

Mr. Kutz we will begin with you, followed by Mr. Lanzillotta and finally Mr. Granetto. The subcommittee appreciates the extensive written testimonies and would ask that you limit your opening testimonies here today to approximately 10 minutes, and then we'll get into questions and you certainly will have an opportunity to expand.

So Mr. Kutz if you would like to begin, the floor is yours.

STATEMENTS OF GREGORY D. KUTZ, DIRECTOR OF FINANCIAL MANAGEMENT AND ASSURANCE, GENERAL ACCOUNTING OFFICE; LAWRENCE J. LANZILLOTTA, PRINCIPAL DEPUTY AND THE DEPUTY UNDER SECRETARY OF DEFENSE FOR MANAGEMENT REFORM, OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER); AND PAUL GRANETTO, DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. KUTZ. Thank you Mr. Chairman and Representative Towns, it is a pleasure to be here to discuss financial management at the Department of Defense.

As both of you mentioned, DOD is enormous when compared to other entities, with a reported over \$1 trillion in both assets and liabilities, \$380 billion in net program costs and a work force of over 3 million. To provide some perspective on the size of DOD, consider that it had 35 times more employees, at least six times more in assets and spent \$200 billion more than Exxon-Mobil in fiscal year 2002.

The recent success of our forces in Iraq has demonstrated, once again, that our military forces are second to none. However, that same level of excellence is not evident in many of DOD business operations, including the topic of today's hearing, financial management.

The bottom line of my testimony this afternoon is that DOD is taking positive steps to reform its financial management. However, the road to reform is very long with significant challenges ahead. My testimony has two parts. First, DOD's financial management challenges and the related causes; and second, the key elements necessary for successful reform and some progress to date.

First, DOD's financial management challenges relate to people, processes and systems. These problems have resulted in the lack of reliable information for decisionmaking, have hindered operational efficiency, impacted mission performance and left DOD vulnerable to fraud, waste and abuse. Significant weaknesses exist across the board ranging from asset accountability to the lack of reliable cost information. Secretary Rumsfeld has stated that successful business process reform could save DOD 5 percent of its budget or \$20 billion a year.

One example of inefficiency is DOD's 2,300 stove-piped duplicative business systems which will cost \$18 billion this year. Successful systems modernization would improve the quality of information and save billions of dollars annually. Problems impacting mission performance include the inability to locate defective chem-bio suits, shortages of key aircraft spare parts, and problems with timely and accurate payment of military personnel.

You are probably wondering why these problems have not been fixed. Based on our experience, we believe the reasons include the lack of sustained top-level leadership and accountability, cultural resistance to change, including service parochialism, lack of results-oriented performance measures and inadequate incentives for change.

My second point relates to what we believe are seven key elements necessary for successful reform. I will touch on three of those seven now.

First, financial management challenges must be addressed as part of a comprehensive, integrated, DOD-wide business process reform. Financial management is a cross-cutting issue that impacts all of an organization's business operations. Currently 9 of the 25 GAO high-risk areas in the Federal Government are relevant to DOD. These management challenges must be addressed in an integrated fashion. DOD agrees with us and is working on integrated solutions to many of these problems. For example, DOD is currently attempting to modernize its systems by developing and implementing a Business Enterprise Architecture. We support this effort, as successful modernization of DOD's 2,300 systems is essential to addressing many of DOD's nine high-risk challenges.

Second, results-oriented performance measures and top-level management monitoring are critical. DOD is focused on the right goal, which is reducing cost and developing systems that produce timely, reliable financial information. In addition to the long-term systems effort, DOD is working on improving its internal controls and processes. Examples of improvements include reduced travel card delinquencies, the elimination of over 100,000 purchase cards and reduced payment recording errors. We attribute these improvements primarily to top management focus and the use of results-based performance metrics.

Third, we believe effective oversight and monitoring of DOD's strategy and progress are critical. Oversight hearings, like the one today, provide a constructive dialog for discussing progress made and actions needed. The Inspector General and GAO can contribute by providing professional, objective and constructive input on financial management reform.

In closing, I offer the question, is reforming DOD possible? DOD has made great strides in its military capabilities, as demonstrated in Afghanistan and Iraq. I believe DOD can make great strides in its business operations with similar management focus and attention. It is too early to predict whether the current reform effort will succeed, but there will be certain indicators of success, such as the elimination of hundreds of DOD's duplicative business systems.

In addition, you will know reform is working when GAO and the IG having a hard time identifying fraud, waste and abuse, DOD senior management has taken positive reform steps. However,

there is a risk that other priorities, such as the reconstruction of Iraq, will dilute the management focus necessary for reform to succeed, which is understandable. At the same time, with waste and inefficiency costing \$20 billion or more a year, true reform is needed to restore public confidence that taxpayer dollars are well spent in meeting our Nation's defense objectives.

Mr. Chairman, this ends my statement and I would be happy to answer any questions.

Mr. PLATTS. Thank you, Mr. Kutz.

[The prepared statement of Mr. Kutz follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Efficiency and
Financial Management, Committee on Government Reform,
House of Representatives

For Release on Delivery
Expected at 2:30 p.m. EST
Wednesday, June 25, 2003

**DEPARTMENT OF
DEFENSE**

**Status of Financial
Management Weaknesses
and Progress Toward
Reform**

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





Highlights of GAO-03-8317, a testimony to the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

Why GAO Did This Study

As seen again in Iraq, the excellence of our military forces is unparalleled. This same level of excellence is not yet evident in the Department of Defense's (DOD) financial management and other business areas, impeding DOD's ability to provide complete, reliable, and timely information to the Congress, DOD managers, and other decision makers. The Subcommittee asked GAO to testify on the status of DOD's financial management and business process reform efforts. Specifically, GAO was asked to provide an overview of the long-standing financial management weaknesses facing DOD and a summary of the underlying causes of DOD's financial management challenges. In addition, GAO's testimony focused on (1) key actions necessary to correct DOD's financial management problems and (2) the progress DOD is making toward business process reform.

www.gao.gov/cgi-bin/getrpt?GAO-03-8317
To view the full product, including the scope and methodology, click on the link above.
For more information, contact Gregory D. Kutz at (202) 512-9085 or kutzg@gao.gov.

June 25, 2003

DEPARTMENT OF DEFENSE

Status of Financial Management Weaknesses and Progress Toward Reform

What GAO Found

Overhauling DOD's financial management represents a major challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. Of the 25 areas on GAO's governmentwide "high risk" list, 6 are DOD program areas, and the department shares responsibility for 3 other high-risk areas that are governmentwide in scope. Key financial management weaknesses include the lack of effective and efficient asset management and accountability; unreliable estimates of environmental and disposal liabilities; lack of accurate budget and cost information; nonintegrated and proliferating financial management systems; and fundamental flaws in DOD's overall control environment.

GAO has identified four underlying causes for DOD's inability to resolve its long-standing financial management problems:

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

The following are elements that GAO has identified as key to a successful approach to financial management and business process reform:

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

DOD has taken positive steps in many of these key areas. For example, the Secretary of Defense has included improving DOD's financial management as one of his top 10 priorities, and DOD has already taken a number of actions under its Business Transformation Program, including its efforts to develop an enterprise architecture to guide operational and technological changes. However, these are beginning steps and formidable challenges remain in each of the key reform areas.

Dear Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to discuss the status of financial management and business process reform efforts at the Department of Defense (DOD). DOD faces financial and related management problems that are pervasive, complex, long standing, and deeply rooted in virtually all business operations throughout the department. These problems have impeded the department's ability to provide complete, reliable, and timely business operations information to the Congress, DOD managers, and other decision makers. In addition, DOD's financial management weaknesses have resulted in the failure of the department, its military services, and its major components from passing the test of an independent financial audit and are a significant obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. Overhauling DOD's financial management represents a major challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. Of the 25 areas on GAO's governmentwide "high risk" list, 6 are DOD program areas, and the department shares responsibility for 3 other high-risk areas that are government wide in scope.¹ Central to effectively addressing DOD's financial management problems will be understanding that these 9 areas are interrelated and cannot be addressed in an isolated, stovepiped, or piecemeal fashion. While Secretary of Defense Rumsfeld has initiated a program to transform DOD's business processes, including establishing a new management structure to oversee reform efforts, DOD has not yet developed an overarching plan tying key reform efforts together in an integrated program.

DOD's size, structure, and diversity of activities increase the difficulty and complexity of reform efforts. For example, DOD is the nation's largest employer, with

- 1.4 million men and women currently on active duty,
- 1.2 million serving in the Reserve and Guard components, and

¹ U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003). The nine interrelated high-risk areas that represent the greatest challenge to DOD's development of world-class business operations to support its forces are: contract management, financial management, human capital, information security, infrastructure management, inventory management, real property, systems modernization, and weapon system acquisition.

-
- 675,000 civilians.

DOD operates more than 600,000 individual buildings and structures located at more than 6,000 different locations and using more than 30 million acres. For fiscal year 2002, DOD expended approximately \$371 billion to operate and maintain about 250,000 vehicles, over 15,000 aircraft, more than 1,000 oceangoing vessels, and some 550 public utility systems.²

DOD's financial management problems are the result of long-standing deficiencies related to its systems, processes, and people. Therefore, to be successful, reform efforts will need to address all three factors. In recognition of the far-reaching nature of DOD's financial management problems, on September 10, 2001, Secretary Rumsfeld announced a broad, top-priority initiative intended to "transform the way the department works and what it works on." This new broad-based business transformation initiative, led by DOD's Senior Executive Council and the Business Initiative Council, incorporates a number of defense reform initiatives begun under previous administrations but also encompasses additional fundamental business reform proposals. In announcing his initiative, Secretary Rumsfeld recognized that transformation would be difficult and expected that needed changes would take 8 or more years to complete.

As we have seen again in Iraq, the excellence of our military forces is unparalleled. This same level of excellence is not yet evident in the department's financial management and other business areas. This is particularly problematic because effective financial and related management operations are critical to achieving the department's mission in a reasonably economical, efficient, and effective manner and to providing reliable, timely financial information on a routine basis to support management decision making at all levels throughout DOD. Transforming DOD's business operations would free up resources that could be used to enhance readiness, improve the quality of life for our troops and their families, and reduce the gap between "wants" and available funding in connection with major weapon systems. In fact, Secretary Rumsfeld has estimated that successful business process reform could save DOD 5 percent of its budget or \$20 billion a year.

² *Department of Defense, Performance and Accountability Report: Fiscal Year 2002* (Washington, D.C.: January 2003).

Today, I will focus mainly on the key actions necessary to correct DOD's financial management problems and the progress DOD is making toward business process reform. But first, I want to provide you with an overview of the long-standing financial management weaknesses facing DOD—as highlighted by the results of audit work performed over the past few years—and a summary of the underlying causes of DOD's financial management challenges. My statement is based on previous GAO reports as well as on our review of DOD Inspector General (IG) reports and recent DOD reports and studies.

Long-standing Financial Management Weaknesses

DOD continues to confront pervasive, decades-old financial management problems related to its systems, processes (including internal controls), and people (human capital). These problems have (1) resulted in a lack of reliable information needed to make sound decisions and report the status of DOD's activities through financial and other reports, (2) hindered its operational efficiency, (3) impacted mission performance, and (4) left the department vulnerable to fraud, waste, and abuse.

DOD's serious financial management and related business systems problems led us in 1995 to put both DOD financial management and systems modernization on our list of high-risk³ areas in the federal government, a designation that continues today.⁴ As discussed in the results of our audit of the fiscal year 2002 Financial Statements of the U.S. Government,⁵ DOD's financial management deficiencies, taken together, continue to represent one of the largest obstacles to achieving an unqualified opinion on the U.S. government's consolidated financial statements. To date, none of the military services or major DOD components has passed the test of an independent financial audit because

³ GAO has designated government operations and programs as "high risk" because of either their greater vulnerabilities to waste, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness.

⁴ U.S. General Accounting Office, *High-Risk Series: An Overview*, GAO/HR-95-1 (Washington, D.C.: February 1995); *High-Risk Series: Defense Financial Management*, GAO/HR-97-3 (Washington, D.C.: February 1997); *High-Risk Series: An Update*, GAO-01-283 (Washington, D.C.: January 2001); and *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003).

⁵ U.S. General Accounting Office, *Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform*, GAO-03-572T (Washington, D.C.: Apr. 8, 2003).

of pervasive weaknesses in financial management systems, processes, and controls. These weaknesses not only hamper the department's ability to produce timely and accurate financial management information but also impact mission performance and make mission costs unnecessarily high. Ineffective asset accountability and the lack of effective controls continue to adversely affect visibility over its estimated \$1 trillion investment in inventories and property, plant, and equipment (including weapon systems and other property). Such information is key to meeting military objectives and readiness goals. Further, unreliable cost and budget information related to a reported \$700 billion of liabilities, particularly \$59 billion of reported environmental liabilities, and about \$380 billion of reported costs negatively affects DOD's ability to effectively project funding needs, maintain adequate funds control, reduce costs, and measure performance. DOD has invested, and continues to invest, significant resources—in terms of dollars, time, and people—in its systems without demonstrated improvement in its business operations and adequate management and oversight, thereby continuing to perpetuate a proliferation of systems that do not adequately address the department's needs. Finally, DOD's weak overall control environment has left the department vulnerable to fraud, waste, and abuse. As the results of the department's fiscal year 2002 financial audit and other audit work demonstrate, DOD continues to confront serious weaknesses in these areas.

Asset Management and Accountability

Of the \$776 billion of inventory and related property and general property, plant, and equipment (PP&E)⁶ assets reported by federal entities for fiscal year 2002, DOD is responsible for about half—approximately \$146 billion in inventory and related property and \$226 billion of general PP&E, comprised of \$162 billion in real property (land, buildings, facilities, capital leases, and improvements to those assets); \$37 billion in personal property (such as vehicles, equipment, telecommunications systems, computers, and software); and \$27 billion in construction-in-progress, the largest amount of which belongs to the Corps of Engineers. While DOD is not presently required to report dollar values for its weapons systems and support PP&E used in the performance of military missions, such reporting will be required beginning October 1, 2002.⁷ The amount subject to reporting will likely be significant considering that DOD has estimated an acquisition cost of over \$64 billion for only three of its major weapons systems acquisition programs.

Effective and efficient asset management and accountability is crucial to DOD's defense of our national interests. While the department has undertaken several initiatives over the years to improve its asset management and accountability systems, processes, and controls, material weaknesses persist. As a result, DOD lacks reliable information about the quantity, location, condition, and value of inventory and property—including military equipment—critical to the department's ability to effectively meet military objectives and readiness goals. Ineffective and inefficient asset management and accountability leave the department vulnerable to fraud, waste, and abuse. Over the past 2 years, the DOD Inspector General (IG) and we have issued numerous reports detailing problems with asset management and accountability, including the following examples.

⁶ Statement of Federal Financial Accounting Standards No. 6 states that general PP&E is any property, plant, and equipment used in providing goods and services.

⁷ Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant and Equipment*, was issued on May 8, 2003, and is effective for periods beginning after September 30, 2002.

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- DOD and its military services and units did not know how many Joint Service Lightweight Integrated Suit Technology (JSLIST)⁸—commonly referred to as “chem-bio suits”—they had, their condition, and where they were located.⁹ This lack of visibility was due to several factors, including the use of nonstandard, nonintegrated, stovepiped systems. Nonintegrated systems are unable to share data across business applications and therefore, multiple manual data entries must be made into numerous stand-alone systems, which result in errors, add significantly to administrative costs, and generally exacerbate asset visibility problems. The methods used to control and maintain visibility over JSLIST ranged from stand-alone automated systems, to spreadsheet applications, to pen and paper, to nothing at all. For JSLIST, the result was that DOD was excessing and selling these suits on the Internet for pennies on the dollar, while at the same time procuring hundreds of thousands of new garments annually. Similarly, a few years ago, the Defense Logistics Agency (DLA) had problems identifying and removing from its inventory defective Battle Dress Overgarments (BDO)—the JSLIST predecessor. As a result, some of the defective suits were shipped to U.S. forces in high-threat areas. In a June 2000 testimony, the DOD IG pointed out that a physical count of BDOs could not locate 420,000 protective suits that were recorded in DLA’s accountability database.

⁸ JSLIST is a universal, lightweight, two-piece garment (coat and trousers) that when combined with footwear, gloves, and protective mask and breathing device, forms the war fighter’s protective ensemble. Together the ensemble is to provide maximum protection to the war fighter against chemical and biological contaminants without negatively impacting the ability to perform mission tasks.

⁹ U.S. General Accounting Office, *DOD Management: Examples of Inefficient and Ineffective Business Processes*, GAO-02-873T (Washington, D.C.: June 25, 2002).

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- DOD lacked effective processes and controls to ensure that easily pilferable and sensitive items were properly recorded and safeguarded. For example, we found that the military services failed to record all of the pilferable and sensitive items acquired through purchase card transactions, including the Navy's failure to record a \$757,000 purchase comprised of 430 computers, 213 flat panel monitors, and other computer hardware and software.¹⁰ The Navy was unable to provide us with evidence confirming the location of 187 of those computers and 87 of the flat panel monitors. Similarly, in our recent review¹¹ of property controls at three military treatment facilities, we found that items such as a laptop computer, a Sony monitor, and a sterilizer were not recorded in the property records. We also found that numerous recorded items could not be located. Most of these were lower priced (under \$5,000) or pilferable items such as a personal digital assistant, a cellular telephone, computer monitors, color printers, a handheld radio, and various pieces of medical equipment such as a stretcher, electric beds, and intravenous pumps.

Environmental and Disposal Liabilities

Under federal, state, and international law, DOD faces a major funding requirement associated with environmental cleanup and disposal resulting from prior and current operations and from the production of weapons systems. In its fiscal year 2002 financial statements, DOD reported an estimated liability of \$59 billion to manage and clean up or contain a diverse population of environmental contamination comprised of

- \$22 billion for closed and open sites where past and current waste disposal practices, leaks, spills, and other activities have created a risk to public health or the environment;
- \$14 billion for closed, transferring, and active military ranges where contamination and unexploded ordnance create environmental hazards; and

¹⁰ U.S. General Accounting Office, *Purchase Cards: Navy Is Vulnerable to Fraud and Abuse but Is Taking Action to Resolve Control Weaknesses*, GAO-02-1041 (Washington, D.C.: Sept. 27, 2002).

¹¹ U.S. General Accounting Office, *Military Treatment Facilities: Internal Control Activities Need Improvement*, GAO-03-168 (Washington, D.C.: Oct. 25, 2002).

- \$23 billion for cleanup, demilitarization, and disposal of nuclear and non-nuclear weapons systems, chemical weapons, and munitions.

DOD's reported cost represents the current value of estimated future cash outlays that will need to be paid from appropriations; therefore, the Congress needs reliable information in order to plan how much and when to provide funding for cleanup activities. In past years, we and the DOD IG have repeatedly reported that the environmental liability amounts presented in DOD's financial statements were not reliable because the department did not have (1) sufficient guidance for identifying and categorizing cleanup activities whose costs must be included in the liability calculation, (2) complete inventories of the sites and weapons systems that will require cleanup or containment, and (3) valid cost estimating models that produce consistent and supportable liability estimates. These deficiencies were not systems related but rather resulted from inadequate policies and processes and a lack of leadership.

We have also issued individual reports on several environmental cleanup categories, including training ranges and on-going operations.¹² In those reports, we specifically cite weaknesses related to DOD's lack of complete site inventories, which means that the department's reported liability amount is likely understated. In line with our findings, the Air Force has recently confirmed that it is investigating possible radioactive waste buried at more than 80 former and current air bases around the country. According to the Air Force, it lost track of the waste burial sites because of poor record keeping and is now trying to identify and inspect the lands for safety concerns. Costs for cleaning up these sites are not currently included in the Air Force's reported liability amounts. In addition, incomplete identification of cleanup sites on installations that are currently being used by the military could have negative consequences for future base reutilization, alignment, and closure decisions.

**Budget and Cost
Information**

DOD's appropriation for fiscal year 2002 represented 18 percent of the total U.S. budget and 48 percent of discretionary funds. For fiscal year 2002, DOD reported disbursing \$347 billion to, among other things, make

¹² U.S. General Accounting Office, *Environmental Liabilities: DOD Training Range Cleanup Cost Estimates Are Likely Understated*, GAO-01-479 (Washington, D.C.: Apr. 11, 2001) and *Environmental Liabilities: Cleanup Costs From Certain DOD Operations Are Not Being Reported*, GAO-02-117 (Washington, D.C.: Dec. 14, 2001).

payments to 5.7 million military and civilian personnel and annuitants, process and pay 11.2 million contractor invoices, and make 7.3 million travel payments. The magnitude of the dollars and number of transactions involved makes it imperative that DOD maintain accurate fund balances and properly account for costs; however, DOD financial management systems and processes continue to be significant impediments to reporting complete and accurate information with respect to budgetary and disbursement activities.

Weaknesses in DOD's accounting for its funds include (1) the inability to reconcile its balances to Treasury's, a process similar in concept to individuals reconciling their checkbooks with their bank statements, (2) payment recording errors, including disbursements that are not properly matched to specific obligations recorded in the department's records, and (3) limited ability to track the use of funds appropriated for contingency purposes. For example,

- For fiscal year 2002, we found that DOD had at least \$7.5 billion in unexplained differences between Treasury and DOD fund activity records. Many of these differences represent disbursements made and reported to Treasury that had not yet been properly matched to obligations and recorded in DOD accounting records. In addition to these unreconciled amounts, DOD identified and reported an additional \$3.6 billion in payment recording errors. These include disbursements that DOD has specifically identified as containing erroneous or missing information and that cannot be properly recorded and charged against the correct, valid fund account. DOD records many of these payment problems in suspense accounts and made \$1.6 billion in unsupported adjustments to its fund balances at the end of fiscal year 2002 to account for a portion of these payment recording errors. These adjustments did not resolve the related errors.
- In June 2001, we reported that DOD's financial systems could not adequately track and report on whether the \$1.1 billion in earmarked funds that the Congress provided to DOD for spare parts and associated logistical support were actually used for their intended purpose.¹⁵ The vast majority of the funds—92 percent—were transferred to the military services operation and maintenance accounts. Once transferred, the

¹⁵ U.S. General Accounting Office, *Defense Inventory: Information on the Use of Spare Parts Funding Is Lacking*, GAO-01-472 (Washington, D.C.: June 11, 2001).

department could not separately track the use of the funds. As a result, DOD lost its ability to assure the Congress that the funds it received for spare parts purchases were used for, and only for, the designated purpose.

- In April 2003, we reported¹⁴ that DOD was not able to separately track Emergency Response Funds provided under appropriations in fiscal years 2002 and 2003 (\$20.5 billion). These funds were commingled in DOD's regular appropriations accounts with funds appropriated for other purposes. Because DOD's accounting system only captures data on total obligations and does not distinguish among original sources of funds, DOD is not able to identify those obligations that are funded from emergency response funds.
- In December 2000, we reported¹⁵ that our review of DOD functions that were studied over the past 5 years for potential outsourcing under OMB Circular A-76 showed that while DOD reported that savings had occurred as a result of these studies, we could not determine the precise amount of any such savings because the department lacked actual cost data. Further, in March 2002, we testified¹⁶ that while significant savings were being achieved, it has been difficult to determine the magnitude of those savings.

DOD's continuing inability to capture and report the full cost of its programs represents one of the most significant impediments facing the department. DOD does not have the systems and processes in place to capture the required cost information from the hundreds of millions of transactions it processes each year. Lacking complete and accurate overall life-cycle cost information for weapon systems impairs DOD's and congressional decision makers' ability to make fully informed judgments about which weapons, or how many, to buy. DOD has acknowledged that the lack of a cost accounting system is its largest impediment to controlling and managing weapon systems costs.

¹⁴ U.S. General Accounting Office, *Defense Budget: Tracking of Emergency Response Funds for the War on Terrorism*, GAO-03-346 (Washington, D.C.: Apr. 30, 2003).

¹⁵ U.S. General Accounting Office, *DOD Competitive Sourcing: Results of A-76 Studies Over the Past 5 Years*, GAO-01-20 (Washington, D.C.: Dec. 7, 2000).

¹⁶ U.S. General Accounting Office, *Competitive Sourcing: Challenges in Expanding A-76 Governmentwide*, GAO-02-498T (Washington, D.C.: Mar. 6, 2002).

An April 2001 report on the results of an independent study of DOD's financial operations commissioned by the Secretary of Defense concluded that DOD lacked the ability to routinely generate cost-based metrics to link financial management to DOD's goals.¹⁷ For example, DOD's reporting under the Government Performance and Results Act of 1993 (GPRA)¹⁸ often did not address the cost-based efficiency aspect of performance, making it difficult for DOD to fully assess the efficiency of its performance. DOD's most recent performance plan (fiscal year 2001) included 45 unclassified metrics but only a few of those contained efficiency measures based on costs.

Financial Management Systems

For fiscal year 2003, DOD estimated that it would spend approximately \$18 billion¹⁹ to operate, maintain, and develop business systems. Of that amount, \$5.2 billion relates directly to business systems and the remaining \$12.8 billion relates to the infrastructure that supports the systems. While funding system development and modernization activities is crucial, it is only part of the solution needed to improve DOD's current business systems and operating environment. Key ingredients to successful systems development and modernization include effective management and oversight of ongoing and planned investments.

However, in February 2003,²⁰ we reported that DOD had yet to establish the necessary departmental investment governance structure and process controls needed to adequately align ongoing investments with its architectural goals and direction. An effective governance structure should include

¹⁷ Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change* (Washington, D.C.: Apr. 13, 2001).

¹⁸ Government Performance and Results Act of 1993, Pub. L. 103-62, 107 Stat. 285, Aug. 3, 1993. Pertinent performance planning and reporting requirements have been codified, as amended, at 31 U.S.C. sections 1115 and 1116.

¹⁹ U.S. General Accounting Office, *DOD Business Systems Modernization: Continued Investment in Key Accounting Systems Needs to be Justified*, GAO-03-455 (Washington, D.C.: Mar. 28, 2003).

²⁰ U.S. General Accounting Office, *DOD Business Systems Modernization: Improvements to Enterprise Architecture Development and Implementation Efforts Needed*, GAO-03-458 (Washington, D.C.: Feb. 28, 2003).

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- a hierarchy of investment review boards composed of representatives from across the department who are assigned investment selection and control responsibilities based on project threshold criteria;
 - a standard set of investment review and decision-making criteria for use by all boards, including criteria to ensure compliance and consistency with its newly developed enterprise architecture or “blueprint for reform”; and
 - a specified, near term date by which ongoing investments have to be subject to this standard investment review process, and by which decisions should be made as to whether to proceed with each investment.

DOD’s lack of effective oversight and process controls over IT investments perpetuates the existence of an incompatible, duplicative, and overly costly systems environment, which undermines its ability to optimally support mission performance. For example,

- In March 2003, we reported²¹ that DOD did not effectively manage and oversee its planned investment of over \$1 billion in four Defense Finance and Accounting Service (DFAS) systems modernization efforts. DOD invested approximately \$316 million in these projects without first demonstrating that they would markedly improve the information needed for decision-making and financial reporting purposes. The DOD Comptroller terminated one of the four projects we reviewed after an investment of over \$126 million, citing poor program performance and increasing costs. Investments in the other three projects continue despite the absence of the requisite analyses of costs, benefits, and risks to demonstrate that the projects will produce value commensurate with the cost being incurred.
- In March 2002, the DOD IG reported that DOD’s Joint Total Asset Visibility Program (JTAV) system provided incomplete asset visibility to military commanders in chief (CINCs) and joint task force commanders.²² Required capabilities were not developed before the

²¹ GAO-03-465.

²² DOD Inspector General, *Information Technology: Effectiveness of the Joint Total Asset Visibility Program*; Audit Report D-2002-057 (Arlington, Va., Mar. 11, 2002).

program was placed into service, including asset and personnel visibility for the warfighter, accurate and timely source data, and data links to critical data in other DOD systems. As a result, CINCs and joint task force commanders did not have access, through the program, to all required data on the location, movement, status, and identity of military units, personnel, equipment, and supplies as intended.

- In June 2002, DOD reported²³ that shortcomings in existing nonintegrated personnel and pay systems caused delays in military payroll payments (some as much as 6 or more months after the event occurred) and resulted in errors (both under- and overpayments). DOD estimated that system input errors ranged from 5 to 15 percent and that these errors necessitated complex retroactive computations, data reconciliation and corrections, losses due to overpayments, debt processing, and costs to recoup overpayments.
- As of October 2002, DOD reported that its current business systems environment consisted of 1,731 systems and system acquisition projects (a number that has since risen to about 2,300 as DOD has identified additional systems). DOD reported that it had 374 systems to support civilian and military personnel matters, 335 systems to support finance and accounting functions, and 310 systems that produce information for management decision making.

As we have previously reported,²⁴ these numerous systems have evolved into the overly complex and error-prone operation that exists today, including (1) little standardization across DOD components, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, (4) manual data entry into multiple systems, and (5) a large number of data transactions and interfaces that combine to exacerbate the problems of data integrity. While the department recognizes the uncontrolled proliferation of systems and the need to eliminate as many systems as possible and to integrate and standardize those that remain, DOD components continue to receive and control their own IT investment funding.

²³ Department of Defense, *Report to Congress: Defense Integrated Military Human Resources System (Personnel and Pay)*, June 2002.

²⁴ U.S. General Accounting Office, *DOD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment*, GAO-02-784T (Washington, D.C.: June 4, 2002).

Weak Control Environment

Fundamental flaws in DOD's systems, processes, and overall control environment leave the department at risk of fraud, waste, and abuse. Over the past few years, we have reported numerous instances of breakdowns in—or lack of—internal control that have had serious economic and legal consequences for the department, including

- government travel card delinquency rates for the Army and the Navy that were nearly double those of federal civilian agencies;²⁵
- pervasive purchase and travel card control breakdowns that resulted in numerous instances of potentially fraudulent, improper, and abusive transactions and increased DOD's vulnerability to theft and misuse of government property;²⁶
- inadequate management and reporting on the funding associated with the Air Force's contracted depot maintenance that resulted in understating the dollar value of year-end carryover work by tens of millions of dollars;²⁷
- adjustments to DOD's closed appropriations that resulted in about \$615 million in adjustments that should not have been made, including \$146 million that was illegal;²⁸

²⁵ U.S. General Accounting Office, *Travel Cards: Control Weaknesses Leave Navy Vulnerable to Fraud and Abuse*, GAO-03-147 (Washington, D.C.: Dec. 23, 2002); *Air Force Management Has Reduced Delinquencies, but Improvements in Controls Are Needed*, GAO-03-298 (Washington, D.C.: Dec. 20, 2002); *Travel Cards: Control Weaknesses Leave Army Vulnerable to Potential Fraud and Abuse*, GAO-03-169 (Washington, D.C.: Oct. 11, 2002).

²⁶ U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave the Air Force Vulnerable to Fraud, Waste, and Abuse*, GAO-03-292 (Washington, D.C.: Dec. 20, 2002); *Purchase Cards: Navy Is Vulnerable to Fraud and Abuse but Is Taking Action to Resolve Control Weaknesses*, GAO-02-1041 (Washington, D.C.: Sept. 27, 2002); *Purchase Cards: Control Weaknesses Leave Army Vulnerable to Fraud, Waste, and Abuse*, GAO-02-732 (Washington, D.C.: June 27, 2002); *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-32 (Washington, D.C.: Nov. 30, 2001).

²⁷ U.S. General Accounting Office, *Air Force Depot Maintenance: Management Improvements Needed for Backlog of Funded Contract Maintenance Work*, GAO-02-623 (Washington, D.C.: June 20, 2002).

²⁸ U.S. General Accounting Office, *Canceled DOD Appropriations: \$615 Million of Illegal or Otherwise Improper Adjustments*, GAO-01-697 (Washington, D.C.: July 26, 2001).

- hundreds of millions of dollars of over- and underpayments to contractors,²⁹ and
- lost opportunities to collect millions of dollars of reimbursements for services performed in military treatment facilities because not all patients with third party insurance coverage were identified or because those insurers were not billed.

In general, DOD does not have the necessary control processes and procedures in place to identify problem situations like the ones listed above. However, DOD usually takes action to try to correct and then prevent these problems once they have been identified by auditors.

Underlying Causes of Financial and Related Business Process Reform Challenges

In the past, DOD initiated a number of departmentwide reform initiatives to improve its financial operations as well as other key business support processes. While these initiatives produced some incremental improvements, they did not result in the fundamental reform necessary to resolve these long-standing management challenges. For example, in 1989, DOD began the Corporate Information Management (CIM) initiative, which was expected to save billions of dollars by streamlining operations and implementing standard information systems across the department to support common business operations. DOD intended CIM to reform all of its functional areas—including finance, procurement, material management, and human resources—through the consolidation, standardization, and integration of its numerous, duplicative information systems. DOD spent billions of dollars on this initiative with little sound analytical justification. Rather than relying on a rigorous decision-making process for information technology investments, as used in leading private and public organizations we studied, DOD made systems decisions without (1) appropriately analyzing cost, benefits, and technical risks, (2) establishing realistic project schedules, or (3) considering how business process improvements could affect information technology investments. For one effort alone, DOD spent about \$700 million trying to develop and implement a single system for the material management business area—but this effort proved unsuccessful. After 8 years and about \$20 billion in

²⁹ U.S. General Accounting Office, *DOD Contract Management: Overpayments Continue and Management and Accounting Issues Remain*, GAO-02-835 (Washington, D.C.: May 30, 2002).

expenditures, DOD abandoned the CIM initiative. However, some of the conditions that led to its defeat remain today.

We first identified underlying causes for the department's inability to resolve its long-standing financial management problems, as well as the other areas of its operations most vulnerable to waste, fraud, abuse, and mismanagement, in our May 1997 testimony.³⁰ We have continued to highlight in various testimonies what we believe are the underlying reasons for the department's inability to fundamentally reform its business operations. There are four underlying causes:

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

Lack of Leadership and Accountability

Historically, DOD has not routinely assigned accountability for performance to specific organizations or individuals who have sufficient authority to accomplish desired goals. For example, under the Chief Financial Officers Act (CFO) of 1990,³¹ it is the responsibility of the agency CFO to establish the mission and vision for the agency's future financial management and to direct, manage, and provide oversight of financial management operations. However, at DOD, the Comptroller—who is by statute the department's CFO—has direct responsibility for only an estimated 20 percent of the data relied on to carry out the department's financial management operations. The other 80 percent comes from DOD's other business operations. In addition, DOD's past experience has suggested that top management has not had a proactive, consistent, and

³⁰U.S. General Accounting Office, *DOD High-Risk Areas: Eliminating Underlying Causes Will Avoid Billions of Dollars in Waste*, GAO/T-NSIAD/AIMD-97-143 (Washington, D.C.: May 1, 1997).

³¹Chief Financial Officers Act of 1990, Pub. L. 101-576, 104 Stat. 2842, Nov. 15, 1990 (codified as amended in scattered sections of 31 U.S.C.).

continuing role in building capacity, integrating daily operations for achieving performance goals, and creating incentives. Major improvement initiatives must have the direct, active support and involvement of the Secretary and Deputy Secretary of Defense to ensure that daily activities throughout the department remain focused on achieving shared, agencywide outcomes and success. Furthermore, sustaining top management commitment to performance goals is a particular challenge for DOD because the average 1.7-year tenure of the department's top political appointees has served to hinder long-term planning and follow-through. Based on our survey of best practices of world-class financial management organizations,³² strong executive leadership is essential to (1) making financial management an entitywide priority, (2) redefining the role of finance, (3) providing meaningful information to decision makers, and (4) building a team of people that delivers results.

Cultural Resistance and Parochialism

Cultural resistance to change, military service parochialism, and stovepiped operations have also played a significant role in impeding previous attempts to implement broad-based management reforms at DOD. The department has acknowledged that it confronts decades-old problems deeply grounded in the bureaucratic history and operating practices of a complex, multifaceted organization. For example, the effectiveness of the Defense Management Council, established in 1997 to help break down organizational stovepipes and overcome cultural resistance to change, was impaired because members were not able to put their individual military services' or DOD agencies' interests aside to focus on departmentwide approaches to long-standing problems.³³ DOD's stovepiped approach is most evident in its current financial management systems environment, which DOD recently estimated to include approximately 2,300 systems and system development projects—many of which were developed in piecemeal fashion and evolved to accommodate different organizations, each with its own policies and procedures.

³² U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: Apr. 1, 2000).

³³ U.S. General Accounting Office, *Defense Management: Actions Needed to Sustain Reform Initiatives and Achieve Greater Results*, GAO/NSIAD-00-72 (Washington, D.C.: July 25, 2000).

Unclear Goals and
Performance Measures

Lack of clear, linked goals and performance measures has handicapped DOD's past reform efforts. As a result, DOD managers lack straightforward road maps showing how their work contributes to attaining the department's strategic goals, and they risk operating autonomously rather than collectively. According to its fiscal year 2002 Performance and Accountability report, DOD is still in the process of developing measurable annual performance goals and objectives.

In our assessment of DOD's Fiscal Year 2000 Financial Management Improvement Plan³⁴—its most recent plan—we found that it presented the military services' and DOD components' individual improvement initiatives for reforming financial management but did not clearly articulate how their individual efforts would result in a collective, integrated DOD-wide approach to financial management improvement. In addition, the product did not include performance measures that could be used to assess DOD's progress in resolving its financial management problems. As a result, the product was more a compilation of a data call than a strategic plan. Furthermore, while DOD plans to invest billions of dollars in modernizing its financial management systems, it currently does not have effective management governance and controls in place to guide and direct these investments. We will discuss DOD's work to develop an initial business enterprise architecture later in our testimony.

Lack of Incentives for
Change

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

³⁴ U.S. General Accounting Office, *Financial Management: DOD Improvement Plan Needs Strategic Focus*, GAO-01-764 (Washington, D.C.: Aug. 15, 2001).

The lack of incentive has been most evident in the department's acquisition area. In DOD's culture, the success of a manager's career has depended more on moving programs and operations through the DOD process than on achieving better program outcomes. The fact that a given program may have cost more than estimated, taken longer to complete, and not generated results or performed as promised was secondary to fielding a new program. To effect real change, actions are needed to (1) break down parochialism and reward behaviors that meet DOD-wide and congressional goals, (2) develop incentives that motivate decision makers to initiate and implement efforts that are consistent with better program outcomes, including saying "no" or pulling the plug on a system or program that is failing, and (3) facilitate a congressional focus on results-oriented management, particularly with respect to resource-allocation decisions.

Keys to Fundamental Financial Management Reform and Progress to Date

Successful reform of DOD's fundamentally flawed financial management operations must simultaneously focus on its systems, processes, and people. While DOD has made some encouraging progress in addressing specific challenges, it is still in the very early stages of a departmentwide reform that will take many years to accomplish. As a result, it is not possible to predict when—or even whether—the effort will be successful.

Our experience has shown there are several key elements that collectively would enable the department to effectively address the underlying causes of its inability to resolve its long-standing financial management problems. For the most part, these elements, which should not be viewed as independent actions but rather a set of interrelated and interdependent actions, are consistent with those discussed in the department's April 2001 financial management transformation report.³⁵ These elements, which we believe are key to any successful approach to financial management reform, include

- addressing the department's financial management challenges as part of a comprehensive, integrated, DOD-wide business reform;
- providing for sustained leadership by the Secretary of Defense and resource control to implement needed financial management reforms;

³⁵Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change*, (Washington, D.C.: Apr. 13, 2001).

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- establishing clear lines of responsibility, authority, and accountability for such reform tied to the Secretary;
 - incorporating results-oriented performance measures and monitoring tied to financial management reforms;
 - providing appropriate incentives or consequences for action or inaction;
 - establishing and implementing an enterprise architecture to guide and direct financial management modernization investments; and
 - ensuring effective executive and congressional oversight and monitoring.

While DOD still has a long way to go, it has made serious efforts to address many of the key areas over the past 2 years. We will discuss each of the areas and provide examples of improvement actions—long-term and/or short-term—where relevant. Both long-term actions focused on the Secretary's envisioned business transformation and short-term actions focused on improvements within existing systems and processes are critical to forward movement.

Integrated Business Reform Strategy

As we previously reported,³⁶ establishing the right goal is essential for success. Central to effectively addressing DOD's financial management problems will be the recognition that they cannot be addressed in an isolated fashion separate from the other high-risk areas and management challenges facing the department. Further, successfully reforming the department's operations—which consist of people, business processes, and technology—will be critical if DOD is to effectively address the deep-rooted organizational emphasis on maintaining business-as-usual across the department. DOD has recently taken important steps to begin improving its people, processes, and systems.

We have reported³⁷ that many of DOD's financial management shortcomings were attributable in part to human capital issues. In April 2002, DOD published a departmentwide strategic plan for its civilian employees, which sets forth its vision to "design, develop and implement

³⁶ U.S. General Accounting Office, *Department of Defense: Progress in Financial Management Reform*, GAO/FAIMD/NSIAD-00-163 (Washington, D.C.: May 9, 2000).

human resources policies, strategies, systems, and tools to ensure a mission-ready civilian workforce that is motivated to excel.³⁵ Although a positive step, the plan needs further refinement to achieve the Secretary of Defense's transformation initiatives, including (1) integration of component-level plans with the department-level plan, (2) development of key elements, such as results-oriented performance measures, and (3) integration with military personnel planning and sourcing decisions.³⁶ Recently, DOD proposed a National Security Personnel System that would provide for wide-ranging changes in DOD's civilian personnel pay and performance management. While we strongly support the concept of modernizing and making more flexible federal human capital policies, we have warned that the appropriate infrastructure and adequate safeguards need to be in place for successful implementation and to prevent abuse.³⁷ In addition, in its fiscal year 2003 Defense Authorization Act, DOD sought and obtained authorization to prescribe certification and credential standards for its professional accounting positions and is currently drafting the relevant regulations. These are important steps in DOD's plans to develop a human capital investment strategy and plan.

The department recently renamed its Financial Management Modernization Program to the Business Management Modernization Program, a move that recognizes that financial management is a crosscutting issue that affects virtually all DOD business areas. For example, improving its financial management operations so that they can produce timely, reliable, and useful cost information is essential to effectively measure its progress towards achieving many key outcomes and goals across virtually the entire spectrum of DOD's business areas. At the same time, the department's financial management problems—and, most importantly, the keys to their resolution—are deeply rooted in and dependent upon developing solutions to a wide variety of management problems across DOD's various organizations and business areas. In line with this, DOD has designated

³⁵ U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-01-244 (Washington, D.C.: Jan. 1, 2001).

³⁶ U.S. General Accounting Office, *DOD Personnel: DOD Actions Needed to Strengthen Civilian Human Capital Strategic Planning and Integration with Military Personnel and Sourcing Decisions*, GAO-03-475 (Washington, D.C.: Mar. 28, 2003).

³⁷ U.S. General Accounting Office, *Human Capital: DOD's Civilian Personnel Strategic Management and the Proposed National Security Personnel System*, GAO-03-483T (Washington, D.C.: May 12, 2003).

owners of seven key department business lines,⁴⁰ or domains, to transform the department's business operations and implement its enterprise architecture.

As we mentioned earlier, and it deserves emphasis, the department has reported that an estimated 80 percent of the data needed for sound financial management comes not from the Comptroller's operations but from its other business operations, such as its acquisition and logistics communities. DOD's vast array of costly, nonintegrated, duplicative, and inefficient financial management systems reflects its lack of an integrated approach to addressing management challenges. DOD has acknowledged that one of the reasons for the lack of clarity in its reporting under the Government Performance and Results Act has been that most of the program outcomes the department is striving to achieve are interrelated, while its management systems are not integrated. In fact, DOD is redefining its performance metrics and program outcomes as they relate to four risk areas: (1) force management, (2) operations, (3) future challenges, and (4) institutional.

Secretary of Defense Rumsfeld recognized the far-reaching nature of DOD's financial management problems and, on September 10, 2001, he announced a broad, top-priority initiative intended to "transform the way the department works and what it works on." This new broad-based business transformation program incorporates a number of defense reform initiatives begun under previous administrations but also encompasses additional fundamental business reform proposals. However, like defense reform initiatives begun under the previous administration, the transformation program has not yet developed an overarching plan tying all the individual reform efforts together. The development of an overarching plan could take on increased importance, particularly where initiatives are interrelated and up-front investments are required.

DOD has already taken a number of actions under its business transformation program. In this context, the Secretary established a number of top-level councils, committees, and boards, including the Senior Executive Council, the Business Initiative Council, and the Defense

⁴⁰DOD's seven business process areas include: (1) acquisition/procurement, (2) finance, accounting operations, and financial management, (3) human resource management, (4) logistics, (5) strategic planning and budgeting, (6) installations and environment, and (7) technical infrastructure.

Business Practice Implementation Board. The Senior Executive Council was established to help guide efforts across the department to improve its business practices. This council—chaired by the Secretary of Defense, and with membership to include the Deputy Secretary, the military service secretaries, and the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L)—was established to function as the “board of directors” for the department. The Business Initiative Council—comprised of senior DOD and military service officials and headed by the Under Secretary of Defense for Acquisition, Technology and Logistics—was established to encourage the military services to explore new money-saving business practices to help offset funding requirements for transformation and other initiatives. The Defense Business Practice Implementation Board is an advisory board whose mission is to make recommendations to the Senior Executive Committee on strategies for implementing best business practices in matters relating to management, acquisition, production, logistics, personnel leadership, and the defense industrial base.

Our research of successful public and private sector organizations shows that such entities, comprised of enterprisewide executive leadership, provide valuable guidance and direction when pursuing integrated solutions to corporate problems. Inclusion of the department’s top leadership could help to break down the cultural barriers to change and result in an integrated DOD approach for business reform.

Sustained Leadership and Resource Control

The department’s successful Year 2000 effort illustrated, and our survey of leading financial management organizations⁴¹ captured, the importance of strong leadership from top management. As we have stated many times before, strong, sustained executive leadership is critical to changing a deeply rooted corporate culture—such as the existing “business-as-usual” culture at DOD—and to successfully implementing financial management reform. For example, in the case of the Year 2000 computer challenge, the personal, active involvement of the Deputy Secretary of Defense played a key role in building entitywide support and focus. Given the long-standing and deeply entrenched nature of the department’s financial management problems—combined with the numerous competing DOD organizations,

⁴¹ GAO/AIMD-00-134.

each operating with varying, often parochial views and incentives—such visible, sustained top-level leadership will be critical.

In discussing their April 2001 report to the Secretary of Defense on transforming financial management,⁴² the authors stated that, “unlike previous failed attempts to improve DOD’s financial practices, there is a new push by DOD leadership to make this issue a priority.” To demonstrate his commitment towards reforming the department, Secretary Rumsfeld designated improving financial management operations, which included not only finance and accounting but also such business areas as logistics, acquisition, and personnel management, as 1 of the department’s top 10 priorities for reform.⁴³ While the commitment of the Secretary is vital to the success of any DOD-wide reform effort, strong, sustained executive leadership—over a number of years and administrations—will be key to changing a deeply rooted culture and to truly transforming DOD’s business systems and operations so that the department can meet the mandate of the CFO Act and achieve the President’s Management Agenda goal of improved financial management performance.

Additionally, the tenure of the department’s top political appointees has generally been short in duration and as a result, it is sometimes difficult to maintain the focus and momentum that are needed to resolve the management challenges facing DOD. This is particularly evident with the postwar reconstruction of Iraq along with DOD’s substantial commitment to the continuing war on terrorism. The resolution of the array of interrelated business system management challenges that DOD faces is likely to span several administrations. As we have proposed in previous congressional testimonies,⁴⁴ one option to address the continuity issue would be the establishment of the position of chief operating or

⁴²Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change* (Washington, D.C.: Apr. 13, 2001).

⁴³The Secretary’s top ten priorities: successfully pursue the global war on terrorism, strengthen joint warfighting capabilities, transform the joint force, optimize intelligence capabilities, improve force Manning, new concepts of global engagement, counter the proliferation of weapons of mass destruction, homeland security, streamline DOD business processes, and improve interagency processes, focus, and integration.

⁴⁴U.S. General Accounting Office, *DOD Financial Management: Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform*, GAO-02-497T (Washington, D.C.: Mar. 6, 2002); U.S. General Accounting Office, *DOD Financial Management: Important Steps Underway But Reform Will Require a Long-term Commitment*, GAO-02-784T (Washington, D.C.: June 4, 2002).

management officer. This position could be filled by an individual appointed for a set term of 5 to 7 years with the potential for reappointment. Such an individual should have a proven track record as a business process change agent for large, diverse organizations—experience necessary to spearhead business process transformation across the department and serve as an integrator for business reform.

Clear Lines of Responsibility and Accountability

Another key to reform is the establishment of clear lines of responsibility, decision-making authority, and resource control for actions across the department tied to the Secretary. As we previously reported,⁴⁵ such an accountability structure should emanate from the highest levels and include the secretary of each of the military services as well as heads of the department's various major business areas.

The Secretary of Defense has taken action to vest responsibility and accountability for financial management modernization with the DOD Comptroller. In October 2001, the DOD Comptroller established the Financial Management Modernization Executive⁴⁶ and Steering Committees as the governing bodies that oversee the activities related to the modernization effort. The Executive Committee is to advise the DOD Comptroller on the modernization effort and provide strategic direction, whereas the Steering Committee is to advise the Executive Committee on the program's performance and provide guidance to the program management office.

Results-oriented Performance

As discussed in our January 2003 report on DOD's major performance and accountability challenges,⁴⁷ establishing a results orientation is another key element of any approach to reform. Such an orientation should draw upon results that could be achieved through commercial best practices, including outsourcing and shared servicing concepts. Personnel

⁴⁵ GAO/NSIAD-00-72 and GAO-03-458.

⁴⁶ Effective December 28, 2001, Sec. 1009 of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, Pub. L. No. 107-107, 115 Stat. 1012, 1206 (codified at 10 U.S.C. Sec. 185), required the Secretary of Defense to establish a Financial Management Modernization Executive Committee.

⁴⁷ U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-03-98 (Washington, D.C.: Jan. 1, 2003).

throughout the department must share the common goal of establishing financial management operations that not only produce financial statements that can withstand the test of an audit but more importantly, routinely generate useful, reliable, and timely financial information for day-to-day management purposes. To its credit, DOD has initiated a number of improvement actions to address accountability and financial information deficiencies.

- In its most recent performance and accountability report, DOD stated that it had (1) validated cost-estimating models used in calculating environmental liability costs, (2) developed a methodology for estimating liabilities associated with nuclear powered ships and submarines, and (3) issued improved guidance—for all areas except ongoing operations—to help components compile complete, accurate, and fully substantiated environmental liability data. In addition, DOD claimed that it is developing and maintaining supporting documentation and audit trails for 30,000 closed contamination sites, including open and closed installations and base reutilization and alignment sites.
- Through training and implementation of more efficient and effective processes, DOD is improving its fund accounting and disbursement activities. During fiscal year 2002, DOD improved its disbursement activity reporting and its procedures for reconciling its fund balance records with similar information maintained by the Department of Treasury. As a result, the number and amount of disbursement disparities between DOD's records and Treasury's records decreased from the previous year. DOD is taking the necessary first steps to identifying and eliminating payment recording problems.
- DOD's major components must now prepare quarterly financial statements along with extensive footnotes that explain any improper balances or significant variances from previous year quarterly statements. In addition, the midyear and end-of-year financial statements must be briefed to the DOD Comptroller by the service Assistant Secretary for Financial Management or the head of the defense agency. We have observed several of the midyear briefings and have noted that the practice of preparing and explaining interim financial statements is instilling discipline into DOD's financial reporting processes, which will help improve the reliability of DOD's financial data.

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- DOD has begun to develop methodologies for valuing and depreciating the cost of its weapons systems and other equipment used to support its military operations. The department completed a similar effort to obtain a baseline for the majority of its real property assets in fiscal year 1999. These valuation efforts represent important steps toward obtaining cost data for management decision making and financial reporting. However, in order for the department to reap the full benefits of these and similar efforts, it must develop and implement efficient and effective systems, processes, and controls—consistent with its enterprise architecture—to sustain the calculated baselines and capture subsequent additions, modifications, and deletions of property assets.

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

In the short term, it is important to focus on actions that can be taken using existing systems and processes. It is critical to establish interim measures to both track performance against the department's overall transformation goals and facilitate near-term successes using existing systems and processes. The department has established an initial set of metrics intended to evaluate financial performance and it has seen improvements. For example,

- With respect to closed appropriation accounts, during the first 6 months of fiscal year 2002, DOD reported a reduction in the dollar value of adjustments to closed appropriation accounts of about 80 percent from the same 6-month period in fiscal year 2001.
- For DOD individually billed travel cards, the delinquency rate dropped from 8.9 percent in March 2002 to 5.7 percent in March 2003.
- From March 2001 through March 2003, DOD reduced its commercial pay backlogs (payment delinquencies) by 46 percent and its payment recording errors by 43 percent.

While DOD's metrics show significant improvements from 2001 to today, statistics for the last few months show that progress has slowed or even taken a step backward for payment recording errors and commercial pay backlogs. Our report on DOD's metrics program⁴⁸ included a caution that, without modern integrated systems and the streamlined processes they engender, reported progress may not be sustainable if workload is increased. It could be that DOD is experiencing problems accounting for the additional volume of transactions resulting from contingency funding and increased appropriations amounts.

We note that DOD is still formulating departmentwide performance goals and measures to align with the outcomes described in its strategic plan—the September 2001 Quadrennial Defense Review. We agree with the department's efforts to expand the use of appropriate metrics to guide its financial management reform efforts. However, it is important for DOD to synchronize its development of these metrics with its efforts to develop departmentwide goals and measures, including nonfinancial metrics, to ensure consistency.

Incentives and Consequences

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

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

⁴⁸U.S. General Accounting Office, *Financial Management: DOD's Metrics Program Provides Focus for Improving Performance*, GAO-03-457 (Washington, D.C.: Mar. 28, 2003).

If people are to be held more accountable for achieving desired outcomes, then DOD must make sure that such outcomes are in fact, achievable. Along these lines, DOD has taken a positive step to reform its acquisition process by revising part of its acquisition regulations related to weapons systems. The revisions have focused primarily on (1) making sure technologies are demonstrated to a high level of maturity before beginning a weapon system program and (2) taking an evolutionary, or phased, approach to developing a system. Separating technology development from a weapons system development program would help curb incentives to over-promise the capabilities of a new weapon system and to rely on immature technologies. Also, an evolutionary approach to developing requirements and making improvements to a system's capabilities is different from the historical approach of trying to deliver all desired capabilities in one "big bang." In addition, it has been reported that DOD plans to begin using program cost estimates from the Office of the Secretary of Defense's Cost Analysis Improvement Group, rather than those prepared by the military services, which may lead to more realistic cost estimates when pricing programs.

Enterprise Architecture

Enterprise architecture development, implementation, and maintenance are a basic tenet of effective IT management. Used in concert with other IT management controls, an architecture can increase the chances for optimal mission performance. We have found that attempting to modernize operations and systems without an architecture leads to operational and systems duplication, lack of integration, and unnecessary expense. Our best practices research of successful public and private sector organizations has similarly identified enterprise architectures as essential to effective business and technology transformation.⁴⁹

Following our May 2001 report,⁵⁰ the Secretary of Defense directed the development and implementation of a departmentwide enterprise architecture, and established a program to accomplish this. In doing so, the Secretary assigned responsibility for the program to the DOD

⁴⁹U.S. General Accounting Office, *Executive Guide: Improving Mission Performance through Strategic Information Management and Technology*, GAO/AIMD-94-115 (Washington, D.C.: May 1, 1994).

⁵⁰U.S. General Accounting Office, *Information Technology: Architecture Needed to Guide Modernization of DOD's Financial Operations*, GAO-01-525 (Washington, D.C.: May 17, 2001).

Comptroller, in coordination with the Under Secretary of Defense for AT&L and the DOD Chief Information Officer. To assist in overseeing and guiding the program, the DOD Comptroller established the Financial Management Modernization Executive Committee to oversee the architecture and systems modernization efforts, and the Financial Management Modernization Steering Committee to advise and guide the program. Efforts began in earnest in April 2002 when DOD hired a contractor to develop the department's enterprise architecture.

The Clinger-Cohen Act of 1996⁵¹ requires major departments and agencies to develop, implement, and maintain an integrated architecture. As we previously reported,⁵² such an architecture can help ensure that the department invests only in integrated business system solutions and, conversely, will help move resources away from non-value-added legacy business systems and nonintegrated business system development efforts. Without a complete enterprise architecture to guide information technology investments, and adequate oversight of IT investments to ensure compliance, DOD runs the serious risk that its investments will perpetuate the existing systems environment that suffers from systems duplication, limited interoperability, and unnecessarily costly operations and maintenance.

The fiscal year 2003 National Defense Authorization Act (the Act),⁵³ enacted on December 2, 2002, required DOD to develop by May 1, 2003, a financial management enterprise architecture and a transition plan for implementing the architecture that meet certain requirements. The Act also requires DOD to control expenditures for financial system improvements while the architecture and transition plan are being developed and after they are completed. According to DOD, the Comptroller approved the initial version of the department's business enterprise architecture in May 2003. Developing and implementing a business enterprise architecture for an organization as large and complex as DOD is a formidable challenge but it is key to achieving the Secretary's vision of relevant, reliable, and timely financial information needed to

⁵¹Clinger-Cohen Act of 1996, Pub. L. 104-106, Div. E, 110 Stat. 679, Feb. 10, 1996 (codified as amended at scattered sections of the U.S.C.).

⁵²GAO/T-AIMD/NSIAD-00-163.

⁵³Bob Stump National Defense Authorization Act for Fiscal Year 2003, Pub. L. 107-314, Sec. 1004, 116 Stat. 2458, 2629, Dec. 2, 2002.

support the department's vast operations. We plan to report on DOD's progress in developing its architecture and its transition efforts in the near future.

As part of its ongoing business system modernization effort and consistent with our past recommendations,⁵⁴ DOD is creating a repository of information about its existing systems environment. To accomplish this, DOD initiated an extensive effort to document its business systems currently relied upon to carry out financial management operations throughout the department. To date, the department has identified approximately 2,300 systems that support its business operations. In developing its systems inventory, DOD has recognized that financial management is broader than just accounting and finance systems. Rather, it includes the department's acquisition, budget formulation, inventory management, logistics, personnel, and property management systems.

DOD is investing billions of dollars in financial management solutions and business process reform. In moving forward with the implementation of its business enterprise architecture, DOD needs to ensure that the multitude of systems efforts currently underway are designed as an integral part of the architecture. The effort to implement the architecture will be further complicated as the department strives to develop multiple architectures across its various business areas and organizational components. In this regard, it is critical that DOD has the management structure and processes in place to effectively control the estimated \$19 billion that will be spent on its business systems in fiscal year 2004. However, as we have previously reported,⁵⁵ the department has yet to establish the requisite investment governance structure and process controls needed to adequately align ongoing investments with its architectural goals and direction. To its credit, the department has recognized that it cannot continue with the proliferation of duplicative, nonstandard, and nonintegrated systems and is in the process of developing policies and procedures to obtain better visibility and accountability over its IT business system investments. A key to success will be DOD's ability to effectively manage and oversee its investments in systems. DOD can ill afford to invest billions of dollars in

⁵⁴ U.S. General Accounting Office, *Financial Management: Analysis of DOD's Inventory of Financial Management Systems Is Incomplete*, GAO/AMD-97-39 (Washington, D.C.: Jan. 28, 1997); *Financial Management: DOD Improvement Plan Needs Strategic Focus*, GAO-01-764 (Washington, D.C.: Aug. 17, 2001).

⁵⁵ GAO-03-458.

systems that are not capable of providing DOD management and the Congress with more accurate, timely, and reliable information on the results of the department's business operations.

Monitoring and Oversight

Ensuring effective monitoring and oversight of progress will also be key to bringing about effective implementation of the department's financial management and related business process reform. We have previously testified⁵⁹ that periodic reporting of status information to department top management, the Office of Management and Budget, the Congress, and the audit community is another key lesson learned from the department's successful effort to address its Year 2000 challenge.

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

In conclusion, we support Secretary Rumsfeld's vision for transforming the department's financial and business related operations. The continued leadership and support of the Secretary and other DOD top executives will be essential to successfully change the DOD culture that has over time perpetuated the status quo and been resistant to a transformation of the magnitude envisioned by the Secretary. As noted throughout this testimony, DOD is taking steps to begin transformation; however, the

⁵⁹ GAO-01-244.

events of September 11, 2001, the continuing war on terrorism, and the reconstruction of Iraq may dilute the focused attention and sustained action that are necessary to fully realize the Secretary's transformation goal, a situation that is understandable given the circumstances. At the same time, with waste and inefficiencies potentially costing \$20 billion or more annually, true reform is needed to restore public confidence that taxpayer dollars are well spent in meeting our national defense objectives.

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

Contacts and Acknowledgments

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Mr. PLATTS. Mr. Lanzillotta.

Mr. LANZILLOTTA. Thank you Mr. Chairman and members of the committee. I am pleased to be here to discuss financial management in the Department of Defense and the progress that the Department is making.

The overarching challenge facing us is to reform DOD business processes and systems. The size of the Department makes this a challenge of magnitude that has never been attempted in the private sector. Our challenge requires not only an overhaul of those processes and systems but a cultural change for the people using them.

Our success will be measured by efficiently providing DOD decisionmakers with timely, accurate, and reliable information. To accomplish these reforms, we must facilitate the integration and streamlining and modernization of the DOD business functions, transform the Department's business processes and fulfill all financial management laws, standards and requirements.

Currently DOD's business processes and financial management systems are not able to meet this challenge. The primary reason is that those processes and systems were not designed to meet today's requirements and the volume of transactions. In the past, each major DOD organization was allowed to design and manage its own systems without having to integrate it into a DOD-wide architecture. This created a stove-piped support structure that was inefficient and unresponsive to leaders' needs.

Clearly the Department of Defense needs much more than a marginal change to set things right. The solution is a long-term, comprehensive reform of its financial management and business processes.

The Department of Defense has undertaken such a comprehensive overhaul of its business practices and financial management. The overhaul will also enable us to meet all business management requirements, including a clean audit opinion on our financial statements.

To achieve our business management goals, our strategy is to take the lessons learned from the warfighters and integrate them into our business practices. We plan to use a DOD-wide architecture to describe standard business and financial rules; employ a DOD-wide oversight process directed by senior leaders to implement the architecture and to guide spending; refine and extend the architecture to create a seamless connection between it and other Federal and DOD transformation initiatives; and in the near term, address the critical financial problems, notably financial reporting.

The Department's Business Management Modernization Program was developed to overhaul our business management. The blueprint for this overhaul will be our Business Enterprise Architecture which we recently made public.

In developing our Business Enterprise Architecture, the Department and IBM experts applied over 160 business and technology practices used successfully in industry organizations. The architecture is a function of the technical requirements for design in the integrating of DOD business practices. It will provide a road map to reduce our 2,000 plus systems to a much smaller number of integrated, compatible systems.

What is the difference from previous approaches for reform is that the Department has created what we term domains. Under seven domains or business lines, we have grouped our major business processes. These domains define and illustrate the scope of our Business Management Modernization Program. The domains are Logistics; Acquisition/Procurement; Installations and Environment; Human Resources; Accounting and Financial Management; Strategic Planning and Budgeting; and Technical Infrastructure.

The domain leaders will implement the architecture by re-engineering business processes and developing a systems solution that is consistent with the Enterprise Architecture. In this way, leaders who are expert in each domain will reengineer the way the Department does business and formulate business improvements.

These domain leaders and staff are excited about the plan. Just today I opened the conference for domain owners to explain the responsibilities, and there were over 400 people in attendance. This governance process was designed to build, buy, and at the same time make the Department's experts available for this project. The DOD senior leadership has developed a strong governance process to guide the implementation and the refinement of the Business Management Modernization Program and the Business Enterprise Architecture. Our governance process will ensure that all improvements are fully supportable for our long-term goal for a cohesive business management across the entire Department. It will also guide our investment in information systems and technologies.

The overhaul being advanced by the Business Management Modernization Program promises to greatly improve the Department's financial reporting. But we cannot put off fixing the Department's financial reporting until BMMP is fully implemented. We must achieve clean opinions on the DOD financial statements as soon as possible.

As the senior official directly responsible for financial reporting, the Under Secretary Defense (Comptroller) Dr. Dov Zackheim is intensely involved in improving financial management statements. Of special note, he has directed each of the major DOD reporting entities to prepare a comprehensive plan of how it can achieve a favorable audit opinion in 2004. The Controller's leadership is being briefed on each agency's and components' financial statements on a quarterly basis. From these quarterly briefs, lessons are learned and provided to other components and agencies. An example would be the establishment of audit committees. That involved not only members of the Comptroller staff and Defense Finance and Accounting Service, but the Inspector General as well.

The Department is making improvements in management outside the focus of this hearing, and I would like to list a few. Last year we overhauled the management of the government charge cards. We clarified and strengthened policies and increased oversight to prevent abuse and made other changes to ensure that the charge card programs will be a source of government savings and not an opportunity for abuse.

The Department is changing its budgeting process to increase our focus on program performance and results. We are developing an increase in the use of performance metrics to measure the programs' effectiveness and have moved to an internal 2-year budget-

ing cycle requiring us to formulate a completely new budget only every other year. This will enable an off-year focus on budget execution and program performance. We are continuing our adherence to realistic budgeting.

We are continuing our reengineering of our processes. As an example, the Department is seeking statutory authority to transfer the field Personnel Security Investigation function to the Office of Personnel Management, which would make it a central provider of these services to the Federal Government. This would eliminate redundancies and other inefficiencies.

In closing, I want to assure this committee that the Department of Defense is advancing as rapidly as possible in its bold agenda for overhauling the DOD financial management and business processes. We have partnered with GAO, the IG, OMB, and other Federal agencies to address our goal. Our ultimate aim is to streamline integrate and modernize business management systems that fully and efficiently meet the needs of the DOD decisionmakers and all financial management requirements.

Transformation of its business management is one of Secretary Rumsfeld's top priorities for the Department of Defense, and we are confident of success. Thank you Mr. Chairman, and I am prepared to take your questions.

Mr. PLATTS. Thank you Mr. Lanzillotta.

[The prepared statement of Mr. Lanzillotta follows:]

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HOUSE COMMITTEE ON
GOVERNMENT REFORM

STATEMENT OF

Larry J. Lanzillotta

**Principal Deputy Under Secretary of Defense (Comptroller)
And Deputy Under Secretary of Defense
for Management Reform**

BEFORE THE

**House Committee on Government Reform
Subcommittee on Government Efficiency and
Financial Management**

25 June 2003

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HOUSE COMMITTEE ON
GOVERNMENT REFORM

Statement of Larry J. Lanzillotta
Principal Deputy Under Secretary of Defense (Comptroller) and
Deputy Under Secretary of Defense for Management Reform
Before the House Committee on Government Reform
Subcommittee on Government Efficiency and Financial Management
25 June 2003

Mr. Chairman, members of the Committee, I am pleased to be here to discuss financial management in the Department of Defense (DoD).

The Department of Defense faces substantial financial management challenges. Over the past two years, we have made dramatic progress in overcoming these challenges. But complete success will take years, not months. And we will need to continue to make additional near-term investments before realizing long-term savings.

DoD Financial Management (FM) Challenges and Causes

The overarching challenge facing us is to reform DoD business processes and systems. That will require both an overhaul of those processes and systems and a cultural change for the people using them. For success, our reformed processes and systems must:

- Efficiently provide DoD decisionmakers with timely, accurate, and reliable information.
- Facilitate integration, streamlining, and modernization of all DoD business functions.
- Lead the Department in transforming how it does business.
- Fulfill all financial management laws, standards, and requirements.

Why are DoD business processes and financial management systems not able to meet this challenge? The primary reason is that those processes and systems were not designed to meet today's requirements. In the past, each major DoD organization was allowed to design and manage its own systems without having to integrate into a DoD-wide architecture. This created a stove-piped support structure that was inefficient and unresponsive to leaders' needs. Additionally, until recently DoD financial management has been focused almost exclusively on accounting for annual budget appropriations, not producing clean financial statements and other requirements.

Clearly the Department of Defense needs much more than marginal changes to set things right. The solution is the long-term, comprehensive reform of its financial management and business processes.

Reforming DoD Financial Management and Business Processes

The Department of Defense has undertaken just such a comprehensive overhaul of its business processes and financial management. The main goal is to streamline processes and integrate systems to enable DoD decisionmakers to get timely and accurate information to make

the best allocation of defense resources and people. The overhaul also will enable us to meet all business management requirements including clean audit opinions on DoD financial statements.

To achieve our business management goals, our strategy is to:

- 1) Use a DoD-wide architecture to prescribe standard business and financial rules.
- 2) Employ a DoD-wide oversight process, directed by DoD senior leaders, to implement the architecture and to guide DoD spending.
- 3) Refine and extend the architecture to create a seamless connection between it and other Federal and DoD transformation initiatives.
- 4) In the near-term, address critical financial problems – notably DoD financial reporting.

Business Management Modernization Program (BMMP)

The Department's Business Management Modernization Program was developed to overhaul DoD business management. The blueprint for this overhaul will be our Business Enterprise Architecture (BEA), which we recently made public.

In developing the BEA, DoD and IBM experts applied over 160 business and technology practices used by successful industry organizations. The Architecture is a compilation of functional and technical requirements for defining and integrating DoD business processes. It will provide the roadmap to reduce our 2000+ systems to a much smaller number of integrated, compatible systems.

What is different from previous approaches for reform is that the Department has created what we term domains. Under seven domains or business lines, we have grouped all our major business processes. These domains define and illustrate the scope of the Business Management Modernization Program. The domains are Logistics; Acquisition/Procurement; Installations and Environment; Human Resources; Accounting and Financial Management; Strategic Planning and Budgeting; and Technical Infrastructure.

Domain leaders will implement the architecture by reengineering business processes and developing a systems solution that is consistent with the Enterprise Architecture. In this way, leaders who are experts in each domain will reengineer the way the Department does business and formulate business improvements.

The DoD senior leadership has developed a strong governance process to guide implementation and refinement of the Business Management Modernization Program and Business Enterprise Architecture. Our governance process will ensure that all improvements fully support our long-term goal for cohesive business management across the entire Department. It also will guide investments in information systems and technologies.

Accomplishments and Progress in Improving Financial Reporting

The overhaul being advanced by the Business Management Modernization Program promises to greatly improve the Department's financial reporting. But we cannot put off fixing DoD financial reporting until BMMP is fully implemented. We must achieve clean audit opinions on DoD financial statements as soon as possible.

We recognize that DoD is critical to the success of financial reporting for the entire federal government. Financial reporting also is critical because they will help decision-makers get timely and accurate information and analysis. Secretary Rumsfeld and his senior leadership is squarely behind the improvement of DoD financial reporting.

As the senior official directly responsible for financial reporting, Under Secretary of Defense (Comptroller) Dov Zakheim is intensely involved in improving financial statements. Of special note, he has directed each of the major DoD reporting entities to prepare a comprehensive plan for how it can achieve a favorable audit opinion in 2004. Our Comptroller leadership also is receiving periodic briefings on our progress.

Specific accomplishments. In his April 8 testimony before this subcommittee, Comptroller General David Walker noted that DoD is unable to comply with applicable financial reporting requirements in six areas. Here is an update on our progress in those six areas:

- 1) Plant, Property, and Equipment (PP&E). We have a major initiative to accurately report the value of PP&E with a goal of a qualified opinion in 2004.
- 2) Inventory and operating materials and supplies. We are phasing in a methodology that will accurately report the value of our inventory over the next several years.
- 3) Environmental liabilities. Auditors are validating our improvements, and we expect favorable audit results in 2004.
- 4) Military retirement health care liability. We expect a favorable opinion on new Medicare Eligible Retiree Health Benefits Fund.
- 5) Intragovernmental eliminations. We are participating in a pilot project that will implement the government-wide standard rules internally prior to a government-wide pilot in 2004.
- 6) Cost accounting. We are exploring possibilities for capturing and using existing data elements to meet this requirement prior to pilot programs associated with the long-term solution.

We have had other accomplishments as well. We have reduced Problem Disbursements over 80% over the past few years. This means we are matching our disbursements with valid obligations in our accounting records. We believe that this is no longer a material weakness for the Department's financial reporting. Additionally, we have asked auditors to perform an assessment of the Fund Balance With Treasury account to determine if it is ready for audit.

While making these improvements, we have accelerated the reporting schedule in accordance with the OMB guidance. We plan to submit the FY 2003 financial statements forty days ahead of the required January 31, 2004 due date.

Overall, we are addressing DoD's financial reporting problems on a very broad front – and we are not waiting for the long-term to arrive before we put solutions in place. The Department has achieved clean audit opinions on four of its reporting entities. These clean opinions represent approximately 26% of our assets and 50% of our liabilities. Other entities with clean opinions on the horizon will bring us to over 90% of our liabilities supported by a clean opinion.

Other DoD Management Improvements

The Department of Defense is making improvements in management areas outside the focus of this hearing.

Last year we overhauled DoD management of its government charge cards. We clarified and strengthened policies, increased oversight to prevent abuses, and made other changes to ensure that charge card programs will be a source of government savings, not an opportunity for abuse.

The Department is changing its budgeting process to increase our focus on program performance and results. We are developing and increasing the use of performance metrics to measure a program's effectiveness. And we have moved to a 2-year internal budget cycle, requiring us to formulate a complete new budget only every other year. This will enable an off-year focus on budget execution and program performance.

We are continuing our adherence to realistic budgeting. All pieces of the DoD budget must be based on sound cost projections. For acquisition programs, realistic budgeting is key to sustaining stable funding, which is essential to having efficient, cost-effective defense acquisition.

We are continuing studies of 226,000 DoD positions to determine which public or private organization can best provide the functions of those positions. Once the results of the studies are implemented, savings for FY 2006-2009 would likely exceed \$300 million.

DoD is seeking statutory authority to transfer the Personnel Security Investigation function to the Office of Personnel Management, which would make it the central provider of these services for the federal government. This would eliminate redundancy and other inefficiencies.

The Defense Logistics Agency will divest its Document Automation and Production Service, finance various logistics studies from within available resources, and demolish obsolete fuel facilities. The Defense Contract Audit Agency will conduct a pilot test for outsourcing its audit workload.

We are working to achieve savings by pooling and bundling unused cell phone minutes by organization, installation, or regional level. This initiative now has been broadened to encourage users to obtain flexible cell phone plans that are tailored to their needs and most cost effective.

We are advancing the use of several efficient means for outsourcing non-core DoD functions to the private sector. Such means include direct service contracts and the commercial cost comparison option permitted by the Federal Acquisition Regulation. One example: One DoD organization outsourced its desktop computer services by defining them as a new requirement, then negotiating with the private sector for the efficient delivery of those services.

For DoD contracts, we are looking to convert from paper-based to web-enabled process. This would speed up processing, make payments more timely and thus reduce penalties against DoD, and save operating costs.

Closing

In closing I want to assure this committee that the Department of Defense is advancing as rapidly as possible its bold agenda for overhauling DoD financial management and business processes. Our ultimate aim is a streamlined, integrated, and modernized business management system that fully and efficiently meets the needs of DoD decisionmakers and all financial management requirements. Short-term, we are making strong progress toward achieving unqualified audit opinions on its financial statements and making a broad range of management improvements.

Transformation of its business management is a top priority of the Department of Defense, and we are confident of success. Thank you.

Mr. PLATTS. Mr. Granetto.

Mr. GRANETTO. Mr. Chairman and members of the committee, I want to thank you for the opportunity to appear before the committee today and to address your questions concerning the Department's financial management.

I am pleased to report that the Department has undertaken the ambitious task of overhauling its financial management systems and business processes. Nevertheless, the current financial statements remain generally unreliable. For fiscal year 2002, we again issued a disclaimer of opinion for the Department of Defense agency-wide financial statements. Serious deficiencies continue to exist, particularly with the quality of data, adequacy of the reporting systems and the reliability of internal controls. We also issued a disclaimer of opinion on all but one of the major reporting entities. As in past years, we issued an unqualified or a clean opinion for the Military Retirement Funds financial statements.

Data reliability, integrity, timeliness and auditability continue to impede our ability to render an opinion on the financial statements. The Department has readily acknowledged that many of its financial management and feeder systems simply do not produce accurate enough data to support some material amounts on the financial statements. Although the annual audit opinions may continue to attract more attention than other individual audit reports, the Department's progress in addressing the specific findings and recommendations of those individual reports will be an extremely critical factor in determining how much financial management improvement actually occurs.

Section 1008 of the National Defense Authorization Act for fiscal year 2002 directed our office to perform only the minimum audit procedures required by auditing standards, provided management acknowledges the financial statements are unreliable. We agree with the rationale behind Section 1008, and we have complied with those requirements in performing our audits of the fiscal year 2002 Departmental financial statements.

Generally, the financial management weaknesses acknowledged by management were of such a magnitude that they simply required us to limit our audit work and issue disclaimers. However, these known weaknesses may represent only the tip of the iceberg. To mitigate the risk of new weaknesses surfacing during the financial statement audits, we have encouraged departmental management to rigorously and thoroughly review the impact of corrective actions before asserting that the statements are ready.

On September 18, 2002, the U.S. Army Corps of Engineers, Civil Works management represented that their fiscal year 2002 financial statements would be fairly presented in all material aspects. After the audit began, the Corps and we realized that audit-ready evidential matter was simply not available for our review. As a result, we issued a disclaimer of opinion in January 2003. We are continuing extensive financial audit work in the Army Corps of Engineers, Civil Works, and we are finding additional problem areas. The Corps is, however, taking very aggressive action to correct those problems when they are identified.

However, the Corps audit has demonstrated the magnitude of the effort required to perform comprehensive audits in nondepart-

mental entities. In supporting our disclaimer of opinion on the balance sheet for the Corps, I used 120 auditors to perform that audit. Since the Corps is one of the smaller departmental entities, additional auditors will be needed to audit larger components. The current initiative by the Comptroller in establishing the Department of Defense Business Management Modernization Program Office supports the course mandated by Section 1008 of the fiscal year 2002 National Defense Authorization Act.

We believe that the effort to establish Comprehensive Business Systems Architecture is a necessary and very long-overdue step. There are however undeniable risks. Implementation of the architecture could take much longer than anticipated. The cost to implement the architecture might be prohibitive and the Department may simply lack the discipline to make system program managers conform to the architecture over an extended period of time.

In addition to the effort to upgrade its financial systems, the Department faces challenges related to accelerated reporting requirements, the new requirements to include military equipment on the financial statements and implementing numerous open recommendations from prior audits.

Like other Federal entities, the Department is faced with the challenge of submitting the fiscal year 2004 audited financial statements by November 15, 2004. The accelerated reporting deadline has very vividly emphasized the already evident need for systems that can produce reliable information on a real-time basis.

One new challenge, specific to fiscal year 2003, is the requirement to report military equipment on the primary financial statements. The Department currently estimates that more than \$1.1 trillion, minus depreciation, will need to be added to the financial statements. DOD will need to emphasize the development and implementation of a robust framework for tracking and valuing military equipment as it returns to the Department's financial statements.

During the past 5 years, we have issued more than 115 financial audit reports with almost 600 recommendations. About one-third of those recommendations are still open while management completes corrective action. The financial reporting process will be significantly impacted by the OMB's new accelerated reporting deadline, by the Department's very energetic effort to overhaul its systems and business processes and by the very significant efforts made by the Comptroller and his staff to fully engage all parties including GAO, OMB and my own office in full and open dialog on the Department's problems in achieving a favorable audit opinion.

The Comptroller is the Department's Chief Financial Officer, and his staff have a very refreshing attitude and open door policy to the Office of Inspector General. We both realize that the lack of a favorable opinion on the Department's financial statements is the major impediment to the U.S. Government receiving an unqualified opinion on its annual financial statements. Without compromising our status as the independent auditor, the Inspector General, at the request of the Comptroller, is actively participating in discussions with senior leadership within the Department and the government on ways to help the Department achieve a favorable audit opinion.

The Inspector General has also recently reorganized my financial auditing operations in order to better facilitate our responses to the Department's increased emphasis on financial auditing and achieving favorable audit opinions. I now report directly to the new Deputy Inspector General for Auditing.

For budgetary purposes, we have recently analyzed the size, scope and potential costs of comprehensive audits of the Department's financial statements once they become reliable. We considered various mixes of government and public accounting resources. Comptroller staff is currently evaluating this information but conclusions have not been finalized on how best to support our long-term strategy.

Concurrent with our development of a long-term audit strategy, the Comptroller, as Mr. Lanzillotta has mentioned, requested the military departments and DLA to develop an estimate of resources required to correct existing deficiencies in order to achieve a qualified audit opinion on the fiscal year 2004 financial statements. These plans generally conclude that it is neither cost effective nor practical to invest the resources necessary to obtain a favorable audit opinion by fiscal year 2004. We are evaluating the results of those plans. But we generally accept the conclusion that it may be impractical to expect a favorable audit opinion in the very near future for the financial statements of the major departmental components.

The Comptroller and our office plan to develop a coordinated approach to addressing the challenges that impede an audit of the Department's financial statements. Regardless of the approach, we will need additional audit resources as the Department begins to improve its systems and processes and certifies that various financial statement line items and components are ready for comprehensive audits.

We believe that strong leadership is the key element to successful financial management reform. The Department must continue to improve its systems, processes and internal controls in order to ensure that financial information is accurately recorded and reported. We are fully committed to meeting the challenges ahead. Thank you for considering our views. This concludes my testimony.

Mr. PLATTS. Thank you Mr. Granetto.

[The prepared statement of Mr. Granetto follows:]

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Statement
of
Paul J. Granetto, Director
Defense Financial Auditing Service
Office of the
Inspector General
Department of Defense
to the
Subcommittee on Government Efficiency
and Financial Management
House Government Reform Committee
On
Defense Financial Management

Not to be released before
2:30 p.m.
June 25, 2003

Department of Defense
Office of the Inspector General

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to provide the views of the Office of the Inspector General of the Department of Defense on financial management, which continues to rank as one of the Department's most difficult management improvement challenges. I would like to begin by noting the fundamental fiduciary responsibility of the Department of Defense, which is to manage assets purchased with taxpayer dollars effectively and efficiently. The American taxpayer should expect no less than that: Article I, Section 9 of the Constitution stipulates that: "a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." Accordingly, the Chief Financial Officers Act, as amended, describes the Inspector General's responsibility for auditing the financial statements of the Department of Defense.

The importance of reliable financial information is reiterated by recent military actions in Afghanistan and Iraq. Decision-makers responsible for planning military actions need reliable financial information so that they can prudently manage available resources and allocate dollars to those processes that yield maximum support for the war fighters. I am pleased to report to you today that the Department of Defense has undertaken an ambitious task to overhaul its financial management systems and business processes. However, current financial statements remain generally unreliable.

Opinions on Financial Statements for FY 2002

In terms of audit opinions, I wish we could report more significant progress in achieving a favorable audit opinion for the Department. For FY 2002, we again issued a disclaimer of opinion for the Department of Defense Agency-Wide Financial Statements because serious deficiencies continue to exist related to the quality of data, adequacy of

reporting systems, and reliability of internal controls. We also issued a disclaimer of opinion on all but one of the major reporting entities. As in past years, we issued an unqualified (clean) opinion for the Military Retirement Fund's financial statements. We continue to support the Senate Select Committee on Intelligence's objective to improve financial reporting within the intelligence community. Unfortunately, we found that the National Security Agency, Defense Intelligence Agency, and the National Imagery and Mapping Agency continued to produce unreliable financial statements because they lack compliant accounting systems, did not devote adequate resources to financial operations, and had not implemented prior audit recommendations. (Attachment 1 shows the reporting entities for 2002 and the number of financial statements required for each reporting entity.) Four other Department of Defense agencies¹ whose funds are not large enough to require separate reporting to the Office of Management and Budget have received unqualified opinions from independent public accounting firms. That is a positive sign, but the impact of these statements is minimal on the Department of Defense Agency-Wide Financial Statements because the balances are not significant.

Internal Control Deficiencies

Data reliability, integrity, timeliness and auditability continue to impede our ability to render an opinion on the financial statements. The Department has readily acknowledged that many of its financial management and feeder systems do not produce adequate data to support various material amounts on the financial statements. We reported the following material control deficiencies in our audit report for the FY 2002 Department of Defense Agency-Wide Financial Statements:

¹Defense Contract Audit Agency, Defense Commissary Agency, Defense Finance and Accounting Service, and the Defense Threat Reduction Agency

- **Financial Management Systems.** As a result of the Department-wide deficiencies in financial systems and business practices, the Department is unable to collect and report financial performance information that is timely, accurate, and reliable.
- **Intragovernmental Eliminations and Other Accounting Entries.** Most intragovernmental transactions cannot be reconciled. Therefore, related adjustments cannot be verified. Also, the Department continues to record material amounts of unsupported accounting entries as they prepare their financial statements for audit.
- **Fund Balance with Treasury and Problem Disbursements.** A significant dollar value of disbursements is not accurately reported. Uncleared differences exist between cash transactions reported by the Department and the Treasury Department's records. Also, disbursements are not properly matched to specific obligations in accounting systems.
- **Military Retirement Health Care Liabilities.** The quality of direct care data in the military health care system affected the accuracy of the unfunded liability.
- **Environmental Liabilities.** The Department has difficulty estimating the environmental liabilities because of problems with guidance, audit trails, estimating models, and site inventories.
- **General Property, Plant and Equipment.** The value of General Property, Plant, and Equipment is not reliably reported due to lack of supporting documentation.
- **Government-Furnished Material and Contractor Acquired Material.** The value of Defense property and material in the possession of contractors is not reliably reported.
- **Inventory.** The existing inventory valuation method does not produce an auditable approximation of historical cost because the associated gains and losses cannot be accurately tracked to specific items or purchases.

- Operating Material and Supplies. The Department's systems were designed to expense materials when purchased rather than when consumed, which causes the true value of this inventory account to be unknown.
- Statement of Net Cost. The Statement of Net Cost is presented by appropriation categories that cannot be aligned with the major goals and outputs described in the Department's strategic plan and performance measures.
- Statement of Financing. The Department cannot reconcile budgetary obligations to net cost without making adjustments.

Other Recent Audit Results

Although the annual audit opinions may continue to attract more attention than other individual audit reports, the Department's progress in addressing the specific findings and recommendations of individual reports will be a critical factor in determining how much financial management improvement actually occurs. The following examples show the variety of financial management challenges that the Department faces.

--When the Defense Finance and Accounting Service began taking steps to close down their old contract disbursing system (MOCAS), nearly 4,000 old contracts with unpaid invoices surfaced. The unpaid invoices totaled approximately \$97 million. Some contracts were improperly funded from cancelled appropriations. Various Defense entities had not identified funding to make payments, and prompt payment penalties were accruing. The Department needed to find current funding to pay the invoices so that the contracts could be closed. (Report D-2002-076)

--Since July 2002, the Inspector General issued 13 reports in support of the Federal Information Security Management Act, which requires Government-wide, cost-effective policies for security of Federal information systems. Eight of the reports discussed financial systems. We found a variety of security-related problems in these audits. For example, In December 2002, we reported that the Defense Finance and Accounting Service had not fully implemented information security controls for a system used by the Military Departments. The numerous material weaknesses indicated that controls were not in place to detect or prevent unrestricted access or fraudulent payments. The weak controls led to at least \$500 thousand of fraudulent payments in the past 6 years. Management was awaiting implementation of a new system to correct control weaknesses; however, implementation had been delayed. Management agreed to correct the weaknesses when we brought the problems to their attention. (Report D-2003-035)

--A series of three OIG audits identified hundreds of millions of dollars of deferred maintenance not identified and reported on the financial statements. The Military Departments were not consistently and accurately compiling deferred maintenance information on weapons systems. Also, the Military Departments did not collect information on all maintenance actions funded by the Operation and Maintenance appropriation, did not perform a required reconciliation between deferred maintenance information and budget documentation, and did not collect information on deferred maintenance incurred on support ships. (Reports D-2003-030, D-2003-054, D-2003-058)

--In two audits discussing Navy assets, we reported significant misstatements: The Navy materially misstated inventory by about \$500 million because its revaluation methodology was incorrect. (Report D-2003-039) The Navy also

incorrectly classified \$6.9 billion in principal end items as operating materials and supplies that would be used in normal operations. (Report D-2003-020)

Congressional Guidance

Section 1008 of the National Defense Authorization Act for FY 2002 directed the Office of the Inspector General of the Department of Defense, when auditing the year-end financial statements, to perform only the minimum audit procedures required by auditing standards when management acknowledges the financial statements are unreliable. We have long advocated that resources should not be expended to conduct costly audits to produce a disclaimer of opinion at year-end.

We agree with the rationale behind Section 1008 and we have complied with those requirements in performing our audits of the FY 2002 Department of Defense-Wide Financial Statements and 6 of the other required reporting entities. We were able to efficiently plan limited audit procedures commensurate with management representations that we received from the Office of the Under Secretary of Defense (Comptroller) and Military Departments. The Military Retirement Fund and U.S. Army Corps of Engineers, Civil Works management represented their financial statements were fairly presented and we initiated a full scope audit.

Generally the financial management weaknesses acknowledged by management were of such a magnitude that they enabled us to limit our audit work and issue disclaimers. However, those known weaknesses may represent the tip of the iceberg. We recognize, and have advised Department of Defense management, that additional weaknesses may be identified in the future when we initiate detailed financial statement audit work in response to management's improved representations. To mitigate the risks

of new weaknesses surfacing during the financial statement audits, we have encouraged Department of Defense management to rigorously and thoroughly review the impact of corrective actions.

U. S. Army Corps of Engineers

On September 18, 2002, the U.S. Army Corps of Engineers, Civil Works management represented that their FY 2002 financial statements would be fairly presented in all material respects and in accordance with Generally Accepted Accounting Principles. After initiating our audit effort, the Corps realized that audit-ready evidential matter was not readily available for our review, and as a result we issued a disclaimer of opinion in January 2003. We are continuing extensive financial audit work in the Army Corps of Engineers, Civil Works, and we are finding additional problem areas. The Army Corps of Engineers is taking aggressive actions to correct problems as they are identified.

The audit of the U.S. Army Corps of Engineers, Civil Works has demonstrated the magnitude of the effort required to perform comprehensive audits on Department of Defense entities. In supporting our disclaimer of opinion on the Balance Sheet, 120 auditors were involved in performing audit work. Additional auditors will be needed to audit larger components. For example, the U.S. Army Corps of Engineers, Civil Works reported \$43 billion in assets and \$12 billion in Budgetary Resources. However, the Army General Fund reported more than \$90 billion in assets and \$112 billion in Budgetary Resources. The Office of the Inspector General will require additional audit resources as other Department of Defense components assert that previously reported

problems have been corrected and data supporting the financial statements is auditable and reliable.

Business Management Modernization Program

The Department of Defense has numerous business systems performing a myriad of tasks. These systems are often characterized by multiple systems performing the same tasks, the same data stored in multiple systems, manual data entry and reentry into multiple systems, and extensive data translations. These characteristics limit data integrity and require extensive efforts by management to compile financial statements. The current initiative by the Office of the Under Secretary of Defense (Comptroller) in establishing the Department of Defense Business Management Modernization Program Office supports the course mandated by Section 1008 to correct system weaknesses prior to expending significant efforts to compile and audit the Department's financial statements. On April 30, 2003, the Business Management Modernization Program delivered the initial Business Enterprise Architecture (Architecture), which is currently in the implementation phase. The Architecture is essentially a blueprint describing the Department's future financial management systems and processes. The blueprint and its associated transition plan will be the basis for financial reform in the Department. Full implementation of the Architecture will allow the Department to comply with Federal accounting and financial management reporting requirements, especially those mandated by the Federal Financial Management Improvement Act of 1996. The Architecture also provides an approach that leads to the integration of budget, accounting, and program information and systems. We believe that the effort to establish a comprehensive business systems architecture is a necessary and long overdue step. The General Accounting

Office is evaluating the architecture as required by the FY 2003 National Defense Authorization Act.

In preparation for the Architecture, the Business Management Modernization Program was required to compile a Department of Defense business systems inventory. On May 9, 2003, the Business Management Modernization Program reported an inventory of 2,274 business systems. However, this inventory still may not be complete and the Under Secretary of Defense (Comptroller) will need to continue to work with the Assistant Secretary of Defense for Networks Information Integration to develop a single source for business systems information to enhance implementation of the Architecture.

There are undeniable risks—implementation of the Architecture could take much longer than anticipated, the cost to implement the architecture might be prohibitively expensive, and the Department may lack the discipline to make system program managers conform to the architecture over an extended period of time. The Department has taken a major step forward by accepting the premise that the business management improvement effort needs to be treated as a program, with all of the appropriate controls required of a very large program. Those include a master plan, well-defined management accountability, full visibility in the budget, regular performance reporting, and comprehensive audit coverage. Until the Department installs its new financial management architecture and integrated systems, it must rely on work-arounds and manual compilations of financial data that are prone to errors. We believe that the Department of Defense is making a good faith effort to create a strong management structure for the systems improvement effort. We look forward to assisting the Department in this endeavor.

Additional Challenges

In addition to the need for comprehensive financial systems to enable the Department to achieve audit opinions on the financial statements, the Department faces additional challenges related to accelerated reporting requirements, the new requirement to include military equipment on the financial statements, and implementing numerous open recommendations from prior audits.

Like other Federal entities, the Department of Defense is faced with the challenge of submitting the FY 2004 audited financial statements to the Office of Management and Budget by November 15, 2004. The Department has voluntarily taken action to accelerate the reporting schedule for FY 2003 and anticipates transmitting the FY 2003 audited financial statements to the Office of Management and Budget by December 19, 2003. Both the Department and the Inspector General have initiated joint planning tools and communication channels to better synchronize our efforts toward producing and auditing the financial statements. However, the impact of the accelerated reporting deadline has vividly emphasized the already evident need for systems that can produce reliable information on a real time basis.

One new challenge specific to FY 2003 is the requirement to report Military Equipment on the primary financial statements. In 1998, the Federal Accounting Standards Advisory Board directed that all military equipment be removed from the Department's Balance Sheet. Under a new accounting standard issued by the Federal Accounting Standards Advisory Board, the Department now must value and report Military Equipment as property on the Balance Sheet. The Department of Defense has struggled with developing policy and processes to track and value this equipment;

however, Military Equipment represents a significant portion of assets on the Balance Sheet. The Department currently estimates that more than \$1.1 trillion (less depreciation) will need to be added to the FY 2003 financial statements. Therefore, DoD will need to emphasize, as a priority, the development and implementation of a robust framework for tracking and valuing Military Equipment as it returns to the Department's financial statements.

During the past 5 years, we have issued more than 115 financial audit reports with almost 600 recommendations. About one-third of these recommendations are still open while management completes corrective action. These recommendations have covered a large number of problems relating to systems and process and control weaknesses within the Defense Finance and Accounting Service, the Military Departments, and various Defense agencies.

Strategy for Audited Financial Statements.

The financial reporting process will be significantly impacted by accelerated reporting requirements directed by the Office of Management and Budget, by the Department's energetic effort to overhaul its systems and business processes, and by the significant efforts made by the Under Secretary of Defense (Comptroller) and his staff to fully engage all parties including the Office of Management and Budget, the General Accounting Office, and the Office of the Inspector General in full and open dialogue on the Department's problems in achieving a favorable audit opinion.

This Winter, the Honorable David Walker, Comptroller General of the United States; the Honorable Mark Everson, then Deputy Director for Management of the Office of Management and Budget; the Honorable Dov Zakheim, Under Secretary of Defense

(Comptroller); and the Honorable Joseph Schmitz, Inspector General of the Department of Defense, all met to jointly agree on a strategy to accelerate the financial management improvement efforts in the Department. This cooperative effort is unprecedented in the history of the Department.

I would like to mention that the Under Secretary of Defense (Comptroller), as the Department's Chief Financial Officer, and his staff have a refreshing and unique open door policy to the Office of the Inspector General. The Office of the Inspector General, along with the Under Secretary of Defense (Comptroller), realize that the lack of a favorable opinion on the Department of Defense financial statements is a major impediment to the U.S. Government receiving an unqualified opinion on its annual financial statements. Without compromising our status as the independent auditor, the Inspector General, at the request of the Under Secretary of Defense (Comptroller), is actively participating in discussions with senior leadership within the Department and within the Government on ways to help the Department achieve a favorable audit opinion. Additionally, we now participate in joint quarterly reviews of the Department's financial statements with the Under Secretary of Defense (Comptroller) and senior financial managers of the Military Departments to identify material issues that impact the quality of the Department's financial reporting process.

The Inspector General has recently reorganized our financial auditing operations in order to better facilitate the increased emphasis on financial auditing and achieving favorable opinions on the various financial statements within the Department. The need to increase the level of professionalism of the audit staff was recognized and steps were initiated to encourage and fund the achievement of professional certifications and

advanced degrees. In addition, we are able to rapidly change priorities and audit efforts in order to respond to management assertions that financial data is ready for audit. For example, last year the U.S. Army Corps of Engineers provided us with a management representation that their Civil Works financial statements were reliable, fairly stated, and ready for audit. In support of the request, we quickly responded to the challenge by suspending numerous on-going projects and assigning 120 auditors (the majority of my staff) to verify the validity of management's representation.

For budgetary purposes, we recently analyzed the size, scope, and potential costs of comprehensive audits of Department of Defense financial statements when the Department represents that the statements are reliable. We considered various mixes of Government and public accounting resources. The Office of the Under Secretary of Defense (Comptroller) is currently evaluating this information, and conclusions have not been finalized.

Concurrent with our development of a long-term audit strategy, in February 2003, the Under Secretary of Defense (Comptroller) requested the Military Departments and the Defense Logistics Agency to develop an estimate of resources required to correct existing deficiencies in order to achieve a qualified audit opinion (rather than a disclaimer opinion) of the FY 2004 financial statements. Prior to the request, only the Army had prepared a long-term strategic plan to correct impediments to achieving a favorable opinion. The Army refined its plan and the other components prepared plans showing that, because of existing system deficiencies, large amounts of human and financial capital would be needed to ensure accounting records would be in a condition for a comprehensive audit of the FY 2004 financial statements. The plans generally conclude

that it is neither cost-effective nor practical to invest the resources necessary to obtain a favorable audit opinion by FY 2004. We are evaluating the results of these plans, and we generally accept their conclusions that it may be impractical to expect a favorable audit opinion on the FY 2004 financial statements of the major Department of Defense components. However, these plans are beneficial because they identify problems that need to be corrected, and will aid the Department in developing a methodical rationale for investing resources to correct the identified problems. The Under Secretary of Defense (Comptroller) and our office plan to develop a coordinated approach to addressing the challenges that impede an audit of the Department's financial statements.

These studies by the Military Departments and our estimates of the resources required for comprehensive audits of the financial statements for Department of Defense components have highlighted the challenges that we all face, and have given a new sense of urgency to solving long-standing financial accounting problems within the Department. We believe that these plans will provide a critical road map towards improvement and a means for measuring progress. However, regardless of the approach, we will need additional audit resources as the Department begins to improve its systems and processes and certifies that various financial statement line items and Components are ready for comprehensive audits.

Conclusion

As part of the effort to move forward and improve those systems and business processes, the Department's leadership has provided increased access and cooperation to

the Office of the Inspector General during the financial statement preparation and audit process. We especially want to thank the Under Secretary of Defense (Comptroller) and his staff for their relentless pursuit of the strategies needed to expedite the correction of long-standing problems preventing the Department from receiving a favorable audit opinion. This strong leadership is the key element to successful financial management reform. Our only concern is whether the Department's commitment can be sustained over the long road to successful completion of the numerous ongoing initiatives.

We are now fully committed to meet the challenges ahead. The Department must continue to improve its systems, processes, and internal controls necessary to ensure that financial information is accurately recorded and reported.

Thank you for considering the views of the Office of the Inspector General on financial management within the Department of Defense. This concludes my testimony.

ATTACHMENT 1

Required Financial Statement Audits. The Chief Financial Officers Act, the Government Management Reform Act Public Law 103-356, and Office of Management and Budget Bulletin 01-09, "Form and Content of Agency Financial Statements," require the Department of Defense and 23 other Federal agencies to prepare agency-wide financial statements in accordance with Generally Accepted Accounting Principles. The financial statements must cover all accounts and associated activities of each agency. The Department of Defense Agency-wide financial statements provide the financial status of the entire Department. Within the Department, there are ten OMB required reporting entities that, while included in the Department of Defense Agency-wide statements, prepare separate stand-alone financial statements.

FY 2003 Reporting Requirements

REPORTING ENTITIES	NUMBER OF STATEMENTS
Agency -Wide	6
Army General Fund	5
Army Working Capital Fund	5
Navy General Fund	5
Navy Working Capital Fund	5
Air Force General Fund	5
Air Force Working Capital Fund	5
Military Retirement Fund	5
U.S. Army Corps of Engineers, Civil Works	5
Medicare Eligible Retiree Health Care Fund*	5
TOTAL REQUIRED BY OMB	51
National Security Agency**	5
Defense Intelligence Agency**	5
National Imagery and Mapping Agency**	5
Total	66

* New Reporting Requirement effective in FY 2003

** The Senate Select Committee on Intelligence in Committee Report 107-63 directed audits of the form and content of the financial statements. The Committee further directed that these intelligence agencies receive an annual audit of their financial statements beginning in FY 2004.

Each reporting entity prepares the following five financial statements.

- Balance Sheet
- Statement of Budgetary Resources
- Statement of Net Cost
- Statement of Changes in Net Position
- Statement of Financing

The annual financial statements also include an Overview, Notes to the Principal Statements, and Required Supplemental and Other Accompanying Information, as appropriate.

In addition to the reporting entities required by the Office of Management and Budget shown in the table above, the remaining accounts of the Department are reported in two columns of the consolidating balance sheet for the Department of Defense Agency-wide financial statements. The two columns present the accounts of:

Other Defense Organizations-General Fund
Other Defense Organizations-Working Capital Fund

Included in the Other Defense Organizations are approximately 38 Defense agencies, field activities, trust funds, and other funds administered by the Office of the Secretary of Defense. The Under Secretary of Defense (Comptroller) requires an additional nine of these Other Defense Organizations to prepare stand-alone financial statements:

- Defense Advanced Research Projects Agency
- Defense Commissary Agency
- Defense Contract Audit Agency
- Defense Finance and Accounting Service
- Defense Information Systems Agency
- Defense Logistics Agency
- Defense Security Service
- Defense Threat Reduction Agency
- Missile Defense Agency

Statement of Custodial Activity. The DoD Agency-wide financial statements also include a Statement of Custodial Activity that includes deposits by foreign governments and disbursements in their behalf.

Attachment 2

Audit Reports		
Report Number	Report Title	Report Date
D-2003-091 (Secret)	"Reliability of the FY 2002 National Security Agency Financial Statements and Adequacy of Related Procedures and Control"	May 14, 2003
D-2003-074 (Secret)	"Reliability of the FY 2002 Defense Intelligence Agency Financial Statements and Adequacy of Related Procedures and Control"	April 7, 2003
D-2003-073 (Secret)	"Reliability of the FY 2002 National Imagery and Mapping Agency Financial Statements and Adequacy of Related Procedures and Control"	April 2, 2003
D-2003-067	"Audit of Recoveries of Prior-Year Obligations"	March 21, 2003
D-2003-058	"Financial Reporting of Deferred Maintenance Information on Navy Weapon Systems for FY 2002"	March 6, 2003
D-2003-054	"Financial Reporting of Deferred Maintenance Information on Army Weapons Systems for FY 2002"	February 3, 2003
D-2003-050	"Independent Auditor's Report on the Department of Defense Fiscal Year 2002 Agency-Wide Principal Financial Statements"	January 15, 2003
D-2003-047	"Independent Auditor's Report on the Army General Fund Fiscal Year 2002 Principal Financial Statements"	January 8, 2003
D-2003-046	"Independent Auditor's Report on the Army Working Capital Fund Fiscal Year 2002 Principal Financial Statements"	January 8, 2003
D-2003-045	"Independent Auditor's Report on the Department of the Navy Working Capital Fund Fiscal Year 2002 Principal Financial Statements"	January 7, 2003

D-2003-044	"Independent Auditor's Report on the Navy General Fund Fiscal Year 2002 Principal Financial Statements"	January 7, 2003
D-2003-043	"Independent Auditor's Report on the U.S. Army Corps of Engineers, Civil Works, Fiscal Year 2002 Principal Financial Statements"	January 6, 2003
D-2003-042	"Independent Auditor's Report on the Air Force Working Capital Fund Fiscal Year 2002 Principal Financial Statements"	January 6, 2003
D-2003-041	"Independent Auditor's Report on the Air Force General Funds Fiscal Year 2002 Principal Financial Statements"	January 6, 2003
D-2003-039	"Naval Supply Systems Command Revaluation of Inventory to Latest Acquisition Cost"	December 31, 2002
D-2003-035 (FOUO)	"The Integrated Automated Travel System Information Security Program"	December 16, 2002
D-2003-030	"Financial Reporting of Deferred Maintenance Information on Air Force Weapons Systems for FY 2002"	November 27, 2002
D-2003-020	"Naval Air Systems Command Financial Reporting of Non-Ammunition Operating Material and Supplies for FY 2002"	November 8, 2002
D-2002-076	"Funding Invoices to Expedite the Closure of Contracts Before Transitioning to a New DoD Payment System"	March 29, 2002

Mr. PLATTS. We will now proceed to questions. Mr. Towns is going to try to come back. He had to run off for a meeting, and hopefully be able to come back for some questions.

Mr. Lanzillotta, I would like to start with a more broad question to you. In your testimony both written and here today, you talk about the comprehensive approach you're taking, and you state what is different this time around than in the past. You touched on the seven domain areas where you are crossing services and looking at acquisition, all charges under the Department or whatever the domain area in question is, and that would be a different approach. And my question is when we look back at the history, and we have had testimony here today about the savings that we can achieve in billions of dollars. We have had testimony about how much has been spent time and time again over the last 15 to 20 years, specifically the effort in the late 80's, early 90's, the Corporate Information Management System. And in GAO's report they talk about an 8-year effort, \$20 billion. And I am going to read the language of the GAO report where they talk about one of the focuses of that report was implementing standard information systems across the Department to support common business operations. DOD intended CIM to reform all of its functional areas, including finance, procurement, material management, human resources. That sounds very much—functional areas—domain, sounds very similar to what we're talking about now. Why should this committee, or the taxpayers have more confidence this time around that we are not going to be 8 years from now with billions more dollars spent and be in the same situation where we don't have—we are not any closer to a clean audit.

Mr. LANZILLOTTA. Thank you Mr. Chairman.

I believe one of the major differences between this effort and some of the past efforts and the CIM effort that you made reference to, the CIM effort was a much more centralized, controlled approach where all the money was held in one office and everybody had to go back and get that approved. It wasn't really a cross-domain effort. It wasn't an effort where the entire Department was involved. It was definitely an office that had control of that program. And I believe why other past efforts have failed is because they have gone to that same area. Each of the services have stove-piped their area, and they have tried to fix it in their domains, and they didn't worry about what happens when it left that area, that domain, that service.

All the witnesses, I think, have mentioned the fact that the Department of Defense and the huge effort it has. It has a huge effort because of the diversity and size of the transactions we have to accomplish.

I believe this approach is fundamentally different because we are not trying to stove-pipe. This is trying to bring in all the different areas, all the different business lines into one comprehensive approach. We are not trying to get an office that controls all the funding, but we have created the seven domains or business lines for them to review the funding and make recommendations to a central committee that will then implement it in the budget request one way or the other.

I believe that the only way that this program will succeed where the others have failed is because we do have senior level participation at all levels, and we have transparency; people see what we do and we have participation. All the services are involved. When I talked about the 400 people that came to the domain owners, I think currently on the project we have 275 people, 75 of those are government. They are not all Comptroller people. They are from the Army, Navy, Marines defense agencies. They are all coming together. The Departments are coming together to accomplish that.

I would say in summary, the difference is it is more of a broader approach, it is more inclusive, and I do believe we have senior level management and oversight watching this program.

Mr. PLATTS. Certainly having people throughout all Departments, agencies within DOD, buying in is going to be critical to the success. The example of kicking off the efforts with the 400 employees is a good effort of having that buy-in and that empowerment. What authority for that work, for that cross-service effort to work, and to really be by business line, there is going to have to be some authority or cross service for those business lines. And can you share some of the authority that these individuals responsible for these domain areas are going to have to actually have uniformity occur and have those changes occur across the service lines.

Mr. LANZILLOTTA. All authority to this program, of course, generates from the Secretary. And he has made my boss, Dr. Dov Zackheim, responsible for getting this program off the ground. The authority for the domain owners, which I think goes back to your original question, we are developing a set of responsibilities as a guideline for running the domains or at least the domain owner will know what those responsibilities are. We are also developing criteria for which they can judge programs and investment. What we plan to do with the domain owners is give them a box or set of responsibilities and requirements to get accomplished and then let that domain owner who is a functional expert in that area go ahead and carry out that project. The domain owner for that area has the ultimate responsibility. It has been delegated to him or her to make that happen. I believe that the use of domains is going to be a significant advantage for the department in trying to institute this new architecture.

Mr. PLATTS. My understanding is that the domain owners will be delegated the authority basically from the Secretary, to go in and say to Army, Navy, Air Force, on acquisition you are to go do X, Y and Z to have a more uniformed effort to bring everybody onto the same page and everybody in line; that they will be able to have that authority across the services.

Mr. LANZILLOTTA. They will have that authority across the services and defense agencies, but we like to refer to it more on the activity that they are accomplishing, a supply activity. We want them to look at the supply activity and how the supply activity should be reengineered and accomplished and then they say this is best practice. And then everybody else's has to fall into line. We don't expect the domain owner to go into each of the services and go over and reengineer their practice. We expect them to reengineer the activity or the process, and then the service will have to have the re-

sponsibility of making it compliant to that requirement or that set of requirements that the domain owner has put forth.

Mr. PLATTS. If the service doesn't followup, I mean the domain owner is responsible for that change, but is not the one actually implementing it, you know, what are the consequences for that service not following that model that has now been identified?

Mr. LANZILLOTTA. Another advantage we have with this program is the Comptroller has teamed up with the Department's Chief Information Officer, and we manage this program together. We, and the Comptroller are the traffic cops through the budgeting process. When the domain owner comes over there and does a review of a system and tells us that certain systems ought to be turned off or certain systems ought to be funded and they bring it up to the steering group and it gets approved then we implement that in the budget process. So we will either take the money away from the services for systems they say need to be turned off on a schedule that they give us, or we will approve the funding for a new system that the domain owner has said, I reviewed this system, and it's compliant and it meets our requirements for standard business process, and also it has been reengineered and whatever the requirement would be.

Mr. PLATTS. Sounds like that would go toward the GAO's recommendation that the incentives or consequences has to be part of your program to truly have everyone buy in. If they don't follow what's identified, there is going to be a consequence, and there are incentives to buy in and make it their best effort.

Mr. LANZILLOTTA. I think it is a little different task than what Mr. Kutz would give you. But I think if—we do have a huge budget in the Department of Defense but we also have a huge requirement that goes along with that budget. And I always believe—I always tell people, they say they have a \$12 million budget and they have a small unfunded requirement, but it is a small budget. We have a big budget and we have big requirements that are driven by such things as Iraq. The incentive is if they find the money in the savings, then they can keep that money to plow it back into their program. If we have to go find it then we take it. So the incentive is to find the business process, find the savings and reengineer the business process before we get to it, because if we get to it, then it's gone.

The other thing that we have is an incentive that private industry doesn't have, we have a mission. And I think if you go in your own district and talk to some of your people, they really feel that the mission of their accomplishment is their job satisfaction. It's what they feel that they need to do. They feel that it has priority. They feel it is satisfying and they feel that they do important work. And they do important work. And this helps them accomplish that. So their incentive although it is not like private industry which equates to money, this is what they get and surprisingly enough for most, that's enough.

Mr. PLATTS. I appreciate your answers regarding the differences now than in the past in trying to be comprehensive in your approach.

Let me ask and I will start with you, Mr. Lanzillotta, and then involve Mr. Kutz and Mr. Granetto on this issue. We heard testi-

mony regarding the push to get a clean audit or at least a qualified opinion for the 2004 fiscal year. And while we are certainly anxious for DOD to get to that point, as I stated in my opening, it's not just getting to a clean audit that maybe through heroic efforts that we get there, but that we actually have a change in process and are able to maintain that process of clean audits. And my question would be, Mr. Lanzillotta, if you do push forward and as I understand that DOD wants to get at least a qualified opinion for the 2004 year, do you think it's realistically going to be sustainable in 2005, and 2006 based on what it will take to get it in 2004?

Mr. LANZILLOTTA. Dr. Zackheim and others in the senior leadership have put forth that we won't do anything that is just going to give us that one time help. I think the original plans that the services costed out, it would take \$1.8 billion from the services to try to correct fiscal year 2004 problems and another \$500 million to the IG to get the auditing assets to make that work. Then you have to do that again in 2005 and do it again in 2006 and have to continue to do that. That doesn't make economic sense for us to try to do that. We are much more following the belief that what we need to do is something that is sustainable and go for the long-term solution and fix it. That doesn't mean that in areas where there are not systems problems like their processes or procedures, that we can't make progress, because we are making progress on environmental liability and several areas that I think will be close to audit in 2004. I believe for the taxpayers money, what we have to do is look for the long-term solution that occurs every year instead of trying to make a heroic effort in 1 year and then have to repeat that every year just to get a clean opinion.

Mr. PLATTS. And I would agree. I think it defeats the purpose of the efforts of getting a true financial process in place that is going to negate the need for that annual effort. Do I take from your answer that you are basically not looking—you are going to keep moving forward which is what we want and is the whole purpose of our oversight, but that the discussions about pushing forward for 2004 to have a DOD Department-wide qualified opinion is not going to be present because you have identified several billion dollars requirement for that 1-year clean opinion and then an annual repeating of that. What I hear you saying is you looked at that, but in making a cost-benefit analysis, you are not going to pursue that avenue?

Mr. LANZILLOTTA. I believe when it is all said and done and the IG was going to have a big piece of that, that is absolutely correct. That it won't be economically beneficial for the Department to try to do that. The other point I want to try to make is the whole purpose of the program is to provide timely and accurate management information. If you spend \$2 billion to get accurate information at the end of the year, then that information isn't available for the managers to make a decision during the course of the year. And so you get a clean opinion, but you don't get the benefits of being able to make the smart decisions over the course of the year to manage the programs because you had to wait until the end of the year to get the information and unfortunately, you make those decisions throughout the course of the year.

Mr. PLATTS. And I couldn't agree more. That is the exact message that we want to see as a committee namely, change that allows, day one in the middle of the second quarter you can see where you stand and the same for the third quarter, it's not just at the end of the year. You can say here are our books; that we truly have processes in place that throughout the year, every Department under the CFO Act are able to give a good assessment of where they stand.

Mr. Kutz, I would take from your testimony here and your extensive written testimony, that GAO shares the position that spending several million dollars for a one time 2004 qualified opinion is not a wise course to follow.

Mr. KUTZ. We would share that position and I would say, I have done dozens of audits in my career and given that its June 2003 and the deadline would be November 2004 it isn't feasible given the size and all of the different issues at DOD.

So I think that a qualified opinion in 2004 is about as close to zero percent possible as you can get without being zero.

Mr. PLATTS. Mr. Granetto, for it to happen, your office—you talked with just the Army Corps, 120 auditors and made note that is a small part of DOD and that 120 was a substantial majority of your entire auditor work force. Can you give us—and I was going to ask in the context of 2004 but maybe in a broader sense, what would it take for your manpower needs? And Mr. Lanzillotta mentioned the figure of \$500 million for your offices' needs. Is that a fair guesstimate in your opinion?

Mr. GRANETTO. That, in fact, was our guesstimate. We have done a study. It is a little beyond guesstimate, but my staff and I believe that in the long run, we probably need a growth of about 240 people internally. And then you would be in the range of 2,000 to 3,000 auditors to audit this Department and all its financial entities.

Mr. PLATTS. What is your number today?

Mr. GRANETTO. 160-some.

Mr. PLATTS. You need 240 more?

Mr. GRANETTO. That is our estimate as of the moment. And this may well change because what we are doing, as Mr. Lanzillotta pointed out, we have taken the service studies on the 2004. And while I don't think the 2004—I am even more pessimistic than Mr. Kutz. I think it is zero that you would get a 2004 opinion. But those two efforts are going to be very valuable in the long run because it is going to turn into planning with us. And we are going to have to sit down and chart this out and see what is going to be ready when, when we are going to need it and what kind of moneys we are going to need. We have a study that says \$500 million possibly to audit this Department and all its financial statements. But that \$500 million is to hire CPA firms. We are not thinking in terms of doing it ourselves. We don't have the resources.

[The information referred to follows:]

Insert for the Record

Additional Statement by the Honorable Joseph E. Schmitz, Inspector General of the Department of Defense

Within the bounds of professional independence, the new Deputy Inspector General of the Department of Defense for Auditing, Francis "Gene" Reardon, and I will continue to encourage the professional auditors of our Defense Financial Auditing Service proactively to cooperate with the other components of the Department of Defense to achieve at least an overall "qualified" audit opinion by the end of Fiscal Year 2004. Considering the Constitutional provision that "a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time," we consider our extraordinary ongoing efforts to assist the Department of Defense in achieving a qualified opinion in FY 2004 -- a necessary first step towards an unqualified opinion -- to be well-worth the expenditure of tax dollars.

Mr. KUTZ. One of the reasons it takes extraordinary efforts from the auditors is again the current state of records over at DOD. When you audit and it has these many problems, you end up spending an enormous amount of time reconciling. You have 2,300 systems that have financial information at this point. Just the sheer volume of time it would take to reconcile and get supporting data is just enormous. And in a normal audit you would not have that kind of a scenario, let's say auditing Johnson & Johnson or Exxon-Mobil where you have good day-to-day operations and you're not going through the heroic effort to put something together.

So those audit resources of several thousand possibly would come down dramatically if reform was successful.

Mr. GRANETTO. I should add too that we are talking a first-year audit. And once you get an audit opinion, then the resources also go down dramatically.

Mr. PLATTS. From a realistic standpoint in the labor force with SEC hiring huge numbers of new auditors for their new responsibilities, have you made—in addition to how many slots you need to fill an assessment of what you believe is your ability to fill those slots in a timely fashion?

Mr. GRANETTO. I think that is going to be a problem—I mean essentially, for me to pick up 240 people, we are talking about 80 people a year for the next 3 years. That we can do. I don't have a problem. But to go out and find—I question whether we would get a bid if we put the whole Department out on the street. I'm not sure anybody's big enough. And unless Mr. Lanzillotta or the Army have a warehouse full of auditors that we don't know about, I don't think they are there right at the present time—I really don't.

Mr. PLATTS. And that leads to a question, Mr. Lanzillotta, that goes to our conversation before the hearing started. You touched on personnel challenges here for auditors, and for you in the sense of getting individuals to buy in to the challenges facing the Department. That includes perhaps attracting new staff. And I was wondering if you could share as part of the record the example in getting a new staff person under the current personnel requirements because it relates to a broader issue that the full Committee on Government Reform had hearings on and acted on and is moving through the legislative process regarding personnel changes that are DOD-wide and would relate to the ability to go out and hire new auditors and compete in the private sector where there is a lot of demand. You shared a great example on that personnel issue that really didn't relate to an auditor, but I think gives an example of the challenges you are facing.

Mr. LANZILLOTTA. What I was referring to is we had an applicant, which goes back to my earlier point that you have a lot of people who go out there and have a strong desire to help the government, a strong desire to get the mission accomplished. She was willing to come on to be a program manager for this program.

Mr. PLATTS. For one of the domain areas?

Mr. LANZILLOTTA. For the overall program in the Comptroller's shop. She also had an offer from a leading consulting firm to be a partner, and that had a \$350,000 salary attached to it, but she was willing to come in and help us out and do this job and she knew what we were paying, which was basically an SES 1 Level, which

I think is somewhere around \$123. I would have to check that, but it is very close to that. And she said, you know, I am willing to do this if you are willing to hire me. And I had to tell her no, I can't. The way the personnel system works is you have to apply, then you have to get through personnel, and if you are on the list, and you go to a board which is composed of three people, of which I only have one person from my organization, and they give you—they give us your name, then we can select you, and then it goes to OPM for final decision. So she said, well, I have this offer. You know, can you give me a commitment? No, I can't. Because that would be preselection and that would invalidate the entire process. And so, needless to say, she is working elsewhere.

Mr. PLATTS. I appreciate you sharing that because that directly impacts this programs' success and the challenges facing Mr. Granetto in a more finite way and the challenges you are going to face as you are required to ramp up and fill more and more spots. And I certainly commend Secretary Rumsfeld and your Department. That is an issue that is on the human resource side but it will impact financial management success as well and we will hopefully see success on that at the program level and at the IG's Office as well.

Mr. Lanzillotta, could you expand a little bit on the Business Enterprise Architecture Plan. I know that the blueprint was recently released and the GAO's reviewing that. What are your thoughts, on the success of what's being proposed. But Mr. Lanzillotta, can you give us kind of maybe a little more detail on how long you think it is going to take to implement the Architecture Plan and within that, the decisionmaking timetable within the Architecture Plan?

Mr. LANZILLOTTA. Mr. Chairman, that is a difficult question. The next phase of the program is—we just delivered the architecture and Mr. Kutz and his people are getting ready to evaluate it—but the next phase of the program is to define some core business segments, and those business segments are—equate to processes, business processes. What we want to do is define these business processes, these core segments, reengineer those segments and find out what the technical solution would be to make those segments work.

There's 103 segments or business processes that we have identified in the Department of Defense. This will be a phased approach, and I don't have an exact date as to when it will be complete, but then again I don't know if the exact date is as important as the department making progress and reengineering our processes and getting better; because I've always believed, even at the inception of this program, that this was going to be one of those things that we were just going to constantly be getting better.

You know, I don't know if there's really a date that I'm going to be able to sit down there and say June 7, 2008, we're there, because I—you know, we have some defense agencies now that have clean opinion, next year we hope for more. We hope for the medical accrual fund to get a clean opinion and we hope to make gradual progress as we reengineer these systems. So I guess the long and the short of it is I don't have an exact date as to when the entire architecture will be implemented.

And I'd also like to say that I don't think that the architecture is—it's a living document, and it's technology—we're using some

technology that wasn't around 18 months ago. And as technology advances, we are always going to implement it and put it back into our architecture. We call our architecture that we have out now version 1.0, because it's a living document, and as we reengineer our business practices we go back into the architecture and redo it for that piece of it. It may be not be a terribly satisfying answer, but it will be a gradual process and I don't have an exact date.

Mr. PLATTS. I have some followup questions on the architecture plan, but I want to recognize our vice chair from Tennessee, the gentlelady Ms. Marsha Blackburn. And Marsha, I apologize, I got involved in my questions and didn't realize you were over here and certainly want to give you the opportunity to ask questions.

Mrs. BLACKBURN. I appreciate that, Mr. Chairman, and I apologize that I was not here as you all were giving your statements. I had a meeting elsewhere and had to be there.

I do appreciate also that you all gave us your testimony in advance, because that does help us to do the reading and a little bit of advance work and to prepare. And I will have to admit last night when I was reading this, I thought I cannot wait to see these individuals and see, first of all, if they are absolutely black and blue from being—feeling as if they're being beat up with trying to wrestle with this system.

I congratulate you all for the challenges that you're facing and for the decisions that you're trying to make to address these challenges, because I want to be sure that I understood what I read, and these were some of the key points that I pulled out of this. And then I want to be sure that we as a committee—and the chairman and I both are two individuals that are very committed to helping you with government reform. I came out of the State senate in Tennessee, and one of my key issues is governmental reform. I think it is incumbent upon us as elected officials to do everything we can to be sure that 21st-century government is responsive to the taxpayers. So I want you to know that as you address these, that we will gladly work with you.

But what I gleaned from this is seven key points: that DOD's financial system has been in almost total disarray in all business operations for the last 7 years; that DOD has developed 2,300 financial management systems over the last 40 years; that DOD is required under the Bob Stump authorization act to produce a financial management architecture along with a transition plan; that DOD awarded a contract for this plan, and it is currently being reviewed by the GAO. This plan is expected to take a decade for full implementation. A reform plan by Business Executives for National Security [BENS], in June 2001 was claimed to totally revolutionize DOD's financial system into the 21st century. And the last point: 30 percent of DOD's budget is on weapons training and combat, whereas 70 percent is on support functions.

So my question is—and I do not know who would like to answer, or if all of you would like to start through these. If you would like to verify for me, whomever, that these are the appropriate and correct assumptions—Mr. Kutz, would you like to go first?

Mr. KUTZ. Yeah. With respect to the 7 years you're probably going back to when we first recognized DOD financial management as high risk, but that doesn't mean it started in 1995. I fully sus-

pect it's been high risk for some time longer. We didn't start a high-risk series of reports until the 1990's. So this problem, I suspect, goes way back to the beginning of the Department.

Mrs. BLACKBURN. OK. Any other comment on this?

Mr. KUTZ. With respect to the 2,300 systems, that is something that has also—that was not something that was designed by the Department. They didn't plan to have 2,300 systems. It has evolved over time, as I think Mr. Lanzillotta has said in his opening statement, because you've got a lot of people with different buckets of money that have developed their own systems for their narrowly focused solutions to a bigger problem, and there has not really been a corporate structure driving systems modernization. It's been more of a subsidiary function, where the Army, Navy, Air Force, have each tried to develop their own solutions to problems. So that is how you end up getting 2,300 different systems.

We are currently looking at the business enterprise architecture and we'll be issuing a report early next month on, as Larry said, version 1.0 of the architecture. But I want to make sure that you understand we fully support them doing an architecture, developing one and implementing one. It is one of the key elements that we believe is necessary for them to reform financial management.

A couple of things. The contract with IBM, that's been something we've had for quite some time. We're not looking at just the contract. We're actually looking at the entire effort to develop and implement the architecture, including the kinds of oversight they have over their current and ongoing investments while they are developing the architecture. It's important to understand that there's billions of dollars being spent on systems as they're trying to develop an architecture. So if you think about it like building a house, they don't have a blueprint, but they're building a house, and so you can imagine what kind of situation that would create. And that again gets back to how you got to 2,300 systems.

With respect to your question on the budget, I think Mr. Lanzillotta is probably in a better position to discuss that, but I believe the numbers that you said are accurate from the breakdown of the budget.

Mrs. BLACKBURN. Thank you very much.

Mr. Lanzillotta.

Mr. LANZILLOTTA. When this problem—Greg is right. This problem didn't occur in 1995, and my view of it is prior to the CFO Act of 1990, these systems were put into place to track appropriations, because that is the way the Department was tracking its expenses. It wasn't until the CFO Act came into place and financial statements became the area of focus that we looked back and looked at our systems to see what they could do. These systems were never designed in this case to produce financial information. They were designed to do appropriation and congressional reporting requirements, and that's what they did, and they did that very well.

We later got these old systems, and we tried to modify them to get the financial data that we needed, but these are old systems, and we forget now sometimes that technology has evolved such that we're on—I don't know even know what, Pentium 4—or what is the current speed? I just looked to see that you can get a great

computer from Dell—I don't know if I should say that, you know—for like \$400.

Mrs. BLACKBURN. That is fine. They're in Tennessee. That works for me. You go right ahead.

Mr. LANZILLOTTA. I have a Dell. I have to say that my first computer did not have a hard drive, and it had two floppy disks, and I thought that I was really riding high. The systems that we had in that place, you know, some of the systems that we're writing are DL4. They are in COBOL, some of the languages that won't handle the type of information that we want it to handle.

Mrs. BLACKBURN. Yes, sir. Now, if I remember correctly from our previous hearing, you all have moved to the model, now the management model, where you do have a Chief Technology Officer, is that not correct? And someone who is handling your systems in the integration of each and every one of these systems; is that not correct?

Mr. LANZILLOTTA. Ma'am, are you referring to the Department's Chief Information Officer or—

Mrs. BLACKBURN. Yes. Yes. You may call him the Chief Information Officer.

Mr. LANZILLOTTA. The Department does have that. We are in league—his name is—the Chief Information Officer is helping us manage—he is co-managing this program. So we manage this program together.

To go back to your other statement or one of your points about the 2,300 financial management systems, only about 20 percent of those are actually financial management systems; 80 percent of those systems are what we call feeder systems. And what the definition of a feeder system is, is a system that was originally intended to do something else, and we draw on those systems to feed our financial systems. So when we look at the number of systems we have, they're not all financial management systems. Some of those systems are made to keep track of Band-Aids in hospitals or spare parts for aviation or spare parts for a tank battalion or acquisition systems, personnel systems, all kinds of systems.

We did put together an architecture, and we did do it with a contractor. The Department felt that we didn't have the technical expertise to use leading-edge practices and technology without some help.

When we went through the process, the acquisition process, we determined that IBM—or team IBM, because it's actually a coalition of six contractors—were best able to help us transform the Department. The plan for 10 years goes back to the chairman's question. This progress will be continual. I believe that every year we are going to make progress. I don't know if the architecture is ever going to be 100 percent implemented, because just this week our chief architect came in from IBM, and he says, you know, we are going to start using some technologies that weren't even available 18 months ago, but these technologies are going to help us cure some of your problems. Now these technologies are common practice, but when we started this concept or this idea, these technologies were a PowerPoint drawing or something.

Mrs. BLACKBURN. And I appreciate that very much, and, you know, the life cycle of any of the technological advances is about

18 months. I think that when we look at something taking 10 years, you know how outdated that would be by the time it's finished, and so it is something that would be an evolving process; but I think—I personally feel that it would be helpful if we had a plan that had some tangible benchmarks and some goals that you all were going to hit. As you move to a business model, one of the great motivating factors in any business model, whether it is a growth business or something that you're sustaining, is having benchmarks and some goals that you are striving to reach, and then incentivizing that process. So I would hope that we can help you all with that.

Mr. Granetto, so you're saying \$500 million is what you think it's going to cost to put this in place?

Mr. GRANETTO. That is our current estimate of what it would cost to get CPA firms in.

Mrs. BLACKBURN. Have you raised or lowered that estimate since your beginning?

Mr. GRANETTO. No, ma'am. This is a very recent estimate. It will change once we start evaluating the plans that the services have put forth on an opinion.

Mrs. BLACKBURN. OK. And you need 2,000 to 3,000 auditors. So what you're saying is you could basically employ every accounting student that is graduating this year?

Mr. GRANETTO. I suspect that is what we could do. I'm not sure there's a CPA firm big enough out there. They might have to go to a consortium—we might have to break this down into chunks, Army, Navy, Air Force, DLA, something like that to get somebody to bid on it.

Mrs. BLACKBURN. Well, I appreciate all of those thoughts and comments, and, again, as someone who is passionate about government reform and leaving things in better shape than I found them when I got here, I hope that we can do our part to help you along the path to that.

I told someone today, I said, you know, I'm 51 years old, and when I am 81 and have my grandkids, I hope that they look at me and say, well, she made some good decisions. I hope they do not say, "Man, what a sorry legislator and what a big bill we have to pay for," because it's taking so much to pay for government. So I hope that we can encourage you along the road to some of these efficiencies. Thank you all very much.

Mr. PLATTS. Thank you, Mrs. Blackburn.

Mr. Lanzillotta, I want to come back to where I was on the business enterprise architecture and a couple more specific questions. When identifying the various systems—and we're talking now over 2,300 as of last fall, do we have a good comfort level that we now have our arms around the whole picture, that it's not going to be 2,500 or 3,000 as far as what we're really trying to deal with? Because that kind of epitomized to me one of the challenges you're facing is just identifying the systems that need to be correlated and brought, you know, together as one.

Mr. LANZILLOTTA. Mr. Chairman, you're right. We have—when we started this number, I think it was originally 475 systems, but when we started to do our operational architecture and we started to actually diagram our processes, we started to diagram our proc-

esses and then look back to see how many systems that we were touching; and as we fully developed this operational architecture, we went through and then that's when we started going and the number of systems started jumping as we started going through and looking at the number of systems that we were dealing with; and that's when we got to the 2,274 systems.

I have a high degree of confidence that is the ballpark range where we're at, but the Department is large. There are other systems out there. And as we further define our operational architecture and we go down another couple of levels as we reengineer these processes, we might find that we go over there and touch another system that we didn't know that we touched.

One of the accomplishments, I guess, from kind of a technical point of view—and it doesn't mean much to most, but we actually now have a list or an inventory of these systems, and that is a major event for the Department, to be able to look at a list and have these systems; and we have them in the domains that we know where they affect and who's watching them, because this in itself added another degree of supervision and oversight that did not exist before. So it's kind of I guess a budget geek kind of dream to make sure that we go in there and know exactly how many systems we're dealing with.

Mr. PLATTS. And, Mr. Granetto, I assume that process of even identifying all of those systems is helpful to your office.

Mr. GRANETTO. Absolutely.

Mr. PLATTS. Again, to get your arms around exactly what you're supposed to be looking at is—even though we may be a ways off from where we want to be ultimately, each one of these steps is going to help you in doing your duties.

Mr. GRANETTO. It is. And they are keeping us very well informed on what's going on.

Mr. PLATTS. And it is what might be helpful as you complete that identification process and realize that it may change. As you say, it is a kind of a living document you're working with, this architecture plan. If you could submit for the record a listing of all those systems that you identified, it would give us kind of a comprehensive understanding of what all you're dealing with.

When you get into making decisions about those systems—and you stated that they're identified kind of by domain, and your domain owners are making recommendations of which ones should go, i.e., should not be funded, and, which ones should remain, my understanding from your previous comments, is that those domain owners will make recommendations to the comptroller's office. And is it the Senior Executive Council that will make a final decision that this recommendation, we accept it and we're going to eliminate this system and do this instead? How is this process going to work?

Mr. LANZILLOTTA. We have set up a series of a hierarchical boards. At the bottom is the domains where they have the seven domains and they kind of report into a centralized office, which is our office, the BMMP Program Office, that kind of keeps everything moving and kind of makes sure that the domains are integrated.

When it comes time for reporting, we have a senior steering group. The senior steering group is chaired by myself and the Department's Chief Information Officer. We chair the group. Members of the board are the assistant secretaries for financial management, acquisition and installations. GAO is an observer.

There's a wealth of representation from the Department. These domains will then come and make their presentations as to what they think should be in the budget, as is the system turned off, system turned on? And the reason why we keep this presentation up to the system and don't make the domain owners particular kings or queens of their area is we want to make sure everybody stays honest. We want to make sure that a certain domain owner doesn't think that they are going to bypass these principles of the architecture just because they want to make sure the system is fielded, because no longer are we just going to field the system to field it. They will come to the board and make that recommendation. The board ultimately reports to an executive committee, which is chaired by the Comptroller, the Chief Information Officer, the Under Secretary for Acquisition, and all of the service under secretaries are represented on that board.

So there is a hierarchical board that the domain owners will report through to make their recommendation. When approved, then it will be implemented in the budget process through the comptroller's office.

Mr. PLATTS. OK. Mr. Kutz, with GAO playing an advisory role in this process—or envisioned in playing—

Mr. KUTZ. We do what we call our constructive engagement because we have to be independent because we're doing audits of these items, but we are there real-time and do provide our observations where we can to improve the situation. And I would say in our view the governance situation is moving in the right direction, but it still has not yet been fully defined. And there's a lot of things that are being worked out as to how that's actually going to work, because if you think about it down the road with the 2,300 systems, the rubber is going to really hit the road when they start to try to reduce those systems, and some of the owners of those systems are going to have to have them terminated and someone is not going to get to keep their system. That is where I think you're really going to see how this governance works with respect to the architecture.

Mr. PLATTS. Mr. Lanzillotta, that point being well taken, about, you know, where the rubber meets the road—as we actually start to make decision—when do you see even your initial—I realize that you can't give me a date of everything being in place and working as you want it, but when do you see some of the decisions on systems being made—i.e., the recommendation is going to be to terminate this system and we move forward with that? When is the earliest as a committee we could start to see that type of action take place?

Mr. LANZILLOTTA. Mr. Chairman, two of the systems in the financial accounting systems have already been terminated. We evaluated a system called DJAS, which was the Defense Joint Accounting System. It was a misnomer, because it wasn't going to be used by all defense agencies. It was only going to be used by the Army

Missile Defense Agency. When we reviewed the system, it just wasn't going to match the architecture on what we needed for a general accounting system, and that system was terminated.

We terminated DPPS, which was the standard procurement payment system, because it was replacing a system which was very old, MOCAS. But when we looked to see the linkup with the other systems that it was supposed to talk to, it didn't, and it wasn't going to be as good as the system that was going to be replaced, you know. So before it was fielded, it was terminated.

We are going to continue to look at these systems and have already started to look at some of these systems and have terminated those systems when we found them. There will be more.

Mr. KUTZ. Mr. Chairman, one important point with that is those are Comptroller-controlled systems. The difference is going to be when they start doing that with Navy, Army, and Air Force systems, and that will be a little different game.

Mr. PLATTS. That's one of my followups. If I understand the testimony, the written testimony correctly, about 20 percent you have direct responsibility for, 80 percent is outside of the Comptroller's area of responsibility. How are you going to deal with that challenge? Is it because of the leadership of the Secretary, Secretary Rumsfeld, you know, to say you're going to do this, you know, across the service department lines?

Mr. LANZILLOTTA. I can assure you, Mr. Chairman, I deeply feel that I have the backing of the Secretary when we look at these systems. Of course, all authority starts with the Secretary. He has delegated it down to my boss. I feel no apprehension at all to cancel an Army, Navy, Air Force system that's not working, or it should not be deployed.

I understand in the past, because I have been in the Department in the past administrations, and sometimes it gets to be a concern; but one thing with Secretary Rumsfeld, this is a priority with him. I honestly don't believe that a service secretary would try to defend a system that wasn't doing what it was supposed to do. There is always that gray area, and there is always that room for discussion, because as many systems as you have, you'll have different people with different opinions. But when it comes right down to it, I don't think that—I have full faith and confidence. I really believe that Secretary Rumsfeld has changed the culture in that regard, and the service secretaries I don't think would even defend one of their systems that wasn't working.

Mr. PLATTS. And a quick followup. Then I want to yield to Mrs. Blackburn again quickly.

And so you have that authority with the Chief Information Officer, and that is kind of your board that you structured where that is the final authority to say to the Army, now you're getting rid of that system. You have that authority now?

Mr. LANZILLOTTA. We have that authority now. An example I could give is on the Navy ERPs. The Navy ERPs were a little in front of us as far as the architecture goes. We weren't trying to stop the development of all the systems, because these systems need to go on to support the warfighter and the Department's ability to do the Department's mission. But we withheld \$57 million from the Navy ERPs until they could prove their convergence

issues and that there wouldn't be cross-domain issues with other systems. When they came in and we agreed on a schedule and we agreed on milestones and performance measures that they would go through and tell us and show us that they would be fully compliant, then we released the money. These Navy ERPs, we released the money in stages. We'd get an agreement of what the system is supposed to do, how it's supposed to do it, and then they get the money.

If a system doesn't live up to that agreement or it doesn't come off as advertised, the money is not released and the money is withheld. In the words of Admiral Owens, a former vice chairman of the chiefs, you know, all transformation is done through the budget, and I believe that, and we're able to use—with the CIO's advantage with technology and acquisition experience and our leverage with the budget, this is another thing that has made this program different than past programs. You know, we are married with the CIO. So we bring that IT experience, that acquisition experience, married in with the budget and the power that you can get through leveraging the budget. And so I think that is a major difference as to why this program will be more successful than past programs.

Mr. PLATTS. Thank you. Mrs. Blackburn.

Mrs. BLACKBURN. Thank you, Mr. Chairman.

I want to follow right along with that line of questioning and tie a couple of things in this. As you look at those benchmarks, have you been given the appropriate responsibilities in handling the plans and working to pull this architecture together? And if not, what additional leeway or responsibility would you need? I think you referenced the hiring being a problem. Is there anything else?

Mr. LANZILLOTTA. The hiring is not just my problem. I mean, that's—crosses anywhere in the Department or some places, probably the Federal Government as a whole. We have asked the Congress—and if you don't mind me using this as a lead-in—for several legislative changes that we would like.

Mrs. BLACKBURN. I think that would be helpful, because it helps us to know what we can do to help you and what you see—you know, where you see our role, things that we could do that would allow you to maybe move more expediently, to move forward with maybe a little bit more empowerment and a little bit more encouraged. So let's answer that and then let's move to a human capital question.

Mr. LANZILLOTTA. To follow on to Mr. Chairman—his question that he had on this committee's role at the full committee level on the civilian personnel reform, we have asked for authority to do split disbursements. And what split disbursements are is when a member of the Department of Defense uses their travel card and they fill out their voucher and those expenses are verified by their supervisor, it's outlined on that voucher as to whether it belongs to the credit card company or they get reimbursed. So if they use their credit card company to pay for their hotel, if they outline that on their travel voucher, we will pay the hotel for them, and then they won't have to get their money and then later send a check to the credit card company. That is called split disbursement.

For the military we have made it mandatory for split disbursement, but we don't have the authority at the civilian level, because it has to be negotiated at the local level.

In the Department of Defense there are 1,400 local bargaining units. I am told that it takes on the average of 5 years to negotiate any agreement through all 1,400 units. I recently had a—the Congress had graciously given us the ability to reimburse our employees for training that they received. So we want people to get certain certifications. We now have the authority to pay for that. That also requires us to go to the 1,400 local bargaining units to get—to bargain that to say, look, we want to pay these people and reimburse these people when they go through this. That's split disbursement.

On DSS in front of the Congress right now, we have a request to transfer that function, the field function, for personnel security investigations to OPM. When we went and looked at our security process, we reengineered that process, and what we decided to do was that automation has matured enough, that we used to—every time you had a top secret clearance, you get a mandatory investigation at the 5-year point. So if you were kind of bad up to 4½ years, then you left, you didn't get an investigation because it wasn't at the 5-year point.

So now we have one of these systems where your record can always be monitored for certain hits, like if you declare bankruptcy and you have a top secret clearance, maybe somebody needs to come over there and look at your record even though it's not at the 5-year point. Maybe you have a top secret clearance, but you don't have access to top secret information. So maybe we don't need to come see you every 5 years because you have no access. We now have the ability through automation to make those determinations, and we have put \$91 million into this program to reengineer that process.

When we look at the field investigation piece of this of DSS, OPM was doing it much better. In fact, we were OPM's No. 1 customer, and so we were competing with ourselves on contracts to do these personnel security investigations. We decided that we could either put money to modernize our field operating agencies, or we could give the entire function to OPM to accomplish for the government in a consolidated effort. We decided, based on the market factors that OPM and that DOD were bidding against each other and bidding out the cost of these investigations, that if we left OPM just to manage it, that it would be cheaper for the entire Federal Government; that it would be in our best interest to transfer this function and 1,800 field investigators to OPM.

We have asked for that authority, because right now we have the authority to do that, but we would have to RIF 1,800 people, and OPM would have to hire 1,800 people. We prefer the authority just to transfer these 1,800 people and not put these people through the angst of going through this process, even though the process has been set that these people would get the jobs, but this would just make it so much smoother on these families.

We are going through processes of consolidation and realignment that we will be coming up to the Congress and asking for permis-

sion on further consolidations and realignment where we think we can make a business case where it makes sense.

Something that I don't know if this committee could help us with—with the number of appropriations that we have. Every year we get 80 active checking accounts, per se, and some of these checking accounts are good for a number of years. So I might be wrong on this number—and I'll correct it for the record—but I think there's 247 active checking accounts that leads to our financial management problem, because we have so many appropriations that we get, so many small appropriations we get in a number of years, and all this has to be kept in the right year, in the right appropriation.

Mrs. BLACKBURN. And we've got 435 Members.

Mr. LANZILLOTTA. I could go on, but I've overstayed my welcome and the light is on.

Mrs. BLACKBURN. The light is on red. Mr. Chairman, can I ask, though, one final question?

Mr. PLATTS. Yes.

Mrs. BLACKBURN. OK.

Mr. Granetto and Mr. Lanzillotta, I think this goes to both of you. The Department's human capital strategy and the other reform initiatives that we hear are going on there, how do those relate back into the enterprise architecture?

Mr. LANZILLOTTA. Human capital is a serious problem—it was actually identified by Greg early on in the financial management area. We have an aging work force. This aging work force is getting toward retirement. We need a professional development program to take care of training new people as this aging work force retires.

When I first got to the comptroller shop in our SES level, I had 27 SES's, and 43 percent of them were retirement eligible. In the last 2 years they have retired as expected. I only have three left to be retired. That's why this personnel reform becomes an issue, because it often takes me a lot longer to hire somebody new than it takes to leave.

The other part of the human capital piece that you're referring to is our professional development program. We have instituted reimbursement on professional certificates, and we need to get more, and it's a challenge to the Department to ensure our professional development of our people, that we grow our people. That way they can replace the senior management people and personnel that are leaving.

I take the challenge, and it's an area that the Department needs to continue to look at as far as incentive initiatives, but some of the packages that the full committee was gracious enough to give the Department will go a long way into helping us develop our work force and be able to make this happen.

Mr. KUTZ. Representative Blackburn, I would make a comment on that. Right now for financial management the environment is actually quite good to hire, with what happened with Arthur Andersen and the public accounting profession. At GAO we used to have a difficult time competing for people. That has changed. The government looks as a much more favorable place right now, with more stability, interesting work, and so we've had a good hiring group the last several years.

One other thing to consider here is as they transform from where they are today to the future, they're going to need different skill sets across DOD. Right now you have a lot of people entering and reentering data manually because of the bad systems we've talked about. You've got people who are correcting errors. You've got hundreds of people out at DFAS Columbus who are involved in contract reconciliation. And, again, once you reform, you're going to need people—instead of data processors, you're going to need data analyzers and different types of skill sets, so human capital is a critical element of this architecture reform effort.

Mrs. BLACKBURN. Thank you.

Mr. LANZILLOTTA. I couldn't agree more with Greg's statement. As we get the better systems on board, we'll reduce the number of people, but the skill set keeps on changing, and what we have to do is be dynamic enough to train our people for the new skill sets that we need.

Mrs. BLACKBURN. Thank you. Thank you, Mr. Chairman.

Mr. PLATTS. Thank you, Mrs. Blackburn.

And your final comment about being dynamic in training your people for the skill sets needed kind of goes to that—again, that transformation you're looking for; whereas today, if it's to train them in something that is outside their specific job description, your hands are often tied, because of the bargaining process you need to go through to make that type of change in a timely fashion is just not doable.

So, again, I hope we can see on the human capital side some added flexibility, that we do get that through and give you some more options.

Mr. GRANETTO, I wanted to get your thoughts on looking at examples—and we've heard lots of estimates of what the cost savings will be, from \$15 to \$30 billion a year; Secretary Rumsfeld's 5 percent, perhaps \$20 billion a year.

The DFAS example, which, I understand, has installed a CFO Act compliant financial management system and has received a clean audit—the numbers I've seen is that over a 5 year period we've had a significant reduction in work force, about 4,500 positions a correlated cost savings, while we've seen that office handle an increased amount of workload. Is that a good example of what we can hope to see across the board as we get a financial management system in place that's working?

Mr. GRANETTO. I don't think so, and I'll tell you why: Because that CFO-compliant system that they're putting in is a four-part system. They have two parts in now. It's very recent. The DFAS improvements that you're talking to and the savings are really caused by DFAS' consolidation efforts and among its functioning offices, its improvements in its automated processes, and it's done a significant amount of outsourcing, and we've created other process improvements.

I would state that the Secretary has said there is a 5 percent improvement or savings involvement. I think that is true, but this is not a good example of that.

Mr. PLATTS. It's other structural changes.

Mr. GRANETTO. It's other structural changes.

Mr. LANZILLOTTA. Could I amplify that comment? I think DFAS, though, is an excellent example of what the Department is trying to accomplish. It may not be true because of all the automation systems that DFAS has, because Paul is right; they are incrementally putting in new systems. But the Director of DFAS, Tom Bloom, has been very successful in reengineering his processes. We have gone from numerous personnel pay systems and brought them down. In fact, DFAS now is a provider of civilian pay services to other Federal agencies. He has reengineered, he has consolidated, and he has brought in and is in the process of putting in new automation systems. He recently realigned the work force from Europe, because our force structure in Europe has been significantly reduced, and has brought that back home through the use of automation systems, because it's no longer important that the finance clerk sit exactly where the troops are, because what he needs is somebody to talk to. And then all the work can be done—he needs a store-front operation. Then all the work can be done back in the States where existing systems take place.

So we're able to bring—reengineer that process where we brought workload home from Europe, put it in three or four locations here in the States, with fewer people. So he is an excellent example of reengineering processes and administrative procedures to do it better. It might not be straight-through automation. And he has been extremely successful in being more efficient.

Mr. KUTZ. Mr. Chairman, I would concur with that. One other thing, too—

Mr. PLATTS. I wanted to ask you your assessment as well.

Mr. KUTZ. DFAS is a working capital fund, and so they are required to charge fees that cover their cost, and so over time compared to other parts of DOD, they have better cost information. And so I would say that they are one of the leaders in DOD in showing that they can reduce and out costs by having good cost information and performance-based metrics and other types of management focus. So they have done a reasonably good job compared to certainly other parts of DOD in getting some of those costs out.

Mr. PLATTS. And hopefully they will be an example to be followed, and not necessarily the savings, again, directly related to the financial management aspect, but to that kind of big-picture restructuring. And as you continue to bring work back from Europe—if you're looking for a good location, south central Pennsylvania is a beautiful area, and we have a lot of very content Federal workers there now. We're always glad to have more.

Mr. Lanzillotta, in your testimony, near the conclusion I think it was, you talked about what you see over the horizon, and that perhaps 90 percent of the liabilities of the Department will be included in clean opinions in the near future. I think you're somewhere now like 28 percent of your liability is with the agencies that do have clean opinions.

Could you expand on that? It was a pretty bright picture you painted in your statement. I wasn't sure I actually understood completely what you were envisioning.

Mr. LANZILLOTTA. Ninety percent of our liabilities basically exist in three areas. They exist in the military retirement trust fund, the military health benefits, and the environmental liabilities. So when

we talk about 90 percent of our liabilities, that is where they are. So getting a clean statement, it's only in those three areas that we're talking about. The problems in the financial statements are evaluation of assets, spares, property and other lines in the financial statements.

I think it is a rosy picture as far as these three funds go. I think that the military retirement fund has had a clean opinion, and we hope that the military health benefits, which is a new fund, will get a clean opinion since it is a new fund. And we're making progress on the environmental area where there's some systems—Army, environmental liabilities, and Navy nuclear ships—that we believe are ready for audit.

So in these areas I think we're making good progress, but this is what I talked about, about the incremental approach. I never believed that we would just have a bad opinion and then 1 day in the future we would just have a good opinion. It was going to be an incremental approach. We would get things like liabilities taken care of. We'd get more defense agencies, and before too long we hope to have a service organization pop, and then I think the rest of it will come.

Mr. PLATTS. Mr. Kutz or Mr. Granetto, would you want to comment on that projection on the liability side?

Mr. KUTZ. Yes. With respect to the retirement liability for the military personnel, that is one that has had a clean opinion for quite some time. The other larger chunk is the post-retirement health care liability, which is the present value of the future cash-flows for post-retirement health benefits. That one, as far as we understand, is reasonably close to having a chance to get an opinion on it.

I would say environmental in our view would be further away from success than certainly the post-retirement health one, although I don't believe it's as large necessarily dollarwise. But there is important progress being made on all three of those, and for the most part those aren't systems issues. Those are process issues and people issues, which are again some of the—you talk about metrics you can use to measure the Department's progress. Those are ones that you can hold them accountable for in the short term, because again it had be a matter of management focus and attention.

Mr. PLATTS. Mr. Granetto.

Mr. GRANETTO. I would agree with Larry. I would point out that—and Greg, for that matter—point out that the two liabilities you're talking about are both actuarial liabilities, and those are fairly easy to audit. We have Deloitte & Touche doing the one, and they've been doing it for the last 6 years. We've got a clean opinion. I think it's fairly—we're fairly close to opinion, although I don't speak for the CPA firm on the other liability, the military retirement health care liability.

The environmental liability, I would like to make a point. Larry says they're ready for audit, and really what we are doing is assessing whether it is ready for audit. I've got a team doing that now, approximately 20 to 30 people and one of our other directorates taking a look at that. I do not know at this point in time what the assessment on that will be, but we will probably be prepared to discuss that in a couple of weeks.

The other two, no problem. I think we're going to get opinions on both of those.

Mr. PLATTS. On the environmental, does that fall within the 2002 authorization language that you have to make that assessment on whether you think it's at a stage where you should invest?

Mr. GRANETTO. Yes. That's one of the intricacies of the authorization act. What it says is we shouldn't spend resources to audit if something is not ready. But if we do that, if I literally wait until they assert that something is ready for audit, I've got a problem, and it occurred with us on the Corps this year—or this last year. When the Corps came in with an assessment that they were ready for a complete audit, we were caught by total surprise, because we had no auditors in there to speak of and no real basic knowledge. It caused a lot of problems in my operation. So from that viewpoint I have a little problem with section 1008. I need to keep on it so I know they're ready for audit. That's why we're going to assessments.

Mr. PLATTS. Was the Corps incident maybe a good wakeup as far as the—

Mr. GRANETTO. Oh, yes, it was.

Mr. PLATTS [continuing]. Interaction between the offices that you're onboard early, that they're getting closer, not—

Mr. GRANETTO. That's what's driven us to the cooperation and to the amount of planning that's going back and forth across the board. If the Air Force, for example, is ready to state that the Air Force statement of budgetary resources is ready, I'd like to know that a year in advance so I've got the resources ready to go. And that's what we're going to do.

Mr. LANZILLOTTA. One of the things we've done, Mr. Chairman, is we've established these audit committees, and by establishing these audit committees, the IG is a member of all these audit committees. So when they meet, he's in at the ground level and knows what the problems are and the state of that particular organization's financial statements.

The other things that we've done are, although the law does not require us to put auditors on those statements that we know aren't going to make it, we still require quarterly financial statements and we still require these statements to be briefed.

In the last go-around, I don't know how many hours' worth of financial statements I've listened to—somewhere around a day I think, 24 hours, but by doing that and doing it on a quarterly basis, we check things. Last time we concentrated on footnotes, and this time around when the financial statements were briefed, that part of the financial statements made remarkable improvement as far as explaining footnotes.

When we concentrate on these areas, even though we're not turning them over to the IG for audit, we're still making progress, and we're still—the services are still looking at it in more detail; and when they know they have to brief their statement, they're also taking ownership. Because we had a problem when we first came in, that a lot of the organizations sat down there and says, well, it's a systems problem, and those systems belong to DFAS and so I can never get a clean statement. And we said, no, it may be a

systems problem, but they're your systems, your financial statements, and you need to make that progress.

Since then, I think that we've made significant progress. And these statements are brief, I'm being reminded by the IG, GAO and OMB, as well as the OSD comptroller.

Mr. PLATTS. Well, I think that is one of the silver linings or the bright spots as we look ahead to truly having success this time. The examples like what's happened with the Corps issue and what has resulted in that will hopefully be long term, and that there is throughout the Department more and more cooperation and interaction, to getting to the same achievement at the end of the day.

I want to turn to Mr. Kutz. Earlier this year, I think it was late March, GAO testified on your oversight of the systems that were being used by DOD and not necessarily seeing a lot of changes in the specifically at-risk aspects of DOD. And I think, if I have this right, that \$18 million was being designated for business systems in the current fiscal year; that money was at risk of being spent without a good return for the taxpayer I guess is how I'd say it.

I was wondering if you could expand on that previous testimony, but from GAO, what is meant by that being at risk, you know, what causes that opinion to be given?

Mr. KUTZ. Right. If you think about the architecture as a blueprint, what is at risk is the ability to build out the blueprint, and with respect to developing information technology systems. And we looked at four systems that DFAS was developing, and we found serious problems with the investment management of those four systems. They all had serious problems with cost, schedule, and performance.

And Mr. Lanzillotta mentioned one of them earlier, the defense procurement payment system [DPPS], which they terminated at a cost of \$126 million for which the government got virtually nothing for that. And so my view is that in addition to developing the architecture, they're going to have to make some serious improvements in their investment management and project management practices, because otherwise what you're going to have is a blueprint that never gets built out.

And so this is just another area where we believe, parallel with the development of the architecture, they've got to put good project management controls in place over investment technology investments.

Mr. PLATTS. And I was going to ask you a followup. Since then, what's transpired? One system is being terminated. What about the other three of the four identified?

Mr. KUTZ. I can't answer. They were going to go back and reassess those three and determine whether or not additional investment was justified. Now, Mr. Lanzillotta can probably answer with respect to those three—possibly can answer to those three.

Mr. LANZILLOTTA. One system was terminated. Two others are under review right now. DDRS is probably the one system that's probably not all we want it to be, but right now it is one of our critical systems to be able to produce financial statements. We are looking at that more seriously as to what we can do to correct the problems in that system, more so than what we did with DPPS,

where we terminated it because we never thought that the system would meet our expectations.

In line with that, Mr. Chairman, one of the things that we've established on the new systems, we have put in metrics to measure the performance of these systems to see how they're going to do at the initial stages versus taking them farther on down the line. We also have asked our program analysis and evaluation [PA&E], which is outside of the comptroller shop, to also do evaluations on major systems independent of our evaluation to make sure that they come up with the same evaluation that we did. This is also in conjunction with the CIO's program reviews that he does on these major systems.

So we have introduced the concept of performance measures on these systems on early development to try to avoid some of these problems that Greg has alluded to. Is it perfect? Not yet, but we hope to get there.

Mr. PLATTS. Well, having that performance measurement process completed or implemented hopefully will keep us from getting where we have \$136 million spent and no return. Because it's easy to understand, I think we'd all agree, why the taxpayer is sitting back in whatever town and whatever State saying what the heck are they doing? They spent \$136 million, and it got that far along before they realized that. What I take from your efforts is your intent to put a process in place across the board so that doesn't continue to happen, that we do have early identification.

And that kind of leads to my next question, which is in the private sector the marketplace really drives a lot of the accountability in the private sector—competition. For government in general there's not that same type of market pressure as to how we perform—the drivers for change that we need to see happen at DOD—that is what we're talking about here today.

You know, I'd be interested in—all three of you, comments on who are the drivers or the change agents that will make it happen for DOD, that is the market in the private sector? Who is the market? What is going to drive this? Is it going to be oversight from Congress being the key, you know, with GAO; is it the senior leadership combination? What is the most important issue to help drive this effort home so we don't have that repeat of the system?

Mr. GRANETTO. Let me deal with that one first, Mr. Platts. My concern, and I've said this before, we have to embed this somehow in the Department. I have no doubt that Mr. Lanzillotta and the current management of the Department intend for this thing to roll forward like nobody's business, and they doing a great job of doing it. But what happens when Dr. Zakheim isn't there? I've seen—I can maybe name a couple of things I've seen—let me back up. I've been in the Department since 1964 as an auditor with GAO and the Department. I have seen one of the major financial issues corrected six times and declared fixed. We still have the problem. It's the property in the hands of contractors.

The embedding of this—it's got to be embedded and it's got to continue when the current leadership changes, and I don't know how you do that.

Mr. PLATTS. And that was going to be my followup. Before we move on, we would welcome your insights and would thank you for

your 39 years of service. I won't tell you what year I was born, but your insights and expertise, we would welcome suggestions to me and to this committee as to how to—because I share your assessment that the sincerity of Mr. Lanzillotta and the leadership there now want to do this; but given that we're talking about it being many years of effort, you know, my hope is that the current administration and its appointees are there for many more years. But how do we make sure that happens, that it's not, you know, the effort of today but not of tomorrow?

So if you—not meaning today, but if you continue to give thought to it and want to share suggestions, whether it be legislative in nature or just from our oversight responsibilities, I'd welcome them.

Mr. Lanzillotta.

Mr. LANZILLOTTA. I agree with Paul. You know, our challenge institutional-wise is this, while we're there, because if this is going to continue, it must continue over the next administration and the next administration; otherwise it will just be another wasted effort.

I believe the answer, though, is probably more motherhood and apple pie, but I think it is still true. I think that the oversight committee is playing an important role here. I think that the oversight committees—as long as Congress continues to demonstrate interest, the Department will continue to demonstrate interest. I think that GAO coming in and offering observations has been most helpful to make this program go along. I think that the senior leadership needs to be informed. But then it goes back to Paul's point that the process has to be institutionalized.

One of the ways that we hope to do that is these domains, by use across sections of the Department, using the Entire department instead of just making it another stovepipe system, that this is the way the Department will do business.

The major motive factor yet remains is that we're there to support the warfighter, and that requirement to do it better, to turn over these savings into those programs is always there. And now that we are transforming the Department, I think that these requirements will continue and will even be more emphasis, because people now have started to see their product for the transformation.

You know, the recent military operation showed where, because of information technology, that we can pick up intelligence, put ordnance on target in a matter of hours. You know, that used to take us weeks to do that, and so I think people are seeing the advantage of that, and I think the warfighter's appetite for that type of technology is growing. And I think that he, the warfighter, will continue to put emphasis on the support systems to reengineer these processes. I don't think that they will tolerate—you know, we've never tolerated a second-rate military force and never had a second-rate military force, but I don't think that our military forces will tolerate a second-rate business process anymore either.

Mr. PLATTS. And, Mr. Kutz, before you expand or comment on this, I think that internal incentive—it actually surprised me that hasn't driven more accountability over many years from that soldier on the front lines, and I'll use an example. We're very grateful in the 19th District being home to the Carlisle—the war college in Carlisle and a major new investment in housing there. And, you

know, for senior leaders of the army that go through there, the standard of the housing now is pretty abysmal, and the Army is, through the residential initiative, making substantial investment.

If we turn to the families of those leaders going through the War College over the past many years, or the privates out on the front lines and said, we want you all to come to the Pentagon and get some answers as to why we just spent \$136 million on an accounting system that we now know doesn't work but we won't, or can't, you know, give adequate housing for you and your family out in whatever base you're on. That should drive some real incentive to fix the problems. Unfortunately, though, it doesn't seem to have done that in the last several years or decades.

Yet it should be a natural incentive that we—we talk about \$20 billion, you know, what that translates to, whether it be family issues for our military personnel, whether it be training for our military personnel, whether it be actual equipment purchases and program development. It would seem to me the most natural incentive that would drive these changes, but it hasn't for some reason; and so, I think that's why looking at institutionalizing changes that really are going to be lasting is going to be critical.

Mr. LANZILLOTTA. I don't know when Secretary Rumsfeld came to the Department whether everybody believed him, that transformation and concentrating on developing new capabilities was the thing to do. I think now the military leaders have seen that the transformation of this military capability and the things that it can now produce, everybody is a believer. That is institutionalized. No longer do you have to preach transformation. Everybody preaches transformation, and that is driving these new requirements now on the support system.

Another example would be during Desert Storm we moved a huge amount of logistics and supplies over into theatre. Some of that, according to Greg, was never opened and shipped back unopened, because there were supplies that weren't needed or were lost.

GAO was right, but the warfighter drove the technology in re-engineering their business practice. We now invest in little radio transmitters that actually have logged in them everything that is in that shipping container. So when that shipping container gets to port and they're looking for Band-Aids, they can pull it up on the computer, and it says it's in storage container number such-and-such, and then they can go to that storage container and find that. These type of transformational efforts on the business side were being driven by the warfighter. So I think that this is one of the ways that this is going to institutionalize the way that we do business that didn't exist prior to this.

On your example on the systems that were canceled, we do need to go early on and decide whether the system is going to live up to its advertisement, and if it's not, to cancel it a lot earlier than wait till further on down the line.

I still believe there's no way out to not develop the system to a certain point so it can be judged. But this milestone in my example of how we withheld the \$57 million is a system that I think that we have to go in the future.

We have to wait and say, hey, you said you were going to do this. OK. If you can do that, then you get the money. If you can't, then I'm sorry. And in DPPS's case the reason why we canceled it even after the \$126 million had been spent is because to fix it, to do the fixes we wanted it to do, was too costly. We decided that it was cheaper to fix the current system to do the things we wanted to do and not put the money into the system. So there was a business case there that, you know, came down to canceling that system, and I think all these systems come down to a business case.

Mr. PLATTS. Well—and while the loss of the money that was invested in the system, canceled is unfortunate, you're right that we want to make that cost/benefit, even if it's down the road. The earlier we can make it the better, but making that cost/benefit analysis and then having that drive our actions as opposed to, well, hey, we said we're going to build this so we're going to build this whether it makes sense or not.

So I commend you for making those decisions, even when it brings forth examples of dollars that were spent that we wish hadn't been done.

I want to give Mr. Kutz the—we kind of got away from it, but on the issue of driving the change permanently, your—

Mr. KUTZ. Yeah. With respect to drivers, certainly the ones that have been mentioned are—I think Congress, GAO, the IG, etc. I think maybe the fiscal condition of the country will ultimately be the driver as we go forward with the deficits and the challenges we face there.

But again, Congress having oversight, consistent oversight, and providing incentives to DOD is very important.

With respect to institutionalizing, that is something that is another challenge that we actually have offered something in several of—my testimony and Comptroller General Walker's testimony, the concept of a Chief Management Officer. And I don't know if you're familiar with that concept from other testimony we've given or someone else has given, but it's kind of like the idea of Charles Rossotti over at IRS, where he was brought in for a term of 5 years for his credentials. He was nonpolitical. He was brought in for his business background and his management background, and he stayed at IRS for 5 years. I think it would be nice to have him stay 5 more years, but he made a significant impact over there.

In the Federal Government, the average political appointee turns over less than every 2 years, or less than 2 years. So maintaining that consistent leadership and drive is a challenge. And certainly there's great leadership right now at DOD with the Comptroller and the Secretary, but whether they will be around long enough to sustain this over the period of time necessary has yet to be seen. So this Chief Management Officer is something that we've thrown out there as an idea for consideration.

Mr. PLATTS. And I know that the Department has looked at that and is aware of that proposal from GAO. Would you want to comment on the general, you know, pros and cons as the Department sees it? And the exact proposal for DOD was a 10-year, I think—wasn't it—to have a chief management—

Mr. KUTZ. I think we've talked 5 to 7 years, but it could be 10 years, a number of years—

Mr. PLATTS [continuing]. The IRS a better example of that 5 years than 10, but I don't know if you want to comment at all.

Mr. LANZILLOTTA. Greg is right. The GAO has proposed this several times. And the Department at last has taken a look at it, and currently the Department is looking at something very similar. In the logistics area, the Secretary received a briefing as to whether there should be one guy in charge of all logistics throughout the Department, which is a very similar concept as to what Greg is proposing, a chief operating officer to take a look at these programs.

There are several initiatives that the Department is looking at, and I don't know how these initiatives will come out. It's kind of proposing a different structure for the Department—for the OSD staff, instead of an Under Secretary for Acquisition Technology and Logistics, one for Personnel Readiness and one for Comptroller. What Greg is alluding to is probably a different OSD structure that would have operating officers for different business lines, per se.

The Secretary has several studies going on right now. He has been briefed on several of these concepts already and has not made any decision as to how he wants to proceed with this. There are certain pros and cons. Greg is right. It does institutionalize it for that area, but I don't know—the Department once had a similar concept, and went away from that concept because it didn't work. There was too much conflict between the current deputy that was supposed to be sort of policy and the deputy that was—for a deputy secretary that was for operating management. And it went back to the one deputy. So it's not without precedent, and it's not without precedent that it had to go back to the previous form.

Mr. PLATTS. What's the timeframe for what is being looked at within the Department such as for a logistics? Is there a timeframe, you know, for reviewing this and making a decision or recommendation as to whether to pursue it or not?

Mr. LANZILLOTTA. It was briefed to the Secretary. He's asked several other questions that people have been tasked to come back to, and I wouldn't hazard a guess as to when he'll make that decision.

Mr. PLATTS. OK. Thank you.

One other specific area I wanted to touch on. Mr. Lanzillotta I mentioned to you, I think before, about having the Navy Supply Systems Command in my district—and I've been briefed there on some of the significant changes that the Navy has made with the purchase and travel card programs, and they clearly seem to be on very much the right track of getting control and responsibility in these programs. And I give great credit to my predecessor, subcommittee chairman Steve Horn and his work on that issue. And I think this is a very good example of the oversight that this committee can play by shedding light and working with GAO and bringing attention to an issue, have some serious problems addressed, and very good results come from that oversight. And I know that Chairman Horn probably is pleased with the results he is seeing.

I saw the Navy's efforts, and I was wondering if, Mr. Lanzillotta, you could expand on where you see DOD in total today on the travel and purchase card issues and trying to ensure that the abuses of the past don't reoccur to the level they were; and then also

what—if you can give us any specific examples of what consequences have resulted from those abusing travel purchase cards.

Mr. LANZILLOTTA. The Department has done several things, and I think when you talk about what the Navy has done, it has been a product of a joint task force. When this problem was highlighted to the Department that we were having, not with just purchase cards but with travel cards and charge cards in general, the Secretary asked Dr. Zakheim to convene a task force and look into this in a more serious way. We got a task force and got all the people involved, from the services to the Department of Justice, to OMB, GAO, IG, and the whole host of issues. We came out with certain findings that I think that we're starting to see the results of.

By another metric, performance measures, our delinquency rate is way down, and we hope that the possibility of fraud is being eliminated. We've done this by increasing our oversight, and we've increased our oversight by the services by making them report on cases and also by tracking through performance metrics of what the services are doing. We've canceled a lot of cards 400,000 travel cards and 80,000 purchase cards, I believe, to take away the possibility of somebody having a card and using it for a purpose that it wasn't intended for. We increased the amount of training, because part of our problem was that the people who had these cards were not fully trained; or they were given a CD that says, you know, here is an 8-hour CD, watch this before you use this card. And of course they didn't, you know, and we ran into problems that way.

And we've also started the process of data mining, and we use data mining to find possible cases of abuse, and we run different scenarios. They come over there and show us, this is a possible case. We prosecuted—and you probably read about it in the papers—somebody in the Department of Defense Graphics Division that had embezzled \$1.7 million. That was found through our efforts in data mining. It wasn't found by the IG or GAO. It was found by data mining, and we were able to go after that person and prosecute that person for fraud. What we're hoping is more of this data mining, more of these—not that we want more of these cases, but when people know that we're doing this, it will keep people from attempting to use this.

Are there more cases of fraud out there? I guess these two gentlemen out there will let us know. But we are making efforts in those areas to try to put emphasis on these programs and so eliminate it, and I think your example of the Navy is an excellent example of leadership and supervision in the things that it can accomplish.

Mr. PLATTS. I would be interested, Mr. Kutz—both of you—if you want to comment, on your assessment on where we are on the purchase.

Mr. KUTZ. With respect to consequences, I guess that was one of the areas where we did see significant issues. And whether it was fraud that either we identified, the IG or the Department identified, people went after those folks and attempted to prosecute them.

Where we are talking about abuse improper usage of the cards, where you were buying things you really didn't need like \$500 com-

puter bags, we saw little or no consequence to those folks. They might have had their card taken away eventually, but, for the most part, there was little or no consequence.

With respect to fraud, there were consequences. Although one issue that's interesting with credit cards is U.S. Attorneys often-times will decline cases under \$100,000. So many of the civilians who didn't go through the military justice system walked, basically.

There is substantial progress, though. The NAVSUP team you mentioned in your district, they have done a tremendous job—we work very well with them—in improving the controls, processes; and they have actually reduced the Navy's cards from about 60,000 when we first started working with them down to about 20,000.

Mr. PLATTS. Using technology available now seems to be a huge part—

Mr. KUTZ. Right. If they are automating their systems. It used to be a very paper-intensive and more costly system, so they are making great progress there, and they have done a real good job there.

With respect to the extent of the problem, we are still looking at one of the programs called the centrally billed travel accounts; and we have to report out on that and will be doing that over the next 6 months.

With respect to the purchase cards and the individually billed travel cards, there has been good progress in improving the systems processes and controls; and we have not been back to audit that.

We are required by law to report back in December on the progress against our recommendations and some of the open investigations and other cases we had.

Mr. PLATTS. Mr. Granetto.

Mr. GRANETTO. We are very actively involved in this. I'm probably not going to make Mr. Lanzillotta very happy at this point, because we are about to issue a report prior to early next week, another one on this, and there will be several more after this.

I think it's fair to say, from a publicity viewpoint, this issue is going to continue to bleed. We are very, very intimately involved in it. The Department is very aggressive in reacting when we come up with something.

The data mining effort is part of our information. Colonel Kelly, who works for us and originally worked for me, is running a large part of that. We are almost on real-time. Right now, we are near real-time on the transactions. We're getting them in less than a month. We could almost have them on the day they occurred, except we can't handle the volume of data at this point in time.

Well, you asked—there are IPTs going on. Let me read you a couple of things that will not make, I am sure, people happy: A cardholder purchased a Santa suit for \$232 with a government purchase card.

A cardholder inappropriately rented a vehicle for \$910 using the government purchase card. That individual was terminated from Federal employment and allowed to reimburse the \$910.

A cardholder accessed pornographic sites and sports-related Web sites with the government purchase card.

A Navy facility building renovations budgeted at more than \$500,000 was paid for by the government purchase card by splitting the project into smaller transactions to stay below the \$2,500 micropurchase threshold.

One Navy cardholder used the government purchase card to purchase two automobiles, surgical enhancements and a motorcycle.

A cardholder made 59 fraudulent purchases that totaled more than \$132,000.

A cardholder purchased personal goods and services, meals, gasoline. This particular cardholder made 29 inappropriate or unauthorized purchases that totaled about \$6,000.

Air Force individuals used the Air Force purchase card for 155 purchases and transactions totaling \$30,000. They then disputed 118 of these charges as inappropriate and got a credit of \$28,000 back.

One cardholder split a \$9,131 requirement to four separate transactions with the same date to purchase new uniforms for military personnel.

He already mentioned the \$1.7 million in fraudulent purchases in the Washington headquarters service.

One cardholder used a purchase card 52 times in an 8-week period to make a single purchase for more than \$551,000.

Those are the kinds of things we are finding. They are still there. It is tightening down. The Department is reacting very quickly. Some of these are ongoing. All of them are being resolved via investigations.

We have an employee at the Naval Service Weapons Center who pled guilty in U.S. District Court, Eastern District, theft of government property and was sentenced to 6 months home confinement and 3 years probation because of misuse of the card for \$29,000 to include purchase of motorcycles.

We have an employee at the Naval Service Warfare Center who pled guilty in District court same thing, theft of government property, and was sentenced to 5 years probation and ordered to pay a \$1,000 fine for using the card to purchase several items, including an all-terrain vehicle, a motorcycle and a brass bed.

And we have another Defense Commissary employee who pled guilty to possession of child pornography and theft of government property for using his government-issued purchase card to purchase personal items to include that child pornography.

All of these were acted upon once we found out. We have the investigators involved. They are involved. We have the service auditors involved in this. The Department is emphasizing it. The Department is making it very well known that they are prosecuting and taking action.

In my opinion, we are going in the right direction. It is still a problem.

Mr. PLATTS. Are the examples you are citing ones that occurred not recently, but have more been called recently, so some of the changes that are happening, technology and the fact that 100,000 or less cardholders—that they were incidents before these changes and are now being pursued?

Mr. GRANETTO. These were instances in 2001 and 2002 that we found by mining that old data, and we are getting very current with the data.

Mr. PLATTS. It sounds like where you are finding it, the Department is aggressively pursuing, especially where there is fraud involved—but it also sounds like that there are some challenges with the U.S. Attorneys Office as far as getting them to actually prosecute.

Mr. LANZILLOTTA. We have come up with an alternative that the Department of Justice has decided not to prosecute. It doesn't make me happy or sad. It makes me sad if a Federal employee misuses a government card and does things like this. It makes me happy when somebody else does my work and finds it for me so we can take action.

Mr. PLATTS. I see that, as an example, where there is a partnership here and all three of your offices are looking to tighten down the hatches when these instances are happening and, if they are happening, aggressively pursuing them.

Mr. LANZILLOTTA. We have 1.1 million travel cards out there. We reduced that number by 400,000, but we continually review this every 6 months as to who ought to have cards. We have 143,000 purchase cards out there, and we have reduced—that number is down 33 percent from where it was. There is always the possibility that somebody's looking for the free lunch.

I have another list of people that we've caught and prosecuted and taken similar action with. I think it's encouraging not that we found people, but I think it's encouraging that action is being taken. With that many cards in circulation, I guess statistically I feel that somebody is going to try to take advantage of it and do something that they shouldn't be doing. You see it all over on corporate cards. You read about cases where people have done certain things on corporate cards and private sector that they aren't happy that shows up in the paper.

There were some recent articles in the D.C. government about the purchase card, because I remember going with relief that they had some examples and it wasn't DOD, great.

Mr. KUTZ. With respect to the purchase card, I think DOD was one of the first ones to be looked at governmentwide. We have people calling and talking to us about this, and we just issued a guide for auditing and investigating. So some of the same things that were happening here at DOD are happening at a lot of other organizations.

Mr. LANZILLOTTA. But the important thing to remember is that there is action being taken.

Mr. PLATTS. And certainly, because of the media's interest in this issue, it gets a lot of attention. Hopefully, the action that is being taken gets equal attention so when the disclosures of somebody doing this is played up that the consequences that are taken against an individual are also equally reported. But it is a small part of that big picture of getting control of our financial management processes and that we are doing right by the taxpayers.

At the end of a good number of hours of your patience with me and our questions, I didn't mean to touch on a sensitive issue, but also it is an important issue, and with the report that you reference

next week, we will certainly look forward to receiving that and reviewing that as well.

I have no other questions I want to ask. I don't know if you have anything you want to add before we do wrap up our discussion here today.

If not, I want to thank each of you for your efforts; and if you could convey to your colleagues and each of your offices my gratitude as well. Because, of the magnitude of the issue we are dealing with in trying to get our arms around the financial management of a \$400 billion annual expenditure by that entity, it is not going to take one person, one office doing it. It's going to take a partnership.

One of the things I am most encouraged by is what seems to me the openness and the cooperation that is now going on between the three of you, OMB as well. There is a team effort here that will help get to that institutionalizing, you know, these changes, that it's not just one entity's idea of a shared vision and commitment and goal of all.

So as a subcommittee and as Chair of the subcommittee I certainly look forward to continuing to work with each of you and your offices as we continue our oversight and really, as we are at the early stages of the business enterprise architecture, to see how that actually moves forward. The example of the two systems that already have been terminated is a good start, but as we get into some of those challenges that are outside of your direct oversight and Department, how the plan actually gets implemented and acted upon is something we are going to be closely watching and hoping to promote and to praise is what we hope to be doing as we see successes being achieved.

But, again, my sincere thanks for your efforts day in and day out and your efforts in preparing for this hearing and your patience with me over several hours of questioning.

So, I appreciate that, and we will keep the record open for 2 weeks for any additional submissions such as the systems that you have identified that you are now reviewing or will be reviewing and any other information that is to be submitted.

Otherwise, this meeting stands adjourned.

[Whereupon, at 5 p.m., the subcommittee was adjourned.]

