



## Testimony

Before the Subcommittee on Readiness and  
Management Support, Committee on Armed Services,  
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# DOD FINANCIAL MANAGEMENT

## Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform

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Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here to discuss financial management at the Department of Defense (DOD). Today, DOD faces financial management problems that are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. DOD's financial management deficiencies, taken together, represent the single largest obstacle 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 have passed the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls.

Overhauling financial management represents a major management challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. Previous administrations over the past several decades have tried to address these problems in various ways but have largely been unsuccessful. In this regard, on September 10, 2001, Secretary of Defense Rumsfeld announced a broad initiative intended to "transform the way the department works and what it works on" that he estimated could save 5 percent of DOD's budget—or an estimated \$15 to \$18 billion annually. The Secretary recognized that transformation would be difficult and expected the needed changes would take 8 or more years to complete.

The President's Management Agenda includes improved financial management performance as one of his five governmentwide management goals. In addition, in August 2001, the Principals of the Joint Financial Management Improvement Program—the Secretary of the Treasury, the Director of the Office of Management and Budget, the Director of the Office of Personnel Management, and I, in my role as the Comptroller General—began a series of quarterly meetings that marked the first time all four of the Principals had gathered together in over 10 years. To date, these sessions have resulted in substantive deliberations and agreements focused on key issues such as better defining measures for financial management success. These measures include being able to routinely provide timely, reliable, and useful financial information and having no material internal control weaknesses. Success on these measures will be a significant challenge to DOD. The Principals plan to invite Defense Comptroller Zakheim to their upcoming April 2002 meeting to discuss the department's transformation effort and to begin a constructive engagement with DOD on this important initiative.

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With the events of September 11, and the federal government's short- and long-term budget challenges, it is more important than ever that DOD effectively transform its business processes to ensure it gets the most from every dollar spent. The department must be able to effectively account for the funding it receives and carry out its stewardship responsibilities for the vast amount of equipment and inventories used in support of military operations. Even before the events of September 11, increased globalization, changing security threats, and rapid technological advances were prompting fundamental changes in the environment in which DOD operates. These trends place a premium on increasing strategic planning, enhancing results orientation, ensuring effective accountability, transparency, and using integrated approaches. Six of the 22 areas on GAO's governmentwide "high-risk" list are DOD program areas, and DOD shares responsibility for 2 other high-risk areas that are governmentwide in scope.<sup>1</sup> Central to effectively addressing DOD's financial management problems will be the understanding that these eight areas are interrelated and cannot be addressed in an isolated, stovepiped, or piecemeal fashion.

The recent success of our forces in Afghanistan has again demonstrated the unparalleled excellence of our military forces. This same level of excellence is not yet evident in the department's financial management and other business processes. This is particularly problematic because effective financial management operations are critical to achieving the department's mission in a reasonably economical, efficient, and effective manner and providing reliable, timely financial information on a routine basis to support management decision-making at all levels throughout DOD. This will also be critical in order to enhance overall transparency and accountability. Success in this area will also serve to free-up resources that can be redeployed 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.

Today, I will provide my perspectives on (1) how Defense got where it is today and the underlying causes of the department's longstanding inability to effectively reform its financial management and other business systems and processes and (2) the keys to successfully carrying out the Secretary's business process transformation and DOD's plans and actions to date. Last summer, I shared with Secretary Rumsfeld and Comptroller Zakheim a

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<sup>1</sup>U.S. General Accounting Office, *High-Risk Series: An Update*, [GAO-01-263](#) (Washington, D.C.: Jan. 2001).

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business transformation paper, which provided an overview of our views on the current challenges facing the department and the keys to effective reform, and detailed one option for addressing these challenges.

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## Long-Standing Financial Management Problems and Attempts at Reform

History is a good teacher, and to solve the problems of today, it is instructive to look to the past. The problems with the department's financial management operations date back decades, and previous attempts at reform have largely proven to be unsuccessful. These problems adversely affect DOD's ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget, such as for health care, weapon systems, and environmental liabilities, measure performance, maintain funds control, prevent fraud, and address pressing management issues.

Problems with the department's financial management operations go far beyond its accounting and finance systems and processes. The department continues to rely on a far-flung, complex network of finance, logistics, personnel, acquisition, and other management information systems—80 percent of which are not under the control of the DOD Comptroller—to gather the financial data needed to support day-to-day management decision-making. This network was not designed, but rather has 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 translations and interfaces which combine to exacerbate problems with data integrity. DOD determined, for example, that efforts to reconcile a single contract involving 162 payments resulted in an estimated 15,000 adjustments.

Many of the department's business processes in operation today are mired in old, inefficient processes and legacy systems, some of which go back to the 1950s and 1960s. For example, the department relies on the Mechanization of Contract Administration Services (MOCAS) system to process a substantial portion of DOD contract payment transactions for all DOD organizations, which totaled about \$78 billion in fiscal year 2001. When MOCAS was first implemented in 1968, "mechanization" was a high tech word. Past efforts to replace MOCAS have failed. Most recently, in 1994, DOD began acquiring the Standard Procurement System (SPS) to

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replace the contract administration functions currently performed by MOCAS. However, our July 2001 and February 2002 reporting<sup>2</sup> on DOD's \$3.7 billion investment in SPS showed that this substantial investment was not economically justified and raised questions as to whether further investment in SPS was justified. For the foreseeable future, DOD will continue to be saddled with MOCAS.

Moving to the 1970s, we, the Defense Inspector General, and the military service audit organizations, issued numerous reports detailing serious problems with the department's financial management operations. For example, between 1975 and 1981, we issued more than 75 reports documenting serious problems with DOD's existing cost, property, fund control, and payroll accounting systems. In the 1980s, we found that despite the billions of dollars invested in individual systems, these efforts too fell far short of the mark, with extensive schedule delays and cost overruns. For example, in 1989, our report<sup>3</sup> on eight major DOD system development efforts—including two major accounting systems—under way at that time, showed that system development cost estimates doubled, two of the eight efforts were abandoned, and the remaining six efforts experienced delays of from 3 to 7 years.

Beginning in the 1990s, following passage of the Chief Financial Officers (CFO) Act of 1990, there was a recognition in DOD that broad-based financial management reform was needed. Over the past 12 years, the department has initiated several departmentwide reform initiatives intended to fundamentally reform its financial operations as well as other key business support processes, including the Corporate Information Management initiative, the Defense Business Operations Fund, and the Defense Reform Initiative. These efforts, which I will highlight today, have proven to be unsuccessful despite good intentions and significant effort. The conditions that led to these previous attempts at reform remain largely unchanged today.

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<sup>2</sup>U.S. General Accounting Office, *DOD Systems Modernization: Continued Investment in the Standard Procurement System Has Not Been Justified*, [GAO-01-682](#) (Washington, D.C.: July 31, 2001) and *DOD's Standard Procurement System: Continued Investment Has Yet to Be Justified*, [GAO-02-392T](#) (Washington, D.C.: Feb. 7, 2002).

<sup>3</sup>U.S. General Accounting Office, *Automated Information Systems: Schedule Delays and Cost Overruns Plague DOD Systems*, [GAO/IMTEC-89-36](#) (Washington, D.C.: May 10, 1989).

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**Corporate Information Management.** The Corporate Information Management (CIM), initiative, begun in 1989, was expected to save billions of dollars by streamlining operations and implementing standard information systems. CIM was expected to reform all DOD's functional areas, including finance, procurement, material management, and human resources through consolidating, standardizing, and integrating information systems. DOD also expected CIM to replace approximately 2,000 duplicative systems. Over the years, we made numerous recommendations to improve CIM's management, but these recommendations were largely not addressed. Instead, DOD spent billions of dollars with little sound analytical justification. We reported in 1997,<sup>4</sup> that 8 years after beginning CIM, and spending about \$20 billion on the initiative, expected savings had yet to materialize. The initiative was eventually abandoned.

**Defense Business Operations Fund.** In October 1991, DOD established a new entity, the Defense Business Operations Fund by consolidating nine existing industrial and stock funds and five other activities operated throughout DOD. Through this consolidation, the fund was intended to bring greater visibility and management to the overall cost of carrying out certain critical DOD business operations. However, from its inception, the fund was plagued by management problems. In 1996, DOD announced the fund's elimination. In its place, DOD established four working capital funds. These new working capital funds inherited their predecessor's operational and financial reporting problems.

**Defense Reform Initiative (DRI).** In announcing the DRI program in November 1997, the then Secretary of Defense stated that his goal was "to ignite a revolution in business affairs." DRI represented a set of proposed actions aimed at improving the effectiveness and efficiency of DOD's business operations, particularly in areas that have been long-standing problems—including financial management. In July 2000, we reported<sup>5</sup> that while DRI got off to a good start and made progress in implementing many of the component initiatives, DRI did not meet expected timeframes and goals, and the extent to which savings from these initiatives will be

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<sup>4</sup>U.S. General Accounting Office, *High-Risk Series: Information Management and Technology*, [GAO/HR-97-9](#) (Washington, D.C.: February 1997).

<sup>5</sup>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).

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realized is yet to be determined. GAO is currently examining the extent to which DRI efforts begun under the previous administration are continuing.

The past has clearly taught us that addressing the department's serious financial management problems will not be easy. Early in his tenure, Secretary Rumsfeld commissioned a new study of the department's financial management operations. The report on the results of the study, *Transforming Department of Defense Financial Management: A Strategy for Change*, was issued on April 13, 2001. The report recognized that the department will have to undergo "a radical financial management transformation" and that it would take more than a decade to achieve. The report concluded that many studies and interviews with current and former leaders in DOD point to the same problems and frustrations, and that repetitive audit reports verify systemic problems illustrating the need for radical transformation in order to achieve success. Secretary Rumsfeld further confirmed the need for a fundamental transformation of DOD in his "top-down" Quadrennial Defense Review. Specifically, his September 30, 2001, Quadrennial Defense Review Report concluded that the department must transform its outdated support structure, including decades old financial systems that are not well interconnected. The report summed up the challenge well in stating: "While America's business have streamlined and adopted new business models to react to fast-moving changes in markets and technologies, the Defense Department has lagged behind without an overarching strategy to improve its business practices."

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## Underlying Causes of Financial and Related Business Process Reform Challenges

As part of our constructive engagement approach with DOD, I met with Secretary Rumsfeld last summer to provide our perspectives on the underlying causes of the problems that have impeded past reform efforts at the department and to discuss options for addressing these challenges. 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.

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## Lack of Leadership and Accountability

Historically, DOD has not routinely assigned accountability for performance to specific organizations or individuals that have sufficient authority to accomplish desired goals. For example, under the CFO Act, it

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is the responsibility of agency CFOs to establish the mission and vision for the agency's future financial management. 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 department has learned through its efforts to meet the Year 2000 computing challenge that to be successful, major improvement initiatives must have the direct, active support and involvement of the Secretary and Deputy Secretary of Defense. In the Year 2000 case, the then Deputy Secretary of Defense was personally and substantially involved and played a major role in the department's success. Such top-level support and attention helps ensure that daily activities throughout the department remain focused on achieving shared, agency-wide outcomes. A central finding from our report on our survey of best practices of world-class financial management organizations—Boeing, Chase Manhattan Bank, General Electric, Pfizer, Hewlett-Packard, Owens Corning, and the states of Massachusetts, Texas and Virginia—was that clear, strong executive leadership was essential to (1) making financial management and entitywide priority, (2) redefining the role of finance, (3) providing meaningful information to decision-makers, and (4) building a team of people that deliver results.<sup>6</sup>

DOD past experience has suggested that top management has not had a proactive, consistent, and continuing role in building capacity, integrating daily operations for achieving performance goals, and creating incentives. Sustaining top management commitment to performance goals is a particular challenge for DOD. In the past, the average 1.7 year tenure of the department's top political appointees has served to hinder long-term planning and follow-through.

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## Cultural Resistance and Parochialism

Cultural resistance to change and military service parochialism 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, and that many of these practices were

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<sup>6</sup>U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, [GAO/AIMD-00-134](#) (Washington, D.C.: Apr. 2000).



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developed piecemeal and evolved to accommodate different organizations, each with its own policies and procedures.

For example, as discussed in our July 2000 report,<sup>7</sup> the department encountered resistance to developing departmentwide solutions under the then Secretary's broad-based DRI.<sup>8</sup> In 1997, the department established a Defense Management Council—including high-level representatives from each of the military services and other senior executives in the Office of the Secretary of Defense—which was intended to serve as the “board of directors” to help break down organizational stovepipes and overcome cultural resistance to changes called for under DRI. However, we found that the council's effectiveness was impaired because members were not able to put their individual military services' or DOD agencies' interests aside to focus on department-wide approaches to long-standing problems.

We have also seen an inability to put aside parochial views. Cultural resistance to change has impeded reforms in not only financial management, but also in other business areas, such as weapon system acquisition and inventory management. For example, as we reported<sup>9</sup> last year, while the individual military services conduct considerable analyses justifying major acquisitions, these analyses can be narrowly focused and do not consider joint acquisitions with the other services. In the inventory management area, DOD's culture has supported buying and storing multiple layers of inventory rather than managing with just the amount of stock needed.

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## Unclear Goals and Performance Measures

Further, DOD's past reform efforts have been handicapped by the lack of clear, linked goals and performance measures. 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. In some cases, DOD had not yet developed appropriate strategic goals, and in other cases, its strategic

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<sup>7</sup>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).

<sup>8</sup>Announced by the Secretary of Defense in 1997, DRI represents a set of actions aimed at reforming the department's major business processes and support operations.

<sup>9</sup>U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, [GAO-01-244](#) (Washington D.C.: Jan. 2001).

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goals and objectives were not linked to those of the military services and defense agencies.

As part of our assessment of DOD's Fiscal Year 2000 Financial Management Improvement Plan, we reported<sup>10</sup> that, for the most part, the plan represented the military services' and Defense components' stovepiped approaches to reforming financial management, and did not clearly articulate how these various efforts will collectively result in an integrated DOD-wide approach to financial management improvement. In addition, we reported the department's plan did not have performance measures that could be used to assess DOD's progress in resolving its financial management problems. DOD officials have informed us that they are now working to revise the department's approach to this plan so that it in future years' updates it will reflect a more strategic, department-wide vision and tool for financial management reform.

The department faces a formidable challenge in responding to technological advances that are changing traditional approaches to business management as it moves to modernize its systems. For fiscal year 2001, DOD's reported total information technology investments of almost \$23 billion, supporting a wide range of military operations as well as its business functions. As we have reported,<sup>11</sup> while DOD plans to invest billions of dollars in modernizing its financial management and other business support systems, it does not yet have an overall blueprint—or enterprise architecture—in place to guide and direct these investments. As we recently testified,<sup>12</sup> our review of practices at leading organizations showed they were able to make sure their business systems addressed corporate—rather than individual business unit—objectives by using enterprise architectures to guide and constrain investments. Consistent with our recommendation, DOD is now working to develop a financial management enterprise architecture, which is a very positive development.

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<sup>10</sup>U.S. General Accounting Office, *Financial Management: DOD Improvement Plan Needs Strategic Focus*, [GAO-01-764](#) (Washington D.C.: Aug. 17, 2001).

<sup>11</sup>U.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).

<sup>12</sup>U.S. General Accounting Office, *Defense Acquisitions: DOD Faces Challenges in Implementing Best Practices*, [GAO-02-469T](#) (Washington, D.C.: Feb. 27, 2002).

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## 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 DOD decisionmakers 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."

This underlying problem has perhaps 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 rather than on achieving better program outcomes. The fact that a given program may have cost more than estimated, took longer to complete, and did not generate results or perform 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 decisionmakers 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.

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## Keys to Fundamental DOD Financial Management Reform

As we testified in May 2001,<sup>13</sup> our experience has shown there are several key elements that, collectively will enable the department to effectively address the underlying causes of DOD's inability to resolve its long-standing financial management problems. These elements, which will be 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 process reform;
- providing for sustained leadership by the Secretary of Defense and resource control to implement needed financial management reforms;

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<sup>13</sup> [GAO-01-681T](#).

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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 an enterprisewide system architecture to guide and direct financial management modernization investments; and
  - ensuring effective oversight and monitoring.

Actions on many of the key areas central to successfully achieving desired financial management and related business process transformation goals—particularly those that rely on longer term systems improvements—will take a number of years to fully implement. Secretary Rumsfeld has estimated that his envisioned transformation may take 8 or more years to complete. Consequently, both long-term actions focused on the Secretary’s envisioned business transformation, as well as short-term actions, focused on improvements within existing systems and processes, will be critical going forward. Short-term actions in particular will be critical if the department is to achieve the greatest possible accountability over existing resources and more reliable data for day-to-day decision-making while longer term systems and business process reengineering efforts are under way.

Beginning with the Secretary’s recognition of a need for a fundamental transformation of the department’s business processes, and building on some of the work begun under past administrations, DOD has taken a number of positive steps in many of these key areas. At the same time, the challenges remaining in each of these key areas are somewhat daunting.

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## Integrated Business Process Reform Strategy

As we have reported in the past,<sup>14</sup> 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, stovepiped, or piecemeal fashion separate from the other high-risk areas facing the department.<sup>15</sup> Successfully reengineering the

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<sup>14</sup>U.S. General Accounting Office, *Department of Defense: Progress in Financial Management Reform*, GAO/T-AIMD/NSIAD-00-163 (Washington, D.C.: May 9, 2000).

<sup>15</sup>The eight interrelated high-risk areas that represent the greatest challenge to DOD developing world-class business operations supporting its forces are: financial management, human capital, information security, systems modernization, weapon system acquisition, contract management, infrastructure management, and inventory management.

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department's processes supporting its financial management and other business support operations will be critical if DOD is to effectively address deep-rooted organizational emphasis on maintaining "business as usual" across the department.

Financial management is a crosscutting issue that affects virtually all of DOD's business areas. For example, improving its financial management operations so that they can produce timely, reliable, and useful cost information will be essential if the department is to effectively measure its progress toward achieving many key outcomes and goals across virtually the entire spectrum of DOD's business operations. 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. For example, we have reported<sup>16</sup> that many of DOD's financial management shortcomings were attributable in part to human capital issues. The department does not yet have a strategy in place for improving its financial management human capital. This is especially critical in connection with DOD's civilian workforce, since DOD has generally done a much better job in conjunction with human capital planning for its military personnel. In addition, DOD's civilian personnel face a variety of size, shape, skills, and succession planning challenges that need to be addressed.

As I mentioned earlier, and it bears repetition, the department has reported that an estimated 80 percent of the data needed for sound financial management comes 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 is reflective of the lack of an enterprisewide, integrated approach to addressing its 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.

As I mentioned earlier, the Secretary of Defense has made the fundamental transformation of business practices throughout the department a top priority. In this context, the Secretary established a number of top-level

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<sup>16</sup> [GAO-01-244](#).

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committees, councils and boards, including the Senior Executive Committee, Business Initiative Council, and the Defense Business Practices Implementation Board. The Senior Executive Committee was established to help guide efforts across the department to improve its business practices. This committee, 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, Logistics and Technology, was established to function as the board of directors for the department. The Business Initiative Council, comprised of the military service secretaries 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 Secretary also established the Defense Business Practices Implementation Board, composed of business leaders from the private sector. The board is intended to tap outside expertise to advise the department on its efforts to improve business practices.

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## Active Leadership and Resource Control

The department's successful Year 2000 effort illustrated and our survey of leading financial management organizations<sup>17</sup> 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 successfully implementing financial management reform. As I mentioned earlier, the personal, active involvement of the Deputy Secretary of Defense played a key role in building entitywide support and focus for the department's Year 2000 initiatives. Given the long-standing and deeply entrenched nature of the department's financial management problems combined with the numerous competing DOD organizations, each operating with varying and 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,<sup>18</sup> 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.” With respect to

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<sup>17</sup>[GAO/AIMD-00-134](#).

<sup>18</sup>Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change*, (Washington, D.C.: Apr. 13, 2001).

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the key area of investment control, the Secretary took action to set aside \$100 million for financial modernization. Strong, sustained executive leadership—over a number of years and administrations—will be key to changing a deeply rooted culture. In addition, given that significant investments in information systems and related processes have historically occurred in a largely decentralized manner throughout the department, additional actions will likely be required to implement a centralized IT investment control strategy. For example, in our May 2001 report,<sup>19</sup> we recommended DOD take action to establish centralized control over transformation investments to ensure that funding is provided for only those proposed investments in systems and business processes that are consistent with the department’s overall business process transformation strategy.

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## Clear Lines of Responsibility and Accountability

Last summer, when I met with Secretary Rumsfeld, I stressed the importance of establishing clear lines of responsibility, decision-making authority, and resource control for actions across the department tied to the Secretary as a key to reform. As we previously reported,<sup>20</sup> such an accountability structure should emanate from the highest levels and include the secretaries 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 Executive and Steering Committees as the governing bodies to oversee the activities related to this modernization effort and also established a supporting working group to provide day-to-day guidance and direction on these efforts. DOD reports that the executive and steering committees met for the first time in January 2002.

It is clear to us that the Comptroller has the full support of the Secretary and that the Secretary is committed to making meaningful change. To make this work, it will be important that the Comptroller has sufficient authority to bring about the full, effective participation of the military services and business process owners across the department. The

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<sup>19</sup> [GAO-01-525](#).

<sup>20</sup> [GAO/NSIAD-00-72](#).



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Comptroller has direct control of 20 percent of the data needed for sound financial management and has historically had limited ability to control information technology investments across the department. Addressing issues such as centralization of authority for information systems investments and continuity of leadership will be critical to successful business process transformation.

In addition to DOD, a number of other federal departments and agencies are facing an array of interrelated business system management challenges for which resolution is likely to require a number of years and could span administrations. One option that may have merit would be the establishment of chief operating officers, who could be appointed for a set term of 5 to 7 years, with the potential for reappointment. These individuals should have a proven track record as a business process change agent for a large, diverse organization and would spearhead business process transformation across the department or agency.

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## Results-Oriented Performance

As discussed in our January 2001 report on DOD's major performance and accountability challenges,<sup>21</sup> establishing a results orientation will be 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 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.

In addition, we have previously testified<sup>22</sup> that DOD's financial management improvement efforts should be measured against an overall goal of effectively supporting DOD's basic business processes, including appropriately considering related business process system interrelationships, rather than determining system-by-system compliance. Such a results-oriented focus is also consistent with an important lesson learned from the department's Year 2000 experience. DOD's initial Year 2000 focus was geared toward ensuring compliance on a system-by-system basis and did not appropriately consider the interrelationship of systems

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<sup>21</sup>GAO-01-244.

<sup>22</sup>GAO/T-AIMD/NSIAD-00-163.



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and business areas across the department. It was not until the department, under the direction of the then Deputy Secretary, shifted to a core mission and function review approach that it was able to achieve the desired result of greatly reducing its Year 2000 risk.

Since the Secretary has established an overall business process transformation goal that will require a number of years to achieve, going forward, it will be especially critical for managers throughout the department to focus on specific measurable metrics that, over time, collectively will translate to achieving this overall goal. It will be 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 to track progress toward this goal.

In the short term, it will be important to focus on actions that can be taken using existing systems and processes. Establishing interim measures to both track performance against the department's overall transformation goals and facilitate near term successes using existing systems and processes will be critical. The department has established an initial set of metrics intended to evaluate financial performance, and reports that it has seen improvements. For example, with respect to closed appropriation accounts, DOD reported during the first 4 months of fiscal year 2002, a reduction in the dollar value of adjustments to closed appropriation accounts of about 51 percent from the same 4-month period in fiscal year 2001. Other existing metrics concern cash and funds management, contract and vendor payments, and disbursement accounting. DOD also reported that it is working to develop these metrics into higher level measures more appropriate for senior management. We agree with the department's efforts to expand the use of appropriate metrics to guide its financial management reform efforts.

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## Incentives and Consequences

Another key to breaking down parochial interests and stovepiped approaches that have plagued previous reform efforts will be 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 decisionmakers to initiate and implement efforts that result in fundamentally reformed financial management and other business support operations.

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In addition, such incentives and consequences will be 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.

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## Enterprise Architecture

Establishing and implementing an enterprisewide financial management architecture will be essential for the department to effectively manage its large, complex system modernization effort now underway. The Clinger-Cohen Act requires agencies to develop, implement, and maintain an integrated system architecture. As we previously reported,<sup>23</sup> such an architecture can help ensure that the department invests only in integrated, enterprisewide business system solutions and, conversely, will help move resources away from non-value added legacy business systems and nonintegrated business system development efforts. In addition, without an architecture, DOD runs the serious risk that its system efforts will result in perpetuating the existing system environment that suffers from systems duplication, limited interoperability, and unnecessarily costly operations and maintenance. In our May 2001 report,<sup>24</sup> we pointed out that DOD lacks a financial management enterprise architecture to guide and constrain the billions of dollars it plans to spend to modernize its financial management operations and systems.

DOD has reported that it is in the process of contracting for the development of a DOD-wide financial management enterprise architecture to “achieve the Secretary’s vision of relevant, reliable and timely financial information needed to support informed decision-making.” Consistent with our previous recommendations in this area, DOD has begun an extensive effort to document the department’s current “as-is” financial management architecture by inventorying systems now relied on to carryout financial management operations throughout the department. DOD has identified 674 top-level systems and at least 997 associated interfaces thus far and estimates that this inventory could include up to 1,000 systems when completed.

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<sup>23</sup> [GAO/T-AIMD/NSIAD-00-163](#).

<sup>24</sup> [GAO-01-525](#).

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While DOD's beginning efforts at developing a financial management enterprise architecture are off to a good start, the challenges yet confronting the department in its efforts to fully develop, implement, and maintain a DOD-wide financial management enterprise architecture are unprecedented. Our May 2001 report<sup>25</sup> details a series of recommended actions directed at ensuring DOD employs recognized best practices for enterprise architecture management. This effort will be further complicated as the department strives to develop multiple enterprise architectures across its various business areas. For example, in June 2001, we recommended<sup>26</sup> that DOD develop an enterprise architecture for its logistics operations. As I discussed previously, an integrated reform strategy will be critical. In this context, it is essential that DOD closely coordinate and integrate the development and implementation of these, as well as other, architectures. By following this integrated approach and our previous recommendations, DOD will be in the best position to avoid the serious risk that after spending billions of dollars on systems modernization, it will continue to perpetuate the existing systems environment that suffers from duplication of systems, limited interoperability, and unnecessarily costly operations and maintenance.

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## Monitoring and Oversight

Ensuring effective monitoring and oversight of progress will also be a key to bringing about effective implementation of the department's financial management and related business process reform. We have previously testified<sup>27</sup> that periodic reporting of status information to department top management, the Office of Management and Budget (OMB), the Congress, and the audit community was another key lesson learned from the department's successful effort to address its Year 2000 challenge.

Previous Financial Management Improvement Plans DOD submitted to the Congress 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 its plans in an enterprise system architecture. If the department's future plans are upgraded to provide a

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<sup>25</sup>[GAO-01-525](#).

<sup>26</sup>U.S. General Accounting Office, *Information Technology: DLA Should Strengthen Business Systems Modernization Architecture and Investment Activities*, [GAO-01-631](#) (Washington, D.C.: June 29, 2001).

<sup>27</sup>[GAO-01-244](#).

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department-wide strategic view of the financial management challenges facing the DOD along with planned corrective actions, these plans can serve as an effective tool not only to help guide and direct the department's financial management reform efforts, but a tool for oversight. Going forward, this Subcommittee's annual oversight hearings, as well the active interest and involvement of other cognizant defense and oversight committees in the Congress, will continue to be key to effectively achieving and sustaining DOD's financial management and related business process reform milestones and goals.

Given the size, complexity, and deeply engrained nature of the financial management problems facing DOD, heroic end-of-the year efforts relied on by some agencies to develop auditable financial statement balances are not feasible at DOD. Instead, a sustained focus on the underlying problems impeding the development of reliable financial data throughout the department will be necessary and is the best course of action. I applaud the proposals spearheaded by the Senate Armed Services Committee, and subsequently enacted as part of the fiscal year 2002 National Defense Authorization Act, to provide a framework for redirecting the department's resources from the preparation and audit of financial statements that are acknowledged by DOD leadership to be unauditable to the improvement of DOD's financial management systems and financial management policies, procedures and internal controls. Under this new legislation, the department will also be required to report to the Congress on how resources have been redirected and the progress that has been achieved. This reporting will provide an important vehicle for the Congress to use in assessing whether DOD is using its available resources to best bring about the development of timely and reliable financial information for daily decisionmaking and transform its financial management as envisioned by the Secretary of Defense.

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In conclusion, we support Secretary Rumsfeld's vision for transforming the department's full range of business processes. Substantial personal involvement by the Secretary and other DOD top executives will be essential for success to change the DOD culture that has over time perpetuated the status quo and been resistant to transformation of the magnitude envisioned by the Secretary. Comptroller Zakheim, as the Secretary's leader for financial management modernization, will need to have the ability to make the tough choices on systems, processes, and personnel, and to control spending for new systems across the department, especially where new systems development is involved. Processes will have to be reengineered, and hierarchical, process-oriented,

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stovepiped, and internally focused approaches will have to be put aside. The past has taught us that well-intentioned initiatives will only succeed if there are the right incentives, transparency, and accountability mechanisms in place.

The events of September 11 and other funding and asset accountability issues associated with the war on terrorism, at least in the short term, may dilute the focused attention and sustained action that will be necessary to fully realize the Secretary's transformation goal, which is understandable given the circumstances. At the same time, the demand for increased Defense spending, when combined with the government's long-range fiscal challenges, means that solutions to DOD's business systems problems are even more important. As the Secretary has noted, billions of dollars of resources could be freed up for national defense priorities by eliminating waste and inefficiencies in DOD's existing business processes. Only time will tell if the Secretary's current transformation efforts will come to fruition. Others have attempted well-intentioned reform efforts in the past. Today, the momentum exists for reform. But, the real question remains, will this momentum continue to exist tomorrow, next year, and throughout the years to make the necessary cultural, systems, human capital, and other key changes a reality? For our part, we will continue to constructively work with the department and the Congress in this important area.

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.

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## Contacts and Acknowledgments

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