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THE FEDERAL GOVERNMENT'S FINANCIAL STATEMENT AND ACCOUNTABILITY OF TAXPAYER DOLLARS AT THE DEPARTMENTS OF DEFENSE AND HOMELAND SECURITY

HEARING

BEFORE THE

FINANCIAL MANAGEMENT, THE BUDGET, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

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CONTENTS

WITNESSES

THURSDAY, JULY 8, 2004

ALPHABETICAL LIST OF WITNESSES

Page

APPENDIX

THE FEDERAL GOVERNMENT'S FINANCIAL STATEMENT AND ACCOUNTABILITY OF TAX-PAYER DOLLARS AT THE DEPARTMENTS OF DEFENSE AND HOMELAND SECURITY

THURSDAY, JULY 8, 2004

UNITED STATES SENATE,
FINANCIAL MANAGEMENT, THE BUDGET, AND
INTERNATIONAL SECURITY SUBCOMMITTEE,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC

The Subcommittee met, pursuant to notice, at 10:32 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Peter G. Fitzgerald, Chairman of the Subcommittee, presiding.

Present: Senators Fitzgerald and Akaka.

OPENING STATEMENT OF SENATOR FITZGERALD

Senator FITZGERALD. This Subcommittee hearing will come to order. I would like to welcome our witnesses for being here today.

Today, the Subcommittee is conducting a hearing on the Financial Report of the United States and the accompanying audit of the report conducted by what used to be known as the General Accounting Office, but which as of yesterday has officially been renamed the Government Accountability Office. But it still has the same acronym, GAO. We congratulate the GAO on their official name change.

The hearing also will focus on the financial management of two departments: The Department of Defense, which was one of three Federal agencies to receive a disclaimer in fiscal year 2003, and the Department of Homeland Security, which the GAO listed on its high-risk list, citing a number of major management challenges and program risks.

This administration and the Federal agencies are making significant strides to improve their financial management. In testimony before the House earlier this year, Comptroller General Walker indicated that agencies made laudable progress in expediting the preparation of their annual financial statements. Mr. Walker noted that eight agencies submitted their fiscal year 2003 financial statements in November, less than 2 months after the close of the fiscal year.

In her House testimony, Ms. Springer indicated that the administration's goal of shortening the time for agencies to prepare audited financial statements from 5 months to 45 days after the end of the fiscal year was achieved by a third of the major agencies a year in advance of the new deadline.

Yet billions of American tax dollars are wasted by fiscal mismanagement, fraud, and abuse. A review by the Congressional Research Service of selected estimates of Federal Government savings indicates that more than $55 billion could be lost each year from improper payments paid by the Federal Government, the lack of adequate financial and inventory controls at the Department of Defense, and waste in other government agencies. This staggering amount is greater than the gross national product of over 80 countries around the world.

This is not a trickle of coins. It is a deluge of dollars that is costing our government its fiscal integrity. Instead of disappearing into the abyss of government balance statements, this money should be equipping our troops in the war on terror, or securing our homeland from attacks, or being used for any other number of very worthy causes, or returned to the taxpayers, for that matter.

For the seventh year in a row, the GAO was unable to audit the Federal Government's fiscal year 2003 consolidated financial statement for three primary reasons. First, serious financial management problems continue to exist at the Department of Defense. Second, the Federal Government is unable to account for billions of dollars of transactions between Federal Government entities. And third, the Federal Government's process for preparing the consolidated financial statements is ineffective.

The government's consolidated financial statement fails to account for a $24.5 billion shift in net position. The amount of this so-called plug in their financial statements is up from a plug of $17 billion in fiscal year 2002. Imagine they just come up with a number, and plug in $24.5 billion to make the balance sheet match. In the private sector, a company with a big plug in its financial statements probably couldn't get any credit from a bank, nor would the Securities and Exchange Commission ever allow such a company to sell its shares to the public. Yet we apparently tolerate this kind of plug, amounting to billions and billions of dollars every year, with our own Federal Government.

In fiscal year 2003, 20 of the 23 Federal departments covered by the Chief Financial Officers Act received an unqualified or clean audit opinion on their financial statements. The Department of Defense, the Small Business Administration, and NASA each received disclaimers. A disclaimer is given when an agency's financial records are so unreliable that an audit simply cannot be conducted, and for that disclaimer of the DOD, we have put up a chart showing the inability to conduct an audit at the DOD because the books and records are in such disarray that heads or tails cannot be made of those statements.[1]

I commend Secretary of Defense Donald Rumsfeld for placing financial management reform on his list of top ten priorities at DOD. In fact, I remember talking to him on the day he was sworn in. He is from my home State, and I thought, if anybody is tailor made to bang heads together and get this problem fixed, it is Secretary Rumsfeld. I know of no one tougher or more qualified for that task.

[1] The chart referred to appears in the Appendix on page 304.

I shudder to think that if Secretary Rumsfeld is having a hard time getting it done, how are we ever going to get this done? It is such a monumental, daunting challenge.

It is daunting because the Department has over 2,200 financial management systems, many of which are redundant or are not integrated, and this has led the GAO to list DOD's financial management and business system modernization on its high-risk list every year since 1995.

Today, we will hear from the GAO about specific examples of wasteful programs that are linked to DOD's financial management, and we have a second chart that should give you an idea of what these programs are. For example, the chart at the end of the dais—and there are two of them, one so that the audience can see over there and one so that Senators can see over here—the chart highlights some of these examples.[1]

Failed business systems—apparently, DOD spent $179 million on two financial accounting systems, and then decided that they didn't work and just terminated the projects with no resultant benefit to the taxpayers or the government. One-hundred-and-fifteen million dollars on thousands of unused airline tickets valued at up to $9,800 each. One-hundred-million dollars for the failure to collect unpaid Federal taxes from DOD contractors. Many people with contracts or companies with contracts from the DOD were continuing to get payments on their contracts even though they weren't paying taxes they owed to the Federal Government. And $34 million annually required to reconcile contract payments. DOD does not have an integrated system, apparently, to reconcile contract payments with contracts. Therefore, it is a labor-intensive process to issue contracts and record then in the payment system.

In all, those examples total over $400 million alone.

In addition to lost dollars, inadequate financial and inventory management also undermines DOD's operations and the security of our troops, and for that, we have another chart at the end of the dais. This chart reflects the GAO's findings of pay problems in the Army Guard that impact morale and retention; the inability to locate more than 250,000 defective chemical and biological safety suits; improper granting of security clearances; and the public sale of sensitive biotech equipment.[2]

And now, beneath that sheet, we have on display an actual chem-bio suit from the defective lot that the GAO found DOD had distributed to combat soldiers, possibly to soldiers in Iraq, as well as local law enforcement agencies. When the suits were found to be defective, DOD could not recall all of them due to insufficient inventory controls. Additionally, the next generation of this chem-bio suit was available for purchase on e–Bay for $3 when, at the same time, DOD was purchasing the same suit for more than $200. Not only is this wasteful spending, but this error places our soldiers and local law enforcement officials at risk.

During the hearing by our full Committee in May of last year, I asked Homeland Security Secretary Tom Ridge about his plans to ensure sound financial management of his new Department and

[1] The chart referred to appears in the Appendix on page 307.
[2] The chart referred to appears in the Appendix on page 308.

he assured the Subcommittee that this was a top priority. Since then, DHS has made significant progress in integrating its 22 component agencies and implementing its budget of $33 billion. We must, however, work to ensure that Homeland Security does not evolve into another DOD, where audit disclaimers are the norm and inventory controls are lacking.

Unfortunately, the first warning flags are waving on the homeland security front. The *Washington Post* reported last November that State and local governments had used Federal homeland security dollars to fill perceived budget holes, including procurement of janitorial services, rather than to fund critical homeland security needs.

The Department of Homeland Security is the only cabinet department not yet subject to CFO Act requirements, but is required under the Accountability of Tax Dollars Act to prepare and have audited financial statements. Last year, Senator Akaka and I introduced S. 1567, legislation that would apply the CFO Act to the Department of Homeland Security. The Senate passed this legislation and the House is expected to pass its version in the near future. We look forward to hearing from our witnesses on their views regarding the importance of applying the CFO Act to DHS.

Publicly traded companies are held to the highest level of scrutiny and financial accountability in order to ensure that accurate financial information is presented to shareholders. The Federal Government should be held to the same level of accountability and provide accurate financial information to its shareholders, the American taxpayers.

This is not an idle exercise in arcane accounting procedure. Every dollar lost to waste, fraud, or abuse or mismanagement is a dollar that could have been used to fight terrorism at home and abroad. Inefficiency makes us all less safe.

Before we hear from our first panel, I would like to recognize the Subcommittee's Ranking Member, Senator Akaka, for an opening statement. Senator Akaka.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Thank you very much, Mr. Chairman. I appreciate you holding today's hearing to review the recent Federal financial audits of the Departments of Defense and Homeland Security. I also want to thank our distinguished witnesses for their testimony and for the efforts they are making in this regard. Mr. Chairman, I want to tell you that I admire you for moving into this area and I want you to know I am on your side.

Just a little over 3 months ago, the Armed Services Readiness Subcommittee held a similar hearing. As that panel's Ranking Member, I had the opportunity to discuss with Comptroller General Walker the shortcomings in the financial management systems at DOD. The General Accounting Office issued its fiscal year 2003 audit of the government's consolidated financial statement in February. Although noting progress with Federal financial management activities, GAO has also found continuing "significant material weaknesses or deficiencies," in the government's consolidated statement for the seventh consecutive year. Among the three top factors contributing to these deficiencies are the serious financial management problems in DOD.

Mr. Chairman, it is disturbing that little has changed at DOD. Since 1995, the Department's financial management has been on GAO's high-risk list and has failed to develop an enterprise architecture blueprint for its business systems even though DOD said the blueprint would be in place by March 2003.

To address these fundamental problems, the National Defense Authorization Act of 2003 required DOD to develop and implement a new financial management architecture and transition plan by early 2004. To date, DOD does not have a blueprint. I am hopeful that today's hearing will help the Department of Homeland Security avoid the financial management problems and resistance to change that plagues the Department of Defense.

Mr. Chairman, you and I have worked together to increase the transparency, timeliness, relevancy, and usefulness of financial information in the mutual funds industry to protect investors. In a similar fashion, we understand that until the agencies get their financial houses in order, the government cannot manage effectively.

Congress and the American taxpayers have the right to know how much Federal agencies spend on providing essential services, how an agency has spent its appropriated funds, and whether there are unspent monies left in the pipeline.

Capturing accounting data is the easy part. What is hard is how to integrate financial data with management systems that are flexible enough to adapt to changing goals and priorities. You and I share the belief that our focus should be not only on what has gone wrong, but on how we can move forward in a constructive way to address the underlying problems.

In fiscal year 2003, the authorization for both the Departments of Defense and Homeland Security totaled $487 billion, or 22 percent of the Federal budget. Given that fighting terrorism and the war in Iraq will continue to dominate other budget priorities, we must fully understand why DOD and DHS are encountering difficulties in reconciling their annual statements. Failing to do so will limit our ability to make sound budgeting decisions in the future. Moreover, without improving financial management systems, there will be further incidents such as when the Bureau of Immigration and Customs Enforcement at DHS imposed a hiring freeze because its financial management system indicated current and projected spending would exceed its budget.

We are faced with enormous financial challenges which demand timely and accurate financial data in order to instill accountability and ensure Federal programs are executed in the most effective manner.

The establishment of DHS was the largest government reorganization since the late 1940's. I commend DHS for meeting the challenges of starting a new Department. However, the consolidation of the legacy agencies into one Department has resulted in a non-integrated financial management system which puts the entire Department at risk.

I support putting DHS under the Chief Financial Officers Act, which is why you and I introduced legislation last year to do that. Widening the scope of DHS's financial regulations would improve the agency's ability to manage effectively and efficiently the inherited financial activities of its legacy agencies and those unique to its new organization.

This is what we are looking at at this hearing. I want to thank our witnesses and look forward to their testimonies. I know you all will be helpful to us. And I want to thank you, Mr. Chairman, again for this hearing and for what you are doing.

Senator FITZGERALD. Senator Akaka, thank you very much.

I would now like to introduce our first panel of witnesses. Our first witness on this panel is the Hon. David M. Walker, Comptroller General of the United States. Mr. Walker began his 15-year term as the Nation's Chief Accountability Officer and was appointed in 1998 as head of the U.S. General Accounting Office, now referred to as the Government Accountability Office. Through his role as Comptroller General, Mr. Walker oversees the GAO's work to improve the performance and accountability of the Federal Government, including measures to improve the efficient use of taxpayer dollars.

Our second witness is the Hon. Linda M. Springer, Controller of the Office of Federal Financial Management at the Office of Management and Budget, the OMB. Ms. Springer was confirmed in this position on March 31, 2003, after having joined OMB in September of 2002. In her role as Controller, Ms. Springer provides governmentwide leadership for strengthening the financial management of the Executive Branch, including the Improved Financial Performance Initiative of the President's Management Agenda.

Our third witness is Donald V. Hammond, Fiscal Assistant Secretary at the Department of the Treasury. Mr. Hammond has served in this capacity since September 27, 1998, after serving as the Deputy Fiscal Assistant Secretary since July 1996. In his current position, Mr. Hammond is responsible for management of the government's cash flow and the operation of governmentwide financial accounting and reporting systems, including the consolidated financial statements of the United States.

Again, I would like to thank you all for being here today, and recognize, please, that your prepared statements will be submitted in the Subcommittee's official record of this hearing, and please feel free to summarize your remarks off the top of your head if you feel able to do that. If you could try and keep your remarks to 5 minutes, we would appreciate it.

Comptroller General Walker, thank you.

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

Mr. WALKER. Thank you, Mr. Chairman and Senator Akaka. It is a pleasure to be back before you. I would like to thank both of you at the outset for your support of the Human Capital Reform Act of 2004 for GAO, which was signed by the President yesterday. It is really going to help us and I appreciate your support.

I also would like to thank you for holding this oversight hearing. Candidly, there is not enough oversight being done in a number of areas. There is not enough attention being placed on the impor-

[1] The prepared statement of Mr. Walker appears in the Appendix on page 45.

tance of sound Federal financial management practices, and I want to commend you and thank both of you for taking time out of your very busy schedules to conduct this hearing and be here today.

As you mentioned, Mr. Chairman, as in the six previous years, or otherwise for the seventh year in a row, certain material weaknesses in internal control and selected accounting and reporting practices resulted in conditions that did not allow the GAO to express an opinion on the consolidated financial statements of the U.S. Government. We did perform a number of audit procedures, and fairly extensive audit procedures, in conjunction with the auditors of various departments and agencies, but certain impediments were there that have been there for a number of years that prohibited us from being able to express an opinion.

While the Federal Government has not yet been able to prepare auditable financial statements, the requirement imposed by the CFO Act and others Acts for there to be annual audits has yielded important results to date. We have seen continuous improvement and significant progress with regard to the number of agencies that have been able to achieve clean opinions on their financial statements, but more importantly, we have seen a continuous improvement among most Federal agencies in their ability to generate timely, accurate, and useful financial information to make informed decisions on a day-to-day basis.

In that regard, in fiscal 2003, as was the case in fiscal 2002, 20 of the 23 CFO Act agencies were able to obtain an unqualified opinion on their financial statements. That is up from six agencies in 1996. However, only 3 of those 20 agencies met the more substantive definition of success in financial management that has been agreed to by the Director of OMB, the Secretary of the Treasury, and myself as Comptroller General of the United States, namely that not only do you have a clean opinion on your financial statements, but you have no material control weaknesses, no major compliance problems, and systems that provide for timely, accurate, and useful information to make sound management decisions on a day-to-day basis. Only the Energy Department, the National Science Foundation, and the Social Security Administration met that more substantive test, and I would like to congratulate and acknowledge the efforts of all three of those agencies.

As you mention, Mr. Chairman, there are three major impediments to the ability of the GAO to express an opinion on the consolidated financial statements of the U.S. Government. First and foremost, serious financial management problems at the Department of Defense, which is the largest agency in the Federal Government.

Second, the Federal Government's inability to fully account for and reconcile transactions between various Federal Government entities. And third, the Federal Government's process for preparing the consolidated financial statements, which can result in the plug that you referred to.

The fact of the matter is, significant progress is being made on No. 2 and No. 3. Some progress is being made on No. 1. But that is the big challenge and we are not going to be in a position to express an opinion on consolidated financial statements until the

DOD issue is dealt with, and that is by far the most complex challenge that remains before us.

Mr. Chairman, irrespective of where we stand on financial management with regard to current and past activity engaged by the Federal Government with taxpayer money, I think it is also important that we start looking from a more strategic perspective. There is a problem with regard to how the Federal Government currently keeps score, both for accounting and reporting standpoint and also from a budgetary perspective. The simple fact of the matter is, if you look at the consolidated financial statements of the U.S. Government as of September 30, 2003—and this chart shows various related numbers. There are a lot of numbers up here, so I will try to hit the bottom line.

It will show you that since the beginning of the Republic in 1789, we have run up about $7 trillion—that is a "T" as in trillion, 12 zeros—in total debt, debt held by the public as well as debt held by the "trust funds," like Social Security and Medicare. And yet what it doesn't show adequately is that we have a number of significant commitments and contingencies that we have already made that are not shown as liabilities for various reasons but yet are very real, for example, the difference between the projected cost in discounted present value dollar terms of Social Security and Medicare and the amount of payroll taxes and other premiums that we expect to receive.

If you look at how much money we would have to have today invested at Treasury rates to deliver on the promises that have already been made, it is really not $7 trillion, it is more like $42 trillion. That is over three-and-a-half times the entire economy, about 18 times the current Federal budget, over $140,000 for every man, woman, and child in the United States.

Senator FITZGERALD. Isn't it $32 trillion?

Mr. WALKER. Forty-two trillion plus.

Senator FITZGERALD. Forty-two?

Mr. WALKER. That includes the $7 trillion. And of that $42 trillion, roughly $27 to $28 trillion is Medicare, and of that, roughly $8 trillion is the new prescription drug benefit.

So the bottom line is, we have a number of commitments and contingencies that already exist that we are going to have to come to grips with, and the way that we look at things from a budgetary standpoint is problematic because 10-year horizons are simply not adequate given the demographic challenges that we face. This chart represents the result of the most recent long-range budget simulation by GAO, which shows that we face large and growing structural deficits due to a number of factors, including known demographic trends and rising health care costs.

And in the final analysis, Mr. Chairman, the Congress is going to have to review and reform basic entitlement programs, look at the base of discretionary and other spending, and look at tax policy in order to close this gap. But that is going to take a concerted effort by a variety of parties over a number of years.

So in summary, Mr. Chairman, progress clearly has been made, in large part due to the acts that Congress took in the 1990's to legislative important management reforms, not just in the financial management area but other areas, to bring good management practices, if you will, to the Federal Government. Progress has been made. It is continuing to be made. The big challenge is the Department of Defense. We are committed to doing our part to try to help, not only deal with financial management challenges, but also the imbalances that lie before us, and I look forward to working with you, Senator Akaka, and others to address these challenges.

Thank you, Mr. Chairman.

Senator FITZGERALD. Thank you, Mr. Walker. Ms. Springer.

TESTIMONY OF LINDA M. SPRINGER,[1] CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, U.S. OFFICE OF MANAGEMENT AND BUDGET

Ms. SPRINGER. Thank you, Mr. Chairman and Senator Akaka. I am happy to be here today with you to discuss our Financial Report of the U.S. Government for Fiscal Year 2003 and other related financial management issues. I look forward to sharing with you some of the significant progress made by Federal agencies during the past year that underlies that report and positions it for the future.

Financial management extends beyond receiving an unqualified audit opinion. Integrity and reliability, the things to which a clean audit attests, should be a given. First class financial management requires the integration of the financial impact of an agency's activities into the operational, execution, and senior management decisionmaking at an agency, just like it does in the private sector. It is accompanied by accountability standard setting, performance tracking, and other analyses. These are among the characteristics we should seek in the Federal Government, every bit as much as we do in the private sector.

Only a few short years ago, such a standard was not prevalent in the Federal Government. Through the President's Management Agenda, the Office of Management and Budget has set what many view to be very aggressive goals to achieving respectability in the government's financial management practices. It is not surprising that this results-focused approach, while acknowledged to be a positive influence, has forced significant and challenging process modifications at many agencies. The degree of transformation reflects just how far we have had to go to catch up to accepted practices of well-run financial management organizations in the private sector.

So the question is, are these efforts that we describe paying off? Well, the answer is an indisputable yes. Where it took agencies 5 months to prepare audited financial reports in the past, it now takes 45 days for many and only 2½ months for most. Agencies are building on momentum from our fiscal year 2003 reporting acceleration successes to achieve the mandatory November 15 reporting date for fiscal year 2004. Interim financial reports were unheard of before 2002 and they are now being completed by 21 days after the close of each calendar quarter.

It is often said that these achievements are only achieved by— or these accomplishments are only achieved by heroic efforts, and hard work is always a factor, but these results are really a tribute

[1] The prepared statement of Ms. Springer appears in the Appendix on page 89.

to detailed planning, to effective management, and excellent execution.

While the acceleration targets are critical, they are not our ultimate objective. Rather, the discipline and improved control needed to accelerate financial reporting is only the foundation for ensuring the availability of useful financial information. The incorporation of timely and accurate financial information into management decisionmaking and operational assessment continues to be our main goal.

Progress toward this goal during fiscal 2003 was shown by the addition of two agencies, the Social Security Administration and Environmental Protection Agency, that achieved green status under the financial initiative of the President's Management Agenda. These agencies were later joined by the Department of Education in the first quarter of 2004. Today, not only do the managers in these agencies have timely and accurate information, but they are using it for their program assessment and for their planning.

I wanted to say here that if you have accurate and timely financial information, and you really need to have both, you are able to do those things. If you have accurate information but it is too late to use it, then it is worthless. If it is on time but it is inaccurate, you had better not be using it. So you really need to have both accurate and timely information. We believe that meeting timely reporting standards and getting clean audits is evidence that the agencies will have that information for their management and their decisionmaking.

The mandatory financial reporting date of November 15 will require much work from the agencies this year. However, this accelerated deadline is an attainable goal, shown by the large number of major agencies, over 75 percent, that were able to report their financial statements by the end of December last year. So they have made significant progress. They have a little bit further to go. In those cases, strong agency senior leadership, careful planning, innovative thinking, and focused efforts were all necessary elements for success.

This fiscal year, we are meeting regularly with each CFO of the agencies as well as their IGs to review plans for hitting their November deadlines. Clearly, some agencies have more challenges and obstacles than others, but all agencies are expected to take necessary steps to meet the accelerated date.

Some of the best practices that agencies are implementing include disciplined processes and audit schedules, aggressive tracking and issue resolution in risk areas, reengineering of their financial reporting processes and their audit processes, early and frequent communication with their auditors from that opening conference on day one at the beginning of the year right on through, and focused financial management priorities.

So we will continue to work and we meet with the high risk agencies on a monthly basis from now right up through November 15.

There are some emerging issues that I would like to share with the Subcommittee briefly. Internal control—the internal control environment of any entity is an area of focus both for management and for the auditor, and the agencies of the Federal Government are no exception. There are several existing laws that govern agencies in assessing and representing the quality of their internal control. However, not all agencies are able to provide the positive assurance that goes with those requirements. But all continue to make progress in eliminating barriers to compliance. Many of these are longstanding system issues that will take a period of years to require full remediation.

However, what you should know is that both OMB and the CFO Council and the Inspectors General are working together today to review the internal control challenges and what the best way is to close the gap between where we stand today and a Sarbanes-Oxley type of management control environment.

The other issue I would like to bring to your attention in the emerging category is related to unfunded liabilities and social insurance scrutiny. As mentioned by Comptroller General Walker, this is an area of high concern and FASAB, the Federal Accounting Standards Advisory Board, has taken some steps already to increase audit scrutiny and the prominence of the social insurance statements within the Government's Consolidated Financial Report. So in the future, you will see that in a more prominent position in the statement. It will become one of the basic statements and it will receive full audit scrutiny. So that is a step toward having information that is certified in a way that we can make the right policy decisions about funding.

So our outlook for the future, to summarize, is that we have seen many achievements in the past year, but there remains a long way to go. We will continue to set and achieve higher standards of performance dealing with issues like asset management, elimination of improper payments, and many other areas that we believe to be fertile ground. It is our opinion that the Federal Government should be held to as high, if not a higher, standard than financial management in the private sector, and I was happy to hear you, Mr. Chairman, say the same thing.

American citizens don't have the option of taking their investment elsewhere. They have to pay their taxes. So we owe them the highest level of scrutiny and management of the taxpayer dollars that they have entrusted with us. We believe it is incumbent on every financial professional in the government to execute their duty according to those standards of excellence, and that is what we are striving to do. We have made some progress and we are going to continue on that path. Thank you.

Senator FITZGERALD. Ms. Springer, thank you very much. Mr. Hammond.

TESTIMONY OF DONALD V. HAMMOND,[1] FISCAL ASSISTANT SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Mr. HAMMOND. Mr. Chairman, it is my pleasure today to represent the Treasury Department to discuss the status of the Federal Government's financial reporting, and in particular the Financial Report of the U.S. Government. We have come a long way in the 7 years that we have prepared this report, but we face some significant challenges, and as such, the financial report is indeed

[1] The prepared statement of Mr. Hammond appears in the Appendix on page 95.

a work in progress. My written testimony today explains more fully the challenges we face.

The Committee's interest today, however, is very important because this is an area, as the Comptroller General has pointed out, that needs continuing scrutiny. The Treasury Department has a longstanding responsibility and commitment to report accurate and useful information about the Nation's finances. Our objective in preparing the consolidated financial statements is to provide the Congress and the public with a reliable, consistent, timely, and useful report about the costs of the government's operations, the sources used to fund them, and the implications of its financial commitments.

I am pleased that last year, we were able to release the report a month earlier than in prior years. That accomplishment is due in large measure to the progress that the agencies have made in accelerating their financial reporting. For the 2004 statements, as you have already heard, OMB has requested that the agencies prepare statements by November 15 and the governmentwide statements will be issued by December 15, based on those agencies' submissions. This more timely preparation of the Consolidated Report means that the financial information will be available prior to the release of the President's budget and providing actual data on an accrual basis for reference in those discussions.

The financial report is an important addition to Federal financial reporting. It provides an across-the-board look at the Federal Government, computed in accordance with accrual accounting standards established by independent Generally Accepted Accounting Principles, or GAAP. The report goes beyond simple reporting of results, as it displays the effects of all significant assets, liabilities, stewardship responsibilities, and other commitments and responsibilities. The considerable financial implications of the government's social insurance programs—Social Security and Medicare in particular—are reported in the stewardship accounting.

The report is subject to audit by the GAO, and although the report has improved over the years as we have strived to make it more useful, the GAO has been unable to render an opinion on the financial statements. For the 2003 report, as has been noted today, GAO cited three principal reasons for the disclaimer. As the next panel will no doubt discuss, the DOD has displayed a strong commitment to correct its extensive financial management problems through a comprehensive financial management modernization program. Therefore, I will focus my remarks on the two other material weaknesses.

We have a number of initiatives underway to resolve the material weaknesses and to improve the government's management and accountability. The Financial Management Service, Treasury's bureau responsible for governmentwide accounting operations, is making real progress. We have been focusing on the problem of intergovernmental activity and balances and are devoting much attention to help agencies fully reconcile these areas through the development of a new analytical tool and increased reporting frequency. I am optimistic that the reporting for the quarter ended June 30 will show significant further improvement.

However, I must note, there is not a single centralized system solution to the problem of intergovernmental balances. Each agency's management must make it a priority to improve the agency's data quality, reconcile amounts with their trading partners, and adhere to the standard business rules issued by OMB for processing intergovernmental transactions. This is basic to accurate and consistent financial reporting.

With regard to the report preparation weakness, we are addressing each of the three aspects. For the unexplained transactions that affect the change in net position and that require us to use a reconciling entry, or plug, in the financial statements, we believe the larger problem has its roots in the intergovernmental balances, but we are also employing other analytical techniques because we believe that there may be some activity related to custodial revenues reported by the agencies.

As a result, we are taking those various components apart and hoping to be able to understand more fully the causes of that issue as we understand the intergovernmental balances, as well as how certain custodial revenue may be reported.

As to the need to directly link agencies' audited financial statements with the data used for compiling the governmentwide reports, FMS is completing the implementation of a new closing package system. This new system will provide a clear audit trail that will facilitate the audit of the financial report and demonstrate that it is consistent with the underlying information in agencies' audited financial statements. We are also addressing the process to ensure that the notes or disclosures in our report are in compliance with GAAP.

In summary, I look forward to meeting the new due dates this year, but I recognize the difficulties involved. We are dealing with a new central reporting process and are working with agencies whose financial reporting is not yet where it needs to be to meet these dates. That being said, I visualize the day when we have fully achieved more timely reporting and can obtain the full value of financial reporting by having reports that are truly useful. Usefulness is the final element of effective financial reporting. Financial reports should provide relevant financial and performance information that not only supports management decisionmaking, but also informs the public. Herein lies the greatest challenge and potentially the greatest benefit from our financial reporting.

We have come a long way. Our upcoming challenges are significant, but manageable, and I am confident that we will continue to see real progress. Thank you, Mr. Chairman, and that concludes my remarks.

Senator FITZGERALD. Thank you. I want to start with a question that takes a little bit of heat off of the Executive Branch of Government. Mr. Walker, right now, there are no audits of the Legislative or Judicial Branches of Government, are there?

Mr. WALKER. Well, there are audits of many Legislative Branch entities. For example, GAO has an audit. Several of the other Legislative Branch agencies also have audits.

Senator FITZGERALD. Does the Senate or the House have an audit?

Mr. WALKER. It is my understanding that the House does have an audit. The Senate does not have an audit. However, the Senate is trying to take steps right now to explore the possibility of voluntarily doing an audit, even though they are not required to by law.

Senator FITZGERALD. How about the court system?

Mr. WALKER. No. They are not required, and I think the Administrative Conference of the Courts is obviously the entity that is the most logical one to take a look at, if Congress decides to pursue such a requirement.

Senator FITZGERALD. Since nobody is auditing that co-equal branch of government called the Judicial Branch, it is just not being audited?

Mr. WALKER. That is my understanding, Mr. Chairman.

Senator FITZGERALD. And the Senate and the House, the House is maybe auditing itself? Do you get to review those audits or comment on those?

Mr. WALKER. They are not material to the consolidated financial statements. I mean, we have the ability to do it. We do not perform that audit ourself, and for a variety of reasons, I don't think it would be appropriate for us to do that.

Senator FITZGERALD. Maybe because we control you. [Laughter.]

Mr. WALKER. It would be challenging to audit individual offices of Senators and Members of Congress. Let us just say that would be something we would prefer not to have to do directly ourselves.

Senator FITZGERALD. I understand. Let me ask you this about the consolidated financial statements of the U.S. Government. Do you put figures in there representing the Legislative and Judicial Branches of Government?

Mr. WALKER. That is correct. We do, Mr. Chairman.

Senator FITZGERALD. And where do you get those figures?

Mr. WALKER. We get them based on information that they report. I mean, many entities will report information, but that information may not be audited.

Senator FITZGERALD. OK.

Mr. WALKER. And Don may want to comment, since he is responsible for the consolidated financial statements.

Mr. HAMMOND. What we use is primarily the budgetary information for those three entities, combined with the audited financial reports for the components of the Legislative Branch that do prepare statements, such as the General Accounting Office, or, I am sorry, the Government Accountability Office—it will take me a little while to get used to that one—as well as the Library of Congress.

The Administrative Office of the U.S. Courts for the Judicial Branch is a particular challenge, because even there, the extent of the budgetary information is even more limited than what we receive from the Legislative Branch. We don't believe that those are particularly material balances. That being said, we would like the report to be complete and we would also like to be able to establish the significance of those amounts.

Senator FITZGERALD. At future hearings, perhaps, this Subcommittee, I hope, will take up that issue.

Are you putting accrual figures in this consolidated report for unfunded liabilities? Is it appropriate to say that this report is prepared in conformity with accrual accounting?

Mr. WALKER. It is based upon accrual concepts, and I think it is important to note that substantial progress has been made over the last several years to enhance the transparency and also the accountability associated with some big numbers, for example, Social Security and Medicare commitments. I am pleased to say that several years ago, the Federal Accounting Standards Advisory Board created a separate statement that included discounted present value numbers for these programs for the first time. They subsequently made it a primary financial statement, or basic financial statement, and it is now going to be subject to audit. So that is tremendous progress, if you will, and it is using accrual concepts, which I think is important.

Senator FITZGERALD. And are you looking at the assumptions used in coming up with those accrual numbers and checking them to make sure that they are reasonable?

Mr. WALKER. We look at the methodology that is employed, whether or not that methodology is generally accepted. We look at the reasonableness of the assumptions. And as you know, Mr. Chairman, in the case of Social Security, Social Security Administration is audited, I believe, by PriceWaterhouseCoopers, and in the case of CMS, which is responsible for Medicare, I believe they are also audited by PriceWaterhouseCoopers.

Senator FITZGERALD. That is where those unfunded liabilities are—it is PriceWaterhouseCoopers for the Social Security unfunded liability. Are they coming up with that number?

Mr. WALKER. They are working with the actuaries for the Social Security Administration as well as the actuaries for the Center for Medicare and Medicaid Services.

Senator FITZGERALD. OK.

Mr. WALKER. They need to satisfy themselves, and we obviously have to satisfy ourselves to the extent that we are going to be in a position to express an opinion. But as I mentioned before, unless and until the Department of Defense gets its act together, and they are working hard to try to do that, we are not going to be in a position to express an opinion on the consolidated financial statements.

Senator FITZGERALD. OK, and I will get to the Department of Defense in a moment, but in your consolidated financial statement, I think there is some point at which you discuss the explicit debt per American, our national debt per American, and I think it is some $7,000. But then when you factor in the unfunded liabilities, the debt per American citizen is really closer to $100,000.

Mr. WALKER. Well, it depends on how you look at it, Mr. Chairman. Using the most up-to-date numbers, if you look at the per capita burden, if you will, and that is what I would call it, a burden, per American based upon the total debt, which is around $7 trillion as of this point in time, that is about $24,000 for every man, woman, and child in the United States. If you add on top of that not just the results of historical activity but also what the difference is between how much we have promised and the revenues that we have dedicated to meet those promises for things like Social Security and Medicare and you calculate the gap today, the burden goes from about $24,000 per person to over $140,000 per person.

Senator FITZGERALD. Over $140,000?

Mr. WALKER. That is correct.

Senator FITZGERALD. OK. And you are not talking per family, you are talking per person?

Mr. WALKER. Including the newest newborn.

Senator FITZGERALD. So that is a big number. Now, with respect to the DOD, what are we going to do about the DOD? This is apparently just a humongous problem that we are having a hard time getting our arms around. I remember Secretary Rumsfeld when he first inquired about this issue when he first took over, even before he was sworn in. I think he had talked to the accounting people at DOD, and they had told him that their accounting system was designed not really to do financial accounting, but it was more designed so that they could tell Members of Congress what projects they were doing in each of their districts. It was a whole mess, and the whole system needs to be revamped.

Ms. Springer, in your judgment, are we making progress there, and how long will it take? This has been going on a very long time now, since the requirement of audited financials was put in place. Was that 1995?

Ms. SPRINGER. Ninety-six.

Senator FITZGERALD. Ninety-six. So we are talking 8 years or so. We still can't get it right. When do you think we will be able to get it right at DOD?

Ms. SPRINGER. I don't know what the date is, and I would be interested in what your next panel tells you the date is, and I hope you ask them that same question——

Senator FITZGERALD. They are going to be asked, yes.

Ms. SPRINGER. But what I believe is going on there at DOD and where I think they should head next is the following. There is a huge effort, their overall business modernization program that I am sure they will tell you more about. But what doesn't get much publicity is some of the smaller issues and efforts that deal with specific line items, for example, on their balance sheet.

One area—88 percent of their liabilities, I believe, or somewhere in that range—deals with post-retirement benefit liabilities. They have gotten, I think, roughly half of that to the point where it would get a clean opinion, if it were subject to an audit today. That kind of thing doesn't make the headlines, post-retirement benefit liabilities and the opinion on that. But they are working through various line items on their balance sheet at the same time that they are doing this huge, mammoth, overall reengineering process.

We believe that filling the under secretary position, CFO position, comptroller position at the Department of Defense is critical for that effort to get back on track, in my view, and continue to make progress.

Senator FITZGERALD. That position is vacant now?

Ms. SPRINGER. There is a nominee that has not been confirmed, and we believe there is a leadership issue. They can have all the project managers in the world on this project——

Senator FITZGERALD. How long have they had that situation?

Ms. SPRINGER. Since Dr. Zakheim left, I think, roughly in the spring. And I don't know what the prospects are, but I believe that when you have a leadership void, if you will, or an empty slot in a very key position, and Dr. Zakheim gave very significant motivation and leadership there, forcefulness, I think that the project suffers, frankly.

Senator FITZGERALD. So right now, they are without a general in their war on cleaning up their accounting mess.

Ms. SPRINGER. You can ask them if they feel that way——

Senator FITZGERALD. OK.

Ms. SPRINGER [continuing]. But I believe that it has an impact.

Senator FITZGERALD. OK.

Ms. SPRINGER. I also believe that the Department needs to take a step back and carve out some pieces of that effort, maybe certain components or certain projects or certain issues to work at in a more concentrated way with their auditor and their Inspector General to try and make progress on those smaller pieces. It is a huge mountain to move and I think that is why it is difficult to show progress. I think it would be helpful to pick certain components where you can maybe get some hits.

Senator FITZGERALD. Does OMB lean on the DOD in this area?

Ms. SPRINGER. I am working right now with other parts of OMB, the "B" side of the house, if you will, to come up with some recommendations and we plan to meet with DOD shortly. This would be news to your second panel that we are starting to think this way.

Senator FITZGERALD. OK.

Ms. SPRINGER. It is not to take any emphasis off their existing project, but we believe that maybe some sub-segments of that might be helpful to address.

Senator FITZGERALD. Now, Mr. Walker, if DOD were at least able to get a qualified opinion, would that enable you to do a consolidated financial statement that would be auditable?

Mr. WALKER. Depending upon the nature of the qualification. If they could get to a qualified opinion and we could get comfortable as to the basis for that qualified opinion, that could put us in a position to issue a qualified opinion on the financial statements as a whole. I doubt very seriously that if they have got a qualified opinion that we would get to the point of being able to issue an unqualified opinion on the overall financial statements.

I would say, if I can, Mr. Chairman, I think this is very important, since DOD is really the biggest challenge that we face, several comments for your consideration and Senator Akaka's. I think it is going to take several things to get them to where they need to be.

First, they have to have commitment from the top and it has got to be a priority——

Senator FITZGERALD. Do you think that commitment is there at the Secretary's level?

Mr. WALKER. Yes. I do believe it is there and I want to note that for the record. I do believe the Secretary is committed. I do believe that the key players who are in place are committed. There are, however, some critically vacant positions right now. For example, the Under Secretary and Comptroller position is vacant. Without the person who is on the point, responsible and accountable, you are not going to make much progress, quite frankly.

Second, I think they are going to need some additional resources. They are going to need some new talent within DOD. They are also going to need some contractor assistance to be able to get this done. They also need to complete a plan for how they are going to get from where they are today——

Senator FITZGERALD. Couldn't they have just contracted out this whole thing to fix this?

Mr. WALKER. Well, in theory, you could, but there are a number of major challenges there. There are independence issues. There are so many of the major firms that have done work in the Department of Defense in the financial management area that they may not be deemed to be independent under Generally Accepted Government Auditing Standards, and we are working in a constructive way with the Inspector General, who is assuming responsibility for this audit and who will have significant contractor assistance, to help sort through those issues.

There is no way that the IG can do it by themselves, and quite frankly, it would be difficult for any one firm to do it by themselves because the DOD is one of the largest and most complex entities on the face of the earth, if you looked at it as a separate enterprise by itself. But they have to have a plan, and on that plan to recognize that they are going to go from no opinion to a qualified opinion to an unqualified opinion. In that regard, they should do it in a matrix fashion. By that I mean, recognize that they need to look at various entities or units, and try to get clean opinions on certain units, and then they need to look horizontally on functional activities and line items, as was mentioned, to try to get them to where they need to be.

Senator FITZGERALD. Would you be able to suggest what parts of DOD are particular problems in this regard, or do you have an idea?

Mr. WALKER. Well, frankly, their problems are pervasive. They have problems from the standpoint of the asset side. They have problems from the standpoint of the liability side. Controller Springer just noted the fact that they are making progress with regard to post-employment obligations. That is a huge number on the balance sheet. But we need to make some progress on the asset side.

Two other things real quickly, Mr. Chairman, and that is they have to have the resources. Congress is working to provide those resources, but they have got to have the plan to effectively use those resources to make sure there is not waste and that they get real results. They need to modify their performance management systems to link the ratings of the key people with the results that we are trying to achieve.

And lastly, there needs to be ongoing and effective oversight. Frankly, this, until recently, has not been a priority for the Department but it is now. As you know, DOD has 9 of GAO's 25 high risk areas.

And the last thing I want to mention on this, I believe very strongly if we are going to solve the basic management problems at DOD, we need a Chief Management Officer at DOD who is a level two official, who is a pro, who has a proven track record for success, a term appointment, a performance contract, who will take a more strategic integrated and innovative approach not just to financial management but to the enterprise architecture, the logistics systems and things of that nature. The absence of having a pro who has got a proven track record, who is going to be there long enough to get it done, at the right level, has been a huge impediment and I question whether we are going to be successful without it.

Senator FITZGERALD. And maybe we need to pay that person an extraordinary amount—I am thinking, why is somebody who is qualified to do that actually going to want to come in and take over that headache?

Mr. WALKER. I actually believe that there are persons who would do it for their country because it would be a huge challenge. And it may be somebody, for example, that retired early out of the private sector, hopefully with some prior public sector experience, who has made money and wants to do something for their country.

The problem is that without that person who is responsible and accountable, who has got a proven track record, who is going to be there long enough and is at the right level to get the job done, I question whether we are ultimately going to effectively address not just this area, but frankly, a whole range of high risk areas within DOD.

Senator FITZGERALD. Thank you. Senator Akaka.

Senator AKAKA. Thank you, Mr. Chairman.

Mr. Walker, as always, I have enjoyed working with you and talking with you.

Over the years, you have made an impressive case for financial transparency and accountability in the Federal Government and you have just given us some idea as to what needs to be considered to begin this kind of change which should start from the top level. Unless we do that, then we can't begin to make changes.

You have long stated that the key to breaking down parochial interests and stovepipe approaches would be establishing mechanisms to reward organizations and individuals for behaviors that comply with DOD-wide and Congressional goals. Unfortunately, we continue to see a lack of progress in this area.

Let me follow up on Senator Fitzgerald's question. Has the Department set up the necessary mechanisms to reward organizations and individuals for working toward overall financial management goals in a coordinated manner, and if not, what can we do to move DOD in that direction?

Mr. WALKER. Well, Senator, first, they have taken some steps, but they need to take many more. As you know, DOD achieved enactment of the National Security Personnel System Reform Act, which will give DOD the ability to modernize and design new human capital policies and performance management systems in ways that they have not been able to in the past.

I think it is important that we recognize that this is a challenge not only at the senior executive level, not just for the political appointees, but also for the career civil servants and that key changes need to be cascaded down through all levels of the organization. We need to define what we are trying to achieve, what are the measures of success, what are the key milestones, and then to be able to link institutional, unit, and individual performance measurement reward systems with those desired outcomes and key milestones.

If you do that, it will have a powerful impact. But in order to be able to do it, you also have to have not only the plan and the infrastructure in place, you have got to have the leader who is going to be there long enough to get the job done. And from a practical standpoint, historically, there is frequent turnover in key leadership positions and this is a multi-year task, there is no doubt about it.

Senator AKAKA. Ms. Springer, let me follow up on my question to Mr. Walker. Since linking goals and performance measures are key components of the President's Management Agenda, would you please comment on Mr. Walker's response and discuss how OMB is working with the DOD on this problem.

Ms. SPRINGER. From a general standpoint of linking performance and results to budget, for example, we have, as you know, our PART process at OMB that now is working through—has been generally accepted, I think, by all of the agencies to align our budget requests and the strategies of the agencies to performance of programs so that the demonstration of results has really become the ultimate test in whether or not taxpayer dollars should be reinvested in programs. Are they succeeding? Are they getting the benefits that were expected and promised?

To the extent that we are talking about human capital issues, which I think was your specific question, I believe that also comes within that scope of the PART and also is a part of the President's initiative with respect to human capital, one of the five initiatives under his management agenda. But there is an overall support by the administration for results-based compensation. The Human Capital Performance Fund, I think, was an initiative of the administration, certainly in that area, and we remain committed to that.

Senator AKAKA. Mr. Walker.

Mr. WALKER. As you probably know, the Office of Personnel Management has the lead on human capital issues under the President's Management Agenda. In that regard, they just hired one of our senior executives to try to help work with DOD on some of these issues and we at GAO are trying to work in a constructive fashion with Navy Secretary England, who Secretary Rumsfeld has designated as a point person on the NSPS design and implementation, to try to share knowledge and best practices in a constructive way without compromising our independence.

Senator AKAKA. Thank you, Mr. Walker. Mr. Hammond, I would like to thank you for your attention to improving the financial reporting of Federal agencies. I am also interested in the governmentwide Accounting Modernization Project, which is, I understand, now underway. I understand that GWA enables agencies to process certain transfers and transactions without having to complete burdensome paperwork.

My question to you is, since GAO has identified intra-agency transfers as one of three impediments to consolidated financial statements, what safeguards are built into GWA to ensure that the convenience of this project does not compromise the security of financial information and become a mechanism for waste, fraud, and abuse?

Mr. HAMMOND. The GWA project is really an exciting opportunity to totally change the way we are going to do budgetary accounting. It is the capability and the long-term vision to build a web-based system so that agency financial information from the budgetary operations will flow automatically into the central accounting systems. It is the primary way of solving a number of the issues that today we are trying to clean up after the fact as they deal with budget authority, budget transfers, and that level of intergovernmental activity.

What it is going to do is, and certainly the phases that have been implemented already have effectively done, is allow an agency to enter a transaction once, not only complete the transaction but carry out the accounting related to that transaction at the same time, thereby posting the balance consistent with the transaction itself, eliminating the need for clean-up activity after the fact, removing the potential for mispostings or misclassification after the fact as someone is trying to do the accounting subsequent to the transaction.

It really will, once fully enforced, provide us with an opportunity to get rid of amazing numbers of reconciliation activities across the agencies. It is, though, however, that level of fundamental change that is going to take some time, because the agencies, in fact, have to be prepared to provide the feeder data into the system at the same time.

As for the security of the system, we have built it around a fairly robust Internet IP platform. Because these are not actual financial transactions in the traditional sense—there is not money leaving the government—the level of security is consistent with the risk involved. This doesn't trigger spending. This is reporting on moving budget authority from pocket A to pocket B, for example, with regard to transfer activity.

Senator AKAKA. Mr. Walker, as you know, the Department of Homeland Security is not subject to the Chief Financial Officers Act and, therefore, is not required to implement and to maintain financial management systems that comply with the government-wide standards. Also, its Chief Financial Officer is not confirmed by the Senate. As an original cosponsor of the 1990 CFO Act, I believe this law continues to offer a firm foundation on which agencies should build their financial management practices.

My question to you is, what impact do you believe the exemption from the CFO Act has had on the financial situation at DHS?

Mr. WALKER. Well, as you know, while they are not covered by the CFO Act, they are covered by certain other acts which require them to have audited financial statements.

I think to a great extent, this is a philosophical issue. The Department of Homeland Security is one of the largest Department in the Federal Government. It is on our high-risk list as it relates to the integration and transformation of that Department. It has significant responsibilities that are of importance to all Americans, and it has a tremendous amount of financial resources. From an intellectual standpoint, it is hard to see why the Department of Homeland Security would not be covered under the CFO Act.

With regard to the confirmation issue, if I might add, Senator Akaka, GAO and I myself as Comptroller General have testified, are there certain agencies that I believe could benefit from this chief management official—chief operating officer, whatever you want to refer to the title—and I think to the extent that position is in place, Congress needs to consider whether and to what extent the positions that would support to this chief management official should be Senate confirmed.

I think it is very important that there be statutory qualification requirements for these persons and that they be presidential appointees, but I think that if we can get the right type of person at the level two level, as the chief management official with a term appointment and a performance contract, with a proven track record, you might want to reconsider which positions below that level should have Senate confirmation. That doesn't mean they wouldn't have visibility. That doesn't mean they wouldn't be presidential appointments. That doesn't mean they wouldn't have statutory qualification requirements. Those things, I think, are important. But you have a lot of work to do on confirmations and I think you should always be looking at how many positions should be confirmed versus not.

Senator AKAKA. Thank you for your response.

Senator FITZGERALD. Would Ms. Springer have a response on that——

Senator AKAKA. Yes.

Senator FITZGERALD [continuing]. What she thinks about applying the CFO Act to DHS? It is the only cabinet agency that doesn't have that requirement.

Senator AKAKA. I certainly would like to hear from Ms. Springer.

Ms. SPRINGER. Thank you, Mr. Chairman. I share some of Mr. Walker's comments from the standpoint that I believe that DHS has acted and carried out its duties very much as it would if it were a CFO Act agency. I don't think you would see much difference in the sense that they have embraced the audit requirement. They didn't seek the waiver that they could have under the Accountability for Tax Dollars Act. And they have worked very diligently to do all the things that a CFO Act agency would do. So in our minds, there is no distinction.

I would like to comment in particular on the confirmation aspect, the requirement. Certainly, the administration has put forward a model at DHS for management, the management structure, and it is a little different than what was envisioned under the CFO Act. The thing that I think concerns me, though, particularly about putting DHS under the CFO Act would be that the CFO would be required to go through that confirmation process, which has cost the administration, just this administration, somewhere in the neighborhood of 5 to 6 years of lost time of nominees in that waiting position where they have been—this is after the—in addition to, I should say, all of the clearance that the White House Personnel Office does.

So from the time when that person is first identified, all of the White House clearance, FBI checks and all of that, and then the Senate confirmation process, just from that point has been about 6 years of lost time. With CFOs that have already served, even just as recently as within this administration moving to other departments, in one case, 6 months for that one individual that already had a track record, who was already confirmed by this Senate.

So it becomes very frustrating for me to try and get them to make these management improvements that we are all interested in when they are in that holding pattern. So that is the thing that I have the strongest reservation about personally. But to answer your question, I think that the agency has acted in every respect as it would if it were under the CFO Act.

Senator AKAKA. Mr. Walker.

Mr. WALKER. If I can, Senator, and I have never said this before, I am just thinking out loud here, if the Congress were to move in selected departments and agencies, such as DOD, DHS, to the model that I talked about, where you have a level two, that means deputy secretary level or principal under secretary level, a person focused on management issues which are inherently good government, and nonpartisan issues, with a proven track record, statutory qualification requirements, performance contract, term appointment, if you did that, I think you should consider whether or not the CFO, the CIO, and some of these other positions should be Senate confirmation. But there may be another way to make sure that you are getting qualified people.

For example, there could be a notification requirement and a period of time before the appointment would take effect such that if there was concern in the Senate or elsewhere with regard to whether or not the person met the statutory qualification requirements, those concerns could be expressed. I think we need to look for ways that, for the good government positions, they can be filled by qualified people at an appropriate level in a timely manner with Congress having appropriate input, but yet not having undue delays. Just a thought.

Senator AKAKA. Thank you. Thank you for giving me all the time I need, Mr. Chairman. I thank our witnesses so much for their responses. For me, it has been helpful. Thank you.

Senator FITZGERALD. You have been a terrific panel, and I want to thank you very much for your time.

I just want to say on the CFO Act for the Department of Homeland Security, I think the current administration, at the OMB, you guys are doing a great job and I love your performance management requirements. I have talked to Clay Johnson extensively about OMB doing a great job. My concern, though, is about future administrations that may not have the same financial accountability concerns that this administration has demonstrated. So I think that is something we need to consider, whether we want to allow Homeland Security out there to just be exempt from an act that other cabinet departments have to follow.

But you are certainly right about the Senate confirmation process. We are hearing the other branch of government's feelings on that issue.

But thank you all. You have been terrific witnesses and we thank you. We will try and keep up our oversight in this area. Keep up the good work. Thank you all very much.

I would invite the second panel to please come up. Now I would like to introduce the witnesses on the second panel.

Our first witness on this panel is Lawrence J. Lanzillotta. Mr. Lanzillotta is the Acting Under Secretary of Defense (Comptroller) at the DOD. We were just wondering what sort of person would undertake that kind of a job. Mr. Lanzillotta is responsible for the initiation of reforms within the Office of the Department of Defense Comptroller.

Our second witness is Francis E. Reardon, Deputy Inspector General for Auditing at the Department of Defense. Mr. Reardon has served as Deputy Inspector General since 2003, after serving since 1992 as Auditor General of the Army. In his current position, he is responsible for all financial and performance audits of the DOD, defense agencies, and joint commands.

Third on this panel is Gregory D. Kutz, Director of Financial Management and Assurance at the Government Accountability Office. In his role as Director, Mr. Kutz is responsible for financial management issues relating to the Departments of Defense and State, as well as NASA and the Agency for International Development.

Our fourth witness on this panel is Andrew B. Maner, the Chief Financial Officer for the Department of Homeland Security. Mr. Maner has served in this capacity since January of this year, when he was appointed by President Bush. In his role as CFO, Mr. Maner is responsible for department-wide financial management, including all budget, finance and accounting, and strategic planning and evaluation systems. You spent the past 8 years in Illinois before you came out here, is that correct?

Mr. MANER. Indeed.

Senator FITZGERALD. Well, welcome. Our next witness is the Hon. Clark Kent Ervin, Inspector General for the Department of Homeland Security. Mr. Ervin began his service at the Department in January 2003 as Acting Inspector General and has subsequently served as Inspector General since December 2003. In this position, Mr. Ervin is responsible for independent and objective audits, inspections, and investigations of the Department's operations, including its efforts to consolidate legacy components.

Our sixth and final witness is McCoy Williams, Director of Financial Management and Assurance at the Government Accountability Office. In this position, he is responsible for the GAO's financial management work at eight CFO Act agencies, as well as the Department of Homeland Security. He is also responsible for GAO's work regarding governmentwide improper payments, internal control standards, and single audit reviews.

Again, I would like to thank all of you for being here today. In the interest of time, I would ask that you not read your prepared statements. Those will all be submitted and made part of the permanent record of this hearing. I would ask that you limit your opening remarks to no more than 5 minutes. If you can be briefer than that, we would welcome it because this is a very large panel, with six witnesses.

With that, we will begin with Mr. Lanzillotta. You may begin. Thank you.

TESTIMONY OF LAWRENCE J. LANZILLOTTA,[1] ACTING UNDER SECRETARY OF DEFENSE (CONPTROLLER)

Mr. LANZILLOTTA. Thank you, Mr. Chairman and Members of the Committee. I want to thank you for this opportunity to discuss the Department of Defense business management. This will be one of my last hearings before leaving the Department and so I want to give you my observations from three-plus years of working on DOD management challenges.

My message today is the Department has undertaken an unprecedented comprehensive and visionary transformation to achieve this aim. We are making progress to correct weaknesses and control business system investment. Strong and consistent Congressional support of this transformation is vital to sustaining our progress.

To transform DOD's management, the Department must succeed with three interdependent pillars of its strategy: Overhaul and integration of DOD business processes and systems throughout the Department's Business Management Modernization Program; refine and advance financial management improvement plans of the military services and defense agencies to enable them to produce auditable financial statements, resulting in a clean, auditable opinion; and audit items on the financial statements as they become ready for audit by developing the capability to do so. This transformation not only will be dramatically improved, DOD's business and financial management, but it will also enable DOD leaders to make resource decisions based on the best management information available. And it will enable the Department to meet the Chief Financial Officers Act and other legal requirements, including satisfactory statements.

Briefly, over the last 3 years, we have been able to establish a comprehensive inventory of business management systems. We began to build a blueprint or architecture to guide our transformation efforts. We designed an incremental strategy to achieve our transformational goals. We developed a governance process to provide strategic direction and oversee our transformation of business processes and systems. We have organized all major DOD business activities into six areas or domains and designated an Under Secretary of Defense as a domain owner to oversee each business area. We established a portfolio management process, an industry standard for managing IT systems. We established the DOD Audit Committee to provide concerted senior leadership focus and produce an auditable financial statement resulting in clean opinions. We developed individual reporting entity improvement plans that show planned improvements and milestones. And we implemented additional discipline to our quarterly reporting process, accelerating our preparation of financial reports and elevated our commitment to quality.

It is important to note that domain owners are responsible for overseeing the transformation of business activities managed by the military services and other DOD components. This governance plan has already demonstrated that it can work. We are continuing

[1] The prepared statement of Mr. Lanzillotta with attachments appears in the Appendix on page 102.

to strengthen and expand it. Some observers do not believe we are moving fast enough, yet acknowledging that DOD is one of the world's largest and most complex organization, with a huge business transformational challenge.

The Department of Defense is in the business transformation for the long term. It will take years to fix our systematic problems, which evolved over several decades.

The last observation I would like to make, we set out on a course of transformation, outlining this course with domains and our governance process to control our IT investment and the direction for the Department. I would ask that the Congress not change our direction. Both bills of the National Defense Authorization bill significantly cut the funding for this effort and dramatically change the direction of this effort. Changing course right now would delay an untold number of years in our effort to correct this problem.

In closing, I urge you and other Congressional leaders to continue to support the Department of Defense in its efforts to transform DOD's business management. Congress and the Department must continue to partner in this unprecedented undertaking. Our business transformation progress is consistent with U.S. industry standards and it is all the more remarkable that our accomplishments have occurred while we are fighting the global war on terrorism, advancing bold initiatives to transform America's military capability.

This is a critical time for us to ensure that DOD's management and business systems become just as superlative as the military forces they support. We, in the Department of Defense, appreciate and continue to need the Congressional support to achieve this vital priority. Thank you, Mr. Chairman.

Senator FITZGERALD. Thank you. Mr. Reardon.

TESTIMONY OF FRANCIS E. REARDON,[1] DEPUTY INSPECTOR GENERAL FOR AUDITING, U.S. DEPARTMENT OF DEFENSE

Mr. REARDON. Mr. Chairman and Members of the Committee, the Department of Defense Inspector General, Hon. Joseph Schmitz, regrets that he is unable to attend this hearing.

In addition, I would like to thank you for the opportunity to discuss first the status and progress in achieving an unqualified audit opinion for the Department of Defense, and second, other areas of financial management within the Department.

The Department's financial statements are the most extensive, complex, and diverse in the government. The Department faces financial management problems that are longstanding, pervasive, and deeply rooted. These problems have impeded the Department's ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions.

To address these issues, the Department has undertaken the ambitious task of overhauling its financial management systems and business processes, and we are encouraged by the many current initiatives led by the Office of the Under Secretary of Defense/Comptroller and senior financial managers within the DOD components to correct longstanding problems. Given these initiatives, we

[1] The prepared statement of Mr. Reardon appears in the Appendix on page 176.

believe there is a chance of the Department of Defense reaching the goal of a favorable audit opinion for fiscal year 2007. However, what is most encouraging is the effort being expended to correct the Department's problems.

In order to adequately support the Department's goals of a clean fiscal year 2007 audit opinion, we in the Office of the Inspector General are putting in place plans and actions to increase our financial auditing capability during the next 3 years. Our efforts are directly related to the Department of Defense plan to assert that its financial data is reliable and ready for audit between now and 2007. During this time period, there could be more than 100 assertions on financial statements, systems, or line items. As those assertions occur, we must be ready to audit as required by the CFO Act.

We also strongly support Section 1008 of the fiscal year 2002 National Defense Authorization Act, which directs us to perform only minimal audit procedures required by auditing standards until management asserts that the financial statements are reliable.

We are, therefore, working with the Department to ensure that we do not expend taxpayer dollars for extensive audit work until we believe that favorable opinions are probable. However, if the funding for our planned build-up and contracting efforts is delayed until the Department asserts that all DOD-wide financial statements are reliable and ready for audit, it will be impossible to complete the necessary audit work in a timely manner, thus further delaying a favorable audit opinion on the U.S. Government Annual Financial Report.

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. The Department of Defense established the Business Management Modernization Plan to transform and modernize the Department's business and financial processes and systems to optimize efficiency and effectiveness. We are monitoring progress in achieving the plan's goals and have made recommendations for improvements in the business enterprise architecture as part of the overall modernization plan. However, our efforts on the Business Management Modernization Plan have been primarily limited to coordination with the Government Accountability Office, which is doing extensive work in this area, as evidenced by their recent reports being discussed during this hearing.

The weaknesses that affect the auditability of the financial statement also impact other DOD programs and operations and contribute to waste, mismanagement, and inefficient use of DOD resources. For example, we testified before the Senate Committee on Governmental Affairs on April 28, 2004, and reported that purchase cards accounted for 25 percent of the purchase actions made in the Department in fiscal year 2003. We presented the results of three recent OIG–DOD audit reports that identified management control problems with the use of purchase cards.

Subsequent to that hearing, our office issued an additional report on purchase cards which discussed further internal control weaknesses. We are working with both the Purchase and Travel Card Program Management Offices to improve these programs by reducing financial risk to the government and offering recommendations to improve the Federal Managers Financial Integrity Act Controls.

Thank you for considering the views of the Office of the Inspector General. We have provided additional details on our efforts in the written testimony provided to you for this hearing and I would be happy to address further questions as we go along. This concludes my testimony.

Senator FITZGERALD. Thank you, Mr. Reardon. Mr. Kutz.

TESTIMONY OF GREGORY D. KUTZ,[1] DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. KUTZ. Mr. Chairman, thank you for the opportunity to discuss financial management at the Department of Defense.

The following two examples show the importance of successful financial management and business reform at DOD. First, 94 percent of mobilized Army National Guard soldiers that we investigated had pay problems. These problems distracted these special forces and military police from their missions, imposed financial hardships on their families, and has had a negative impact on retention. Our soldiers deserve better.

Second, DOD was unable to effectively recall 250,000 defective chemical and biological protective suits from its inventory. As a result, many Congressional Members were concerned that our forces in Iraq were issued these defective suits. Thousands of these defective suits were sold to the public on the Internet, including 379 that we purchased in an undercover operation, and you showed one of those 379 in your opening statement. It is the exhibit to my left. And thousands of these suits were improperly issued, as you mentioned, to local law enforcement officials.

DOD's stovepiped, duplicative systems contribute to these and many other problems and will cost taxpayers $19 billion in 2004. That is $52 million a day. Attempts to modernize DOD's business systems routinely cost more than planned, miss their schedules by years, and deliver only marginal improvements or are terminated with no benefits at all.

DOD's superior warfighting capabilities were clearly demonstrated in Iraq and Afghanistan. However, that excellence is often achieved despite the enormous problems with DOD's business systems and processes.

DOD's senior leadership is committed to transform the Department's business operations and financial management. With waste and inefficiency costing $20 billion or more a year, the success of their efforts is critical.

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

Senator FITZGERALD. Thank you very much, Mr. Kutz. Mr. Maner.

[1] The prepared statement of Mr. Kutz appears in the Appendix on page 195.

TESTIMONY OF ANDREW B. MANER,[2] CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF HOMELAND SECURITY

Mr. MANER. Thank you, Mr. Chairman, for the opportunity to be here and discuss progress that DHS has made in the area of financial management and thank you for your personal support that you have provided DHS since our creation.

All of us at the Department are proud of the progress we have made since the Department's inception in March 2003 while dealing with the enormous challenges involved in starting up the third largest department in the Federal Government. With Secretary Ridge's support, we have made tremendous headway in unifying and strengthening the Department's financial management, accounting, budgeting, strategic planning, and performance measurement process and systems. We have vastly streamlined the number of financial management service providers. We have consolidated bank card programs.

Two months after our creation, we subjected ourselves to the rigors of a consolidated financial statement audit and obtained a qualified opinion on our September 30 balance sheet. We submitted our first strategic plan and continue to perfect our investment review process. We completed and will soon submit our first future years' Homeland Security program, known as the FYHSP. We have made great strides in building an integrated financial system for the Department and have begun developing department-wide standard operating procedures for financial management.

With these accomplishments under our belt, we continue to forge ahead towards our goal of making DHS the model of 21st Century financial management excellence.

Progress in our endeavor to further define and consolidate these functions within the Department is made every day. We continue to look at the most efficient and effective way to deliver financial management services to the Department long-term. We continue to utilize best practice capabilities within the Department and work diligently on the weaknesses that exist.

Essential to consolidated management functions is an integrated department-wide resource management system. E-Merge^2 is the Department's initiative that will consolidate and integrate our budget, accounting, cost management, acquisition, grants, and asset management functions. As e-Merge^2 is implemented over the next few years, not only will it enable consolidation of these functions, but it will greatly enhance our visibility, oversight, and accountability of component operations and financial management.

Financial management excellence also requires accountability, oversight, and significant attention to developing a strong internal control environment, which I remain committed to. For example, in order to correct the material weaknesses identified in our 2003 audit, corrective action plans have been developed by each organization and I hold monthly meetings with these organizations to ensure progress is being made on these weaknesses. We are also addressing other important issues, such as elimination of improper payments and ensuring that the funds made available to State and

[2] The prepared statement of Mr. Maner appears in the Appendix on page 223.

local governments and other non-Federal recipients are awarded in a timely and proper manner.

In closing, I would like to thank the Subcommittee again for the opportunity to be here. DHS has accomplished much under challenging circumstances and I am confident we will realize even greater progress in the coming years. Thank you, Mr. Chairman.

Senator FITZGERALD. Thank you, Mr. Maner. Mr. Ervin.

TESTIMONY OF CLARK KENT ERVIN,[1] INSPECTOR GENERAL, U.S. DEPARTMENT OF HOMELAND SECURITY

Mr. ERVIN. Thank you, Mr. Chairman. As you noted, I have submitted a longer statement for the record, and in the interest of time, I will truncate my oral remarks, as well.

The Office of Inspector General engaged KPMG to complete an audit of DHS's financial statements as of September 30, 2003, and for the 7 months then ended as required by the Accountability of Tax Dollars of 2002. KPMG gave a qualified opinion on the consolidated balance sheet and the statement of custodial activity, meaning that except for three areas, these statements were presented fairly and free of material misstatements.

The three areas were, one, a lack of documentation related to the Coast Guard's property, plant, and equipment, valued at $2.9 billion; two, KPMG's inability to observe a sufficient number of the physical counts of operating materials and supplies at the Coast Guard, or otherwise to verify $497 million of such assets; and three, the lack of sufficient actuarial documentation provided prior to the completion of KPMG's audit procedures to support retirement benefits recorded at $3.3 billion at the Secret Service and post-employment benefits reported at $201 million at the Coast Guard.

This was not unexpected in a first-year audit. The Coast Guard's financial statements had never been audited at the level of detail required at DHS, where the Coast Guard became a larger bureau relative to its parent Department. Since the audit, the Secret Service has obtained an actuarial report on its retirement benefits liability and believes it has recorded the correct amount. And likewise, the Coast Guard has done the same with regard to the post-employment benefits liability issue.

KPMG was unable to provide an opinion on the other statements, which we collectively call the cost activity statements, and I will be happy to explain the reasons if there are questions about that.

Let me turn now to just a word about the audit challenges for 2004. As you know, the reporting deadline has been accelerated to November 15, 2½ months earlier than last year's deadline. Meeting that date will be a considerable challenge for DHS.

As well, one of the greatest challenges that the Department has faced this year is the realignment of back office functions at the ICE Bureau, Immigration and Customs Enforce, Customs and Border Protection Bureau, and the Citizenship and Immigration Services Bureau that took place at the start of fiscal year 2004. Nine months into the fiscal year, many agreements regarding intra-bu-

[1] The prepared statement of Mr. Ervin appears in the Appendix on page 229.

reau services that are being provided between and among the bureaus are not in place, leaving many accounting issues open. The CFO has recently reported progress in this area, and we are pleased to hear that, but time is short to clear up any accounting issues that remain this year.

Because the performance and accountability report was issued in February, DHS has had little time to take corrective action on the material weaknesses and reportable conditions, about which I can speak in greater detail later, reported last year before they entered into this year's audit cycle. To the extent that these weaknesses remain, they, too, will continue to make the preparation of the financial statements and the auditing of them more difficult.

That concludes my short statement, and again, I will be happy to answer questions. Thank you very much.

Senator FITZGERALD. Thank you, Mr. Ervin. Mr. Williams.

TESTIMONY OF McCOY WILLIAMS,[1] DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. WILLIAMS. Thank you, Mr. Chairman. I am pleased to be here today to discuss financial management challenges facing the Department of Homeland Security.

First, DHS faces the challenge of obtaining an unqualified financial statement audit opinion and fixing the previously identified internal control weaknesses it inherited from its component agencies. As of September 30, 2003, DHS had 14 reportable conditions, seven of which are material weaknesses.

Like other Federal agencies, DHS has a stewardship obligation to prevent fraud, waste, and abuse, to use taxpayers' dollars appropriately, and to ensure financial accountability. DHS management must establish effective internal controls to safeguard assets, protect revenue, and make authorized payments. Improper payments, which are a governmentwide problem, occur for many reasons, but the root cause can typically be traced to a breakdown in internal control.

While DHS was not required to report improper payments for 2003, several of its inherited control weaknesses suggest risk of improper payments and loss of revenue. As it addresses inherited control weaknesses and integrates its business management functions, DHS should pay close attention to implementing strong internal controls.

Mr. Chairman, another significant challenge for DHS is developing a financial management architecture with integrated systems and business processes. According to DHS officials, the Department is in the early stages of acquiring a financial enterprise solution to consolidate and integrate its financial accounting and reporting systems. Similar projects have proven challenging and costly for other Federal agencies. For example, efforts at NASA failed to meet the needs of users and key stakeholders. To avoid similar problems, DHS must ensure commitment and extensive involvement from top management and users in the financial system development and integration.

[1] The prepared statement of Mr. Williams appears in the Appendix on page 245.

Mr. Chairman, DHS is the only cabinet-level department in the Federal Government today that is not subject to the CFO Act. With a fiscal year 2004 budget of nearly $40 billion and more than 180,000 employees, the Department does not have a presidentially-appointed CFO subject to Senate confirmation and is not required to comply with FFMIA. DHS should not be the only cabinet-level department not covered by what is the cornerstone for pursuing and achieving the requisite financial management systems and capabilities in the Federal Government. We believe enactment of S. 1567 will increase the likelihood that financial management challenges at DHS will be overcome.

In closing, Mr. Chairman, I want to emphasize that the American people have increasingly demanded accountability from government and the private sector. We know that many of the larger agencies transferred to DHS have a history of poor financial management systems and significant internal control weaknesses, providing further evidence that DHS should be subject to the CFO Act and thus FFMIA.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions that you may have.

Senator FITZGERALD. Thank you. I want to hone in on this issue about DHS not being subject to the CFO Act. We do have a CFO, Mr. Maner, who is here today, but he is not presidentially appointed. He is not confirmed by the Senate. As a practical matter, other than Mr. Maner is not confirmed by the Senate and appointed by the President technically, what are the other things specifically—you mentioned that the Department is not subject to the FFMIA. What requirements do we impose on other departments that aren't being imposed on the Department of Homeland Security? Maybe Mr. Williams would like to go into that.

Mr. WILLIAMS. Well, within the requirements of FFMIA, that would be a report that would talk about the various systems, whether they are in compliance with JFMIP requirements. I think the bottom line is that you hit on a key point on the first panel, and that is that while this administration has demonstrated strong support for the intent of the legislation, the issue—when this particular act was passed, I was involved in working with this Subcommittee's counterpart on the House side, and the concern then and the concern that you raised this morning that still exists is that you want to make sure that you have a structure in place that will make sure that whether it is this administration or the next administration or ten administrations from now, that you have individuals in this position that are qualified to carry out the various financial management functions, that you have policies or laws in place that will make sure that agencies are striving to have systems that can produce information in a timely manner, because it is not just a matter of producing the information once a year in which you get a clean opinion and then the next day you have got to start back over again. You want to have that information throughout the year.

So I think these requirements for having good systems in place, making sure that the individual in the position is qualified and that the structure is in place, not just for one administration but for any administration that is in office.

Senator FITZGERALD. Mr. Maner, I don't know that it is your role to comment on whether your Department should be subject to the CFO Act. Do you have any thoughts you want to offer?

Mr. MANER. Well, just two quick thoughts, just for the record, just to make sure that it is stated correctly. I am presidentially appointed and not Senate confirmed, just so we are all on the same page there.

Senator FITZGERALD. OK.

Mr. MANER. Again, my thoughts are that the Homeland Security Act set up DHS less than 2 years ago. My broad thought is that the structure that was put in place in the Homeland Security Act should be given a chance to work.

In terms of the CFO Act and FFMIA, certainly those, and for everyone in the government, those are beacons of how to manage. And so we certainly use those to manage. One example of that is as we——

Senator FITZGERALD. Even though they don't apply to you?

Mr. MANER. That is right. One example of that is as we went out for our——

Senator FITZGERALD. But wouldn't you agree that we have no assurance that some successor of yours in a future administration would voluntarily decide to comply with those acts?

Mr. MANER. Yes. It would be hard to dispute that.

Senator FITZGERALD. OK.

Mr. MANER. But one point I would want to make is in the spirit of FFMIA, for example, when we go out, or when we went out with our e-Merge[2] solicitation, in that RFP was the requirement that the provider be compliant with those standards. So we have tried to integrate it as best we can. And also, other parts of the CFO Act, slightly less known, such as being a member of the OMB CFO Council, those things we are doing today, so I would leave it at that.

Senator FITZGERALD. OK. Now, I mentioned in my opening remarks that several news reports, particularly in the *Washington Post,* have criticized homeland security spending by State and local governments, citing the use of Federal homeland security funds to plug perceived budget holes or to fund purchases that do not appear critical to homeland security needs. I think there was one news report that cited spending on janitorial services by some local unit of government.

While such reports may be due in part to the lack of Federal guidelines or restrictions on the use of Federal funds, they raise concerns regarding the Department's efforts to ensure that taxpayer dollars are being spent wisely. Mr. Maner, how are you working with State and local officials to ensure the proper use of Homeland Security funds?

Mr. MANER. I will talk for a second a bit about structure and then a bit about systems, because I think they are both important. One of the items that the Department has done is to consolidate this year. Secretary Ridge has consolidated all the grants management functions, or the policy for grants management, in one office in Homeland Security. That is taking effect this next fiscal year. So part of it is to get all of the grants in one location, which I think will prove to be effective.

The second is to create a systems environment that allows for information visibility, allows for perfect visibility into the grants management process and such. And one of the things that I have found very important and am very committed to is including grants management in our e-Merge[2] project so that we are, as part of our financial system rollout, including grants management, because at the end of the day, I do believe very strongly that having visibility, a wide swath of visibility to all the money that is put out to State and locals——

Senator FITZGERALD. Do you know how much money we are talking about that is issued in grants? Would you know roughly?

Mr. MANER. I know that in, really in the last three grant cycles, we have put out about $8 billion, but if you don't mind, I will get back to you with specifics for the record.

INFORMATION PROVIDED FOR THE RECORD

In FY 2003, the Department awarded $8.0 billion in non-disaster grants and $5.9 billion in disaster grants.

Senator FITZGERALD. OK. Mr. Ervin.

Mr. ERVIN. Yes. If I could just add something on that, Mr. Chairman, a couple of things. First of all, the *Washington Post* article that you are referring to, we ourselves were asked about that by Congressman Sensenbrenner and it turns out that particular article was based on a Justice Department grant as opposed to a Department of Homeland Security one.

Having said that, certainly this kind of thing could be happening in the Department of Homeland Security, and that being so, we are going to start auditing the expenditure of these first responder funds. We will be doing that later this year. As you may know, we have issued a report already about the flow of funds from the Department to State and local governments and first responders, and actually that was a good news story for the Department. But we haven't, as I said, begun to look at exactly how those funds were being spent at the State and local and first responder level. We will do that.

If I could talk more generally just for a second about grants. As Mr. Maner says, the Department is to be applauded for moving toward consolidating the grant process in the Department, and also e-Merge[2] will include, we are told, a grants component, and that is to be applauded, as well.

There are certain structural issues, as well, that are important here, and that is true for the Office of CFO and for the Office of the Chief Information Officer, as well, and that is with regard to the Chief Procurement Officer. Right now, there are only seven procurement shops that came into the Department of Homeland Security to date. Fifteen other components of the Department are still being serviced by entities outside the Department, and you can see the problem there in terms of consistency and control.

Further, with regard to the seven procurement shops that are in the Department of Homeland Security, the Chief Procurement Officer does not have operational control over those shops and cannot impose consistency among those shops. So there are certain structural issues that must be attended to.

Senator FITZGERALD. Does the Government Purchasing Act—the traditional government procurement laws apply to all those procurements?

Mr. ERVIN. I believe, so, yes. That is right.

Senator FITZGERALD. OK. Once a grant leaves Homeland Security and goes to a unit of local government, does your office have the ability to go audit that unit of local government to see how it is spending the money? I hope all local governments are concerned that somebody may come in and audit how they use this money.

Mr. ERVIN. Yes, sir, the answer is yes, and we do that. For example, since the Department has been operational, March 1, 2003, we audited 121 FEMA disaster grants to State and local communities and questioned $68 million in costs. One of the things that we found during the course of those audits were recurring problems, and this is another issue. More attention on the Department's part to working with State and local governments to make sure that these recurring problems don't occur is called for.

For example, with regard to the $68 million, we frequently found that the State and local governments did not, as they are required to do, seek FEMA's written permission to either continue the project past the expiration of the time allotted for it or to continue to run up costs after the ceiling had been reached. And then at the conclusion, FEMA would give a retroactive waiver or permission for that having been done. Obviously, that conduces to waste, fraud, and abuse. So there needs to be attention paid on FEMA's part and the part of other components to making sure that the terms of these grants are complied with, and when they are not, there need to be consequences to the State and local awardees or sub-grantees.

Senator FITZGERALD. Mr. Lanzillotta, you mentioned that bills moving through Congress may cut funding for the effort that includes the accountability or the accounting at the DOD. Could you elaborate on that? What bills are you referring to?

Mr. LANZILLOTTA. I am referring to, Mr. Chairman, the House and Senate version of the authorization bill that is in conference right now. Each bill took reductions to each part of our strategy, to the IG, to our audit ability.

Senator FITZGERALD. How about the actual DOD appropriations bill that passed the Senate?

Mr. LANZILLOTTA. Both of those bills also took reductions.

Senator FITZGERALD. How big were the reductions?

Mr. LANZILLOTTA. Ranging from $45 million to $150 million.

Senator FITZGERALD. Out of how much total is spent——

Mr. LANZILLOTTA. Against these three programs where they took the reduction, of about $500 million.

Senator FITZGERALD. So that is an enormous percentage if you are looking at the $140 million reduction.

Mr. LANZILLOTTA. Correct.

Senator FITZGERALD. OK. That is something I am glad you—if your office could work with my staff on that, it might not be too late to write a letter to Senator Warner or somebody on that conference committee to talk about the importance of continuing the efforts to improve the financial accounting in DOD.

Mr. LANZILLOTTA. We would be happy to, Mr. Chairman.

Senator FITZGERALD. I hope the Armed Services Committee is aware of the importance of this issue and it is not just the Governmental Affairs Committee.

Mr. LANZILLOTTA. They are my next stop right after this hearing.

Senator FITZGERALD. OK. I am glad you are making your views known.

Mr. Reardon, you believe that by fiscal year 2007, there is a chance that DOD could be in a position to merit a qualified opinion, but only a chance, I guess you said. I know Mr. Lanzillotta mentioned that he is leaving, is that correct? You are leaving the DOD?

Mr. LANZILLOTTA. Yes, Mr. Chairman. This will be, hopefully, my last hearing. [Laughter.]

Senator FITZGERALD. This will be your last hearing? Oh, gosh. [Laughter.]

And it has probably been a very difficult and frustrating job. I kind of wondered out loud why anybody would want to take up this task. It is like Hercules trying to clean up the Agean stables. That is what it sounds like to me. It is kind of a thankless task.

We are now missing a—we don't have a Comptroller position filled. That is pending for appointment right now. How much do you think, Mr. Reardon, we are being held back by turnover in personnel and just the lack of appeal that positions such as Mr. Lanzillotta has in trying to clean up this mess at DOD? How big of a factor is that?

Mr. REARDON. Obviously, it is a factor and leadership does chart the way. I don't know how to put a percentage on it, but with turnover, there is the factor of lost leadership and direction.

But what I have seen in the Department in the year that I have been there is that there are a number of career civil servants that are working these issues, working the committees, working the various sort of audit committees that we attend, as well as the Comptroller's shop. People like Joanne Boutelle and Terry McKay are trying to work with each of the components of each of the services to get improvements done.

And when I said "chance," I mean, it is a limited chance to get a qualified opinion. But every year we see coming up, based on the progress that has been made, improvements.

Ms. Springer talked about focusing on certain segments. We see for fiscal year 2005 that the fund balance at Treasury may, in fact, be able to have us do audit work on it and attest to whether it is reliable or not. The Air Force is working on its statement of budgetary resources, again, with the idea that in 2005, that they will assert that they are ready. The Corps of Engineers is doing the same sort of thing.

So I think there is some delay, some halting, going back and forth, but what I do see underneath it is a number of people working to try in the different departments to at least show improvement, and we are seeing improvement with the systems, some of the legacy systems, and we are seeing improvement in the processes and stuff. I think that is important, and having an overall leader there for a sustained period of time is good. Dr. Zakheim was there just 3 years and made some good progress. I just think it helps.

Senator FITZGERALD. Mr. Lanzillotta.

Mr. LANZILLOTTA. Mr. Chairman, if you don't mind, could I make an observation from my 3 years of working on this?

Senator FITZGERALD. Yes.

Mr. LANZILLOTTA. For the Department to continue to make progress, I would like to emphasize Mr. Reardon's comment, it is a culture that has to be created for change. And once this culture is created, the political leadership that comes and goes is important, and I don't want to belittle that. But if the change in the culture is there, then progress will be continually made and it won't be based on one individual, because if we base any of this on one individual, whether it was Dr. Zakheim, myself, or the future Comptroller, this initiative will fail.

I think that some of the examples that Mr. Reardon talked about from the career side is a change in culture as to where we are making progress on how this should go. I would like to make a plea that part of this culture change is Congressional. We need the Congressional support, and since I am leaving, we need the Congressional pressure to continue this program. We need chairmen like yourself to call us up here and make us accountable for how this works, because that is part of the change in the culture. We have that.

When I first started this 3 years ago, 3-plus year ago, I would try to come over here, because I did work on the Senate staff side, and try to brief as to what we were doing, and that worked for a while because some of my friends would take briefings. Now, nobody takes briefings. I need to go to the Defense committees. I know the Government Reform Committee. I need to be able to get Congressional support because that all adds to it.

And it is the culture, because once the Department changes its culture, which I believe they have, but if we can maintain that, you see the things that the Department has done in Iraq and Desert Storm and Afghanistan. I mean, we can make remarkable progress. Two-thousand-seven is achievable, aggressive, heroic to get there. It is achievable as long as we can maintain the momentum.

Senator FITZGERALD. When you say the culture needs to change there, are you talking about the rank-and-file civilian employees? Career employees who, when a political appointee who may be in charge of their work comes in, they look at this person and say, well, we have always done things this way, and we are used to doing it this way. They are resistant to the change, and they look at their politically-appointed superiors as only here temporarily and we are just going to continue doing things the way we have always been doing them, or——

Mr. LANZILLOTTA. It has to start—they know—I don't say that they do this—that a political appointee stays about 18 months, maybe 2 years, and they know that the political leadership changes. They know that as the leadership changes, sometimes they change direction. They know that you could wait out political leadership. But what is more important, not that they will because I think some of the examples that Mr. Reardon talked about, these are all advances that were made by the career force.

And what has got to change and what has changed is when we have 4,000 business systems of some type, which is a remarkable number, we have 42 or 43—I forget the number now exactly—travel systems that do exactly the same thing. That started with the culture that everybody stovepiped. Everybody was worried about their problem. Everybody said, this is how I am going to fix my problem, by getting this system to do this for me. Nobody worried as to how that fit into the overall financial systems, the inventory systems, the asset visibility systems. Nobody worried about the end-to-end process.

What we have done in the Department is at the lowest levels at every staff agency, we have decided to build the architecture, and the architecture to outline and map out what our activities and processes are. Now, there were two values to that. The first value is we needed to find out how many systems we had and we needed to put down on a piece of paper on how we do business, and we needed everybody to see it. So when we say we need to design an end-to-end system, it wasn't up to Larry Lanzillotta to decide what that end-to-end system was. It was in the architecture that it went from this point to this point as to what that end-to-end system was.

The reason why some of our systems have failed in the past is the same reason why they fail in private industry. They haven't mapped it out, they haven't done the planning, and they don't know what it affects. They don't know where the interfaces are, so when they put their new system on, it doesn't work, or a system that was depending on it all of a sudden doesn't work.

We are changing that culture now. We have outlined our business systems. We have divided up our business areas. We put our business systems underneath these business areas. We have made people responsible for looking at investment in these business systems, approving investment in these business systems, and more importantly, when we field the new system, instead of just fielding a new system as to what systems get turned off to make it work.

So back to the example of the defense travel, the defense travel system has had a checkered past. The one thing that defense travel did, it reengineered the business process. It checked with all the interfaces to the financial systems and it goes from the traveler all the way through his trip, through the financial statements, all the way up and back down to pay him his check. It is untouched by human hands.

The examples you had, or the IG or Mr. Kutz talked about the JSLIST suits, it all goes back to the same problem. It is asset visibility, and the asset visibility, you don't get until you do an end-to-end process which shows the interfaces between these systems, and that is the course we are on.

Now, it is kind of like, in my fleeting moments here in the Department, I am just imploring the Congress to stay the course. I just feel in my heart of hearts that we are at the point where we are going to make great progress, and it has been slow. It has been slow and it has been tedious. When we went out and mapped out for the architecture, there are 180,000 statutory or regulatory requirements that had to be considered, 180,000. In the finance and accounting systems alone, I had 5,000 statutory or regulatory rules that had to be verified and checked or challenged. At the end of the day, we are going to come back to the Congress with a package of, "these rules don't make sense."

Senator FITZGERALD. You are still working on that, aren't you? I think I have asked the Secretary to give us a list. I know he cited some 750 reports, or maybe it was less than that, for example, that DOD had to submit every year to Congress. Many of these were obsolete reports, and you just have people complying with these ancient laws of Congress forever and ever producing reports that nobody is even reading. That was just one example that the Secretary gave us.

Mr. LANZILLOTTA. We can provide you, Mr. Chairman, a binder. Last time we took this effort, we put in a six-inch binder a one-page description of every report that the Department was required to do. I need to update that because that binder is about 2 years old, and every year we add about 500, 600 reports to it.[1]

Senator FITZGERALD. OK. Well, please give that list to us and we will see what we can do before I leave Congress. I didn't tell you, I am retiring in January, too. But there will be others like Senator Akaka here to keep supporting the DOD in changing their accounting system.

Mr. Kutz, I want to get to you. You talked about the suits and you mentioned, I think, a figure of $19 billion a year lost through waste, mismanagement, and you said that came out to $55 million a day.

Mr. KUTZ. The $19 billion is the amount they spent on business systems annually, including modernization and legacy systems.

Senator FITZGERALD. On business systems alone?

Mr. KUTZ. That would be on logistics, on finance systems, acquisition systems. It would be the business side, excluding intelligence-related and weapons systems. The total Department budget may be $30 billion or a little bit more. That would be maintaining and operating the current, what Mr. Lanzillotta testified yesterday and just mentioned, the current inventory of about 4,000-plus business systems. So that is the cost of having the stovepiped, non-integrated systems that don't work.

Senator FITZGERALD. Unbelievable.

Mr. KUTZ. So it is an enormous amount of money, and that is one of the places where when I mentioned the $20 billion or more that could be saved through improvements in accounting——

Senator FITZGERALD. Are they all custom-made business systems, too?

Mr. KUTZ. Some are, some aren't. I mean, they have evolved over time. There was no plan that Mr. Lanzillotta is talking about now that they are trying to develop so there is an architecture. They were developed in stovepipes because each service had their own money. They decided they wanted to do their own type of system. And now you have hundreds of logistics systems, dozens of travel systems, hundreds of personnel systems, etc.

I want to go back to the culture issue, because——

Senator FITZGERALD. Who is responsible for cleaning that up, for example, the business system? Mr. Lanzillotta, is there somebody in the DOD who is responsible for getting common business systems, where we are not spending $19 billion a year, $55 million a day, just on maintaining the existing business systems?

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[1] The list of active CMRs submitted for the record appears in the Appendix on page 105.

Mr. LANZILLOTTA. Mr. Chairman, to go back to one of your earlier comments about the CFO Act, yes. I am. And we have done several things to do away with that. I disagree with Greg as to what that number is, but it doesn't do away with the point that Greg is trying to make, that we have a lot of money in these stovepiped systems.

The two examples that you have here that you mentioned earlier in your statement about the two failed systems, we had to play the cards of where we were at. When we came in 3 years ago and said, this is what we are going to do. We are going to develop a common architecture. We were going to see where everything fit. We were going to know our interfaces and what we needed to do the end-to-end process.

We stopped or slowed investment into legacy, what we call legacy systems, and the systems that you mentioned, the reason we killed them is that they weren't ever going to meet our needs. They were COD systems, in some cases, that we had so many bolt-ons that they didn't work right and they were never going to be financially compliant or give us the type of information or do the end-to-end process that we wanted to have.

Business systems in the private sector fail because the ERPs fail. In fact, a majority of ERPs fail in the private sector and they fail because they haven't done the proper planning. What we have done with these systems, we had another example—I will give you two examples. These are two failed systems. They didn't work. We didn't have our requirements right. When we came in and we started building our architecture, we looked at these systems and we said they were never going to fit in and it was better to terminate these systems now than try to go through the life-cycle cost of these systems and go 10 years from now and say they don't work.

I have a problem with my pay systems. My pay systems, military pay systems are written in a language called COBALT, and when I was in college, that is a language that I studied. I can't find a COBALT programmer right now. They are very hard to find. I haven't been able to make a change to this program since 1997. I maintain 500 people to hand-jam pay changes into my military pay systems since 1997. That is all they do.

We went to PeopleSoft—that is part of Deimer's—and I said, I have a problem. I can't continue to do this. My military pay systems are going to fail. If I don't do something now, I run the risk of not being able to make a payroll, and that would be disastrous. Can you help me? And I got, umm, get out of the way. Let me get the next vendor in here. They said, I think we can help you if you work with us.

I wouldn't let the people change one business practice that wasn't already in that system, and in 6 months, it ran the Army payroll in 2 hours. When I compared it to my current payroll system that takes me a week to run the military payroll—I believe it is a week, I will have to correct that for the record if it is wrong—the PeopleSoft system for compatible pay was more accurate in every case.

So I was able to buy it. We already had the license. I didn't have to buy it. I was able to use an existing license for COD software, change our business practices to match the leading industry business practices in the software. I had to work with PeopleSoft to get the tax package in it, because it wasn't ready to go. And in 6 months, I was able to do a proof of concept and run the military payroll in 2 hours more correctly than I can do it right now.

I will pay for this system after I fully field it in 18 months. But that is the type of progress we can make if we stay the course.

Senator FITZGERALD. So you are making progress in discrete areas like that. What about like on inventory control, which was the problem that gave rise to the defective suits not being recallable?

Mr. KUTZ. We issued a report yesterday on a system that Defense Logistics Agency developed, and again, it was a stovepiped solution. It was represented at hearings over the last several years before the National Security Subcommittee on the House side that this BSM systems project would fix the JSLIST suit problem. So if we had defective suits again, we would be able to recall them, or if there was an emergency and suits needed to be identified to be shipped to a certain part of the world, that they would be able to be done.

That system is being implemented. It is going to cost probably $1 billion or more and it doesn't fix that problem. It is a stovepiped solution. It will fix issues within DLA, but it does not provide the end-to-end visibility of the JSLIST suits from the time that they are shipped from a DLA warehouse to the Army, Navy, or whoever else gets them so that, again, if you wanted to find them, you couldn't. You would have to do a data call. So that is an example of today, a system that is being developed right now that isn't going to solve corporate problems.

I think, when Mr. Lanzillotta was talking about the culture, they are in the infancy stages of dealing with the culture. They are going right now from uncontrolled proliferation of business systems to trying to develop some semblance of control and management oversight over the enormous amount of money being spent on these business systems and I think they are at the very early stages of getting control of this and making it work the right way.

Senator FITZGERALD. Mr. Kutz, what should Congress be doing about it?

Mr. KUTZ. Well, I think one of the reasons, if you go back to Mr. Lanzillotta talking about the budget cut, and I can only speculate here, but the armed services put in a provision last year that said all systems that have obligations over $1 million should go through a certain procedure and be approved by the Comptroller before the obligation is made.

I have testified several times now that we identified $863 million of systems that were obligated that did not go through that process. I think, quite honestly, they are a bit disturbed that they passed a law and the Defense Department did not follow it. And that gets back to the culture, because some of the people that have even called us have said they don't even know what the business enterprise architecture is, and these are people working at the Chief Information Officers of some of the services. They may be being clever in saying that, but it may also be true that they don't know what it is. But whatever the point is, there is probably billions of dollars of these systems that are still being invested in that aren't necessarily corporate solutions or consistent with the plan that Mr. Lanzillotta is talking about for the architecture for the Department.

Senator FITZGERALD. Is DOD just too big to ever get our arms around it?

Mr. KUTZ. No, I don't think so, and again, Mr. Walker talked about something like the Chief Management Official that we believe is an important aspect of this. And again, I would agree that person alone cannot solve the problem, but that is going to be someone who is a high-caliber person coming in to lead an effort. It is a monumental challenge, but the level of complexity is so much more difficult than anything you would see in the Federal Government or private sector. If it was easy, it would have been done decades alone.

Senator FITZGERALD. Mr. Lanzillotta.

Mr. LANZILLOTTA. Mr. Chairman, I agree with Mr. Kutz. I sometimes disagree with the way he would implement it, different recommendations. He is correct when we were legislated to certify every system over $1 million.

Legislative change alone doesn't always make it possible for us to get our arms around it. We had to develop databases. We had to develop an inventory. We had to develop, to know what those million-dollar systems are. We are in the process of doing that.

We went out to industry, brought in a leading practice or portfolio management, but one of the culture changes that had to occur is we had to teach our domains. We had to teach the people what portfolio management was. We had to go through. We had to bring in people and say, this is how you do portfolio management. We had to run everybody through on concepts on how to develop portfolio management. And this year when they deliver the POMS, the future year's program in the budgets in August, we are set for everybody to go through and certify their systems.

Now, one thing that we found out when we developed these systems, and we are in the process of developing a database, in the finance and accounting arena, I only have about—how many systems is it, I think about, like, 20 systems that account for about 85 percent of my dollars.

The first time, it is going to be ugly. We are going to go through and we are going to look at this, but each year we are going to get better at doing this. I don't believe we are at the infancy stage—I would say maybe the adolescent stage of doing this—but we have some maturing to go and I don't want to miss Mr. Kutz's point. We still have some maturing to go on how we do this.

But that is why I say, a legislative provision that says you are going to certify 4,000 systems and review 4,000 systems right now, we are trying. But I told the writers of that legislation, fine, do that. We need you to do that. We need you to give us the power to do that. But you also understand that the first year, we are not going to be able to get it done. There isn't enough staffing in the world, enough IT people in the world that I could get to make this work.

Mr. KUTZ. But one of the points I would make with that is that Mr. Lanzillotta and the Comptroller sent out a policy memo that said you are supposed to submit these systems to the Comptroller, and the fact of the matter is, people did not submit them. So there was a policy and a memo in place that directed the services and everyone with the systems to do it. They just didn't follow it. So it wasn't like the guidance wasn't out there and people didn't know. And it is a separate issue, is if those systems had all come in for approval, whether they had the infrastructure to actually review them all in a substantive way, but they didn't even come in.

Senator FITZGERALD. OK. We are getting close to one o'clock and we are going to have to terminate this hearing. It has been a wonderful hearing. I have one final question. I know, Mr. Kutz, your office did a lot of research into the situation with the unused plane tickets, for example, at DOD. I have a somewhat related question.

I bumped into someone who owns a charter private jet service, and he told me one of his biggest customers was the Department of Defense and he was under the impression—he asked me how he could get in and fly Senators around. I told him, well, Senators fly commercial. And he said, "They do?" He said, "The officers at the Pentagon, they take private jets." And I said, well, like where? And he said, "Well, between Washington and St. Louis and other big cities."

Is it true that officers fly private jets and charter private jets at enormous expense to the taxpayers instead of flying commercially?

Mr. KUTZ. We have not investigated that issue before.

Senator FITZGERALD. Mr. Lanzillotta.

Mr. LANZILLOTTA. Mr. Chairman, I am going to have to say you have got me. I know we own aircraft that we use for certain levels of officers. They are usually four-star officers, combat and commanders, service chiefs, to fly. We own those aircraft, and those aircraft, we own them because of security needs, because of communications gear that has to go in there, and normal aircraft would not make that work. We also have certain VIP aircraft and we use the VIP for several VIPs and different types of VIPs to make trips. This is true. I was unaware that we chartered. I will have to go back and investigate——

Senator FITZGERALD. Would you look into that and let me know? I would be interested. Maybe it is that a jet wasn't available, a military jet wasn't available for generals, and then they chartered one. I would be interested, and I hope you are able to get that information. I would appreciate that.

Mr. LANZILLOTTA. Mr. Chairman, for troop movements, we charter aircraft all the time.

Senator FITZGERALD. Oh, I understand that. This guy rents private jets for corporate executives, typically, and said some of his best business was with the DOD and that kind of shocked me. I just wanted to check into that.

All of you, thank you very much. You have been terrific witnesses. I appreciate your time.

Mr. Lanzillotta, thank you for your service to the government. I know it is a thankless job. I certainly would never want to undertake cleaning up all of those systems over at the Pentagon, and so thank you for your service. I thank all of you for your service to the public. Thank you.

The record will remain open for additional statements until the close of business next Wednesday, July 14. We appreciate your being here.

This hearing is adjourned.

[Whereupon, at 1:01 p.m., the Subcommittee was adjourned.]

APPENDIX

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Financial Management, the Budget, and International Security, Committee on Governmental Affairs, U.S. Senate

For Release on Delivery
Expected at 10:30 a.m. EDT
Thursday, July 8, 2004

FISCAL YEAR 2003 U.S. GOVERNMENT FINANCIAL STATEMENTS

Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges

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

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GAO-04-886T

July 8, 2004

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Highlights

Highlights of GAO-04-886T, testimony before the Subcommittee on Financial Management, the Budget, and International Security, Committee on Governmental Affairs, U.S. Senate

FISCAL YEAR 2003 U.S. GOVERNMENT FINANCIAL STATEMENTS

Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges

Why GAO Did This Study

GAO is required to annually audit the consolidated financial statements of the U.S. government.

Proper accounting and reporting practices are essential in the public sector. The U.S. government is the largest, most diverse, most complex, and arguably the most important entity on earth today. Its services—homeland security, national defense, Social Security, mail delivery, and food inspection, to name a few—directly affect the well-being of almost every American. But sound decisions on the future direction of vital federal government programs and policies are made more difficult without timely, accurate, and useful financial and performance information.

Until the problems discussed in GAO's audit report on the U.S. government's consolidated financial statements are adequately addressed, they will continue to (1) hamper the federal government's ability to accurately report a significant portion of its assets, liabilities, and costs; (2) affect the federal government's ability to accurately measure the full cost as well as the financial and nonfinancial performance of certain programs while effectively managing related operations; and (3) significantly impair the federal government's ability to adequately safeguard certain significant assets and properly record various transactions.

www.gao.gov/cgi-bin/getrpt?GAO-04-886T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jeffrey C. Steinhoff or Gary T. Engel at (202) 512-2600.

What GAO Found

As in the 6 previous fiscal years, certain material weaknesses in internal control and in selected accounting and reporting practices resulted in conditions that continued to prevent GAO from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements of the U.S. government are fairly stated in conformity with U.S. generally accepted accounting principles. Three major impediments to an opinion on the consolidated financial statements continue to be (1) serious financial management problems at DOD, (2) the federal government's inability to fully account for and reconcile transactions between federal government entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements.

For fiscal year 2003, 20 of 23 Chief Financial Officers (CFO) Act agencies received unqualified opinions, the same number received by these agencies in fiscal year 2002, up from 6 for fiscal year 1996. However, only 3 of the CFO Act agencies had neither a material weakness in internal control, an issue involving compliance with applicable laws and regulations, nor an instance of lack of substantial compliance with Federal Financial Management Improvement Act requirements.

The requirement for timely, accurate, and useful financial and performance management information is greater than ever as our nation faces major long-term fiscal challenges that will require tough choices in setting priorities and linking resources to results. Given the nation's large and growing long-term fiscal imbalance, which is driven largely by known demographic trends and health care costs, coupled with new homeland security and defense commitments, the status quo is unsustainable. Current financial reporting does not clearly and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending and provides an unrealistic and even misleading picture of the federal government's overall performance and financial condition. In addition, too many significant federal government commitments and obligations, such as Social Security and Medicare, are not adequately addressed in the federal government's financial statements and budget process, and current federal financial reporting standards do not require such disclosure.

A top-to-bottom review of government activities to ensure their relevance and fit for the 21st century and their relative priority is long overdue. The federal government needs a three-pronged approach to (1) restructure existing entitlement programs, (2) reexamine the base of discretionary and other spending, and (3) review and revise the federal government's tax policy and enforcement programs. New accounting and reporting approaches, budget control mechanisms, and metrics are needed for considering and measuring the impact of spending and tax policies and decisions over the long term.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our report on the U.S. government's consolidated financial statements for fiscal years 2003 and 2002.[1] Both the consolidated financial statements and our report are included in the fiscal year 2003 *Financial Report of the United States Government*, which was issued by the Department of the Treasury (Treasury) on February 27, 2004, and is available through GAO's Internet site, at www.gao.gov, and Treasury's Internet site, at www.fms.treas.gov/fr/index.html.

As in the 6 previous fiscal years, certain material weaknesses[2] in internal control and in selected accounting and reporting practices resulted in conditions that continued to prevent us from being able to provide the Congress and American citizens an opinion as to whether the consolidated financial statements of the U.S. government are fairly stated in conformity with U.S. generally accepted accounting principles (GAAP). Until the problems discussed in our report are adequately addressed, they will continue to (1) hamper the federal government's ability to accurately report a significant portion of its assets, liabilities, and costs; (2) affect the federal government's ability to accurately measure the full cost as well as the financial and nonfinancial performance of certain programs while effectively managing related operations; and (3) significantly impair the federal government's ability to adequately safeguard certain significant assets and properly record various transactions.

While the federal government has not yet been able to prepare auditable financial statements, the requirement to do so at the consolidated level as well as at the agency level has already yielded important results. We see continuous movement toward the ultimate goals of annual accountability

[1]In addition, GAO is providing separate statements today on problems related to financial and business management systems and processes at the Department of Defense and the Department of Homeland Security. See U.S. General Accounting Office, *Department of Defense: Financial and Business Management Transformation Hindered by Long-standing Problems*, GAO-04-941T (Washington, D.C.: July 8, 2004), and *Department of Homeland Security: Financial Management Challenges*, GAO-04-945T (Washington, D.C.: July 8, 2004).

[2]A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

and, more importantly, of development of the day-to-day financial information that the federal government will need to best address today's budgetary challenges and the looming longer-term fiscal imbalance driven by demographic trends, rising health care costs, and new homeland security and defense commitments. Across government, financial management improvement initiatives are under way that, if effectively implemented, have the potential to appreciably improve the quality of the federal government's financial management and reporting. Federal agencies continue to make progress in their efforts to modernize their financial management systems and improve financial management performance as called for in the President's Management Agenda.[3]

The Principals of the Joint Financial Management Improvement Program (JFMIP)[4] agreed with the Office of Management and Budget's (OMB) initiative to accelerate the agency financial statements reporting date to November 15 for fiscal year 2004. For fiscal year 2003, OMB required the Chief Financial Officers (CFO) Act agencies[5] to deliver their Performance and Accountability Reports, including their audited financial statements, to OMB by January 30, 2004. However, to prepare for meeting the required November 15 accelerated reporting date for fiscal year 2004, OMB encouraged the CFO Act agencies to accelerate the issuance of their fiscal year 2003 audited financial statements to November 15, 2003, or as close to that date as possible. OMB reported that 8 CFO Act agencies—the Department of Education, the Environmental Protection Agency, the Department of Health and Human Services, the National Science Foundation, the Social Security Administration, the Department of the

[3]The President's Management Agenda is the Bush administration's strategy for improving the management and performance of the federal government. Its purpose is to identify and address the most significant problems facing the federal government. It contains five governmentwide and nine agency-specific goals to improve federal management and deliver results to the American people.

[4]JFMIP is a joint and cooperative undertaking of the Department of the Treasury, GAO, the Office of Management and Budget (OMB), and the Office of Personnel Management working in cooperation with each other and other federal agencies to improve financial management practices in the federal government. Leadership and program guidance are provided by the four Principals of the JFMIP—the Comptroller General of the United States, the Secretary of the Treasury, and the Directors of OMB and the Office of Personnel Management.

[5]31 U.S.C. § 901(b). One of the 24 CFO Act agencies, the Federal Emergency Management Agency, was transferred to the new Department of Homeland Security effective March 1, 2003. With this transfer, the Federal Emergency Management Agency will no longer be required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies.

Treasury, the Agency for International Development, and the Department of Veterans Affairs—were able to issue their fiscal year 2003 financial statements with unqualified audit opinions by mid-November 2003. Another 10 CFO Act agencies issued their financial statements by December 31, 2003, and the remaining 5 CFO Act agencies issued by the end of January 2004. A 24th major agency, the Department of Homeland Security (DHS),[6] issued its financial statements on February 13, 2004. DHS faced a herculean challenge with respect to issuing audited financial statements, since the department had been in operation only for the last 7 months of the fiscal year and involved a transfer of operations from a number of diverse entities, some with known financial management problems.

While these results represent a significant improvement over previous years in the timeliness of CFO Act agencies' issuance of audited financial statements, they also demonstrate the significant challenges that the federal government will face in meeting the November 15 accelerated reporting date for fiscal year 2004. Auditors at several of the CFO Act agencies reported that the agencies may not be able to produce auditable financial statements within the accelerated time frame for fiscal year 2004 without making fundamental changes to improve a number of their financial management practices. For example, certain federal agency auditors reported that major improvements are needed in (1) management controls to monitor established policies and procedures for conducting financial analyses and reconciliations throughout the year, (2) fully integrating financial management systems, and (3) providing adequate and skilled staff to support efficient, effective preparation of federal agency consolidated financial statements. Our experience as the auditor of the financial statements of the Internal Revenue Service, which successfully accelerated its reporting to November 15 beginning with its fiscal year 2002 financial statements, showed that significant changes had to be made to improve routine financial management procedures in order to be able to accelerate reporting.

[6]DHS is not a CFO Act agency and is therefore not subject to CFO Act requirements. However, along with most other executive branch agencies not covered by the CFO Act, DHS is required to prepare and have audited financial statements under the Accountability of Tax Dollars Act of 2002, Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002). For fiscal year 2003, the act provided that OMB could grant executive branch agencies' requests for waivers from having audited financial statements for fiscal year 2003. However, DHS and certain other agencies chose to prepare and have their fiscal year 2003 financial statements audited.

For fiscal year 2003, as in fiscal year 2002, 20 of 23 CFO Act agencies were able to attain unqualified audit opinions on their financial statements (see table 1 and app. I),[7] up from 6 agencies for fiscal year 1996. This is the same number of unqualified opinions received by these CFO Act agencies for fiscal year 2002. However, 2 agencies' fiscal year 2003 opinions were different from those they received for fiscal year 2002. The Agency for International Development received an unqualified opinion on all of its fiscal year 2003 financial statements for the first time, while the National Aeronautics and Space Administration (NASA), which for fiscal year 2002 received an unqualified opinion on its financial statements, received a disclaimer of opinion for fiscal year 2003. DHS, which as I mentioned before prepared consolidated financial statements for fiscal year 2003 covering its first 7 months of operations, received a qualified opinion on two of the six required financial statements.[8]

In identifying improved financial performance as one of its five governmentwide initiatives, the President's Management Agenda recognized that a clean (unqualified) financial audit opinion is a basic prescription for any well-managed organization. At the same time, it recognized that "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records" at or after year-end. The President's Management Agenda further recognized that without sound internal control and accurate and timely financial information, it is not possible to accomplish the agenda and secure the best performance and highest measure of accountability for the American people. The JFMIP Principals have defined certain measures, in addition to receiving an unqualified financial statement opinion, for achieving financial

[7]At least 4 CFO Act agencies restated certain of their audited fiscal year 2002 financial statements to correct misstatements in such financial statements. All 4 of the agencies had received unqualified opinions on their fiscal year 2002 financial statements. These restatements were not material to the consolidated financial statements.

[8]DHS began operations as an agency 5 months after the start of the fiscal year, on March 1, 2003. Transfers of funds, assets, liabilities, and obligations from 22 existing federal agencies to DHS began on March 1, 2003. DHS's auditors issued a qualified opinion on the consolidated balance sheet and statement of custodial activity as of September 30, 2003, and disclaimed on the consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the 7 months ended September 30, 2003. In accordance with Federal Accounting Standards Advisory Board Technical Bulletin 2003-1, *Certain Questions and Answers Related to the Homeland Security Act of 2002*, the fiscal year 2003 activities that occurred prior to the transfer of operations to DHS were to be reflected in the transferring agencies' financial statements.

management success. These additional measures include being able to routinely provide timely, accurate, and useful financial and performance information and having no material internal control weaknesses or material noncompliance with laws and regulations and the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).[9] As shown in table 1, while the severity and magnitude of the problems identified vary greatly, reports of inspectors general and their contract auditors indicated that for fiscal year 2003 only 3 of the 23 CFO Act agencies had neither a material weakness in internal control, an issue involving compliance with applicable laws and regulations, nor an instance of lack of substantial compliance with the requirements of FFMIA.

Table 1: Fiscal Year 2003 CFO Act Agency Results Reported by Auditors

Agencies with unqualified opinions	Agencies with unqualified opinions and no material weaknesses or noncompliances
20[a]	3[b]

Source: GAO.

[a]Agriculture, Commerce, Education, Energy, Health and Human Services, Housing and Urban Development, Interior, Justice, Labor, State, Transportation, Treasury, Veterans Affairs, Agency for International Development, Environmental Protection Agency, General Services Administration, National Science Foundation, Nuclear Regulatory Commission, Office of Personnel Management, and Social Security Administration.

[b]Energy, National Science Foundation, and Social Security Administration.

In this testimony, I will highlight the major issues relating to the consolidated financial statements for fiscal years 2003 and 2002, discuss systems problems that continue to hinder federal agency accountability, and describe progress that has been made toward addressing major impediments to an opinion on the consolidated financial statements. I will also discuss why sound financial management today and in the future is critical to meeting tomorrow's fiscal needs and the need for "truth and transparency" in connection with our nation's financial condition and fiscal outlook.

[9]FFMIA, Pub. L. No. 104-208, div. A, § 101(f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996).

Highlights of Major Issues Related to the U.S. Government's Consolidated Financial Statements for Fiscal Years 2003 and 2002

As I mentioned earlier, as has been the case for the previous 6 fiscal years, the federal government continues to have a significant number of material weaknesses related to financial systems, fundamental recordkeeping and financial reporting, and incomplete documentation. Several of these material weaknesses (referred to hereafter as material deficiencies) resulted in conditions that continued to prevent us from forming and expressing an opinion on the U.S. government's consolidated financial statements for the fiscal years ended September 30, 2003 and 2002.[10] There may also be additional issues that could affect the consolidated financial statements that have not been identified.

Major challenges include the federal government's inability to

- properly account for and report property, plant, and equipment and inventories and related property, primarily at the Department of Defense (DOD);
- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities and related costs at DOD, and ensure complete and proper reporting for commitments and contingencies;
- support major portions of the total net cost of government operations, most notably related to DOD, and ensure that all disbursements are properly recorded;
- fully account for and reconcile intragovernmental activity and balances;
- demonstrate how net outlay amounts reported in the consolidated financial statements were related to net outlay amounts reported in the underlying federal agencies' financial statements; and
- effectively prepare the federal government's financial statements, including ensuring that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP.

[10]We previously reported that material deficiencies prevented us from expressing an opinion on the fiscal years 1997, 1998, 1999, 2000, 2001, and 2002 consolidated financial statements of the U.S. government.

In addition to these material deficiencies, we identified four other material weaknesses in internal control related to loans receivable and loan guarantee liabilities, improper payments, information security, and tax collection activities.

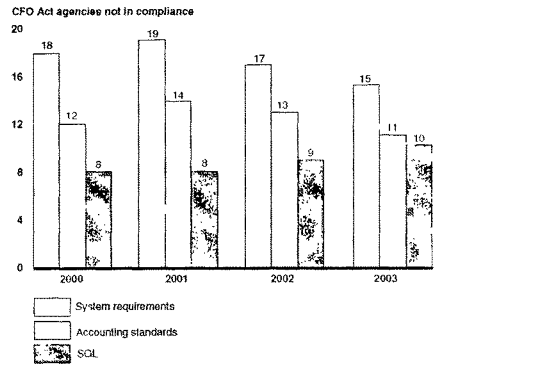
The material weaknesses identified by our work are discussed in more detail in appendix II, and their primary effects are described in appendix III.

Recurring Systems Problems Hinder Accountability

The ability to produce the data needed to efficiently and effectively manage the day-to-day operations of the federal government and provide accountability to taxpayers and the Congress has been a long-standing challenge at most federal agencies. The results of the fiscal year 2003 assessments performed by agency inspectors general or their contract auditors under FFMIA show that these problems continue to plague the financial management systems used by most of the CFO Act agencies. While the problems are much more severe at some agencies than at others, their nature and severity indicate that overall, management at most CFO Act agencies lacks the full range of information needed for accountability, performance reporting, and decision making. These problems include nonintegrated financial systems, lack of accurate and timely recording of data, inadequate reconciliation procedures, and noncompliance with accounting standards and the U.S. Government Standard General Ledger (SGL).

Agencies' inability to meet the federal financial management systems requirements continues to be the major barrier to achieving compliance with FFMIA. Under FFMIA, CFO Act agency auditors are required to report, as part of the agencies' financial statement audits, whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the SGL at the transaction level. As shown in figure 1, auditors most frequently reported instances of noncompliance with federal financial management systems requirements. These instances of noncompliance involved not only core financial systems, but also administrative and programmatic systems.

Figure 1: Auditors' FFMIA Assessments for Fiscal Years 2000, 2001, 2002, and 2003



Source: Independent auditors' reports for fiscal years 2000, 2001, 2002, and 2003, prepared by agency inspectors general and contract auditors.

For fiscal year 2003, auditors for 17 of the 23 CFO Act agencies reported that the agencies' financial management systems did not comply substantially with one or more of FFMIA's three requirements. For the remaining 6 CFO Act agencies, auditors provided negative assurance, meaning that nothing came to their attention indicating that the agencies' financial management systems did not substantially meet FFMIA requirements. The auditors for these 6 agencies did not definitively state whether the agencies' systems substantially complied with FFMIA requirements, as is required under the statute. DHS is not subject to the requirements of the CFO Act and, consequently, is not required to comply with FFMIA. Accordingly, DHS's auditors did not report on DHS's compliance with FFMIA. However, the auditors identified and reported deficiencies that related to the aforementioned three requirements of FFMIA.

Federal agencies have recognized the seriousness of their financial systems weaknesses and have efforts under way to implement or upgrade their financial systems to alleviate long-standing problems, but some of these efforts face significant challenges. For example, as we testified in May 2004,[11] we have identified several issues related to NASA's financial management systems modernization effort: (1) NASA did not involve key stakeholders in the design and implementation of the agency's new financial management system's core financial module; (2) NASA did not follow key best practices for acquiring and implementing this system; and (3) the new system lacks key external reporting capabilities for property and budgetary data. In addition, as I will discuss later in this testimony, DOD faces major challenges in its efforts to develop a business enterprise architecture. We recognize that it will take time, investment, and sustained emphasis to improve agencies' underlying financial management systems.

Addressing Major Impediments to an Opinion on Consolidated Financial Statements

As I mentioned earlier, for the past 7 fiscal years, the federal government has been required to prepare, and have audited, consolidated financial statements. Successfully meeting this requirement is tightly linked to the requirements for the CFO Act agencies to also have audited financial statements. This has stimulated extensive cooperative efforts and considerable attention by agency chief financial officers, inspectors general, Treasury and OMB officials, and GAO. With the benefit of the past 7 years' experience by the federal government in having the required financial statements subjected to audit, more intensified attention will be needed on the most serious obstacles to achieving an opinion on the U.S. government's consolidated financial statements. Three major impediments to an opinion on the consolidated financial statements are (1) serious financial management problems at DOD, (2) the federal government's inability to fully account for and reconcile transactions between federal government entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements.

Financial Management at DOD

Essential to achieving an opinion on the consolidated financial statements is resolution of the serious financial management problems at DOD, which

[11] U.S. General Accounting Office, *National Aeronautics and Space Administration: Significant Actions Needed to Address Long-standing Financial Management Problems*, GAO-04-754T (Washington, D.C.: May 19, 2004).

we have designated as high risk[12] since 1995. In accordance with section 1008 of the National Defense Authorization Act for Fiscal Year 2002,[13] DOD reported that for fiscal year 2003, it was not able to provide adequate evidence supporting material amounts in its financial statements. DOD stated that it is unable to comply with applicable financial reporting requirements for (1) property, plant, and equipment (PP&E); (2) inventory and operating materials and supplies; (3) environmental liabilities; (4) intragovernmental eliminations and related accounting adjustments; (5) disbursement activity; and (6) cost accounting by responsibility segment. Although DOD represented that the military retirement health care liability data had improved for fiscal year 2003, the cost of direct health care provided by DOD-managed military treatment facilities was a significant amount of DOD's total recorded health care liability and was based on estimates for which adequate support was not available.

DOD continues to confront pervasive decades-old financial management and business problems related to its systems, processes (including internal controls), and people (human capital). These problems preclude the department from producing accurate, reliable, and timely information to make sound decisions and to accurately report on its billions of dollars of assets. DOD's long-standing business management systems problems adversely affect the economy, effectiveness, and efficiency of its operations and have resulted in a lack of adequate accountability across all major business areas. To date, none of the military services or major DOD components has passed the test of an independent financial audit[14] because of pervasive weaknesses in financial management systems, operations, and controls.

Additionally, the department's stovepiped, duplicative, and nonintegrated systems contribute to its vulnerability to fraud, waste, and abuse. In this

[12]GAO identifies areas at high risk due to either their greater vulnerabilities to waste, fraud, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness.

[13]Pub. L. No. 107-107, § 1008, 115 Stat. 1012, 1204 (Dec. 28, 2001).

[14]Although not major DOD components, the Military Retirement Fund received an unqualified opinion on its fiscal year 2003 financial statements, and the DOD Medicare-Eligible Retiree Health Care Fund received a qualified opinion on its fiscal year 2003 financial statements.

regard, we have recently testified on problems related to military pay[15] and unused airline tickets.[16] Vulnerability to fraud, waste, and abuse continues despite substantial systems investment. For fiscal year 2004, DOD requested approximately $19 billion to operate, maintain, and modernize its reported 2,274 business systems. The duplicative and stovepiped nature of DOD's systems environment is illustrated by the numerous systems it has in the same functional areas. For example, DOD reported that it has 565 systems to support logistics functions. These systems are not integrated and thus have multiple points of data entry, which can result in significant data integrity problems.

Further, DOD continues to lack effective management oversight and control over business systems modernization investments. The actual funding continues to be distributed among the military services and defense agencies, thereby enabling the numerous DOD components to continue to develop stovepiped, parochial solutions to the department's long-standing financial management and business operation challenges. Lacking a departmentwide focus and effective management oversight and control of business systems investment, DOD continues to invest billions of dollars in systems that fail to provide integrated corporate solutions to its long-standing business operations problems.

Over the past 14 years, DOD has initiated several broad-based reform efforts intended to fundamentally reform its business operations and improve the reliability of information used in the decision-making process. While these initiatives produced some incremental improvements, they did not result in the fundamental reform necessary to resolve the department's long-standing management challenges. Secretary Rumsfeld has made business transformation a priority. For example, through its Business Management Modernization Program, DOD is continuing its efforts to develop and implement a business enterprise architecture and establish effective management and control over its business system modernization investments.

[15]U.S. General Accounting Office, *Military Pay: Army National Guard Personnel Mobilized to Active Duty Experienced Significant Pay Problems*, GAO-04-413T (Washington, D.C.: Jan. 28, 2004).

[16]U.S. General Accounting Office, *DOD Travel Cards: Control Weaknesses Led to Millions in Fraud, Waste, and Improper Payments*, GAO-04-825T (Washington, D.C.: June 9, 2004).

However, we recently reported[17] that after about 3 years of effort and over $203 million in obligations, we have not seen significant change in the content of DOD's architecture or in DOD's approach to investing billions of dollars annually in existing and new systems. Few actions have been taken to address the recommendations we made in our previous reports,[18] which were aimed at improving DOD's plans for developing the next version of the architecture and implementing the institutional means for selecting and controlling both planned and ongoing business systems investments. To date, DOD has not addressed 22 of our 24 recommendations.

Currently, DOD has various initiatives under way to support its efforts to obtain an unqualified audit opinion on its fiscal year 2007 financial statements. Because there are not yet detailed plans guiding these activities, however, it is unclear whether and how they support each other and whether they support this goal. Therefore, the feasibility of meeting this goal is as yet unknown.

The seriousness of DOD's business management weaknesses underscores the importance of no longer condoning "status quo" business operations at DOD. Cultural resistance to change, military service parochialism, and stovepiped operations have all contributed significantly to the failure of 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 developed piecemeal and evolved to accommodate different organizations, each with its own policies and procedures.

[17] U.S. General Accounting Office, *DOD Business Systems Modernization: Limited Progress in Development of Business Enterprise Architecture and Oversight of Information Technology Investments*, GAO-04-731R (Washington, D.C.: May 17, 2004).

[18] U.S. General Accounting Office, *DOD Business Systems Modernizations: Improvements to Enterprise Architecture Development and Implementation Efforts Needed*, GAO-03-458 (Washington, D.C.: Feb. 28, 2003), and *DOD Business Systems Modernizations: Important Progress Made to Develop Business Enterprise Architecture, but Much Work Remains*, GAO-03-1018 (Washington, D.C.: Sept. 19, 2003).

To improve the likelihood that the department's current business transformation efforts will be successful, we have previously suggested[19] that a chief management official[20] position be created. Previous failed attempts to improve DOD's business operations illustrate the need for sustained involvement of DOD leadership in helping to assure that DOD's financial and overall business process transformation efforts remain a priority. While the Secretary and other key DOD leaders have demonstrated their commitment to the current business transformation efforts, the long-term nature of these efforts requires the development of an executive position capable of providing strong and sustained executive leadership over a number of years and various administrations.

This position would provide the sustained attention essential for addressing key stewardship responsibilities such as strategic planning, performance and financial management, and business systems modernization in an integrated manner. This position could be filled by an individual, appointed by the President and confirmed by the Senate, for a set term of 7 years with the potential for reappointment. Such an individual should have a proven track record as a business process change agent in large, complex, and diverse organizations—experience necessary to spearhead business process transformation across the department, and potentially administrations, and serve as an integrator for the needed business transformation efforts.

Further, in a recent report[21] we also suggest that to improve management oversight, accountability, and control of the department's business systems funding, Congress may wish to consider providing the funds to operate, maintain, and modernize DOD's business systems to the functional areas,

[19]U.S. General Accounting Office, Department of Defense: Further Actions Needed to Establish and Implement a Framework for Successful Financial and Business Management Transformation, GAO-04-551T (Washington, D.C.: Mar. 23, 2004), and Department of Defense: Further Actions Needed to Establish and Implement a Framework for Successful Business Transformation, GAO-04-626T (Washington, D.C.: Mar. 31, 2004).

[20]On September 9, 2002, GAO convened a roundtable of executive branch leaders and management experts to discuss the Chief Operating Officer concept. For more information, see U.S. General Accounting Office, *Highlights of a GAO Roundtable: The Chief Operating Officer Concept: A Potential Strategy to Address Federal Governance Challenges*, GAO-03-192SP (Washington, D.C.: Oct. 4, 2002).

[21]U.S. General Accounting Office, DOD Business Systems Modernization: Billions Continue to Be Invested with Inadequate Management Oversight and Accountability, GAO-04-615 (Washington, D.C.: May 27, 2004).

known as domains, rather than the military services and the defense agencies. Currently, each military service and defense agency receives its own funding and is largely autonomous in deciding how to spend these funds, thereby hindering the development of broad-based, integrated corporate system solutions to common DOD-wide problems. We believe it is critical that funds for DOD business systems be appropriated to the domain owners in order to provide for accountability and the ability to prevent the continued parochial approach to systems investment that exists today. The domains would establish a hierarchy of investment review boards with DOD-wide representation, including the military services and defense agencies. These boards would be responsible for reviewing and approving investments to develop, operate, maintain, and modernize business systems for the domain portfolio, including ensuring that investments were consistent with DOD's business enterprise architecture.

DOD still has a long way to go, and top leadership must continue to stress the importance of achieving lasting improvement that truly transforms the department's business systems and operations. Only through major transformation, which will take time and sustained leadership from top management, will DOD be able to meet the mandate of the CFO Act and achieve the President's Management Agenda goal of improved financial performance.

Intragovernmental Transactions

OMB and Treasury require the CFOs of 35 executive departments and agencies, including the 23 CFO Act agencies, to reconcile selected intragovernmental activity and balances with their "trading partners"[22] and to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts. A substantial number of the agencies continue to be unable to fully perform reconciliations of intragovernmental activity and balances with their trading partners, citing reasons such as (1) trading partners not providing needed data; (2) limitations and incompatibility of agency and trading partner information systems; and (3) lack of human resources. Amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance in the aggregate for both fiscal years 2003 and 2002.

[22]Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

We reported in previous years that the heart of the intragovernmental transactions issue was that the federal government lacked clearly articulated business rules for these transactions so that they would be handled consistently by agencies. In this regard, at the start of fiscal year 2003, OMB issued business rules to transform and standardize intragovernmental ordering and billing. To address long-standing problems with intragovernmental exchange transactions between federal agencies, Treasury provided federal agencies with quarterly detailed trading partner information during fiscal year 2003 to help them better perform their trading partner reconciliations. In addition, the federal government began a three-phase Intragovernmental Transactions e-gov project to define a governmentwide data architecture and provide a single source of detailed trading partner data. On April 20, 2004, however, OMB announced that it was appropriate to pause and evaluate the results of the project to date. OMB estimated that the evaluation will take 120 days and will be followed by a phased deployment. Resolving the intragovernmental transactions problem remains a difficult challenge and will require a commitment by the CFO Act agencies and continued strong leadership by OMB.

Preparing the Consolidated Financial Statements

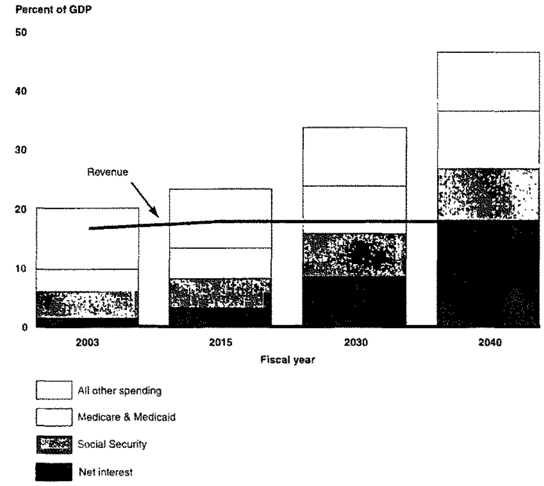
The federal government did not have adequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with GAAP. In this regard, Treasury is developing a new system and procedures to prepare the consolidated financial statements beginning with the statements for fiscal year 2004. Treasury officials have stated that these actions are intended to, among other things, directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements and resolve many of the issues we identified in the process for preparing the consolidated financial statements. As part of our fiscal year 2004 audit, we will evaluate the new system and procedures as they are fully developed and implemented and determine the extent of linkage accomplished for the fiscal year 2004 financial statements. Resolving issues surrounding preparing the consolidated financial statements has been a significant challenge and will require continued strong leadership by Treasury management.

Truth and Transparency in the Fiscal Outlook

Our nation's large and growing long-term fiscal imbalance, which is driven largely by known demographic trends and rising health care costs—coupled with new homeland security and defense commitments—serves to sharpen the need to fundamentally review and re-examine basic federal entitlements, as well as other mandatory and discretionary spending, and tax policies. As we look ahead, our nation faces an unprecedented demographic challenge with significant implications, among them budgetary and economic. Between now and 2035, the number of people who are 65 years old or over will double, driving federal spending on the elderly to a larger and ultimately unsustainable share of the federal budget. As a result, tough choices will be required to address the resulting structural imbalance.

GAO prepares long-term budget simulations that seek to illustrate the likely fiscal consequences of the coming demographics and rising health care costs. Our latest long-term budget simulations reinforce the need for change in the major cost drivers—Social Security and health care programs. As shown in figure 2, by 2040, absent reform of these entitlement programs, projected federal revenues may be adequate to pay little beyond interest on the debt.

Figure 2: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows with GDP after 2004 and All Expiring Tax Provisions Are Extended



Source: GAO's March 2004 analysis.

Note: Although expiring tax provisions are extended, revenue as a share of gross domestic product (GDP) increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the alternative minimum tax, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Current financial reporting does not clearly and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending and provides an unrealistic and even misleading picture of the federal government's overall performance and financial condition. Few agencies adequately show the results they are getting with the taxpayer dollars they spend. In addition, too many significant federal government commitments and obligations, such as Social Security and Medicare, are not fully and consistently disclosed in the federal government's consolidated financial statements and budget, and current federal financial reporting standards do not require such disclosure.[23] Figure 3 shows some selected fiscal exposures. The spectrum of these exposures ranges from covering only the explicit liabilities that are shown on the consolidated financial statements to implicit promises embedded in current policy or public expectations. These liabilities, commitments, and promises have created a fiscal imbalance that will put unprecedented strains on the nation's spending and tax policies. Although economic growth can help, the projected fiscal gap is now so large that the federal government will not be able to simply grow its way out of the problem. Tough choices are inevitable.

[23] The Federal Accounting Standards Advisory Board has a project under way to consider recognition, measurement, and display of social insurance obligations.

Figure 3: Selected Fiscal Exposures: Sources and Examples[a]

Type	Example (dollars in billions)
Explicit liabilities	Publicly held debt ($3,913) Military and civilian pension and post-retirement health ($2,857) Veterans benefits payable ($955) Environmental and disposal liabilities ($250) Loan guarantees ($35)
Explicit financial commitments	Undelivered orders ($596) Long-term leases ($47)
Explicit financial contingencies	Unadjudicated claims ($9) Pension Benefit Guaranty Corporation ($86) Other national insurance programs ($7) Government corporations, e.g., Ginnie Mae
Implicit exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts ($2,859)[b] Future Social Security benefit payments ($3,699)[c] Future Medicare Part A benefit payments ($8,236)[c] Future Medicare Part B benefit payments ($11,416)[c] Future Medicare Part D benefit payments ($8,119)[c] Life-cycle cost, including deferred and future maintenance and operating costs (amount unknown) Government-Sponsored Enterprises, e.g., Fannie Mae and Freddie Mac

Source: GAO analysis of data from the Department of the Treasury; the Office of the Chief Actuary, Social Security Administration; and the Office of the Actuary, Centers for Medicare and Medicaid Services.

[a]All figures are as of the end of fiscal year 2003, except Social Security and Medicare estimates, which are as of the end of calendar year 2003.

[b]This amount includes $774 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

[c]Figures for Social Security and Medicare are net of debt held by the trust funds ($1,531 billion for Social Security, $256 billion for Medicare Part A, and $24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be $10.4 trillion, $21.8 trillion for Medicare Part A, $23.2 trillion for Medicare Part B, and $16.5 trillion for Medicare Part D.

Particularly troubling are the many big-ticket items that taxpayers will eventually have to deal with. The federal government has pledged its support to a long list of programs and activities, including pension and health care benefits for senior citizens, medical care for veterans, and contingencies associated with various government-sponsored entities, whose claims on future spending total trillions of dollars. Despite their serious implications for future budgets, tax burdens, and spending flexibilities, these unfunded commitments get short shrift in the federal government's current financial statements and in budgetary deliberations.

The federal government's gross debt as of September 2003 was about $7 trillion, or about $24,000 for every man, woman, and child in this country today. But that number excludes many big-ticket items, including the gap between promised and funded Social Security and Medicare benefits, veterans' health care, and a range of other commitments and contingencies. If these items are factored in, the total burden in current dollars is at least $42 trillion. To put that number into perspective, $42 trillion is 18 times the current federal budget, or 3.5 times our current annual gross domestic product. One of the biggest contributors to this total bill will be the new Medicare prescription drug benefit, whose estimated current-dollar cost over the next 75 years is more than $8 trillion. Stated differently, the current total burden for every American is more than $140,000—and every day that burden is growing larger. GAO's long-term budget simulations show that by 2040, the federal government may have to cut federal spending by 60 percent or raise taxes to about 2.5 times today's level to pay for the mounting cost of the federal government's current unfunded commitments. Either would be devastating.

Proper accounting and reporting practices are essential in the public sector. After all, the U.S. government is the largest, most diverse, most complex, and arguably the most important entity on earth today. Its services—homeland security, national defense, Social Security, mail delivery, and food inspection, to name a few—directly affect the well-being of almost every American. But sound decisions on the future direction of vital federal government programs and policies are made more difficult without timely, accurate, and useful financial and performance information.

Fortunately, we are starting to see efforts to address the shortcomings in federal financial reporting. The President's Management Agenda, which closely reflects GAO's list of high-risk government programs, is bringing attention to troubled areas across the federal government and is taking steps to better assess the results that programs are getting with the resources they are given. The Federal Accounting Standards Advisory Board is also making progress on many key financial reporting issues.

In addition to these efforts, we have published frameworks for analyzing various Social Security reform proposals[24] and for analyzing health care reform proposals.[25] We have also helped to create a consortium of "good government" organizations to stimulate the development of a set of key national indicators to assess the United States' overall position and progress over time and in comparison to those of other industrialized nations.

Budget experts at the Congressional Budget Office (CBO) and GAO continue to encourage reforms to the federal budget process to better reflect the federal government's commitments and signal emerging problems. Among other things, we have recommended that the federal government issue an annual report on major fiscal exposures. The President's fiscal year 2005 budget also proposes that future President's budgets report on any enacted legislation in the past year that worsens the unfunded obligations of programs with long-term actuarial projections, with CBO to make a similar report. Such reporting could be a good starting point.

Although these are positive initial steps, much more must be done given the magnitude of the federal government's fiscal challenge. A top-to-bottom review of government activities to ensure their relevance and fit for the 21st century and their relative priority is long overdue. As I have spoken about in the past, the federal government needs a three-pronged approach to (1) restructure existing entitlement programs, (2) reexamine the base of discretionary and other spending, and (3) review and revise the federal government's tax policy, including major tax preferences, and enforcement programs. New accounting and reporting approaches, budget control mechanisms, and metrics are needed for considering and measuring the impact of spending and tax policies and decisions over the long term.

[24]U.S. General Accounting Office, *Social Security Reform: Analysis of Reform Models Developed by the President's Commission to Strengthen Social Security*, GAO-03-310 (Washington, D.C.: Jan. 15, 2003).

[25]GAO's health care framework can be found at www.gao.gov/cghome/hccrisis/health.pdf. See also *Comptroller General's Forum on Health Care: Unsustainable Trends Necessitate Comprehensive and Fundamental Reforms to Control Spending and Improve Value*, GAO-04-793SP (Washington, D.C.: May 1, 2004).

Closing Comments

Our report on the U.S. government's consolidated financial statements for fiscal years 2003 and 2002 highlights the need to continue addressing the federal government's serious financial management weaknesses. With the significantly accelerated financial reporting time frame for fiscal year 2004 and beyond, it is essential that the federal government move away from the extraordinary efforts many federal agencies continue to make to prepare financial statements and toward giving prominence to strengthening the federal government's financial systems, reporting, and controls. This is the only way the federal government can meet the end goal of making timely, accurate, and useful financial and performance information routinely available to the Congress, other policymakers, and the American public. The requirement for timely, accurate, and useful financial and performance management information is greater than ever as our nation faces major long-term fiscal challenges that will require tough choices in setting priorities and linking resources to results.

The Congress and the President face the challenge of sorting out the many claims on the federal budget without the budget enforcement mechanisms or fiscal benchmarks that guided the federal government through the previous years of deficit reduction into the brief period of surplus. While a number of steps will be necessary to address this challenge, truth and transparency in federal government reporting are essential elements of any attempt to address the nation's long-term fiscal challenges. The fiscal risks I mentioned earlier can be managed only if they are properly accounted for and publicly disclosed. A crucial first step will be to face facts and identify the significant commitments facing the federal government. If citizens and federal government officials come to understand various fiscal exposures and their potential claims on future budgets, they are more likely to insist on prudent policy choices today and sensible levels of fiscal risk in the future. In addition, new budget control mechanisms will be required, along with effective approaches to successfully engage in a fundamental review, reassessment, and reprioritization of the base of federal government programs and policies that I have recommended previously.

Public officials will have more incentive to make difficult but necessary choices if the public has the facts and comes to support serious and sustained action to address the nation's fiscal challenges. Without meaningful public debate, however, real and lasting change is unlikely. Clearly, the sooner action is taken, the easier it will be to turn things around.

I believe that nothing less than a national education campaign and outreach effort is needed to help the public understand the nature and magnitude of the long-term financial challenge facing this nation. An informed electorate is essential for a healthy democracy. Members of Generations X and Y especially need to become active in this discussion because they and their children will bear the heaviest burden if policymakers fail to act in a timely and responsible manner.

We at GAO are committed to doing our part, but others also need to step up to the plate. By working together, I believe we can make a meaningful difference for our nation, fellow citizens, and future generations of Americans.

In closing, Mr. Chairman, I want to reiterate the value of sustained congressional interest in these issues, as demonstrated by the Congress's annual hearings on the results of our audit of the consolidated financial statements and of audits of certain federal agencies' financial statements. It will also be key that the appropriations, budget, authorizing, and oversight committees hold agency top leadership accountable for resolving these problems and that they support improvement efforts.

Contacts

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Appendix I

Selected Major Federal Agencies: Fiscal Year 2003 Audit Results, Principal Auditors, and Number of Other Audit Contractors

23 CFO Act agencies	Audit results	Principal auditor	Number of other audit contractors
Agency for International Development	Unqualified	Inspector General	1
Agriculture	Unqualified	Inspector General	3
Commerce	Unqualified	KPMG LLP	0
Defense	Disclaimer	Inspector General	1
Education	Unqualified	Ernst & Young LLP	0
Energy	Unqualified	KPMG LLP	0
Environmental Protection Agency	Unqualified	Inspector General	0
General Services Administration	Unqualified	PricewaterhouseCoopers LLP	0
Health and Human Services	Unqualified	Inspector General	4
Housing and Urban Development	Unqualified	Inspector General	1
Interior	Unqualified	KPMG LLP	0
Justice	Unqualified	PricewaterhouseCoopers LLP	2
Labor	Unqualified	R. Navarro & Associates, Inc.	2
National Aeronautics and Space Administration	Disclaimer	PricewaterhouseCoopers LLP	2
National Science Foundation	Unqualified	KPMG LLP	0
Nuclear Regulatory Commission	Unqualified	R. Navarro & Associates, Inc.	0
Office of Personnel Management	Unqualified	KPMG LLP	0
Small Business Administration	Disclaimer	Cotton & Company LLP	0
Social Security Administration	Unqualified	PricewaterhouseCoopers LLP	0
State	Unqualified	Leonard G. Birnbaum and Company, LLP	2
Transportation	Unqualified	Inspector General	2
Treasury	Unqualified	Inspector General	6[a]
Veterans Affairs	Unqualified	Deloitte & Touche LLP	0
Other major agency			
Homeland Security	Disclaimer[b]	KPMG LLP	0

Source: GAO.

[a]In addition, GAO audited the Internal Revenue Service's financial statements and the Schedules of Federal Debt Managed by the Bureau of the Public Debt.

[b]DHS began operations as an agency 5 months after the start of the fiscal year, on March 1, 2003. Transfers of funds, assets, liabilities, and obligations from 22 existing federal agencies to DHS began on March 1, 2003. DHS's auditors issued a qualified opinion on the consolidated balance sheet and statement of custodial activity as of September 30, 2003, and disclaimed on the consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the 7 months ended September 30, 2003.

Appendix II

Material Deficiencies

The federal government did not maintain adequate systems or have sufficient, reliable evidence to support information reported in the consolidated financial statements of the U.S. government, as described below. These material deficiencies contributed to our disclaimer of opinion on the consolidated financial statements and also constitute material weaknesses in internal control.

Property, Plant, and Equipment and Inventories and Related Property

The federal government could not satisfactorily determine that all PP&E and inventories and related property were included in the consolidated financial statements, verify that certain reported assets actually exist, or substantiate the amounts at which they were valued. Most of the PP&E and inventories and related property are the responsibility of DOD. As in past years, DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Other agencies, most notably the National Aeronautics and Space Administration, reported continued weaknesses in internal control procedures and processes related to PP&E.

Liabilities and Commitments and Contingencies

The federal government could not reasonably estimate or adequately support amounts reported for certain liabilities. For example, DOD was not able to estimate with assurance key components of its environmental and disposal liabilities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities included in federal employee and veteran benefits payable. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment facilities. Further, the federal government could not determine whether commitments and contingencies, including those related to treaties and other international agreements entered into to further the U.S. government's interests, were complete and properly reported.

Cost of Government Operations and Disbursement Activity

The previously discussed material deficiencies in reporting assets and liabilities, material deficiencies in financial statement preparation, as discussed below, and the lack of adequate disbursement reconciliations at certain federal agencies affect reported net costs. As a result, the federal government was unable to support significant portions of the total net cost of operations, most notably related to DOD.

With respect to disbursements, DOD and certain other federal agencies did not adequately reconcile disbursement activity. For fiscal years 2003 and 2002 there were unsupported adjustments to federal agencies' records and unreconciled disbursement activity, including unreconciled differences between federal agencies' and Treasury's records of disbursements, totaling billions of dollars, which could also affect the balance sheet.

Accounting for and Reconciliation of Intragovernmental Activity and Balances

OMB and Treasury require the CFOs of 35 executive departments and agencies, including the 23 CFO Act agencies, to reconcile selected intragovernmental activity and balances with their "trading partners"[1] and to report to Treasury, the agency's inspector general, and GAO on the extent and results of intragovernmental activity and balances reconciliation efforts. A substantial number of the agencies did not fully perform the required reconciliations for fiscal years 2003 and 2002, citing reasons such as (1) trading partners not providing needed data, (2) limitations and incompatibility of agency and trading partner information systems, and (3) lack of human resources. For both of these years, amounts reported for federal agency trading partners for certain intragovernmental accounts were significantly out of balance. Treasury's ability to eliminate certain intragovernmental activity and balances is impaired by these federal agencies' problems in handling their intragovernmental transactions.

Net Outlays

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*,[2] states that outlays in federal agencies' Statements of Budgetary Resources (SBR) should agree with the respective agency's net outlays reported in the budget of the U.S. government. In addition, Statement of Federal Financial Accounting Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires explanation of any material differences between the information required to be disclosed (including net outlays)

[1]Trading partners are U.S. government agencies, departments, or other components included in the consolidated financial statements that do business with each other.

[2]Office of Management and Budget Bulletin No. 01-09, *Form and Content of Agency Financial Statements* (Washington, D.C.: Sept. 25, 2001). This bulletin is OMB's official guidance for the form and content of federal agencies' financial statements.

and the amounts described as "actual" in the budget of the U.S. government.

We found material differences between the total net outlays reported in selected federal agencies' audited SBRs and the records used to prepare the Statement of Changes in Cash Balance from Unified Budget and Other Activities (Statement of Changes in Cash Balance),[3] totaling about $140 billion and $186 billion for fiscal years 2003 and 2002, respectively.[4] Two agencies (Treasury and the Department of Health and Human Services (HHS)) accounted for about 83 percent and 75 percent of the differences identified in fiscal years 2003 and 2002, respectively. We found that the major cause of the differences for the two agencies was the treatment of offsetting receipts.[5] Some offsetting receipts for these two agencies had not been included in the agencies' SBRs, which would have reduced the agencies' net outlays and made the amounts more consistent with the records used to prepare the Statement of Changes in Cash Balance.[6] For example, we found that HHS reported net outlays for fiscal year 2003 as $596 billion on its audited SBR, while the records that Treasury uses to prepare the Statement of Changes in Cash Balance showed $505 billion for fiscal year 2003 for this agency. Until these differences between the total net outlays reported in the federal agencies' SBRs and the records used to prepare the Statement of Changes in Cash Balance are reconciled, the effect that these differences may have on the U.S. government's consolidated financial statements will be unknown. OMB has stated that it plans to work with the agencies to address this issue.

[3]OMB and U.S. generally accepted accounting principles (GAAP) require agencies to report net outlays in the SBR. The Statement of Changes in Cash Balance also reports unified budget outlays-actual. Both are intended to represent the same amount and be consistent with the information presented in the budget of the U.S. government.

[4]In some agencies' fiscal year 2003 financial statements, the comparable fiscal year 2002 amounts were restated.

[5]Offsetting receipts are collections that are credited to general fund, special fund, or trust fund receipt accounts and that offset gross outlays at the agency or governmentwide level.

[6]These two agencies did not adequately explain their fiscal year 2002 differences between the net outlays reported on the SBR and the budget of the U.S. government in their notes to the fiscal year 2003 financial statements.

Preparation of Consolidated Financial Statements

The federal government did not have adequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with generally accepted accounting principles (GAAP). During our fiscal year 2003 audit, we found the following:[7]

- The process for compiling the consolidated financial statements does not directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements, and therefore does not ensure that the information in the consolidated financial statements is consistent with the underlying information in federal agencies' audited financial statements and other financial data.

- Internal control weaknesses exist in Treasury's process for preparing the consolidated financial statements, such as a lack of (1) segregation of duties and (2) appropriate documentation of certain policies and procedures for preparing the consolidated financial statements.

- The net position reported in the consolidated financial statements is derived by subtracting liabilities from assets, rather than through balanced accounting entries. To make the fiscal years 2003 and 2002 consolidated financial statements balance, Treasury recorded a net $24.5 billion and a net $17.1 billion decrease, respectively, to net operating cost on the Statements of Operations and Changes in Net Position, which it labeled "Unreconciled Transactions Affecting the Change in Net Position."[8] An additional net $11.3 billion and $12.5 billion of unreconciled transactions were recorded in the Statements of Net Cost for fiscal years 2003 and 2002, respectively. Treasury does not

[7] The same issues we identified in fiscal year 2003 existed in fiscal year 2002, and some have existed for a number of years. In October 2003, we reported in greater detail on the issues we identified, in U.S. General Accounting Office, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003). This report included 44 recommendations to address weaknesses we identified. It also included recommendations related to 16 disclosure areas that are required by GAAP. We recommended that the 16 disclosures that are not included in the consolidated financial statements either be included or that the rationale for their exclusion be documented.

[8] Although Treasury was unable to determine how much of the unreconciled transactions, if any, relate to operations, it reported unreconciled transactions as a component of net operating cost in the consolidated financial statements.

identify and quantify all components of these unreconciled activities, nor does Treasury perform reconciliation procedures, which would aid in understanding and controlling the net position balance as well as eliminating the unreconciled transactions associated with compiling the consolidated financial statements.

- Significant differences in other intragovernmental accounts, primarily related to appropriations, still remain unresolved. Intragovernmental activity and balances are "dropped" or "offset" in the preparation of the consolidated financial statements rather than eliminated through balanced accounting entries. This contributes to the federal government's inability to determine the impact of these differences on amounts reported in the consolidated financial statements.

- The federal government did not have an adequate process to identify and report items needed to reconcile the operating results, which for fiscal year 2003 showed a net operating cost of $665 billion, to the budget results, which for the same period showed a unified budget deficit of $374.8 billion.

- The consolidated financial statements include certain financial information for the executive, legislative, and judicial branches, to the extent that federal agencies within those branches have provided Treasury such information. However, there are undetermined amounts of assets, liabilities, costs, and revenues that are not included, and the federal government did not provide evidence or disclose in the consolidated financial statements that such excluded financial information was immaterial.

- Treasury lacks an adequate process to ensure that the financial statements, related notes, Stewardship Information, and Supplemental Information are presented in conformity with GAAP. We found that certain financial information required by GAAP was not disclosed in the consolidated financial statements. Treasury did not provide us with documentation of its rationale for excluding this information. As a result of this and certain material deficiencies noted above, we were unable to determine if the missing information was material to the consolidated financial statements.

Other Material Weaknesses

In addition to the material deficiencies noted above, we found four other material weaknesses in internal control as of September 30, 2003: (1) several federal agencies continue to have deficiencies in the processes and procedures used to estimate the costs of their lending programs and value their related loans receivable; (2) most federal agencies have not reported the magnitude of improper payments in their programs and activities; (3) federal agencies have not yet fully institutionalized comprehensive security management programs; and (4) material internal control weaknesses and systems deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities.

Loans Receivable and Loan Guarantee Liabilities

In general, federal agencies continue to make progress in reducing the number of material weaknesses and reportable conditions[9] related to their lending activities. However, significant deficiencies in the processes and procedures used to estimate the costs of certain lending programs and value the related loans receivable still remain. These deficiencies continue to adversely affect the government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities. The most notable deficiencies existed at the Small Business Administration (SBA), which, while improved from last year, continues to have a material weakness related to this area. For example, SBA did not adequately document its estimation methodologies, lacked the management controls necessary to ensure that appropriate estimates were prepared and reported based on complete and accurate data, and could not fully support the reasonableness of the costs of its lending programs and valuations of its loan portfolio. We are currently assessing SBA's actions to resolve certain of these deficiencies related to accounting for previous loan sales and cost estimates for disaster loans.

Improper Payments

Across the federal government, improper payments occur in a variety of programs and activities, including those related to health care, contract

[9] Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the federal government's ability to meet the internal control objectives relating to financial reporting and compliance with laws and regulations.

management, federal financial assistance, and tax refunds.[10] While complete information on the magnitude of improper payments is not yet available, based on available data, OMB has estimated that improper payments exceed $35 billion annually. Many improper payments occur in federal programs that are administered by entities other than the federal government, such as states. Improper payments often result from a lack of or an inadequate system of internal controls. Although the President's Management Agenda includes an initiative to reduce improper payments, most federal agencies have not reported the magnitude of improper payments in their programs and activities.

The Improper Payments Information Act of 2002[11] provides for federal agencies to estimate and report on their improper payments. It requires federal agencies to (1) annually review programs and activities that they administer to identify those that may be susceptible to significant improper payments, (2) estimate improper payments in susceptible programs and activities, and (3) provide reports to the Congress that discuss the causes of improper payments identified and the status of actions to reduce them. In accordance with the legislation, OMB issued guidance for federal agencies' use in implementing the act. Among other things, the guidance requires federal agencies to report on their improper payment-related activities in the Management Discussion and Analysis section of their annual Performance and Accountability Reports (PAR). While the act does not require such reporting by all federal agencies until fiscal year 2004, OMB required 44 programs and 14 CFO Act agencies to report improper payment information in their fiscal year 2003 PARs. Our preliminary review of the PARs found that 12 of the 14 agencies reported improper payment amounts for 27 of the 44 programs identified in the guidance. We also found that, for the programs where improper payments were identified, the reports often contained information on the causes of the payments but little information that addressed the other reporting requirements cited in the legislation.

[10]Improper payments include inadvertent errors, such as duplicate payments and miscalculations, payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.

[11]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002). The act's reporting requirement on actions taken by agencies to reduce improper payments applies only to an agency program or activity with estimated improper payments exceeding $10 million.

Information Security

Although progress has been made, serious and widespread information security weaknesses continue to place federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. GAO has reported information security as a high-risk area across government since February 1997. Such information security weaknesses could result in compromising the reliability and availability of data that are recorded in or transmitted by federal financial management systems. A primary reason for these weaknesses is that federal agencies have not yet fully institutionalized comprehensive security management programs, which are critical to identifying information security weaknesses, resolving information security problems, and managing information security risks on an ongoing basis. The Congress has shown continuing interest in addressing these risks, as evidenced by recent hearings on information security and enactment of the Federal Information Security Management Act of 2002[12] and the Cyber Security Research and Development Act.[13] In addition, the administration has taken important actions to improve information security, such as integrating information security into the Executive Branch Management Scorecard.[14]

Tax Collection Activities

Material internal control weaknesses and systems deficiencies continue to affect the federal government's ability to effectively manage its tax collection activities.[15] Due to errors and delays in recording activity in taxpayer accounts, taxpayers were not always credited for payments made on their taxes owed, which could result in undue taxpayer burden. In addition, the federal government did not always follow up on potential unreported or underreported taxes and did not always pursue collection efforts against taxpayers owing taxes to the federal government.

[12]E-Government Act of 2002, Pub. L. No. 107-347, title III, 116 Stat. 2899, 2946 (Dec. 17, 2002).

[13]Pub. L. No. 107-305, 116 Stat. 2367 (Nov. 27, 2002).

[14]The Executive Branch Management Scorecard highlights agencies' progress in achieving management and performance improvements embodied in the President's Management Agenda.

[15]U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2003 and 2002 Financial Statements*, GAO-04-126 (Washington, D.C.: Nov. 13, 2003).

Appendix III

Primary Effects of the Material Weaknesses Described in This Report

Areas Involving Material Weaknesses	Primary Effects on the Fiscal Years 2003 and 2002 Consolidated Financial Statements and the Management of Government Operations
Property, plant, and equipment and inventories and related property	Without accurate asset information, the federal government does not fully know the assets it owns and their location and condition and cannot effectively (1) safeguard assets from physical deterioration, theft, or loss, (2) account for acquisitions and disposals of such assets, (3) ensure the assets are available for use when needed, (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand, and (5) determine the full costs of programs that use these assets.
Liabilities and commitments and contingencies	Problems in accounting for liabilities affect the determination of the full cost of the federal government's current operations and the extent of its liabilities. Also, improperly stated environmental and disposal liabilities and weak internal control supporting the process for their estimation affect the federal government's ability to determine priorities for cleanup and disposal activities and to allow for appropriate consideration of future budgetary resources needed to carry out these activities. In addition, when disclosures of commitments and contingencies are incomplete or incorrect, reliable information is not available about the extent of the federal government's obligations.
Cost of government operations and disbursement activity	Inaccurate cost information affects the federal government's ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required. Improperly recorded disbursements could result in misstatements in the financial statements and in certain data provided by federal agencies for inclusion in the President's budget concerning obligations and outlays.
Accounting for and reconciliation of intragovernmental activity and balances	Problems in accounting for and reconciling intragovernmental activity and balances impair the government's ability to account for billions of dollars of transactions between governmental entities.
Net outlays	Until the differences between the total net outlays reported in federal agencies' Statements of Budgetary Resources and the records used by the Department of the Treasury to prepare the Statement of Changes in Cash Balance from Unified Budget and Other Activities are reconciled, the effect that these differences may have on the U.S. government's consolidated financial statements will be unknown.
Preparation of consolidated financial statements	Because the federal government did not have adequate systems, controls, and procedures to prepare its consolidated financial statements, the federal government's ability to ensure that the consolidated financial statements are consistent with the underlying audited agency financial statements, balanced, and in conformity with U.S. generally accepted accounting principles was impaired.
Improper payments	Without a systematic measurement of the extent of improper payments, federal agency management cannot determine (1) if improper payment problems exist that require corrective action, (2) mitigation strategies and the appropriate amount of investments to reduce them, and (3) the success of efforts implemented to reduce improper payments.
Loans receivable and loan guarantee liabilities	Weaknesses in the processes and procedures for estimating credit program costs affect the government's ability to support annual budget requests for these programs, make future budgetary decisions, manage program costs, and measure the performance of lending activities.
Information security weaknesses	Information security weaknesses over computerized operations are placing enormous amounts of federal assets at risk of inadvertent or deliberate misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption.

(Continued From Previous Page)

Areas Involving Material Weaknesses	Primary Effects on the Fiscal Years 2003 and 2002 Consolidated Financial Statements and the Management of Government Operations
Tax collection activities	Weaknesses in controls over tax collection activities continue to affect the federal government's ability to efficiently and effectively account for and collect revenue. Additionally, weaknesses in financial reporting affect the federal government's ability to make informed decisions about collection efforts. As a result, the federal government is vulnerable to loss of tax revenue and exposed to potentially billions of dollars in losses due to inappropriate refund disbursements.

Source: GAO.

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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

June 28, 2004

The Honorable Christopher Cox
Chairman
Select Committee on Homeland Security
House of Representatives

Subject: *The Chief Operating Officer Concept and its Potential Use as a Strategy to Improve Management at the Department of Homeland Security*

Dear Mr. Chairman:

In a May 18, 2004 letter, you observed that many management and integration challenges remain at the Department of Homeland Security (DHS) and to strengthen the departmentwide reforms and transformation underway at DHS the Select Committee is considering options such as the Chief Operating Officer (COO) concept to help address these challenges. At your request, this letter describes the roles and responsibilities of an effective COO and presents certain options that could serve to strengthen and streamline management functions in a department as large and diverse as DHS. As agreed, we have summarized our reports on the COO concept, organizational transformation, as well as DHS's management and transformation challenges.

On September 9, 2002, GAO also convened a roundtable of government leaders and management experts to discuss the COO concept and how it might apply within selected federal departments and agencies.[1] The intent of the roundtable was to generate ideas and to engage in an open dialogue on the possible application of the COO concept to selected federal departments and agencies. There was general agreement on a number of overall themes concerning the need for agencies to elevate, integrate, and institutionalize attention on key management challenges. Our prior work presented in issued reports on DHS's management and transformation challenges was done in accordance with generally accepted government auditing standards. Because this response is based primarily on our previously issued work and the non-audit work performed for the roundtable, we

[1]U.S. General Accounting Office, *Highlights of a GAO Roundtable: The Chief Operating Officer Concept: A Potential Strategy to Address Federal Governance Challenges*, GAO-03-192SP (Washington, D.C.: Oct. 4, 2002).

did not obtain agency comments on a draft of this letter. However, we are sending a copy of this letter to the Secretary of the Department of Homeland Security.

As DHS and other agencies across the federal government embark on large-scale organizational change initiatives in order to address 21st century challenges, there is a compelling need to elevate, integrate, and institutionalize responsibility for key functional management initiatives to help ensure their success. A COO or similar position may effectively provide the continuing, focused attention essential to successfully completing these multiyear transformations. However, the specific implementation of such an approach must be determined within the context of the particular facts, circumstances, challenges, and opportunities of each individual agency. In addition, certain mechanisms can serve to augment the COO position, and thus further strengthen and streamline management functions within an agency. These mechanisms include articulating the COO's role in statute in order to make clear its broad responsibilities, using performance agreements to clarify individual performance expectations, and setting a term appointment for the position to ensure accountability over the long term. Finally, strong and continuing congressional oversight can help determine how best to elevate, integrate, and institutionalize key management and transformation responsibilities in executive agencies.

DHS Faces Management and Organizational Transformation Challenges

DHS faces enormous management and organizational transformation challenges as it works to simultaneously establish itself, integrate numerous entities and systems, and protect the nation from terrorism. To achieve success, the result should not simply be a collection of components in a new department, but the transformation of the various programs and missions into a high-performing, focused organization.[2] However, the size, complexity, and importance of DHS's mission make the challenges involved especially daunting. As a reflection of this, in January 2003 we designated the implementation and transformation of DHS as high risk.[3] This determination reflected the fact that DHS was formed from diverse components with a wide array of existing major management challenges and program risks. For example, one DHS directorate's responsibility includes the protection of critical information systems that we already considered a high-risk area. Also, many of the originating components—including the Immigration and Naturalization Service, the Transportation Security Administration, the U.S. Customs Service, the Federal Emergency Management Agency, and the U.S. Coast Guard—individually faced one or more major management challenge, such as strategic human capital risks, critical

[2]For additional information on the attributes of high-performing organizations, see U.S. General Accounting Office, *Highlights of a GAO Forum on High-Performing Organizations: Metrics, Means, and Mechanisms for Achieving High Performance in the 21st Century Public Management Environment*, GAO-04-343SP (Washington, D.C.: Feb. 13, 2004).

[3]U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003).

information technology management challenges, or financial management vulnerabilities.[4]

The high-risk designation also reflected DHS's daunting management challenge associated with the process of organizational integration and transformation itself. During its first year of operations, nearly 180,000 employees from 22 different agencies with a combined budget of over $30 billion became part of the new department. Moreover, we have previously noted that successful merger and transformation efforts can be much more difficult to achieve in the public sector than in the private sector.[5] Public sector transformation efforts, such as that under way at DHS, must contend with more stakeholders and power centers, less management flexibility, and greater transparency than in the private sector. Organizational mergers of this magnitude carry significant risks, including lost productivity and inefficiencies. Furthermore, top officials in the public sector are typically political appointees who do not stay in their positions long enough to effectively address key transformation initiatives. Indeed, major mergers and acquisitions in the private sector often do not live up to their expectations, and in the short term, the experience of major private sector mergers and acquisitions has been that productivity and effectiveness actually decline.[6] This can happen for a number of reasons. For example, attention is concentrated on critical and immediate integration issues and diverted from longer-term mission issues. In addition, employees and managers inevitably worry about their place in the new organization. The key is to adopt practices that minimize the duration and the significance of factors that reduce productivity and effectiveness.

The COO Concept Can Provide Needed Focus to Address Management and Organizational Transformation Challenges

The COO concept may provide federal agencies, such as DHS, with a tool to provide the long-term attention required to effectively address significant management challenges and transformational needs. Under this concept, the COO provides a single organizational focus for key management functions, such as human capital, financial management, information technology, acquisition management, and performance management as well as for selected organizational transformation initiatives. Establishing a COO position can enable selected federal agencies to address the following.

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[4]GAO-03-119, and U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Homeland Security,* GAO-03-102 (Washington, D.C.: January 2003).

[5]U.S. General Accounting Office, *Highlights of a GAO Forum: Mergers and Transformation: Lessons Learned for a Department of Homeland Security and Other Federal Agencies,* GAO-03-293SP (Washington, D.C.: Nov. 14, 2002).

[6]U.S. General Accounting Office, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations,* GAO-03-669 (Washington, D.C.: July 2, 2003).

Elevate Attention on Management Issues and Transformational Change

As a result of short-term priorities and other demands on the time of agency heads and their deputies, they generally do not have the ability to focus enough dedicated attention to management issues. However, the nature and scope of the changes needed in many agencies require the sustained and inspired commitment of the top political and career leadership. As mentioned earlier, many of the originating organizational components merged to create DHS brought with them preexisting management challenges. Top leadership attention is essential to overcome organizations' natural resistance to change, marshal the resources needed to implement change, and build and maintain the organizationwide commitment to new ways of doing business. We have previously reported that building an effective DHS will require consistent and sustained leadership from top management to ensure the needed transformation of disparate agencies, programs, and missions into an integrated organization.[7] A COO position can provide one potential approach for achieving this goal.

Integrate Various Key Management and Transformation Efforts

By their very nature, the problems and challenges facing agencies are crosscutting and thus require coordinated and integrated solutions. However, the federal government too often places management responsibilities, such as information technology, human capital, or financial management, into "stovepipes" and fails to design and implement organizational transformation efforts in a comprehensive, ongoing, and integrated manner. In recent testimony before the Select Committee, DHS's Deputy Secretary reported that DHS has consolidated 22 different personal property management systems into 3 and expects to further reduce them to a single, departmentwide system over the next few years.

The COO concept is consistent with the commonly agreed-upon governance principle that there needs to be a single point within agencies with the perspective and responsibility—as well as authority—to ensure the successful implementation of functional management and, if appropriate, transformation efforts. At the same time, given the competing demands on deputy secretaries in executive branch departments across the government to help execute the President's policy and program agendas, it is not practical to expect that they will be able to consistently undertake this vital integrating responsibility. Moreover, while many deputy secretaries may be nominated based in part on their managerial experience, it has not always been the case, and not surprisingly, the management skills, expertise, and interests of the deputy secretaries have always varied and will continue to vary.

To take advantage of the added status and visibility a COO position would provide and in order to be successful, the COO will need to be among an agency's top leadership (for example, a new level two position with the title of deputy secretary

[7]GAO-03-102.

for management or principal under secretary for management). However, consistent with the desire to integrate responsibilities, the creation of a senior management position needs to be considered carefully with regard to existing positions and responsibilities so that it does not result in unnecessary "layering" at an agency.

Institutionalize Accountability for Addressing Management Issues and Leading Transformational Change

Management weaknesses in some agencies are deeply entrenched and long-standing and will take years of sustained attention and continuity to resolve. This is especially important since private sector experience with mergers and acquisitions suggests that over 40 percent of executives in acquired companies leave within the first year and 75 percent within the first 3 years.[8] In addition, making fundamental changes in agencies' cultures will also require a long-term effort. In our previous work, we have noted that the experiences of successful transformation initiatives in large private and public sector organizations suggest that it can often take at least 5 to 7 years until such initiatives are fully implemented and the related cultures are transformed in a sustainable manner.[9] In the federal government, the frequent turnover of the political leadership has often made it extremely difficult to obtain the sustained attention required to make needed changes. The creation of a COO position can provide one way for institutionalizing accountability over the long term.

Certain Mechanisms Can Augment the COO Position

In the context of providing agencies with a tool to elevate, integrate, and institutionalize responsibility for certain key management functions and transformational efforts within federal agencies, Congress can further enhance the importance and authority of the COO position, and thus strengthen and streamline management functions within a department. For example, Congress could articulate the COO's broad responsibilities in statute. In 2003, Congress created the position of Deputy Architect of the Capitol/COO; this official is responsible for the overall direction, operation, and management of that organization. Under the statute, besides developing and implementing a long-term strategic plan, including a comprehensive mission statement and an annual performance plan, the Deputy Architect/COO is to propose organizational changes and new positions needed to carry out the organization's mission and strategic and annual performance goals.[10]

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[8]GAO-03-669.

[9]GAO-03-293SP.

[10]Section 1203 of Division H, Title I, Pub. L. No. 108-7, February 20, 2003, (The Consolidated Appropriations Resolution, 2003). The Architect of the Capitol appointed the first COO on July 28, 2003.

Articulating the role and responsibilities of the COO in statute helps to create unambiguous expectations for the position and underscores Congress' desire to follow a professional, nonpartisan approach in connection with these positions. In addition, it provides, in effect, an implicit set of qualification standards and expectations that the incumbents will have leadership experience in the areas that will be within their portfolios. For example, under the statute, the Deputy Architect/COO is to have strong leadership skills and demonstrated ability in management, including such areas as strategic planning, performance management, worker safety, customer satisfaction, and service quality. Congress also set qualifications in statute when it created the position of Chief Financial Officer (CFO) at 24 departments and federal agencies. The CFOs are to "possess demonstrated ability in general management of, and knowledge of and extensive practical experience in financial management practices in large governmental or business entities."[11] In addition, Congress set the qualifications for the position of Chief Information Officer (CIO) at federal departments and agencies. CIOs are to "be selected with special attention to the professional qualifications" required for records management, information dissemination, security, and technology management among others areas.[12]

Another potentially important accountability mechanism to augment the COO role is to use clearly defined, results-oriented performance agreements accompanied by appropriate incentives, rewards, and accountability mechanisms.[13] Performance agreements for senior leaders provide a potentially important mechanism for clarifying expectations, monitoring progress, and assessing accountability. In addition, we have reported on a number of benefits of performance agreements.[14] Performance agreements can

- strengthen alignment of results-oriented goals with daily operations,
- foster collaboration across organizational boundaries,
- enhance opportunities to discuss and routinely use performance information to make program improvements,
- provide a results-oriented basis for individual accountability, and
- maintain continuity of program goals during leadership transitions.

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[11]Pub. L. No. 101-576, November 15, 1990, 104 Stat. 2838.

[12]Pub. L. No. 104-13, May 22,1995, 44 U.S.C. §§3501-3521.

[13]U.S. General Accounting Office, *Results-Oriented Government: Shaping the Government to Meet 21st Century Challenges*, GAO-03-1168T (Washington, D.C.: Sept. 17, 2003).

[14]U.S. General Accounting Office, *Managing for Results: Emerging Benefits From Selected Agencies' Use of Performance Agreements*, GAO-01-115 (Washington, D.C.: Oct. 30, 2000).

While performance agreements can be implemented administratively as was done in the Department of Transportation since the mid-1990s, Congress has also required performance agreements in statute as well as provided for performance assessments with consequences.[15] For example, in 1998 Congress established a COO position at the Department of Education's Office of Student Financial Assistance.[16] In 2000 we reported that the COO is to complete an annual performance agreement with measurable organizational and individual goals that the COO would be accountable for achieving. Further, the COO's progress in meeting these goals is to form the basis of a possible performance bonus of up to 50 percent of base pay, as well as any decisions to remove or reappoint him or her. The COO is to enter into subsequent performance agreements with the Office of Student Financial Assistance's senior managers. Similarly, Congress made it clear in statute that the Deputy Architect/COO may be removed from office for failure to meet performance goals. Congress also required in statute that annual performance reports contain an evaluation of the extent to which the Office of the Architect of the Capitol met its goals and objectives.

To help ensure accountability over the long term, setting a term appointment can help provide the continuing focused attention essential to successfully completing multiyear transformations, which can extend beyond the tenure of political leaders. As mentioned above, large-scale change initiatives and organizational transformations typically require long-term, concerted effort, often taking years to complete. Providing a COO with a term-appointment of about 5 to 7 years would be one way to institutionalize accountability over extended periods needed to help ensure long-term management and transformation initiatives are successfully completed. No matter how the position is structured, it is critical that the people appointed to these positions be vested with sufficient authority to achieve results.

Finally, through enhanced oversight, Congress will need to continue to be fully engaged in any ongoing discussions on how best to elevate, integrate, and institutionalize key management and transformation responsibilities and what role the COO concept should play in achieving this goal. The Select Committee's record of holding oversight hearings and its interest in considering a variety of potential strategies to strengthen the management functions at DHS provides a clear example of this engagement. For selected agencies, Congress may want to make the COO subject to Senate confirmation to ensure that nominees have the requisite leadership and management skills and the proven track records in similar positions to successfully address the challenges facing federal agencies. In creating such a position, Congress might consider making certain subordinate positions, such as the CFO, not subject to Senate confirmation.

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[15]GAO-01-115, and U.S. General Accounting Office, *Results-Oriented Cultures: Creating a Clear Linkage between Individual Performance and Organizational Success*, GAO-03-488 (Washington, D.C.: Mar. 14, 2003).

[16]The name of the Office of Student Financial Assistance was changed to Federal Student Aid on March 6, 2002.

We are sending copies of this letter to the Vice Chair and Ranking Minority Member of the Select Committee on Homeland Security, the Chairman and Ranking Minority Member of the Senate Committee on Governmental Affairs, and the Secretary of the Department of Homeland Security. In addition, we will make copies available to others upon request. This letter will also be available on the GAO Web site at www.gao.gov. If you have any questions concerning this letter, please contact me on (202) 512-5500 or J. Christopher Mihm, Managing Director, Strategic Issues, on (202) 512-6806 or at mihmj@gao.gov.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

(450333)

Statement of The Honorable Linda M. Springer
Controller, Office of Federal Financial Management
Office of Management and Budget

Before the
Subcommittee on Financial Management, the Budget, and International Security
Committee on Governmental Affairs
United States Senate
July 8, 2004

The Federal Government's 2003 Financial Statement:
Improving Accountability of American Taxpayers' Dollars

Thank you, Mr. Chairman and Members of the Subcommittee.

I am happy to be with you today to discuss the *Financial Report of the United States Government* (the Financial Report) for fiscal year (FY) 2003 and other related financial management issues. I look forward to sharing with you some of the significant progress made by Federal agencies during the past year that underlies the Financial Report and positions us for the future.

Agency Accomplishments and Progress

In the area of Federal financial reporting, there were several notable agency accomplishments in the past fiscal year. For instance, during fiscal 2003,

- a record 18 of the 24 (75%) major agencies and departments completed their Performance and Accountability Reports (PARs) by the end of December, compared to only two agencies in fiscal year 2002;
- of the above 18 agencies, eight accelerated the submission of their PARs to mid-November of 2003, a year ahead of the 2004 requirement, all with unqualified audit opinions;
- 20 of the 23 Chief Financial Officer (CFO) Act agencies received an unqualified opinion on their financial statements;
- agencies completed quarterly financial statements for the first time ever;
- the Department of Homeland Security (DHS), created five months into the fiscal year, elected to forgo its first-year waiver and prepare audited financial statements;

- DHS received a qualified opinion on its Balance Sheet and Custodial Activity Statement;

- the United States Agency for International Development (USAID) received an unqualified opinion on all of its audited financial statements for the first time in its history and met the mid-November reporting date;

- the Department of Defense's (DoD) Medicare-Eligible Retiree Health Care Fund financial statements received a qualified opinion in its first year and the National Reconnaissance Office received an unqualified opinion on its statements;

- the Small Business Administration (SBA) developed or significantly revised credit models for five of its financial assistance programs during the course of the year;

- the total number of material weaknesses reported by auditors was reduced by 18% in 2003;

- the total number of Federal Manager's Financial Integrity Act (FMFIA) material weaknesses was reduced by 38% in 2003;

- new financial management systems went live in many agencies, including four between the close of the fiscal year and the end of December.

While we are pleased with the above achievements made by agencies during the past fiscal year, we are not satisfied. Much work remains to be done – such as attaining unqualified audit opinions and resolving all material weaknesses at agencies. Additionally, and just as important, we must raise agencies to the level of first class financial management practices, where financial performance information is used in day-to-day decision making. Although we are not yet there, agencies are moving in the right direction and are positioning themselves to reach their goals.

Auditor's Opinion and Material Weaknesses

The General Accounting Office (GAO) issued a disclaimer of opinion on the 2003 Financial Report. In making this determination, GAO continued to identify three main impediments to rendering an opinion: financial management problems at the Department of Defense (DoD), deficiencies in accounting for intragovernmental transactions, and ineffective processes for preparing the consolidated financial statements. The Office of Management and Budget (OMB) concurs with these observations. Efforts have been underway this fiscal year to address these issues as noted in the auditor's report.

Getting an opinion, qualified initially, on the government-wide financial statements remains our goal. OMB is working closely with the Department of the Treasury (Treasury) to create a closer link between audited agency financial statements and the government-wide statements reflected in the Financial Report. Beginning with fiscal year 2004, a new process will be implemented to better align the agency statements with the government-wide report.

Weaknesses at DoD are being addressed. Progress is being made, but it is important to recognize that long-standing issues in a department having over 300 sub-entities are not easily remediated. In many cases, elimination of DoD material weaknesses is dependent upon the new financial management systems implementation. OMB meets periodically with both the DoD CFO and its Inspector General (IG) to review plans for each area of concern and to monitor progress.

The inability to balance significant amounts of intragovernmental transactions is being addressed on several fronts by OMB and Treasury. Process enhancements, such as more frequent reporting and reconciliation, and new tools will support our efforts to eliminate reporting errors.

GAO's report comments on timeliness issues at the agency level that impacted its audit scope. It should be understood that this was the direct result of variations in the degree to which agencies were able to accelerate from the official 2003 fiscal year reporting date of January 30, 2004. Moving forward from this transitional year, we will turn to the single Performance and Accountability Report due date of November 15.

Financial Reporting Acceleration

The mandatory financial reporting date of November 15 will require much work from the agencies this fiscal year. However, this accelerated deadline is certainly an attainable goal, as shown by the large number of major agencies (75%) that were able to report their financial statements by the end of December last year. In those cases, strong agency senior leadership, careful planning, innovative thinking, and focused efforts were all necessary elements for success.

This fiscal year, we are regularly meeting with the CFO Offices of all major agencies as they work toward the mandatory November deadline. Clearly, some agencies have more obstacles and challenges to overcome than others. However, all agencies are expected to take the necessary steps for meeting the accelerated date. Some best practices being implemented by agencies include:

- Disciplined processes and audit schedule;
- Aggressive tracking and resolving risk areas;
- Reengineering of financial reporting and audit processes;
- Early and frequent communication with auditors; and
- Focused financial management priorities.

We look forward to continuing to work with the agency CFOs in meeting the November 15 financial reporting deadline.

Federal Accounting Standards

During the 2003 fiscal year, the Federal Accounting Standards Advisory Board (FASAB) issued Statement of Federal Financial Accounting Standard (SFFAS) No. 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment.* Among the provisions of this standard is the requirement that the Statement of Social Insurance, which is currently reported in the stewardship section of the Financial Report, become a basic financial statement with full audit scrutiny. This Statement provides estimates for important components of the Social Security and Medicare programs and is accompanied by an expansive discussion of underlying assumptions and sensitivity analyses. This requirement will enhance the significance and the prominence of what is one of the most extensively presented components of the current Financial Report.

Improving Internal Control

The internal control environment of any entity is an area of focus for both management as well as its auditor. The agencies of the Federal Government are no exception. There are several existing laws governing the agencies in assessing and representing the quality of their internal control. For example, agency heads are required to provide reasonable assurance of compliance with the Federal Manager's Financial Integrity Act (FMFIA) with respect to both management control and financial management systems. Agency heads are also required to certify that their systems satisfy specified requirements under the Federal Financial Management Improvement Act (FFMIA). Additionally, the Federal Information Security Management Act (FISMA) provides for government-wide management and oversight of information security risks and agency information security programs. As such, FISMA requirements provide an additional standard for financial systems control.

Not all Federal agencies are able to provide these assurances; however, all continue to make progress in eliminating barriers to compliance. Because financial systems are a major part of the universe to which these statutes apply, it is entirely possible that positive assurance from the collective group of agencies will emerge over a period of years due to the time required for new system design, development and implementation.

Both OMB and the CFO Council are keenly aware of the internal control challenges and related new assurance requirements that have been reported in the private sector. We are actively engaged with the Inspector General community in reviewing these requirements and their potential applicability to Federal Government agencies.

CFO Council and Committees

Much progress has been made through the OMB partnership with the CFO Council over the past fiscal year. Consisting of the CFOs and Deputy CFOs of the 23 major Federal departments and agencies, the Council recently reassessed its working committees, as well as refreshed and updated its targeted focus. Existing committees such as the Financial Reporting Acceleration and Improper Payments Committees have been, and continue to be, very influential in providing forums for sharing best practices and influencing OMB guidance. New committees, such as the Financial Management Policies and Practices group, are actively engaged in studying emerging issues. CFO Council Committees will continue to partner with representatives of other groups, such as the President's Council on Integrity and Efficiency (PCIE) and the Chief Information Officers (CIO) Council.

Eliminating Improper Payments

Let me first say that eliminating improper payments by the Federal Government has been, and continues to be, a major management focus of this Administration. It is our goal to ensure that every dollar spent by the Federal Government is a dollar that is spent wisely and for the purpose for which it is intended. Given the Federal Government's current budget in excess of $2 trillion annually and the many important competing priorities and programs, our mission is more important now than ever before.

Specifically, it is our job to make certain that government agencies review their payments and assess whether a risk of improper payment exists. If such a risk does exist, then corrective action must be taken to ensure that the improper payment does not occur again. We anticipate that ongoing agency efforts will ultimately lead to a review of every single dollar that the government spends to ensure that taxpayer money is spent for the purpose for which it was intended.

Since the President's Management Agenda (PMA) was first announced in 2001, the elimination of improper payments has been a key component of the Improved Financial Performance initiative. Initially, the effort to eliminate improper payments focused on Federal agencies having programs making annual payments in excess of $2 billion. These agencies were directed to follow the necessary requirements set out in Section 57 of OMB Circular A-11 and report on the programs in their annual budget submissions. Collectively, the Section 57 programs comprised about $1 trillion in government spending – nearly half of all annual government expenditures. We estimate that improper payments exceed $35 billion a year out of the $1 trillion in spending by these programs.

When the Improper Payments Information Act of 2002 (IPIA or the Act) was passed, we appreciated the Congress' concurrence with our concern and its efforts to create a review process that would identify and eliminate erroneous payments throughout all major Federal programs and activities. In May of 2003, OMB issued guidance to agencies regarding how to go about complying with the requirements of the new law. As part of IPIA implementation, Federal agencies have established specific milestones to: 1) develop program inventories; 2) perform risk assessments to determine which programs are risk susceptible; 3) statistically sample those programs determined to be high risk; 4) create corrective action plans; and 5) establish baseline error rates and improvement targets for future reporting.

In the last year, we have met with the Offices of the CFO and the IG at each major agency, on more than one occasion, to ensure that the plans to meet the requirements of the IPIA are being developed and implemented. At these meetings, we finalized the agency plans to comply with the IPIA and directed the agencies to set specific target dates for completing the required steps to ensure that results are achieved on a timely basis. We now have specific dates in which the key milestones are expected to be completed, and we will track each agency's progress in meeting these deadlines over the course of the coming months.

All agencies are required to report their activities relating to the elimination of improper payments in their 2004 PARs, which are to be issued this November. During these next five months and beyond, we will be working with the agencies to make certain that progress is made, target dates are met, milestones are completed, and results are achieved.

Outlook for the Future

Our outlook for improving the quality and timeliness of financial reporting to the American citizen is positive. Many challenges remain, but others that appeared similarly insurmountable just a few years ago are being solved. For example, who would have thought that the Administration's goal of shortening the time for agencies to prepare audited financial statements from five months to 45 days after the end of the year would be attained by a third of the major agencies a year in advance of the deadline?

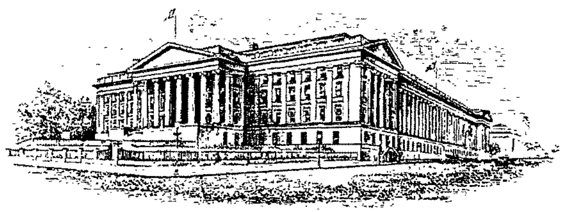
It is often said that such achievements can only be accomplished by heroic efforts. Hard work is always a factor, but these results are a tribute to detailed planning, effective management and excellent execution.

While the acceleration targets are critical, they are not our ultimate objective. The discipline and improved control needed to accelerate financial reports are only the foundation for ensuring the availability of useful financial information. The incorporation of timely and accurate financial information into management decision-making and operational assessment continues to be our main goal. Progress toward this goal was made during fiscal year 2003, as shown by the addition of two agencies (the Environmental Protection Agency and the Social Security Administration) that achieved green status under the PMA Improved Financial Performance initiative. They were joined by the Department of Education in the first quarter of fiscal 2004.

We look forward to continued execution of our role in leading the Federal financial management community and reporting additional progress across the financial management spectrum to you in the months ahead.

In closing, it is my opinion that the Federal Government should be held to as high, if not higher, a standard of financial management as the private sector. American citizens do not have the option of "taking their business" elsewhere – they cannot elect to stop new investments (tax payments) until the company (Federal Government) improves its financial management practices. Accordingly, I believe it is incumbent upon every financial professional in the government to execute his or her duties according to the standards of excellence consistent with this stewardship responsibility. That is what we strive to do. And that is what we will continue to do.

Thank you for listening. I am happy to entertain your questions.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED FOR DELIVERY
July 8, 2004

Contact: Brookly McLaughlin
202/622-2960

Statement of Donald V. Hammond
Fiscal Assistant Secretary, U.S. Department of the Treasury
before the Senate Committee on Governmental Affairs
Subcommittee on Financial Management, the Budget
and International Security

Financial Report of the United States Government Improves Government Accountability

Mr. Chairman and Members of the Subcommittee, it is my pleasure today to represent the Treasury Department to discuss the status of the Federal government's financial reporting through the Financial Report of the United States Government and the incorporated consolidated financial statements. This important document helps ensure better accountability for the federal funds because it adds to the financial information available to the public, provides insight into the government's complex operations, and sets a framework for consistent reporting throughout the government. We have come a long way in seven years but we face some significant challenges and as such the Financial Report is a work in progress. I will explain more fully the challenges we face as we try to achieve the highest standards of financial performance and accountability. Today's hearing is very timely, and the committee's interest is greatly appreciated.

Treasury Financial Reporting

The Treasury Department has a long-standing responsibility and commitment to report accurate and useful information about the Nation's finances. Our objective in preparing the consolidated financial statements is to provide the Congress and the public with a reliable, consistent, timely, and useful report on the cost of the government's operations, the sources used to fund them, and the implications of its financial commitments.

As you know, the Government Management Reform Act of 1994 requires the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, to prepare and submit to the President and the Congress the preceding fiscal year's audited financial statements, not later than March 31. I'm pleased that we were able to submit the FY 2003 Financial Report to the Congress in February 2004, a month earlier than in previous years.

We were able to submit the report earlier largely because of the progress agencies made in accelerating their financial reporting. Three-fourths of the major agencies completed their audited financial statements by the end of December 2003, and eight agencies issued their statements by mid-November 2003, a year ahead of the accelerated deadline that goes into effect this fall. For the FY 2004 statements, OMB has established the due dates as November 15 for the agency statements and December 15 for the government-wide statements. This more timely preparation of the consolidated report means that this financial information will be available in December, preceding publication of the President's Budget, providing actual data on an accrual basis for reference.

Importance of the Report

The Financial Report is an important addition to federal financial reporting. It provides an across-the-board look at the total costs of the Federal Government, computed in accordance with accrual accounting standards established by generally accepted accounting principles (GAAP). The report presents a picture of government-wide costs that is not otherwise available. Under the accrual method, transactions are recorded as they occur, whereas under the cash basis of accounting, transactions are recorded when cash is received or paid. This accrual-based information complements the traditional outlay information in the Budget and helps to assess the long-term impact of the government's policy decisions. The availability of this additional information more fully informs the budget process.

The standardized reporting framework promotes comparability and consistency in reporting across years and among agencies. The report goes beyond simple reporting of results as it displays the effects of all significant assets, liabilities, stewardship responsibilities and other commitments and responsibilities. The considerable financial implications of the government's social insurance programs (principally Social Security and Medicare) are reported in the stewardship accounting for these programs. For example, the net present value (over a 75-year period) of our additional responsibilities for the social insurance programs was estimated in the

FY 2003 report at $26.9 trillion. These future program responsibilities do not fit neatly into current accounting classifications. The appropriate accounting treatment in the future for these social insurance programs is a current topic of discussion at the Federal Accounting Standards Advisory Board (FASAB).

The report is subject to audit by the GAO, and they have done so each of the seven years the report has been issued. The audit enhances the report's credibility as well as highlighting areas for improvement. Although the report has improved over the years as we have strived to make it more useful, the GAO has been unable to render an opinion on the financial statements, resulting in a disclaimer of opinion.

Challenges in Preparing the Report

For the FY03 report, GAO cited three principal reasons for the disclaimer: (1) serious financial management problems at the Department of Defense (DoD); (2) the federal government's inability to completely account for transactions between federal entities; and (3) deficiencies in the report preparation processes. We will soon receive the related management letter from GAO providing a more detailed description of some of the deficiencies as well as recommendations for their resolution. We recognize that many of the GAO recommendations will improve the accuracy and usefulness of the report. We have been working to address many of the recommendations from the FY02 audit and believe that we are making significant progress.

As the next panel will no doubt discuss, the DoD has displayed a strong commitment to correct its extensive financial management problems through a comprehensive financial management modernization program. Therefore, I will focus my remarks on the two other material weaknesses.

The first of these is the government's inability to account properly for all financial transactions between federal agencies. In essence, two agencies that have been parties to a transaction are reporting different amounts for the same transaction resulting in differences which cannot be eliminated when we prepare the consolidated report. Many of these differences result from the agencies' inconsistent use of accounting conventions or data compilations. These differences indicate a fundamental weakness in data integrity at the agency level.

The second weakness the report preparation process has three aspects: (1) the need to directly link agencies audited financial statements with the agency data used in the consolidated financial statements; (2) unexplained transactions that affect the government's net position and that result in the need for a "plug" or reconciling entry; and (3) ensuring that the financial statements are in compliance with GAAP.

Progress in Addressing GAO Recommendations

We have a number of initiatives underway to resolve the material weaknesses GAO identified and to improve the government's financial management and accountability. The Financial Management Service (FMS), the Treasury bureau responsible for government-wide accounting operations, is making real progress. Some of these initiatives are in the developmental phase; however, I'm pleased to report that FMS has already succeeded in implementing major improvements.

We have been focusing on the problem of intragovernmental activity and imbalances and are devoting much attention to help agencies fully reconcile these areas. FMS has added a new tool to help agencies properly identify and record these intragovernmental transactions. The *Intragovernmental Reporting and Analysis System (IRAS)* has been instrumental in classifying inter-agency activity and balances. It now identifies recording differences for the same transaction between agency *trading partners* (one agency doing business with another), provides information for agencies to correct reporting errors, and assists them in reconciling major differences. *IRAS* offers a database solution for tracking quarterly accounting errors and timing differences and a systematic documentation of the different accounting methods used by the agencies. This year Treasury and OMB required agencies to report and reconcile intragovernmental activity quarterly instead of just at the end of the year. These more frequent reconciliations have already led to a reduction in differences in agency reporting. I am optimistic that the reporting for June 30 will show even more significant improvement. As we continue to expand its use, *IRAS* will become a centerpiece in tracking the reporting of intragovernmental transactions.

As helpful as *IRAS* has been thus far, there is no single, centralized systems solution to the problem of intragovernmental transaction imbalances. Each agency's management must make it a priority to improve their agency's data quality, reconcile amounts with their trading partners, and adhere to the standard business rules issued by OMB for processing intragovernmental transactions. In addition, the agency must conduct the required quarterly reconciliations so that there is less work to do at year-end when the financial statements are prepared. The agency must understand the process and apply consistency and attention to detail in recording information at the points where the transactions take place. This is basic to accurate and consistent financial reporting.

Related to the intragovernmental balance problem is one of the report preparation weaknesses noted by GAO, namely the unreconciled or unexplained transactions that affect the change in net position and that require us to use a reconciling entry or "plug" in the financial statements. We recognize the need to address this long-standing problem, which calls for better reconciliation procedures and balanced accounting entries to derive the change in net position. We believe the larger problem has its roots in the unreconciled intragovernmental balances, and we are therefore focusing our efforts on that area first. When that problem is resolved, we believe it will go a long way toward correcting the net position problem. We have also done some pilot work to determine if certain custodial receipts collected by the agencies may be contributing to the problem. Our early findings indicate that this area may be the cause of some of the unexplained net position differences. We are considering additional analytical approaches to further explain these differences.

We are also addressing the process issue GAO raised about the need to directly link agencies' audited financial statements with the data they provide to Treasury for compiling the government-wide consolidated statements. FMS is completing the implementation of a new *closing package* process called the Government-wide Financial Report System (GFRS). This process is the foundation for ensuring that the government-wide consolidated statements contain the same information as the agency financial statements.

Five agencies pilot-tested this new, internet-based system last year, and the system has now been introduced government-wide. FMS met with all agency CFOs and IGs to explain the requirements of the new system and is training agency accounting personnel to use it. As they complete the training, agencies are entering their fiscal 2003 actual data. This process will be completed in August. Additionally, GAO has begun its audit work on the new system. In November, as agencies issue their statements, they will then report their fiscal 2004 data using the new process. GFRS will provide a clear audit trail that will facilitate the audit of the Financial Report and demonstrate that it is consistent with the underlying information in agencies' audited financial statements.

We are also addressing GAO's recommendation that we ensure that the notes or disclosures in our report are in compliance with generally accepted accounting principles (GAAP). This will entail presenting information we had not previously included. Beginning with the FY 2004 report, agencies will submit through GFRS certain financial statement notes or disclosures. Since this information is being collected government-wide for the first time, it will require analysis and review to determine whether and how it should be consolidated. We are uncertain at this point how many of the new disclosures will be included in the FY2004 Financial Report. Additionally, we are considering approaching (FASAB) for additional clarity on specific disclosures that do not lend themselves to a data roll-up such as treaties and condition reporting.

Other Improvements Underway

In addition to addressing the audit findings, we have been taking steps to support better financial management across government. A major acceleration initiative implemented over the course of the past two fiscal years has resulted in earlier agency data input and an earlier release of the Monthly Treasury Statement of Receipts and Outlays of the United States Government (MTS). Each month, the MTS displays official budget results, including data on the budget deficit or surplus. Agencies are now submitting their monthly financial data to Treasury within three workdays of the end of the month, compared with five to seven days a year ago. This accelerated reporting has enabled Treasury to provide agency expenditure balances and other financial information which agencies need to prepare their financial statements much earlier than in the past. Several years ago, the MTS was released on the 17th workday after the end of the month; at the start of 2003, it was released on the 14th workday and now is being released on the 8th workday. By providing timelier information, we can better inform the decision-making process.

Another Treasury initiative that is improving financial management is the Government-wide Accounting Modernization Project (GWA). GWA provides agencies with significantly better tools for reporting their financial information and monitoring its status. Treasury has implemented an account statement module that allows agencies to view their account balances on a near real-time basis. Prior to this module, agencies were unable to see their account balances until the 9th workday after the end of the month. Another segment of the system now allows agencies to process certain transfers and borrowing transactions and eliminates a burdensome paper process that had existed for many years. In addition, the project has been expanded to allow agencies to access their monthly disbursement and collection data on the Internet. GWA, when fully operational, will provide more timely financial information to agencies and will eliminate duplicative reporting and costly, manually-intensive reconciliations.

Conclusion

I look forward to meeting the new due dates this year, but I recognize the difficulties involved. We are dealing with a new central reporting process, and are working with agencies whose financial reporting is not yet where it needs to be to meet this date. That being said, I visualize the day when we have fully achieved more timely reporting and can obtain the full value of financial reporting by having reports that are truly useful. Accurate, reliable, and on-time financial reports that comply with statutory and administrative requirements are basic elements, but not sufficient to achieve the full value of financial reporting. Usefulness is the final element of effective financial reporting. Financial reports should provide relevant financial and performance information that not only supports management decision making but also informs the public. Here lies the greatest challenge and potentially the greatest benefit from financial reporting.

In conclusion, we have come a long way, our upcoming challenges are significant but manageable, and I am confident that we will continue to see real progress. Thank you, Mr. Chairman. This concludes my formal remarks.

Statement of Larry J. Lanzillotta
Acting Under Secretary of Defense (Comptroller)
Senate Government Affairs Committee
Subcommittee on Financial Management, the Budget, and International Security
8 July 2004

Mr. Chairman and Members of the Committee, thank you for this opportunity to discuss Department of Defense (DoD) business management. This will be one of my last hearings before leaving the Department of Defense, and so I want to give you my observations from the last three years of working on DoD management challenges.

Led by Secretary Rumsfeld, transforming DoD business management has been a top priority. Our overarching aim has been achieving an integrated environment of DoD business processes -- supported by systems that efficiently deliver relevant decision-making information to DoD leaders and fulfill all financial management requirements.

My message today is: The Department of Defense has undertaken an unprecedented, comprehensive, and visionary transformation to achieve this aim. We are making progress to correct weaknesses and control business system investments. Strong and consistent Congressional support of this transformation is vital to sustaining our progress.

A Three-Pillar Strategy

To transform DoD business management, the Department must succeed with all three, interdependent pillars of its strategy:

(1) Overhaul and integrate DoD business processes and systems through the Department's Business Management Modernization Program (BMMP).

(2) Refine and advance the financial improvement plans of the military services and defense agencies to enable them to produce auditable financial statements resulting in clean (unqualified) audit opinions.

(3) Audit line items on financial statements as they become ready for such an audit.

Each of these pillars is essential. They must be advanced simultaneously. None can be stopped or slowed without hurting the progress of the entire transformation.

This transformation will not only dramatically improve DoD business and financial management. It also will enable DoD leaders to make resource decisions based on the best information and data obtainable. And it will enable the Department to meet Chief Financial Officers (CFO) Act and other legal requirements – including satisfactory financial statements.

Accomplishments in Transforming of DoD Business Management

During the three years since the Department of Defense began its business management transformation, we have had substantial accomplishments. The Department has:

- Established a progressively more comprehensive inventory of all DoD business systems. (Total is currently over 4000 systems, and more systems are expected to be identified.)
- Began to build a blueprint, or architecture, to guide the transformation from the current, stove-piped conglomeration of DoD business systems into an integrated environment of overhauled systems and processes.
- Designed an incremental strategy to achieve our transformation goals and defined the focus for each increment.
- Developed a governance process to provide strategic direction to oversee the transformation of business process and systems so they will transcend organizational boundaries and become integrated.
- Organized all major DoD business activities into six areas or domains, and designated an Under Secretary of Defense (USD) as a Domain Owner to oversee each business area – for example, the USD for Acquisition, Technology and Logistics to oversee all logistics business activities.
- Established a portfolio management process by which Domain Owners will oversee investments in information technology to ensure full integration of all DoD business processes and systems.
- Established the DoD Audit Committee to provide a concerted senior leadership focus to produce auditable financial statements resulting in clean audit opinions.
- Developed for individual reporting entities improvement plans that show planned improvements and milestones.
- Implemented additional discipline in our quarterly reporting processes that have accelerated the preparation of financial reports and elevated our commitment to quality.

It is important to note that Domain Owners are responsible for overseeing the transformation of business activities managed by the Military Services and other DoD components. This governance plan has already demonstrated that it can work, and we are continuing to strengthen and expand it. Some observers do not believe that we are moving fast enough, yet acknowledging that DoD is one of the world's largest and most complex organizations, with a huge business transformation challenge.

The Department of Defense is in business transformation for the long-term. It will take years to fix our systemic problems, which evolved over several decades.

Congressional Direction and Support

DoD accomplishments over the last three years have significantly benefited from both Congressional and GAO support of our comprehensive transformation initiative. In view of this strong past support, we are concerned by the apparently contradictory direction given by the Congress in both the House and Senate FY 2005 defense authorization bills. Both bills cut funding that is essential to achieving the transformation that everyone agrees is essential. The rationale seems to be that progress has been too slow, yet the funding cuts will make continued progress more difficult.

Besides funding cuts, both authorization bills propose a radical change in the role of Domain Owners: Changing the Domain Owners role from oversight of business systems to being responsible for virtually all aspects of business systems. To date, the DoD approach has been to give Domain owners oversight responsibility using our prescribed architecture standards and business rules. This structure will enable Domain Owners to control business-related investments, ensure that standards are adhered to, and move DoD business systems and processes toward full integration. The complimentary nature of the domain process to traditional acquisition management enhances our ability to meet Service unique warfighting needs while implementing business standards across the Department.

We should be careful about derailing this governance structure. It promises to overhaul and integrate DoD business activities – ultimately saving billions of dollars. Changing this governance structure could prevent us from eliminating stove-pipe systems or create new stove-pipe problems. For decades, DoD and Congressional leaders have recognized the need for operational expertise and perspective in the managing of business systems. We should resist centralizing all business system decisions and losing this expertise and perspective.

Closing

In closing, I urge you and other Congressional leaders to continue to support the Department of Defense in its efforts to transform DoD business management. Congress and the Department must continue to be partners in this unprecedented undertaking.

Our business transformation progress is consistent with U.S. industry standards. And it is all the more remarkable that our accomplishments have occurred while we fight the global war on terrorism and advancing bold initiatives to transform America's military capabilities.

This is a critical time for ensuring that DoD management and business systems become just as superlative as the military forces they support. We in the Department of Defense appreciate and continue to need the Congress's support to achieve this vital priority. Thank you.

Active CMRs

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
Type Law	PL					
1826	PL	108-87	8081		A	ADVANCED CONCEPT TECHNOLOGY DEMONSTRATION PROJECTS
1365	PL	91-611	235(d)		A	SUSQUEHANNA RIVER BASIN STUDY
1366	PL	94-587	109		A	SANTA ANA RIVER, CALIFORNIA, FLOOD CONTROL PROJECT
1367	PL	94-587	141		A	FEASIBILITY OF PROVIDING FLOOD PROTECTION BY DREDGING THE SUSQUEHANNA RIVER IN THE WYOMING VALLEY, PENNSYLVANIA
1368	PL	98-063			A	FEASIBILITY REPORT ON WATER RESOURCE NEEDS
1369	PL	99-662	1101(f) (1)		A	EFFECTIVENESS OF ICE CONTROL PROGRAM ON KANKAKEE RIVER, WILMINGTON, ILLINOIS
1370	PL	99-662	1107(c)		A	PANEL FINDINGS ON THE EFFECTIVENESS OF THE OPERATION OF AREA VIII OF THE RED RIVER BASIN
1371	PL	99-662	302(b)		A	RECOMMENDATIONS ON THE COMMERCIAL NAVIGATIONAL FEATURES AND COMPONENTS OF INLAND WATERWAYS AND HARBORS
1391	PL	99-145	1437(a)		A	REMOVAL OF BASIC POINT DEFENSE MISSILE SYSTEM FROM NAVAL AMPHIBIOUS VESSELS
1374	PL	99-662	701		A	WATER RESOURCES PROJECTS AT ILLINOIS RIVER, HARDIN, ILLINOIS, AND KINNICKINNIC RIVER, MILWAUKEE COUNTY, WISCONSIN

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1362	PL	89-789	209		A	SURVEYS OF WATER RESOURCE PROJECTS BY THE CHIEF OF ENGINEERS
1376	PL	99-662	811(b)		A	LONG TERM SOLUTIONS TO SHOALING PROBLEMS IN SANTA CRUZ HARBOR, SANTA CRUZ, CALIFORNIA
1377	PL	99-662	844(b)		A	INCLUSION OF MEMBERS OF MINORITY GROUPS AND MINORITY OWNED FIRMS
1380	PL	99-167	205(l)		A	JUSTIFICATION OF EXPENDITURE FOR NAVAL STRATEGIC HOMEPORTING
1381	PL	99-661	203(g)		A	EXPENDITURE OF RESEARCH AND DEVELOPMENT FUNDS FOR PROGRAMS RELATED TO LIBYAN LESSONS-LEARNED MODIFICATIONS
1385	PL	96-418	810		A	PROGRESS OF FEASIBILITY STUDY AND DEMONSTRATION OF DECONTAMINATING KAHOOLAWE ISLAND, HAWAII
1387	PL	98-094	1260(d)		A	OFFSHORE ZONES ALONG THE U.S. IN WHICH OIL OR GAS DRILLING WOULD CAUSE APPRECIABLE IMPACT ON NAVAL OPERATIONS
1388	PL	97-099	205		A	COSTS OF PROPOSED CONTRACT FOR THE SUPPLY OF STEAM/STEAM AND ELECTRICITY
1267	PL	97-269	103		A	NOTICE OF INTENTION TO MAKE FUNDS AVAILABLE FOR ANY ACTIVITY NOT SPECIFICALLY AUTHORIZED
1372	PL	99-662	401		A	FLOOD CONTROL STORAGE DAM ON THE SANTA ANA RIVER MAINSTEM, CALIFORNIA
1332	PL	99-145	1426(b)		A	CONVENTIONAL ALTERNATIVES REGARDING THE SM-2(N) STANDARD MISSILE
1654	PL	103-160	271		A	RESEARCH ON EXPOSURE TO DEPLETED URANIUM BY MILITARY PERSONNEL WHO SERVED IN THE PERSIAN GULF WAR

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1275	PL	97-099	915(f)		A	TERMS RELATING TO LAND EXCHANGE AT SOUTH CHARLESTON, WEST VIRGINIA
1288	PL	102-484	141(b)(1)		A	FUNDING FOR CERTAIN TACTICAL INTELLIGENCE PROGRAMS
1298	PL	99-661	1363		A	NATURE OF DECISION TO CHANGE SOURCE PROVIDING GRADUATE EDUCATIONAL SERVICES FOR MINUTEMAN EDUCATION PROGRAM
1311	PL	100-676	47(b)		A	IMPACT OF A MUNICIPAL LANDFILL ON THE NEWARK VALLEY AQUIFER
1313	PL	101-229	104(j)		A	STATUS OF THE NATURAL RESOURCES OF THE C-111 BASIN AND FUNCTIONALLY RELATED ISLANDS
1316	PL	102-580	313(f)		A	SO. CENTRAL PA ENVIRONMENTAL RESTORATION INFRASTRUCTURE AND RESOURCE PROTECTION DEVELOPMENT PILOT PROGRAM
1317	PL	93-251	57		A	BEACH EROSION AT PRESQUE ISLE PENINSULA, ERIE, PENNSYLVANIA
1364	PL	91-611	231(a)		A	ESTABLISHMENT OF A NATIONAL RECREATION AREA IN THE UPPER KENTUCKY AND LICKING RIVER BASINS
1326	PL	97-099	704		A	CONSTRUCTION CONTRACTS AWARDED ON OTHER THAN A COMPETITIVE BASIS
1363	PL	91-611	204(a)		A	PUERTO RICO WATER CONSERVATION PLANS
1340	PL	99-167	840(d)(A)		A	ECONOMIC ANALYSIS ON PROPOSED CONTRACT FOR SALE OF GREGG CIRCLE AREA, FORT JACKSON, SC

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1346	PL	100-676	45(d)		A	DES PLAINS RIVER WETLANDS DEMONSTRATION PROJECT
1348	PL	101-640	307(e)(2)		A	PROGRAM FOR THE TRAINING AND CERTIFICATION OF INDIVIDUALS AS WETLANDS DELINEATORS
1349	PL	101-640	404(c)		A	DEMONSTRATION OF CONSTRUCTION OF FEDERAL PROJECT BY NON-FEDERAL INTERESTS
1355	PL	102-580	114(r)(2)		A	HAMPTON AND POQUOSON, VIRGINIA
1359	PL	102-580	310(b)		A	REND LAKE, ILLINOIS
1361	PL	102-580	340(e)		A	SOUTHERN WEST VIRGINIA ENVIRONMENTAL RESTORATION INFRASTRUCTURE AND RESOURCE PROTECTION DEVELOPMENT PILOT PROGRAM
1396	PL	95-452	5(d)		A	PARTICULARLY SERIOUS OR FLAGRANT PROBLEMS, ABUSES, OR DEFICIENCIES IN THE ADMINISTRATION OF PROGRAMS AND OPERATIONS
1325	PL	97-099	704		A	DOLLAR VALUE OF COMPLETED CONSTRUCTION CONTRACTS, DESIGN, CONSTRUCTION SUPERVISION, AND OVERHEAD FEES CHARGED
1584	PL	106-398	576		A	TEST OF ABILITY OF RESERVE COMPONENT INTELLIGENCE UNITS TO MEET CURRENT AND EMERGING DEFENSE INTELLIGENCE NEEDS
1562	PL	106-259	8052		A	RESTRICTION ON USE OF FUNDS TO ESTABLISH A FIELD AGENCY OR FUND HQ PERSONNEL ASSIGNED OR REASSIGNED TO SUCH FIELD AGENCY
1563	PL	106-259	8061		A	RESTRICTION ON THE USE OF FUNDS - PENTAGON RENNOVATION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1552	PL	106-065	3017		A	ONGOING DECONTAMINATION
1564	PL	106-259	8071		A	LOAN GUARANTEES
1565	PL	106-259	8092		A	PROHIBITION ON USE OF FUNDS FOR SECURITY FORCES TRAINING
1566	PL	106-259	8095		A	PROCUREMENT RESTRICTIONS ON ADC(X) CLASS OF SHIPS
1568	PL	106-259	8131		A	OVERSEAS CONTINGENCY OPERATIONS TRANSFER FUND
1390	PL	98-094	108(a)(1)		A	PROPOSED ACQUISITION OF A VESSEL FOR THE STRATEGIC SEALIFT READY RESERVE PROGRAM
1577	PL	106-398	355		A	PERFORMANCE OF EMERGENCY RESPONSE FUNCTIONS AT CHEMICAL WEAPONS STORAGE INSTALLATIONS
1557	PL	106-259	8016		A	PURCHASE OF WELDED SHIPBOARD ANCHOR AND MOORING CHAIN - RESTRICTIONS
1598	PL	106-398	1001(d)		A	TRANSFER AUTHORITY - NOTICE TO CONGRESS
1601	PL	106-398	1052		A	REPORT ON SUBMARINE RESCUE SUPPORT VESSELS
1607	PL	106-398	1501(c)		A	ASSISTANCE FOR ECONOMIC GROWTH ON VIEQUES - NOTICE TO CONGRESS
1639	PL	104-106	3302(b)		A	AUTHORIZED USES OF STOCKPILE FUNDS - ADDITIONAL OBLIGATIONS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1643	PL	105-261	1204		A	SECRETARY OF DEFENSE REPORTS ON OPERATIONS IN BOSNIA AND HERZEGOVINA
1646	PL	104-106	1343		A	SEMIANNUAL REPORTS CONCERNING UNITED STATES-PEOPLE'S REPUBLIC OF CHINA JOINT DEFENSE CONVERSION COMMISSION
1648	PL	103-160	1434		A	REPORTS ON EFFORTS TO SEEK COMPENSATION FROM GOVERNMENT OF PERU FOR DEATH AND WOUNDING OF CERTAIN U. S. SERVICEMEN
1653	PL	103-160	270		A	GRANTS TO SUPPORT RESEARCH ON EXPOSURE TO HAZARDOUS AGENTS AND MATERIALS BY MILITARY PERSONNEL IN THE PERSIAN GULF WAR
1569	PL	106-259	8127		A	BMDO NOTICE ON INFORMATION OR PROPOSAL SOLICITATION
1459	PL	105-085	743(f)		A	AUTHORITY FOR AGREEMENT FOR USE OF MEDICAL RESOURCE FACILITY, ALAMAGORDO, NEW MEXICO
1401	PL	101-510	1764(d)		A	AUTHORITY TO ESTABLISH DIFFERENT MINIMUM EXPERIENCE REQUIREMENTS (FOR ACQUISITION POSITIONS)
1409	PL	85-561	924		A	REPORT CARD FROM DoDDS PARENTS
1410	PL	95-079	812		A	HOST NATION SUPPORT FOR PETROLEUM LOGISTICS
1421	PL	104-032			A	FAMILY HOUSING IMPROVEMENT FUND
1422	PL	104-032	107		A	MINOR CONSTRUCTION
1423	PL	104-032	110		A	OVERSEAS CONSTRUCTION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1424	PL	104-032	119		A	NATO BURDENSHARING
1430	PL	104-032	113		A	MILITARY EXERCISES
1560	PL	106-259	8033		A	RESTRICTIONS ON PROCUREMENT OF CARBON, ALLOY OR ARMOR STEEL PLATE
1455	PL	105-085	122(f)(3)		A	CVN-77 NUCLEAR AIRCRAFT CARRIER PROGRAM
1559	PL	106-259	8021		A	RESTRICTION ON ORGANIZATION RELOCATION
1465	PL	105-085	848		A	REQUIREMENTS RELATING TO MICRO-PURCHASES
1472	PL	105-085	1033		A	AUTHORITY TO PROVIDE ADDITIONAL SUPPORT FOR COUNTER-DRUG ACTIVITIES OF PERU AND COLOMBIA
1473	PL	105-085	1034		A	ANNUAL REPORT ON DEVELOPMENT AND DEPLOYMENT OF NARCOTICS DETECTION TECHNOLOGIES
1511	PL	106-065	233(c)(3)		A	ACQUISITION STRATEGY FOR THEATER HIGH-ALTITUDE AREA DEFENSE (THAAD) SYSTEM
1512	PL	106-065	234(h)		A	SPACE-BASED LASER PROGRAM - ANNUAL REPORT
1541	PL	106-065	1065		A	CHEMICAL AGENTS USED FOR DEFENSIVE TRAINING

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1556	PL	106-259	8014		A	CONVERSION OF DOD ACTIVITY OR FUNCTION TO CONTRACTOR PERFORMANCE - RESTRICTIONS
1266	PL	102-190	1001(d)		A	NOTIFICATION OF TRANSFERS OF AUTHORIZATIONS OR APPROPRIATIONS OF DOD FUNDS
1449	PL	105-085	328		A	PROHIBITION OF IMPLEMENTATION OF TIERED READINESS SYSTEM
604	PL	100-180	3202(c)		A	STRATEGIC MATERIALS STOCKPILE REQUIREMENTS
1218	PL	99-661	704(a)(2)		A	EVALUATION OF EXTENDED BENCHMARK TEST OF COMPETING MEDICAL INFORMATION SYSTEM
1223	PL	96-130			A	TRANSFER OF FUNDS FOR MILITARY CONSTRUCTION OR FAMILY HOUSING TO COMPENSATE FOR FOREIGN CURRENCY FLUCTUATIONS
1279	PL	100-456	823(a)		A	CRITICAL TECHNOLOGIES PLAN
1287	PL	101-510	364(c)		A	TRANSPORTATION OF CHEMICAL WEAPONS FROM THE FEDERAL REPUBLIC OF GERMANY TO JOHNSTON ISLAND
205	PL	99-591	121		A	FOREIGN CURRENCY FLUCTUATIONS, DEFENSE REPORT
255	PL	103-087	525		A	NOTIFICATION OF LOAs FOR SALE OF EXCESS DEFENSE ARTICLES
552	PL	101-189	841a		A	NATIONAL CRITICAL TECHNOLOGIES PANEL
751	PL	100-456	1202(e)		A	CHANGE IN NOTICE OF TRANSFER AUTHORITY

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
602	PL	100-180	1201(d)		A	USE OF TRANSFER AUTHORITY
1211	PL	97-106	109		A	NONFEASIBILITY OF USE OF FOREIGN CURRENCIES
651	PL	100-456	118		A	REVISION TO CHEMICALLY DEMILITARIZED PROGRAM REPORTS
659	PL	102-580			A	AVAILABILITY OF DoD WAREHOUSE STORAGE SPACE IN DC AREA TO SUPPORT LIBRARY OF CONGRESS
665	PL	100-456	241(e)		A	ADVANCED SUBMARINE TECHNOLOGY PROGRAM
675	PL	100-456	317		A	OBLIGATION OF FUNDS FOR CIVILIAN PERSONNEL
687	PL	100-456	512(b)		A	ADDITIONAL INFORMATION ON JOINT OFFICER POLICIES
725	PL	102-580			A	CONSTRUCTION NOTIFICATIONS
733	PL	100-456	731		A	EXPANDED NET ASSESSMENT REQUIREMENTS
1268	PL	99-145	109, 202		A	REDUCTIONS OR TRANSFERS DUE TO THE RENDERING OF SAVINGS FROM VARIOUS SOURCES
578	PL	99-145	209(c)		A	SMALL INTERCONTINENTAL BALLISTIC MISSILE LEGISLATIVE ENVIRONMENTAL IMPACT STATEMENT
93	PL	103-087	515		A	FOREIGN ASSISTANCE & RELATED PROGRAMS APPNS ACT: OBLIGATION OF FUNDS NOT JUSTIFIED FOR A FY

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
24	PL	102-580			A	EXCLUSION OF ASBESTOS REMOVAL FROM M&R LIMITS
1741	PL	107-314	1205		A	COMPREHENSIVE ANNUAL REPORT TO CONGRESS ON COORDINATION AND INTEGRATION OF ALL UNITED STATES NONPROLIFERATION ACTIVITIES
1742	PL	107-314	1402		A	COMPREHENSIVE PLAN FOR IMPROVING THE PREPAREDNESS OF MILITARY INSTALLATIONS FOR TERRORIST INCIDENTS
1745	PL	107-314	3141(e)		A	ANNUAL ASSESSMENTS AND REPORTS TO THE PRESIDENT AND CONGRESS RE: THE CONDITION OF THE U.S. NUCLEAR WEAPONS STOCKPILE
1746	PL	107-314	1508		A	GENERAL PROVISIONS APPLICABLE TO TRANSFERS
976	PL	99-661	1207(g)(4)		A	FAILURE OF MINORITY CONTRACTORS TO MEET REQUIREMENTS
987	PL	99-661	1362(1)(2)		A	NATURE OF INTENT TO CLOSE FT. RILEY CORRECTIONAL FACILITY
1136	PL	103-160	846(a)		A	IMPROVEMENT OF PRICING POLICIES
1217	PL	99-145	1203(g)(2)		A	EVALUATION OF TEST RESULTS OF USING VETERANS ADMINISTRATION DECENTRALIZED HOSPITAL COMPUTER PROGRAM
1140	PL	98-094	1231(d)		A	DEPLOYMENT OF A SMALL MOBILE INTERCONTINENTAL BALLISTIC MISSILE
1213	PL	100-463	8075(a)		A	CHAMPUS DEMONSTRATION PROJECT ON CHEMICAL AVERSION THERAPY

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
108	PL	103-087	515		A	FOREIGN ASSISTANCE & RELATED PROGRAMS APPNS ACT: PROGRAM CONTENT NOTIFICATION
938	PL	102-580			A	NORTH CAROLINA - PORT OF WILMINGTON
184	PL	100-496	14		A	PROMPT PAYMENT ACT
822	PL	101-189	115(b)		A	ONGOING INDEPENDENT ASSESSMENT OF B-2 PROGRAM
823	PL	102-580			A	FOREIGN LEASES
826	PL	101-189	121(d)		A	B-1B AVIONICS TEST PROGRAM
828	PL	101-189	211(e)		A	BALANCED TECHNOLOGY INITIATIVE PROGRAM
760	PL	100-456	1309		A	ASSESSMENT OF SECURITY AT U.S. BASES IN THE PHILIPPINES
1139	PL	98-525	1302(b)		A	EXERCISE OF AUTHORITY TO INCREASE THE NUMBER OF EMPLOYEES
1200	PL	100-202			A	NOTIFICATION OF SHIPMENT OF HUMANITARIAN RELIEF TO COUNTRIES NOT PREVIOUSLY AUTHORIZED BY CONGRESS
1119	PL	101-189	803(a)		A	LOW RATE INITIAL PRODUCTION OF NAVAL VESSEL AND SATELLITE PROGRAMS
1123	PL	101-510	826(a)		A	DEFENSE INDUSTRIAL BASE FOR TEXTILE AND APPAREL PRODUCTS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1125	PL	103-337	1314(a)		A	NATIONAL SECURITY CONSEQUENCES OF UNITED STATES MILITARY COOPERATION PROGRAMS
1126	PL	103-337	602(b)(2)		A	COST-OF-LIVING ALLOWANCE FOR MEMBERS OF THE UNIFORMED SERVICES ASSIGNED TO HIGH COST AREAS IN CONUS
1191	PL	101-189			A	FAILURE OF A MILITARY DEPARTMENT TO SPEND FUNDS
1193	PL	101-510	342(b)(4)		A	ENVIRONMENTAL COMPLIANCE AT OVERSEAS MILITARY INSTALLATIONS
1194	PL	103-337	3306(c)		A	DOMESTIC PRODUCTION OF HIGH PURITY CHROMIUM METAL IN THE UNITED STATES
743	PL	100-456	1201		A	TRANSFER AUTHORIZATIONS
1197	PL	99-606	8(e)(3)		A	STATUS OF CONTAMINATED PUBLIC LANDS AND ACTIONS TAKEN CONCERNING THE STATE OF CONTAMINATION
1057	PL	103-355			A	PEACEKEEPING OPERATIONS - CONSULTATIONS
1202	PL	101-510	1456(b)		A	WAIVER OF LIMITATION ON THE COSTS TO THE U.S. FOR PAYMENTS TO FOREIGN NATIONALS EMPLOYED AT BASES OUTSIDE THE U.S.
1204	PL	102-025	608(d)		A	WAIVER OF WITHHOLDING OF PAYMENTS TO INDIRECT-HIRE CIVILIAN PERSONNEL OF NONPAYING PLEDGING NATIONS
1234	PL	100-456	801(a)		A	CONTRACTS NEGOTIATED DURING THE PRECEDING FISCAL YEAR
1235	PL	100-463	8061		A	CONVERSION OF DEPARTMENT OF DEFENSE ACTIVITIES TO CONTRACTOR PERFORMANCE

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1237	PL	97-099	703(g)		A	IDENTIFICATION OF EACH CONSTRUCTION PROJECT REDUCED WITHIN AUTHORIZATION
1252	PL	101-623	14		A	PROCUREMENT OF SURFACE WATER CRAFT FOR COUNTERNARCOTICS PROGRAMS
1264	PL	100-202	8096		A	CUMULATIVE REPROGRAMMINGS FROM ANY PROJECT OR PROGRAM IN EXCESS OF FIXED DOLLAR AMOUNTS
1265	PL	100-456	1202(2)		A	TRANSFER OF DEFENSE FUNDS OF $2 BILLION OR MORE
1196	PL	99-606	7(b)		A	DECONTAMINATION EFFORTS ON PUBLIC LANDS
919	PL	99-145	106(a)(2)		A	NATO COOPERATIVE PROGRAM AGREEMENTS
796	PL	102-580			A	EXERCISE CONSTRUCTION - PROJECTS WHICH EXCEED $100,000
800	PL	100-456	2819		A	BASE REUTILIZATION COMMISSION REPORT
833	PL	101-189	224(a)		A	PROGRAMS AND PROJECTS THAT CONSTITUTE THE SDI INITIATIVES
864	PL	101-189	852(b)		A	FOREIGN CONTRACTS - INTELLECTUAL PROPERTY TREATIES
904	PL	94-106	808		A	CHANGES IN 5-YEAR NAVAL SHIP CONSTRUCTION PROGRAM
907	PL	96-418	802(e)		A	MX & TRIDENT COMMUNITY ASSISTANCE

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
909	PL	98-094	1260(a)		A	POTENTIAL EFFECT ON NAVAL OPERATIONS OF OFFSHORE LANDS FOR OIL OR GAS DRILLING
910	PL	98-115	803(b)(2)		A	WAIVER OF FOREIGN PRE-FAB CONSTRUCTION REQUIREMENT
1115	PL	103-335			A	DATA CALL FOR DOD AUTOMATED DOCUMENT CONVERSION MASTER PLAN
915	PL	98-525	1002(d)(2)		A	ADD SELECTED INDICATORS TO NATO REPORT
1096	PL	102-580			A	USE OF EXISTING FACILITIES BY THE RESERVE COMPONENTS
934	PL	102-580			A	NONAPPROPRIATED FUND INSTRUMENTALITIES
951	PL	102-580			A	OPERATIONS AND MAINTENANCE: EXPENDITURES OVER $15K FOR REPAIR OF NON-GENERAL OR NON-FLAG OFFICER QUARTERS
960	PL	99-145	913		A	PROCUREMENT COMPETITION GOALS
965	PL	99-661	1207(g)(3)		A	MINORITY CONTRACT GOALS
1028	PL	99-145	1101		A	EUROPEAN END STRENGTH
1045	PL	101-511	6		A	NATIONAL COMMISSION ON DEFENSE AND SECURITY - ACTIVITIES OF THE COMMISSION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1050	PL	102-580			A	STUDY OF UNUSED FACILITIES
1375	PL	99-662	727		A	DETERMINATION ON IMPROVEMENTS FOR FLOOD CONTROL AND RELATED PURPOSES IN UTAH
912	PL	98-525	1002(d)(1)		A	NATO MUNITIONS AND AIRCRAFT SHELTERS
1718	PL	107-314	366(c)		A	TRAINING RANGE INVENTORY
1677	PL	106-398	721		A	MODIFICATION OF PROHIBITION ON REQUIREMENT OF NON-AVAILABILITY STATEMENT OR PREAUTHORIZATION
1775	PL	108-136	927		A	COMMERCIAL IMAGERY INDUSTRIAL BASE
1776	PL	108-136	1001		A	TRANSFER AUTHORITY
1777	PL	108-136	1003		A	AUTHORIZATION OF SUPPLEMENTAL APPROPRIATIONS FOR FISCAL YEAR 2003
1685	PL	107-333	1065(C)(2)		A	REPAIR, RESTORATION, AND PESERVATION OF LAFAYETTE ESCADRILLE MEMORIAL, MARNES-LA-COQUETTE, FRANCE
1803	PL	108-132	NO NUMBER		A	MILITARY CONSTRUCTION, ARMY
1804	PL	108-132	NO NUMBER		A	MILITARY CONSTRUCTION, NAVY

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1805	PL	108-132	NO NUMB ER		A	MILITARY CONSTRUCTION, AIR FORCE
1806	PL	108-132	NO NUMB ER		A	MILITARY CONSTRUCTION, DEFENSE-WIDE
1807	PL	108-132	103		A	FEDERAL HIGHWAY ADMINISTRATION
1808	PL	108-132	121		A	FAMILY HOUSING IMPROVEMENT FUND
1809	PL	108-132	123		A	MILITARY FAMILY HOUSING
1690	PL	107-333	1506		A	COMBATING TERRORISM: QUARTERLY REPORT
1828	PL	108-87	8082		A	CLASSIFIED MATTERS
1692	PL	107-333	1605		A	GOVERNORS' REPORTS ON IMPLEMENTATION OF RECOMMENDATIONS FOR CHANGES IN STATE LAW MADE UNDER FEDERAL VOTING ASSISTANCE P
1829	PL	108-87	8084		A	COMPLIANCE WITH FINANCIAL MANAGEMENT MODERNIZATION PLAN
1830	PL	108-87	8084		A	COMPLIANCE WITH FINANCIAL MANAGEMENT MODERNIZATION PLAN
1831	PL	108-87	8085		A	REIMBURSEMENT BY ANOTHER DEPARTMENT OR AGENCY

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1832	PL	108-87	8103		A	NEW STARTS
1833	PL	108-87	8130		A	PERSONAL COMMERCIAL SOLICITATION ON DOD INSTALLATIONS
1750	PL	108-136	123		A	MULTIYEAR PROCUREMENT AUTHORITY FOR VIRGINIA CLASS SUBMARINE PROGRAM
1683	PL	107-333	1008(b)		A	MINIMIZATION OF USE OF RESOURCES FOR UNRELIABLE FINANCIAL STATEMENTS
1682	PL	107-333	1008(a)		A	RELIABILITY OF DEPARTMENT OF DEFENSE FINANCIAL STATEMENTS
1680	PL	107-333	802		A	SAVINGS GOALS FOR PROCUREMENTS OF SERVICES
1679	PL	107-333	804		A	REPORTS ON MATURITY OF TECHNOLOGY AT INITIATION OF MAJOR DEFENSE ACQUISITION PROGRAMS
1752	PL	108-136	132		A	LIMITATION ON RETIRING C-5 AIRCRAFT
1753	PL	108-136	214		A	FUTURE COMBAT SYSTEMS
1678	PL	107-333	738		A	JOINT DOD-VA PILOT PROGRAM FOR PROVIDING GRADUATE MEDICAL EDUCATION AND TRAINING FOR PHYSICIANS
1827	PL	108-87	8081		A	ADVANCED CONCEPT TECHNOLOGY DEMONSTRATION PROJECTS
1735	PL	107-314	1001		A	TRANSFER AUTHORITY

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1717	PL	107-314	366		A	TRAINING RANGE SUSTAINMENT PLAN, GFLOBAL STATUS OF RESOURCES AND TRAINING SYSTEM, AND TRAINING RANGE INVENTORY
1716	PL	107-314	351		A	ANNUAL SUBMISSION OF INFORMATION REGARDING INFORMATION TECHNOLOGY CAPITAL ASSETS
1715	PL	107-314	314		A	PROCUREMENT OF ENVIRONMENTALLY PREFERRABLE PROCUREMENT ITEMS
1724	PL	107-314	562		A	ANNUAL REPORT ON STATUS OF FEMALE MEMBERS OF THE ARMED FORCES
1713	PL	107-314	246		A	DEFENSE NANOTECHNOLOGY RESEARCH AND DEVELOPMENT PROGRAM
1726	PL	107-314	583		A	REPORTS ON EFFORTS TO RESOLVE STATUS OF CAPTAIN MICHAEL SCOTT SPEICHER, UNITED STATES NAVY
1731	PL	107-314	803		A	SPIRAL DEVELOPMENT UNDER MAJOR DEFENSE ACQUISITION PROGRAMS
1710	PL	107-314	221		A	REPORT REQUIREMENTS RELATING TO BALLISTIC MISSILE DEFENSE PROGRAMS
1733	PL	107-314	817		A	GRANTS OF EXCEPTIONS TO COST OR PRICING DATA CERTIFICATION REQUIREMENTS AND WAIVERS OF COST ACCOUNTING STANDARDS
1709	PL	107-314	216		A	ARMY SELF-PROPELLED FUTURE COMBAT SYSTEMS
1708	PL	107-314	212(c)		A	RESPONSIBILITY FOR NAVAL MINE COUNTERMEASURES PROGRAM - NOTIFICATION OF PROPOSED CHANGES
1707	PL	107-314	141		A	DESTRUCTION OF EXISTING STOCKPILE OF LETHAL CHEMICAL AGENTS AND MUNITIONS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1373	PL	99-662	603		A	STREAMBANK EROSION CONTROL DEMONSTRATION PROGRAM AT VARIOUS LOCATIONS
1705	PL	107-314	113(b)		A	FAMILY OF MEDIUM TACTICAL VEHICLES - CERTIFICATION
1684	PL	107-333	1008(d)		A	LIMITATION ON INSPECTOR GENERAL AUDITS
1736	PL	107-314	1004		A	DEVELOPMENT AND IMPLEMENTATION OF FINANCIAL MANAGEMENT ENTERPRISE ARCHITECTURE
1738	PL	107-314	1032		A	ANNUAL REPORT ON WEAPONS TO DEFEAT HARDENED AND DEEPLY BURIED TARGETS
1739	PL	107-314	1043		A	ANNUAL REPORT ON THE CONDUCT OF MILITARY OPERATIONS CONDUCTED AS PART OF OPERATION ENDURING FREEDOM
1748	PL	107-314	1206		A	RUSSIAN PROLIFERATION TO IRAN AND OTHER COUNTRIES OF PROLIFERATION CONCERNS
1749	PL	108-136	122		A	MULTIYEAR PROCUREMENT AUTHORITY FOR TACTICAL TOMAHAWK CRUISE MISSILE PROGRAM
1784	PL	108-136	1302		A	FUNDING ALLOCATIONS
1785	PL	108-136	1302		A	FUNDING ALLOCATIONS
1786	PL	108-136	1303		A	LIMITATION ON USE OF FUNDS UNTIL CERTAIN PERMITS OBTAINED
1693	PL	107-333	2813		A	PILOT PROGRAM TO PROVIDE ADDITIONAL TOOLS FOR EFFICIENT OPERATION OF MILITARY INSTALLATIONS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1796	PL	108-136	2808		A	TEMPORARY, LIMITED AUTHORITY TO USE OPERATION AND MAINTENANCE FUNDS FOR CONSTRUCTION PROJECTS OUTSIDE THE UNITED STATES.
1797	PL	108-136	2808		A	TEMPORARY, LIMITED AUTHORITY TO USE OPERATION AND MAINTENANCE FUNDS FOR CONSTRUCTION PROJECTS OUTSIDE THE UNITED STATES
1798	PL	108-136	2808		A	TEMPORARY, LIMITED AUTHORITY TO USE OPERATION AND MAINTENANCE FUNDS FOR CONSTRUCTION PROJECTS OUTSIDE THE UNITED STATES
1800	PL	108-136	3301		A	AUTHORIZED USES OF NATIONAL DEFENSE STOCKPILE FUNDS
1706	PL	107-314	113(c)		A	FAMILY OF MEDIUM TACTICAL VEHICLES - WAIVER
1816	PL	108-87	8008		A	MULTIYEAR CONTRACTS
1658	PL	107-333	346(b)		A	DEVELOPMENT OF ARMY WORKLOAD AND PERFORMANCE SYSTEM AND WHOLESALE LOGISTICS MODERNIZATION PROGRAM
1657	PL	107-333	345		A	PILOT MANPOWER REPORTING SYSTEM IN DEPARTMENT OF THE ARMY
1810	PL	108-132	125		A	OPERATION AND MAINTENANCE, FAMILY HOUSING
1811	PL	108-132	125		A	OPERATION AND MAINTENANCE, FAMILY HOUSING
1813	PL	108-87	NO NUMB ER		A	NATIONAL DEFENSE SEALIFT FUND

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1656	PL	107-333	317(e)		A	DEPARTMENT OF DEFENSE ENERGY EFFICIENCY PROGRAM
1661	PL	107-333	411(d)		A	END STRENGTHS FOR SELECTED RESERVE: SECRETARIAL WAIVER
1815	PL	108-87	8007		A	SPECIAL ACCESS PROGRAM
1812	PL	108-87	8006		A	WORKING CAPITAL FUNDS
1817	PL	108-87	8008		A	MULTIYEAR CONTRACTS
1818	PL	108-87	8047		A	FIELD OPERATING AGENCY
1819	PL	108-87	8055		A	PENTAGON RENOVATION
1820	PL	108-87	8059		A	BALL AND ROLLER BEARINGS
1821	PL	108-87	8061		A	SUPERCOMPUTER
1822	PL	108-87	8065		A	LIMITATION ON TRANSFER OF DEFENSE ARTICLES AND SERVICES
1823	PL	108-87	8074		A	END-ITEMS
1824	PL	108-87	8076		A	DEFENSE ITEMS FROM FOREIGN SOURCES

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1825	PL	108-87	8079		A	T-AKE CLASS SHIPS
1814	PL	108-87	8006		A	WORKING CAPITAL FUNDS
1721	PL	107-314	531	10 USC 510(e)	A	ENLISTMENT INCENTIVES FOR PURSUIT OF SKILLS TO FACILITATE NATIONAL SERVICE
157	PL	101-510	2906	10 USC 2687 note	A	BASE CLOSURE AND REALIGNMENT - USE OF FUNDS
1778	PL	108-136	1032	10 USC 113 note	A	PLAN FOR PROMPT GLOBAL STRIKE CAPABILITY
1758	PL	108-136	320	10 USC 113 note	A	REPORT REGARDING IMPACT OF CIVILIAN COMMUNITY ENCROACHMENT AND CERTAIN LEGAL REQUIREMENTS ON MILITARY INSTALLATIONS
1760	PL	108-136	403	10 USC 115	A	PERSONNEL STRENGTH AUTHORIZATION AND ACCOUNTING PROCESS
1770	PL	108-136	903	10 USC 153	A	BIENNIAL REVIEW OF NATIONAL MILITARY STRATEGY BY CHAIRMAN OF THE JOINT CHIEFS OF STAFF
1771	PL	108-136	903	10 USC 153	A	BIENNIAL REVIEW OF NATIONAL MILITARY STRATEGY BY CHAIRMAN OF THE JOINT CHIEFS OF STAFF
1754	PL	108-136	223	10 USC 223a	A	OVERSIGHT OF PROCUREMENT, PERFORMANCE CRIERIA, AND OPERATIONAL TEST PLANS FOR BALLISTIC MISSILE DEFENSE PROGRAMS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1755	PL	108-136	223	10 USC 223a	A	OVERSIGHT OF PROCUREMENT, PERFORMANCE CRIERIA, AND OPERATIONAL TEST PLANS FOR BALLISTIC MISSILE DEFENSE PROGRAMS
1782	PL	108-136	1221	10 USC 2249c	A	AUTHORITY TO USE FUNDS FOR PAYMENT OF COSTS OF ATTENDANCE OF FOREIGN VISITORS UNDER REGIONAL DEFENSE COUNTERTERRORISM
1773	PL	108-136	911	10 USC 2272	A	COORDINATION OF SPACE SCIENCE AND TECHNOLOGY ACTIVITIES OF THE DEPARTMENT OF DEFENSE
1756	PL	108-136	232	10 USC 2352	A	DEFENSE ADVANCED RESEARCH PROJECTS AGENCY BIENNIAL STRATEGIC PLAN
1793	PL	108-136	1601	10 USC 2370a note	A	RESEARCH AND DEVELOPMENT OF DEFENSE BIOMEDICAL COUNTERMEASURES
1792	PL	108-136	1601	10 USC 2370a note	A	RESEARCH AND DEVELOPMENT OF DEFENSE BIOMEDICAL COUNTERMEASURES
1791	PL	108-136	1601	10 USC 2370a note	A	RESEARCH AND DEVELOPMENT OF DEFENSE BIOMEDICAL COUNTERMEASURES
1774	PL	108-136	924	10 USC 2430 note	A	MANAGEMENT OF NATIONAL SECURITY AGENCY MODERNIZATION PROGRAM
1759	PL	108-136	335	10 USC 2461 note	A	DELAYED IMPLEMENTATION OF REVISED OMB CIRCULAR A-76 BY DEPARTMENT OF DEFENSE PENDING REPORT
1764	PL	108-136	653	10 USC 2482(a)	A	LIMITATIONS ON PRIVATE OPERATION OF DEFENSE COMMISSARY STORE FUNCTIONS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1767	PL	108-136	814	10 USC 2501 note	A	PRODUCTION CAPABILITIES IMPROVEMENT FOR CERTAIN ESSENTIAL ITEMS USING DEFENSE INDUSTRIAL BASE CAPABILITIES FUND
1768	PL	108-136	814	10 USC 2501 note	A	PRODUCTION CAPABILITIES IMPROVEMENT FOR CERTAIN ESSENTIAL ITEMS USING DEFENSE INDUSTRIAL BASE CAPABILITIES FUND
1766	PL	108-136	813	10 USC 2501 note	A	IDENTIFICATION OF ESSENTIAL ITEMS: MILITARY SYSTEM BREAKOUT LIST
1765	PL	108-136	812	10 USC 2501 note	A	ASSESSMENT OF UNITED STATES DEFENSE INDUSTRIAL BASE CAPABILITIES
1769	PL	108-136	821	10 USC 2534 note	A	ELIMINATION OF UNRELIABLE SOURCES OF DEFENSE ITEMS AND COMPONENTS
1799	PL	108-136	2812	10 USC 2865(b)	A	RETENTION AND AVAILABILITY OF AMOUNTS REALIZED FROM ENERGY COST SAVINGS
1795	PL	108-136	2805	10 USC 2869	A	CONVEYANCE OF PROPERTY AT MILITARY INSTALLATIONS CLOSED OR REALIGNED TO SUPPORT MILITARY CONSTRUCTION
1794	PL	108-136	2805	10 USC 2869	A	CONVEYANCE OF PROPERTY AT MILITARY INSTALLATIONS CLOSED OR REALIGNED TO SUPPORT MILITARY CONSTRUCTION
1762	PL	108-136	527	10 USC 4331 note	A	ACTIONS TO ADDRESS SEXUAL HARASSMENT AND VIOLENCE AT THE SERVICE ACADEMIES
1779	PL	108-136	1054	10 USC 488	A	DEPARTMENT OF DEFENSE BIENNIAL STRATEGIC PLAN FOR MANAGEMENT OF ELECTROMAGNETIC SPECTRUM

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1751	PL	108-136	126	10 USC 7291 note	A	PILOT PROGRAM FOR FLEXIBLE FUNDING OF CRUISER CONVERSIONS AND OVERHAUL
1761	PL	108-136	509	10 USC 777(b)	A	SECRETARY OF DEFENSE APPROVAL REQUIRED FOR PRACTICE OF WEARING UNIFORM INSIGNIA OF HIGHER GRADE KNOWN AS "FROCKING"
1757	PL	108-136	319	16 USC 1371	A	MILITARY READINESS AND MARINE MAMMAL PROTECTION
1783	PL	108-136	1231	22 USC 1928 note	A	ANNUAL REPORT ON THE NATO PRAGUE CAPABILITIES COMMITMENT AND THE NATO RESPONSE FORCE
1787	PL	108-136	1305	22 USC 5961	A	REQUIREMENT FOR ON-SITE MANAGERS
1788	PL	108-136	1307	22 USC 5962	A	ANNUAL CERTIFICATIONS ON USE OF FACILITIES BEING CONSTRUCTED FOR COOPERATIVE THREAT REDUCTION PROJECTS OR ACTIVITIES
1789	PL	108-136	1308	22 USC 5963	A	AUTHORITY TO USE COOPERATIVE THREAT REDUCTION FUNDS OUTSIDE THE FORMER SOVIET UNION
1763	PL	108-136	602	37 USC 1009(a)	A	REVISED ANNUAL PAY ADJUSTMENT PROCESS
1790	PL	108-136	1442	41 USC 253 note	A	PUBLIC DISCLOSURE OF NONCOMPETITIVE CONTRACTING FOR THE RECONSTRUCTION OF INFRASTRUCTURE IN IRAQ
1802	PL	108-136	3531	46 USC 53102	A	ESTABLISHMENT OF MARITIME SECURITY FLEET

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1801	PL	108-136	3531	46 USC 53102	A	ESTABLISHMENT OF MARITIME SECURITY FLEET
1772	PL	108-136	906	5 USC 1101 note	A	TRANSFER TO OFFICE OF PERSONNEL MANAGEMENT OF PERSONNEL INVESTIGATIVE FUNCTIONS AND RELATED PERSONNEL OF THE DEPT OF DEF
1780	PL	108-136	1101	5 USC 9902	A	DEPARTMENT OF DEFENSE NATIONAL SECURITY PERSONNEL SYSTEM
1781	PL	108-136	1211	50 USC app 2404 note	A	REVIEW OF EXPORT PROTECTIONS FOR MILITARY SUPERIORITY RESOURCES

Total Type Law for This Section 286

Type Law **SL**

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
379	SL	95-452	8	5 USC APP 8(b)(3)	A	ADDITIONAL PROVISIONS WITH RESPECT TO THE INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE
387	SL	95-452	8	5 USC APP 8(f)(1)	A	DOD INSPECTOR GENERAL SEMIANNUAL REPORT ON CONTRACT AUDITS
271	SL	89-554		5 USC 552(e)	A	DoD FREEDOM OF INFORMATION ACT PROGRAM REPORT TO CONGRESS
374	SL			5 USC 552b	A	OPEN MEETINGS
1650	SL	105-261	1101	5 USC 3104 note	A	EXPERIMENTAL PERSONNEL PROGRAM FOR SCIENTIFIC AND TECHNICAL PERSONNEL

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1457	SL	105-085	1309	10 USC 113 note	A	ANNUAL REPORT ON MORATORIUM ON USE BY ARMED FORCES ON ANTIPERSONNEL LANDMINES
1145	SL	103-160	542	10 USC 113 note	A	PROPOSED CHANGES IN COMBAT ASSIGNMENTS TO WHICH FEMALE MEMBERS MAY BE ASSIGNED
1544	SL	106-065	1202	10 USC 113 note	A	ANNUAL REPORT ON MILITARY POWER OF THE PEOPLE'S REPUBLIC OF CHINA
411	SL	100-180	1121(f)	10 USC 113 note	A	COUNTERINTELLIGENCE POLYGRAPH PROGRAM: ANNUAL REPORT
1537	SL	106-065	1039(b)	10 USC 113 note	A	REPORT ON NATO DEFENSE CAPABILITIES INITIATIVE
1535	SL	106-065	1025	10 USC 113 note	A	ANNUAL REPORT ON UNITED STATES MILITARY ACTIVITIES IN COLUMBIA
414	SL	101-189	1505(2)(e)	10 USC 113 note	A	CLOSURE OF MILITARY CHILD DEVELOPMENT CENTERS FOR UNCORRECTED INSPECTION VIOLATIONS
1146	SL	103-160	543	10 USC 113 note	A	GENDER-NEUTRAL OCCUPATIONAL PERFORMANCE STANDARDS
878	SL	102-484	1082	10 USC 113 note	A	REPORT ON PARTICIPATION OF DEFENSE DEPARTMENT IN OVERSEAS TRADE SHOWS AND MILITARY EXHIBITIONS
406	SL	87-651	202	10 USC 113(c)(1)	A	EXPENDITURES, WORK, ACCOMPLISHMENTS OF THE DEPARTMENT OF DEFENSE

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
249	SL	87-651	202	10 USC 113(c)(2)	A	RESERVE PROGRAMS OF THE DEPARTMENT OF DEFENSE
410	SL	87-651	202	10 USC 113(e)(1)	A	FOREIGN POLICY AND MILITARY FORCE STRUCTURE
407	SL	87-651	202	10 USC 113(i)(1)	A	COMPREHENSIVE NET ASSESSMENT OF THE DEFENSE CAPABILITIES AND PROGRAMS OF THE ARMED FORCES
409	SL	87-651	202	10 USC 113(j)(1)	A	COST OF STATIONING UNITED STATES ARMED FORCES OUTSIDE THE UNITED STATES
1613	SL	105-261	1212(b)	10 USC 113(m)	A	INFORMATION TO ACCOMPANY FUNDING REQUEST FOR CONTINGENCY OPERATION
510	SL	102-484	402	10 USC 114(c)(4)	A	PERSONNEL STRENGTHS - WAIVER AND TRANSFER AUTHORITY
788	SL	102-527		10 USC 115	A	EQUIPMENT COMPATIBILITY
34	SL	101-510	1483(a)	10 USC 115a(a)	A	ANNUAL DEFENSE MANPOWER REQUIREMENTS REPORT
436	SL	99-433	110(b)	10 USC 116(a)(1)	A	ANNUAL OPERATIONS AND MAINTENANCE REPORT
1482	SL	105-261	373(a)(1)	10 USC 117(e)	A	JOINT READINESS REVIEWS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1529	SL	106-065	901	10 USC 118(d)	A	QUADRENNIAL DEFENSE REVIEW
457	SL	100-180	1132(a)	10 USC 119(a)(1)	A	SPECIAL ACCESS PROGRAMS - CONGRESSIONAL OVERSIGHT
456	SL	100-180	1132(a)	10 USC 119(b)(1)	A	SPECIAL ACCESS PROGRAMS - NOTIFICATION OF NEW PROGRAMS
461	SL	100-180	1132(a)	10 USC 119(c)(1)	A	SPECIAL ACCESS PROGRAMS - CLASSIFICATION CHANGES
462	SL	100-180	1132(a)	10 USC 119(d)	A	SPECIAL ACCESS PROGRAMS - MODIFICATION OR TERMINATION OF POLICY AND CRITERIA USED FOR DESIGNATING A PROGRAM
463	SL	100-180	1132(a)	10 USC 119(e)(2)	A	SPECIAL ACCESS PROGRAMS - JUSTIFICATION FOR A WAIVER
1122	SL	94-106	804(a)	10 USC 127(c)(1)	A	EMERGENCY AND EXTRAORDINARY EXPENSES: NOTIFICATION TO CONGRESS
579	SL	94-106	804(a)	10 USC 127(d)	A	QUARTERLY REPORT OF EMERGENCY AND EXTRAORDINARY EXPENSES
1131	SL	103-160	1108(a)	10 USC 127a(a)(3)	A	FINANCIAL PLAN FOR CONTINGENCY OPERATIONS
1740	SL	107-314	1065	10 USC 127b	A	ASSISTANCE IN COMBATTING TERRORISM: REWARDS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1479	SL	97-086	904(a)	10 USC 129(f)	A	PROHIBITION OF CERTAIN CIVILIAN PERSONNEL MANAGEMENT CONSTRAINTS
1262	SL	104-106	564(a)(1)	10 USC 129c(c)	A	MEDICAL PERSONNEL: LIMITATIONS ON REDUCTIONS - CERTIFICATION
1468	SL	105-085	911(a)(1)	10 USC 130a(g)	A	MAJOR DEPARTMENT OF DEFENSE HEADQUARTERS ACTIVITIES PERSONNEL: LIMITATION
437	SL	98-094	1211(a)(1)	10 USC 139(f)	A	DIRECTOR OF OPERATIONAL TEST AND EVALUATION - ANNUAL REPORTING REQUIREMENT
1536	SL	106-065	1033	10 USC 153(c)	A	RISKS UNDER NATIONAL MILITARY STRATEGY
1614	SL	99-433	201	10 USC 153(d)	A	ANNUAL REPORT ON COMBATANT COMMAND REQUIREMENTS
1542	SL	106-065	1201(d)	10 USC 168 note	A	LIMITATION ON MILITARY-TO-MILITARY EXCHANGES AND CONTACTS WITH CHINESE PEOPLES' LIBERATION ARMY - ANNUAL CERTIFICATION
1543	SL	106-065	1201(e)	10 USC 168 note	A	MILITARY-TO-MILITARY EXCHANGES AND CONTACTS WITH CHINESE PEOPLES' LIBERATION ARMY - ANNUAL REPORT
1615	SL	104-106	905	10 USC 181(d)	A	AVAILABILITY OF OVERSIGHT INFORMATION TO CONGRESSIONAL DEFENSE COMMITTEES

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1616	SL	106-398	912(a)(1)	10 USC 184(a)	A	ADVANCE NOTIFICATION TO CONGRESS OF THE ESTABLISHMENT OF NEW REGIONAL CENTERS (FOR SECURITY STUDIES)
1596	SL	106-398	912(a)(1)	10 USC 184(b)	A	DEPARTMENT OF DEFENSE REGIONAL CENTERS FOR SECURITY STUDIES
514	SL	105-085	383(a)	10 USC 195	A	DEFENSE AUTOMATED PRINTING SERVICE - APPLICABILITY OF FEDERAL PRINTING REQUIREMENTS
1734	SL	107-314	932	10 USC 2166(f)	A	WESTERN HEMISPHERE FOR SECURITY COOPERATION: AUTHORITY TO ACCEPT FOREIGN GIFTS AND DONATIONS
1567	SL	106-259	8097	10 USC 221 note	A	BUDGET JUSTIFICATION DOCUMENTS
1618	SL	105-085	327	10 USC 221 note	A	INCLUSION OF AIR FORCE DEPOT MAINTENANCE AS OPERATION AND MAINTENANCE BUDGET LINE ITEMS
1619	SL	105-262	8093	10 USC 221 note	A	BUDGET JUSTIFICATION DOCUMENT FOR ACTIVE AND RESERVE MILITARY PERSONNEL ACCOUNTS
447	SL	101-189	1602(a)(1)	10 USC 221(a)	A	FUTURE YEARS DEFENSE PROGRAM: SUBMISSION TO CONGRESS; CONSISTENCY IN BUDGETING
1617	SL	102-484	1002(a)	10 USC 222(a)	A	FUTURE-YEARS MISSION BUDGET
1673	SL	107-333	232	10 USC 223(c)	A	PROGRAM ELEMENTS FOR BALLISTIC MISSILE DEFENSE ORGANIZATION: REQUIREMENT FOR ANNUAL PROGRAM GOALS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1674	SL	107-333	232	10 USC 223(d)	A	PROGRAM ELEMENTS FOR BALLISTIC MISSILE DEFENSE ORGANIZATION: ANNUAL PROGRAM PLAN
1675	SL	107-333	232	10 USC 223(h)	A	PROGRAM ELEMENTS FOR BALLISTIC MISSILE DEFENSE ORGANIZATION: ANNUAL OT&E ASSESSMENT OF TEST PROGRAM
1141	SL	102-190	1002	10 USC 226	A	OMB AND CBO: DEFENSE BUDGET MATTER: OMB/CBO SCORING OF OUTLAYS
1453	SL	105-085	321(a)(1)	10 USC 228	A	QUARTERLY REPORTS ON ALLOCATION OF FUNDS WITHIN O&M BUDGET SUBACTIVITIES
1532	SL	106-065	932	10 USC 229(a)	A	PROGRAMS FOR COMBATING TERRORISM: DISPLAY OF BUDGET INFORMATION
1533	SL	106-065	932	10 USC 229(d)	A	SEMIANNUAL REPORTS ON OBLIGATIONS AND EXPENDITURES ON COMBATING TERRORISM
1649	SL	101-510	1004	10 USC 374 note	A	ADDITIONAL SUPPORT FOR COUNTER-DRUG ACTIVITIES - CONGRESSIONAL NOTIFICATION OF FACILITIES PROJECTS
1534	SL	106-065	1023	10 USC 382 note	A	MILITARY ASISTANCE TO CIVIL AUTHORITIES TO RESPOND TO ACT OR THREAT OF TERRORISM
1561	SL	107-117	8009	10 USC 401 note	A	HUMANITARIAN AND CIVIC ASSISTANCE
580	SL	99-661	333(a)(1)	10 USC 401(d)	A	HUMANITARIAN AND CIVIC ASSISTANCE PROVIDED IN CONJUNCTION WITH MILITARY OPERATIONS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
361	SL	96-450	401(a)	10 USC 421(c)	A	FUNDS FOR FOREIGN CRYPTOLOGIC SUPPORT
444	SL	102-088	504(a)(2)	10 USC 437(b)	A	CONGRESSIONAL OVERSIGHT OF COMMERCIAL ACTIVITIES - CURRENT INFORMATION
452	SL	102-088	504(a)(2)	10 USC 437(c)	A	CONGRESSIONAL OVERSIGHT: ANNUAL REPORT (ON COMMERCIAL ACTIVITIES)
1263	SL	104-201	571	10 USC 481(c)	A	RACE RELATIONS, GENDER DISCRIMINATION, AND HATE GROUP ACTIVITY: ANNUAL SURVEY AND REPORT
589	SL	104-106	361(a)(1)	10 USC 482(a)	A	PERSONNEL AND UNIT READINESS QUARTERLY REPORTS
1447	SL	105-085	323(a)	10 USC 483(a)	A	REPORTS ON TRANSFERS FROM HIGH-PRIORITY READINESS APPROPRIATIONS
1483	SL	105-085	323(a)	10 USC 483(b)	A	REPORTS ON TRANSFERS FROM HIGH-PRIORITY READINESS APPROPRIATIONS - MIDYEAR REPORTS
1448	SL	105-085	324(a)(1)	10 USC 484(a)	A	ANNUAL REPORT ON AIRCRAFT INVENTORY
1484	SL	105-261	923(b)(1)	10 USC 485(a)	A	JOINT WARFIGHTING EXPERIMENTATION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1513	SL	106-065	241(a)(1)	10 USC 486(a)	A	QUADRENNIAL REPORT ON EMERGING OPERATIONAL CONCEPTS
1531	SL	106-065	923(b)(1)	10 USC 487	A	UNIT OPERATIONS TEMPO AND PERSONNEL TEMPO: ANNUAL REPORT
1620	SL	106-398	563	10 USC 503(c) note	A	ACCESS TO SECONDARY SCHOOLS FOR MILITARY RECRUITING PURPOSES
440	SL	99-433	401(a)	10 USC 662(b)	A	PROMOTION POLICY OBJECTIVES FOR JOINT OFFICERS
1696	SL	107-107	523(c)	10 USC 664(i)	A	JOINT DUTY CREDIT
259	SL	99-433	401(a)	10 USC 667	A	JOINT DUTY ASSIGNMENTS - ANNUAL REPORT TO CONGRESS
428	SL			10 USC 838(7)	A	DUTIES OF TRIAL COUNSEL AND DEFENSE COUNSEL
431	SL	101-189	1301(c)	10 USC 946(c)	A	UNIFORM CODE OF MILITARY JUSTICE - ARTICLE 146 CODE COMMITTEE
1112	SL	104-106	541(a)	10 USC 983(e)	A	INSTITUTIONS OF HIGHER EDUCATION THAT PREVENT ROTC ACCESS / MILITARY RECRUITING ON CAMPUS DENIAL OF GRANTS AND CONTRACTS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1603	SL	106-398	1071(a)	10 USC 986	A	SECURITY CLEARANCES: LIMITATIONS
1732	SL	107-107	802	10 USC 2330 note	A	PERFORMANCE GOALS FOR PROCURING SERVICES PURSUANT TO MULTIPLE AWARD CONTRACTS
1747	SL	106-181	740	10 USC 2576 note	A	EXTENSION OF AUTHORITY FOR SECRETARY OF DEFENSE TO SELL AIRCRAFT AND AIRCRAFT PARTS FOR USE IN RESPONDING TO OIL SPILLS
1744	SL	107-314	2812	10 USC 2694a	A	CONVEYANCE OF SURPLUS REAL PROPERTY FOR NATURAL RESOURCE CONSERVATION
1527	SL	106-065	723(e)	10 USC 1071 note	A	QUALITY OF HEALTH CARE
1526	SL	106-398	753	10 USC 1071 note	A	ACTIVITIES OF THE MEDICAL INFORMATICS ADVISORY COMMITTEE
1667	SL	105-261	745(E)	10 USC 1071 note	A	JOINT DEFENSE AND VETERANS AFFAIRS REPORTS RELATING TO INTERDEPARTMENTAL COOPERATION IN THE DELIVERY OF HEALTH CARE
897	SL	102-484	722	10 USC 1073 note	A	MILITARY HEALTH CARE FOR PERSONS RELIANT ON HEALTH CARE FACILITIES AT BASES BEING CLOSED OR REALIGNED
574	SL			10 USC 1073(b)	A	EVALUATION METHODOLOGY REQUIREMENTS FOR CHAMPUS REFORM INITIATIVE
1666	SL	102-190	734	10 USC 1074 note	A	REGISTRY OF MEMBERS OF THE ARMED FORCES EXPOSED TO FUMES OF BURNING OIL IN CONNECTION WITH OPERATION DESERT STORM

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1637	SL	103-335	721	10 USC 1074 note	A	PROGRAMS RELATED TO DESERT STORM MYSTERY ILLNESSES: ANNUAL REPORT TO CONGRESS
1525	SL	106-065	711	10 USC 1076a(j)	A	LIMITATION ON REDUCTION OF BENEFITS
1668	SL	104-106	743	10 USC 1086 note	A	EVALUATION AND REPORT ON TRICARE PROGRAM EFFECTIVENESS
1728	SL	107-314	711	10 USC 1095c(d)	A	CLAIMS INFORMATION
501	SL	99-661	701(a)(1)	10 USC 1098(b)(2)	A	INCENTIVES FOR PARTICIPATION IN COST-EFFECTIVE HEALTH CARE PLANS
1451	SL	105-085	766	10 USC 1107(f) note	A	NOTICE OF USE OF AN INVESTIGATIONAL NEW DRUG OR A DRUG UNAPPROVED FOR ITS APPLIED USE
1622	SL	106-398	713(a)(1)	10 USC 1114	A	BOARD OF ACTUARIES
1623	SL	104-106	526(a)	10 USC 1130(b)	A	CONSIDERATION OF PROPOSALS FOR DECORATIONS NOT PREVIOUSLY SUBMITTED IN TIMELY FASHION: PROCEDURES FOR REVIEW...
1590	SL	106-398	751	10 USC 1178(b)	A	MANAGEMENT OF ANTHRAX VACCINE IMMUNIZATION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1725	SL	107-314	581	10 USC 118a	A	QUADRENNIAL QUALITY OF LIFE REVIEW
1720	SL	107-314	505	10 USC 1370	A	GENERAL OR FLAG OFFICER SERVICE CREDIT: ADVANCE NOTICE TO CONGRESSIONAL COMMITTEES
1719	SL	107-314	505(e)	10 USC 1370	A	RETIRING GENERAL AND FLAG OFFICERS: ADVANCE NOTICE TO CONGRESSIONAL COMMITTEES
1663	SL	96-513	112	10 USC 1370(c)	A	COMMISSIONED OFFICERS: RETIRED GRADE
502	SL	98-094	925(a)(1)	10 USC 1464(c)	A	BOARD OF ACTUARIES - STATUS OF FUND
1624	SL	106-065	578(i)(5)	10 USC 1491(e)	A	FUNERAL HONORS FUNCTIONS AT FUNERALS FOR VETERANS: WAIVER AUTHORITY
1486	SL	105-261	567(b)(1)	10 USC 1491(g)(2)	A	HONOR GUARD DETAILS AT FUNERALS OF VETERANS
1487	SL	105-261	544	10 USC 1557(e)	A	TIMELINESS STANDARDS FOR DISPOSITION OF APPLICATIONS BEFORE CORRECTION BOARDS
1522	SL	106-065	591(e)	10 USC 1562 note	A	DEFENSE TASK FORCE ON DOMESTIC VIOLENCE - ANNUAL REPORT

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1583	SL	106-398	542	10 USC 1563	A	CONSIDERATION OF PROPOSALS FOR POSTHUMOUS AND HONORARY PROMOTIONS AND APPOINTMENTS: PROCEDURES FOR...
1691	SL	107-333	1602	10 USC 1566(c)(3)	A	VOTING ASSISTANCE: COMPLIANCE ASSESSMENTS; ASSISTANCE
519	SL			10 USC 1597(1)	A	GUIDELINES FOR REDUCTIONS IN CIVILIAN POSITIONS
261	SL	101-510	322(a)	10 USC 1597(c)	A	CIVILIAN EMPLOYMENT MASTER PLAN
557	SL	101-510	322(a)	10 USC 1597(d)	A	EXCEPTIONS TO GUIDELINES FOR REDUCTIONS IN CIVILIAN POSITIONS
561	SL	101-510	322(a)	10 USC 1597(e)	A	INVOLUNTARY REDUCTIONS OF CIVILIAN POSITIONS
584	SL	104-201	1632(b)	10 USC 1609(c)	A	TERMINATION OF DEFENSE INTELLIGENCE EMPLOYEES
1185	SL	103-359	806(a)(1)	10 USC 1611(e)	A	POSTEMPLOYMENT ASSISTANCE: CERTAIN TERMINATED INTELLIGENCE EMPLOYEES
1507	SL	104-201	1632(b)	10 USC 1613(d)	A	CIVILIAN DEFENSE INTELLIGENCE EMPLOYEES: MISCELLANEOUS PROVISIONS: NOTICE OF REGULATIONS
136	SL	101-923		10 USC 1722(a)	A	DEFENSE ACQUISITION WORKFORCE CAREER DEVELOPMENT

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1393	SL	98-525	706(a)	10 USC 2006(e)(3)	A	STATUS OF DOD EDUCATION BENEFITS FUND
308	SL	99-661	1321	10 USC 2010(b)	A	PARTICIPATION OF DEVELOPING COUNTRIES IN COMBINED EXERCISES: PAYMENT OF INCREMENTAL EXPENSES
310	SL	102-190	1052(a)	10 USC 2011(e)	A	SPECIAL OPERATIONS FORCES: TRAINING WITH FRIENDLY FOREIGN FORCES
1626	SL	105-085	325(a)	10 USC 2014(a)	A	ADMINISTRATIVE ACTIONS ADVERSELY AFFECTING MILITARY TRAINING OR OTHER READINESS ACTIVITIES
1595	SL	106-398	911	10 USC 2166(h)	A	WESTERN HEMISPHERE INSTITUTE FOR SECURITY COOPERATION
1664	SL	107-333	528	10 USC 2167(c)	A	NATIONAL DEFENSE UNIVERSITY: ADMISSION OF PRIVATE SECTOR CIVILIANS TO PROFESSIONAL MILITARY EDUCATION PROGRAMS
1627	SL	106-065	580(a)	10 USC 2193b(g)	A	IMPROVEMENT OF EDUCATION IN TECHNICAL FIELDS
1228	SL	100-370	1(d)(1)	10 USC 2201(d)	A	APPORTIONMENT OF FUNDS: AUTHORITY FOR EXEMPTIONS; EXCEPTED EXPENSES
314	SL	87-651	207(a)	10 USC 2203	A	DEPARTMENT OF DEFENSE BUDGET ESTIMATES - INCLUSION OF NUMBERS
1517	SL	106-065	331	10 USC 2208(j)(2)	A	SALES OF ARTICLES AND SERVICES OF DEFENSE INDUSTRIAL FACILITIES TO PURCHASERS OUTSIDE THE DEPARTMENT OF DEFENSE

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1470	SL	105-085	207(a)	10 USC 2208(l)	A	CONTRACTING FOR CAPITAL ASSETS PROCUREMENT IN ADVANCE FUNDS
1488	SL	87-651	207(a)	10 USC 2208(q)	A	WORKING-CAPITAL FUNDS: ANNUAL REPORTS AND BUDGET
1489	SL	105-261	911(a)	10 USC 2212(d)	A	OBLIGATIONS FOR CONTRACT SERVICES: REPORTING IN BUDGET OBJECT CLASSES
505	SL	105-262	8005	10 USC 2214 note	A	TRANSFER OF WORKING CAPITAL FUNDS
504	SL	101-510	1482(c)	10 USC 2214(c)	A	TRANSFER OF FUNDS: PROCEDURE AND LIMITATIONS; NOTICE TO CONGRESS
1188	SL	103-160	1106(a)(1)	10 USC 2215(a)	A	TRANSFER OF FUNDS TO OTHER DEPARTMENTS AND AGENCIES: LIMITATION; CERTIFICATION REQUIRED
503	SL	104-106	912(a)(1)	10 USC 2216(i)	A	DEFENSE MODERNIZATION ACCOUNT: QUARTERLY REPORTS
506	SL	102-484	1024(a)	10 USC 2218(h)	A	NATIONAL DEFENSE SEALIFT FUND - BUDGET REQUESTS
1594	SL	106-398	812	10 USC 2225	A	INFORMATION TECHNOLOGY PURCHASES: TRACKING AND MANAGEMENT
1599	SL	106-398	1006(c)	10 USC 2226 note	A	CONTRACTED PROPERTY AND SERVICES: PROMPT PAYMENT OF VOUCHERS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1475	SL	105-085	1074(d)(1)	10 USC 2281(d)	A	SUSTAINMENT AND OPERATION OF THE GLOBAL POSITIONING SYSTEM
1570	SL	106-398	131(a)(1)	10 USC 2282	A	ANNUAL REPORT ON B-2 BOMBER
1528	SL	101-510	831	10 USC 2302 note	A	MENTOR-PROTÉGÉ PROGRAM IMPROVEMENTS
1435	SL	104-201	805(a)(2)	10 USC 2302d(c)(3)	A	MAJOR SYSTEM: DEFINITIONAL THRESHOLD AMOUNTS: ADJUSTMENT AUTHORITY
1240	SL	98-369	2723(a)	10 USC 2304(c)(7)(B)	A	DETERMINATION THAT IT IS IN THE PUBLIC INTEREST TO USE OTHER THAN COMPETITIVE PROCEDURES FOR A SPECIFIC PROCUREMENT
71	SL			10 USC 2306a(3)	A	COST OR PRICING DATA: TRUTH IN NEGOTIATIONS
1555	SL	106-259	8008	10 USC 2306b note	A	TRANSFERS OF FUNDS - ECONOMIC ORDER QUANTITY PROCUREMENT
1230	SL	103-355	1022(a)(1)	10 USC 2306b(g)	A	CONTRACT CANCELLATION CEILINGS EXCEEDING $100,000,000
1436	SL	106-065	809	10 USC 2306b(i)(1)	A	DEFENSE ACQUISITIONS SPECIFICALLY AUTHORIZED BY LAW

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1461	SL	103-355	1022(a)(1)	10 USC 2306b(l)(1)(a)	A	MULTIYEAR PROCUREMENT CONTRACTS - NOTICE OF INTENT TO INITIATE
1462	SL	103-355	1022(a)(1)	10 USC 2306b(l)(6)	A	MULTIYEAR PROCUREMENT CONTRACTS - NOTICE OF INTENT TO TERMINATE
319	SL	85-800	9	10 USC 2307(i)(7)	A	CONTRACT FINANCING: ADVANCE PAYMENTS TO CONTRACTORS: ACTION IN CASE OF FRAUD
1730	SL	107-314	801	10 USC 2308	A	BUY-TO-BUDGET ACQUISITION: END ITEMS
306	SL	102-484	801	10 USC 2323(d)	A	CONTRACT GOAL FOR SMALL DISADVANTAGED BUSINESSES AND CERTAIN INSTITUTIONS OF HIGHER EDUCATION - APPLICABILITY
324	SL	102-484	801	10 USC 2323(i)(1)	A	CONTRACT GOAL FOR SMALL AND DISADVANTAGED BUSINESSES AND CERTAIN INSTITUTIONS OF HIGHER EDUCATION - ANNUAL REPORT
1460	SL	105-085	804(a)(1)	10 USC 2325(b)	A	LIMITATION AND REPORT ON PAYMENT OF RESTRUCTURING COSTS UNDER DEFENSE CONTRACTS
1397	SL	99-591	908	10 USC 2326 note	A	MANAGEMENT OF UNDEFINITIZED CONTRACTUAL ACTIONS
98	SL	99-500	951(a)	10 USC 2327(c)(1)(A)	A	CONTRACTS: CONSIDERATION OF NATIONAL SECURITY OBJECTIVES

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
292	SL	96-323	2(a)	10 USC 2341(c)	A	THEATER MISSILE DEFENSE INITIATIVE
1686	SL	107-333	1212	10 USC 2350a(a)(3)	A	EXTENSION OF AUTHORITY FOR INTERNATIONAL COOPERATIVE RESEARCH AND DEVELOPMENT PROJECTS: NOTICE-AND-WAIT REQUIREMENT
282	SL	101-189	931(a)(2)	10 USC 2350a(g)(3)	A	COOPERATIVE RESEARCH AND DEVELOPMENT PROJECTS - OBLIGATION OF FUNDS BY DDR&E
346	SL	99-145	1102(b)(1)	10 USC 2350b(d)(1)	A	COOPERATIVE PROJECTS UNDER ARMS EXPORT CONTROL ACT: ACQUISITION OF DEFENSE EQUIPMENT
347	SL	99-145	1102(b)(1)	10 USC 2350b(d)(2)	A	NOTIFICATION OF WAIVERS GRANTED TO PRIME CONTRACTORS IN CONJUNCTION WITH COOPERATIVE AGREEMENTS
1438	SL	106-065	1402(a)	10 USC 2350j(e)(1)	A	BURDEN SHARING CONTRIBUTIONS BY DESIGNATED COUNTRIES AND REGIONAL ORGANIZATIONS: NOTICE AND WAIT REQUIREMENTS
90	SL	103-160	1402(a)	10 USC 2350j(f)	A	BURDEN SHARING CONTRIBUTIONS BY DESIGNATED COUNTRIES AND REGIONAL ORGANIZATIONS
1711	SL	107-314	242(h)	10 USC 2359a	A	TECHNOLOGY TRANSITION INITIATIVE
117	SL	100-456	220(a)	10 USC 2361(b)(2)	A	AWARDS OF GRANTS AND CONTRACTS TO COLLEGES AND UNIVERSITIES - NOTIFICATION
686	SL	99-500	101(c)	10 USC 2366(c)(1)	A	SURVIVABILITY TESTING AND LETHALITY TESTING REQUIRED BEFORE FULL-SCALE PRODUCTION: WAIVER

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
363	SL	99-500	101(c)	10 USC 2366(d)	A	SURVIVABILITY TESTING AND LETHALITY TESTING REQUIRED BEFORE FULL-SCALE PRODUCTION, RESULTS
130	SL	99-500	101(c)	10 USC 2367(c)(A)	A	LIMITATION ON CREATION OF NEW FEDERALLY FUNDED RESEARCH AND DEVELOPMENT CENTERS
364	SL	99-500	101(c)	10 USC 2367(d)(1)	A	USE OF FEDERALLY FUNDED RESEARCH AND DEVELOPMENT CENTERS -PROPOSED MAN-YEARS OF EFFORT
1672	SL	99-500	101(c)	10 USC 2367(d)(2)	A	USE OF FEDERALLY FUNDED RESEARCH AND DEVELOPMENT CENTERS - OBLIGATIONS AND MAN HOURS AT EACH
1628	SL	103-160	845	10 USC 2371 note	A	AUTHORITY OF THE DEFENSE ADVANCED RESEARCH PROJECTS AGENCY TO CARRY OUT CERTAIN PROTOTYPE PROJECTS
548	SL	101-189	251(a)(1)	10 USC 2371(h)	A	RESEARCH PROJECTS: TRANSACTIONS OTHER THAN CONTRACTS AND GRANTS
1515	SL	106-065	244	10 USC 2374a	A	PRIZES FOR ADVANCED TECHNOLOGY ACHIEVEMENTS
1714	SL	107-314	248	10 USC 2374b	A	PRIZES FOR ACHIEVEMENTS IN PROMOTING SCIENCE, MATEMATICS, ENGINEERING, OR TECHNOLOGY EDUCATION
1681	SL	107-333	834	10 USC 2389(b)	A	ENSURING SAFETY REGARDING INSENSITIVE MUNITIONS
368	SL	101-510	4004(c)	10 USC 2391(d)(3)	A	FEDERAL ECONOMIC ADJUSTMENT PROGRAM - ECONOMIC ADJUSTMENT PLANNING

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
376	SL	101-189	802(a)(1)	10 USC 2399(b)(3)	A	OPERATIONAL TEST AND EVALUATION OF DEFENSE ACQUISITION PROGRAMS
1328	SL	101-189	802(a)(1)	10 USC 2399(g)	A	OPERATIONAL TEST AND EVALUATION: DIRECTOR'S ANNUAL REPORT (INCLUSION OF WAIVERS GRANTED UNDER SECTION 2399(e)(2))
284	SL	98-094	1202(a)(1)	10 USC 2401(b)(1)(B)	A	REQUIREMENT FOR AUTHORIZATION BY LAW OF CERTAIN CONTRACTS RELATING TO VESSELS AND AIRCRAFT
386	SL	102-484	1332(a)	10 USC 2410i(c)	A	WAIVER ON PROHIBITION ON CONTRACTING WITH ENTITIES THAT COMPLY WITH THE SECONDARY ARAB BOYCOTT OF ISRAEL
1463	SL	105-085	831(a)	10 USC 2410m(c)	A	RETENTION OF AMOUNTS COLLECTED FROM CONTRACTORS DURING THE PENDENCY OF CONTRACT DISPUTE
22	SL	100-026	7(b)(2)	10 USC 2430(b)	A	ADJUST THE AMOUNTS (AND THE BASE FISCAL YEAR) ON THE BASIS OF DEPARTMENT OF DEFENSE ESCALATION RATES
1163	SL	93-155	803(a)	10 USC 2431(a)	A	WEAPONS DEVELOPMENT AND PROCUREMENT SCHEDULES
421	SL	97-252	1107(a)(1)	10 USC 2432(b)(1)	A	QUARTERLY SELECTED ACQUISITION REPORTS
424	SL	102-484	817(c)(3)(B)	10 USC 2432(b)(3)(B)	A	WAIVER OF THE REQUIREMENT TO SUBMIT SELECTED ACQUISITION REPORTS FOR A PARTICULAR DOD PROGRAM

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
425	SL	97-252	1107(a) (1)	10 USC 2432(f)	A	COMPREHENSIVE SELECTED ACQUISITION REPORTS
1492	SL	97-252	1107(a) (1)	10 USC 2432(h)	A	DECISION TO PROCEED TO ENGINEERING AND MANUFACTURING
429	SL	97-252	1107(a) (1)	10 USC 2433(d)(3)	A	UNIT COST REPORTS
1253	SL	97-252	1107(a) (1)	10 USC 2433(e)(1)(A)	A	UNIT COST REPORTS - PERCENTAGE INCREASE IN THE PROGRAM ACQUISITION UNIT COST EXCEEDS 15 PERCENT
430	SL	97-252	1107(a) (1)	10 USC 2433(e)(2)	A	UNIT COST REPORTS - PERCENTAGE INCREASE IN THE PROGRAM ACQUISITION UNIT COST EXCEEDS 25 PERCENT - CERTIFICATION
1580	SL	105-261	349	10 USC 2458 note	A	ADDITIONS TO PLAN FOR ENSURING VISIBILITY OVER ALL IN-TRANSIT END ITEMS AND SECONDARY ITEMS
1007	SL	100-370	2(a)(1)	10 USC 2461(b)	A	COMMERICAL OR INDUSTRIAL TYPE FUNCTIONS: REQUIRED STUDIES AND REPORTS BEFORE CONVERSION TO CONTRACTOR PERFORMANCE
1076	SL	100-370	2(a)(1)	10 USC 2461(c)	A	COMMERCIAL OR INDUSTRIAL TYPE FUNCTIONS - NOTIFICATION OF DECISION TO CONVERT
50	SL	105-262	8014	10 USC 2461(f) note	A	COMMERCIAL OR INDUSTRIAL TYPE FUNCTIONS - REQUIRED NOTICE TO CONGRESS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1009	SL	100-370	2(a)(1)	10 USC 2461(g)	A	COMMERCIAL OR INDUSTRIAL TYPE FUNCTIONS - ANNUAL REPORT
1576	SL	106-398	354	10 USC 2461a(d)	A	DEVELOPMENT OF SYSTEM FOR MONITORING COST SAVINGS RESULTING FROM WORKFORCE REDUCTIONS: ANNUAL REPORT
453	SL	100-370	2(a)(i)	10 USC 2464(b)(3)(A)	A	CORE LOGISTICS FUNCTIONS - WAIVER
1518	SL	100-456	333	10 USC 2466(e)(1)	A	LIMITATIONS ON THE PERFORMANCE OF DEPOT-LEVEL MAINTENANCE OF MATERIAL
1520	SL	106-065	333	10 USC 2466(e)(2)	A	EXPENDITURES FOR PERFORMANCE OF DEPOT-LEVEL MAINTENANCE AND REPAIR WORKLOADS BY PUBLIC AND PRIVATE SECTORS
1519	SL	106-065	342	10 USC 2467(c)	A	CONGRESSIONAL NOTIFICATION OF COST COMPARISON WAIVER
1439	SL	104-106	312(a)-(b)	10 USC 2472(b)	A	MANAGEMENT OF DEPOT EMPLOYEES - ANNUAL REPORT
1574	SL	106-398	353(c)	10 USC 2475(a)	A	CONSOLIDATION, RESTRUCTURING, OR ENGINEERING OF ORGANIZATIONS, FUNCTIONS, OR ACTIVITIES: ANNUAL PLAN
1575	SL	106-398	353(c)	10 USC 2475(b)	A	CONSOLIDATION, RESTRUCTURING, OR REENGINEERING OF ORGANIZATIONS, FUNCTIONS, OR ACTIVITIES: NOTIFICATION OF DECISION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1612	SL	106-398	353	10 USC 2475(b)(2)	A	CONSOLIDATION, RESTRUCTURING, OR REENGINEERING OF ORGANIZATIONS, FUNCTIONS, OR ACTIVITIES: NOTICE OF INTENT
1426	SL	99-661	313(a)	10 USC 2486(b)	A	AUTHORIZED COMMISSARY MERCHANDISE CATEGORIES
778	SL	99-661	313(a)	10 USC 2486(d)	A	ESTABLISHMENT OF SALE PRICE; CONGRESSIONAL NOTIFICATION
1629	SL	106-065	1066(a)(22)	10 USC 2492(b)	A	OVERSEAS COMMISSARY AND EXCHANGE STORES; CONTROLLED ITEM LISTS
1493	SL	105-261	365	10 USC 2492(c)	A	OVERSEAS COMMISSARY STORES: ACCESS AND PURCHASE RESTRICTIONS
1494	SL	105-261	906(a)	10 USC 2493(g)	A	FISHER HOUSE: ADMINISTRATION AS NONAPPROPRIATED FUND INSTRUMENTALITY
1630	SL	106-065	212	10 USC 2501 note	A	DEFENSE SCIENCE AND TECHNOLOGY PROGRAM
1167	SL	104-201	829(e)	10 USC 2504	A	DEPARTMENT OF DEFENSE TECHNOLOGY AND INDUSTRIAL BASE POLICY GUIDANCE: ANNUAL REPORT TO CONGRESS
1428	SL	102-484	4225(a)	10 USC 2515(d)	A	ACTIVITIES OF THE DEFENSE OFFICE OF TECHNOLOGY TRANSITION
1441	SL	102-484	836(a)(1)	10 USC 2536(b)(2)	A	AWARD OF CERTAIN CONTRACTS TO ENTITIES CONTROLLED BY A FOREIGN GOVERNMENT: PROHIBITION : WAIVER

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
448	SL	102-484	838(a)	10 USC 2537(b)	A	IMPROVED NATIONAL DEFENSE CONTROL OF TECHNOLOGY DIVERSIONS OVERSEAS
834	SL	102-484	304(c)	10 USC 2561(c)	A	HUMANITARIAN ASSISTANCE: STATUS REPORTS
838	SL	102-484	304(c)	10 USC 2561(d)	A	HUMANITARIAN ASSISTANCE - RELIEF FOR UNAUTHORIZED COUNTRIES
1516	SL	106-065	331	10 USC 2563(c)	A	ARTICLES AND SERVICES OF INDUSTRIAL FACILITIES: SALE TO PERSONS OUTSIDE THE DEPARTMENT OF DEFENSE
1442	SL	104-201	367(a)	10 USC 2564(e)	A	PROVISION OF SUPPORT FOR CERTAIN SPORTING EVENTS: ANNUAL REPORT
1604	SL	106-398	1203	10 USC 2565(c)	A	NUCLEAR TEST MONITORING EQUIPMENT: FURNISHING TO FOREIGN GOVERNMENTS
1579	SL	106-398	381	10 USC 2582(a)	A	MILITARY EQUIPMENT IDENTIFIED ON UNITED STATES MUNITIONS LIST: ANNUAL REPORT OF PUBLIC SALES
1631	SL	106-446	1(a)	10 USC 2583(f)	A	MILITARY WORKING DOGS: TRANSFER AND ADOPTION AT END OF USEFUL WORKING LIFE
471	SL	101-403	202	10 USC 2608(e)	A	ACCEPTANCE OF CONTRIBUTIONS FOR DEFENSE PROGRAMS, PROJECTS, AND ACTIVITIES
1444	SL	103-160	315(a)	10 USC 2631(b)(3)	A	SUPPLIES: PREFERENCE TO UNITED STATES VESSELS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1445	SL	104-201	1079(b)(1)	10 USC 2645(d)(1)	A	INDEMNIFICATION OF DEPARTMENT OF TRANSPORTATION FOR LOSSES COVERED BY VESSEL WAR RISK INSURANCE: NOTICE
477	SL	86-070	6(c)	10 USC 2662(a)	A	REAL PROPERTY TRANSACTIONS - REPORTS TO CONGRESSIONAL COMMITTEES
528	SL	86-070	6(c)	10 USC 2662(b)	A	REAL PROPERTY TRANSACTIONS: REPORTS TO CONGRESSIONAL COMMITTEES
492	SL	86-070	6(c)	10 USC 2662(e)	A	REAL PROPERTY TRANSACTIONS - LEASE OF RENTAL PROPERTY BY GSA FOR DOD IN EXCESS OF $500,000
493	SL	86-070	6(c)	10 USC 2662(f)	A	REAL PROPERTY TRANSACTIONS - DOD INTELLIGENCE COMPONENTS
1632	SL	106-398	1[2811]	10 USC 2662(g)(3)	A	REAL PROPERTY TRANSACTIONS: REPORTS TO CONGRESSIONAL COMMITTEES: EXCEPTIONS FOR TRANSACTIONS FOR WAR AND...
1496	SL	106-398	2812	10 USC 2667a(c)(2)	A	LEASES: NON-EXCESS PROPERTY OF DEFENSE AGENCIES: COMPETITIVE SELECTION
303	SL	94-107	607(8)	10 USC 2672a(b)	A	ACQUISITION: INTERESTS IN LAND WHEN NEED IS URGENT
152	SL	101-510	2804(a)(1)	10 USC 2674(a)(2)	A	OPERATION AND CONTROL OF PENTAGON RESERVATION AND DEFENSE FACILITIES IN NATIONAL CAPITAL REGION
247	SL	85-861	1(51)	10 USC 2676(d)	A	ACQUISITION: LIMITATION ON REAL PROPERTY NOT OWNED BY THE UNITED STATES

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
474	SL	101-510	2906(c)	10 USC 2687 note	A	BASE CLOSURE ACCOUNT - ANNUAL REPORT
482	SL	101-510	2921(e)	10 USC 2687 note	A	NEGOTIATIONS FOR PAYMENTS-IN-KIND WITH HOST COUNTRIES
169	SL	104-106	2840	10 USC 2687 note	A	TRANSFER AUTHORITY IN CONNECTION WITH CONSTRUCTION OR PROVISION OF MILITARY FAMILY HOUSING
933	SL	101-510	2921(f)	10 USC 2687 note	A	BASE CLOSURE AND REALIGNMENT: OMB REVIEW OF PROPOSED SETTLEMENTS
866	SL	100-526	206	10 USC 2687 note	A	BASE CLOSURE AND REALIGNMENT - REPORTS
1047	SL	101-510	2926(g)	10 USC 2687 note	A	BASE CLOSURE AND REALIGNMENT: CONTRACTS FOR CERTAIN ENVIRONMENTAL RESTORATION ACTIVITIES
1558	SL	106-259	8019	10 USC 2687 note	A	EXECUTIVE AGREEMENTS WITH NATO MEMBERS
1046	SL	101-510	2921(g) (2)	10 USC 2687 note	A	BASE CLOSURE AND REALIGNMENT: CONGRESSIONAL OVERSIGHT OF PAYMENTS-IN-KIND (HOST NATION PAYMENT OF OPERATING COSTS)
1044	SL	101-510	2921(g) (1)	10 USC 2687 note	A	BASE CLOSURE AND REALIGNMENT: CONGRESSIONAL OVERSIGHT OF PAYMENTS-IN-KIND (MILITARY CONSTRUCTION / FACILITY IMPROVEMENT)
472	SL	101-510	2907	10 USC 2687(b)(1)	A	BASE CLOSURES AND REALIGNMENTS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1497	SL	105-085	2812(a)	10 USC 2688(e)	A	UTILITY SYSTEMS: CONVEYANCE AUTHORITY: NOTICE-AND-WAIT REQUIREMENT
1498	SL	105-085	2814(a)	10 USC 2696(c&d)	A	SCREENING OF REAL PROPERTY FOR FURTHER FEDERAL USE BEFORE CONVEYANCE
499	SL			10 USC 2701	A	POLICY AND REPORT ON ENVIRONMENTAL COMPLIANCE AT OVERSEAS MILITARY INSTALLATIONS
1056	SL	104-201	325(h)	10 USC 2701 note	A	AUTHORITY TO DEVELOP AND IMPLEMENT LAND USE PLANS FOR DEFENSE ENVIRONMENTAL RESTORATION PROGRAM
33	SL	102-484	324(b)	10 USC 2701 note	A	OVERSEAS ENVIRONMENTAL RESTORATION
91	SL	105-085	349(e)	10 USC 2702 note	A	PARTNERSHIPS FOR INVESTMENT IN INNOVATIVE ENVIRONMENTAL TECHNOLOGIES
1633	SL	106-398	1[311]	10 USC 2703(b)(2)	A	ENVIRONMENTAL RESTORATION ACCOUNTS: FACILITY RELOCATION COSTS
522	SL	103-160	1001	10 USC 2706(a)	A	REPORT ON ENVIRONMENTAL RESTORATION ACTIVITIES
523	SL	99-499	211(a)(1)	10 USC 2706(b)	A	REPORT ON ENVIRONMENTAL QUALITY PROGRAMS AND OTHER ENVIRONMENTAL ACTIVITIES
1634	SL	104-201	324(c)	10 USC 2706(b) note	A	REPORT ON COMPLIANCE WITH ANNEX V TO THE CONVENTION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1454	SL	99-499	211(a)(1)	10 USC 2706(d)	A	REPORT ON ENVIRONMENTAL TECHNOLOGY PROGRAM
525	SL	99-499	211(a)(1)	10 USC 2721(b)(3)	A	PROPERTY RECORDS: MAINTENANCE ON QUANTITATIVE AND MONETARY BASIS
1539	SL	106-065	1042	10 USC 2723	A	NOTICE OF CERTAIN SECURITY AND COUNTERINTELLIGENCE FAILURES WITHIN THE DEPARTMENT OF DEFENSE
1331	SL	102-190	2868	10 USC 2802(a) note	A	MILITARY CONSTRUCTION PROJECTS
227	SL	97-214	2(a)	10 USC 2803(b)	A	EMERGENCY CONSTRUCTION
526	SL	97-214	2(a)	10 USC 2804(b)	A	CONTINGENCY CONSTRUCTION
244	SL	97-214	2(a)	10 USC 2805(b)	A	UNSPECIFIED MINOR CONSTRUCTION
527	SL	97-214	2(a)	10 USC 2806(c)(2)	A	CONTRIBUTIONS FOR NORTH ATLANTIC TREATY ORGANIZATION INFRASTRUCTURE
486	SL	97-214	2(a)	10 USC 2807(b)	A	ARCHITECTURAL AND ENGINEERING SERVICES AND CONSTRUCTION DESIGN

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
529	SL	97-214	2(a)	10 USC 2807(c)	A	REASONS FOR INCREASE OF FUNDS FOR ARCHITECTURAL AND ENGINEERING SERVICES AND CONSTRUCTION DESIGN
148	SL	97-214	2(a)	10 USC 2808(b)	A	CONSTRUCTION AUTHORITY IN THE EVENT OF A DECLARATION OF WAR OR NATIONAL EMERGENCY
48	SL	99-167	811(a)	10 USC 2809(f)	A	LONG-TERM FACILITIES CONTRACTS FOR CERTAIN ACTIVITIES AND SERVICES
1499	SL	99-661	315(a)	10 USC 2811(d)	A	REPAIR OF FACILITIES
49	SL	101-189	2809(a)	10 USC 2812(c)(1)	A	LEASE-PURCHASE OF FACILITIES
47	SL	103-160	2805(a)(1)	10 USC 2813(c)	A	ACQUISITION OF EXISTING FACILITIES IN LIEU OF AUTHORIZED CONSTRUCTION - NOTICE
1549	SL	106-065	2802	10 USC 2814	A	SPECIAL AUTHORITY FOR DEVELOPMENT OF FORD ISLAND, HAWAII
1608	SL	106-398	2801	10 USC 2815	A	JOINT USE MILITARY CONSTRUCTION PROJECTS: ANNUAL EVALUATION
1698	SL	106-246	127	10 USC 2821 note 4	A	LIMITATION ON USE OF O&M FUNDS FOR MAINTENANCE AND REPAIR OF FLAG AND GENERAL OFFICER QUARTERS - ANNUAL REPORT OF COMP
1697	SL	106-246	127	10 USC 2821 note 4	A	LIMITATION ON USE OF O&M FUNDS FOR MAINTENANCE AND REPAIR OF FLAG AND GENERAL OFFICER QUARTERS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
60	SL	97-214	2(a)	10 USC 2825(b)(1)	A	IMPROVEMENTS TO FAMILY HOUSING UNITS
68	SL	97-214	2(a)	10 USC 2825(c)(1)	A	IMPROVEMENTS TO FAMILY HOUSING UNITS - CONSTRUCTION IN LIEU OF IMPROVING
1609	SL	106-398	2803	10 USC 2826(b)	A	MILITARY FAMILY HOUSING: LOCAL COMPARABILITY OF ROOM PATTERNS AND FLOOR AREAS
73	SL	97-214	2(a)	10 USC 2827(b)	A	RELOCATION OF MILITARY FAMILY HOUSING UNITS
208	SL	97-214	2(a)	10 USC 2829(f)	A	LEASING OF MILITARY FAMILY HOUSING
149	SL	102-190	2806(a)	10 USC 2835(b)(2)	A	LONG-TERM LEASING OF MILITARY FAMILY HOUSING TO BE CONSTRUCTED
1323	SL	102-190	2806(a)	10 USC 2835(g)	A	LONG-TERM LEASING OF MILITARY FAMILY HOUSING TO BE CONSTRUCTED - NOTICE
159	SL	102-190	2809(a)(1)	10 USC 2836(b)(2)	A	MILITARY HOUSING RENTAL GUARANTEE PROGRAM
191	SL	102-190	2809(a)(1)	10 USC 2836(f)(1)	A	MILITARY HOUSING RENTAL GUARANTEE PROGRAM - NOTICE
188	SL	103-337	2803(a)	10 USC 2837(c)(2)	A	LIMITED PARTNERSHIPS WITH PRIVATE DEVELOPERS OF HOUSING - SELECTION OF INVESTMENT OPPORTUNITIES

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1330	SL	103-337	2803(a)	10 USC 2837(f)	A	LIMITED PARTNERSHIPS WITH PRIVATE DEVELOPERS OF HOUSING
992	SL	97-214	2(a)	10 USC 2853(c)	A	AUTHORIZED COST VARIATIONS
946	SL	97-214	2(a)	10 USC 2854(b)	A	RESTORATION OR REPLACEMENT OF DAMAGED OR DESTROYED FACILITIES
1259	SL	104-106	2818(a)(1)	10 USC 2854a(c)	A	CONVEYANCE OF DAMAGED OR DETERIORATED MILITARY FAMILY HOUSING; USE OF PROCEEDS
1500	SL	97-214	2(a)	10 USC 2859	A	TRANSMISSION OF ANNUAL MILITARY CONSTRUCTION REQUEST
534	SL	101-510	2851(a)	10 USC 2865(e)(2)	A	ENERGY CONSERVATION CONSTRUCTION PROJECTS
533	SL	101-510	2851(a)	10 USC 2865(f)	A	ENERGY SAVINGS AT MILITARY INSTALLATIONS - ANNUAL REPORT
1257	SL	103-160	2803(a)	10 USC 2866(c)(2)	A	WATER CONSERVATION AT MILITARY INSTALLATIONS
1440	SL	98-407	810	10 USC 2867(c)	A	SALE OF ELECTRICITY FROM ALTERNATE ENERGY AND COGENERATION PRODUCTION FACILITIES
1501	SL	106-246	125	10 USC 2872 note	A	GENERAL AUTHORITY - MILITARY CONSTRUCTION AND MILITARY FAMILY HOUSING

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1635	SL	104-106	2801(a) (1)	10 USC 2875(e)	A	INVESTMENTS
1336	SL	104-106	2801(a) (1)	10 USC 2883(f)	A	DEPARTMENT OF DEFENSE HOUSING FUNDS: NOTIFICATION REQUIRED FOR TRANSFERS
1394	SL	104-106	2801(a) (1)	10 USC 2884(a)	A	FAMILY HOUSING CONSTRUCTION CONTRACTS AND CONVEYANCE OR LEASE OF EXISTING PROPERTY AND FACILITIES
1378	SL	104-106	2801(a) (1)	10 USC 2884(b)	A	DEPARTMENT OF DEFENSE HOUSING FUNDS - ANNUAL REPORTS
1695	SL	107-333	3005	10 USC 2906a	A	DEPARTMENT OF DEFENSE BASE CLOSURE ACCOUNT 2005
1694	SL	107-333	2914	10 USC 2914(c)(2)	A	SPECIAL PROCEDURES FOR MAKING RECOMMENDATIONS FOR REALIGNMENTS AND CLOSURES FOR 2005 ROUND
1418	SL			10 USC 3013 note	A	DEMONSTRATION PROJECT FOR USE OF ARMY INSTALLATIONS TO PROVIDE PRERELEASE EMPLOYMENT TRAINING
1503	SL	90-168	2(16)	10 USC 3038(f)	A	OFFICE OF CHIEF ARMY RESERVE: ANNUAL REPORT
1665	SL	107-333	541	10 USC 3264(g)	A	18-MONTH ENLISTMENT PILOT PROGRAM
174	SL	102-484	380(d)	10 USC 4316	A	ARMY TRAINING REPORT

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1169	SL	85-861	33(a)(26)	10 USC 4342(h)	A	CADETS: APPOINTMENT; NUMBERS, TERRITORIAL DISTRIBUTION
1550	SL	106-065	2871	10 USC 4357(c)	A	ACCEPTANCE OF GUARANTEES IN CONNECTION WITH GIFTS TO MILITARY SERVICE ACADEMIES (ARMY)
1343	SL	99-500	101(c)	10 USC 4542(g)(1)	A	TECHNICAL DATA PACKAGES FOR LARGE-CALIBER CANNON: NOTICE
489	SL	99-500	101(c)	10 USC 4542(g)(2)	A	TECHNICAL DATA PACKAGES FOR LARGE-CALIBER CANNON: SEMIANNUAL REPORT
1573	SL	106-398	344	10 USC 4553(e)(2)	A	ARMAMENT RETOOLING AND MANUFACTURING SUPPORT INITIATIVE
1723	SL	107-314	561	10 USC 481	A	SURVEYS OF RACIAL AND ETHNIC ISSUES AND OF GENDER ISSUES IN THE ARMED FORCES
1172	SL	104-201	1212(b)(1)	10 USC 5143(e)	A	ANNUAL REPORT OF THE CHIEF: OFFICE OF NAVAL RESERVE
1245	SL	104-201	1212(c)(1)	10 USC 5144(d)	A	ANNUAL REPORT OF THE COMMANDER, MARINE FORCES RESERVE
194	SL	87-651	124	10 USC 6954(f)	A	NOMINATION OF PERSONS FOR APPOINTMENT TO THE ACADEMY: NOTICE TO CONGRESS
1551	SL	106-065	2871	10 USC 6975	A	ACCEPTANCE OF GUARANTEES IN CONNECTION WITH GIFTS TO MILITARY SERVICE ACADEMIES (NAVY)

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1582	SL	106-398	535	10 USC 7049(c)	A	DEFENSE INDUSTRY CIVILIANS: ADMISSION TO DEFENSE PRODUCT DEVELOPMENT PROGRAM: ANNUAL DETERMINATION
1737	SL	107-314	1021	10 USC 7296	A	COMBATANT SURFACE VESSELS: NOTICE BEFORE REDUCTION IN NUMBER; PRESERVATION OF SURGE CAPABILITY
543	SL	89-348	1(10)	10 USC 7306(d)	A	VESSELS STRICKEN FROM NAVAL VESSEL REGISTER; CAPTURED VESSELS; TRANSFER BY GIFT OR OTHERWISE
213	SL	93-365	702	10 USC 7307(b)	A	NAVAL VESSELS: DISPOSAL TO FOREIGN NATIONS
240	SL	100-370	1(n)(1)	10 USC 7313(a)(2)	A	SHIP OVERHAUL WORK: AVAILABILITY OF APPROPRIATIONS FOR UNUSUAL COST OVERRUNS FOR CHANGES IN SCOPE OF WORK
551	SL	87-796	1(4)	10 USC 7424(b)	A	PROTECTION OF OIL RESERVES: CONTRACTS FOR CONSERVATION
1344	SL	94-258	201(6)	10 USC 7425(b)	A	ACQUISITION BY CONDEMNATION AND PURCHASE
163	SL	87-796	1(7)	10 USC 7431(c)	A	CONSULTATION AND APPROVAL OF THE STEPS INVOLVED IN THE PRODUCTION OF NAVAL PETROLEUM RESERVES
1505	SL	89-067		10 USC 7622(b)	A	ADMIRALTY CLAIMS AGAINST THE UNITED STATES
1309	SL	104-201	282(a)(1)	10 USC 7902(e)	A	NATIONAL OCEANOGRAPHIC PARTNERSHIP PROGRAM

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1329	SL	90-168	2(a)	10 USC 9038(f)(1)	A	THE CHIEF OFFICE OF THE AIR FORCE RESERVE - ANNUAL REPORT
1553	SL	106-065	2871	10 USC 9356	A	ACCEPTANCE OF GUARANTEES IN CONNECTION WITH GIFTS TO MILITARY SERVICE ACADEMIES (AIR FORCE)
1408	SL	104-201	1079(a)(1)	10 USC 9514(c)(1)	A	INDEMNIFICATION OF DEPARTMENT OF TRANSPORTATION FOR LOSSES COVERED BY DEFENSE-RELATED AVIATION INSURANCE - NOTICE
1429	SL	104-106	513(c)(1)	10 USC 10216(c)	A	ANNUAL END STRENGTH FOR MILITARY TECHNICIANS
1272	SL	103-337	904(a)	10 USC 10504(b)	A	CHIEF OF NATIONAL GUARD BUREAU: ANNUAL REPORT
435	SL	101-510	1483(a)	10 USC 10541(a)	A	ANNUAL REPORT ON NATIONAL GUARD AND RESERVE COMPONENT EQUIPMENT
814	SL	103-160	521(a)	10 USC 10542(a)	A	ARMY NATIONAL GUARD COMBAT READINESS: ANNUAL REPORT
648	SL	104-201	1257(a)(1)	10 USC 10543 note	A	NATIONAL GUARD AND RESERVE COMPONENT EQUIPMENT PROCUREMENT AND MILITARY CONSTRUCTION FUNDING
1636	SL	102-190	414(a)-(c)	10 USC 12001 note	A	ANNUAL REPORT ON IMPLEMENTATION: PILOT PROGRAM
1662	SL	107-333	415	10 USC 12011	A	LIMITATIONS ON NUMBERS OF RESERVE PERSONNEL SERVING ON ACTIVE DUTY OR FULL-TIME NATIONAL GUARD DUTY...

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
280	SL	103-337	1662(e)(2)	10 USC 12302(b)	A	READY RESERVE ORDER TO ACTIVE DUTY IN TIME OF NATIONAL EMERGENCY
283	SL	103-337	16629e)(2)	10 USC 12302(d)	A	READY RESERVE ORDER TO ACTIVE DUTY IN TIME OF NATIONAL EMERGENCY - ANNUAL REPORT
1166	SL	94-286	1	10 USC 12304(f)	A	SELECTED RESERVE; ORDER TO ACTIVE DUTY OTHER THAN DURING WAR OR NATIONAL EMERGENCY
295	SL	98-525	705(a)	10 USC 16137	A	EDUCATIONAL ASSISTANCE FOR MEMBERS OF THE SELECTED RESERVE
843	SL	85-685	601(3)	10 USC 18233a(a)(1)	A	LIMITATION ON CERTAIN PROJECTS; AUTHORITY TO CARRY OUT SMALL PROJECTS WITH OPERATIONS & MAINTENANCE FUNDS
115	SL			14 USC 475	A	LEASING AND HIRING OF QUARTERS: RENTAL OF INADEQUATE HOUSING
541	SL			15 USC 313(2)	A	TROPICAL CYCLONE RESEARCH ACTIVITIES
572	SL			15 USC 644(f)(1)	A	EXPANDING SMALL BUSINESS PARTICIPATION IN DREDGING - FINAL REPORT
598	SL	100-180	273(b)(3)	15 USC 4603	A	SEMICONDUCTOR TECHNOLOGY COUNCIL
1480	SL	105-085	2906	16 USC 670a(f)	A	INTEGRATED NATURAL RESOURCES MANAGEMENT PLANS ANNUAL REPORT

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
556	SL	94-524	9	18 USC 3056 note	A	REPORT OF EXPENDITURES IN SUPPORT OF THE SECRET SERVICE
276	SL			20 USC 922(d)(2)	A	OVERSEAS DEFENSE DEPENDENTS' EDUCATION
791	SL	95-561	1405	20 USC 924	A	DODDS EDUCATIONAL ASSESSMENT
1404	SL			20 USC 927(b)	A	FORMULA FOR DETERMINING MINIMUM ALLOTMENT OF FUNDS FOR DODDS
1651	SL	95-561	1412	20 USC 930	A	STUDY OF DEFENSE DEPENDENTS' EDUCATION SYSTEM
1103	SL	102-190	1046	22 USC 1928 note	A	DEFENSE COST-SHARING AGREEMENTS
1642	SL	105-261	1223	22 USC 1928 note	A	REPORTS ON THE DEVELOPMENT OF THE EUROPEAN SECURITY AND DEFENSE IDENTITY
77	SL	100-456	1009(b)	22 USC 1928 note	A	REPORT ON OFFICIAL DEVELOPMENT ASSISTANCE PROGRAM OF JAPAN
281	SL	98-525	1001(c) (2)	22 USC 1928 note	A	CERTIFICATION THAT NATO MEMBERS HAVE UNDERTAKEN SIGNIFICANT MEASURES TO IMPROVE CONVENTIONAL DEFENSE CAPACITY
1605	SL	106-398	1221	22 USC 1928 note	A	REPORT ON BURDENSHARING OF FUTURE NATO OPERATIONS

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1647	SL	103-337	1313	22 USC 1928 note	A	COST-SHARING POLICY AND SUPPORT
278	SL	98-525	1003	22 USC 1928 note	A	U.S. EXPENDITURES IN SUPPORT OF NATO - REPORT ON ALLIED CONTRIBUTIONS TO THE COMMON DEFENSE
286	SL	87-195	505	22 USC 2314	A	FURNISHING OF DEFENSE ARTICLES OR RELATED TRAINING OR OTHER DEFENSE SERVICE ON GRANT BASIS - VIOLATIONS
288	SL	91-194	100	22 USC 2344 note	A	INCREASES IN MILITARY ASSISTANCE PROGRAMS
290	SL	91-194	120	22 USC 2344 note	A	CONSIDERATION OF DIVERSION OF RESOURCES FOR ECONOMIC AND AGRICULTURAL DEVELOPMENT TO MILITARY PURPOSES
1701	SL	103-337	1503	22 USC 2751 note	A	REPORTS ON COUNTERPROLIFERATION ACTIVITIES AND PROGRAMS
1134	SL	103-160	1603	22 USC 2751 note	A	STUDIES RELATING TO UNITED STATES COUNTERPROLIFERATION POLICIES
141	SL	90-629	21	22 USC 2761(c)(2)	A	REPORT ON SIGNIFICANT HOSTILITIES OR TERRORIST ACTS
176	SL	90-629	21	22 USC 2761(d)	A	DETERMINATION THAT EMERGENCY CONDITIONS WARRANT EXTENDING TO 120 DAYS THE PAYMENT DEADLINE FOR A SALE...
189	SL	94-329	205	22 USC 2761(l)	A	SALES FROM STOCKS HAVING AN ADVERSE IMPACT ON THE READINESS OF U.S. ARMED FORCES

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
190	SL	90-629	22	22 USC 2762(b)	A	ISSUANCE OF LETTERS OF OFFER UNDER EMERGENCY DETERMINATION; AVAILABILITY OF APPROPRIATIONS FOR PAYMENT
210	SL	90-629	25	22 USC 2765(a)	A	ANNUAL ESTIMATE & JUSTIFICATION FOR SALES PROGRAM
250	SL	90-629	27	22 USC 2767(f)	A	AUTHORITY OF PRESIDENT TO ENTER INTO COOPERATIVE PROJECTS WITH FRIENDLY FOREIGN COUNTRIES
233	SL	90-629	36	22 USC 2776(a)	A	REPORTS AND CERTIFICATIONS TO CONGRESS ON MILITARY EXPORTS: REPORT BY PRESIDENT
335	SL	90-629	36	22 USC 2776(b)	A	LETTER OF OFFER TO SELL DEFENSE ARTICLES, SERVICES, DESIGN AND CONSTRUCTION SERVICES, OR MAJOR EQUIPMENT
1548	SL	106-065	1402	22 USC 2778 note	A	TRANSFERS OF MILITARILY SENSITIVE TECHNOLOGY TO COUNTRIES AND ENTITIES OF CONCERN
1702	SL	105-261	1514	22 USC 2778 note	A	NATIONAL SECURITY CONTROLS ON SATELLITE EXPORT LICENSING: MANDATORY NOTIFICATION TO CONGRESS ON LICENSES
1703	SL	105-261	1514	22 USC 2778 note	A	NATIONAL SECURITY CONTROLS ON SATELLITE EXPORT LICENSING: MANDATORY REPORTING ON MONITORING ACTIVITIES
1554	SL	106-065	1409(b)	22 USC 2778 note	A	ANNUAL REPORT ON IMPLEMENTATION OF SATELLITE TECHNOLOGY SAFEGUARDS
391	SL			22 USC 2796a(a)	A	REPORT ON PROPOSED LEASES OF DEFENSE ARTICLES (INCLUDING RECIPROCAL NO-RENT LOSSES)

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1545	SL	106-065	1301	22 USC 5952 note	A	REPORT ON COOPERATIVE THREAT REDUCTION (CTR) OBLIGATION OR EXPENDITURE OF FUNDS FOR OTHER PURPOSES
1644	SL	105-261	1307	22 USC 5952 note	A	SUMMARY OF AMOUNTS REQUESTED BY PROJECT CATEGORY
110	SL	103-337	1205	22 USC 5952 note	A	FUNDING FOR COOPERATIVE THREAT REDUCTION
1645	SL	104-106	1205	22 USC 5955 note	A	PRIOR NOTICE TO CONGRESS OF OBLIGATION OF FUNDS
1546	SL	106-065	1312	22 USC 5955 note	A	RUSSIAN NONSTRATEGIC NUCLEAR ARMS
1640	SL	106-398	1308	22 USC 5959	A	REPORTS OF ACTIVITIES AND ASSISTANCE UNDER COOPERATIVE THREAT REDUCTION PROGRAMS
1335	SL	87-195	656	22 USC 2416	A	FOREIGN MILITARY TRAINING ON DoD ENGAGEMENT ACTIVITIES OF INTEREST
1687	SL	107-333	1403	24 USC 411(e)(3)	A	ESTABLISHMENT OF THE ARMED FORCES RETIREMENT HOME
1688	SL	107-333	1403	24 USC 411(h)	A	ARMED FORCES RETIREMENT HOME: ANNUAL REPORT
1689	SL	107-333	1405	24 USC 414(c)	A	ARMED FORCES RETIREMENT HOME: FIXING FEES

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1120	SL	101-510	1516(f)	24 USC 415(f)	A	ARMED FORCES RETIREMENT HOME ANNUAL REPORT
312	SL	101-510	1518	24 USC 418	A	ARMED FORCES RETIREMENT HOME - INSPECTION BY INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE
321	SL			30 USC 1604(d)	A	CRITICAL MATERIALS NEEDS RELATED TO NATIONAL SECURITY
1699	SL			31 USC 1344(d)(4)	A	PASSENGER CARRIER USE
325	SL			31 USC 1352(e)	A	LIMITATION ON USE OF APPROPRIATED FUNDS TO INFLUENCE CERTAIN FEDERAL CONTRACTING AND FINANCIAL TRANSACTIONS
212	SL	97-258		31 USC 1517(b)	A	PROHIBITED OBLIGATIONS AND EXPENDITURES
327	SL			31 USC 1551	A	CLOSING ACCOUNTS - OBLIGATIONS AND ADJUSTMENT TO OBLIGATIONS
809	SL	97-255		31 USC 3512(d)(3)	A	INTERNAL MANAGEMENT CONTROL PROGRAM
1471	SL	105-085	1031(c)	32 USC 112(g)	A	USE OF NATIONAL GUARD FOR STATE DRUG INTERDICTION AND COUNTER-DRUG ACTIVITIES
1476	SL	105-085	1076	32 USC 509(k)	A	NATIONAL GUARD CHALLENGE PROGRAM OF OPPORTUNITIES FOR CIVILIAN YOUTH

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
345	SL	99-662	1001	33 USC 579a	A	TRANSMISSION TO CONGRESS OF LIST OF UNCONSTRUCTED PROJECTS OR SEPARABLE ELEMENTS AUTHORIZED
175	SL	90-608		33 USC 701	A	FLOOD CONTROL - EXAMINATIONS AND SURVEYS
187	SL			33 USC 701-1(a)	A	WORKS OF IMPROVEMENT FOR NAVIGATION OR FLOOD CONTROL - DECLARATION OF POLICY OF 1944 ACT
1384	SL	105-225	1	36 USC 154112	A	NAVAL SEA CADET CORPS: ANNUAL REPORT
333	SL	105-225		36 USC 300110	A	AMERICAN NATIONAL RED CROSS ACCOUNT AUDIT BY THE DEPARTMENT OF DEFENSE
1727	SL	107-314	616	37 USC 307a	A	SPECIAL PAY: ASSIGNMENT INCENTIVE PAY
558	SL	93-294	2(3)	37 USC 301a(f)	A	INCENTIVE PAY: AVIATION CAREER PERTAINING TO THE UNIFORMED SERVICES
559	SL	96-342	806(a)(1)	37 USC 301b(i)	A	SPECIAL PAY: AVIATION CAREER OFFICERS EXTENDING PERIOD OF ACTIVE DUTY
1586	SL	106-398	633	37 USC 323(b)	A	SPECIAL PAY: RETENTION INCENTIVES FOR MEMBERS QUALIFIED IN A CRITICAL MILITARY SKILL
1587	SL	106-398	633(a)(1)	37 USC 323(h)	A	SPECIAL PAY: RETENTION INCENTIVES FOR MEMBERS QUALIFIED IN A CRITICAL MILITARY SKILL: ANNUAL REPORT

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1585	SL	106-398	604	37 USC 402a(f)	A	SUPPLEMENTAL SUBSISTENCE ALLOWANCE FOR LOW-INCOME MEMBERS WITH DEPENDENTS
1199	SL			37 USC 431(a)(d)	A	PROPOSED COMPARABILITY REGULATIONS
1523	SL	106-065	673	37 USC 1015	A	ANNUAL REPORT ON EFFECTS OF RECRUITMENT AND RETENTION INITIATIVES
1676	SL	107-107	654	38 USC 3020	A	TRANSFER OF ENTITLEMENT TO BASIC EDUCATIONAL ASSISTANCE: MEMBERS OF THE ARMED FORCES WITH CRITICAL MILITARY SKILLS
342	SL	98-525	702(a)(1)	38 USC 3036	A	EDUCATIONAL ASSISTANCE PROGRAM - BENEFITS ASSESSMENT
562	SL	96-022	301(a)	38 USC 8111	A	SHARING OF DEPARTMENT OF VETERANS AFFAIRS AND DEPARTMENT OF DEFENSE HEALTH-CARE RESOURCES
1659	SL	102-190	3	38 USC 8111A(d)	A	FURNISHING OF HEALTH-CARE SERVICES TO MEMBERS OF THE ARMED FORCES DURING A WAR OR NATIONAL EMERGENCY
344	SL	90-135	206	40 USC 786	A	TRANSFER OF GOVERNMENT OWNED LONG-LINES COMMUNICATION FACILITIES IN AND TO ALASKA - ANNUAL REPORT
353	SL	90-135	206	40 USC 786	A	TRANSFER OF GOVERNMENT OWNED LONG-LINES COMMUNICATION FACILITIES IN AND TO ALASKA - NOTICE OF TRANSFER
354	SL			41 USC 10b-2	A	LIMITATION ON AUTHORITY TO WAIVE BUY AMERICAN ACT

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
1464	SL	104-201	827	41 USC 10b-3	A	ANNUAL REPORT RELATING TO BUY AMERICAN ACT
355	SL			41 USC 11	A	NO CONTRACTS OR PURCHASES UNLESS AUTHORIZED OR UNDER ADEQUATE APPROPRIATION
1273	SL			41 USC 11	A	USE OF SPECIAL AUTHORITY (ADVISE CONGRESS)
1589	SL	106-398	712(e)	42 USC 1395ggg	A	BEFORE MAKING CERTAIN (CHAMPUS OR TRICARE) PROGRAM CHANGES: NOTICE
497	SL			42 USC 1962d-5(a)	A	WATER RESOURCE DEVELOPMENT PROJECTS INVOLVING NAVIGATION, FLOOD CONTROL, AND SHORE PROTECTION
359	SL	99-410	101(B)(6)	42 USC 1973ff	A	REPORT TO THE PRESIDENT AND THE CONGRESS ON THE EFFECTIVENESS OF A FEDERAL VOTING ASSISTANCE PROGRAM UNDER 42 USC 1973ff
564	SL			42 USC 2021c	A	RESPONSIBILITIES FOR DISPOSAL OF LOW-LEVEL RADIOACTIVE WASTE
1138	SL	103-082	114(3)	42 USC 12632(c)	A	STUDY OF THE EFFECT OF THE PROGRAMS CARRIED OUT UNDER 42 USC 12632 ON RECRUITMENT
393	SL			43 USC 620a	A	RECOMMENDATIONS FROM THE CHIEF OF ENGINEERS ON ADDITIONAL EASEMENTS THAT MAY BE REQUIRED TO ASSURE WATER STORAGE
1671	SL	106-398	1061	44 USC 3535	A	GOVERNMENT INFORMATION SECURITY REFORM: ANNUAL INDEPENDENT EVALUATION

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
61	SL	103-160	3301	50 USC 98d note	A	DISPOSAL OF OBSOLETE AND EXCESS MATERIALS CONTAINED IN THE NATIONAL DEFENSE STOCKPILE - CONDITIONS ON DISPOSAL
554	SL	103-160	3304(b)	50 USC 98h-2(b)	A	CONVERSION OF CHROMIUM ORE TO HIGH PURITY CHROMIUM METAL - INCLUSION IN ANNUAL MATERIALS PLAN
381	SL	100-180	3202(c)	50 USC 98h-5	A	BIENNIAL REPORT ON STOCKPILE REQUIREMENTS
1190	SL	101-189	3312(a)	50 USC 98h-6(c)	A	PROPOSED TRANSACTIONS INCLUDED IN ANNUAL MATERIALS PLAN; AVAILABILITY OF FUNDS
1400	SL	103-359	602	50 USC 403-2b (b)(2)	A	LIMITATION ON CONSTRUCTION OF FACILITIES TO BE USED PRIMARILY BY INTELLIGENCE COMMUNITY
581	SL	102-088	602(a)	50 USC 413a(1)	A	INTELLIGENCE ACTIVITIES - INFORMING CONGRESS (OTHER THAN COVERT OPERATIONS)
86	SL	102-088	602(a)	50 USC 413b(b)	A	REPORTS TO INTELLIGENCE COMMITTEES - COVERT ACTIONS
830	SL	99-169	401(a)	50 USC 414(d)	A	REPORT TO CONGRESSIONAL COMMITTEES REQUIRED FOR EXPENDITURE OF NONAPPROPRIATED FUNDS FOR INTELLIGENCE ACTIVITY
1700	SL	106-065	1041(a)	50 USC 435 note	A	CERTIFICATION REQUIRED WITH RESPECT TO AUTOMATIC DECLASSIFICATION OF RECORDS
1386	SL	85-804	1	50 USC 1431	A	EXTRAORDINARY CONTRACTUAL ACTIONS EXCEEDING $25,000,000

Report Number	Doc Type	Number	Section	USC Title Number	Status	Report Title
508	SL	85-804	3	50 USC 1433(b)	A	REVIEW OF CONTRACTS - OMISSION FROM FOREIGN CONTRACTS OF THE CLAUSE CALLING FOR REVIEW BY THE COMPTROLLER GENERAL
1278	SL	91-441	506(d)	50 USC 1518	A	EMERGENCY DISPOSAL OF CHEMICAL OR BIOLOGICAL WARFARE AGENTS
1477	SL	105-085	1078	50 USC 1520a(d)	A	RESTRICTIONS ON THE USE OF HUMAN SUBJECTS FOR TESTING OF CHEMICAL OR BIOLOGICAL AGENTS
396	SL			50 USC 1521(b)(3)	A	DESTRUCTION OF EXISTING STOCKPILE OF LETHAL CHEMICAL AGENTS AND MUNITIONS - DEFERRAL
583	SL			50 USC 1521(b)(4)	A	DESTRUCTION OF EXISTING STOCKPILE OF LETHAL CHEMICAL AGENTS AND MUNITIONS - DELAY
397	SL	99-145	1412(g)	50 USC 1521(g)	A	DESTRUCTION OF EXISTING STOCKPILE OF LETHAL CHEMICAL AGENTS AND MUNITIONS ANNUAL REPORT
1149	SL	103-160	1703	50 USC 1523	A	ANNUAL REPORT TO CONGRESS ON CHEMICAL AND BIOLOGICAL WARFARE DEFENSE
1606	SL	106-398	1233	50 USC 1701 note	A	ANNUAL REPORT OF COMMUNIST CHINESE MILITARY COMPANIES OPERATING IN THE UNITED STATES
1704	SL	105-085	234	50 USC 2367	A	ANNUAL REPORT ON THREAT POSED TO UNITED STATES BY WEAPONS OF MASS DESTRUCTION, BALLISTIC MISSILES, AND CRUISE MISSILES

Total Type Law for This Section 443

Total Active CMRs 729

July 8, 2004

Statement
of
Francis E. Reardon
Deputy Inspector General for Auditing
Office of the Inspector General
Department of Defense

before the

Subcommittee on Financial Management, the Budget and International Security
Senate Committee on Governmental Affairs

on

"Department of Defense FY 2003 Financial Statements"

Department of Defense
Office of the Inspector General

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to discuss, first, the status of progress in achieving an unqualified (clean) audit opinion for the Department of Defense and, second, other areas of financial management within the Department. The Department's financial statements are the most extensive, complex, and diverse financial statements in the Government. The Department faces financial management problems that are long-standing, pervasive, and deeply rooted in virtually all operations. These financial management problems have impeded the Department's ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions. The problems have also prevented the Department from receiving an unqualified opinion on its financial statements.

To address these issues, the Department has undertaken the ambitious task of overhauling its financial management systems and business processes. Although DoD has initiated a process to improve the reliability of its financial reporting and actions to correct previously reported weaknesses, most financial statements today remain unreliable and much work needs to be done. However, we are encouraged by the many current initiatives led by the Office of the Under Secretary of Defense (Comptroller/Chief Financial Officer) and senior financial managers within the DoD Components to correct long-standing problems in order to achieve a favorable audit opinion by FY 2007. We believe there is a chance of reaching this goal; however, what is most encouraging is the effort being expended to correct the Department's problems.

In order to adequately support the Department's goal of an unqualified audit opinion by FY 2007, we in the Office of the Inspector General put in place plans and actions to increase our financial auditing staff during the next three years. We also plan to issue several contracts with independent public accounting firms for financial and systems audit work as management asserts that their financial data is reliable and ready for audit. Over the next three years, the Department has reported that they could assert as being ready for audit over 100 lines, systems, or audit opinions. If the funding for our buildup and contracting efforts is delayed until the Department asserts that the *entire* financial statements are reliable and ready for audit, it will be impossible to complete necessary audit work in a timely manner—thus further delaying a favorable audit opinion on the U.S. Government Annual Financial Report.

Opinions on Financial Statements for FY 2003

For FY 2003, we issued a disclaimer of opinion for the Department of Defense Agency-Wide Financial Statements because numerous 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 two of the nine major DoD reporting entities included in the Department of Defense Agency-wide Financial Statements requiring an audit opinion. As in past years, the FY 2003 Military Retirement Fund's financial statements received an unqualified opinion. The newly established Medicare Eligible Retiree Health Care Fund received a qualified audit opinion for FY 2003.

The Department has taken aggressive actions to improve financial management and reporting during the past several months. However, the Department and we expect no change in the status of audit opinions for the FY 2004 financial statements for the major DoD reporting entities to be issued in November 2004.

Internal Control Deficiencies

Issues of reliability, integrity, timeliness, and auditability of financial data continue to impede our ability to render an opinion on the financial statements. We have reported those weaknesses to the Department and have also made recommendations to correct those weaknesses. The Department's progress in addressing the specific findings and recommendations made in individual audit reports will be a critical factor in determining how much financial management improvement actually occurs.

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. As a result of the Department-wide deficiencies in accounting systems and business practices, the Department is unable to collect and report financial performance information that is timely, accurate, and reliable. However, DoD is making progress in correcting and reducing the materiality of the weaknesses. In FY 2002, we reported 13 material weaknesses for the DoD Agency-wide financial statements.
In FY 2003, corrective actions were taken to reduce major deficiencies related to problem disbursements and the reported military retirement health benefits liabilities. Let me briefly discuss the current material internal control weaknesses and the actions needed to correct these weaknesses.

1. **Financial Management Systems.** The Department has been unable to collect and report financial information that is timely, accurate, and reliable. DoD has numerous business systems performing a myriad of tasks, and many of these financial management systems do not comply substantially with federal financial management system requirements. In addition, there is little standardization across the Department. Multiple systems perform the same task, identical data are stored in multiple systems, data are manually entered into multiple systems, and there are many work-around and off-line records to translate data from one system to another. These characteristics limit data integrity and require extensive effort by management to compile financial statements. These system deficiencies affect many aspects of financial reporting.

   Previously, we have reported—and management has acknowledged—that Department financial management systems do not substantially comply with federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Additionally, we have reported that the Department's financial management and feeder systems cannot provide adequate evidence to support various material amounts on the financial statements. We have also recommended improvements to the Department's overall management of information technology, and that the Department improve the quality of information technology reporting to Congress and the Office of Management and Budget, which would increase the usefulness of the information and demonstrate that the Department was effectively managing information technology investments.

In regard these issues, it is our opinion that that the Department's effort to address weaknesses in financial information systems with the Business Management Modernization Plan (BMMP) is a necessary and overdue step. In July 2001, the Secretary of Defense established the BMMP to transform and modernize the Department's business and financial processes and systems to optimize the efficiency and effectiveness of all DoD business processes—financial, procurement, logistical, and personnel. The overall goal is to transform the Department's business operations so that accurate, reliable, and timely business information is available on a routine basis to support informed decision-making at all levels in the Department. Although the BMMP is a long-term approach to the Department's financial management problems, one of the early objectives of the BMMP is to achieve an unqualified audit opinion on the FY 2007 DoD Agency-Wide Financial Statements.

Until the BMMP is in place, the Department will continue to use legacy systems to provide data for the FY 2007 DoD Agency-Wide Financial Statements. Even though the Department has much work to complete in this area, we believe that continued reviews of financial systems that will eventually be replaced or upgraded are necessary to ensure that reliable data are available to be transferred to the reengineered processes and systems and for effective business management now and in the future. Accordingly, we plan to perform, as funding is available, reviews of legacy systems to verify that the data in existing systems are reliable. We believe that the Department's efforts are focused on a plan to use BMMP initiatives information from legacy systems to deliver auditable information for financial statements. However, I again reiterate that audit processes are set up so that we will not expend taxpayer dollars unless we believe a favorable opinion can be delivered.

2. **Fund Balance with Treasury.** The FY 2003 DoD Fund Balance With Treasury account was approximately 22 percent of reported assets. During the year, more than

$500 billion in funding flowed through the account—an increase from prior years. Despite the increase in disbursements, problem disbursements, although significant, continued to decline. However, differences continue to exist between the Department of Treasury and DoD disbursement records. Last year, we reported that the absolute value of the DoD differences was approximately $20.6 billion. The Department has obtained legislative permission, which we supported, to clear old transactions prior to 2001 from its accounts when documentation is no longer available to support the transactions. This action should reduce the differences and gives us encouragement that the Department is making real progress in improving the reliability of this account.

Because of the number and complexity of the systems within the Department that support the Fund Balance With Treasury account, automated reconciliation is not possible. In light of these realities, we have recommended that DoD improve the reconciliation process and supporting systems as soon as possible. The Department and this office, as the responsible auditors, are making it a top priority, pending the availability of funds, to validate the reliability of data processed by the systems used to support the Fund Balance With Treasury account. Also, we expect both the Army and the Air Force to assert that their Fund Balance With Treasury accounts are ready for audit in early FY 2005.

3. **Inventory.** Inventory makes up about 5 percent of the reported assets on the Department's financial statements. 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. Prior audit reports have identified inaccurate inventory records, deficiencies related to existence and completeness of inventory, and inaccurate inventory valuation. The Department has issued a contract to assist in transitioning inventory accounting to the historical cost method, and has established a working group with DoD Components to work through the impediments to obtain a favorable opinion by FY 2007. We continue to

work with the Department working group on these extremely complex issues and are supporting its efforts to resolve these deficiencies.

4. **Operating Materials and Supplies.** Operating Materials and Supplies makes up about 12 percent of total reported assets on the Department's Balance Sheet. Generally accepted accounting principles require that Operating Materials and Supplies be expensed as they are consumed. However, DoD accounting systems were designed to expense these materials when they are purchased rather than when consumed. In addition, significant amounts of Operating Materials and Supplies in the possession of contractors are not included in the Operating Materials and Supplies account balance. The Department included Operating Materials and Supplies in its contract to establish a supportable baseline for Inventory. The contractor is also evaluating how the Department can transition from the purchase method to the consumption method of accounting and how it can fully account for all of its Operating Materials and Supplies. The Department working group for Operating Material and Supplies is making progress as they work toward developing a proposed valuation methodology for establishing the baseline for historical cost that will support the valuation assertion. The final valuation methodology is due in December 2004, and the Department expects the implementation of the business enterprise architecture to correct reported weaknesses by the end of FY 2005. We continue to work with the Department to support their effort to develop a strategy to properly value and account for Operating Materials and Supplies.

5. **Property, Plant, and Equipment (PP&E).** Reported PP&E on the FY 2003 Financial Statements was more than $446 billion, or almost 40 percent of total reported assets. The Department has acknowledged that PP&E is not reliably reported because legacy property and logistic systems were not designed to capture all costs or to calculate depreciation. The Military Departments are in the process of correcting weaknesses in property systems identified by auditors and improving processes and controls for property systems under development. For example, the Navy and the Air Force expect reported real property to be ready for audit during FY 2005, and we plan to begin audit coverage as assertions are made. We are also

working with each DoD Component and the General Accounting Office to ensure that a baseline for data for real and personal property is accurate and fully supported with source documents.

The task for achieving property balances that are accurately and reliably reported has been made much more difficult because of an FY 2003 policy change by the Federal Accounting Standards Advisory Board. This policy change requires the cost of Military Equipment to be reported on the Balance Sheet rather than as Required Supplementary Stewardship Information. The FY 2003 Agency-Wide Balance Sheet included a depreciated cost of $325 billion for Military Equipment. We are working with the General Accounting Office and the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics to ensure that the Department's business rules, strategy, and approach to implement the new policy will meet generally accepted government accounting standards. The Department expects to complete the Military Equipment valuation by the end of FY 2006, and we are providing continuing audit coverage as they progress.

6. **Government-Furnished Material and Contractor-Acquired Material.** When it is in the best interest of the Government, the Department provides to contractors government property necessary to complete contract work. DoD has acknowledged that it is unable to comply with applicable requirements for reporting Government-Furnished Property and Contractor-Acquired Materials. The cost of DoD property and material in the possession of contractors is not reliably reported because of changes in accounting requirements and a lack of an integrated reporting methodology with industry. We are working with the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics), which is rewriting policy on property in the hands of contractors, to ensure that the policy will meet generally accepted accounting principles for Federal reporting entities and provide full accountability. The Department expects to correct this weakness by the end of FY 2005.

7. **Environmental Liabilities.** Reported environmental liabilities are about 4 percent of total reported DoD liabilities. DoD has acknowledged that environmental guidance, inventory of ranges and operational activities, and audit trails are incomplete, and that it has not recognized unamortized clean-up costs associated with PP&E. Our audit report D-2004-0080, "Environmental Liabilities Required to be Reported on the Annual Financial Statements," May 5, 2004, showed that Army environmental estimates were unreliable because Army activities did not have effective controls in place to ensure adequate audit trails and documentation for supporting estimates. Furthermore, Army activities did not comply with established guidance when developing estimates and effective quality control programs had not been established. The Army has initiated actions to improve those controls and is also implementing a new feeder system to reduce the possibility of errors. The Deputy Under Secretary of Defense (Installations and Environment) has agreed to implement guidance to improve the development, recording, and reporting of environmental liabilities. The Military Departments expect all deficiencies to be corrected during FYs 2004 through 2006, and we will conduct audits as they assert that major portions of environmental liabilities are ready.

8. **Intragovernmental Eliminations and Other Accounting Entries.** DoD acknowledges that it makes unsupported adjustments with its trading partners because of the inability to reconcile most intragovernmental transactions with its trading partners. In addition, DoD acknowledges that it makes material amounts of unsupported accounting adjustments. The number and amount of unsupported adjustments have continued to decrease because the Department took corrective actions based on audit recommendations to improve the documentation supporting accounting adjustments. However, unsupported adjustments related to the inability to identify trading partners continue to be a major weakness. The Department of the Treasury is implementing a new Intragovernmental Management Control Plan to address this Government-wide material weakness. As part of our planned audit procedures for FY 2004, we will determine whether DoD complied with the plan's new requirements. The Department expects to be able to reconcile intragovernmental

transactions and resolve the material weaknesses related to intragovernmental eliminations by the end of FY 2006.

9. **Statement of Net Cost.** Many of the Department's financial systems and processes were not designed to collect and record financial information on a full accrual accounting basis as required by generally accepted accounting principles. Therefore, transactions are generally recorded on a cash and budgetary basis. In addition, costs cannot be accumulated for major programs based on performance measures as required by the Government Performance and Results Act because current financial processes and systems do not capture and report this type of cost information. The Department has undertaken efforts to determine the actions required to bring its financial and non-financial feeder systems into compliance with generally accepted accounting principles. We are waiting for new systems and methodologies to be implemented before performing extensive audit work in this area -- the Department is aware of its deficiencies and is focusing on the most effective ways to make improvements. The Department has stated that the weaknesses will be corrected by the end of FY 2006.

10. **Statement of Financing**. The Department has acknowledged that it is unable to reconcile budgetary data to net costs. Specifically, budgetary data are not in agreement with proprietary expenses and capitalized assets. DoD disclosed in the notes to the FY 2003 financial statements that the Statement of Financing was adjusted by a net of $12.5 billion to match the Statement of Net Costs. Also, the Department presented the Statement of Financing on a combined basis instead of a consolidated basis as required by the Office of Management and Budget because the Department is unable to perform the required intragovernmental eliminations. The current Treasury initiatives, when implemented, should help eliminate unsupported adjustments related to intragovernmental transactions. The Department expects that the implementation of the business enterprise architecture will correct this material weakness by the 4th quarter of FY 2006.

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 that the financial statements are unreliable. We have long advocated that resources that are already scarce should not be expended to conduct complete audits that produce only a disclaimer of opinion at year-end. However, we strongly support and believe there are benefits to be gained by performing limited audits of current financial systems because data reliability must be ascertained before any opinion can be rendered.

We agree with the rationale behind Section 1008 and we have complied with those requirements in performing our audits of the FY 2003 DoD Agency-Wide Financial Statements and the nine other required reporting entities. We limited our audit procedures related to audit opinions commensurate with management representations that we received from the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Military Departments. However, as the Department asserts that financial data is ready for audit, we must provide the required audit coverage, which will require additional resources.

The financial management weaknesses acknowledged by management during previous years and for FY 2004 enabled us to limit our audit work to issue disclaimers of opinion. We recognize, and have advised DoD 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. However, as the Department continues to take corrective actions and improve systems and controls, we need to have trained audit staff available to promptly validate these actions in order to meet the Department's ambitious goal of achieving a favorable opinion for FY 2007. Our joint strategy with the Department is for us to audit specific lines items and financial statements as they become ready for audit, rather than waiting until all of the Department's problems are corrected, and is the best way to achieve optimal result.

Cooperation with DoD Management

I would like to mention that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, as the Department's Chief Financial Officer, and his staff have a refreshing and unique open door policy to the OIG. The Office of the Inspector General, along with the Under Secretary of Defense (Comptroller)/Chief Financial Officer, realize that the lack of a favorable opinion on the Department's 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)/Chief Financial Officer, 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)/Chief Financial Officer and senior financial managers of the Military Departments to identify material issues that impact the quality of the Department's financial reporting process. It is on the basis of these meetings and our further involvement in more than 20 departmental audit committees that we are pressing forward with plans to build up our staff and resources to audit the Department as it prepares for a clean opinion in FY 2007.

In addition, I serve as a permanent independent advisory member on the recently established Financial Improvement Executive Steering Committee that includes the Deputy Chief Financial Officer, the Deputy Comptroller (Program and Budget), and the Director, Defense Finance and Accounting Service. The committee monitors and directs the progress of the DoD Financial Improvement Plan process. This committee also reviews, approves, and prioritizes those financial statement line items that DoD Components assert are candidates for assessment and audit.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer has just finalized the financial improvement initiatives business rules to guide IG DoD and DoD

Components in determining when financial statements or line items are ready for audit. These business rules are designed to ensure that financial audits of specific line items and specific financial statements for DoD Components are only initiated when the specific Component has asserted that known deficiencies have been corrected. These business rules will help ensure that Government funds are used efficiently in compliance with Section 1008 of the FY 2002 National Defense Authorization Act. Of course, our ongoing audits to reduce waste and mismanagement within the Department are continuing.

Impact of the Inability to Prepare Auditable Financial Statements

The weaknesses that affect the auditability of the financial statements also impact other DoD programs and operations and contribute to waste, mismanagement, and inefficient use of DoD resources. These weaknesses affect the safeguarding of assets and proper use of funds and impair the prevention and identification of fraud, waste, and abuse.

Purchase Cards

You have expressed an interest in our work on the purchase cards and Government charge cards and we have done, and are doing, considerable work in these areas. Office of the Inspector General of the Department of Defense (OIG) personnel testified before the Senate Committee on Governmental Affairs on April 28, 2004, on "How to Save the Tax Payers Money Through Prudent Use of the Purchase Card." At that hearing, we reported that purchase cards accounted for 25 percent of the purchase actions made in the Department in FY 2003. We presented the results of three OIG DoD audit reports issued in FYs 2003 and 2004, which identified management control problems with the use of purchase cards. At that hearing, we provided some of the following examples of questionable, inappropriate, or fraudulent purchases.

- One cardholder used the purchase card to make 59 fraudulent purchases totaling more than $130,000. The purchases included two automobiles, a motorcycle, and cosmetic enhancements done through surgery. ("Summary Report on the Review of Selected DoD Purchase Card Transactions," June 27, 2003, [IG DoD Report

No. D-2003-109])

- A DoD official was convicted of theft of Government property stemming from her use of the Government charge card to make about $1.7 million of fictitious purchases from a fictitious firm. ("Selected Purchase Card Transactions at Washington Headquarters Services and Civilian Personnel Management Service," October 16, 2003, [IG DoD Report No. D-2004-002])

- Approximately $1.1 million of Space and Naval Warfare Systems Command, New Orleans Information Technology Center purchases were questionable because there was no obvious mission need for the items purchased. Questionable items purchased included six bicycles costing $2,393 to be used by interns from New Orleans University in a non-existent intern program; three global positioning systems costing about $1,720 for the Director to use because he routinely got lost when he went on travel; and luggage costing about $700 that was purchased because the Director and his Deputy traveled frequently and needed to carry briefing papers. ("Purchase Card Use at the Space and Naval Warfare Systems Command, Information Technology Center, New Orleans, Louisiana," November 14, 2003, [IG DoD Report No. D-2004-016])

We also discussed using data mining techniques and working with the Department to reduce costs related to prices on purchase card buys. However, this is an area where the Administrator of the General Services Administration (GSA) should take the lead. We feel that GSA, as a minimum, should establish a central data repository of charge card transactions for use by all Governmental agencies. This would eliminate or reduce costs for both the banks and Governmental agencies and ensure data could be shared. The central data repository could then be used to identify spending trends and help in the development of discounts across the Government. In addition, by having the data in one place, oversight agencies like GAO and the Offices of the Inspector General throughout the Government would not have to make additional queries of banks to obtain transaction information.

We also suggested that a Center of Excellence be established by the Government under GSA or associated with an educational institution staffed with experts who perform continuous research, develop training for users to be more effective buyers, negotiate point of sale discounts for all Federal agencies, and develop data mining tools and techniques to help all Federal agencies improve management of charge cards and, thus, reduce the potential for fraud, waste, and abuse.

Subsequent to the April 28, 2004, hearing, our office issued an additional report on purchase cards: "Controls Over Purchase Cards at the Naval Medical Center San Diego," June 29, 2004, (IG DoD Report No. D-2004-096). We found no evidence of fraud. However, 52 of the 65 transactions we reviewed, valued at $53,000, had one or more internal control weaknesses. Additionally, billing cycle limits were $1.9 million higher than necessary for 18 of the 32 cardholders reviewed.

Travel Cards

We, along with GAO, also performed audit work on the travel card program. IG DoD Report No. D-2004-083. ("Management of the Centrally Billed Travel Card Program at Defense Agencies," May 24, 2004) reported the following:

- Controls over centrally billed travel accounts were adequate at the Joint Chiefs of Staff, Defense Commissary Agency, Defense Security Cooperation Agency, and the National Defense University based on a review of documentation for the selected transactions. However, improvements were needed at the Travel Card Program Management Office and at Washington Headquarters Services.

- The Travel Card Program Management Office did not monitor centrally billed travel accounts. As a result, credit limits were about $457 million higher than needed, and the Department was placed at increased risk for financial loss.

- Washington Headquarters Services did not properly establish and appropriately use a centrally billed travel account. For example, the Budget and Finance

Directorate opened five travel transaction accounts instead of using purchase cards and did not have adequate supporting documentation for purchases. As a result, non-travel related transactions, totaling about $11,600, were processed on three of the five accounts. These transactions included purchases for art supplies, flowers, pen gift sets, receptions and meals, and a forklift. Travel-related charges of about $158,400 were made and approved on these accounts without proper documentation. Additionally, the Director, Budget and Finance, Washington Headquarters Services did not always use the contracted Commercial Travel Office to provide required travel services. As a result, the Director, Budget and Finance violated the commercial travel office contract and the Joint Travel Regulation, and incurred excess travel expenses of about $44,000.

We are currently working with the DoD Program Management Office for purchase cards to assist them in developing data mining indicators and tools to identify potentially fraudulent charges and situations discussed in these reports, so situations of this nature can be eliminated. We also are continuing to work with both the Purchase and Travel Card Program Management Offices to improve the programs, by reducing the financial risk to the Government, and offering recommendations to improve the Federal Managers Financial Integrity Act controls.

Other Audit Work

The Military Service audit agencies and we have also performed audits in many other areas. During the last semiannual report to Congress covering the six months ended March 31, 2004, the OIG DoD and the Military Service audit agencies issued 251 reports that identified opportunities for nearly $1 billion in monetary benefits. These reports and more current reports issued during the past three months show our commitment to improving financial management and efficiency within the Department and reducing fraud, waste, and abuse at all levels. For example:

- The Air Force Audit Agency reported that a lack of system interfaces, data edits, and the inability of systems to identify certain types of transactions, in addition to needed policy changes, contributed to the Air Force granting $96.3 million in inappropriate credits (that is, customer refunds) to DoD customers who turned in spare assets to supply. The inappropriate credits deplete cash resources. By implementing the recommended corrective actions, the working capital fund's recurring negative cash position could be improved by at least $578 million over the 6-year Future Years Defense Plan. (Air Force Audit Agency, "Credit Returns Management," October 22, 2003, [F2004-0001-FC4000])

- Lack of priority, attention, and resources and noncompliance with existing policies caused delays in closing contracts. At the Defense Finance and Accounting Service-Columbus, 1,084 contracts valued at $2.9 billion remained open for 2 to 9 years while awaiting financial adjustment. The high numbers of outstanding contracts awaiting financial adjustments, including adjustments to resolve negative unliquidated obligations and potential overpayments, jeopardize DoD efforts to prepare financial information and statements that are auditable. ("Contracts Awaiting Financial Adjustments at the Defense and Accounting Service Columbus," October 24, 2003, [IG DoD Report No. D-2004-004])

- Lack of procedures to prevent manually processed invoices from being paid earlier than allowed by the Prompt Payment Act caused $1.6 billion in payments to contractors to be made more than seven days prior to the due date. This potentially cost the U.S. Treasury an estimated $1.5 million in lost interest. ("Early Payments of Invoices by the Defense Finance and Accounting Service Columbus," March 12, 2004, [IG DoD Report No. D-2004-058])

- The Defense Logistics Agency was purchasing new property items to fill requisitions while the same property items, in new or unused condition, were being disposed of and sold to a commercial contractor. DoD could have avoided costs of about $9.2 million if the property items were used to fill open requirements instead of disposing of them. DoD could also increase revenues up to $18.7 million if certain disposed items were sold back to DoD by the commercial contractor before being placed on auction. ("Defense Reutilization and Marketing Services Commercial Venture Contracts for Privatization of the DoD Surplus Sales Program," December 30, 2003, [IG DoD Report No. D-2004-037])

- An audit of Navy controls over material designated for or sent to the Defense Reutilization and Marketing Service showed that essential management controls needed improvement. As a result, $39 million in acquisition costs of Government property that was not recorded on accountable supply records was vulnerable to loss or undetected theft, and resources could be expended unnecessarily in researching erroneous disposal transactions. ("Navy Controls Over Materiel Sent to Defense Reutilization and Marketing Offices," June 24, 2004, [IG DoD Report No. D-2004-095])

In addition, we are currently working on several audits to identify and detect areas of fraud, waste and abuse, and mismanagement and to improve overall efficiency and effectiveness within the Department. For example,

- **Cash Management.** We are auditing, at management's request, the cash management of the Foreign Military Sales Trust Fund.
- **Contract Financing Payments.** We are reviewing DoD accounting policy and procedures to determine whether they properly record and account for contract financing payments.
- **Erroneous Payments**. We are determining whether DoD identified and reported all programs and activities that may be susceptible to significant erroneous payments.
- **Overpayment to Deceased Retirees**. We are reviewing the process used by the Military Retirement Fund to suspend the personnel accounts of suspected deceased retirees upon receipt of a death notice and to recover any overpayments once a death is confirmed.
- **Prompt Pay**. We are reviewing DFAS Columbus vendor pay processes to determine whether they are in compliance with the Prompt Payment Act and DoD disbursing policies.

- **Charge Cards.** We have on-going projects on convenience checks, purchase cards, and premium travel. In addition, we are planning additional efforts in FYs 2005 through 2009 on the charge cards under the SmartPay contract.
- **Vendor Pay.** We are reviewing the Air Force General Fund vendor pay disbursement cycle to assess internal controls and compliance with laws and regulations.

Conclusion

As part of the effort to move forward and improve systems and business processes, the Department's leadership has provided increased access and cooperation to the OIG during the financial statement preparation and audit process. We especially want to thank the Under Secretary of Defense (Comptroller)/Chief Financial Officer and his staff for their relentless pursuit of the strategies needed to expedite the correction of the long-standing problems preventing the Department from receiving a favorable audit opinion. This strong leadership is the key element to successful financial management reform. We support the Department's commitment to successfully complete the numerous ongoing initiatives, and believe the Department is committed to continue to improve its systems, processes, and internal controls to ensure that financial information is accurately recorded and reported. The only viable approach to achieving a favorable audit opinion by FY 2007 is to provide incremental funding to audit individual line items and financial statements for each DoD Component when management asserts that deficiencies have been corrected. If funding for audit support to validate the Department's progress is not provided, the goal of achieving a favorable audit opinion by FY 2007 may be further delayed.

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.

United States General Accounting Office

GAO

Testimony

Subcommittee on Financial Management, the Budget, and International Security, Committee on Governmental Affairs, U. S. Senate

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DEPARTMENT OF DEFENSE

Financial and Business Management Transformation Hindered by Long-standing Problems

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

GAO
Accountability * Integrity * Reliability

GAO-04-941T

July 8, 2004

GAO Highlights

Highlights of GAO-04-941T, a testimony before the Subcommittee on Financial Management, the Budget, and International Security, Committee on Governmental Affairs, United States Senate

DEPARTMENT OF DEFENSE

Financial and Business Management Transformation Hindered by Long-standing Problems

Why GAO Did This Study

GAO has previously reported on the Department of Defense's (DOD) financial management and business related problems and key elements necessary for successful reform. Although the underlying conditions remain fundamentally unchanged, DOD continues to be confronted with pervasive problems related to its systems, processes (including internal controls), and people (human capital). These problems impede DOD's ability to operate its numerous business operations in an efficient and effective manner. The Subcommittee asked GAO to provide its views on (1) the impact that long-standing financial management and related business process weaknesses continue to have on DOD, (2) the underlying causes of DOD business transformation challenges, and (3) DOD's business transformation efforts.

In addition, GAO reiterates the key elements to successful reform: (1) an integrated business management transformation strategy, (2) sustained leadership and resource control, (3) clear lines of responsibility and accountability, (4) results-oriented performance measures, (5) appropriate incentives and consequences, (6) an enterprise architecture to guide reform efforts, and (7) effective monitoring and oversight.

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To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory Kutz, (202) 512-9505 (kutzg@gao.gov)

What GAO Found

DOD's senior civilian and military leaders are committed to transforming the department and improving its business operations and have taken positive steps to begin this effort. However, overhauling the financial management and related business operations of one of the largest and most complex organizations in the world represents a daunting challenge. Six DOD program areas are on GAO's "high risk" list, and the department shares responsibility for three other governmentwide high-risk areas. DOD's substantial financial and business management weaknesses adversely affect not only its ability to produce auditable financial information, but also to provide accurate and timely information for management and Congress to use in making informed decisions. Further, the lack of adequate accountability across all of DOD's major business areas results in billions of dollars in annual wasted resources in a time of increasing fiscal constraint.

Impact of Weaknesses in Human Capital Management, Internal Control, and Systems

Business area affected	Problem identified
Military pay	Ninety-four percent of mobilized Army National Guard soldiers GAO investigated had pay problems. These problems distracted soldiers from their missions, imposed financial hardships on their families, and had a negative impact on retention.
Logistics	Asset visibility and other logistical support problems hampered mission readiness during Operation Iraqi Freedom, resulting in a discrepancy of $1.2 billion between the materiel shipped and the acknowledgement by the activity that the materiel was received.
Travel	Seventy-two percent of the over 68,000 premium class airline tickets DOD purchased for fiscal years 2001 and 2002 were not properly authorized and 73 percent were not properly justified.
Property	New JSLIST chem-bio suits sold on the Internet for $3 while at the same time DOD was buying them for over $200. Further, thousands of defective suits declared excess by DOD were improperly issued to local law enforcement agencies—which are likely to be first responders in case of a terrorist attack.
Contract payments	Some DOD contractors were abusing the federal tax system, with little or no consequence. As of September 2003, DOD had collected only $687,000 of unpaid federal taxes through a mandated levy program. GAO estimated that at least $100 million could be collected annually through effective implementation of the levy on DOD contract payments.
Systems	The department invested $179 million on two failed system efforts that were intended to resolve its long-standing disbursement problems.

Source: GAO.

Four underlying causes impede reform: (1) lack of sustained leadership, (2) cultural resistance to change, (3) lack of meaningful metrics and ongoing monitoring, and (4) inadequate incentives and accountability mechanisms. To address these issues, GAO offers two suggestions for legislative action. First, a senior management position should be established to manage and oversee DOD's financial and business management transformation efforts. Second, in a recent report GAO proposes that Congress shift the control and accountability for business systems investments from the DOD components to the recently created functional areas known as domains. DOD disagrees and stated that its portfolio management process would provide the needed control over business system investments. In GAO's view, providing the funding to the domains would be one way of overcoming DOD's parochial operations and help preclude spending billions on nonintegrated systems.

Mr. Chairman and Members of the Subcommittees:

It is a pleasure to be here to discuss key aspects of business transformation efforts at the Department of Defense (DOD). At the outset, we would like to thank the Subcommittee for having this hearing and acknowledge the important role hearings such as this one serve. The involvement of this Subcommittee is critical to ultimately assuring public confidence in DOD as a steward that is accountable for its finances. DOD continues to confront pervasive decades-old financial management and business problems related to its systems, processes (including internal controls), and people (human capital). 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.[1] These problems preclude the department from producing accurate, reliable, and timely information to make sound decisions and to accurately report on its trillions of dollars of assets and liabilities. Further, DOD's financial management deficiencies, taken together, continue to represent the single largest obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements.

Today, we will provide our perspectives on (1) the impact that long-standing financial management and related business process weaknesses continue to have on DOD, (2) the underlying causes that have impeded the success of prior reform efforts, and (3) DOD's business systems transformation efforts. In addition, we will offer two suggestions for legislative consideration, which we believe improve the chances that DOD business systems transformation efforts will succeed. Our statement is based on previous GAO reports and testimonies.

Summary

DOD's substantial long-standing business management systems and related problems adversely affect the economy, efficiency, and effectiveness of its operations, and have resulted in a lack of adequate accountability across all major business areas. These problems have left the department vulnerable to billions of dollars of fraud, waste, and abuse annually, at a time of increasing fiscal constraint. Secretary Rumsfeld has estimated that successful improvements to DOD's business operations could save the department 5 percent of its budget a year, which equates to over $20 billion a year in savings. The following examples indicate the magnitude and severity of the problems.

- Ninety-four percent of mobilized Army National Guard soldiers from the six units we reviewed had pay problems. According to the individuals we interviewed, these problems distracted from the soldiers missions, imposed financial hardships on their families, and had a negative impact on retention.[2] For example, the commander of an Army National Guard Special Forces unit stated in January 28, 2004, testimony that 25 soldiers left his unit as a

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[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 management, information security, inventory management, real property, systems modernization, support infrastructure management, and weapon systems acquisition.

[2] U.S. General Accounting Office, *Military Pay: Army National Guard Personnel Mobilized to Active Duty Experienced Significant Pay Problems*, GAO-04-89 (Washington, D.C.: Nov. 13, 2003).

direct result of the pay problems they experienced and that another 15 asked for transfers to the inactive National Guard.

- DOD sold new Joint Service Logistics Integrated Suit Technology—chem-bio suits—on the Internet for $3 while at the same time DOD was buying them for over $200.[3] Ineffective supply chain management resulted in thousands of defective suits being declared excess by DOD and then improperly issued to local law enforcement agencies—which are likely to be first responders in case of a terrorist attack.[4]

- Asset visibility and other logistical support problems hampered mission readiness during Operation Iraqi Freedom, including cannibalization of vehicles for parts and duplication of requisitions.[5]

Further evidence of DOD's problems is the long-standing inability of any military service or major defense component to pass the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls.

Over the years, the department has initiated several broad-based reform efforts intended to fundamentally reform its business operations. However, these efforts have not resulted in the fundamental reform necessary to resolve the department's long-standing management challenges because the department has not addressed the four underlying causes that have impeded meaningful reform:

- lack of sustained leadership and management accountability;
- deeply embedded cultural resistance to change, including military service parochialism and stovepiped operations;
- lack of results-oriented goals and performance measures and monitoring; and
- inadequate incentives and accountability mechanisms for business transformation efforts.

These four issues, to a large degree, have impeded DOD's efforts to modernize its business systems—a critical factor in its transformation efforts. DOD's stovepiped, duplicative, and nonintegrated systems environment contributes to its operational problems and costs the taxpayers billions of dollars each year. For fiscal year 2004, DOD requested approximately $19 billion to operate, maintain, and modernize its reported 2,274 business systems. The existing systems environment evolved over time as DOD components—each receiving their own funding—developed narrowly focused parochial solutions to their business problems. Unfortunately, however, these system solutions have not been implemented on time, within budget, and delivered the promised capability. Two systems discussed in our recent report[6]—the

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

[4] U.S. General Accounting Office, *DOD Excess Property: Risk Assessment Needed on Public Sales of Equipment That Could Be Used to Make Biological Agents*, GAO-04-81TNI (Washington, D.C.: Oct. 7, 2003).

[5] U.S. General Accounting Office, *Defense Logistics: Preliminary Observations on the Effectiveness of Logistics Activities during Operation Iraqi Freedom*, GAO-04-305R (Washington, D.C.: Dec. 18, 2003).

[6] U.S. General Accounting Office, *DOD Business Systems Modernization: Billions Continue to Be Invested with Inadequate Management Oversight and Accountability*, GAO-04-615 (Washington, D.C.: May 27, 2004).

Defense Logistics Agency's Business Systems Modernization (BSM) effort and the Army's Logistics Modernization Program (LMP)—are no exception.

Successful reform of DOD's fundamentally flawed financial and business 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. Secretary Rumsfeld has made business transformation a priority. For example, through its Business Management Modernization Program (BMMP), DOD is continuing its efforts to develop and implement a business enterprise architecture (BEA) and establish effective management oversight and control over its business systems modernization investments. However, after about 3 years of effort and over $203 million in reported obligations, we have not seen significant change in the content of DOD's architecture or in its approach to investing billions of dollars annually in existing and new systems. We have made numerous recommendations aimed at improving DOD's plans for developing the next version of the architecture and implementing controls for selecting and managing business systems investments.[7] To date, DOD has not addressed 22 of our 24 recommendations.

The seriousness of DOD's business management weaknesses underscores the importance of no longer condoning "status quo" business operations at DOD. To improve the likelihood that the department's current business transformation efforts will be successful, we have previously suggested[8] that a chief management official[9] position be created. The individual would be responsible for overseeing key areas such as strategic planning, performance and financial management, and business systems modernization, while also facilitating the overall business transformation effort within the department.

Further, in a recent report[10] we also suggest that to improve management oversight, accountability, and control of the department's business system funding, Congress may wish to consider providing the funds to operate, maintain, and modernize DOD's business systems to the functional areas, known as domains, rather than the military services and the defense agencies. Currently, each military service and defense agency receives its own funding and is largely autonomous in deciding how to spend these funds, thereby hindering the development of broad-based, integrated corporate system solutions to common DOD-wide problems. Transforming DOD's business operations and making them more efficient would free up resources that could

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[7] See Related Reports.

[8] U.S. General Accounting Office, *Department of Defense: Further Actions Needed to Establish and Implement a Framework for Successful Financial and Business Management Transformation,* GAO-04-551T (Washington, D.C.: Mar. 23, 2004) and U.S. General Accounting Office, *Department of Defense: Further Actions Needed to Establish and Implement a Framework for Successful Business Transformation,* GAO-04-626T (Washington, D.C.: Mar. 31, 2004).

[9] On September 9, 2002, GAO convened a roundtable of executive branch leaders and management experts to discuss the Chief Operating Officer concept. For more information see U.S. General Accounting Office, *Highlights of a GAO Roundtable: The Chief Operating Officer Concept: A Potential Strategy to Address Federal Governance Challenges,* GAO-03-192SP (Washington, D.C.: Oct. 4, 2002).

[10] GAO-04-615.

be used to support the department's core mission, enhance readiness, and improve the quality of life for our troops and their families.

Background

Because DOD is one of the largest and most complex organizations in the world, overhauling its business operations represents a huge management challenge. In fiscal year 2003, DOD reported that its operations involved over $1 trillion in assets, nearly $1.6 trillion in liabilities, approximately 3.3 million military and civilian personnel, and disbursements of over $416 billion. For fiscal year 2004, the department was appropriated more than $425 billion, which included approximately $65 billion for contingency operations. Execution of DOD operations spans a wide range of defense organizations, including the military services and their respective major commands and functional activities, numerous large defense agencies and field activities, and various combatant and joint operational commands that are responsible for military operations for specific geographic regions or theaters of operation. To execute these military operations, the department performs an assortment of interrelated and interdependent business processes, including logistics management, procurement, healthcare management, and financial management.

Transformation of DOD's business systems and operations is critical to the department providing Congress and DOD management with accurate and timely information for use in decision making. One of the key elements we have reported[11] as necessary to successfully execute the transformation is establishing and implementing an enterprise architecture. In this regard, the department has undertaken a daunting challenge to modernize its existing business systems environment through the development and implementation of a business enterprise architecture (BEA)—a modernization blueprint. This effort is an essential part of the Secretary of Defense's broad initiative to "transform the way the department works and what it works on."

Pervasive Financial and Business Management Problems Affect DOD's Efficiency and Effectiveness

For several years, we have reported that DOD faces a range of financial management and related business process challenges that are complex, long-standing, pervasive, and deeply rooted in virtually all business operations throughout the department. As the Comptroller General testified in March 2004 and as discussed in our latest financial audit report,[12] DOD's financial management deficiencies, taken together, continue to 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 has passed the test of an independent financial audit because

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[11] U.S. General Accounting Office, *Department of Defense: Status of Financial Management Weaknesses and Progress Toward Reform*, GAO-03-931T (Washington, D.C.: June 25, 2003).

[12] U.S. General Accounting Office, *Fiscal Year 2003 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges*, GAO-04-477T (Washington, D.C.: Mar. 3, 2004) and our report contained in the U.S. Department of the Treasury, Financial Report of the United States Government (Washington, D.C.: Feb. 27, 2004).

of pervasive weaknesses in internal control and processes and fundamentally flawed business systems.

In identifying improved financial performance as one of its five governmentwide initiatives, the President's Management Agenda recognized that obtaining a clean (unqualified) financial audit opinion is a basic prescription for any well-managed organization. At the same time, it recognized that without sound internal control and accurate and timely financial and performance information, it is not possible to accomplish the President's agenda and secure the best performance and highest measure of accountability for the American people. The Joint Financial Management Improvement Program (JFMIP)[13] principals have defined certain measures, in addition to receiving an unqualified financial statement audit opinion, for achieving financial management success. These additional measures include (1) being able to routinely provide timely, accurate, and useful financial and performance information; (2) having no material internal control weaknesses or material noncompliance with laws and regulations; and (3) meeting the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).[14] Unfortunately, DOD does not meet any of these conditions. For example, for fiscal year 2003, the DOD Inspector General (DOD IG) issued a disclaimer of opinion on DOD's financial statements, citing 11 material weaknesses in internal control and noncompliance with FFMIA requirements.

Pervasive weaknesses in DOD's financial management and related business processes and systems have (1) resulted in a lack of reliable information needed to make sound decisions and report on the status of DOD activities, including accountability of assets, through financial and other reports to Congress and DOD decision makers; (2) hindered its operational efficiency; (3) adversely affected mission performance; and (4) left the department vulnerable to fraud, waste, and abuse, as the following examples illustrate.

- Of the 481 mobilized Army National Guard soldiers from six GAO case study Special Forces and Military Police units,[15] 450 had at least one pay problem associated with their mobilization. According to the individuals we interviewed, DOD's inability to provide timely and accurate payments to these soldiers, many of whom risked their lives in recent Iraq or Afghanistan missions, distracted them from their missions, imposed financial hardships on

[13] JFMIP is a joint undertaking of the Office of Management and Budget, GAO, the Department of Treasury, and the Office of Personnel Management, working in cooperation with each other and with operating agencies to improve financial management practices throughout the government.

[14] FFMIA, Pub. L. No. 104-208, div. A., §101(f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996), requires the 23 major departments and agencies covered by the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990) (as amended), to implement and maintain financial management systems that comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) *U.S. Standard General Ledger (SGL)* at the transaction level.

[15] The six case study units reviewed include the Colorado B Company Special Forces, Virginia B Company Special Forces, West Virginia C Company Special Forces, Mississippi 114th Military Police Company, California 49th Military Police Headquarters and Headquarters Detachment, and the Maryland 200th Military Police Company. In addition, our limited review of pay experiences of soldiers in the Colorado Army Guard's 220th Military Police Company, which recently returned from Iraq, indicated that some of the same types of pay problems that we found in our case studies had also affected soldiers in this unit.

the soldiers and their families, and has had a negative impact on retention.[16] More specifically, in January 28, 2004, testimony, the commander of a special forces unit stated that 25 soldiers left the unit as a direct result of the pay problems they experienced and that another 15 asked for transfers to the inactive National Guard. He also stated that because it would take an estimated 2 years and $250,000 to train each replacement, these losses have had a significant negative impact on the unit's mission capability—one of only six such units in the nation.

- DOD incurred substantial logistical support problems as a result of weak distribution and accountability processes and controls over supplies and equipment shipments in support of Operation Iraqi Freedom activities, similar to those encountered during the prior Gulf War. These weaknesses resulted in (1) supply shortages, (2) backlogs of materials delivered in theater but not delivered to the requesting activity, (3) a discrepancy of $1.2 billion between the amount of materiel shipped and that acknowledged by the activity as received, (4) cannibalization of vehicles, and (5) duplicate supply requisitions.[17]

- Our analysis of data on more than 50,000 maintenance work orders opened during the deployments of six battle groups indicated that about 29,000 orders (58 percent) could not be completed because the needed repair parts were not available on board ship. This condition was a result of inaccurate ship configuration records and incomplete, outdated, or erroneous historical parts demand data. Such problems not only have a detrimental impact on mission readiness, they may also increase operational costs due to delays in repairing equipment and holding unneeded spare parts inventory.[18]

- Inadequate asset visibility and accountability resulted in DOD selling new Joint Service Lightweight Integrated Suit Technology—the current chemical and biological protective garment used by our military forces—on the Internet for $3 each (coat and trousers) while at the same time buying them for over $200 each.[19] DOD has acknowledged that these garments should have been restricted to DOD use only and therefore should not have been available to the public.

- DOD sold excess biological laboratory equipment, including a biological safety cabinet, a bacteriological incubator, a centrifuge, and other items that could be used to produce biological agents. Using a fictitious company and fictitious individual identities, we were able to purchase a large number of new and usable equipment items and protective gear over the Internet from DOD. Although the production of biological warfare agents requires a high degree of expertise, the ease with which these items were obtained through public sales increases the risk that terrorists could obtain and use them to produce biological agents that

[16] GAO-04-89.

[17] GAO-04-305R.

[18] U.S. General Accounting Office, *Defense Inventory: Opportunities Exist to Improve Spare Parts Support Aboard Deployed Navy Ships,* GAO-03-887 (Washington, D.C.: Aug. 29, 2003).

[19] GAO-02-873T.

could be used against the United States.[20]

- Some DOD contractors have been abusing the federal tax system with little or no consequence, and DOD is not collecting as much in unpaid taxes as it could. Under the Debt Collection Improvement Act of 1996, DOD is responsible—working with the Treasury Department—for offsetting payments made to contractors to collect funds owed, such as unpaid federal taxes. However, we found that DOD had collected only $687,000 of unpaid taxes as of September 2003. We estimated that at least $100 million could be collected annually from DOD contractors through effective implementation of levy and debt collection programs. We also found numerous instances of abusive or potentially criminal activity[21] related to the federal tax system during our audit and investigation of 47 DOD contractor case studies. The 34 case studies involving businesses with employees had primarily unpaid payroll taxes, some dating to the early 1990s and some for as many as 62 tax periods.[22] The other 13 case studies involved individuals who had unpaid income taxes dating as far back as the 1980s. Several of these contractors provided parts or services supporting weapons and other sensitive military programs.[23]

- Based on statistical sampling, we estimated that 72 percent of the over 68,000 premium class airline tickets DOD purchased for fiscal years 2001 and 2002 were not properly authorized and that 73 percent were not properly justified. During fiscal years 2001 and 2002, DOD spent almost $124 million on airline tickets that included at least one leg in premium class—usually business class. Because each premium class ticket costs the government up to thousands of dollars more than a coach class ticket, unauthorized premium class travel resulted in millions of dollars of unnecessary costs being incurred annually.[24]

- Control breakdowns resulted in DOD paying for airline tickets that were not used and not processed for refund—amounting to about 58,000 tickets totaling more $21 million for fiscal years 2001 and 2002. DOD was not aware of this problem before our audit and did not maintain any data on unused tickets. Based on limited data provided by the airlines, it is possible that the unused value of the fully and partially unused tickets DOD purchased from

[20] U.S. General Accounting Office, *DOD Excess Property: Risk Assessment Needed on Public Sales of Equipment That Could Be Used to Make Biological Agents,* GAO-04-81TNI (Washington, D.C.: Oct. 7, 2003).

[21] We characterized as "potentially criminal" any activity related to federal tax liability that may be a crime under a specific provision of the Internal Revenue Code. Depending on the potential penalty provided by statute, the activity could be a felony (punishable by imprisonment of more than 1 year) or a misdemeanor (punishable by imprisonment of 1 year or less). Some potential crimes under the Internal Revenue Code constitute fraud because of the presence of intent to defraud, intentional misrepresentation or deception, or other required legal elements.

[22] A "tax period" varies by tax type. For example, the tax period for payroll and excise taxes is one quarter of a year. The taxpayer is required to file quarterly returns with IRS for these types of taxes, although payment of the taxes occurs throughout the quarter. In contrast, for income, corporate, and unemployment taxes, a tax period is 1 year.

[23] U.S. General Accounting Office, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence,* GAO-04-95 (Washington, D.C.: Feb. 12, 2004).

[24] U.S. General Accounting Office, *Travel Cards: Internal Control Weaknesses at DOD Led to Improper Use of First and Business Class Travel,* GAO-04-229T (Washington, D.C.: Nov. 6, 2003), and U.S. General Accounting Office, *Travel Cards: Internal Control Weaknesses at DOD Led to Improper Use of First and Business Class Travel,* GAO-04-88 (Washington, D.C.: Oct. 24, 2003).

fiscal years 1997 through 2003 with DOD's centrally billed account could be at least $115 million.[25]

- We found that DOD sometimes paid twice for the same airline ticket—first to the Bank of America for the monthly credit and bill, and second to the traveler, who was reimbursed for the same ticket. Based on our mining of limited data, the potential magnitude of the improper payments was 27,000 transactions for over $8 million. For example, DOD paid a Navy GS-15 civilian employee $10,000 for 13 airline tickets he had not purchased.[26]

- We found[27] that 38 of 105 travel cardholders we reviewed who had their accounts charged-off due to nonpayment still had active secret or top-secret clearances as of June 2002. Some of the Army personnel holding security clearances who have had difficulty paying their travel card bills may present security risks to the Army. Army regulations provide that an individual's finances are one of the key factors to be considered in determining whether an individual should continue to be entrusted with a secret or top-secret clearance. However, we found that Army security officials were unaware of these financial issues and consequently could not consider their potential effect on whether these individuals should continue to have security clearances.

- Our review of fiscal year 2002 data revealed that about $1 of every $4 in contract payment transactions in DOD's MOCAS system was for adjustments to previously recorded payments—$49 billion of adjustments out of $198 billion in disbursement, collection, and adjustment transactions. According to DOD, the cost of researching and making adjustments to accounting records was about $34 million in fiscal year 2002, primarily to pay hundreds of DOD and contractor staff.[28]

- Tens of millions of dollars are not being collected each year by military treatment facilities from third-party insurers because key information required to effectively bill and collect from third-party insurers is often not properly collected, recorded, or used by the military treatment facilities.[29]

- DOD cannot provide reasonable assurance to the Congress that its IT budget request includes all funding for the department's business systems. We have reported[30] that DOD's IT budget

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[25] U.S. General Accounting Office, *DOD Travel Cards: Control Weaknesses Led to Millions of Dollars of Wasted on Unused Airline Tickets,* GAO-04-398 (Washington, D.C.: Mar. 31, 2004).

[26] U.S. General Accounting Office, *DOD Travel Cards: Control Weaknesses Resulted in Millions of Dollars of Improper Payments,* GAO-04-576 (Washington, D.C.: June 9, 2004).

[27] U.S. General Accounting Office, *Travel Cards: Control Weaknesses Leave Army Vulnerable to Potential Fraud and Abuse,* GAO-03-169 (Washington, D.C.: Oct. 11, 2002).

[28] U.S. General Accounting Office, *DOD Contract Payments: Management Action Needed to Reduce Billions in Adjustments to Contract Payment Records,* GAO-03-727 (Washington, D.C.: Aug. 8, 2003).

[29] U.S. General Accounting Office, *Military Treatment Facilities: Improvements Needed to Increase DOD Third-Party Collections,* GAO-04-322R (Washington, D.C.: Feb. 20, 2004).

[30] U.S. General Accounting Office, *Information Technology: Improvements Needed in the Reliability of Defense Budget Submissions,* GAO-04-115 (Washington, D.C.: Dec. 19, 2003).

submission to Congress for fiscal year 2004 contained material inconsistencies, inaccuracies, or omissions that limited its reliability. We identified discrepancies totaling about $1.6 billion between two primary parts of the submission—the IT budget summary report and the detailed capital investments reports on each IT initiative. These problems were largely attributable to insufficient management attention and limitations in departmental policies and procedures, such as guidance in DOD's Financial Management Regulation, and to shortcomings in systems that support budget-related activities.

These examples clearly demonstrate not only the severity of DOD's current problems, but also the importance of business systems modernization as a critical element in the department's transformation efforts to improve the economy, efficiency, and effectiveness of its operations, and to provide for accountability to Congress and American taxpayers.

Underlying Causes of Financial and Related Business Process Transformation Challenges

Since May 1997,[31] we have highlighted in various reports and testimonies what we believe are the underlying causes of the department's inability to resolve its long-standing financial management and related business management weaknesses and fundamentally reform its business operations. We found that one or more of these causes were contributing factors to the financial management and related business process weaknesses previously discussed. Over the years, the department has initiated several broad-based reform efforts intended to fundamentally reform its business operations and improve the reliability of information used in the decision-making process. Unfortunately, these initiatives have generally proven to be less successful than anticipated because DOD has not addressed the following four underlying causes:

- 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;
- lack of results-oriented goals and performance measures and monitoring; and
- inadequate incentives and accountability mechanisms relating to business transformation efforts.

If not properly addressed, these root causes, which I will now highlight, will likely result in the failure of current DOD transformation efforts and continue to hinder the department's ability to produce accurate, reliable, and timely information to make sound decisions and to accurately report on its billions of dollars of assets, such as inventory.

Lack of Sustained Leadership and Adequate Accountability

Historically, DOD has not routinely assigned accountability for financial management performance to specific organizations or individuals who have sufficient authority to accomplish desired goals. For example, under the Chief Financial Officers Act of 1990,[32] it is the

[31] U.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).

[32] Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838, 2843 (Nov. 15, 1990) (*codified, as amended, in scattered sections of* title 31, United States Code).

responsibility of the agency Chief Financial Officer (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 remaining 80 percent comes from DOD's other business areas such as acquisition and personnel, which are not under the control and authority of the DOD Comptroller.

Further, DOD's past experience has suggested that top management has not had a proactive, consistent, and continuing role in integrating daily operations for achieving business transformation performance goals. It is imperative that major improvement initiatives 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. While DOD leadership has demonstrated its commitment to reforming the department's business operations, the magnitude and nature of day-to-day demands placed on these leaders, given the current world events associated with fighting the war on terrorism, clearly affect the level of oversight, commitment, and involvement they can devote to the transformation efforts. Given the importance of DOD's business transformation efforts, it is imperative that it receives the sustained leadership needed to improve the economy, efficiency, and effectiveness of DOD's business operations. Based on our surveys of best practices of world-class organizations,[33] strong executive CFO and Chief Information Officer (CIO) leadership and centralized control over systems investments are essential to (1) making financial management an entitywide priority, (2) providing meaningful information to decision makers, (3) building a team of people that delivers results, and (4) effectively leveraging technology to achieve stated goals and objectives.

Cultural Resistance and Parochialism

Cultural resistance to change, military service parochialism, and stovepiped operations have all contributed significantly to the failure of 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 developed piecemeal and evolved to accommodate different organizations, each with its own policies and procedures. Recent audits reveal that DOD has made only small inroads in addressing these challenges. For example, as discussed in our May 2004 report,[34] DOD does not have the processes and controls in place to provide reasonable assurance that it is in compliance with the fiscal year 2003 defense

[33] U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management,* GAO/AIMD-00-134 (Washington, D.C.: April 2000) and U.S. General Accounting Office, *Executive Guide: Maximizing the Success of Chief Information Officers: Learning From Leading Organizations,* GAO-01-376G (Washington, D.C.: February 2001).

[34] U.S. General Accounting Office, *DOD Business Systems Modernization: Limited Progress in Development of Business Enterprise Architecture and Oversight of Information Technology Investments,* GAO-04-731R (Washington, D.C.: May 17, 2004).

authorization act,[35] which requires the DOD Comptroller to review all system improvements with obligations exceeding $1 million. As a result, DOD was not able to satisfy our request for information on all obligations in excess of $1 million for system modernizations since passage of the act. Based upon a comparison of limited information provided by the military services and defense agencies for fiscal years 2003[36] and 2004, as of December 2003, we identified a total of $863 million in obligations that exceeded $1 million for system improvements that were not submitted to the DOD Comptroller for required review.

Additionally, as discussed in our recent report,[37] DOD continued to use a stovepiped approach to develop and fund its business system investments. As shown in table 1, DOD requested approximately $18.8 billion for fiscal year 2004 to operate, maintain, and modernize its reported 2,274 nonintegrated, duplicative, stovepiped business systems. The table also shows how business system funding is spread across various DOD components.

Table 1: DOD Fiscal Year 2004 Information Technology Budget Request for Business Systems by DOD Component
(Dollars in millions)

Component	Total
Army	$3,652
Navy	3,778
Air Force	3,737
DISA[a]	3,938
TRICARE[b]	980
DLA[c]	774
DFAS[d]	502
Other DOD components[e]	1,440
Total	**$18,801**

Source: GAO analysis based on DOD's fiscal year 2004 IT budget request.

[a] The Defense Information Systems Agency provides DOD and other organizations with a wide range of information services, such as data processing, telecommunications services, and database management.
[b] TRICARE is the health care system for DOD's active duty personnel, their dependents, and retirees.
[c] DLA is DOD's logistics manager for all consumable and some repair items; its primary business function is providing supply support to sustain military operations and readiness.
[d] Defense Finance and Accounting Services is the centralized accounting agency for DOD.
[e] Other DOD components include entities such as the Office of the Secretary of Defense and the Defense Contract Management Agency.

[35] Subsection 1004 (d) of the Bob Stump National Defense Authorization Act for Fiscal Year 2003, Pub. L. No. 107-314, 116 Stat. 2629 (Dec. 2, 2002), provides that any amount in excess of $1 million may be obligated for financial system improvements before approval of its enterprise architecture and a supporting transition plan only if the DOD Comptroller makes a determination that the improvement is necessary for (1) critical national security capability or critical safety and security requirements or (2) prevention of significant adverse effect on a project that is needed to achieve an essential capability. The act further provides that after the architecture is approved, the DOD Comptroller must determine before making obligations that exceed $1 million for system improvements that such improvements are consistent with the enterprise architecture and the transition plan.

[36] We requested obligational data for fiscal year 2003 for the period December 2, 2002, the date of the enactment of the act, through September 30, 2003.

[37] GAO-04-615.

The existing systems environment evolved over time as DOD components—each receives its own system funding and follows decentralized acquisition and investment practices—developed narrowly focused parochial solutions to their business problems. DOD's ability to address its current "business-as-usual" approach to business system investments is further hampered by its lack of

- a complete inventory of business systems—a condition we first highlighted in 1998. In fact, the DOD Comptroller testified in March 2004[38] that the size of DOD's actual systems inventory could be twice the size currently reported;
- a standard definition of what constitutes a business system;
- a well-defined BEA; and
- an effective approach for the control and accountability over business system modernization investments.

Until DOD develops and implements an effective strategy for overcoming resistance, parochialism, and stovepiped operations, its transformation efforts will not be successful. Further, there can be little confidence that it will not continue to spend billions of dollars on stovepiped, duplicative, and nonintegrated systems that do not optimize mission performance and support the warfighter.

Lack of Results-Oriented Goals and Performance Measures

At a programmatic level, the lack of clear, linked goals and performance measures handicapped DOD's past reform efforts. As a result, DOD managers lacked straightforward road maps showing how their work contributed to attaining the department's strategic goals, and they risked operating autonomously rather than collectively. As of March 2004, DOD formulated departmentwide performance goals and measures and continued to refine and align them with the outcomes described in its strategic plan—the September 2001 Quadrennial Defense Review (QDR). The QDR outlined a new risk management framework, consisting of four dimensions of risk—force management, operational, future challenges, and institutional—to use in considering trade-offs among defense objectives and resource constraints. According to DOD's Fiscal Year 2003 Annual Report to the President and the Congress, these risk areas are to form the basis for DOD's annual performance goals. They will be used to track performance results and will be linked to resources. As of March 2004, DOD was still in the process of implementing this approach on a departmentwide basis.

DOD currently has plans to institutionalize performance management by aligning management activities with the President's Management Agenda. As part of this effort, DOD linked its fiscal year 2004 budget resources with metrics for broad program areas, e.g., air combat, airlift, and basic research in the Office of Management and Budget's (OMB) Program Assessment Rating

[38] U.S. General Accounting Office, *Department of Defense: Further Actions Needed to Establish and Implement a Framework for Successful Business Transformation*, GAO-04-626T (Washington, D.C.: Mar. 31, 2004).

Tool.[39] We have not reviewed DOD's efforts to link resources to metrics; however, some of our recent work notes the lack of clearly defined performance goals and measures in the management of such areas as defense inventory and military pay.[40] Further, without modern integrated systems and streamlined business processes, the accuracy and reliability of DOD's performance data will be questionable.

One program that has yet to establish measurable, results-oriented goals is the BMMP.[41] The BMMP is the department's business transformation initiative encompassing defense policies, processes, people, and systems that guide, perform, or support all aspects of business management, including development and implementation of the BEA. A key element of any major program is its ability to establish clearly defined goals and performance measures to monitor and report its progress to management. Since DOD has yet to develop performance measures for the BMMP, it is difficult to evaluate and track, on an ongoing basis, specific program progress, outcomes, and results, such as explicitly defining performance measures to evaluate the architecture's quality, content, and utility of subsequent major updates. Given that DOD has reported obligations of over $203 million since architecture development efforts began 3 years ago, this is a serious performance management weakness.

DOD recognizes that it needs to develop detailed plans and establish performance metrics to measure and track program progress to determine what it planned to accomplish by a certain point in time, what it actually accomplished at that point in time, and what has been spent thus far. In its March 15, 2004, progress report on the implementation of the BEA, DOD reported that it plans to establish an initial approved program metrics baseline to evaluate the cost, schedule, and performance of the BMMP and that, beginning with the fourth quarter of fiscal year 2004, it plans to begin formal tracking and reporting of specific program goals, objectives, and measures. Without explicitly defined program baselines, detailed plans, and performance measures, it is difficult to validate or justify the $122 million requested for fiscal year 2005 and the $494 million estimated to be needed for fiscal years 2006 through 2009.

[39] OMB developed the Program Assessment Rating Tool to strengthen the process for assessing the effectiveness of programs across the federal government. For fiscal year 2004, OMB rated the following 12 defense program areas: Air Combat; Airlift; Basic Research; Chemical Demilitarization; Communications Infrastructure; Defense Health; Energy Conservation Improvement; Facilities Sustainment, Restoration, Modernization, and Demolition; Housing; Missile Defense; Recruiting; and Shipbuilding. DOD linked metrics for these program areas, which represent 20 percent of the department's fiscal year 2004 budget; it linked another 20 percent in the 2005 budget and 30 percent in the 2006 budget, for a total of 70 percent.

[40] In July 2003 we reported that DOD and the military services do not have an effective approach to prevent and mitigate equipment corrosion, and that DOD's strategic plan should contain clearly defined goals, measurable, outcome-oriented objectives, and performance measures. (U.S. General Accounting Office, *Defense Management: Opportunities to Reduce Corrosion Costs and Increase Readiness*, GAO-03-753 (Washington, D.C.: July 7, 2003)). Similarly, in January 2004 we testified that existing processes and controls used to provide pay and allowances to mobilized Army Guard personnel prevented DOD from being able to reasonably assure timely and accurate payroll payments. We stated that DOD needs to establish a unified set of policies and procedures, as well as performance measures in the pay area. (U.S. General Accounting Office, *Military Pay: Army National Guard Personnel Mobilized to Active Duty Experienced Significant Pay Problems*, GAO-04-413T (Washington, D.C.: Jan. 28, 2004)).

[41] GAO-04-731R.

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" operations, systems, and organizational structures. Traditionally, DOD has focused on justifying its need for more funding rather than on the outcomes its programs have produced. DOD has historically measured its performance by resource components such as the amount of money spent, people employed, or number of tasks completed.

The lack of incentive to change is evident in the business systems modernization area. Despite DOD's acknowledgement that many of its systems are error prone, duplicative, and stovepiped, DOD continues to allow its component organizations to make their own investments independently of one another and implement different system solutions to solve the same business problems. These stovepiped decision-making processes have contributed to the department's current complex, error-prone environment. For example, our March 2003 report[42] noted that DOD had not effectively managed and overseen its planned investment of over $1 billion in four Defense Finance and Accounting Service (DFAS) system modernization efforts. One project's estimated cost had increased by as much as $274 million, while the schedule slipped by almost 4 years. For each of these projects, DOD oversight entities—DFAS, the DOD Comptroller, and the DOD CIO—could not provide documentation that indicated they had questioned the impact of the cost increases and schedule delays, and allowed the projects to proceed in the absence of the requisite analytical justification. Such analyses provide the requisite justification for decision makers to use in determining whether to invest additional resources in anticipation of receiving commensurate benefits and mission value. Two of the four projects—the Defense Procurement Payment System and the Defense Standard Disbursing System—were terminated in December 2002 and December 2003, respectively, after an investment of approximately $179 million that did not improve the department's business operations.

GAO and the DOD IG have identified numerous business system modernization efforts that are not economically justified on the basis of cost, benefits, and risk; take years longer than planned; and fall short of delivering planned or needed capabilities. Despite this track record, DOD continues to invest billions of dollars in business systems modernization, while at the same time it lacks the effective management and oversight needed to achieve results. Without appropriate incentives to improve their project management, ongoing oversight, and adequate accountability mechanisms, DOD components will continue to develop duplicative and nonintegrated systems that are inconsistent with the Secretary's vision for reform.

Keys to Successful Reform

Successful reform of DOD's fundamentally flawed financial and business management operations must simultaneously focus on its systems, processes, and people. While DOD has

[42] GAO-03-465.

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. At this time, it is not possible to predict when—or even whether—DOD's reform 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. These elements, which we believe are key to any successful approach to transforming the department's business operations, include

- addressing the department's financial management and related business operational challenges as part of a comprehensive, integrated, DOD-wide strategic plan for business reform;
- providing for sustained and committed leadership by top management, including but not limited to the Secretary of Defense;
- establishing resource control over business systems investments;
- establishing clear lines of responsibility, authority, and accountability;
- incorporating results-oriented performance measures and monitoring progress tied to key financial and business transformation objectives;
- providing appropriate incentives or consequences for action or inaction;
- establishing an enterprise architecture to guide and direct business systems modernization investments; and
- ensuring effective oversight and monitoring.

These elements, which should not be viewed as independent actions but rather as a set of interrelated and interdependent actions, are reflected in the recommendations we have made to DOD and are consistent with those actions discussed in the department's April 2001 financial management transformation report.[43] The degree to which DOD incorporates them into its current reform efforts—both long and short term—will be a deciding factor in whether these efforts are successful. Thus far, the department's progress in implementing our recommendations has been slow. Further, as will be discussed in more detail later, we have not yet seen a comprehensive, cohesive strategy that details how some of the ongoing efforts are being integrated. For example, we have not seen how the department plans to integrate its objective of obtaining an unqualified audit opinion in fiscal year 2007 with the BMMP. It appears as if these two key efforts are being conducted in a stovepiped manner.

DOD Business Transformation Efforts

Over the years, we have given DOD credit for beginning numerous initiatives intended to improve its business operations. Unfortunately, most of these initiatives failed to achieve their intended objective in part, we believe, because they failed to incorporate key elements that in our experience are critical to successful reform. Today, we would like to discuss one very important broad-based initiative—the BMMP—that DOD currently has underway and, if properly developed and implemented, will result in significant improvements in DOD's business systems and operations.

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

Effectively managing and overseeing the department's $19 billion investment in its business systems is key to the successful transformation of DOD's business operations. The transformation also depends on the ability of the department to develop and implement business systems that provide users and department management with accurate and timely information on the results of operations and that help resolve the numerous long-standing weaknesses. As DOD moves forward with BMMP, it needs to ensure that the department's business systems modernization projects—such as BSM and LMP, discussed in our recently issued report—are part of a corporate solution to DOD long-standing business problems. To assist the department with it ongoing efforts, we would like to offer two suggestions for legislative consideration that we believe could significantly increase the likelihood of a successful business transformation effort at DOD.

Business Management Modernization Program

The BMMP, which the department established in July 2001 following our recommendation that DOD develop and implement an enterprise architecture,[44] is vital to the department's efforts to transform its business operations.[45] The purpose of the BMMP is to oversee development and implementation of a departmentwide BEA, transition plan, and related efforts to ensure that DOD business systems investments are consistent with the architecture and provide world class mission support to the fighting force. A well-defined and properly implemented BEA can provide assurance that the department invests in integrated enterprisewide business solutions and, conversely, can help move resources away from nonintegrated business system development efforts.

However, we recently reported[46] that since our last review,[47] and after about 3 years of effort and over $203 million in reported obligations, we have not seen significant change in the content of DOD's architecture or in DOD's approach to investing billions of dollars annually in existing and new systems. Few actions have been taken to address the recommendations we made in our previous reports,[48] which were aimed at improving DOD's plans for developing the next version of the architecture and implementing the institutional means for selecting and controlling both planned and ongoing business systems investments. To date, DOD has not yet addressed 22 of our 24 recommendations.

Further, DOD has not yet developed either near-term or long-term plans for developing the architecture that explicitly identify and establish a baseline for the actions to be taken, milestones

[44] DOD has one Enterprise Information Environment Mission, and six departmental domains including (1) acquisition/ procurement; (2) finance, accounting, and financial management; (3) human resource management; (4) logistics; (5) strategic planning and budgeting; and (6) installations and environment.

[45] GAO-01-525.

[46] GAO-04-731R.

[47] GAO-03-1018.

[48] GAO-03-458 and GAO-03-1018.

to be achieved, cost estimates to be met, and targeted outcomes to be achieved. DOD has adopted an incremental approach to developing the architecture, including the transition plan, and plans to refine and extend the architecture in three increments, the first of which includes in part the department's efforts to obtain an unqualified audit opinion of DOD's consolidated fiscal year 2007 financial statements.

However, it is unclear what the increments individually or collectively mean, and what they will provide or allow DOD to achieve in the near and long term, because, as previously discussed, DOD has yet to develop detailed performance measures. Although the three increments were identified in November 2003, program officials do not expect to have a plan for increment one until the next version of the transition plan is completed in August 2004. According to program officials, the goals and scope for the second and third increments were only recently approved and, therefore, detailed plans of action and milestones do not yet exist.

Currently, DOD has three initiatives under way to support increment one. First, the program office is developing a plan of action for increment one and intends to complete the plan by August 2004. Second, the accounting and finance domain is conducting workshops to develop needed business rules and requirements for extending and evolving version 2.0 of the architecture. Last, DOD components are developing individual plans detailing their respective efforts for supporting increment one. However, there is no evidence that the program office is coordinating with the components and that the components are coordinating amongst themselves. Because there are not yet detailed plans guiding the program's activities, it is unclear whether and how these activities support each other and whether they support the department's goal of achieving an unqualified audit opinion in 2007.

As DOD moves forward with the BEA, it will be essential that the department have the management structure and processes in place to (1) improve the control and accountability over its billions of dollars of business systems investments; (2) develop corporate solutions to common business problems; and (3) implement system projects within budget, on time, and deliver the promised capability. The failure of the department to have the appropriate management structure and processes could result in billions of dollars continuing to be at risk of being spent on more systems that are duplicative, are not interoperable, cost more to maintain than necessary, and do not optimize mission performance and accountability.

Control and Accountability Over Business System Investments

As previously discussed, DOD continues to lack adequate control and accountability over its billions of dollars of business systems investments. Each DOD component continues to make its own investment decisions, which has led to the proliferation of systems. As shown in table 2, the department has reported that it has at least 2,274 business systems. For example, the department reportedly has 665 systems to support human resource management, 565 systems to support logistical functions,[49] 542 systems to perform finance and accounting functions, and 210 systems to support strategic planning and budget formulation.

[49] According to logistics domain officials, there are currently about 3,000 systems just within the logistics domain. Of that amount, about 1,900 systems have been validated by the DOD components as logistics systems—that is, they are not merely a spreadsheet or a report. Such a determination has not been made for the other 1,100.

Table 2: Reported DOD Business Systems by Domain and Functional Area

Domain	Air Force	Army	Navy/ Marine Corps	DFAS	Other	Total
Acquisition	27	31	61	3	21	**143**
Accounting and finance	43	88	195	165	51	**542**
Human resource management	71	387	86	33	88	**665**
Installations and environment	12	98	9	1	8	**128**
Logistics	180	191	104	11	79	**565**
Strategic planning and budgeting	23	63	98	15	11	**210**
Enterprise information environment	1	5	2	3	10	**21**
Total	**357**	**863**	**555**	**231**	**268**	**2,274**

Source: GAO analysis of BMMP data.

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 translations and interfaces that combine to exacerbate problems with data integrity. The proliferation of systems has resulted because DOD components are largely autonomous and each receives its own business system funding.

DOD has recognized the need to improve its control and accountability of its business system investments and has various initiatives underway and planned. For example, in response to our recommendations,[50] DOD issued a policy in March 2004 that assigns the domains the responsibility for IT portfolio management. However, the procedures to be followed to implement the policy are currently being developed and no time frames for completion have been provided. In addition, specific roles and responsibilities of the domains have not yet been formalized, standard criteria for performing the system reviews have not been developed, and explicit authority for fulfilling roles and responsibilities has not been assigned. Although DOD recognizes the need to clarify the roles and responsibilities associated with managing the domains' portfolios of business systems and ensuring compliance with the architecture, it has not yet established time frames for completing these activities.

While DOD is continuing to work toward establishing the structure and processes to manage its business systems investments, it has not yet conducted a comprehensive system review of its ongoing IT investments to ensure that they are consistent with its BEA efforts. Additionally, execution of a comprehensive review of all modernization efforts by DOD before billions of dollars have been invested will reduce the risk of continuing the department's track record of business systems modernization efforts that cost more than anticipated, take longer than expected, and fail to deliver intended capabilities.

[50] GAO-01-525 and GAO-03-458.

Corporate Solutions to Common Problems

The department's business transformation also depends on its ability to develop and implement business systems that provide corporate solutions to DOD's numerous long-standing problems. This approach should help preclude the continued proliferation of duplicative, stovepiped systems and reduce spending on multiple systems that are supposed to perform the same function. However, as discussed in our recently released report,[51] DOD is still developing systems that are not designed to solve corporatewide problems. BSM and LMP were initiated in November 1999 and February 1998, respectively, prior to DOD undertaking the BEA and establishing the domains. As such, they were not directed towards a corporate solution to the department's long-standing weaknesses in the inventory and logistics management areas, such as total asset visibility. Rather, both projects are more focused on DLA's and the Army's respective inventory and logistics management operations. Today, I would like to focus on one of those issues—total asset visibility, because of its significant impact on DOD's operational effectiveness.

In October 2002, a DLA official testified[52] that BSM would provide improved control and accountability over the Joint Services Lightweight Integrated Suit Technology (JSLIST), which is a lightweight, two-piece garment—coat and trousers—designed to provide maximum protection against chemical and biological contaminants. Total asset visibility is critical for sensitive items such as the JSLIST. For example, tracking the specific location of each suit by lot number is necessary if for any reason they have to be recalled, as was the case with the JSLIST predecessor the Battle Dress Overgarment (BDO).

Over 700,000 of the BDOs were found to be defective and were recalled. Since DOD's systems did not provide the capability to identify the exact location of each suit, a series of data calls were conducted, which proved to be ineffective. We reported in September 2001[53] that DOD was unable to locate approximately 250,000 of the defective suits and therefore was uncertain if the suits were still in the possession of the military forces, or whether they had been destroyed or sold. Subsequently, we found that DOD had sold many of these defective suits to the public as excess, including 379 that we purchased in an undercover operation.[54] In addition, DOD may have issued over 4,700 of the defective BDO suits to local law enforcement agencies. This is particularly significant because local law enforcement agencies are most likely to be the first responders to a terrorist attack, yet DOD failed to inform these agencies that using these suits could result in death or serious injury.

At the October 2002 hearing, the DLA official stated that JSLIST would be included in BSM at the earliest practicable date, which was estimated to be December 2003. BSM, however, is not

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[51] GAO-04-615.

[52] *Chemical and Biological Equipment: Preparing for a Toxic Battlefield: Hearing Before the House Committee on Government Reform, Subcommittee on National Security, Veterans Affairs and International Relations*, 107th Cong. 119 (Oct. 1, 2002) (statement of Deputy Commander, Defense Supply Center Philadelphia, Mr. George H. Allen).

[53] U.S. General Accounting Office, *Chemical and Biological Defense: Improved Risk Assessment and Inventory Management Are Needed*, GAO-01-667 (Washington, D.C.: Sept. 28, 2001).

[54] U.S. General Accounting Office, *DOD Excess Property: Risk Assessment Needed on Public Sales of Equipment That Could Be Used to Make Biological Agents*, GAO-04-81TNI (Washington, D.C.: Oct. 7, 2003).

designed to provide the corporate total asset visibility necessary to locate and track the suits throughout DOD's supply chain. While the suits are expected to be included in a future deployment of BSM, at the time of our review program officials had not yet specified a date when they will be included. Even when the suits are included, BSM is designed to provide visibility over the suits only within the DLA environment—something DLA has stated already exists within its current system environment.

As we have previously reported,[55] the lack of integrated systems hinders DOD's ability to know how many JSLIST it has on hand and where they are located once they leave the DLA warehouse. For example, we found that military units that receive JSLIST from DLA warehouses maintained inventory data in nonstandard, stovepiped systems that did not share data with DLA or other DOD systems. The methods used to control and maintain visibility over JSLIST at the units we visited ranged from stand-alone automated systems, to spreadsheet applications, to pen and paper. One military unit we visited did not have any inventory system for tracking JSLIST. BSM does not address asset visibility outside of DLA's supply chain for the JSLIST, and thus cannot provide DOD with the capability to readily locate JSLIST for any reason, including any potential need for a recall of defective suits.

Similarly, we recently reported[56] that LMP will not provide the Army with total asset visibility until a suite of other systems has been developed and implemented. Specifically, Army officials have stated that LMP will require integration with other Army systems that are under development in order to achieve total asset visibility within the Army. These additional systems are the Product Lifecycle Management Plus (PLM+) and Global Combat Support System—Army (GCSS–A). According to the Army, PLM+ is to integrate LMP and GCSS–A to create end-to-end solution for Army logistics. However, time frames and cost estimates have not been developed for these two additional system initiatives.

Further, to help provide for departmentwide total asset visibility, DLA is undertaking the implementation of the Integrated Data Environment (IDE) program. According to DLA, this initiative is intended to provide the capability for routing data from multiple systems within DLA and DOD into one system. According to DLA, IDE is expected to reach full operational capability in August 2007, with a current estimated cost of approximately $30 million. However, successfully meeting this completion depends on other departmental efforts being completed on time, such as PLM+, for which a completion date had not been established.

Project Management and Oversight

While the success of BMMP and improved control and accountability of business system investments are critical aspects of the department's transformation efforts, equally important is the ability of DOD to implement chosen systems solutions on time, within budget, and with the promised capability. The department has not demonstrated the ability to achieve these goals.

[55] GAO-02-873T.

[56] GAO-04-615.

As discussed in our recently released report,[57] BSM and LMP have experienced cost increases, schedule slippages, and did not deliver planned system capabilities in their first release. Our analysis indicated that many of the operational problems experienced by BSM and LMP can be attributed to DOD's inability to effectively implement the disciplined processes necessary to reduce the risks associated with these projects to acceptable levels. Disciplined processes have been shown to reduce the risks associated with software development and acquisition efforts to acceptable levels and are fundamental to successful systems acquisition.

Specifically, in the case of these two projects, they had significant deficiencies in defining requirements and testing—two areas that form the foundation for a project's success or failure. In fact, DLA and Army program officials acknowledged that requirements and testing defects were factors contributing to the operational problems and stated that they are working to develop more effective processes. To their credit, DLA and the Army have decided that future deployments of BSM and LMP will not go forward until they have reasonable assurance that the deployed systems will operate as expected for a given deployment. Our analysis of selected BSM and LMP key requirements[58] and testing processes found that (1) the functionality to be delivered was not adequately described or stated to allow for quantitative evaluation; (2) the traceability among the various process documents (e.g., operational requirements documents, functional or process scenarios, and test cases) was not maintained; and (3) system testing was ineffective.

In commenting on the report,[59] the department acknowledged that the initial implementation of BSM and LMP experienced problems that could be attributed to the lack of adequate requirements determination and system testing. To address these inadequacies, the department noted that requirements analysis had been expanded to include greater specificity and that the successful completion of comprehensive testing would be required prior to further implementation of either system.

Suggestions for Legislative Consideration

We would like to offer two suggestions for legislative consideration that we believe could contribute significantly to the department's ability to not only address the impediments to DOD's success but also to incorporate needed key elements to successful reform. These suggestions would include the (1) creation of a chief management official and (2) centralization of the funding business systems investments with the domain leaders responsible for the department's various business areas, such as logistics and human resource management. We provided similar views in our testimonies on March 23, 2004,[60] before the Subcommittee on Readiness and

[57] GAO-04-615.

[58] BSM and LMP have identified and documented 202 and 293 system requirements, respectively. For BSM, we reviewed 13 requirements related to finance, order fulfillment, planning, and procurement. For LMP, we reviewed 12 requirements related to planning and budget development, asset management, inventory management, and maintenance analysis and planning.

[59] GAO-04-615.

[60] GAO-04-551T.

Management Support, Senate Committee on Armed Services, on March 31, 2004,[61] before the Subcommittee on Terrorism, Unconventional Threats, and Capabilities, House Committee on Armed Services, and yesterday[62] before a joint hearing of the Subcommittee on National Security, Emerging Threats, and International Relations, the Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, and the Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform.

Chief Management Official

I will now discuss our first matter for consideration. Previous failed attempts to improve DOD's business operations illustrate the need for sustained involvement of DOD leadership in helping to assure that DOD's financial and overall business process transformation efforts remain a priority. While the Secretary and other key DOD leaders have demonstrated their commitment to the current business transformation efforts, the long-term nature of these efforts requires the development of an executive position capable of providing strong and sustained executive leadership over a number of years and various administrations.

However, 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. For example, the former DOD Comptroller, who was very supportive of the current transformation effort, and one of its principal leaders, served as the DOD Comptroller for slightly over 3 years. Further, within the office of the DOD Comptroller, the current Principal Deputy/Deputy Under Secretary of Defense for Management Reform will soon be leaving the department. He also was in that position for slightly over 3 years. Additionally, leadership voids have existed in other key positions such as the program manager for BMMP. From May 2003 to February 2004, there was no program manager to identify, direct, and execute program activities.[63] The resolution of the array of interrelated business system management challenges that DOD faces is likely to span several administrations and require sustained leadership to maintain the continuity needed for success.

One way to ensure sustained leadership over DOD's business transformation efforts would be to create a full-time executive level II position for a chief management official[64] who would serve as the Principal Under Secretary of Defense for Management. This position would provide the sustained attention essential for addressing key stewardship responsibilities such as strategic planning, performance and financial management, and business systems modernization in an integrated manner. This position could be filled by an individual, appointed by the President and confirmed by the Senate, for a set term of 7 years with the potential for reappointment. Such an individual should have a proven track record as a business process change agent in large, complex, and diverse organizations—experience necessary to spearhead business process

[61] GAO-04-626T.

[62] U. S. General Accounting Office, *Department of Defense: Long-standing Problems Continue to Impede Financial and Business Management Transformation*, GAO-04-907T (Washington, D.C.: July 7, 2004).

[63] GAO-04-731R.

[64] GAO-03-192SP.

transformation across the department, and potentially administrations, and serve as an integrator for the needed business transformation efforts. In addition, this individual would enter into an annual performance agreement with the Secretary that sets forth measurable individual goals linked to overall organizational goals. Measurable progress towards achieving agreed-upon goals would be a basis for determining the level of compensation earned, including any related bonus. In addition, this individual's achievements and compensation would be reported to Congress each year.

Functional Domain Control and Accountability Over Business System Investments

We have made numerous recommendations to DOD intended to improve the management oversight and control of its business systems investments. However, progress in achieving this control has been slow and, as a result, DOD has little or no assurance that current business systems investments are being spent in an economically efficient and effective manner. DOD's current systems funding process has contributed to the evolution of an overly complex and error-prone information technology environment containing duplicative, nonintegrated, and stovepiped systems. Given that DOD spends billions of dollars annually on business systems and related infrastructure, it is critical that actions be taken to gain more effective control over such business systems funding.

The second suggestion we have for legislative action to address this issue, as discussed in our report[65] and consistent with our open recommendations to DOD, is to establish specific management oversight, accountability, and control of funding with the "owners" of the various functional areas or domains. This legislation would define the scope of the various business areas (e.g., accounting, acquisition, logistics, and personnel) and establish functional responsibility for management of the portfolio of business systems in that area with the relevant Under Secretary of Defense for the six departmental domains and the CIO for the Enterprise Information Environment Mission (information technology infrastructure). For example, planning, development, acquisition, and oversight of DOD's portfolio of logistics business systems would be vested in the Under Secretary of Defense for Acquisition, Technology and Logistics.

We believe it is critical that funds for DOD business systems be appropriated to the domain owners in order to provide for accountability and the ability to prevent the continued parochial approach to systems investment that exists today. The domains would establish a hierarchy of investment review boards with DOD-wide representation, including the military services and defense agencies. These boards would be responsible for reviewing and approving investments to develop, operate, maintain, and modernize business systems for the domain portfolio, including ensuring that investments were consistent with DOD's BEA. All domain owners would be responsible for coordinating their business systems investments with the chief management official who would chair the proposed Defense Business Systems Modernization Executive Committee and provide a cross-domain perspective. Domain leaders would also be required to report to Congress through the chief management official and the Secretary of Defense on applicable business systems that are not compliant with review requirements and to include a summary justification for noncompliance.

[65] GAO-04-615.

In commenting on our report, DOD stated that it did not agree with this funding concept. The department stated that the portfolio management process being established—to include investment review boards—would provide the appropriate control and accountability over business system investments. DOD also stated that beginning with the fiscal year 2006 budget review process, the domains will be actively involved in business system investment decisions. DOD stated that the military services implement their own statutory authorities for acquisition and IT systems development in consultation with DOD. While the establishment of the investment review boards is consistent with our previous recommendations, we continue to believe that appropriating funds for DOD business systems to the domains, rather than the various DOD entities, will significantly improve accountability over business system investments. DOD's comments indicate that the domains will be more accountable for making business system investment decisions, but unless they control the funding, they will not have the means to effect real change. Continuing to provide business system funding to the military services and defense agencies is an example of the department's embedded culture and parochial operations. As a result of DOD's intent to maintain the status quo, there can be little confidence that it will not continue to spend billions of dollars on duplicative, nonintegrated, stovepiped, and overly costly systems that do not optimize mission performance and accountability and, therefore, do not support the department's transformation goals.

Conclusion

The excellence of our military forces is unparalleled. However, that excellence is often achieved in the face of enormous challenges in DOD's financial management and other business areas, which have serious and far-reaching implications related to the department's operations and critical national defense mission. Our recent work has shown that DOD's long-standing financial management and business problems have resulted in fundamental operational problems, such as failure to properly pay mobilized Army Guard soldiers and the inability to provide adequate accountability and control over supplies and equipment shipments in support of Operation Iraqi Freedom. Further, the lack of appropriate accountability across all business areas has resulted in fraud, waste, and abuse and hinders DOD's attempts to develop world-class operations and activities to support its forces. Additionally, DOD cannot provide Congress reasonable assurance that the billions of dollars spent annually on business systems modernizations are not being wasted on projects that will perpetuate the current costly, nonintegrated, duplicative systems environment. If DOD is unable to address the underlying causes that have resulted in the failure of previous broad-based reform efforts, improvements will remain marginal, confined to narrowly defined incremental improvements.

As our nation continues to be challenged with growing budget deficits and increasing pressure to reduce spending levels, every dollar that DOD can save through improved economy and efficiency of its operations is important. As previously noted, the Secretary has stated that the department could save approximately 5 percent of its budget annually—which equal about $20 billion—through improved business operations. DOD's senior leaders have demonstrated a commitment to transforming the department and improving its business operations and have taken positive steps to begin this effort. We believe that implementation of our open recommendations and our suggested legislative initiatives would greatly improve the likelihood of meaningful, broad-based reform at DOD.

The continued involvement and monitoring by congressional committees will also be critical to ensure that DOD's transformation actions are sustained and extended and that the department achieves its goal of securing the best performance and highest measure of accountability for the American people. We commend the Subcommittee for holding this hearing and we encourage you to use this vehicle, on at least an annual basis, as a catalyst for long overdue business transformation at DOD.

Mr. Chairman, this concludes our statement. We 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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Selected GAO Products Related to DOD's Business Systems Modernization

U.S. General Accounting Office, *DOD Business Systems Modernization: Important Progress Made to Develop Business Enterprise Architecture, but Much Work Remains*, GAO-03-1018 (Washington, D.C.: Sept. 19, 2003).

U.S. General Accounting Office, *Business Systems Modernization: Summary of GAO's Assessment of the Department of Defense's Initial Business Enterprise Architecture*, GAO-03-877R (Washington, D.C.: July 7, 2003).

U.S. General Accounting Office, *DOD Business Systems Modernization: Longstanding Management and Oversight Weaknesses Continue to Put Investments at Risk*, GAO-03-553T (Washington, D.C.: Mar. 31, 2003).

U.S. General Accounting Office, *DOD Business Systems Modernization: Continued Investment in Key Accounting Systems Needs to be Justified*, GAO-03-465 (Washington, D.C.: March 28, 2003).

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).

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

(192138)

Statement of Andrew B. Maner
Chief Financial Officer
Department of Homeland Security
Before the Senate Committee on Governmental Affairs
Subcommittee on Financial Management, the Budget and International Security
July 8, 2004

Thank you Mr. Chairman, for the opportunity to be here and discuss the progress and accomplishments the Department of Homeland Security has made in the area of financial management. I would also like to thank the Senate, and specifically this subcommittee and its members, for their commitment to assisting DHS in this critical area.

In the six months that I have been the Chief Financial Officer at DHS, I with the help of a great staff have been committed to developing and improving financial management within the Department. I have instituted a comprehensive program to improve the areas of financial systems, program analysis and evaluation, and financial management and reporting. I began the development of a base of strategic financial management goals, practices and systems that will aid the Department for decades to come and am energized by the opportunity to assist our leadership in this endeavor.

All of us at the Department are very proud of the progress we have made since the Department's inception in March 2003. In a short span of 15 months we have dealt with the enormous challenges involved in standing up the 3rd largest Department in the Federal government. We have managed to make tremendous headway in unifying and strengthening the Department's financial management, accounting, budgeting, strategic planning, and performance measurement processes and systems.

In the past year, we streamlined the number of financial management service providers in the Department from nineteen of the 22 legacy components to ten. We are implementing a consolidated bankcard program that is reducing the significant number of bankcard programs for purchase, travel, and fleet throughout the Department among the legacy entities to three. We developed and delivered to Congress on time the Department's FY 2005 President's Budget and accompanying Congressional Justifications. We completed and will soon submit our first Future Years Homeland Security Program. We underwent a full-scope audit of our FY 2003 consolidated financial statements that complied with the requirements of the CFO Act of 1990. We have also made strides in our attempt to build an integrated financial system for the Department. In less than a year we have developed requirements that support both the DHS business processes and the Enterprise Architecture and will select a solution from vendor submissions by the end of the month. We submitted our Department's first Strategic Plan and we continue to work in perfecting a robust investment review and joint requirements process. Our first quarterly performance report was issued to the Department's senior leadership. We have begun to develop Department-wide standard operating procedures for financial management, which will be rolled out across DHS this September. Most importantly, all of this has been accomplished with no negative impact on mission operations.

While we have much to be proud of, much remains to be done. I am committed to the continued development of four overall management goals:

- Increase efficiency and effectiveness by producing financial data that is visible, timely, reliable, and useful to decision makers;
- Strengthen accountability by ensuring that internal controls are in place across the Department and appropriate oversight reviews are conducted;
- Manage costs by consolidating functions, systems, and processes and by instituting best business practices; and
- Achieve results through the use of rigorous planning, measurement and evaluation processes.

To carry out these goals, we are focusing on the people, processes, and systems in the areas of financial management, financial systems, and program analysis and evaluation. I would like to take this opportunity with you here today to tell you where we are and where we are going in our drive towards achieving these goals and in making DHS the model of management excellence.

Financial Management

One of our greatest accomplishments is that only two months after its creation, DHS took on the tremendous challenge of subjecting ourselves to the rigors of a consolidated financial statement audit. The challenges were complicated by the obstacles in coordinating the efforts of 19 separate and distinct accounting offices and the unfamiliarity of several bureaus in facing audits for the first time. The Office of the Chief Financial Officer designed and implemented the methodologies and controls necessary to produce consolidated statements. In the span of two months, the Department was able to submit quarterly financial statements to OMB. This demonstrated an ability to comply with the full gauntlet of requirements outlined by OMB for consolidated financial statements. The Department completed the audit and submitted the Performance and Accountability Report (PAR) to OMB. More noteworthy was the ability to pass the scrutiny of audit to the extent necessary to support a qualified opinion on the September 30 balance sheet. The 2003 audit was paramount for the Department to have a basis for improvement in 2004. Although the audit identified seven material weaknesses, this was a substantial improvement over the 18 material weaknesses that were inherited from the DHS components' legacy agencies. Nine inherited material weaknesses were either corrected or partially corrected. The rest were consolidated into seven. Nevertheless, we are committed to resolving these remaining weaknesses and have set forth an aggressive plan to do so. Corrective actions have been developed by each applicable bureau/office and submitted to the OCFO. We have implemented a DHS-wide tracking system to monitor the corrective action status. Commencing in April 2004, we began monitoring the status of corrective actions through monthly Clean Action Plan (CAP) meetings with each bureau or entity that has outstanding material weaknesses. Our goal is to have all of the material weaknesses corrected by the end of FY 2005.

The elimination of improper payments, consistent with the President's Management Agenda, is another area of focus for DHS. We are in varying stages of conducting recovery audits for the three bureaus in the Department that spend more than $500 million per year on contracts: the Coast Guard, Customs & Border Protection

(CBP), and Immigration and Customs Enforcement (ICE). The Coast Guard has previously had a clean recovery audit and will undergo a controls review to confirm its continued excellent status in this area. CBP will begin its recovery audit in August. ICE will issue an RFQ in July and will begin its recovery audit shortly thereafter. We have also completed our Improper Payment Act compliance reviews and will be improving our methodology for FY 2005 in the coming months in conjunction with OMB and our auditors.

In the grants area, we are aware of the challenges ensuring that funds made available to State and Local governments and other non-Federal recipients are awarded in a timely manner. DHS is actively evaluating this issue and has taken a number of steps to develop best practices to mitigate the barriers that have caused delays in the award process. For example, we incorporated grants management planning, awarding and oversight in our plans for the Department's single financial system, we convened a task force in March 2004 to address the concerns related to State & Local homeland security funding, and we established an internal Grants Council with representatives from all the bureaus to provide advice on grants management policies and procedures.

I am also confident that DHS is taking the proper steps now to submit its FY 2004 PAR, including audited financial statements, by the accelerated due date of November 15, 2004. This year's effort will benefit from the methodologies developed and lessons learned from the first year audit. Many bureaus that faced audits for the first time in FY 2003 have made major strides in upgrading their systems and training their staff in dealing with the rigors of the audit. We have also centralized and automated many of the consolidated monthly reporting requirements. This will yield substantial economies of scale and will free up bureau accounting personnel for other PAR activities. (We will have a hard close for the third quarter (June) in advance of fiscal year-end to help insure the fiscal year close by November 15.) Going forward, all DHS bureaus will benefit from implementation of Department-wide standard operating procedures expected in September.

As a result of our progress to date, we are increasingly turning our focus to daily oversight of DHS bureaus and are actively engaged in resolving issues that surface. For example, we established a reconciliation team composed of staff from the CFO's Office, Border & Transportation Security, Citizenship & Immigration Services, and the Coast Guard to assess questions concerning the apportionment of FY 2004 funds among ICE, CBP and CIS. The work has been ongoing, but agreements have been recently reached to permanently realign funds between the Bureaus.

Financial Systems

Essential to sound financial management is a sound and robust financial management system. When DHS was created, we inherited 81 resource management systems and initiatives from the 22 agencies and components that were merged to create DHS. The systems count increases to 101 when other resource management systems we interface with—external to DHS—are included. Few of these systems are integrated and the majority is outdated and many have limited functionality. To address this problem, the Department has undertaken a resource management transformation initiative entitled eMerge^2. The goal of eMerge^2, which stands for *"electronically managing enterprise resources for government effectiveness and efficiency"*, is to improve resource management and enable the bureaus to move "Mission Support" savings to "Front Line" operations. eMerge^2 is a business-focused program that seeks to consolidate and integrate the Department's budget, accounting and reporting, cost management, acquisitions and grants, asset management, and budget functions. Once procured and configured, the solution will be implemented in several phases focusing first on those organizations most in need of improved basic financial management services. eMerge^2 has completed an exhaustive requirements definition and design phase, obtained unanimous approval of these requirements from the DHS Management Council, and recently issued an RFQ to begin the process of vendor selection. We fully expect an award to be made at the end of this month, with piloting and implementation scheduled to begin shortly thereafter. As eMerge^2 is implemented over the next few years, it will greatly enhance Departmental visibility, oversight and accountability of component operations and financial management.

Program Analysis and Evaluation

Sensible financial management requires informed financial and management decisions. To ensure policy decisions are made based on sound rationale, such as a program's contribution to our strategic goals and measurable results, DHS has put in place a comprehensive planning, evaluation, and investment review process.

At the core of this process is the Future Years Homeland Security Program (FYHSP). Section 874 of the Homeland Security Act of 2002, requires the Department to prepare the FYHSP. The FYHSP will ensure current and out year program requirements are properly planned, identified, aligned with DHS goals and priorities and have measurable meaningful performance outcomes. We recently completed the Department's first FYHSP and will be providing it to Congress in the near future.

In addition, the Department's first high-level Strategic Plan was released in February. This Strategic Plan sets forth the vision and mission statements, core values, guiding principles and strategic goals and objectives that provide the framework to guide the actions that make up the daily operations of the Department. The Department's FY 2005 budget request is tied to the strategic plan and provides annual performance measures for each agency.

Holding managers accountable for achieving established goals and results is integral to DHS's financial management and planning. Towards this end, the performance budget forges a strong link between resources and performance, shows what is being accomplished with the money being spent, and establishes accountability for the levels of performance achieved. The Program Assessment Rating Tool (PART) complements the performance budget by providing the Department an objective means of assessing the value and contribution of individual programs to achieving the Department's objectives. It also provides a tool for assessing how the program is being managed. DHS has met OMB's goal of using PART for 60% of the Department's programs.

In the past year, an Investment Review Board (IRB) and Joint Requirements Council (JRC) were established and their structures refined to ensure the proper identification, prioritization and evaluation of cross-cutting investment opportunities both within and outside the Department and to ensure optimal allocation of resources. Specifically, the IRB and JRC review major capital investments to:

- Integrate Departmental priorities, resource planning, investment control, budgeting, acquisition, and investment management to ensure resources are wisely used.
- Ensure that spending directly supports and furthers DHS's mission and provides optimal benefits and capabilities to stakeholders and customers.
- Identify poorly performing programs and investments so corrective actions can be taken.
- Identify duplicative efforts for consolidation and mission alignment when it makes good sense or when economies of scale can be achieved.

The JRC has recently prioritized all 100+ investment proposals across the Department in accordance with our Strategic Plan and has developed a 6-month work plan to evaluate them. The IRB and JRC have also been involved in our eMerge[2] project and will conduct periodic reviews throughout its implementation, ensuring maximum benefit from this investment across DHS.

S. 1567, Department of Homeland Security Financial Accountability Act

Like many others, I appreciate and applaud the objectives of S. 1567, the "Department of Homeland Security Financial Accountability Act" and the companion House bill, H.R. 4259. As the CFO of DHS, I commend all relevant efforts by the executive and legislative branches, including those of the Chairman and Mr. Akaka with S. 1567 and the Accountability of Tax Dollars Act of 2002, to make our controls tighter and to provide financial managers better tools to complete our mission more efficiently and effectively. Today, DHS complies with the intent of the Chief Financial Officers Act of 1990 and will continue to do so. Our audits comply with requirements of the Accountability of Tax Dollars Act, and the deployment of eMerge[2] will bring our financial systems in line with the Federal Financial Management Improvement Act.

A provision I would like to discuss specifically is one that would require an audit of the Department's internal controls beginning in FY 2005. There are several factors that lead me to believe that this should not be mandated for the coming fiscal year. They include:

- The current audit of financial statements includes testing of internal controls to the extent necessary to support an audit opinion on the statements. The financial statement testing will identify material weakness in internal controls and other reportable conditions related to financial reporting. An additional audit of internal controls may be somewhat redundant. In addition, the Federal government has many checks and balances in place that help address concerns about internal controls (GAO, IG, etc.).
- U.S. Customs Service (now CBP) had an audit of internal controls performed for the FY 2002 period in place of a full-scope CFO financial statement audit. It was done by KPMG under the direction of the Treasury OIG. We would

like to evaluate the outcome of that process further to help assess the potential value of a controls audit for DHS.

- Such an audit could be costly in dollars and staff time and may not bring the level of benefits to the agency that it might be intended to provide. I believe consideration should be given to having the Chief Financial Officers Council and the President's Council on Integrity and Efficiency conduct a cost benefit analysis of an audit of internal controls, as contemplated in H.R. 4259.
- As a result, I believe consideration should be given to postponing the effective date of this provision until at least FY 2006.

Closing

In closing, I would like to thank the Committee again for the opportunity to appear before you here today and assure you that the Department and I are committed to achieving the goals we have established. We have already made great progress under challenging circumstances. Now, with a strong, growing and motivated staff and the continued support of DHS leadership, OMB and Congress, I am confident we will realize even greater progress in this, our second year of the Department.

I would now be happy to answer any questions you may have.

STATEMENT OF CLARK KENT ERVIN

INSPECTOR GENERAL

U.S. DEPARTMENT OF HOMELAND SECURITY

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

SUBCOMMITTEE ON FINANCIAL MANAGEMENT, THE BUDGET, AND INTERNATIONAL SECURITY

UNITED STATES SENATE

JULY 8, 2004

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to be here today to discuss the FY 2003 financial statement audit at the Department of Homeland Security (DHS) and ways to improve the financial management and accountability of DHS. My remarks will focus on financial accounting and reporting, revenue collection, contract management, grants management, and information technology.

On March 1, 2003, almost 180,000 employees and 22 disparate agencies combined to form DHS in one of the largest government reorganizations ever. The reorganization had elements of a merger, divestiture, acquisition, and startup. Notably, the General Accounting Office (GAO) designated the implementation and transformation of DHS as a "high risk" because of the size and complexity of the effort, the existing challenges already faced by the incoming components, and the importance of DHS' mission. GAO also noted that successful transformations of large organizations under even less complicated situations could take from 5 to 7 years.

Since the department's formation it has made noteworthy progress in the integration of legacy agencies and the development of department-wide functions. Still, there is much to be done, including needed improvements in DHS financial operations.

Financial Accounting and Reporting

The most immediate financial management challenge for DHS has been the orderly transition of the financial operations of its inherited components and the development of plans for its own integrated financial management system. Further, DHS was presented with the challenge of preparing its first set of financial statements for audit, and met that challenge under difficult circumstances.

The Office of Inspector General (OIG) engaged KPMG LLP (KPMG), to complete an audit of DHS' financial statements as of September 30, 2003, and for the seven months then ended, as required by the Accountability of Tax Dollars Act of 2002. Despite limited staff with many other responsibilities, DHS officials ultimately agreed to accept the challenge of a financial statement audit even though it added strain to its relatively limited resources. They recognized that an audit would establish a solid baseline from which DHS could plan for and build good financial management processes. With this audit, DHS now has that solid baseline for measuring improvement.

KPMG gave a qualified opinion on the consolidated balance sheet and statement of custodial activity, meaning that, except for certain items described below, they were presented fairly and free of material misstatements. KPMG was unable to provide an opinion on the remaining statements for the reasons discussed below. The qualification on the balance sheet related to:

(1) The lack of sufficient documentation provided prior to the completion of KPMG's audit procedures to support $2.9 billion in property, plant, and equipment at the Coast Guard;

(2) KPMG's inability to observe a sufficient number of the physical counts of operating materials and supplies at Coast Guard or otherwise verify the valuation of operating materials reported in the amount of $497 million; and

(3) The lack of sufficient, actuarial documentation provided prior to the completion of KPMG's audit procedures to support retirement benefits recorded at $3.3 billion at the Secret Service and post-employment benefits recorded at $201 million at the Coast Guard.

The Coast Guard's financial statements had never been audited at the level of detail required at DHS, where Coast Guard became a larger bureau relative to its parent department. It is not uncommon for a large established agency such as the Coast Guard to require additional time to get its processes and systems in place to facilitate a financial statement audit at this level of detail. The Secret Service has since obtained an actuarial report on its retirement benefits liability, and believes it has recorded the correct amount. Coast Guard has likewise done the same for its post-employment benefits liability.

KPMG was unable to provide an opinion on the consolidated statements of net cost and changes in net position, the combined statement of budgetary resources, and the consolidated statement of financing for several reasons. First, several "legacy" agencies (agencies from which component entities or functions were transferred to DHS) submitted accounting and financial information over which DHS had limited control. Consequently, the auditors were unable to complete procedures relating to revenue, costs, and related budgetary transactions reported by the legacy agencies to DHS. In addition, KPMG was unable to complete audit procedures over certain revenues, costs, and related budgetary transactions at the Coast Guard prior to the completion of the DHS consolidated audit.

DHS inherited 18 material weaknesses from the Customs Service, the Immigration and Naturalization Service (INS), the Federal Emergency Management Agency (FEMA), and the Transportation Security Administration (TSA). KPMG determined that nine of the material weaknesses were corrected or partially corrected. The remaining ones were consolidated into seven DHS material weaknesses or reclassified to a reportable condition or other matter for management's attention. The seven material weaknesses included the following:

- Financial Management and Personnel: DHS' Office of the Chief Financial Officer (OCFO) needed to establish financial reporting roles and responsibilities, assess critical needs, and establish standard operating procedures (SOPs).

These conditions were not unexpected for a newly created organization, especially one as large and complex as DHS. The Coast Guard and the Strategic National Stockpile had weaknesses in financial oversight that led to reporting problems, as discussed further below.

- Financial Reporting: Key controls to ensure reporting integrity were not in place, and inefficiencies made the process more error prone. At the Coast Guard, the financial reporting process was complex and labor-intensive. Several DHS bureaus lacked clearly documented procedures, making them vulnerable to the loss of key people.

- Financial Systems Functionality and Technology: The auditors found weaknesses across DHS in its entity-wide security program management and in controls over system access, application software development, system software, segregation of duties, and service continuity. Many bureau systems lacked certain functionality to support the financial reporting requirements.

- Property, Plant, and Equipment (PP&E): The Coast Guard was unable to support $2.9 billion in PP&E due to insufficient documentation provided prior to the completion of KPMG's audit procedures, including documentation to support its estimation methodology. TSA lacked a comprehensive property management system and adequate policies and procedures to ensure the accuracy of its PP&E records.

- Operating Materials and Supplies (OM&S): Internal controls over physical counts of OM&S were not effective at the Coast Guard. The Coast Guard also had not recently reviewed its OM&S capitalization policy, leading to a material adjustment to its records when an analysis was performed.

- Actuarial Liabilities: The Secret Service did not record $3.3 billion in pension liability for certain of its employees and retirees, and when corrected, the auditors had insufficient time to audit the amount recorded. The Coast Guard also was unable to provide, prior to the completion of KMPG's audit procedures, sufficient documentation to support $201 million in post-service benefits.

- Transfers of Funds, Assets, and Liabilities to the Department: DHS lacked controls to verify that monthly financial reports and transferred balances from legacy agencies were accurate and complete.

Other Reportable Conditions included the following:

- Drawback Claims on Duties, Taxes, and Fees: The Bureau of Customs and Border Protection's (CBP) accounting system lacked automated controls to detect and prevent excessive drawback claims and payments.

- Import Entry In-bond: CBP did not have a reliable process of monitoring the movement of "in-bond" shipments -- i.e., merchandise traveling through the U.S. that is not subject to duties, taxes, and fees until it reaches a port of destination. CBP lacked an effective compliance measurement program to compute an estimate of underpayment of related duties, taxes, and fees.

- Acceptance and Adjudication of Immigration and Naturalization Applications: The Bureau of Citizenship and Immigration Services' (CIS) process for tracking and reporting the status of applications and related information was inconsistent and inefficient. CIS did not perform cycle counts of its work in process that would facilitate the accurate calculation of deferred revenue and reporting of related operational information.

- Fund Balance with Treasury (FBWT): The Coast Guard did not perform required reconciliations for FBWT accounts and lacked written standard operating procedures to guide the process, primarily as the result of a new financial system that substantially increased the number of reconciling differences.

- Intra-governmental Balances: Several DHS bureaus had not developed and adopted effective SOPs or established systems to track, confirm, and reconcile intra-governmental balances and transactions with their trading partners.

- Strategic National Stockpile (SNS): The SNS accounting process was fragmented and disconnected, largely due to operational challenges caused by the laws governing the SNS. A $485 million upwards adjustment had to be made to value the SNS in DHS' records properly.

- Accounts Payable and Undelivered Orders: CIS and the Bureau of Immigration and Customs Enforcement (ICE), TSA, and the Coast Guard had weaknesses in their processes for accruing accounts payable and /or reporting accurate balances for undelivered orders.

Further, KPMG identified weaknesses in the department's reporting process for the Federal Managers' Financial Integrity Act of 1982 and instances of non-compliance with the Federal Information Security Management Act. KPMG also noted instances where DHS was not in full compliance with Office of Management and Budget Circular A-133, subpart D – *Federal Agencies and Pass-Through Entities* and Appendix B, *Compliance Supplement.*

Compliance with Laws and Regulations

For agencies subject to the Chief Financial Officers' Act (CFO Act), the Federal Financial Management Improvement Act (FFMIA) requires financial statement auditors to report on compliance with it. DHS is not subject to the CFO Act, and, consequently, FFMIA; therefore, KPMG did not directly report on DHS' compliance with FFMIA. However, KPMG did report significant deficiencies in the three key areas of FFMIA: financial management systems, the application of federal accounting standards, and the recording of financial transactions at the U.S. standard general ledger level. Based on these deficiencies, if DHS were subject to FFMIA, the Office of Inspector General (OIG) would have concluded that DHS was not in substantial compliance with FFMIA. Specific areas of non-compliance are described within the material weaknesses and reportable conditions already cited.

DHS had not implemented procedures to ensure accuracy and completeness in its reporting process for the Federal Managers' Financial Integrity Act (FMFIA). FMFIA, as implemented by OMB Circular A-123, *Management Accountability and Control,* requires agencies to report on an annual basis material weaknesses in their controls and plans to correct those weaknesses. KPMG noted that DHS did not report some material weaknesses identified in the *Independent Auditors' Report*, nor corrective actions plans for all material weaknesses. KPMG also noted some timeliness and consistency issues between the bureaus and DHS headquarters.

KPMG found weaknesses across DHS in its entity-wide information security program management and in controls over system access, application software development, system software, segregation of duties, and service continuity. These weaknesses represent instances of non-compliance with the Federal Information Security Management Act, which requires agencies to provide information security for their systems. Because of the importance of system security, I am providing more details of these findings later in this testimony.

KPMG also noted that certain cost-share analyses and follow-up were not performed when the percentage of cost share funds paid/unpaid was greater than 20 percent. This is required under OMB Circular A-133, subpart D – *Federal Agencies and Pass-Through Entities* and Appendix B, *Compliance Supplement.*

Corrective Action Plans

Because DHS is not subject to FFMIA, it is not required to submit an FFMIA mandated remediation plan to OMB. However, DHS has a corrective action plan covering all of the bureaus that, we are told, is near completion. Many of these weaknesses will not be fully addressed until the department and its bureaus implement information technology (IT) system solutions. OIG will be working closely with DHS officials to ensure that remedial actions are timely and complete.

Audit Challenges Faced in 2003

The challenges of this audit were several. First, the mid-year and mid-quarter creation of DHS made it difficult to get good cut-off balances as of March 1, 2003; that is, beginning balances for DHS. Beginning balances are needed to audit successfully activity over a period of time. Many of DHS' bureaus had to reconstruct their balance sheets as of March 1, 2003, which was outside of their normal reporting periods. The bureaus mostly succeeded in this task; however, in the case of the Coast Guard, difficulties in conducting the audit, as described in the next paragraphs, caused KPMG to run out of time to complete its audit procedures in this area. This was a contributing factor to KPMG's inability to opine on the DHS' consolidated statement of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing, which I will refer to as "activity statements" for the purpose of this testimony. One of the results of this beginning balance work, though, is that it helped the bureaus and programs ensure a more complete and accurate documentation of the transfer of assets, liabilities, and budgetary authorities into DHS, which were then compared for consistency with transfers out by the legacy agencies.

Second, the Coast Guard is proportionally a larger bureau within DHS compared to the Department of Transportation, its legacy parent department. This brought with it proportionally more scrutiny during our audit, something for which the Coast Guard was not fully prepared. Its financial reporting processes were inefficient and complex. Because the Coast Guard had never received an audit opinion on its own financial statements (although its financial information received audit coverage specific to its legacy department's financial statement audit), auditing standards required KPMG to test certain Coast Guard balances related to prior years. The Coast Guard had not maintained certain documentation needed to support the valuation and existence of PP&E in the net amount of $2.9 billion out of total net balance of $9.1 billion at the DHS consolidated level. Much of the $2.9 billion related to PP&E acquired prior to 1996, just when departments were starting to implement reform legislation requiring audited financial statements. Nevertheless, auditing standards required us to seek objective evidence, including estimates using documented and acceptable methodologies, to support this balance. Because the Coast Guard could not provide sufficient documentation, KPMG qualified its opinion on the balance sheet for the $2.9 billion.

The Coast Guard also had significant weaknesses related to OM&S. The Coast Guard maintains OM&S primarily as inventory to support its fleet of ships and aircraft. Because of poor controls at field sites over physical counts (procedures that verify the existence and completeness of inventory), KPMG could not validate the valuation of $497 million out of $1.2 billion net OM&S, inventory, and stockpile balance at the DHS consolidated level. Auditing standards require auditors to observe physical counts of inventories as part of its validation procedures. KPMG attempts to observe inventory procedures were made difficult in some cases because of ships being out to sea, or the Coast Guard being unable to resolve differences between the physical counts and the accounting records.

Third, financial reporting at the consolidated level in particular was a challenge. Although the large bureaus came into DHS with financial reporting mechanisms in place, those processes had to be created at the consolidated level. DHS was fortunate to be able to use the Department of the Treasury's *Treasury Information Executive Repository* (TIER), a data warehouse that collects DHS bureaus' financial information, interfaces with other software, and supports preparation of DHS consolidated and individual bureau financial statements. Difficulties in using TIER, however, prevented DHS from preparing timely and accurate periodic consolidated financial statements. Most bureau financial systems were not electronically interfaced with TIER, and bureaus had to configure their systems and processes to meet TIER submission requirements. As a result, errors occurred. TIER is a temporary system solution until a permanent financial reporting system architecture for DHS can be developed and implemented.

The OCFO is responsible for the preparation of consolidated financial statements using TIER. The OCFO operated with relatively few finance personnel, who principally served to coordinate financial management policy and consolidate financial information submitted by the bureaus. The OCFO had not established a hierarchy of financial reporting authority, or an entity-wide financial management organization chart that clearly defined roles and responsibilities and assisted with the identification of critical human resources needed to ensure that all financial management responsibilities were assigned. The OCFO had not developed SOPs that would result in consolidated financial reports that are consistent, timely, accurate, and in compliance with federal accounting standards. These conditions were not unexpected for a newly created organization, especially one as large and complex as DHS. Nevertheless, the problems associated with TIER, the lack of clear DHS-wide organizational roles and responsibilities and SOPs, and the insufficient number of qualified personnel or contractors at the OCFO would continue to make complying with financial reporting requirements difficult.

Audit Challenges for 2004

For FY 2004 OMB has accelerated the reporting deadline for audited financial statements and the *Performance and Accountability Report* to November 15, two and a half months earlier than last year's deadline. Meeting this date will be a considerable challenge for DHS.

Many of the financial reporting challenges that DHS faces stem from its still recent creation from 22 disparate agencies. Although DHS has reduced the number of accounting service providers from 19 to 10, reporting processes remain complicated, and financial managers continue to spend considerable time on transitional issues.

One of the greatest transitional challenges DHS has faced this year is the realignment of back office functions at ICE, CBP, and CIS that took place at the start of FY 2004. Nine months into the fiscal year, many agreements regarding intra-bureau services that are being provided between the bureaus are not in place, leaving many accounting issues open. The CFO recently reported progress in this area, but time is short to clear up the accounting issues in this fiscal year. Also, as part of this realignment, ICE took over accounting responsibilities for several other DHS components, several of which were previously serviced by legacy agencies. This has taxed ICE's accounting resources, which already had been taxed by significant staff attrition in the last year.

As noted in last year's audit report, weaknesses in financial systems complicate the financial reporting process. There is not an integrated system to consolidate financial information from the bureaus, so in many instances a manual interface is necessary, and changes, corrections, and reconciliations are more difficult. Financial managers' time also has been taken up closing temporary accounts used in FY 2003 to help get DHS off the ground. Transitioning these accounts into permanent account structures is another task unique to DHS that has claimed a portion of its limited resources.

Because the *Performance and Accountability Report* was issued in February, DHS had little time to take corrective action on the material weaknesses and reportable conditions reported last year before it entered the FY 2004 audit cycle. To the extent that these weaknesses remain, they will continue to make preparation of the financial statements and the auditing of them more difficult. The accelerated reporting date requires a new audit approach that relies more heavily on internal controls and systems and earlier audit testing.

Another challenge for DHS is its cost accounting processes. The financial systems that DHS components brought with them from their legacy agencies were designed to summarize financial information for the purposes of those legacy agencies. Summarizing cost information by DHS' new priorities – its strategic goals – is very difficult, and makes compilation of DHS' Statement of Net Cost a challenge.

Finally, key milestones for this audit are approaching fast. July will be a crucial month because this is when balance testing must begin. It will be difficult for DHS and the auditors to overcome any significant problems that remain beyond July. The lack of sufficient staff, particularly in the OCFO and ICE, to deal with these problems and others that may arise is another of the major challenges DHS financial management faces.

Revenue Collection

CBP is not only responsible for border security and narcotics interdiction, it is also responsible for enforcing trade regulations and collecting associated revenues. Annually, the United States collects more than $24 billion in customs duties, excise taxes, fines, penalties and other revenue, the second largest revenue source after income taxes. While it is paramount that DHS ensure that the nation's ports are secure from terrorist activities, it is also important that the revenue base is protected.

CBP's Compliance Measurement Program targets importers to assess trade compliance and project the revenue base, along with the associated revenue gap. The revenue gap is the difference between the dollar amount of import duties, taxes, and fees that CBP could have collected under current operations had all goods been entered in full compliance, and the actual amount of revenue collected by CBP. CBP estimated the revenue gap to be $170 million for FY 2003. However, the reliability of the compliance measurement data is questionable. OIG identified discrepancies in the data used to establish the compliance rate, for example, import data varied depending on the database accessed. Accordingly, the compliance rate may be inaccurate.

The Treasury OIG had conducted a review of CBP's international mail operations. Each year a huge volume of international mail transported by foreign postal administrators - approximately 160 million letters and parcels - enters the United States at 13 international mail branches (IMB). These IMBs are dispersed throughout the country, but are often co-located with international airports, seaports, and land ports. In addition to examining the mail for implements of terror and contraband, CBP examines the mail to identify dutiable parcels. Treasury OIG reported that information on values from the mail declarations is often inaccurate, and reliance on such information has resulted in CBP's losing revenue. CBP has taken measures to improve the collectability of mail revenue. These measures include:

(1) Using the mail survey results to target where the greatest potential for revenue in mail packages is located based on type of mail, country of origin, etc.;

(2) Revising its International Mail Operations and Enforcement Handbook to standardize operations at all IMBs, and;

(3) Monitoring incoming mail to ensure that international mail is delivered to CBP for inspection.

However, since receipt of the mail at the IMB is the primary mission of the U.S. Postal Service, CBP must work cooperatively with the Postal Service to ensure that all mail is delivered to CBP for inspection, and outstanding duties are collected from the Postal Service.

Both ICE and CIS perform an integral role in collecting and accounting for the more than $1 billion in application fees from non-citizens seeking entry into the U.S. In fulfilling its mission, CIS processes millions of actions and requests that are documented in paper files. The systems that track these applications are non-integrated, and many are ad hoc. As a result, CIS must perform regular data calls to obtain information on its pending application inventory, which is important in measuring performance. Also, DHS' financial statement audit found that CIS lacks standard operating procedures to track and report the status of applications and related information. The challenge for CIS is to move from paper based and non-integrated processes to an integrated case management system, which CIS is planning to implement.

CBP processes "drawback" claims on duties, taxes, and fees. A drawback is a remittance of duties, taxes, or fees previously paid by an importer, and typically occurs when the imported goods on which duties, taxes, or fees have been previously paid are subsequently exported from the U.S. or destroyed prior to entering the U.S. commerce. The Automated Commercial System (ACS), which accounts for the revenue, lacks controls to detect and prevent excessive drawback claims and payments. Also, ACS does not have the capability to compare, verify, and track essential information on drawback claims to the entries or export documentation upon which the drawback claim is based. Also, drawback review policies do not require drawback specialists to review all related drawback claims against the associated entries to determine whether, in aggregate, an excessive amount was claimed. Accordingly, CBP must rely on a manual sampling approach to compare, verify, and match entries and export documentation to drawback claims submitted by importers. As a result, the risk of fraudulent claims or claims made in error is increased.

Also, CBP is responsible for collecting user fees from air passengers and commercial vessels arriving in the U.S. as required by Consolidated Omnibus Reconciliation Act. The retailer of the passengers' tickets must collect the user fee and remit payment to CBP quarterly. The fees are designed to pay for the costs of inspection services provided by CBP, which now includes INS and the Animal and Plant Health Inspection Service (APHIS) inspection processes. CBP tracks the fees in a database and follows up with delinquent carriers. However, the list of retailers that are liable for payment cannot be reconciled with the user fees that are due. CBP has no viable method to identify all parties selling tickets subject to the fee. Accordingly, CBP cannot impose penalties on the ticket seller for not collecting the fee.

To comply with the reporting requirements of the Aviation and Transportation Security Act (ATSA), CBP mandated the use of the Advanced Passenger Information System (APIS) to target people who could threaten homeland security. However, the APIS is utilized only by the enforcement branch of CBP and the information gathered on arriving passengers, which includes the country of origin, is not shared with the financial staff responsible for collecting the user fees. CBP collects information regarding the number of passengers on each vessel by reviewing flight/ship manifest information that is entered into the Entry Clearance Arrival Record (ECAR) system. The information entered in ECAR does not include information regarding country of origin, and thereby does not specify the fee required from the passenger. As a result, CBP may not be collecting all the passenger user fees mandated by law from people entering the U.S.

Between Fiscal Year 1998 and 2002, the former Customs Service collected $1.1 billion from the airlines. Now that CBP's inspection workforce has expanded to include INS and APHIS inspection services, it important that CBP ensure that the appropriate revenues are collected and are adequate to cover the costs of services provided.

Similarly, TSA is also required by statute to impose a fee on passengers of air carriers and may impose a fee on air carriers for the difference between TSA's costs of providing civil aviation security services, and the amount of passenger fees collected. These fees are designed to pay for the costs of providing civil aviation security services including: costs of screening personnel and their supervisors; equipment; federal law enforcement officers, and civil aviation security research and development. TSA should also ensure that the appropriate revenues are collected and are adequate to cover the costs of services provided.

Contracts Management

A major challenge for DHS has been the identification and management of its procurements (the "procurement universe"). Although the department inherited procurement responsibility for 22 incoming organizations, only 7 procurement shops came into DHS. The remaining 15 components were receiving procurement services from organizations outside of the department, limiting the department's ability to apply effective and consistent oversight to its procurements. In addition, the Chief Procurement Officer has not been granted the authority to realign existing procurement resources to meet the procurement service needs of all 22 components better. Under these circumstances, the department has struggled even to prepare a detailed and accurate listing of its procurement universe. The data the department has received to date has come from 22 different sources and has not been independently validated. For example, FEMA discovered that it had not been reporting or tracking procurements let by its disaster field offices. Although efforts are under way to bring all department procurements under the umbrella of one comprehensive reporting system, data for fiscal years 2003 and 2004 have not been reported in detail sufficient to manage the procurement universe. DHS needs to integrate the procurement functions of its component organizations to ensure that good management controls are consistently applied.

Several of the incoming procurement organizations lacked important management controls. For example, during its first year of operation, TSA relied extensively on contractors to accomplish its mission, while providing little contract oversight. Contracts were written without clearly defined deliverables, were not modified to reflect changed circumstances, and, in some circumstances, TSA failed to provide a basis for assessing contractors' performance. As a result, the cost of some contracts ballooned. For example, TSA made major changes to its screener recruitment contract without performing trade-off studies or cost benefit analysis. The ceiling for that contract rose from $104 million to $741 million. TSA also did not follow sound practices in awarding and administering a contract for the installation and maintenance of Explosives Detection Systems and Explosives Trace Detection Systems. As a result, TSA paid contract fees based on a percentage of total invoiced costs, which had the effect of creating a cost-plus-a-percentage-of-cost type contract. This type of contract is prohibited in the federal government. TSA also paid more than $44 million in award fees without adequate evaluation of the contractor's performance, and paid the contractor a profit that was disproportionately high when compared to the contractor's cost and risk and compared to what other agencies allow as profit under such contracts.

TSA has since devised policies and procedures that require adequate procurement planning, contract structure, and contract oversight. For example, TSA has established a contract management team that closely monitors the work of its current personnel recruitment contractors. This team is responsible for all activities related to inspection of contractor's performance and documenting compliance with contract provisions, including tracking cost and schedule performance. Their oversight activities include a formal monthly program review to gauge programmatic success and identify issues. TSA intends to establish similar contract management teams for each of its major programs.

Other bureaus have large, complex, and high-cost procurement programs under way that need to be closely managed. For example, CBP's Automated Commercial Environment (ACE) system project will cost $5 billion, and the Coast Guard's Deepwater Capability Replacement Project will cost $17 billion and take two to three decades to complete. Further, the department recently awarded a contract for the development of United States Visitor and Immigrant Status Indication Technology System (US-VISIT). US-VISIT is an automated system for tracking and controlling the entry and exit of all aliens by air, land, and sea ports of entry. US-VISIT will be up to a $10 billion dollar program implemented over the next ten years. DHS OIG will be reviewing these major procurements on an ongoing basis.

Grants Management

DHS inherited a variety of grant programs that provide money for disaster preparedness, response, and prevention. Significant shortcomings had been identified in many of these programs in the past, and the potential for overlap and duplicate funding has grown as the number of grant programs has grown. For example, DHS OIG's report on the Assistance to Firefighters Grant Program (OIG-ISP-01-03, September 2003) pointed out that many items authorized for purchase under the program are also authorized for purchase under the State Homeland Security Grant Program. In addition, preparedness grant programs were located in different DHS directorates, creating challenges related to intra-departmental coordination, performance accountability, and fiscal accountability. Furthermore, DHS program managers need to develop meaningful performance measures to determine whether the grant programs have actually enhanced state and local capabilities to respond to terrorist attacks and natural disasters.

DHS has made significant strides in this area, particularly in consolidating the preparedness grant programs. However, problems remain, and means must be found to ensure that first responder funds are being used effectively and getting to those who need them in a timely manner. OIG's March 2004 report (OIG-04-15) on distributing and spending first responder grant funds identified a number of reasons for delays in getting equipment and training into the hands of first responders. ODP has begun taking actions recommended in the report.

OIG continues to audit individual disaster assistance grants awarded by FEMA to states and sub-awarded to local governments. We have reported on 121 such audits since March 1, 2003, and questioned $68 million in claimed grant costs. An important byproduct of those audits is that we identify recurring problems, such as repeated instances of FEMA's not enforcing regulations designed to ensure managerial control over grant funding. For example, state and local subgrantees often ignore the requirement that they get written approval from FEMA before continuing with public assistance projects that are going to cost more or take more time to complete than estimated at the time FEMA initially approved the project. Often, when FEMA closes the grant and discovers this rule violation, it retroactively approves the increases with no consequence to the grantee or subgrantee. Ignoring such regulations increases the risk of waste, fraud, and abuse.

Consolidation of Preparedness Grants

DHS consolidated two offices, the Office of Domestic Preparedness and the Office of State and Local Government Coordination, into the Office of State and Local Government Coordination and Preparedness. The new office addresses the need to locate all DHS terrorism grant programs in a single office and eliminate the inefficiency resulting from similar grant programs located in separate organizational units. When the reorganization is completed, the office will include 25 DHS grant programs and will provide a "one-stop shop" for DHS terrorism preparedness grants. OIG applauds this effort.

In addition, DHS established a Grant Council that provides a forum for senior DHS financial assistance officials to work together. The Council is intended to address issues affecting DHS financial assistance mechanisms (grants, cooperative agreements, reimbursable agreements and other types of assistance) to meet the common needs of organizational elements, and to develop and implement short term and long term goals for the DHS grants management system. The Council is intended to address innovative approaches to promote effective business practices and ensure the timely delivery and proper stewardship of DHS grants. OIG supports this effort and participates in an advisory role.

DHS Grants Management System

DHS is making progress in developing an integrated grants and financial management system. Grants are still being processed outside the department under memoranda of understanding with other federal agencies. However, the department is developing an integrated grant and financial management system, known as "eMerge2" (electronically managing enterprise resources for government effectiveness and efficiency), which is scheduled for implementation by September 2006. The Office of Grant Policy and Oversight, which reports to the Chief Procurement Officer, and several DHS major grant-awarding offices, have been involved in the development of this system, but the primary responsibility for its development and implementation resides with the DHS Resource Management Transformation Office.

The department has updated the Catalog of Federal Domestic Assistance to reflect the assistance programs that were either transferred from the 22 federal agencies or developed as a result of congressional direction and new funding. Also, the department has created internal and external websites to provide updated information on grant activities. OIG will continue to monitor DHS' progress.

Information Technology

Systems Integration

DHS organizational elements have over 100 disparate, redundant, and non-integrated systems used to support a range of administrative functions, such as accounting, acquisition, budgeting, and procurement. Because of the lack of standardization and systems interoperability in the current environment, many of these activities are tedious, manual, and burdensome. The eMerge2 program is intended to address these issues by implementing DHS-wide enterprise solutions to increase efficiency and effectiveness significantly while optimizing investments. Based upon recent OIG discussions with management officials, the program is on schedule in the design and acquisition phase, requirements have been identified, and a request for proposals has been issued for enterprise-wide solutions to meet mission requirements.

Further, the CIO must ensure that individual technology investments are aligned with an overarching, department-wide framework for IT. To this end, the CIO has a stated goal of implementing "one network, one infrastructure" by December 2005. To establish the network, the CIO has set up an Enterprise Infrastructure Board that meets periodically to discuss strategies for connecting DHS networks, which include local area networks, metropolitan area networks, and wide area networks. The Enterprise Infrastructure Board is comprised of a number of project teams, such as the Network Security Board, which is tasked with implementing an initiative to institute the firewalls, routers, switches, and other technologies needed to secure the DHS networks. DHS is enhancing ICE's backbone to create the department-wide network that establishes data communications among all of its organizational elements.

With release of the first version of an enterprise architecture in September 2003, the CIO has also made progress toward the goal of one DHS infrastructure. In December 2003, enterprise architecture officials in the CIO's office told OIG that the department had not yet issued a request for proposal to implement the enterprise architecture. Version 1 of the document outlines a general transition strategy, but it must be detailed further for the architecture to be implemented. Work is currently under way on version two of the enterprise architecture. One of the objectives of the DHS enterprise architecture team is to make the transition strategy in version 2 more detailed and easier to implement.

Information Technology Controls

A key aspect of the financial statement audit was the assessment of DHS IT general controls, as IT systems significantly facilitate DHS' financial processing activities and maintain important financial data. Controls over IT and related financial systems are essential elements of financial reporting integrity. Effective general controls in an IT and financial systems environment are typically defined in seven key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, service continuity, and system functionality. In addition to reliable controls, federal financial management system functionality is important to program monitoring, increasing accountability of financial and program managers, providing better information for decision making, and increasing the efficiency and effectiveness of services provided by the federal government.

KPMG found weaknesses at each bureau across all IT general control areas. Collectively, these weaknesses limited DHS' ability to ensure that critical financial and operational data was maintained in such a manner to ensure confidentiality, integrity, and availability. In addition, these weaknesses negatively affected the internal controls over DHS financial reporting and its operation, and KPMG considered them collectively to represent a material weakness, as mentioned earlier.

The challenge of merging numerous entities into DHS has been a key contributing factor to these weaknesses. These various entities have had their own IT functions, controls, and processes. DHS has taken some steps to begin addressing these issues, such as implementing the *Information Technology Security Program Publication*, which contains many requirements for maintaining a DHS-wide information security program. In addition, DHS is currently designing a department-wide IT architecture, as mentioned above. Until the architecture is complete and the related IT infrastructure, controls, and processes are implemented, DHS' IT control environment will continue to consist primarily of the IT processes and controls in place at the entities that were consolidated into DHS.

We believe that to address these weaknesses DHS needs to design and implement DHS-wide policies and procedures related to IT controls, and to ensure that the policies and procedures are enforced through the performance of periodic control assessments and audits. Focus should be aimed at implementing and enforcing a DHS-wide security certification and accreditation (C&A) program, and IT training for administrators and users. Many of the technical issues identified during this review, such as weak technical security controls and the lack of contingency planning strategies, can be addressed through an effective C&A and training program.

Conclusion

Mr. Chairman, this concludes my prepared statement. Please be assured that our office will continue to place a high priority on financial management issues. Again, I appreciate your time and attention and welcome any questions you or members of the subcommittee might have.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Financial Management, the Budget, and International Security, Committee on Governmental Affairs, U.S. Senate

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DEPARTMENT OF HOMELAND SECURITY

Financial Management Challenges

Statement of McCoy Williams, Director
Financial Management and Assurance

GAO
Accountability * Integrity * Reliability

GAO-04-945T

July 8, 2004

GAO
Accountability-Integrity-Reliability

Highlights

Highlights of GAO-04-945T, a testimony before the Subcommittee on Financial Management, the Budget, and International Security, Committee on Governmental Affairs, U.S. Senate

DEPARTMENT OF HOMELAND SECURITY

Financial Management Challenges

Why GAO Did This Study

The Homeland Security Act of 2002 brought together 22 agencies to create a new cabinet-level department focusing on reducing U.S. vulnerability to terrorist attacks, and minimizing damages and assisting in recovery from attacks that do occur. GAO has previously reported on the Department of Homeland Security's (DHS) financial management challenges and key elements necessary for reform.

DHS continues to be faced with significant financial management challenges, including addressing existing internal control weaknesses and integrating redundant inherited financial management systems. Additionally, DHS is the largest entity in the federal government that is not subject to the Chief Financial Officers (CFO) Act of 1990 or the Federal Financial Management Improvement Act (FFMIA) of 1996.

In light of these conditions, the Subcommittee asked GAO to testify on the financial management challenges facing DHS.

www.gao.gov/cgi-bin/getrpt?GAO-04-945T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at (202) 512-6906 or williamsm1@gao.gov.

What GAO Found

One of the challenges DHS faces is obtaining an unqualified financial statement audit opinion and fixing the previously identified internal control weaknesses that the department inherited from component agencies, as well as newly identified weaknesses. Component agencies took action to resolve 9 of the 30 internal control weaknesses DHS inherited, while 9 of the inherited weaknesses were combined and reported as material weaknesses in DHS's first Performance and Accountability Report and 5 were reported as reportable conditions. The remaining 7 inherited weaknesses were classified as observations and recommendations to management. In addition, improper payments, a significant and widespread challenge facing the federal government, can typically be traced to a lack of or breakdown in internal control. DHS would be remiss to not pay adequate attention to developing a strong internal control environment at the department.

According to DHS officials, the department is in the early stages of acquiring a financial enterprise solution to consolidate and integrate its financial accounting and reporting systems. Similar projects have proven challenging and costly for other federal agencies. For example, efforts at the National Aeronautics and Space Administration failed to meet the needs of users and key stakeholders. To avoid similar problems, DHS must ensure commitment and extensive involvement from top management and users in the financial system development and integration.

Currently, DHS is the only cabinet-level department in the federal government that is not subject to the CFO Act. As such, this department, with a fiscal year 2004 budget of nearly $40 billion and more than 180,000 employees, does not have a presidentially appointed CFO subject to Senate confirmation and is not required to comply with the requirements of FFMIA. DHS should not be the only cabinet-level department not covered by what is the cornerstone for pursuing and achieving the requisite financial management systems and capabilities in the federal government. S. 1567 would, among other things, amend the CFO Act to (1) add DHS as a CFO Act agency, and (2) require DHS to obtain an audit opinion on its internal controls. Enactment of this legislation will increase the likelihood that the financial management challenges at DHS will be overcome.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss financial management challenges facing the Department of Homeland Security (DHS). When DHS began operations in March 2003, it faced the daunting task of bringing together 22 diverse agencies. Not since the creation of the Department of Defense in the 1940s had the federal government undertaken a transformation of this magnitude. Because of the challenges and risks associated with the transformation and implementation of DHS, the sheer size of the undertaking, and the prospect of serious consequences for the nation should DHS fail to adequately address its management challenges and risks, GAO designated the transformation and implementation of DHS high-risk in January 2003.[1] Our high-risk program, established in 1990, has helped the executive branch and the Congress to galvanize efforts to seek lasting solutions to high-risk problems and challenges.

As we previously reported,[2] DHS faces significant financial management challenges, including (1) addressing the existing and newly identified internal control weaknesses in the inherited components, and (2) integrating a myriad of redundant financial management systems. Enactment of the Department of Homeland Security Financial Accountability Act (S. 1567) will enhance DHS's chances for overcoming these challenges.

DHS, like other federal agencies, has a stewardship obligation to prevent fraud, waste, and abuse; to use tax dollars appropriately; and to ensure financial accountability to the President, the Congress, and the American people. Management must establish effective internal controls to safeguard assets, protect revenue, and make authorized payments. Unfortunately, improper payments are a widespread and significant problem receiving increased attention in the federal government. Improper payments occur for many reasons including insufficient oversight or monitoring, inadequate benefits eligibility controls, and automated system deficiencies. However, based on our previous work, one point is clear, the basic or root causes of improper payments can typically be traced to a lack of or breakdown in internal control. While DHS was not required to report improper payments for fiscal year 2003, several of its inherited weaknesses clearly suggest risk for improper payments and loss of revenue. DHS, as it addresses inherited material weaknesses and integrates its business functions, should pay close attention to implementing strong internal controls.

For the most part, DHS's component entities are using legacy financial management systems that have a myriad of problems, such as disparate, nonintegrated, outdated, and inefficient systems and processes. DHS will need to focus on building future systems as

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[1]U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003).

[2]For example, see U.S. General Accounting Office, *Major Management Challenges and Program Risk: Department of Homeland Security*, GAO-03-102 (Washington, D.C.: January 2003) and *Department of Homeland Security: Challenges and Steps in Establishing Sound Financial Management*, GAO-03-1134T (Washington, D.C.: Sept. 10, 2003).

part of its enterprise architecture approach to ensure an overarching framework for the agency's integrated financial management processes. Plans and standard accounting policies and procedures must be developed and implemented to integrate the various financial management environments under which inherited agencies operate so that DHS can produce useful and timely financial information.

Currently, DHS is the only cabinet-level department in the federal government that is not subject to the Chief Financial Officers (CFO) Act of 1990.[3] As such, this department, with a fiscal year 2004 budget of nearly $40 billion and more than 180,000 employees, does not have a presidentially appointed CFO subject to Senate confirmation and is not required to comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).[4] The goals of the CFO Act and related financial reform legislation, such as FFMIA, are to provide the Congress and agency management with reliable financial information for managing and making day-to-day decisions and to improve financial management systems and controls to properly safeguard the government's assets.

S. 1567, as passed by the Senate on November 21, 2003, would, among other things, amend the CFO Act to (1) add DHS as a CFO Act agency, and (2) require DHS to obtain an audit opinion on its internal controls. While DHS's CFO has testified that the department complies with the audit provisions of the CFO Act and will continue to do so, we believe DHS should not be the only cabinet-level department not covered by what is the cornerstone for pursuing and achieving the requisite financial management systems and capabilities in the federal government. While this administration has voluntarily complied with some provisions of the CFO Act, making DHS subject to the CFO Act through enactment of S. 1567 would assist the department in facing and overcoming the financial management challenges it faces and legislate future compliance with the important provisions of the CFO Act and related legislation.

The perspectives we offer in this testimony are derived from work completed by us, inspectors general, independent auditors, as well as from executive guidance and testimony related to financial management and DHS.

Addressing Internal Control Weaknesses

DHS faces the challenge of correcting the previously identified material weaknesses that the agencies brought with them to DHS, as well as addressing newly identified weaknesses from DHS's first financial statement audit and obtaining an unqualified or "clean" audit opinion. I will first highlight the results of DHS's first financial statement

[3]Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990).

[4]FFMIA, Pub. L. No. 104-208, div. A, §101(f), title VIII, 110 stat. 3009, 3009-389 (Sept. 30, 1996). FFMIA requires the major departments and agencies covered by the CFO Act to implement and maintain financial management systems that comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the federal government's standard general ledger at the transaction level.

audit and then I will discuss some of DHS's internal control weaknesses. Finally, as you requested, I will include in my statement today a brief discussion of the growing governmentwide problem of improper payments.

On its first financial statement audit, for the 7-month period from March 1, 2003, to September 30, 2003, DHS received a qualified opinion from its independent auditors on its consolidated balance sheet as of September 30, 2003, due in part to the auditors' inability to determine if certain asset balances reported by the U.S. Coast Guard were fairly presented. In addition, auditors were unable to opine on the consolidated statements of net costs and changes in net position, combined statement of budgetary resources, and consolidated statement of financing. The disclaimer on these statements was due to the auditor's inability to observe certain inventory counts at Coast Guard, among other things. In addition, the auditors reported numerous internal control weaknesses, which I would now like to discuss.

Collectively, internal controls are an integral component of an organization's management that provides reasonable assurance that the organization achieves its objectives of (1) effective and efficient operations, (2) reliable financial reporting, and (3) compliance with laws and regulations. Internal controls are not one event, but a series of actions and activities that occur throughout an entity's operations and on an ongoing basis. When DHS was formed from 22 component agencies, there were 30 identified internal control weaknesses that DHS inherited. Component agencies took action to resolve 9 of these 30 weaknesses. These actions included reinstating procedures to accurately estimate financial data, performing risk assessments of major systems, and instituting processes to ensure accounts receivable and fixed assets are properly recorded. Of the remaining 21 weaknesses,

- 9 were combined and reported as material weaknesses,[5]
- 5 were combined and reported as reportable conditions,[6] and
- 7 weaknesses were classified by the department's independent auditors as observations and recommendations.[7]

DHS's independent auditors reported 6 new internal control weaknesses as of September 30, 2003, bringing the total number of DHS reportable conditions to 14—7 of which are considered to be material weaknesses. These weaknesses included the lack of procedures at DHS to verify the accuracy and completeness of balances transferred on

[5]A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to the stewardship information would be prevented or detected on a timely basis.

[6]Reportable conditions are matters coming to auditor's attention that, in their judgment, should be communicated because these represent significant deficiencies in the design or operation of internal control that could adversely affect the federal government's ability to meet the internal control objectives.

[7]Observations and recommendations are weaknesses that do not meet the criteria for reportable conditions that are typically communicated from the auditor to the appropriate level of entity management in a management letter.

March 1, 2003, and significant weaknesses with the number of qualified financial management personnel employed by the department.

While DHS has taken steps to resolve some of the internal control weaknesses it inherited from component agencies, continued focus on resolving weaknesses and developing strong internal controls cannot be understated. For example, increased attention has recently been paid to the prevalence of improper payments in the federal government. Improper payments occur for many reasons including insufficient oversight or monitoring, inadequate eligibility controls, and automated system deficiencies. However, based on our previous work, the basic or root causes of improper payments can typically be traced to a lack of or breakdown in internal control.

Improper payments include inadvertent errors, such as duplicate payments and miscalculations; payments for unsupported or inadequately supported claims; payments for services not rendered; payments to ineligible beneficiaries; and payments resulting from outright fraud and abuse by program participants and/or federal employees. In 2003, the first year certain agencies were required by the Office of Management and Budget to publicly report their improper payments, 15 agencies reported estimates of improper payments exceeding $35 billion. We have included in appendix I, a summary of improper payment estimates agencies reported in fiscal year 2003.

Additionally, I would like to highlight a few specific examples of financial management challenges DHS faces.

Federal Emergency Management Agency (FEMA)

We recently performed a review of FEMA's property management. One of our objectives was to determine whether controls were in place to ensure that property acquired during the 5 months prior to FEMA transferring its functions to DHS was properly accounted for in the property management system.[8] We found that FEMA continued to lack the controls and key information necessary to ensure that personal property is properly accounted for. For example, its property management systems do not share common data identifiers such as serial numbers or purchase order numbers. Without these data, we were unable to perform certain tests to conclude whether or not FEMA properly accounted for property it acquired prior to transferring to DHS. Considering that FEMA reported approximately $355 million in property, of which approximately 67 percent is considered sensitive and thus more susceptible to theft or pilferage, strong internal controls over its property systems are needed. Absent integrated or adequately interfaced financial management systems with the key information necessary to track and account for property, FEMA's property is vulnerable to loss or misappropriation and there is an increased risk that property could have been purchased and not recorded in FEMA's personal property systems.

[8]Prior to its transfer to DHS, FEMA was 1 of the 24 CFO Act agencies.

Customs

Despite the former U.S. Customs Service's progress in implementing recommendations we have made regarding the development of Customs' planned import system, the Automated Commercial Environment (ACE),[9] numerous weaknesses remain. ACE is intended to replace the current system used for collecting import-related data and ensuring, among other things, that trade-related revenue is properly collected and allocated. To ensure proper implementation of these initiatives, DHS's management must continue to provide a sustained level of commitment to its successful implementation. Until this system is fully implemented, billions of dollars annually in trade-related revenue will continue to be tracked by systems with inadequate controls, leaving it increasingly susceptible to inaccurate reporting.

Coast Guard

Concerns have been reported regarding the Coast Guard's Deepwater Procurement Project (Deepwater), which began in 2002 and currently has an estimated cost of $17 billion over 20 years—the largest in Coast Guard's history.[10] It is intended to replace or modernize by 2022 all assets used in missions that generally occur offshore. However, it is already difficult to determine the degree to which the Deepwater project is on track with regard to its original acquisition schedule because the Coast Guard has not maintained and updated its acquisition schedule. The absence of an up-to-date acquisition schedule is a concern because it raises some question as to whether the acquisition is being adequately managed and whether the government's interests are being properly safeguarded. Further, a recent disclosure that, just a few years into the acquisition, costs have risen by $2.2 billion indicates the need for a clear understanding of what assets are being acquired, when they are being acquired, and at what cost. The high cost and long-term needs of the Coast Guard coupled with the absence of an up-to-date acquisition schedule early in the project should make financial management of the Deepwater project a key priority of DHS in order to prevent the project from greatly exceeding cost estimates and ensure program goals are met.

Integrating Financial Systems

Another significant challenge for DHS is developing a financial management architecture with integrated systems and business processes. According to DHS officials, the department is in the early stages of acquiring a financial enterprise solution to consolidate and integrate the department's financial accounting and reporting systems, including budget, accounting and reporting, cost management, asset management, and

[9]U.S. General Accounting Office, *Customs Service Modernization: Automated Commercial Environment Progressing, but Further Acquisition Management Improvements Needed*, GAO-03-406 (Washington D.C.: Feb. 28, 2003).

[10]U.S. General Accounting Office, *Coast Guard: Deepwater Program Acquisition Schedule Update Needed*, GAO-04-695 (Washington D.C. June 14, 2004).

acquisition and grants functions. The project, which DHS has termed *"electronically Managing enterprise resources for government effectiveness and efficiency" (eMerge²)* was initiated in August 2003, and DHS expects it to be completed in 2006 at a cost of approximately $146 million.

While DHS is early in the process of acquiring an integrated financial enterprise solution, similar projects have proven challenging and costly for other federal agencies, such as the testimony on the Department of Defense provided today by my colleague.[11] Additionally, we have reported on the efforts of National Aeronautics and Space Administration[12] (NASA) to acquire new information systems. NASA is on its third attempt in 12 years to modernize its financial management process and systems, and has spent about $180 million on its two prior failed efforts. One of the key impediments to the success of integration efforts at NASA was the failure to involve key stakeholders in the implementation or evaluation of system improvements. As a result, new systems failed to meet the needs of key stakeholders. To avoid similar problems, DHS must ensure commitment and extensive involvement from top management and users in the financial system development and integration.

Additionally, over the past year, DHS has reported that it has reduced the number of its financial management service providers from the 19 at the time DHS was formed to the 10 it currently uses. DHS has plans to further consolidate to 7 providers. A DHS official estimated approximately $5 million in savings through the reduction of the number of financial management service centers.

Homeland Security Financial Accountability Act—S. 1567

I would now like to talk about why we support the Homeland Security Financial Accountability Act (S. 1567).[13] S. 1567 as introduced by you on August 1, 2003 and passed by the Senate on November 21, 2003, would, among other things, amend the CFO Act to (1) add DHS as a CFO Act agency and (2) require DHS to obtain an audit opinion on its internal controls. Enactment of this legislation will increase the likelihood that the challenges discussed earlier in my testimony will be overcome.

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[11]U.S. General Accounting Office, *Department of Defense: Financial and Business Management Transformation Hindered by Long-standing Problems*, GAO-04-941T (Washington, D.C.: July 8, 2004).

[12]U.S. General Accounting Office, *Information Technology: Architecture Needed to Guide NASA's Financial Management Modernization*, GAO-04-43 (Washington, D.C.: Nov. 21, 2003) and U.S. General Accounting Office, *National Aeronautics and Space Administration: Significant Actions Needed to Address Long-standing Financial Management Problems*, GAO-04-754T (Washington, D.C.: May 19, 2004).

[13]The U.S. House of Representatives is considering a related bill with similar provisions, the Department of Homeland Security Financial Accountability Act, H.R. 4259.

Inclusion of DHS as a CFO Act Agency

We strongly supported passage of the CFO Act in 1990 and continue to strongly support its objectives of (1) giving the Congress and agency decision makers reliable financial, cost, and performance information both annually and, most important, as needed throughout the year to assist in managing programs and making difficult spending decisions; (2) dramatically improving financial management systems, controls, and operations to eliminate fraud, waste, abuse, and mismanagement and properly safeguard and manage the government's assets; and (3) establishing effective financial organizational structures to provide strong leadership. Achieving these goals is critical for establishing effective management of any enterprise. We have seen unprecedented progress in improving federal financial management that has resulted since passage of the CFO Act and we strongly support amending the CFO Act to include DHS.

The CFO Act requires the agency's CFO to develop and maintain an integrated accounting and financial management system that provides for complete, reliable, and timely financial information that facilitates the systematic measurement of performance at the agency, the development and reporting of cost information, and the integration of accounting and budget information. The CFO is also responsible for all financial management personnel and all financial management systems and operations, which in the case of DHS would include the component CFOs and their staff. The CFO is responsible for asset management as well. The act also requires that the agency's CFO be qualified, appointed by the President, approved by the Senate, and report to the head of the agency. With the size and complexity of DHS and the many significant financial management challenges it faces, it is important that DHS's CFO is qualified for the position, displays leadership characteristics, and is regarded as top management. Appointment of the CFO by the President, subject to Senate confirmation, is one way to ensure that the intent of the law is met. Currently, the CFO at DHS reports to the Under Secretary for Management while directorate CFOs report to the head of their respective directorates, not to DHS's CFO. Making DHS subject to the CFO Act would assist the department in facing and overcoming the financial management challenges inherent in its formation and others that have come to light since its formation.

Under the Accountability of Tax Dollars Act of 2002,[14] DHS, as an executive branch agency with budget authority greater than $25 million, is required to obtain annual financial statement audits; however, its auditors are not required to report on compliance with FFMIA. FFMIA requires that CFO Act agencies implement and maintain financial management systems that substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the U.S. Government Standard General Ledger at the transaction level. The ability to produce the data needed to efficiently and effectively manage the day-to-day operations of the federal government and provide accountability to taxpayers has been a long-standing challenge at most federal agencies.

[14]Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002).

Opinion on Internal Controls

31 U.S.C. 3512(c), (d) (commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA)) requires agencies to establish internal controls that provide reasonable assurances that:

- obligations and costs are in compliance with applicable law,
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and
- revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

FMFIA requires the head of each agency to sign a statement as to whether the agency's internal controls fully comply with the above requirements or that they do not fully comply and the reasons why they do not. In effect, this reporting is management assertion as to whether the agency's internal controls are effective.

Current OMB guidance for audits of government agencies and programs[15] requires auditor reporting on internal control, but not at the level of providing an opinion on internal control effectiveness. We have long believed and the Comptroller General has gone on record in congressional testimony[16] that auditors have an important role in providing an opinion on the effectiveness of internal control over financial reporting and compliance with laws and regulations in connection with major federal departments and agencies. For a number of years, we have provided opinions on internal control effectiveness for the federal entities that we audit because of the importance of internal control in protecting the public's interest. Specifically, we provide opinions on internal controls and compliance with laws and regulations for our audits of the U.S. government's consolidated financial statements, the financial statements of the Internal Revenue Service and Federal Deposit Insurance Corporation, the Schedules of Federal Debt managed by the Bureau of the Public Debt, and numerous small entities' operations and funds. Our reports and related efforts have engendered major improvements in internal control.

As part of the annual audit of GAO's own financial statements, we practice what we recommend to others and contract with an independent public accounting firm for both an opinion on our financial statements and an opinion on the effectiveness of our internal control over financial reporting and on compliance with laws and regulations. Our goal is to lead the way in establishing the appropriate level of auditor reporting on

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[15]Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, Bulletin 01-02 (Washington, D.C.: Oct. 16, 2000).

[16]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).

internal control for federal agencies, programs, and entities receiving significant amounts of federal funding. Additionally, three other agencies, the Social Security Administration (SSA), General Services Administration (GSA), and the Nuclear Regulatory Commission (NRC) voluntarily obtain separate opinions on internal control effectiveness from their auditors, which is commendable.

Also, publicly traded corporations recently were subjected to a requirement to disclose management attestations on corporations' internal controls and to obtain an audit opinion on those attestations. A final rule issued by the Securities and Exchange Commission that took effect in August 2003 and provides guidance for implementation of Sections 302, 404, and 906 of the Sarbanes-Oxley Act of 2002,[17] which requires publicly traded companies to establish and maintain an adequate internal control structure and procedures for financial reporting and include in the annual report a statement of management's responsibility for and assessment of the effectiveness of those controls and procedures in accordance with standards adopted by the Securities and Exchange Commission.[18] The final rule defines this requirement and requires applicable companies to obtain a report in which a registered public accounting firm issues an attestation on management's assessment of the effectiveness of internal controls over financial reporting.

Auditor reporting on internal control is a critical component of monitoring the effectiveness of an organization's accountability. GAO strongly believes that this is especially important for large, complex, or challenged entities that use taxpayer dollars. By giving assurance about internal control, auditors can better serve their clients and other financial statement users and better protect the public interest by having a greater role in providing assurances of the effectiveness of internal control in deterring fraudulent financial reporting, protecting assets, and providing an early warning of internal control weaknesses. We believe auditor reporting on internal control is appropriate and necessary for publicly traded companies and major public entities alike. We also believe that such reporting is appropriate in other cases where management assessment and auditor examination and reporting on the effectiveness of internal control add value and mitigate risk in a cost-beneficial manner.

We fully support having DHS, as well as all CFO Act agencies, obtain an opinion on its internal control. If DHS is truly committed to becoming a model federal agency, it should begin obtaining opinions on internal control as soon as practical and set an example for other agencies to follow and in keeping with the actions already taken by SSA, GSA, NRC, and GAO.

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[17]Pub. L. No. 107-204, §§302, 404, 906 116 Stat. 745, 777, 789, 806 (July 30, 2002).

[18]The Securities and Exchange Commission approved the Public Company Accounting Oversight Board's Auditing Standard Number 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*, on June 17, 2004. This guidance provides standards and related performance guidance for independent audits as they attest to, and report on, management's assessment of the effectiveness of internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002.

In closing, the American people have increasingly demanded accountability from government and the private sector. The Congress has recognized, through legislation such as the CFO Act, that the federal government must be held to the highest standards. We already know that many of the larger agencies transferred to DHS have a history of poor financial management systems and significant internal control weaknesses. These known weaknesses provide further evidence that DHS's systems and financial controls should be subject to the CFO Act and thus FFMIA. We also strongly encourage DHS to become a model agency and, as soon as practical, obtain an opinion on its internal controls and report performance information in its accountability reports.

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

Contacts and Acknowledgments

For information about this statement, please contact McCoy Williams, Director, Financial Management and Assurance, at (202) 512-6906, or Casey Keplinger, Assistant Director, at (202) 512-9323. You may also reach them by e-mail at williamsm1@gao.gov or keplingerc@gao.gov. Individuals who made key contributions to this testimony include Cary Chappell, Heather Dunahoo, Saurav Prasad, and Scott Wrightson.

Appendix I

Table 1: Improper Payment Estimates Reported in Agency Fiscal Year 2003 Performance and Accountability Reports.

1. Department of Agriculture	1. Food Stamps	$1,507,000,000
	2. Commodity Loan Programs	153,000,000
	3. National School Lunch and Breakfast	0
	4. Women, Infants, and Children	0
2. Department of Defense	5. Military Retirement Fund	33,087,000
	6. Military Health Benefits	53,484,000
3. Department of Education	7. Student Financial Assistance—Pell Grants	377,500,000
	Student Financial Assistance—non-program specific	105,000,000
	8. Title I	0
4. Department of Health and Human Services	9. Medicaid	0
	10. Medicare	11,600,000,000
	11. Head Start	0
	12. Temporary Assistance for Needy Families	0
	13. Foster Care—Title IV-E	0
	14. State Children's Insurance Program	0
	15. Child Care and Development Fund	0
5. Department of Housing and Urban Development	16. Low Income Public Housing	650,000,000
	17. Section 8 Tenant Based	1,215,000,000
	18. Section 8 Project Based	662,000,000
	19. Community Development Block Grant (Entitlement Grants, States/Small Cities)	0
6. Department of Labor	20. Unemployment Insurance	4,225,000,000
	21. Federal Employees' Compensation Act	9,055,000
	22. Workforce Investment Act	3,066,075
7. Department of Treasury	23. Earned Income Tax Credit	10,500,000,000
8. Department of Transportation	24. Airport Improvement Program	14,000,000
	25. Highway Planning and Construction	1,400,000
	26. Federal Transit—Capital Investment Grants	32,000,000
	27. Federal Transit—Formula Grants	64,000,000

9. Department of Veterans Affairs	28. Compensation	129,063,000
	29. Dependency and Indemnity Compensation	0
	30. Pension	250,535,000
	31. Insurance Programs	261,000
10. Environmental Protection Agency	32. Clean Water State Revolving Funds	.13% Reported as a rate, no amount
	33. Drinking Water State Revolving Funds	.04% Reported as a rate, no amount
11. National Science Foundation	34. Research and Education Grants and Cooperative Agreements	0
12. Office of Personnel Management	35. Retirement Program (Civil Service Retirement System and Federal Employees Retirement System)	177,300,000
	36. Federal Employees Health Benefits Program	28,200,000
	37. Federal Employees Group Life Insurance	448,000
13. Railroad Retirement Board	38. Retirement and Survivors Benefits	168,327,370
	39. Railroad Unemployment Insurance Benefits	2,778,000
14. Small Business Administration	40. 7(a) Business Loan Program	13,000,000
	41. 504 Certified Development Companies	None
	42. Disaster Assistance	0[a]
	43. Small Business Investment Companies	0[b]
15. Social Security Administration	44. Old Age and Survivors' Insurance	600,000,000
	45. Disability Insurance	340,000,000
	46. Supplemental Security Income Program	2,740,000,000
	31 of 46 agency programs reported estimated amounts	**$35,654,504,445**

Source Agency fiscal year 2003 Performance and Accountability Reports (data), GAO (analysis)
Note An "0" indicates that the agency did not report amounts for the program.

[a]SBA reported improper payment rates and amounts for certain disaster loans; it did not provide a programwide estimate of improper payments.

[b]SBA reported potential improper payment rates and amounts for certain small business investment company transactions; it did not provide a programwide estimate of improper payments.

Selected GAO Products Related DHS's Financial Management Challenges

U.S. General Accounting Office, *Department of Homeland Security: Challenges and Steps in Establishing Sound Financial Management,* GAO-03-1134T (Washington, D.C.: Sept. 10, 2003).

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).

U.S. General Accounting Office, *Customs Service Modernization: Automated Commercial Environment Progressing, but Further Acquisition Management Improvements Needed,* GAO-03-406 (Washington, D.C.: Feb. 28, 2003).

U.S. General Accounting Office, *Transportation Security Administration: Actions and Plans to Build a Results-Oriented Culture,* GAO-03-190 (Washington, D.C.: Jan. 17, 2003).

U.S. General Accounting Office, *High-Risk Series: An Update,* GAO-03-119 (Washington, D.C.: January 2003).

U.S. General Accounting Office, *Major Management Challenges and Program Risks: Federal Emergency Management Agency,* GAO-03-113 (Washington, D.C.: January 2003).

U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of the Treasury,* GAO-03-109 (Washington, D.C.: January 2003).

U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Justice,* GAO-03-105 (Washington, D.C.: January 2003).

U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Homeland Security,* GAO-03-102 (Washington, D.C.: January 2003).

U.S. General Accounting Office, *Financial Management: FFMIA Implementation Necessary to Achieve Accountability,* GAO-03-31 (Washington, D.C.: Oct. 1, 2002).

U.S. General Accounting Office, *Homeland Security: Critical Design and Implementation Issues,* GAO-02-957T (Washington, D.C.: July 17, 2002).

U.S. General Accounting Office, *A Model of Strategic Human Capital Management,* GAO-02-373SP (Washington, D.C.: March 2002).

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

(195046)

RESPONSES TO POST-HEARING QUESTIONS FROM MR. WALKER

GAO
Accountability • Integrity • Reliability

Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

September 1, 2004

The Honorable Peter Fitzgerald
Chairman
Subcommittee on Financial Management, the Budget, and International Security
Committee on Governmental Affairs
United States Senate

Subject: *Responses to Posthearing Questions Related to GAO's July 8, 2004, Testimony on the U.S. Government's Consolidated Financial Statements for Fiscal Year 2003*

Dear Mr. Chairman:

On July 8, 2004, I testified before your subcommittee at a hearing on our report on the U.S. government's consolidated financial statements for fiscal year 2003.[1] This letter responds to Senator Frank Lautenberg's subsequent questions related to our testimony that he asked us to answer for the record.

1. **Have erroneous payments, which were in excess of $30 billion in fiscal year 2001, come down at all since then?**

Improper payments reported in federal agency fiscal year 2003 Performance and Accountability Reports (PAR) totaled approximately $36 billion. Requirements set out in former section 57 of OMB Circular No. A-11 directed 15 federal departments and agencies to report improper payments for 46 programs in their fiscal year 2003 PARs.[2] Collectively, the 46 programs accounted for about $1 trillion in federal government spending—not quite half of all annual federal government expenditures. As GAO testified in April 2004,[3] the estimate of nearly $36 billion came from just 31 of

[1]GAO, *Fiscal Year 2003 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges*, GAO-04-886T (Washington, D.C.: July 8, 2004). The fiscal year 2003 *Financial Report of the United States Government*, issued by the Department of the Treasury on February 27, 2004, is available through GAO's Web site at www.gao.gov and Treasury's Web site at www.fms.treas.gov/fr/index.html.
[2]Section 57 was eliminated from OMB Circular No. A-11 and was replaced with OMB's guidance for implementing the Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 stat. 2350 (Nov. 26, 2002). The new guidance expands the reporting requirements to programs not included in OMB's fiscal year 2003 guidance. See OMB Memorandum M-03-13, Improper Payments Information Act of 2002 (Public Law No. 107-300) (May 21, 2003).
[3]GAO, *Financial Management: Fiscal Year 2003 Performance and Accountability Reports Provide Limited Information on Governmentwide Improper Payments*, GAO-04-631T (Washington, D.C.: Apr. 15, 2004).

the 46 programs. Essentially, there are federal programs making expenditures of over $1 trillion annually that have not yet reported estimated improper payments.

While specific federal programs, such as the Department of Agriculture's Food Stamp Program, may report success in reducing annual error rates, with over half of the annual federal government expenditures not included in the $36 billion estimate, it is unlikely that the total governmentwide estimate that will be reported for fiscal year 2004 will decrease below $36 billion.

2. **According to a March GAO report, the federal government's 2003 operating results showed a deficit of $665 billion, while the budget results showed a $375 billion deficit, and the federal government lacks a method to reconcile these results. What are the reasons for this discrepancy?**

In February 2004, we issued our disclaimer of opinion on the consolidated financial statements of the U.S. government (CFS) for the fiscal years ended September 30, 2003 and 2002. In our report we stated that the federal government did not have an adequate process to identify and report items needed to reconcile the operating results, which for fiscal year 2003 showed a net operating cost of $665 billion, to the budget results, which for the same period showed a unified budget deficit of $375 billion in the Reconciliation of Net Operating Cost and Unified Budget Deficit (hereafter referred to as the reconciliation statement).

The reconciliation statement is expected to explain differences that occur because the net operating cost in the consolidated financial statements is prepared on the accrual basis in accordance with U.S. generally accepted accounting principles. Under accrual accounting, transactions are reported when the event or transaction is recognizable under U.S. generally accepted accounting principles rather than when cash is received and paid. By contrast, federal budgetary reporting is, with certain exceptions, on the cash basis, in accordance with accepted budget concepts and policies. In order to reconcile the net operating cost to the unified budget deficit, the preparer is required to identify all the items that are (1) components of net operating cost and not part of the unified budget deficit, such as depreciation expense, and (2) components of the budget deficit and not part of net operating cost, such as the acquisition of capital assets.

We found that Treasury was not able to identify and support all the reconciling items needed to adequately prepare the reconciliation statement. As part of our fiscal year 2002 audit,[4] we recommended that Treasury, as preparer of the reconciliation statement, develop and implement a process that ensures that agencies adequately identify and report items needed to reconcile net operating cost and unified budget deficit or surplus.

3. **Which agencies are being the most cooperative and making the most progress towards implementing financial management reforms? Which agencies are being the least cooperative? What lessons are being learned**

[4]GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003).

from the most successful agencies that can be applied to less successful ones?

In the area of financial performance, we have continued to point out that the federal government has a long way to go to successfully implement the statutory reforms the Congress enacted during the 1990s.[5] A range of financial management system weaknesses, poor recordkeeping and documentation, weak internal controls, and lack of information have prevented the federal government from having the cost information needed to effectively and efficiently manage operations or accurately report a large portion of its assets, liabilities, and costs.

We have not conducted any analysis to determine the level of federal agencies' cooperation toward implementing financial management reforms. However, across the federal government, there are a range of financial management improvement initiatives under way that, if effectively implemented, will improve the quality of the federal government's financial management and reporting. In this regard federal agencies have started to make progress in their efforts to modernize their financial management systems and improve financial management performance as called for in the President's Management Agenda (PMA). In identifying improved financial performance as one of its five governmentwide initiatives, the PMA stated that "a clean financial audit is a basic prescription for any well-managed organization," and that "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records." Further, the PMA stated that without accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people. The PMA uses the Executive Branch Management Scorecard to track how well the federal departments and major agencies are executing the five governmentwide management initiatives, including financial performance. The scores are intended to indicate how well federal agencies have met the standards for success defined by the President's Management Council as determined by the Office of Management and Budget (OMB). Federal agencies that are considered by OMB to have successfully met these standards receive a green score, indicating that they have the capability to produce timely and accurate financial information to manage their operations and plan for the future. As of June 30, 2004, five agencies had received from OMB the green PMA scores for financial performance–the Department of Education, the Environmental Protection Agency, the National Science Foundation, the Social Security Administration, and most recently, the Department of Energy (DOE). According to the PMA, DOE has been a leader in complying with financial reporting requirements and is now making relevant financial information accessible to program managers in the agency.

Although there have been some successes in implementing financial management reform, federal agencies still face a range of challenges. Our July 2004 testimony on the CFS for fiscal year 2003 stated that one of the three largest impediments to an unqualified opinion continues to be the Department of Defense's (DOD) serious financial management problems, which we have designated as high risk since 1995.[6]

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[5]GAO, *Major Management Challenges and Program Risks: A Governmentwide Perspective*, GAO-03-95 (Washington, D.C.: January 2003).
[6]GAO-04-886T.

DOD faces financial management problems that are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department.[7] These problems preclude DOD from producing accurate, reliable, and timely information to make sound decisions and to accurately report on its billions of dollars of assets. Overhauling DOD's financial management operations represents a challenge that goes far beyond financial accounting to the very fiber of the department's business operations and management culture. To date, none of the military services or major DOD components has passed the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls.

One of the challenges faced by the Department of Health and Human Services in the Medicare and Medicaid programs is common to many agencies—the difficulties in ensuring that underlying financial management processes, procedures, and information are in place for effective program management. Federal agencies need to take steps to continuously improve internal controls and underlying financial and management information systems to ensure that managers and other decision makers have reliable, timely, and useful financial information to ensure accountability; measure, control, and manage costs; manage for results; and make timely and fully informed decisions about allocating limited resources.

In September 2003, we reported that meeting the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA) presents longstanding, significant challenges that will be attained only through time, investment, and sustained emphasis on correcting deficiencies in federal financial management systems.[8] The widespread systems problems facing the federal government need sustained management commitment at the highest levels of government. Today, we are seeing a strong commitment from the President, the Joint Financial Management Improvement Program (JFMIP) Principals, and the secretaries of major federal departments, such as the DOD, to ensuring that needed modernization efforts come to fruition. This commitment is critical to the success of these efforts that are under way, as well as those still in a formative stage, to achieve the goals of the Chief Financial Officers (CFO) Act of 1990 and FFMIA.

Through the PMA, OMB has initiatives under way to provide federal agencies with keys to future success and best practices from federal agencies that have made successful financial management improvements. In August 2004, OMB reported the results of focus groups conducted at several agencies in which managers suggested several key factors to their agencies' continued successful focus on results.[9] One of the key factors identified was to make achieving results a top priority. To do this, according to the focus groups, federal agencies should "clearly define success, the action plan to achieve success, the person responsible and a due date for each required action; and ensure aggressive follow-through." Federal agencies that have made successful financial management improvements have also made their best

[7] GAO, *Major Management Challenges and Program Risks: Department of Defense*, GAO-03-98 (Washington, D.C.: January 2003).
[8] GAO, *Financial Management: Sustained Efforts Needed to Achieve FFMIA Accountability*, GAO-03-1062 (Washington, D.C.: Sept. 30, 2003).
[9] Office of Management and Budget, *The Federal Government is Results-Oriented: A Report to Federal Employees*, (Washington, D.C.: August 2004).

practices available for other agencies through the PMA website. For example, the Department of Agriculture reported on the barriers to obtaining a clean audit and described how it was able to overcome those barriers and obtain its first clean audit in December 2002.

4. **According to an October GAO report, six agencies (the National Aeronautics and Space Administration (NASA), the General Services Administration, the Department of Agriculture, the Department of Commerce, the Social Security Administration, and the Department of Transportation) aimed to implement core financial management systems in 2003 and 2004. Did those agencies meet those targets, or are they on track to meet them?**

As we discussed in our September 2003 report on federal agencies' compliance with the FFMIA, 17 CFO Act agencies reported having core financial systems implementation efforts under way as of September 30, 2002.[10] Core financial systems, as defined by the JFMIP include managing general ledger, funding, payments, receivables, and certain basic cost functions. Of the 17 agencies with core financial systems efforts underway, 3 agencies—the Department of Agriculture, the General Services Administration, and the National Aeronautics and Space Administration—planned to complete implementation in fiscal year 2003. Three other agencies—the Social Security Administration, the Department of Commerce, and the Department of Transportation—planned to complete their implementations in fiscal year 2004. The remaining agencies had established target dates for implementation ranging from fiscal year 2005 through fiscal year 2008. DOD had not yet determined a date for full implementation. The 6 agencies that anticipated completing their core financial systems implementations in fiscal year 2003 or fiscal year 2004 have publicly reported in their PARs, strategic plans, and other documents, such as those highlighting results for the PMA, that the target dates were largely achieved.

However, it is important to note that while these agencies may have publicly reported that they have substantially implemented new core financial systems, it is not clear whether these newly implemented systems are providing the full capabilities envisioned. For example, our work at NASA indicated that although NASA has met its core financial module's implementation schedule, the system, as implemented in June 2003, does not provide many key external financial reporting capabilities.[11] In fact, when NASA announced in June 2003 that the core financial module was fully operational at each of its 10 centers, about two-thirds of the financial events or transaction types needed to carry out day-to-day financial operations and produce external financial reports had not been implemented. Further, as part of its implementation strategy, NASA deferred implementation of key core financial module capabilities. These deferred capabilities and other problems indicated that NASA's June 2003 core financial module and related systems do not substantially comply with the requirements of FFMIA. The results of NASA's fiscal year 2003 financial statements audit confirmed that NASA's financial management problems continued. NASA's independent auditor, Pricewaterhouse Coopers, disclaimed an

[10] GAO-03-1062.
[11] GAO, *Business Modernization: NASA's Integrated Financial Management Program Does Not Fully Address Agency's External Reporting Issues*, GAO-04-151 (Washington, D.C.: November 2003).

opinion on NASA's fiscal year 2003 financial statements; reported material weaknesses in internal controls; and, for the third straight year, concluded that the agency's new financial management system did not substantially comply with any of the FFMIA requirements.

Regarding target dates in general, at a JFMIP-sponsored forum held in June 2003 on system implementation success factors, one of the major success factors identified was that the project management team should manage the expectations of senior management, program managers, and oversight entities so that projects do not become date-driven. The participants acknowledged that there are tremendous pressures to implement a system "on time" even if the system is not ready. Therefore, project managers must be empowered to delay implementation if the system is not ready. In addition, it is imperative that senior leaders establish appropriate success measures based on performance outcomes and avoid arbitrary deadlines as the measure of success. The undue emphasis on meeting dates can lead to date-driven failures.

5. Do we have adequate tools to monitor and control progress on implementation of financial management systems in various agencies?

The Congress and OMB have powerful tools to monitor and control progress on federal agencies' financial management systems implementation. The Congress periodically holds hearings to discuss the status of selected projects, which provide important information for funding decisions. Also, the Congress can rein in projects that are not proceeding as envisioned by not appropriating funds for the project. Similarly, OMB has federal agencies provide updates on the status of certain projects and uses the budget submission process to obtain more detailed information on a project's status.

A key monitoring and control activity at the federal agency level is establishment of an Information Technology (IT) investment management board. Such executive-level boards, made up of business-unit executives, concentrate management's attention on assessing and managing risks and regulating the trade-offs between continuing to fund existing operations and developing new performance capabilities. Our review of 26 major federal agencies' investment management practices found that agencies generally had IT investment management boards but that no agency had the practices associated with oversight of IT investments fully in place.[12] Although some federal agencies could not provide an explanation, others cited a variety of reasons for not having practices fully in place, including that the chief information officer position had been vacant and that the investment management process was being revised. By improving their practices, federal agencies can better ensure that they are being responsible stewards of the billions of dollars for IT they have been entrusted with through the wise investment of these funds.

However, it should be noted that, as we discussed above regarding the NASA financial management system implementation, the monitoring mechanisms that are in

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[12]GAO, *Information Technology Management: Governmentwide Strategic Planning, Performance Measurement, and Investment Management Can Be Further Improved,* GAO-04-49 (Washington, D.C.: Jan. 12, 2004).

place have not always successfully identified implementations that are in trouble. In the case of the NASA financial management system implementation, it took a focused GAO review to identify the implementation problems. Similarly, GAO recently completed two case study projects—the Defense Logistics Agency's Business Systems Modernization program and the Army's Logistics Modernization Program—that are examples of how DOD's lack of control and accountability over business systems investments continues to result in the department's spending hundreds of millions of dollars on systems that will not result in integrated corporate solutions to long-standing problems.

In response to a request from the Chairman, Ranking Minority Member, and Vice-Chair of the Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform, we plan to review financial management systems implementation efforts at selected CFO Act agencies. This will be a multi-year effort to assess whether federal agencies that are implementing new financial management systems are following best practices, commonly referred to as disciplined processes, that can reduce the potential for risks to occur and help prevent those that do occur from having any significant adverse impact on the cost, timeliness, and performance of the project. Of the six federal agencies that expected to complete their core financial systems implementation in fiscal year 2003 or fiscal year 2004, we have to date had an opportunity only to review NASA.

6. Do you think we need to get the top management—I mean the secretaries—of problem departments, or all departments, up to the Hill to discuss these issues? Would that help implementation?

It is widely accepted that top management commitment is critical to any systems implementation project's success. Our *Executive Guide: Creating Value through World-class Financial Management*[13] highlights the importance of top executives' sustained commitment to improving financial management through both their words and actions. To ensure that federal financial management improvement efforts succeed and that the President's and the CFO Council's priorities are achieved, the support and involvement of key nonfinancial executives and managers are also critical. The commitment starts with the heads of federal agencies establishing priorities and setting expectations and continues with the active involvement of program and line managers and executives in driving financial improvement initiatives. The Standish Group International, Inc.,[14] has identified executive support as one the 10 project success factors.

Congressional hearings and other congressional oversight activity have historically served as powerful drivers to stimulate needed change. In the past few months, we have testified at hearings regarding NASA's implementation of a new financial management system and DOD's problems relating to modernizing its business systems. Most often, the key federal agency financial official, the CFO for NASA and the Comptroller for DOD, have represented their respective agencies at these

[13]GAO, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: April 2000).
[14]The Standish Group is a well-known research advisory firm that focuses on mission-critical software applications, management techniques, and technologies.

hearings. Getting the federal agency heads more closely involved in ensuring that these systems implementations are well-planned and -managed and are following disciplined processes that minimize risk could provide a needed stimulus for achieving project success. This approach could help federal agencies minimize the risk related to these financial systems implementations and consequently help achieve the goal of implementing financial management systems that produce timely, useful, and accurate data for management decisionmaking and financial reporting. At the same time, addressing key financial and other management issues with current and proposed cabinet officials and agency heads, as appropriate, would also help to assure progress in these areas.

Also, see the response of Greg Kutz, Director, Financial Management and Assurance, GAO regarding the involvement of DOD's top management in financial management issues.

7. Are the project managers we are hiring capable? Do we have sufficient personnel in general to succeed in these projects?

The Standish Group has identified hiring an experienced project manager as one of the 10 project success factors from its review of successful systems implementation projects in the private sector. With many new financial management systems being implemented in the federal government, it is crucial that the federal government has a qualified workforce with the right mix of skills to successfully implement financial management systems. Our report on effective strategic workforce planning highlighted five principles that such a process should address irrespective of the context in which planning is done.[15] Among the principles are determining the critical skills and competencies needed to achieve current and future results and developing strategies tailored to address gaps in the number, deployment, and alignment of human capital.

As acknowledged by the Standish Group, a key factor in successfully implementing a system is having a well-qualified project manager to lead the effort. At the same time, it is very difficult to find all of the skills needed by a project manager implementing a financial management system in a single individual. A common cause of project failure is assigning underskilled project managers to complex projects. The "ideal" competencies and levels of expertise are rare, and some balancing of priorities and compromising is necessary in order to choose the best-qualified candidate. It is important that project managers have actual project management experience before they are selected to implement a financial management system.

While we have not performed any studies on the project management capacity currently available in the federal government, at a JFMIP-sponsored forum on successful integration of business management systems held in May 2004, the participants noted that federal agencies are losing experienced project managers for a variety of reasons and excessively relying on outside contractors because they have no other choice. Participants expressed concern that internal staff lack the technical expertise needed. Federal agency officials overseeing implementations have

[15]GAO, *Human Capital: Key Principles for Effective Strategic Workforce Planning*, GAO-04-39 (Washington, D.C.: Dec. 11, 2003).

expertise in functional requirements, such as government accounting standards, but vendors and integrators have little expertise in these areas. This is extremely high risk and costly, and greater oversight and close monitoring of contractors is needed.

Thank you for the opportunity to testify on these important issues.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

Enclosure

cc: The Honorable Daniel K. Akaka
United States Senate

The Honorable Frank R. Lautenberg
United States Senate

RESPONSES TO POST-HEARING QUESTIONS FROM MS. SPRINGER

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 3 0 2004

THE CONTROLLER

The Honorable Daniel K. Akaka
Ranking Member
Subcommittee on Financial Management, the Budget,
and International Security
Committee on Governmental Affairs
United States Senate
Washington, DC 20510

Dear Senator Akaka:

I am writing in response to your follow-up questions from the July 8th hearing before the Subcommittee on Financial Management, the Budget, and International Security on the "Federal Government's Financial Statement and Accountability of Taxpayer Dollars." I appreciate the opportunity to address your questions.

1. *Currently, the Office of Management and Budget (OMB) is targeting the financial management of Department of Defense (DOD) assets and improper payments. For the Record, please explicitly outline what steps OMB is taking to fulfill this objective.*

The Administration has taken many steps to improve the management of government assets and properties. This past February, the President issued Executive Order 13327, "Federal Real Property Asset Management," which promotes more efficient and effective use of Federal real property resources. The order established an interagency Federal Real Property Council (FRPC) and created the position of Senior Real Property Officer (SRPO) at all major executive agencies. The Council, which has met several times since the order, is working diligently to establish government-wide requirements and performance measures for improved real property management. As members of the Council, the SRPOs are working to develop and implement agency asset management plans at their agencies to improve the overall management of its properties.

To better ensure that Federal agencies effectively implement the FRPC-issued guidelines and requirements, the Administration has added Federal Real Property Asset Management as a program initiative to the President's Management Agenda (PMA). As part of this new PMA initiative, DOD and 13 other agencies are now evaluated quarterly by OMB on enhancements to asset management planning, the accuracy and completeness of their real property inventory, and the use of performance metrics in the management decision-making process. DOD continues to be an active participant in this initiative.

Starting in fiscal year (FY) 2001, OMB required agencies to report on programs with significant risk of improper payments through Circular A-11, Section 57. DOD possessed two programs that were subject to this reporting process – military retirement and military health benefits. Under the recently-enacted Improper Payments Information Act and subsequent OMB implementing guidance (M-03-13), DOD will continue to report on these two programs. DOD will also conduct an annual assessment of their total program inventory to identify any additional high risk programs.

DOD's military retirement and military health benefits continue to record very low annual improper payments rates of approximately 0.10% and 1.36%, respectively. These rates, however, can generate millions of dollars in improper payments each year due to the large amount of annual outlays. Consequently, DOD is continuing to refine its pre- and post-payment audit processes to reduce the error rates to their lowest level feasible.

DOD has also achieved success in reducing improper payments to contractors through its various recovery auditing efforts. For example:

- Recovery auditing efforts at the Department of Defense have led to an identification of more than $16 million in possible recoveries, with approximately $14.4 million actually collected;
- The Defense Logistic Agency is currently collecting approximately $200,000 each month, representing a total of $10.1 million over the past eight years; and
- The Navy, the Defense Commissary Agency and the Defense Information Security Agency are all in the initial phases of their recovery auditing efforts. Collectively, they have recovered nearly $200,000, and expect to collect another $500,000 in the near future.

To further ensure that Federal agencies focus the necessary resources and attention toward eliminating improper payments, the Administration recently announced a new program initiative within the PMA dedicated to this critically important area. Under the Eliminating Improper Payments initiative, DOD and 14 other agencies will be evaluated quarterly by OMB on improved detection, measurement, and elimination of improper payments. This initiative will officially begin in the first quarter of FY 2005.

2. *You note that OMB meets periodically with the DOD Chief Financial Officer and its Inspector General to review plans for each area of concern and to monitor progress. Given that 22 out of the 24 recommendations made by GAO to strengthen DOD's financial management in 2001 are still unmet by DOD, can you share with us what progress is resulting from the periodic meetings OMB has had with DOD?*

OMB regularly meets with DOD officials to share program information, status, and progress related to financial management initiatives. OMB has also identified specific financial management improvement goals through its quarterly scorecard, which tracks how well the department is executing the Improving Financial Performance initiative of the PMA.

DOD is addressing the difficult task of business transformation through the Business Management Modernization Program (BMMP). During the three years since the department began this program, OMB and DOD meetings have facilitated progress in building the baseline architecture, governance structure and re-engineering methodology that is necessary to reach the ultimate goal of streamlining and integrating business processes and systems. Through these accomplishments, DOD has set the groundwork for significant further progress during the coming year.

In concert with the BMMP process, OMB will work with the Office of the Secretary of Defense to track the progress of DOD's major components to develop and implement Financial Improvement Plans for getting a clean opinion. These plans identify actions that address deficiencies and corrective actions necessary to lead to a clean opinion.

With respect to the GAO recommendations, DOD has already partially addressed many open recommendations and has corrected 13 BMMP technical deficiencies with the July 31, 2004, release of the Business Enterprise Architecture (BEA) (version 2.2).

3. *Overall, $41 billion in government-wide homeland security funds are spread out among 21 agencies, including the Department of Homeland Security (DHS). Of this amount, $24 billion is administered by agencies outside of DHS. Is OMB looking to consolidate any homeland security functions to better manage these funds within DHS?*

The creation of DHS has significantly consolidated government-wide homeland security resources. Prior to the creation of DHS, several agencies (Departments of Defense, Justice, Health and Human Services, Transportation, and Treasury) each administered approximately 10 to 25 percent of Federal homeland security resources. With $41 billion in government-wide homeland security funds in FY 2004, DHS will administer close to 60 percent of the Federal Government's homeland security resources. Only the Department of Defense will administer more than 10 percent.

The Administration regularly considers options to better align and manage homeland security resources, both within DHS and among agencies. When reviewing these options, OMB weighs the potential benefits, such as improved policy planning and reduced duplication, against their potential costs, such as the consequences in separating a program from an agency with related core capabilities. The Administration moves forward with proposals when appropriate.

The Administration is constantly striving to improve performance, to enhance operational efficiency, to facilitate coordination, and to reduce overlap and replication in homeland security programs. We will continue to consider consolidation as an option when deemed appropriate.

Thank you again for your questions, and I look forward to continuing to work with you and the other members of the Committee on these important issues.

Sincerely,

Linda M. Springer
Controller

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 3 0 2004

THE CONTROLLER

The Honorable Frank Lautenberg
United States Senate
Washington, DC 20510

Dear Senator Lautenberg:

I am writing in response to your follow-up questions from the July 8th hearing before the Subcommittee on Financial Management, the Budget, and International Security on the "Federal Government's Financial Statement and Accountability of Taxpayer Dollars." I appreciate the opportunity to address your questions.

1. *Have erroneous payments, which were in excess of $30 billion in FY 2001, come down at all since then?*

As of fiscal year (FY) 2001, the Office of Management and Budget (OMB) estimated that approximately $35 billion in improper payments are made annually. Since that time, OMB and the Chief Financial Officer community, with the added tools provided by the Improper Payments Information Act (IPIA) of 2002, have taken a hard look at the root causes of payment errors, and have begun implementing the required corrective actions. Because IPIA mandates a broader look at program payment errors than previously required under OMB Circular A-11, Section 57, the dollars reported as paid improperly will most likely increase. This does not mean, however, that more errors are being made – but rather that more errors are now being reported.

The FY 2004 Performance and Accountability Reports (PARs), due to be made public by November 15, 2004, will provide an updated estimate of improper payments for each agency. The PARs will also provide detailed descriptions of agency plans for improving the identification and elimination of improper payments going forward.

Recently, the Administration added Eliminating Improper Payments as a separate program initiative to the President's Management Agenda (PMA). At the major agencies where susceptibility to improper payments exists, this initiative will follow progress in completing risk assessments, statistical analyses, establishing reduction targets and corrective action plans, and demonstrating that it is meeting its improper payment reduction targets.

2. *What kinds of increased flexibility, if any, do federal agencies need in pay scales in order to attract quality people to do these jobs?*

All agencies have a number of flexibilities that may be used to recruit high quality applicants for positions in general financial management throughout the Federal Government.

These include student loan repayment authority, relocation, and recruitment and retention bonuses. In addition, full funding of the President's request for $300 million for the Human Capital Performance Fund would allow agencies to better recognize and reward high performers. However, agencies' efforts in these areas are threatened by a proposed across-the-board pay increase in excess of the 1.5 percent increase provided for in the President's Budget. If enacted, this increase would have to be absorbed by the agencies and would divert resources that agencies would otherwise be able to use for high-priority programs or for more targeted recruitment and retention efforts.

3. *How much money is being spent on implementing these initiatives? Is it sufficient? What are some of the personnel issues you are facing?*

Department of Defense

Congress has appropriated $257 million through FY 2004 for the DOD Business Management Modernization Program (BMMP) Program Office. DOD plans to obligate all appropriated funds by September 30, 2004.

DOD officials believe that recent cuts in the FY 2005 Defense Appropriations Act to its proposed FY 2005 budget for BMMP are excessive and will adversely impact the business transformation initiative. DOD officials believe that vital work will be left undone and will result in overall program slippage by approximately one year. In his July 8, 2004, letter to the Committees on Appropriations, the Deputy Secretary of Defense expressed concern about such large cuts to the President's budget request. The Deputy Secretary specifically pointed to the potentially adverse impact on business transformation, and stated his belief that the cuts will curtail critical management reforms and may delay achievement of an unqualified audit opinion on DOD's financial statements.

At the July 8th hearing, subcommittee members and witnesses expressed concern about several department position vacancies. For example, the Comptroller position had been vacant since April. Since that time, however, Ms. Tina Jonas has been confirmed as the Under Secretary of Defense (Comptroller).

Department of Homeland Security

DHS has budgeted approximately $146 million for the design, acquisition and implementation of the financial systems initiative *eMerge²* over a 3-year time frame (FY 2004-2006). Although DHS has not yet awarded the acquisition and implementation contract for *eMerge²*, this figure is the department's best estimate and is based on market research of initiatives of similar size, scope and complexity. The *eMerge²* program office has strived to minimize costs by actively managing requirements and by aggressively managing contract performance.

The *eMerge*[2] initiative is a department-wide effort, and DHS bureaus have detailed subject matter experts to support the requirements development phase. In addition, detailees have been requested to support the upcoming conference room pilot phase. Wherever possible, DHS has augmented the program office with contract personnel support to ensure adequate resources.

4. *How do the financial management initiatives that are part of the President's Management Agenda mesh, compare, or conflict with the statutory requirements of the CFO Act and other legislation.*

The PMA reinforces the Chief Financial Officer's Act (CFO) of 1990 by functioning as a tool for OMB to gauge agency progress on management improvements and ensure that agencies initiate corrective actions expeditiously. This is accomplished through the quarterly reporting cycle that monitors the key elements of management improvement from the CFO Act and other related management legislation.

The three PMA initiatives related to financial management are: Improved Financial Performance, Real Property Asset Management, and Eliminating Improper Payments. These initiatives are aligned with, and build upon the foundation of, the CFO Act and other financial and management-related laws and regulations. These three initiatives provide an accountability framework that ensures increased agency attention to these critically important activities.

The Improved Financial Performance initiative, the major government-wide PMA financial management effort, closely mirrors the reporting requirements of the CFO Act. This initiative measures agencies on performance in the following areas: financial systems and the Federal Financial Managers Financial Improvement Act of 1996, auditor identified material weaknesses, the Federal Managers Financial Integrity Act of 1982, financial statements and reporting, compliance with laws and regulations (e.g., Debt Collection Improvement Act, Prompt Payment Act), and the Anti-Deficiency Act. The Improved Financial Performance scorecard also requires that agencies establish and execute a continuous improvement plan whereby agencies demonstrate to OMB how they use financial information in the agency decision-making process.

This year, the PMA added real property asset management as a new program initiative, which applies to the largest landholding agencies. This initiative directly aligns with Executive Order 13327, "Federal Real Property Asset Management," which was issued to promote the efficient and effective use of Federal real property resources. The order created the interagency Federal Real Property Council (FRPC), which is responsible for developing guidance to facilitate the success of agency asset management activities. The real property scorecard monitors agency progress in complying with FRPC standards when preparing an asset management plan, maintaining and reporting on current inventory, and tracking activities through performance measures.

As discussed earlier, the Eliminating Improper Payments initiative was added to the PMA this year. This initiative will follow agency progress in completing risk assessments, statistical analyses, establishing reduction targets and corrective action plans, and demonstrating that it is meeting its improper payment reduction targets.

5. *According to an October GAO report, six agencies (NASA, GSA, USDA, Commerce, SSA, DOT) aimed to implement core financial systems in 2003 and 2004. Did those agencies meet those targets, or are they on track to meet them?*

NASA

NASA reported full implementation of its core financial module as of June 30, 2003. Some residual issues include: extensive data conversion; compliance with Federal Financial Management Improvement Act; and asset management, including internal controls over materials and property, plant, and equipment.

GSA

GSA reported the core financial system was implemented in October of 2002. There are no significant data clean-up or data conversion issues remaining.

USDA

USDA reported the core financial system was implemented on schedule (October 2002). There are no remaining data clean-up or data conversion issues.

Commerce

Department of Commerce reported the core financial system was implemented on schedule (October 2003). There are no remaining clean-up or data conversion issues.

SSA

Social Security Administration reported the core financial system was implemented on schedule (October 2003). There are no remaining clean-up or data conversion issues.

DOT

Department of Transportation reported that its core financial system was implemented on schedule, with its final agency (FAA) receiving the system in November of 2003. There are no remaining data conversion issues, while minor data clean-up is ongoing.

Thank you again for your questions, and I look forward to continuing to work with you and the other members of the Committee on these important issues.

Sincerely,

Linda M. Springer
Controller

Answers of Donald Hammond, Treasury Fiscal Assistant Secretary
to Senator Lautenberg's QFRs from the
July 8, 2004 Hearing of the Senate Committee on Government Affairs
Subcommittee on Financial Management

Q1: How do the financial management initiatives that are part of the President's Management Agenda mesh, compare or conflict with the statutory requirements of the CFO Act and other legislation?

A1: The components of the financial management section of the President's Management Agenda (PMA) encompass the key components of the principal financial management statutory requirements. The PMA requirements increase the visibility of the statutory provisions and reinforce their importance. An agency must not only be in full compliance with these provisions in order to be graded "green" but must also perform at a higher level with regard to the use of their financial information in managing the agency's programs.

Q2: According to an October GAO report, six agencies (NASA, GSA, USDA, Commerce, SSA, DOT) aimed to implement core financial systems in 2003 and 2004. Did those agencies meet those targets, or are they on track to meet them?

A2: I am not familiar with the specific status of these agency efforts. However, OMB monitors the agencies' activity with regard to the installation of new financial management systems and would have current status information.

Responses to Questions for the Record Submitted by Senator Daniel K. Akaka for Francis E. Reardon, Deputy Inspector General for Auditing, Office of the Inspector General for the Department of Defense

1. Mr. Lanzillotta testified that the DoD relies on nearly 4,000 business systems to manage its financial activities which cost $30 billion annually to maintain. He also stated that a significant portion of these systems are obsolete.

For the record, how is DoD ensuring that it only invests in business systems that effectively and expediently process financial information? Furthermore, what steps is DoD taking to consolidate its financial management investments to heighten efficiency and savings?

In July 2001, the Secretary of Defense established the Business Management Modernization Program to integrate and transform business operations and financial management throughout DoD. A Business Modernization and Systems Integration office was also established to provide strategic planning, oversight, and guidance for DoD business transformation efforts. Additionally, a governance structure was developed that established several oversight committees, established six business domains, and assigned responsibility for the business domains. Listed below are the business domains and their owners.

- Accounting and Finance
  Under Secretary of Defense (Comptroller)/Chief Financial Officer
- Acquisition
  Under Secretary of Defense (Acquisition, Technology, and Logistics)
- Human Resources Management
  Under Secretary of Defense (Personnel and Readiness)
- Installations and Environment
  Under Secretary of Defense (Acquisition, Technology, and Logistics)
- Logistics
  Under Secretary of Defense (Acquisition, Technology, and Logistics)
- Strategic Planning and Budgeting
  Under Secretary of Defense (Comptroller)/Chief Financial Officer

The owners of these business domains were delegated implementation authority, responsibility, and accountability for their respective business areas. Business domain owners are responsible for:

- leading the business transformation within the business domain,
- establishing and maintaining a business domain governance process that ensures representation of Defense organizations and appropriate Federal agencies,
- managing its respective portfolio to ensure implementation of and compliance with the Business Enterprise Architecture and transition plan,
- performing system reviews and approving initiative funding as part of portfolio management,
- assisting in the extension of the Business Enterprise Architecture,
- guiding implementation activities, and
- representing a specific business domain's perspective in resolution of cross business domain issues

Additionally, the Secretary of Defense issued a memorandum in March 2004 that establishes policy and assigns responsibilities for managing information technology investments as portfolios. See Attachment A for a copy of the memorandum. The memorandum states that it is DoD policy to manage information technology investments as portfolios. Decisions on what information technology investments to make, modify, or terminate shall be based on the Global Information Grid Integrated Architecture, mission area goals, risk tolerance level, outcome goals, and performance.

The memorandum specifically requires the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer to establish policies and procedures to ensure that financial, accounting, and other systems are designed, developed, maintained, and used effectively by DoD. The policies and procedures also need to ensure that systems provide reliable financial data consistently and expeditiously, and support programmatic information technology investment decisions consistent with DoD policy. In addition, the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer is responsible for developing and maintaining the DoD Business Enterprise Architecture and Business Enterprise Transition Plan in coordination with the Chief Information Officer.

In order to manage information technology as portfolios, the DoD Chief Information Officer issued a memorandum in July 2004 to collect data pertaining to certain high priority systems for the recently developed DoD Information Technology Portfolio Data Repository. See Attachment B for a copy of the memorandum. The Chief Information Officer expects the initial collection of 375 systems with 32 data elements to be completed by August 2004. A second data call is planned before the end of the calendar year, which will be for all DoD systems with planned expenditures of $1 million or more in any one year of the Future Years Defense Plan. Currently, there are no DoD repositories containing this investment expenditure information.

The IG DoD and the GAO are continuing their audit coverage of these systems and are monitoring information technology developments.

2. According to the Government Accountability Office (GAO), among the three top factors contributing to the significant material weaknesses or deficiencies in the government's consolidated statement is the serious financial management problems in DoD. Since 1995, the Department's financial management has been on GAO's High Risk List and it has failed to develop an enterprise architecture blueprint for its business systems even though DoD officials said the blueprint would be in place by March 2003.

On July 12, 2004, the Office of Personnel Management granted DoD direct-hire authority to immediately recruit more than 100 experienced auditors. How will the use of this authority help DoD obtain an unqualified audit opinion? What additional resources or authorities are needed to reach this goal? What training or guidance has the Department received from the Office of Personnel and Management to use this authority?

Hiring additional auditors will not guarantee that DoD will receive an unqualified (clean) audit opinion on its FY 2007 financial statements. Changes in DoD business and financial processes and improvements in its accounting and financial feeder systems are more directly related to helping DoD achieve a clean audit opinion. However, as DoD makes improvements, it is absolutely necessary that we have qualified, experienced auditors to validate DoD progress in achieving reliable and accurate financial data. Direct hire authority will allow us to expeditiously hire experienced financial auditors who can quickly identify problem areas, make viable recommendations for improvements, and validate progress as DoD moves toward an opinion on its financial statements.

Through their Financial Improvement Plans, DoD has developed a process for obtaining an unqualified opinion in FY 2007. DoD strategy is to incrementally audit financial statement line items and individual statements as they become ready for audit. The Financial Improvement Plans provide schedules of when DoD and its Components plan to assert that line items or financial statements are ready for audit. To meet the objective of obtaining an unqualified opinion by FY 2007, DoD is already beginning to assert that certain line items and financial statements are ready for audit. For example, in FY 2004, DoD has asserted that the following line items are ready for audit: appropriations received, investments, and the Federal Employees Compensation Act liability. Furthermore, the Army and Navy plan to assert that their Fund Balance With Treasury account is ready for audit and the Air Force plans to assert that its Statement of Budgetary Resources will be ready for audit by the end of FY 2004. Additionally, the DoD IG is in the process of issuing contracts to perform reliability assessments of the following five key DoD financial systems and the agency that provides automated support for DoD systems. Specifically:

- Database Management Systems
- Standard Army Finance Information System
- Defense Property Accounting System
- Defense Data Reporting System
- Defense Civilian Payroll System
- Defense Information Systems Agency

The DoD IG needs additional financial statement audit staff and support staff to meet the demand for its audit services. Increased audit staff is necessary to validate corrective actions taken; conduct attestation engagements and financial statement audits; develop statements of work; review contract proposals; award contracts to Independent Public Accountants; and oversee the contracts. Performing these audit services will let DoD financial managers know the extent of progress being made in achieving reliable financial data. Furthermore, it will allow financial managers to make the necessary adjustments to their Financial Improvement Plans to correct deficiencies identified by the auditors during their audit work.

Therefore, the DoD IG needs to start hiring auditors with financial statement audit experience to meet the increasing demand for its audit services and to prepare for the FY 2007 financial statement audits. Experienced auditors new to DoD and college recruits will need to be trained and given time to obtain a working knowledge of DoD business and financial processes, organizational structure, and systems. Specifically, the DoD IG will need a significant amount of time to hire and train auditors to audit or perform oversight of DoD and its Components financial statements and systems. For example, it takes about 4 years to develop a college recruit into a fully trained and qualified auditor capable of independently auditing financial statements.

For FYs 2004 and 2005, the DoD IG will receive additional funding of $5.7 million and $33.8 million for auditors and support staff respectively. The DoD IG may request additional funding for auditors and support staff in future fiscal years because of changes in accounting and auditing requirements, material internal controls weaknesses identified during current and future audit work, added financial statement audits, and\or insufficient amount of auditors to meet the current auditing requirements and standards.

On July 12, 2004, the Office of Personnel Management approved our request for direct hire authority for GS-0511 auditors at grade levels 11 through 15. The request was approved because the DoD IG has a critical need to fill more than 100 auditor vacancies with specialized skills and management experience in auditing financial statements and systems. In addition, the DoD IG was given direct hire authority to fill 200 additional auditor vacancies at GS-11 and above during the next 3 years. The Office of Personnel Management memorandum encourages the DoD IG selecting officials to make employment offers to well-qualified applicants with veterans' preference whenever possible. Also, on a periodic basis, the Office of Personnel Management will review the DoD IG use of the direct hire authority to ensure that it is being used properly and to determine if the continued use of the authority is still supportable. The procedures for use of direct hire authority are straightforward, and the DoD IG has used these procedures in the past; therefore, special training on the use of direct hire authority is not necessary.

3. For agencies to avoid financial and business mismanagement they must eliminate government waste, fraud, and abuse. Key to meeting this goal is providing effective whistleblower protection to federal employees who come forward to disclose government wrongdoing. What has DoD done to notify employees of their whistleblower rights and protections and ensure that employees feel secure in making disclosures to your office.

The DoD IG has established an effective Hotline program to assist DoD employees and other concerned citizens in disclosing fraud, waste, and abuse. The IG Defense Hotline receives and processes all disclosures of information made to this agency. The IG Defense Hotline also maintains a user-friendly website that provides additional information and interactive complaint forms to assist DoD personnel submitting complaints. In addition, the IG Defense Hotline publicizes its primary mission of encouraging DoD employees to report abuses within DoD by: providing Hotline posters to display at DoD components world-wide, publishing Hotline information in military and civilian news sources, and briefing headquarters and Component-level employees about their duty to report abuses within the Department. As a result of these initiatives, the IG Defense Hotline received 13,840 disclosures of information in FY 2003, a 16% increase in 3 years.

In July 2004 the IG Defense Hotline sent a memorandum to the Secretaries of the Military Departments and directors of other DoD Components, requesting that these agencies publicize the Defense Hotline within their agencies "using local newspapers, official notices, telephone directories, posters, and other media." The IG Defense Hotline distributed this memorandum after members of the Senate Armed Services Committee expressed concern, during a hearing on Iraqi prisoner abuses, that "there was no opportunity for military service members to report suspected incidents of wrongdoing outside their chain of command." The IG Defense Hotline memorandum also informed the Secretaries of the Military Departments and directors of other DoD Components that since 1982 the IG Defense Hotline has provided Service members and the general public with a safe environment outside the chain of command to report wrongdoing, offering both confidentiality and whistleblower protection.

Regarding whistleblower rights and protections, the Defense Hotline is required to protect, to the greatest extent possible, the identity of individuals who request anonymity when making disclosures of fraud, waste, and abuse. Hotline investigators often need to contact complainants to obtain additional information or clarify their disclosures, which may be necessary for the successful conclusion of an investigation. Although Hotline investigators encourage complainants to identify themselves, it is not required. If complainants choose to identify themselves, Hotline investigators will not divulge their identities to outside agencies without their expressed consent.

The DoD IG is also responsible for investigating allegations of whistleblower reprisal made by military members, non-appropriated fund instrumentality employees, and Defense contractor employees under title 10, U.S.C. sections 1034, 1587, and 2409, respectively. The Directorate for Military Reprisal Investigations uses the IG Defense Hotline website, posters, and briefings throughout DoD to publicize whistleblower protections. Approximately 600 whistleblower reprisal complaints were submitted to DoD IG and Military Department Inspector Generals under these statutes in FY 2003, a 33% increase in 3 years.

The Office of Special Counsel has primary jurisdiction under Title 5 to investigate allegations of whistleblower reprisal made by civilian appropriated fund employees. The Office of Special Counsel has created an Outreach Program in response to a congressional mandate that requires Federal agencies to inform civilian employees of their rights and responsibilities under the statutes enforced by the Office of Special Counsel. In response to this mandate, the Office of Special Counsel established a Certification Program to assist Federal agencies in meeting the statutory obligations, which includes displaying posters in all agency EEO and personnel offices that provide information about prohibited personnel practices and how to make confidential disclosures of abuses to Office of Special Counsel. On December 31, 2002, the DoD IG was the first DoD Component to be certified by the Office of Special Counsel as Section 2302(c) compliant.

The DoD IG recently created a Directorate for Civilian Reprisal Investigations to expand whistleblower protections for DoD appropriated-fund civilian employees, including employees of DoD intelligence agencies that are exempt from the Office of Special Counsel whistleblower protection. The jurisdictional authority of the Civilian Reprisal Investigations is derived from the Inspector General Act of 1978. As a practical matter, the mission of Civilian Reprisal Investigations includes identifying reprisal complaints for investigation that, if substantiated, have the most potential to strengthen the integrity of DoD operations.

RESPONSES TO POST-HEARING QUESTIONS FROM MR. KUTZ

GAO
Accountability • Integrity • Reliability

United States Government Accountability Office
Washington, DC 20548

September 1, 2004

The Honorable Peter G. Fitzgerald
Chairman, Subcommittee on Financial Management,
the Budget, and International Security
Committee on Governmental Affairs
United States Senate

Subject: *Responses to Posthearing Questions Related to GAO's July 8, 2004, Testimony on the U.S. Government's Consolidated Financial Statements for Fiscal Year 2003*

Dear Mr. Chairman:

On July 8, 2004, we testified before your Subcommittee at a hearing on our report on the U.S. government's consolidated financial statements for fiscal year 2003.[1] My testimony focused on financial and business transformation efforts at the Department of Defense. This letter includes my responses to questions for the record from Senators Akaka and Lautenberg.

Question from Senator Daniel K. Akaka

You testified that continued weaknesses in the Department of Defense's (DOD) financial management and related business processes has led to a $1.2 billion discrepancy between the amount of items shipped and received during Operation Iraqi Freedom.

First, in your view, will the legislation included in the FY05 Defense Authorization bill, if fully implemented, prevent the recurrence of this kind of problem in the future? Second, since this legislation will take several years to implement, what immediate steps should DOD take now to resolve financial weaknesses that could pose an imminent threat to public safety and mission performance in Iraq?

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[1] GAO, *Fiscal Year 2003 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges,* GAO-04-886T (Washington, D.C.: July 8, 2004). The fiscal year 2003 *Financial Report of the United States Government,* issued by the Department of Treasury on February 27, 2004, is available through GAO's Web site at www.gao.gov and Treasury's Web site at www.fms.treas.gov/fr/index.html. GAO, *Department of Defense: Financial and Business Management Transformation Hindered by Long-standing Problems* (GAO-04-941T, July 8, 2004). GAO, *Department of Homeland Security: Financial Management Challenges* (GAO-04-945T, July 8, 2004).

In December 2003, GAO reported a $1.2 billion discrepancy in Army financial records resulting from material shipped from various Department of Defense sources of supply to Army units in Kuwait and Iraq in support of activities for Operation Iraqi Freedom. As of May 2004, the Army estimated that this discrepancy totals approximately $1.4 billion, and to date it had only reconciled $50 million, or 3.6 percent, of the estimated total. This discrepancy represents the difference between assets bought by units through the Army Working Capital Fund, and assets recorded as received in the supply system by Army units in Kuwait and Iraq.

The Army provided us with several reasons for why the discrepancy occurred. First, CENTCOM decided to move to the Army's Single Stock Fund (SSF) before the Army fully fielded this program, thereby confusing existing accounting and financial controls that SSF was meant to address. Second, the Army's two primary digital supply systems, the Command Commodity Supply System (CCSS) for National Item Managers, and the Standard Army Retail Supply Systems (SARSS) for Army units at the retail level, are not fully integrated and interoperable. Third, National Item Managers decided to "push" assets to units in theater without their knowledge, and these items were never properly entered into the supply system. Fourth, the pace of OIF and the stress of combat conditions prohibited the precise handling of assets upon arrival at supply depots in the theater, and the processing and receipting of these assets into SARSS (as normally would occur in a garrison situation). A fifth reason, found by GAO through its fieldwork, is that the Army lacked sufficient numbers of—and sufficiently trained—supply personnel at supply depots in theater, which resulted in assets not being properly managed and receipted into SARSS.

The Army is taking some actions, which may address additional occurrences of this problem in current and future contingency operations. According to Army officials, the full fielding of the SSF should remedy the accounting issues that the Army encounters when units move from a garrison to a deployed environment. The Army is also emphasizing the need for better logistics information technology and communications equipment through its "Connect the Logistician" program. Additionally, the Army also believes that the interoperability problems encountered with the dual use of the CCSS and SARSS will be remedied when the Army replaces these systems with the Global Combat Service Support System Army (GCSS-A).

However, it is not clear yet how the Army plans to address the other conditions mentioned above that led to the $1.4 billion discrepancy. Moreover, although the Army is in the process of awarding a contract to reconcile this discrepancy, it is not yet clear how the Army will account for all of its assets, and in what time frame it intends to accomplish the reconciliation. Therefore, given the unknowns in Army plans, we cannot at this time determine whether the fiscal year 2005 Defense Authorization bill, if fully implemented, will prevent the reoccurrence of this problem in the future.

Questions from Senator Frank R. Lautenberg

1. **Do you think we need to get the top management—I mean the Secretaries—of problem departments, or all departments, up to the Hill to discuss these issues? Would that help implementation?**

With regard to the Department of Defense (DOD), we believe that the continued involvement and monitoring by congressional committees will be a critical factor in ensuring that DOD's transformation actions are sustained and extended and the department achieves its goal of securing the best performance and highest measure of accountability for the American people. We have reported and testified that Secretary Rumsfeld and other key DOD leaders have demonstrated their commitment to the current business transformation efforts. However, as we testified, the long-term nature of these efforts requires the development of an executive position capable of providing strong and sustained executive leadership over a number of years and across administrations. To that end, we have suggested legislative action to create a full-time executive level II position for a chief management official who would serve as the Principal Under Secretary of Defense for Management. This position would provide the sustained attention essential for addressing key stewardship responsibilities such as strategic planning, performance and financial management, and business systems modernization in an integrated manner. Further, congressional monitoring could be greatly enhanced if this position included measurable individual goals linked to overall organizational goals. The individual's measurable progress and achievements would be reported to Congress at least annually to serve as the basis for more informed oversight.

2. **Are the project managers we are hiring capable? Do we have sufficient personnel in general to succeed in these projects?**

With regard to DOD, we have not done any audit work that specifically addressed the number or qualifications of personnel assigned to project management. However, as we testified, successful reform of DOD's fundamentally flawed financial and business management operations must simultaneously focus on its systems, processes, and people. While the success of DOD's Business Management Modernization Program and improved control and accountability of business system investments are critical aspects of the department's transformation efforts, equally important is effective project management to implement chosen systems solutions on time, within budget, and with the promised capability. In the past, DOD has not demonstrated the ability to achieve these goals. For example, as discussed in our recent report (GAO-04-615), two logistics systems have experienced cost increases and schedule slippages and did not deliver planned system capabilities in their first release. Our analysis indicated that many of the operational problems experienced by these two systems can be attributed to DOD's inability to effectively implement the disciplined processes necessary to reduce the risks associated with these projects to acceptable levels.

3. Are agencies, particularly DOD, cooperating with GAO's recommendations?

With regard to DOD, we have found that department officials generally agree with us on the facts and findings included in our reports on financial management and business transformation issues. In most cases, DOD has taken a proactive approach to addressing our recommendations and has made encouraging progress in addressing specific challenges. For example, in a series of reports and testimonies beginning in 2001, we highlighted pervasive weaknesses in DOD's overall control environment and specific controls over its multibillion-dollar purchase and individually billed travel card programs. DOD has taken action to implement many of the about 200 recommendations we have made to improve program operations and has substantially lowered its vulnerabilities by reducing the number of purchase and travel cards by over 900,000 and avoiding costs of nearly $200 million. While DOD has made good progress in limited areas, we have not yet seen similar results for some of our more broad and far-reaching recommendations. Specifically, we recently reported (GAO-04-731R) that since our last review, and after about 3 years of effort and over $203 million in reported obligations, we have not yet seen significant change in the content of DOD's business enterprise architecture or in DOD's approach to investing billions of dollars annually in existing and new systems. As we testified, few actions have been taken to address the recommendations we made in our previous reports, which were aimed at improving DOD's plans for developing the next version of the architecture and implementing the institutional means for selecting and controlling both planned and ongoing business systems investments. To date, DOD has not yet addressed 22 of our 24 recommendations in this area.

4. DOD has a "PART" score (under the President's Management Agenda) of "green" for progress, meaning that it is progressing well in improving its financial management. Do you agree with this assessment?

We note that as of June 30, 2004, the Executive Branch Management Scorecard downgraded DOD's progress in the area of financial performance from "green" to "yellow." However, "red"—meaning that initiatives are in serious jeopardy and the agency is unlikely to realize objectives absent significant management intervention—may be a more accurate assessment of DOD's current progress. As we testified, DOD's substantial long-standing business management systems and related problems adversely affect the economy, efficiency, and effectiveness of its operations, and have resulted in a lack of adequate accountability across all major business areas. These problems have left the department vulnerable to billions of dollars of fraud, waste, and abuse annually, at a time of increasing fiscal constraint. DOD is still in the very early stages of a departmentwide reform that will take many years to accomplish. As stated previously, we have not seen significant change in the content of DOD's architecture or in its approach to investing billions of dollars annually in business systems. If DOD is unable to address the underlying causes that have resulted in the failure of previous broad-based reform efforts, improvements will remain marginal, confined to narrowly defined incremental improvements.

5. **GAO has raised concerns about information security. Specifically, what is being done to protect personal information from disclosure? Is classified information at risk here?**

Our detailed answer to this question is included in the response of McCoy Williams, Director, Financial Management and Assurance, GAO.

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Thank you for the opportunity to testify on these important issues. Please contact me at (202) 512-9095 or kutzg@gao.gov if you or you staff have any further questions.

Sincerely yours,

Gregory D. Kutz

Gregory D. Kutz
Director
Financial Management and Assurance

cc: The Honorable Daniel K. Akaka
United States Senate

The Honorable Frank R. Lautenberg
United States Senate

Questions for the Record
Senator Daniel K. Akaka
Subcommittee on Financial Management, the Budget, and International Security
"The Federal Government's Financial Statement and Accountability of Taxpayer Dollars at the Departments of Defense and Homeland Security"
July 8, 2004

Question for Andrew Maner, Chief Financial Officer of the Department of Homeland Security:

1. The hearing concluded with discussion about Department of Homeland Security (DHS) officials allegedly using grant funds to cover unauthorized expenses. You reported that DHS is in the process of incorporating grant management into its eMerge^2 Program. Once fully implemented, this initiative is intended to enhance the accountability of DHS operations and financial management.

In the interim, what financial management tools is DHS applying to foster transparency and accountability of its grant program?

Response:

DHS has undertaken several proactive initiatives to improve and foster transparency and accountability of its grant programs. Under the Chief Procurement Officer, there exists a Grant Policy and Oversight office with responsibility to set Department policy and conduct grant oversight. In addition, on March 9, 2004, DHS established a Grants Council with representatives from all DHS grant-making components and representatives from the CFO and CPO's office to provide advice on grants policies and procedures. In conjunction with the work of the Grant Council, DHS is currently developing and rolling out standardized grants policies and procedures that will enable better grants administration and oversight. In addition, DHS convened on March 15, 2004 a task force on State & Local Homeland Security funding, which made several constructive recommendations to improve transparency in the grants area.

Many other routine protections are in place today to ensure proper use of grants funds. For example, DHS receives regular progress reports and financial reports when grants are issued. According to OMB Circular A-133, if a grantee or sub-grantee spends more than $500K in any fiscal year, an independent audit must be submitted to a government-wide clearing house. The Department monitors submission of these audits. In addition, DHS officials from ODP, FEMA and TSA, for example, make selected site visits to grantees to conduct on site programmatic and financial reviews.

DHS has many other efforts underway to further improve accountability of its grants programs. ODP is actively engaged in improving its programmatic and financial review processes, which includes the development of a more effective grant monitoring protocol. In addition, at the direction of Secretary Ridge, DHS and ODP are jointly developing a plan that will (1) migrate ODP off the DOJ general ledger system and onto the DHS general ledger system and (2) migrate all other adminstrative and support related functions from DOJ to DHS to enhance ODP's accountability and oversight.

With the launch of eMerge^2 in FY 2005, DHS will have in-house control of grants solicitation, awards, disbursement, monitoring, administration and financial management, ensuring greater transparency under a single organization with world class systems.

RESPONSES TO POST-HEARING QUESTIONS FROM MR. ERVIN

1. For agencies to avoid financial and business mismanagement they must eliminate government waste, fraud, and abuse. Key to meeting this goal is providing effective whistleblower protection to federal employees who come forward to disclose government wrongdoing. What steps has the Department of Homeland Security taken to notify employees of their whistleblower rights and protections and ensure that employees feel secure in making disclosures to your office?

Answer:

Shortly after the department's creation, at our request, the Secretary issued an interim Management Directive (MD) generally describing the role of the Office of Inspector General (OIG) and the responsibility of employees to cooperate with OIG investigations. However, the interim MD covered only "headquarters operations," and we found that some components in the field were actively discouraging employees from reporting allegations to OIG, and, instead requiring employees to report allegations only to the department's internal affairs offices (IA). For the next year and a half, we repeatedly urged that the MD be finalized, expanded to cover the entirety of the department, clarified to give employees the option of reporting allegations either to OIG or to IA, and strengthened to emphasize OIG's statutory investigative primacy vis-à-vis IA with regard to allegations of criminal misconduct and serious non-criminal misconduct. (We referred to this issue in two semiannual reports to Congress, as you may recall.) A so revised MD was finally issued this past June, and a copy placed on the department's website. (A copy is attached for your information.)

Around the time that the revised MD was issued, the Commission of Customs and Border Protection (CBP) and the Assistant Secretary for Immigration and Customs Enforcement created a "joint intake center (JIC)" to unify procedures for reporting allegations of misconduct in those bureaus. The CBP portion of the department website that announces the formation of the JIC references the revised MD and provides a link to it. In addition, employees are advised that federal laws and regulations prohibit retaliation against employees for reporting misconduct.

While the revised MD has been placed on the department's website and referred to elsewhere therein, we question whether most employees are aware of it, as we find it unlikely that employees make a practice of regularly reviewing the website for new management directives or memoranda that may pertain to them. So as to be certain that employees know of their right to make allegations to OIG and to do so without fear of retaliation, and that employees know of their responsibility to cooperate with an OIG investigation if they are a subject or witness, we have urged for two months now that the Secretary (or some other high level management official) disseminate the MD to all employees, with a message indicating his support for it and his expectation that employees will abide by it. While unsuccessful in this regard to date, based on a conversation yesterday with the department's General Counsel, we remain hopeful that these steps will be taken.

In the absence of wide dissemination of the MD by the department, we have done our best to advise department employees of their rights by: (a) widely distributing throughout DHS facilities nationwide an OIG hotline poster which specifically advises employees that they may make complaints to OIG anonymously and confidentially; and (b) distributing the MD where and when we can.

We would welcome congressional efforts to ensure that DHS employees are advised of their right to complain to OIG without fear of retaliation, as well as efforts to ensure that IA cooperates with OIG by promptly referring allegations of criminal misconduct and serious misconduct to OIG for our investigative consideration, as the applicable statutory provisions and the MD require.

Department of Homeland Security
Management Directive System
MD Number: 0810.1

THE OFFICE OF INSPECTOR GENERAL

1. Purpose

This directive establishes Department of Homeland Security (DHS) policy regarding the Office of Inspector General (OIG). Any prior Management Directive and any instruction or agreement of any kind issued by or entered into by any DHS official or component that is inconsistent in any respect with this directive is hereby superseded to the extent it is inconsistent with this directive.

2. Scope

This directive applies to all DHS organizational elements (OEs), including all employees, contractors, and grantees.

3. Authorities

A. The Inspector General Act of 1978, as amended

B. The Homeland Security Act of 2002, as amended, codified in Title 6, US Code

4. Definitions

OE Offices - As used in this Management Directive, the term OE offices include all Organizational Element offices of internal affairs, inspections, audits or Professional Responsibility. This term also includes the DHS Office of Security.

DHS Organizational Element – As used in this directive, the term DHS Organizational Element (OE) shall have the meaning given to the term DHS Organizational Element in DHS MD 0010.1, Management Directives System and DHS Announcements. This includes Elements such as the Bureau of Customs and Border Protection, the United States Coast Guard, the Federal Emergency Management Agency, etc. It also includes entities that report to DHS Organizational Elements, such as National Laboratories.

5. Responsibilities

A. ***The heads of DHS Organizational Elements*** shall:

1. promptly advise the OIG of allegations of misconduct in accordance with the procedures described in Appendix A, and when they become aware of any audit, inspection or investigative work being performed or contemplated within their offices by or on behalf of an OIG from outside DHS, the General Accounting Office, or any other law enforcement authority, unless restricted by law;

2. ensure that, upon request, OIG personnel are provided with adequate and appropriate office space, equipment, computer support services, temporary clerical support and other services to effectively accomplish their mission;

3. provide prompt access for auditors, inspectors, investigators, and other personnel authorized by the OIG to any files, records, reports, or other information that may be requested either orally or in writing;

4. assure the widest possible dissemination of this directive within their OEs. They may issue further instructions as necessary to implement this policy. Any such further instructions shall not conflict with this MD and shall be provided to the OIG immediately upon issuance;

5. assist in arranging private interviews by auditors, inspectors, investigators, and other officers authorized by the OIG with staff members and other appropriate persons;

6. advise the OIG when providing classified or sensitive information to the OIG to ensure proper handling.

B. ***DHS employees*** shall report suspicions of violations of law or regulation to the DHS Office of Inspector General or the appropriate OE offices, and will likewise:

1. cooperate fully by disclosing complete and accurate information pertaining to matters under investigation or review;

2. inform the investigating entity of any other areas or activities they believe require special attention;

3. not conceal information or obstruct audits, inspections, investigations, or other official inquiries;

4. be subject to criminal prosecution and disciplinary action, up to and including removal, for knowingly and willfully furnishing false or misleading information to investigating officials; and

5. be subject to disciplinary action for refusing to provide documents or information or to answer questions posed by investigating officials or to provide a signed sworn statement if requested by the OIG, unless questioned as the subject of an investigation that can lead to criminal prosecution.

6. Policy and Procedures

A. The OIG, while organizationally a component of the DHS, operates independent of the DHS and all offices within it. The OIG reports to the Secretary. Under circumstances specified by statute, the Secretary, upon written notification to the OIG which then must be transmitted to Congress, can circumscribe the OIG's access to certain types of sensitive information and exercise of audit, investigative, or other authority. The DHS Inspector General is the head of the OIG.

The OIG is authorized, among other things, to:

1. administer oaths;

2. initiate, conduct, supervise and coordinate audits, investigations, inspections and other reviews relating to the programs and operations of the DHS;

3. inform the Secretary, Deputy Secretary, and the Congress fully and currently about any problems and deficiencies relating to the administration of any DHS program or operation and the need for, and progress of, corrective action;

4. review and comment on existing and proposed legislation and regulations relating to DHS programs, operations, and personnel;

5. distribute final audit and inspection reports to appropriate authorizing and oversight committees of the Congress, to all headquarters and field officials responsible for taking corrective action on matters covered by the reports and to Secretarial officers, office heads, and other officials who have an official interest in the subject matter of the report;

6. receive and investigate complaints or information from employees, contractors, and other individuals concerning the possible existence of criminal or other misconduct constituting a violation of law, rules, or

regulations, a cause for suspension or debarment, mismanagement, gross waste of funds, abuse of authority, or a substantial and specific danger to the public health and safety, and report expeditiously to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law;

7. protect the identity of any complainant or anyone who provides information to the OIG, unless the OIG determines that disclosure of the identity during the course of the investigation is unavoidable.

Further, the OIG shall:

8. follow up on report recommendations to ensure that corrective actions have been completed and are effective;

9. prepare a semiannual report to the Secretary and the Congress, summarizing OIG audit and investigative activities within DHS. Section 5(a) of the Inspector General Act of 1978, as amended, requires this report.

B. Allegations received by the OIG or OE offices shall be retained or referred in accordance with Appendix A of this MD. The only exception to this requirement is that the OIG and the United States Secret Service will adhere to the terms of the Memorandum of Understanding entered into between those two entities on December 8, 2003, and as may be amended from time to time.

C. ***Standards.*** Audits shall be conducted consistent with the standards issued by the Comptroller General of the United States. Inspections and investigations shall be conducted consistent with the quality standards issued by the President's Council on Integrity and Efficiency (PCIE).

D. ***Questions or Concerns.*** Any questions or concerns regarding this directive should be addressed to the OIG.

J.M. Loy, ADM
Deputy Secretary

Issue date: JUN 1 0 2004

APPENDIX A

The categories of misconduct identified below shall be referred to the OIG. Such referrals shall be transmitted by the OE offices immediately upon receipt of the allegation, and no investigation shall be conducted by the OE offices prior to referral unless failure to do so would pose an imminent threat to human life, health or safety, or result in the irretrievable loss or destruction of critical evidence or witness testimony. In such extraordinary situations, the OIG will be contacted as soon as practical, and all information and evidence collected by the OE office shall then be provided to the OIG as part of the OE referral to the OIG. The OIG will accept and retain all such allegations for investigation subsumed under this exigent circumstance exception.

- All allegations of criminal misconduct against a DHS employee;

- All allegations of misconduct against employees at the GS-15, GM-15 level or higher, or against employees in the OE offices;

- All allegations of serious, noncriminal misconduct against a law enforcement officer. "Serious, noncriminal misconduct" is conduct that, if proved, would constitute perjury or material dishonesty, warrant suspension as discipline for a first offense, or result in loss of law enforcement authority. For purposes of this directive, a "law enforcement officer" is defined as any individual who is authorized to carry a weapon, make arrests, or conduct searches;

- All instances regarding discharge of a firearm that results in death or personal injury or otherwise warrants referral to the Civil Rights Criminal Division of the Department of Justice;

- All allegations of fraud by contractors, grantees or other individuals or entities receiving DHS funds or otherwise engaged in the operation of DHS programs or operations;

- All allegations of visa fraud by DHS employees working in the visa issuance process.

In addition, the OIG will investigate allegations against individuals or entities that do not fit into the categories identified above if the allegations reflect systemic violations, such as abuses of civil rights, civil liberties, or racial and ethnic profiling, serious management problems within the department, or otherwise represent a serious danger to public health and safety.

With regard to categories not specified above, the OE offices will initiate the investigation upon receipt of the allegation, and shall notify within five business days the OIG's Office of Investigations of such allegations. The OIG shall notify the OE offices if the OIG intends to assume control over or become involved in such an investigation, but absent such notification, the OE office shall maintain full responsibility for these investigations.

Any allegations received by the OIG that do not come within the categories specified above, or that the OIG determines not to investigate, will be referred within five business days of receipt of the allegation by the OIG to the appropriate OE office along with any confidentiality protections deemed necessary by the OIG.

The OE offices shall provide monthly reports to the OIG on all open investigations. In addition, upon request, the OE offices shall provide the OIG with a complete copy of the Report of Investigation, including all exhibits, at the completion of the investigation. Similarly, the OIG shall provide the OE offices, upon request, with a complete copy of any Report of Investigation relating to its OE, including all exhibits, at the completion of the investigation. The OIG shall have the right to request more frequent or detailed reports on any investigations and to reassert at any time exclusive authority or other involvement over any matter within its jurisdiction.

2. Earlier this year, the Federal Emergency Management Agency (FEMA) discovered that it had not been reporting or tracking procurement items used by its disaster field offices and FEMA continues to struggle to improve its disaster logistics management system. FEMA estimates the total value of its disaster equipment to be worth $100 million. What is FEMA doing to ensure that its previously procured resources are fully accounted for and utilized in the event of a disaster instead of purchasing duplicate items?

Answer:

FEMA launched a new Logistics Information Management System (LIMS III) in May 2003 that consolidates information from 11 different servers onto 1 server in a web-based system. The new system allows Accountable Property Officers (APOs) to update the system for inventory transfers automatically and to better manage stock reorders. The system will provide visibility of available assets to reduce the potential of purchasing duplicate items and also allow better tracking of accountable property purchased during disaster operations.

RESPONSES TO POST-HEARING QUESTIONS FROM MR. WILLIAMS

GAO
Accountability • Integrity • Reliability

United States Government Accountability Office
Washington, DC 20548

September 1, 2004

The Honorable Peter G. Fitzgerald
Chairman, Subcommittee on Financial Management,
the Budget, and International Security
Committee on Governmental Affairs
United States Senate

Subject: *Responses to Posthearing Questions Related to GAO's July 8, 2004, Testimony on the U.S. Government's Consolidated Financial Statements for Fiscal Year 2003*

Dear Mr. Chairman:

On July 8, 2004, we testified before your Subcommittee at a hearing on our report on the U.S. government's consolidated financial statements for fiscal year 2003.[1] My testimony focused on financial management challenges at the Department of Homeland Security. This letter includes my responses to questions for the record from Senator Lautenberg.

Questions from Senator Frank R. Lautenberg

1. **Do you think we need to get the top management—I mean the Secretaries—of problem departments, or all departments, up to the Hill to discuss these issues? Would that help implementation?**

At the Department of Homeland Security, the importance of creating strong financial management is particularly challenging because it was so recently created through the consolidation and merging of 22 diverse agencies, each with their own financial management systems, processes, and in some case deficiencies. We previously reported[2] on several steps DHS might take in establishing sound financial

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[1]GAO, *Fiscal Year 2003 U.S. Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Future Fiscal Challenges,* GAO-04-886T (Washington, D.C.: July 8, 2004). The fiscal year 2003 *Financial Report of the United States Government,* issued by the Department of Treasury on February 27, 2004, is available through GAO's Web site at www.gao.gov and Treasury's Web site at www.fms.treas.gov/fr/index.html. GAO, *Department of Defense: Financial and Business Management Transformation Hindered by Longstanding Problems,* GAO-04-941T (Washington, D.C.: July 8, 2004). GAO, *Department of Homeland Security: Financial Management Challenges,* GAO-04-945T (Washington, D.C.: July 8, 2004).

[2]GAO, *Department of Homeland Security: Challenges and Steps in Establishing Sound Financial Management,* GAO-03-1134T (Washington, D.C.: September 10, 2003).

management, one of which was establishing financial management as an entity wide priority through various steps such as providing clear, strong, executive leadership. While this step is logically applicable to DHS management, oversight and strong leadership by the Congress would only provide greater support for DHS as it continues to establish its financial management environment. Historically, Congressional hearings and other congressional oversight activity have served as powerful drivers to stimulate needed change and such oversight could be helpful as DHS continues in its transformation.

Further, the Congress has the opportunity to solidify the importance of financial management at DHS by passing legislation that would make the department subject to the Chief Financial Officers Act of 1990 (CFO Act),[3] as amended, and related legislation. As discussed in my testimony, the CFO Act designates executive branch officials responsible for the development and maintenance of integrated accounting and financial management systems that provide for complete, reliable, and timely financial information and that, among other things, facilitate the systematic measurement of agency performance. We have seen unprecedented progress in improving federal financial management since the passage of the CFO Act and we believe the CFO Act should be amended to include DHS.

2. **Are the project managers we are hiring capable? Do we have sufficient personnel in general to succeed in these projects?**

We have not done any audit work at DHS to specifically address the qualifications or sufficiency of personnel. However, in a recent report,[4] we discussed the importance of DHS ensuring commitment and extensive involvement from top management as it develops its integrated financial enterprise solution. We noted in that report that projects similar to the one DHS has undertaken have proven challenging and costly for other federal agencies and have been unsuccessful in producing an effective financial management system, capable of providing the information needed by management.

3. **Are agencies, particularly DHS, cooperating with GAO's recommendations?**

As you know, DHS was formed on March 1, 2003—about eighteen months ago—through the merger of a wide array of agencies, each with its own unique operations and background. Since its formation, we have been actively engaged in reviewing the department's operations and activities and, as appropriate, making recommendations to the department based on our work; and determining whether DHS has implemented previously issued recommendations made to its legacy components. A recent product we issued provides some information on the status of recommendations implementation at DHS.[5] This product reviewed 325

[3]Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990).

[4]GAO, *Financial Management: Department of Homeland Security Faces Significant Financial Management Challenges*, GAO-04-774 (Washington, D.C.: July 19, 2004).

[5]GAO, *Status of Key Recommendations GAO Has Made to DHS and Its Legacy Agencies*, GAO-04-865R (Washington, D.C.: July 2, 2004).

recommendations made in our unclassified and limited official use reports issued to DHS and its 22 legacy agencies between March 1, 1997, and March 1, 2004. We prioritized them according to the greatest risk and identified 104 key recommendations[6] that reflect actions we believe should be taken either to aid in securing the nation's homeland or to swiftly and appropriately respond to future terrorist attacks. Based on information provided by DHS on actions taken to implement key recommendations, we assessed the status of each recommendation. Of the 104 key recommendations made to DHS, 40 have been implemented. DHS is currently in the process of addressing another 63 key recommendations and 1 key recommendation was closed although action taken by one of DHS's legacy agencies did not fully address the intent of the recommendation prior to closure. While this review did not assess how well DHS is responding to all of our recommendations, it does provide a general assessment of their response to our recommendations related to securing the homeland. DHS's response rate to more back-office related recommendations, including those related to financial management issues, is not necessarily similar or dissimilar to the results reported in this product.

4. **DHS has "PART" scores (under the President's Management Agenda) of "green" for progress, meaning that they are progressing well in improving their financial management. Do you agree with this assessment?**

As of June 30, 2004, the Executive Branch Management Scorecard indicated DHS's progress in the area of financial performance as "green"—indicating that implementation is proceeding according to plans. The current status of DHS's performance related to improved financial performance is "red"—indicating that the agency has any one of a number of serious flaws based on the criteria outlined in the President's Management Agenda for improved financial performance. Examples of criteria for obtaining a "red" status include agencies that: do not meet financial reporting deadlines, get a disclaimer of opinion on its annual financial statements, or are in material non-compliance with laws or regulations. Generally, we agree with these assessments. However, DHS is still relatively early in its integration process and is faced with substantial challenges in the area of financial management. The department inherited component agencies with 30 reportable internal control conditions[7] that had been identified in prior component financial audits. Of the 30 reportable conditions, 18 were so severe they were considered material weaknesses. These weaknesses include insufficient internal controls or processes to reliably report financial information such as revenue, accounts receivable, and accounts payable; significant system security deficiencies; financial systems that required extensive manual processes to prepare financial statements; and incomplete policies and procedures necessary to complete basic financial management activities. DHS

[6]We believe that the implementation of these recommendations is key to the agency's ability to effectively fulfill its homeland security mission.

[7]Under standards issued by the American Institute of Certified Public Accountants, "reportable conditions" are matters coming to the auditors' attention relating to significant deficiencies in the design or operation of internal controls that, in the auditors' judgment, could adversely affect the department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

has taken action to resolve 9 of the 30 weaknesses it inherited but significant weaknesses still exist and could severely impede DHS's ability to produce relevant and timely information for decision makers. Further, DHS is in the early stages of acquiring a financial enterprise solution to consolidate and integrate the department's financial accounting and reporting systems. This project began in August 2003 and is expected to be completed in 2006 at an estimated cost of approximately $146 million. Other agencies have failed in attempts to develop financial management systems with few diverse operations. An effective strategic management framework, sustained management oversight, and user acceptance of the efforts, among other things, will be key to DHS's success in this endeavor.

While the challenges facing DHS are substantial, the department has taken commendable actions in the area of financial management. For example, though it could have applied for a waiver, DHS underwent a financial statement audit for the 7-month period from March 1, 2003 to September 30, 2003, and received a qualified opinion from its independent auditors on its consolidated balance sheet as of September 30, 2003, and the related statement of custodial activity for the 7 months ending September 30, 2003. Auditors were unable to opine on the consolidated statements of net costs and changes in net position, combined statement of budgetary resources, and consolidated statement of financing. Obtaining an independent audit for its first year of operations was an important step as the department works toward obtaining an unqualified or "clean" audit opinion on its financial statements—an important factor in the President's Management Agenda.

5. **GAO has raised concerns about information security. Specifically, what is being done to protect personal information from disclosure? Is classified information at risk here?**

Federal information security law, policy, and guidance require that agencies' information security programs include the protection of personal information. In particular, the Federal Information Security Management Act of 2002 (FISMA)[8] defines the term "information security" as protecting information and information systems from unauthorized access, use, disclosure, disruption, modification, or destruction to provide integrity, confidentiality, and availability. Confidentiality specifically includes preserving authorized restrictions on access and disclosure, including means for protecting personal privacy and proprietary information.

To help improve federal information security, FISMA requires each agency, including agencies with national security systems,[9] to develop, document, and implement an

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[8]Pub. L. No. 107-347, title III, 116 Stat. 2899, 2946 (Dec. 17, 2002).

[9]As currently defined in FISMA, the term "national security system" means any information system (including any telecommunications system) used or operated by an agency or by a contractor of an agency, or other organization on behalf of an agency (1) the function, operation, or use of which involves intelligence activities, cryptologic activities related to national security, command and control of military forces, equipment that is an integral part of a weapon or weapons system, or is critical to the direct fulfillment of military or intelligence missions (excluding systems used for routine administrative and business applications); or (2) is protected at all times by procedures established for information that have been specifically authorized under criteria established by an executive order or an act of Congress to be kept classified in the interest of national defense or foreign policy.

agencywide information security program to provide information security for the information and information systems that support the operations and assets of the agency, including those provided or managed by another agency, contractor, or other source. Such a program, which addresses both national security and other systems, is to include

- periodic assessments of the risk and magnitude of harm that could result from the unauthorized access, use, disclosure, disruption, modification, or destruction of information or information systems;
- risk-based policies and procedures that cost-effectively reduce information security risks to an acceptable level and ensure that information security is addressed throughout the life cycle of each information system;
- periodic testing and evaluation of the effectiveness of information security policies, procedures, and practices, performed with a frequency depending on risk, but no less than annually, and that includes testing of management, operational, and technical controls for every system identified in the agency's required inventory of major information systems;
- a process for planning, implementing, evaluating, and documenting remedial action to address any deficiencies in the information security policies, procedures, and practices of the agency; and
- procedures for detecting, reporting, and responding to security incidents.

FISMA also mandates that each agency have an annual independent evaluation of its information security program and practices, including control testing and compliance assessment. Such evaluations are to be performed by the agency inspector general or an independent external auditor except that evaluations for national security systems are to be performed only by an entity designated by the agency head. Further, FISMA requires each agency to report annually to the Office of Management and Budget (OMB), selected congressional committees, and the Comptroller General on the adequacy of information security policies, procedures, and practices, and compliance with FISMA's requirements. In addition, agency heads are required to annually report the results of their independent evaluations to OMB. OMB is also required to submit a report to the Congress no later than March 1 of each year on agency compliance with FISMA's requirements, including a summary of findings of agencies' independent evaluations.

OMB has provided FISMA reporting instructions that include performance measures to help agencies show whether they have implemented the required agencywide information security program and the effectiveness of their information security policies, procedures, and practices. And based on agencies' FISMA reporting for fiscal year 2003, both OMB[10] and GAO[11] reported that agencies had made progress in implementing the act's requirements as indicated by selected performance measures, which included such measures as the numbers of agency systems that have been assessed for risk and the numbers that have been authorized for processing after

[10]Office of Management and Budget, *FY 2003 Report to Congress on the Federal Government Information Management*, March 1, 2004.

[11]GAO, *Information Security: Continued Efforts Needed to Sustain Progress in Implementing Statutory Requirements*, GAO-04-483T (Washington, D.C.: Mar. 16, 2004).

certification and accreditation.[12] However, individual agency progress indicated by these measures varied widely. For example, for fiscal year 2003, DOD reported performance measurement data for a sample of its systems, including both national security and sensitive but unclassified systems, that showed more than half these systems met all of the selected performance measures except one—security controls tested and evaluated. Further, its reported percentages for these measures exceeded overall average percentages for 24 large agencies (which include both DOD and DHS) for five of the seven measures. For DHS, however, fiscal year 2003 performance data reported by the department for its non-national security systems showed that less than half its systems met these selected measures and all were less than the 24-agency average percentages. Table 1 summarizes the data reported for fiscal year 2003 by DOD, DHS, and by the 24 large agencies.

Table 1: Summary of Fiscal Year 2003 FISMA Performance Measurement Data Reported by DOD, DHS, and 24 Large Federal Agencies

	Reported percentage of total systems meeting performance measure		
Performance measure	**DOD (sample)**	**DHS**	**Average for 24 agencies**
Assessed for risk and assigned a level of risk	91	42	78
Information technology security plan is up-to-date	88	45	73
Processing authorized following certification/ accreditation	80	42	62
Security control costs integrated into system life cycle	64	44	77
Security controls tested and evaluated in the last year	42	19	64
Contingency plan documented	79	36	68
Contingency plan tested	51	13	48

Source: OMB's FY 2003 Report to Congress on Federal Government Information Security Management.

OMB monitors agency performance by requiring agencies to provide quarterly updates on this key subset of performance measures. Further, the next annual reports (for fiscal year 2004) that agencies must submit to the Congress are due to OMB by October 6, 2004. These annual reports should provide updated information on agency progress in implementing FISMA's information security requirements.

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[12] *Certification* is the comprehensive evaluation of the technical and nontechnical security controls of an IT system that provides the necessary information to a management official to formally declare that an IT system is approved to operate at an acceptable level of risk. This management approval, or *accreditation*, is the authorization of an IT system to process, store, or transmit information that provides a form of quality control and challenges managers and technical staff to find the best fit for security, given technical constraints, operational constraints, and mission requirements. The accreditation decision is based on the implementation of an agreed-upon set of management, operational, and technical controls, and by accrediting the system, the management office accepts the risk associated with it. Agencies are required to reaccredit their systems prior to a significant change in processing, but at least every 3 years (more often where there is a high risk and potential magnitude of harm).

Thank you for the opportunity to testify on these important issues. Please contact me at (202) 512-6906 or williamsm1@gao.gov if you or you staff have any further questions.

Sincerely yours,

McCoy Williams

McCoy Williams
Director
Financial Management and Assurance

cc: The Honorable Daniel K. Akaka
United States Senate

The Honorable Frank R. Lautenberg
United States Senate

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

December 10, 2003

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE
(COMPTROLLER)/CHIEF FINANCIAL OFFICER

SUBJECT: Independent Auditor's Report on the Department of Defense Fiscal Year 2003 Agency-Wide Principal Financial Statements (Report No. D-2004-036)

The Chief Financial Officers (CFO) Act of 1990, as amended, requires the Inspector General of the Department of Defense to audit the accompanying DoD Consolidated Balance Sheet as of September 30, 2003 and 2002, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, the Combined Statement of Financing, and the Statement of Custodial Activity for the fiscal years then ended. The financial statements are the responsibility of DoD management. DoD is also responsible for implementing effective internal control and for complying with laws and regulations. In addition to our disclaimer of opinion on the financial statements, we are including the required reports on internal control and compliance with laws and regulations.

Disclaimer of Opinion on the Financial Statements

The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us that (1) DoD financial management systems do not substantially comply with Federal financial management systems requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level and (2) DoD financial management and feeder systems cannot provide adequate evidence to support various material amounts on the financial statements. Therefore, we did not perform auditing procedures to determine if material amounts on the financial statements were fairly presented. In addition, other auditing procedures were not performed because Section 1008(d) of the FY 2002 National Defense Authorization Act requires the Inspector General of the Department of Defense to perform only the audit procedures required by generally accepted government auditing standards that are consistent with representations made by DoD management.[1] DoD has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of other information contained in the annual financial statements, much of which is taken from the same data sources as the principal financial statements.[2] These deficiencies would have precluded an audit

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[1] We performed audit work on the U.S. Army Corps of Engineers account balances during FY 2003 because management asserted that their financial statements were ready for audit. In addition, we performed audit work on the DoD Environmental Liability account balance because management asserted that the account balance was ready for audit.

[2] The annual financial statements include the principal financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. —Constitution of the United States, Article I, Section 9 opinion. Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

Summary of Internal Control

In planning our audit, we considered DoD internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance because previously identified reportable conditions,[3] all of which are material, continued to exist in the following areas:

- financial management systems;
- Fund Balance with Treasury;
- Inventory;
- Operating Materials and Supplies;
- Property, Plant, and Equipment (PP&E);
- Government-Furnished Material and Contractor-Acquired Material;
- Environmental Liabilities;
- intragovernmental eliminations and other accounting entries;
- Statement of Net Cost; and
- Statement of Financing.

A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us that DoD financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level.

[3] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. Constitution of the United States, Article I, Section 9

Our work supports DoD conclusions and confirms that uncorrected instances of noncompliance continue to exist related to other provisions of laws and regulations.

In order for DoD to comply with statutory reporting requirements and applicable financial management systems requirements, the Under Secretary of Defense (Comptroller)/Chief Financial Officer is developing a DoD-wide Business Enterprise Architecture. It is unlikely that DoD will be able to fully comply with the statutory reporting requirements until the architecture is fully developed and implemented. See the Attachment for additional details on compliance with laws and regulations.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not have been sufficient for other purposes. Our objective was not to express an opinion on noncompliance with applicable laws and regulations.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of section 3512, title 31, United States Code, which incorporates the reporting requirements of the Federal Managers' Financial Integrity Act (FMFIA) of 1982, are met;
- ensuring that DoD financial management systems substantially comply with Federal Financial Management Improvement Act (FFMIA) of 1996 requirements; and
- complying with applicable laws and regulations.

Paul J. Granetto

Paul J. Granetto, CPA
Director
Defense Financial Auditing
Service

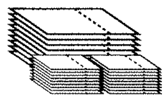
Attachment
As stated

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. Constitution of the United States, Article I, Section 9

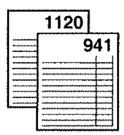
3

DOD Financial Management: Systemic Examples of Waste

$179 million 2 Failed DOD business systems



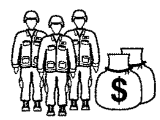
$115 million Thousands of unused airline tickets valued at up to $9,800 each



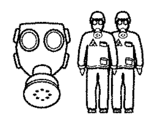
$100 million Failure to collect unpaid federal taxes from DOD contractors

$34 million (annually) Annual funding required to reconcile contract payments

DOD Financial Management: Operational and Security Impacts



Army Guard pay problems adversely impact soldier morale and retention



250,000 defective biochem suits may have been distributed to combat soldiers

Security clearances held by individuals with significant financial problems

Sensitive biotech equipment sold publicly