

T

estimony



STATEMENT OF
ROBERT J. LIEBERMAN
DEPUTY INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
BEFORE THE
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY,
FINANCIAL MANAGEMENT AND
INTERGOVERNMENTAL RELATIONS
HOUSE COMMITTEE ON GOVERNMENT REFORM
ON
DEFENSE FINANCIAL MANAGEMENT

Report No. D-2001-120

DELIVERED: May 8, 2001

Office of the Inspector General
Department of Defense

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to be here today to discuss the significant challenges facing the Department of Defense (DoD) in financial management and the progress made in the year since your last hearing on these matters.

Financial Reporting for FY 2000

For FY 2000, the DoD Components' financial statements reported total assets of \$616 billion, total liabilities of \$1.0 trillion, total net costs of operations of \$347 billion, and total budgetary resources of \$656 billion. The extensive DoD efforts to compile and audit the FY 2000 financial statements, for the Department as a whole and for the 10 subsidiary reporting entities like the Army, Navy and Air Force General Funds, could not overcome the impediments caused by poor systems and unreliable documentation of transactions and assets. We were able to issue a clean audit opinion for the Military Retirement Fund, but disclaimers were necessary for all other major funds, including the DoD-wide consolidated statements. Some examples of the problems in these year-end statements follow.

Department-level accounting adjustment entries used to compile the financial statements were \$4.4 trillion, with \$1.1 trillion

of those unsupported by reliable explanatory information and audit trails. This is an improvement from FY 1999, when \$7.6 trillion of adjustments were made with \$2.3 trillion unsupported, but remains a good indication of the need for wholesale changes to the financial data reporting systems.

Outpatient medical care services data for the year-end statements were materially flawed. These data represent \$86 billion of the reported \$192.4 billion of military retirement health benefits liability. Further, questionable demographic data provided to the DoD actuary caused us to have additional concerns about the accuracy of the total liability estimate. As a result of recent legislation that expands the medical benefits for military retirees, this liability is expected to more than double by 2003 and the importance of recognizing this cost exposure has greatly increased.

The estimate of \$63.2 billion for environmental liabilities could not be verified. The unsupported increases and decreases in the environmental liability estimate from year to year (for FY 1999 it was \$79.7 billion) underscore the unreliability of the cumulative year-end reports.

We were unable to verify the \$112.5 billion reported as the value of general property, plant, and equipment on the balance sheet.

DoD lacks supporting documentation for the reported value of many of its 800,000 individual items of real property, mostly buildings.

Accurate reporting of inventory and property remains a continuing challenge for each of the Military Departments and Defense Logistics Agency because of problems in logistics and other feeder systems. For example, the Defense Logistics Agency supply inventory value of \$7.2 billion was unreliable because of pricing data problems, and the reported fuel inventory value of \$3.2 billion was unreliable because of untimely completion and reconciliation of inventories, as well as untimely posting of transactions.

During the past year, the DoD made some progress in addressing major impediments to favorable audit opinions, but the pace of improvement is slow. The Department has many complex ongoing corrective actions under way to improve the accuracy of data and address every one of the issues discussed above, and we look forward to the new ideas of the incoming Comptroller leadership on what more can be done. We are participating in almost every one of the current improvement efforts and the DoD internal audit community has an excellent working relationship with the Department on these matters.

Nevertheless, the level of frustration is high. Although the DoD has put a full decade of effort into improving its financial reporting, it seems that everyone involved--the Congress, the Office of Management and Budget, the audit community, and DoD managers--have been unable to determine or clearly articulate exactly how much progress has been made. In my view, this is at least partially caused by the emphasis on overall audit opinions for the year-end statements, as opposed to focus on the status of individual system modernization projects.

Financial and Feeder Systems Compliance Process

Throughout the 1990's and again in 2000, the DoD attempted to compile year-end financial statements, despite the fact that it lacks systems capable of producing auditable results. Using convoluted, makeshift processes for transferring data from non-financial feeder systems, and making several trillion dollars' worth of accounting adjustments to transfer data into prescribed formats each year, the DoD has expended tremendous time and effort in futile attempts to compile auditable year-end financial statements.

The DoD also has been working to identify and evaluate all finance, accounting, and feeder systems against Federal financial management requirements and Federal accounting standards to identify specific system deficiencies. Although it would be

unfair to characterize this vital systems improvement effort as futile, progress has been slow. Because of the successful results of DoD Y2K initiatives, two years ago we recommended that DoD apply the same general management approach to bringing its systems into compliance with Federal financial management systems requirements. The Under Secretary of Defense (Comptroller) formally put into place the Financial and Feeder Systems Compliance Process in January 2001 to oversee and monitor the DoD Components' efforts to develop and modify critical systems. We believe this initiative is important and offers the best hope for more effective management of this crucial activity. We realize that the incoming financial managers may wish to alter various details, but we hope that the basic approach will be followed.

If DoD is able to achieve success in the Financial and Feeder Systems Compliance Process, more useful financial data will start to flow to Defense managers as each system achieves compliance. These improvements can and should occur years prior to the Department achieving clean audit opinions. I believe this is the correct course to follow because it properly places achieving useful financial information ahead of achieving clean audit opinions.

Financial Management Improvement Plan

The DoD Financial Management Improvement Plan offers a potentially excellent vehicle for displaying the relevant performance goals and progress against those goals. Each iteration of the Plan has been more informative, but it remains a one-time status report rather than a management tool that is actually used for management oversight. In addition, there are problems with its accuracy.

We reported in March that the latest Plan still did not contain a complete inventory of financial management systems. DoD needs to first map the flow of data from transaction origination point to presentation on the financial statements to ensure identification of all systems involved with processing financial data. The new DoD Financial and Feeder Systems Compliance Process requires that this mapping be done.

This year, DoD reported in the Plan that 19 of the 167 systems were compliant with Federal Financial Management Systems requirements. We found, however, that at least 12 of the systems either were not compliant or the reported compliance status was based on questionable support.

According to the Plan, it will cost about \$3.7 billion to make the critical reporting systems compliant with standards by 2003.

However, we noted that many systems lacked any cost estimate for corrective action, there is no process to validate the cost estimates, and it is uncertain that all systems have been identified. Therefore the actual total cost could be considerably higher.

We also doubt that the Department can successfully manage the retirements, replacements, and upgrades for 167 systems by 2003 as shown in the Plan. We believe that 2003 is an overly optimistic forecast. Meeting information technology system development schedules is frequently a problem in both the public and private sectors; the DoD is no exception. In any event, success or failure in the systems compliance effort will determine whether DoD ever achieves accurate financial reporting, both at year-end and during the year whenever managers need information.

Conclusion

The DoD continues to face a wide array of financial management challenges. I have concentrated on financial reporting today because most of our audits have addressed that aspect. However, the Department also has compelling challenges in achieving better integration of financial management and other management functions and in improving finance operations.

We look forward to working with the new Administration on the Department's financial management challenges. We very much appreciate the Subcommittee's interest in these matters as well.

A list of our financial audit reports from FY 2001 to date is attached.

Examples of FY 2001 Inspector General, DoD
Reports on Financial Management

2001-110 Defense Health Program Funds Administered as Part of the TRICARE Program dated April 30, 2001

2001-109 DoD Payroll Withholding Data for FY 2000 dated April 27, 2001

2001-108 Recognition of Revenues and Expenses in the Defense Business Management System dated April 27, 2001

2001-99 Use of Contract Authority for Distribution Depots by the Defense Logistics Agency dated April 16, 2001

2001-97 Preparing Financial Reports for Marine Corps Appropriations dated April 10, 2001

2001-85 The 2000 DoD Financial Management Improvement Plan dated March 19, 2001

2001-81 Financial Reporting at the Washington Headquarters Service dated March 15, 2001

2001-79 Inventory Valuation at the Defense Supply Center Richmond dated March 14, 2001

2001-78 Inventory Valuation at the Defense Supply Center Columbus dated March 14, 2001

2001-71 Navy Financial Reporting of Government-Owned Materials Held by Commercial Shipyard Contractors dated March 2, 2001

2001-70 Internal Controls and Compliance with Laws and Regulations for the DoD Agency-Wide Financial Statements for FY 2000 dated February 28, 2001

2001-68 Inspector General, DoD, Oversight of the Audit of the FY 2000 Military Retirement Fund Financial Statements dated February 28, 2000

2001-67 Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 2000 U.S. Army Corps of Engineers, Civil Works Program, Financial Statements dated February 28, 2001

2001-64 Inspector General, DoD, Oversight of the Army Audit Agency Audit of the Fiscal Year 2000 Army General Fund Financial Statements dated February 28, 2001

2001-63 Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 2000 Army Working Capital Fund Financial Statements dated February 28, 2001

2001-62 Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 2000 Air Force Working Capital Fund Financial Statements dated February 28, 2001

2001-60 Internal Controls and Compliance with Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations - General Funds dated February 28, 2001

2001-58 Inspector General, DoD, Oversight of the Air Force Audit Agency Audit of the FY 2000 Air Force General Fund Financial Statements dated February 21, 2001

2001-57 Inspector General, DoD, Oversight of the Naval Audit of the FY 2000 Navy Working Capital Fund Financial Statements dated February 21, 2001

2001-56 Inspector General, DoD, Oversight of the Naval Audit Service Audit of the FY 2000 Department of the Navy General Fund Financial Statements dated February 21, 2001

2001-49 Abnormal General Ledger Account Balances for Other Defense Organizations Reported by DFAS Cleveland dated February 13, 2001

2001-48 Financial Reporting for Other Defense Organizations at the Defense Agency Financial Services Accounting Office dated February 9, 2001

2001-42 Accounting and Disclosing Intragovernmental Transactions on the DoD Agency-Wide Financial Statement dated January 31, 2001

2001-41 Journal Entries to Support Departmental Reporting for the Marine Corps dated January 31, 2001

2001-39 Financial Reporting of Department 97-Funded Property, Plant, and Equipment dated January 30, 2001

2001-30 Oversight of Defense Finance and Accounting Service Corporate Database Development dated December 28, 2000

2001-26 Accuracy of the Government-Owned Contractor-Occupied Real Property in the Military Departments' Real Property Databases dated December 22, 2000

2001-14 Development and Implementation of a Joint Ammunition System dated December 6, 2000

2000-11 Prior Period Adjustment to Remove National Defense Property, Plant, and Equipment from the DoD Agency-Wide Balance Sheet dated November 16, 2000

The reports are available on the Web at www.dodig.osd.mil/audit/reports