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DEPARTMENT OF DEFENSE
IMPLEMENTATION OF THE
CHIEF FINANCIAL OFFICER ACT

by

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June 1992

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This thesis analyzes the provisions of the Chief Financial Officers (CFO) Act of 1990 as they apply to the Department of Defense (DOD). It identifies the background environment in which the CFO Act was formulated and the steps that DOD is taking to implement the law. Particular attention is given to the developement of the federal financial management improvement process, including congressional committee hearings and arguments for and against the use of Generally Accepted Accounting Principles in the federal sector. The DOD implementation plan focuses on three key Defense Management Report initiatives as the means to attain the goals and objectives of the CFO Act. Accordingly, the initiatives of Corporate Information Management, Defense Finance and Accounting Service, and the Defense Business Operations Fund are discussed. In addition, government-wide and DOD efforts to develop and institute audited financial statements and establish CFO qualification standards are explored. Problems in implementation are presented. Specifically, problems with the integration of budgeting and accounting, valuation of weapon systems, accuracy of tracking and reporting inventories, and the adequacy of internal controls are reviewed. Finally, a comparison is made between DOD's efforts relative to action underway in other government agencies.

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Implementation of the
Chief Financial Officer Act

by

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ABSTRACT

This thesis analyzes the provisions of the Chief Financial Officers (CFO) Act of 1990 as they apply to the Department of Defense (DOD). It identifies the background environment in which the CFO Act was formulated and the steps that DOD is taking to implement the law. Particular attention is given to the development of the federal financial management improvement process, including congressional committee hearings and arguments for and against the use of Generally Accepted Accounting Principles in the federal sector. The DOD implementation plan focuses on three key Defense Management Report initiatives as the means to attain the goals and objectives of the CFO Act. Accordingly, the initiatives of Corporate Information Management, Defense Finance and Accounting Service, and the Defense Business Operations Fund are discussed. In addition, government-wide and DOD efforts to develop and institute audited financial statements and establish CFO qualification standards are explored. Problems in implementation are presented. Specifically, problems with the integration of budgeting and accounting, valuation of weapon systems, accuracy of tracking and reporting inventories, and the adequacy of internal controls are reviewed. Finally, a comparison is made between DOD's efforts relative to action underway in other government agencies.

TABLE OF CONTENTS

I. INTRODUCTION

The Chief Financial Officer Act was enacted into public law in 1990 as part of a long-term, comprehensive strategy to improve federal government performance in financial management. That goal is focused into four key areas of concern.

First, the Act establishes a primary accountable official as the statutory Chief Financial Officer. Second, it puts a powerful financial management organizational structure in place with 23 CFOs reporting directly to the heads of departments and agencies. Third, it requires agencies to develop financial management plans and produce annual progress reports. Fourth, it sets the stage to move toward financial statements that classify costs by program, provide corresponding measures of program performance, and project future liabilities and returns on investments.

While the passage of the act represents a major step forward to improving the quality of federal financial management, it also presents many challenges to the agencies charged with the monumental task of implementation. The Department of Defense (DOD), as one of the larger and more diverse agencies affected, will be faced with many unique problems to implement the CFO Act.

A. RESEARCH QUESTIONS

Primary Research Question:

What are the provisions of the CFO Act of 1990 and what steps is the Department of Defense taking to implement this law?

Subsidiary Research Questions:

(a) What qualification standards have been established for the DOD Chief Financial Officer?

(b) What chain of command has been established for reporting on DOD financial concerns?

(c) What long term goals and plans has DOD established for the CFO?

(d) How is DOD planning to institute the requirement for audited financial statements? When and which activity has DOD selected to publish the first set of audited financial statements?

(e) What changes are proposed by the Financial Accounting Standards Advisory Board (FASAB) and how will they impact DOD development of audited financial statements?

(f) What steps are being taken to standardize DOD accounting systems?

(g) How does the DOD effort compare to the actions underway within other federal agencies?

(h) How does the DOD effort compare with initial implementation plans certified by the Office of Management and Budget?

B. SCOPE OF THE THESIS

The purpose of this thesis is to identify the background environment in which the CFO Act was formulated and the steps that DOD is taking to implement the law. Specific attention is given to long range financial plans developed by DOD and the programs established to institute audited financial statements. This study also looks at resource requirements to implement the law, steps being taken to consolidate accounting systems, CFO qualification standards and a comparison of DOD's efforts relative to action underway in other government agencies.

This thesis does not argue the strengths, weaknesses or usefulness of audited financial statements. It does not constitute an in depth review of accounting principles brought into question by the Act. It does not debate the advantages or disadvantages of accrual accounting vice the government's current cash basis system. It will not include a comprehensive study of the interrelationship between the DOD Chief Financial Officer and other DOD initiatives such as the Defense Business Operations Fund.

C. METHODOLOGY

Research data were collected through review of materials available in published Public Hearings of Congress, government agency documents, current periodical literature and prior research. The majority of government documentation was obtained from the Office of Management and Budget, the Government Accounting Office, the Department of Defense and the Department of the Navy. Additionally, telephone interviews were conducted with key staff in the Office of the Secretary of Defense, Office of Management and Budget, Department of the Navy Comptroller's Office and with congressional staff.

D. BENEFITS OF STUDY

The Department of Defense and all military services will benefit from this study. By consolidating the background and requirements of the Chief Financial Officer Act in the same document and summarizing DOD's planned implementation, readers of this thesis will gain an understanding of the issues and actions set in motion with the passage of this law.

II. FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT

The Chief Financial Officer (CFO) Act was enacted into public law in 1990 in a process led by the House of Representatives Committee on Government Operations to strengthen federal financial management. The CFO act was not created in a vacuum however, and must be seen as part of a long term comprehensive strategy to improve the federal government's performance. It follows in a wake of similar legislative reform initiatives such as the Inspector General Act, Prompt Payment Act, Federal Managers Financial Integrity Act, Competition in Contracting Act, Debt Collection Act and Single Audit Act. While these laws have had a major impact on the way in which the federal government does business it is understood by Congress that more needs to be done.

As a result of hearings held by the Committee on Government Operations, numerous General Accounting Office (GAO) and Inspector General (IG) reports, the Committee found the need for financial management reform was great. The failure to detect problems early and quickly remedy the savings and loan crisis is but one example where the problem, can in part, be attributed to poor financial management in federal agencies. Additionally, GAO and the Office of Management and Budget (OMB) studies of "high risk" programs in 1989 identified as many as 78 different problems which potentially pose liabilities of hundreds of billions of dollars.[Ref. 1:p. 14] Among the material weaknesses are the failure of the IRS to collect $63 billion in back taxes, an alleged $30 billion in unnecessary inventories bought by the Department of Defense and losses at the Federal housing Administration estimated at over 4 billion. While the causes of these problems are many and varied they are precisely what the CFO Act is focused on: the need to revitalize the financial management infrastructure and the capacity to perform effectively.

Before discussing the implementation of the CFO Act, it may be of interest to define what the government includes under the heading of financial management. Next this act should be placed in the context of the problems with federal financial management, including a look at where we have been and where we are now, and then look at the testimony which called for the legislation.

A. FINANCIAL MANAGEMENT DEFINED

OMB under President Reagan has defined Federal financial management to include:[Ref. 2:p. 135]

- Cash and credit management
- Internal controls against fraud, waste and abuse
- Budget and financial systems, which encompasses: Budget formulation and execution; Financial management information and systems; Program and administrative

accounting, personnel, payroll, grants, cash, credit, property and asset management.

- Financial management organization

OMB's role within the federal establishment is enormous. It spends an amount equal to one-fourth of the Gross National Product, manages a $2 trillion cash flow with 900 million payments annually, a personnel system for 5 million civilian and military personnel, 1,962 separate budget accounts and 253 separate financial management systems.

B. PROBLEMS IN FINANCIAL MANAGEMENT

Congress enacted major accounting reforms in 1950 with the passing of the Budget and Accounting Procedures Act. Starting in 1981, the string of legislation cited above established inspector generals in major federal agencies and set new rules for debt management, procurement, and other management practices. Related legislation includes the Federal Grant and Cooperative Agreement Act and the Intergovernmental Cooperation Act.

The executive branch has been quite active also. In 1981, OMB found federal financial management focused on budgeting and neglectful of cash, credit, and financial management systems. Some specific problems identified are: [Ref. 2:p. 136]

- No comprehensive federal credit policy existed for programs totaling $505 billion in direct and guaranteed loan portfolios. Total delinquent debt was computed at $30 billion and growing at a rate of 43.6% annually.

- No government wide cash management system was in place. 30% of payments to firms were late while 45% were made too early. The government could not receive or make payment by electronic funds transfer.

- Almost 400 financial systems, mostly antiquated, incompatible, and redundant, were in use. There was a lack of awareness of the need for internal controls to prevent fraud, theft, diversion or misuse of funds or federal assets. There was no connection between budget and accounting data and very little management information to measure the impact and benefits of funds spent.

To combat these problems the Reagan Administration introduced Reform 88, a far reaching program designed to improve the management and integrity of the government. Reform 88 achieved major gains such as the prompt payment and debt collection acts, and reinforced the administration's efforts to improve its cash management position. The results entailed implementation of a 30 day bill paying standard, electronic funds transfer and direct deposits, and use of credit cards for government services. A look at the real gains in cash management show that some 311 accounts in 50 agencies have been converted to the nation wide lockbox system. Annual cash flow through lockboxes now totals $26 billion. Additionally, electronic collection of funds owed the government through the Fedwire Deposit System now amounts to $286 billion annually.

Generally accepted credit practices were also instituted. These include use of credit reports to screen loan applicants. In addition, federal loan program performance was improved by salary offsets, tax refund offsets, use of private collection firms, and prosecution of delinquent debt by the Justice Department. For example, over $839 million has been collected from the tax refund offset program in just three years. Also, a requirement that each agency have a single primary accounting system addresses the issue of duplicate and redundant systems while aggressive efforts have been made to convince smaller agencies to use systems at larger agencies.

As each of these reforms was instituted a similar pattern developed. Initial efforts began in the Executive Branch after consultation with appropriate Committees of the Congress, the GAO, operating departments and agencies, etc. Initial policy was announced by Executive order, OMB circular, or other directive based on Presidential authority. Congress followed up on these initiatives with oversight hearings, usually through the Government Operations Committee. Reports on those hearings reflected support for the policy and recommended modifications. Meanwhile, operating divisions and agencies had an opportunity to experiment with alternative methods of implementation. Congress and the Executive branch evaluated these alternatives, often with the aid of GAO or agency IG audit reports. What emerged from this process was legislation that not only sounded good theoretically, but legislation that both branches of government knew would work. [Ref. 2:p. 221]

C. COMMITTEE HEARINGS

The testimony offered to the Committee on Government Operations on September 22, 1988 discussed three areas where follow-on legislation should be aimed. These areas can be summarized as management weaknesses, government accounting systems and internal controls, and audited financial statements.

1. Management weaknesses

Decisionmakers at all levels of the federal government are not getting the financial information they need to make policy and management decisions and to know the ultimate financial impact of those decisions. Most important decisions being made today are based on today's government check book balance with little consideration given to the qualitative nature of these expenditures and even less attention given to the future costs and liabilities inherent in them. [Ref. 2:p. 38] As a result, the President and Congress constantly battle over meeting short term budget targets little regard for the long term implications their actions will have on the future economic health of the United States.

The decisionmaking process is further inhibited because financial management functions are split within the executive branch between OMB, Department of the Treasury, and the General Services Administration. Because none of these players has clear-cut responsibility for oversight and direction of financial management operations, it is virtually impossible to establish a sustained effort toward long-term improvements. Therefore, a Chief Financial Officer of the United States was called for to provide the needed centralized leadership to federal financial management.

Specific problems identified in the testimony where strong leadership from a CFO might have made a difference include: [Ref. 2:p. 90]

- The farm credit system
- FSLIC
- DOD inventory build up
- The Maritime Administration' vessel construction program
- The Department of Energy's uranium enrichment program

There was much debate over whether to locate the government-wide Chief Financial Officer in OMB or the Department of the Treasury.

> Ultimately, the Committee decided OMB was the best location; as the management and budget power center for the Federal Government, it is better positioned to establish government-wide policies to achieve financial management reforms. Treasury, on the other hand, with its large staff at the Financial Management Service, was viewed as best suited to continue its operational support role for financial management efforts. [Ref. 1:p. 16]

2. Accounting and internal controls

President Reagan's report, Management of the United States Government-- Fiscal Year 1989, states: "Once a leader in the early days of automation, the Government's financial systems and operations have eroded to the point that they do not meet generally accepted accounting standards." It is well documented that the federal government is managing today's financial challenges with yesterdays technology. Without modern accounting systems, financial managers can not do their job as well as they might. Costs associated with servicing, upgrading and replacing antiquated systems amount to billions of dollars. [Ref. 2:p. 34]

While accounting systems and internal controls have been strengthened somewhat in recent years continued deficiencies have serious consequences. For example: [Ref. 2:p. 59]

- The Congress, in making multimillion dollar program funding decisions, must rely on Selected Acquisition Reports that may not provide an accurate or timely reflection of program costs and schedule variances for major weapons systems.
- Weakness in agencies' debt collection systems remain; and delinquencies in non-tax debt owed the federal government have grown by 167% since 1981 to $32 billion at the beginning of fiscal year 1988.
- For 10 years DoD has not been able to account for hundreds of millions of dollars of advances made by foreign customers for weapons system purchases.
- Financial audits routinely uncover weak controls which permit such thing as over $50 million in undetected fraudulent insurance claims at the Federal Crop Insurance Corporation or excessive rate charging by the Rural Telephone Bank.
- In reports required by the Financial Integrity Act, 17 of 18 agencies disclosed significant weaknesses in financial management and associated areas.

- Between 1982 and 1988, DoD received about $55 billion more for anticipated inflation than was warranted by the inflation that subsequently occurred. According to Defense, most of the inflation dividends were cut by Congress, spent on defense programs, or lapsed and returned to the Treasury. Because these funds have not been fully monitored and accounted for, exactly what happened to the total excess inflation funds cannot be determined.

This lack of timely, relevant, comprehensive financial information and persistent internal control weaknesses have undoubtedly increased the difficulty of controlling government operations and costs. One popular solution discussed at the hearings suggested the government adopt the same accounting principles that businesses use; Generally Accepted Accounting Principles, or GAAP.

a. GAAP in the federal sector

Currently the federal government is using only a cash basis budgeting and accounting system to measure spending. Instituting GAAP rules would move the process toward capital budgeting and accrual accounting. Gaap has been developed to provide users of financial documents with an understanding as to the basis with which they have been prepared. "Most importantly, GAAP recognizes liabilities as they are incurred and associates the cost of assets with the period during which they are utilized or consumed [Ref. 2:p. 45]." Conversely, assets such as Federal buildings or equipment would be recognized as items that have value under GAAP.

The advantage seen in using GAAP is that decisionmakers are given a more complete and accurate picture of government finance then they currently receive from the cash-basis snap shot. For example, on a balance sheet using GAAP, the construction of a new academic building at the Naval Postgraduate School would not appear as a one time debit with no future benefit, as it now does under the cash basis. Instead its full value over its entire life would be recognized and understood by budget managers. Specifically, a depreciation charge could then be made against the asset. This depreciation charge now serves as a useful reminder of the assets limited useful life and the eventual need to repair or replace the building. GAO goes a step further by suggesting depreciation should be used as an "asset consumption" amount to be reported as an operating cost, and could be "...credited to the capital budget as a means of financing part of the year's costs of acquiring new physical assets [Ref. 3:p. 41]."

GAAP would make it much more difficult for the President and Congress to manipulate budget accounts. For example, trust fund accounts which are in surplus are added to the unified budget to offset deficits in other areas of the budget. Or, military paydays are shifted from one fiscal year to the next to meet Gramm-Rudman targets. Under Gaap supported financial statements these "games" would have been impossible because a budget liability always appears on the balance sheet, regardless of when it must be paid.

Of the many arguments proposed against GAAP-based systems and financial statements, all are founded upon one premise. That premise states that the federal government is so different from the private sector that accounting techniques employed under private sector GAAP are not appropriate for the federal sector. Federal performance is mission driven, based on the needs of the nation as perceived by the electorate, vice profit motivated, subjected to the needs of stockholders and pressures of financial markets. Stated another way, many of the governments programs are social in nature with no real means to assess program efficiencies or determine a "bottom line" on which to assess federal performance.

Whether or not Generally Accepted Accounting Principles are adopted, two things are clear, first:

> Consistent, comparable data from integrated financial systems is essential for preparing government-wide financial statements. These statements can supplement other budgeting and accounting information by giving an overall picture of the financial health of the government that is not available elsewhere. [Ref. 4:p. 14]

Second, auditing of the financial statements ensures reliability of the data used during the year to produce those statements at the end of the year.

3. Audited financial statements

A key element to financial management reform is strengthened and expanded financial reporting in the form of annual financial statements that are audited. Financial statements provide a scorecard. Pulling numbers together for an agency, and subjecting them to the rigors of an independent audit, instills discipline in the financial systems and strengthens accountability. [Ref. 4:p. 68] Moreover, the discipline resulting from preparing financial statements will ensure financial management subsystems and subaccounts (i.e. inventory accounts) are in balance.

Audited financial statements are already being used and have proven successful at the agency level. At the Social Security Administration for example, the 1988 annual report published for the first time audited financial statements which fully disclosed all financial information on all agency administered programs. Those statements clearly demonstrated the financial soundness of the social security system. In another instance, audited financial statements have proven their worth by detecting serious financial problems. When GAO audited the Federal Savings and Loan Insurance Corporation using accrual based accounting, it showed a $13.7 billion deficit. The cash based data for the same period reflected a substantial surplus. [Ref. 4:p. 25]

D. SUMMARY

The CFO Act is the latest addition to the ongoing efforts of the Congress to reform federal financial management. Legislation calling for a CFO had the support of the Senate in

1985. The House of Representatives blocked the Bill until Rep. Conyers' Committee on Government Operations became an advocate in 1988. A review of the recent past shows neglect and material weakness in financial management which accounts for billions of dollars in lost resources annually. Committee hearings showed that while much has been done to prevent and recoup losses, more legislation was required. The Committee focused on three main areas: management weaknesses, accounting and internal controls, and audited financial statements. The CFO Act was then modeled to attack these deficiencies.

III. THE CFO ACT

A. LEGISLATION

The CFO act seeks to strengthen the general and financial management practices of the federal government to make government operations more efficient and effective. It will "provide for improvement in each agency of the Federal Government, of systems of accounting, financial management, and internal controls to assure the issuance of reliable financial information to deter fraud, waste and abuse of Government resources [Ref. 5:p. 2]." The Act does this by establishing a centralized financial management structure within OMB and in major departments and agencies. This structure is headed by a new Deputy Director for Management and Finance who will also be designated Chief Financial Officer of the United States. This legislation also creates an Office of Federal Financial Management in OMB, headed by a Controller who will serve as deputy for the CFO. The CFO and Controller will preside over a network of agency CFOs located in the 14 departments and 9 major agencies of the executive branch as listed below:

The Dept. of Agriculture
The Dept. of Commerce
The Dept. of Defense
The Dept. of Education
The Dept. of Energy
The Dept. of Interior

The Dept. of Health and Human Services
The Dept. of Housing and Urban Development
The Dept. of Justice
The Dept. of Labor
The Dept. of State
The Dept. of Transportation
The Dept of the Treasury
The Dept. of Veterans Affairs
The Environmental Protection Agency
The National Aeronautics and Space Administration
The Agency for International Development
The Federal Emergency Management Agency
The General Services Administration
The National Science Foundation
The Nuclear Regulatory Commission
The Office of Personnel Management
The Small Business Administration

The CFO of the United States is appointed by the President, with the advice and consent of the Senate. As Deputy Director for Management, he/she will "provide overall direction and leadership to the executive branch on financial management matters by establishing financial management policies and requirements, and by monitoring the establishment and operation of Federal Government financial management systems [Ref. 5:Sec. 202]." Essentially, The CFO will be charged with providing a road map of how the government intends to carry out financial management improvements by specifying the type and form of information that will be produced by the government's financial management systems, identifying projects that will accomplish systems integration, and estimate the cost of the plan. These factors will be highlighted in annual reports to Congress to keep attention on the improvement process.

Agency Chief Financial Officers are to be appointed by the President or designated by agency heads, as required by law, and must posses demonstrated knowledge, ability, and extensive practical experience in the financial management practices in large business or governmental entities. An agency CFO is to report directly to the agency head on financial management matters. A September 1991 GAO document outlines agency CFO responsibilities to include the following: [Ref. 6:p. 6]

- developing and maintaining integrated accounting and financial management systems;
- directing, managing, and providing policy guidance and oversight of all agency financial management personnel, activities and operations;
- approving and managing financial management systems design and enhancement projects;
- developing budgets for financial management operations and improvements;
- overseeing the recruitment, selection and training of personnel to carry out agency financial management functions;
- implementing agency asset management systems, including systems for cash management, credit management, debt collection, and inventory management and control; and
- monitoring the financial execution of the agency budget in relation to actual expenditures.

While the statutory provision establishing CFOs is the central focus of The Act, there are several additional requirements intertwined in the fabric of the law. These policies will have a significant impact on how the government conducts business and will further enhance financial management internal controls by mandating:

1. The preparation of five year financial management systems improvement plans both government-wide and in all 23 agencies covered by this Act.

2. The preparation of financial statements and audits of agencies to hold agency heads accountable for their operations.

3. Annual reporting to the President and Congress on the status of general and financial management in the Federal Government.

B. IMPLEMENTATION

Not surprisingly, many challenges face those government officials charged with the enormous task of implementation of the Act. The available literature to date tends to focus on the requirements, qualifications and role of the newly appointed CFO's and the difficulties that they must surmount. Furthermore, the changes called for in government operating procedures will not be inexpensive. While not all of the implications of the Act can be foreseen, some of the more difficult and sensitive issues have yet to be hammered out. These involve such things as the form and content of financial statements, the scope of audits, consolidation and interaction between various accounting systems, changes in agency relationships and infrastructure issues. Some of these issues are summarized below.

1. Qualifications

The myriad of responsibilities consolidated under the CFO indicates that those individuals must have a broadly configured management portfolio. The Act specifies the basic qualification standards as cited in the preceding section, but it goes further by requiring OMB develop and maintain additional qualification standards for agency CFOs and Deputy CFOs. The Act clearly envisions the CFO to exert a leadership role with the deputy as the technical expert. It also seems both these individuals must be experienced comptrollers, management aficionados, skilled in FM system design, and have a working knowledge of procurement, human resources and regulatory affairs. While there are already some in government who fit the bill, there is equally many in federal financial management who will not measure up under such rigid standards.

Specific qualification standards call for sufficient experience and knowledge of:

- generally accepted accounting principles
- laws and regulations applicable to financial management and operations
- budget preparation and execution
- principles, preparation and auditing of financial statements
- financial performance standards and measurement concepts
- internal and management control concepts
- design installation and management of automated FM systems

Furthermore, an academic degree in either accounting, business administration, finance, information systems or public administration is desired. Practical experience in these areas is expected to be obtained though high level exposure to private sector businesses, a major federal or state government agency, or work in the field of public accounting.

In his statement before the Senate Committee on Governmental Affairs, Comptroller General of the United States Charles Bowsher commented on OMB's draft qualifications standards. Foremost, he felt agency CFOs would need a background in financial management and accounting. Additionally, he states:

> To carry out the broad mandates of the CFO Act, agency CFOs must have demonstrated capability as influential financial management leaders, successful catalysts for bringing about change, and accomplished managers at the top levels of an organization. ... Also, a CFO must be skilled at (1) effectively communicating financial management objectives and issues to the agency head and other top level official outside the financial management area and (2) applying sound judgement in planning, developing and implementing financial management systems. [Ref. 7:p. 5-6]

What really will be required as CFOs are chosen and installed is (1) flexibility and (2) investment. Each agency must be looked at individually. "If an agency has an equivalent official in place who can effectively carry out the CFO role, he or she should be considered for the CFO appointment [Ref. 8:p. 14]." Equally important, investment must be made in people currently running the Governments vast financial network. As stated by the House report which accompanied the Act:

> The Federal Government must compete for the top college graduates and provide them a career path that is professionally and financially rewarding. Investments must be made to ensure that employees maintain, and even increase, their professional skills to help the government keep pace with emerging technology and developments in financial management. [Ref. 1:p. 17]

2. Resources

The sweeping changes required by the act do not come cheap. While not all the implementation cost can be quantified in dollar terms, OMB identified in the 1992 President's budget the requirements related to the Act.

> The 1992 budget [requested] about $104.4 million for audited financial statements - $31 million for the preparation of the statements, and $73.4 million for the audits of those statements. This $104.4 million request compares to a total of $10 million provided in the enacted 1991 budget for audited financial statements. [Ref. 8:p. 14]

Final FY92 appropriations provided $57 million for the preparation and audit of financial statements. One conclusion is obvious, continued pressure for funding must be applied to sustain these initiatives.

3. Form and content of financial statements

Notwithstanding the experience of a few agencies with audited financial statements, their practical utility has not yet been proven and many question need still be answered. Clearly, financial statements are needed for business type activities dealing in real estate transactions, credit programs, and trust and revolving funds. However, their usefulness for other government activities is still being debated. Statements of profit and loss don't make much sense for most government programs. Further complications involve questions of asset classification, liability reporting, accounting standards and the creation of the basic form and content of financial statements. Another concern is the fear that budgetary decisions would be skewed to favor capital investments over human investments.

With respect to the issuance of standards, OMB, GAO and the Treasury Dept. have created the Federal Accounting Standards Advisory Board (FASAB). OMB has until June 1993 to submit a report to Congress detailing the costs and benefits of a pilot program of agency-wide audited financial statements. Furthermore, over the next five years, FASAB is to recommend a comprehensive set of accounting standards. "In 1992 and 1993, exposure drafts will be issued on accounting standards relating to inventories and other materials held by government entities; loans and loan guarantees; unfunded liabilities; revenue recognition; and physical assets [Ref 11:p. iii]."

For the short run, FASAB has recommended guidance on interim accounting standards to used by federal agencies. Concurrently, OMB has published Bulletin No. 91-15 which provides specific guidance to the heads of executive departments on the form and content of financial statements on

FY 1991 financial activity. OMB Bulletin No. 91-15 defines an "Annual Financial Statement" as called for in Section 3515 of the Act and requires four principal statements be included in an agencies Annual Financial Statement as follows.

An Annual Financial Statement comprises:

1. Overview of the Reporting Entity
2. Principal Statements
3. Notes to the Principal Statements
4. Combining Statements
5. Supplemental Financial and Management Information

The Principal Statements include:

1. <u>Statement of Overall Financial Position</u> - Discloses the reporting entity's assets, liabilities and net position

2. <u>Statement of Operations</u> - Discloses the results of the reporting entity's operations for the period on an accrual basis

3. <u>Statement of Cash Flows</u> - Discloses the reporting entity's gross cash receipts and cash payments with an explanation of the changes in cash or cash equivalents for the reporting period

4. <u>Statement of Reconciliation to Budget Reports</u> - Reconciles operating expenses to budget obligations and outlays for the fiscal year. A draft OMB document indicates this report will be changed for FY92 to a <u>Statement of Budgeted and Actual Expenses</u>. This report will provide, by program, a comparison of the entity's current fiscal year budgetary resources and obligations reported on the entity's SF 133s (Statement of Budget Execution) against expenses reported on the entity's Statement of Operations, accompanied by a reconciliation of these expenses to the budget.

4. Scope of audits

OMB has issued guidance on the audit scope to meet the intent of the Act in Bulletin No. 91-14. At a minimum audits should result in an opinion on the statements, a report on internal controls, and a report on compliance with laws materially effecting the statements. In addition, it must be determined that the information presented in the Overview of the Reporting entity is consistent with the data presented in the Principal Statements. Also, to the extent possible, audit procedures will be developed and applied to assess the reliability of performance data presented in the Overview and Supplemental Financial Information.

The last point mentioned above shows that there is much pressure to expand audits to encompass performance measures at each activity. While this would increase the value of the audit enormously, it would cause significant difficulty as well. In effect, it would convert each financial audit in to a financial/performance audit requiring great care in sampling, testing and evaluation [Ref. 9:p. 8]. An audit on such a massive scale, containing untried financial statements, could quickly overwhelm the experience base of GAO and the IGs.

C. FEDERAL AGENCY OVERVIEW

1. OMB's Role

The CFO Act instituted sweeping organizational changes on the management side of OMB. First, as shown in Figure 1, the law created the position of Deputy Director for Management who is also designated the Chief Financial Officer of the United States. The CFO, Mr Frank Hodsell, reports directly to the director of OMB. Now OMB management offices are connected directly to a strong central leader, equal to the Budget Director, who has broad powers in both federal management and general management. Second, the Office of Federal Financial Management (OFFM) was established under the CFO Act. The OFFM serves to tie federal financial management together under the guidance of the Deputy CFO (Comptroller). Specifically, the Comptroller is charged with central coordination of financial standards, federal procurement issues and information resources management activities.

2. Government-wide Progress

While the powers given the Deputy Director for Management under Title II of the Act are wide-ranging, they essentially license an oversight capacity that demands agencies make tough choices or risk sustaining losses at the budget table. As of March 1992, OMB reports progress as follows: [Ref 10:p. 5]

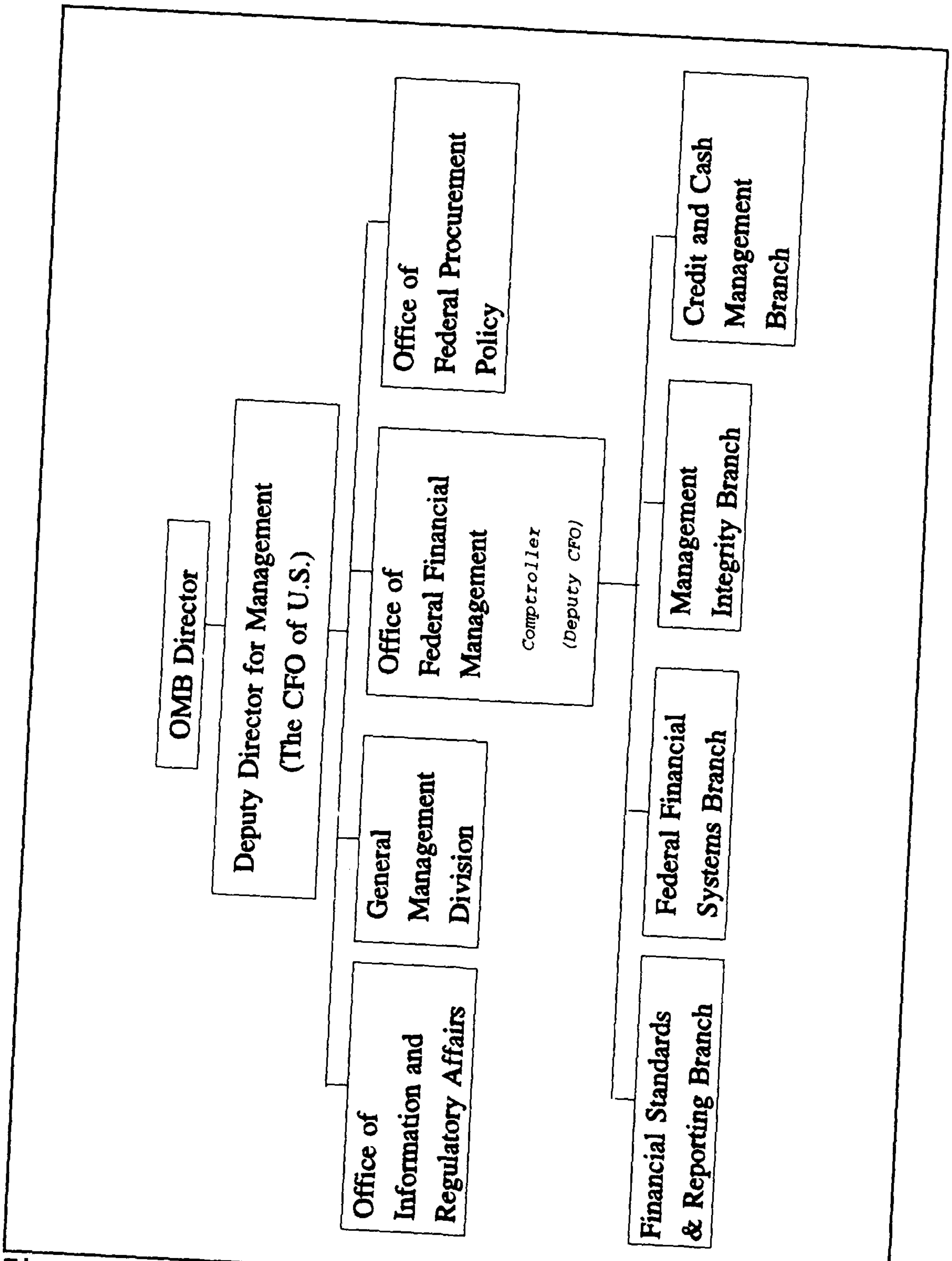

Figure 1: CFO structure within the Office of Management and Budget

- Financial management organizations have been approved and are in the process of implementation in 21 of 23 agencies covered under the Act[1]

- 14 of 23 CFOs are in place[2]

- The President's 1993 budget requests $659 million for improved financial systems, $31 million more than enacted in 1992

- The President's 1993 budget requests $101 million for improved financial reporting, $44 million more than enacted in 1992

- Audited financial statements are underway in the seven pilot agencies: Department of Agriculture, Department of the Army, Department of Labor, Department of Veterans Affairs, General Services Administration, Social Security Administration,and the Department of Housing and Urban Development

- A Federal Accounting Standards Advisory Board has been established

- OMB has published guidance on the Form and Content of Federal Financial Statements and Audit Requirements for Federal financial Statements

- GAO, Treasury, and OMB have initiated substantial training efforts, job classification and qualification standards and the Inspectors General have established an IG Auditor Training Institute

- The Federal Credit Reform Act of 1990 is being implemented

The evidence demonstrates shows that implementation of the Act is in its infancy and much work remains. OMB plans

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[1]The Departments of Agriculture and Justice have submitted plans but await completion of OMB analysis.

[2]The following agencies have career Senior Executive Service CFO's appointed but not yet confirmed by the Senate: The Departments of Agriculture, Education, Energy, Justice Labor, and Transportation, the Environmental Protection Agency, General Services Administration, and National Aeronautics and Space Administration.

to generate a model to compare agencies; however, the model has not yet been formulated. Additionally, the House of Representatives Committee on Government Operations intends to hold follow-up hearings sometime in 1993 to assess federal implementation efforts. In the meantime, OMB has published the Federal Financial Management Status Report and Five Year Plan in April 1992. This five year plan presents a "general road map" with which OMB will instruct agencies to develop detailed agency financial management plans.

OMB's strategy for improving federal financial management performance under the five year plan may be summarized by several principles. First and foremost, OMB officials feel principal improvements must occur at the agency level with responsibility placed squarely on the shoulders of agency heads and agency CFOs. Second, agency management must seek creative solutions to achieve specific performance objectives while reporting on the status of financial management through the use of straightforward performance measures that promote attention, praise or corrective action by senior agency officials. Third, OMB and senior agency officials must be outcome oriented with respect to financial management performance. Agency progress in achieving basic financial management performance objectives will be stimulated by interagency comparisons that note positive progress. Lastly, where resources are limited, agencies should first ensure that system modifications support achievement of basic financial management performance objectives. [Ref. 11:p. 47]

While the five year plan constitutes a general policy statement, it does give some insight into specific efforts underway in OMB and other federal agencies. For instance, the report states that OMB will integrate government-wide financial systems and eliminate duplicative and unnecessary systems through cross-servicing arrangements. To accomplish this goal, the Department of Agriculture will complete projects in 1993 to provide full payroll servicing for the Departments of Justice and Treasury. Additionally, OMB has sought increased funding to upgrade financial systems. The President's 1992 Budget requested $647 million; $628 million was appropriated by Congress. The 1993 budget requests $659 million for financial systems improvements.

In the area of financial systems, OMB's High Risk List reports on the status of federal financial systems. Based on an assessment of 16 high risk areas, 13 of 23 CFO Act agencies are included on the list. (DOD is not listed) To correct these weaknesses OMB plans to supplement updated policy guidance with action. OMB Circular A-123, "Internal Control Systems" and Circular A-127, "Financial Systems", will be revised in 1992 to simplify guidance, establish definitive standards and stress the importance of reporting on internal control and financial system weaknesses. In agencies where the pace of corrective action needs to be accelerated, OMB will continue employing the use of SWAT teams. The SWAT team concept was initiated in 1990 as a special joint agency/OMB effort to target the most serious material weakness identified in Federal Manager Financial Integrity Act reports. As of April 1992, 10 SWAT team projects have been completed and another 18 are in progress.

The five year plan states: "Integrated central agency systems are necessary to ensure adequacy, consistency, and timeliness of financial information for government-wide reporting [Ref. 11:p. 52]." To promote this concept OMB and Treasury will collaborate to expand Treasury's ADEPT database to include comprehensive financial and performance data and support one time electronic filing of required reports. This is a short term effort to eliminate redundancy and provide an operationally integrated data base by 1994. During the same period, OMB and Treasury will conduct an information architecture study to design a fully efficient and comprehensive central data system for the long term.

The Federal Government has made significant progress in it management of receivables and cash, as reported in the previous chapter. As OMB's five year plan unfolds, several agencies will initiate programs to address continuing concerns in the areas cash and credit management. For example, OMB's long-term cash management goal is to convert, as much as possible, the $2.6 trillion annual government cash flow to a fully electronic collection and payment system. The Department of Health and Human Services and the Department of Agriculture will participate in a pilot program to deliver food stamps and other cash benefits via electronic benefit transfer (automatic tellers, grocery store card scanners etc.) payment mechanisms. In addition, the Internal Revenue Service plans a 1993 test of the Federal Tax Deposit Redesign Project. This project will test electronic receipt, processing and deposit of annual employer tax deposits.

OMB officials view the area of federal performance measurement as uncharted territory for the federal government [Ref. 11:p. 29]. At the same time, OMB Bulletin 91-15, "Guidance on the Form and Content of Financial Statements on FY91 Financial Activity," requires agencies to include performance data in their annual financial statements. The purpose of providing these measures is stated as follows:

> ... (i) target higher levels of accomplishment by the agency; (ii) strengthen management's ability to know how it is doing; (iii) create measures of shared accountability throughout the organization; and (iv) motivate personnel toward achieving improved performance. [Ref 11: p. 61]

To that end, several agencies have set the stage for successful implementation of performance indicators. Specifically, the CFO's annual report for the Department of Labor included data showing improved performance in cash and credit management. The CFO's annual report for the General Services Administration presented extensive program performance data. The report submitted operating costs per square foot in government-owned office buildings for 1985-1990. The Department of Health and Human Services also provided considerable performance measurement data which was contained in the Social Security Administration FY90 financial statements. For instance, the unit cost of processing a Social Security claim and check issue procedures were presented.

The future promises continued progress. The President's FY 1993 budget sets some specific objectives. For example, based on work in the CFO council, OMB will provide more detailed guidance on financial reporting and financial performance measures. Treasury will integrate the financial data standards into the U.S. standard General Ledger. A policy and procedures manual for the audit of federal entities will be developed. Finally, the United States Chief Financial Officer, Mr. Frank Hodsell has stated:

> We're moving. But we have a long way to go. ... We need to roll up our sleeves over the next few years and move this progress forward -- so that we will have the right numbers to the right people at the right time. [Ref. 10:p. 8-9]

D. SUMMARY

The CFO Act incorporates many of the principles and elements in a decade long effort to reform federal financial management. First, it establishes a primary accountable official in the body of the statutory Chief Financial Officers. Second, it puts a financial management organizational structure in place with 23 CFOs reporting directly to the heads of agencies. Third, it requires agencies to develop financial management plans and produce annual progress reports. Fourth, it sets the stage to move toward financial statements that classify costs by program, provide corresponding measures of program performance, and project future liabilities and returns on programs investments.

Efforts to comply with the requirements of the CFO Act are underway in all 23 agencies. The Presidentially-appointed, Senate-confirmed positions of Deputy Director for Management and Comptroller and an Office of Federal Financial Management are established in OMB. Fourteen of 23 Agency CFO's have also been confirmed. In April 1992, OMB published the Federal Financial Management Status Report and 5-Year Plan. The 5-Year plan outlines how OMB and federal agencies will use the tools provided by the CFO Act to improve financial management.

While the passage of the act represents a major step forward to improve the quality of federal financial management, it also presents many challenges in the monumental task of implementation to meet the goal of one of its authors - Rep. John Conyers, Jr.- to make the 1990's the "Age of Accountability."

IV. DEPARTMENT OF DEFENSE IMPLEMENTATION

The Department of Defense has embraced the CFO Act as a valuable opportunity to improve financial management. Initiatives underway in response to the Department's Defense Management Report (DMR), approved by President Bush in July 1989 nine months prior to passage of the Act, prepositioned the agency to quickly implement the law. The Defense Management Report highlighted the need to improve the management infrastructure within DOD and in particular the financial management systems. With initiatives such as the consolidation of the Defense Finance and Accounting Service and Corporate Information Management taking root, the Department concluded that changes already in progress are needed to fulfill the provisions of the law. Specifically:

> Our review of the Comptroller/CFO's current responsibilities shows that DOD is well equipped to respond to the requirements of the new CFO legislation without changes to the organizational alignments within the Department, and only minor changes to the functional responsibilities of the DOD comptroller/CFO. These changes will involve added responsibilities for the preparation of auditable financial statements, greater authority over the implementation of financial systems improvements, and a more active role in the training and selection of financial personnel. [Ref. 12:p. 1-1]

DOD took the first step to exercise the authority provided by the CFO Act when the President designated the DOD Comptroller, the Honorable Sean O'Keefe, to be the DOD Chief

Financial Officer. Next, DOD evoked the CFO act to strengthen and define clear lines of financial authority which established the DOD Comptroller/CFO as the single official responsible for the department financial management goals and objectives. The CFO office was then organized as displayed in Figure 2.

This figure shows that while the Department of Defense components have retained their own budgeting, accounting and financial management offices, the operation of these offices is subordinate to the overall direction and guidance provided by the CFO of the Department. This oversight and approval position is exactly what the legislation envisioned. Its purpose, with respect to DOD, is to prevent the Military departments from developing redundant systems and establishing individual financial management goals. Furthermore, the CFO now has both the responsibility and authority to govern the Departmental budget process, introduce improvements and hold component managers accountable for their efforts.

As indicated above, DOD swiftly adopted the goals and objectives set forth in the CFO act. To better understand how far the Department has come this chapter will look more closely at the key DMR initiatives including the consolidation of DOD Accounting and Finance Operations, Corporate Information Management, and the Defense Business Operations Fund. Additionally, the effort to publish audited financial statements will be explored. Last, a review of GAO's audit of

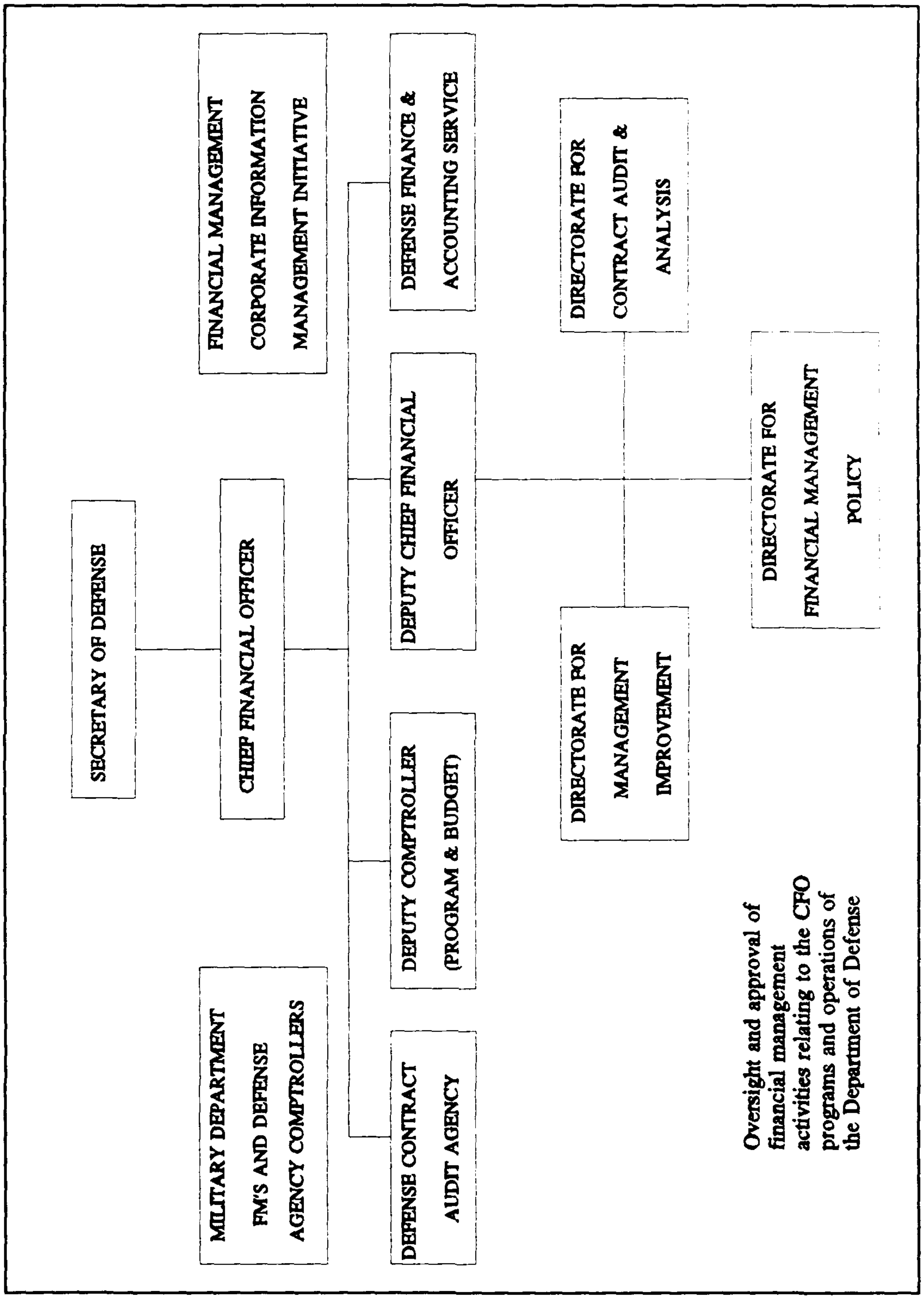

Figure 2: CFO structure within the Department of Defense

the Air Force will show that while the Department is positioned to meet long term requirements of the Act, there are several systemic deficiencies that must be corrected.

A. CONSOLIDATION OF DOD ACCOUNTING AND FINANCE OPERATIONS

On January 15, 1991 the Defense Finance and Accounting Service (DFAS) was established by consolidating the military department's finance and accounting centers into a single organization under the DOD Chief Financial Officer. DFAS is intended to provide uniform accounting policy guidance, establish requirements for financial systems, provide finance and accounting services, and prepare financial statements. "The objective of this initiative is to provide the Department with a more timely, comprehensive, and accurate financial data; consolidate and standardize the Department's diverse finance and accounting operations, systems and policies; and improve customer service, while reducing costs [Ref. 13:p. 3]."

In its first three months DFAS consolidated twenty-two major financial offices and organizations. DFAS will ultimately incorporate 1,300 field activities. Unfortunately, however, consolidation is not that simple. Two major hurdles remain. There are still numerous accounting systems and modules in operation within the Department (see CIM below) and DFAS has still to expand to encompass many of the base level finance and accounting functions. Until these weakness are corrected the Department's efforts to achieve uniform operating procedures, streamline reporting requirements, eliminate redundancy and cut cost further will not be met.

B. CORPORATE INFORMATION MANAGEMENT

Introduced in October 1989, the Corporate Information Management initiative was established to develop concepts for improved business processes and increase management efficiencies. CIM's importance stems not only from its potential to offer significant savings through improved business practices, but also from its potential to revolutionize and streamline the use of DOD's information resources. The stated objective of the CIM project is to provide standardization, improve the quality and consistency of information systems, and reduce redundant systems meeting the same functional requirement. To ensure that past pitfalls are not designed into new development efforts, DOD has created several forums for CIM issues such as a CIM Council, Functional Steering Committees and Functional Groups.

The CIM Council is composed of senior level (flag or Senior Executive Service) representatives of the Office of the Secretary of Defense, Joint Chiefs of Staff, Defense Logistics Agency, Military Services, etc. A Financial Functional Steering Committee, chaired by the CFO, has been established to oversee efforts involving financial management systems. Functional Groups have been established to review and develop standard information requirements for specific business areas. Groups are composed of senior level policy makers and information and subject matter experts on a DOD-wide basis. Four financial management functional groups are currently developing standard financial systems to replace existing financial systems being operated by various DOD organizations. These groups are: [Ref. 12:p. 1-4]

- Financial Operations
- Civilian Pay
- Government Furnished Material
- Contract Payments

Defense officials estimate that designing and implementing the systems under development by these Functional Groups could take many years. Original expectations allowed one to two years for the groups to formulate a strategy for producing standard practices and systems, then six to eight years for actual system development. In the meantime, the CIM project is considering the best of the military service financial systems to use as an interim system until it decides how to best implement CIM standard systems.

As of February 1992, the Department has selected standard systems for civilian pay, military pay and travel. Twenty-seven different civilian pay systems will be replaced when the new pay system comes on line. A military pay system has been chosen to replace the separate systems used by the Military

Departments. It will enable the Department to pay active, reserve and national guard members from the same system. The standard travel system, when implemented, will simplify and standardize the computation of travel entitlements, reduce accounting reconciliation problems and greatly reduce the manual processing of travel vouchers. [Ref. 13:p. 10]

For the final comment on CIM, note the chain of command depicted on Figure 1. The diagram shows only a dotted line between the CFO and the Financial management/Corporate Information Management Initiative. This indicates the CFO has only oversight and approval authority over CIM. Not shown is that the CIM project is under the direction of the Assistant Secretary of Defense for Command Control, Communications and Intelligence. This was done to integrate Defense computing, telecommunications and information management and to establish a new organization to implement CIM. The CIM project will need to be closely coordinated with the Comptroller's office because by the Act, it is the CFO who has the final responsibility for ensuring that financial management systems comply with applicable regulations.

C. DEFENSE BUSINESS OPERATIONS FUND

As of October 1, 1991 (FY 1992) selected DOD industrial funds, stock funds and other commercial activities were consolidated into one Defense Business Operations Fund (DBOF). The total value of goods and services to be financed by the fund is approximately $77 Billion in FY92. The Fund's objective is to "provide a business management structure that encourages employees of the Department's support organizations to recognize and recover the costs of producing a product or providing a service; ...and provide products at the lowest cost [Ref. 13:p. 6]." Specifically, by identifying support costs DOD will be able to determine the total cost of operating individual components, such as a military base or a fighter squadron.

The success of the Defense Business Operations Fund is closely tied to the two initiatives just described. To meet its objective, the Fund will require effective and coordinated financial systems (CIM) and accurate financial reporting (DFAS). The Fund is essentially an extension of the revolving fund concept that have been in use throughout DOD for over thirty-five years. Figure 3 shows the relationship of the various DOD Funds. As a revolving fund, DBOF is required by the CFO Act to submit audited financial statements. It is intended that the respective military services continue to maintain individual control and submit statements separately for each fund absorbed under DBOF.

1. Revolving operations

To form a revolving fund a specific group of assets or services are capitalized as one account. That account (fund) is then reimbursed as the assets or services are

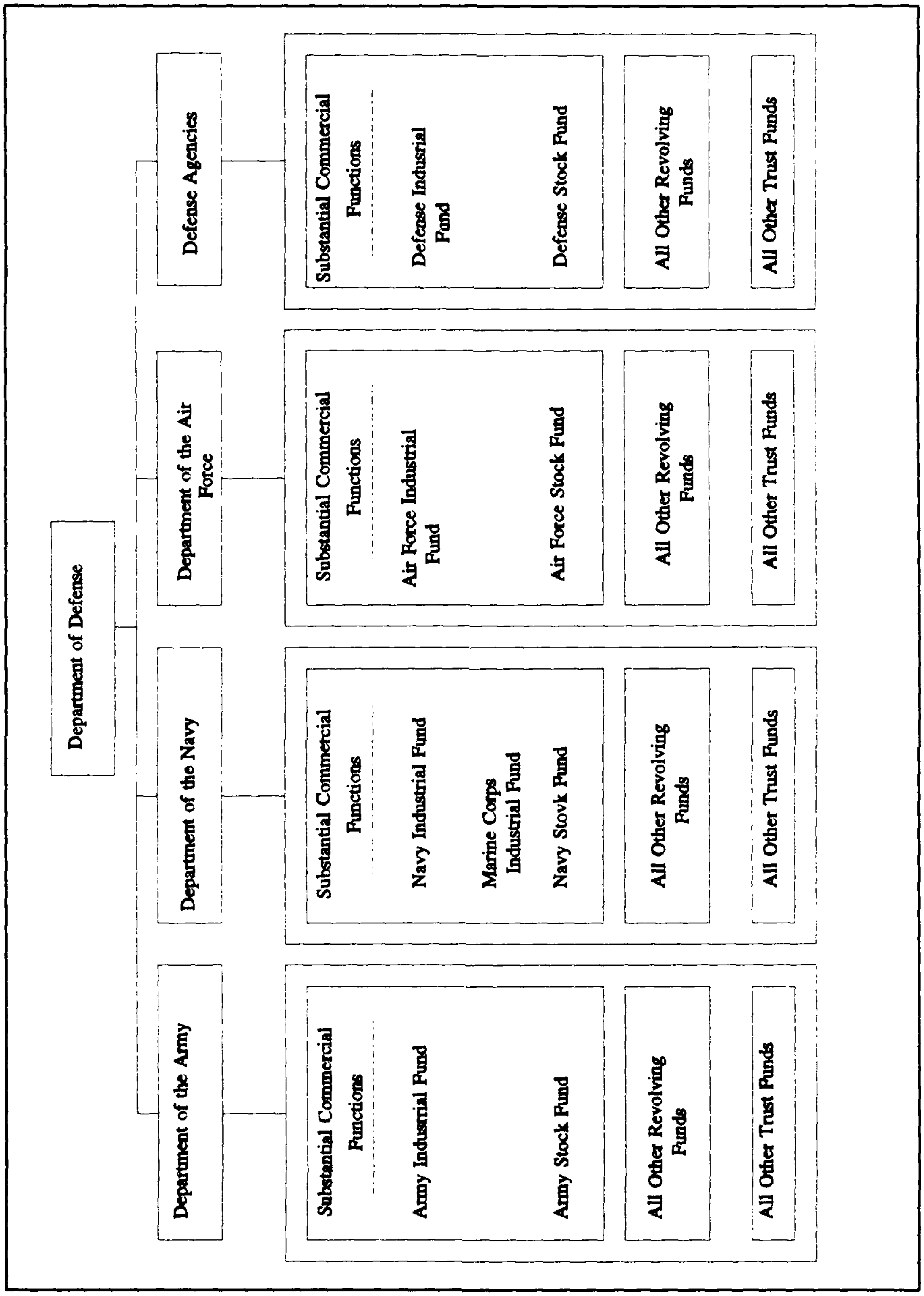

Figure 3: Relationship between DOD revolving funds

utilized. A revolving fund is set up similar to a non-profit business. The goal is to break-even by charging an amount sufficient to cover the cost of providing goods and services to its customers. In the case of DBOF, customers are the Defense activities supported by appropriated funds. Payment is most commonly made in the form of a transfer from an operations and maintenance account. There are basically two types of revolving funds in use by the Department - industrial funds and stock funds.

An industrial fund (IF) is designed to provide an effective means to finance and control the cost of repair and maintenance facilities. Typical activities accounted for under industrial funds include naval shipyards and aircraft rework depots. An industrial fund activity's budgetary resources are generated through customer orders and limited working capital appropriated by Congress. Under the reimbursable process, customers use their appropriations to finance an order which, when accepted by the IF activity, causes a shift of budget authority from one account to the other. For FY91 DOD listed eighty IF activities which handled business valued at approximately $25 billion.

Defense stock funds provide financial management, inventory control, and distribution of supply system stock to support military operations. A stock fund buys and holds inventory for sale to authorized customers. A surcharge is then added to each item so when sold, sufficient funds are generated to cover cost and replenish inventory. "For FY91, Defense Officials will have inventory valued at $66 billion and annual sales of $39 billion [Ref. 14:p. 7]."

2. Concept and benefits of DBOF

"The concept is rooted in two fundamental principles -- total cost visibility and basic economics [Ref. 13:p. 6]." Old accounting systems and current budget formulation have not provided an adequate understanding of all the expenses incurred when carrying out a service or performing a support function. Although operating cost were captured in the Department's accounting systems they were broken down such that they only gave a piece of the puzzle. Rarely did all the pieces get the visibility where a manager could assemble the puzzle to make an informed decision. For example, until recently, stock fund prices excluded military personnel costs, warehouse construction and industrial plant and equipment costs because they where accounted for separately at each supply activity.

Knowledge of the total cost of providing support functions in theory leads to the application of basic economics. Support functions are provided as required by operating military units. Essentially, support services are supplied at the level demanded by the market place. "The economics of the Business Operations Fund puts the funding in the hands of the operating forces to pay for the levels of service and support required [Ref. 13:p. 8]." Where options are available and customers can make informed unit cost or full cost tradeoff decisions, competition will force suppliers to be more efficient. This has already been proven where shipyards have competed against each other for ship overhauls.

Department of Defense (OSD) managers believe one additional benefit will accrue from DBOF and unit costing. Information alone does not bring about cost tradeoffs. At the core of DBOF is the revolving fund philosophy with the intuitive goal to make the best use of every dollar spent, rather then simply ensuring it all is obligated by the end of the fiscal year. The CFO, Mr. O'Keefe, feels that if this approach can change spending behavior it may be the most "...dramatic cultural change associated with the Business Operations Fund initiative [Ref. 13:p. 8]."

3. Challenges to success

Five months before DOD formally established the Fund the Government Accounting Office testified to Congress that while they strongly supported the DBOF concept, the Fund's implementation was premature. Given the size and complexity of Fund, GAO cited several weaknesses which could inhibit the future success of the program.

a. Accounting weaknesses

GAO officials also made it clear that in their opinion, Defense does not have the financial management systems inplace to operate the Fund as an effective and efficient business like entity. They cited the Department's own Federal Financial Managers' Financial Integrity Act reports which have pointed out that the financial systems supporting the fund lack adequate internal controls and the ability to accurately report on the results of operations. The issue is a matter of accounting system adequacy. If the Fund cannot accurately accumulate and allocate costs, then its liquidity could be seriously effected.

From the GAO perspective, problems exist in all the stock and industrial funds. GAO has indicated that some Air Force industrial activities have material issues that exceed requirements and have not been able to match costs incurred to specific job orders. For accurate cost accounting, control, and billing these activities need to know how much material each job should require and how much was actually used. Without such data cost overruns are unavoidable. Furthermore, the cost of work preformed on a specific job order may be understated because all relevant costs may not have been allocated. (In counterpoint, the DBOF initiative says the same thing -- in essence arguing for implementation of the Fund) Either way, customers that have not been properly billed may not be reimbursing a fund for work performed and fund solvency could be impacted. These and other Air Force problems will be addressed more thoroughly later in this chapter.

The Air Force is not the only activity to be cited as having accounting problems. GAO maintains that the Navy has reported over he past six years that its stock fund accounting system had material weaknesses. For instance, stock fund records required extensive manual manipulation and did not provide sufficient details to influence decisionmakers. Furthermore, GAO points out:

> ... since 1985, the Department of the Navy has reported in its Federal Managers' Financial Integrity Act Reports that Navy's industrial fund accounting system is not in compliance with GAO's accounting principles, standards, and related requirements. Navy reported in its fiscal year 1990 report that the system had material deficiencies in the following areas: (1) general ledger control and reporting, (2) accounts receivable, (3) systems control, (4) audit trails, (5) cash procedures, (6) system documentation, (7) system interfaces, (8) timeliness or usefulness of reports and budgetary accounting, and (9) property accounting, including accounting for government furnished material. [Ref. 14:p. 20]

The Department of Defense Comptroller, in order to receive congressional approval of DBOF, has addressed each of these concerns in direct negotiation with GAO.

b. Impact on congressional oversight

In order to manage the many revolving funds consolidated in DBOF with business acumen, the Department raised the level of congressional oversight and control from many separate accounts to one large account. Managing one large fund Defense officials have increased flexibility to shift budget authority, including cash, between the fund's accounts. Under the old rules, Defense policy required that all transfers of budget authority between the various stock and industrial funds be approved by the Armed Services and Appropriation Committees. Under DBOF, reprogramming is governed by the more liberal rules applicable to reprogramming within a single appropriation. For example, cash can now be shifted between the Navy Stock fund and any other stock fund as management deems necessary without consulting congressional committees.

The advantages this increased flexibility gives the Fund managers are there by design. However, DOD should guard against potential political ramifications if members of Congress feel they have lost control. Ultimately, with the proper reporting on the results of the Funds operations, the Congress should continue to receive the information it needs to maintain proper oversight of the Fund. Conversely, GAO Officials fear that without sound reporting and control, increased flexibility could lead to abuses. [Ref. 14:p. 17]

4. DBOF summary

The Defense Business Operations Fund initiative strives to instill a more business-like approach to the management of Department support functions. This approach focuses the attention of management on the cost of carrying out defense operations. DOD Officials believe that summing the various revolving funds into one account makes economic sense and will raise cost conscienceness. On the other hand, GAO staff has argued that Defense did not have the policies and procedures in place to implement the Fund and make it effective. Also, GAO notes that the methods for maintaining congressional oversight are not yet developed.

While the problems GAO cites are not insurmountable, they are not easily solved. The success of the Fund is closely interrelated to the CIM and DFAS initiatives. Carefully planned standard financial systems developed under CIM could correct the accounting and cost control deficiencies which plague the revolving funds. The Congress may achieve improved oversight of Defense business operations as DFAS improves financial reporting by providing audited financial statements.

D. AUDITED FINANCIAL STATEMENTS

During testimony presented to the Senate Governmental Affairs Committee, the Department's CFO testified that audited Financial statements are the "capstone" of DOD's financial management improvement process. CIM, DFAS, and DBOF are designed to generate systems and procedures to promote the standardization and production of more timely, accurate and meaningful financial information for management. Once these programs are inplace, audited financial statements become an easily obtained by-product of the vastly improved accounting process. [Ref. 13:p. 4-5]

Section 3515(a) of the CFO Act of 1990 requires that the head of each executive agency prepare and submit to the

Director of OMB, not later than March 31, 1992, a financial statement for the preceding fiscal year. To meet this deadline, DOD published a memorandum on November 13, 1991 to provide guidance on the form and content of financial statements on FY 1991 activity. Essentially, this document absorbed the guidance delineated by OMB in Bulletin 91-15[3] and specifies which Defense Department entities must submit statements, establishes reporting standards to be followed, and tailors performance measures to be used by DOD activities.

1. Reporting entities

The Department of Defense and OMB have agreed upon fifteen reporting entities for FY 1991 as shown in Figure 4. A separate financial statement is to be prepared for each reporting entity in an agency. DOD reporting entities have been selected for the purpose of: [Ref. 15:p. 2-1]

> 1. Identifying the substantial commercial functions, revolving funds, and trust funds to be covered by financial statements
>
> 2. Determining DOD components in which to group these functions and funds. These groupings represent units for which meaningful performance measures can be developed now or in the future
>
> 3. Determining whether a financial statement will be prepared for the entire Military Service or Defense Agency or only that portion of the DOD Component directly related the commercial functions, revolving funds, and/or trust funds.

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[3]Refer to Chapter III, p. 25-26 for a description of required statements

DEPARTMENT OF DEFENSE
REPORTING ENTITIES

Department of the Army	Defense Industrial Fund - Communications
Navy Industrial Fund	Defense Industrial Fund - Clothing and Textile
Navy Stock Fund	Defense Agencies, Other Revolving Funds
Marine Corps Stock Fund	Defense Agency Trust Fund
Marine Corps Industrial Fund	Defense Agencies, Other Trust funds
Navy, Other Revolving Funds	Foreign Military Sales
Navy, Other Trust Funds	
Department of the Air Force	
Defense Stock Fund	

Figure 4

The Department of the Army has been selected to be the test platform in preparing organization-wide financial statements in addition to the separate statements covering its commercial functions and revolving funds. Notice than while the various revolving funds are still being accounted for separately, in the future they will be accounted for as one entity under DBOF. Of the reporting entities listed in Figure 4, only statements prepared for the Department of the Army, the Navy Industrial Fund, Navy and Marine Corps Stock Funds, Marine Industrial Fund, and the Defense Agencies Stock Fund will be audited. The Department has opted to request waivers from the audit of the remaining entities FY 1991 financial statements, but not from the preparation of those statements.

2. Accounting principles and standards

DOD is actively working with the Federal Accounting Standards Advisory Board (FASAB) to develop accounting standards which can be applied on a government-wide basis. Pending issuance of final accounting standards, FASAB has recommended that executive agencies continue using the policies and procedures already in effect to produce financial statements. To that end, DOD has specified mandatory use of the DOD Accounting Manual that implements Title 2, "Accounting Principles and Standards", of <u>The Policy and Procedures Manual for the Guidance of Federal Agencies</u>, published by the U.S. General Accounting Office [Ref. 15:p. 4-1]. Any deviations from these sources must be fully disclosed in the "Notes to the Principle Statements."

To the extent that guidance is not provided in the DOD Accounting Manual, and GAO, OMB, or Treasury publications, the Department is forwarding new methodology to the FASAB for consideration. For example, DOD has requested the board approve a proposed method for valuing DOD's inventory for financial statement presentation. The proposed method provides DOD inventory be valued at the latest acquisition price paid for an item. The Department seeks to use this method as the basis for inventory valuations in financial statements because it is thought to yield the best approximation of the utility value of the inventory to DOD's mission. DOD has suggested that other agencies operating revolving funds may find this approach useful.

3. Performance/trend analysis

OMB has defined five separate parts that will comprise an entity's financial statements. Part one, Overview of the Reporting Entity, is considered to be the most widely used by high level decision makers and non-accountants. It must provide readers with a clear and concise understanding of the reporting entity's activities, accomplishments, financial results and conditions, problems, and needs. [Ref. 16:p. 2]

To accomplish this purpose, the Overview should provide a brief description of the reporting entity including program and administrative highlights. It should include a narrative discussion and analysis of the financial condition of the entity. This discussion must be more than a simple summary of the information contained in the Principle Statements. The discussion should present information based on the results of an analytical review of relevant financial and performance data of each entity's programs and funds. Relevant trends should also be identified and discussed.

a. *Analysis framework*

In developing financial, statistical, and other information for presentation in the Overview, DOD policy has incorporated the guidance contained in the March 1991 staff study by the U.S. General Accounting Office entitled <u>Financial</u>

Reporting - Framework for Analyzing Federal Agency Financial Statements. Using this study, DOD has identified seven financial attributes that will form the focus of financial statement analysis. These attributes will be quantified in terms of measures and indicators that will be subjected to detailed examination. Next, the financial statements can be further analyzed to produce a comprehensive evaluation and interpretation of the program or agency financial attributes.

A financial attribute is defined as a distinct aspect of financial management in an agency or program. For example, operating costs and capital investments are attributes of a DOD program. The term "measure" is used as a quantitative gauge of a financial attribute. Net operating costs of an agency measured in dollar amounts by subtracting the agency's revenues from its accrued expenses is an example. The term "indicator" refers to a quantity in terms of dollars or percentages that assists users in making a judgement about the significance, magnitude, or direction of a change in a financial attribute. For instance, in commercial-type entities, the ratio of assets to accrued liabilities is considered a an indicator of the entity's solvency.

TABLE 1: DOD FINANCIAL ATTRIBUTES, MEASURES AND INDICATORS

Attributes	(M) = measure; (I) = indicator
Operating costs	(M) The net operating cost = expenses - (revenues + reimbursements)
	(I) Average annual percentage change in the net operating cost
Operating results	(M) Net operating cost - appropriated funds
	(I) Appropriated fund/net operating costs
	(I) Operating deficit/net operating cost
Operating efficiency	(I) Input required per unit of output
Capital investments	(M) Gross capital expenditure - capital recovered from the disposition of assets
	(I) Net capital investments/average balance of investments
	(I) Agency or program net capital investments/U.S. government net capital investments
Financial obligations	(M) The amount of liabilities
	(I) Assets reserved for a liability/the amount of the liability
Financial condition	(I) Cash surplus or shortfalls
	(I) Net income + depreciation + interest expense/debt service costs
	(I) Liquid assets/current liabilities
	(I) Liabilities/assets
Efficiency in managing assets	(I) Inventory turnover ratio (average inventory/materials and supplies expenses

Table 1 summarizes the financial attributes, measures, and indicators[4] to be used to by DOD when analyzing Department financial statements.

In addition to the generic measures and indicators used to support financial attributes, each applicable DOD Component is required to include performance

NAVY INDUSTRIAL FUND

Military Sea Lift Command:
Ship days
Measurement tons, point to point
Long tons

Public Work Centers:
Maintenance & repair items
Utility services
Sanitation services

Navy Publication & Printing Office:
Units printed

Research & Development:
Direct workyears; tech base
Direct workyears; other RDT&E,N
Direct workyears; other customers
Total cost per direct workyear

Figure 5

measurements as a part of their financial statements. These performance measures are more commonly called as work load

[4]For complete description of attributes, measures, and indicators to be used by DOD for financial statements analysis see Reference 12, chapter 5.

indicators by GAO. The purpose of a performance measure is to provide quantification of the output of an entity for which financial statements have been prepared. These measures may be expressed in both financial (dollar) and nonfinancial (workload) terms. Program specific performance measures are expected to appear in the narrative overview for DOD

NAVY/MARINE CORPS INDUSTRIAL FUNDS	NAVY STOCK FUND
Depot maintenance:	Supply Operations:
Direct Labor Hours	Line items managed
Planes reworked/repaired	Requisitions received
Engines reworked/repaired	Receipts
Missiles reworked	Issues
Ship overhauls	Contract executed
	Net unit cost per sale

Figure 6

reporting entities as a means of further judging that program's effectiveness. For example, Figures 5 and 6 show selected Department of the Navy proposed workload indicators.

A program-based analysis is particularly important for the DOD, since it operates multiple programs with diverse missions. Each program may have its unique operating characteristics and environment which may not be completely defined by the financial attributes data available. For example, revolving fund accounts can and do incur costs to taxpayers where expenses exceed revenues. Thus, the financial condition and operating results of these programs are subject to analysis using the financial attribute method to assess their current cost and future demand for federal resources. The Department then adds workload indicators to ensure users of financial statements have a full understanding of the reporting activity and its functions, accomplishments and problems.

The last step in analyzing the financial statements for the Overview is to produce a comprehensive evaluation and interpretation of program and agency financial attributes. The Department and GAO suggest the use of certain analytical techniques. The most commonly used methods of analysis can be summarized into four categories:

- Trend Analysis
- Cross-Sectional Analysis
- Structural Analysis
- Causal factor Analysis

Trend analysis is used to examine the historical behavior of a financial variable over time. For that reason it has also been called time series analysis. "Trend analysis is useful in two ways: (1) it provides a clue for further investigation into factors that might have caused the increase or decrease in a financial measure and (2) it provides a trend to help make predictions about the future [Ref. 17:p. 29]." Cross sectional analysis, on the other hand, compares a financial attribute of an entity with the same attribute of entities having similar characteristics.

The structural analysis technique, also called decomposition, analyzes the components of a financial attribute, their relative shares, and changes in the structure of the attribute. For example, total operating cost of a program can be broken down into cost components by either object (salaries, supplies, utilities) or by activity. Each cost component can then be expressed as a percentage share of the total operating cost. This technique helps provide insight into the internal structure of an agency's assets, liabilities, expenses or revenues.

Any factor which has a significant effect on financial measures or indicators, directly or indirectly, is known as a causal factor. An analysis of causal factors helps explain what changes took place in a financial attribute in the past and may help predict future changes. Overall, the primary role of the financial statement analysis techniques described is to highlight and interpret the changes that have taken place in the financial condition and operating results of a program or agency.

4. Financial statement summary

The Department of Defense is required by the CFO Act to prepare financial statements covering its substantial commercial functions, revolving funds, trust funds and eventually - complete agency-wide statements. Financial statements prepared by DOD components are expected to provide information to program managers, the Congress and the public which will facilitate the effective allocation of resources and enable realistic assessments of management performance.

Audited financial statements may be viewed as a report card on agency financial management to point out deficient systems, quantify the extent of problems, and highlight what needs to be done to improve the system. In addition, financial statements can highlight critical information such as the significance of capital investments, inventories, and cash utilization. Financial statements also may be used to show trends, make comparisons and provide a basis for evaluating an agencies performance.

All financial management information may be defined in terms of financial attributes. In turn, each attribute may be quantified in terms of measures and indicators. Federal agency financial statements must be analyzed to produce an in-depth evaluation and interpretation of program and agency financial attributes. The examination process uses the analysis techniques of Trend, Cross-Sectional, Structural or Causal Analysis to answer such questions as: Has a financial measure or indicator changed over a period of time? If so, by how much? What are the major components of a financial attribute that are responsible for the changes? How do a program's financial measures and indicators compare with similar programs? Findings and conclusions of these analytical tools will help users of federal agency financial statements better evaluate the historical data, make more informed planning and budgeting decisions and make better predictions about future operations.

E. PROBLEMS WITH DOD IMPLEMENTATION

In 1990 the General Accounting Office evaluated the Air Forces financial management operations and systems for fiscal years 1988 and 1989 and issued a comprehensive report on the results of the audit. Since the release of that report the GAO has carefully followed the progress of corrective actions planned by DOD and the Air Force. In GAO's opinion, "...the Air force had failed to implement corrective Actions in accordance with its action plan and as a result, only limited progress has been made in rectifying the deficiencies [that were] previously reported [Ref. 18:p. 2]." GAO does recognize, however, that the implementation of the CFO legislation has affected the nature and timing of DOD and Air Force actions. While the Department of Defense has quickly moved to implement the provisions of the Chief Financial Officer Act, the programs initiated are long-term solutions to present financial management problems.

The audit report cited four major areas where the GAO considered improvements necessary. The DOD Comptroller concurred with these four major areas and added that "they represent systemic deficiencies that exist not only in the Air Force but throughout the Department of Defense [Ref. 13:p. 14]." These areas are:

1. Integration of budgeting and accounting systems
2. valuation of major weapons systems
3. Accuracy of tracking and reporting inventories
4. Adequacy of internal controls

Each of these areas are now addressed in greater detail.

1. Integration of budgeting and accounting systems

Department officials recognizes that the issue of integrated budgeting and accounting systems has been a long standing problem and cites the DFAS and CIM initiatives discussed earlier as the corrective action. Under DFAS the Air Force Accounting and Finance Center has been consolidated into DFAS, Denver Center. Thus, because of this reorganization, actions requiring major system changes in response to the GAO report will have to be directed by DFAS rather than the Air Force. Furthermore, a long range goal of these initiatives is establishing a single accounting system in DOD. The Air Force development effort to improve its financial systems was delayed when the focus shifted to a DOD-wide project. While DOD and Air Force action plans are progressing under these initiatives, it must be stressed that the these programs are only in their early stages of a long development process. Tangible benefits are unlikely to realized for several years.

2. Valuation of major weapons systems

The GAO report recommended that the Department accumulate and report the actual cost of weapon systems, which include acquisition cost, government furnished material, operating and maintenance cost and modifications.

The valuation of major weapon systems in the Air force, and throughout DOD, has normally been computed at standard or contract costs. The contract cost is the budgeted per unit cost of a weapon system. The department's accounting systems have not been capable of tracking and accounting for those systems once they have been put into operational use. Currently, program managers maintain weapon system cost data on logistic systems designed to meet operation needs. Consequently, in August 1991, the Department began an effort to identify logistical and accounting systems used to obtain information on real and personal property values for year end financial reporting. Until that process is completed, DOD will not be able to provide documented audit trails for property assets reported in financial statements.

Government furnished equipment has traditionally been overlooked in the valuation of weapon systems since it is not included in contract costs. Additionally, modifications are not included in weapon system costs unless the modification leads to a new weapon system. Including these costs in FY 1992 financial statements in the absence of an integrated, transaction based general ledger (CIM/DFAS project), will require considerable amounts of manual review and calculations. However, to accomplish this task DOD is negotiating with GAO officials the use of a weighted average valuation concept. This concept was first proposed by GAO in their review of Army financial statements for 1991 [Ref. 13:p. 18]. If approved the Department will begin valuing the majority of weapon systems and increase coverage in subsequent years. This procedure is acknowledged by DOD to be a stop gap measure until standard procedures for accumulating and reporting actual costs are adopted throughout the Department.

3. Accuracy of tracking and reporting inventories

There are two inventory areas where DOD and GAO officials believe work must be done to meet the objectives of the CFO Act. First, the standard sales price used to value inventory items must be adjusted to better represent the true utility value of inventory to DOD's mission. DOD's proposal is to replace standard costing with the Latest Acquisition Cost Method [Ref. 13:p. 20]. Application of this method is pending approval of the Federal Accounting Standard Advisory Board. Second, the value of unserviceable items must be adjusted to allow for the cost of repair and unrequired inventory disposed of and taken off the books.

DOD is in the process of implementing an overall plan to reduce inventory that involves a comprehensive evaluation of material requirements and the inventory management process. From FY 1991 on, the value of unserviceable items will be decreased by the amount of repair on financial statements. Unrepairable items be valued as scrap. Both excess and scrap will be offered for sale at public auction. As part of this project, GAO reported the Air Force has held warehouse reviews for excess items at all Air Logistics Centers. As a result, more than $600 million worth of items were sent to disposal which freed over 1.2 million cubic feet of storage spaces. [Ref. 18:p. 19]

4. Adequacy of internal controls

Department officials have acknowledge that internal control failures have led to loss of resources. In its response to GAO's Air Force audit, DOD attributed non-compliance with or lack of knowledge of existing internal controls as the cause of the deficiencies cited [Ref. 13:p. 20]. In the short run, the Air Force has reviewed and revised instructions to clarify requirements and conducted formal training in financial management. For the long run, DOD must overhaul its education and training programs to keep pace with the changes taking place within the Department in response to the CFO Act.

A review of financial management education and training systems is underway in the Department under DMR 985. Training must parallel the system developments in CIM and DFAS. An advisory board has been created and analysis of current and future education and training needs have been separated into five functional areas--finance and accounting, comptroller, auditing, budgeting and cost analysis. The educational requirements of each of these areas will be reviewed, new material added and duplicative course work eliminated.

The Defense Finance and Accounting Service has been designated as executive agent for DMR 985. The key to this initiative is establishment of the Defense Resource Management Institute (DRMI). The Defense Management Resource Education Center, a tenant command of the Naval Postgraduate School, will become DRMI and will perform a broadened role in support of financial management education and training. In addition to providing instruction in advanced resource management for DOD, the Institute will perform several new functions. DRMI will review new financial management education and training course development proposals from the military departments and agencies. DRMI will also assume the function of periodic production of the Catalog of Financial Management Education and Training. Finally, innovative curriculum development will be encouraged through a program whereby DOD institutions may apply to DRMI for project funding.

F. SUMMARY

The Department of Defense swiftly implemented the provisions of the Chief Financial Officer Act. The DOD Comptroller, Sean O'Keefe, has been designated by the President as the Departments's CFO. The DOD implementation plan has been approved by OMB and is being put in action. Three Defense Management Report initiatives form the basis of the Department's strategy.

First, Corporate Information Management sets the stage for financial management reform by (1) ensuring that standardization, quality and consistency are built in to data resident in DOD information management systems, (2) identifying and implementing management efficiencies, and (3) eliminating duplicate efforts in systems development. Second, the Defense Finance and Accounting Service has been established. DFAS is responsible for executing statutory and regulatory financial reporting requirements and preparing consolidated financial statements required by the Act. Third, the Defense Business Operations Fund pools existing revolving funds together into one account. This will enable DOD to determine the total cost of operating individual components.

Audited financial statements are considered the capstone of the Departments financial management improvement program. They are intended to serve as a report card on the Department's progress. The financial attribute method, workload indicators and other analytic techniques will provide a comprehensive evaluation of DOD's effective use of resources. This extensive review process will also highlight problem areas, some of which have already been identified. Specifically, GAO officials and the DOD Comptroller have agreed on four problem areas that represent systemic deficiencies that exist throughout the Department.

VI. CONCLUSIONS

A. RESEARCH QUESTIONS

Primary Research Question:

> What are the provisions of the CFO Act of 1990 and what steps is the Department of Defense taking to implement this law?

The CFO Act incorporates many of the principles and elements in a decade long effort to reform federal financial management. There are four fundamental provisions set forth in the Act. First, it puts a powerful financial management organizational structure in place with the assignment of a Deputy Director for Management (The CFO of the U.S.) and the creation of the Office of Federal Financial Management with in OMB. Second, it establishes a network of accountable officials in the body of 23 statutory Chief Financial Officers reporting directly to the heads of agencies. Third, it requires agencies to develop financial management plans and produce annual progress reports. Fourth, it requires the preparation of audited financial statements.

The Department promptly took steps to execute its responsibilities under the new legislation. A Department CFO was chosen by the President and an implementation plan published. The Defense Management Report initiates of DFAS, CIM and DBOF form the basis of the Department's strategy.

Additional points are addressed in the subsidiary questions below.

Subsidiary Research Questions:

What qualification standards have been established for the DOD Chief Financial Officer?

The DOD Chief Financial Officer must meet the qualification standards set forth in the Act. Furthermore, OMB has been tasked to publish qualification standards for all agency CFO's. By law, the Department must measure its CFO and Deputy CfO against those criteria. The standards are designed to ensure individuals selected to serve as CFO's are experienced comptrollers and managers, skilled in financial management system design, and have a working knowledge of procurement, human resources and regulatory affairs. An academic degree in either accounting, business administration, finance, information systems or public administration is desired. Finally, a CFO should be a technical expert in, or as a minimum, have sufficient experience and knowledge of, generally accepted accounting principles, budget preparation and execution, auditing of financial statements, and internal control procedures.

What chain of command has been established for reporting on DOD financial concerns?

The DOD Comptroller/CFO is the single official responsible for the department financial management goals and objectives. The CFO reports directly to the Secretary of Defense. While the military departments and other DOD component organizations have retained their own budgeting, accounting and financial management functions, the operation of these offices is subordinate to the overall direction and guidance provided by the CFO of the Department. Additionally, the Defense Finance and Accounting Service will receive financial statements for consolidation from each military department and DOD component and will submit combined statements as required by law.

What long term goals and plans has DOD established for the CFO?

The Department of Defense has absorbed the requirements of the CFO Act into its program of initiatives put in place just prior to the passage of the Act. These initiatives are consistent with the Chief Financial Officer goals. They include: the establishment of the Defense Finance and Accounting Service with the goal of providing centralized accounting services; Corporate Information Management initiatives to develop standard management systems; and the Defense Management Report for proposing initiatives to streamline and strengthen financial management operations. Additionally, the Department plans the preparation of auditable financial statements and an increase in the breath and depth of its financial management training programs.

How is DOD planning to institute the requirement for audited financial statements? When and which activity has DOD selected to publish the first set of audited financial statements?

The Secretary of Defense has submitted to the Director of OMB, on 1 April 1992, financial statements for the preceding fiscal year. To meet this deadline, DOD published a memorandum on November 13, 1991 which provides guidance on the form and content of financial statements on FY 1991 activity. This document specifies which Defense Department entities must submit statements, establishes reporting standards to be followed, and tailors performance measures to be used by DOD activities.

The Department of the Army has been selected as the test organization in preparing organization-wide financial statements. Moreover, only statements prepared for the Department of the Army, the Navy Industrial Fund, Navy and Marine Corps Stock Funds, Marine Industrial Fund, and the Defense Agencies Stock Fund will be audited. The Department has opted to request waivers from the audit of the ten remaining entities FY 1991 financial statements but not from the preparation of these statements.

What changes are proposed by the Financial Accounting Standards Advisory Board (FASAB) and how will they impact DOD development of audited financial statements?

The Financial Accounting Standards Board has not yet published specific guidance for federal financial statement preparation and auditing. Pending issuance of final accounting standards, FASAB has recommended that executive agencies continue using the policies and procedures already in effect to produce financial statements. DOD has submitted a proposal to FASAB requesting approval to use the Latest Acquisition Cost Method for inventory valuation. The Department seeks to use this method as the basis for inventory valuations in financial statements because it is viewed to yield the best approximation of the utility value of the inventory to DOD's mission. The Latest Acquisition Cost Method was used in the preparation of FY91 financial statements.

What steps are being taken to standardize DOD accounting systems?

The Corporate Information Management initiative has the lead role in developing standard accounting and financial management systems. Four financial management functional groups are currently developing standard financial systems to replace existing financial systems being operated by various DOD organizations. These groups are Financial Operations, Civilian Pay, Government Furnished Material and Contract Payments. Actual development of these systems is expected to take eight to ten years. In the mean time, the CIM project is considering the best of the military service financial systems to use as an interim system until it decides how to best implement CIM standard systems. As of February 1992, the

Department has selected standard systems for civilian pay and military pay and travel.

How does the DOD effort compare to the actions underway within other federal agencies?

Although no formal measure has been taken, DOD is certainly a leader among federal agencies with its extensive implementation program. The DOD implementation plan was submitted and approved in April 1991 but, one year later two agency plans still have not been approved. A draft of the required five year financial plan is in circulation at the Pentagon. The DOD Chief Financial Officer has been actively engaged in charting a course for the Department for over a year. In contrast, nine agencies do not yet have CFO's confirmed by the Senate.

The OMB 5-year plan calls for integrated government-wide financial systems and the elimination of duplicative and unnecessary sys' -- The DOD Corporate Information Management initiative addresses this requirement precisely. Furthermore, programs established for cross servicing of payrolls between the Department of Agriculture, Justice and Treasury compare favorably with DOD's formation of the Defense Finance and Accounting Service.

DOD's FY92 financial statements have been submitted to OMB and contain extensive use of performance measurement indicators. While highly desired by OMB, the use of these indicators is considered "uncharted territory." The only other agencies that presented performance indicators in their annual submissions are the Departments of Labor and Health and Human Services and The General Services Administration.

How does the DOD effort compare with initial implementation plans certified by the Office of Management and Budget?

The Department has stated for the outset that it is well equipped to respond to the requirements of the new CFO legislation with only minor changes. Consequently, the implementation plan indicated DOD was already on track when the law took effect. The crux of the DOD plan for the CFO Act falls in the domain of the DFAS, CIM and DBOF initiatives. These programs were already underway or were about to begin when the Act was passed. Furthermore, a blueprint for audited financial statements has been negotiated with OMB and statements are being submitted in accordance with that plan.

B. CONCLUSIONS

The Department of Defense has made notable progress in implementing the Chief Financial Officers Act. The basic framework has been laid to support the requirements of the legislation and prepare audited financial statements. The Defense Finance and Accounting Service has been established and has submitted the first set of combined financial statements. The Corporate Information Management initiative has a firm foundation in systems development, and long-term programs continue to make headway toward improving the quality and consistency of information systems. Finally, the Department is working closely with the General Accounting Office to modify, standardize and improve its financial procedures to create the desired financial management architecture for the Defense Business Operations Fund.

It is generally understood throughout the federal government that the Chief Financial Officers Act is a long-term effort. However, the DOD Comptroller reports that it has been a catalyst for making needed short-term procedural improvements [Ref. 13:p. 23]. These changes are designed to improve the way DOD conducts its day-to-day operations. Furthermore, Department of Defense officials recognize that many benefits will accrue as result of implementing the Defense Management Report initiatives cited in conjunction with the CFO Act. Additional benefits include: [Ref. 13:p. 23-24]

- Greater consistency in the application of accounting principles and standards on a Department-wide basis
- Minimized costs associated with the implementation of new requirements for the identification of financial management information
- Enhanced management ability to make "smarter" and more cost effective decisions by providing more timely, meaningful, and accurate financial information regarding budget execution and various other financial management matters

- Facilitation of the development of standard systems
- More rapid development and implementation of standard systems for finance and accounting functions, as well as significant increases in the benefits accruing from such systems
- Increased opportunities to achieve savings through the elimination of duplicate operations, systems, and developmental and maintenance efforts, and other costs

Although DOD officials envision that the DMR initiatives will solve many of the financial management problems analyzed in this thesis, these are long-term proposals. Relatively few corrective actions will be realized quickly. Understandably, problems will persist due to the sheer size and complexity of the improvement program undertaken. DOD must take aggressive action to improve the quality of financial data and internal controls in existing systems until DMR initiatives can be brought to fruition. The Department will have to use existing systems for several more years, making it quite important that DOD continue efforts to correct existing deficiencies to the fullest extent possible.

C. AREAS FOR FURTHER RESEARCH

Since the programs highlighted in this thesis are in their infancy, there are many additional areas for further research. Foremost is the continued assessment of Department of Defense implementation of the Defense Management Report initiatives supporting the goals and objectives of the CFO Act. As discussed herein, the DFAS, CIM and DBOF initiatives have time horizons out to ten years or more. The success of each of these programs may be measured against the initial plans set forth by the Department. Additionally, a comparison of DOD audited financial statements to those produced by the other seven pilot agencies programs is needed. Finally, an evaluation of the success and usefulness of performance measurements in financial statement analysis to discover new financial management problem areas would be worthwhile.

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