

GAO

Testimony



141863

For Release
on Delivery
Expected at
9:00 a.m.
Wednesday
July 25, 1990

Department of Defense: Improving Management to
Meet the Challenges of the 1990s

Statement of
Charles A. Bowsher, Comptroller General
of the United States
Before the
Committee on Armed Services
United States House of Representatives



Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss opportunities for improving the management of defense programs and the potential savings associated with those actions. As this Committee is well aware, recent and continuing developments in Eastern Europe and the USSR are greatly altering the national security environment and will significantly affect the future course of the budget for national defense. At the same time, as evidenced by the ongoing budget summit there is a need to find solutions to address the mounting deficit crisis which also effects defense spending levels.

All of these factors set the stage for historic changes to the composition of U.S. military forces, the threats they will defend against, and where they will be deployed around the world. As these decisions are being made I think this is also an opportune time to take stock of how our defense programs are managed and to initiate actions to correct longstanding management problems. Managing defense programs during a significant restructuring of forces and declining budgets presents a formidable challenge.

Successfully meeting this challenge will require that defense managers take actions that will allow them to achieve national security goals in the most economic and efficient manner possible. The actions taken can not reflect a business as usual approach of

cutting a little here and there, while retaining the same inefficient or outdated organizational structures and systems.

More fundamental changes are needed to ensure that organizational structures are economic and efficient and information systems provide the data needed to provide effective stewardship over defense activities. I do not believe those conditions exist today. There are a number of actions that I believe are needed. Before I discuss them in detail I would like to summarize the main areas where corrective actions are needed.

-- DOD's 5 year spending plan needs to reflect fiscal reality and recent world events. As in the past, DOD continues to plan for more weapon systems than the nation can afford to build, operate, and support. The proposed 1991 budget reflects a 1990-1994 defense budget projection totaling \$1.5 trillion. However, the total planned spending for individual programs exceeds this amount by over \$100 billion. This is because DOD has not yet decided where to make all the reductions needed to achieve the \$1.5 trillion spending level. Further, the budget resolution also indicates the 5 year spending level is too high.

-- DOD needs to more fully test the weapon systems it is developing and correct identified problems to assure itself that these systems perform as required before they are

procured. During the past 10 years, billions of dollars were wasted on systems because this was not done. The reason usually given for following this practice was that systems were needed quickly to meet the Soviet threat. The B-1B bomber is just one example. Many other programs, such as the SSN-21 submarine and its advanced combat system, are following the same path today.

We believe such programs should be reexamined because the urgency to produce systems to meet the Soviet threat is not as great as it was previously. The funding for these and other programs with similar uncertainties that we have reviewed represent about \$17 billion in DOD's fiscal year 1991 budget request. I would suggest that all such programs should be examined closely as the Committee considers making reductions.

-- DOD needs to adopt management philosophies, controls, and organizational structures that place a high value on economy, efficiency, and accountability in the inventory system. Such a management culture has been particularly absent during this past decade. For example, as of September 30, 1989, the defense wholesale inventory of spare parts and other secondary items exceeded \$109 billion of which \$34 billion has been identified by DOD as exceeding current operating and war reserve requirements. Also unneeded stock exists at the

retail level. Further, there have been numerous reports of theft from the system. These are longstanding problems, but DOD has not made the fundamental changes to correct them. Based on our work, we believe that there is potential to reduce the DOD's proposed 1991 funding levels for secondary inventory items by at least 10 to 20 percent or about \$2 to \$4 billion.

-- Financial systems are needed that provide decision makers with accurate data on the actual cost of programs, assets and operations. My observation from working on major financial crises involving New York City, the Chrysler Corporation, and the Savings and Loan industry is that accurate financial information was not available to decision makers. Defense managers face similar problems. Our financial audit of the Air Force shows the Air Force lacks accurate cost data for almost all of its non-cash assets such as inventory, equipment, aircraft and missiles. You simply can not manage effectively without accurate cost information.

-- DOD managers need to commit themselves to developing and implementing an effective system of management controls. Our reviews of the implementation of the Federal Managers Financial Integrity Act of 1982 have shown that DOD tends to be reactive rather than proactive in identifying and addressing internal control weaknesses. The lack of effective

controls is a recurring theme in the specific areas I am addressing today.

- Duplicative and wasteful DOD organizations and systems need to be eliminated or streamlined. For too long we have seen such systems among the services for common activities. Many of these were identified in DOD's Defense Management Report. Given that our recommendations relating to operations and maintenance expenditures have resulted in reductions of about \$1.7 billion over the past 3 years for non inventory related activities, we believe that operations and maintenance funding is also a candidate for reductions.

- DOD needs to closely look at opportunities for reducing the overall size of its military forces. Removing troops from overseas locations will not by itself result in substantial savings; such savings will only occur by removing personnel and reducing the force structure. The Secretary of Defense has discussed personnel reductions of about 25 percent by 1995. This would represent about 400,000 personnel less than we have today. Similarly, reductions will be needed in battle carrier groups, divisions, and air wings. Changes in these areas, in turn, lead to opportunities to reduce or eliminate weapon system programs required by the current force structure.

Closely tied to such reductions is the need to develop a more efficient military base infrastructure at home and abroad. The structure that exists today is widely recognized as being inefficient and as DOD reduces its force structure it is also the perfect time to attack this problem as well. This is an area that we will be examining as events in Europe continue to unfold.

Before I provide more specifics let me first say that I recognize that managing the DOD is an enormously difficult and complex job--perhaps the most difficult in government. I do not want to leave the impression that Secretary Cheney and his assistants are not attempting to address these problems. For example, the Secretary of Defense's Management Report calls for \$39 billion in savings and he also announced plans for about \$17 billion in budget reductions from adjustments to 6 major aircraft programs.

I also want to stress, while I am focusing on opportunities for management change and budget savings there will also be some costs associated with the changes that will be occurring. For example, there will be costs associated with closing overseas bases, from separating foreign national employees, and correcting environmental problems among other things. In the long run money will be saved, but in some areas it is going to cost in the short run.

THE MOUNTING DEFICIT INCREASES
PRESSURE TO REDUCE DEFENSE SPENDING

To set the framework for addressing defense management issues I think it is first necessary to discuss the overall budget situation. The mounting deficit crisis is having a significant impact on defense spending levels and the need to institute management practices that emphasize economy and efficiency.

When the President's budget was published in January, it estimated that the deficit for fiscal year 1990 would be \$122 billion, dropping to \$100.5 in fiscal year 1991, on a path projected to lead to a surplus in 1995. It is now clear that those estimates were wildly off the mark.

OMB recently estimated that the deficit for this year will be \$218.5 billion and \$231.4 billion in fiscal year 1991. If all of the cost of the savings and loan clean-up --including interest payments and administrative expenses-- is excluded the deficit would be \$161.3 billion for fiscal year 1990 and \$168.8 billion in fiscal year 1991.

The projected deficit with RTC excluded for fiscal year 1991 is \$104.8 billion above the Gramm-Rudman-Hollins baseline of \$64 billion. If no action is taken to adjust the baseline deficit, outlays will have to be reduced by \$104.8 billion, one-half of which, or \$52.4 billion would come from defense. In order to

achieve an outlay reduction of \$52.4 billion in DOD military accounts, fiscal year 1991 budget authority would need to be reduced by \$96.3 billion. This assumes that military personnel accounts are exempted from the cuts.

After five years of relying on the Gramm-Rudman approach, the deficit is again out of control.

But reality is even worse. The true deficit situation is masked because we are using larger and larger amounts of trust fund surpluses (from Social Security, Military and Civil Service Retirement, and other programs) to pay current operating expenses. This year CBO estimates that the federal government will use about \$123 billion of trust fund surpluses to pay for current operations. In 1991, that will rise to \$135 billion. If these trust fund surpluses are excluded, the CBO deficit estimate for the general fund will exceed \$317 billion in 1990 and reach \$367 billion in 1991.

If we continue along this same path, CBO estimates that the national debt will increase to \$4.9 trillion by fiscal year 1995. A debt of this magnitude would entail annual interest payments of \$351 billion or more, which could represent the largest single item in the federal budget. As we look to attack the deficit by controlling spending and reducing it wherever possible, all spending programs must be examined very closely. This is

particularly true of defense, in light of changing circumstances around the world.

With this as a backdrop let me turn to what needs to be done to improve defense management and those areas where there is potential to reduce defense spending.

FIVE YEAR DEFENSE PLAN
MUST BE REALISTIC

A pressing management issue that must be addressed is the need for a 5 year defense plan that reflects fiscal realities, and is based on current threats and warfighting strategies. DOD essentially lacked this during the 1980s and while the situation has improved somewhat, the problem is still exists. Without a realistic financial resources road map program management suffers and effective budget oversight can not be accomplished. This is a major reason why DOD has more weapon systems in development and production than is affordable. As a result, DOD and the Congress annually debate on cancelling, delaying, or stretching out programs.

The President's 1991 proposed budget request reflects a fiscal year 1990 to 1994 defense budget projection of \$1.5 trillion. After adjusting for inflation estimate changes, this will require \$212 billion in reductions to the April 1989 Five Year Defense Program. However, DOD has not decided where to take over \$100 billion in

programmatic reductions to reach the \$1.5 trillion projected budget for the 1990 to 1994 period. Difficult as it will be to accomplish these reductions, they will still only bring the defense program in line with the President's 1991 budget submission. The events in Eastern Europe and the Soviet Union along with the mounting federal deficit will likely result in further reductions.

If these events continue on their present course, with the rise of democracy in Eastern Europe and a diminishing Soviet military threat in Central Europe, DOD will face the even more daunting task of restructuring the military establishment for a radically different national security environment. In time, that may well permit substantial additional reductions in defense plans and required funding.

While Pentagon spending is coming down from the ambitious projections of the 1980s, it will take major restructuring over a number of years to achieve the substantial savings that may be possible. Achieving such savings will require cuts throughout the defense budget--in areas such as personnel, operations and maintenance, and weapon systems acquisition. For example, DOD must see that duplicate weapon systems and forces are not being created to defend against the same threat. Those decisions cannot be made hastily or without an overall strategic framework. That is why we have been urging DOD to move expeditiously to develop a 5 year defense plan that reflects the dramatically changed national

security environment. Otherwise defense management will continue to annually adjust programs to reflect reality, while at the same time, planning for future expenditures that are unrealistic. That practice creates ineffective and inefficient programs and impedes Congressional oversight.

LONGSTANDING ACQUISITION AND INVENTORY MANAGEMENT PROBLEMS

Now I want to discuss the critical need to correct longstanding acquisition and inventory management problems along with some solutions and opportunities for potential budget reductions. Last summer, to help avoid another HUD type scandal, we launched a major effort to identify areas that are at risk to mismanagement, fraud, and abuse. We identified 2 areas in defense--major system acquisition and inventory management--that are "vulnerable" and targeted them for special attention.

Weapon System Acquisition

Problems with defense acquisition have been known for a long time. Over the past 20 years, numerous studies have identified problems in the way DOD acquires its weapon systems and other goods and services. Unfortunately, the problems that have plagued defense acquisition over that period--cost growth, schedule delays, and performance shortfalls--still exist today. Delivering capable and supportable weapons to the user when and where they are needed and

at a reasonable cost has been the exception in defense acquisition rather than the rule. Today, I will discuss three key problem areas--affordability, concurrency, and the acquisition process.

Affordability

As previously mentioned, there is currently a mismatch between the programs being planned and the level of funding that can realistically be expected. There are over 100 major acquisition programs in various stages of development and procurement. The estimated acquisition cost of these programs is over \$1 trillion, with well over half that amount yet to be spent. There are also many other smaller programs.

DOD needs to decide which of the planned programs it can afford. Overoptimistic planning tends to obscure defense priorities and delay tough decisions and tradeoffs. This practice leads to unstable program funding, costly program stretch outs, and terminations.

Concurrency

DOD must also end management practices that in the past--and particularly in the last decade--have proven very costly. As noted above weapon systems currently in development or production are expected to cost over \$1 trillion. All too often costly new weapon

systems have been rushed into production without adequately testing their ability to perform and be supported as intended. The justification was usually that there was an imminent threat and the system was urgently required to counter the threat. Only later, after spending billions of dollars were defects discovered that impaired the ability of the system to meet mission requirements.

In some cases, this led to costly retrofits; in others, it led to proposals for still other, even more costly new systems to fill the supposed gap. The Army's Apache helicopter, and the Air Force's B-1 aircraft are examples.

With the diminishing conventional Soviet threat, we should reject the "urgency" argument and insist that new weapon systems be fully and realistically tested--in terms of the missions they are intended to carry out--before we decide whether or not to buy them and start high rates of production. Similarly, concurrency should be reduced as much as possible.

I want to caution here that I am not advocating that programs should be stretched out. This is a practice that I strongly advise against because it results in increased program cost. What I am saying is that DOD needs to follow management practices that will result in the economical production of systems that meet contract performance specifications.

Based on our work, let me suggest some programs for review. We estimate that these and other programs with similar characteristics represent funding requests totaling more than \$17 billion in DOD's fiscal 1991 budget request. If reductions to programs must be made, we would suggest these programs as candidates for review.

The B-2 Bomber: In February of this year, we testified before this Committee that it would be prudent to reduce the pace of funding and production for the B-2 until critical performance elements of the aircraft, such as its integrated offensive and defensive avionics, were adequately demonstrated. At that time, we said that under the DOD acquisition plan, 31 B-2 aircraft would be on order and over \$48 billion would be appropriated before anyone knew whether this airplane will do its job. As you know, Secretary of Defense Cheney recently announced his intention to buy 75 rather than 132 B-2 bombers. Under Secretary Cheney's plan, the fiscal year 1991 buy is reduced from 5 to 2 aircraft and the 1992 buy from 10 to 6 aircraft. As a result, 24 rather than 31 B-2s will be on order before testing is completed. We remain concerned, however, that production of this plane is continuing without adequate assurance that it can perform its mission.

The C-17A Aircraft: In August 1989 we reported that the C-17A program faced significant cost, schedule, and performance challenges. On April 26, 1990, the Secretary of Defense proposed to significantly restructure the C-17A program by reducing (1) the

program from 210 to 120 production aircraft, (2) the pending fiscal year 1991 budget request from 6 to 2 aircraft, and (3) advanced procurement funds from 12 to 6 aircraft in fiscal year 1992. This proposal also reduced the fiscal year 1991 budget request from about \$2.7 to \$1.7 billion.

On the basis of current schedule delays and the resulting funding buildup, we believe that Congress should consider further reducing the proposed fiscal year 1991 buy of two C-17A aircraft and the advanced procurement funds for 6 aircraft in fiscal year 1992. This could provide an opportunity to further reduce concurrency in the program by having the Air Force limit production commitments until the critical elements of a realistic and achievable flight test program are completed and any identified problems resolved.

Rail Garrison: The initial low rate production decision for the Rail Garrison is scheduled before the first test flight of the complete weapon system. We recommended that the initial production decision be deferred until the Air Force has conducted some operational test and evaluation of the complete weapon system. While the Air Force has delayed the initial production decision from April 1990 to February 1991, the first flight test of the complete weapon system is not scheduled until the third quarter of fiscal year 1992. Therefore, we believe that the \$1.62 billion in the fiscal year 1991 budget for the procurement of the rail launch cars (\$1.35 billion) and construction of the garrisons (\$269

million) should be deferred pending completion of operational tests and evaluation. We also believe that the \$102.6 million in advanced procurement funding and the \$104.8 million in military construction funding, which was appropriated in fiscal year 1990, should be rescinded. Indeed, the entire strategic missile basing program should be reviewed in light of the changes in the world.

The M-1 Block II Program: Last November, we reported that the benefits of the modified M-1 Block II (M1A2) tank had not been demonstrated. We recommended that the Army not proceed into production until the Army demonstrated that the M1A2 tank would increase warfighting capabilities enough to justify the more than \$300,000 per unit increase associated with the modifications. We were concerned that the results of the Army's analysis supporting the cost-effectiveness of the modified tank were invalid because of poor assumptions used in their models. Subsequently, the Army decided some modifications would not be incorporated into the tank, thus further calling into question the results of the Army's analysis. We were also critical of their acquisition strategy because some key modifications would not be tested before making a production decision.

The Army did not reevaluate the M1A2 effectiveness in light of its reduced capabilities. However, the Secretary of Defense, in his fiscal year 1991 budget request limited production to 62 tanks.

In an attempt to field the M1A2 tank within the prescribed time frame, the Army adopted a compressed acquisition strategy. We believe this is risky because key components of the modification package are in the early stages of development, and testing and evaluation will not be completed before certain production decisions are made. Under current plans the Army will commit \$81.2 million in advanced procurement funding received in fiscal year 1990 and the \$178.3 million requested in fiscal year 1991 before test results are available and cost-effectiveness is demonstrated.

We believe no funds should be spent until the Army justifies the M1A2 capabilities.

The DDG-51: The DDG-51 will replace retiring destroyers and will be equipped with the AEGIS combat system. The DDG-51's contractor has experienced problems in designing and constructing the lead ship. Because of these problems and since the Navy has changed the contract's requirements, costs have increased substantially, and the expected delivery schedule has slipped about 17 months from the original estimate. In January 1990, we issued a report on the DDG-51 program in which we recommended that the Secretary of Defense ensure that sufficient information exists on the DDG-51 program development and affordability to justify the award of additional follow-on ships beyond the seven awarded to date.

In February 1990, the Navy awarded contracts for 5 follow-on ships and now has a total of 12 follow-on ships under contract. Furthermore, the Navy could have as many as 17 follow-on ships under construction or awarded before the lead ship has finished testing and has been delivered in February 1991. We believe the DDG-51 program should be reexamined. For fiscal year 1991, DOD has requested \$3.6 billion to purchase another five ships.

The Advanced Combat System for Submarines: The SSN-21 Seawolf attack submarine and its combat system, the AN/BSY-2 are multibillion dollar programs. In May 1990, we reported that as many as 15 of 29 planned SSN-21s worth more than \$21 billion, will be under contract before the first ship is available for operational testing. The AN/BSY-2 is crucial to the performance of the SSN-21s mission and one of the most technically challenging and complex software development efforts for a submarine which will require up to 800 personnel to develop and integrate about 3.2 million lines of computer code. Timely operational test and evaluation on critical subsystems such as the AN/BSY-2 should be conducted.

We reported that the Navy can not demonstrate the AN/BSY-2 combat system's potential for improved effectiveness over prior systems until it is operationally tested. Such tests are scheduled for two years after the delivery of the first system. Problems encountered during such tests could require redesign and/or configuration

changes to SSN#21s delivered and under construction, which could further delay deliveries and increase costs. This has already occurred. In fiscal year 1991, the Navy is requesting \$3.5 billion for the second and third ships, two combat systems, and long lead time items for the fiscal year 1993 program.

Attachment I contains examples of other DOD programs where we have similar concerns.

Improving the Acquisition Process

The need to improve the acquisition process is another area of long-standing concern identified by various studies including the Packard Commission. A number of initiatives resulting from Secretary Cheney's defense management review (completed in July 1989) are directed at correcting these problems. Some initiatives have been completed while others are still in process.

In our recently issued report, "Defense Acquisition: Perspectives on Key Elements for Effective Management" (GAO/NSIAD-90-90, May 14, 1990), we discuss seven key elements we believe are necessary for an effective acquisition process. These include:

-- strong, sustained leadership by the Secretary of Defense,

- a highly qualified, technically competent acquisition workforce operating together as a team,
- a mirrored organization structure between the Office of the Secretary of Defense and the military services,
- a free flow of current and objective information both up and down the organization,
- compliance with an effective internal control system,
- a requirements determinations process that considers fiscal constraints right from the start, and
- a strong link between DOD's weapon system decision process and its resource allocation process.

We are encouraged by the parallels between the areas addressed in Secretary Cheney's July 1989 Defense Management Report and those GAO believes are necessary to resolve long-standing acquisition problems. However, highly publicized initiatives have in the past come and gone without effectively solving the tough management issues surrounding defense acquisition. Strong, long-term leadership by the Secretary and teamwork on the part of the services, combined with timely and objective information and strong compliance with internal controls, are essential to break down

existing cultural barriers that, to date, have precluded, lasting improvement in defense acquisition.

More Economical Approaches to
Managing Inventories Are Needed

Now let me turn to DOD's inventory management practices--another area of longstanding concern. Over the last 20 years, we have issued more than 100 reports dealing with specific aspects and problems in DOD's inventory management. On March 26, 1990, we issued a report to the Secretary of Defense that summarizes our evaluations of DOD's inventory management. The problem areas we identified include growth in unrequired inventory, buying spare parts too early, not terminating contracts for excess on-order material, duplicative inventory due to multiple inventory levels, inaccurate records, inadequate controls over material and equipment furnished to government contractors, inadequate physical security, lax controls over shipments, deficiencies in supply cataloging, and computer system delays and cost overruns.

Here are a few examples of these problems that we and others have identified:

-- DOD's secondary wholesale inventory, such as spare and repair parts, grew by 152 percent in the 1980s, while unrequired inventory increased by 237 percent. As of September 30, 1989, about \$34 billion of DOD's secondary wholesale inventory was in

unrequired stock, i.e., stock that is above requirements for current needs and reserves for future wars.

- All the services buy spare parts too early and in amounts that exceed current needs. For example, we recently reported that two Army buying commands had initiated item purchases earlier than they should have and also made purchases exceeding authorized requirements. In August 1989, we reported that 31 items with an estimated cost of \$87 million procured by the Army Tank-Automotive Command had been bought prematurely. Of these buys, about \$30 million, or more than 34 percent of the original purchase amount, was no longer needed to meet requirements that had been projected at the time the purchases were initiated. We found this practice is still occurring and in February 1990 issued a letter to the Army about this.

- The services often have millions of dollars of excess material on order. In November 1989, DOD's Office of the Inspector General issued a summary report of past DOD and GAO reports on excess on-order material for the Army, Navy, and Air Force. These reports identified excess assets totaling \$1.8 billion. As of September 30, 1988, DLA's supply centers reported \$471 million of excess material on order.

- Inventory is being purchased which is already in an excess position. Item managers at the retail level often have not

reported their excess items; consequently, managers at the wholesale level buy items unnecessarily. For example, in January 1990, we reported that 13 Army divisions had \$184 million worth of spare and repair parts that were excess to their needs and had not been reported to the buying commands. At the same time, we found that three Army buying commands were buying 1,669 of these same items worth \$66.9 million

DOD has promised corrective actions in response to our recommendations in these areas, and it has made some improvements, such as amending policies and procedures to increase inventory accuracy by determining and correcting the cause of inventory inaccuracies. Such initiatives are encouraging, but substantial problems in DOD's inventory management remain.

Now let me turn to what we see as some necessary steps to correcting the problems in inventory management that I have been discussing. Fundamental to this process is strong leadership and a change in management philosophy. A key element is a management agenda that places a greater value on economy and efficiency than exists today and that puts in place the structures and systems for more effective management. The agenda should include a number of changes.

- A commitment is needed to update the supply system and take advantage of management innovations and technologies that have taken place over the last 10 years.

- Accurate and useful management information should be available to managers. Inaccurate inventory records, coupled with poor physical security, make DOD's inventories highly vulnerable to theft, diversions, and other abuses. As I will discuss financial data on inventory costs is one area that needs improvement.

- Management incentives should discourage buying unnecessary inventory. Our inventory growth work shows that buying large quantities of future stock is very risky. DOD's supply system responds to the operational imperative to fill orders within a specific time frame and to obligate the funds allocated to the supply mission. However, a corresponding emphasis on reducing costs and promoting economy and efficiency is lacking. DOD needs to change its mind-set and introduce a new culture into the way it manages its supply system. This means both requiring and rewarding efficient management practices while satisfying customer demands.

- Annual goals must be established for reducing existing inventory to minimize the system's overall vulnerability to mismanagement, fraud, and abuse. The sheer size of the

inventory complicates the management of an already cumbersome system.

- Accountability needs to be built into the system. One must seriously question the adequacy of management controls in a system that is allowed to generate \$34 billion in unneeded inventory. Similarly, accountability for safeguarding and accounting for inventory is also lacking. The DOD has reported that theft from the inventory system is a major problem.

- Managers must have systems that provide information on the quantities and locations of items in the wholesale and retail inventory within and among the services. The systems in place today do not provide for such visibility. Therefore, managers could be purchasing items unnecessarily because they do not know whether needs could be satisfied by items already in the inventory.

- Every component of the requirements process needs to be critically examined. Indications are that requirements computations are adjusted to ensure funds are obligated rather than to ensure the economy and efficiency of purchases.

As I mentioned we have been looking at this area very closely. Based on our prior and ongoing work we believe there is potential to reduce DOD's fiscal 1991 request of \$2.8 billion in direct

procurement funds for secondary inventory items and about \$20.8 billion, mostly operations and maintenance funds, to purchase inventory items from DOD's stock funds in fiscal year 1991.

We believe that funds to be used to acquire secondary inventory items can be reduced by 10 to 20 percent or between \$2 and \$4 billion in operations and maintenance funds and \$280 to \$560 million in procurement funds. This estimate is based principally on DOD's propensity to overstate requirements, the impending force reductions, and the excesses that exist in the system today. Our recent work shows that excess on-order for material for the Army and DLA represented about 10 percent of orders as of September 30, 1988. In December 1989 DOD reduced obligational authority for its stock funded items by 20 percent to account for similar factors. Therefore, we believe our estimates for potential reductions are conservative.

FINANCIAL MANAGEMENT: DOD NEEDS BETTER
INFORMATION TO REDUCE COSTS AND INCREASE
EFFICIENCY

As I remarked at the outset, the lack of accurate financial data for decision makers was a critical problem in the New York City, Chrysler Corporation, and Savings and Loan crises. A similar lack of financial data exists in DOD today. To be successful, any efforts to improve overall management at DOD must include as a

primary component major, comprehensive changes in its approach to financial management. As cost effectiveness becomes more important to DOD management, improvements in program management can be accomplished.

However, such improvements will not be realized unless DOD organizations develop and operate sound financial and accounting systems capable of reliably reporting on assets, operations and costs, and use such information to measure efficiency. Such data can only be produced by fully functional and complete accounting systems disciplined by independent audits.

Our evaluations of DOD's practices clearly show that it does not adequately control its resources; provide its managers, the Congress, or the public with a true accounting for the financial assets entrusted to it; or effectively control costs. DOD needs accurate, and comprehensive information on costs, assets, liabilities and funding.

Absent such information the following situations can occur.

- Operating costs of ships, air wings, bases, depots, and commands cannot be consistently compared and evaluated.
- Losses from mismanagement, fraud, and abuse may not be identified and their causes dealt with.

-- Cost factors may not be properly considered when deciding to replace or upgrade existing weapons systems.

Recently Reported Financial
Management Problems At The
U.S. Air Force

We recently testified before this Committee's Subcommittee on Readiness on problems noted by our audit of the Air Force's fiscal year 1988 financial statements. We have no reason to believe the kinds of problems which we found are confined to the Air Force. Rather, we expect they exist to varying degrees in other DOD organizations. I will briefly highlight some problems found by the Air Force audit:

-- Accounting Systems: Air Force accounting systems do not provide accurate cost data for almost 70 percent of its assets, such as weapons, inventory, and equipment. The General Accounting and Finance System was intended to serve as the Air Force's general ledger, but a number of very significant accounts were not included. Certain data, such as aircraft values (\$82 billion) and accounts payable amounts (\$18 billion) had to be derived from property systems or from extracts of budgetary data.

As a result both the summary data included in financial statements and the historical cost information, which should be included in management reports to all levels of management, is inaccurate.

-- Internal Controls: We found that billions of dollars in adjustments were made which could not be supported or explained by finance officials. For example, the Space Systems Division's trial balance for March 31, 1988 differed from its subsidiary records by \$2.4 billion. To get the two systems to agree, officials simply "plugged" the accounts. As a result, accountability was lost and an opportunity to deal with possible mismanagement, fraud, or abuse was missed.

-- Weapons System Costs: We compared the accounting system costs to Selected Acquisition Reports (SARs) accounting, and to expenditures from budgetary reports and found significant differences. For example, the B-1 bomber acquisition cost per aircraft is recorded in the accounting system at \$150 million and in the SARs at \$202 million in 1981 dollars and about \$274 million in then year dollars. The more accurate amount is over \$316 million in then year dollars. The SARs do not adequately disclose all costs associated with major weapon systems. While we believe that our estimate is closer to the actual cost, the fact is that no one has actual figures. Additionally, the Air Force accounting systems do not capture

all operating and support costs associated with weapons systems. As a result, the Congress is not getting accurate and complete data on weapon systems life cycle costs.

-- Inventories: To maintain and support its operations and weapon systems, the Air Force manages about 1.6 million different kinds of spare parts and supply items valued at about \$64 billion. However, systems used to track and value these immense inventories do not maintain accurate data supporting either the quantities or values. As a result, inventory management is weak, excess quantities are being purchased; and losses and unnecessary carrying costs are being incurred.

Needed Improvements To Financial Management

Improvement of financial management in DOD will require a strong organization, well-planned systems improvements coupled with the preparation of auditable financial statements, and associated financial management reports.

Many of the problems we pointed out in the Air Force audit are included in the defense management review initiatives. We strongly believe that fixing these problems will require both a strong financial management organization at the top of DOD as well as a carefully thought out systems improvement plan. In the latter respect, we believe that the short-term repair and modification of

existing systems to provide good controls and basic information is vitally necessary, as well as a longer-term, DOD-wide systems improvement plan, designed to move incrementally toward an integrated DOD-wide system. I say incrementally because much needs to be done to upgrade and correct existing systems, before major changes are implemented.

We also believe that these systems improvements must be made in conjunction with a program of annual financial statement audits. Audited financial statements can be viewed as a report card which will point out seriously deficient systems and control problems; identify the causes of the problems and their effects, point the way to solutions, and gauge progress made on previously identified weaknesses.

Aside from the role in helping to assure that better financial information is available for OSD and service management, audited financial statements will provide benefits to Congress in carrying out its oversight role. More reliable and consistent information on many areas including weapon systems costs, inventory levels, and budgetary issues, would assist the congressional oversight process.

We are convinced that periodic preparation and audit of agency financial statements can be a key element in achieving needed systems improvements, encouraging cost effectiveness, and

enhancing Congressional oversight. We believe that so much is at stake that it is appropriate at this time to move legislatively to require such statements.

ELIMINATING AND/OR STREAMLINING

DUPLICATIVE AND INEFFICIENT ADMINISTRATIVE

AND SUPPORT ACTIVITIES

In previous reports we and others have recommended changes that would result in more efficient and economical management. For example, we have recommended consolidating supply depots and maintenance facilities, centralizing payroll functions, reducing supply system costs, establishing realistic aircraft spare requirements, and streamlining the acquisition process.

The July 1989 Defense Management Report incorporates initiatives that address many of our past recommendations. DOD is projecting that it will save \$39 billion between fiscal years 1991 and 1995 by implementing some of these initiatives. Of the savings DOD has identified, \$2.3 billion is related to the fiscal year 1991 budget. DOD has not yet attached savings to all of its initiatives. Savings are anticipated by streamlining the operations of organizations, reducing the numbers of civilian and military personnel associated with these activities and reducing purchases of inventories.

I would like to emphasize that the anticipated savings from the Defense Management Report are merely projections. To a large extent, the initiatives to achieve these savings are proposed in broad terms; statements on these initiatives do not contain the detailed plans or milestones that will be required to successfully implement the initiatives. Also, the initiatives are in differing stages of development. Some are still in the decision making stage, some are in the planning stage and others are moving into implementation. The savings referred to in the report are targets based on judgments and past experience. It is too early to tell whether these projected savings will be achieved.

I want to further caution you as you start to look at these savings that they are tied into the planning reality problem I mentioned earlier. We estimated that the fiscal year 1989 5-year defense plan, needed to be reduced by \$212 billion in order to bring spending into line with the President's budget. So part of the \$39 billion helped to bring things into line with the revised 5 year total of \$1.5 trillion. So I am not so sure that these are savings or just a matter of facing reality. As I look at the 1991 budget proposal I see only a 1 percent reduction in real growth (using 1991 constant dollars) in the operations and maintenance accounts where it appears most of Defense Management Report savings are related to.

We have not done specific work focusing on the overall operations and maintenance account. However, based on our recommendations the Congress has reduced operations and maintenance funding in the last three fiscal years by about \$1.7 billion for non inventory related activities. Thus, given the proposed force structure reductions, and the inefficiencies we have seen in this area in the past, it seems to me there is opportunity for additional reductions in this area.

I certainly want to support the initiatives DOD proposes in its Defense Management Report. As I stated earlier, many are based on GAO and others recommendations and offer opportunities to achieve significant savings, while at the same time, streamlining the operations of the Defense Department. Most important, in my opinion, is that these changes need to improve accountability while saving money. DOD's track record in carrying out such long-term initiatives has not been good. I understand there is already considerable controversy concerning the proposed DOD initiatives. This is particularly the case regarding the consolidation of various functions and activities. So achieving these management improvements and savings will require a sustained effort on the part of DOD's management.

REFOCUSING GAO'S EFFORTS TO
MEET CHANGING NEEDS

Before closing my statement, I want to briefly discuss how we are refocusing our defense work to address the dramatic changes that are taking place in Eastern Europe.

A key issue that we will be focusing on is the restructuring of the Armed Forces in response to changes in Eastern Europe. As DOD undertakes this task, we believe that sound planning will be essential if readiness and force quality are to be preserved during this turbulent period. In my view, the defense forces would be better served by ensuring that a smaller force is well trained and equipped than by trying to maintain a larger force with no muscle. Further, these forces must be structured to reflect the post cold war threat. Otherwise opportunities for substantial savings will be missed.

DOD's planning is complicated by a still-evolving definition of the threat, ongoing conventional and strategic arms negotiations, and budgetary pressures that may force deeper-than-anticipated cuts in defense spending. It is important to recognize that while some budgetary savings will result from reducing U.S. forces in Europe substantial savings can only be achieved by reducing the overall size of the force. We plan to monitor DOD's evolving plans and to report as necessary on the reasonableness of the criteria used in

making major force restructuring decisions as well as the efficiency and effectiveness of other planned changes.

An initial effort we have made along these lines is a report we issued last year on the U.S. military presence in Europe. The report shows that more than 723,000 servicemen and women, U.S. civilian employees, dependents, and foreign national employees were stationed in Europe. The report provides a baseline of data that your and other committees can use in assessing the President's proposal to reduce U.S. forces in Europe and concerns about the costs associated with maintaining U.S. overseas commitments. Similarly, in May 1990, we issued a report that provides baseline information on military force structure, modernization programs and readiness, and sustainability measures. This information should be useful in assessing proposed reductions to the military force structure.

We will also be focusing on areas that will be impacted by restructuring the forces such as manpower, logistics, facilities, weapon systems acquisition, the defense industrial base, and strategy and doctrine. Some issues included here are:

-- How will the return of troops and equipment to the United States alter deployment plans and affect of logistical support and strategic air and sealift requirements?

- > Are proposals to close domestic and overseas bases, and plans for military construction and land acquisition consistent with the overall changes being made to the force structure?

- > As budgetary pressures intensify the debate over the future of key weapon acquisition programs and force modernization plans, how will the resulting decisions impact the U.S. defense industrial base?

- To what extent will the anticipated conventional and strategic arms control agreements require a reassessment of basic military strategies and doctrine? For example, will major decisions on the naval force structure be needed as land forces are withdrawn from Europe and will changes be needed to the way reserve forces are employed, trained, and equipped?

We have a series of ongoing and planned assignments to address these as well as other issues.

* * * * *

In closing, let me reemphasize that the convergence of a dramatically changing national security environment and worsening budget deficit situation are setting the stage for significant changes to U.S. military forces. This situation creates a window of opportunity--that may well not appear again for some time--to

put into place management practices that can help to solve many of the longstanding problems that have plagued defense programs. It is my goal to work with the Congress and DOD to ensure that this unique opportunity to improve defense management is realized.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer questions at this time.

PROGRAM CONCERNSARMY

<u>Program name</u>	<u>Research, Development, Test and Evaluation (RDT&E)/ Procurement Funding Request Fiscal Year (FY) 1991</u>
Line-of-Sight Forward Heavy Air Defense System	\$235.6 million for procurement plus \$36.2 million for advance procurement

Summary: Operational testing of the Line-of-Sight Forward Heavy Air Defense System was completed in May 1990. The Army did not demonstrate that the system could meet its operational requirements. Thus, as mandated in the fiscal year 1989 Defense Authorization Act, the Secretary of the Army may not obligate procurement funds for fiscal years 1990 or 1991. However, a decision on the future of the program is pending; the Army may decide to delay the production decision and continue with system development. Such a decision would require RDT&E funding. We believe production of the system should be deferred.

NAVY

<u>Program name</u>	<u>RDT&E/Procurement Funding Request (FY 1991)</u>
Navy T-45 Training System	\$14.9 million for RDT&E plus \$329.9 million for procurement

Summary: The T-45 training system has been in low-rate production since fiscal year 1988, but the Navy still does not have a proven stable aircraft design. After initial test failures, the Navy postponed aircraft tests involving carrier suitability and other critical issues. We believe the Navy's 1991 procurement of 12 aircraft and 3 of 5 simulators should be deferred until those tests are completed and a stable aircraft design is demonstrated.

<u>Program name</u>	<u>RDT&E/Procurement Funding Request (FY 1991)</u>
Tactical Airborne Reconnaissance Program	Amount of funding requested is classified.

Summary: The Navy's Tactical Airborne Reconnaissance Program is scheduled to fund procurement of the Advanced Tactical Airborne Reconnaissance System (ATARS) in fiscal year 1991. Plans call for integrating ATARS into a modified F/A-18 aircraft and medium range unmanned aerial vehicle. A ground station is also needed to receive data from ATARS. The ATARS, F/A-18 modifications and unmanned aerial vehicle and ground stations are being concurrently developed. Because development of the ground station and unmanned aerial vehicle have slipped significantly, we believe that funding for ATARS procurement should be deferred until fiscal year 1992.

<u>Program name</u>	<u>RDT&E/Procurement Funding Request (FY 1991)</u>
Low frequency active sonar systems	
--Ship Sonar AN/SQQ-89 (I)	\$158.9 million for RDT&E
--Air Deployable Active Receiver (ADAR)	\$11.7 million for RDT&E
--Active Surface Towed Array Surveillance System (SURTASS)	\$26.9 million for RDT&E

Summary: To counter the quiet Soviet submarine threat, the Navy is developing the following three near-term low-frequency active sonar systems: the AN/SQQ-89 (I), ADAR and active SURTASS. During fiscal years 1990/91 these systems are scheduled to transition into full scale development. Our work to date indicates the Navy has not demonstrated that it has minimized certain technical and operational risks involving the development and use of low-frequency active sonar systems. Therefore, we believe that the Navy should keep these systems in advanced development until technical and operational risk have been minimized.

<u>Program name</u>	<u>RDT&E/Procurement Funding Request (FY 1991)</u>
Airborne Self- Protection Jammer (ASPJ)	\$5.0 for RDT&E and \$168.4 million for procurement

Summary: The ASPJ is currently in low rate initial production. Operational testing by Navy has shown that the ASPJ is only marginally effective and marginally operationally suitable. We believe that low-rate production should be slowed to the minimum rate necessary to avoid a break in production until required performance is demonstrated. As a result, DOD's fiscal year 1991 request for \$168 million in procurement funding is not needed.

AIR FORCE

<u>Program name</u>	<u>RDT&E/Procurement Funding Request (FY 1991)</u>
Advanced Medium Range Air-to-Air Missile (AMRAAM)	\$1.34 billion for procurement

Summary: In our report "Missile Procurement: Further Production of AMRAAM Should Not Be Approved Until Questions Are Resolved," (GAO/NSIAD-90-146), May 4, 1990, we suggested that "...the Congress should deny the \$1.34 billion requested for AMRAAM procurement in fiscal year 1991 because the missile's performance, reliability, producibility, and affordability remain questionable. Moreover, missile deliveries from the first production year are at least 6 months behind schedule, and additional delays appear likely. Because funds have already been appropriated for three additional production years, it is highly unlikely that additional procurement funds will be necessary before fiscal year 1992..."

<u>Program name</u>	<u>RDT&E/Procurement Funding Request (FY 1991)</u>
ALQ-184 Jammer	\$120.4 million for procurement

Summary: The Air Force began low rate production of the ALQ-184 jammer before beginning operational testing. Subsequent operational testing revealed significant performance problems. To correct these problems the Air Force began an improvement program. Although the modifications have not been operationally tested production is continuing and previously produced jammers are being retrofitted. We believe that production should be slowed to the minimum rate necessary to avoid a break in production, pending demonstration of satisfactory performance.

<u>Program name</u>	<u>RDT&E/Procurement Funding Request (FY 1991)</u>
ALQ-135 (P3I)	\$259.4 million in prior year unobligated procurement funds. Funds requested for this program in fiscal year 1991 are included as part of the F-15 procurement funding. Air Force officials stated that they plan to allocate \$137 million of F-15 funding for procurement of the ALQ-135 (P3I).

Summary: The Air Force began production of the ALQ-135 (P3I) jammer before conducting operational testing and subsequently discovered a software development problem. Production has continued while the Air Force has attempted to correct the problem. To date operational testing still has not been conducted. All ALQ-135 (P3I) jammers produced were placed in storage since they were not functional. We believe that production should be slowed to the minimum rate necessary to avoid a break in production, pending solution of the software development problem and completion of operational testing.