

GAO

## Testimony

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# DOD FINANCIAL MANAGEMENT

## Important Steps Underway But Reform Will Require a Long-term Commitment

Statement of Gregory D. Kutz  
Director, Financial Management and Assurance

Randolph C. Hite  
Director, Information Technology Architecture and  
Systems Issues

David R. Warren  
Director, Defense Capabilities and Management



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Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss financial management at the Department of Defense (DOD). Today, DOD faces financial and related management problems that are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. DOD's financial management deficiencies, taken together, represent the single largest obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. To date, none of the military services or major DOD components has passed the test of an independent financial audit because of weaknesses in financial management systems, operations, and controls.

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

The President has made financial management and the use of technology integral to his fiscal year 2002 *Management Agenda* for making the federal government more focused on citizens and results. The President's *Management Agenda* notes, "Without accurate and timely information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people."

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With the events of September 11, and the federal government's short- and long-term budget challenges, it is more important than ever that DOD effectively transform its business operations to ensure that it gets the most from every dollar spent. The department must be able to effectively carry out its stewardship responsibilities for the funding it receives and for the vast amount of equipment and inventories used in support of military operations. Even before the events of September 11, increased globalization, changing security threats, and rapid technological advances were prompting fundamental changes in the environment in which DOD operates. These trends place a premium on increasing strategic planning, enhancing results orientation, ensuring effective accountability, maintaining transparency, and using integrated approaches. Of the 22 areas on GAO's governmentwide "high-risk" list, 6 are DOD program areas, and DOD shares responsibility for 2 other high-risk areas that are government wide in scope.<sup>1</sup> Central to effectively addressing DOD's financial management problems will be the understanding that these eight areas are interrelated and cannot be addressed in an isolated, stovepiped, or piecemeal fashion.

The excellence of our military forces is unparalleled. This same level of excellence is not yet evident in the department's financial management and other related business areas. This is particularly problematic because effective financial and related management operations are critical to achieving the department's mission in a reasonably economical, efficient, and effective manner and to providing reliable, timely financial information on a routine basis to support management decision making at all levels throughout DOD. Transforming DOD's business operations would free up resources that could be used to enhance readiness, improve the quality of life for our troops and their families, and reduce the gap between "wants" and available funding in connection with major weapon systems.

Today, we will provide our perspectives on the (1) department's long-standing inability to effectively reform its financial management and other business systems and processes and (2) keys to successfully carrying out the Secretary's business process transformation. Last summer, the Comptroller General shared a business transformation paper with Secretary Rumsfeld and Comptroller Zakheim. This paper provided an overview of our views on the challenges facing the department, the keys to

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

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effective reform, and detailed one option for addressing these challenges. Our testimony today highlights the keys to success included in that paper.

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

History is a good teacher. To solve the problems of today, it is important to avoid repeating past mistakes. Over the past 12 years, the department has initiated several broad-based departmentwide reform efforts intended to fundamentally reform its financial operations as well as other key business areas, including the Defense Reform Initiative, the Defense Business Operations Fund, and the Corporate Information Management initiative. These efforts, which are highlighted below, have proven to be unsuccessful despite good intentions and significant effort. The conditions that led to these previous attempts at reform remain largely unchanged today.

**Defense Reform Initiative (DRI).** In announcing the DRI program in November 1997, the then Secretary of Defense stated that his goal was “to ignite a revolution in business affairs.” DRI represented a set of proposed actions aimed at improving the effectiveness and efficiency of DOD’s business operations, particularly in areas that had been long-standing problems—including financial management. In July 2000, we reported<sup>2</sup> that while DRI got off to a good start and made progress in implementing many of the component initiatives, it did not meet expected time frames and goals, and the extent to which savings from these initiatives would be realized was yet to be determined. We noted that a number of barriers had kept the department from meeting its specific time frames and goals. The most notable barrier was institutional resistance to change in an organization as large and complex as DOD, particularly in such areas as acquisition, financial management, and logistics, which transcend most of the department’s functional organizations and have been long-standing management concerns. We also pointed out that DOD did not have a clear road map to ensure that the interrelationships between its major reform initiatives were understood and addressed and that it was investing in its highest priority requirements. We are currently examining the extent to which DRI efforts begun under the previous administration are continuing.

**Defense Business Operations Fund.** In October 1991, DOD established a new entity, the Defense Business Operations Fund by consolidating nine

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<sup>2</sup>U.S. General Accounting Office, *Defense Management: Actions Needed to Sustain Reform Initiatives and Achieve Greater Results*, [GAO/NSIAD-00-72](#) (Washington, D.C.: July 25, 2000).

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existing industrial and stock funds and five other activities operated throughout DOD. Through this consolidation, the fund was intended to bring greater visibility and management to the overall cost of carrying out certain critical DOD business operations. However, from its inception, we reported that the fund did not have the policies, procedures, and financial systems to operate in a businesslike manner. In 1996, DOD announced the fund's elimination. In its place, DOD established four working capital funds. DOD estimated that for fiscal year 2003 these funds would account for and control about \$75 billion. These new working capital funds inherited their predecessor's operational and financial reporting problems. Our reviews of these funds have found that they still are not in a position to provide accurate and timely information on the results of operations. As a result, working capital fund customers cannot be assured that the prices they are charged for goods and services represent actual costs.

**Corporate Information Management (CIM).** The CIM initiative began in 1989 and was expected to save billions of dollars by streamlining operations and implementing standard information systems to support common business operations. CIM was expected to reform all of DOD's functional areas—including finance, procurement, material management, and human resources—through consolidating, standardizing, and integrating information systems. DOD also expected CIM to replace approximately 2,000 duplicative systems. Over the years, we made numerous recommendations to improve CIM's management to help preclude the wasteful use and mismanagement of billion of dollars. However, these recommendations were generally not addressed. Instead, DOD spent billions of dollars with little sound analytical justification. Rather than relying on a rigorous decision-making process for information technology investments—as used in leading private and public organizations we studied, DOD made systems decisions without (1) appropriately analyzing cost, benefits, and technical risks; (2) establishing realistic project schedules; or (3) considering how business process improvements could affect information technology investments. For one effort alone, DOD spent about \$700 million trying to develop and implement a single system for the material management business area—but this effort proved unsuccessful. We reported in 1997<sup>3</sup> that the benefits of CIM had yet to be widely achieved after 8 years of effort and spending about \$20 billion. The CIM initiative was eventually abandoned.

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<sup>3</sup>U.S. General Accounting Office, *High-Risk Series: Information Management and Technology*, GAO/HR-97-9 (Washington, D.C.: Feb. 1997).

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DOD's long-standing financial management difficulties have adversely affected the department's ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget (such as for health care, weapon systems, and environmental liabilities), measure performance, maintain funds control, prevent fraud, and address pressing management issues.

In this regard, I would like to briefly highlight three of our recent products that exemplify the adverse impact of DOD's reliance on fundamentally flawed financial management systems and processes and a weak overall internal control environment.

- In March of this year, we testified<sup>4</sup> on the continuing problems with internal controls over approximately \$64 million in fiscal year 2001 purchase card transactions involving two Navy activities. Consistent with our testimony<sup>5</sup> last July on fiscal year 2000 purchase card transactions at these locations, our follow-up review demonstrated that continuing control problems contributed to fraudulent, improper, and abusive purchases and theft and misuse of government property. We are currently auditing purchase and travel card usage across the department.
- In July 2001, we reported<sup>6</sup> that DOD did not have adequate systems, controls, and managerial attention to ensure that the \$2.7 billion of adjustments affecting closed appropriation accounts made during fiscal year 2000 were legal and otherwise proper. Our review of \$2.2 billion of these adjustments found about \$615 million (28 percent) of the adjustments should not have been made, including about \$146 million that violated specific provisions of appropriations law and were thus illegal. For example, the stated purpose of one adjustment was to charge a \$79 million payment made in February 1999 to a fiscal year 1992 research and development appropriation account to correct previous payment recording errors. However, the fiscal year 1992 research and

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<sup>4</sup>U.S. General Accounting Office, *Purchase Cards: Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, [GAO-02-504T](#) (Washington, D.C.: Mar. 13, 2002).

<sup>5</sup>U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, [GAO-01-995T](#) (Washington, D.C.: July 30, 2001).

<sup>6</sup>U.S. General Accounting Office, *Canceled DOD Appropriations: \$615 Million of Illegal or Otherwise Improper Adjustments*, [GAO-01-994T](#) (Washington, D.C.: July 26, 2001).

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development appropriation account closed at the end of fiscal year 1998—4 months before the \$79 million payment was made. Therefore, the adjustment had the same effect as using canceled funds from a closed appropriation account to make the February 1999 expenditure, which is prohibited by the 1990 law. As of April 2002, DOD had reversed 140 of the 162 transactions and provided additional contract documentation for the remaining 22 transactions. However, DOD has yet to complete the reconciliation for the contracts associated with these adjustments and make the correcting entries. DOD has indicated that it will be later this year before the correct entries are made.

- In June 2001, we reported<sup>7</sup> that DOD's financial systems could not adequately track and report on whether the \$1.1 billion in earmarked funds that the Congress provided to DOD for spare parts and associated logistical support were actually used for their intended purpose. The vast majority of the funds—92 percent—were transferred to the military services operation and maintenance accounts. Once the funds were transferred into the operation and maintenance accounts, the department could not separately track the use of the funds. As a result, DOD lost its ability to assure the Congress that the funds it received for spare parts purchases were used for, and only for, that purpose.

Problems with the department's financial management operations go far beyond its accounting and finance systems and processes. The department continues to rely on a far-flung, complex network of finance, logistics, personnel, acquisition, and other management information systems—80 percent of which are not under the control of the DOD Comptroller—to gather the financial data needed to support the day-to-day management decision making. This network was not designed to be, but rather has evolved into, the overly complex and error-prone operation that exists today, including (1) little standardization across DOD components, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, (4) manual data entry into multiple systems, and (5) a large number of data translations and interfaces that combine to exacerbate problems with data integrity.

Many of the department's business operations are mired in old, inefficient processes and legacy systems, some of which go back to the 1950s and

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<sup>7</sup>U.S. General Accounting Office, *Defense Inventory: Information on the Use of Spare Parts Funding Is Lacking*, GAO-01-472 (Washington, D.C.: June 11, 2001).

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1960s. For example, the department still relies on the Mechanization of Contract Administration Services (MOCAS) system—which dates back to 1968—to process a substantial portion of the contract payment transactions for all DOD organizations. In fiscal year 2001, MOCAS processed an estimated \$78 billion in contract payments. Past efforts to replace MOCAS have failed and the current effort has been delayed. As a result, for the foreseeable future, DOD will continue to be saddled with MOCAS.

In the 1970s, we issued numerous reports detailing serious problems with the department's financial management operations. Between 1975 and 1981, we issued more than 75 reports documenting serious problems with DOD's cost, property, fund control, and payroll accounting systems. In the 1980s, we found that despite the billions of dollars invested in individual systems, these efforts, too, fell far short of the mark, with extensive schedule delays and cost overruns. For example, our 1989 report<sup>8</sup> on eight major DOD system development efforts—including two major accounting systems—under way at that time, showed that system development cost estimates doubled, two of the eight efforts were abandoned, and the remaining six efforts experienced delays of 3 to 7 years.

Two recent specific system endeavors that have fallen short of their intended goals are the Standard Procurement System and the Defense Joint Accounting System. Both of these efforts were aimed at improving the department's financial management and related business operations.

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<sup>8</sup>U.S. General Accounting Office, *Automated Information Systems: Schedule Delays and Cost Overruns Plague DOD Systems*, [GAO/IMTEC-89-36](#) (Washington, D.C.: May 10, 1989).



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**Standard Procurement System (SPS).** In November 1994, DOD began the SPS program to acquire and deploy a single automated system to perform all contract management-related functions within DOD's procurement process for all DOD organizations and activities. The laudable goal of SPS was to replace 76 existing procurement systems with a single departmental system. DOD estimated that SPS had a life-cycle cost of approximately \$3 billion over a 10-year period. According to DOD, SPS was to support about 43,000 users at over 1,000 sites worldwide and was to interface with key financial management functions such as payment processing. Additionally, SPS was intended to replace the contract administration functions currently performed by MOCAS. Our July 2001 report<sup>9</sup> and February 2002 testimony<sup>10</sup> before this Subcommittee identified weaknesses in the department's management of its investment in SPS. Specifically:

- The department had not economically justified its investment in the program because its latest (January 2000) analysis of costs and benefits was not credible. Further, this analysis showed that the system, as defined, was not a cost-beneficial investment.
- The department was not accumulating actual program costs and therefore, did not know the total amount spent on the program to date, yet life-cycle cost projections had grown from about \$3 billion to \$3.7 billion.
- Although the department committed to fully implementing the system by March 31, 2000, this target date had slipped by over 3 ½ years to September 30, 2003, and program officials have recently stated that this date will also not be met.

We recommended that the Secretary of Defense make additional investments in SPS conditional upon first demonstrating that the existing version of SPS is producing benefits that exceed costs and that future investment decisions, including those regarding operations and

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<sup>9</sup>U.S. General Accounting Office, *DOD Systems Modernization: Continued Investment in the Standard Procurement System Has Not Been Justified*, [GAO-01-682](#) (Washington, D.C.: July 31, 2001).

<sup>10</sup>U.S. General Accounting Office, *DOD's Standard Procurement System: Continued Investment Has Yet to Be Justified*, [GAO-02-392T](#) (Washington, D.C.: Feb. 7, 2002).

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maintenance beyond fiscal year 2001, be based on complete and reliable economic justifications.

**Defense Joint Accounting System (DJAS).** In 1997, DOD selected DJAS<sup>11</sup> to be one of three general fund accounting systems.<sup>12</sup> As originally envisioned, DJAS would perform the accounting for the Army and the Air Force as well as the DOD transportation and security assistance areas. Subsequently, in February 1998, Defense Finance and Accounting Service (DFAS) decided that the Air Force could withdraw from using DJAS. DFAS made the decision because either the Air Force processes or the DJAS processes would need significant reengineering to allow for the development of a joint accounting system. As a result, the Air Force was allowed to start development of its own general fund accounting system—General Fund and Finance System—which resulted in the development of a fourth general fund accounting system.

In June 2000, the DOD Inspector General reported<sup>13</sup> that DFAS was developing DJAS at an estimated life-cycle cost of about \$700 million without demonstrating that the program was the most cost-effective alternative for providing a portion of DOD's general fund accounting. More specifically, the report stated that DFAS had not developed a complete or fully supportable feasibility study, analysis of alternatives, economic analysis, acquisition program baseline, or performance measures, and had not reengineered business processes. According to data provided by DFAS, for fiscal years 1997-2000 approximately \$120 million was spent on the development and implementation of DJAS. However, today DJAS is only being operated at two locations—Ft. Benning, Georgia, and the Missile Defense Agency. According to a DFAS official, DJAS is considered to be fully deployed—which means it is operating at all intended locations.

Significant resources—in terms of dollars, time, and people—have been invested in these two efforts, without demonstrated improvement in DOD's

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<sup>11</sup>The original name of the system was the Corps of Engineers Financial Management System (CEFMS). After it was determined that CEFMS could be modified to satisfy Army customers and had the potential for supporting the Defense Working Capital Funds, DFAS selected CEFMS to meet the DJAS requirements.

<sup>12</sup>The other two general fund systems were the Standard Accounting and Reporting System and the Standard Accounting and Budgetary Reporting System.

<sup>13</sup>Department of Defense Office of the Inspector General, *Acquisition of the Defense Joint Accounting System*, Report No. D-2000-151 (Arlington, VA.: June 16, 2000).

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business operations. It is essential that DOD ensure that its investment in systems modernization results in more effective and efficient business operations, since every dollar spent on ill-fated efforts such as SPS and DJAS is one less dollar available for other defense spending priorities.

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

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

- a lack of sustained top-level leadership and management accountability for correcting problems;
- deeply embedded cultural resistance to change, including military service parochialism and stovepiped operations;
- a lack of results-oriented goals and performance measures and monitoring; and
- inadequate incentives for seeking change.

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## Lack of Sustained Leadership and Accountability

Historically, DOD has not routinely assigned accountability for performance to specific organizations or individuals who have sufficient authority to accomplish desired goals. For example, under the CFO Act, it is the responsibility of agency CFOs to establish the mission and vision for the agency's future financial management. However, at DOD, the Comptroller—who is by statute the department's CFO—has direct responsibility for only an estimated 20 percent of the data relied on to carry out the department's financial management operations.

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- The department has learned through its efforts to meet the Year 2000 computing challenge that to be successful, major improvement initiatives must have the direct, active support and involvement of the Secretary and Deputy Secretary of Defense. In the Year 2000 case, the then Deputy Secretary of Defense was personally and substantially involved and played a major role in the department's success. Such top-level support and attention helps ensure that daily activities throughout the department remain focused on achieving shared, agencywide outcomes. A central finding from our report on our survey of best practices of world-class financial management organizations—Boeing; Chase Manhattan Bank; General Electric; Pfizer; Hewlett-Packard; Owens Corning; and the states of Massachusetts, Texas, and Virginia—was that clear, strong executive leadership was essential to (1) making financial management an entitywide priority, (2) redefining the role of finance, (3) providing meaningful information to decision makers, and (4) building a team of people that delivers results.<sup>14</sup>

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

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## Cultural Resistance and Parochialism

Cultural resistance to change and military service parochialism have also played a significant role in impeding previous attempts to implement broad-based management reforms at DOD. The department has acknowledged that it confronts decades-old problems deeply grounded in the bureaucratic history and operating practices of a complex, multifaceted organization, and that many of these practices were developed piecemeal and evolved to accommodate different organizations, each with its own policies and procedures.

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<sup>14</sup>U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: Apr. 2000).

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For example, as discussed in our July 2000 report,<sup>15</sup> the department encountered resistance to developing departmentwide solutions under the then Secretary's broad-based DRI. In 1997, the department established a Defense Management Council—including high-level representatives from each of the military services and other senior executives in the Office of the Secretary of Defense—which was intended to serve as the “board of directors” to help break down organizational stovepipes and overcome cultural resistance to change called for under DRI. However, we found that the council's effectiveness was impaired because members were not able to put their individual military services' or DOD agencies' interests aside to focus on departmentwide approaches to long-standing problems.

Cultural resistance to change has impeded reforms not only in financial management, but also in other business areas, such as weapon system acquisition and inventory management. For example, as we reported<sup>16</sup> last year, while the individual military services conduct considerable analyses justifying major acquisitions, these analyses can be narrowly focused and do not consider joint acquisitions with the other services. In the inventory management area, DOD's culture has supported buying and storing multiple layers of inventory rather than managing with just the amount of stock needed.

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## Unclear Goals and Performance Measures

DOD's past reform efforts have been handicapped by the lack of clear, linked goals and performance measures. As a result, DOD managers lack straightforward road maps showing how their work contributes to attaining the department's strategic goals, and they risk operating autonomously rather than collectively. In some cases, DOD had not yet developed appropriate strategic goals, and in other cases, its strategic goals and objectives were not linked to those of the military services and defense agencies.

As part of our assessment of *DOD's Fiscal Year 2000 Financial Management Improvement Plan*, we reported<sup>17</sup> that, for the most part, the

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<sup>15</sup>[GAO/NSIAD-00-72](#).

<sup>16</sup>U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, [GAO-01-244](#) (Washington D.C.: Jan. 2001).

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

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plan represented the military services' and defense components' stovepiped approaches to reforming financial management and did not clearly articulate how these various efforts would collectively result in an integrated DOD-wide approach to financial management improvement. In addition, we reported that the department's plan did not include performance measures that could be used to assess DOD's progress in resolving its financial management problems. DOD officials have informed us that they are now working to revise the department's approach to this plan so that future years' updates will reflect a more strategic, departmentwide vision and provide a more effective tool for financial management reform.

As it moves to modernize its systems, the department faces a formidable challenge in responding to technological advances that are changing traditional approaches to business management. For fiscal year 2003, DOD's information technology budgetary request of approximately \$26 billion will support a wide range of military operations as well as DOD business functions. As we have reported,<sup>18</sup> while DOD plans to invest billions of dollars in modernizing its financial management and other business support systems, it does not yet have an overall blueprint—or enterprise architecture—in place to guide and direct these investments. As we recently testified,<sup>19</sup> our review of practices at leading organizations showed they were able to make sure their business systems addressed corporate—rather than individual business unit—objectives by using enterprise architectures to guide and constrain investments. Consistent with our recommendation, DOD is now working to develop a financial management enterprise architecture, which is a very positive development.

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## Lack of Incentives for Change

The final underlying cause of the department's long-standing inability to carry out needed fundamental reform has been the lack of incentives for making more than incremental change to existing "business-as-usual" processes, systems, and structures. Traditionally, DOD has focused on justifying its need for more funding rather than on the outcomes its programs have produced. DOD generally measures its performance by the

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<sup>18</sup>U.S. General Accounting Office, *Information Technology: Architecture Needed to Guide Modernization of DOD's Financial Operations*, [GAO-01-525](#) (Washington, D.C.: May 17, 2001).

<sup>19</sup>U.S. General Accounting Office, *Defense Acquisitions: DOD Faces Challenges in Implementing Best Practices*, [GAO-02-469T](#) (Washington, D.C.: Feb. 27, 2002).

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amount of money spent, people employed, or number of tasks completed. Incentives for its decision makers to implement changed behavior have been minimal or nonexistent. Secretary Rumsfeld perhaps said it best in announcing his planned transformation at DOD: “There will be real consequences from, and real resistance to, fundamental change.”

This lack of incentive has perhaps been most evident in the department’s acquisition area. In DOD’s culture, the success of a manager’s career has depended more on moving programs and operations through the DOD process than on achieving better program outcomes. The fact that a given program may have cost more than estimated, taken longer to complete, and not generated results or performed as promised was secondary to fielding a new program. To effect real change, actions are needed to (1) break down parochialism and reward behaviors that meet DOD-wide and congressional goals; (2) develop incentives that motivate decision makers to initiate and implement efforts that are consistent with better program outcomes, including saying “no” or pulling the plug on a system or program that is failing; and (3) facilitate a congressional focus on results-oriented management, particularly with respect to resource-allocation decisions.

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## Independent Assessment Calls for the Reform of DOD’s Financial Operations

Recognizing the need for improved financial data to effectively manage the department’s vast operations, Secretary Rumsfeld commissioned an independent study to recommend a strategy for financial management improvements. The report<sup>20</sup> recognized that the department would have to undergo “a radical financial management transformation” and that it would take more than a decade to achieve. The report also noted that DOD’s current financial, accounting, and feeder systems do not provide relevant, reliable, and timely information. Further, the report pointed out that the “support of management decision-making” is generally not an objective of the financially based information currently developed or planned for future development. Additionally, the report stated that although the department had numerous system projects underway, they were narrowly focused, lacked senior management leadership, and were not part of an integrated DOD-wide strategy. The report also noted that the systemic problems discussed were not strictly financial management problems and could not be solved by DOD’s financial community. Rather, the solution would

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<sup>20</sup>Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change* (Washington, D.C.: Apr. 13, 2001).

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require the “concerted effort and cooperation of cross-functional communities throughout the department.”

The report recommended an integrated approach to transform the department’s financial operations. The report noted that its proposed framework would take advantage of certain ongoing improvement actions within the department and provide specific direction for a more coordinated, managed, and results-oriented approach. The proposed course of action for transforming the department’s financial management centered around six broad elements: (1) leadership, (2) incentives, (3) accountability, (4) organizational alignment, (5) changes in certain rules, and (6) changes in enterprise practices.

The report referred to its approach as a “twin-track” course of action. The first track employs a DOD-wide management approach to developing standard integrated systems; obtaining relevant, reliable, and timely financial data; and providing incentives for the department to utilize financial data in an efficient and effective way. This track will require a longer time frame and will include establishing a centralized oversight process under the DOD Comptroller for incrementally implementing the recommended structural changes and developing standard, integrated financial systems.

The second track focuses on targeting, selecting, and overseeing implementation of a limited number of intraservice/cross-service projects for major cost savings or other high-value benefits under a process led by the DOD Comptroller and assisting the Secretary of Defense in establishing and managing a set of metrics. Prime tools of such improvements would include activity-based costing and benchmarking/best practices analysis to identify cost-saving opportunities.

A July 19, 2001, departmental memorandum from Secretary Rumsfeld confirmed that the department needs to develop and implement an architecture for achieving integrated financial and accounting systems in order to generate relevant, reliable, and timely information on a routine basis. Secretary Rumsfeld further reiterated the need for a fundamental transformation of DOD in his “top-down” Quadrennial Defense Review. Specifically, his September 30, 2001, *Quadrennial Defense Review Report* concluded that the department must transform its outdated support structure, including decades-old financial systems that are not well interconnected. The report summed up the challenge well in stating: “While America’s businesses have streamlined and adopted new business



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models to react to fast-moving changes in markets and technologies, the Defense Department has lagged behind without an overarching strategy to improve its business practices.”

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## Keys to Fundamental DOD Financial Management Reform

Our experience has shown there are several key elements that collectively would enable the department to effectively address the underlying causes of its inability to resolve its long-standing financial management problems. For the most part these elements are consistent with those discussed in the department’s April 2001 financial management transformation report. These elements, which we believe are key to any successful approach to financial management reform, include

- addressing the department’s financial management challenges as part of a comprehensive, integrated, DOD-wide business reform;
- providing for sustained leadership by the Secretary of Defense and resource control to implement needed financial management reforms;
- establishing clear lines of responsibility, authority, and accountability for such reform tied to the Secretary;
- incorporating results-oriented performance measures and monitoring tied to financial management reforms;
- providing appropriate incentives or consequences for action or inaction;
- establishing and implementing an enterprise architecture to guide and direct financial management modernization investments; and
- ensuring effective oversight and monitoring.

Actions on many of the key areas central to successfully achieving desired financial management and related business transformation goals—particularly those that rely on longer term systems improvements—will take a number of years to fully implement. Secretary Rumsfeld has estimated that his envisioned transformation may take 8 or more years to complete. Our research and experience with other federal agencies have shown that this is not an unrealistic estimate. Additionally, these keys should not be viewed as independent actions, but rather, a set of interrelated and interdependent actions that are collectively critical to transforming DOD’s business operations.

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Consequently, both long-term actions focused on the Secretary's envisioned business transformation and short-term actions focused on improvements within existing systems and processes will be critical going forward. Short-term actions in particular will be critical if the department is to achieve the greatest possible accountability over existing resources and more reliable data for day-to-day decision making while longer term systems and business process reengineering efforts are under way. Beginning with the Secretary's recognition of a need for a fundamental transformation of the department's business operations and building on some of the work begun under past administrations, DOD has taken a number of positive steps in many of these key areas, but these steps are only a beginning. Challenges remain in each of these key areas that are formidable.

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## Integrated Business Reform Strategy

As we previously reported,<sup>21</sup> establishing the right goal is essential for success. Central to effectively addressing DOD's financial management problems will be the recognition that they cannot be addressed in an isolated, stovepiped, or piecemeal fashion separate from the other high-risk areas facing the department.<sup>22</sup> Further, successfully reforming the department's operations—which consist of people, business processes, and technology—will be critical if DOD is to effectively address the deep-rooted organizational emphasis on maintaining business-as-usual across the department.

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<sup>21</sup>U.S. General Accounting Office, *Department of Defense: Progress in Financial Management Reform*, [GAO/T-AIMD/NSIAD-00-163](#) (Washington, D.C.: May 9, 2000).

<sup>22</sup>The eight interrelated high-risk areas that represent the greatest challenge to DOD's developing world-class business operations supporting its forces are: contract management, financial management, human capital, information security, infrastructure management, inventory management, systems modernization, and weapon system acquisition.

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Financial management is a crosscutting issue that affects virtually all of DOD's business areas. For example, improving its financial management operations so that they can produce timely, reliable, and useful cost information is essential to effectively measure its progress toward achieving many key outcomes and goals across virtually the entire spectrum of DOD's business operations. At the same time, the department's financial management problems—and, most importantly, the keys to their resolution—are deeply rooted in and dependent upon developing solutions to a wide variety of management problems across DOD's various organizations and business areas. For example, we have reported<sup>23</sup> that many of DOD's financial management shortcomings were attributable in part to human capital issues. The department does not yet have a strategy in place for improving its financial management human capital. This is especially critical in connection with DOD's civilian workforce, since DOD has generally done a much better job in conjunction with human capital planning for its military personnel. In addition, DOD's civilian personnel face a variety of size, shape, skills, and succession-planning challenges that need to be addressed.

As we mentioned earlier, and it bears repetition, the department has reported that an estimated 80 percent of the data needed for sound financial management comes from its other business operations, such as its acquisition and logistics communities. DOD's vast array of costly, nonintegrated, duplicative, and inefficient financial management systems is reflective of its lack of an integrated approach to addressing management challenges. DOD has acknowledged that one of the reasons for the lack of clarity in its reporting under the Government Performance and Results Act has been that most of the program outcomes the department is striving to achieve are interrelated, while its management systems are not integrated.

As we discussed previously, the Secretary of Defense has made the fundamental transformation of business practices throughout the department a top priority. In this context, the Secretary established a number of top-level committees, councils, and boards, including the Senior Executive Committee, Business Initiative Council, and Defense Business Practices Implementation Board. The Senior Executive Committee was established to help guide efforts across the department to improve its business practices. This committee—chaired by the Secretary of Defense,

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<sup>23</sup>U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-01-244 (Washington, D.C.: Jan. 2001).

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and with membership to include the Deputy Secretary, the military service secretaries, and the Under Secretary of Defense for Acquisition, Technology and Logistics—was established to function as the “board of directors” for the department. The Business Initiative Council—comprising the military service secretaries and headed by the Under Secretary of Defense for Acquisition, Technology and Logistics—was established to encourage the military services to explore new money-saving business practices to help offset funding requirements for transformation and other initiatives.

Our research of successful public and private sector organizations shows that such entities, comprised of enterprisewide executive leadership, provide valuable guidance and direction when pursuing integrated solutions to corporate problems. Inclusion of the department’s top leadership should help to break down the cultural barriers to change and result in an integrated DOD approach for business reform.

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## Sustained Leadership and Resource Control

The department’s successful Year 2000 effort illustrated, and our survey of leading financial management organizations<sup>24</sup> captured, the importance of strong leadership from top management. As we have stated many times before, strong, sustained executive leadership is critical to changing a deeply rooted corporate culture—such as the existing “business-as-usual” culture at DOD—and to successfully implementing financial management reform. In the case of the Year 2000 challenge the personal, active involvement of the Deputy Secretary of Defense played a key role in building entitywide support and focus. Given the long-standing and deeply entrenched nature of the department’s financial management problems—combined with the numerous competing DOD organizations, each operating with varying, often parochial views and incentives—such visible, sustained top-level leadership will be critical.

In discussing their April 2001 report to the Secretary of Defense on transforming financial management,<sup>25</sup> the authors stated that, “unlike previous failed attempts to improve DOD’s financial practices, there is a

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<sup>24</sup>U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, [GAO/AIMD-00-134](#) (Washington, D.C.: Apr. 2000).

<sup>25</sup>Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change* (Washington, D.C.: Apr. 13, 2001).

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new push by DOD leadership to make this issue a priority.” Strong, sustained executive leadership—over a number of years and administrations—will be key to changing a deeply rooted culture. In addition, given that significant investments in information systems and related processes have historically occurred in a largely decentralized manner throughout the department, additional actions will likely be required to implement centralized information technology investment control.

In our May 2001 report<sup>26</sup> we recommended that DOD take action to provide senior departmental commitment and leadership through establishment of a enterprisewide steering committee sponsored by the Secretary, that could guide development of a transformation blueprint and provide for centralized control over investments to ensure funding is provided for only those proposed investments in systems and business reforms that are consistent with the blueprint. Absent such a control, DOD runs the serious risk that the fiscal year 2003 information technology budgetary request of approximately \$26 billion and future years’ requests will not result in marked improvement in DOD’s business operations. Without such an approach, DOD runs the risk of spending billions of dollars on systems modernization, which continues to perpetuate the existing systems environment that suffers from duplication of systems, limited interoperability, and unnecessarily costly operations and maintenance and will preclude DOD from achieving the Secretary’s vision of improved financial information on the results of departmental operations.

Additionally, as previously discussed, the tenure of the department’s top political appointees has generally been short in duration and as a result it is sometimes difficult to maintain the focus and momentum that is needed to resolve the management challenges facing DOD. The resolution of the array of interrelated business system management challenges previously discussed is likely to require a number of years and therefore span several administrations. The Comptroller General has proposed in congressional testimony that one option to consider to address the continuity issue would be the establishment of the position of chief operating officer. This position could be filled by an individual appointed for a set term of 5 to 7 years with the potential for reappointment. Such an individual should have a proven track record as a business process change agent for large, diverse

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<sup>26</sup>U.S. General Accounting Office, *Information Technology: Architecture Needed to Guide Modernization of DOD’s Financial Operations*, [GAO-01-525](#) (Washington, D.C.: May 2001).

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organizations and would spearhead business process transformation across the department.

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## Clear Lines of Responsibility and Accountability

Last summer, when the Comptroller General met with Secretary Rumsfeld, he stressed the importance of establishing clear lines of responsibility, decision-making authority, and resource control for actions across the department tied to the Secretary as a key to reform. As we previously reported,<sup>27</sup> such an accountability structure should emanate from the highest levels and include the secretary of each of the military services as well as heads of the department's various major business areas.

The Secretary of Defense has taken action to vest responsibility and accountability for financial management modernization with the DOD Comptroller. In October 2001, the DOD Comptroller, as previously mentioned, established the Financial Management Modernization Executive<sup>28</sup> and Steering Committees as the governing bodies that oversee the activities related to this modernization effort and also established a supporting working group to provide day-to-day guidance and direction in these efforts. DOD reports that the executive and steering committees met for the first time in January 2002. At the request of the Subcommittee on Readiness and Management Support, Senate Committee on Armed Services, we are initiating a review of the department's efforts to develop and implement an enterprise architecture. As part of the effort, we will be assessing the department's efforts to align current investments in financial systems with the proposed architecture.

It is clear to us that the DOD Comptroller has the full support of the Secretary and that the Secretary is committed to making meaningful change. The key is to translate this support into a funding control mechanism that ensures DOD's components information technology investments are aligned with the department's strategic blueprint. Addressing issues such as centralization of authority for information systems investments and continuity of leadership is critical to successful business transformation. To make this work, it is important that the DOD Comptroller have sufficient authority to oversee the investment decisions

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<sup>27</sup>[GAO/NSIAD-00-72](#).

<sup>28</sup>The structure and responsibilities of the Executive Committee as outlined in the October 2001 memorandum are consistent with the provisions of Section 1009 of Public Law 107-107.

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in order to bring about the full, effective participation of the military services and business process owners across the department.

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## Results-oriented Performance

As discussed in our January 2001 report on DOD's major performance and accountability challenges,<sup>29</sup> establishing a results orientation is another key element of any approach to reform. Such an orientation should draw upon results that could be achieved through commercial best practices, including outsourcing and shared servicing concepts. Personnel throughout the department must share the common goal of establishing financial management operations that not only produce financial statements that can withstand the test of an audit but more importantly, routinely generate useful, reliable, and timely financial information for day-to-day management purposes.

In addition, we have previously testified<sup>30</sup> that DOD's financial management improvement efforts should be measured against an overall goal of effectively supporting DOD's basic business processes, including appropriately considering related business process system interrelationships, rather than determining system-by-system compliance. Such a results-oriented focus is also consistent with an important lesson learned from the department's Year 2000 experience. DOD's initial Year 2000 focus was geared toward ensuring compliance on a system-by-system basis and did not appropriately consider the interrelationships of systems and business areas across the department. It was not until the department, under the direction of the then Deputy Secretary, shifted to a core mission and function review approach that it was able to achieve the desired result of greatly reducing its Year 2000 risk.

Since the Secretary has established an overall business process transformation goal that will require a number of years to achieve, going forward it is especially critical for managers throughout the department to focus on specific metrics that, over time, collectively will translate to achieving this overall goal. It is important for the department to refocus its annual accountability reporting on this overall goal of fundamentally transforming the department's financial management systems and related

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<sup>29</sup>[GAO-01-244](#).

<sup>30</sup>[GAO/T-AIMD/NSIAD-00-163](#).

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business processes to include appropriate interim annual measures for tracking progress toward this goal.

In the short term, it is important to focus on actions that can be taken using existing systems and processes. It is critical to establish interim measures to both track performance against the department's overall transformation goals and facilitate near-term successes using existing systems and processes. The department has established an initial set of metrics intended to evaluate financial performance, and it reports that it has seen improvements. For example, with respect to closed appropriation accounts, DOD reported during the first 6 months of fiscal year 2002 a reduction in the dollar value of adjustments to closed appropriation accounts of about 80 percent from the same 6-month period in fiscal year 2001. Other existing metrics concern cash and funds management, contract and vendor payments, and disbursement accounting. We are initiating a review of DOD's short-term financial management performance metrics and will provide the Subcommittee the results of our review. DOD also reported that it is working to develop these metrics into higher-level measures more appropriate for senior management. We agree with the department's efforts to expand the use of appropriate metrics to guide its financial management reform efforts.

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## Incentives and Consequences

Another key to breaking down the parochial interests and stovepiped approaches that have plagued previous reform efforts is establishing mechanisms to reward organizations and individuals for behaviors that comply with DOD-wide and congressional goals. Such mechanisms should be geared to providing appropriate incentives and penalties to motivate decision makers to initiate and implement efforts that result in fundamentally reformed financial management and other business support operations.

In addition, such incentives and consequences are essential if DOD is to break down the parochial interests that have plagued previous reform efforts. Incentives driving traditional ways of doing business, for example, must be changed, and cultural resistance to new approaches must be overcome. Simply put, DOD must convince people throughout the department that they must change from business-as-usual systems and practices or they are likely to face serious consequences, organizationally and personally.



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## Enterprise Architecture

Enterprise architecture development, implementation, and maintenance are a basic tenet of effective information technology management. Used in concert with other information technology management controls, an architecture can increase the chances for optimal mission performance. We have found that attempting to modernize operations and systems without an architecture leads to operational and systems duplication, lack of integration, and unnecessary expense. Our best practices research of successful public and private sector organizations has similarly identified enterprise architectures as essential to effective business and technology transformation.<sup>31</sup>

Establishing and implementing a financial management enterprise architecture is essential for the department to effectively manage its modernization effort. The Clinger-Cohen Act requires major departments and agencies to develop, implement, and maintain an integrated architecture. As we previously reported,<sup>32</sup> such an architecture can help ensure that the department invests only in integrated, business system solutions and, conversely, will help move resources away from non-value-added legacy business systems and nonintegrated business system development efforts. Without an enterprise architecture to guide and constrain information technology investments, DOD runs the serious risk that its system efforts will perpetuate the existing system environment that suffers from systems duplication, limited interoperability, and unnecessarily costly operations and maintenance.

In our May 2001 report,<sup>33</sup> we pointed out that DOD lacks a financial management enterprise architecture to guide and constrain the billions of dollars it plans to spend to modernize its financial management operations and systems. According, we recommended that the department develop and implement an architecture in accordance with DOD's policies and guidance and that senior management be involved in the investment decision-making process.

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<sup>31</sup>U.S. General Accounting Office, *Executive Guide: Improving Mission Performance through Strategic Information Management and Technology*, GAO/AIMD-94-115 (Washington, D.C.: May 1994).

<sup>32</sup>[GAO/T-AIMD/NSIAD-00-163](#).

<sup>33</sup>[GAO-01-525](#).

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DOD has awarded a contract for the development of a DOD-wide financial management enterprise architecture to “achieve the Secretary’s vision of relevant, reliable and timely financial information needed to support informed decision-making.” In fiscal year 2002, DOD received approximately \$98 million and has requested another \$96 million for fiscal year 2003 for this effort. Consistent with the recommendations contained in our January 1999<sup>34</sup> and May 2001 reports, DOD has begun an extensive effort to document the department’s current “as-is” financial management architecture by identifying systems currently relied upon to carry out financial management operations throughout the department. To date, the department has identified over 1,100 systems that are involved in the processing of financial information. In developing the “as-is” environment DOD has recognized that financial management is broader than just accounting and finance systems. Rather, it includes the department’s budget formulation, acquisition, inventory management, logistics, personnel, and property management systems.

In developing and implementing its enterprise architecture, DOD needs to ensure that the multitude of systems efforts currently underway are designed as an integral part of the architecture. As discussed in our May 2001 report,<sup>35</sup> the Army and the Defense Logistics Agency (DLA) are investing in financial management solutions that are estimated to cost about \$700 million and \$900 million, respectively. Further, the Naval Audit Service has reported that the Navy has efforts underway which are estimated to cost about \$2.5 billion.<sup>36</sup> These programs—commercial enterprise resource planning (ERP) products—are intended to implement different commercially available products for automating and reengineering various operations within the organization.<sup>37</sup> Among the functions that these ERP programs address is financial management. However, since DOD has yet to develop and implement its architecture,

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<sup>34</sup>U.S. General Accounting Office, *Financial Management: Analysis of DOD’s First Biennial Financial Management Improvement Plan*, GAO/AIMD-99-44 (Washington, D.C.: Jan. 29, 1999).

<sup>35</sup>[GAO-01-525](#).

<sup>36</sup>Naval Audit Service, *Department of the Navy Implementation of Enterprise Resource Planning Solutions*, N2002-0024 (Washington, D.C.: Jan. 25, 2002).

<sup>37</sup>ERP products consist of multiple, integrated functional modules that do different tasks, such as track payroll, keep a standard general ledger, manage supply chains, and organize customer data.

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there is no assurance that these separate efforts will result in systems that are compatible with the DOD designated architecture. For example, the Naval Audit Service reported that there are interoperability problems with the four Navy ERP efforts and the entire program lacks appropriate management oversight.

The effort to develop a financial management architecture will be further complicated as the department strives to develop multiple architectures across its various business areas and organizational components. For example, in June 2001, we recommended<sup>38</sup> that the DLA develop an architecture to guide and constrain its Business Systems Modernization acquisition. Additionally, we recommended that the department develop a DOD-wide logistics management architecture that would promote interoperability and avoid duplication among the logistics modernization efforts now under way in DOD component organizations, such as DLA and the military services.

As previously discussed, control and accountability over investments are critical. DOD can ill-afford another CIM, which invested billion of dollars but did not result in systems that were capable of providing DOD management and the Congress with more accurate, timely, and reliable information of the results of the department's vast operations. To better control DOD's investments we recommended in our May 2001 report,<sup>39</sup> that until the architecture is developed investments should be limited to (1) deployment of systems that have already been fully tested and involve no additional development or acquisition cost, (2) stay-in-business maintenance needed to keep existing systems operational, (3) management controls needed to effectively invest in modernized systems, and (4) new systems or existing system changes that are congressionally directed or are relatively small, cost effective, and low risk and can be delivered in a relatively short time frame.

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<sup>38</sup>U.S. General Accounting Office, *Information Technology: DLA Should Strengthen Business Systems Modernization Architecture and Investment Activities*, [GAO-01-631](#) (Washington, D.C.: June 29, 2001).

<sup>39</sup>[GAO-01-525](#).

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## Monitoring and Oversight

Ensuring effective monitoring and oversight of progress will also be key to bringing about effective implementation of the department's financial management and related business process reform. We have previously testified<sup>40</sup> that periodic reporting of status information to department top management, the Office of Management and Budget (OMB), the Congress, and the audit community is another key lesson learned from the department's successful effort to address its Year 2000 challenge.

Previous submissions of the department's *Financial Management Improvement Plan* have simply been compilations of data call information on the stovepiped approaches to financial management improvements received from the various DOD components. It is our understanding that DOD plans to change its approach and anchor the plan in the enterprise architecture. If the department's future plans are upgraded to provide a departmentwide strategic view of the financial management challenges facing the department, along with planned corrective actions, these plans can serve as an effective tool not only to help guide and direct the department's financial management reform efforts, but also to help maintain oversight of the department's financial management operations. Going forward, this Subcommittee's oversight hearings, as well as the active interest and involvement of the defense appropriations and authorization committees, will continue to be key to effectively achieving and sustaining DOD's financial management and related business process reform milestones and goals.

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In conclusion, we support Secretary Rumsfeld's vision for transforming the department's financial and business related operations. The continued leadership and support of the Secretary and other DOD top executives will be essential to successfully change the DOD culture that has over time perpetuated the status quo and been resistant to a transformation of the magnitude envisioned by the Secretary. Comptroller Zakheim, as the Secretary's leader for financial management modernization, will need to have the authority to make the difficult investment decisions involving the billions of dollars being spent on systems across the department. DOD business operations—people, processes, and technology—will have to be reengineered and stovepiped and internally focused approaches will have to be put aside. The past has taught us that well-intentioned initiatives will

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<sup>40</sup>[GAO-01-244](#).

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only succeed if they are transparent and the incentives and accountability mechanisms are in place.

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

Mr. Chairman, this concludes my statement. We would be pleased to answer any questions you or other members of the Subcommittee may have at this time.

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## Contacts and Acknowledgments

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-9095 or [kutzg@gao.gov](mailto:kutzg@gao.gov), Randolph C. Hite at (202) 512-3439 or [hiter@gao.gov](mailto:hiter@gao.gov), or David R. Warren at (202) 512-8412 or [warrend@gao.gov](mailto:warrend@gao.gov). Other key contributors to this testimony include Geoffrey Frank, Paul Francis, Cynthia Jackson, John Ryan, Darby Smith, and Jenniffer Wilson.