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Rumsfeld Inherits Financial Mess

By Kelly Patricia O'Meara

The Defense Department cannot account for \$1.1 trillion that seems to have vanished within the tangled system of **financial** accounting put in place by private contractors. Every year trillions of dollars are unaccounted for by federal agencies, and every year these same agencies are called before congressional oversight committees to explain this mismanagement of taxpayers' funds.

Year after year the bureaucratic mea culpas are longer on process and shorter on substance, leaving overseers with little or no information that is useful to correct the gross mismanagement. Take, for instance, the **financial mess** at the Department of Defense (DOD).

In May, DOD Deputy Inspector General Robert Lieberman reported to Congress that "the extensive DOD efforts to compile and audit the FY [fiscal year] 2000 **financial** statements for the department as a whole and for the 10 subsidiary reporting entities like the Army, Navy and Air Force General Funds, could not overcome the impediments caused by poor systems and unreliable documentation of transactions and assets."

Without ever using the word "money," a practice common among inspectors general (IGs), the deputy IG at the Pentagon read an eight-page summary of DOD fiduciary failures. He admitted that \$4.4 trillion in adjustments to the Pentagon's books had to be cooked to compile the required **financial** statements and that \$1.1 trillion of that amount could not be supported by reliable information. In other words, at the end of the last full year on Bill Clinton's watch, more than \$1 trillion was simply gone and no one can be sure of when, where or to whom the money went.

For most Americans, an official admission that \$1.1 trillion in taxpayers' money cannot be accounted for is incomprehensible. To put it in perspective, consider that this missing sum would buy the following:

- nearly 14 million accounting degrees from any four-year state college, estimating the cost at \$20,000 per year;
- · · 36 million automobiles at an estimated cost of \$30,000 each; and
- · · about 8 million single-family houses costing \$140,000 per home.

Also, consider this:

- Assuming the average working life is 30 years, the average annual income is \$34,000 and the average federal tax on that income is \$6,830, nearly 5.5 million Americans will work their entire lives to pay \$1.1 trillion in taxes.
- · · In fiscal 1999, 124,227,000 Americans paid a total of more than \$855 billion in individual income taxes, which means that the next year the Pentagon misplaced, lost or otherwise cannot account for all the money the IRS collected in fiscal 1999 from individual, estate, gift, corporate and excise taxes.

The General Accounting Office (GAO), which is the investigative arm of Congress, wrote in its January 2001 report, DOD Major Management Challenges and Program Risks, that the Pentagon "continues to confront pervasive and complex **financial**-management problems ... and has been on our list of high-risk areas vulnerable to waste, fraud, abuse and mismanagement since 1995. To date, no major part of the department's operations has passed the test of an independent **financial** audit because of pervasive weaknesses in the department's **financial**-management systems, operations and controls."

Specifically, the GAO found that the DOD had "(1) an inability to reconcile an estimated \$7 billion difference between its available fund balances and the Treasury's balance; (2) there were frequent adjustments of recorded payments between appropriation accounts - with nearly \$1 of every \$3 in fiscal year 1999 contract payments representing an adjustment; and (3) there are incorrect or unsupported obligations."

What this means to the average American is that the Pentagon checking-account balance doesn't match the bank (Treasury) balance. One out of every three dollars entered in the ledger had to be adjusted to get the account in balance - with the Pentagon owing huge sums for which it cannot account.

Despite the comprehensive analysis of the DOD's finances by the GAO, little, if any, specific information is provided about the contractors paid hundreds of millions of dollars to put reliable and accurate **financial**-accounting systems in place at DOD.

The GAO made it clear in the January report that the DOD's **financial**-management system is "flawed with decades-old problems that will be impossible to reverse overnight: They do not comply with federal **financial**-management-systems requirements and were not designed to collect data in accordance with generally accepted accounting principles." Yet nowhere in the GAO report are the companies identified that were contracted to put such systems in place.

When asked why these contractors were allowed to remain anonymous, especially in light of the enormous amount of money at stake, GAO Director of **Financial** Management and Assurance Gregory Kutz tells Insight: "That's a good question. I don't think we've ever been asked by Congress to look at that. ... Our work is mandated by Congress, and it is based on how they

ask us to carry out investigations. We tend to point the finger at the department and not the contractors they hire. But it's a good point and it would be interesting to do a report about what level of blame might be placed on specific contractors. There are pockets of excellence but, for the most part, we're not getting good value for our money."

How many contractors has the DOD hired to set up a reliable **financial**-management system? The GAO doesn't have the information. In fact, Kutz tells Insight, "I'd have to spend months trying to find who the contractors are, and even then there is no way to be sure. With DOD you don't know if you have a complete list of the systems, and even then the list probably would be several pages long. DOD has so many people building systems for them it's part of the problem."

DOD public-affairs spokeswoman Susan Hansen explains that "the systems currently in place weren't developed to link all the information. It isn't one particular vendor's fault that the system isn't integrated. For decades leading up to the legislation calling for auditable **financial** statements, having the system linked together was not part of the vendor's requirements. This administration is looking at developing at DOD a **financial**-management architecture - a system that works together."

Like GAO's Kutz, Hansen also was unable to provide a list of past or present contractors tasked with setting up the **financial**-management system at the DOD.

While it seems clear that dozens of contractors have been involved in designing **financial** systems at the DOD, the names of some are known. One in particular is on the hot seat at other federal and state agencies for delivering systems that met neither the contractor's promises nor the agency's expectations: American Management Systems Inc. (AMS).

This Fairfax, Va.-based software company last month was hit with a \$350 million lawsuit by the Federal Retirement Thrift Investment Board for "fraudulent procurement, fraudulent performance and reckless breach of a contract with the Board to build a computerized record-keeping system." AMS was contracted to "design and develop a new record-keeping system to automate, simplify and improve the Board's service to the Fund's participants." The estimated cost of the project was \$30 million.

However, more than a year later, "AMS has been unable to deliver a reduced-function system at its most recently estimated cost of approximately \$87 million. The delays and cost overruns have been caused by AMS' reckless and willful misconduct."

AMS' problems with the Thrift Investment Board are only the latest resulting in a string of lawsuits plaguing a company deeply involved in developing **financial**-management systems for federal and state agencies - including Vermont, where AMS' system is used in the state's tax department, and Ohio, where AMS is the defendant in a class-action lawsuit involving the child-support-payments system. Last year, AMS paid a record settlement to Mississippi for failure to implement the system for the state's tax department.

How involved AMS is in developing the new "architecture" for the DOD's **financial**-management system is unknown. Neither the GAO nor the DOD could provide specific information about the kind of contracts awarded to AMS at the Pentagon. Despite Insight's repeated attempts to obtain the information from the contractor, AMS did not return the calls.

Rep. Steve Horn (R-Calif.), chairman of the House Government Reform subcommittee on Government Efficiency, **Financial** Management and Intergovernmental Relations, is concerned

about all of this. He tells Insight that "over the last few years federal agencies have made incremental progress toward producing **financial** statements which received clean audits. But good **financial** management also requires systems that provide accurate, day-to-day **financial** information. If some government contractors are unable to develop systems that can provide that type of information, Congress needs to know it, and we're asking the GAO to look into it."

Many **financial** analysts familiar with contractor gouging believe that bringing the contractors out of the shadows is the first step toward turning around the government's **financial** problems. A Wall Street analyst, who asked not to be identified for fear of retaliation, put it this way: "How is it that the companies hired to develop **financial**-management systems for government that never seem to do the job - that can't track the money or produce auditable **financial** statements - don't have any problem with the **financial** systems in their own companies? How is it that regardless of their size they can track their own money and come up with clean **financial** statements?"

Corporate-securities attorney Jack Spidi of the Washington law firm of Malizia, Spidi and Fisch tells Insight, "You don't get a 10-year grace period when you're publicly traded. You have to submit certified audits from day one or you're in trouble. There's no calling the Securities and Exchange Commission and telling them, 'Oh, our **financial** systems aren't talking to each other.'"

Spidi explains: "The government, if it were treated like a publicly traded corporation on the stock exchange, would be required by the SEC to have these systems in place and would be subject to very detailed and rigorous accounting and reporting standards. If a large corporation like any of the defense contractors were unable to provide **financial** statements, it could lose its ability to trade on the exchange. Stockholders would be filing lawsuits right and left, which would cause the stock to tank. The question is: Should there be public reporting by government agencies like all publicly traded corporations in the U.S. are required to provide? And, if there were, would these agencies be more rigorous and careful about how they account for the money? Public companies are accountable for the accuracy of their **financial** statements; why shouldn't government agencies be held to the same standard?"

The situation faced by the incoming Bush administration was grave, and nowhere graver than at the Pentagon, where insiders say Defense Secretary Donald **Rumsfeld** has been heavily focused on the problem. Deputy IG Lieberman told Congress that "although DOD has put a full decade of effort into improving its **financial** reporting, it seems that everyone involved - the Congress, the Office of Management and Budget, the audit community and DOD managers - have been unable to determine or clearly articulate exactly how much progress has been made."

This soon may be remedied. With **Rumsfeld** demanding accountability and hacking furiously at waste, and lawmakers now calling for an investigation of which contractors have been paid how many hundreds of millions of dollars for **financial**-reporting systems that don't work, there is just a chance that something may be done about that \$1.1 trillion for which the Clinton administration could not account.

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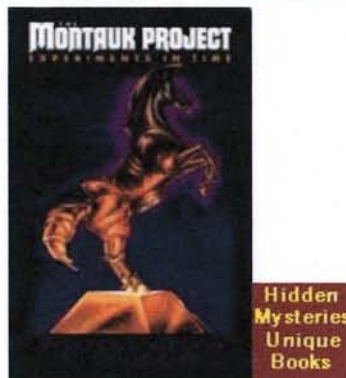
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