IMPLEMENTING COST ACCOUNTING AT THE DEPARTMENT OF VETERANS AFFAIRS AND THE DEPARTMENT OF LABOR

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE, AND ACCOUNTABILITY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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IMPLEMENTING COST ACCOUNTING AT THE DEPARTMENT OF VETERANS AFFAIRS AND THE DEPARTMENT OF LABOR

WEDNESDAY, SEPTEMBER 21, 2005

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
FINANCE, AND ACCOUNTABILITY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:40 p.m., in room 2247, Rayburn House Office Building, Hon. Todd Russell Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts and Duncan.

Staff present: Mike Hettinger, staff director; Dan Daly, Tabetha Mueller, and Jessica Friedman, professional staff members; Erin Phillips, clerk; Adam Bordes, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. PLATTS. This hearing of the Government Reform Subcommittee on Government Management, Finance, and Accountability will come to order.

Mr. Towns will be joining us here shortly, and we believe we have about an hour window before the next series of votes. So we are going to see if we can get as far as we can on our testimony and Q and A, and hopefully, those votes will be pushed off long enough that we don't have to have our witnesses here waiting while we run through a series of votes.

In order to manage effectively, we need reliable information on the true cost of Federal programs. In our current budget environment, this information takes on added importance as agencies try to accomplish their missions with fewer resources. As a Nation at war, and now recovering from one natural disaster, and a new hurricane threatening our shorelines, being responsible and efficient with our taxpayer funds is all the more critical. With timely and accurate cost information, managers can make sound decisions on a day to day basis, and policymakers can prioritize scarce resources more effectively.

The subcommittee has asked the Government Accountability Office to conduct a series of case studies to determine the extent to which Federal agencies develop and use cost information. In its first study, GAO looked at the Department of Veterans Affairs and the Department of Labor. The results of this case study were released on September 2nd.

We are pleased to have the author of the GAO report, Mr. Robert Martin, here with us today. Mr. Martin, we thank you for your work on this first study, and we look forward to subsequent work on the other agencies and also your testimony with us today.

We are also joined by officials from the two Federal agencies that were part of this initial case study: The Honorable Sam Mok, Chief Financial Officer of the Department of Labor; and the Honorable Tim McClain, General Counsel and Acting Chief Management Officer of the Department of Veterans Affairs.

On behalf of the subcommittee, again, we thank each of you for being here with us. We will look forward to your testimony and then to the opportunity to have Q and A with you. I think what we will do is go into testimony. We do appreciate the written testimonies you have provided the subcommittee. If we can try to limit our opening statements to about 5 minutes each, and try to get into a good exchange with each of you, that would probably be most helpful. When Mr. Towns arrives, if he has an opening statement, we will proceed to his testimony or statement between our witnesses.

If I could ask each of our witnesses to stand and be sworn in. It is a practice of the subcommittee. Any staff that will be advising you as part of your testimony here today, if they would also take the oath.

[Witnesses sworn.]

Mr. PLATTS. Thank you. You may be seated. The clerk will note that all witnesses and staff participating have affirmed the oath.

We will proceed to our opening statements. Mr. Martin, I believe we will begin with you in an overview of the case study that you completed.

STATEMENTS OF ROBERT MARTIN, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; SAMUEL MOK, CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF LABOR; AND TIM S. MCCLAIN, GENERAL COUNSEL AND ACTING CHIEF MANAGEMENT OFFICER, U.S. DEPARTMENT OF VETERANS AFFAIRS, ACCOMPANIED BY ED MURRAY, VA DEPUTY CHIEF FINANCIAL OFFICER; JIMMY NORRIS, CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF VETERANS AFFAIRS; JAMES BOHMBACH, CHIEF FINANCIAL OFFICER, VETERANS BENEFITS ADMINISTRATION; AND DAN TUCKER, CHIEF FINANCIAL OFFICER, NATIONAL CEMETERY ADMINISTRATION

STATEMENT OF ROBERT MARTIN

Mr. MARTIN. Thank you, Mr. Chairman.

Mr. Chairman, I am pleased to be here today to talk about managerial cost accounting at the Departments of Labor and Veterans Affairs. As you know, this topic is all about promoting efficiency and the best use of limited resources. Managerial cost accounting involves answering a very simple question: How much is it costing us to do something? This involves analyzing financial and non-financial data to determine what it is costing us to achieve performance goals, to deliver programs, and to pursue other activities.

Mr. PLATTS. Mr. Martin, the mic is on, but pull it a little closer to you, and direct it at you. Yes, that is great. Thank you. I could hear it, but I am not sure if anyone behind you could.

Mr. MARTIN. Is that better?

Mr. PLATTS. Thank you.

Mr. MARTIN. Reliable data, both financial and non-financial, are critical, because if one is wrong, then the resulting analysis can be wrong. And in light of this subcommittee's interest in promoting the use of cost accounting across the Government, as you mentioned previously, you have asked us to look at two things in the Departments: How are they generating cost information, and how they are using it.

I do have a written statement that I would like to submit for the record, but I will take about 5 minutes to recap our work. I will start with the Department of Labor and then talk about Veterans Affairs.

The Department of Labor, with leadership from the Chief Financial Officer and the Secretary, has implemented a department-wide system. Virtually all of its components built models that have been customized to meet their respective business needs. The system uses financial information that comes from the core accounting system. Non-financial information such as the number of hours worked on a project, or the number of people trained, that kind of thing comes from a variety of other sources.

We do believe the controls over this non-financial data need some further attention to ensure data reliability. In its 2004 performance plan, the Labor Department identified data validation as a challenge. In addition, the Inspector General recently reported high error rates in performance data reported by grantees. The IG also raised concerns about the use of this data for decisionmaking. Labor officials have agreed and acknowledged the importance of this data and have told us that they are implementing additional measures to address this issue.

The Department of Veterans Affairs, as I will discuss now, has taken a different approach. The VA does not have a department-wide system. They have instead chosen to delegate the responsibility to the component administrations. We reviewed the two largest components, which together account for over 95 percent of VA's budget. We found that one was implementing managerial cost accounting, and one was not.

At the Veterans Health Administration [VHA], they have a system in place that uses data from nearly 50 feeder sources. However, auditors have raised concerns about data reliability. For example, about a year ago the Inspector General reported that most of the legacy systems at the Bay Pines Medical Center contained inaccurate data. The IG further stated that this might be a systemic problem across VHA. In addition, VHA's financial statement auditor found that cost data from an old system that was no longer being maintained, and thus contained errors, was being used for a variety of cost analysis purposes.

At VA's other large component, the Veterans Benefits Administration, we found that no system was in place and operating. We were told that in March 2003 they had stopped using the system that they had once been using. It was an activity-based costing sys-

tem. They stopped using it because there was a loss of key personnel, and also one of the methodologies they used for allocating indirect costs lacked credibility with some of their managers. So they stopped using the system.

In closing, Mr. Chairman, I just want to emphasize that departmental leadership is required to implement managerial cost accounting. The leaders really need to focus on promoting the benefits of doing so, monitoring the implementation, and also establishing a system of controls that will ensure that the data used are reliable. This is true regardless of whether a department chooses a department-wide approach or chooses to delegate the responsibility to the components.

This concludes my statement. I would be happy to take questions at the appropriate time.

[The prepared statement of Mr. Martin follows:]

United States Government Accountability Office

GAO

Testimony Before the Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

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MANAGERIAL COST ACCOUNTING PRACTICES

Departments of Labor and Veterans Affairs

Statement of Robert E. Martin, Director
Financial Management and Assurance

GAO-05-1031T

September 21, 2005

GAO
Accountability • Integrity • Reliability

Highlights

Highlights of GAO-05-1031T, a report to Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

MANAGERIAL COST ACCOUNTING PRACTICES

Departments of Labor and Veterans Affairs

Why GAO Did This Study

In the past 15 years, a number of laws, accounting standards, system requirements, and related guidance have emphasized the need for cost information in the federal government, establishing requirements and accounting standards for managerial cost accounting (MCA) information. Among them was the Federal Financial Management Improvement Act of 1996 (FFMIA), which required Chief Financial Officers Act agencies' systems to comply substantially with federal financial management systems requirements and federal accounting standards, including managerial cost accounting standards.

In light of these requirements, the Chairman asked GAO to determine how federal agencies generate MCA information and how government managers use that information to support their decision making and provide accountability. GAO briefed subcommittee staff on its work at the Departments of Labor (DOL) and Veterans Affairs (VA) on July 15 and issued a report on its findings that included recommendations on September 2, 2005 (GAO-05-1013R).

www.gao.gov/cgi-bin/getrpt?GAO-05-1031T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Robert Martin at (202) 512-6131 or martinr@gao.gov.

What GAO Found

The principle purpose of managerial cost accounting (MCA) is to determine the cost of achieving performance goals, delivering programs, and pursuing other activities. This allows the organization to assess whether the cost is reasonable or to establish a baseline for comparison with what it costs others to do similar work. Although the factors analyzed depend on the operations and needs of the organization, reliable financial and nonfinancial data are critical. Without reliable data, the analysis can be distorted. Strong leadership that provides a structure for good controls and assessments of system operations helps set the conditions for data reliability. GAO found that DOL and VA had different approaches to implementing MCA systems and that both had some control weaknesses with respect to the quality of certain of the data they used and documenting policy and procedures.

DOL, under the direction of its Chief Financial Officer, implemented a departmentwide MCA system upon which 15 of its 18 component agencies built MCA models tailored to meet their respective needs. Component agencies continue to refine their models, and DOL is updating its policies and procedures to reflect the new system and processes. A formal post-implementation review of the system is not planned, however. While DOL has various controls in place over financial data, GAO found that controls over nonfinancial data need further attention to ensure reliability. DOL officials are taking additional steps to address these issues.

VA adopted a different approach and does not have a departmentwide system. Instead, it has delegated this responsibility to the individual components. Of the two largest components, only the Veterans Health Administration (VHA) had an operating MCA system. The Veterans Benefits Administration had discontinued use of its MCA system in 2003 because of system credibility and personnel issues. GAO found that the VHA system uses data from nearly 50 feeder systems. Other auditors have raised data reliability concerns with respect to certain of these systems. Raising concerns about data reliability in one of the VHA systems, the VA Office of Inspector General stated that this might be a systemic problem. In addition, GAO found that VHA was unable to produce documentation of the system readily, which could inhibit efforts to determine whether costs are properly assigned. With no MCA system overall at VA, it uses manual cost-finding techniques for external reporting. VA's independent financial statement auditor found control weaknesses in this manual process, and VA officials stated that documentation of compilation procedures for its Statement of Net Costs was not current.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to talk about managerial cost accounting practices (MCA) at the Department of Labor and Department of Veterans Affairs. This topic is all about efficiency, productivity, and the best use of resources. Taxpayers expect us to act in their best interests in managing their money, and managerial cost accounting can help us to do so. To that end, over the past 15 years, a number of laws, accounting standards, system requirements, and related guidance have emphasized the need for cost information and cost management in the federal government, establishing requirements and accounting standards for MCA at federal agencies.

The Chief Financial Officers (CFO) Act of 1990[1] contains several provisions related to managerial cost accounting, one of which states that an agency's CFO should develop and maintain an integrated accounting and financial management system that provides for the development and reporting of cost information and the systematic measurement of performance. The Federal Financial Management Improvement Act of 1996 (FFMIA)[2] required CFO Act agencies' systems to comply substantially with federal accounting standards and federal financial management systems requirements. Federal managerial cost accounting standards,[3] which became effective in fiscal year 1997, provide a conceptual framework and standards for MCA implementation. The Joint Financial Management Improvement Program's (JFMIP)[4] *System Requirements for Managerial Cost Accounting,*[5] published in 1998, builds upon, and provides an approach to implement requirements for cost accounting set forth in the CFO Act and federal MCA standards.

MCA essentially entails answering a very simple question: How much is it costing to do something, be it some extensive overall or program effort or the incremental and iterative efforts associated with a project or activity? As such, it involves accumulating and analyzing both financial and nonfinancial data[6] to determine the costs of achieving performance goals, delivering programs, and pursuing other activities. The principal purpose, of course, is to assess how much it is costing to do whatever is being measured, thus allowing assessments of whether that seems reasonable, or perhaps establishing a baseline for comparison with what it costs others to do similar work or achieve similar performance. The factors analyzed and the level of detail depends on the operations and needs of the organization. As cornerstones of this type of analysis, reliable financial and nonfinancial data are critical, because if either is wrong the resulting analysis can give a distorted view of how well an organization is doing.

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[1] Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990).
[2] Pub. L. No. 104-208, div. A., § 101(f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996).
[3] Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government.*
[4] In 2005, JFMIP's responsibilities for financial management and policy oversight were realigned to the Office of Management and Budget, the Office of Personnel Management, and the Chief Financial Officers Council.
[5] Joint Financial Management Improvement Program, *System Requirements for Managerial Cost Accounting* (Feb. 1998).
[6] Nonfinancial data measure the occurrences of activities and can include, for example, hours worked, units produced, grants managed, inspections conducted, or people trained.

In light of the requirements for federal agencies to prepare MCA information and your interest in financial management and accountability, you asked us to determine how federal agencies generate MCA information and how government managers use that information to support their decision making and provide accountability. We will be looking at 10 agencies in a four-phase study of this issue. DOL and VA are the first agencies we reviewed.

To respond to this first phase of your request, we interviewed officials at DOL and VA and reviewed documentation on the status of MCA system implementation including successes and obstacles to managerial costing. We also reviewed departmental guidance and looked for evidence of DOL and VA leadership and commitment to the implementation of entitywide cost management practices. Using the *Standards for Internal Control in the Federal Government*[7] as a guide, we examined DOL and VA internal controls over the reliability of financial and nonfinancial information used in MCA. To determine how DOL and VA managers used cost information to support managerial decision making and provide accountability, we interviewed agency officials, identified examples, and reviewed documentation provided by the departments. We briefed your staff on the results of our review of these departments on July 15, 2005, and issued a report to you highlighting that work on September 2, 2005.

We found that DOL and VA adopted different approaches for pursuing MCA. DOL implemented a departmentwide system upon which 15 of its 18 component agencies have built MCA models tailored to their respective needs. At VA, responsibility for MCA implementation has been vested with individual component agencies. I will talk first about DOL and then about VA.

Department of Labor

As you know, DOL's mission is to foster and promote the welfare of our country's job seekers, wage earners, and retirees. For fiscal year 2005, DOL has a budget of approximately $51 billion. It employs nearly 17,000 people at 10 mission agencies and 8 support agencies.

DOL's initial MCA efforts in the form of pilots in 1999 were unsuccessful. Its current efforts were spurred, in part, by its Office of Inspector General's (OIG) findings in 2002 and 2003 that DOL's accounting system was not in substantial compliance with FFMIA because it did not meet the accounting standards regarding MCA requirements. The OIG recommended that DOL develop a comprehensive departmentwide MCA system implementation plan. Although DOL disagreed with the OIG conclusions, it did agree to focus more attention on MCA. DOL's Office of the Chief Financial Officer (OCFO) was assigned responsibility for MCA development.

[7] GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

DOL's new MCA system, referred to as Cost Analysis Manager (CAM), uses commercial software designed to collect and analyze agency financial, and labor distribution,[8] and performance data. According to DOL officials, CAM can provide management with information and reports concerning the costs, including most direct and indirect costs, of performance goals, activities, and outputs. They also said that CAM can provide integrated performance and financial information, trend analysis, benchmarking data, and "what if" analysis. Agency and OCFO personnel developed component-specific CAM models. These models are in place at all 10 mission agencies and 5 of the 8 support agencies.[9] DOL officials told us that the Secretary of Labor had discussed CAM regularly in monthly meetings with agency managers to emphasize the importance of MCA implementation.

The CAM system became operational in September 2004. DOL's component agencies continue to refine the models to meet their needs. In doing so, they learn about system capabilities while considering additional applications for CAM. DOL is updating its MCA policy and procedures to reflect newly developed systems and processes. DOL officials told us that component-specific cost model reference manuals would be distributed to components by the end of fiscal year 2005. The manuals will combine, in one resource, descriptions of the CAM methodology and assumptions and other documentation.

Planned systemwide refinements include (1) automating the data extraction and import process, (2) integrating budget and performance data, and (3) adding programs and outputs not included in baseline models. However, a post-implementation review (PIR) of the new CAM system was not planned. A formal PIR would document the evaluation criteria and differences between estimated and actual costs and benefits as well as opportunities for management to extract "lessons learned" and improve control processes.

DOL's CAM incorporates financial information from its core accounting system, while nonfinancial information, such as hours worked on particular projects or the number of people trained, is obtained from other sources. There are various controls over financial data in place, including (1) annual audits of financial statements, which have had unqualified opinions beginning with fiscal year 1997; (2) reconciliations of CAM to the general ledger system; and (3) quarterly attestations by component agencies' senior officials concerning the adequacy of internal controls, the accuracy of transaction recording, and regulatory compliance.

According to DOL, the process of building and updating the MCA models includes supervisory review of nonfinancial data, such as labor distribution and performance data, as well as review by line managers, senior managers, and program administrators. Controls over nonfinancial labor distribution and performance data need further attention, however. In its fiscal year 2004 performance plan, DOL identified validation of

[8] Labor distribution is essentially the number of hours worked pursuing a particular performance goal, program, or other activity.

[9] The three agencies without MCA models represent approximately 0.1 percent of the department's budget. Initially, implementing MCA at the three smaller support agencies was not deemed a priority because of their small size and the nature of the support services they provide.

such data as one of its challenges. In the DOL 2004 Performance and Accountability Report, the Inspector General stated that prior year audit work identified high error rates in grantee-reported performance data at the Employment and Training Administration.[10] The OIG also raised concerns about DOL using those data for decision making. DOL officials recognize the importance of this type of data to cost analysis and told us that they are implementing additional data validation systems to address these issues.

DOL's component agencies are focusing on further refining their respective models to help manage programs and resources more effectively. Even though CAM was only recently implemented, DOL agencies identified many uses for CAM data. For example, DOL officials said they have begun to use CAM data to identify and analyze (1) program costs across regions; (2) comparative costs of grant management activities by type of grant; (3) full administrative costs related to the development of policies, regulations, and legislative proposals; (4) unit costs of training and employment programs; and (5) budget justifications and resource allocations.

VA, as I will discuss now, has taken a different approach.

Department of Veterans Affairs

VA's mission is to administer laws that provide health care, financial assistance, burial benefits, and other services to veterans, their dependents, and their beneficiaries. For fiscal year 2005, VA's net budget authorization is about $67 billion. Its two largest component agencies, in terms of budget and staff size, are the Veterans Health Administration (VHA) and the Veterans Benefits Administration (VBA). Its third and smallest administration is the National Cemetery Administration (NCA). With over 193,000 employees, VHA is VA's largest component. VHA health care facilities provide a broad spectrum of medical, surgical, and rehabilitative care. VBA has about 13,000 employees who process claims for VA benefits. NCA's staff of about 1,500 provides direction and oversight for 120 cemeteries.

By design and policy, VA does not have an entitywide MCA model. According to department officials, each of the VA agencies has independently built a cost accounting system for identifying, accumulating, and assigning the costs of its outputs, though VBA discontinued use of its system in 2003. Officials told us that VA's financial management priority has been the removal of a material weakness that was identified by the independent auditors related to the lack of an integrated financial management system at the department.

VA did state that having a fully operational MCA model at each component was important to managerial decision making. Although VA has published cost accounting policy and guidance delegating implementation responsibility to component agencies, VA officials we interviewed could not identify examples of proactive department-level leadership to ensure that MCA systems were in place in the component agencies. Not

[10] The Employment and Training Administration's fiscal year 2005 budget authority represented nearly 91 percent of DOL's total.

surprisingly, the degree to which MCA had been embraced varied at VHA and VBA, the two component agencies we reviewed.[11]

VHA, VA's largest component in terms of number of employees, provides medical care to our country's veterans. It should be expected to routinely know its cost of care and has a system, referred to as the Decision Support System (DSS), for that purpose. According to VHA officials, DSS models significant VHA cost flows and activities. DSS facilitates cost and workload analyses of VHA's locations, programs, activities, and individual patients. It obtains data from 49 feeder sources, including VA's Financial Management System general ledger and VHA's Veteran's Health Information Systems and Technology Architecture (VistA).[12] DSS includes direct and indirect costs for VA hospitals and supporting organizations.

According to VA officials, DSS was used to generate cost information to support internal budgeting, resource allocation, performance measurement, fee reviews, and cost analysis for programs, activities, and outputs. For example, officials told us that a chief pharmacist's request for additional funds for high-cost providers and drugs used at a VA hospital was supported by a DSS analysis of the local pharmacy costs for that location. They said DSS was also used to compare the costs among the hospitals to determine where services can be provided at the lowest cost. In one case, this kind of DSS information analysis was used in the decision-making process to consolidate inpatient psychiatric services. DSS is also used to determine the costs of services provided for individual customers, as DSS records allow information to be tracked for individual patients.

VA officials informed us that the extent and nature of DSS's use for management decision making varied from one medical facility to the next because of different levels of training among medical facility staff. VA's independent auditor found that some VHA medical centers were continuing to use cost data from Cost Distribution Report, an outdated cost accounting system, which was replaced by DSS and is not reliable because it is no longer maintained. According to the independent auditor, the data from these systems were used for a variety of purposes, including setting fees, budgeting and cost control, and contracting out decisions.[13]

As in any MCA system, the completeness and accuracy of the data in DSS depend on the quality of data from the feeder systems. Financial information included in DSS is subject to controls that help ensure data reliability. VA officials told us that they periodically reconcile DSS to the general ledger system, and provided an example of such a reconciliation. Annual audits of VA's annual financial statements, which are based on the same financial information that feeds DSS, have resulted in unqualified opinions for fiscal years 1999 through 2004. However, in its report on the audit of VA's fiscal year 2004 financial statements, the OIG stated that extensive efforts were required after the fiscal year end to overcome control weaknesses and produce auditable information. The

[11] VHA and VBA accounted for 43 percent and 54 percent of VA's 2004 budget outlays, respectively.
[12] VistA is VHA's nonfinancial workload information system for hospitals.
[13] This concern was reported to VA management in the IPA's letter dated November 4, 2004. In that letter, the IPA noted that this was a continuing issue that had been previously observed.

OIG also stated that although these efforts resulted in materially correct financial statements, reliable information was not readily available during the year. These concerns about financial information reliability could extend to DSS financial data.

Further, both VA's OIG and independent auditor raised concerns about the quality of data from DSS nonfinancial feeder systems. In August 2004, the OIG reported that most of the legacy systems, such as VistA, at VA's Bay Pines Medical Center contained inaccurate data. The OIG also stated that this might be a systemic problem throughout VHA. According to that report, VHA officials concurred with the OIG and agreed to take corrective action. Since VistA is among the 49 feeder sources for DSS, the independent auditor and OIG findings raise concerns about the quality of nonfinancial data in that system.

In addition, in its fiscal year 2004 management letter, the independent auditor noted an increasing shortage of information technology (IT) staff supporting VistA applications and related network infrastructures at the medical centers. The independent auditor concluded that "[t]his loss of human capital and knowledge in the IT organizational structure places VA's information and its processing capabilities at risk." As mentioned previously, reliable financial and nonfinancial data are both critical in cost analysis because if either is wrong the resulting analysis can be distorted.

The VHA Decision Support Office, which is responsible for operating DSS, was unable to readily produce documentation of the mechanism used to assign indirect costs to cost objects in DSS. The lack of readily available system documentation could inhibit efforts to determine whether such costs are properly assigned and precludes an opportunity to provide guidance for employees using the system, especially new employees.

VBA, VA's second largest component, discontinued the use of its Activity Based Costing (ABC) system in March 2003 because of the loss of key personnel, and because the ABC indirect cost distribution methodology, a central part of the ABC system, lacked credibility with some managers. Because VBA was not funding or promoting MCA at the time of our review, we pointed out to VBA officials the requirements for pursuing MCA and highlighted potential benefits of doing so, including some examples of using cost information at VHA. Subsequently, according to VA officials, the VBA CFO informed them that he would seek funding in VBA's 2007 budget request to develop cost accounting capabilities.

At the department level, VA used manual cost-finding techniques to accumulate cost information to prepare the Statement of Net Cost and to support budgeting. This process, which uses Excel spreadsheets, can be burdensome, time consuming, and error prone when the roll-up process must be redone because of end-of-year auditor adjustments and edits. VA officials told us that the documentation of its Statement of Net Cost compilation procedures was not current. VA's independent financial statement auditor reported control weaknesses in the agency's manual process to prepare its annual financial statements.

Conclusions

In closing, Mr. Chairman, I want to emphasize that strong leadership in the departments will be required to implement managerial cost accounting across government. This is true regardless of whether the department wants a department-wide system or delegates responsibility for system development to component agencies. In either case, the leadership will need to focus on promoting the benefits of managerial cost accounting, monitoring its implementation, and establishing a sound system of controls to help ensure the reliability of the data used.

Although DOL's recent efforts to implement CAM were significantly boosted by its departmental leadership, maximizing CAM's contribution to improved management will require continuing improvements to system data reliability, system documentation, and assessments of system effectiveness.

VA's department-level leadership has not taken steps that ensured the implementation and continuation of MCA practices at VBA. While the DSS system is in place at VHA, documentation of system processes and controls and other auditors' concerns about the quality of data require attention in order to enhance the reliability of information for managerial decision making.

Our report made recommendations to the Secretary of Labor and the Secretary of Veterans Affairs that if fully implemented, should help improve data reliability, documentation, and implementation of appropriate MCA methodologies.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or members of the subcommittee may have.

Contact and Acknowledgments

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Mr. PLATTS. Thank you, Mr. Martin.
Mr. Mok.

STATEMENT OF SAMUEL MOK

Mr. MOK. Mr. Chairman, thank you for the opportunity to testify on behalf of the U.S. Department of Labor concerning our efforts to implement managerial cost accounting.

It is an honor to speak with you this afternoon regarding this very significant financial management tool. The availability of timely, accurate, and useful information is essential to any well-managed, effective organization. Managerial cost accounting provides program managers and decisionmakers an indispensable tool for enhancing program performance. It improves accountability and transparency for how well tax dollars are being spent.

To implement and, more importantly, sustain the use of managerial cost accounting across the U.S. Department of Labor, my office developed a strategic plan and instituted a managerial cost accounting system which we named Cost Analysis Manager [CAM]. This system provides cost information to managers at all levels to support program evaluation, decisionmaking, and cost effectiveness.

We began by providing Labor Department program managers with cost information that had immediate value for improving their programs. Today, we have begun to use managerial cost accounting for budget formulation, justification, resource allocation, and determining best practices across similar programs or regions.

Through CAM, examples of agencies using managerial cost accounting are numerous. For example, in one of our enforcement agencies, CAM results showed inspection costs were higher than normal in one region as compared to a national norm. Initially, the higher costs were attributed to a greater travel cost in that region. However, analysis revealed the travel cost for the region was actually in line with the national average. The actual reason for higher inspection costs was due to a longer time spent preparing investigative reports in that region as compared to the national norm.

One of our agencies used CAM to monitor the effectiveness of projects supporting better jobs for women across the country. This usage enabled better allocation of resources to new or existing projects. Another agency used CAM for performance-based allocation of discretionary funds. Regions exhibiting better performance received more resources to continue their excellent work.

A key factor in ensuring CAM's ongoing success at the U.S. Department of Labor has been the leadership of Department of Labor Secretary, Elaine L. Chao. Secretary Chao has a deep appreciation for effective financial management and sound fiscal integrity. Her understanding and support of managerial cost accounting have been crucial to our efforts to make managerial cost accounting a lasting legacy that will benefit the Department and American taxpayers for years to come.

In conclusion, the implementation of managerial cost accounting is a continuous journey of gaining experience rather than a race for the finish line. Success in implementation takes strong, sustained commitment from senior management. As leaders, we must dem-

onstrate to managers that this tool is designed to meet their needs and not just another silver bullet.

I will be happy to answer any of your questions, sir.

[The prepared statement of Mr. Mok follows:]

Statement of Samuel T. Mok

Chief Financial Officer

U.S. Department of Labor

Before the

Subcommittee on Government Management, Finance and Accountability

Committee on Government Reform

United States House of Representatives

September 21, 2005

"Implementing Managerial Cost Accounting Practices"

Thank you, Mr. Chairman.

I appreciate the opportunity to testify before this Subcommittee to discuss the U.S. Department of Labor's (DOL) implementation of managerial cost accounting.

The availability of timely, accurate, and useful cost information is an essential component of any well-managed, effective organization. Managerial cost accounting provides the means to accumulate, measure, analyze, interpret, and report cost information that is critical to improving the performance of government. This capability provides program managers and decision makers an essential tool for enhancing the performance of their mandated missions while

improving accountability for the resources entrusted to their stewardship. Effective managerial cost accounting practices support both financial integrity and program performance.

A key statutory foundation for managerial cost accounting is the Chief Financial Officers (CFO) Act of 1990 (P.L. 101-576). The CFO Act requires CFOs to develop and maintain an integrated agency accounting and financial management system. This system must include financial reporting and internal controls that comply with applicable accounting principles. Importantly, the system must provide for the development of cost information and provide for the systematic measure of performance. Subsequently, the Government Performance and Results Act of 1993 (GPRA) (P.L. 103-62) established new performance measurement requirements for program activities, effectively extending the language in the CFO Act concerning the "systematic measurement of performance."

As part of its mission to develop generally accepted accounting principles for federal financial reporting entities, the Federal Accounting Advisory Standard Board (FASAB) published the Statement of Federal Financial Accounting Standards Number 4 (SFFAS #4) in July 1995. SFFAS #4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, clearly established the importance of cost information to Congress and federal executives for use "in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance." SFFAS #4 also recognizes that the discipline of managerial cost accounting can assist agency executives and program managers by enhancing the basis for decisions they make to improve program efficiencies and overall effectiveness. In January 1995, the former Joint Financial Management Improvement Program (JFMIP) issued its *Framework for Federal Financial Management Systems* which emphasized that MCA should be

a fundamental part of a financial management system.

The Federal Financial Management Improvement Act (FFMIA) of 1996 (P.L. 104-208) requires that agencies implement and maintain management systems that substantially comply with federal financial management systems requirements. These requirements are established by the JFMIP Federal Financial Management System Requirements and the Office of Management and Budget's Circular A-127, Financial Management Systems. In February 1998, JFMIP issued two MCA documents: *System Requirements for Managerial Cost Accounting* and *Managerial Cost Accounting Implementation Guide.*

Within this environment, DOL began implementing managerial cost during FY 1999 with agency-specific pilot programs. Initially, DOL planned for the cost models developed in the pilot studies to be aggregated into an integrated agency-wide cost accounting system. However, these first steps produced only isolated successes, which were not generally sustainable and did not gain sufficient managerial acceptance to broaden to other programs. Since these initial efforts were not based on a Department-wide, strategic, and structured approach, they did not garner sufficient executive-level attention and support. Some managers viewed their pilot simply as another accounting exercise to be endured, with a little appreciation for the benefits cost accounting information would provide. By FY 2001, DOL had abandoned this approach. In FY 2002, DOL renewed its managerial cost accounting efforts and began to gain the focus and institutional momentum necessary to sustain effective action. The impetus behind this renewed endeavor came from the President's Management Agenda and audit findings by the Department's own Office of the Inspector General (OIG).

In the summer of 2001, President Bush released his aggressive strategy for improving the management of the Federal government. The President sent the clear message that "good beginnings are not the measure of success. What matters in the end is completion. Performance. Results." Two of the five initial government-wide initiatives in the President's Management Agenda (PMA)—improved financial performance and budget and performance integration—need enterprise-wide implementation of managerial cost accounting for success. Both these initiatives challenge agencies to use high quality, integrated financial and performance information to strengthen control over resources and reinforce measurable accountability for results by program managers.

The Office of Management and Budget (OMB) established Executive Branch management scorecards to track how well the departments and major agencies are executing the five government-wide management initiatives. By the spring of 2002, DOL had met all criteria for improving financial management except demonstrating that the Department had integrated financial and performance information using managerial cost accounting. More importantly, however, the Department had not shown that integrated financial and performance information is routinely used by program managers to support operational evaluations and day-to-day decision-making.

In the FY 2002 and FY 2003 audits, the Department's OIG expressed the opinion that DOL was not in compliance with SFFAS #4. The OIG stated that DOL had not succeeded in its efforts to implement a functional managerial cost accounting system which in turn precluded the Department from using managerial cost information for purposes of performance measurement, planning, budgeting and forecasting. DOL differed with the OIG's conclusions that the

Department's core accounting system was not in substantial compliance with the FFMIA, but DOL did agree that more attention on Managerial Cost Accounting (MCA) implementation was warranted. In September 2002, DOL's Deputy Secretary had already conveyed to Departmental agency heads the importance of moving forward on a Department MCA program. The Deputy Secretary emphasized to senior management how improved cost information would assist in measuring performance, reducing and controlling program costs, making decisions about modifying or discontinuing program initiatives, and making other important programmatic decisions. This "top down" approach breathed new life into the Department's managerial cost accounting efforts and received strong support from the Department's individual agency heads. DOL was ready to take a more strategic approach to integrating cost and performance information.

In May 2003, DOL's Office of the Chief Financial Officer (OCFO) issued a comprehensive managerial cost accounting plan of action. The plan of action followed an intense reassessment of previous MCA implementation efforts and led to a new implementation strategy. As part of this process, OCFO's MCA Project Management Office (PMO) surveyed and interviewed DOL agency heads, financial managers, and administrative officers of all DOL agencies. Through this process, OCFO sought to better define a Departmental focus for MCA, paying particular attention to guiding principles and criteria by which to measure success. While important consideration was given to department-level strategic needs, agency-specific needs were the primary considerations. Obtaining support from agency heads for the renewed MCA initiative and OIG concurrence with the approach were top priorities in developing the plan of action.

The plan defined roles and responsibilities to implement and sustain MCA in DOL and included

an implementation timeline with key milestones for each agency. Rather than relying on well-intended, but programmatically isolated pilots, this approach targeted a concurrent Department-wide implementation of MCA with support from top management. Early on, the new program gained the acronym CAM for "cost analysis manager."

Several key principles have been behind the success of the CAM initiative at DOL. First, we have sought to implement a flexible, scaleable MCA capability that leverages what has already been done in DOL's agencies. DOL has a diverse set of programs ranging from occupational safety and health to pension protections. In addition, some agencies, by virtue of their size, scope, nationwide presence, and prior MCA experience, required detailed cost information by region and on a monthly or quarterly basis to fulfill their management needs. Other agencies only needed annual cost information. We sought to avoid the pitfall of over-standardization; managers won't use irrelevant information.

We began with a "keep it simple" approach starting with straightforward cost models, but allowing for increased complexity and other "bells and whistles" over time. We wanted to extend MCA capability to each agency within a two-year period, at which time managers would begin to use cost information to support decision making on a routine basis. To avoid overreaching our available resources during the initial implementation phase, we tailored implementation to each agency to provide actionable information that could be incorporated into regular decision making and sustained over time.

During FY 2003 and FY 2004, OCFO's MCA PMO worked with agencies to develop 18 cost models for 15 agencies. Cost models address the broad spectrum of the Department's key

business areas: income maintenance; employment and training; labor, employment and pension standards; worker safety and health; and statistics. They help managers assess the reasons for differences in costs of inspections across the country and variances in the cost of providing benefits to recipients from region to region. In the course of developing cost models, the OCFO team worked with CAM implementers from each agency to brief their agency heads on how the cost models were structured and the progress being made on their implementation. Each agency also established its own internal CAM team.

To communicate progress, ideas, and concerns, the OCFO initiated periodic DOL CAM user group meetings. The CAM user group meetings build a collective experience knowledge base and keep agencies advised on CAM development. These meetings serve as a venue to give agency program managers a better feel for the capabilities of managerial cost accounting and as a constant communication forum for agencies to share best practices and lessons learned. At these user group meetings, agencies also report on their CAM implementation progress.

DOL's CAM system went live on September 30, 2004. CAM reports provide managers at all levels with cost information to support program evaluation, decision making, and cost effectiveness in delivery of programs and attainment of goals. As DOL's program managers have found value in cost information and grown comfortable in its use, they are beginning to use the CAM system for budget formulation and justification, resource allocation, and determining "best practices" across similar programs or regions. DOL has also shared best practices from the CAM program with other federal agencies seeking to improve their managerial cost accounting expertise. These best practices include the need for senior management commitment and involvement from the start and ensuring that the MCA system is designed to provide useful

information that addresses major business issues. The MCA system must also meet an agency's cost information requirements to meet its strategic plan, PMA, and PART objectives. Getting participation from managers from all areas of an organization and providing training as an awareness and change management tool are also vital to the success of MCA implementation.

Beyond finding the right methodology to implement managerial cost accounting at DOL, two key factors have made the ongoing success of the CAM initiative possible. First, from a leadership perspective, Department of Labor Secretary Elaine L. Chao has a deep appreciation for effective financial management and sound fiscal integrity. Her understanding and support of managerial cost accounting has been crucial to our efforts to make MCA a lasting legacy that will benefit the Department and American taxpayers for years to come.

Second, DOL has had an enterprise-wide, core financial system since 1989. Over the years, this central system has made possible the delivery of timely and accurate financial information across the Department. External validation of this sound accounting is evidenced by eight consecutive clean audit opinions on the Department's financial statements. Although this system has well served the Department's accounting needs, it does not meet our needs for a financial management information system that provides readily available, transparent data to managers and decision makers for use on a day-to-day basis. We are in the midst of a multi-year project to replace it with a new commercial-off-the-shelf (COTS) system.

As the technical capabilities of DOL's CAM system continue to evolve and as the Department's managerial expertise with cost and performance integration matures, the information generated through managerial cost accounting will become an essential part of program evaluation,

decision-making, and cost effectiveness in the delivery of programs and the attainment of strategic goals. Executives and managers of regional and national programs will be able to make decisions regarding resource allocation for activities that align with and lead to achievement of performance goals by comparing costs of activities and outputs across the district offices, analyzing causes for differences in unit costs of providing services across regions, and identifying best practices and transplanting them across all district offices to achieve desired program results.

In the near term, DOL expects CAM to drive tangible cost and performance enhancements in the Department in several areas:

1. **Improved Cost Management** — Integrating cost information with program performance measures provides insight into the cost-effectiveness of programs and accountability to Congress and the public. Cost information relating to program activities and outputs enables managers to manage costs by identifying high cost activities and redirecting scarce resources from inefficient to cost-effective work processes. CAM can also aid management in identifying and managing these cost differences to improve program performance. By determining the full cost of outputs based on annual and multi-year strategic performance goals, CAM can assist managers' to allocate resources to the highest priority initiatives. For example, several DOL agencies (Mine Safety and Health Administration, Occupational Safety and Health Administration, and Employee Benefits Security Administration) now have cost information on the cost per case or investigation by region or district. Analyzing cost differences among the regions or districts provides insight that helps to identify and manage these cost differences, ultimately improving

program performance. CAM provides the full cost of outputs, which in some cases can be aligned with strategic, outcome, and performance goals. This information allows managers to allocate resources to highest priority initiatives. Lastly, cost information can be used to gauge the economic feasibility of competitively sourcing a particular function. For example, the Office of the Inspector General plans to use cost information to assess whether to perform certain audits in-house or to use contractors to conduct those audits.

2. **More Transparent Fee-Setting** — At DOL, managers of the Working Capital Fund will benefit in two ways. First, managers will be able to use cost information to determine more accurate reimbursement levels for Working Capital Fund services provided to other DOL agencies, such as information technology, human resources, and building facilities services. Second, managers will be able to strengthen their supplier-customer relationships by better explaining to their customers the activities performed and the costs incurred in support of such services. Managerial cost accounting can also help to determine fees to be charged to external customers.

3. **Stronger Budget Formulation and Justification** — Some DOL agencies currently use accounting data to develop their annual budgets. Full cost data available through CAM will help DOL improve its budget formulation process by providing cost information on specific programs and outputs that is aligned with agency annual and strategic goals and outcomes. OCFO's MCA PMO is working with DOL's Center for Program Planning and Results to tie CAM to departmental budget and performance integration efforts. Throughout the fiscal year, DOL will be able to assess its performance against the budget by tracking actual costs of outputs and aligned outcomes — thereby integrating budget, financial, and program information.

OCFO's MCA PMO is currently working with agencies to automate the process of data collection for updating cost models. This will reduce the time and effort required to update the cost models and allow users to utilize cost information and focus on analysis. DOL is planning to expand the capability of the CAM COTS software through COTS add-on modules that will provide users with additional capabilities such as "what-if" analysis and activity-based budgeting.

In conclusion, the implementation of managerial cost accounting is a continuous journey of gaining experience rather than a race to a finish line. Success in implementation takes strong, sustained commitment from senior management and the ability to demonstrate to managers that managerial cost accounting is a tool designed to meet their needs and not just another "silver bullet" from central management.

Thank you for your time. I will be happy to answer any of your questions.

Mr. PLATTS. Thank you, Mr. Mok.
Mr. McClain.

STATEMENT OF TIM S. MCCLAIN

Mr. MCCLAIN. Mr. Chairman, good afternoon. Thank you for the invitation to testify on behalf of the Department of Veterans Affairs concerning the requirements of managerial cost accounting. First, I would like to ask that my full written statement be made a part of the record.

Mr. PLATTS. Without objection, it will.

Mr. MCCLAIN. Thank you, sir. Accompanying me today are Mr. Ed Murray, the VA Deputy CFO; Mr. Jimmy Norris, the CFO for the Veterans Health Administration; Mr. James Bohmbach, CFO for Veterans Benefits Administration; and Mr. Dan Tucker, CFO for the National Cemetery Administration.

My staff has worked with VA's three administrations to comply with the Federal Accounting Standards and Federal Financial Management Systems requirements. This hearing and the GAO report have given VA the opportunity to review its managerial cost accounting system and has spurred senior management to review VA's current practices. In response to the comments in the GAO report, VA has initiated a broad review of available software and MCA programs to ensure VA systems provide the most accurate and reliable cost data to senior management.

VA has been involved in managerial cost accounting since the subject was first considered by the Federal Accounting Standards Advisory Board. VA does not have a department-level cost accounting system.

Due to the broad differences in size, mission, and need, the three VA administrations were directed in the 1990's to establish independent cost accounting systems to meet the specialized requirements of their individual organizations. VHA, the largest administration in the Department, uses the Decision Support System while the National Cemetery Administration uses Activity Based Costing.

MCA is not the sole source for making management decisions but is used in conjunction with other factors in determining how resources are utilized. The review by GAO has given VA senior management the opportunity to evaluate VA's current MCA structure, and we are actively pursuing state-of-the-art solutions. While VA currently does not have a central repository for its accounting data, it does consolidate costs for the three administrations and staff offices in a statement of net costs along 10 business lines.

VA takes our financial management and stewardship responsibilities seriously. Over the past several years, our clear focus has been to maintain an unqualified audit opinion, which we have retained since 1999, and substantially reduce VA's auditor-identified material weaknesses and reportable conditions. From 2001 to 2004, VA has reduced material weaknesses and reportable conditions from 11 to 4, a reduction of 60 percent.

However, VA realizes that more needs to be done in MCA, and we have initiated a review, and we will explore all opportunities for a department-wide MCA system. A centralized MCA system would improve the accessibility and availability of cost accounting data and enhance managerial decisionmaking throughout VA.

Mr. Chairman, this concludes my statement. I will be glad to answer any questions.

[The prepared statement of Mr. McClain follows:]

STATEMENT OF

THE HONORABLE TIM S. McCLAIN
GENERAL COUNSEL AND CHIEF MANAGEMENT OFFICER
U.S. DEPARTMENT OF VETERANS AFFAIRS

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE, AND ACCOUNTABILITY
COMMITTEE ON GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

September 21, 2005
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Mr. Chairman and members of the Subcommittee:

Thank you for the opportunity to testify on behalf of the Department of Veterans Affairs (VA) concerning the requirements and accounting standards for managerial cost accounting (MCA). Accompanying me today are Mr. Ed Murray, Deputy CFO, Mr. Jimmy Norris, CFO for VHA, Mr. James Bohmbach, CFO for VBA, and Mr. Dan Tucker, CFO for NCA. The VA Chief Financial Officer's (CFO) staff has worked with VA's three administrations—the Veterans Health Administration (VHA), Veterans Benefits Administration (VBA), and National Cemetery Administration (NCA), as well as other VA elements - to comply with federal accounting standards and federal financial management systems requirements. This hearing and the GAO report have given VA the opportunity to review its managerial cost accounting system and have spurred senior management to review VA's current practices. In response to the comments in the GAO report, VA has initiated a broad review of available software and MCA

programs to ensure VA systems provide the most accurate and reliable cost data to senior management.

VA'S MANAGERIAL COST ACCOUNTING SYSTEM

VA has been involved in managerial cost accounting since the subject was first considered by the Federal Accounting Standards Advisory Board. VA assisted in the development and implementation of the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government." Subsequent to its adoption, VA formed, staffed and chaired the Federal workgroup that developed the "Managerial Cost Accounting Implementation Guide" that was adopted by the Federal CFO Council. VA was one of the first departments to publish a comprehensive MCA policy that met the requirements of SFFAS 4, "Managerial Cost Accounting Concepts and Standards," and required MCA implementation in all its major components. The Department CFO oversaw and ensured that each VA administration implemented an MCA system that was appropriate for its line of business. Further, in FY 2004, VA leadership established a Finance and Logistics Council to address numerous issues including the implementation and use of cost accounting in VA's decision-making processes. This council is chaired by the VA CFO and all VA administration CFOs are members.

VA does not have a Department-level cost accounting system. Due to the broad differences in size, mission and need, the three VA administrations were directed to establish independent cost accounting systems to meet the specialized

requirements of their individual organizations. VHA uses the Decision Support System (DSS), while NCA uses Activity Based Costing (ABC). VBA also used an ABC system until early in FY 2004, but is not currently using this system. MCA is not the sole source for making management decisions, but is used in conjunction with other factors in determining how resources are utilized. The review by GAO has given VA senior management the opportunity to evaluate VA's current MCA structure and we are actively pursuing state-of-the-art solutions.

NCA implemented an ABC accounting system at all national cemeteries to determine full costs and unit costs for cemetery services. NCA staff worked to develop a cost model, which was implemented using commercial off-the-shelf (COTS) software. The same model is used for all cemeteries, which links the resources consumed to the activities performed and the services provided. NCA also determines costs for other programs it administers such as the State Veterans Cemetery Grant Program.

The Decision Support System (DSS) is VHA's managerial cost accounting system that integrates clinical, financial and workload data and has been fully implemented throughout the Administration since 1998. DSS data allow each medical center to establish data-driven operating budgets at the Department level and to monitor monthly variance from expected cost and workload. The process allocates resources, such as staff time and supply costs, to determine the cost to provide healthcare services locally. In addition, DSS information is used in developing model prices for the Veterans Equitable Resource Allocation

(VERA), which allocates funds across VHA's 21 Networks. Many Networks further allocate funding to facilities based on DSS costs, as DSS is able to provide detailed patient utilization information based on diagnosis and for services provided. By using DSS utilization data, Networks are able to determine needed shifts of resources within the Network. The system provides objective information which can be summarized at the Network and national levels for cost comparison and is used in various productivity measures. Additionally, steps are being taken to ensure the availability of an adequate number of skilled professionals who are fully trained in managerial cost accounting practices at all levels of the Administration. Comprehensive education and training related to implementation of DSS is available to all DSS site team members as well as Network DSS coordinators. In an independent review completed by Bearing Point in September 2004, DSS was verified as substantially compliant with the Chief Financial Officer's Act of 1990 and other financial management regulatory requirements, including compliance with both SFFAS 4, "Managerial Cost Accounting Concepts and Standards," and SFFAS 7, "Accounting for Revenue and Other Financing Sources." Although the system has been verified and functions as designed, VA has embarked on a full-system review to determine if there is a better system for MCA in the Veterans Health Administration.

VBA is currently in the process of re-establishing an MCA system, consistent with GAO's recommendation that the Administration develop, implement, and operate an appropriate MCA system to improve managerial decision-making. VBA concurred with this recommendation and has identified funding for MCA. In July

2005, the VBA CFO directed his staff to develop a plan of action by October 1, 2005, to accelerate the development and implementation of MCA prior to 2007. VBA concluded that extensive modification of the current ABC cost system model is not feasible given the change in VBA organizational structure and business processes. VBA also conducted market research with two leading accounting firms to discuss managerial cost accounting methodologies and systems currently in use by government and private industry. Finally, VBA is drafting a Statement of Work to assess VBA's business processes and MCA requirements and to identify applicable systems that can be evaluated for use.

VA prepares a unified Statement of Net Costs (SNC). The SNC is audited and is a component of VA's annual consolidated financial statements. VA anticipates implementing an annual certification process that will require VHA, VBA and NCA to state that they are meeting all the Federal requirements. These annual certification statements will be presented to VA's Finance and Logistics Council for review and approval.

VA appreciates the professionalism of GAO and the many observations in their report. However, VA does not agree entirely with all of the recommendations. The GAO report stated that VA should periodically validate the non-financial data used for MCA and should assess related internal controls over non-financial data quality. The VHA Decision Support Office (DSO) provides all VHA medical centers and Networks with a standardized and comprehensive audit guide. This document identifies the audits to be conducted with a goal of ensuring that the

data are complete and accurate in terms of the quantity of product (workload) and total dollars and hours (financial) captured in the system.

VA instituted a self-certification program to ensure VHA medical centers comply with the requirements of SFFAS 4 and 7. Accordingly, every 2 years each VHA medical center self-certifies that its cost accounting procedures comply with SFFAS 4 and 7 and that that their procedures comply with Federal pricing policies, including disclosures for non-recovery of full cost as appropriate. The Management Quality Assurance Service (MQAS), part of the VA CFO's Office of Business Oversight, is responsible for conducting random reviews of VHA medical centers' certification statements to validate their statements and ensure the integrity of the self-certification program. MQAS will compile the results of the random reviews and provide recommendations on necessary improvements to further strengthen VHA's program.

The GAO report concluded that VHA should document the DSS processes and controls for assigning direct and indirect costs to cost objects. In fact, VHA does document processes and controls for assigning direct and indirect costs to cost objects. Each year the DSO issues an Annual Fiscal Year Conversion document, which is a detailed set of processes for assigning direct and indirect costs, to the DSS teams at every VA medical center. Refresher training is provided through a series of bi-weekly Teaching Calls that the DSO provides to those same site teams.

GAO also reported that VHA should take steps to ensure that there are adequate numbers of properly trained Information Technology (IT) staff at field locations to administer DSS in order to help maximize the utilization of DSS. Because their primary function is to capture and report MCA data, DSS site teams are composed of professionals with financial and clinical backgrounds. Once assigned, these personnel complete written and on-the-job training on the technical portion of the DSS. Currently, DSO is sponsoring a workgroup that will provide staffing criteria to include the recommended professional background, training and required staffing level for all VA medical centers. Very few, if any, field IT staff are involved in the hands-on operation of the DSS.

VA continues to look at and implement mechanisms to streamline and automate the SNC process, where appropriate, in order to reduce the risks of errors and delays from manual efforts. VA has an initiative underway, which will be implemented in FY 2006, to automate the preparation of its consolidated financial statements, which includes the SNC. This follows VA's successful implementation in FY 2005 of labor distribution functionality within its legacy payroll system that allows for tracking an employee's costs by up to four distinct lines of business. This effectively resolved a long-standing material weakness, and the Office of Inspector General approved the closure of this weakness in FY 2005.

While VA currently does not have a central repository for its accounting data, it does consolidate costs for the three administrations and staff offices in the SNC

along ten lines of business. End-of-year auditor adjustments are a normal function in preparing the Department's consolidated financial statements. They are not unique to the preparation of the SNC. VA uses a network of Excel spreadsheets in preparing the SNC, which allows adjustments to flow through all the appropriate lines of business. Implementation of the financial reporting tool in FY 2006 will assist in further automating the preparation of all VA's financial statements.

VA takes our financial management and stewardship responsibilities seriously. Over the past several years, our clear focus has been to maintain our unqualified audit opinion, which we have retained since 1999, and substantially reduce VA's auditor-identified material weaknesses and reportable conditions. From 2001 to 2004 VA has reduced material weaknesses and reportable conditions from eleven to four – a reduction of over 60%.

However, VA realizes that more needs to be done. VA has initiated a review of major MCA software providers to explore opportunities for a Department-wide MCA system. A centralized MCA system would improve the accessibility and availability of cost accounting data and enhance managerial decision-making throughout VA. This review is in conjunction with the Department's efforts to develop an integrated financial management system.

Mr. Chairman, this concludes my statement. VA will continue to work toward full compliance with all federal accounting standards and federal financial management systems requirements. My colleagues and I would be pleased to answer any questions.

Mr. PLATTS. Thank you, Mr. McClain.

We are joined by the gentleman from Tennessee, Mr. Duncan. We appreciate your being with us. We will go into questions. Again, we appreciate your testimonies and all of your service to our fellow citizens, both the GAO, Department of Labor, and Veterans Administration.

As one who has not worn the uniform of our Armed Forces, I am especially grateful for the assistance and guidance given our veterans through the VA because I just think our veterans, if there is a group of Americans worthy of our fellow citizens looking out for, it is our veterans. So the work of you and your staff is much appreciated in doing right by those who have worn the uniform of our Armed Forces.

I guess we will start with some specific examples of managerial cost accounting. Mr. Martin, if you want to start and give us some examples that, in your review of the two Departments, you want to highlight as good examples of the benefits of MCA, and that we can put some specifics with what we are talking about.

Mr. MARTIN. I would be happy to, Mr. Chairman. I think what managerial cost accounting does for you is enable you to get a look at both cost and performance or output information at the same time. A lot of people tend to look at one or the other, but this brings both together, and it allows you to do what I think both of the other gentlemen referred to, which is make resource allocation decisions. You can direct your resources to programs that are efficient and effective, and therefore, you can deliver more services for your constituents.

We did see examples of resource allocation decisions, budget formulation, and budget justification, that kind of thing. We saw at VHA they analyzed costs across different hospitals to look at how they were doing things. Within the Department of Labor, they were looking at the training programs and the cost of delivering those at different locations, and unit cost, per person cost, that kind of thing. So we did see some good examples.

Mr. PLATTS. That information at more the micro-level in evaluating specific training programs and how effective they are with the dollars spent, did you see that transfer all the way through the policymakers up to the Secretary level in how that information was shared through the Departments?

Mr. MARTIN. Well, certainly, at the Department of Labor, I think it is clear that is more of a department-wide initiative they have ongoing, and there has been more Secretarial involvement. And it has just been made a priority. So I would say yes, that Department did some of that.

Mr. PLATTS. You referenced the budget preparations, not just the preparations but in what is submitted to Congress. I don't serve on the Appropriations or Budget Committees, but is there a good use of the managerial cost accounting data in making the case then to Congress as part of the appropriations requests when those budgets are submitted?

Mr. MARTIN. Well, I think the process is more mature than the data at this point. I mean, even at Labor, they have some data issues that they acknowledge and are addressing. So I think that as they get better and better data, then the budget formulation will

be more accurate because what managerial cost accounting does is enable you to see what your costs have been with some precision over years, what the trend is, and you can then better predict what you need in the future.

Mr. PLATTS. Mr. Mok and Mr. McClain, we will start at a similar place, if you want to highlight what you think would be one of the best examples of where managerial cost accounting has benefited your Department in the provision of services in a very efficient, effective, responsible manner.

Mr. MOK. At the U.S. Department of Labor, as Mr. Martin said, we have used managerial cost accounting rather extensively. We have trained 250 managers and senior staff on the use of the managerial cost accounting, and we have also briefed senior executives on an individual basis.

The knowledge base is expanding every day. I would like to see it much bigger, but it will take a little time. The managerial cost accounting allows us to understand the true full cost of delivering services. It also allows us to understand the cost drivers of how some of these program costs are derived.

One of the examples I would like to share with you is in one particular case, an agency was noticing that investigative costs in a particular region were very high. So when they started analyzing that, the regional administrator surmised that one of the reasons the cost was high was because of the new staff, the learning curve. For the following fiscal year when they did the analysis, it validated that assumption, because the cost went down once they learned how to do the investigative report faster.

Another example was a performance-based allocation method used by another agency to allocate a portion of the discretionary budget based on efficiency and measurement of success which, to us, is important because it is better use of tax dollars. Another example is a particular agency in of the Labor Department that use data as budget justification for resource allocation rather extensively, and this resulted in a much better budget presentation. So we have many examples of success in that category.

Mr. PLATTS. Mr. McClain.

Mr. MCCLAIN. Mr. Chairman, thank you. As the GAO report pointed out, there were two administrations that used the managerial cost accounting system in VA. The largest of those, which takes up the vast majority of our resources and our employees, is the Veterans Health Administration, and they use the Decision Support System. That system does have a feed of over 50 inputs and is used at the medical center level and at what we call the VISN level.

Now VISNs are Veteran Integrated Service Networks. Essentially, they are areas, and we have 22 of those VISNs around the United States. We have a VISN Director who also monitors budget needs, resources, and such. And so, the Decision Support System is used by the Medical Center Director and by the VISN Director who has many medical centers under his or her responsibility.

Also, the VA has what is known as a VERA allocation. Now, the VERA allocation is a Veterans Equitable Resource Allocation, and it is essentially a fund that VA keeps back and distributes as we see the workload across the United States. And so, as the workload

comes to us, then we are able to provide funds as to where the veterans are and where they come to us for service. That Decision Support System is used directly in determining what the VIRA allocation will be.

Also, our National Cemetery Administration has an accounting system which is an activity-based system, which they are able to determine the unit costs for all of their cemetery services. And everything that they do in our 120 national cemeteries from a managerial aspect is run through this activity-based accounting system.

Mr. PLATTS. A quick followup, then I want to yield to my colleague, Mr. Duncan, on the use of the process in the allocation of resources so that where the veterans are, you have the dollars to meet the services that are going to be provided, or other examples within the Department.

Is there a broad ability, when we look at the requirements for managerial cost accounting and the accounting standards of the Federal Government and how it applies to each of your Departments, to say by doing this, by fulfilling these requirements, X dollars were saved or X dollars were better spent over the course of the past year?

I imagine that it is hard to put a dollar amount in total because it is more about are you providing the service in the best way you can versus actually saving dollars, but is there an ability to do that? Because one of the things we are looking at as a committee, and I talked about it in Orlando, is this comprehensive review of what we require of all our Departments and agencies and what makes sense today, and part of that is a cost benefit analysis in what we are requiring. Is there a gain back to government and ultimately to the people? Is it too difficult to actually put dollar values because of the way this information is used?

Mr. MOK. If you talk about payback, there is payback in two ways. As you know, our system, our cost model at the Labor Department is about 1 year old. We went live here in the last fiscal year. So it is still in a maturing stage. We do not look at this system as a pure payback, but as a mechanism. We look at it as how to maximize our resources, so that we have better accountability and more transparency through the process.

I also personally believe that because of better information coming out of the system, we will have better information, and therefore can provide better service and better results. And through that, we will get a reduction in waste and mismanagement. As our system matures, I am very confident that we will start being able to measure the actual cost savings, because if our managerial cost accounting cannot measure cost savings, we have a problem.

Mr. PLATTS. Do you want to add anything, Mr. McClain?

Mr. MCCLAIN. No, I would like to say what he said. [Laughter.]

At VA, we do not have a specific number that we could attach to our managerial cost accounting systems. We do track what we call management efficiencies, which is a conglomeration of management actions which we feel have saved money for the taxpayer.

Mr. PLATTS. OK. Mr. Duncan.

Mr. DUNCAN. Well, thank you very much, Mr. Chairman. I know it is not the most exciting thing in the world to talk about managerial cost accounting and subjects like we are discussing here today,

but I want to commend you for continuing to look into ways to make the Federal Government more accountable, more efficient, more economical, because I know people's eyes glaze over when you talk about a national debt of almost $8 trillion now that in a few months will be $9 trillion because that is where we have raised the debt limit to.

We are getting into a very dangerous situation. It is not going to be 2038, or 2043, or some year way off in the future when we are not going to be able to pay all these veterans' benefits, or Civil Service pensions, or Social Security pensions, or Medicare, or Medicaid, or some of these other things. I think that we all need to desperately work together to try to make the Federal Government more economical and more efficient. I know one columnist for Scripps Howard recently said that we are heading into a financial tsunami, is the way she put it, a financial tsunami, when the baby boomers start retiring.

Now, in this report, and I am sorry I didn't get to hear the testimony. I have been in other meetings. But it looks like the Department of Labor came out pretty good. It says the Department of Labor has implemented a department-wide MCA system with 15 of its 18 component agencies. And it says while DOL has various controls in place over financial data, GAO found that controls over non-financial data need further attention to ensure reliability. DOL officials are taking additional steps to address those issues. So it sounds like progress is being made there.

The question I have, though, comes in the next part of the report. I assume that what we are aiming at here is that this managerial cost accounting system is the best way to go. But it says that the Veterans Benefits Administration had discontinued use of its MCA system in 2003 because of system credibility and personnel issues. I am wondering what problems came up.

I serve on three committees and seven subcommittees. In addition, I read about all these other things and try to keep up with them. Whenever any department or agency of the Federal Government messes up, or gets in a scandal, or has a problem they always say one of two things, or maybe both. No. 1, they always say they are underfunded. No. 2, they say their computer system is obsolete or their computers can't talk to each other. Those are the two things.

Well, the computers that the Federal Government has are far better and far more advanced than those found in the business world, because we are told that computers are obsolete the day that they are taken out of the box. So everybody can always say their computer system is behind the times. But what do we need to do here?

I know the Veterans Administration is not underfunded because they have gotten a $3 billion or $4 billion increase every year since I have been here, and this is my 17th year here. When I first came, the appropriations were down to $28 billion or $29 billion. Now we are up to about $67 billion, and that is fine. I am not criticizing that, but I am just saying that I don't think there is any underfunding there.

I am not an accountant. So I assumed something that maybe I shouldn't have assumed. Is this managerial cost accounting the

way to go, and if so, why did the Veterans Benefits Administration discontinue use of the MCA system? Was something better done?

Mr. MCCLAIN. Congressman Duncan, I am from the VA, and I think I can attempt to answer that question. I will not give you either of those excuses. There was no funding problem that entered into that decision, nor was it particularly a computer problem. It was a situational problem, however, and the situational problem was simply that the expertise that was resident for that particular activity-based accounting system retired and left the administration, left the Veterans Benefits Administration.

And it was, I will have to say, a lack of oversight in senior management that allowed it to lapse and not require it to startup immediately again. It is currently being restaffed and restarted, and there will be a managerial cost accounting system in VBA. So the answer to your first question really is yes, I believe the managerial cost accounting system is a benefit and is the way to go, and all three administrations in the VA will have theirs.

Mr. DUNCAN. All right. OK. Thank you very much, Mr. Chairman.

Mr. PLATTS. Thank you, Mr. Duncan. Let me pick up there in the comparison of the Department of Labor both in the approach of what is already in place with managerial cost accounting and also the manner in which it has been put in place, department-wide versus component-specific, with the Department of Labor having it department-wide and Veterans Affairs being component-specific.

Mr. Martin, in your review of the two, obviously you found differences in the two Departments' evaluations. Is there a recommendation that you want to expand on as to one approach or the other based on what you found on these two Departments?

Mr. MARTIN. I think that either approach can work. You can either have a department-wide system, or you can delegate responsibility. But I think in either case, you are going to have to have Department level leadership that focuses on making sure it gets implemented, monitoring it, and setting up the proper system of controls and oversight. So I think either approach can work.

Mr. PLATTS. It seems like that leadership issue at the top levels is especially important. With Secretary Chao, we have seen that, the Department of Labor taking a very hands-on approach. And that is something that you would identify as one of the keys to the success of the Department of Labor's experience?

Mr. MARTIN. Yes, absolutely.

Mr. PLATTS. At the VA, Mr. McClain, taking that component-specific, and you have just talked about where you are heading. My first question would be in the decision to focus on the material weaknesses and internal controls, especially specifically on internal controls, I strongly believe in that foundation place. Unless you have those good internal controls, whatever you are doing beyond that is going to probably be challenged to have good results because of the data not being verifiable.

But the law, when that decision was made, was still that you were to be engaged in managerial cost accounting under the CFO Act, the FFMIA, and various regs. It seems to me the decision to step back with one of the components was contrary to the legal requirements on the Department at the time. Do you interpret that

differently, or just that you made a decision that maybe didn't fully comply with the legal requirements regarding managerial cost accounting, but you just had to do what you had to do to start at a foundation level?

Mr. MCCLAIN. I think it would probably be the latter, Mr. Chairman. Certainly, there was no conscious decision to violate the law or ignore the law. We are well aware of it, and we intend to be fully in compliance with the law. The Veterans Benefits Administration will be gearing up a managerial cost accounting system this year in fiscal year 2006, and they will be on board as quickly as we can get them up.

Mr. PLATTS. The approach is still to take a component-specific, though, not a department-wide plan, right?

Mr. MCCLAIN. The first step is getting all administrations on board with an MCA program. The second step is a review. Now, when the decision was made historically, I understand that the different administrations do their own, that was at a time, as Congressman Duncan said, things changed, computers changed, software changed. There wasn't anything out there that we saw that could handle a Department of our size.

We want to take another look now, because software has come in leaps and bounds, and now there are much better programs, much faster computers. And so, we want to take a good survey of the field to see what is out there that could possibly handle a $67 billion budget.

Mr. PLATTS. Is there a timeframe for that review and making those decisions?

Mr. MCCLAIN. The Secretary has set no timeframe although personally I would like to see it done within 6 months.

Mr. PLATTS. Mr. Mok, as far as at the Department of Labor, can you share, first in the decision to do it on a department-wide approach rather than component-specific, and now after this first year, your thoughts on that decision and how it is working?

Mr. MOK. From our experience at the Department of Labor, we started this project in the late 1990's, and we started typically like other Federal agencies with small pilots that did not yield a whole lot of success. Then in 2002, shortly after I arrived there, I looked at the situation, and we decided we would take a lesson from Detroit. We want to have a common approach and yet allow all the different agencies to do their own thing.

As you know, the Department of Labor is a conglomerate. We have many operating divisions with different cultures, different needs, and different management approaches. So what we did we built a common chassis and allowed each agency to build an SUV, a truck, a sedan, but at the same time we have a lot of standardized components, such as the drive train. So that way, we can talk to each other, at the same time we have some control and also minimize costs. Because with managerial cost accounting, if it is not cost controlled, then it is not managerial cost accounting.

Mr. PLATTS. How about on the internal control aspect, especially on the non-financial, one of the issues identified that was a weakness, and where you stand on trying to correct that weakness?

Mr. MOK. Yes, GAO's report indicated that our non-financial data needed to be validated in a more systemic and a formal manner.

We do not disagree with that. We feel comfortable with the process so far. We acknowledge, absolutely, there is plenty of room for improvement. However, we are comfortable with our data at this point, because all these non-financial data at different levels are reviewed.

For example, labor distribution, they have time cards; they have different levels of checks. We acknowledge, however, the GAO finding that we should and we can go about it in a more systemic and a formal manner, which we intend to, and we are committed to do that.

Mr. PLATTS. Is part of that one of the things highlighted in Mr. Martin's report, the lack of a post-implementation review, and that would give you some good data to know what you thought was going to be the case, and to how it would play out, and to what actually happened? Is that something you are reconsidering or addressing in a different fashion?

Mr. MOK. We have never opposed a post-implementation review at the Labor Department. Under the leadership of Secretary Elaine L. Chao, she is, as you know a Harvard MBA, so she really knows a lot about management, we have a very methodical method toward a lot of projects and management issues. One of which we use extensively is something called a Technical Review Board. Technical Review Board managers always take projects and look at a standardization of approach.

The Technical Review Board consists of key members throughout the whole Department in the management team. And one of the requirements of the Technical Review Board is any time when a new system is operational, 6 to 9 months after that, we would do a post-implementation review. So when GAO came in, absolutely, we had not done a formal post-implementation review. But I believe, if I remember correctly, when GAO came in and reviewed the project, it was about 6 to 7 months after we went live.

In the meantime, we have been using users groups. We have informal meetings. We have executive briefings of lessons learned, shared best practices. So we have a modified form of post-implementation, not as formal as GAO would like to see. We agree it is a good methodology. We intend to do that, but our time line basically calls for it after 6 to 9 months of full implementation. Our Technical Review Board has procedures in place to do what we call a post-implementation review. So the short answer is yes, we do it.

Mr. PLATTS. Mr. Martin, that would really get to what you ultimately would like to see, right?

Mr. MARTIN. Yes, it would. Yes.

Mr. MOK. And you have our assurance that is something that we plan to do.

Mr. PLATTS. Great. The issue of internal controls and the importance of that, whether it be the financial data or the non-financial, is an issue that is beyond just managerial cost accounting. But when we passed legislation last year and tried to help the Department of Homeland Security get its arms around its many material weaknesses that it inherited from the 22 different agencies that came together as that new Department, one of the requirements in the legislation we passed was an internal control audit to get that baseline of their internal controls to then build on, instead of play-

ing catch-up and not getting to where the Department of Defense is 40 years down the road. It is tough to go back and do it all over.

With both of your Departments, is that something that going to that extent would be worth the investment, the cost? Obviously, they are different sized Departments, and what it would involve, and the cost of each. But your opinion on that type of approach, I would be interested in.

Mr. MOK. VA is a lot bigger. So I will defer to someone else.

Mr. MCCLAIN. Thank you. Mr. Chairman, that is certainly an excellent suggestion. We have quite a few programs going on right now that are addressing internal controls, in particular the requirement that we be in compliance with A123. So we are actually in the process right now of trying to assure that we have the internal controls in place so that we can meet the certification requirements of A123.

Mr. PLATTS. But not to the extent of actually doing as part of your audit, having an audit opinion on your internal controls, right?

Mr. MCCLAIN. That is correct.

Mr. PLATTS. I know at DHS, the estimate, because they are required in the coming year to do that, and $4 million is what they are estimating the cost of that. Given some of the breakdowns in internal controls that we have seen with that Department, we think it will be money well spent because of the possible savings, but that is going to, again, vary by department.

Now, I know at the Department of Labor, you led the charge on the quarterly reporting regarding internal controls and the importance of that. As far as going to the level of an actual audit, is that something you think worthy of the expenditure of those funds?

Mr. MOK. We always support a higher, enhanced process of internal control, and we always support strengthening the control process because we believe that investment up front is a lot more than spending money to fix the damage afterwards. At our Department, we believe that we may be one, if not the first, Department to ask senior managers to provide quarterly certifications to the Secretary.

And these certifications are very important, because I personally meet with all the assistant secretaries on a one-on-one every quarter. And if a particular Assistant Secretary fails to find time to meet with me, I inform the Secretary, and that person will get a call from the Secretary.

When we sit down, it is at least half an hour. I remind the Assistant Secretary of their fiduciary responsibility under the law on the importance of internal control. I explain to them the current requirement on internal control and also give them a chance to talk about problems and how to identify problems early, so that we don't wait until the end of the year.

And at the same time, we help them answer three questions when something happens. The three questions I always remind every assistant secretary they need to answer are: when something happens, what did you know, when did you know, and should you have known. The first two questions are easy to answer. The third question will get a lot of people in trouble, and we try to keep them out of trouble. So that is, we believe, a good investment.

Mr. PLATTS. Good approach.

Mr. MOK. Thank you.

Mr. PLATTS. For all of us.

Mr. MOK. Thank you.

Mr. PLATTS. How about the relationship of Congress with your Departments and the various requirements? We are looking at the reform of statutes and how to streamline them. Is there something that is missing from a statutory standpoint that would help you when it comes to managerial cost accounting, anything that would give you additional leverage or authority?

Mr. MCCLAIN. Nothing that I am aware of, sir.

Mr. MOK. I think we have many very good statutes already in place. I think we need to do a better job together to enforce, enhance, and implement some of these statutes. I am not sure if you can legislate behavior. I think a lot of this better Government has to come from the culture of the organization. And I believe that the leadership sets the tone.

I believe that in our Department Secretary Chao has set a very excellent atmosphere and has given her unyielding support in that respect. As you may recall, she inherited United Way after a big financial scandal. So she is extremely sensitive and very, very appreciative of the importance of fiscal integrity and good financial management. And I am very blessed to have the opportunity to serve in that Department under her.

Mr. PLATTS. That is something the report highlights, the importance of that senior leadership. I would gather from your comment that having it at the Secretary level is critically important to the success of managerial cost accounting, not just at the CFO level, or the CMO, but that it is clear to everybody within that Department that this is a priority.

Mr. MOK. I agree 100 percent. The CFO alone cannot do it. Without the unyielding support and the commitment from the Cabinet Secretary, I do not think we would be able to accomplish as much in managerial cost accounting as we have today. We still have room to grow. We still have improvements to make. But we got to where we are because of the support from Secretary Chao.

Mr. PLATTS. Mr. McClain, would you like to add anything?

Mr. MCCLAIN. No, sir.

Mr. PLATTS. OK. The other aspect of Congress' role is not just statutes but is money, and part of the report seemed to identify that the lack of funding may have played a role. Mr. Duncan is not here to hear me say this, but it may have played a role in the approach you took and the focus on managerial cost accounting across the Department. Is that a problem with dollars that are specifically provided by Congress for this aspect of the Department's administrative work?

Mr. MCCLAIN. In today's VA budget, no, sir. It is not. That is not the problem.

Mr. PLATTS. OK, great. On the other hand, Mr. Mok, the Department of Labor seems to be on a great track and has already had some important successes. How do you see maintaining that from a finance standpoint, that you have the resources to continue to implement and move forward?

Mr. MOK. We have been funding this initiative with existing resources. However, if Congress would like to give us more money, we will always put it to very good use. [Laughter.]

Mr. PLATTS. As a non-appropriator, I say sure. [Laughter.]

I will commit my appropriator friends to just that. They may have something else to say about it. I think one of the challenges for Congress is that to save money, we do need in certain instances to spend money, whether it be on internal control audits or just having the manpower to effectively do managerial cost accounting and to make sure of your internal controls. In challenging financial times, we sometimes maybe forget that, that we are hurting the Federal Treasury because saving money up front means it is going to cost us more down the road.

And that is something as a subcommittee, we try to make that case to leadership and administration appropriators that, in some instances, spending more money actually will end up being a savings. So we will continue to press that message.

On a specific issue, Mr. McClain, I don't think you will be surprised at my questions regarding the shortfall at the end of this current year that seemed to come out of the blue with the Department of Veterans Administration. If you want to summarize what happened and how managerial cost accounting played a role, either because we didn't do a good job, and that played a role, and why we had this shortage come up on a quick notice, or how could it have been prevented if we had done a better job.

Mr. MCCLAIN. Mr. Chairman, no, it is no surprise that question may come up. The supplemental and indeed the amendment for 2006 has been the subject of several hearings already in the House and the Senate. Rather than kind of rehash what was said at those, I will try and concentrate on the managerial cost accounting aspect of this.

There were a lot of reasons why this occurred, and probably the greatest of the reasons is that more veterans came to us than we projected. Now, there are a lot of reasons why, and No. 1, that more veterans came, and No. 2, that our projections were not accurate as to who might come to us for care. I am talking mostly health care here, because that is the largest part of our budget. Probably the main reason is that the model that we used for projecting for who might come to us used data that was over 2 years old, about 2½ years old, by design. That is the way that the model was designed.

And a confluence of events, one being that the VA is a very good health care system. In fact, according to JAHCO, we are the No. 1 system in the United States right now. So we are just getting more people coming to us for care. We are getting more people coming to us for the pharmaceutical benefit and for a lot of other things that VA has for our veterans.

The other thing is that managerial cost accounting, for the most part, is a look back, or in other words, what did it cost us to provide a particular service. In some cases, then, that look back can help you to project in the future how much it is going to cost to provide services in the future.

So really, the problem came up about mid-year in fiscal year 2005. It was about March that it came up. So it was a workload

problem for the most part. In other words, more veterans came to us for more services.

So it was not only an increase in utilization, the number of veterans is up; the veterans who are in the system used the system more often; and the services that they were requiring were more costly than we had predicted because we are getting into an older population. Our veterans who come to us for health care have an average age of, I think, 68.

So as you get older, I don't think it is any secret, you require more services, and more tests, and more expensive services. And as we testified at the House Veterans Affairs Committee, the model needs to be adjusted so that we can pick those things up much quicker than at a 2-year or 2½ year interval.

Mr. PLATTS. One quick specific question on that average age, is that dropping, that veterans are coming earlier?

Mr. MCCLAIN. That is a good question.

Mr. NORRIS. I am not sure I know the answer to that right now, but I think overall, it has remained fairly constant over time. It is rational to assume that with the advent of the OIF/OEF veterans coming back and availing themselves to services, that one would expect that perhaps that would drop some.

Mr. PLATTS. Also because of the escalating cost of health care for everybody that veterans who maybe wouldn't have come into the system at all because their own health care was covering it, but are finding they are struggling more to pay the bill, they are accessing the system.

I use my father as an example who has now passed on 4 years ago, but he never did access the VA health care. He was in the process of doing it at the time he passed away. Because he was in his early 70's, and even though he had retirement health care——

Mr. MCCLAIN. Right.

Mr. PLATTS [continuing]. He was starting to have more out-of-pocket costs in addition within that coverage. So he said, well, it is a benefit I really never intended to use, but given what is happening.

So my thought is, given the whole environment out there with all of our citizens, including the veterans, that you are going to continue to see more accessing, earlier rather than later. That being the case, and what you already found this year, your model, I assume, is being adjusted or has been adjusted to reflect that you are likely to continue to see that trend?

Mr. MCCLAIN. Yes, sir.

Mr. PLATTS. I think from a congressional standpoint, we want to provide whatever the need is. We have programs available for good reason. These are men and women who have served our Nation, and when they come, we just need to find the means to provide the assistance. Your Department, I think, has worked hard to do that. In Congress, we need to stand ready to ensure you have what you need in those resources.

I have tried to run through these questions in a number of different areas and shortcut in a number of areas, because the series of votes that we are about to start between several amendments, 10 minute debate on recommittal, 15 minute recommittal, final passage, my guess it is going to be at least an hour. So we are

going to conclude here shortly before I go so that you don't have to wait here. I am sorry in the sense that I may be rushing through some of these areas that I was planning on expanding on a little further.

Actually, I had a followup question on the specific, and it just went out the window. If it comes back to me, I will followup with you.

Actually, it was specifically on VA. It was on the response to the report. In the response back to GAO, you seemed to take exception to some of the findings in the report regarding the reliability of the data. The report was saying that you needed to look at the reliability of the data you were using closer, and you seemed to take a little bit of an exception to that finding of the report. Your IG's report seems to correlate with what Mr. Martin's finding found.

I was wondering if you could explain further why you took exception, or what it was that you disagreed with regarding the reliability of data that you were referring to?

Mr. MCCLAIN. Well, Mr. Chairman, I think that is a fair question, and we did disagree just on the level where I believe the GAO report said that we didn't have certain training, we didn't have certain people in place, we didn't have certain controls, reliable data.

Mr. PLATTS. But that is more of a systemic problem is what I think their finding or thought was.

Mr. MCCLAIN. Right, and I believe we do have reliable data. I mean we try and scrub the data. We try and double check it and cleanse the data. And from a day to day operational point of view, where a senior manager could rely, or a front line manager could rely on the data, I believe that it is reliable for business purposes and for business decisions.

Can it be better? Absolutely. Do we need to do more? Yes, and we will continue to work toward ensuring that we have the absolute best data that we can. But we have been doing this for quite a while and realizing that, after what happened this year, it is kind of difficult to make the statement, but actually, we have done pretty well in the past 5 or 6 years on hitting our projections and making the proper decisions of placing assets where they should be.

Mr. PLATTS. Mr. Martin, in the exchange since your report and the feedback from the Department, where do you think the Department is, or specifics that you would encourage the Department to further look at to ensure the reliability?

Mr. MARTIN. I like what I am hearing about the management commitment and leadership commitment, obviously, some very good plans there, I think, and intentions.

I think maybe the data issue is indicated by the problems they had with the model, that was that data was 2½ years old. It illustrates some of the problems you can have if you aren't really active in making sure you have the best available data. It can cause you to make some bad estimates. And that is all we are trying to say, is that should be strengthened, and it should be looked at in the materiality of the data and the accuracy of it.

Mr. PLATTS. Is some of that, such as maybe the time sensitivity of the data, the 2-year old data versus using 1 year, that type of concern?

Mr. MARTIN. Right. Exactly.

Mr. PLATTS. Mr. Martin, in wrapping up, before I run over for these votes, your general thoughts that, as we look ahead to the next series, what is most important that we take out of your review of these two Departments, nicely with two different approaches regarding managerial cost accounting, department-wide versus entity-specific? Anything you want to make sure we take with us?

Mr. MARTIN. Sure. I think the key is leadership, and the leadership needs to focus on promoting the benefits of doing this, and not just focus on it as a cost-cutting tool, but illustrate that this is a way to deliver more services to our constituents. And that gets your program people excited about it because they can do more, get more bang for their buck.

When you draw people in that are not just your typical financial shop people, instead of pushing it out, you create a pull from the agency managers. You need leadership that promotes the benefits, and that monitors the implementation, and then sets up the sound system of controls and a process to make sure it all works. So that would be, I think, the lesson learned at this point.

Mr. PLATTS. Thank you.

Mr. Mok, Mr. McClain, is there anything that you would like to add, that you want to make sure of as we go forward as a subcommittee?

Mr. MOK. I agree with Mr. Martin 100 percent. Our approach is basically, I would offer as an acronym to echo what he said, LOVE, L-O-V-E. LOVE stands for leadership at the top; O is ownership for the stakeholders; V is bringing value to the table for the stakeholders; and E is implement efficiently and effectively. And I think that is how we managed to get the program to where we are today, but good leadership also.

Mr. PLATTS. Well, love is always a good thing to share and spread. [Laughter.]

Mr. McClain, anything? Hard to follow.

Mr. MCCLAIN. I need an acronym, and I don't have one. [Laughter.]

No sir, I don't have anything.

Mr. PLATTS. Well, we appreciate your participation here today. Our intent as a subcommittee is to try to work as part of the same team with those of our colleagues in the Departments or GAO, that the end result is we are all just trying to ensure that the Federal Government is as efficiently and well run and provides the services to our citizens that they need.

Especially in the times we are in, and as we recover from Katrina, and the recovery and rebuilding effort that is now underway, managerial cost accounting is something that really can play an important role. As we say, we have a lot of money, it is not an unlimited sum. What we can put into this effort? How can we best use it, and what is the best return for the investment to those in need?

As a subcommittee, we appreciate the case studies of your two Departments, because that gives us some initial data as we go forward with GAO and some other reviews. Again, besides your testimony here today, just day in and day out, your work and leadership in your Departments, Mr. Martin at GAO, we are grateful for

your service and glad to be part of the same team with you. Thank you.

We will keep the record open for 2 weeks for any additional information that needs to be shared. Otherwise, this hearing stands adjourned.

[Whereupon, at 3:45 p.m., the subcommittee was adjourned.]