

**Statement of the Honorable Dov S. Zakheim  
Under Secretary of Defense (Comptroller)  
Senate Armed Services Committee – Readiness and Management Support Subcommittee  
23 March 2004**

Mr. Chairman, members of the Committee, I am happy to be here to update you on the ongoing transformation of Department of Defense (DoD) financial management.

Before doing that, since this is likely to be my last appearance before the Senate Armed Services Committee as Under Secretary of Defense (Comptroller), I want to thank Committee members and staff for the support and courtesy given me these past three years. Congress's oversight of all facets of America's national security posture is vital, and the Committee's leadership has been very important to helping the President and Department of Defense fulfill their responsibilities. On behalf of the Department and myself, thank you.

Turning now to the subject of this hearing, Mr. Chairman, I first want to underscore the resolve of the Department of Defense to sustain and expand the substantial financial management progress of the last three years. I am happy that the Comptroller General, David Walker, is joining the discussion today because he and his people have provided key support for our efforts. We in the Department continue to find the General Accounting Office (GAO) a major ally as we seek to improve DoD financial management. Both our department and the GAO agree that much remains to be done. With the support of the Congress and continued help from the GAO, the Department of Defense can and must complete the planned overhaul of its financial management.

Today I want to summarize the financial management challenges DoD has faced, what we have done to overcome these challenges, and the work ahead to finish the task.

**Financial Management Challenges DoD Has Faced**

Over the past three years, under Secretary Rumsfeld's strong leadership and determination, the Department of Defense has made enormous progress in overcoming financial management challenges that developed and persisted over the past several decades. Financial management generally has been a backwater. Only in government could the job of Chief Financial Officer be less important than that of Comptroller.

For many years, DoD business management systems have been unable satisfactorily to:

- Interact with one another and facilitate the synthesis of management processes;
- Provide DoD decision makers with timely, accurate, and reliable information;
- Fulfill all financial management laws, standards, and requirements; or
- Produce auditable financial statements.

The primary cause of this situation was that for decades each military service and most DoD agencies and functional communities were permitted to develop and use its own business processes and systems. There was no requirement to adhere to a DoD-wide architecture or set of

standards. Inevitably these independent systems rarely could interact with others. Their information could not easily be exchanged nor aggregated for use by senior DoD leaders.

The Department's inability to produce clean, auditable financial statements reflected the fact that DoD business systems were not designed to produce the data necessary for such statements. It is important to remember that the information required for financial statements must come from many different DoD business systems: logistics, acquisition, human resources management, and others. Most of these systems were designed primarily to manage inventory, people, and purchases -- not to feed into financial statements. Moreover, DoD accounting and finance systems were developed to track and ensure the proper expenditure of appropriated funds, not to produce auditable financial statements. Therefore, when the Government Management Results Act of 1994 mandated that the Department of Defense and 23 other federal agencies produce auditable financial statements, DoD systems simply were not capable of complying.

One of the most important actions of the Bush Administration regarding DoD financial management was to decide that marginal changes would not be sufficient to overcome challenges that had been developing for decades. In previous administrations, marginal changes had produced only marginal results. So in 2001, Secretary Rumsfeld and his leadership team embarked on an aggressive path to achieve the comprehensive solution needed to give the Department superlative, integrated management processes and systems and to meet federal government requirements -- notably, auditable financial statements resulting in clean (unqualified) audit opinions.

On our path to reform, we have been fortunate to have had access to private sector expertise through the Secretary's Defense Business Board (DBB) -- 20 distinguished private sector business executives who advise the Secretary of Defense and senior DoD leaders on business management and related subjects. DBB recommendations have been especially valuable for the management of DoD-wide reform, development of financial management metrics, reform of the defense working capital fund, and development of balanced scorecard metrics that align measurement with the key management risk areas. I am especially grateful that David Walker of the GAO, as well as the Controller of the Office of Management and Budget (OMB), have served as observers on this board since its inception.

### **Business Management Modernization Program**

To transform DoD financial management, my fellow DoD leaders and I realized that we needed to transform management processes and systems in all major functional areas -- not just financial. To transform all DoD business management, we created the Business Management Modernization Program (BMMP). The centerpiece of the BMMP is the transformational tool known as the Business Enterprise Architecture (BEA). The BEA will help DoD's diverse business communities guide and constrain the transformation of their processes and systems.

BMMP is a massive undertaking and will take several more years to complete. This program is as much about changing our business processes as it is about eliminating redundant and non-compatible systems. We are working to streamline, reengineer, and standardize our business processes -- not simply improve the handling of information from those processes. BMMP will enable us to transition from the current collection of mostly incompatible and inadequate

management systems to an integrated network of systems, based on the uniform implementation of requirements across the Department. Our last completed inventory identified about 2300 DoD business systems. Our ongoing efforts to identify all DoD business systems indicate that the real total is a much higher number.

The Department's business transformation is being guided through an extensive governance process that includes all senior DoD managers. Specific responsibilities for business transformation will be detailed in a directive to be published soon.

It is important to remember that we are necessarily taking a top-down, incremental approach to business transformation. Our task is to transform an extraordinarily complex conglomeration of business systems, and our only practical option is to do that in increments. We cannot shut down the Department of Defense for a decade, throw out all old business processes and systems, and start from scratch guided by a fully developed, comprehensive enterprise architecture.

BMMP evolution. The Department's ongoing and planned actions for BMMP are consistent with the recommendations in GAO Report 03-1018. Most of those recommendations were related to continuing development of the BEA, which we are implementing. Our aim is that each successive BEA version includes more of the detail needed to guide and complete fully the transformation of DoD business processes and systems.

We also are aggressively building a comprehensive, detailed Transition Plan, which will depict the systems and schedules for migration from our legacy systems environment to the new mix of systems needed to achieve DoD business transformation goals. The Transition Plan will guide us from our "As Is" inefficient and ineffective environment to a "To Be" fully transformed state, which we are continuing to refine and specify.

The FY 2005 budget requests \$122 million to continue the transformation efforts of BMMP, including the evolution and extension of the BEA. I urge congressional support for that request, which is critical to the business transformation that DoD, OMB, and GAO all agree is vitally needed.

Controlling business systems investments. Even though the BEA is in continuing development, the current version is sufficient to enable the Department to ensure strong oversight over ongoing and planned investments in business systems. We are accomplishing this through what we term "portfolio management" by each of the owners of the 7 so-called domains or business areas: Logistics, Acquisition, Installations and Environment, Human Resources Management, Accounting and Financial Management, Strategic Planning and Budgeting, and Technical Infrastructure. Portfolio management efforts of the components that serve as "domain owners" are coordinated and integrated by the Business Modernization and Systems Integration Office, which is the program office and leader of BMMP.

Each domain owner -- for example, the Under Secretary of Defense (Acquisition, Technology, and Logistics) for the Acquisition domain -- oversees investments in business systems for that domain. The owner is responsible for ensuring that those investments are consistent with the BEA, Transition Plan, and requirements of Section 1004 of the FY 2003 National Defense Authorization Act. Especially critical is ensuring that these investments support achievement of

an unqualified audit opinion. The Department has certified some new system initiatives with investments of more than \$1 million and is setting up the processes needed to review thoroughly all other like investments exceeding \$1 million, as required by law.

Each domain owner will also have the lead in determining what business systems need to be phased out – and when to do so to best complement the investment in new initiatives necessary to achieve an unqualified audit opinion. Since the Department began its business transformation in early 2001, we have eliminated about 238 systems. We still have a long way to go.

### **Producing Auditable Financial Statements**

DoD leaders realized early on that BMMP was the only long-term, sustainable solution to its financial reporting inadequacies. But we also realized that -- since it would take several years to complete development and implementation of all BMMP initiatives -- we would need faster remedies to fulfill financial reporting requirements. We therefore, have been advancing various complementary measures to achieve acceptable DoD financial statements by FY 2007.

I have initiated an unprecedented DoD-wide effort to attain an unqualified audit opinion on all of the Department's FY 2007 financial statements. Central to this effort has been the requirement that all major DoD reporting components develop a Financial Management Improvement Plan that details how each component will overcome the deficiencies that prevent it from obtaining an unqualified audit opinion. To ensure progress my office conducts quarterly top-down reviews of financial statements from DoD components and tracks ongoing corrective actions year-round. As Chief Financial Officer, I require semi-annual briefings by all major reporting components – and I personally check progress, reviewing each financial statement – including its footnotes.

DoD Improvement Plans follow a process designed to ensure that the Department complies with Section 1008 of the FY 2002 National Defense Authorization Act, which is aimed at minimizing DoD expenditures for preparing and auditing financial statements that are not likely to be reliable. The essence of the Improvement Plan process is:

- Components identify and correct problems with their accounting systems and financial reporting processes – problems that prevent favorable audit opinions.
- Components validate that corrections have been made and then inform the DoD Inspector General (IG) that their systems corrections and statement are ready for its review.
- The DoD IG performs a limited review to confirm that a component's accounting system and financial statement is ready for a complete review.

The DoD IG is the responsible agent for performing audits of DoD financial statements and the systems that support the statements and for rendering an opinion on their fair presentation of DoD operations. The IG expects to continue to fulfill some of this responsibility by contracting with outside auditing organizations with the requisite qualifications. To fulfill this responsibility, the DoD IG estimates its FY 2004 costs will be \$115 million. During FY 2004, these costs will be covered by the components being audited.

For FY 2005 the Department has requested \$231 million to enable the DoD IG to perform these assessments and audits. This request funds the increased involvement of the auditors, which is vital to sustaining our progress toward clean financial statements. My office, the DoD IG, OMB, and GAO continue to work together to guide this progress, and we will also be working together to ensure the wise expenditure of these FY 2005 funds.

Of the 21 DoD components required to submit financial reports, five received clean audit opinions and one received a qualified audit opinion in FY 2003. Other DoD advances toward ensuring an unqualified audit opinion on its financial statements include:

- We continue to make corrections on the reporting of environmental liabilities and needed changes on expenditure reconciliation.
- We continue progress to correct weaknesses in inventory valuation.
- Nearly 50 percent of the Department's reporting of its liabilities received favorable audit results in FY 2003.
- We improved the timeliness of financial statements by reducing annual financial report production time by 45 percent in FY 2004.
- We substantially improved the clarity, formatting, and footnoting of DoD financial statements. The statements and notes are more citizen-focused and carry a reader friendly analysis to show variances between comparative periods. Our ability to communicate our financial position better enables us to convey more clearly the challenges we face and the services we provide.
- We are establishing the DoD Audit Committee to provide a concerted senior leadership focus to achieve and sustain a favorable audit opinion, and import best practices from other organizations who have achieved success in obtaining a favorable audit opinion. The Committee will review accounting and auditing issues and provide advice and counsel to the Secretary on solutions to resolve Department-wide challenges. It also will review DoD progress on implementing improvement plans and resolving major financial reporting deficiencies.

### **Other Accomplishments**

Besides BMMP and direct action to achieve auditable financial statements, the Department has had other accomplishments related to its financial management.

We have adopted a new approach to the management of retirement funds. In response to an DoD IG recommendation, the Department created the DoD Investment Board to provide additional oversight over the management of eight retirement and trust funds with assets now totaling almost \$250 billion. These funds include the Medicare-Eligible Retirement Health Care Fund, begun in FY 2003; its assets now total \$37 billion, but it is expected to grow eventually to over \$400 billion. The new Board has approved an investment strategy that aims to minimize risk and maximize returns on investments. As a result of our new strategy, currently the Military Retirement Fund, with assets of about \$200 billion, is earning returns that are better than those of equivalent funds – notably, Vanguard and T Rowe Price funds holding similar government securities. Our Retirement Fund has better returns over a 1-year, 5-year, and 10-year period.

We have been using Management Initiative Decisions (MIDs) to improve business processes directly. For example, we used MIDs to make two especially significant changes:

- We initiated the extensive use of performance metrics to measure program results, and began the use of those metrics to improve programs and guide budget decisions.
- We designed and launched a new 2-year Planning, Programming, Budgeting, and Execution process, whose features include a combined program and budget review and a more intense focus on enhancing joint warfighting capabilities.

We inaugurated the DoD Financial Management Balanced Scorecard Program to align financial management performance measures to the Department's overall priorities. Examples of our scorecard actions include:

- Our FY 2003 goal for interest penalties for late commercial payments was that we not exceed \$206 per million dollars paid. We surpassed that goal, ending FY 2003 at \$160 per million. We have reduced our interest penalties from \$291 per million in April 2001 to \$124 per million in January 2004.
- Our FY 2003 goal was that we not exceed 5 percent of over aged invoices as compared to the total number of invoices on hand. We surpassed that goal, ending FY 2003 at 3.66 percent backlog.

We have overhauled policies and management of DoD government charge cards (purchase cards and travel cards). The problems we found centered on inadequate management control, too many cards being issued, and delinquent payments on individually billed accounts. To remedy these problems, we strengthened our internal controls, increased training, curtailed and restricted cards, and developed automated surveillance tools. Reflecting our progress:

- For purchase cards, since FY 2001 we have reduced the number issued by 42 percent and cut the delinquency payments rate in half.
- For the delinquency rate for travel cards, we surpassed our FY 2003 Balanced Scorecard goal of 3 percent for centrally billed accounts, ending the year at 1.3 percent. For individually billed accounts, we ended the year at 5.1 percent, a significant reduction from the January 2003 level of 11.5 percent.
- In FY 2003 we cancelled 490,000 travel cards for nonuse and 9,000 due to separations and retirements.

We have made progress in eliminating Antideficiency Act (ADA) violations. We increased the speed of ADA investigations, which helps us determine what went wrong in each violation and make the appropriate corrections. Violations are frequently addressed with minor disciplinary actions. While some may disagree with the disciplinary decisions made, commanders and supervisors have been given discretion and responsibilities appropriate to the facts and circumstances. In my personal view, violators receive only minor punishment far too often. This is frustrating, and there is little senior civilian leaders can do to strengthen punishments because of prohibitions on command influence on the military's punishment decisions. Perhaps the Congress can help and find a way through this major complicating factor.

Among our other accomplishments over the past three years, we have:

- Reduced problem disbursements from \$4.1 billion in January 2001 to \$1.0 billion at the end of FY 2003 – just 24 percent of that earlier level. (The end of the fiscal year is the best time to measure our progress.) Problem disbursements consist of negative unliquidated obligations and unmatched disbursements.
  - Negative unliquidated obligations dropped from \$1.4 billion in January 2001 to \$125 million at the end of FY 2003.
  - Unmatched disbursements dropped from \$2.8 billion in January 2001 to \$854 million at the end of FY 2003.
- Strengthened internal controls to detect and prevent financial management mistakes.
- Intensified procedures to prevent erroneous commercial payments and to recover such payments if made.
- Initiated measures to detect, reverse, and prevent use of closed appropriations.
- Initiated changes in partnership with the Treasury Department to improve our collection of federal debts from delinquent DoD contractors.
- Progressed toward strengthening the professional qualifications of the DoD financial management workforce.

### **Closing**

In closing, I again want to thank this committee, and the GAO, for their interest in the Department of Defense effort to transform its business management and to fulfill its financial reporting responsibilities. We are at a critical stage in our transformation. We are off to a strong start, but much remains to be done. We face difficult challenges as we maneuver our way during these next several years.

This transformation is as complex and difficult as any challenge the Department has faced. What is at stake is nothing less than the future quality and cost of DoD management of its hundreds of billions of dollars in assets, liabilities, and appropriations. Successful transformation is essential to ensuring the very best management of our defense resources, and also is key to sustaining strong support to America's armed forces. The Department finally has a program, the Business Management Modernization Program, comprehensive enough truly to transform its business processes and systems in a sustainable way. We owe our taxpaying citizens nothing less. We need and welcome Congress's support and assistance to complete this historic undertaking. Thank you.