FINANCIAL MANAGEMENT REFORMS
(for inclusion in 2000 DRI Update Report)

The Department of Defense is continuing to vigorously transform its financial management operations, processes and systems. Once fully transformed, the Department's financial management process will rely on a smaller number of modernized finance and accounting systems, adhere to new government-wide accounting requirements promulgated in recent years, and reap the benefits of substantial compatibility among its financial and nonfinancial systems. As a result, more accurate and timely financial services will be provided at a lower cost.

The Department's pivotal agent for accomplishing these reforms is the Defense Finance and Accounting Service (DFAS). The DFAS has made remarkable progress since its formation in 1991. As the largest finance and accounting firm in the world, the DFAS now processes a monthly average of nearly 10 million payments to DoD personnel; 1.2 million commercial invoices; 450,000 travel vouchers/settlements; 500,000 savings bond issuances; and 122,000 transportation bills of lading, with monthly disbursements averaging $24 billion.

The Financial Management Improvement Plan is the Department's blueprint for financial management reform. The goals of the Plan are to implement more effective systems, reengineer DoD business practices, and improve the financial management framework.

IMPLEMENT MORE EFFECTIVE SYSTEMS

The Department's approach for improving financial management is to move toward the target architecture of an integrated financial management system--comprised primarily of compliant finance, accounting, and critical feeder systems.

The strategy for achieving an integrated financial management system includes eliminating unnecessary systems and consolidating others. Consolidation efforts are generally complete for the finance functions, while the accounting systems consolidations are still underway. As of October 1999, 98 finance and accounting systems were operating--down from 324 in 1991. The goal is to reduce the number of systems to 31 by 2003. These consolidations achieve genuine benefits. For example, when all DoD's one million civilian payroll accounts were consolidated into a single system, 26 separate systems were eliminated and 348 payroll offices closed. In 1999, a typical civilian payroll technician handled over 2,100 accounts, compared to 380 accounts in the 1991 environment.

The Department's effort to consolidate systems, however, is not simply intended to reduce the number of systems, and thereby reduce operating costs. The consolidation, standardization, and modernization of the Department's financial management systems will enable the Department to eliminate its outdated noncompliant financial management systems and substantially meet federal financial management system requirements, adhere to new applicable federal accounting standards, and use the United States Standard General Ledger at the transaction level.

A DFAS Corporate Information Infrastructure (DCII) is being implemented to help modernize finance and accounting systems and support future DoD financial activities. DCII will support the use of common standard data for the collection, storage, and retrieval of financial information. It also will simplify and standardize DoD finance and accounting transactions. Included in DCII is an ambitious effort to standardize and share acquisition data. This will greatly improve the interactions between DoD procurement systems and the financial systems that process and account for payments of procurements.

REENGINEER DOD BUSINESS PRACTICES

A critical aspect of the Department's financial management reform is to exploit successful business practices from both the private and government sectors. The goal is to make DoD business practices simpler, more efficient, and less prone to error.

A management oversight structure was constructed to ensure the involvement of the Department's senior leaders in the financial management improvement process. This structure includes a DoD Financial Management Steering Committee and Defense Working Capital Funds Policy Board. These entities actively engage in approving and monitoring the Department's financial management reform.

The Department is taking steps to reduce the volume of financial management regulations by publishing a DoD-wide "DoD Financial Management Regulation" ("DoDFMR"). Once completed, the "DoDFMR" is expected to replace approximately 70,000 pages of separate DoD regulations by consolidating and standardizing DoD policy and procedures and eliminating duplicate or obsolete policy and directives. To date, over 24,000 pages of financial management guidance have been eliminated by incorporating standardized policies into the "DoDFMR."

Changes implemented by the DFAS, as a result of competition studies, have produced annual savings of $37 million through streamlining of administration operations, facilities, and logistics, and consolidating debt and claims management, vendor payments, transportation accounting, and depot maintenance accounting.

The Department is using public-private competition--the A-76 process--to improve functions and reduce costs. Currently, A-76 studies are underway in the civilian and retiree/annuitant payroll areas. To date, approximately one-third of the DFAS operations, measured in terms of costs, either have been outsourced, competed for outsourcing, or are being subject to an outsourcing competition.

The DFAS is promoting the paperless exchange of financial information through a variety of initiatives. Electronic Document Access (EDA), Electronic Document

Management (EDM), and worldwide web applications are enabling on-line, real-time access to documents needed to perform bill paying and accounting operations.

Electronic Funds Transfer (EFT) is being used to reduce the cost and improve the accuracy and timeliness of disbursements. Over 98 percent of DoD civilian and military employees have their pay directly deposited into their personal bank accounts. The direct deposit participation rate for individual travel payments is at 94 percent. In 1999, EFT accounted for about $63 billion, or 90 percent, of the total contract dollars disbursed by the Department.

Electronic Data Interchange (EDI) is enabling the DFAS to send remittance information directly to vendors and currently is processing EDI contracts and contract modifications into its finance and accounting systems. The DFAS also is implementing a web-based invoicing system that provides industry with an economical method to submit electronic invoices.

Through its Joint Electronic Commerce Program Office, the Department has fielded a web-based Central Contractor Registration (CCR) that provides all DoD procurement and payment offices with a single source of valid and reliable contractor data. The CCR capability also helps DFAS capture up-front contractor financial systems data that facilitates EDI and EFT payments.

The Department also is implementing the Defense Cash Accountability System (DCAS). DCAS allows DoD to electronically collect and distribute cross disbursement voucher data. DCAS is expected to reduce the DoD disbursing cycle from over 90 days to 48 hours.

IMPROVE FINANCIAL MANAGEMENT FRAMEWORK

Since the activation of DFAS in January 1991, over 330 financial management field sites have been consolidated into 5 DFAS centers and 20 operating locations. Through these consolidations, the Department has been better able to eliminate redundancy, facilitate standardization, improve and accelerate service to customers, and increase productivity. As a result of various initiatives and efficiencies undertaken by the DFAS between 1993 and 1999, personnel levels at the DFAS have decreased by 28 percent--from 27,000 personnel in 1993 to 19,500 at the end of 1999. By 2003, DFAS expects to further reduce its personnel levels by another 2,000 personnel--to 17,500. Thus, over the 10-year period from 1993-2003, the DFAS will have achieved a 35 percent reduction in its personnel levels through various efficiencies. DFAS already has generated savings in operating costs totaling about $1 billion since 1991.

Adequate internal controls minimize the Department’s susceptibility to fraud, waste and abuse within its finance and accounting operations. The Department has taken significant actions to strengthen internal controls. The vast majority of the Department’s financial management employees are dedicated, honest and understand clearly their responsibility to the American taxpayers. Nevertheless, on occasion the Department has been victimized by fraud. To strengthen internal controls, the DFAS recently formed a Fraud and Internal Control Office. This office will help ensure that programs achieve intended results, laws and regulations are obeyed, resources are appropriate for a program's mission, data is reliable, and fraud is prevented.

To improve its contract payment process, the Department, prior to making a payment, completes a rigorous validation and certification process to verify that a valid contract exists and that the goods or services have been received. The Department makes in excess of 10 million payments each month with average monthly disbursements totaling $24 billion.

Over 99 percent of the Department's payments are matched to recorded obligations at the time the payment is made or shortly thereafter. A small percentage of payments, however, require additional time and research to ensure that the transactions are recorded correctly in the Department's accounting records. This additional effort is required because, within the Department, separate offices and separate automated systems are used to record the obligation of purchases in the accounting records, compute payment entitlements (i.e., determine how much should be paid and when), disburse funds (i.e., make payments), and then record the payment in the accounting system.

This separation of duties reflects good internal controls. However, because the applicable entitlement, payment, and accounting systems are not fully integrated, some of the data required to process these transactions must be input manually into the Department's automated systems. This creates the potential for "unmatched" transactions as data flows between the different systems involved. For example, simple keystroke errors may occur during the process of manually inputting data. Such errors can result in mismatches when data is transmitted between systems. These mismatches often are referred to as "Unmatched Disbursements." Also, a "Negative Unliquidated Obligation" may result if the amount in one system varies from the amount in another system.

The Department has made great strides in reducing the occurrence of these mismatches. Concerted efforts are being made throughout the Department to accelerate the resolution of "mismatched" records. Additionally, improvements are underway to more fully integrate the accounting, entitlement, and payment systems to help prevent future mismatches.

The Department also is taking aggressive action to implement new federal accounting standards. This requires overhauling DoD-wide management information using both long-term and short-term strategies.

The long-term strategy is to ensure that DoD financial systems can implement new federal accounting standards, and that they interface with the Department's other financial systems as well as the nonfinancial systems that feed data to them.

Short-term, the Department is developing interim methodologies to achieve more acceptable results in its major accounts sufficient to support a more favorable opinion on

DoD financial statements. For example, the Department has hired respected private accounting firms to assist in the valuation of its property and in the development of new procedures on accountability. The Department also is working with the audit community to develop more detailed policy guidance to assist DoD Components in identifying and reporting information needed for better financial statements. In the interim, various corrective actions are being put into place to overcome gaps or problems in current information flows. These actions are closely coordinated with the Office of Management and Budget, the United States General Accounting Office, and the Inspector General, DoD.

Today's financial management workforce is well qualified and highly motivated, but tomorrow's must be even better qualified. The Department needs to prepare the next generation of financial management leaders. To that end, an extensive workforce development program is underway within DoD. An agreement with the U.S. Department of Agriculture Graduate School has been reached to present an enhanced financial management 5-day training class. This training will be available to over 2000 DoD financial managers each year over the next five years. These classes, which address financial management challenges that face the Department of Defense, are intended to ensure that the DoD financial management workforce "knows the rules" that affect the administration of the Department's funds.

DEFENSE WORKING CAPITAL FUND

Before 1991, the Department of Defense (DoD) financed industrial and supply operations through multiple revolving funds. These funds, then called Industrial Funds and Stock Funds, provided commercial and industrial services to customers and were reimbursed for the majority of expenses they incurred through prices charged customers. However, not all costs were included within the prices charged customers. In some of these funds salaries or other overhead costs were financed by direct appropriations and the full cost of providing the goods or services was not visible to customers or senior officials. In 1991, DoD attempted to create a more business-like environment by merging these existing revolving funds and establishing the Defense Business Operating Fund, or DBOF, for delivering logistics goods and services. The DBOF began the practice of including full operating expenses (with the exception of Major Military Construction costs) within the prices charged customers. In 1997, DoD transitioned the DBOF into the current Defense Working Capital Fund, or DWCF. DWCF continues the policy, started in DBOF, of including these additional costs such as salaries and fringe benefits, accounting, information services, military labor, and other overhead in the pricing structure to make the total costs visible to the customer.

In August 1998, the Defense Reform Initiative Office chartered a Task Force to address customer and management concerns related to the operation of the DWCF. The goal of the Task Force was to propose changes to improve the delivery of goods and services to DWCF customers. In February 2000, the Deputy Secretary of Defense approved the Task Force recommendations in the areas of rate or price setting, best business practices, systems improvements, and providing for customer and manager education by independent study.

In the area of rate or price setting, DoD Components will be allowed to propose new methods of recovering the total costs of operations through means other than customer prices, while maintaining full cost visibility. DoD also will expand the process of recovering unplanned operating losses, in excess of amounts budgeted, during the year the budget is executed. Existing policy requires DWCF activity groups to set rates and hold them constant during the entire year of execution. Any operating loss is then recouped from customers in the next fiscal year through price increases. This policy was revised for Depot Maintenance activities to avoid excess operating losses and to preclude large rate increases for subsequent fiscal years. This procedure will now also be applied to the Central Design Agent's activity groups. In addition, DoD will reevaluate the criteria for evaluating candidates for inclusion in the DWCF.

In the area of best business practices, DoD will submit a flexible workforce legislative proposal to include a more aggressive use of nonpermanent positions. DoD will develop implementing guidance to provide a clearer set of options and instructions for pursuing public-private partnering relationships between DWCF activities and private contractors. DoD also will develop, review and revise the policy for direct funding of DWCF activities slated for closure. Currently, operating costs of closing activities are included in Revolving Fund Rates until the year of closure. The smaller workload base at closing facilities makes them cost inefficient and artificially increases rates for other activities in the activity group. DoD will revise depot inventory accounting procedures to provide more accurate inventory accounting systems; and develop and implement improved performance measures to better achieve business and customer mission objectives.

In the area of systems improvements, DoD will develop plans and implementing procedures to improve the management of DWCF costs and cash.

Finally, in the area of independent study, DoD will develop a plan for DWCF curricula to educate customers, operational managers, and senior managers on the operations of Working Capital Funds.

DoD is taking steps to implement the DWCF Task Force recommendations. The DWCF Policy Board will monitor implementation of these reforms. Approved changes will be incorporated into the DoD Financial Management Regulation.