Mr. Chairman and members of the Committee, I am pleased to update you on the status of financial management reform within the Department of Defense.

**CONTINUING LEADERSHIP COMMITMENT**

As we transform our Nation’s defense posture, it is critical that we reform the management of the Department’s finances. Just as we are transforming our military forces and combat capabilities, we must with equal vigor transform our business practices and systems. In that way, the Department may not only reap the benefits of greater efficiency but also apply those resources directly to our warfighting capability. Every dollar wasted on an inefficient process is a dollar that could have been utilized to fight the war on terrorism.

To get this job done, Secretary Rumsfeld directed his entire leadership team to conduct a complete overhaul of the Department’s financial management practices and processes. He has tasked me, along with other senior leaders, to lead these efforts. He is holding each one of us accountable for the results.

Our reform initiative involves almost every transaction in the Department. It is the most comprehensive and integrated financial management reform effort ever attempted within DoD. We are making fundamental and sweeping changes to our financial management practices and supporting infrastructure in order to demonstrate fully both to the Congress and the American people that we are responsible stewards of the resources entrusted to us.
We realize that our reform effort is aggressive--some think overly aggressive. I do not believe that is the case. I have set the bar high and I am firmly committed to major change in this important area. The taxpayer deserves nothing less.

ADDRESSING THE PROBLEM

Our transformation initiative is integrating business process reform with systems renovation. We are setting clear-cut goals for our managers and using understandable measures to evaluate performance. Before I discuss what we are doing to improve financial management, I must emphasize that the only permanent solution to our financial difficulties will be the long-term modernization of our financial management systems and business processes.

Root Causes. Our Financial Management Modernization Program is a central focus of our long-term reform plan. It is designed to revamp those processes and systems in the Department that generate financial information. It targets the root causes of the Department’s financial management problems. Those are:

1. the uncontrolled proliferation of antiquated and standalone financial management systems, and
2. the inefficient business processes that they support.

These systems and processes were developed to support the budget and appropriation process. Unfortunately, they do not generate financial information that meets the needs of both our senior managers and government-wide management. In particular, they do not contain standard accounting requirements. We intend to fix that.
This proliferation of systems can be seen in our inventory schematic. It demonstrates the complexity of the Department’s system that produces most of our financial management information. There are no less than 673 systems in our inventory. The majority of these systems manage personnel, logistics, health care, and other non-financial functions. Yet we must consider them to be integral to the financial management system because they generate financial data. They are as important to financial management reform as those systems handling only accounting data.

This schematic is itself the product of a major effort. It documents, for the first time, the Department’s “AS-IS” inventory--a vital element for change.

The key to the Department’s long-term success lies in eliminating as many systems as possible, integrating and standardizing those that remain, and modernizing the business processes that produce our financial information. Some Components in the Department already are actively working to eliminate systems and reengineer their business processes. We are working closely with all Components to ensure that what they are doing to enhance financial management fits into the Department’s long-term strategy for reforming its financial management infrastructure.

We are developing a systems “blueprint” that will underpin our Financial Management Modernization Program for the long-term. Systems experts call this blueprint an “enterprise architecture.” Just as an architect uses a blueprint to construct a building, the Department will use a systems blueprint to construct its future financial management infrastructure. The blueprint will describe how to modernize and link both systems and business processes, now isolated from each other, across the functional areas I mentioned earlier: logistics, health care, accounting, finance, and others. The blueprint will also include Department-wide financial management standards.
We expect the finished blueprint to be ready for implementation by March 2003. At that time, we will begin testing--or prototyping--the solution we developed in our blueprint.

**Short-Term Progress.** Concurrent with our long-term efforts to fix systems and processes, we have begun to address many pressing problems.

Already, the Department is making progress in several key areas. For example:

1. We accelerated and expanded the use of performance measures and data to target serious issues:
   - From April 2001 to October 2001, we reduced by 41 percent the backlog of commercial payments. Paying our bills on time improves our business relationships and reduces wasteful interest payments,
   - Between January 2001 and December 2001, we increased management oversight of travel cards, which resulted in a 34 percent reduction in personal payment delinquencies and an 86 percent reduction in organizational delinquencies. This increases confidence and reduces the cost of the card,
   - We decreased our payment recording errors by 57 percent between October 2000 and October 2001. The elements of this reduction include:
     - a 51 percent reduction in the dollar value of our unmatched transactions,
     - a 92 percent reduction in the dollar value of our transactions not obligated,
     and
     - a 74 percent reduction in the dollar value of transactions requiring additional research.
2. As I mentioned, we have clearly defined the extent of the Department’s systems problems by cataloging—for the first time—a complete inventory of the systems that produce financial information.

3. I have instituted tighter controls over the development and proliferation of financial management systems, thus slowing investments in systems that are not compliant with financial management requirements.

4. The Defense Contract Audit Agency (DCAA) and Defense Finance and Accounting Service (DFAS) are jointly identifying and collecting contract overpayments. DCAA has finished audits of contractor overpayments at 46 major contractors and is completing audits at 124 others. Auditors have found overpayments of $50 million, with over $20 million of the overpayments already returned to the government. DCAA and DFAS are working to recover the balance.

5. We are improving accounting for our weapons systems and support equipment. We are working with the Federal Accounting Standards Advisory Board to change the way the Department accounts for ships, tanks, aircraft, and other military end items. We soon expect to begin recording their full costs in our accounts and showing those costs on our balance sheets. As a result, our managers, and the public, will have a clearer view of the total costs associated with these items.

6. The Department is standardizing the way it values inventory. We are beginning to use standard commercial methods to account for and control inventory. We have also increased the accuracy of our inventory accounts by $69 billion.
7. We are developing more accurate methods to estimate our environmental liabilities. These new methods will help the Department report reasonably accurate estimates for its clean-up costs.

8. We are balancing our checkbook with the U.S. Treasury. We have improved procedures for reconciling our Fund Balance with Treasury accounts and have created a new training program to teach our accountants these procedures.

9. Further, I have directed the Department to reduce unreconciled balances by recording obligations for payments that are over 120 days old, rather than our former target of 180 days.

10. We have also established a Financial Management Modernization Executive Committee to provide consistent top level leadership. This committee is comprised of the Department’s most senior managers and is providing guidance and advice to staff implementing the Financial Management Modernization Program.

11. We are tackling the significant management control weaknesses that continue to permeate the processes we use to generate and handle financial management information. We are expanding training and reengineering our most vulnerable business processes. Only by remedying management control weaknesses can we reduce the tremendous amounts of time and resources we currently must devote to reworking and adjusting our accounts.

These problems, and others like them, have caused the confusion in the Department’s finances. The result is that our managers cannot use our data, the auditors cannot audit our data, and the Congress and the Public are skeptical about our data. And, of course, we cannot obtain a clean audit opinion. The goal of the Secretary’s reform initiative is to end this disorder.
Human Capital. In addition to addressing systems issues, business processes, and policies and procedures, we are strengthening the Department’s financial management workforce. Secretary Rumsfeld has spoken repeatedly of the need to improve the professional qualifications and skills of the Department’s workforce. The Department takes this issue seriously. To tackle the challenges we confront in this area, the Department has formed a Financial Management Human Capital Workgroup.

This workgroup is creating a detailed roadmap that will outline tangible steps the Department can take to bolster the talents and experience of its financial workforce. Further, the workgroup is proposing incentives that encourage financial management personnel to attain recognized professional qualifications, such as Certified Public Accountant. The Defense Finance and Accounting Service and Defense Contract Audit Agency, the Department’s two major financial agencies, are both members of the workgroup and are cooperating closely to upgrade the skills of their financial personnel. This is the first time that these two agencies have worked together in this kind of endeavor. We are integrating the procedures developed by this group into our overall transformation initiative. The workgroup’s plan will include both its short-term and long-term recommendations, and will be finished in April 2002.

Defense Business Practices Implementation Board. To help the Department in this enormous undertaking, Secretary Rumsfeld established the Defense Business Practices Implementation Board. The Board will advise us on applying best business practices to management, finance, acquisition, production, and logistics operations. Comprised of senior executives and experts from the business community, the Board will help the Department formulate and achieve its ongoing management reform. Both the Comptroller General of the United States and the Controller, Office
of Federal Financial Management, Office of Management and Budget, serve as observers on the Board. The first meeting is scheduled for March 15, 2002.

**CLOSING**

In conclusion, I want to reiterate that Secretary Rumsfeld and his senior leadership are determined to transform financial management in the Department of Defense. We are using transformation techniques that are novel to the Department--as well as keeping the best of what was in our previous improvement plans. We have set an ambitious schedule and are making every effort to meet it.

I would like to thank this Committee for its support in the past for our efforts. As with any major undertaking in the Department, we will need continued support from the Congress--to include approval of our Fiscal Year 2003 budget request for financial management modernization.

We also need to continue our strong partnership with the General Accounting Office and the Office of Management and Budget. Together, we can create the world-class financial management infrastructure that will be needed to complete the revitalization and transformation of America’s defense posture.