Testimony

of

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before the

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Mr. Chairman, Members of the Committee, thank you for the opportunity to update you on the progress the Department has made in business transformation and financial management – and through you, the American people.

As stewards of the resources entrusted to us for the defense of the Nation, we take our responsibilities to the American taxpayer seriously. We also strive to never lose sight of the fact that everything we do – every dollar we manage, every contract we fund – affects the men and women in uniform who put their lives on the line every day to protect our freedom.

Secretary's Message

Indeed, more than anything else, the Department's business transformation and financial management efforts are about supporting the warfighters who defend the Nation.

This has been the case since the Administration took office. As Secretary Rumsfeld said on September 10, 2001 when he announced this campaign to transform the Pentagon bureaucracy, "This is not just about money or waste... In the end," the Secretary said, "it is really a matter of life and death – ultimately, every American's ..."

"Our job," the Secretary said, "is defending America, and if we cannot change the way we do business, then we cannot do our job well, and we must."

2001 QDR GOALS

In the first year of Secretary Rumsfeld's tenure, the 2001 Quadrennial Defense Review was released. The QDR challenged the Department to

modernize its approach to business operations and information, especially with regard to enabling the Department's financial and non-financial operations to work together effectively – which was not then the case.

To correct this deficiency, the QDR called for the creation of a DOD-wide blueprint, or architecture, to guide the development of enterprise-level processes and systems throughout the Department of Defense. The QDR also prescribed periodic consultation with the U.S. Comptroller-General for better insight and support, and improved coordination with Congress regarding financial management oversight activities.

Since that time, Mr. Chairman, we have been working to make these goals a reality.

Meeting the Challenge

The challenges the Department faced were not insignificant – beginning with the sheer size of the enterprise. With more than 600,000 buildings and structures in over 146 countries around the globe, the Department's assets and liabilities alone exceed those of WalMart, Exxon, Ford and IBM combined.

Add to that an employment roster that includes 1.4 million active duty men and women, 740,000 civilians, 860,000 Guard and Reserve, 2 million retirees and families, and an operating budget in excess of $400 billion, and you have some idea of the sheer volume of financial information, not to mention the difficulty in consistently capturing that information and uniformly applying solutions.

Indeed, for decades there were no uniform solutions, only a wide variety of disparate systems and processes unable to talk to one another, and thus unable to produce accurate, complete or timely information.

Agenda for Change

In 2001, the Department embarked upon an ambitious plan to bring the Department of Defense into the 21st century. After four years of work and preparation, two comprehensive and integrated plans for financial improvement and business systems modernization were launched in 2005: The Enterprise Transition Plan (ETP); and The Financial Improvement and Audit Readiness Plan (FIAR).

The Enterprise Transition Plan (ETP) consolidates DoD's many disparate business systems and focuses resources to minimize redundancy and reduce overhead. The Enterprise Transition Plan also details the schedules, milestones, and costs for 98 key transformational programs and initiatives across the Department.

The Financial Improvement and Audit Readiness Plan, or "FIAR" Plan, focuses the Department's efforts on improving business processes and internal controls. It unites DoD's functional and financial operations and comprehensively guides the effort to incrementally resolve material weaknesses to achieve an independently verified, or "clean," audit opinion.

Together, the Enterprise Transition Plan and the Financial Improvement and Audit Readiness Plan are reducing the cost of operations, increasing speed and efficiency, improving internal controls and financial accountability, and most

importantly, positively impacting our primary mission: supporting the warfighters who defend the Nation.

Improving Financial Management and Audit Readiness

Employing an incremental methodology to achieving audit readiness, the FIAR Plan focused its initial efforts on four high-impact areas that represent a significant portion of the Department's assets and liabilities: Military Equipment, Real Property, Medicare-Eligible Retiree Health Care Fund, and Environmental Liabilities. Fund Balance with Treasury is also a priority.

The goal is to produce an independently verified opinion of 73 percent of the Department's assets and 80 percent of its liabilities by 2010.

Each focus area includes specific milestones for achieving a successful audit, and during the last six months, 64 percent of these milestones have been met.

Military Equipment

In the area of Military Equipment – which represents fully 27 percent of all DoD assets – an auditable baseline valuation for 100 percent of all Military Equipment programs – everything from combat vehicles to ships to aircraft – has now been established, and was included in the Department's third quarter fiscal year 2006 financial statement.

This is especially significant because the Department has never before had an accurate valuation of its military equipment. This work also lays the

foundation for the development of depreciation schedules for the Department's largest category of assets.

Fund Balance With Treasury

Also, for the first time in its history, the Air Force Fund Balance with Treasury – which represents five percent of all DoD assets – is now ready for audit, meeting its target goal for 2006.

Real Property

In the area of Real Property, long-standing issues regarding the best way to value real property assets have now been resolved, and the process of identifying and accurately reporting real property is moving forward. This process allows us to fully understand the cost of operating facilities, and also improves our ability to negotiate contracts and identify savings associated with the Base Realignment and Closure process.

Environmental Liabilities

In the area of environmental liabilities, an initial inventory and estimate for 97 percent of all environmental liabilities have now been completed for Navy nuclear-powered vessels, the Defense Environmental Restoration Program, Base Realignment and Closure, and the Chemical Weapons Program. In addition to calculating the value of this important category of liabilities, this work will enable the Department to better identify the amount and timing of funding requirements necessary to resolve environmental issues.

Medicare-Eligible Retiree Health Care Fund Liabilities

In the area of health care liabilities, a new system that will provide an improved capability to manage the cost of this increasingly expensive liability is expected to be in place within the next two years.

Component Progress

In addition to the four focus areas of the DoD balance sheet, the military components are making good progress toward independent audit opinions. For example, the U.S. Army Corps of Engineers is currently undergoing an audit of *its* FY 2006 financial statements, and the Marine Corps expects to be ready for a full audit of their financial statements in FY 2007.

Clean audits for the military components confirm both the reliability of financial information and demonstrate the Department's commitment to accurate reporting.

Improving Business Systems and Processes

Effective business systems and processes also support "clean" audit opinions and the internal controls that help eliminate material weaknesses.

In this respect, the Department has made clear and measurable progress in modernizing and consolidating DoD business systems and operations, and improving the accuracy, reliability and timeliness of information.

Specifically, the major milestones for improved financial visibility, as outlined in the Enterprise Transition Plan, are being achieved on schedule. These milestones include implementation of the Standard Financial Information Structure (SFIS), which will allow all DoD financial systems to speak the same language, and facilitate more accurate compilation and reporting of financial information.

Other enterprise-level financial management initiatives and programs are also proceeding on schedule and reviewed monthly by the Deputy Secretary of Defense and the Defense Business Systems Management Committee (DBSMC).

As noted in the Department's March report to Congress, the Department has achieved 74 percent of the six-month milestones identified in the Enterprise Transition Plan, and is proactively resetting the remaining 26 percent to ensure that those milestones are achieved in the next six months.

Additionally, the Department has certified over 200 systems modernization efforts, each valued at $1 million or more, to ensure compliance with the Enterprise Transition Plan and the Business Enterprise Architecture. An update to the Enterprise Transition Plan will be published in September.

So, I feel good about our progress. And it's not just the Department saying that. Our recent success in business systems modernization was affirmed by the Government Accountability Office in two consecutive reports (November and May), which cited important progress in this area, and by the Office of Management and Budget, which elevated the Department's progress rating from yellow to green.

Indeed, there are numerous examples of how the Department is improving its business processes and systems. For example:

- Since 2001, process efficiencies at the Defense Finance and Accounting Service have resulted in manpower cost savings of approximately $238 million – all while improving productivity and service to the warfighter.

  As new automated systems are implemented, and the Base Realignment and Closure process is completed, manpower costs will decrease by an additional 45 percent, with a projected annual savings of $357 million.

- Past due individual travel accounts have been reduced from 18.4% in 2001 to an all-time low of 3.2 percent -- which results in increased public credibility and improved negotiating power for new card service contracts.

- Fully 95 percent of all vendor payments are now done electronically, as compared with 86 percent in 2001, realizing a savings of $6 million.

- Delinquent debts receivable have been reduced by 42 percent – or $1.1 billion – from FY 2004 to FY 2005.

- Likewise, unsupported accounting entries have been reduced by 86 percent, or $1.98 trillion, from FY 1999 to FY 2005.

- Late payment penalties have continued to decrease from $343 per million dollars of payments in 2001 to $127 per million in 2006 – a 63 percent improvement that has avoided $140 million in interest payments.

- We have also steadily reduced the amount of overpayment to vendors, which has resulted in a reduction of approximately $39 million of improper payments.

These are just some of the ways, improved business processes and systems are making a difference at the Department of Defense. Of course, the most important improvement has been the clear and comprehensive process for change outlined in the Enterprise Transition Plan and the Financial Improvement and Audit Readiness Plan.

Looking forward, the September 2006 FIAR Plan will include four new focus areas for financial management improvement: Accounts Payable, Accounts Receivable, Inventory, and Operating Material and Supplies. A special initiative *focusing on* improvements to Military Pay will also be addressed.

All in all, since the 2001 QDR was released, $16 billion has been spent on business systems modernization -- $12.6 billion at the Component level, and $3.4 billion at the enterprise level – in my view a wise investment for the return we have already realized, as well as for what we can expect in the years ahead.

Responsibility and Accountability

The responsibility for improved financial management and business modernization rests with every employee of the Department of Defense. Because personal integrity, responsibility, and competence permeate all financial

improvement efforts, every person is responsible for safeguarding assets, ensuring compliance, and maintaining effectiveness. And, starting at the top, all are responsible for identifying and resolving problems in operations and compliance.

Indeed, the Deputy Secretary of Defense has designated financial improvement to be a Department-wide priority, and personally ensures that DoD senior leadership stay committed and informed.

To manage the FIAR Plan, and ensure that DoD-wide financial improvement efforts are fully integrated with other transformation activities across the Department, the Office of the Under Secretary of Defense (Comptroller) established the FIAR Committee and the FIAR Directorate, its program management office.

The FIAR Committee leads the process for establishing and monitoring FIAR Plan priorities. Chaired by the Deputy Chief Financial Officer, the Committee includes executive-level representatives of the Military Departments, the Defense Logistics Agency, the Business Transformation Agency, and the Defense Finance and Accounting Service. The Inspector General, DoD acts as an adviser to the FIAR Committee. This collaborative management structure reinforces business integration.

But, the Department is not alone in providing oversight. The President's Management Agenda requires federal agencies to improve financial performance, and the Office of Management Budget monitors this progress against metrics on which DoD reports quarterly.

Reporting began in December 2005 for the first quarter of FY 2006. Regular DoD progress reviews, and key milestone controls, ensure that the financial improvement metrics reported are reliable and based on strict internal management objectives.

Mr. Chairman, the challenges we have faced in this endeavor have been many, and the task is still far from complete, but I believe the Department of Defense has made clear and measurable progress in improving the business systems and financial management of the Nation's largest and most complex department – and that that progress will continue.

Mr. Chairman, I thank you again for the opportunity to share these accomplishments with you, and on behalf of Department of Defense, I thank the Committee for its support for these important efforts, and most importantly, for their continued strong support of the men and women of America's Armed Forces and their families.

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