

**NOT FOR PUBLICATION UNTIL
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ARMED SERVICES COMMITTEE**

STATEMENT OF

THE HONORABLE GLADYS J. COMMONS

**ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)**

BEFORE THE

HOUSE ARMED SERVICES COMMITTEE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

ON

DEPARTMENT OF DEFENSE AUDITABILITY CHALLENGES

14 SEPTEMBER 2012

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Chairman Wittman, Congressman Cooper, thank you for the opportunity to appear before you today to discuss the Department of the Navy's drive to achieve and sustain financial audit readiness -- and the challenges we face as we move forward. Our Navy-Marine Corps efforts continue to build momentum as we follow our detailed roadmap to achieve auditability in the Department of the Navy (DON). Achieving audit readiness, and subsequently maintaining it, requires a fundamental change in the way we execute our Departmental business processes.

The Department of the Navy's senior leaders are solidly committed to our audit readiness efforts. The Under Secretary of the Navy and Chief Management Officer, the Vice Chief of Naval Operations, and the Assistant Commandant of the Marine Corps have actively and repeatedly emphasized the importance of audit readiness to the entire Department. Under Secretary Robert Work stresses the mandate for audit readiness at each of his Town Hall meetings with senior executives and the inclusion of audit readiness objectives in their annual performance plans. The Vice Chief of Naval Operations, Admiral Mark Ferguson is visiting each major command, discussing their audit readiness efforts and how they are contributing to the overall success of the Departmental plan. The Assistant Commandant of the Marine Corps, General Joseph Dunford has stressed the importance of audit readiness to his general officers and senior executives and oversees the ongoing Marine Corps audit.

Financial audit readiness depends on the actions of thousands of leaders, managers and employees throughout the Department of the Navy and outside the Department. We have actively engaged the many stakeholders who play a critical role in Navy-Marine Corps business processes and systems, enlisting their immediate participation in our plan for auditability. Senior functional managers have been assigned to lead Departmental audit readiness efforts for their respective business processes. Nurturing and maintaining this cross-cultural engagement, a most

essential element of our recent successes, is also one of our biggest challenges in achieving audit readiness.

Recognizing the need to keep the cross-cultural engagement active and growing and to ensure that all our employees understand their role in audit readiness, we have launched an aggressive education, training and communication plan. These efforts include one-on-one, face to face communications on a number of fronts, and using our internet website, training seminars, video presentations, technical workshops, newsletters and town hall sessions to reach the widest cross-section of employees.

We are moving forward to meet the goals we have established. Over the past year, the Department of the Navy (DON) has received unqualified opinions on our Funds Receipt and Distribution process, our E-2D Hawkeye aircraft major acquisition program process executed through Navy Enterprise Resource Planning (ERP), and on our asset management processes for our ships, submarines, satellites, ballistic missiles, and aircraft. We have asserted audit readiness for our Civilian Pay and Transportation of People processes and expect that examinations on these business segments will start this month. The Marine Corps' audit engagement on its Statement of Budgetary Resources (SBR) continues. This audit engagement serves as a guide as we undertake broader efforts within the Department of the Navy and has yielded lessons for the DON and the rest of the Defense Department.

We continue to use our detailed plan to achieve Navy-Marine Corps SBR auditability as our guide and adjust it as necessary based on our findings and experience. Our steady progress is bringing increased confidence that the Department of the Navy will meet Secretary Panetta's goal of SBR auditability by Fiscal Year (FY) 2014.

We realize that Department of the Navy audit readiness efforts are also dependent on the assistance from our primary service providers – defense agencies which provide support to our business processes. We rely on these outside organizations to pay our bills and our people, receive and accept goods and services on our behalf, provide us consumable material, manage our major contracts, and to do our accounting, including preparing our financial statements. The Department of the Navy’s audit readiness will depend directly on the audit readiness of these service providers’ processes and systems. We have drawn them into our widening circle of accountability, forming alliances, obtaining their support, and incorporating their organizational efforts into our detailed plan of action.

We have learned that some business processes, while designed and used to meet specific needs of the entire Defense Department, do not comply with financial audit standards. An example is the material receipt and acceptance procedure that comes with hiring one government agency to provide goods and services to another. The process as currently practiced, does not promote a disciplined receipt and acceptance process prior to the payment for the goods and services. In this case, we are working with the Defense Comptroller’s staff to ensure that governing policies are clear and lead to consistent and repeatable process execution, that is compatible with a financial auditor’s expectations.

Achieving the requirements of auditability and then being able to demonstrate this readiness to an outside auditor is a new skill that we are developing. To hone this ability, we are relying on the lessons we have learned from the Marine Corps audit. In addition, we are actively engaged with the Defense Department’s Financial Improvement and Audit Readiness Directorate. This close and regular collaboration has increased the collective expertise guiding our efforts and is raising the quality of our audit readiness.

Information technology (IT) systems remain a significant challenge. Our systems were not designed to account for our resources in a way compatible with financial statement requirements. Currently, we do not have documented assurance that major business systems producing our financial data have the necessary controls to ensure the data's accuracy and reliability. We have begun assessments of these information systems within our Department to identify control weaknesses and are making system changes as necessary for auditability. Concurrently, our management team is conferring with outside service providers to ensure that similar assessments (which will support Navy-Marine Corps audit readiness timelines) are underway on the (IT) systems they manage and which affect our audit readiness.

We discovered that a consistent deficiency in our audit readiness is the ability to consistently produce appropriate documentation to substantiate a transaction. In some instances, we found that auditing standards required a longer retention period than normally required by the business process. Earlier this year, the Department of the Navy issued guidance on required documentation to support auditability, complete with retention timelines. This policy will add needed discipline to our day-to-day business practices.

We also need to strengthen the internal controls surrounding our business processes and to verify that they have been tested. We have begun testing the internal controls in each of our business processes to ensure that they are effective and that they will enhance our financial auditability.

To ensure we preserve our gains as we overcome the challenges to audit readiness, we are building the audit response infrastructure needed to house, retrieve, and evaluate the large volumes of electronic audit documentation required during an audit. This scalable repository

doubles as an audit management tool, supporting assertion preparations, audit engagements, and sustainment activities. This is one of the more valuable lessons learned from the Marine Corps audit of their SBR. This capability will be indispensable as our auditability pace accelerates to encompass the entire DON.

I noted earlier that our Department is making progress in asset management, with unqualified audit opinions on the management of most of our military equipment. We are expanding our scrutiny to other assets classes. We have established a senior-level, Department of the Navy Property Council, which will oversee audit readiness policy for property throughout Department.

Over the past year, I have seen our functional managers embrace audit readiness not only to achieve auditable financial statements, but as a mechanism to correct long standing deficiencies in our business processes. We are aggressively addressing numerous challenges as we encounter them, and our efforts are increasingly effective. In closing, achieving audit readiness and subsequently maintaining it is challenging. Given our accomplishments over the past year, our growing level of knowledge, and the breadth and depth of audit readiness activities across the DON, I am cautiously, but increasingly, optimistic that we will achieve the ambitious audit readiness goals we have set for our Department. I would be happy to answer any of your questions at the appropriate time.