

Statement of

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and

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before the

House Armed Services Committee

Subcommittee on  
Oversight and Investigations

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Mr. Chairman, Congressman Cooper, Members of the Subcommittee, thank you for the opportunity to discuss the challenges we face in achieving audit readiness at the Department of Defense (DoD). We'll focus on areas where we seek improvements in our financial processes; these areas also capture the challenges we face.

We agree that audit readiness matters. In the first place, it is a matter of law, beginning with the CFO Act of 1990 and followed by the Government Management and Reform Act of 1994 that established the specific requirement to prepare and have financial statements audited.

But also, we need to make the most of the taxpayer resources that are provided to us for purposes of national defense. That is especially important in time of fiscal stress and declining budgets. Financial accountability is also essential if we hope to maintain the public's trust in our stewardship of taxpayer dollars.

While DoD's financial statements are not auditable, I want to assure you that we are spending the dollars that you have provided us for the purpose intended. With rare exceptions, we pay our people and our contractors accurately and on time, and we regularly record obligations accurately. If we did not, we would experience serious mission problems, and you would hear about it. Neither is occurring.

Nonetheless, we currently lack the ability to consistently provide auditable documentation and to demonstrate reliable and well-controlled business processes. These capabilities are required to pass a financial audit. We know this. Part of the challenge lies with DoD's unique size and mission. Moreover, until fairly recently, there has been neither sustained attention nor a plan that is widely supported within DoD. Today we have both and are moving forward.

### **FIAR Plan Shows the Way Ahead**

In May, we released our semi-annual Financial Improvement and Audit Readiness (FIAR) Status Report, including details on how we will meet our objectives. This was the first full status report detailing our plans for realizing Secretary Panetta's accelerated goal of achieving audit readiness for the Statement of Budgetary Resources (SBR) for General Funds by 2014, and for all financial statements by September 30, 2017.

The report reflects the fact that Army and Air Force audit readiness target dates for the SBR were moved up -- to 2014, from 2015 and 2017 respectively. The Navy's audit readiness target date remains in compliance with the Secretary's accelerated goal

and allows for implementation of efforts to capitalize on lessons learned from the Marine Corps' SBR audit experience.

For the first time the FIAR report also highlights the activities of Defense Agencies and the role played by service providers in achieving audit readiness. These include the Defense Finance and Accounting Service, which provides accounting services to the Components, and the Defense Logistics Agency, which manages many of the Department's enterprise-wide systems. The services they provide influence the auditability of the amounts reported on Component financial statements, and their audit readiness efforts are becoming more integrated in the Component efforts.

The defense agencies and other organizations are making progress. Four of our Defense organizations are under audit and receiving clean opinions already, and three more will assert audit readiness during the upcoming fiscal year. "Appropriations Received", the initial audit element for the SBR, will undergo an examination or "mock audit" beginning in a few weeks. As I will refer to later in my statement, these examinations under audit conditions provide us with invaluable experience in evaluating both our current business and our progress.

### **Leadership Making a Difference**

In this Department-wide effort, Secretary Panetta's leadership and personal commitment to auditability have been invaluable, beginning with his directive last October to accelerate the drive to audit readiness. What's more, his involvement did not end there. The Secretary has reviewed the Department's accelerated plans with Service leaders. In May, he summarized his guidance in a videotaped message to the Department. And he directed Deputy Secretary Carter, in his role as Chief Management Officer (CMO), to conduct periodic reviews to ensure that our audit readiness goal is achieved in FY 2014.

The Deputy does this in Defense Management Action Group (DMAG) meetings, where the Military Department CMOs are present along with other military and defense leaders. At the meetings, the CMOs commit to, and are held accountable for accomplishing, specific FIAR near-term goals and milestones. The next DMAG on audit is scheduled for later this month.

We are also working to involve our civilian and military managers. In May, we joined Dr. Carter hosting an SES Town Hall meeting on audit readiness. We called on these civilian executives to pass the word that audit readiness is an all-hands effort.

On the military side, the Service Secretaries and Chiefs of Staff of the Armed Services have committed themselves to specific goals for achieving auditable financial statements. Senior leadership is deliberately reaching out to express the importance of taking action and making progress:

- General Raymond Odierno, Chief of Staff of the Army, issued an audit readiness message to all General Officers in April, stating, “I will routinely review the [FIAR] plan’s key milestones and readiness review results to ensure we remain on track. We must make every dollar count and be accountable to ourselves, the Congress, and the American people.”
- General Gary North, Commander of Pacific Air Forces (PACAF), got the word out in a memorandum to his command in March. He wrote, “The Air Force’s ability to undergo and obtain a clean audit opinion of our financial statements is a direct reflection of how well we manage the entire Air Force.”
- Vice Admiral Dave Architzel, former Commander of the Naval Air Systems Command, included a specific reference in his “Commander’s Intent,” referring to the need to “standardize financial processes in accordance with the Navy’s Financial Improvement Program to provide accurate and auditable information that supports program execution decisions.”
- General Robert Cone, Commander of the U.S. Army Training and Doctrine Command (TRADOC), put it this way in a memo to his command: “Achieving audit readiness is not optional and is the direct responsibility of every commander, leader and program manager throughout TRADOC.”

To capitalize on this leadership commitment, and to measure our progress, we have established interim goals for each FIAR objective. The FIAR Governance Board, which we jointly chair, monitors the plans of each Military Department, the Defense Agencies, and the other Defense organizations. Through this group, appropriate political appointees and senior executives serving at OSD and in the Components are held accountable for achieving FIAR goals. These goals have been incorporated in Senior Executive performance plans. Leadership is taking action and is confident that we will meet the Secretary’s accelerated goals.

## **DoD is Maturing its Business Environment**

One of the focus areas for our leadership is efforts to improve and mature our business environment. Over the past year, the Department has taken a number of steps to improve its overarching business environment. These steps include advancements in Business Enterprise Architecture, business process reengineering, strategic planning and performance management, acquisition oversight, and investment management. Our forward progress has been greatly enabled by the tools provided to us by the Armed Services Committees, particularly in regard to the management of our defense business systems, which provide key support to our audit efforts.

Specifically, and most recently, Section 901 of the Fiscal Year 2012 National Defense Authorization Act (NDAA), will significantly advance our efforts to create a rationalized, interoperable DoD business systems environment by reviewing the planning, design, acquisition, development, deployment, operation, maintenance, modernization, and project cost benefits of all defense business systems that have total costs greater than \$1 million across the current future-year defense program, including legacy systems. To do this effectively, the Department has created a single Investment Review Board (IRB) chaired by the DCMO. This single, cross-functional board provides significantly greater visibility of the IT investments planned for the Business Mission Area and will better integrate end-to-end and functional business strategies with investment decisions. This greater understanding of our business systems environment will significantly aid our audit efforts. This forum will help make better investment decisions, ask the right questions when it comes to things like duplicative systems and the number of interfaces, and reinforce the relationship of this business environment to the audit.

Additionally, with the new IRB reviewing all defense business system investments, rather than just development or modernization, it will allow us to more readily retire legacy systems that are no longer needed when we make targeted investments in IT systems. We also want to ensure that we are optimizing the capabilities inherent in the modern IT solutions, taking full advantage of the robust internal controls and data integrity. While we were pleased with the Department's FY 2011 progress in eliminating 120 legacy systems, we anticipate that the changes introduced by Section 901 will help to further accelerate the transition away from our legacy environment.

Additionally, many of the Department's major Enterprise Resource Planning (ERP) acquisition programs have delivered important capability to DoD users, enabling

improved business outcomes. For example, the Army's Logistics Modernization Program (LMP) Increment One has retired more than 40 legacy inventory and asset systems, significantly reduced the time it takes Army maintenance planners to schedule maintenance, from 2-3 weeks to 2-3 hours, and reduced the time it takes the Army Materiel Command to complete its year end close, from 4-5 days to 8-12 hours. As an additional example, the Air Force's Defense Enterprise Accounting and Management System (DEAMS) technology demonstration currently fielded at Scott Air Force Base and Defense Finance and Accounting Service Limestone, Maine has improved financial management operations by reducing late interest payments within the U.S. Transportation Command from approximately \$161 per \$1 million to approximately \$7 per \$1 million. Finally, the Global Combat Support System – Marine Corps (GCSS-MC) Release 1.1 is now fielded to 85 percent of the Marine Corps and has generated business benefits such as: "Time to First Status" has been reduced from over 36 hours to an average of 10 hours; "Order Ship Time" has been reduced 26 percent; "Repair Cycle Time" has been reduced 43 percent; and "Logistics Response Time" has been reduced 40 percent.

DoD's modernized systems environment, including each of the Department's ERPs, provides the opportunity for improvements in financial management and accounting operations by providing users with standardized financial and business processes, a single authoritative data source, and real-time posting to external sources. In the past, we had to rely on manually-generated summary information; we now have increased access to transaction-level data that will help support future audits and provide leaders with information for better business decisions. These programs and their organizational sponsors are committed to realizing this significant potential.

### **Signs of Progress Are Visible**

With senior leadership clearly highlighting the priority and need, and a more capable business environment emerging, the Department of Defense has made significant progress towards auditable financial statements. Our strategy focuses the Department's efforts first on the financial information we use most to manage. As we have discussed with the House Armed Services Committee on several occasions, the priorities are budgetary information and the existence and completeness (E&C) of mission critical asset records. DoD Components are committed to meeting interim and long-term milestones, and we have seen significant accomplishments over the last year.

Perhaps our most noteworthy effort is the audit of the U.S. Marine Corps SBR. While they have yet to achieve an opinion for the statement, the audit effort continues to uncover and resolve process and systems issues that are applicable to all DoD

Components. We believe the USMC will achieve their goal of an audit opinion on FY12 budgetary activity by this December for its current resources.

Most of our SBR audit readiness efforts are focused on improving the documentation and controls within major business process cycles. Recent achievements have included the following:

- **An unqualified opinion on the audit readiness of the budgetary information for the Navy's E2-D aircraft – a major defense acquisition program.** This achievement shows that the underlying data and controls exist to a large degree in the Navy's major acquisition process.
- **Unqualified opinions on the E&C audit readiness of the vast majority of Navy and Air Force Military Equipment.** This proves that we have control over some of the most expensive and important assets in the Department.
- **Unqualified Opinion on Air Force Reconciliation of Funds Balance with Treasury.** In partnership with DFAS, Air Force becomes the second military service that has demonstrated that they can balance their checkbook, serving as a model for others.
- **Audit opinions on the controls of two key processes supported by our major internal service providers – DFAS and DISA.** Business processes in DoD always involve shared service providers who furnish common services to the Military Departments and other Components. These audits paved the way to develop the coordination of the audit effort and also demonstrate that in key areas the Department has controls in place that already support auditable financial statements.

These achievements are important in and of themselves. They demonstrate that we have moved beyond planning to actually assess and improve processes, and we have done so to such a degree that independent auditors agree on our audit readiness. The Department has commitments to build on these successes and to demonstrate substantial audit readiness progress over the coming months. Examples of audit readiness validations presently underway include:

- **10 Army sites that were among the early adopters of their General Funds Enterprise Business System.** The Army approach is to move installation-by-installation to test the audit readiness of nine business processes at the same time, providing feedback to the Army of the extent of progress on most material business processes.

- **Navy Civilian Pay and Transportation of People.** Validating these significant spending streams will prove that Navy now understands audit requirements and can focus on applying their knowledge and experience to other business areas.
- **Defense Agencies funds receipt and distribution processes.** Coming on the heels of clean audit readiness opinions for the Military Departments' funds receipt and distribution processes, this validation will prove for the first time that a business process across the entire Department is audit-ready.

We also see progress in resolving the cultural impediments to audit readiness in the Department, including the erroneous perception that audit readiness is the sole responsibility of the Comptroller community. Secretary Panetta's insistence that audit readiness is an "all hands" effort has engaged leadership at all levels and has helped to create awareness in non-financial communities.

We are seizing this golden opportunity. Efforts are underway to check that the information needed by an auditor is readily accessible at the command level, and we have stepped up our effort to get the word out through more targeted communications, including a monthly Defense Audit Readiness Newsletter. We are reaching out to commanders and managers throughout the Department to help them understand how audit readiness will help to ensure more-informed decisions on resource expenditures and requests.

Another important DoD-wide development is the progress we have made in instituting a course-based certification program for Defense financial management professionals. This program will provide a vehicle for audit training as well as other financial training. We announced our plans last year, having in mind a certification system similar to the one in the Defense acquisition community. Since our announcement, we have developed a framework for the program and carried out the many steps necessary to bring it to reality. We are introducing pilot versions of the program for several Components this year, with large-scale implementation planned to begin in 2013.

### **Challenges to Audit Readiness ... and Our Responses**

Progress is visible on a variety of fronts that provides us with confidence that the challenges that still confront us can be overcome. These challenges, and our responses include:

**Driving culture of audit into the organization.** The sheer size of DoD exacerbates the challenge of translating changes into day-to-day routine. Using the existing “chain of command” is critical. For example, we have provided our commanders with an Audit Readiness Checklist which provides Defense managers with a tool like the operational readiness checklists employed by military commanders. It provides leaders with a definitive list of questions to help ensure that organizations have the records needed for sound resource decisions and success in coming audits. The checklist provides commanders with the basic actions an organization should take to determine whether they are audit-ready and to identify areas for improvement. Our culture values mission readiness. We need a similar view of business readiness—one that highlights efficiency and resource stewardship in every field organization.

**Building the skills and experience of our people.** We know how we do business now, but we have little experience in presenting it for financial audit. For this reason, we also have made significant progress in training both financial and non-financial managers on the requirements of audit readiness. We are reinforcing these lessons through a partnership with private sector auditors who are experienced in financial audits. As mentioned earlier, we are using examination engagements that are an integral part of our audit readiness methodology to familiarize DoD personnel with the requirements for audits. The audit firms performing these engagements employ the same procedures used in an actual audit, but on a smaller scope and scale. These exercises provide our employees with experience that is otherwise difficult to gain.

In addition, the DoD Financial Improvement and Audit Readiness (FIAR) Directorate has developed a series of professional development training courses designed to enhance Department-wide knowledge and understanding of goals and priorities, as well as instructions to become audit-ready and to reinforce the Department’s internal control over financial reporting requirements. Since we began this program in FY 2011, nearly 1,900 DoD personnel have received this training. Additional professional development courses have been added since, including “FIAR 100” which focuses on training DoD senior leaders to understand the impact of operations on financial management and audit readiness, as well as to identify initiatives they can undertake to assist the Department with its auditability objectives.

**Providing adequate resources.** Over the next few years the Department plans to spend \$300 million to \$400 million per year on improving business operations and achieving auditable financial statements. In a time of tight budgets, this commitment is a measure of our seriousness.

**Implementing modern, compliant IT systems.** Today, DoD is implementing multiple business systems across the Military Departments and Defense Agencies to serve as the business backbone of their operations. Each of these implementations is at a different stage of its lifecycle and most have experienced challenges as they have moved from design to implementation. These challenges have led to cost and schedule overruns of varying degrees and include issues such as insufficient business process reengineering being conducted early and upfront in their lifecycles, data quality/cleansing, and changing scope and requirements. While some of these programs continue to experience challenges, the Department has taken, and continues to take, steps to put itself on a path to success. Specifically, over the past two years the Department has implemented a number of important improvements, incorporating lessons learned, to its overall defense business systems acquisition process, its individual ERP system programs, and its overarching business processes. As previously discussed, these improvements are generating results and capability is being delivered to DoD users. Additionally, we believe that improvements will accelerate as the result of the recent changes to the IRB process, allowing us to more readily retire legacy systems. While the Department recognizes additional opportunities for improvement, these ERP programs remain a vital part of the Department's long-term efforts to improve its business systems environment and overall operations. This will allow us to develop a sustainable business environment that can be cost-effectively audited. That said, it is also important to recognize that the Department is planning to achieve the 2014 audit goal with a combination of both target and legacy systems.

**Implementing comprehensive and meaningful controls.** While critically important, improved financial systems will not by themselves eliminate our weaknesses or guarantee auditable statements. Achieving auditability also requires consistent process controls that cross organizations and functional areas. Business and financial information that is passed from system to system must be subject to adequate controls. This environment ensures that only authorized personnel are using the system and that these systems protect the data quality and maintain an acceptable audit trail within the end-to-end business process. This process must be controlled at the transaction level, all the way from the source to the general ledger postings and to accurate trial balances and reliable period closeouts. Only by completing these steps can we prepare financial statements that an auditor can review and verify without the need for audit sample sizes that are unaffordable. Many elements of our current business environment must be changed to allow us to meet these kinds of routine financial audit standards. This includes more work in improving our financial reporting controls. Sound internal controls over financial reporting are the foundation of audit success, but we have sometimes found that ours are inadequately documented and inconsistently executed.

The primary improvement we have already made in this area is to enlist more help from the Service audit agencies. They have the personnel qualified to assess internal controls and to make sound recommendations for corrective actions. Each Service has developed a strategy and is applying significant personnel resources that will focus solely on evaluating controls at the operational level. Solutions are recommended for issues identified, with follow-up to ensure rapid implementation of those solutions.

**Sustained Momentum During Leadership Transition.** The final challenge, one that was highlighted by your Panel on Financial Improvement, is that of maintaining momentum during periods of leadership transition. These transitions tend to occur regardless of the outcome of Presidential elections. Civilian SES leaders will help during transitions and are being held accountable through inclusion of FIAR goals in performance plans and organization strategic plans. We also have a strong governance structure that provides direction to Components and reviews status to ensure goals are being met. Congressional attention is another effective means to keep FIAR a priority despite leadership changes.

## **Conclusion**

In sum, we are providing personnel, training, tools, and support to achieve auditable financial statements. There are significant challenges, but they are not insurmountable. We are making meaningful progress. We see substantive challenges in effecting some major changes within a very compressed timeframe.

That said, there is a lot to do, and very little time available. We plan to use this as an opportunity to encourage both concurrency in our efforts along with efficiency and focus. We must leverage what we are already doing and doing well, making those near-term adjustments in processes and controls that are both cost-effective and sustainable.

While we are mindful of the work that remains, we are reasonably confident that we will achieve our audit goals. As we look ahead, we appreciate the support we have received here in Congress. Your Financial Improvement Panel was an unprecedented investment that represented your genuine interest in understanding our challenges and providing meaningful recommendations. We anticipate continued Congressional oversight and will use it to help ensure that audit readiness remains a high priority.

There is one additional way that Congress can help. In recent years we have encountered unprecedented budgetary uncertainty, including no fewer than four threats of government shutdown, which generated time-consuming and unproductive planning efforts. Now the shadow of possible sequestration is falling across our path.

Dealing with these uncertainties drains valuable time and leadership attention from important initiatives, including our commitment to audit readiness. Congress could help a great deal by returning to a more orderly budget process.

We close by reiterating our commitment to the financial management goals of the Department of Defense, including – and especially – auditability. We owe it to you. We owe it to the troops. And we owe it to the American taxpayers.