

**NOT FOR PUBLICATION UNTIL
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HOUSE ARMED SERVICES COMMITTEE**

**Statement of
Ms. Martha Smith
Director, Defense Finance and Accounting Service – Cleveland
before the
House Armed Services Committee
Panel on
Defense Financial Management and Auditability Reform
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Chairman Conaway and distinguished Members of the panel, my name is Martha Smith. I am the Director of the Defense Finance and Accounting Service (DFAS) Cleveland Center. Thank you for the opportunity to testify to you this morning.

I am here today to discuss the services DFAS provides for our military, the complexity involved in providing these centralized financial services and the ways we have garnered efficiencies for the Department of Defense (DoD). I will also discuss our efforts to get DFAS, as a service provider to the DoD, to an audit ready state by fiscal year 2017. Along those lines, I will also talk about our challenges, our progress and some of the lessons we have learned in supporting the Marine Corps during their recent audit.

In terms of our mission, DFAS provides payroll, commercial and travel payments, and financial reporting services for the military and its civilians. We also provide the summary-level financial reports that Congress uses to monitor the financial health of the Military Services. Through the years, DFAS has made major progress toward streamlining the preparation of these financial reports, but we still face challenges.

To prepare these reports, the Department has to work with hundreds of disparate systems that are not always efficiently interfaced with one another. And to complicate the process, we have a very short period of time to prepare the financial statements each month and ensure the summary total dollar values are correct for DoD appropriations. I would like to explain the complexity by detailing some sample processes from the beginning, through the compilation of the financial statements.

All financial reporting begins with a single transaction. That transaction may be produced in one of many ways. Some examples include: a Service member or DoD civilian employee recording their time and attendance on a sheet of paper (and entering it into one of

many time and attendance systems); a storekeeper buying supplies for a ship; a secretary buying supplies for the office; a traveler creating travel orders; a group of lawyers and contracting officials drafting up a multi-million dollar contract for a major weapons system; or a base Commanding Officer renting a facility, paying for utilities and buying uniforms.

In fiscal year 2010, we processed 169 million pay transactions with associated lines of accounting for the more than 6 million people we pay and the 156,000 contractors who support the Department each year. These lines of accounting are consolidated into the 1,129 active DoD appropriations, and each one of those transactions must be reflected in over 255 million general ledger accounts on the official accounting reports prepared by DFAS.

To illustrate some of the complexity of our processes, the current Black Hawk Helicopter program consists of three contracts, one for the production of new units and two for upgrades to existing helicopters. The program's funding is spread among the Army, Navy, Air Force and Foreign Military Sales (FMS). The program's total obligations currently exceed 10 billion dollars. Since the original contract award in 2000, we have made approximately 22,000 payments for nearly 7.8 billion dollars, and there have been almost 1,700 contract modifications.

Since fiscal year 2009 alone, DFAS has received approximately 211 invoices each month for disbursements that average about 188 million dollars. There are also 151 active delivery orders pending. We expect Black Hawk purchases to continue, and the current production contract to run through December 2012. As with most major weapons systems, we anticipate more modifications, and other contracts will most likely be awarded.

Like the Black Hawk disbursements, nearly all DoD transactions make their way to the 111 systems used by DFAS, many owned by the Services, but used by DFAS employees at our 10 sites. DFAS employees create or monitor the transactions in automated systems, validate

authenticity and accuracy, consolidate the transactions into reports, and validate the accuracy of those reports. Once originating transactions, such as time and attendance records or procurement transactions reach the DFAS doors, DFAS employees compute civilian pay for approximately 1.2 million federal government employees, military pay for about 2.3 million Service Members, and retired and annuitant pay for about 2.5 million retirees. We also pay 156,000 vendors and are responsible for reporting all of these transactions to Treasury. We have numerous transactions processed for us outside of DoD, such as State Department, General Services Administration, and others. DFAS is responsible for compiling those transactions into the DoD financial statements, as well.

In addition, we reconcile approximately 100 billion dollars worth of transactions, approximately 85 billion dollars in disbursements and 15 billion dollars in collections each month. We project DFAS will disburse approximately 668 billion dollars in fiscal year 2011. We consolidate all of this accounting information into monthly budget execution financial reports that are due to the Office of the Secretary of Defense on the 10th of each month.

The Services originally designed and operated the legacy systems we use to provide local-level management reports and summary-level information via trial balances to higher-level systems to departmental-reporting systems that prepared the financial statements. Over the years, some of the local processes were capitalized by DFAS, and the financial statement preparation shifted from the Military Services to DFAS. Added to that mix are new Enterprise Resource Planning (ERP) systems used by local-level commands to produce financial information related to their individual programs. The ERP systems provide a level of discipline and standardization to the local procurement process that is extremely beneficial to DOD's audit efforts. However, a massive amount of data is still fed into those ERP systems from the legacy

environment. This data equates to entitlements or dollars owed to individuals and contractors, dollars that are disbursed from other legacy systems, such as military pay, civilian pay and large multi-Service procurement efforts (such as the Mechanization of Contract Administration Services or MOCAS system).

DFAS either processes or has disbursing and Treasury reporting responsibility for most of the DoD entitlement transactions. Although we take this entitlement and disbursing responsibility very seriously, through our own audit efforts and those underway for the Marine Corps, we have learned that visibility and traceability of these entitlement transactions are an integral part of any audit. We are working to make sure our processes and these transactions are audit-ready by partnering with our customers to be able to trace transactions from the beginning of the process to our financial statements. Overall, we are working to make our processes and those of our customers audit ready by improving our transaction-level visibility and strengthening our internal controls.

DFAS efforts to standardize and strengthen internal controls began when we were created 20 years ago, with over 300 DFAS sites, 28,000 people and 300 systems that had previously been owned by the Military Services.

In 1991, we began strengthening our internal controls at those 300 field sites and then quickly decreased the number of sites to a manageable number and began to standardize day-to-day activities and improve or eliminate systems. We further reduced our footprint with the Base Realignment and Closure Act of 2005. We have consolidated many of those “field-level” accounting and finance functions with our financial reporting entities, so we can have a better opportunity to fix problems at the source.

At DFAS, our most valuable asset is our people, and we could not attempt to help our customers with their audit efforts without them. Over the last two decades, we've made investments to strengthen our workforce. We have implemented programs to attract and retain a professional workforce. We have seen a 15 percent increase in employees with college degrees since 2001; in fact, 85 percent of our accountants have degrees. We have seen an 88 percent increase in the number of Certified Public Accountants and Certified Management Accountants and a 322 percent increase in Project Management Professional certifications since 2007. DFAS is committed to providing our employees with the skills and abilities needed to not only perform the mission, but also to help our customers attain auditability. We have quite a bit of expertise in this area. DFAS has maintained an unqualified audit opinion for the past 11 years.

To support our customers in their audit efforts, we have mapped processes, implemented control points, tested internal controls and mitigated risks for many of the key processes impacting the financial statements. These efforts are still in process and in coordination with our customer's assertion schedules. We see the end product, resulting from the original transaction; we understand the implications to the accounting statements; and we are the source of information to improve the financial enterprise.

We use the overarching principles from the DoD Financial Improvement and Audit Readiness (FIAR) plan to ensure audit readiness is focused on:

- day-to-day activities, not a point-in-time event. We are working to institutionalize in our operations the processes, controls and behaviors to ensure that our day-to-day activities—processing payments, posting accounting transactions, etc.—will withstand auditor scrutiny.
- a proactive approach for correcting deficiencies before auditors perform audits. Our self-identified deficiency reporting process provides all employees the means to identify a deficiency and for management to create or execute action plans to correct those deficiencies. By doing so, we strive to reach the point where we identify and correct deficiencies internally before we undergo an audit. This also supports our efforts to institutionalize audit readiness in day-to-day activities.

- sustainable process improvements. We are focused on identifying root causes of problems and deficiencies and improving the processes, controls, etc. to prevent recurrence.

In addition to FIAR principles, DFAS has two primary goals to help the Department achieve audit readiness: first, to be prepared when customers assert on specific parts of their financial statements and second, to be prepared for examinations of the services we provide for our customers in conjunction with their assertion schedules.

First, we have established audit-readiness teams at each of our sites to support our customers as they prepare for assertions, audits and post audit. This customer-centric approach provides real-time support during pre-assertion preparation, support during an audit and will provide post-audit support. The team also assesses lessons learned and implements improvements.

Also, as part of our audit readiness efforts, we are establishing a Senior-level Steering Committee (SSC) to proactively implement process and control improvements in response to all lessons learned so we can reduce or eliminate the recurrence of the same findings in future audits. The SSC provides oversight and governance of project teams established to implement lessons learned enterprise-wide. Three project teams were established in fiscal year 2011 to address lessons learned by focusing on accounting adjustments, reconciliations and document retention. The objective is to limit our risk of encountering the same audit findings in future audits by:

- Establishing a structured “Audit Lessons Learned” framework to share lessons.
- Developing corrective action plans to ensure that root causes are addressed across DFAS.
- Monitoring corrective action plans to ensure timely implementation.

We are paying close attention to data integrity and system interface controls; updating process maps and narratives; identifying key controls and risks; and focusing on a strong

communication plan with the Services. Overall, for all of our customers, we are focusing on each interface involved in the transactions' journey through the myriad of systems involved in the entire process. We have implemented tools to provide auditors visibility of complete documentation in support of each transaction processed by DFAS. Our goal is to provide that documentation within 48 hours, and we are improving electronic document retrieval mechanisms to support this effort.

We continue to identify the reasons for discrepancies at the summary level, by tracking the transactions back to the source and either correcting the systems and their interfaces or helping to train our customers on the appropriate process. We have made progress in this area, but we have much to do and are coordinating our efforts in conjunction with the Services' assertion criteria and timelines. As an example, we have created an integrated plan with the Navy, listing our necessary steps to achieve auditability, such as appropriate reconciliations, systems enhancements, transaction testing and improvement initiatives.

In support of our second DFAS goal, DFAS is preparing to undergo examinations of our centralized processes, such as civilian pay, used by all Military Services. This single audit of services will provide customers and auditors a level of assurance that our processes, systems and controls are operating as intended across the Department and other federal agencies. The single audit approach is also cost effective because it eliminates the need for multiple audits of the same process. Recently, DFAS completed an assertion on a portion of our Civilian Pay processes and the Defense Civilian Payroll System and is contracting for an audit of the assertion in fiscal year 2012.

DFAS is walking in concert with our customers, expediting improvement initiatives, addressing systems challenges and moving toward audit readiness and the goals established by

DoD and Congress. We are making progress, managing responsibly and successfully moving toward financial auditability. Our financial management workforce is well-trained to ensure compliance with financial laws, regulations and processes. The support of our senior-most leaders, involvement of every employee in the process and the continued collaboration with our customers are all keys to our success.

Chairman Conaway and distinguished Members: Thank you for your time today. I look forward to your questions.