

Statement of

Mark Easton
Deputy Chief Financial Officer
Department of Defense

before the

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Auditability Reform Panel

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Chairman Conaway, Ranking Member Andrews, Members of the Panel, thank you for your invitation to speak before you today on three specific subjects relating to Financial Management within the Department of Defense (DoD): Improper Payments, Problem Disbursements, and Anti-Deficiency Act (ADA) violations.

I am Mark Easton, the Deputy Chief Financial Officer for DoD. In this capacity, I am responsible to the Chief Financial Officer for the financial policy, systems compliance, and associated internal controls that govern the financial and accounting aspects of business operations across the Defense enterprise. I have had the privilege of serving our nation within DoD—both in uniform and as a civil servant—at various levels and in various capacities over the past 38 years. I am proud to be a part of a financial management workforce that is operating today around the world, providing mission support to our warfighters. I am also mindful of our public stewardship responsibility, and in that regard will be speaking on the efforts that are underway to strengthen DoD financial management, in order to improve the quality and timeliness of financial information for leadership decision-making, and ultimately demonstrate accountability with a clean financial opinion.

I also recognize that DoD financial management has remained on the GAO high-risk list since 1995. My experience in working within the Department over an extended period of time tells me that a reasonable level of controls exists within the various elements of our business especially with regard to local control of assets and expenditure of funds. My current position, however, provides me with a broader perspective that must recognize enterprise-wide weaknesses in DoD business processes that negatively impact our financial management capabilities. These weaknesses go well beyond the financial management community, extending into all functional business areas throughout the enterprise. As such, they demand an enterprise-wide business response. The lack of auditable financial statements for DoD as a whole reflects those weaknesses.

DoD Financial Management Goals

As part of the DoD Comptroller's Strategic Management Plan for Fiscal Years 2011 through 2017, the Department has three comprehensive strategic goals for financial management that covers our business from planning to execution including the quality of our workforce:

1. Acquire the resources necessary to meet national security objectives;
2. Ensure the legal, effective, and efficient use of those resources; and
3. Maintain a capable financial management workforce.

Each goal is equally important and mutually supporting. The outcome of any one goal impacts the success of the other two. I spend much of my time and energy on the second goal— working to develop an improved business infrastructure in order to strengthen financial management capability within the Department. Much like the nation’s interstate highway system that supports the efficient movement of commerce, this business infrastructure carries the Department’s transactional business across functional areas and through a myriad of systems and organizations. When working well, these transactions provide the audit trails that also support financial auditability. You’ve asked some specific questions about improper payments, problem disbursements, and ADA violations. Many of the root causes behind these areas reflect problems within our business infrastructure. To better understand some of the challenges associated with our business, I’d like to provide some basic context.

DoD Business is High-Volume, Complex, and Diverse

To say that we have a challenging business environment is an understatement. It is not merely our size; it is a combination of size, complexity, and the geographical dispersion of our numerous Components. The complexity is apparent in the large number of transactions and dollar values that flow through DoD processes each day. But the essence of our business today involves people, processes and systems and how effectively they can work together.

The people part of this equation represents both a strength and an opportunity for improvement. We have a dedicated, experienced workforce that is supporting key mission needs around the world; in fact, in the very decentralized non-standard way we often do business, we rely heavily on its dedication and technical experience. However, this business environment must change, and our workforce must help lead this change. The business environment must necessarily become more standard, better controlled and more automated. Our training must also be dynamic enough to continue to meet both this evolving business need and, more importantly, our increasingly demanding mission requirements. We have increased our training efforts to ensure that we equip our existing staff and future personnel with the right tools. Our goal is to train and sustain our strong financial management workforce through a centrally managed, course-based certification program.

Another key business element involves processes and internal controls. Our business processes must become better documented and better controlled. This goes hand-in-hand with system implementation, where a properly implemented, compliant system will enforce standards and facilitate many of these controls. But it also goes well beyond the systems. Processes must be documented along with operating procedures that are routinely followed. The level of standardization and the degree to which key controls are clearly identified and

routinely tested directly contributes to the reliability, and auditability of those processes. This is an area that we continue to improve upon. This is critically important to resolving impediments to sound, reliable processes that produce accurate and timely financial information for both reporting and decision-making.

The final element is implementation of improved business systems including Enterprise Resource Planning (ERP) systems within the Department of Defense Components. System automation and integration is important for efficient management of the volume and complexity of transactions across the Department. We obligate an average of \$2 billion to \$3 billion each business day and manage hundreds of thousands of payment transactions in thousands of locations globally, including combat zones. Many of our business systems that process these transactions are old and we are transitioning. Large, integrated systems replacing them represent commercial off-the-shelf software that embodies best practices but also requires significant business process reengineering to effectively implement and use this capability. The magnitude and complexity of DoD business processes makes this transition from legacy to modern ERP system problematic and in some cases is exacerbating problems associated with our day-to-day process flow. Over time however, these systems are the key to sustaining our financial improvement and audit readiness efforts. This improved business systems environment will also help the Department to improve the efficiency of its payment integrity efforts.

Improper Payments

DoD has been estimating and reporting improper payments using statistical sampling since Fiscal Year 2004 for five of our six programs: Military Pay, Civilian Pay, Military Retiree and Annuitant Benefits, Military Health Benefits, and Travel Pay. For the sixth program, Commercial Pay, we performed statistical sampling until Fiscal Year 2006. Beginning that fiscal year, we began reporting commercial improper payments under the Recovery Auditing section of our annual Agency Financial Report in accordance with Office of Management and Budget (OMB) Circular A-136. The guidance at the time emphasized recovery of erroneous payments. Our assessment was that statistical sampling limited our recovery efforts to items identified in the sample. By reporting our actual Commercial Pay improper payments, we believe the result was more accurate than a statistical sampling. In addition, we were able to recover a greater portion of overpayments, both monetarily and by occurrence.

To meet current requirements of the *Improper Payments Elimination and Recovery Act of 2010*, we are now in the process of implementing a full statistical sampling and review effort for Commercial Pay. We plan to continue our current comprehensive prepayment review

efforts in Commercial Pay, supplementing them with statistical samplings and reviews beginning in Fiscal Year 2012 that will provide annual estimates that meet or exceed OMB statistical parameters.

As you know, the government-wide error rate for Fiscal Year 2010 was 5.49 percent, while the Department's overall error rate was substantially less than half that amount. Our focus is on reduction and prevention of improper payments. We strive to reduce error rates by identifying root causes for all categories of improper payments. We then target the root causes with specific corrective actions that have effectively reduced error rates over time in most areas.

One of our objectives is to improve transparency in support of the Open Government Initiative. Currently, the DoD Improper Payment reporting is submitted annually to OMB for inclusion in OMB government-wide materials, and for posting to websites like Performance.gov. In addition, the DoD Annual Financial Report is published on the Comptroller's public website each year, and includes information on DoD's improper payment performance as well. We plan to post the latest High Dollar Overpayment report to the Comptroller's public web site by September 30th which will be for Quarter 3, FY 2011, and continue to post quarterly thereafter.

All overpayments are established as receivables to recoup the debt as soon as possible. Fortunately, DoD is able to offset overpayments from a pending invoice for the same vendor through its ability to look across payment systems. Each overpayment is also researched to determine why it occurred. Based on this research, corrective action is taken to minimize the likelihood of recurrence. For example, personnel may require additional training, procedures need to be more clearly documented, or a broader system solution may be appropriate.

We have continued to refine and improve our payment integrity efforts over the years. I'm not satisfied with any amount of improper payments, but I know that perfection is not realistic in any large enterprise, especially one as large and complex as DoD. We have a variety of payment types and we believe that we have a fundamentally sound approach to attacking each category. We also know that we need to continue to be vigilant and ready to seize opportunities for improvement when presented.

Problem Disbursements

I would like to begin the discussion of problem disbursements by clarifying DoD terminology and definitions for categories of disbursement transactions that differ from the Government Accountability Office (GAO). Going back to our analogy of transactions flowing

through our various systems, think of this like a check that a citizen might write and that is being cleared through our Federal Reserve processes and finally posted to his or her personal account. For DoD disbursements, this is much the same, except you have literally thousands of people writing checks and thousands of individual accounts because each appropriation, each year, and each individual activity has a separate account. Just one missed digit can delay the accurate posting. Simply put, that is what a problem disbursement really is and within DoD, we have specific definitions for different kinds of problem disbursements.

DoD problem disbursements are technically referred to as unmatched disbursements (UMDs) and negative unliquidated obligations (NULOs).

- An UMD is a disbursement that has not been matched to the corresponding obligation.
- A NULO is a disbursement that was matched to the corresponding obligation but the disbursement amount is greater than the obligation amount.
- Overaged problem disbursements are transactions that fail to post properly and remain uncorrected for 120 days.

These transactions are the result of an error or deficiency that has occurred at some point in the procure-to-pay process. Typically, the error is not significant enough to have precluded the disbursement, but it has prevented proper accounting. We measure the success of correcting problem disbursements in two sub-categories: Less than 120 days and overaged. We have made significant progress in reducing the number of problem disbursements since we began to metric them in 1999, reducing overaged UMDs through July 2011 by 83 percent or \$1.68 billion, and reducing overaged NULOs through July 2011 by 97 percent or \$1.53 billion. Our goal is to reduce these kinds of anomalies to a level that is not material to our business. We're not there yet, but we are moving in the right direction. However, the implementation of modern financial systems, including ERPs, has recently increased the level of problem disbursements, due to issues with data quality and systems interfaces. In their mature and stable end-state, these systems will provide an automated, integrated environment that will significantly reduce the number of problem disbursements.

We also have a category of transactions called "in-transits." These are disbursements that have been processed by the Treasury but are not yet posted in the accounting records. This condition is part of normal processing that can take up to 60 days. The processing timeframe is dependent upon several factors including the location of the accounting and

disbursing activities, the origin of the transaction (internal or external to DoD), and the availability of an automated interface. The transaction is en route and the transit time does not indicate that an error has occurred in the payment process. However, if the transaction is not processed within established timeframes, it may result in a problem disbursement. Therefore, we closely monitor in-transit processing timeframes. While the most recent data shows that in-transits have decreased during the month of July 2011, we have not reduced the overall balance since inception. In discussions with the Services, the processing delays are directly related to ongoing system implementations.

As my GAO colleagues have reported, prior to December 1996, we aggregated the amounts of in-transit transactions with UMDs and NULOs for monthly problem disbursement reporting. Since that time we have maintained separate categories for in-transits and excluded them from our external problem disbursement reporting. However, we continue to track and measure performance for internal reporting in all of these categories and ensure that both internal and external reporting is available to provide full disclosure for Congress and auditors.

Transactions including collections, disbursements, and related adjustments are reported to the Department of Treasury and increase or decrease our Fund Balance with Treasury account. Changes to this account are required to be reported monthly on Statements of Transactions and Statements of Accountability. Problem disbursements cause us to be out of balance with Treasury's records and we must reconcile the differences. Reconciliation requires us to identify transactions that are not recorded or were improperly recorded either at Treasury or within our general ledger. In the reconciliation process, all differences must be identified and explained, accountability assigned, and the proper adjustments made to correct the records. For these reasons, reducing problem disbursements is a critical element for reconciling our Funds Balance with Treasury and ultimately achieving auditability.

Antideficiency Act Violations

The Antideficiency Act is actually a collection of statutes codified in several sections of Title 31 of the United States Code. Violations can occur for many reasons that are routinely related to as "PTA," or purpose, time and amount. Compliance requires timely investigation and reporting of ADA violations. We first strive to prevent the occurrence of ADA violations, and we track the ongoing investigations to ensure that they are completed in a timely fashion.

While each ADA case is unique and requires a thorough investigation, there are recurring themes that transcend most. These include: 1) Lack of understanding of fiscal law; 2) business complexity; and 3) operational or mission urgency that may have driven a quick, but

erroneous decision. Each case requires analysis to determine the circumstances, identify root causes, determine required accounting adjustments, and assign responsibility to include disciplinary action if appropriate. In the vast majority of cases, there is no willful intent, but it is critical that corrective actions be taken in a timely manner and that appropriate lessons are learned and applied.

From Fiscal Years 2008 through 2011, a total of 123 potential ADA cases were identified through Service or DoD Inspector General audits, or through self-reporting. Of this total, 48 cases were investigated and found to be ADA violations and reported to Congress; 37 cases were investigated and found to be non-violations; and 38 are currently under investigation as potential violations. To further improve progress of evaluating potential ADA violation cases on time, we streamlined the evaluation process and expanded the availability of ADA investigator training courses. In Fiscal Year 2009 we started with a baseline of 25 overaged investigations and set a goal to reduce that number -- to 10 cases this year and 5 in FY 2012. We anticipate meeting our goal this fiscal year. Several of the 10 overage cases that will continue into FY 12 are currently under consideration by the Office of the Secretary of Defense Office of General Counsel as to their dispensation and will be closed or reported to Congress within the next several months.

In the terms of ADA violations, I believe that this outcome indicator, relative to our size and complexity, represents one of our strengths. I call it a strength because we have been able to minimize these violations despite the many shortcomings that exist in our current business environment. The number of cases that we report annually has been stable. We continue to emphasize timely action in investigating and reporting these cases and while progress has been made, there continue to be opportunities for improvement. Our overage cases have dropped from 25 in Fiscal Year 2009 to 10 in Fiscal Year 2011, a reduction of 60 percent. From Fiscal Year 2005 to Fiscal Year 2010, 85 cases have been reported to Congress with a total value of \$960 million dollars. Relative to our budgetary authority, this represents 0.0263 percent, or 26 cents out of every \$1000 of spending. While some taxpayers may not fully appreciate the nuances of fiscal law, our investigations reveal that this does not necessarily mean fraud, but in most cases it is simply a matter of the wrong "color" (appropriation) of money being used, or an issue associated with the timing of the need. Having said that, I fully recognize that there is an issue of public confidence and that we must work to minimize the occurrences of these violations. The only correct goal is zero. Please be assured, my colleagues and I are fully committed to fulfilling our stewardship responsibility to the taxpayer.

How Reducing Improper Payments, Problem Disbursements and ADA Violations Relates to Other Priorities

Finally, I want to say a word about the additional benefits that will result from a stronger and better controlled business environment within DoD that will help us reduce improper payments, problem disbursements and ADA violations. From my perspective, there is clear value and critical importance in the public confidence that better business processes – leading to auditability -- would demonstrate. But even beyond the very high priority of auditability, the benefits to the Department, its mission, and the taxpayers are significant. This effort is consistent with the Administration’s overall campaign to reduce waste across the Federal government. In a time of concern about the level of Federal spending, we need to do our part at Defense. We know the American people have always supported Defense spending. But that does not relieve us of the obligation to manage scarce resources carefully and effectively. We are committed to doing so.

This dedication to efficient and effective financial management will also continue our important contributions to the operational efficiencies that are being implemented across the Department. Better financial information will allow us to monitor accomplishment of these efficiencies and ensure that we are getting the most out of the scarce taxpayer dollars available. We are determined to see our financial stewardship responsibilities through and to achieve our objectives in support of our men and women in uniform--and on behalf of the taxpayers.

In this regard, we believe that our programs to measure and reduce improper payments and minimize problem disbursements and ADA violations are generally strong. The current reporting efforts reflect a business environment that is in transition. The transition to better controlled processes and improved integrated, automated, and compliant systems will produce even better results, and those results will be received with an increased level of confidence. Most importantly, this transition will produce higher quality and more timely financial information that will allow us to get more out of each Defense dollar.

Conclusion

In summary, we recognize the challenges we face with improving financial management in the Department of Defense and especially the obstacles associated with implementation of modern financial systems and ERPs within the Components. We believe that an automated, integrated environment will improve the timeliness of information that is needed to flow between disparate business activities by increasing interoperability and improving our business

processes. We are committed to using scarce resources effectively and efficiently. These types of improvements will help us achieve our goals and, most importantly, audit readiness.

Transforming the Department's business systems and processes is an ongoing effort. We have maintained a close working relationship with key stakeholders and oversight bodies, including GAO and the Office of the Inspector General. Our partnership with the Office of the Chief Management Officer and Deputy Chief Management Officer is essential to ensure that policy is aligned with the evolution of technology. We strive to get the best value of every dollar invested in system modernization, and we expect a significant return on these investments in the future. It will improve the efficiency and reliability of our transactional processes and those processes will be financially auditable.

We are committed to improving Defense financial management as part of our overall commitment to meet our national security objectives. We appreciate the support of the Congress and recognize that we cannot achieve our goals without your continued support.

Mr. Chairman, this concludes my statement. I look forward to your questions.