

U.S. ARMY CORPS OF ENGINEERS

TESTIMONY OF

WESLEY C. MILLER
DIRECTOR OF RESOURCE MANAGEMENT

BEFORE

COMMITTEE ON ARMED SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

ON

DEPARTMENT OF DEFENSE COMPONENT AUDIT EFFORTS

SEPTEMBER 8, 2011

Mr. Chairman and Members of the Committee, thank you for the opportunity to be here today to discuss the challenges faced and lessons learned from the U.S. Army Corps of Engineers (Corps) Civil Works Financial Statement Audits. I am Wesley C. Miller, Director of Resource Management for the Corps.

Background:

The Corps has two major programs, Civil Works and Military Programs. The three main Civil Works missions are commercial navigation, flood and storm damage reduction, and aquatic ecosystem restoration. Other Civil Works missions include hydropower, regulatory, recreation, emergency management, environmental stewardship, water supply storage and the Formerly Utilized Sites Remedial Action Program. Military Programs primary focus is on Military Construction, which includes support to Overseas Contingency Operations, Base Realignment and Closure, and Army Transformation. The Civil Works and Military Programs Fiscal Year (FY) 2011 programs are approximately \$7.4 billion and \$26.8 billion, respectively. The Corps also performs approximately \$12.6 billion annually in reimbursable work for other Federal agencies. Roughly 35,000 personnel, primarily civilians, manage these funds for thousands of projects in a decentralized structure that includes a Washington D.C. headquarters, nine regional offices, and 45 district offices. For financial statement audit purposes, the Corps Civil Works financial statements are reported and audited separately from those of Military Programs, which are reported and audited as part of the Army General Fund.

The Corps Civil Works program achieved a major milestone in FY 2008 with the first unqualified audit opinion ever received by a major Department of Defense activity. This opinion on the Corps Civil Works financial statements validated that the statements were fairly presented and the internal controls surrounding the Corps financial processes were operating effectively. In FY 2010, the Corps Civil Works program received its third consecutive unqualified audit opinion, with a fourth anticipated in FY 2011.

Civil Works Audit Readiness Challenges:

The Corps has had many challenges along its journey but overcoming three major challenges were vital to success.

1. Supporting documentation for valuation of Property, Plant and Equipment (PP&E)

The first and largest hurdle was valuation of the Property, Plant and Equipment line on the Balance Sheet, which encompasses approximately 50 percent of total asset value at \$28.6B, and specifically the lack of historical supporting documentation. To overcome this hurdle the Corps partnered with the Department of Defense, Inspector General (DODIG) to determine the best method of valuation within the guidelines provided by the Federal Accounting Standards and Advisory Board (FASAB). In June 2004, after

partnering with the DODIG for over two years, the Corps and DODIG signed a memorandum of agreement that established the framework of supporting documentation requirements for the individual Civil Works assets within the Corps that were placed in service before October 1, 1998. The memorandum of agreement was later documented, as an example, in FASAB Technical Release 13 as an acceptable methodology to estimate historical cost of PP&E. Once the documentation requirements were met, the Corps was able to assert readiness for audit.

2. Auditing of beginning balances

The second major hurdle that the Corps encountered was the first year audit requirement to audit beginning balances. In addition, during a first year audit, auditors assign a higher risk level causing an enormous amount of sample testing. During a first year financial statement audit, the audit firm is required to ensure all balances carried forward into the audited year are materially correct. To ensure all beginning balances were materially correct, the audit firm selected over 14,600 samples ranging from a one-time disbursement to support the Corps Funds Balance with Treasury, to large multi-million dollar major rehabilitation project, to a lock or dam constructed as far back as the 1920's. To manage and process over 14,600 samples being audited by over 190 auditors, a team of Corps financial experts was required full time for approximately seven months to process samples and respond to follow-up questions.

3. Accelerated timelines for audited financial statements

The third major hurdle the Corps encountered was accelerating the financial statement compilation process to meet the audit reporting deadline mandated by the Office of Management and Budget (OMB) in OMB Circular A-136. OMB requires all Federal agencies to complete their financial statement reporting 45 days after the end of the fiscal year. The major issue that had to be overcome was completing the year-end sample testing to include recommended auditor adjustments in the final compilation process. This process of year-end testing and potential for auditor adjustments shortened the financial statement and footnote preparation time from weeks to days. In order to meet the 45 day requirement the Corps, in conjunction with the audit firm, built in additional review periods to allow for multiple opportunities for the audit firm to review and provide suggested changes to the statements and footnotes. By building in these review steps into the process the Corps was able to react to any adjustments identified during the audit and provide a complete package to the audit firm in time for it to finalize the audit report and meet the OMB mandatory deadline.

Lessons Learned:

The Corps has learned many lessons along its journey, three of which were vital to success.

1. Integrated financial management system to support the financial statement audit

The Corps of Engineers Financial Management System (CEFMS) was an important factor in achieving a successful audit. CEFMS was custom built to Corps business processes and includes “hard coded” automated controls, which are transparent to the user and ensure their compliance with key financial management controls. CEFMS was developed as an enterprise financial management system that encompasses travel, training, timekeeping, and acquisition. It is fully integrated with the Corps project and asset management accountability systems, with all financial transactions related to assets built into the system. CEFMS is a single point-of-entry system, meaning that project managers and many other Corps employees are using CEFMS on a daily basis creating purchase orders or travel documents, disposing of excess property, or receiving goods. Many of the Corps internal controls are automated, forcing user compliance. An example of automated controls is the segregation of duties. CEFMS was developed to prevent one person from performing all the critical steps regarding the procurement of goods or services (purchase request, obligation, receipt of the goods or services, and disbursement). Since the system uses an electronic signature function, this key control is easily recognized and operating effectively---lack of compliance is not an option. Auditors rely greatly on system controls to reduce audit risk and minimize sample testing, thereby reducing audit time.

2. Command emphasis

Corps leadership has continuously set the tone for and realized the benefits of Chief Financial Officer’s Act compliance. More specifically leadership provides great emphasis on continually improving management controls related to the financial statements. Corps leadership understands the importance of accurate financial information which is expected by our stakeholders, including our customers whose funding we execute. Early on in the audits the auditors reported that the Corps needed to improve its assessment of risk and compliance with monitoring controls. To address the issues from a leadership perspective the Executive Senior Assessment Team (ESAT) was established. The ESAT mission is to provide leadership and direction over financial audits and associated controls. The Deputy Commander of the Corps chairs the ESAT, which is comprised of all the Headquarters Senior Executive Service directors.

The ESAT’s priorities include approval of the annual Corrective Action Plans for each material weakness reported in the financial statement audit. Corrective Action Plans include a description of the control, an action to improve or implement the control, and a metric to define whether the control was in place and operating. The Deputy Commanding General assigns the Corrective Action Plans to subordinate Commanders to remediate the material weaknesses. The Corps internal auditors perform monthly Corrective Action Plan reviews and report progress to the Deputy Commanding General. This type of continuous monitoring is essential for manual controls, those that

are not “hard coded” into the financial system. An example of a manual control is resource and project managers holding quarterly reviews to ensure completed assets are placed in service timely. This type of leadership emphasis assures that field Commanders make management controls a top priority.

3. Partnering with auditors throughout the audit process

During the Civil Works audits, particularly during the early stages, the Corps, like every Command, had many issues to overcome. The Corps would not have been able to overcome these challenges unless it was able to partner effectively with its auditors. While the Property, Plant and Equipment Memorandum of Agreement was the best example of the Corps partnering with the auditors, the Corps and its auditors are able to work through problems on a daily basis because of the trust that exists between both organizations. The auditors are physically co-located with Corps management most of the year and become knowledgeable in Corps policies and procedures that are critical to the continued success in the Civil Works Financial Statement audits.

Audit Sustainment:

The Civil Works Financial Statement audit has gone from over 14,600 samples in FY 2008 to a very manageable 4,000 samples anticipated in FY 2011. As the audit workload decreases, the Corps continues to focus its resources on improving its own processes and related controls through new policies and procedures. The Corps has a robust internal program to continually document its processes, assess risks and test controls, in accordance with OMB Circular A-123 Appendix A (Internal Controls over Financial Reporting). The Corps anticipates its program will cure an entity wide control weakness reported by the DODIG in FY 2010. Additionally, in FY 2010, the DODIG reported three other material weaknesses in Property, Plant and Equipment, Controls over Customer Agreements and Financial Reporting, and the Corps has taken corrective actions to cure them. Based on its own testing, the Corps issued an unqualified statement of assurance in July 2011, stating the internal controls over financial reporting are operating effectively.

Conclusion:

In conclusion, the Corps is often asked to describe the benefits of a financial audit and an unqualified opinion. While it is not easily quantifiable in dollar savings, the benefits realized are a continuous emphasis and improvement on the internal control program. Given that most Civil Works projects are partially financed by non-federal public entities, auditability is critical to their confidence in the Corps financial integrity. Mr. Chairman, this concludes my statement. Thank you again for allowing me to be here today to discuss the Corps Civil Works financial audits. I would be happy to answer any questions you or other Members may have.