IMPROVING FINANCIAL MANAGEMENT AT THE DEPARTMENT OF DEFENSE

HEARING

BEFORE THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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C O N T E N T S

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WITNESSES

Tuesday, May 13, 2014

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IV

IMPROVING FINANCIAL MANAGEMENT AT THE DEPARTMENT OF DEFENSE

TUESDAY, MAY 13, 2014

U.S. SENATE,
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:30 a.m., in room
SD–342, Dirksen Senate Office Building, Hon. Thomas R. Carper,
Chairman of the Committee, presiding.

Present: Senators Carper, Tester, Coburn, Johnson, and Ayotte.

OPENING STATEMENT OF CHAIRMAN CARPER

Chairman CARPER. Good morning. The hearing will come to
order. Today's hearing will examine, as we know, the efforts under-
way at the Department of Defense (DOD) to improve financial
management and to obtain a clean, unqualified audit of the books
at the Department of Defense. I want to begin today's hearing by
asking why financial management at the Department of Defense,
and any other agency, is important in the first place, but especially
the Department of Defense.

Accurate and complete financial accounts give agency leadership
and Congress the information that we need for effective manage-
ment and planning, and, I might add, execution. Clean auditable
financial statements also give us the information we need to hold
agencies accountable, to look in every nook and cranny of the Fed-
eral Government and ask this question: Is it possible to get better
results for less money?

I talk to people all the time who say to me, I do not mind paying
some extra taxes, I just do not want you to waste my money. And
we waste money probably in every agency to some extent. We espe-
cially waste it in the Department of Defense. You know that is
true, I know that is true. So do our taxpayers.

We cannot, however, effectively identify areas to reduce spending
if we do not know how much and where we are spending that
money in the first place. Federal agencies have been required to
produce auditable financial statements since the mid-1990s. Unfor-
tunately, nearly two decades later, the Department of Defense,
which spends more than $2 billion every day, has yet to meet this
obligation. Despite years of effort and one deadline after another,
Department of Defense books are so flawed that auditors still can-
not even attempt to perform a complete audit.

It is no surprise then that the Department of Defense finances
have been on the Government Accountability Office (GAO) high

risk list since 1995. In part, this is due to pervasive management deficiencies that would never be tolerated in private sector business and that are actively being addressed in other Federal agencies. Here are just two examples.

Just last month, the Government Accountability Office released a report showing that the Department's antiquated inventory systems, often containing incomplete and inaccurate information, have led to millions of dollars in wasteful ammunition purchases. The Department continues to buy spare parts that it does not need.

In fact, last year the Department gave this Committee figures showing that at one point in 2013, it had $754 million worth of items that were on order, but not yet delivered, which the military services simply did not need. However, the Department still paid for and accepted the unneeded items. This is an unacceptable situation. And these are just some of the problems we know about. In all likelihood, the poor state of the Department's books mask even more instances of waste and fraud.

In these tough economic times when we are going to be asked, and we are being asked, to make decisions about pay for our active personnel, compensation for active duty personnel, compensation for our veterans, making those decisions, we are going to be asked to make decisions about base realignment and closures again before too long, making those kind of decisions. And for us, as we face those kinds of decisions, I just want to say, we cannot tolerate this continuing level of mismanagement and waste.

In 2011, we met in this same room. Dr. Coburn and I held a hearing, maybe even with the same title, and we discussed how the Department was going to meet its statutory deadline of achieving financial auditability by 2017. Just after that hearing, then-Secretary of Defense Leon Panetta made an important announcement that greatly elevated the priority of financial management, higher than it had been ever elevated before.

He also established an additional deadline for a partial financial audit by the end of fiscal 2014 in order to quicken the pace of improvements. To his credit, his successor, Secretary Hagel, has stood by these goals. This means that in several months, the entire Department should have its Statement of Budgetary Resources (SBR), a key financial component, ready for audit.

We are here today to get an update on this quickly approaching deadline. Fortunately, the Department can look to some recent successes to help find the right path to reach its goal. The Marine Corps has made some important progress in auditing its books, achieving a clean opinion, at least on a portion of its fiscal year (FY) 2012 accounts, last December. And that is good news.

Also, the Department of Homeland Security (DHS) was until recently the only other department unable to audit its finances. Last year, Homeland Security, as we know, was able to achieve a clean audit. A department created barely 10 years ago, broad, large, lot of people, lot of money, they were able to achieve a clean audit last year.

If they can do that, the Department of Defense needs to keep its—we need to keep your feet to the fire and you all need to get the job done. And this idea of a goal for 2014 slipping and the goal

for 2017 slipping, that dog does not hunt here. We are going to make that perfectly clear.

A key question is whether the entire Department of Defense is learning enough and fast enough from these examples. Let me just say, we have some obligation in this, too, and when we shut down the government, we allowed the government to be shut down, when we do stop and go budgeting, fiscal cliffs, then we are part of the problem and are not part of the solution, I acknowledge that.

Tom Coburn and I have made a compact with Senator Johnson and Senator Tester that we are not going to let the government be shut down again. We are going to do a better job, we are going to do our share, and maybe if we do, you guys will do a better job of doing your part as well. But we do not want to be the problem. We want to be part of the solution.

A key question, again, is whether the entire Department of Defense is learning enough and fast enough from these examples that I just mentioned. Today we have been joined by several witnesses and key players for helping the Department of Defense improve its financial management processes and controls. Their work, if successful, will allow the Department to produce reliable financial statements that regularly produce critical information for decisionmakers.

To our witnesses, we want to thank you for joining us. We look forward to your testimony. Let me now turn to Dr. Coburn for any comments that he wishes to make. Thank you, Dr. Coburn.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. Thank you, Mr. Chairman, for holding this hearing. I would welcome all of our panelists and say we applaud your effort. But as my dad used to say, effort sometimes is not enough. You have to apply maybe a different approach and a different technique.

I want to start by reading an assessment I am going to put up for you comparing 2001 to where we are today.[1] The assessment in 2001, inability to consistently provide reliable financial data, managerial data for effective decisionmaking. Still there, no change. Lack of an overreaching approach to financial management, disparate systems, accounting, financial, and feeder hampered by a lack of integration and standardization. Still exists.

The Financial Improvement and Audit Readiness (FIAR) plan provides the approach. It is unclear right now to me how well it is being implemented, especially as audit goals are descoped and deadlines are missed. Systems environment remains more or less unchanged. Convoluted business processes, which fail to streamline excessive process steps, sometimes driven by accounting, operational and organizational structures, further complicated by aged and disparate systems.

Enterprise Resource Planning (ERP) results have been mixed. Air Force Expeditionary Combat Support System (ECSS) was canceled after nearly 10 years of work and a billion dollars. We recommended in 2011 it be canceled. It took 2½ years to get it can-

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[1] The charts referenced by Senator Coburn appear in the Appendix on page 136 and 137.

celed, then we paid the contractor a payment and did not hold them accountable for what they were developing.

Difficulty in obtaining financially based outcome oriented management metrics. This problem continues. GAO has reported that metrics are not adequately defined. Inability to produce Chief Financial Officer (CFO) Act compliant annual financial statements. No change. Disproportionate budget dollars appear to support non-value-added activities. Since useful information is hard to extract, useful corrective action is difficult to implement with a lack of widespread understanding of how financial information can help us. Has not changed.

Cultural bias toward the status quo driven by disincentives for change and short timeframes of political appointees who otherwise might serve as agents of change. No change. Requirement of an infusion of personnel with technical and financial skill sets necessary to achieve integrated financial management systems. DOD is investing in training programs. It is still not fully implemented, and oftentimes CFO nominees lack the requisite qualifications.

I am most surprised when I hear some of my associates ask why auditability matters. I suspect this question is a result that many of my colleagues lack real world experience. They have never run a business in an organization that has to make the most of its resources that it has available. To a business—and the Pentagon is not a business—but to a management organization, reliable financial data is what powers the strategic planning, the strategic budgeting, and operational decisions, and often means the difference between success and failure.

But even to Congress, auditability is of paramount importance. We cannot do our job without it. The fact that our largest Federal department with nearly a $700 billion budget still cannot comply with the law after several decades is a failure that rests squarely on us, the Congress, because by accepting the continued excuses and delays, we have failed to do our job.

The appropriations and accountability clause of the Constitution, Article I, Section 9, Clause 7, says the following: No money shall be drawn from the Treasury but in consequence of appropriations made by law, and a regular statement and account of the receipts and expenditures of all public money shall be published from time to time. They have not done that in 30 years in the Pentagon.

The intent of this clause is simple. Congress cannot possibly know that the Executive Branch is obeying the first part of the appropriations clause, spending, without confidence in the second, accountability. The decades-long failure by the Pentagon to comply with existing Federal financial management laws is against the very spirit of the Constitution. Our Founding Fathers demanded that those spending taxpayer dollars are held accountable to the taxpayers, the people funding the bill.

The financial management problems within the Pentagon are intimately related to its problems of waste, mismanagement, its budget woes under sequestration. Currently, neither military leaders nor lawmakers can consistently and reliably identify what our defense programs cost, what they will cost in the future, or what they have cost us in the past.

When the Pentagon itself does not know and cannot tell Congress how it is spending its money, good programs face cuts along with wasteful programs that we will not need, which is the situation we find ourselves in today, cutting meat instead of fat. Unreliable financial information makes it impossible to link the consequences of past decisions and, oh by the way, holding people accountable for those decisions to the Defense budget or measure whether or not the activities of the Defense Department are actually meeting military requirements.

The problem is clear. You cannot manage what you cannot measure. If the Pentagon does not know how it spends its money, Congress does not know how DOD is spending its money. With the Nation's debt nearing $18 trillion and counting and tighter budgets across the Federal Government, DOD needs now, more than ever, to better manage the scarce resources. The first charge of the Congress is to defend the country.

Today DOD leadership has told us that they are on the right track, making progress. I have heard that song before. Some of our Nation's best watchdogs, the GAO and DOD Inspector General (IG), will testify that the core financial management weaknesses, the longstanding deficiencies, still exist and remain a significant risk to DOD meeting its statutory, constitutional requirements.

If you take away only one point today it should be this: Poor financial management is the root cause of much of DOD's current problems, be it the ability to control costs, as evidenced by weapon system and information technology (IT) system overruns, anticipate its future costs, measure performance, or prevent waste, fraud, and abuse. Congress best helps DOD fulfill its obligations under the law and to the American taxpayers by holding DOD accountable for its failure to comply with the law.

Mr. Chairman, I have only one request of our first panel, is that you will stay and listen to the GAO and IG. I know they seem to be a thorn, but there is some reality in what they say, and if we mix that reality with a good effort that everybody at this table right now is making—I am talking about our panelists—we will get closer.

I would just summarize, and we will do it through the questioning. We have changed what the National Defense Authorization Act (NDAA) called for by going to the accounts instead of the resources. I understand you were allowed to do that, but if you really want financial data to be able to make good financial decisions and to control costs, you are not going to get it that way until maybe 2022, 2021. With that, I yield back.

Chairman CARPER. Let me just followup on something that Dr. Coburn just said. He has urged you to stay, if you can, for the second panel. I would ask that you do that as well. If for some reason you cannot, please, for God's sake, make sure that you have somebody senior who is going to be here dutifully taking notes.

Jane Hall Lute who about a year or so ago, was the Deputy Secretary of Homeland Security, as you may recall, and she would go meet with Gene Dodaro, the Comptroller General, not every week or every month, but just about, to talk with him face to face—the No. 2 person at DHS—to figure out how to get the Department of Homeland Security off the high risk list at GAO.

And working it, working it, working it month in and month out, and finally they did make progress. And as Dr. Coburn said, some people think of the Government Accountability Office, our watchdog, as a thorn in the side of agencies. They actually play a very constructive role, as you know. And they want agencies off the list. They want to have other things they can focus on instead of the problems that we are going to be talking about here today.

And one of the items they would like to get off the list, and so would I, is major weapons systems cost overruns, which now I think exceeds $400 billion. So plenty of work to do.

I am going to introduce briefly everybody. Mr. Hale, it is not going to be a pleasant hearing, but having said that, I just want to say we do appreciate your service. I know you are going to be stepping down later this year. We appreciate your service and wish you only well as you go forward.

Bob Hale is the Under Secretary and Chief Financial Officer at the Office of Under Secretary of Defense, at the Department of Defense. Mr. Hale was appointed to his current position in January 2009. As Under Secretary of Defense, Mr. Hale is principal advisor to the Secretary of Defense on budgetary and fiscal matters, including development and execution of the Department's annual budget of $600 billion. As Chief Financial Officer, Mr. Hale oversees the Department's financial policy, financial management systems, and business modernization efforts.

Our next witness is Mr. Robert Speer, Acting Assistant Secretary of the Department of the Army. Mr. Speer assumed responsibility for his position a couple months ago, in February of this year. As Acting Assistant Secretary, Mr. Speer advises the Secretary of the Army and Chief of Staff on matters relating to financial management and oversees the development, formulation, and implementation of policies, procedures, and programs for improving the efficiency and effectiveness of Department resources.

Our next witness is the Honorable Susan Rabern. Is it Doctor Rabern? Are you retired Navy?

Ms. RABERN. Yes, sir.

Chairman CARPER. What was your rank in the Navy?

Ms. RABERN. Captain.

Chairman CARPER. Captain. All right. So we will have several titles we will use for you today. The Assistant Secretary of the Department of the Navy for Financial Management and Comptroller. Dr. Rabern was appointed to her current position in August 2013, last year. As Assistant Secretary and Comptroller, Dr. Rabern is responsible for managing and directing financial matters, including the annual budget of the United States Navy and the U.S. Marine Corps. Dr. Rabern, again, retired from the United States Navy and we now know is a retired Navy captain.

Our final witness is the Honorable Jamie Morin. Assistant Secretary of the Air Force for Financial Management and Comptroller. Dr. Morin was appointed to his current position in June 2009. As Comptroller and Chief Financial Officer, Dr. Morin is the principal advisor to the Secretary and Chief of Staff of the Air Force on all financial matters. He is responsible for providing financial management and analytical services necessary for the effective and efficient use of Air Force resources.

We thank you all for being here today. We thank you for your preparation, for your testimony, and for your willingness to respond to our questions. I have one other favor to ask of all of you. I want you to take this to heart. I read through your statements and it was replete with acronyms. I do not like acronyms. GAO is fine, DOD is fine, the Federal Bureau of Investigation (FBI) is fine, the Environmental Protection Agency (EPA) is fine. The Schedule of Budgetary Activity (SBA), which shows up repeatedly. The Americans with Disabilities Act (ADA) shows up repeatedly.

I do not want you to use acronyms. If it is something that is common, we see it all the time, that is fine. Otherwise, I will stop you every time you do it. Use the words. All right? It will help me, it will help us, and ultimately it will help you.

With that having been said, I think we have a vote starting— what time—we will have a vote starting at 11:10. Tom, you and I may want to do what we did last week and just take turns going back and forth so we can make progress. Mr. Hale, please, welcome, and again, please proceed.

TESTIMONY OF THE HON ROBERT F. HALE,[1] UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF DEFENSE

Mr. HALE. OK. Well, thank you, Mr. Chairman, Senator Coburn, Members of the Committee. I am here to report on financial management of the Department of Defense. When I became DOD's Chief Financial Officer more than 5 years ago, I established a number of goals. I have reported on progress on those goals in my prepared statement. In my oral remarks, I will focus on one of those goals, namely, I think the key one for today, improving financial management and achieving auditable financial statements.

Meeting this goal has been a challenge; frankly, more of a challenge than I expected when I started. However, despite the budgetary turmoil of recent years, I believe we have made substantial progress, without question more progress in the last few years than we have made in any other period after passage of the 1994 Act.

Our audit strategy focused first on the elements of our business that most often influence our decisionmaking, particularly budgetary information and counts and location of our property known as existence and completeness, not an acronym, but not a very helpful English phrase either.

We have set interim goals for our audit efforts and we have clearly in mind the legally mandated goals for overall audit readiness. We report on those goals regularly, twice a year, in an audit progress report. We will deliver the ninth installment later this week to the Congress. All of those, I might add, were provided on time.

While we are focusing first on our budget statement and property information, we also have a plan to achieve audit readiness for all of DOD financial statements, and I believe we are on track to achieve audit readiness for all our financial statements by 2017.

Meeting audit goals requires major changes in a department that is big and where change is difficult. We needed new financial sys-

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[1] The prepared statement of Mr. Hale appears in the Appendix on page 60.

tems, we need significant changes in our business practices. They are hard to implement in a big organization and we face special challenges that you alluded to, Mr. Chairman.

Five government shutdown planning drills in the last few years, two 6-month continuing resolutions, last year sequestration and a furlough, followed by a shut-down and a furlough. And we have wasted time—time and again we have wasted time, replanning budgets because of the seemingly constant changes and the outlook for revenues. This turmoil has definitely usurped time that could have been spent on audit and other activities.

But despite that turmoil and other challenges, we have made substantial progress, and much of that has been documented by independent public accounting (IPA) firms, and I think that is a big difference compared to prior periods. We understand that after 20 years without auditable financial statements, Congress is skeptical. You want an independent verification of our progress and, frankly, so do we.

Let me highlight a few audit results for you. The Marine Corps last year received a clean audit opinion on the current year of its budget statement—that is the statement for budgetary activity, but I like the current year better—for 2012 and we expect a similar result in 2013. This result was verified not by one, but by two independent auditors, one in the private sector and one in the public.

The entire Department of Defense has been evaluated and deemed ready for audit of our funds distribution process known as appropriations received. It is a critical accomplishment because it provides verification that we are distributing the funds the way that Congress envisioned when you passed the laws. Again, the services were all verified by independent public accounting firms.

We received a clean audit opinion from an independent auditor on the controls within our civilian personnel data system, as well as systems handling military pay, civilian pay, and disbursing. Navy has achieved a positive opinion on civilian pay and travel expenses; Air Force on funds balance with Treasury; Army has completed an examination similar in scope to the audit they will face this fall.

And finally, DOD is well along in deploying financial systems and they are stabilizing in terms of cost and schedule. So independent auditors have verified progress in many specific areas, but we will soon face a broader goal that we are all aware of, audit ready budget statements by September 2014.

By audit ready, we mean that we have made significant—sufficient progress in processes and data so that we can withstand an independent audit, in the view of management. Audit readiness provides most of the benefits of the audit process. The audit itself attests to our success. It is too early to know for sure the audit ready status for every budget statement by September 30 because we are still in the process of remediation. We are going to use every moment we have to try to make fixes.

However, we expect that most of DOD's budget statements will be ready for audit by September 30, including statements in all of the military services, and I believe that is an enormous accomplishment for this Department. We are finally getting to the real issue

of the military services. We had not done that before and we need to do it.

Once our statements are audit ready, we will pursue the formal audit in a cost-effective manner and that Congress requires that by law, actually. One lesson we learned from the Marine Corps is we simply cannot acquire the documentation needed to verify prior year transactions quickly enough to meet audit needs. Some of those transactions go back 10 years, they are in long-term storage, and we just do not have quick access to them.

We will, therefore, focus the formal audit on the current year budget activity which contains, by far, the most important information. And we will build quickly toward the full SBR, because we will get one year done and that will give us that data correct. We can probably go back a couple of years, so I hope, quickly we will build toward the full SBR, and I do not think that this process will significantly delay the time we get an audit opinion on the full SBR.

Time does not permit me to cover other important goals that we are pursuing. You will see them documented in my statement. I will end with the bottom line on auditability. Despite formidable obstacles, we have made demonstrable progress, progress that has been verified by independent auditors. We still, clearly, have much work to do and I accept that point.

However, in most cases, we will substantially meet the first broad goal for audit readiness and budget statements in September 2014, and we will then begin the formal audit in a cost-effective manner. Meeting this goal is an important step for the Department and that is something that Secretary Hagel believes in. Whenever I talk to him, he clearly is interested in this topic.

Last year he made a video for the entire Department of Defense on audit readiness, and I will quote from that video, and that is, We need audit readiness and audits to demonstrate that DOD manages the public's money with the same confidence and accountability that we bring to our military operations.

Mr. Chairman, that concludes my brief opening remarks. After my colleagues are finished, I will be glad to join in answering questions.

Chairman CARPER. Thanks for that testimony. I am pleased to hear about the video—I heard that Secretary Hagel gave underlining the importance of making progress on this front to the employees of the Department. The video I am really looking forward to is the one that he does later this year and says that we really did—not just most of our agencies, but we nailed it by the end of this fiscal year. And the one I am really looking forward to is 2017. He may not still be the Secretary, but somebody will be, and that is the one I am looking forward to. Thanks very much.

All right. Mr. Speer, please proceed.

TESTIMONY OF ROBERT M. SPEER,[1] ACTING ASSISTANT SEC-RETARY OF THE ARMY (FINANCIAL MANAGEMENT AND COMPTROLLER), U.S. DEPARTMENT OF THE ARMY

Mr. SPEER. Chairman Carper, Ranking Member Coburn, and distinguished Members of the Committee, thank you for the opportunity to appear before you today to discuss the Army's approach to implementing financial improvement, my assessment of Army's progress toward achieving auditable financial statements, and implementation of the Army's enterprise resource planning systems.

In addition, I want to convey to you that Secretary of the Army McHugh, Chief of Staff of the Army Odierno, and Under Secretary of the Army and Chief Management Officer Carson and I remain committed to improving the Army's financial management and meeting the Army's requirement to be auditable by September 2017.

Despite the serious challenges the Army faces from ongoing resource uncertainty, the Army's soldiers and civilians remain dedicated to improving our business processes. The Army's financial management improvement plan documents the Army's approach to achieving our audit readiness milestones, and includes reliance and iterative exams, audits from an independent public accounting firm to inform the Army's audit readiness status, and provide objective feedback on areas requiring additional focus and corrective action.

The Army is making progress. An independent public accounting firm recently examined and delivered a report on the general fund Statement of Budgetary Resources focusing on 2013 transactions within the Army's Enterprise Resource Planning environment. Although not a clean opinion, the independent public accounting firm was able to complete the examination, was able to provide us and confirm confirmation of improvements, and throughout the examination, identify areas we need corrective action.

In response, the Army has been implementing a plan of action to remediate those findings prior to the 2015 audit of scheduled budgetary activities. In addition, during fiscal year 2014, the Army received a clean opinion from a public accounting firm on the examination of real property. Those assets are at 23 different Army installations, which accounted for over 50 percent of the book value of the Army's real property assets. This audit supports the second DOD audit readiness priority verifying the existence and completeness of our assets.

Additionally, the Army continues to achieve success in implementing new systems. The General Fund Enterprise Business System (GFEBS) is our core business system used by over 53,000 users at over 200 locations worldwide. It enables the Army's audit readiness progress while simultaneously modernizing and improving our Army's business processes. The Global Combat Support Systems (GCSS), GCSS-Army, and the Logistics Modernization Program (LMP), our retail supply and wholesale logistics systems, will effectively complement our auditable features of GFEBS.

We recognize audit readiness requires engagement throughout the organization so we hold senior executives accountable for achieving the audit readiness success. Since fiscal year 2012, finan-

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[1] The prepared statement of Mr. Speer appears in the Appendix on page 71.

cial improvement metrics have been a component of all senior executives' annual performance assessments.

The Chief of Staff of the Army regularly monitors progress of both internal assessments as well as external audits and holds formal reviews to hold leaders accountable. The Army-wide engagement has facilitated our progress to date and is critical to our overall success.

The current fiscal environment involving defense requirements, both at home and abroad, present unique challenges for our organization to achieve audit readiness. However, this environment also affords us an opportunity to evaluate and optimize our technology, our organizations, our workforce, and our training to improve the overall business processes.

We are looking to evaluate these financial management optimization concepts in the coming year, and to gain benefits and improve performance from accurate and timely auditable data. We continue to demonstrate improvement across the whole business process area.

Our annual exams have continued to expand on scope and size and mirroring the growth and evolving involvement in our audit readiness program, while providing us valuable insights for remediation and correction toward the overall goal of achieving audit readiness.

I sincerely look forward to continue our work with Members of this Committee, the General Accounting Office, and the DOD Comptroller to ensure our continued improvement in Army business processes to achieve audit readiness. Thank you and I look forward to the engagement.

Chairman CARPER. When Dr. Coburn and I led the Federal Financial Management Subcommittee, we cared a lot about these issues as well. He is going away at the end of the year, but we are going to stay right on this issue for as long as it takes. He has worked there for years, when we were on the Subcommittee, and certainly now as well. So thank you.

Mr. SPEER. Yes, sir.

Chairman CARPER. OK. Captain, Doctor.

TESTIMONY OF THE HON. SUSAN J. RABERN,[1] Ph.D., ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER), U.S. DEPARTMENT OF THE NAVY

Ms. RABERN. Yes, sir. Thank you. Chairman Carper, Senator Coburn, Members of the Committee, I am pleased to have this opportunity to discuss with you the progress the Department of the Navy is making toward Congressional mandates for financial audit readiness. I will share with you some of our significant achievements to date, but I will also tell you that much more hard work needs to be done by our Navy-Marine Corps team before we reach our goal of full financial auditability.

Implementing effective internal controls over the Department's business operations, verified by successful financial audits in coming years, will send a reassuring message to Members of Congress and American taxpayers. The message will be clear. In supporting

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[1] The prepared statement of Ms. Rabern appears in the Appendix on page 78.

our Nation's modern powerful Navy-Marine Corps warfighting team, the Department of Navy is minimizing the risk of misusing taxpayer dollars and maximizing accountability.

The underlying fundamentals for our task are relatively simple. Strong, prescribed internal controls must be in place, regularly performed and periodically tested for effectiveness. Documentation proving the controls performance must be readily available. Implementation of these objectives is known to be extremely complex when applied to a very large organization such as our military department, but all the more critical in an environment of uncertainty.

We are making steady progress toward our goals. Our most immediate objective is complying with the mandate to achieve audit readiness on our Department's Schedule of Budgetary Activity by the end of the present fiscal year. The Marine Corps portion of this schedule has been under audit for four cycles, and in December, the Department of Defense Inspector General issued an unqualified opinion for the fiscal year 2012 schedule.

In addition to the Marine Corps effort, our Department has asserted audit readiness on nine SBA business segments, receiving favorable examination opinions on four of these nine assertions. Exams on three more of the nine assertions are currently underway. The tenth remaining SBA segment, financial statement compilation and reporting, is undergoing remediation which will support an eventual SBA audit. Today I am cautiously optimistic that we will achieve SBA audit readiness by the end of fiscal year 2014.

In the area of asset management we have received favorable audit opinions on the Department's accountability for ships, aircraft, satellites, and fleet ballistic missiles, and shore-based ordnance. In addition to these initial successes, the Department of Navy is now executing a detailed plan to achieve Department-wide compliance with financial standards for all asset classes.

In addition to the benefit of enhanced stewardship over public assets, our auditability efforts will assist in moving needed items to the warfighters more quickly and avoid excess buying. We will face formidable challenges as we pursue full financial auditability by the end of fiscal year 2017. Complying with audit standards for asset accountability, including accurate valuations, will be a complex endeavor.

And as we move to strengthen the capabilities of our present suite of business systems, our future business systems are still evolving. Also, we must continue developing additional capacity to sustain the business improvements we have made Department-wide in every organization, recognizing that reaching audit readiness is not a one-time exercise.

Today I believe we have a solid approach to known remaining impediments to full financial auditability. As with my previous assessment of the fiscal year 2014 SBA goal, I am cautiously optimistic that the Department of Navy will achieve full financial audit readiness by the end of fiscal year 2017.

As we progress, we have begun cataloging tangible efficiencies resulting from our auditability efforts. One example is the significant savings on our departmental bill for paying vendors by expanding automatic feeds of electronic contracting data. As manual

controls are replaced by automatic controls, bill-paying is at the same time less costly and more accurate.

In fiscal year 2013, we estimate that the Department saved approximately $4 million because of the specific improvements in electronic commerce. In a second example, one of our major commands tightened internal controls over its requisitioning process, adding more rigor and validating outstanding orders for goods and services.

By doing so over several years, this organization canceled requisitions totaling $3.5 million for orders no longer needed, recouping this buying power and allowing them to purchase other needed items. Other instances of savings will be replicated through the Department as internal controls are strengthened and lessons learned.

In closing, I would tell you that our Department-wide effort has the active support of our executive leadership and we are driving this accountability all the way down the chain of command. As we make the changes which move us closer to audit readiness, thousands of managers throughout the Department of Navy are embracing these positive improvements to our business environment.

I pledge to you that you have our Department's full commitment to achieve these challenging mandates through the collaborative hard work and persistence of our determined workforce. I would be pleased to address any of your questions at the appropriate time. Thank you very much.

Chairman CARPER. Thanks very much. I am a retired Navy captain as well. Sometimes when we talk about difficult things to do, we talk about trying to change the course of an aircraft carrier, but we know that if we stick with it, all hands on deck, everybody pulling together, we can change the course of aircraft carriers. This is a really big aircraft carrier.

Ms. RABERN. Roger that, sir.

Chairman CARPER. And this is a really tough course change to make.

Ms. RABERN. Yes, sir.

Chairman CARPER. And it is all hands on deck. We appreciate some good things that are going on with the Marine Corps and the encouragement that you have given to us. We just want to keep pushing.

Ms. RABERN. Yes, sir. Will do.

Chairman CARPER. Thank you. Dr. Morin.

TESTIMONY OF THE HON. JAMIE M. MORIN,[1] Ph.D., ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER), U.S. DEPARTMENT OF THE AIR FORCE

Mr. MORIN. Thank you, Mr. Chairman. Thanks for the opportunity, once again, to share Air Force progress toward audit readiness and our strong commitment to the goals set out in the legislation. Sir, in 2011, I testified to your Subcommittee at the time that we saw moderate risk in the Air Force's plan to achieve overall audit readiness by 2017, and that that was mainly due to IT challenges.

Since then, as you know, Secretary Panetta gave us the challenging deadline for the Statement of Budgetary Resources by 2014.

Chairman CARPER. I like the way you caught yourself there. That was good. Let me just say, my admonition at the beginning, I do not like acronyms. In fact, I think lots of my colleagues feel as strongly about it as I do. You are doing just fine on that score. Keep it up.

Mr. MORIN. We will try to keep it up. In response to that near-term aggressive challenge, the Air Force dramatically increased the resources that we are investing in the audit readiness effort, including both management attention and funds.

As a result, I can testify to you today that I believe we have increased the likelihood that we will meet the 2017 audit deadline. And while there is a great deal of work still to be done, I have observed fundamental and positive changes in the Department's approach to the audit agenda over just the last few years. I think these improvements continue under Secretary Hagel's leadership.

Mr. Chairman, you have been a very strong proponent of the military services sharing audit readiness lessons with one another. I am pleased to report we are doing a great deal of that, including learning from the work of outside auditors, like the GAO, and of course from our Inspector General.

For example, a couple of years ago, the GAO briefed this Committee on deficiencies it found during an audit reviewing another service's military pay records. You held a hearing on the topic and we saw that report. We then had the opportunity to request the Air Force audit agency conduct a similar review of our own pay records.

We found that the overwhelming majority of airmen are properly and timely paid, correctly, and we found that our processes were generally good. However, we found that in one specific area, our process for reviewing and retaining documentation about the housing allowances paid to our airmen was not sufficient and we were not retaining enough records to support an audit. We were validating the pay was correct, but not documenting that validation in a way that would withstand audit.

So as a result of that internal audit, my office put in place a new set of procedures for document retention and for validation. We are currently in the midst of an Air Force-wide 100 percent recertification of every Airman's housing allowance entitlement for those with dependents.

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[1] The prepared statement of Mr. Morin appears in the Appendix on page 85.

This is one example. Another example was a best practice we adopted from the Navy. They used their audit agency to conduct monthly field testing of critical financial processes. We took that on a couple of years ago and last year we tested over 10,000 transactions Air Force-wide, assessing each one for compliance with a long list of audit requirements. We have seen compliance increase from roughly 40 percent to roughly 90 percent over those 2 years of testing.

These are just a couple of many collaboration examples; Mr. Chairman, we appreciate the attention and your continued engagement.

To make an assertion of audit readiness on the Schedule of Budgetary Activities at the end of this year, Air Force leadership will need to review our progress and remaining challenges. So let me provide you with just a few specifics about where we are at.

Over the last several years, the Air Force has asserted audit readiness on a variety of processes. You have seen those, including civilian pay, budget authority and distribution, military equipment, spare engines, and other components of our operating materials and supplies. In some cases, we have received clean bills of health from independent auditors. In other cases, as with the other services, we have received a list of specific control weaknesses that we need to fix. We now have well-developed plans to resolve those weaknesses.

Your Air Force is strongly committed to this effort. It is the law, we believe it enhances our readiness, and we believe it is an important sign of good financial stewardship. Secretary James, our Secretary of the Air Force, included the audit and making every dollar count as one of her top three priorities for the Air Force. She recently wrote to key leaders across the Air Force on audit readiness and gave them some very specific directions about things they needed to do to help.

Our Chief of Staff, General Welsh, has also been a strong supporter and is engaged. In addition, many of our major command commanders, our four-star leadership, have integrated audit readiness into their own personal management control structures in a way that simply was not the case years ago.

The support of senior leaders is all the more important when we are asking airmen to do difficult things like the revalidation of housing allowance that I mentioned, or like our count of 1.9 million individual items in our general equipment inventory, which we have been doing. Leadership support has allowed us to increase financial resources approximately eightfold and partner with a Big Four accounting firm to help assess our readiness and identify corrective actions.

There are still, of course, challenges remaining despite all this progress and support. Our IT systems remain our biggest single challenge. We have made great strides, particularly in the last year, in fielding the Defense Enterprise Accounting Management System (DEAMS), to replace our current 1968 accounting system. We received a positive assessment from the Air Force Operational Test and Evaluation Center on DEAMS as currently deployed, and we have deployed it to six more bases since October 1.

We will complete deployment to all of Air Mobility Command in just the next couple of weeks and then many more bases October 1. We are on track to complete deployment Air Force-wide before the full financial statement audits begin.

I do, Mr. Chairman, want to single out the folks at Dover Air Force Base who were some of our early adopters, and their Comptroller, Major Will Vivoni, who is doing a great job leading there. They are pathfinders for us. So while the systems issues continue to be our single greatest risk area——

Chairman CARPER. I am happy to extend your time for a couple more minutes now. You mentioned Dover Air Force Base. Much appreciated. Actually, I will just take a moment. Every year we go— the Air Force and the Commander-in-Chief, go through a process where they evaluate all the Air Force bases across the world, and they go through a Commander-in-Chief evaluation, and there is usually an Air Force base that is on the airlift side and there is a base that is on the fighter aircraft side. And they sort of compete for the top prize.

I think for 3 out of the last 5 years, Dover Air Force Base has been a finalist for 3 of those 5 years. We are enormously proud of them. Thank you for mentioning them.

Mr. MORIN. Absolutely, sir. The work they are doing there supporting the mobility mission and, of course, supporting the dignified return of those that we have lost in conflicts overseas is absolutely central to what your Air Force does every day.

So the systems issues that I mentioned are our single greatest risk factor. As others have testified, budget uncertainty has harmed our audit readiness efforts as well. Restrictions on travel and restrictions coming with the civilian furloughs have all had significant impacts. We are working to recover from those. We also, unfortunately, lost about 7 months due to a contract protest that took our independent public accounting firm support offline. We resolved that last year.

As you acknowledged Mr. Chairman, the single most important thing, I think, that the Congress could do to help and to support our troops in this vital area would be to provide a level of budgetary clarity and to complete legislative work on time.

Based on our assessments to date, sir, I believe it is likely that Air Force leadership will be able to assert audit readiness for our Schedule of Budgetary Activity at the end of this fiscal year. That is a decision to be made later this fiscal year, but that is my current assessment.

An audit of the Schedule of Budgetary Activity beginning in 2015 will be challenging for the Air Force, but I think it will help us accelerate towards a clean audit opinion on all of our statements. I think getting auditors' eyes on our processes has paid dividends so far and will continue to do so.

My final point, if I may, is that for financial improvement and audit readiness, the journey is every bit as important as the outcome.

It is through the process of building toward these clean audits that we are identifying weaknesses in department financial management that we can focus on and correct. It is the correcting of those weaknesses that enables us to carry out our mission as finan-

cial managers in DOD, which is to produce the maximum amount of combat capability for this Nation with each taxpayer dollar that is entrusted to us. That is the job. This journey is well worth the effort.

Chairman CARPER. Well said. Thank you very much to each of you for your testimonies this morning. We have a vote underway and we are about 5 minutes in. I am going to go ahead and ask some questions and then head off and vote. Dr. Coburn is going to come back. Between him and Senator Tester we will tag team and make sure we keep going and do not lose any time.

I mentioned GAO tells us weapons systems cost overruns for major weapons systems, I think, is over $400 billion. Every now and then, though, we do some smart things, too, and I just want to acknowledge that. We have about 100 C–5A's and B's aircraft, huge cargo aircraft. They are about 30, 40 years old. They are very reliable in terms of providing the airlift that we need from time to time.

We collectively made a tough decision, what to do with them. We ultimately decided to go ahead and begin retiring not all, but some of the C–5A's, the older aircraft, and to take the C–5B's and modernize them. And as Mr. Morin and others know, we have now modernized not all, but most of the, I think, C–5B's. They are now C–5M's. We have a whole squadron, about 18 of them at Dover Air Force Base.

About a year and half ago, one of them set, I think, 40 world records for the ability to carry cargo nonstop. We fly routinely over the top of the world from Dover Air Force Base to Afghanistan. They use less gas, they are quieter, and they are much more reliable. I think operations maintenance, rather, their operational capability is approaching 80 percent, which is where it ought to be. So we are pleased with that.

The first question I want to ask is to Comptroller Hale on meeting audit goals. As I mentioned in my opening statement, Secretary Hagel has been vocal in his support, as was Secretary Panetta, for improved financial management at the Department of Defense. Leadership is the key. If we do not have leadership on this stuff, we will never get it done. And their support, from both of them, is incredibly important.

I applaud their strong commitment to improving financial management. Some people think this stuff is just green eye shades and it is not especially interesting and people get lost in the acronyms, SBA, ADA, SBR. What does all this mean? Well, what it means is the ability to be ready, for us to be ready to take on a fight, whatever part of the world it is in.

For us to be effective, to be able to do so with minimal loss of life to our folks, to be able to make sure they are paid, that we have travel systems that work, that we are able to provide for their healthcare needs, that the weapons that they need, the weapons systems that they need are reliable, that we have the spare parts that we need when we need them.

We need to have the ability to have electronic health care records when people go from active duty into the Veterans Affairs (VA) system. All that is necessary for us to be ready for the fight.

Warfighters are counting on us. The American taxpayers deserve our best efforts on this front.

So, again, Mr. Hale, I have already pointed out this is, I think, your last appearance before this Committee. Kind of a mixed blessing, is it not? But we are glad, nonetheless, to see you and wish you well. I understand if you do retire, there is a fellow that the Administration thinks would be a worthy successor. His name is Michael McCord. Has he actually been nominated?

Mr. HALE. Yes, he has been nominated and through Committee for confirmation.

Chairman CARPER. OK. Fair enough. Thank you for that update. In your statement, you said that we expect that most of the DOD budget statements will be ready for audit by September 30, 2014. That would imply that some parts of DOD will not be audit ready. Also your testimony says that for the Department-this is, I think, a quote—eventually a fully auditable Statement of Budgetary Resources will emerge.

I would just say, the audit goal is for the entire Department, to have a fully auditable Statement of Budgetary Resources by the end of fiscal 2014. And that is not that many months away.

Mr. Hale, will the Department of Defense meet the 2014 deadline for achieving a fully auditable Statement of Budgetary Resources or will just some of the requirements of that deadline be met?

Mr. HALE. Well, Mr. Chairman, I think that we will meet the great majority of them, but I am not going to put into audit statements and waste the taxpayers' money if they are not audit ready. There may be a few that are not. Principally, probably, in the Defense agencies. We started later with them and they are particularly complex, although they are smaller.

I hope we can make it with all of them, but I want to be candid with you that we may not and we will move immediately to fix those as quickly as we can. I want to get to the top of the hill badly, and that is audit readiness for all of the Statement of Budgetary Resources, but I also do not want to waste money by putting into audit a statement that we know is not ready.

So bottom line, I think we will get there for most, but there may be a few that are not ready by September 30, and we will move as quickly as we can to fix those.

Chairman CARPER. Most can be 51 percent. Most can be over half.

Mr. HALE. I think it will be more than that. I expect you have heard my colleagues say that we expect—there is a good chance that all four of the military services will declare audit readiness. That is probably more than 80 percent of our budget if that happens. All of our trust funds, like the military retirement trust funds, are all ready. They are auditable or under audit.

And a number of our agencies are ready, but a few may not be. So it will be substantially more than 51 percent.

Chairman CARPER. All right. Mr. Hale, the difference between a Statement of Budgetary Resources audit and a Schedule of Budgetary Assessment audit is, understandably, confusing to a lot of my colleagues and even our staff, smart as they are.

But to my understanding, is that the Schedule of Budgetary Assessment is just a portion of the full Statement of Budgetary Re-

sources. I also understand the Department will need several years of conducting the Schedule of Budgetary Assessment in order to meet the requirements of the Statement of Budgetary——

Mr. HALE. So let us use English. It is current year versus the prior year.

Chairman CARPER. Statement of Budgetary Resources audit.

Mr. HALE. Right.

Chairman CARPER. All right. That was clear, was it not?

Mr. HALE. Yes.

Chairman CARPER. No wonder this is hard to do. It is hard to even say.

Mr. HALE. It is hard to say. So we want the full statement, which is all the current year transactions and prior years. Some go back as much as 10 years. That was our goal and when we got into the Marine audit, we realized that we could not produce the documentation quickly enough. Do you need to leave, Mr. Chairman?

Chairman CARPER. In a moment.

Mr. HALE. When we got into the Marine audit, we realized we could not produce the prior year documentation quickly enough. Some of it is probably in long-term storage. It goes back as much as 10 years. And we were basically wasting our time and audit money looking for data that we could not get.

So we said, Look, let us go after the current year, it is the most important one. It will buildup over a couple of years a body of data where we do have the documentation and that will lead us to a Statement of Budgetary Resources.

I want to get to the top of the hill, but I want to do it in a manner that is reasonable and efficient. If we have to vary the path a little bit we will, and that is what we have done here. But there is no change in the goal. We want to do the full Statement of Budgetary Resources, including both the current year and the prior year information.

Chairman CARPER. All right. Sometime later this year, you will be gone. Maybe Mr. McCord will be in your seat, in your shoes. I said earlier we are going to stay on this. And Dr. Coburn is going to be here until the end of the year. I wish he would stay on a lot longer. We are going to make sure every day that he is here and I am here, this Committee is around, that we are going to just stay on top of this. And if it is 80 percent or 90 percent, that is better than certainly 50 or 60 percent.

Mr. HALE. Better than zero.

Chairman CARPER. It is a lot better than zero, but it is not 100 percent and we want to get as close to 100 percent as we can. And we want to be helpful and not a problem in getting to that goal. Senator Tester and then when Dr. Coburn comes back, he will be chairing and I will be back shortly. Thank you.

OPENING STATEMENT OF SENATOR TESTER

Senator TESTER [presiding]. Absolutely. Thank you, Mr. Chairman. I do want to thank the Ranking Member and I want to thank all the witnesses for being here today. In the Banking Committee, we talk about banks that are too big to fail, and I do not know how we got to this point, but maybe the DOD has gotten too big to audit.

I certainly hope not because I do not think anybody around here disagrees that a full audit of the Pentagon's books is critical for moving forward. It would not only help identify ways to increase operational efficiencies, it would increase transparency, it would bring a more appropriate level of oversight to the Department of Defense.

In a budget environment in which we continue to see requests for program eliminations, base closures, reduced personnel benefits, the DOD's failure to meet audit readiness is frustrating.

I appreciate the fact that Mr. Hale talked about being at 80, potentially 90 percent, but the Chairman is right. We need to get to 100 percent, especially when we continue to hear about wasteful contracts in Afghanistan or the failure of the DOD to develop an electronic health record in tandem with the VA. We can do better, we must do better, and I do look forward to working with all of you to get it done.

As I said when I opened, I do not know how we got here, but we have to get this fixed because, quite frankly, it is unfair to the country and really unfair to the taxpayers.

Mr. Hale, in your testimony, you highlighted that one of your three goals is resources in a legal, effective, and efficient manner. A few months back, we had a few conversations—I appreciate that—about a provision in last year's omnibus appropriations bill that is related to the environmental studies for Intercontinental Ballistic Missile (ICBM) silos. You are nodding your head. You remember. I appreciate those conversations.

As you remember, I felt strongly that the language in the bill clearly prohibited the DOD from taking certain actions. Meanwhile, there were some, not all, but some in the Pentagon and high places that seemed intent on moving forward regardless of what Congress had to say on the matter.

This was incredibly troubling to me, and there is no doubt in my mind that the DOD would have completely disregarded this particular provision if we would not have put pressure, myself and some other Senators, on the DOD.

I just want to ask you a few basic questions. Would you agree that disregarding the voice of Congress is dangerous and counterproductive?

Mr. HALE. Yes. It is also illegal.

Senator TESTER. That is good. When there are questions about the DOD's authority to execute certain funds, how are they resolved?

Mr. HALE. Generally it is clear, from what you say, in the law. When it is not, we consult our lawyers and sometimes they consult the Administration lawyers, and that happened in this case. Lawyers can disagree or there can be vagueness, and so at that point there has to be an adjudication at the highest level, and it occurred here, it does not always come out the way you want, but that is the process.

Senator TESTER. OK.

Mr. HALE. I should tell you that we took it seriously.

Senator TESTER. And I appreciate that and I think you did. You talked to your lawyers, you talked to the Administration's lawyers. Do you ever engage in Congress when there are conflicts like this?

Mr. HALE. Yes, I think so. I mean, it would probably be better to have our general counsel here, but I believe there are discussions with Congressional lawyers when it is appropriate. In the end, I mean, we will be guided by the Administration's lawyers, but we do talk.

Senator TESTER. OK. I just think it is really critically important. I think Congressional intent is very important, and I will tell you that it was more than just a little bit disconcerting when we had the conversation with the ICBM caucus Senators, and basically one of the people in that meeting basically said, We do not care. We are doing what we want to do.

Mr. HALE. I would not agree with that.

Senator TESTER. Well, were you in the meeting?

Mr. HALE. No. I mean, I would not agree with the statement.

Senator TESTER. OK, perfect. That is good.

Mr. HALE. I was not in the meeting.

Senator TESTER. Now I want to talk about the inability of the DOD and the VA to coordinate development and deployment of electronic medical records. The Chairman talked about it a little bit. It allows for a seamless transition for a service member. It is the right thing to do. It has been talked about since January 2007 and maybe before when I walked into this body.

To what extent are you able to answer what the specific challenges are here? Because it seems pretty basic stuff to me. DOD gets together with the VA and moves forward with an electronic medical record that talks to one another. So what is the problem?

Mr. HALE. Well, I am not the expert here, although I am definitely aware of the issue and I think DOD and the VA are committed to that. We have differing views at times about which system to use, but if we choose a different system, it will have to be able to talk to Vista. However, I would like you to consult with others rather than me on the details of that.

Senator TESTER. OK. Anybody specifically?

Mr. HALE. I will get, it is probably just right, our Acting Under Secretary of Defense for Personnel and Readiness (P&R) or our lawyers.

Senator TESTER. OK.

Mr. HALE. I will get you that.[1]

Senator TESTER. Well, this brings me to another issue. If it happens with VA and DOD, the question becomes-when it comes to major acquisitions that the military is going to make, to what extent does your office engage with other agencies, for instance, DHS? There is some parallel work that is being done. They may have already something tricked out that works from a technological standpoint. Do you consult with other agencies?

Mr. HALE. Yes. I mean, we have cooperated with other agencies, satellite programs, with the National Oceanic and Atmospheric Administration (NOAA), for example, as just one example. Many of our weapons are somewhat unique and therefore, the Department-there are not other agencies involved, but where that is appropriate, I believe we do do it. Do you have something specific in mind?

[1] Information submitted by Mr. Hale appears in the Appendix on page 154.

Senator TESTER. No, I can give you specifics, but generally speaking, I think it is critically important, when you guys are looking at a new system, to look around and see if somebody has already built it and then you could utilize it. It saves a whole bunch of money and eliminates the problem.

I know that there are turf issues. We see it in the Senate between committees. It is silly and I think it is silly between agencies, too. So if you can utilize that, I think it makes it more cost effective. And I think it makes you more effective overall. That is all.

Susan—and I appreciate you all being here. But you represent the one service on the panel that has achieved audit readiness. Congratulations.

Ms. RABERN. Thank you, sir.

Senator TESTER. I appreciate your examples of how this accomplishment translates into real-world benefits for our military, our veterans and those who do business with the DOD. Do you have an estimate of the savings that you have achieved from the Marines audit?

Ms. RABERN. Across-the-board, I do not, but I would be happy to provide that for you, sir.[1]

Senator TESTER. That would be great if you had it. I mean, I think that if you could use—if you could utilize the information that you have gained with yours, with your audit process, I think that it makes it all that more important to get a DOD-wide audit done.

I just want to close by saying something similar to what the Chairman said before he left. There is no reason the DOD cannot have an audit. If it is because you are too big, then we need to address that, and you need to be honest with us, but I do not think that is a reason.

I think it has been something that there has not been a focus on. I get the impression that Mr. Hale has put a focus on it and I appreciate that. The proof is going to be in the pudding because the charts that the Ranking Member put up about 2001 compared to today are spot on, and if we are here next year or the year after and we still have those same kind of charts up, there is going to be some ramifications to that because more and more people in the Senate are aware of this and they want it fixed. Thank you all.

Senator COBURN [presiding]. Thank you, Senator Tester.

Let me make just a few comments. Audit readiness to me is a misnomer. What you want is an audit to see whether or not you have the financial controls in place with which to make management decisions. You do not do an audit to do an audit. You do an audit so that it enhances and hones your ability to make financial judgments based on the data, to know that your data is accurate.

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[1] Information submitted by Ms. Rabern appears in the Appendix on page 154.

So, I put up this little chart.[1] It is the audit deadlines, and I understand Senator Carper asked you about SBA versus SBR. But the fact is, an SBA is meaningless to me as an accountant because it gives you just one little scope of period. And the Pentagon has multitude of programs that are run in years. So all it says is for this one short period of time, we have some financial controls if you pass it. Not on the statement of resources, but on the statement of activity.

And so, the whole idea of an audit is to have an audit to know what your holes are and your financial weaknesses and your management weaknesses, so you can change things. Now, let me give you an example of somebody who has done it right in the Air Force, General Wolfenbarger. She is responsible for $16 billion at the supply depots. Three years ago, she instituted a continuous process improvement. Most of the people in the Pentagon do not even have any idea what that is.

But it is how every other modern business combines their audit information with their management so that they achieve savings. General Wolfenbarger and her team have saved, year to date in the last year, about $680 million, and they did it because they actually know what they are doing because they got good numbers.

The question I asked her after she made her presentation is, could you pass an audit? Of course. We could not do continuous process improvement unless we could pass an audit. So I kind of want to take us away from audit readiness, which is the buzzword that we are hearing at this hearing, to having an organization that has the financial controls with which to make the proper decisions, because that is the whole basis.

The audit is the check to see if you have got the information systems, if you have got the financial data. I also have one other anecdote. The commanding general at Altus Air Force Base cut $100 million out of his budget in one year. It is a small Air Force base and he did it through good management. He did not have a general saying, You will cut $100 million. He did it on his own. And, of course, the flashback came, You did not spend all your money, which is another problem. Use it or lose it.

So Mr. Hale, really what has happened is, based on the NDAA, we have descoped on the basis of the outlet clause that was in that, that if it is too hard or too expensive, you can go to one year audit readiness. Right? We descoped what the NDAA said. Is that not correct?

Mr. HALE. Yes, but only as a way to get to the top of the hill, because we knew we could not get there any other way. I mean, we still want the full statement and we will get the full statement. That is the whole point. But I did not want to waste taxpayers' money doing audits when we knew, after the experience in the Marines, that we did not have 10-year-old data quickly enough to satisfy audit needs. So we are going to build toward it more slowly.

Senator COBURN. So when you meet the statutory deadline, if it is met, you will have only 5 years of data?

Mr. HALE. Well, I think we can do better than that. As you get back to the far distant data, it is small as a percentage. If we can

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[1] The chart referenced by Senator Coburn appears in the Appendix on page 135.

get the first few years correct, I think the percentage will be small enough that we may have to engage in some special efforts, but I believe that we will not have to wait 10 years. I mean, it is certainly not our plan.

Senator COBURN. So is 2 years data good?

Mr. HALE. I do not know if two will do it, but I would hope two or three would do it.

Senator COBURN. But right now, do we not have last year's data?

Mr. HALE. We would have last year's data, yes. It is when we go back—I mean, some of our accounts are open for obligation for 5 years, military construction, for example. And then the law allows up to 5 years to expend the money. So some of it goes back as much as 10 years. You get back 5, 7, 8 years, we do not have it readily available. It is there, but it could be in some long-term storage and we need it quickly during an audit. An auditor cannot wait for weeks while we are looking for the data.

And we just found with the Marines, we were not getting there. So, I want to get to the top of the hill, but I want to do it in a way that is as quick as possible, and also mindful that I do not want to spend audit money and I am not getting anything for it.

Senator COBURN. So that question comes on, on construction accounts, for example. Whoever is managing that does not need that long-term data to manage that effectively right now?

Mr. HALE. Yes, they need the data right now. I wish I had it and I do not.

Senator COBURN. So the point is, is because we do not have the data and we have not developed a system for the data, you cannot manage it effectively right now because you have information that is missing.

Mr. HALE. I think our management is impaired. I mean, we do have information on obligations, and I know that is correct. We do 150 million accounting transactions a year. If 1 percent is wrong, we have 1.5 million wrong transactions. We would have massive mispayments. We have massive Antideficiency Act violations. None of that is occurring.

But we need the audit both to verify it and especially for the outlay data. So I agree with you. We need this information as quickly as we can get it. I do not want to waste money in the process of getting it, and I know you do not want me to do that either.

Senator COBURN. So in your written testimony, you say, DOD does have accurate information about where we obligate public funds. If that is true, you know where the money is going.

Mr. HALE. Yes, we know where the obligations are going. And again, my rationale there is what I just gave you. If we did not, we would have massive antideficiency—I mean, even if a tenth of a percent were wrong, we would have 150,000 wrong transactions every year. We would be paying the wrong people, we would be overrunning accounts. None of that is happening.

Senator COBURN. So my question is this: If you know where the money is going, then you should have a Statement of Budgetary Resources.

Mr. HALE. And that is a good question. And I cannot document it in a manner that satisfies auditor. I know it is there because otherwise I would have the problems I just described to you. But I

cannot document it in a way that will satisfy an audit and we need to do that. Moreover, the outlays are more of an issue. I think we do not have——

Senator COBURN. So you know that, but you cannot document it. So my question to you is, how do you know that? If you cannot document—if somebody comes in, you cannot prove it to an auditor, but you can sit here and testify that you know it, but you cannot give us the backup information to say that is true, how can we rely on that as a——

Mr. HALE. Senator, if there were any significant percentage that were wrong, as I said, we would have massive mispayments, and I will tell you what, we would hear about them real quickly if we were not paying our vendors, if we were not paying our people, and we have some, but they are tiny as a percentage.

So I know that that information is right. That does not take away, in my mind, for the need to do the audit at all. We need to verify through an independent audit and we need to correct, other than the obligations, and we need to improve our business practices.

Senator COBURN. OK. The Antideficiency Act you mentioned is a key to Congress's constitutional power to control the purse strings and ensure that public funds are spent as appropriated. The DOD IG reported that it found hundreds of near-missed ADA violations, Antideficiency Act violations—I will try to not use the acronyms to please my Chairman.

Mr. HALE. You could get in trouble, too, Senator.

Senator COBURN [continuing]. Because of inadequate funds control and that several of these near misses turned out to be actual Antideficiency Act violations. In your testimony, you note that one way to reduce the Antideficiency Act violations is to process potential violations quickly. But GAO has reported several examples where investigations of potential Antideficiency Act violations took months or even years to complete.

Would you provide us the number and dollar amount of the investigations that have been initiated, completed, and reported for the last 2 years?

Mr. HALE. Yes. I do not have those in my head.[1] What I can tell you is when I took over this job, we had about 25 ongoing ADA investigations that were late. Now we are down to one and I have worked with my colleagues here and they can attest to that—that we needed to speed up the process. Oftentimes, by the time we finally get done, people are retired, and we need to hold them accountable by doing this more quickly.

Senator COBURN. OK. The other thing I would like for you to answer—you do not have to answer this today—is the average length of time it takes to complete one of those and how many people are involved.

Mr. HALE. OK.

Senator COBURN. You have also reported, and you said so again just in your recent testimony, that they are a small portion of your budget.

Mr. HALE. Yes.

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[1] Information submitted by Mr. Hale appears in the Appendix on page 154.

Senator COBURN. My question is, is it OK to have those even though the numbers are small?

Mr. HALE. No. I mean, zero is the only right goal. I do not know that I will ever get there, but it is the only right goal.

Senator COBURN. Are you aware that the DOD IG has reported that of the 120 actual ADA violations, Antideficiency Act violations reported by Federal agencies, 82 were reported by the Department of Defense?

Mr. HALE. I do not recognize that number. What I have calculated is the percentage of our budget.

Senator COBURN. Well, but your budget is the biggest budget in the Federal Government so percents do not mean anything. Actual dollars mean something to the American people.

Mr. HALE. Zero is the only right goal.

Senator COBURN. OK. I guess we will come back for another round.

Mr. HALE. OK.

Senator COBURN. Thank you.

Chairman CARPER [presiding]. Senator Johnson, I think you are next and then Senator Ayotte.

OPENING STATEMENT OF SENATOR JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman. I want to continue to explore this term audit ready, because I do not think it should be a goal. I mean, it should be a requirement. In business, I would go to the department or division and say, "Are you ready for the audit?", because the audit was going to happen. I just think the purpose and the goals here are just being misused and I think that is part of the problem.

The goal of the audit is not to just prove you are doing everything right. The audit should be used as a management tool to be conducted to tell you where you have deficiencies.

So I think the reason we do not have an audit for the Defense Department is because we have been pursuing what should be a requirement, audit readiness, when we should be pursuing just having the audit and then using the information, because it is going to be a qualified audit. You are not going to get a clean audit. But the goal would be then to utilize the information from the audit to drive your management.

So tell me where I am wrong there. Tell me why we are pursuing what I think is the wrong goal and why do we not just start conducting audits?

Mr. HALE. A couple of years ago, we knew we were not ready and we would have simply wasted time. The auditor probably would have come in and said, You are not even close, and so we would end up paying them to do nothing. That was——

Senator JOHNSON. First of all, I totally disagree with that assessment.

Mr. HALE. OK.

Senator JOHNSON. I do not see how spending money on an audit to determine how bad you really are is a waste of money.

Mr. HALE. Well, I would ask the GAO and IG if they agree that we, 2 or 3 years ago, should have immediately begun an audit. But now, I think we are to the point where you are exactly right. We

will learn so much more by getting into audit because we will have a private sector audit firm that really knows this stuff telling us what is right and what is wrong.

Senator JOHNSON. So when will we do that? When are we going to start? Have we ever conducted an audit on any component of the Defense Department?

Mr. HALE. Oh, yes. If you look at my prepared statement, you will see we have audited or been examined by independent public accountants a large number of parts. We had a full-up audit of the current year of the Marine Corps, and they just got a clean opinion last December. And I hope and I think that we will have——

Chairman CARPER. Excuse me. Would you just stop right there? Say that again, your last statement about full year end—just say that again about the Marine Corps.

Mr. HALE. The Marine Corps had an audit completed last December of the current year of its Statement of Budgetary Resources and got a clean opinion in December of last year. We expect they will get another one—that was on the 2012 statement on the 2013 one. Does that answer your question?

Chairman CARPER. I am confused. I was thinking that progress had been made on 2012, not on the current year.

Mr. HALE. No, I meant current year meaning the 2012 data, just that year, not the prior year data where we could not find the documentation quickly enough.

Chairman CARPER. OK. All right.

Mr. HALE. So that was the year of 2012.

Chairman CARPER. Fair enough. That will not be counted against your time.

Senator JOHNSON. I want to go to a statement that Senator Tester talked about, whether the Department of Defense is too big to be audited. I just want to point out the fact that Walmart's, revenue exceeds $450 billion per year. They have 2.2 million employees, 1.3 million just here in the United States. They have to go through an audit, and they do it successfully, because of Sarbanes-Oxley, risking prosecution and fines if they do not have a successful audit.

What is different about the Defense Department than Walmart in terms of why you just do not do an audit and why you cannot successfully complete one? Tell me the difference between private sector and public sector, why this has been such a difficult task.

Mr. HALE. Well, first off, we are not too big, I mean, and we will divide it up into sections and we are not too big to do it. That is certainly not a reason. Size makes it harder, but we are not too big.

If you ask me why we are not done now, I would really like to have the first 15 years after the Government Management Reform Act, which required auditable statements in 1994, I would like to have them back. We made some progress then, but there was never a coherent plan in the Department and we did not have systematic senior leader attention.

I think in the last 5 years, we have solved both of those problems. We now have a plan. We have resources set aside, which was not the case in those first 15 years, and we clearly have senior leader attention. It starts with Secretary Hagel, but as you have

heard my colleagues say, it goes down through their own leadership and so on.

Senator JOHNSON. Let me back up. The point I am trying to make is if back in 1994, you would have just started conducting audits, start auditing, start seeing the deficiencies and start correcting based on the information, why did we not do that? Would that not have made sense to do that?

Mr. HALE. Well——

Senator JOHNSON. Does it not make sense to do that now?

Mr. HALE. I think it does now.

Senator JOHNSON. Why delay 3, 4, or 5 years?

Mr. HALE. I think it does now and we intend to for the budget statement.

Senator JOHNSON. Anybody else want to chime in in terms of why do we not just start auditing? And does that not make sense for some reason?

Mr. SPEER. No, sir, to me it does not make sense if you know you are not ready. An independent public accounting firm would come in and if after doing an evaluation and testing right away would disclaim. It depends on where you are in your current environment, your controls, and the benefits you can get out of doing the audit. And the cost of that was deemed to be, and rightfully so, that you would not get anywhere to where you are improving or get the financial information that they are expecting and the benefits.

Senator JOHNSON. You know what you get out of it? A lot of management pressure to correct the deficiencies, which I am not seeing right now. That is what you get out of it.

Mr. SPEER. I agree with where we are right now.

Senator JOHNSON. Certainly in public companies, they have the necessary pressure. If they do not do it, they are either going to jail or they are going to have massive fines implemented against them. What kind of pressure do we need to institute against the Department of Defense to actually get it done?

Mr. SPEER. Senator, I believe we have it right now and I believe you have heard it here already. I think to get audited, you are going to hear GAO talk about the six issues and six challenges you have to meet. We have got leadership involvement now. You had to have a reality of understanding the benefits that the Ranking Senator talked about.

It is not just a journey. It is a journey to get you there and prove the controls, but it is using the financial information for the benefit of the entity, and we are about making leadership understand that.

The Vice Chief of Staff of the Army now sees it as readiness, readiness to the units that he oversees. He is brought into the strategic readiness where he looks at units being ready to go. He had to have the understanding and control governance over it. So now that you have the controls put in place, we are putting controls in place that allows the audits. We had systems that did not talk to each other. I do not know how we got to where we were.

Senator JOHNSON. I understand. Again, let me get back to the point. How much of the Defense Department has undergone an audit, what percentage?

Mr. HALE. For the budget statement, it is probably 10 percent at this point. I think for the budget statement, after September, I hope, it will be in the high 80s or more.

Senator JOHNSON. How have you broken down this task into components? What are the components? Is it strictly by service branch? How have you broken it down?

Mr. HALE. More than that.

Senator JOHNSON. Have you broken it down even further?

Mr. HALE. By service and then also each Defense agency and some trust funds on the side. But then we have broken it down, as my statement indicates, into various categories of information, military and civilian pay, our disbursing activities, the various activities that we conduct financially. And we have sought to improve those processes to the point where we can get an examination by an independent public accountant—we are not grading our own homework-and have them come in and say, Yes, it is either right or no, you have to do the following things.

Senator JOHNSON. Is part of the problem there because as those systems are systemwide and they become massive, it becomes pretty difficult to get your arms around that? Again, in a public company, you would audit a division or a department and you would knock it down to small enough component parts and you would complete it. Basically, it is like cleaning out a garage.

You go in the corner, you clean out one of the corners first. Again, have we made this so massive, have we made it such a process that we are just not getting it completed?

Mr. HALE. I do not think so. I think it has been a lack of a coherent plan and attention in the first 15 years. I think we have got them now and you are seeing the results. We are going to be under audit, I believe, starting in October or November for the fiscal 2015 statement on most of the Department's budget.

Senator JOHNSON. Thank you. I am out of time.

Chairman CARPER. Your time is expired. Senator Ayotte, you are on. Welcome.

OPENING STATEMENT OF SENATOR AYOTTE

Senator AYOTTE. Thank you. This is obviously a very important topic. Appreciate all of you being here and I appreciate the Chairman and Ranking Member having this hearing.

One thing I am trying to get a hold of is—and I know, Secretary Hale, we had a recent Armed Services Committee hearing on this acquisition topic as well. I mean, the Department is just littered with failed acquisition programs throughout the services. I mean, billions and billions of dollars. There are lots of examples. $2.8 billion wasted on National Polar Orbiting Operational Environmental Satellite System; 2.5 wasted on the Transformational Satellite Communications System.

From 2007 to 2013, the Air Force wasted $6.8 billion on 12 major acquisition programs that never went to field. Help me understand. I believe that this audit issue is incredibly important, and the fact that we are now diminished from a Statement of Budgetary Resources, which was what what was in the NDAA in terms of requirement, to a statement of budget activity which really only

shows us the year window, how is this tool going to help us with the acquisition programs, Secretary Hale?

Mr. HALE. Well, first off, let me repeat, the Statement of Budgetary activity of the current year is just a means to get to the full statement because we did not have-we cannot produce the data or documentation quickly enough. So we are not backing off of the goal of auditing the full statement at all. We are just getting there in a way that I think is cost-effective.

I am not going to sit here and tell you, Senator Ayotte, that financial statement audits are a panacea for every problem in the Department of Defense, including all the acquisition issues. Requirements are a key issue in terms of determining whether we succeed in acquisition, as are the skills of the workforce, and I think Frank Kendall is working those issues hard.

But I believe we could help by tightening our controls and we will have to do that in the process of getting the financial statements, in terms of giving all of us, including Frank Kendall and those who work for him, better information.

Senator AYOTTE. Can I ask you about a particular one?

Senator COBURN. Could I interrupt for just a second?

Senator AYOTTE. Sure.

Senator COBURN. Here is the difference, Bob. In a large business with big acquisitions, the CEO is getting a report every week, whether it is on time or on budget. We do not have that. Secretary Hagel does not know the major acquisition programs, whether it be an enterprise resource program or a weapons system or anything else. He is not getting a weekly report so he can act on it because we do not have the information to give it to him.

That is the key point. That is why the audit is important, so you will get the financial information so you can flow the information up to the decisionmakers so that when you have a red flag, they know it. Not 2 years after the red flag came up, but the day the red flag came up.

Senator COBURN. Not after we spent billions of dollars.

Mr. HALE. It sounds reasonable to me, Senator Coburn.

Senator AYOTTE. Thank you, Senator Coburn, and I agree fully with the comments of Senator Coburn and how important this is.

So this morning, there was a description of reports that the Pentagon is going to field an $11 billion contract to overhaul its electronic health records system, and this would be by far the biggest IT contract since healthcare.gov failed rollout.

And with all due respect, we do not really have—I think there are a lot of issues with IT acquisition, not just in DOD, but this has been an issue that this Committee has focused on across the government. And as I hear that, it raises red flags for me in terms of what controls are going to be put in place given that you are not in a position, as you would like to be, Secretary Hale, to have this type of data that we just talked about.

What are the controls that are going to be in place for taxpayers on this huge contract? Important. I understand the purpose of the contract. It is going to, as I understand it, impact all of the health records for our men and women in uniform, but we have a history of not having-obviously, we are not in the place we want to be on the audit.

We have notable examples of failed IT projects and this is an $11 billion project. So what controls can you assure us are going to be put in place as you go forward with this? And I guess a good question is, will Secretary Hagel get those reports weekly to know whether the $11 billion is being spent properly and we are on time?

Mr. HALE. That one I think I can tell you he will. He is deeply and personally involved in that program. Frank Kendall meets with him weekly, and although I am not in those meetings typically, I think that this issue will come up. I think he will get regular reports. We will give him the best data we have, and actually on the obligation side—we have had this conversation before—I believe our data is fundamentally accurate. We still need to do the audit to verify that, but I am not seeing the problems that would occur if it were not accurate.

The key thing on the IT—two key things. One is the requirements. There has been a lot of time devoted to trying to make sure the requirements are right in this contract. So although I am not the best guy to talk about it, I know that there has been a great deal of attention.

And I think Frank Kendall, if he were here, would say that we need to develop better training for our acquisition professionals in IT. And they are consciously working to expand the curriculum, for example, the Defense Acquisition University, to try to improve the training.

Senator AYOTTE. So I think this is a contract that this Committee also—we really need to keep an eye on it. It is $11 billion. It is a huge IT acquisition and it makes me very concerned. I am glad that the Secretary himself is going to focus on this because there are just too many examples where we have invested in IT projects that have not gotten the results, and $11 billion is a significant project.

Senator COBURN. Why not convert the VA system to the military? I know that we always have a reason why, just like on our ERP programs, we always buy programs and then modify them to fit the military, rather than have the military modify their programs to fit a proven system.

Senator AYOTTE. Great idea.

Mr. HALE. I would like to get you with Frank Kendall to answer that question, Senator Coburn. I have heard the answer, but I think that he has the depth that is appropriate to address it. If we do go with a separate system, the requirement that it be interoperable and be able to talk to Vista will be a key, which is the VA system will be a key requirement. But I would rather have him address that.

Senator COBURN. Just to note for the record, the Federal Government spends $80 billion a year on IT. Forty billion of it is wasted every year.

Senator AYOTTE. I look forward to seeing that answer as well. Thank you. I wanted to ask you about improper payments. You have, I think, testified again today about the fact that the DOD's rate of improper payments is only .17 percent.

If you compare that to governmentwide, it is 3.53 percent. But GAO, in its 2011 report, really targeted—and I know that some of the data used in that report was going backward. So I will give it

that. But GAO basically found that DOD's improper payment estimates were neither reliable nor statistically valid because of long-standing and pervasive financial management weaknesses.

Of course, this is all about what this hearing is about. But how do we know that what you have given us today is accurate? And can you give me some more details on how DOD's improper payments program has evolved to get to this point where apparently your statistics are quite good?

Mr. HALE. Well, I think the main thing we have done is try to close the barn door before the cows leave, rather than just looking at improper payments after they occur and trying to fix them. For example, we put in place in commercial payments something called the Business Activity Monitoring (BAM) System which looks to see—it is pretty simple.

It has rules. It says, Hey, if two invoices come in within 2 days and they have the same number, spit it out to a human so they can see if it is a duplicate payment. That is a trivial one, but there are many others. We are trying to do something similar in travel, which is an area where we still need to make further improvements.

In terms of the accuracy, we have done, because of IPERA, or to comply with it, pretty extensive statistical testing. GAO does not like all of our testing, but you get two statisticians, you are going to get two different opinions. Our statisticians think our sampling is fine, but we have actually changed it to try to satisfy GAO.

Pretty extensive sampling after the fact to see if indeed the cows are still in the barn, and the data you are seeing reflects that they are, with some exceptions. And again, zero is the only right goal for improper payments.

Senator AYOTTE. Of course.

Mr. HALE. But they are pretty small and I am not sure we are going to get all that much better. I think it is a success area for this Department.

Senator AYOTTE. Thank you. May I ask one more question, Mr. Chairman? I know my time——

Chairman CARPER. Yes.

Senator AYOTTE. I just want to ask the Air Force, when Secretary Hale talked about the 80 percent goal in terms of this fall, obviously we are not where we want to be with the SBRs——

Mr. HALE. The goal is 100, but we may not——

Senator AYOTTE. Correct. Where is the Air Force on this? Because you have been the service branch that I think has had the most difficulties and challenges.

Mr. MORIN. Yes, ma'am. We certainly started behind in this effort. Our financial systems modernization was and remains several years behind the other departments. We are in the early stages of fielding a modern financial system, and are still relying on our 1968 accounting system. The other services are further along.

However, while the ultimate—while the judgment of audit readiness for the Schedule of Budgetary Activity will be made later this year by the Secretary of the Air Force, right now it looks like we will be ready to assert on that schedule. So that is our view at this point. Again, we have significant milestones to get through over the course of the summer. These issues include our work in conjunction

with the Defense Finance and Accounting Service (DFAS). We have corrective action plans that we are laying in place based on past engagements by independent public accounting firms. But our assessment right now is that we are on track for that.

Senator AYOTTE. And on all of this audit issue, is it being driven, I know, not just beyond Secretary Hagel, but at the Secretary level of each service branch?

Mr. MORIN. Senator, when our new Secretary of the Air Force took office just a few months ago, she laid out three top priorities for her tenure and for the Air Force under her authority, direction and control. One of those three was making every dollar count and audit readiness was a key part of that for her. So very much so.

Ms. RABERN. Yes, ma'am. The Secretary of the Navy is a former State auditor for the State of Mississippi. He made it clear to me on day one this was his highest priority and he talks to me about it every week.

Chairman CARPER. Did you say Secretary of the Air Force or the Navy?

Ms. RABERN. Navy, sir.

Chairman CARPER. Thank you.

Mr. SPEER. Yes, ma'am. Secretary McHugh is very heavily involved in and interested in it. I was in the Chief of Staff of the Army's office yesterday talking to him about auditability and he is trying to get better financial information for cost informing readiness. And heavily involved with the Vice Chief of Staff of the Army overseas and on a monthly basis.

Senator AYOTTE. Thank you.

Chairman CARPER. I am a recovering Governor. My last job when trying to solve issues in our little State of Delaware, I would oftentimes say to my Cabinet, some other Governor in some other State has confronted this problem and has figured out how to solve it and we need to find that State, that Governor, and whoever solved it and find out if their solution was exportable to our State.

Occasionally we would have Governors from other States who would say, Well, how did you do this or that, and we would try to help them.

In the Navy, Captain Rabern, I do not know if you ever heard the term refusal speed, but when you have an airplane heading down the runway to take off, the airplane gathers up speed until it finally reaches a speed we call refusal speed, and that is the speed at which the pilot decides to keep the airplane on the ground or decides, We are going to fly this baby.

The Department of Homeland Security a couple of years ago decided—they had, if you will, the aircraft going down the runway moving toward—heading forward to being auditable and actually having a clean audit. And somewhere along the way, they reached refusal speed and they said, We are going to fly, we are going to get this done. And they did.

And it was not just Jane Lute who we have no disrespect for, the Deputy Secretary, it was not just Rafael Borras. It was all the way down and through their organization. But thinking back about my experience as Governor, flying in from other States seeing, how they solved particular problems, what lessons have we learned?

And this is for each of you. What lessons have we learned, taken to heart, from the Department of Homeland Security?

For them to have actually achieved not just to be auditable, but actually have a clean audit within the timeframe they had, it is pretty amazing. They are a huge department. They have hundreds of thousands of employees. They do all kinds of things. They are spread out not just all over the country, all over the world.

If they can do it in a short timeframe, how did they do it? What have we learned from them? What have you learned from them?

Ms. RABERN. Sir, we have learned a lot not only from the Marine Corps, but from our sister services. I am not sure you are aware, I was the Chief Financial Officer of the FBI, U.S. Customs Service, and the Agency for International Development. So I bring those lessons learned to this job.

Chairman CARPER. Well, you have quite a resume.

Ms. RABERN. I have been in other places. I have been blessed. Yes, sir, thank you. The thing that I find most important, absolutely across-the-board in every one of my experiences is if the boss does not get it, then it will not work. So the tone from the top is absolutely most——

Chairman CARPER. Leadership is the key in everything and that includes this.

Ms. RABERN. Absolutely. It is also about me being actively involved and spending time with those who are responsible for the subsections of our budget. We have 19 budget submitting offices. I meet with them regularly. I bring them to me, I go to them, I go into the duck plates. I talk with the people who are actually making the transactions.

You and I both know that you can tell by doing that, walking around management, whether you are ready or not, whether the tone and tenor is right, and absolutely, from my past experience, I can tell you that the Department of the Navy is there. The momentum is there, the refusal speed, I think you called it, we are there. We are excited. We are ready to go. We are ready to take the lead that Senator Johnson has just described. It is time. It is time for us to do it.

Also, having a staff that is trained. This is one of the things that I spend time thinking about and that is making sure that the government employees understand their particular individual role with audit, so their day-to-day duties are well understood about what their personal role is in audit success. We are working on that. We are working on a fundamental training framework so that every person involved in financial management in the Department of the Navy understands what their role is.

The other thing that I have learned across-the-board is that it is not only about training the culture of the organization that is being audited. It is about also understanding. You have to train the auditors so that they understand what the mission of the organization is. And that is something that you have to do up front and early. They have to understand who you are and what your language is and what your business is.

And the other thing—the final thing that I would say is you should never dance in the end zone. You should never discount the

difficulty of this work, nor should you discount the importance of getting on with it. Thank you, sir.

Chairman CARPER. Well, before we can dance in the end zone, we have to get into the red zone. I think we may have moved into the other team's territory, but we are not even in the red zone. So maybe we can get there if we keep this up. We have to. All right?

Ms. RABERN. Yes, sir.

Chairman CARPER. Football is not that far away. So like late September we want to be in that red zone. Dr. Morin, just quickly, Air Force has really the most ground to make up. You said that a couple of times. What do you learn from DHS and the way that they have actually made up ground, they made up quickly, and got into the end zone? I invited them to come here today and do a dance in the end zone. They declined.

Mr. MORIN. Senator Carper, Dr. Rabern has an exceptional resume. I have a very good staff to compensate for my lack of resume. I will note that the Acting CFO of the Department of Homeland Security is a retired Air Force officer who used to work for me, so we have a lot of opportunities to exchange thoughts and ideas on efficient fiscal management as well as audit.

Chairman CARPER. What are some things you have learned from that person or others in DHS that would help expedite this process?

Mr. MORIN. For us, the biggest piece is the value of getting the auditors' eyes in. To Senator Johnson's point from earlier, I think we really are taking exactly the strategy you have laid out, which is starting the audit. I think we have had very recently a Big Four accounting firm in looking at Air Force-wide civilian pay, billions and billions of dollars of our activity, and they looked at it end to end.

They found our noninformation technology controls were generally functioning well. I think it was 25 out of the 28 that they examined they found were well designed and functioning well. Punch list of things to improve, just like you brought up, on the remainder. They found in some of our IT areas we had issues where, for example, we were not doing a good job of purging user rosters on systems, and so people would move on from a job but still retain their systems access.

Again, those are issues, but they are punch list items. Right? You can fix those. I think that is exactly what is going on and that is a key lesson from Homeland Security. You have to build that list of concrete, definitive actions. For many years, the Department would have auditors come in and issue a same day disclaimer: We cannot get to the answer, the systems are not reliable, the data is not reliable, we are done.

We are now to the point that by focusing on these individual segments—we call them assessable units—and breaking it down, we are getting to finite and achievable lists. We are not hitting them all right the first time, but we are getting most of them right and we are cleaning them up as we go. So that is just absolutely key.

Chairman CARPER. Thank you. Real quick, 30 seconds, Mr. Speer, same question.

Mr. SPEER. Yes, sir. I agree with that and I guess my background is in audit and accounting. I came from PriceWaterhouse Coopers

to this job and I was a program manager in the Corps of Engineers audit, which is probably the largest audit in the Department of Defense, and we learned a lot from it. Part of it, I think I agree with Senator Johnson. Get in the game and start playing. You start to learn the value of the audit, you start to learn the culture of an audit, and you start to understand that leadership involvement and commitment to it is what accomplishes it.

You cannot win it if you do not play. So we are at that stage now where I think it is the value of playing the game. I think we have the controls in place and we have leadership involved and you see now the benefit. We see people actually using the data now out of the systems that makes the difference and that is part of the value of the audit.

Chairman CARPER. Mr. Hale, 30 seconds, same question. DHS, what have you learned from them? How have they helped you with this challenge? How are they helping you with this challenge?

Mr. HALE. We actually hired the person who did the DHS audit.

Chairman CARPER. Is that person in this room?

Mr. HALE. Because of personal problems she had to leave us.

Chairman CARPER. Is she in this room?

Mr. HALE. Is Margo here? She is not here. She had some serious personal problems and is going to have to leave us. But I think the tone at the top was clear. They had the biggest problem valuing their assets, which is an issue we have not confronted yet, but I think we got a fair amount out of Margo while she was with us and we will continue to benefit from them.

Chairman CARPER. All right. We wish her well. Thank you. Dr. Coburn.

Senator COBURN. Mr. Hale, let us assume that GAO was right on improper payments and the statistical validation. You disagree with them and you said you have made some changes in how you are doing that. So let us assume that they are right and you are wrong. So we do not know. If we make that assumption, we do not know how all of the money is spent, right? And we do not know the accuracy of the improper payments. And 1 percent of $700 billion is $7 billion in Oklahoma. I do not know what it is up here, but that is what it is.

Mr. HALE. Pretty much the same.

Senator COBURN. $7 billion is a lot of money, and I can tell you I am skeptical at every hearing on the improper payments for the DOD simply because of the massive size of it. Let us talk for a minute about plugs. Tell me what plugs are in your mind in terms of the Pentagon's financial statements.

Mr. HALE. The jargon we use, which I think is more explicit, is journal vouchers. There are circumstances that we need to fix. I will use the analogy, you have 1,000 people on your bank account and by the end of the month 990 of them report and 10 do not. We have to return. We have to tell the Treasury what we spent.

And so we issue what is called a journal voucher that estimates the amount for those 10 who have not reported, and are supposed to go back and reconcile it. We have not always done that and that is one of the things we have to fix and are fixing. They are pretty small as a percentage. They are getting down to levels that may

not be material in a financial audit of less than, say, 1 percent, but they are an issue and they have to get fixed.

Senator COBURN. Mr. Speer, you have received questions from the Senate Armed Services Committee hearings about the Army's decision to process some of their disbursements directly through your ERP system, and in the process, bypassing the need for these transactions to be processed by DFAS. I will use—he is turned around. He will not care that I am using an acronym.

Can you explain why you made that decision and how it improves the Army's financial management capabilities?

Mr. SPEER. Yes, sir. It was part of a review we did. It was part of cure to pay and to analyze and optimize the system. We looked at the way we were currently disbursing and we looked at some of the connectivity between some of the systems that caused us some of the errors. And so, when we looked at Treasury direct disbursing out of the system, we tried to engineer the process and see whether or not that could go direct Treasury disbursement. It eliminates some of those errors and some of the reconciliation needs, some of the plugging of the numbers and fixing back.

And so, we piloted that program and we are phasing it in as we are finding success. We are still measuring whether the results of such provided a reduced cost. We are going through that currently now, the cost benefit analysis. We believe that from—the disbursements we are making now is about 15,000 a month and we are having zero out of balance condition with Treasury, so it provides that correct, easy reconciliation by not going through some of those other processes.

Defense Finance Accounting Service it turns out to be very much still involved in the process, still coming back to the accounting and sees that it still has oversight and participation in that process. So we believe that this entitlement within the system will provide oversight of what we are paying, then creates that disbursement file out of the same system, provides a more easily reconcilable, direct, and less costly way of doing business.

Mr. HALE. I do want to clarify. We have not made any decision to change the roles and missions between the Army and DFAS yet. We are looking, the Army is, we are. If it is cost-effective, we will do it. If it is not, we will not.

Senator COBURN. Well it is only cost-effective if you can have real savings or you can have real accuracy, which you do not have now, and I do not know how you put a dollar on that other than you are going to markedly improve financial management if you have real accuracy.

During your testimony, you mentioned that disbursing straight from Treasury is the best practice. Who has determined that and what other agencies use this?

Mr. SPEER. Most other agencies use Treasury direct disbursing. I do not recall, in terms of the testimony, saying best practice. We believe it is best practice and we are testing that out as part of what we believe it is. We have seen other agencies do so, and so the systems are capable of doing it. It is a changing of the environment of the systems, and so that is why we went to the procure-to-pay pilot to assess that.

Senator COBURN. Well, every other agency uses Treasury.

Mr. SPEER. Yes, sir.

Senator COBURN. I had one other question for you, Mr. Speer. Given the Air Force's success on their supply depots, would it not be nice if the Defense Logistic Agency went and learned from General Wolfenbarger what she did? I do not know what the size of the Defense Logistics Agency (DLA) is, but I know it is bigger than $16 billion.

It would seem to me that you would not have to reinvent the wheel if you went and had a little confab with the head of the DLA and the head of the depot system in the Air Force. And maybe transferred management techniques, motivational techniques, and processes could really significantly increase the savings and also increase the accuracy and decrease the inventory, because that is money that is tied up and we all know that is a problem.

Mr. SPEER. Yes, sir. As a matter of fact, I wrote that one down, to go back and follow through with the Air Force on that one. I am very interested in it. I think we are going through some of our own asset visibility and trying to improve, and General Via has significant efforts ongoing for improving the accuracy of the data.

The U.S. Army Material Command (AMC), for instance, is one of the ones that is reporting directly to the Chief and very involved right now on the cost of training and cost of readiness, and we are looking at those kind of activities.

Senator COBURN. Well, the key thing that Doctor—I want to say Doctor when I say general, pardon me, that is my former training—General Wolfenbarger did is she got her commanders at each one of these to buy into this as well, which you all mentioned. Leadership is the key and the whole goal is to better financially manage so that you do not waste money, that you buy better, that you get a more efficient utilization of the American taxpayer dollars.

So I would just say, just having a meeting, you meet with Wolfenbarger and then see what you think. It is just me saying that, but when I see almost $600 million last year in savings that would not have occurred had they not done that, to me that is real change. That is 10 percent of Oklahoma's budget. Thank you.

Chairman CARPER. Thank you. Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman. I want to just go back to the discussion of the goal of what we should be looking at in terms of an audit. Again, from my standpoint, the goal of an audit is to provide management information. What I am hearing, maybe I am making an incorrect assumption here, is the goal, in terms of the Department of Defense, is to get audit ready so that when you conduct an audit, it is going to be a clean audit. Am I misreading that?

Mr. HALE. Well, it is a step on the road, Senator Johnson. We have to get close enough so that we are just not wasting the public's money with an audit. But no, the goal is to have accurate information and have the audit attest to that.

Senator JOHNSON. OK. I am glad a couple members of the panel have somewhat agreed with my approach—conduct the audit and use the management results. I want to talk about the component parts, how you break this thing down so it is manageable. I think you called it assessable units.

I would like to call it accountable units, because I think leadership is key, but the way you are really going to get results is if you hold people accountable. So I want to go back to how have we broken this down—which is obviously an enormous task—but I go back to my private sector experience here.

You have a large corporation. You are going to have individual divisions. Within the divisions or different companies, you also have individual departments. Each one of those departments, every one of those divisions and every one of those individual companies is accountable for its own successful audit. Sometimes those audits are done by totally different firms.

Would that not be part of the process to do this successfully? Break this down into smaller component parts and hold those individuals accountable, and again, also put pressure on individual units. Here, you have the Navy, you have the Marine Corps. We have a clean audit. What is wrong with the rest of you branches? Set up just that type of pressure.

Mr. SPEER. Yes, Senator, I would agree with you. We have broken it down both in terms of the fire, in terms of doing the Statement of Budgetary Resources first and then moving out broader into existence and completeness. I think somewhat slightly different approach in terms of services. One of the things we did, we followed up with again the Corps of Engineers. We also looked at it as we fielded a new system, our first exam.

We decided to do an exam across five different business processes and did it at the first three installations that adapted the General Fund Enterprise Business System, a new system. The next year we broadened it out to 10 installations, did an audit of eight of their business processes. And this year we audited the whole Army across all business processes for the Statement of Budgetary Resources.

So we have broken it off into pieces and get larger and larger to show success and identify where we can remediate and make a successful audit overall.

Senator JOHNSON. And again, coming from the private sector, you are never going to get an unqualified opinion if you do not have prior years' experience. And because we are not doing audits, is that a bit of a problem in terms of a clean audit? So why not say, let us start auditing so you have that prior year experience?

Mr. SPEER. I believe so, Senator, and I think my earlier statement is if you are not ready, you know you are not ready, you will not get the benefit out of it. We believe we are starting to get closer and closer to ready. That experience, and some of my colleagues here talked about it, they are building the culture of an audit, making sure that people understand how to be audited and know that they are accountable.

That is the lacking we had for many years in the Department of the Army, people who were not held accountable to ensure that they were auditable. It is part now of their business. It is part of the process, part of their controls that they are responsible for and they understand that now. That is part of the audit that builds that kind of accountability.

So one of the things we have seen is we have seen competition between commands now. Hey, I want to show that I am better than

the other command and I am getting the results better. The U.S. Army Forces Command (FORSCOM), if you go to FORSCOM's website during Exam 3, you go and click on the four-star general's website and he would have by installation the results of their individual audits of their documents, whether they turned them in on time and whether they are right or wrong.

Senator JOHNSON. Well, not to beat a dead horse, but once you start doing it, they will be accountable and they will get into line. Secretary Hale, you were talking about, as an example, 10 units that have not reported their cash or their budgetary outlays. How can that be? Tell me about that. Again, coming from the private sector, every division reports their cash position. How are those units not accountable for providing that kind of information on time?

Mr. HALE. Well, they are accountable, but if it does not happen on time that we can report to the Treasury, we have to do something. We are down to less than 1 percent, in most cases, for those journal voucher entries. And it has to get lower than that.

Senator JOHNSON. Again, I understand. The accounting department is going to have to account for it in some way. How is the management structure holding those individuals accountable who are not providing pretty basic information?

Mr. HALE. And I think one of the benefits of the audit is it is raising the visibility to our commanders. I doubt they knew that these things existed. Some of them still do not, but they will if they flunk the audit, as Bob Speer has said and my other colleagues have said. This has now become part of the readiness of the military.

The Vice Chiefs are asking questions of their commanders. And if we are having trouble with journal vouchers, they will be asking questions of them. Do any of you want add to this?

Senator JOHNSON. Let me just say, you are making my point, that you should just go ahead and audit.

Mr. HALE. We are ready to go.

Senator JOHNSON. OK. But again, everything I am seeing is we are just talking about getting audit ready as opposed to just conducting the audit.

Mr. HALE. It is a milestone on the road and more than that, but it is a milestone I believe we have to meet because if we do not, the auditor will just come in and, as Jamie said, give us a same date disclaimer, and especially if it is a firm-fixed price contract, we would have paid a lot of money for it.

You should ask this question, if you are here, of the GAO and the IG. I think they will have to say that we do need to be audit ready before we can do an audit.

Senator JOHNSON. There is one other area I want to talk about, because a number of people have mentioned how disruptive the government shutdowns, the budget dysfunction is in terms of being able to obtain an audit. I understand the disruption. I understand how incredibly difficult it is to manage under those circumstances. But again, in the private sector, there are all kinds of uncertainty. There are all types of disruptions, and yet, you still are able to audit your results.

Specifically, why does that really affect your ability to get an audit unless it is just a personnel issue?

Mr. HALE. It slowed it down, no more than that, no less. I mean, we furloughed 650,000 people, both in their morale and their paychecks, and the time they had were affected. But I agree with you. We have to work beyond it. And I am hoping it never happens again. We need to work hard with the Congress and the President to make sure it does not.

Senator JOHNSON. OK. Thank you. Thank you, Mr. Chairman.

Chairman CARPER. Thank you and thanks for all your questions. I am going to ask just one quick question and ask for a very brief response from each of you. We have heard today from Secretary Hale that audits are not free. They can be very expensive in some cases. Do not want to waste money on an audit. I understand that.

For each of our witnesses, starting with you, Secretary Hale, do you have the resources in this fiscal year, that is 2014, do you have the resources in this fiscal year 2014 and in the fiscal year 2015 budget request from the Administration to actually conduct an audit? I do not want a long answer.

Mr. HALE. Are they adequate, you are asking?

Chairman CARPER. Yes.

Mr. HALE. Yes, I believe they are. I mean, we have worked hard to do so. I will let my colleagues answer, but there is a sizable amount of money set aside over the whole 5-year period from fiscal 2015 through 2019, which is our current and future years defense plan, to carry out this program. That is something that has never been the case in those first 15 years. I think they are, but I will let my colleagues respond.

Chairman CARPER. Mr. Speer.

Mr. SPEER. Yes, Chairman, they are adequate. As a matter of fact, we fenced them in to make sure that we did not touch the funds that we needed in 2015 to make sure we can continue on. That is part of our priority.

Chairman CARPER. All right. Thank you.

Ms. RABERN. Yes, sir, I would agree. The Department of Navy is in the same place.

Chairman CARPER. OK. Dr. Morin.

Mr. MORIN. I would agree as well. Again, we are setting aside fiscal year 2015 funds since the auditors will come on station in fiscal year 2015, and for fiscal year 2014, we have adequate funds to prepare.

Chairman CARPER. Good. Dr. Coburn.

Mr. HALE. Can I have a brief comeback to that? The area that I am concerned about are Defense agencies. We have not necessarily solved that problem fully and we are working it.

Chairman CARPER. All right. Dr. Coburn.

Senator COBURN. I have just one final question. Bob, your service has been remarkable. I want to tell you I appreciate it. I am concerned that who replaces you should have the management experience, the educational experience, the financial auditing experience to actually lead this organization.

We have a good nominee, but he does not have any of those qualifications. Your ideal replacement, not in terms of individuals, but your ideal replacement, what qualifications would they have?

Mr. HALE. First and foremost, I would want somebody who is a leader. I think Mike McCord will do that. I would want somebody who knows the Defense financial management and Federal financial management. And it is not just audit. We have to worry about budget, too. I mean, that is part of the job of the Under Secretary of Defense, Comptroller. I think Mike knows that well.

We have people—he will need help, and I think he would agree with this—on the details of audit and accounting and all these acronyms. I did, too. I am not an accountant or an auditor. But I think we have good people. One of them is sitting behind me, Mark Easton, my Deputy Chief Financial Officer, who knows this well.

I think he will be there to help Mike and I think he will do a great job if he is confirmed.

Chairman CARPER. Before we head to the next panel, two things. One, again, Mr. Hale, thank you. As we say in the Navy, fair winds and a following sea as you weigh anchor. To the others, I would say, for the work that is being done, we are appreciative of that. We do not mean to appear to be unappreciative. But for those of you who are at refusal speed, we want to keep going. We want to get this airplane in the air. And we have just seen from DHS again and again what a great example they have provided for all of us, including for you.

If you are not drilling down with them, Jane Holl Lute is still reachable. Ophil Morris is still reachable, others are. They can be a great resource, use them. I am sure they would be happy to help.

With that, there are going to be a number of questions we have, followup questions to ask of you. We just ask that you respond to those in a timely way. Again, thank you, and have a good day.

Mr. HALE. Mr. Chairman, I am going to do our darndest to stay, as you both requested. I am running short of time. I do want to tell you that I have fairly frequent contact with the DOD IG and my Deputy Chief Financial Officer has regular contact with both the GAO and the IG, and I have talked to Gene Dodaro several times on this topic. But I will stay as long as I can. And my colleagues, I think, will do the same.

Chairman CARPER. All right. We appreciate that. Thank you. All right. Our first panel is excused.

Our second panel will come on, please. Welcome. Jon Rymer, Asif Khan, it is very nice to see you again. I am not going to give your introductions. We are running way late and I want to make sure we have time to hear from you and to ask questions, so I am just going to—we will do all of that for the record in terms of introduction. Delighted to see you. Thank you for being here and thank you for helping us as we deal with these difficult and challenging issues. Mr. Rymer, why do you not lead off, please? Thank you.

TESTIMONY OF THE HON. JON D. RYMER, INSPECTOR GENERAL, U.S. DEPARTMENT OF DEFENSE

Mr. RYMER. Yes, sir. Thank you, Chairman Carper, Ranking Member Coburn, and distinguished Members of the Committee. Thank you for this opportunity to appear before you today to discuss the role of the Office of the Inspector General in the Department of Defense efforts to reach audit deadlines of 2014 and 2017. Hearings such as this are an important means of providing visibility to the Congress, the Department, and the taxpayer of the efforts to achieve financial accountability. These efforts, however, have been underway at the Department for over 20 years.

In my prepared statement,[1] which I request be submitted for the record, I discuss areas requiring continued focus——

Chairman CARPER. Let me say, both of your entire statements will be made part of the record.

Mr. RYMER. Yes, sir.

Chairman CARPER. Just feel free to go ahead and summarize. Thank you.

Mr. RYMER. But to emphasize, in that statement, I emphasize that data quality, timeliness, internal controls, and Enterprise Resource Planning Systems are critical. I would also like to highlight some of the achievements we have observed in the last few years. Achieving auditable financial statements is a team effort which will require extensive cooperation among all stakeholders.

While the Department has the ultimate responsibility to produce auditable financial statements, the Office of Inspector General, under the IG Act, is responsible for providing independent and objective oversight of the Department's efforts to improve its financial management and to provide an opinion on the financial statements.

Independent accounting firms provide support and work under the supervision of my office. As the Department produces auditable financial statements, the Government Accountability Office will ultimately rely on the work of my office to develop its opinion about the financial statements of the United States.

Transforming the financial management of the Department has proven to be a complex and difficult undertaking. The Department's senior leadership have recognized some of the difficulties related to the Department's financial management data, problems with internal controls and related financial systems. For example, to work around difficulties in obtaining adequate supporting documentation for prior year balances, the Department has asserted audit readiness on its Schedule of Budgetary Activity versus the full Statement of Budgetary Resources.

While this incremental approach is a step forward, it does not meet the statutory requirements because the schedule is a subset of the information required by the Statement of Budgetary Resources.

Through our oversight role, we will continue to work with the Department and GAO on moving toward auditable financial statements. The Department must maintain its commitment and may actually need to increase its efforts to meet the 2014 and 2017 deadlines.

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[1] The prepared statement of Mr. Rymer appears in the Appendix on page 92.

The Department's efforts cannot just be an exercise to get a clean opinion. Rather, it needs to be about obtaining quality data that can be relied upon to make critical decisions regarding the operations of the Department. This concludes my opening remarks. I look forward to answering your questions. Thank you.

Chairman CARPER. Thank you, sir. Mr. Kahn.

TESTIMONY OF ASIF A. KHAN,[1] DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. KHAN. Mr. Chairman, Ranking Member Coburn, thank you for the opportunity to discuss the challenges faced by the Department of Defense in improving its financial accountability. Given the Federal Government's continuing fiscal challenges, it is a more important than ever that Congress, the Administration, and Federal managers have reliable, useful, and timely financial and performance information to help ensure fiscal responsibility and demonstrate accountability, particularly for the government's largest department.

Today, I will first discuss the effects of ongoing financial management weaknesses on DOD management and operations, and then DOD's actions to improve its financial management and achieve audit results. My testimony is based on our past and ongoing work at DOD.

DOD faces continuing challenges in establishing sound financial management processes and operations that can routinely generate timely, complete, and reliable financial and other business information for day to day decisionmaking. Operational impact of these weaknesses include, first, DOD's inability to properly account for and report DOD's total assets which are about 33 percent of the Federal Government's reported total assets, including inventory of $254 billion dollars and property, plant, and equipment, with an approximate value of $1.3 trillion.

Second, its inability to accurately estimate the extent of its improper payments because of a flawed estimating methodology that also limits corrective action. Finally, reports of Antideficiency Act violations, 75 violations reported from fiscal year 2007 through fiscal year 2012 total nearly $1.1 billion.

To correct its financial management weaknesses, DOD has numerous efforts underway. Congress has played a major role through its oversight and mandates. Important progress has been made, but key challenges remain. For example, in August 2013, we reported that DOD's audit readiness efforts would benefit from a risk management strategy to help program managers and stakeholders make decisions about assessing risk, allocating resources, and taking actions under conditions of uncertainty.

DOD has identified several risks. However, they were not comprehensive. Without effective Department-wide risk management, DOD is vulnerable for not achieving its audit readiness goals. DOD is monitoring its component agencies' progress toward readiness. As the September 30, 2014 date for asserting audit readiness on a Statement of Budgetary Resources approaches, DOD has empha-

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[1] The prepared statement of Mr. Khan appears in the Appendix on page 102.

sized asserting audit readiness by this date over ensuring the effectiveness of its processes, systems, and controls.

Nevertheless, DOD reports milestone dates that have slipped and timelines that have been compressed, making it questionable whether the corrective actions necessary for audit readiness will be completed by September 2014.

Our ongoing work at the Army and DFAS illustrates this issue. While the Army asserted audit readiness on various assessable units of its SBR, preliminary results from our ongoing review indicate that the Army did not complete key tasks to ensure that its SBR will be audit ready as planned. The deficiencies and gaps in Army's efforts demonstrate a focus on meeting scheduled milestone dates and asserting audit readiness before completing actions to resolve extensive control deficiencies.

DOD has identified contract pay as a key element of SBR. DFAS, the service provider responsible for disbursing nearly $200 billion annually and the Department's contract pay, has asserted that its processes, systems, and controls over contract pay are audit ready. However, preliminary results from our ongoing assessments indicate that DFAS also has numerous deficiencies that have not been remediated. Until DFAS corrects these weaknesses, its ability to process, record, and maintain accurate and reliable contract pay transaction data is questionable.

Timeframes are important for measuring progress, but DOD must not lose sight of its ultimate goal of implementing lasting financial management reform. Regarding business information systems, DOD has identified several multifunctional enterprise resource planning systems as critical to its financial management improvement efforts.

In a report on four of these systems, we found deficiencies in areas such as data quality, data conversion, system interface, and training that affect their capability to perform essential business functions.

DFAS personnel, who are major users of the systems, have reported difficulty in using them to perform day-to-day activities. Without the intended capability of these systems and trained users, DOD's goals of establishing effective financial management operations and becoming audit ready could be jeopardized.

The commitment of DOD leadership to improving the Department's financial management continues to be encouraging, but implementation of DOD's audit readiness strategy Department-wide is an ambitious undertaking that will require the commitment and resources and efforts at all levels in all components and across all DOD financial and business operations such as those in the high risk functional areas of contract management, supply chain management, infrastructure management, and weapon systems acquisition.

To support this Committee's oversight, GAO will continue monitoring and reporting on the Department's financial management improvement efforts. Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions that you and the others may have.

Chairman CARPER. Thank you, Mr. Khan. Our colleagues have heard me quote more than a few times Dr. Alan Blinder, who was

the Vice Chairman of the Federal Reserve for a number of years when Alan Greenspan was Chairman. Dr. Blinder is back now teaching economics at Princeton.

I asked him once at a hearing before the Finance Committee last year when he and others were testifying on deficit reduction, and the question before them was, what do we need to do to make real progress, additional progress on deficit reduction? Dr. Blinder said the 800-pound gorilla in the room is healthcare costs in this country. Medicare and Medicaid eating us alive, making our companies uncompetitive given how much we spend and how relatively little the job pays and other expenses.

So in the Q and A, I asked him, Well, you point this out as a big problem, the 800-pound gorilla in the room, costs of healthcare, what should we do about it? And I will never forget what he said. He said, Find out what works and do more of that. That is all he said. I said, you mean find out what does not work and do less of that? He said yes.

For the folks who have been before us today and for the Department of Defense at large, I have said this several times. I am just going to keep saying it. We have an idea of what works because we have seen the Department of Homeland Security go through this successfully. I asked them repeatedly, What can you learn from from the Department of Homeland Security and some answered and some did not.

What can they learn from the Department of Homeland Security? What can the Department of Defense take for action and improve their opportunities to actually get to refusal speed and carry on beyond that? You want to go first, please?

Mr. KHAN. Senator Carper, I am somewhat familiar with the Department of Homeland Security. One of the key elements is leadership. While DOD has leadership at the highest level, I think it is very important for the key tenets of accountability and audit readiness to go down the second layer and it becoming institutionalized.

That is what the example was at DHS, where it was not only at the top levels, but it was institutionalized as the components who did all the heavy lifting to get audit ready.

Chairman CARPER. All right. Thank you. Mr. Rymer.

Mr. RYMER. Yes, I would agree with Asif. The issue that I see is, as someone said earlier this morning, about driving accountability down through the ranks. I think there is no question there is commitment at the executive and the leadership levels, but I think it must be made apparent that readily accessible, believable numbers are important day to day in running a business operation or running a military unit. So I think it is driving that accountability down and driving that understanding down.

Chairman CARPER. OK. I think a lot about culture, and what you are essentially saying is really a culture change. I like to say there are three things we need to do to continue making progress on deficit reduction, and this is really from the Bowles-Simpson Commission. No. 1, entitlement reform that saves these programs for the long haul, saves money, does not savage old people or poor people. That is No. 1.

No. 2, tax reform that lowers the top corporate rates, but it actually generates some revenues for deficit reduction. And No. 3 is lit-

erally to look at everything we do and say, How do we get a better result for less money? It is really a culture change. And it cannot just be at the secretarial level or the deputy secretary. It needs to be pushed down to the others.

We are an oversight Committee, as you know, and we are an authorizing Committee for Homeland Security Department. We are an oversight Committee for the whole government. And I am going to ask you with my next question to help us be a guided missile as opposed to an unguided missile.

You have heard the previous panel talk about progress that is being made, some areas where maybe it is not so much the case. Make us, as we proceed doing our oversight mission going forward as we approach September 2014 and beyond, make us a guided missile in some of the stuff that you heard here, some of the testimony that you heard here that maybe you do not feel entirely comfortable with that should raise caution flags for us. But just direct us to that, if you will. Direct us to points of concern, please.

Mr. RYMER. I think the biggest concern that I would have, and it is an ongoing concern, are the Enterprise Resource Planning Systems. The reliability of data or the unreliability of data certainly complicates the audit process, makes it extraordinarily difficult to get done. If we cannot take information from systems on its face value, if we have to spend an excessive amount of time verifying data, that, in many cases, makes audits undoable.

So the continued focus by not just the financial leadership, but by the operating leadership, and the IT leadership of the Department on implementing those systems as those systems become operationally accurate is critical. So I think the focus has to be on improvement in IT capabilities, not just financial management.

Mr. KHAN. I agree with Mr. Rymer. I mean, just for the record, these weaknesses are long-standing weaknesses like you and Senator Coburn mentioned. These are long-standing weaknesses. Getting an auditor in at this point in time is not going to reveal any new information. I think what is more important is to make corrective actions to rectify these weaknesses so there could be an efficient and effective audit.

The issue of system certainly is an important one. The other one is also the capability of the workforce. I think Secretary Hale had mentioned that they have invested a fair amount of money in training programs. It is going to be important for the workforce to be trained, to get audit ready. It is going to take about 2 years to get that done and be running against the time for that to happen.

Chairman CARPER. All right. Thank you. One last question and then I will yield to Dr. Coburn. Three years ago in, I think, 2011, Dr. Coburn and I chaired a similar hearing. We asked whether the Department of Defense would meet Congressionally mandated goals of being able to audit all of its finances by 2017.

What is the likelihood that the Department of Defense and the military services will actually meet that 2017 audit goal? Also, what should the Department do in order to increase their chances of meeting those audit deadlines? I think you just talked about it a little bit, but just go ahead. Anything you would like to add or take away?

Mr. KHAN. Yes. I mean, it looks increasingly unlikely that DOD is going to be able to meet the auditability goal for 2014 on the complete Statement of Budgetary Resources for the reason I mentioned earlier on. There is not enough time to make corrective actions to have an efficient audit of the entire SBR like the NDAA asked for.

Some of these time slippages are also going to impact the 2017 data as well. More importantly, like Mr. Rymer mentioned, the system issues are going to get in the way if they are not implemented successfully before then. And the other one is the workforce issue. They have to be trained and be ready to support an audit.

Chairman CARPER. Good. Thank you. Mr. Rymer, just very briefly, please.

Mr. RYMER. I would agree it is going to be difficult, but I would not say impossible. I mean, I have to look back and I think it is obvious that the Department can, with the right focus and continued focus, the Department can change the course of history. So I will not say anything is impossible. But it will be a very difficult, in my view, a very difficult road over the next 3 years with a lot of attention on system improvement. And to me the unpredictable part, is how much improvement we have in the systems.

Chairman CARPER. With that thought, 3 years, 4 years ago, I would not have bet my paycheck that the Department of Homeland Security would become auditable, not just auditable, but actually get a clean audit, and it has shown that it can be done. Again, leadership is the key in making sure we have the right resources. Dr. Coburn, I may have to slip out of here, as I said earlier. My thanks to you very much for being here. It is a good hearing.

Senator COBURN [presiding]. Let us take a little case study, the ERP program that the Air Force canceled, that I called for them to cancel 2½ years before they canceled it. And let us talk about accountability. Has anybody done an after-the-fact scrub of that? You all are talking about these ERP programs are going to be big. If they have complications, it is going to markedly impact auditability. Has there been an after-the-fact review of that and was anybody held accountable?

I noticed that we settled for $150 million to the contractor. So to me, that says we did not know what we want, we were not managing the project right. Otherwise, we should have had the contractor paying us. What have we learned from that and what has happened inside in terms of the Inspector General's Office looking at that? And what does GAO see in terms of that as a prime example of how not to do it?

Mr. KHAN. Senator Coburn, we have not done a followup study on ECSS. That is the Air Force system you had mentioned. One of the lessons learned is not to have too big a system be put out there in one increment. You should implement them in smaller chunks so there are various gates which are tried and tested before you move forward. That was one of the key elements.

Senator COBURN. So continuous improvement.

Mr. KHAN. Absolutely. That was one of the elements that was lacking. Based on the study that we had done several years ago, on your request, they were not following best practices on cost and

schedule. That is an early indicator that there are problems with a particular program.

Mr. RYMER. Sir, I am not familiar specifically with the Air Force situation, but I can tell you that we have done a number of audits of the ERP implementation, continue to do audits of the ERP implementation, and it seems to me that what the Department is trying to do is, find a way to connect over 140 feeder systems to these ERP systems.

There seems often to be a reluctance in changing those entry-level systems because that creates a ripple effect of significant amounts of training and volatility of record keeping. So I think what we have to do is learn from each implementation effort. The one other thing I would mention is that a lot of the core systems or the legacy systems, 140 systems that are out there, were really built for purposes other than financial management. And I think that is sort of the core takeaway that I have learned in the 7-months that I have been the IG.

Those systems were built to account for people and account for things, not to always account for dollars. So what we are doing now with these ERP systems is essentially trying to build an IT structure that is also accounting for dollars, not just the movement of people and equipment like the Department has historically tried to manage.

Senator COBURN. Some of the times when we bring in a big system, what I have noticed, especially in the Defense Department—not exclusively—is we modify a proven system that we are buying to fit our needs, rather than modifying, much as you said, General Rymer, modify the system so that—and once you modify a proven system, you create holes, defects, and problems.

And so, the decisionmaking process and the knowledge about how to buy IT—buying IT is hard. The other thing is, is you have to really know what you want before you order it, and I think some of the biggest problems is, is we do not know what we really want. And we place a contract and then all of a sudden we are changing what our needs are during the contract.

You mentioned, Asif, that a lot of the timelines have slipped. Can you give us some details on that?

Mr. KHAN. Based on the declaration by Secretary Panetta back in 2011, the timelines were compressed. I mean, the timelines before the declaration were made was way beyond—well, somewhat beyond 2014, so they were pulled back. One of the timelines that I want to highlight, and Dr. Morin did not mention, was the Air Force timeline. That is in the first quarter of 2015 for achieving the audit readiness for their SBR.

So the point I was getting at, it is a big question about the compressed timelines and timelines getting extended, whether or not the work is going to be done to make the corrective actions to reach audit readiness.

Senator COBURN. OK. Secretary Hale, Mr. Rymer, said that the ADA violations were a very small percent, 20 cents on $1,000 of the Department's total budget. Do you agree that it is an insignificant level?

Mr. RYMER. I would not say it is an insignificant level, sir. I do not know specifically the amount, sir, but I do not think it is an

insignificant level, and any ADA violation, I think, is significant in and of itself.

Senator COBURN. What are the primary causes of their violations?

Mr. RYMER. I would say fundamentally that the basic ADA violation is using money that is not appropriated for a particular use.

Senator COBURN. Right. That is management.

Mr. RYMER. It is management and accounting and financial record keeping, yes, sir.

Senator COBURN. Are some of the ADA violations that have been seen erroneous, in other words, bad reporting that says they spent money on something that was not appropriated? In other words, are they false ADA violations?

Mr. RYMER. I am not aware of intentional violations, if that is what you are asking, sir.

Senator COBURN. No, just accidental. In other words, paid it out of the wrong account or paid it——

Mr. RYMER. I would say that is probably the nature of most of them, yes, sir.

Senator COBURN. So it is, again, financial integrity and accounting systems that are leading to this?

Mr. RYMER. Systems. A good deal of it could, yes, sir, be system problems.

Senator COBURN. You all have talked about this. Mr. Rymer, can you talk to me about which ERPs right now do you think are most at risk of being unable to support an audit?

Mr. RYMER. No, sir, I cannot give you that. I will be happy to supply that for the record.[1]

Senator COBURN. Can you supply that for the record?

Mr. RYMER. Yes, sir, I will.

Senator COBURN. I made the point earlier with Secretary Hale. Hagel ought to have on his desk every day every major acquisition program, once a week at least, where they are on their timelines, where they are on their budgets, where they are in terms of changes of requirements. I mean, if you really want to manage that—and it is not for him to know it. It is that if everybody else works together to prepare that, they are going to know it and fix it so he does not have to say anything.

So it is this upward mobility of financial information. That is why you want an audit. I mean, who cares if we have an audit. If you have great financial systems and you know they are right, the audit is just a confirming nature. So the whole purpose for getting an audit is to change the financial systems within the DOD so that they have a system that they can utilize, to actually hone and improve and make more efficient everything that they do. Would you agree with that?

Mr. RYMER. Yes, sir, I would. I spent a good deal of my early career, in the banking industry and I can tell you that certainly that industry relies on financial data—I remember every day getting a balance sheet. I knew exactly where my business was every morn-

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[1] The information submitted by Mr. Rymer for the Record appears in the Appendix on page 138.

ing. And I think we need to get to the level in the Department where the availability of financial information is critical.

And financial information is used in the decisionmaking process more often, I believe, than it is now, and I think it is probably not used as much simply because it is not there at someone's fingertips.

Senator COBURN. You have reported that without fully deployed ERPs, the DOD will be unable to produce reliable financial data and auditable financial statements without resorting to heroic efforts such as data calls or manual workarounds.

Can you explain what these manual workarounds would look like and why they are not ideal? And did the Navy have any financial workarounds in their last audit?

Mr. RYMER. I would say, sir, that the inability to produce reliable data in a timely fashion is a red flag in and of itself. Given the fact that we were working on a Schedule of Budgetary Activity, as opposed to a Statement of Budgetary Resources, I do not think we have really made that distinction well enough today, although it has been talked about. I would like to point out that Statements of Budgetary Resources means—that it is something management is asserting and it is auditable. The Schedule of Budgetary Activity is just a schedule. Some of the difficulty we had with the Marine Corps audit was, we were auditing a schedule. We were not auditing a statement.

This means that starting points were difficult to establish, in some cases reliability was difficult. But what it really means, sir, is because we were working on a Schedule of Budgetary Activity that had no Office of Management and Budget (OMB)-required deadlines, or delivery dates. There are, I think, within the Department 10 OMB reportable units that would trigger the November 15 audit report date.

Certainly the Marine Corps is not even a reportable unit and the Schedule of Budgetary Activity is not a report that has to be sent up. So what we did was essentially to show the Marine Corps what it takes to finish the race. We essentially left the audit open for what I believe is an extraordinarily long amount of time to allow them to get the data, to learn where the data was and how difficult it was to get.

Senator COBURN. Were those workarounds?

Mr. RYMER. Well, yes. The systems could not provide data as we needed it, essentially the Marine Corps needed to spend a great deal of time researching on who owned and could provide the support for the transactions and, sometime had to develop the information.

Senator COBURN. So, but what that taught them was, is, Here is what you are going to have to do to perform.

Mr. RYMER. Yes, sir.

Senator COBURN. So here are where the problems are, here is where we are going to direct our efforts, right?

Mr. RYMER. Yes, sir.

Senator COBURN. Going back to Senator Johnson, do the audit to find out what it is?

Mr. RYMER. Right.

Senator COBURN. And that is exactly what you did with the Navy, correct?

Mr. RYMER. With the Marine Corps.

Senator COBURN. I mean, with the Marine Corps.

Mr. RYMER. Yes, sir.

Senator COBURN. Let me go to Senator Johnson.

Senator JOHNSON. Thank you, Senator Coburn. I agree. You need to use the audit as a tool. My background is in manufacturing where you realize you have to have a process that is in control in order to produce a good product. I want to talk about accountability in a manufacturing setting because that is the kind of account-ability I am trying to talk about in driving this process here.

I'm not so much talking about when something goes wrong and you hold somebody accountable by firing them. I am talking about accountability up front to maintain and keep the process in control. In my plastics manufacturing business, the most significant thing we ever did in terms of improving quality and maintaining quality is we required every operator to attach their initials to every roll of plastic they produced. They were going to be accountable. If that was not high enough quality, if that piece of plastic was rejected, they knew they were going to be held accountable. It was amazing how that worked in terms of quality product.

And so, that is the point I am trying to drive in terms of what is the level of accountability? What is the report that is generated by audit ready? How do you hold anybody accountable for not being audit ready? Who is being held accountable? At what levels? General Rymer.

Mr. RYMER. Well, sir, as I said a moment ago, in my view—and I spent a good deal of time in the active and reserve components of the Army, so I think I can speak to some of this firsthand—is that when, at the lowest level, data is entered, whether it is finan-cial data or payroll data, when it is entered, it should be complete, and commanders—the first level supervisors, in my view, should be looking at data to make sure it is complete.

What we find oftentimes is that it is not. We may see a number not accompanied by a description and then we have a difficult——

Senator JOHNSON. I understand. That is a detail problem. But again, I am talking about this overall issue of how do we actually get this management information system up and running and being able to use an audit as a tool. When we are talking about audit ready, how do we hold anybody accountable for not being audit ready other than, I guess, the Secretary of Defense saying, Well, you are still not audit ready? How do we hold those indi-vidual component parts, accountable units, accountable?

Mr. RYMER. Well, it ultimately has to become a personnel process as well. It has to be built into the performance expectations of managers and everybody else.

Senator JOHNSON. Is there a report that is being generated that says that your unit, your service is not audit ready?

Mr. RYMER. Nothing other, sir, than the disclaimers that we issue after the audit is complete.

Senator JOHNSON. Precisely. That is my point about what an audit would bring.

Mr. RYMER. Yes, sir.

Senator JOHNSON. It is going to be a report that holds people accountable so you can work through that process to actually squeeze efficiencies out of this process, prevent the problems of the Antideficiency Act. You need the audit. The sooner we do it, the better, from my standpoint.

Let us talk about those reportable units. In the private sector—again, that is my background—you get little companies and they go through an audit. Sometimes those little companies then get bought by larger organizations and we do not necessarily throw out that audit firm. That audit firm continues to audit that unit. You can have an assembly of hundreds of individual divisions all being audited, all being held accountable, but in the end, you do need information flowing up to the center so that the consolidated set of books can be audited as well.

That is basically what you are talking about in terms of 140 different feedable systems into an ERP system, which, by the way, I have seen, whether the Material Resource Planning (MRP) or ERP systems, be a disaster in the private sector. It is incredibly difficult unless you really look at the component parts and understand exactly what information needs to feed in to that overall system.

That is what I want to talk about, where are we breaking down, in terms of component parts in the Department of Defense, to make this a manageable process? It has been going on for 20 years. It does not seem like it is a manageable process yet. Is that part of the problem? General Rymer.

Mr. RYMER. Well, I would start, sir, that last year we conducted 12 financial statement audits in the Department of Defense.

Senator JOHNSON. Let me stop you right there. How many of those do you think there should be? How many different component part audits do you believe there should be in order to drive accountability down? Should it be 12? Should it be 100? Should it be 1,000?

Mr. RYMER. Well——

Senator JOHNSON. Can I tell you what my bias would be? About 1,000.

Mr. RYMER. 1,000 sounds like a good number then, sir. [Laughter.]

Senator JOHNSON. Do you understand my point?

Mr. RYMER. Yes, sir, I do.

Senator JOHNSON. OK. Is that off base? Does that seem reasonable to you? And again, I am not really looking for——

Mr. RYMER. No, sir. I mean, one thing that Mr. Hale was saying and I would agree with, audits are incredibly expensive and we do need to make sure that the scope of work is meaningful—that there is a bang for the buck.

Senator JOHNSON. How much are we spending trying to get audit ready? Do you get my drift? You were spending all kinds of time and energy to get this audit readiness to do what? Where is the accountability? When are we ever going to get the audit?

So I guess I would argue, I would rather spend money on the audit, realize what a disaster a particular unit is, or how successful a particular unit is. Then you can lift up the best practice and show, Hey, look here in the Marines, they are doing it. Hey, Army, why are you not doing it? Or even within the Army, the different

divisions. This commander over here, he can do it, why can you not? Why are we not utilizing this as a real management tool?

But again, getting back to the component parts, I do not want you using my answer. Just think about it. Should we be talking about hundreds, thousands, tens? I mean, what would be the appropriate level to have individual audits to drive that accountability?

Mr. RYMER. Well, sir, one way to look at it might be a unit, who commands the unit, who owns the unit, does that person actually have control over the numbers? Are they managing with the numbers? So look at it organizationally. Is it 10? Ten is the OMB requirement for audits of DOD financial statement. Right now, I think 10 reportable units, if I am not mistaken. Ten, I think, probably is too few, but frankly, we are conducting a lot more than 10 audits in financial management, but they are not necessarily financial statement audits.

I would explain that there is a lot of financial auditing that are not necessarily financial audits, attestation audits, that are going on. So there is financial accountability beyond just the financial statement audits.

Senator JOHNSON. Well, again, try to and look at a private sector model and transfer that over to the Department of Defense and think, how can we break this up into accountable component parts and then utilize that process in terms of figuring out whether the audit should occur, how many audits, how would those feed into the 10 big OMB audits and then in the end, an overall audit for the Defense Department.

Get off of this idea that we are not going to conduct an audit until we know we are going to have a clean audit, and instead, use an audit as a real management tool, which is what it really should be. Thank you, Senator Coburn. I thank the witnesses.

Senator COBURN. Well, thank you all again. I have a lot of questions still to ask, but I am not going to ask them. I am going to let you go eat lunch. The record will stay open for 15 days, until May 28, and I would very much appreciate responses to questions, especially both of you, and we will move from there. My hope is is that we will have another little followup on this in September or October on how it is going.

The other thing that I think is really important, and, General, I hope you will do this. I know GAO is going to be looking at this, this ERP is a big deal. If it flubs, everything flubs. And so, that ought to be right on the top target list.

Mr. RYMER. Yes, sir. There is quite a bit of work going on. What we will do is, I will make sure we get with your staff and give you a summary of all the ERP work that we have done and that is ongoing.

Senator COBURN. All right. Thank you both for your service. The meeting is adjourned.

[Whereupon, at 1:14 p.m., the hearing was adjourned.]

APPENDIX

Opening Statement of Chairman Thomas R. Carper
Improving Financial Management at the Department of Defense
May 13, 2014

As prepared for delivery:

Today's hearing will examine the efforts underway at the Department of Defense to improve financial management and obtain a clean, unqualified audit of its books.

Let's begin today's hearing by asking why financial management at DOD is important in the first place. Accurate and complete financial accounts give agency leadership and Congress the information necessary for effective management and planning. Clean, auditable financial statements also give us the information we need to hold agencies accountable, to look in every nook and cranny of federal spending and ask this question: 'Is it possible to get better results for less money?'

After all, we can't effectively identify areas to reduce spending if we don't know how much, and where, we're spending that money in the first place.

Federal agencies have been required to produce auditable financial statements since the mid-1990s. Unfortunately, nearly two decades later, the Department of Defense – which spends more than $2 billion every day -- has yet to meet this obligation. Despite years of effort and one deadline after another, DOD's books are so flawed that auditors still cannot even attempt to perform a complete audit.

It's no surprise, then, that the Department's finances have been on the Government Accountability Office's high-risk list since 1995.

In part, this is due to pervasive management deficiencies that would never be tolerated in a private sector business and that are actively being addressed in other federal agencies. Here are just two examples.

Just last month, the Government Accountability Office released a report showing that the Department's antiquated inventory systems, often containing incomplete and inaccurate information, have led to millions of dollars in wasteful ammunition purchases.

The Department continues to buy spare parts that it doesn't need. In fact, last year the Department gave this Committee figures showing that, at one point in 2013, it had $754 million worth of items that were on order, but not yet delivered, which the military services simply did not need. However, the Department still paid for and accepted the unneeded items.

This clearly is an unacceptable situation. And these are just the problems we know about. In all likelihood, the poor state of the Department's books masks even more instances of waste and fraud.

In these tough economic times, we simply cannot tolerate this continuing level of mismanagement and waste.

In 2011, we met in this same room and had a hearing - maybe with the same title - and discussed how the Department was going to meet its statutory deadline of achieving financial auditability by 2017.

Just after that hearing, then-Secretary of Defense Leon Panetta made an important announcement that greatly elevated the priority of financial management.

He also established an additional deadline for a partial financial audit by the end of fiscal year 2014, in order quicken the pace of improvements. To his credit, Secretary Hagel has stood by these goals.

This means that in seven months, the entire department should have its Statement of Budgetary Resources – a key financial component - ready for audit.

We are here today to get an update on this quickly approaching deadline.

Fortunately, the Department of Defense can look to some recent successes to help find the right path to reach its goal.

The Marine Corps has made some important progress in auditing its books, achieving a clean opinion on a portion of its fiscal year 2012 accounts, last December. That is good news.

Also, the Department of Homeland Security was until recently the only other Department unable to audit its finances. Last year, Homeland Security was able to achieve a 'clean' audit.

The key question is whether the entire Department of Defense is learning enough, and fast enough, from these examples.

Today, we have been joined by several witnesses who are each key players in helping the Department of Defense improve its financial management processes and controls.

Their work, if successful, will allow the Department to produce reliable financial statements that regularly produce critical information for decision makers. To our witnesses, thank you for joining us and we look forward to your testimony.

Improving Financial Management at the Department of Defense Hearing

Opening Statement

Senator Tom Coburn, M.D.

Thank you Chairman Carper for holding this important hearing. I want to start by reading an assessment of the DOD financial management from 2001 and asking what has changed in the past 13 years:

I am most surprised when I hear some of my associates ask why auditability matters. I suspect this question is the result that many of my colleagues lack real world experience—they have never run a business or an organization that has to make the most of the resources it has available. To a business, reliable financial data is what powers the company's strategic planning, budgeting and operational decisions and often means the difference between success and failure.

But even to Congress, auditability is of paramount importance. We cannot do our job without it—the fact that our largest federal department, with a nearly $700 billion budget, still cannot comply with the law after nearly several decades is a failure that rests squarely on Congress's shoulders because by accepting the continued excuses and delays we have failed to do our job.

The Appropriations and Accountability Clause in the Constitution, Article 1, Section 9, Clause 7, says:

> "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time."

The intent of this clause is simple: Congress cannot possibly know that the executive branch is obeying the first part of the appropriations clause (spending) of the Constitution without confidence in the second (accountability). The decades-long failure by the Pentagon to comply with existing federal financial management laws is against the very spirit of the Constitution—our Founding Fathers demanded that those spending taxpayer dollars are accountable to taxpayers.

Though the Pentagon is not a business, its financial management problems are intimately related to its problems of waste, mismanagement, and its budget woes under sequestration. Currently, neither Military leaders, nor lawmakers, can consistently and reliably identify what our defense programs cost, will cost in the future, or even what they really cost in the past.

When the Pentagon doesn't know itself and can't tell Congress how it is spending money, good programs face cuts along with wasteful programs that we don't need, which is the situation in which we find ourselves today—cutting the lean instead of the fat.

Unreliable financial information makes it impossible to link the consequences of past decisions to the defense budget or to measure whether or not the activities of the Defense Department are meeting military requirements.

The problem is clear: you can't manage what you can't measure. If the Pentagon doesn't know how it spends its money, Congress doesn't really know how DOD is spending its money. With the nation's debt at near $18 trillion and counting, and tighter budgets across the federal government, DOD needs more than ever to better manage its scarce resources.

Today, DOD leadership has told us that they are on the right track, making progress—but we've heard that song before. Some of our nation's best watchdogs—the GAO and the DOD IG will testify that the core financial management weaknesses—the longstanding deficiencies—still exist, and remain a significant risk to DOD meeting its statutory audit requirements.

If you take away only one point today, it should be this: poor financial management is the root cause of much of DOD's current problems—be it the ability to control costs, as evidenced by weapon system and IT system cost overruns, anticipate its future costs, measure performance, or prevent waste, fraud, and abuse. Congress best helps DOD fulfill its obligations under the law, and to the American taxpayers, by holding DOD accountable for its failure to comply with the law.

Assessment 2001	Current State
Inability to consistently provide reliable financial and managerial data for effective decision-making	No change

Lack of an overarching approach to financial management – disparate systems (accounting, financial and feeder) hampered by lack of integration and standardization	• DOD FIAR plan provides the approach, it is unclear how well it is being implemented, especially as audit goals are de-scoped and deadlines missed • Systems environment remains more or less unchanged
Convoluted business processes which fail to streamline excessive process steps – sometimes driven by accounting, operational and organizational structures, further complicated by aged and disparate systems	Enterprise Resource Planning (ERP) results have been mixed – Air Force Expeditionary Combat Support System (ECSS) cancelled after nearly 10 years and over $1 billion spent
Difficulty in obtaining financially based, outcome-oriented management metrics	This problem continues – GAO has reported that metrics are not adequately defined
Inability to produce Chief Financial Officer (CFO) Act compliant annual financial statements	No change
Disproportionate budget dollars appear to support non-value added activities – since useful information is hard to extract, useful corrective action is difficult to implement – with a lack of wide-spread understanding of how financial information can help	No change
Cultural bias toward status quo – driven by disincentives for change, and short timeframes of political appointees who otherwise might serve as agents of change	No Change
Requires an infusion of personnel with technical and financial skill sets necessary to achieve integrated financial management systems	DOD is investing in training programs, still not fully implemented

Statement of

The Honorable Robert F. Hale
Under Secretary of Defense (Comptroller)/
Chief Financial Officer

Before the

United States Senate
Committee on Homeland Security
and Governmental Affairs

May 13, 2014

Embargoed until released

Mr. Chairman, Senator Coburn, Members of the Committee: Thank you for the opportunity to report on financial management at the Department of Defense (DoD).

When I became DoD's Chief Financial Officer more than five years ago, I established three broad strategic management goals:

- Identify and acquire the minimum resources necessary to maintain a strong national security posture;

- Execute those resources in a manner that is legal, effective, and efficient; and

- Improve the training of the defense financial management workforce.

Meeting these goals has been a challenge, and we still have much work to do. However, despite the budgetary turmoil of recent years, we have made substantial progress.

In my statement today I will speak about just a few of the many initiatives we have undertaken to meet these goals, focusing on those initiatives designed to ensure that DoD resource use remains legal and is rendered more effective and efficient. These initiatives include achieving auditable financial statements, reducing improper payments and related issues, and improving financial management training. My colleagues in the military departments are prepared to address progress on financial systems, another key initiative. All our statements emphasize that, despite our progress, we must make significant additional improvements in coming years.

FIAR — Key to Better Information and Auditability

At the outset it is important to note that DoD does have accurate information about where we obligate public funds. We perform tens of millions of obligations each year, and if we did not have sound and well-controlled business processes for obligations, we would have frequent mis-payments of vendors and personnel and widespread violations of the Anti-Deficiency Act. None of that is happening, as I will note in more detail later in my statement. But we still have work to do to improve our overall business practices and systems, both to improve the quality of our financial information across the enterprise and to pass an independent audit.

The Financial Improvement and Audit Readiness (FIAR) effort is designed to achieve this goal. FIAR has made substantial progress in recent years. For the first time since Congress required auditable financial statements, DoD has a single overall plan for

audit that all Services and Defense Agencies accept and follow. We also have put in place a governance process and have set aside substantial resources across our five-year planning period. Moreover, we have made significant progress – including for the first time a clean audit opinion awarded to a DoD military service. Let me turn now to a discussion of the key elements of our audit efforts.

DoD's Audit Strategy

Our audit strategy focuses first on the elements of our business that most often influence our decision making—namely budgetary dollars and the existence and completeness of property records. Why this approach? Because only experts can interpret -- and few managers actually use -- financial statements. On the other hand, everyone understands the importance of budgetary information, and warfighters are intensely interested in knowing the status of their property – especially weapons and munitions. So we are focusing first on the highest priority information: budgetary and property information.

Starting with these high-priority categories, we must break our audit efforts into manageable pieces – a necessary approach because of DoD's size and organizational complexity. Our audit strategy separates our budget processes into major spending streams or processes such as funds distribution, civilian pay, military pay, funds balance with Treasury, and the like. Each of these processes must be documented and evaluated; then controls must be tested and strengthened. A successful evaluation -- usually by an independent public accounting firm -- validates that we are ready to proceed to audit.

We have set interim goals for many of these audit steps, and we have clearly in mind the legally mandated goals for overall audit readiness. We report on the legally mandated goals and the interim goals in detail in the semi-annual reports to the Congress. Since 2009 we have delivered nine FIAR Plan Status Reports to Congress, on time and in increasing detail. This week we will deliver the next installment in that series. These reports require substantial effort across the Department, and they are also an indication of how seriously we take the FIAR initiative.

While we are focusing first on our budget statement and property information, we also have a general plan to achieve audit readiness for all DoD financial statements. We are mindful of the overall goal to achieve audit readiness for all DoD financial statements by 2017.

Challenges to Auditability

As we seek to meet audit goals, we face some daunting challenges. First there is the challenge created by budgetary turmoil that has been visited on DoD and other Federal agencies in recent years. During the past few years we have planned for no fewer than five government shutdowns and, regrettably, we executed one of those plans last October, as we shut down the government for 16 days. Last fiscal year we faced enormous challenges associated with the abrupt budget cuts caused by sequestration; in DoD's case sequestration cuts were exacerbated by wartime funding shortfalls. We have experienced two six-month continuing resolutions. The continuing resolutions, in particular, greatly increase the complexity of -- and time required for -- financial management. Finally, we wasted time planning and replanning budgets because of seemingly constant changes in the outlook for available resources.

The turmoil surrounding the Defense budget has created uncertainty that has diverted management's attention away from our financial management initiatives -- including audit efforts -- at an especially critical time. The budgetary turmoil and associated furloughs have also seriously damaged the morale of our civilian workforce, including those who work audit issues. And, of course, the turmoil has inflicted other serious damage on the Department, particularly in terms of sharply degraded military readiness. If you want to help DoD achieve auditability, not to mention a stronger national defense, please do just one thing: end this budgetary turmoil now.

Another challenge involves planning for the massive scale of DoD-wide audits, and our collective ability to support them. While both the DoDIG, and their emerging financial audit clients across DoD, are applying the lessons learned from the Marine Corps audit experience, the capacity and infrastructure to support these audits, particularly in a resource constrained environment, will be daunting. The DoDIG is currently working with a contracting officer to engage independent public accounting firms to do much of the audit work beginning in Fiscal Year (FY) 2015, but building capacity and experience in order to support these audits will continue to be a challenge.

A related problem involves the availability of independent public accounting (IPA) firms that are both capable and independent. Many of these IPAs also perform consulting work for DoD that may render them ineligible to perform independent audits. We have developed an audit concept of operations that could alleviate some of this problem, but not all of it. IPA auditor capacity still remains a concern.

Last but not least, the size and complexity of the Department of Defense makes it hard to resolve the business process issues necessary to achieve auditability. In FY 2013, the Department reported $558 billion in net costs and over $2 trillion dollars in assets. It manages about 3 million military members and civilian employees and provides benefits to another 2 million retirees and their family members. More than 450,000 employees are overseas, both afloat and ashore. The Department's physical plant consists of close to 600,000 buildings and structures located at over 4,800 locations world-wide. When added together, the Department uses over 30 million acres of land. The Department's enormous size and geographical dispersion make it difficult to achieve the consistent processes necessary for audit.

Progress to Date

Despite these daunting challenges, we have made substantial progress toward achieving audit-ready statements. Much of that progress has been documented by IPAs. The IPA reports help us to identify risks and areas for improvement. We also understand that, after 20 years without auditable financial statements, Congress and the public want independent verification of our progress. Frankly, so do we.

The semi-annual FIAR reports provide detail on these accomplishments. Let me highlight a few for you:

- The Marine Corps received an unmodified ("clean") opinion on the current year of its Schedule of Budgetary Activity (or SBA) for FY 2012, with a similar result anticipated for FY 2013. This is a major accomplishment and the Corps' success has demonstrated that our audit strategy does work, while also highlighting a path for others to follow.

- The entire Department of Defense has been evaluated and deemed ready for audit on our funds distribution process (known as "appropriations received"). This is a critical accomplishment because it provides verification that we are distributing funds in a manner fully consistent with the laws Congress passes. Independent auditors issued clean opinions on the funds distribution process for the three military departments. Because of auditor independence issues I addressed earlier, the verification for defense agencies had to be done internally.

- We have received a clean audit opinion on the controls within our civilian personnel data system, the Defense Civilian Personnel Data System (DCPDS), which is operated by the Defense Civilian Personnel Advisory Service. DCPDS

provides personnel data used by the Defense Finance and Accounting Service (DFAS) Civilian Pay System to calculate civilian pay. This was a key step in demonstrating audit readiness for payroll activities. Auditors performing other budgetary audits can now rely on this finding.

- DFAS achieved favorable opinions on controls for major systems and processes handling civilian pay and military pay, providing assurance for the processing of over $197 billion in payroll dollars. Additionally, DFAS received a clean opinion on controls for $226 billion in funding for their standard disbursing service, covering over half of the Department's total disbursement activity. Again, auditors can now rely on the adequacy of these systems when they perform budgetary audits.

- The Navy has achieved a positive opinion on civilian pay and travel expenses and is undergoing examinations of military pay, reimbursable work orders, and fund balance with Treasury.

- The Air Force secured a clean opinion on its process for reconciling its fund balance with Treasury and has completed an IPA examination for civilian pay and funds distribution that identified specific areas needing additional work.

- The Army has completed an examination for funds accounted for within its modern accounting system, similar in scope to an audit. This is the largest and most comprehensive examination conducted by an IPA thus far, providing the Army with meaningful feedback to prepare them for their initial budget statement audit.

- All Services and Agencies are deploying new financial systems. The Army has completed deployment throughout most of its organization, and the Navy has completed its program of record providing partial coverage. The Air Force deployment is underway, and the Defense Agencies are making good progress toward deployment. These systems, when fully implemented and stable, will provide the primary mechanism for the sustainment of cost-effective annual audits.

Outlook and Next Steps for Audit Readiness

As many of these examples indicate, we have to make improvements in order to meet our audit challenges. At the same time, we recognize that we will soon face a broader goal – achieving audit-ready budget statements by September 2014.

By "audit ready," we mean that we have made sufficient changes in processes and improvements in data so that management has reasonable confidence that our statements can withstand an independent audit. Achieving audit readiness is an important goal because, once we have achieved and sustained it, the Department will continue to benefit from improved quality information for its managers. Likewise, the improved business processes, along with tested and tightened internal controls that result from the work done to become auditable, add significant value to the enterprise. Examples include more accurate budget estimates, improved efficiency, and more accurate visibility over government property that enhances mission support while minimizing unnecessary orders. The formal audit itself verifies our accomplishment for outside stakeholders.

It is too early to know for sure the audit-ready status for every statement on September 30, 2014. However, we expect that most of DoD's budget statements will be ready for audit by September 30, 2014. This will constitute a major accomplishment for DoD as, for the first time, we actually achieve audit readiness in multiple military Services and an increasing number of Defense Agencies.

Because of the budgetary turmoil and other problems, a few of the budget statements may not be ready by September. We will concentrate on achieving audit readiness for these statements as soon as possible.

Once our statements are audit ready, we will pursue the formal audit in a cost-effective manner. One lesson we learned from the Marine Corps audit of its Schedule of Budgetary Resources is that we cannot produce historical documentation – some of which may be as many as ten years old – quickly enough to meet auditor requirements. We will therefore focus the formal audit on the current-year budgetary activity and transactions -- which we refer to as the Schedule of Budgetary Activity or SBA. This means the initial year audit will not include balances from prior-year appropriations. But the first audit will concentrate on the all-important current year and, with every successive audit year, audits will "build" on succeeding balances so that eventually a fully auditable Statement of Budgetary Resources will emerge, one that includes beginning balances.

This approach means that it will be several years before we achieve clean audit opinions on the full Statement of Budgetary Resources. But it also avoids wasting taxpayer dollars searching for old information that is simply not available in a timely fashion. Both the Government Accountability Office and the DoDIG agree that focusing initial audits on current year activity (the SBA) is a cost-effective and sensible path to full financial statement audit readiness. Moreover, this approach is consistent with the requirements and intent of an earlier National Defense Authorization Act, particularly as it relates to the cost-effectiveness of our investment in moving towards auditability.

The bottom line on auditability is this: Despite formidable obstacles, we have made demonstrable progress. We clearly still have much work to do. However, in most cases we will meet the first key goal for audit readiness of budget statements in September 2014. We will then begin the formal audits in a cost-effective manner.

Meeting this goal is an important step for the Department of Defense as we seek to demonstrate good stewardship of the public's funds. Secretary Hagel said it best in a video on audit readiness that he made for the entire Department. In that video, he asserted that audit readiness will "demonstrate that DoD manages the public's money with the same competence and accountability that we bring to our military operations."

Achieving Additional Financial Management Goals

In addition to our FIAR efforts, we have pursued other important financial management initiatives. These initiatives complement and support our FIAR goals, but they are also important in their own right. Let me highlight a few of them for you.

Minimizing **improper payments** is one key goal. In FY 2013, DoD's improper payments amounted to about 0.17 percent of our total outlays, many times lower than the government-wide average of about 3.53 percent. We continue to work to reduce that percentage even further, because zero is the only acceptable target for improper payments. DoD also met five out of the six compliance criteria established in the FY 2013 Improper Payments Elimination and Recovery Act. Nevertheless, the DoDIG determined that the Department was not compliant based on our failure to satisfy one criterion (outyear reduction targets). There we failed to meet -- by a small fraction of a percent -- the goal set for four out of five outyear reduction targets. The fifth program (DoD Travel Pay) missed by more than three percent, which is why our remediation plan for travel will remain in place and will receive additional oversight. We are working with the Office of Management and Budget (OMB) to provide guidance on reasonable

tolerance thresholds to better convey the true degree of our progress, particularly for programs already achieving excellent results.

While we are achieving positive outcomes on improper payments, we are also improving the documentation that supports those outcomes, as recommended by GAO in a recent report. For example, in our Commercial Pay business process, which is one of the largest functions at DFAS, we are reporting statistically validated estimates of improper payments. During this fiscal year, DFAS will improve and further refine its sampling to include stratification of invoice amounts that will enhance statistical confidence levels. While we are making improvements as directed, it is difficult to move the dial appreciably when our error rate is already so very low.

Another tool to help with reducing improper payments is the Defense Travel Management Office's Travel Policy Compliance Tool, which provides automated monitoring of travel payments and highlights conditions requiring further review. The tool was developed to fulfill the requirement of the National Defense Authorization Act for FY 2012 that sought to minimize inaccurate, unauthorized, overstated, or duplicate claims. This has allowed for timely identification and recapture of travel overpayments.

Similarly, our Business Activity Monitoring (BAM) tool continues to identify and prevent improper commercial payments, totaling $7 billion since BAM was rolled out some five years ago. In fact, BAM prevented more improper payments in FY 2013 than in any previous year--$2.5 billion, a 92 percent increase from the year before. The use of BAM has been expanded in several key areas where the additional investment is justified. DFAS has also successfully implemented Treasury's "Do Not Pay" initiative, and DFAS now reviews 99 percent of all invoices received for "Do Not Pay" status before they are paid. The Army Corps of Engineers and the new Defense Health Agency are also using Treasury's "Do Not Pay" portal with success.

Our progress with **Antideficiency Act (ADA) violations** represents another key aspect of efforts to improve funds control. From FY 2009 to 2013, DoD's ADA violations averaged less than 3 cents out of every $100 dollars of our overall Defense budget. But we continue to seek further reductions, because even a single ADA violation is one too many.

One way to continue to reduce ADA violations is to process potential violations quickly. That way if there is a violation, we can make necessary process changes before more violations occur, and we can hold the accountable party responsible. Through sustained management attention, we have nearly eliminated the backlog of overaged

ADA investigations, reducing the number of overaged cases from 25 in FY 2009 to just one in FY 2013. Our goal this fiscal year is to get the backlog down to zero.

We seek to further decrease the potential for ADA violations by implementation of modern systems with robust internal controls. Timely and accurate funds distribution and disciplined document capture requirements also help control ADAs. These basic precepts have been incorporated into our FIAR efforts, and our new FM certification program includes fiscal law as a basic requirement to improve training and awareness—both contributing factors to ADAs. GAO's recent report on funds control highlighted both awareness and progress in this area.

These various efforts appear to be having positive results. ADAs under investigation have declined from 40 in FY 2009 to 22 cases in FY 2013. In FY 2013, we also introduced new guidance requiring DoD Components to track and report the status of corrective actions resulting from ADA violations and requiring Service financial managers to certify that status. As a result of this new requirement, we hope to further reduce the number of actual ADA violations. Increasing funds control visibility and awareness for effective and efficient management is an important aspect of our business.

Reduction of delinquent debt is a third example of our improved discipline. Improved management of our accounts receivable, along with a close partnership with Treasury, has resulted in significant reductions of outstanding and often delinquent debt. For example, in FY 2013 the Department reduced its public accounts receivable delinquencies by $354 million and the overall delinquency rate fell from ten to six percent. DFAS collected $408 million in FY 2013, a 17 percent increase over the prior year. The Department has also collected $63.1 million through offsets of DoD payments in support of the Treasury Offset Program, recovering amounts owed to other Federal agencies.

Improving Financial Management Training

In order to continue to improve defense financial management, we need to continue to improve financial training in the Department. While there are many training courses available to defense financial managers, until now there has been no framework that permits us to emphasize certain courses and to ensure that proper training occurs at each career point.

We have recently begun implementing a course-based certification program for defense financial managers, similar to the one now in place for DoD acquisition

professionals. This program will permit us to emphasize certain courses – for example, every DoD financial manager will receive at least some audit training. We have sought and received legal authority from Congress to make this program mandatory and have issued a formal DoD Instruction implementing the program. We have inventoried many courses that will count toward certification and put in place a learning management system to help record certification progress. Currently, more than 25,000 DoD financial managers have registered under this new program, and many have begun the required training. Implementation of this new program has been a major step forward in professional development for DoD financial managers.

We have also pursued training specific to audit. We expanded our instructor-led FIAR training to a web-based venue and added three web-based FIAR courses. We developed three new web-based courses in auditing and internal controls. These courses target all levels of our financial management workforce, from basic to senior levels. If we include all audit-specific training, more than 26,700 DoD financial managers have received this training to date, a real step in shifting the community to an audit mindset.

Conclusion

Mr. Chairman, that is a brief review of just some of our many efforts to continue to improve Defense financial management. While we have made significant progress, challenges remain and there is much work still to do. I close by reiterating DoD's strong commitment to improved financial management, including auditability. We owe it to you. We owe it to the troops. And we owe it to the American people.

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RECORD VERSION

STATEMENT BY

MR. ROBERT M. SPEER
ACTING ASSISTANT SECRETARY OF THE ARMY FOR
FINANCIAL MANAGEMENT AND COMPTROLLER

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

SECOND SESSION, 113TH CONGRESS

ON

AUDIT READINESS

MAY 13, 2014

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Chairman Carper, Ranking Member Coburn, and distinguished Members of this Committee, thank you for the opportunity to appear before you today to discuss the Army's approach to implementing financial improvement, my assessment of Army's progress toward achieving auditable financial statements and the implementation of the Army's enterprise resource planning systems. In addition, I want to convey to you that Secretary of the Army McHugh, Chief of Staff of the Army Odierno, Under Secretary of the Army and the Army Chief Management Officer Carson, and I remain committed to improving the Army's financial management and meeting auditability requirements in law. We are unified in our effort to make lasting improvements for the Army and we reaffirm our commitment to asserting audit readiness by September 30, 2017, as required by Section 1003 of the National Defense Authorization Act of Fiscal Year (FY) 2010.

Despite the serious challenges the Army faces from on-going resource uncertainty, the Army's Soldiers and civilian employees remain dedicated to improving our organization's business processes. We continue to follow the Department's Financial Improvement and Audit Readiness (FIAR) Guidance that identifies major mid-term goals to achieve audit readiness of the General Fund (GF) Schedule of Budgetary Activity (SBA) and the existence and completeness (E&C) of General Property Plant and Equipment, including General Equipment and Real Property, by the end of FY 2014.

The Army's Financial Improvement Plan documents the Army's approach to achieving these mid-term milestones, including our reliance on iterative external audits and examinations to inform Army's audit readiness status and provide objective

feedback on the areas requiring additional focus. These audits and examinations simulate the process and activity of a financial statement audit for various sections of the Army's financial statements. For example, an Independent Public Accountant recently examined and delivered a report on the Army General Fund Statement of Budgetary Resources, focusing on FY 2013 transactions within the Army's Enterprise Resource Planning (ERP) business environment, including the General Fund Enterprise Business System (GFEBS), Global Combat Support System – Army (GCSS-Army) and US Army Corps of Engineers Financial Management System. This examination report identified areas for correction, some of which are material in nature. In response to the examination, the Army is implementing a plan of action and milestones to remediate examination findings prior to the FY 2015 audit of the Schedule of Budgetary Activities (SBA).

During FY 2014, the Army received a clean opinion from an independent public accounting firm for an examination of real property assets at 23 Army installations, which accounts for over 50 percent of the net book value for this asset category. This audit supports the second DoD audit readiness priority of verifying the existence and completeness (E&C) of assets. This also marks the second E&C audit the Army has executed, the first being the successful audit of three missile programs – the Javelin, Hellfire, and TOW (Tube-launched, Optically-tracked, Wire-guided) – the DoD Inspector General completed in 2012. As a result of this audit the DoD IG confirmed the E&C of these programs, which total 17 percent of the Army's missile assets, and provided a positive audit opinion. The Army recently asserted audit readiness for General

Equipment and continues to coordinate with the DoD Inspector General to move forward with the examination.

Additionally, the Army continues to implement some of the largest and most complex ERP systems in the world. In July 2012, we completed full deployment of the GFEBS, our core business and accounting support system, to more than 53,000 users at more than 200 locations worldwide. The presence of GFEBS and the users' increasing proficiency with the state-of-the-art system are enabling the Army's audit readiness progress, simultaneously modernizing and improving the Army's business processes. In conjunction with the GFEBS deployment, the Army is modernizing its supply chain processes and systems, primarily with the GCSS-A, the Army's retail supply ERP system. GCSS-A, currently supporting in excess of 3,900 users, is operational within 101 of the 286 scheduled units. Upon full deployment in calendar year 2017, GCSS-A will support nearly 160,000 users. The Logistics Modernization Program (LMP), our wholesale logistics system, functions as the Army's automated and integrated supply chain. This includes maintenance, repair and overhaul planning, in addition to execution, and financial management as the system of record for Army Working Capital Fund (AWCF). With more than 21,000 users now and 14,000 more with Increment 2 in FY 2016, LMP will continue as a world class logistics and financial ERP – effectively developed, deployed, and sustained – to help the AWCF achieve auditability by FY 2017. The iterative examinations by external auditors provide us feedback on the system's compliance and allow us to confirm, our systems meet Federal systems requirements or make improvements in order to support a successful external financial audit.

While modern, auditable systems are critical to the Army's success, we must have properly trained and qualified personnel operating the systems and executing our business in an auditable manner. To that end, we have delivered training to more than 21,000 personnel at more than 270 locations since January 2012. This training program covers multiple functional disciplines, including audit readiness fundamentals, internal controls, testing, and all of the Army general fund business processes, including contractual services, civilian pay, military pay, general equipment, and real property, among others. Our innovative training delivery program includes in-person instructor led training; web-based instructor led training via Defense Connect Online; and self-paced training through the Army Learning Management System. By providing this critical training, the Army is investing in its most critical resource – its people.

We not only train our functional personnel, but we also conduct regular internal assessments that mimic an external auditor's approach. Established in 2012, our program addresses DoD priority areas and assesses a random sample of transactions each month across all major Army Commands and organizations. By measuring our progress internally, we are able to identify areas for correction in advance of any external audits. Army senior leadership and Army Command leadership receive the results of this internal assessment program on a regular basis, which allows us to hold the various Command leaders accountable for supporting the Army's audit readiness program while enabling our eventual success.

We recognize audit readiness requires engagement throughout the organization, so we hold all Senior Executive Service personnel—not just those in the financial management community—accountable for achieving audit readiness milestones. Since

FY 2012, financial improvement metrics have been a component of each Army Senior Executive's annual performance assessment. Moreover, the Vice Chief of Staff of the Army regularly monitors progress of internal assessments and external audits through his formal meetings with Commanders to maintain the appropriate tone at the top of the organization. Commanders and Senior Leaders can monitor progress within their organizations utilizing a Commanders' audit readiness checklist mirroring areas reviewed through internal assessments and external audits. This organization-wide engagement has facilitated our progress to date and is critical to our continued success.

The current Federal fiscal environment and evolving defense requirements, both at home and abroad, present unique challenges for our organizations, to include achieving audit readiness. There are several key focus areas that will require our attention in the near term in order to ensure success. These factors include continued fielding and refinement of our ERPs, inclusion of Military Personnel Appropriations expenditure data in GFEBS and aggressively working the findings identified in our current examination of the Statement of Budgetary Resources. Even confronted with these challenges, we are better prepared to assert audit readiness under conditions outlined by the OSD FIAR guidance than we have ever been in the Army's history. We continue to demonstrate improvement across all business process areas. Our annual exams have continued to expand in size and scope, mirroring the growth and evolution in our audit readiness program. The strong commitment of senior leaders and an extremely dedicated workforce are the Army's greatest assets and enable us to achieve our goals. I sincerely look forward to continuing our work with the members of this

committee, GAO, and the DoD Comptroller to ensure the continued improvement of the

Army's business environment.

STATEMENT OF

THE HONORABLE SUSAN J. RABERN

ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)

BEFORE THE

SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
COMMITTEE

ON

DEPARTMENT OF DEFENSE FINANCIAL ACCOUNTABILITY

13 MAY 2014

Chairman Carper, Senator Coburn, members of the Committee, I am pleased to have this opportunity to discuss with you the progress the Department of the Navy is making toward the Congressional mandates for financial audit readiness. I will share with you some of our significant achievements to date, but I will also tell you that much more hard work remains to be done by our Navy-Marine Corps team before we reach our goal of full financial auditability. Our formidable task is to stimulate a cultural shift in our Department's world-wide business operations.

This comprehensive change calls for vigilant focus on strong internal controls, ensuring the creation of and accountability for substantiating documentation, and constant oversight of the processes and systems which convert billions of taxpayers' dollars into goods and services, pay, and mission-essential assets. Effective internal controls will provide independent auditors with assurance that our business processes and systems produce traceable, reliable, and accurate data.

More importantly, though, effective internal controls over the Department's business operations, to be demonstrated by successful financial audits in coming years, will send a reassuring message to our shareholders -- members of Congress and American taxpayers. The message will be clear: In supporting our nation's modern, powerful Navy-Marine Corps warfighting team, the Department of the Navy is minimizing the risk of misusing taxpayer dollars and maximizing accountability.

Bringing about this cultural shift requires thoughtful analysis and widespread, methodical change. We must ensure that the underlying fundamentals for our tasking are relatively simple: strong, prescribed internal controls are in place, regularly performed, and periodically tested for effectiveness. Documentation proving the controls' performance must be provided regularly to

senior leadership, retained, and readily accessible. Implementation of these straight-forward objectives is known to be extremely complex when applied to very large organizations, with world-wide presence, multiple business lines, and multi-billion-dollar budgets, but all the more critical in an environment of uncertainty.

Several key features are prominent on our detailed roadmap to financial auditability. First, our plan stresses business process standardization. Under this multi-year, Department-wide effort, we have identified best practices and key internal controls among the varying ways we execute our business functions. The result is prescribed, end-to-end business processes and controls that are being fine-tuned for efficiency and effectiveness, with the widest applicability among our major commands. A secondary benefit from these standardization efforts will be a reduction in future annual audit costs by reducing the number of process variations which must be evaluated.

Second, our re-engineered business processes must be complemented by business systems which process data in a well-controlled way, producing accurate, reliable information. More-compliant, better controlled business systems will also require fewer day-to-day management resources to operate and will reduce the cost of testing during financial audits. We have identified more than two hundred business systems that significantly affect the flow of our financial data. These critical information systems require evaluation of their internal controls as a first step in order to ensure they comply with financial audit standards.

Half of these systems are maintained by the Department of the Navy; the remainder are operated by other Defense agencies providing business services to us. We have already begun independent, outside assessments – and have begun remediation where necessary -- for our major

Departmental systems. Our service providers are coordinating with us, synchronizing their own systems assessments with our auditability timelines.

A third essential feature of our auditability plan is widening the circle of accountability for financial audit readiness. Our top leaders, both uniformed and civilian, have repeatedly demonstrated that auditability is a top priority for them in a number of forums. Our Under Secretary and our Vice Chief named senior functional leaders to spear-head Department-wide auditability efforts in their respective business areas. The Vice Chief polled all of the major commanders for a self-assessment of their organizations' progress. Each major command has an active audit readiness program, shouldering responsibility for implementing changes and reporting testing results. With this, we see collaborative interchange growing at every level of activity, and members of the DON team are learning a great deal about audit readiness from each other.

By pursuing these initiatives and others related to them, we are making steady progress toward our goals. Our most immediate objective is complying with the mandate to achieve audit readiness on our Department's Schedule of Budgetary Activity (SBA) in FY2014. The Marine Corps' portion of this statement has been under audit for four annual cycles, and the DoD Inspector General in December 2013 issued an unqualified opinion on the FY2012 SBA, the first audit opinion for a Military Service financial statement. In addition to the Marine Corps success, DON has asserted audit readiness on nine of ten Departmental SBA business segments; independent examinations have concluded on four of the nine asserted segments, with favorable opinions. Exams on three more of the nine asserted segments are currently underway, and we expect the evaluations to conclude later this year. The remaining business segment comprising the SBA, Financial Statement Compilation and Reporting, is under corrective action with

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ongoing remediation which will support the pending SBA audit. Today, I am cautiously optimistic that DON will achieve SBA audit readiness by the end of FY2014 and can successfully undergo an audit on the SBA in FY2015.

In the area of asset management, DON has received favorable examination opinions on the Department's accountability for Ships, Aircraft, Satellites, Fleet Ballistic Missiles, and Shore-based Ordnance. We have moved past these initial successes in asset auditability, finishing work on a comprehensive strategy and timeline for achieving accountability for all asset classes by mid-2016. Each of these nine asset classes is progressing at a differing pace on the spectrum which begins with discovery, moving through corrective action to sustainment, with periodic rounds of testing. In addition to this effort in asset Existence and Completeness, DON is beginning work on an asset valuation strategy which must be executed to achieve full financial auditability. The Department of the Navy Property Governance Council, a senior executive panel, will provide needed enterprise oversight and governance by coordinating policy, enforcing compliance roles and responsibilities, monitoring asset auditability progress, and helping resolve impediments.

A primary benefit in achieving audit readiness in asset management once again is demonstrating sound stewardship over mission-related material. In addition, increased accountability and visibility of these assets will assist in moving needed items to the warfighters more quickly and avoid excess buying.

Achieving full financial auditability by the end of FY2017 will be a daunting challenge. We will encounter major navigation hazards as we steer this course. Establishing added rigor in managing our world-wide assets is an extensive undertaking, and subsequently assigning

accurate valuations to these assets will be equally complex. And, as we move to strengthen the control environment on our present suite of business systems, our future target environment of business systems is still evolving. Also, we must continue developing additional capacity to sustain the business improvements we've made Department-wide in every organization, recognizing that reaching audit readiness is not a one-time exercise.

I recently initiated an in-depth interchange with audit readiness program managers at each of the major commands. These consultations focused on identifying impediments to achieving and sustaining a clean audit opinion, how to steer around these challenges, and what resources will be needed to reach and maintain steady-state audit compliance. To conclude this round of dialog, I chaired a frank roundtable discussion with senior executives responsible for financial auditability from each of the major commands. The group unanimously agreed that the journey so far has strengthened our business environment, and that we can and will stay our course.

I would like to tell you that this process revealed a magic formula for success previously undiscovered. It did not. What I can tell you is that we all concurred that much progress toward financial auditability has been made, but much more hard work remains to achieve a transformed business culture exhibiting every-day audit readiness.

What are the benefits of making this arduous journey? Accountability for public funds is our collective responsibility. Over and above that, we've begun cataloging other tangible efficiencies resulting from our auditability efforts. For example, we're saving significantly on our Departmental bill for paying vendors by expanding automatic feeds of electronic contracting data. As manual controls are replaced by automatic controls, bill paying is at the same time less

costly and more accurate. In FY2013, we estimate that the Department realized approximately $4 million in recurring savings because of these specific improvements in electronic commerce.

In a second example, one of our major commands tightened internal controls over its requisitioning process, adding more rigor in validating outstanding orders for goods and services. By doing so, over several years, this organization cancelled requisitions totaling $3.5 million for orders no longer needed, recouping this buying power, allowing purchase of other needed items.

Other instances of smaller savings will be replicated throughout the Department as internal controls are strengthened and lessons are learned. For instance, by more closely monitoring its travel process, one smaller command reported being able to re-apply $20,000 in funds still reserved for trips not actually made, but which had not been properly cancelled.

In closing, I would tell you that the tenets of our Department-wide effort – improving business processes and systems, implementing tighter internal controls, retaining documentation which proves controls are performed, and extending accountability for these objectives – all have the active support of our executive leadership, and we are driving this accountability all the way down the chain of command. And as we make the changes which move us closer to audit readiness, thousands of managers throughout the Department of the Navy are embracing these positive improvements to our business environment.

I pledge to you that you have our Department's full commitment to achieve these challenging mandates – through the collaborative hard work and persistence of our determined workforce. I would be pleased to address any of your questions at the appropriate time.

United States Air Force
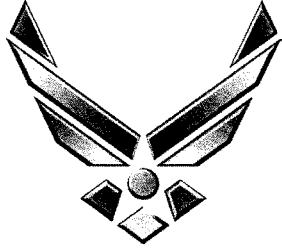
Presentation

Before the Committee on Homeland
Security and Governmental Affairs
United States Senate

Improving Financial Management at the Department of Defense

Statement of
The Honorable Jamie M. Morin
Assistant Secretary of the Air Force
Financial Management and Comptroller

May 13, 2014

The Air Force is committed to financial improvement and audit readiness and is executing a well-designed, albeit risky plan to achieve audit readiness for our Schedule of Budgetary Activity (SBA) by September 30, 2014. Over the last six months, the Air Force Financial Improvement and Audit Readiness (FIAR) team made substantial progress conducting auditability assessments of our SBA and we are confident that we will complete these assessments next month.

Numerous challenges over the last year including a lengthy contract protest that delayed discovery efforts, sequestration and the government shutdown have hindered our progress forcing us to continue developing and implementing corrective actions through September 2014. Results of the recent exams conducted on our civilian pay and funds distribution processes by an Independent Public Accountant have underscored the value of our strategy of getting auditors' eyes on our processes. As a result of these engagements, our resources are increasingly focused on remediating specific deficiencies which entail changes to our business processes, systems and people's roles and responsibilities.

Based on the progress made to date, Air Force leadership believes the most efficient and effective approach for achieving an unmodified audit opinion is to proceed to an audit of the SBA beginning this fall. This audit will be difficult and based on other agencies' experience we expect it will likely reveal some unanticipated weaknesses; however, we believe it will ultimately accelerate us toward our goal of a clean audit.

Commitment and Progress

One of the reasons for our emerging confidence is the strong commitment of the senior-most Air Force leadership to audit readiness. Just this month, Secretary James wrote to key leaders in the field and on the staff directing them to take specific actions in support of audit readiness. Our Chief of Staff and many of our

MAJCOM commanders have integrated audit readiness into their management control structures. Many uniformed leaders have issued letters to their Airmen on the importance of this effort, and I continue to brief financial improvement at our four-star conferences. All of this helps me and my team when we ask Airmen to take burdensome steps needed to make Air Force activities auditable.

This kind of leadership support is necessary but not sufficient by itself. Over the last few years, the Air Force also made major resource commitments to get our financial house in order. Since 2009, we increased funding for audit readiness by a factor of eight. Following the recommendations from the House Armed Services Committee's panel on Defense Financial Management and Auditability Reform, we hired an accounting firm with extensive experience auditing commercial and government clients to support our FIAR team.

The broader Air Force is part of this work as well. For example, in August 2012, we began a 100% inventory of in-use general equipment covering 1.9 million individual assets valued at $30 billion. Last month, we began a re-certification process in which all Airmen who are paid the higher "with dependent" housing allowance are providing documents to verify their eligibility.

We also continue to leverage lessons learned from across the Department. For example, we followed the Navy's technique of using their Audit Agency to perform targeted visits to bases to assess controls over processes such as vendor and military pay. Over the last two years, we matured the process and now perform monthly systematic testing across all of our Major Commands on a broader range of business processes. Last year, we tested over 10,000 transactions to ensure that they complied with more than 57,000 individual audit requirements. Over the past two years, test results have improved steadily with compliance rates rising from 40% to 90% as our Airmen became more familiar with audit requirements.

Challenges

While progress continues, challenges remain. Foremost among these, we continue to rely on numerous legacy systems to support many business processes. As we have testified before, we are pursuing a multifaceted strategy to address this. We are improving manual process controls and making updates to some legacy systems where sensible, while replacing those systems that cannot be fixed in a sustainable way.

An example of how reliant we are on strong systems controls can be illustrated by our recent examinations on civilian pay and funds distribution. During those exams, 23 of 26 non-IT related process controls were deemed to be operating effectively, a dramatic improvement over where we were just a couple years ago. However, the auditor identified more work to be done when it comes to IT controls. Our audit helped identify what needs to be fixed and we are executing a plan to resolve these items by September 30, 2014. By improving these controls, we will give auditors more confidence in the systems feeding our financial statements. Doing so will reduce required audit sample sizes by a factor of ten, reducing the burden of audit on our Airmen.

Our biggest IT problem is that our current legacy accounting system was deployed in 1968, more than 20 years before passage of many of the laws addressing financial statement audits and systems requirements. Today the Air Force and USTRANSCOM are jointly deploying a new accounting system, called the Defense Enterprise and Accounting Management System (DEAMS), providing many of the key controls necessary for a successful audit.

In 2010, DEAMS was deployed to Scott AFB in Illinois. Based on user experiences we found that we needed to do significant work on the system before it was ready to go further. After an additional test deployment to McConnell AFB

and in close collaboration with the DoD test community to assess the system and make necessary improvements, we have now begun broader release. A recent Operational Assessment of DEAMS by the Air Force Operational Test and Evaluation Center (AFOTEC) found that the program has made significant progress since the summer of 2012 and is on track towards effectiveness, suitability, and mission capability.

Since the beginning of this fiscal year, we have deployed DEAMS at Dover AFB in Delaware, Little Rock AFB in Arkansas, Grand Forks AFB in North Dakota, Pope Army Air Field in North Carolina, as well as Fairchild AFB and Joint Base Lewis McChord in Washington. In less than three weeks, we will complete system deployment to all of the Air Mobility Command.

Fielding DEAMS is our biggest systems replacement effort, but there are several others. Last year, we deployed an automated Time and Attendance system that transitioned 113,000 civilian Airmen from an inefficient and poorly controlled paper-based system to an automated one with edit checks and warnings. We also retired three other time and attendance systems, reducing the number of systems requiring FIAR compliance assessments and testing. During the recent government furloughs, our new system allowed rapid updates to excepted employees' timecards, quick retroactive changes following the shutdown, and easy access to reports of missing data so we could ensure all were paid properly and timely.

People are Key

One consistent lesson from government organizations that have secured a clean audit is that engaging people is key to success. We agree. Our Airmen are involved in audit readiness through the monthly testing described earlier as well as our efforts to instill a cost-conscious culture throughout the enterprise. The Air

Force Vice Chief of Staff recently conducted the "Every Dollar Counts" campaign designed to solicit cost savings ideas from all of our Airmen. Of the more than 11,000 submissions Air Force-wide, more than 500 addressed financial management issues. This is clear evidence that our Airmen are eager to support initiatives that save money and promote financial transparency and audit readiness. I do want to respectfully note that many of the recommendations we received tied directly to the challenges Congress has faced in enacting timely appropriations and providing clarity about overall funding levels – we will need your help so that Airmen are spending less time reacting to fiscal crises and more time working on their core responsibilities.

We also know that we need to invest in building the right skills across the Air Force Financial Management community. Moving to modern accounting systems and practices demands more education and training for our financial workforce. We are beginning to make these investments. In 2013, the Air Force piloted the DoD FM Certification program at Air Force Special Operations Command. We then deployed the program throughout the Air Force and have over 9,000 FM professionals enrolled in the program today. Many of those are working on training as we speak, and over 60 have already completed all their certification requirements. Certification ensures our Airmen have the skills and knowledge to operate in a complex modern financial environment. It also includes a continuous education requirement allowing us to upgrade our team's skills as we deploy new IT systems and enhance business processes.

Looking Forward to Audits Beginning in 2015

Over the last few years of audit readiness efforts, the Air Force has made significant investments in process and system controls and has demonstrated success in several key areas including our processes to record Budget Authority

and to reconcile our Fund Balance with Treasury. Many more audit readiness assertions remain to be accomplished throughout the rest of FY2014. We will complete testing and begin implementing corrective actions in areas like contracting, reimbursements and financial reporting.

Based upon our successes to date, the insights gained from our examinations, and the real benefits accruing to Air Force from these efforts, Air Force leadership believes the most efficient and effective approach to achieving an unmodified audit opinion is to proceed with an audit of the Schedule of Budgetary Activity beginning this Fall. We have no illusions that the first audits will be easy. In fact, we fully expect the auditors to identify deficiencies similar to those found in other federal agencies' initial audit attempts. Identifying those deficiencies through a real audit and maintaining momentum in the face of setbacks will be critical, so we look forward to this committee's continued support for these efforts in the months and years ahead.

MAY 13, 2014

Expected Release

10:30 a.m.

Statement of
The Honorable Jon T. Rymer
Inspector General,
Department of Defense

before the

Senate Homeland Security and
Governmental Affairs Committee

on

"Improving Financial Accountability at
the Department of Defense"

Chairman Carper, Ranking Member Coburn, and distinguished Members of the Committee: Good morning and thank you for the opportunity to appear before you to discuss challenges that the Department of Defense must overcome to become "audit ready" by its 2014 and 2017 deadlines.

Achieving auditable financial statements will require a team effort and extensive cooperation among all stakeholders. Accurate, reliable, and timely, financial management information is essential for senior leadership and other decision makers, especially during times of economic uncertainty and fiscal constraints. Under the IG Act, the role of the inspector general is to provide independent and objective oversight of the Department's efforts to improve its financial management.

Today I will highlight several critical areas that DoD must address to improve its financial management and help prepare auditable financial statements. The Department has made progress, but many challenges remain to ensure it reaches the 2014[1] and 2017[2] statutory deadlines.

Before discussing the challenges, I would like to recognize some of the key roles and responsibilities in DoD auditable financial statements. First and foremost, the Department has the ultimate responsibility to produce auditable financial statements. It is the role and responsibility of the Inspector General to opine on the Department's financial statements. Generally, Independent Public Accounting firms provide audit support to the Inspector General and work under the supervision of the Inspector General. However, in some instances, these firms provide audit opinions for some of the

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[1] Public Law 112–81, Section 1003, "Additional Requirements relating to the development of the Financial Improvement and Audit Readiness Plan," requires a plan, including interim objectives and a schedule of milestones for each military department and for the defense agencies, to support the goal established by the Secretary of Defense that the Statement of Budgetary Resources is validated for audit no later than September 30, 2014.

[2] Public Law 111–84, Section 1003, "Audit Readiness of Financial Statements of the Department of Defense," requires that the financial statements of the Department of Defense are validated as ready for audit no later than September 30, 2017.

Department's financial statements when the entity has demonstrated the ability to sustain an unqualified audit opinion. As the Department produces auditable financial statements, the Government Accountability Office, in its role as auditor of the U.S. Government, will rely on the audit work and financial statement opinions issued by Inspectors General, in accordance with the guidance in the Financial Audit Manual and AICPA Audit Standards for opining on the overall U.S. Government financial statements.

Transforming the financial management of the Department has proven to be a complex and difficult undertaking. The Department's senior leaders have demonstrated a commitment to improving financial management and have recognized some of the impediments and actions necessary for improving the Department's financial management data, internal controls, and related financial systems. The Department must maintain this commitment and may actually need to increase its efforts to meet the 2014 and 2017 audit deadlines.

STATUS OF AUDITABILITY EFFORTS

The Department has made progress but many challenges remain to reaching the 2014 and 2017 statutory deadlines. The Department continues to work on its financial improvement and audit readiness and has begun auditing its mission critical assets.

Financial Improvement and Audit Readiness. The Department issues a Financial Improvement and Audit Readiness (FIAR) plan which defines the Department's goals, strategy, priorities, and methodology for achieving financial improvements and audit readiness. The Department provides a biannual status report of the FIAR plan. The draft May 2014 FIAR Plan Status Report states by June 30, 2014, most of the Department, including the Military Departments, will have asserted audit readiness, meaning all reporting entities will either have an audit opinion or be ready for audit..

The FIAR plan seeks to incorporate lessons learned from ongoing and prior financial statement audits. For example, difficulty obtaining adequate supporting documentation

led the United States Marine Corps (USMC) to reassess its approach for FY 2012. In FY 2012, the USMC determined they would prepare a Schedule of Current Year Budgetary Activity (SBA) in lieu of a Statement of Budgetary Resources (SBR) because of the lack of historical data to support beginning account balances in an SBR.[3] The FY 2012 USMC SBA submitted for audit included only current year budget transactions. On December 20, 2013, we issued an unqualified opinion on the USMC Schedule of Current Year Budgetary Activity.[4]

Since the difficulties obtaining adequate supporting documentation for prior year transactions would also affect the other services, the Department plans to assert audit readiness on SBAs, versus full SBRs, as a short-term solution to demonstrate that current year transactions are supported. As a result, the scope of the initial audits of SBAs will not include balances from prior year activity or transactions related to prior activity executed in the current year. According to the FIAR plan, the Department determined that focusing on this information is a sensible path to full audit readiness. This incremental approach to audit readiness does not fully meet the statutory requirements, because the SBA is a subset of information that is presented on the full SBR. The SBA only presents the current year's budgetary activity and does not include beginning balances or amounts obligated and expended for prior year appropriations. However, this approach provides the Department with the opportunity to have a portion of the SBR audited. The Department plans to have the required SBR audits begin in FY 2018 and include auditable opening balances from prior years audited SBAs.

The Department recognizes that significant challenges remain to be addressed such as correcting key internal controls, obtaining supporting documentation for beginning

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[3] An SBR includes among other things: beginning balances, current year transactions, and transactions from prior years that were executed in the current year. The SBA contains only the current year activity that would be included in the SBR.

[4] Report No. DODIG-2014-024, "Independent Auditor's Report on the Department of Defense FY 2013 and FY 2012 Financial Statements," December 16, 2013

balances, and providing adequate support for the value of its assets. While the current FIAR plan focuses on the auditability of the General Fund financial statements, the plan does not present the status and timelines of the audit efforts for the Working Capital Fund financial statements. As a result, it is unclear when the Department plans to have all its financial statements ready for audit.

Existence and Completeness. The DoD IG has also begun auditing the existence and completeness of mission critical assets, which is another critical element to full financial statement audit readiness. The primary focus of these audit efforts is to determine if the Department can account for the number of mission critical assets, such as missiles, submarines or ships, and whether DoD has reliable information on where these assets are located and their operating condition. These audit efforts do not assess the value of these assets because the Department has not yet asserted these amounts are auditable. Based on our work to date, the Department has made progress in accounting for the existence and completeness of mission critical assets. Between January 2012 and April 2014, we issued six reports on existence and completeness of mission critical assets for which the Department received four unqualified and two qualified opinions. These reports also identified internal control deficiencies that still need to be addressed. For example, the Navy received an unqualified opinion on the existence and completeness of the Navy's ships and submarines but could improve its property accountability system. We are currently examining additional Navy mission-critical assets and have one planned examination of Army's mission-critical assets for FY 2014. We continue to monitor the Department's progress in this area and plan to continue to evaluate additional areas once the Department asserts audit readiness.

CHALLENGES REMAINING

While the Department has made progress, many challenges remain for the Department to reach the 2014 and 2017 statutory deadlines. The Department must continue to

aggressively pursue improvements in 1) data quality and timeliness, 2) internal controls, and 3) financial systems.

Data Quality and Timeliness. Reliable and timely data are necessary to make sound business decisions. However, we frequently identify financial data that are unreliable, incomplete, inaccurate, or not readily available. As a result, DoD managers often cannot reconcile financial data or rely on these data to make sound business decisions. Having poor financial data also impedes the Department's ability to obtain unqualified financial statement audit opinions. Furthermore, unreliable data could result in improper payments or missed opportunities to collect debt owed to the Department. From FY 2007 to date, DoD IG has issued more than 100 reports that identified data quality problems that may ultimately affect the reliability of financial data.

For example, in our audit of General Fund Enterprise Business System (GFEBS) acquire-to-retire business process,[5] we found that, although the Army had spent $814 million on this system, it did not provide Army decision makers with relevant and reliable financial information and standardized business processes for real property. In addition, the Army was unable to determine how much it will cost to correct unreliable real property information in GFEBS. Additionally, Defense Finance and Accounting Service (DFAS) made over $100 billion of adjustments because of the ineffective use of GFEBS for the fixed assets reported on the FY 2012 Army General Fund Financial Statements. Consequently, the Army was at increased risk of not accomplishing the goal of full financial statement audit readiness by FY 2017.

In September 2013, to meet the 2017 full financial statement audit readiness requirement, the Department made a significant revision in its approach to the valuation of its General Property, Plant and Equipment. In FY 2013, the Department reported $2.2 trillion dollars in assets. Among the new guidelines, the Department has increased the capitalization

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[5] Report No. DODIG-2013-130, "Army Needs to Improve Controls and Audit Trails for the General Fund Enterprise Business System Acquire-to-Retire Business Process," September 13, 2013

threshold from $100,000 to $1,000,000 for Air Force and Navy General Equipment general fund assets placed into service on or after October 1, 2013. In addition, the capitalization threshold for Real Property was also increased from $20,000 to $250,000. Lastly, the Department stated it will begin using adequate supporting documentation to value all new general property, plant and equipment acquisitions accepted and placed into service on or after October 1, 2013. While the new guidance should assist the Department in valuing its assets going forward, the lack of reliable historical information to support the value of the DoD's assets is still a critical matter requiring attention. In addition, the Department will need to ensure that it has the appropriate procedures in place to property accountability for assets valued below the new capitalization thresholds.

The lack of adequate supporting documentation for account balances and individual transactions included in the financial statements is a long-standing Department-wide problem. During our prior audits of the USMC SBR and SBA, the USMC encountered significant delays gathering key documents to support transactions that were selected for testing. As a result, the audit opinions were delayed. In the future, the Inspector General must issue audit opinions within 45 days of the fiscal year end for full financial statement audits required by the CFO Act. Under these accelerated timelines, providing complete and accurate financial data supporting the financial statements will be essential. Without complete, accurate and timely data, Department will continue to receive disclaimers of opinions on its financial statements.

Internal Controls. Internal controls are an integral part of an organization's management environment and are designed by management to provide reasonable assurance of achieving effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Internal controls include the plans, methods, and procedures used to meet missions, goals, and objectives; they also serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, these controls help senior leaders and managers achieve desired results through effective stewardship of taxpayer dollars.

Although the Department has made steady progress towards audit readiness, it continues to receive a disclaimer of opinion on its financial statement due in part to long-standing material weaknesses. In our most recent disclaimer of opinion on DoD financial statements,[6] DoD IG continued to report 13 material internal control weaknesses. These pervasive material weaknesses affect nearly every key aspect of DoD's financial management operations and include:

- Financial Management Systems;
- Fund Balance with Treasury;
- Accounts Receivable;
- Inventory;
- Operating Materials and Supplies;
- General Property, Plant, and Equipment;
- Government Property in Possession of Contractors;
- Accounts Payable;
- Environmental Liabilities;
- Statement of Net Cost;
- Intragovernmental Eliminations;
- Accounting Entries; and
- Reconciliation of Net Cost of Operations to Budget.

For example, reconciling the Fund Balance with Treasury account at the transaction level has been a long-standing internal control challenge throughout the Department and increases the risk that improper disbursements will not be detected and ultimately corrected in the normal course of business. Fund Balance with Treasury is an asset account that reflects the available budgetary spending authority of a Federal agency. This account is basically the Department's "checkbook" and is the second largest line item on the Department's financial statements. Developing and implementing a reliable

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[6] Report No. DODIG-2014-024, "Independent Auditor's Report on the Department of Defense FY 2013 and FY 2012 Financial Statements," December 16, 2013

reconciliation process will help the Department identify and resolve unmatched disbursements at the detailed transaction level. By performing this key control, DoD can resolve the problems that prevented the transactions from being properly matched to the corresponding obligation within agency accounting records.

Enterprise Resource Planning Systems. The Department is developing and deploying Enterprise Resource Planning systems (ERPs) as a critical component of DoD's auditability strategy. An ERP system is an automated system using commercial off-the-shelf software consisting of multiple, integrated modules that perform a variety of business-related tasks such as general ledger accounting, payroll, and supply chain management. DoD's current financial management and feeder systems were not designed to support various material amounts on the financial statements. The systemic deficiencies in financial management feeder systems and inadequate DoD business processes prevent the Department from collecting and reporting financial and performance data that are accurate, reliable, and timely. Given the large volume of transactions and the complexity of DoD's operations, combined with the inability of the current systems to produce data that comply with accounting standards, we are concerned that the Department will be unable to meets its auditability deadlines without these ERP systems fully up and operational. We continue to report on issues with ERPs

In August 2013, we issued a report on the status of ERP systems' cost and schedule. In this report, we identified that DoD's estimated cost for four of six ERP systems needed to produce auditable financial statements decreased by $681 million and increased by $299 million for two of the six systems. DoD continues to report schedule delays due to challenges in reengineering business processes and correcting known material weaknesses. As a result, DoD continues to use outdated legacy systems. These delays in implementing ERP systems increase the risk that DoD will not achieve an auditable Statement of Budgetary Resources by FY 2014 or meet its deadline of full financial statement audit readiness by FY 2017.

CONCLUSION

As I have discussed today, the Department is making progress improving its financial management operations. However, much work remains to achieve auditable financial statements within the Department. Reliable systems and processes are still in development and have experienced significant challenges. Meeting the 2014 and 2017 auditability deadlines will be a significant challenge for the Department and will likely require additional resources to meet these requirements. Through our oversight role, we will continue to work with the Department on moving towards auditable financial statements. Hearings such as this are an important means of providing visibility to Congress, the Department, and the taxpayers of the daunting tasks and efforts in financial accountability which have been underway within the Department for over 20 years.

This concludes my statement today, and I would be happy to take any questions the Committee may have.

GAO

Testimony
Before the Committee on Homeland
Security and Governmental Affairs,
U.S. Senate

DOD FINANCIAL MANAGEMENT

Effect of Continuing Weaknesses on Management and Operations and Status of Key Challenges

Statement of Asif A. Khan, Director,
Financial Management and Assurance

GAO
Highlights

May 13, 2014

DOD FINANCIAL MANAGEMENT

Effect of Continuing Weaknesses on Management and Operations and Status of Key Challenges

Why GAO Did This Study

Given the federal government's continuing fiscal challenges, it is more important than ever that the Congress, the administration, and federal managers have reliable, useful, and timely financial and performance information to help ensure fiscal responsibility and demonstrate accountability, particularly for the federal government's largest department, the Department of Defense. GAO has previously reported that serious and continuing deficiencies in DOD's financial management make up one of three major impediments to achieving an opinion on the U.S. government's consolidated financial statements.

GAO's statement focuses on (1) the effect of continuing financial management challenges on DOD management and operations and (2) DOD's efforts to improve financial management and its remaining challenges. GAO's statement is primarily based on previously issued reports, including GAO's updates on DOD high-risk areas and its audit reports on DOD's financial management, inventory management and asset visibility, weapon system costs, business transformation, and business system modernization.

What GAO Recommends

GAO has previously made numerous recommendations for improving financial systems and business systems that provide financial information as well as related processes and internal controls. DOD has generally agreed with GAO's recommendations and is taking actions to address many of them.

View GAO-14-576T. For more information, contact Asif A. Khan at (202) 512-9869 or khana@gao.gov.

What GAO Found

Long-standing weaknesses in the Department of Defense's (DOD) financial management adversely affect the economy, efficiency, and effectiveness of its operations. The successful transformation of DOD's financial management processes and operations will allow DOD to routinely generate timely, complete, and reliable financial and other information for day-to-day decision making, including the information needed to effectively (1) manage its assets, (2) assess program performance and make budget decisions, (3) make cost-effective operational choices, and (4) provide accountability over the use of public funds. Examples of the operational impact of DOD's financial management weaknesses include

- the inability to properly account for and report DOD's total assets—about 33 percent of the federal government's reported total assets—including inventory ($254 billion) and property, plant, and equipment ($1.3 trillion);
- the inability to accurately estimate the extent of its improper payments because of a flawed estimating methodology, which also limits corrective actions;
- inconsistent and sometimes unreliable reports to the Congress on estimated weapon system operating and support costs, limiting visibility needed for effective oversight of these costs; and
- continuing reports of Antideficiency Act violations—75 such violations reported from fiscal year 2007 through fiscal year 2012, totaling nearly $1.1 billion—which emphasize DOD's inability to ensure that obligations and expenditures are properly recorded and do not exceed statutory levels of control.

DOD has numerous efforts under way to address its long-standing financial management weaknesses. The Congress has played a major role in many of the corrective actions by mandating them in various fiscal year National Defense Authorization Acts. However, improving the department's financial management operations and thereby providing DOD management and the Congress more accurate and reliable information on the results of its business operations will not be an easy task. Key challenges remain, such as identifying and mitigating risks to achieving the goals of DOD's Financial Improvement and Audit Readiness (FIAR) effort and successfully implementing the FIAR Guidance at the DOD component level, modernizing DOD's business information systems, and improving the financial management workforce.

DOD is monitoring its component agencies' progress toward audit readiness. However, as dates for validating audit readiness approach, DOD has emphasized asserting audit readiness by a certain date instead of making sure that effective processes, systems, and controls are in place, without which it cannot ensure that its components have improved financial management information for day-to-day decision making. While time frames are important to measuring progress, DOD should not lose sight of the ultimate goal of implementing lasting financial management reform to ensure that it can routinely generate reliable financial management and other information critical to decision making and effective operations.

_____ **United States Government Accountability Office**

Chairman Carper, Ranking Member Coburn, and Members of the Committee:

Thank you for the opportunity to be here today to discuss continuing Department of Defense (DOD) financial management challenges and the implications for its management and operations and audit readiness. Having sound financial management practices and reliable, timely financial information is important to ensure accountability over DOD's extensive resources in order to efficiently and economically manage the department's assets, budgets, mission, and operations. Accomplishing this goal is a significant challenge given the worldwide scope of DOD's mission and operations; the diversity, size, and culture of the organization; and its reported trillions of dollars of assets and liabilities and its hundreds of billions of dollars in annual appropriations.

Given the federal government's continuing fiscal challenges, it is more important than ever that the Congress, the administration, and federal managers have reliable, useful, and timely financial and performance information to help ensure fiscal responsibility and demonstrate accountability, particularly for the federal government's largest department. Serious, continuing deficiencies in DOD's financial management have precluded it from producing financial statements that can be audited, and these deficiencies constitute one of three major impediments to achieving an opinion on the U.S. government's consolidated financial statements. Our report on the U.S. government's fiscal year 2013 financial statements highlighted significant DOD weaknesses that contributed to our disclaimer of opinion.[1] They include the following:

- The inability to determine that DOD's total assets were properly reported. For fiscal year 2013, DOD accounted for about 33 percent of the federal government's reported total assets, including inventory ($254 billion) and property, plant, and equipment ($1.3 trillion).
- Unreliable reported estimates of environmental cleanup and disposal liabilities ($58.4 billion) and retiree health care liabilities ($1.1 trillion).
- Ineffective financial management processes and controls.

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[1]GAO, *Financial Audit: U.S. Government's Fiscal Years 2013 and 2012 Consolidated Financial Statements*, GAO-14-319R (Washington, D.C.: Feb. 27, 2014).

- Financial management systems that do not comply with the Federal Financial Management Improvement Act of 1996 (FFMIA).[2]

In addition to the impact on the auditability of the U.S. government's consolidated financial statements, these problems impede DOD's ability to produce timely and accurate financial management information to assist in day-to-day decision making and also significantly impair efforts to improve the economy, efficiency, and accountability of the department's operations. Key areas of concern relate to ineffective asset control and accountability, which affect DOD's visibility over weapon systems and inventory;[3] unreliable budget information, which affects DOD's ability to effectively measure performance, reduce costs, and maintain adequate control of its funds (funds control); and ineffective business systems and processes, which impair DOD's ability to achieve accountability and transparency over its operations and accurately report on the results of operations. DOD is addressing these issues through its Financial Improvement and Audit Readiness (FIAR) Plan, which is DOD's strategic plan and management tool for guiding, monitoring, and reporting on the department's financial management improvement efforts.

To encourage progress, the National Defense Authorization Act (NDAA) for Fiscal Year 2010 mandated that DOD develop and maintain the FIAR Plan to, among other things, describe the specific financial management improvement actions to be taken and costs associated with ensuring that its department-wide financial statements are validated as audit ready by September 30, 2017.[4] In October 2011, the Secretary of Defense directed the department to accelerate audit readiness efforts for key elements of

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[2]Pub. L. No. 104-208, div. A, title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996). DOD's financial management systems are required by FFMIA to comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the *U.S. Standard General Ledger* at the transaction level.

[3]DOD describes asset visibility as the ability to provide timely and accurate information on the location, quantity, condition, movement, and status of items in its inventory, including assets in transit.

[4]Pub. L. No. 111-84, § 1003(a),123 Stat. 2190, 2439-40 (Oct. 28, 2009). As defined in DOD's FIAR Guidance, validation of audit readiness occurs when the DOD Comptroller examines a DOD component's documentation supporting its assertion of audit readiness and concurs with the assertion. This takes place after the DOD Comptroller or independent auditor first reviews the documentation and agrees that it supports audit readiness. A component asserts audit readiness when it believes that its documentation and internal controls are sufficient to support a financial statement audit that will result in an audit opinion.

its financial statements. Subsequently, the NDAA for Fiscal Year 2013 added that the FIAR Plan must also describe the steps to be taken, with associated costs, to ensure that the department's Statement of Budgetary Resources (SBR) is validated as audit ready no later than September 30, 2014.[5]

My statement today focuses on two topics:

- the effect of continuing financial management weaknesses on DOD management and operations and
- DOD's actions to improve its financial management and achieve audit readiness, and its remaining challenges.

My statement is primarily based on previously issued reports, including our reporting on DOD high-risk areas and our audit reports on DOD's financial management, inventory management controls and asset visibility, weapon system costs, business transformation, business system modernization, improper payments, military payroll, and audit risk. A list of related products is included at the end of this statement. This statement also is based on our ongoing analyses of the Army's SBR audit readiness efforts and the Defense Finance and Accounting Service's (DFAS) audit readiness efforts for DOD payments to contractors, or "contract pay." We expect to report the final results from this work in June 2014. For our analyses, we reviewed Army and DFAS documentation, such as departmental guidance and Army and DFAS action plans and statuses, and met with component officials to discuss the basis and timing of their audit readiness assertions. We discussed the preliminary results of our work with cognizant DOD officials.

The work on which this statement is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Additional information on our scope and

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[5]Pub. L. No. 112-239, § 1005(a), 126 Stat. 1623, 1904 (Jan. 2, 2013). The SBR provides information about budgetary resources made available to an agency as well as the status of those resources at a specific point in time.

methodology is available in the previously issued products cited in this statement.

Background

In the face of continuing reports of financial management weaknesses across the federal government, including wasteful spending, poor management, and losses totaling billions of dollars, the Chief Financial Officers (CFO) Act of 1990 was signed into law.[6] The act focuses on

- establishing a leadership structure;
- improving systems of accounting, financial management, and internal control; and
- enabling effective management and oversight through the production of complete, reliable, timely, and consistent financial information.

With the foundation of the CFO Act and the Government Management Reform Act of 1994 (GMRA), with its goal "to provide a more effective, efficient and responsive government,"[7] along with other federal agency management reform legislation, such as the Government Performance and Results Act of 1993[8] (GPRA) and FFMIA, a framework was put in place to improve stewardship, accountability, and transparency in the executive branch. Major goals of the reform legislation have included the following:

- **Strengthening internal control.** Accountability is part of the organizational culture that goes well beyond receiving an unmodified or "clean" audit opinion on agency financial statements; the underlying premise is that agencies must become more results oriented and focused on internal control. Thousands of internal control problems have been identified and corrected in executive branch agencies over the past two decades. A disciplined and structured approach to assessing and dealing with internal controls over the critical flow of funds through the entire agency provides a mechanism that over time mitigates potential damaging breakdowns in financial integrity and mismanagement of funds. Such breakdowns can affect the ability of

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[6]Pub. L. No. 101-576 (Nov. 15, 1990).

[7]Pub. L. No. 103-356 (Oct. 13, 1994).

[8]Pub. L. No. 103-62 (Aug. 3, 1993).

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the agency or entity to carry out its mission and can severely damage public confidence.

- **Accurate accounting and financial reporting.** The CFO Act and FFMIA provide for financial management systems that support reliable financial reporting on the results of operations on a day-to-day basis. This functionality, in turn, supports management decision making on budgets, programs, and overall mission performance and goals. Accurate accounting and financial reporting are also a major element of any effort to achieve auditable financial statements.

- **Improving performance information.** A key goal of much of the federal management reform legislation enacted over the past 25 years, such as the CFO Act and GPRA, is the ability to have reliable information to measure performance against mission goals. Federal agencies have made progress in the preparation of annual performance and accountability reports (PAR).[9] By linking financial and performance information, the PARs provide important information about the return on the taxpayers' investment in agency programs and operations.

- **Enhancing transparency.** Achieving clean audit opinions evidencing sound financial management practices is an overall outcome of effective implementation of these reforms. For example, the achievement of a clean audit opinion on the first-ever annual financial statements for the Troubled Asset Relief Program (TARP) was a significant accomplishment.[10] This provided important accountability and transparency to the public regarding TARP activities.

Many of the problems that preceded passage of the CFO Act also led us to issue our first high-risk list in 1990, designating certain DOD and other federal programs as high risk because of their vulnerability to fraud, waste, abuse, and mismanagement.[11] DOD areas designated as high risk

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[9]A PAR describes an agency's performance measures, results, and accountability processes for the fiscal year. This information enables the President, the Congress, and the American people to assess the agency's accomplishments each fiscal year.

[10]TARP is a federal program established by the Secretary of the Treasury under authority provided by the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, div. A (Oct. 3, 2008), and intended to restore liquidity and stability to the financial system of the United States via the purchase of assets from financial institutions.

[11]See GAO, *High-Risk Series: An Overview*, GAO/HR-95-1 (Washington, D.C.: Feb. 1, 1995) and *High-Risk Series: An Update*, GAO-13-283 (Washington, D.C.: February 2013).

in 1990 included Supply Chain Management and Weapon System Acquisition, followed by Contract Management in 1992, Financial Management and Business Systems Modernization in 1995, Support Infrastructure Management in 1997, and Business Transformation in 2005.[12]

As we reported in our latest high-risk update, DOD is one of the few federal entities that cannot accurately account for its spending or assets and it is the only federal agency that has yet to receive an opinion on at least one of its department-wide financial statements. Without accurate, timely, and useful financial information, DOD is severely hampered in making sound decisions affecting its operations. Further, to the extent that current budget constraints and fiscal pressures continue, the reliability of DOD's financial information and ability to maintain effective accountability for its resources will be increasingly important to the federal government's ability to make sound resource allocation decisions. Effective financial management is also fundamental to achieving DOD's broader business transformation goals in the areas of asset management, acquisition and contract management, and business systems modernization.

Effect of Continuing Financial Management Weaknesses on DOD Management and Operations

As we have previously reported, long-standing weaknesses in DOD's financial management adversely affect the economy, efficiency, and effectiveness of the department's operations.[13] DOD's pervasive financial and related business management and system deficiencies continue to adversely affect its ability to control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; prevent and detect fraud, waste, and abuse; and address pressing management issues. As we have previously recommended, the successful transformation of DOD's financial management processes and operations is necessary for DOD to routinely generate timely, complete, and reliable financial and other information for

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[12]The DOD Personnel Security Clearance Program was added to GAO's high-risk list in 2005, but it was subsequently removed in 2011.

[13]GAO, *DOD Financial Management: Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan*, GAO-11-932T (Washington, D.C.: Sept. 15, 2011), and *DOD Financial Management: Numerous Challenges Must Be Addressed to Improve Reliability of Financial Information*, GAO-11-835T (Washington, D.C.: July 27, 2011).

day-to-day decision making, including the information needed to effectively (1) manage its assets, (2) assess program performance and make budget decisions, (3) make cost-effective operational choices, and (4) provide accountability over the use of public funds.

Asset Management

Since 1990,[14] we have identified DOD supply chain management as a high-risk area in part because of ineffective and inefficient inventory management practices and procedures, weaknesses in accurately forecasting demand for spare parts, and challenges in achieving widespread implementation of key technologies aimed at improving asset visibility.[15] These factors have contributed to the accumulation of billions of dollars in spare parts that are excess to current needs, wasting valuable resources. DOD has made moderate progress in addressing its supply chain management weaknesses, but several long-standing problems have not yet been resolved. To provide high-level strategic direction, DOD issued its Logistics Strategic Plan in July 2010, which among other things, established a goal to improve supply chain processes, including inventory management practices and asset visibility.

With respect to inventory management, in November 2010, as required by the Congress, DOD issued its Comprehensive Inventory Management Improvement Plan, which is aimed at reducing excess inventory by improving inventory management practices. We reported in 2012 and 2013 that DOD had made progress in reducing its excess inventory and

[14]GAO, High Risk: Letter to Congressional Committees Identifying GAO's Original High Risk Areas, (Jan.23, 1990) and GAO-13-283.

[15]GAO, Defense Logistics: Army Should Track Financial Benefits Realized from its Logistics Modernization Program, GAO-14-51 (Washington, D.C.: Nov. 13, 2013); Defense Logistics: A Completed Comprehensive Strategy is Needed to Guide DOD's In-Transit Visibility Efforts, GAO-13-201 (Washington, D.C.: Feb. 28, 2013); Defense Logistics: DOD Has Taken Actions to Improve Some Segments of the Materiel Distribution System, GAO-12-883R (Washington, D.C.: Aug. 3, 2012); Defense Inventory: Actions Underway to Implement Improvement Plan, but Steps Needed to Enhance Efforts, GAO-12-493 (Washington, D.C.: May 3, 2012); Defense Logistics: Improvements Needed to Enhance DOD's Management Approach and Implementation of Item Unique Identification Technology, GAO-12-482 (Washington, D.C.: May 3, 2012); Defense Logistics: DOD Needs to Take Additional Actions to Address Challenges in Supply Chain Management, GAO-11-569 (Washington, D.C.: July 28, 2011); and DOD's 2010 Comprehensive Inventory Management Improvement Plan Addressed Statutory Requirements, But Faces Implementation Challenges, GAO-11-240R (Washington, D.C.: Jan. 7, 2011).

implementing its Comprehensive Inventory Management Improvement Plan.[16] DOD established overarching goals in the plan to reduce the enterprise-wide percentages of on-order excess inventory, those items already purchased that may be excess due to subsequent changes in requirements, and on-hand excess inventory, those items categorized for potential reuse or disposal. Since DOD was exceeding its initial goals for reducing excess inventory, we recommended that DOD's efforts would benefit from establishing more challenging, but achievable, goals for reducing excess inventory and that the department periodically reexamine and update its goals. DOD agreed with our recommendations and revised its on-hand excess inventory goal from 10 percent of the total value of inventory to 8 percent in fiscal year 2016. However, DOD did not make any changes to its on-order excess inventory goals and maintained that its current goals of 6 percent of the total value of on-order inventory in 2014 and 4 percent in 2016 were sufficient. Our work determined that DOD has made progress in reducing on-hand and on order excess inventory. For example:

- Data from the end of fiscal year 2009 showed that of the about $94.5 billion in on-hand inventory, 9.4 percent, or about $8.8 billion, was excess. DOD's most recent fiscal year-end data from September 2013, showed that of the about $98.9 billion in on-hand inventory, 7.3 percent was considered excess.

- Data from the end of fiscal year 2009 through 2013 showed that the department had reduced its percentage of on-order excess inventory from $13.6 billion to about $10.2 billion, from 9.5 to 7.9 percent, with $812 million considered as excess.

With respect to asset visibility, we found that DOD needs to take additional actions to improve asset visibility, to include completing and implementing its strategy for coordinating improvement efforts across the department for asset tracking and in-transit visibility.[17] In February 2013, we reported that DOD had taken steps to improve in-transit visibility of its assets through efforts developed by several of the defense components, but no one DOD organization was fully aware of all such efforts across

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[16]GAO, *Defense Inventory: Actions Underway to Implement Improvement Plan, but Steps Needed to Enhance Efforts*, GAO-12-493 (Washington, D.C.: May 2012), and GAO-13-283.

[17]GAO-13-283.

the department, because they are not centrally tracked.[18] In 2012, DOD began developing a strategy for asset visibility and in-transit visibility; however, as of February 2013 this strategy did not include all key elements of a comprehensive strategic plan. We recommended that the department finalize its strategy and in doing so ensure complete, accurate, and consistent information for all in-transit visibility efforts is captured, tracked, and shared, and the strategy contains all of the key elements of a comprehensive strategic plan, including resources and investments and key external factors. DOD agreed with our recommendation and revised and finalized its asset visibility strategy. We are currently reviewing the new strategy and the department's efforts to improve asset visibility.

In 2012, we reviewed DOD's efforts to incorporate Item Unique Identification (IUID) technology into supply chain management and found a number of implementation challenges.[19] IUID technology allows DOD to label an item and assign a unique number to the item, could improve the accountability of property and equipment, and could enable DOD to track equipment as it moves between its components. Challenges we identified include incomplete information on the number of items that need to be marked with IUID labels, difficulties in collecting information on IUID implementation costs, and the lack of an overarching schedule for the integration of IUID into DOD's information technology systems. DOD is revising its supply chain management policy and guidance to better include IUID use, but has not fully defined requirements for using these data, nor developed complete, integrated master schedules for integrating IUID department-wide and within components' systems. We recommended that DOD complete its implementation and management framework for IUID by incorporating key elements of a comprehensive management approach, such as a complete analysis of the return on investment, quantitatively-defined goals, and metrics for measuring progress. DOD generally agreed with our recommendations and is taking action to address them. We are continuing to monitor DOD's progress in

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[18]GAO, *Defense Logistics: A Completed Comprehensive Strategy is Needed to Guide DOD's In-Transit Visibility Efforts*, GAO-13-201 (Washington, D.C.: Feb. 28, 2013).

[19]GAO, *Defense Logistics: Improvements Needed to Enhance DOD's Management Approach and Implementation of Item Unique Identification Technology*, GAO-12-482 (Washington, D.C.: May 3, 2012).

implementing a comprehensive management approach for using IUID technology.

Effective asset management controls are essential for asset accountability and safeguarding and financial reporting on asset values. DOD primarily relies on various logistical systems to carry out both its stewardship and financial reporting responsibilities for an estimated $1.5 trillion in physical assets, ranging from enormous inventories of ammunition, stockpile materials, and other military items to multimillion-dollar weapon systems. These systems are the primary source of information for maintaining visibility over assets to meet military objectives and readiness goals and for financial reporting. However, our prior reports and DOD Inspector General (IG) reports have shown that these systems have serious weaknesses that in addition to hampering financial reporting, impair DOD's ability to (1) maintain central visibility over its assets; (2) safeguard assets from physical deterioration, theft, or loss; and (3) prevent the purchase of assets already on hand. Collectively, these weaknesses can seriously diminish the efficiency and economy of the military services' support operations.

For example, we have continued to monitor the implementation of the Army's Logistics Modernization Program (LMP) system, which supports both inventory management and financial reporting.[20] In November 2013, we reported that the Army's LMP, which replaced two aging Army systems, is supporting the Army's industrial operations.[21] However, the current system—LMP Increment 1—does not support certain critical requirements, such as automatically tracking repair and manufacturing operations on the shop floor of depots and arsenals. In addition, according to Army officials, the current system will not enable the Army to generate auditable financial statements by 2018, the statutory deadline for this goal. The Army is in the process of developing LMP Increment 2 to, among other things, address some of the identified weaknesses and

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[20]LMP is intended to provide a solution that streamlines the maintenance, repair, and overhaul; planning; finance; acquisition; and supply of weapon systems, spare parts, services, and material for the Army's working capital fund (which funds repairs and spare parts at cost plus a user fee) to Army commands. LMP is intended to enable worldwide, real-time, total asset visibility of inventory, including contractor-managed inventories. It also is intended to provide an anticipatory logistics planning tool that should result in reduced stock levels.

[21]GAO-14-51.

expects to complete fielding by September 2016. To determine whether the Army is achieving its estimated financial benefits in LMP, we recommended that the Army develop and implement a process to track the extent of financial benefits realized from the use of LMP during the remaining course of its life cycle. The Army agreed with our recommendation and stated that it would develop a process to track the extent of financial benefits recognized within LMP. We are continuing to monitor the Army's actions.

Program Performance and Budgeting

Reliable performance and budget information are essential to ensure that DOD has effectively budgeted for its needs so that operations can proceed smoothly to meet mission readiness demands. Accurate and timely performance and budget information also is critical to effective oversight and decision making on DOD's numerous reform initiatives.

The following examples illustrate some of the serious weaknesses we have identified in our past work on DOD's performance management and budget information.

- In our February 2014 report on the audit of the U.S. government's consolidated financial statements, we discussed as a material weakness,[22] DOD's inability to estimate with assurance key components of its environmental and disposal liabilities.[23] Deficiencies in internal control supporting the process for estimating environmental and disposal liabilities could result in improperly stated liabilities as well as adversely affect the ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities for federal employee and veteran benefits. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment

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[22]A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

[23]GAO-14-319R.

facilities. Problems in accounting for liabilities affect the determination of the full cost of the federal governments operations and the extent of its liabilities. DOD is addressing these issues through its implementation of its FIAR Plan.

- In June 2013, we reported[24] that problems with the accuracy of outstanding work orders at fiscal year-end for the Army's Industrial Operations activities resulted in inaccurate budget estimates.[25] To the extent that Industrial Operations does not complete work at year-end, the work and related funding are carried over into the next fiscal year. Carryover is the reported dollar value of work that has been ordered and funded by customers but not completed by Industrial Operations at the end of the fiscal year. We found that the Army did not adequately evaluate program needs and performance management constraints or the budgetary impact of the implementation of its LMP when budgeting for its Industrial Operations. As a result, unreliable information on the scope of work and the lack of available parts affected mission readiness. Further, the overstated Industrial Operations carryover amounts resulted in unreliable estimates of Operations and Maintenance funding levels. For example, the Industrial Fund carryover amounts more than doubled from fiscal years 2006 through 2012, exceeding budget estimates by more than $1.1 billion each year. We made three recommendations aimed at implementing the Army's planned corrective actions to (1) establish a timetable for implementing new policy guidance, (2) improve the budgeting for new orders, and (3) establish procedures for evaluating work orders received to ensure that resources are available to perform the work. DOD agreed with our recommendations and has actions planned or under way to address them.

- The Office of Management and Budget (OMB) requires[26] that federal agency budget submissions reflect anticipated reductions in improper

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[24]GAO, *Army Industrial Operations: Budgeting and Management of Carryover Could Be Improved*, GAO-13-499 (Washington, D.C.: June 27, 2013).

[25]The Army operates 13 Industrial Operations activities that provide depot maintenance and ordnance services.

[26] Office of Management and Budget, *Preparation, Submission, and Execution of the Budget*, OMB Circular No. A-11, § 31.8 (July 26, 2013).

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payments[27] in their PARs or agency financial reports (AFR)[28] pursuant to legal requirements for the estimation of improper payments.[29] For years, DOD has reported over $1 billion annually in improper payments. Improper payments degrade the integrity of government programs, compromise citizens' trust in government, and drain resources away from the missions and goals of the government. As we reported in May 2013, although DOD has reported billions of dollars in improper payments, it does not know the extent of its improper payments because of flaws in its estimating methodology.[30] We found that DOD's improper payment estimates reported in its fiscal year 2011 AFR were neither reliable nor statistically valid because of long-standing and pervasive financial management weaknesses and significant deficiencies in the department's procedures to estimate improper payments. The flawed methodology for estimating improper payments also limits the effectiveness of DOD's corrective actions. We recommended that DOD take steps to (1) improve improper payment estimating procedures, such as developing valid sampling methodologies and error projections; (2) identify programs susceptible to improper payments and perform a risk assessments; (3) develop and implement corrective action plans in accordance with best practices; (4) implement recovery audits; and (5) ensure the accuracy and completeness of improper payment and

[27]The term improper payment means any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments), and includes payments to an ineligible recipient, any payment for an ineligible good or service, any duplicate payment, any payment for a good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts. According to guidance from OMB, agencies should also report as improper payments any payments for which insufficient or no documentation is found.

[28]DOD's AFRs provide an overview of the department's financial information and performance goals and objectives. Additional information, such as the department's reporting on improper payments, is in Addendum A to its AFR.

[29]Federal agencies are required to estimate and report annually on their improper payments under the Improper Payments Information Act of 2002, Pub. L. No. 107-300 (Nov. 26, 2002), *as amended by* Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204 (July 22, 2010), *and* Improper Payments Elimination and Recovery Improvement Act of 2012, Pub. L. No. 112-248 (Jan. 10, 2013), *and codified as amended at* 31 U.S.C. § 3321 note.

[30]GAO, *DOD Financial Management: Significant Improvements Needed in Efforts to Address Improper Payment Requirements*, GAO-13-227 (Washington, D.C.: May 13, 2013).

recovery audit reporting. DOD agreed with our recommendations and cited planned actions to address them.

Cost-effective Choices

Reliable information on the cost of operations is critical to provide accountability for and to efficiently and economically manage DOD's vast resources. Reliable cost information is essential for making important decisions, such as reallocating resources to fighting forces and considering whether to continue, modify, or discontinue programs and activities. However, DOD's legacy financial management systems were not designed to capture the full cost of its activities and programs, and DOD's enterprise resource planning (ERP) systems[31] continue to experience schedule slippages and cost overruns and are not estimated to be fully implemented until the end of fiscal year 2016 or later.[32]

As our prior work has found, to effectively, efficiently, and economically manage DOD's programs, its managers need reliable cost information for (1) evaluating programs (for example, measuring actual results of management's actions against expected savings or determining the effect of long-term liabilities created by current programs); (2) making cost-effective choices, such as whether to outsource specific activities and how to improve efficiency through technology choices; and (3) controlling costs for its weapon systems and business activities funded through working capital funds. The lack of reliable, cost-based information has hampered DOD in each of these areas, as described in the following examples.

- In a February 2014 report on our audit of the U.S. government's consolidated financial statements, we reported that DOD was responsible for the majority of the federal government's inventories and property, plant, and equipment and that DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Further, deficiencies in internal control over such assets could affect the federal government's ability to fully

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[31]An ERP system is an automated system using commercial off-the-shelf software consisting of multiple, integrated functional modules that perform a variety of business-related tasks, such as general ledger accounting, payroll, and supply chain management.

[32]GAO, *DOD Financial Management: Reported Status of Department of Defense's Enterprise Resource Planning Systems*, GAO-12-565R (Washington, D.C.: Mar. 30, 2012).

know the assets it owns, including their location and condition, and its ability to (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets and reliably report asset balances; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.[33] DOD is addressing these issues through implementation of its FIAR Plan.

- With the nation facing fiscal challenges and the potential for tighter defense budgets, the Congress and DOD have placed more attention on controlling the billions of dollars spent annually on weapon system operating and support costs, including costs for repair parts, maintenance, and personnel, which account for 70 percent of the total costs of a weapon system over its life cycle. The Selected Acquisition Report (SAR) is DOD's key recurring status report on the cost, schedule, and performance of major defense acquisition programs and is intended to provide authoritative information for congressional oversight of these programs. Oversight of operating and support costs is important because many of the key decisions affecting these life cycle costs are made during the acquisition process. In February 2012, we reported that DOD's reports to the Congress on estimated weapon system operating and support costs are often inconsistent and sometimes unreliable, limiting visibility needed for effective oversight of these costs.[34] To enhance the visibility of weapon system costs during acquisition, we recommended that DOD improve its guidance to program offices on cost reporting and also to improve its process for reviewing these costs prior to final submission of the SAR to the Congress. DOD concurred with our recommendations and noted actions it was taking to address them. We are continuing to monitor DOD's progress in addressing our recommendations.

- In December 2012, DOD canceled the Air Force's Expeditionary Combat Support System after having spent more than a billion dollars and missing multiple milestones, including failure to achieve deployment within 5 years of obligating funds. The system was to

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[33]GAO-14-319R.

[34]GAO, *Defense Logistics: Improvements Needed to Enhance Oversight of Estimated Long-term Costs for Operating and Supporting Major Weapon Systems*, GAO-12-340 (Washington, D.C.: Feb. 2, 2012).

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provide the Air Force with a single, integrated logistics system that was to control and account for about $36 billion of inventory. We issued several reports on this system and found that among other things, the program was not fully following best practices for developing reliable schedules and cost estimates.[35] We also reported that independent Air Force technical evaluations identified operational deficiencies that impaired the system's efficiency and effectiveness in accounting for business transactions and reporting reliable financial information.

- Accurate and complete cost information also is key to making effective and economical investment decisions. We reported that one-time implementation costs for Base Realignment and Closure (BRAC) 2005 grew from $21 billion originally estimated by the BRAC Commission in 2005 to about $35.1 billion, or by 67 percent, through fiscal year 2011, primarily because of higher-than-anticipated military construction costs.[36] Military construction costs for the BRAC 2005 round increased from $13.2 billion based on original estimates by the BRAC Commission to $24.5 billion, an 86 percent increase, through fiscal year 2011, while over the same period, general inflation increased by 13.7 percent. In certain cases, DOD did not include some significant military construction requirements that were needed to implement the recommendations as envisioned, resulting in the identification of additional requirements and related cost increases after the recommendations were approved by the BRAC Commission. Consequently, the increase of $11.3 billion in military construction

[35]GAO, *Information Technology: OMB and Agencies Need to More Effectively Implement Major Initiatives to Save Billions of Dollars*, GAO-13-796T (Washington, D.C.: July 25, 2013); *Major Automated Information Systems: Selected Defense Programs Need to Implement Key Acquisition Practices*, GAO-13-311 (Washington, D.C.: Mar. 28, 2013); *DOD Financial Management: Challenges in Attaining Audit Readiness and Improving Business Processes and Systems*, GAO-12-642T (Washington, D.C.: Apr. 18, 2012); *DOD Financial Management: Implementation Weaknesses in Army and Air Force Business Systems Could Jeopardize DOD's Auditability Goals*, GAO-12-134 (Washington, D.C.: Feb. 28, 2012); and *DOD Business Transformation: Improved Management Oversight of Business System Modernization Efforts Needed*, GAO-11-53 (Washington, D.C.: Oct. 7, 2010).

[36]GAO, *Military Bases: Opportunities Exist to Improve Future Base Realignment and Closure Rounds*, GAO-13-149 (Washington, D.C.: Mar. 7, 2013), and *Military Base Realignments and Closures: Updated Costs and Savings Estimates from BRAC 2005*, GAO-12-709R (Washington, D.C.: June 29, 2012).

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costs drove about 80 percent of the total cost increases of $14.1 billion for BRAC 2005. Further, because some additional requirements were driven by events after the BRAC Commission's approval, the Congress had limited visibility into the potential costs of the original recommendations. Another reason we identified for the growth in implementation costs over DOD's initial BRAC estimates was that DOD had difficulties accurately anticipating information technology requirements for many recommendations, leading to significantly understated information technology costs for some BRAC recommendations—particularly those that involved missions with considerable reliance on such capabilities. We made 10 recommendations for improving the BRAC process. DOD concurred with 3 of our recommendations, partially concurred with 2, and did not concur with 5 of them. In disagreeing with certain recommendations, DOD expressed concern that our recommendations precluded optimizing military value and stated that the current process was sufficient to address our concerns. We continue to believe that although DOD's BRAC process was fundamentally sound, our recommendations did not preclude opportunities for improvements or the potential for cost savings.

Accountability over Use of Public Funds

We recently reported that our analysis of 333 reports related to DOD funds control issued in fiscal years 2007 through 2013 identified over 1,000 funds control weaknesses related to (1) training, supervision, and management oversight; (2) proper authorization, recording, documentation, and reporting of transactions; and (3) business system compliance with federal laws and accounting standards.[37] We found that these weaknesses led DOD to make program and operational decisions based on unreliable data and impaired DOD's ability to improve its financial management. Specifically, fundamental weaknesses in funds control significantly impaired DOD's ability to (1) properly use resources, (2) produce reliable financial reports on the results of operations, and (3) meet its audit readiness goals as discussed in the following examples.

[37]GAO, *DOD Financial Management: Actions Under Way Need to Be Successfully Completed to Address Long-standing Funds Control Weaknesses*, GAO-14-94 (Washington, D.C.: Apr. 29, 2014).

- Continuing reports of violations of the Antideficiency Act (ADA) and other fiscal laws, such as the Purpose Statute,[38] underscore DOD's inability to assure that obligations and expenditures are properly recorded and do not exceed statutory levels of control.[39] The ADA requires, among other things, that no officer or employee of DOD incur obligations or make expenditures in excess of the amounts made available by appropriation, by apportionment, or by further subdivision according to the agency's funds control regulations. According to copies of ADA violation reports we reviewed, DOD reported 75 ADA violations from fiscal year 2007 through fiscal year 2012, totaling nearly $1.1 billion. We received reports of 2 additional ADA violations in 2013 totaling $148.6 million. However, we determined that the number of violations and dollar amounts reported may not be complete because of weaknesses in DOD's funds control and monitoring processes that may not have allowed all violations to be identified or reported. For example, DOD IG reports issued in fiscal years 2007 through 2012 identified $5.5 billion in potential ADA violations that required further investigation to determine whether an ADA violation had, in fact, occurred, or if adjustments could be made to avoid a violation. Further, while DOD's Financial Management Regulation (FMR)[40] limits the time from identification to reporting of ADA violations to 15 months,[41] our analysis identified several examples of time spans for investigations of potential ADA violations taking several additional months to several years before determinations of actual violations were reported. For example, as of September 30, 2013, three of the DOD IG-reported potential violations totaling $713.1 million could not be fully corrected and, consequently, resulted in $108.8 million in actual, reported ADA violations. To the

[38]31 U.S.C. 1301(a) (appropriations shall be applied only to the objects for which the appropriations were made, except as otherwise provided by law).

[39]31 U.S.C. §§ 1341-42, 1349-52, 1511-19. DOD categorizes violations of various fiscal laws and violations of the ADA collectively as ADA violations. For example, DOD has reported violations of the Purpose Statute as ADA violations. In some cases, reports of ADA violations included both ADA and other fiscal law violations.

[40]DOD FMR, vol. 14, ch. 1, "Administrative Control of Funds" (January 2009). DOD's FMR is issued under the authority of DOD Instruction 7000.14, *Department of Defense Financial Management Policy and Procedures* (rev. Sept. 17, 2008). The DOD FMR directs statutory and regulatory financial management requirements, systems, and functions for all appropriated and nonappropriated working capital, revolving, and trust fund activities

[41]DOD, FMR, vol. 14, ch. 7, "Antideficiency Act Report," § 070102 (November 2010).

extent that ADA violations are not identified, corrected, and reported, DOD management decisions are being made based on incomplete and unreliable data.

- DOD has stated that its major financial decisions are based on budgetary data (e.g., the status of funds received, obligated, and expended). We have found that the department's ability to improve its budgetary accounting has historically been hindered by its reliance on fundamentally flawed financial management systems and processes and transaction control weaknesses. In its November 2013 AFR,[42] DOD self-reported 16 material weaknesses in financial reporting, noting that it has no assurance of the effectiveness of the related controls. These weaknesses affect reporting on budgetary transactions and balances, including budget authority, fund balance, outlays, and categories of transactions, such as civilian pay, military pay, and contract payments. As a result, we have concluded that DOD's reports on budget execution and reports on the results of operations that could have a material effect on budget, spending, and other management decisions are unreliable.

For example, we found that DOD continues to make billions of dollars of unsupported, forced adjustments, or "plugs," to reconcile its Fund Balance with Treasury (FBWT).[43] In the federal government, an agency's FBWT accounts are similar in concept to corporate bank accounts. The difference is that instead of a cash balance, FBWT represents unexpended budget authority in appropriation accounts. Similar to bank accounts, the funds in DOD's appropriation accounts must be reduced or increased as the department spends money or receives collections that it is authorized to retain for its own use. For fiscal year 2012, DOD agencies reported making $9.2 billion in unsupported reconciling adjustments to agree their fund balances with the Department of the Treasury's (Treasury) records. DOD's unsupported reconciling adjustments to agree its fund balances to Treasury records grew to $9.6 billion in fiscal year 2013. We recommended that the Navy develop and implement standard

[42]Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *United States Department of Defense, Agency Financial Report, for Fiscal Year 2013.*

[43]GAO, *DOD Financial Management: Ongoing Challenges with Reconciling Navy and Marine Corps Fund Balance With Treasury,* GAO-12-132 (Washington, D.C.: Dec. 20, 2011).

operating procedures for performing FBWT reconciliations with Treasury records and that it provide training on the new procedures to personnel performing FBWT reconciliations. The Navy has actions under way to address our recommendations.

- Further, we have reported that over the years, DOD has recorded billions of dollars of disbursement and collection transactions in suspense accounts because the proper appropriation accounts could not be identified and charged, generally because of coding errors.[44] Accordingly, Treasury does not accept DOD reporting of suspense transactions, and suspense transactions are not included in DOD component FBWT reconciliations. We have concluded that it is important that DOD accurately and promptly charge transactions to appropriation accounts since these accounts provide the department with legal authority to incur and pay obligations for goods and services. We recommended that the Navy perform periodic testing of systems for reporting transactions to Treasury and prioritize and address identified deficiencies. The Navy agreed with our recommendations and has actions under way to address them. We are monitoring the Navy's progress.

While DOD has actions under way to address its department-wide funds control weaknesses, several are not expected to be completed until 2017. Until fully resolved, these weaknesses will continue to adversely affect DOD's ability to achieve its goals for financial accountability, including the ability to produce consistent, reliable, and sustainable financial information for day-to-day decision making. Sustained leadership commitment will be critical to achieving success. In commenting on our most recent report released this week, DOD stated that while our report recommended no new actions based on the numerous actions that DOD already has under way, the department's commitment to building a stronger business environment via its people, processes, and systems remains paramount.[45]

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[44]GAO-12-132.

[45]GAO-14-94.

DOD's Actions to Improve Financial Management and Achieve Audit Readiness, and Remaining Challenges

Collectively, DOD's major financial management reform efforts are being managed under the FIAR effort as well as several other interdependent efforts, such as DOD's Civilian Workforce Plan and business systems modernization.[46] With the FIAR Plan's emphasis on audit readiness, it is important to note that financial statement audits are not just about validating the amounts and activity reported on the statements. They also provide a framework for assessing and improving internal controls and compliance with laws and regulations; developing effective, integrated financial management systems directed at providing reliable, useful, and timely information for decision making; demonstrating stewardship and accountability over federal programs and resources; and enabling a greater focus on managing the costs of government. Improving the department's financial management operations and thereby providing DOD management and the Congress more accurate and reliable information on the results of its business operations continues to be a difficult task. Below are some of the key challenges we have identified in prior work that DOD must address to improve its financial management and mitigate the operational effects mentioned previously as well as enable DOD to produce auditable financial statements

FIAR Plan Implementation

In 2005, the Under Secretary of Defense Comptroller/CFO (DOD Comptroller) established the FIAR Directorate, consisting of the FIAR Director and his staff, to develop, manage, and implement a strategic approach for addressing financial management deficiencies, achieving audit readiness, and integrating those efforts with other initiatives. In accordance with the NDAA for Fiscal Year 2010, DOD provides reports to relevant congressional committees on the status of DOD's implementation of the FIAR Plan twice a year—no later than May 15 and November 15.[47] In August 2009, the DOD Comptroller sought to focus FIAR efforts by giving priority to improving processes and controls that support the financial information most often used to manage the department. Accordingly, the DOD Comptroller revised the FIAR Plan strategy to focus on two priorities—budgetary information and asset

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[46]DOD's Civilian Workforce Plan encompasses a department-wide effort to ensure that each of DOD's 24 mission areas, including financial management, has the right mix of civilian and military personnel with the right skills and qualifications to effectively perform required mission duties.

[47]Pub. L. No.111-84, §1003(b).

accountability. The first priority was to strengthen processes, controls, and systems that produce DOD's budgetary information. The second priority was to improve the accuracy and reliability of management information pertaining to the department's mission-critical assets, including military equipment, real property, and general equipment. In May 2010, the DOD Comptroller first issued the FIAR Guidance, which provided the standard methodology for the components to implement the FIAR Plan. According to DOD, the components' successful implementation of this methodology is essential to the department's ability to achieve full financial statement auditability.

In October 2011, the Secretary of Defense directed the department to achieve audit readiness for its SBR for general fund accounts by the end of fiscal year 2014,[48] and the NDAA for Fiscal Year 2012 required that the next FIAR Plan update include a plan to support this goal.[49] Further, the NDAA for Fiscal Year 2013 made the 2014 target for SBR auditability an ongoing component of the FIAR Plan by amending the NDAA for Fiscal Year 2010 such that it now explicitly refers to describing the actions and costs associated with validating as audit ready both DOD's SBR by the end of fiscal year 2014 and DOD's complete set of financial statements by the end of fiscal year 2017.[50]

In response to component difficulties in preparing for a full SBR audit, the November 2012 FIAR Plan Status Report and the March 2013 FIAR Guidance included a revision to narrow the scope of initial audits to only current-year budget activity and expenditures on a Schedule of Budgetary Activity. Under this approach, beginning in fiscal year 2015, reporting entities are to undergo an examination of their Schedules of Budgetary Activity reflecting the amount of SBR balances and associated activity related only to funding approved on or after October 1, 2014. As a result, the Schedules of Budgetary Activity will exclude unobligated and unexpended amounts carried over from prior years' funding as well as information on the status and use of such funding in subsequent years

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[48]An agency's general fund accounts are those accounts in the U.S. Treasury that hold all federal money not allocated by law to any other fund account.

[49]Pub. L. No. 112-81, div. A, § 1003 (Dec. 31, 2011).

[50]Most recently, the NDAA for Fiscal Year 2014, Pub. L. No. 113-66, § 1003 (Dec. 26, 2013), mandates that a full audit of DOD's financial statements occur for fiscal year 2018, and that it be completed by March 31, 2019.

(e.g., obligations incurred and outlays). These amounts will remain unaudited. Over the ensuing years, as the unaudited portion of SBR balances and activity related to this funding decline, the audited portion is expected to increase. However, the NDAA for Fiscal Year 2010, as amended by the NDAA for Fiscal Year 2013, requires that the FIAR Plan describe specific actions to be taken and the costs associated with ensuring that DOD's SBR is validated as ready for audit by not later than September 30, 2014. We have reported that because the audit of the Schedule of Budgetary Activity is an incremental step building toward an audit-ready SBR, the FIAR Plan does not presently comply with this requirement.[51] Furthermore, all material amounts reported on the SBR will need to be auditable in order to achieve the mandated goal of full financial statement audit readiness by September 30, 2017. It is not clear how this can be accomplished if activity related to funding provided prior to October 1, 2014, remains unaudited.

The FIAR Guidance sets out a mandatory set of five standardized phases for achieving audit readiness that DOD components are required to apply to each assessable unit.[52] In the first two phases, Discovery and Corrective Action, the components identify, assess, and correct or mitigate deficiencies in the processes and controls of the assessable units related to preparing auditable financial statements, line items, or transactions and the activities that feed into them. In the Assertion/Evaluation phase, the component asserts audit readiness[53] and the FIAR Directorate reviews and gives the component feedback on its state of audit readiness. In the Validation phase, the FIAR Directorate reviews the component's examination report and documentation supporting successful remediation of deficiencies, and determines the reporting entity's audit readiness state. In the Audit phase, an independent auditor or the DOD Office of Inspector General (OIG), performs an audit of the financial statements or specified elements and issues an opinion on whether they are fairly presented in accordance with

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[51]GAO-14-94.

[52]DOD defines an assessable unit as any part of the financial statements, such as a line item or a class of assets, a class of transactions, or a process or a system, that helps produce the financial statements.

[53]A management assertion, according to the November 2013 FIAR Guidance, is a written declaration that the subject matter (assessable unit) is audit ready in conformity with the internal control and supporting documentation criteria based upon the FIAR methodology.

generally accepted accounting principles. We found that while DOD has made progress toward financial audit readiness, according to DOD's November 2013 FIAR Plan Status Report, milestone dates for the Navy have slipped and SBR milestone dates for the Army and defense agencies have been compressed, making it questionable whether corrective actions for these DOD components will be completed by September 2014 for all assessable units.[54] Further, the Air Force has revised its milestone dates for achieving SBR audit readiness to the third quarter of fiscal year 2015. With a reported $187.8 billion in fiscal year 2013 General Fund budgetary resources, the Air Force is material to DOD's SBR, and if the Air Force cannot meet DOD's September 2014 SBR audit readiness goal, DOD will not be able to meet its goal. This in turn raises substantial concerns about DOD's ability to undergo an audit on a full set of financial statements for fiscal year 2018.

In addition, our recent reports have identified several major challenges to DOD's ability to successfully implement the FIAR Plan and meet its audit readiness goals. The following discussion summarizes these challenges.

Process for identifying and mitigating risks to the FIAR effort. In August 2013, we reported that DOD's FIAR effort would benefit from a risk management strategy to help program managers and stakeholders make decisions about assessing risk, allocating resources, and taking actions under conditions of uncertainty.[55] In January 2012, DOD identified six department-wide risks to the FIAR Plan's implementation: (1) lack of DOD-wide commitment, (2) insufficient accountability, (3) poorly defined scope and requirements, (4) unqualified or inexperienced personnel, (5) insufficient funding, and (6) information systems control weaknesses. DOD officials stated that risks are discussed on an ongoing basis during various FIAR oversight committee meetings; however, the risks DOD initially identified were not comprehensive, and DOD provided no evidence of efforts to identify additional risks. Further, we found little evidence that DOD analyzed risks it identified to assess their magnitude or that DOD developed adequate plans for mitigating the risks. DOD's risk mitigation plans, published in its FIAR Plan Status Reports, consisted of brief, high-level summaries that did not include critical management information, such as specific and detailed plans for implementation,

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[54]GAO-14-94.

[55]GAO-13-123.

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assignment of responsibility, milestones, or resource needs. In addition, information about DOD's mitigation efforts was not sufficient for DOD to monitor the extent of progress in mitigating identified risks. We concluded that without effective risk management at the department-wide level to help ensure the success of the FIAR Plan implementation, DOD is at increased risk of not achieving its audit readiness goals. We recommended that the department design and implement department-level policies and detailed procedures for FIAR Plan risk management that incorporate the five guiding principles for effective risk management. DOD acknowledged that it does not have a risk management program that is specifically related to its FIAR effort and cited planned actions that if effectively and efficiently implemented, would address some aspects of the five guiding principles of risk management that are the basis for our recommendations. We are continuing to monitor DOD's actions on our recommendation.

Component implementation of the FIAR Guidance. The FIAR Guidance provides a methodology for DOD components to use in developing and implementing their Financial Improvement Plans (FIP).[56] The guidance details the roles and responsibilities of the DOD components, and prescribes a standard, systematic process for assessing processes, controls, and systems. DOD's ability to achieve department-wide audit readiness greatly depends on its military components' ability to effectively develop and implement FIPs in compliance with the FIAR Guidance. However, we have reported on concerns with the department's efforts to implement this methodology. For example, our review of the Navy's civilian pay and Air Force's military equipment audit readiness efforts identified significant deficiencies in the components' execution of the FIAR Guidance, resulting in insufficient testing and unsupported conclusions.[57] We recommended that DOD take various actions to improve the development, implementation, documentation, and oversight of DOD's financial management improvement efforts. DOD generally concurred with recommendations and noted actions being taken to implement them. We are continuing to monitor Navy and Air Force audit readiness actions.

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[56]A FIP is a framework for planning and tracking the steps and supporting documentation necessary to achieve auditability within the FIAR methodology.

[57]GAO-11-851.

In reviews of other DOD components, we also found internal control weaknesses in DOD's procedures for maintaining accountability for billions of dollars in funds and other resources. For example, the Army and DFAS could not readily identify the full population of payroll accounts associated with the Army's $46 billion active duty military payroll because of deficiencies in existing procedures and nonintegrated personnel and payroll systems.[58] We recommended that the Army identify documents needed to support military payroll transactions affecting the pay of millions of active duty Army military personnel and that it develop and implement procedures for maintaining those documents. As a first step, the Army has developed a matrix of supporting documents for its military pay. However, the Army has not yet completed action to populate a central repository with these records.

Preliminary results from our ongoing work to assess the Army's progress in implementing its FIP for budget execution to help guide its SBR readiness efforts indicate that the Army did not fully complete certain tasks in accordance with the FIAR Guidance to ensure that its FIP adequately considered the scope of efforts required for audit readiness. For example, the Army did not consider the risks associated with excluding prior year balances and current year activity associated with legacy systems and did not adequately identify significant SBR activity attributable to service-provider business processes and systems or obtain sufficient information to assess their audit readiness. These activities may continue to represent material portions of future SBRs, which if not auditable, will likely affect the Army's ability to achieve audit readiness goals as planned. Our review of the Army's monthly tests to assess the effectiveness of selected budget execution controls show that the Army identified extensive deficiencies, such as a lack of appropriate reviews or approvals, and had an average failure rate of 56 percent for control tests from June 2012 through May 2013, the period covered by our review. Further, the Army's corrective actions were not linked to specific corrective action plans to address the causes of identified deficiencies. The deficiencies and gaps we have identified in our preliminary findings throughout various phases of the Army's SBR audit readiness efforts demonstrate a focus on meeting scheduled milestone dates and asserting audit readiness instead of completing actions to resolve extensive control deficiencies.

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[58]GAO-12-406.

Further, the military services rely heavily on DOD's internal service providers to perform a variety of accounting, personnel, logistics, and system operations. For example, DFAS performs accounting and disbursement functions for the military services and defense agencies. The FIAR Guidance requires the service providers to have their control activities and supporting documentation examined by the DOD IG or an independent auditor in accordance with Statement on Standards for Attestation Engagements (SSAE) No.16 so that components have a basis for relying on the service provider's data for their financial statement audits.[59] In August 2013, we reported that DOD did not have an effective process for identifying audit-readiness risks, including risks associated with its reliance on service providers for much of its components' financial data, and it needed better department-wide documentation retention policies.[60] We identified two DOD component agencies—the Navy and the Defense Logistics Agency (DLA)—that had established practices consistent with risk management guiding principles. Because effective service-provider controls are critical to ensuring improvements in DOD funds control, we recommended that DOD consider and incorporate, as appropriate, Navy and DLA practices in department-level policies and procedures. DOD agreed with our recommendation and is taking actions to address it.

DOD has identified contract pay as a key element of its SBR. DFAS, the service provider responsible for disbursing nearly $200 billion annually in the department's contract pay, has asserted that its processes, systems, and controls over contract pay are suitably designed and operating effectively to undergo an audit. Preliminary results from our ongoing assessment of DFAS's implementation of its FIP for contract pay audit readiness indicate that DFAS has numerous deficiencies that have not yet been remediated. For example, DFAS did not adequately perform certain planning activities, such as assessing dollar activity and risk

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[59]In accordance with SSAE No. 16, *Reporting on Controls at a Service Organization*, the auditors of each of these external service organizations issued reports concerning the design and operating effectiveness of the service organizations' internal control over the processing of user transactions. Services provided by an external service organization are considered to be part of a user entity's information system relevant to the user entity's financial reporting if the services affect classes of transactions that are significant to the user entity's financial statements as well as the financial reporting process used to prepare the financial statements.

[60]GAO, *DOD Financial Management: Ineffective Risk Management Could Impair Progress toward Audit-Ready Financial Statements*, GAO-13-123 (Washington, D.C.: Aug. 2, 2013).

factors of its processes, systems, and controls, which resulted in the exclusion of three key processes from the FIP, such as the reconciliation of its contract pay data to components' general ledgers. As a result, DFAS did not obtain sufficient assurance that the contract disbursements it processed were accurately recorded and maintained in the components' general ledgers and that the status of DOD's contract obligations was up-to-date. Although DFAS has asserted audit readiness for contract pay, until it corrects the weaknesses we identified, its ability to process, record, and maintain accurate and reliable contract pay transaction data is questionable. Therefore, our preliminary results indicate that DFAS does not have assurance that its FIP will satisfy the needs of DOD components or provide the expected benefits to department-wide efforts to assert audit readiness for contract pay as a key element of the SBR.

Modern Business Information Systems

In May 2014, we reported that DOD continued efforts to improve its business enterprise architecture (BEA)—a modernization blueprint—and transition plan and modernize its business systems and processes, consistent with key statutory provisions.[61] However, we found that even though DOD has spent more than 10 years and at least $379 million on the architecture, DOD has not yet demonstrated that the BEA has produced business value for the department. For example, while DOD has established a tool that can assist in identifying potential duplication and overlap among business systems, the department has not demonstrated that it has used this information to reduce duplication and overlap. Accordingly, we recommended that the department develop guidance requiring military departments and other defense organizations to use existing BEA content to more proactively identify potential duplication and overlap. DOD agreed with our recommendation. Collectively, the limitations described in our May 2014 report put the billions of dollars spent annually on approximately 2,100 business system investments that support DOD functions at risk.

Further, DOD has identified several, multifunctional ERP systems as critical to its financial management improvement efforts. In a 2012 report on four of these ERPs, we found deficiencies in areas such as data quality, data conversion, system interfaces, and training that affect their

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[61]GAO, *Defense Business Systems: Further Refinements Needed to Guide the Investment Management Process*, GAO-14-486 (Washington, D.C.: May 12, 2014). The relevant legal requirements are codified, as amended, at 10 U.S.C. § 2222.

capability to perform essential business functions.[62] DFAS personnel also reported difficulty in using the systems to perform day-to-day activities. We recommended that DOD ensure that (1) any future system deficiencies identified through independent assessments are resolved or mitigated prior to further deployment of the systems, (2) timelines are established and monitored for those issues identified by DFAS that are affecting their efficient and effective use, and (3) training on actual job processes are provided in a manner that allows users to understand how the new processes support their job responsibilities and the work they are expected to perform.[63] DOD partially concurred with our first recommendation, stating that based on the nature of an identified system deficiency, it will determine whether to defer system implementation until it is corrected. DOD agreed with our recommendations to establish and monitor timelines and provide training on user roles and responsibilities. We are continuing to monitor DOD's actions.

If these business systems do not provide the intended capabilities on schedule, DOD's goal of establishing effective financial management operations and becoming audit ready could be jeopardized. We recently reported that the Air Force did not meet best practices in developing a schedule for the Defense Enterprise Accounting and Management System (DEAMS) program.[64] We believe that this raises questions about the credibility of the deadline for acquiring and implementing DEAMS to provide needed functionality for financial improvement and audit readiness. We recommended that the Air Force update the cost estimate as necessary after implementing our prior recommendation to adopt scheduling best practices. DOD concurred with our recommendation.

Competent Financial Management Workforce

A key principle for effective workforce planning is that an agency needs to define the critical skills and competencies that it will require in the future to meet its strategic program goals. Once an agency has identified critical skills and competencies, it can develop strategies to address gaps in the number of personnel, needed skills and competencies, and deployment of the workforce.

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[62]GAO-12-134.

[63]GAO-12-134.

[64]GAO, *DOD Business System Modernization: Air Force Business System Schedule and Cost Estimates*, GAO-14-152 (Washington, D.C.: Feb. 7, 2014).

In April 2014, we reported[65] that DOD is addressing financial management workforce competencies and training through complementary efforts by (1) the Office of the Under Secretary of Defense for Personnel and Readiness (Personnel and Readiness) to develop a strategic civilian workforce plan that includes financial management,[66] pursuant to requirements in the NDAA for Fiscal Year 2010, as amended,[67] and (2) the DOD Comptroller to develop and implement a Financial Management Certification Program, pursuant to requirements in the NDAA for Fiscal Year 2012.[68] Financial management personnel are expected to possess the competencies that are relevant to and needed for their assigned positions. These competencies include fundamentals of accounting, accounting analysis, budget execution, financial reporting, and audit planning and management, among others. Personnel and Readiness is currently working on a competency assessment tool that will be used by the department, including the financial management functional community. The tool is to capture information related to competencies, such as proficiency level, importance, and criticality, and to identify any gaps in support of the Comptroller's Financial Management Certification Program. Phased implementation of the program began in June 2013, and the current target date for full implementation is the end of fiscal year 2014. The certification program is to be mandatory for DOD's approximately 54,000 civilian and military financial management personnel and may take up to 2 years to complete, depending on the extent to which an individual's prior course work and level of experience to meet the new certification requirements. In April 14, 2014, the Deputy CFO stated that the newly implemented Financial Management Certification Program has already enrolled 22,300 financial managers and certified over 30.[69]

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[65] GAO-14-94.

[66]The details of DOD's financial management workforce assessment are contained in the *Fiscal Year 2010 Department of Defense Strategic Workforce Plan*, app. B-15, Financial Management.

[67]*See* Pub. L. No. 111-84, § 1108(a)(1), (Oct. 28, 2009), *codified as amended at* 10 U.S.C. § 115b.

[68]Pub. L. No. 112-81, div. A, § 1051, (Dec. 31, 2011), *codified at* 10 U.S.C. § 1599d.

[69]GAO-14-94.

Without a competent workforce and effective implementation of financial management processes, systems, and controls, DOD and its components are at risk that DOD's other financial management reform activities will not be successful, resulting in incomplete and unreliable data for decision making. To the extent that these challenges are not addressed, DOD financial management will continue to be at high risk for waste, fraud, abuse, and mismanagement.

In conclusion, while DOD has several financial management improvement efforts under way and is monitoring progress against milestones, as the dates for validating audit readiness approach, DOD has emphasized asserting audit readiness by a certain date over making sure that effective processes, systems, and controls are in place to ensure that its components have improved financial management information for day-to-day decision making. However, several significant factors—including DOD component milestone slippages in meeting audit readiness dates; continuing, uncorrected DOD-wide financial management weaknesses; and inadequate risk management efforts—make it increasingly unlikely that DOD's SBR will be audit ready by September 2014. While establishing and working toward milestones are important to measure progress, DOD should not lose sight of the ultimate goal of implementing lasting financial management reform to ensure that it has the systems, processes, and personnel to routinely generate reliable financial management and other information critical to decision making and effective operations for achieving its missions. Overcoming DOD's long-standing financial management challenges will require strong commitment and top leadership support.

Chairman Carper, Ranking Member Coburn, and Members of the Committee, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

GAO Contacts and Staff Acknowledgments

DOD AUDIT DEADLINES

FY 2014 — Declare the Department's Statement of Budgetary Resources "Audit Ready"

FY 2015 — Conduct audit of FY 2015 Statement of Budgetary Resources

FY 2017 — Declare agency-wide financial statements "Audit Ready"

FY 2018 — Conduct audit of agency-wide FY 2018 financial statements

FY 2019 — Report results of FY 2018 audit to Congress by March 31, 2019

ASSESSMENT 2001	CURRENT STATE
Inability to consistently provide reliable financial and managerial data for effective decision-making	No change
Lack of an overarching approach to financial management – disparate systems (accounting, financial and feeder) hampered by lack of integration and standardization	DOD FIAR plan provides the approach, it is unclear how well it is being implemented, especially as audit goals are de-scoped and deadlines missed

Systems environment remains more or less unchanged |
| Convoluted business processes which fail to streamline excessive process steps – sometimes driven by accounting, operational and organizational structures, further complicated by aged and disparate systems | ERP results have been mixed – Air Force Expeditionary Combat Support System cancelled after nearly 10 years and over $1 billion spent |
| Difficulty in obtaining financially based, outcome-oriented management metrics | GAO has reported that metrics are not adequately defined |

Transforming Department of Defense Financial Management-A Strategy for Change, Final Report, April 13, 2001.

ASSESSMENT 2001	CURRENT STATE
Inability to produce Chief Financial Officer (CFO) Act compliant annual financial statements	No change
Disproportionate budget dollars appear to support non-value added activities – since useful information is hard to extract, useful corrective action is difficult to implement – with a lack of wide-spread understanding of how financial information can help	No change
Cultural bias toward status quo – driven by disincentives for change, and short timeframes of political appointees who otherwise might serve as agents of change	No change
Requires an infusion of personnel with technical and financial skill sets necessary to achieve integrated financial management systems	DOD is investing in training programs, still not fully implemented

Transforming Department of Defense Financial Management: A Strategy for Change, Final Report, April 13, 2001.

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We have concerns whether any of the ERPs will be able to support a financial statement audit until the Army, Navy, and Air Force systems can successfully implement Business Process Reengineering. DoD's current financial management and feeder systems were not designed to support various material amounts on the financial statements. The systemic deficiencies in financial management feeder systems and inadequate DoD business processes prevent the Department from collecting and reporting financial and performance data that are accurate, reliable, and timely. My office has issued 16 reports on 6 systems that included 131 recommendations to address 14 areas of deficiencies. We will continue to report on issues with ERPs.

CHARRTS No.: SHSGAC-03-007
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator McCaskill
Question: #7

Department Auditability

Question. You indicated at the hearing that the Department of Defense (DOD) will not attempt to complete a Statement of Budgetary Resources (SBR) at this time because the SBR requires information from previous fiscal years which would be incredibly difficult and resource intensive to compile. As such, DOD made the decision to focus on completing a Schedule of Budgetary Activity (SBA), which will provide the same information as the SBR, but using information only for a single fiscal year. It is my understanding that, going forward under this plan, DOD will complete an SBA for several consecutive years, which will allow DOD complete an SBR in 3-4 years. The requirement to be able to complete an audit goes back over 20 years to the Chief Financial Officers Act of 1990. Has anyone been held accountable for failing to meet any previously established deadlines related to DOD's auditability?

Answer. Historically, the lack of a clear, Department-wide strategy and set of priorities for achieving auditability has made accountability for meeting established deadlines difficult. During my tenure, however, we have promulgated and frequently updated a consolidated strategy, known as the Financial Improvement and Audit Readiness (FIAR) Guidance. The guidance defines the Department's goals, priorities, strategy, and methodology for becoming audit ready. Further, this guidance details the roles and responsibilities of reporting entities and service providers, as well as the processes they should follow to achieve audit readiness. A clear, comprehensive strategy for achieving audit readiness is critical to ensuring that limited resources are assigned effectively to facilitate sustained and measurable progress. The FIAR strategy provides a critical path for the Department because it balances the need to demonstrate short-term accomplishments that contribute toward achieving long-term goals. In retrospect, this kind of focused approach should have been applied much earlier.

In 2012, we also instituted mandatory FIAR performance objectives for every Senior Executive Service member and general or flag officer having a decision making role in in the Defense business space related to resource management. These same individuals feed their respective chains' audit readiness progress reports to our FIAR governance structure, which oversees our audit readiness efforts while emphasizing critical priorities. The governance structure includes the commitment of the Secretary and Deputy Secretary to put emphasis on and provide oversight for progress. Using the current structure, we fully intend to hold people accountable for results.

CHARRTS No.: SHSGAC-03-008
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department

Witness: USD(C) Hale
Senator: Senator McCaskill
Question: #8

Department Auditability

Question. You indicated at the hearing that the Department of Defense (DOD) will not attempt to complete a Statement of Budgetary Resources (SBR) at this time because the SBR requires information from previous fiscal years which would be incredibly difficult and resource intensive to compile. As such, DOD made the decision to focus on completing a Schedule of Budgetary Activity (SBA), which will provide the same information as the SBR, but using information only for a single fiscal year. It is my understanding that, going forward under this plan, DOD will complete an SBA for several consecutive years, which will allow DOD complete an SBR in 3-4 years. The requirement to be able to complete an audit goes back over 20 years to the Chief Financial Officers Act of 1990. What are the drawbacks and concerns, if any, to the current plan to produce SBAs for 3-4 consecutive years instead of spending the resources to conduct an SBR now which would provide some historical context?

Answer. We know from the experience of the U.S. Marine Corps' audits that pursuing SBA audits in the near-term is the sensible and cost-effective approach to achieving audit readiness of the Department's full financial statements. Although the information being audited is limited to current-year appropriations, the same audit standards are being applied. Findings from an SBA audit will offer immense value to DoD and will help the Department identify and resolve remaining issues that could, if not addressed, impede full audit readiness. By focusing first on information contained in the SBA, the Department will build, over time, the beginning balances necessary to support a full SBR audit and, using lessons learned from the Marine Corps, avoid the costly early pitfalls it faced.

The Marine Corps first attempted to audit its Fiscal Year (FY) 2010 SBR. That audit, conducted by the DoD Inspector General (IG), resulted in a disclaimer of opinion citing the Marine Corps' inability to provide supporting documentation for accounting transactions and disbursements in key areas, which prevented the auditors from completing the audit. An audit of its FY 2011 SBR also resulted in a disclaimer. After consulting with internal DoD leadership, as well as that of our oversight bodies at DoD IG and the Government Accountability Office, the decision was made to shift to a prospective audit approach using the current year SBA. We believe that this is a sensible, cost-effective methodology that provides no significant drawbacks. It will allow us to demonstrate progress while achieving a fully auditable SBR within similar timeframes.

CHARRTS No.: SHSGAC-03-009
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator McCaskill
Question: #9

Audit Readiness

Question. You stated at the hearing that the biggest issue the Department of Homeland Security had in getting to audit readiness was in valuing its assets, and that is an issue that you said DOD has not even confronted yet. It also took the Marine Corps 5 years to complete a Schedule of Budgetary Activity (SBA), when it initially set out to obtain a more comprehensive Statement of Budgetary Resources (SBR). In order to be audit ready by FY 2018, the other 3 services, which are much larger than the Marine Corps and DHS, are each going to have to get 3 consecutive SBAs done without any problems and then, in 2017, for the first time, get Balance Sheets, Statements of Net Cost and Statements of Changes in Net Position together without anything going wrong in addition to valuing all of its assets around the globe. Given these obstacles, how feasible is the current timeline?

Answer. The Department is aggressively working to complete corrective actions that are necessary to support current timelines. As we learn more and gain further DoD-wide support, we expect that the pace of audit successes will accelerate. Therefore, it is expected that most DoD budgetary statements will be audit ready September 30, 2014. The May 2014 Financial Improvement and Audit Readiness (FIAR) Plan Status Report includes messages from chief management officers of the Military Departments reaffirming their commitment to the Department's audit readiness timeline. Although risks and challenges still exist, including maintaining a stable budget environment, we believe that the path we are on is correct, and that our FIAR strategy is sound and will result in the Department conducting its first full financial statement audit beginning in FY 2018. The timeline is ambitious, but achievable.

CHARRTS No.: SHSGAC-03-010
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator McCaskill
Question: #10

Audit Readiness

Question. Since you will be leaving DOD soon, and most, if not all, of the political appointees at DOD will be gone by the beginning of FY 2018, who should be held responsible for meeting the current timeline for audit readiness?

Answer. The Secretary of Defense, no matter how long in office, is always accountable for the Department's commitments – particularly for those that require long-term and sustained focus. I expect that the Secretary of Defense will continue to hold the Under Secretary of Defense (Comptroller)/Chief Financial Officer responsible for overall success. In addition, in the case of Financial Improvement and Audit Readiness, accountability for progress has been included in performance plans of our civilian executive corps as well as many general/flag officers. We expect that this "top-down" emphasis will also translate into similar elements in the plans of those in the rank and file who are involved in business support throughout the chain of

command. This, along with sustained, constructive oversight from Congress, will institutionalize the kind of increased discipline and management accountability that annual audits demand.

CHARRTS No.: SHSGAC-03-011
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator McCaskill
Question: #11

Continuous Process Improvement

Question. As Sen. Coburn pointed out at the hearing, one Air Force general, General Wolfenbarger, in charge of $16 billion at supply depots, instituted continuous process improvement, and her team has saved $680 million as a result. If DOD found the same 4.25% in savings across its entire budget as a single Air Force general was able to find, it would save the government $22 billion just from improving its financial management practices. How aware was your office of General Wolfenbarger's efforts?

Answer. Best practices and lessons learned are regularly shared across the financial management community and with leadership. My office was aware of the Air Force's overall initiatives that have targeted operational efficiencies in "back room" functions involving depot maintenance and supply chain management, however not specifically attributed to General Wolfenbarger. Continuous process improvement efforts such as these will also serve to improve financial management and audit readiness. Financial improvement efforts, in turn, complement and support continuous process improvement.

CHARRTS No.: SHSGAC-03-012
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator McCaskill
Question: #12

Continuous Process Improvement

Question. As Sen. Coburn pointed out at the hearing, one Air Force general, General Wolfenbarger, in charge of $16 billion at supply depots, instituted continuous process improvement, and her team has saved $680 million as a result. If DOD found the same 4.25% in savings across its entire budget as a single Air Force general was able to find, it would save the government $22 billion just from improving its financial management practices. What lessons were learned by the efforts of General Wolfenbarger that are being applied to audit readiness efforts DOD-wide?

Answer. Continuous process improvement is an essential part of the Department's efforts to improve the efficiency of our business operations. It is also, as it was with Air Force Materiel Command, part of the Department's strategy to absorb the significant cuts in DoD's budget and personnel levels. The Department has focused intensely on improving financial management and systems, as well as promoting efficiencies in operations. Best practices and lessons learned are regularly shared.

Continuous process improvement practices also embody the key elements used in supporting financial auditability – specifically well-documented processes, process measurement, and effective controls to reduce variability. Audit readiness helps the Department ensure reliable information is available for management decision-making, and demonstrates to Congress and the public that the Department's financial practices are sound and reliable. Audit readiness means the Department has strengthened internal controls and improved financial practices, processes, and systems so there is reasonable confidence the information can withstand an audit by an independent auditor.

CHARRTS No.: SHSGAC-03-001
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator Coburn
Question: #1

Antideficiency Act investigations

Question. What is the number and dollar amount of Antideficiency Act (ADA) investigations that have been initiated, completed, and reported for the last 2 years?

Answer. In Fiscal Year (FY) 2012 and FY 2013, 39 formal cases were investigated and completed by the Military Services and Defense Agencies. Of the 39 cases, 15 cases were found to be ADA violations, and 31 people were disciplined. The dollar amount of the 15 cases found to be violations of the ADA totaled $555,469,753, which represents about 0.043 percent of total DoD budgets for those years. Two Army ADA violations accounted for over 50 percent ($285,000,000) of the dollar amount reported. These two violations occurred in the Army's FY 2005 and FY 2008 Military Personnel account when the Army over-obligated its Military Personnel Appropriation during those fiscal years. These centrally-managed, one-year accounts are particularly challenging during wartime.

CHARRTS No.: SHSGAC-03-002
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator Coburn
Question: #2

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Antideficiency Act investigations

Question. What is the average length of time it takes to complete an ADA investigation? How many staff are assigned to do ADA investigations?

Answer. In Fiscal Year (FY) 2012 and FY 2013, 39 cases were investigated by the Military Services and Defense agencies. The average length of time for these 39 investigations to be completed was just over 21 months. Many of these cases involved complex issues of fiscal law and policy that needed to be coordinated at several levels. Such coordination requires time. Competing workload does account for some of the time, as this is typically a collateral duty for many of the investigators, and resources devoted to headquarters reviews are equally limited. With that said, we have emphasized reducing the backlog and increased training. This has contributed to a reduction of the number of cases. We are looking at additional opportunities to reduce the time required to complete investigations.

Each Military Service assigns one investigator and one legal advisor to each case. The legal advisor can assist an investigating officer in framing the issues, identifying the information required, planning the investigation, and interpreting and analyzing the information obtained. The attorney's role, however, is to provide legal advice and assistance, not to conduct the investigation or substitute his judgment for that of the investigating officer. In addition, the potential violation might involve a complex situation where a subject matter or technical expert with the requisite knowledge in all of the functional areas involved will be needed to support the investigator.

CHARRTS No.: SHSGAC-03-003
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator Coburn
Question: #3

FIAR plan

Question. In the Department's FIAR plan you identify Department-wide commitment as a risk to auditability. Do you think the dotted line reporting relationships between the DOD CFO and the department CFOs hinders the ability of the position incumbent to effectively direct and coordinate efforts as needed to effect the DOD-wide change needed to improve financial management in the Department?

Answer. No. The current reporting relationships support, rather than hinder, our efforts to effect DoD-wide change necessary to improve financial management. The Assistant Secretaries of the Military Departments (Financial Management and Comptroller) are appropriately positioned within their respective organizations as the Services' chief financial officers (CFOs). Their roles are consistent with statutory responsibilities invested in the Service

Secretaries, and they provide critical leadership in a Department that's as large, varied, and complex as the DoD. In some cases, the unique component mission requirements and associated execution methodologies also must be considered. Within this environment, I have established a collaborative relationship with the Service CFOs, characterized by frequent and open communication. I meet with Service CFOs weekly or more frequently to discuss enterprise issues such as audit readiness and operational efficiencies. I also enjoy senior leadership support and engage with component chief management officers in pursuing enterprise goals such as Financial Improvement and Audit Readiness, or even implementing operational efficiencies across the department. Collectively, these relationships have worked well.

CHARRTS No.: SHSGAC-03-004
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator Coburn
Question: #4

Valuation of assets

Question. What is the Department's plan for completing the valuation of its assets as required by the fiscal year 2017 deadline to declare its department-wide financial statements audit ready?

Answer. Resolving existence and completeness (E&C) issues is an essential first step to valuing assets and reporting them on the balance sheet, which must be completed by September 30, 2017, to achieve audit readiness on DoD's full financial statements. Today, 69 percent of mission critical assets reported on the Balance Sheet as General Property, Plant, and Equipment have been asserted as audit ready, and 26 percent of mission critical assets reported as Inventory and Related Property have been asserted as audit ready for attributes related to E&C. Further, the Army, Navy, and Air Force have asserted audit readiness on the majority of their most important mission critical assets. And the Department has set an internal deadline of validating all E&C of mission critical assets by June 30, 2016.

Active and detailed planning for translating property E&C to full valuation is underway. For example, the Department recently published guidance for valuing equipment and has begun socializing this guidance. The Department will use Statement of Federal Financial Accounting Standards 35 to provide allowable estimates of equipment values using techniques such as contract-based analysis, budget-based values, or data obtained through electronic invoicing. Essentially we will leverage information that we use and sustain every day. A similar approach will be used for Real Property valuation where we will apply current standards in the most cost-effective way possible. In all cases, priority will be placed on assets with a remaining net book value as of September 30, 2017. Finally, our plans call for an increased level of engagement on the part of functional sponsors such as the logistics and installation management communities.

CHARRTS No.: SHSGAC-03-005
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator Coburn
Question: #5

Comptroller staff

Question. How many total full time federal employees serve on the OSD Comptroller staff? How many staff have completed the DOD Financial Management Certification Program?
Answer. OSD Comptroller has 167 authorizations (civilian/military). Of those authorizations, 138 positions require the DoD Financial Management Certification, of which, 121 are currently occupied.

The DoD FM Certification is being phased in throughout the DoD Active Component in FY2014. Reserve/Guard Component will be phased in during FY2015. As of 31 May 2014, the OUSD(C) has 23 individuals (19% of the on-board staff who require certification) who have already achieved certification. Members have until 1 July 2016 to achieve certification, or two years from the time that they are brought into the program, whichever is later.

CHARRTS No.: SHSGAC-03-006
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: USD(C) Hale
Senator: Senator Coburn
Question: #6

Electronic health records

Question. Why does DOD need a separate system from the Department of Veteran's Affairs (VA) to manage its electronic health records? Did DOD consider adopting the system used currently by the VA? What technical and/or functional issues preclude the use of the current VA system?

Answer. DoD and VA face different electronic health record (EHR) requirements due to health demands of their clients, where they receive their care and the current state of their EHR systems. These factors drive each organization towards independent EHR solutions to ensure they deliver the best medical care available at acceptable cost and risk.

Different Health Requirements
The VA generally treats an older population while DoD primarily cares for a younger, active duty population and their families. The principal focus of VA is on the delivery of primary and

mental health care for Veterans, while DoD maintains primary care for active duty Service members, and their families, to include services such as pediatric care, or obstetric and gynecological care (accounting for 25 percent of hospital costs).

Moreover, DoD's specific patient population is highly mobile. To reach all beneficiaries, DoD's system must operate worldwide, including theater environments, aboard ships and aircraft. Further, more than sixty percent of the health care provided to DoD eligible beneficiaries occurs in the private sector and outside of the DoD or VA EHR systems. For our clinicians to provide the best possible health care, it is essential that we ensure secure and accurate access to all remote locations and interoperability between DoD, VA, and the private sector. DoD must provide access to the needed health data regardless of where the care is provided or system being used.

Today, DoD has a number of different systems, and the modernization will transform how we deliver care, reduce costs, and improve our overall readiness. The selection of DoD's EHR modernization system will be based on which solution meets DoD's requirements in the most effective and cost efficient manner. The solution must prepare for and perform the healthcare mission anytime, anywhere, to support a global patient community in diverse operational environments. To fully meet our requirements the system must support our Health Service Delivery (HSD), Health System Support (HSS), and Force Health Protection and Readiness (FHP) Concept of Operations. These capabilities contribute to the overall ability of DoD to perform its health mission and are designed to enable mission elements of the Military Health System: casualty care and humanitarian assistance/disaster response; fit, healthy, and protected force; healthy and resilient individuals, families, and communities; education, research, and performance improvement.

Evaluating VistA and Commercial Systems for the DoD
In February 2013, VA determined that the best course of action with respect to its EHR system and VA patient data was to evolve its current legacy system, the Veterans Health Information Systems and Technology Architecture (VistA) system. As a result of VA's decision, DoD chartered an independent review to assess its own requirements and examine previous analysis of alternatives, industry analysis of the commercial Health IT market, and DoD's current acquisition approach. The analysis identified a number of viable off-the-shelf options for DoD, to include VistA-based products. It was recommended that DoD competitively pursue a system solution for electronic healthcare records.

Why Not VistA?
- *Current infrastructure:* The primary reasons that made VistA a logical and sound decision for the VA do not exist for the DoD. VA, with its large installed base, trained workforce, and in-house development and support capacity, has the capability to undertake this effort. DoD's deployment landscapes and requirements are far more expansive.

- *Functional capabilities:* Over the years, VistA has been optimized to meet the health needs of the VA's client base. However, VistA lags commercial systems in health specialties demanded by the DoD client base such as pediatric care, or obstetric and gynecological care.

Today's commercial systems, driven by competition and national health standards, are at the forefront of data interoperability and cloud based access. Further, these systems have attained accreditation by independent health industry experts that exceeds any current VistA-based system in both functional health care capabilities and data exchange.

- *Cost:* The Department's analysis suggests the DoD can adopt a commercial system at lower cost and technical risk. A recent study on the DoD approach indicates that this approach brings the Department closer in line with the industry and has a potential cost avoidance of between $2.1 billion and $5.8 billion over the previous Inter-Agency approach.

Summary
The DoD faces different challenges than the VA in transforming how we deliver healthcare. We are confident that an open competition that includes both VistA and non-VistA-based commercial systems provides the best opportunity to ensure we best serve the men and women in today's military and their families.

CHARRTS No.: SHSGAC-03-013
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: Speer
Senator: Senator Coburn
Question: #13

Financial Management Metrics

Question. What are the specific financial management metrics against which senior Army leadership is evaluated in the monthly readiness meetings conducted by the Vice Chief of Staff of the Army? Please provide all metrics and the most recent evaluation for each command and component evaluated.
Answer. The VCSA and ASA (FM&C) evaluate financial management metrics in monthly and quarterly meetings with principal commanders. The meetings review overall pass/fail rates by business process area, test type, and assessment of cause of failure (i.e. untimely transaction processing, inadequate supporting documents, transaction signatures were not present, etc.).

The VCSA regularly monitors the progress of internal audit readiness assessments and external audits through his formal meetings with Commanders to maintain the appropriate tone at the top of the organization. This organization-wide engagement facilitates the Army's progress to date and is critical to our continued success.

The key objective of these VCSA meetings is to provide senior leadership with a review of monthly test results and provide any additional support to Commanders for financial improvement and audit readiness success. On a monthly basis, the Army tests internal controls and detailed transactions (substantive tests) to determine whether controls over financial

transactions are in place and operating effectively, and proper documentation is available to support these transactions. Testing is performed on the Statement of Budgetary Resources (SBR) transactions and assets (which include Real Property, Operating Materials and Supplies (Ammunition), and General Equipment). Monthly testing is performed throughout all Army commands including:

U.S. Army Materiel Command (AMC)
U.S. Army Central (USARCENT)
Army National Guard (ARNG)
U.S. Army North (USARNORTH)
U.S. Army South (USARSOUTH)
U.S. Army Test and Evaluation Command (ATEC)
U.S. Army Forces Command (FORSCOM)
Headquarters, Department of the Army (HQDA)
U.S. Army Installation Management Command (IMCOM)
U.S. Army Network Enterprise Technology Command (NETCOM)
U.S. Army Space and Missile Defense Command/Army Strategic Command (USASMDC)
U.S. Army Training and Doctrine Command (TRADOC)
U.S. Army Acquisition Support Center (USAASC)
U.S. Army Africa (USARAF)
U.S. Reserve Command (USARC)
U.S. Army Europe (USAREUR)
U.S. Army Pacific (USARPAC)

The results from monthly testing illustrate the pass and fail rates for each key internal control tested and an analysis of the exceptions identified during testing. The metrics detailed below are based on the results from the May 2014 testing period and cover each assessable unit. Because samples are drawn using statistical sampling techniques, not all commands are tested on each assessable unit or control each month.

The overall pass rates for each accessible unit were as follows: 92 percent for General Equipment, 90 percent for Real Property, 80 percent for Operating Materials and Supplies, and 75 percent for Statement of Budgetary Resources.

For testing of General Equipment transactions, the Command specific pass rates were as follows: 100 percent for USARSOUTH, NETCOM, SMDC, and USARC; 95 percent for FORSCOM; 93 percent for IMCOM; 92 percent for USARPAC and ARNG; 90 percent for TRADOC; 88 percent for AMC; 86 percent for USARCENT; 82 percent for USAREUR; 80 percent for ATEC; 68 percent for USAASC, and 0 percent for USARNORTH.

For testing of Real Property transactions, the Command specific pass rates were as follows: 100 percent for USARCENT; 98 percent for AMC; 97 percent for USARC; 95 percent for ARNG; 89 percent for IMCOM, and 75 percent for USAREUR.

For testing of Operating Materials and Supplies transactions, the Command specific pass rates were as follows: 100 percent for FORSCOM and IMCOM; 93 percent for USAREUR; 90

percent for USARPAC; 87 percent for AMC and USARCENT; 75 percent for USARAF; 58 percent for ARNG, and 50 percent for USARSOUTH.

For testing of Statement of Budgetary Resources transactions, the Command specific pass rates were as follows: 100 percent for NETCOM, FORSCOM, and SMDC; 96 percent for TRADOC; 95 percent for USARC; 91 percent for AMC; 88 percent for ATEC; 82 percent for USARPAC; 80 percent for USARSOUTH; 79 percent for USAREUR; 67 percent for IMCOM; 65 percent for HQDA; 60 percent for USARCENT; 52 percent for ARNG; 50 percent for USAASC, and 0 percent for USARNORTH and USARAF.

The types of failures most common for all Commands include: untimely processing of transactions, inadequate documents provided to complete testing, transaction signatures were not present or could not be verified and no response to the request for sample.

Commanders are addressing these test sample failures through the implementation of corrective action plans and expect significant improvement in monthly test results.

CHARRTS No.: SHSGAC-03-014
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: Speer
Senator: Senator Coburn
Question: #14

Treasury Disbursements Pilot

Question. For the approximately $15,000 that you disburse direct from Treasury currently, you stated you have zero out-of-balance condition with Treasury. For those same disbursements, what was the out-of-balance condition for the 12 months prior to the implementation of the new process?

Answer. Note: At the time of his testimony, the "15,000" to which Mr. Speer referred was the number of invoices direct Treasury disbursed each month via the General Fund Enterprise Business System (GFEBS), the Army's new core accounting system. Since the testimony, the population of payments has grown to approximately 18,000 invoices/$525 million per month. Since inception in December 2011, Army's Treasury disbursing program has disbursed approximately 133,000 payments for $4.68 billion in total; no out-of-balance condition. "Zero out-of-balance condition" with Treasury signifies that at the close of each month since pilot initiation, Army and the Treasury Department recorded the exact same number, value of transactions, and source of funding during that period.

We do not have data regarding the out-of-balance condition for the 12 months prior to the implementation of the new process for similar DFAS disbursements. However, in May 2014, DFAS reported that for similar transactions disbursed through the DFAS Automated Disbursing System, there were 5,500 backlogged un-reconciled/out-of-balance errors. These errors indicate transactions disbursed, but unable to be cleared due to data inconsistencies. Each error requires

analysis and rework to ensure proper recording of the transaction.

Army is currently working with DFAS to obtain information necessary to complete a proper Cost Benefit Analysis (CBA) by the end of August 2014.

CHARRTS No.: SHSGAC-03-015
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: Speer
Senator: Senator Coburn
Question: #15

Treasury Disbursements Pilot

Question. When will you conclude the pilot of the direct from Treasury disbursements? What percentage of the Army's total monthly disbursements is represented by the pilot? How did you choose the pilot size? What are the estimated benefits, including cost savings, at full rollout? What factors will you use to determine if the process should be expanded for other disbursements? When will that analysis be conducted and concluded?

Answer. We concluded the initial phase of the Army direct Treasury disbursement pilot in December 2012, when the Chief Management Officer (CMO) directed the Assistant Secretary of the Army for Financial Management and Comptroller (ASA(FM&C)) to expand the effort Army-wide. Based on the benefits seen to date, the Army has continued to expand its direct Treasury disbursing to other payments types beyond the scope of the original pilot. The Army's goal is to increase to 100 percent Direct Treasury disbursement of all GFEBS-based payments by 2nd Quarter Fiscal Year 2015 (2Q FY 15). Currently, approximately 30 percent of GFEBS-based U.S. dollar payments are directly Treasury-disbursed.

The Army's direct Treasury disbursement population initially consisted of a subset of simple vendor Contract Payments. We limited the number to demonstrate the benefits of direct Treasury disbursement and to ensure we had properly established controls and business processes. Given the favorable results during the six month pilot period, the CMO approved the ASA(FM&C) recommendation to expand the Army's direct Treasury disbursement efforts to include additional contract payments, Government Purchase Card payments, and Miscellaneous Payments.

Benefits of direct Treasury disbursement are improved traceability and auditability with limited rework or reconciliation of errors. Documents are linked from request through payment, and Treasury and Army have accurately accounted for every transaction direct Treasury disbursed over the last 29 months. Another major benefit is that the Treasury Department does not charge for its services. The Army currently pays the Defense Finance and Accounting Service (DFAS) for processing and disbursing payments. Unfortunately, we have not yet segregated the costs specific to disbursing at a granular enough level to do a detailed cost comparison. The Army believes payments disbursed using the Treasury's shared services capabilities will lead to

reduced labor and system update costs in future years. We expect reduced costs associated with maintaining and updating Defense disbursing systems, extensive manual reconciliation, and disbursement-related costs, such as processing electronic funds transfer rejects, returned checks, and fraud. Key evaluation factors for determining expansion will include accuracy, auditability, and cost. The Army is working with DFAS to do a thorough Cost Benefit Analysis (CBA), detailing Treasury disbursing cost savings, by the end of fourth quarter fiscal year 2014 (4Q FY 14).

CHARRTS No.: SHSGAC-03-016
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: Speer
Senator: Senator Coburn
Question: #16

Treasury Disbursements Pilot

Question. Did you receive pressure from or were you directed by the Defense Finance and Accounting Service (DFAS), DOD leadership, or Congress to limit the scope of the pilot? What are DFAS' concerns about the Army disbursing directly from Treasury?

Answer. The Army has not received pressure from DoD or DFAS not to implement improvements in direct Treasury disbursement.

During the Treasury disbursements pilot, to limit initial complexity and volume of transactions, the Army and DFAS agreed to a subset of contract payments for the initial Treasury population. During the first few months, payment volume was very low (~20 payments/month) but continued to grow as new system capabilities and business rules were established. In December 2012, one year after pilot inception, the program had grown to approximately 1000 payments for $60 million per month. Army and DFAS expanded Treasury disbursement to Miscellaneous Payments and ultimately Government Purchase Card payments in March 2013. Each payment category has grown steadily since introduction, bringing the Army to approximately 18,000 payments for $525 million per month in May 2014. Since December 2011, the Army's Treasury disbursing program has made nearly 133,000 payments totaling $4.68 billion in value.

Due to the success of the program, Army is planning to use direct Treasury disbursing for similar payments for its Sensitive Activities community and we are analyzing this approach for future Military payroll payments. Throughout implementation, the Army's Treasury disbursing program's progress has been limited by system capabilities, resources, and ensuring effective processes were in place before adding additional scope.

The concerns DFAS has expressed to the Army on Treasury disbursement have centered on the efficiency of the process, change management, and a clear understanding of roles and responsibilities. Additionally, DFAS, Army, and Treasury have been in continuous dialogue to determine whether Treasury can support specific Army mission needs such as on demand

checks, unique currencies, local depository accounts, and agent operations. Until we have confirmation that Treasury can handle Army unique transaction types, we will continue to use Defense/Army systems and processes for some portion of the disbursements.

CHARRTS No.: SHSGAC-03-017
Senate Committee on Governmental Affairs
Hearing Date: May 13, 2014
Subject: Improving Financial Management at the Defense Department
Witness: Speer
Senator: Senator Coburn
Question: #17

Army Financial Management Staff

Question. How many total full time federal employees serve on the Army's financial management staff? How many of those employees have completed the DOD Financial Management Certification Program?

Answer. There are 9,712 full time federal employees serving as members of the Army's financial management staff. The official start date of the Department of Defense (DoD) Financial Management Certification Program is 1 July 2014. To date, 6,743 have already successfully enrolled into the FM Certification Program, with 19 of these enrollees fully completing course base certification as of 16 June 2014.

The Army is currently completing the enrollment of all designated FM personnel into the DoD Certification Program. Enrollment includes an on-boarding process, which includes identifying which of the three specific levels of certification is required of each person, specifying training required for achievement of the certification level designated for the individual, and documenting training the individual has already completed. The Army expects all current FM personnel to complete enrollment and the on-boarding process by September 2014. Following enrollment, individuals will have two years to complete their designated position level of certification. FM Personnel hired or enrolled after July 2014 will have two years from the date of their enrollment to complete certification.

Army Financial Managers are generally well trained and we are making good progress with the DoD Financial Management Certification Program. The Army remains committed to improving financial management and meeting the goal of achieving standardize training requirements and certification of our FM workforce.

Hearing Date: May 13, 2014
Hearing: Improving Financial Management at the Defense Department
Member: Senator Tester
Insert: (Page 54, Line 14)
Witness: Dr. Rabern
File Name: SHSGAC-03-001-IFR

(The information follows):
Due to audit lessons learned and an analysis of actual FY 2013 military Permanent Change of
Station (PCS) obligations, the Marine Corps reduced its FY 2015 President's Budget (PB)
budget request by $66.8 million when compared to the FY 2013 PB request. The root cause of
the analysis and validation through audit testing revealed that household goods (HHG)
expenditures were less than corresponding obligations. Consequently, a reduction in the cost per
HHG shipment is reflected in budget projections and enables the Marine Corps to submit a PB
2015 requirement below FY 2014 enacted levels.

Additionally, several years ago, as the Marine Corps accelerated their pursuit of financial
auditability, the Department of the Navy attempted to estimate expected returns on their
investment in business process improvements. Based on the pilot analysis of four Marine Corps
Financial Improvement initiatives, an estimated return of $17.4 M had been delivered in the form
of staffing efficiencies, reduced interest and interagency payments, and cost avoidance.

Although savings such as those highlighted above are important, accountability and prudent
stewardship of the resources entrusted to us is key to the Marine Corps. Consequently, we are
focused on continuously improving our business and financial processes and systems. Having
auditable financial statements is a key enabler that helps our leaders make well-informed
resource decisions that are based on more accurate, timely and transparent financial data.

Hearing Date: May 13, 2014
Hearing: Improving Financial Management at the Defense Department
Member: Senator Tester
Insert: (Page 53, Line 4)
Witness: USD(C) Hale
File Name: SHSGAC-03-002-IFR

(The information follows):

In Fiscal Year (FY) 2012 and FY 2013, 39 formal cases were investigated and completed by the
Military Services and Defense Agencies. Of the 39 cases, 15 cases were found to be ADA
violations, and 31 people were disciplined. The dollar amount of the 15 cases found to be
violations of the ADA totaled $555,469,753, which represents about 0.043 percent of total DoD

budgets for those years. Two Army ADA violations accounted for over 50 percent ($285,000,000) of the dollar amount reported. These two violations occurred in the Army's FY 2005 and FY 2008 Military Personnel account when the Army over-obligated its Military Personnel Appropriation during those fiscal years. These centrally-managed, one-year accounts are particularly challenging during wartime.

Hearing Date: May 13, 2014
Hearing: Improving Financial Management at the Defense Department
Member: Senator Coburn
Insert: (Page 62, Line 8)
Witness: USD(C) Hale
File Name: SHSGAC-03-003-IFR

(The information follows):

DoD and VA face different electronic health record (EHR) requirements due to health demands of their clients, where they receive their care and the current state of their EHR systems. These factors drive each organization towards independent EHR solutions to ensure they deliver the best medical care available at acceptable cost and risk.

Different Health Requirements
The VA generally treats an older population while DoD primarily cares for a younger, active duty population and their families. The principal focus of VA is on the delivery of primary and mental health care for Veterans, while DoD maintains primary care for active duty Service members, and their families, to include services such as pediatric care, or obstetric and gynecological care (accounting for 25 percent of hospital costs).

Moreover, DoD's specific patient population is highly mobile. To reach all beneficiaries, DoD's system must operate worldwide, including theater environments, aboard ships and aircraft. Further, more than sixty percent of the health care provided to DoD eligible beneficiaries occurs in the private sector and outside of the DoD or VA EHR systems. For our clinicians to provide the best possible health care, it is essential that we ensure secure and accurate access to all remote locations and interoperability between DoD, VA, and the private sector. DoD must provide access to the needed health data regardless of where the care is provided or system being used.

Today, DoD has a number of different systems, and the modernization will transform how we deliver care, reduce costs, and improve our overall readiness. The selection of DoD's EHR modernization system will be based on which solution meets DoD's requirements in the most effective and cost efficient manner. The solution must prepare for and perform the healthcare mission anytime, anywhere, to support a global patient community in diverse operational environments. To fully meet our requirements the system must support our Health Service Delivery (HSD), Health System Support (HSS), and Force Health Protection and Readiness (FHP) Concept of Operations. These capabilities contribute to the overall ability of DoD to

perform its health mission and are designed to enable mission elements of the Military Health System: casualty care and humanitarian assistance/disaster response; fit, healthy, and protected force; healthy and resilient individuals, families, and communities; education, research, and performance improvement.

Evaluating VistA and Commercial Systems for the DoD

In February 2013, VA determined that the best course of action with respect to its EHR system and VA patient data was to evolve its current legacy system, the Veterans Health Information Systems and Technology Architecture (VistA) system. As a result of VA's decision, DoD chartered an independent review to assess its own requirements and examine previous analysis of alternatives, industry analysis of the commercial Health IT market, and DoD's current acquisition approach. The analysis identified a number of viable off-the-shelf options for DoD, to include VistA-based products. It was recommended that DoD competitively pursue a system solution for electronic healthcare records.

Why Not VistA?

- *Current infrastructure:* The primary reasons that made VistA a logical and sound decision for the VA do not exist for the DoD. VA, with its large installed base, trained workforce, and in-house development and support capacity, has the capability to undertake this effort. DoD's deployment landscapes and requirements are far more expansive.

- *Functional capabilities:* Over the years, VistA has been optimized to meet the health needs of the VA's client base. However, VistA lags commercial systems in health specialties demanded by the DoD client base such as pediatric care, or obstetric and gynecological care.

  Today's commercial systems, driven by competition and national health standards, are at the forefront of data interoperability and cloud based access. Further, these systems have attained accreditation by independent health industry experts that exceeds any current VistA-based system in both functional health care capabilities and data exchange.

- *Cost:* The Department's analysis suggests the DoD can adopt a commercial system at lower cost and technical risk. A recent study on the DoD approach indicates that this approach brings the Department closer in line with the industry and has a potential cost avoidance of between $2.1 billion and $5.8 billion over the previous Inter-Agency approach.

Summary

The DoD faces different challenges than the VA in transforming how we deliver healthcare. We are confident that an open competition that includes both VistA and non-VistA-based commercial systems provides the best opportunity to ensure we best serve the men and women in today's military and their families.

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

JUN 2 6 2014

The Honorable Thomas Carper
Chairman
Committee on Homeland Security and Governmental Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Thank you for holding the recent hearing on "Improving Financial Management at the Department of Defense." I believe that hearings such as this are an important means of providing visibility of the efforts to achieve financial accountability in the Department of Defense.

Enclosed please find responses to the five Post-Hearing Questions for the Record (QFRs) from Ranking Member Coburn. Also enclosed are my recommended edits to the hearing transcript. I look forward to continuing to work with your Committee to assist the Department in achieving audit readiness.

Should you have any questions regarding this matter, please contact me or Mr. Larry D. Turner, Acting Assistant Inspector General for Communications and Congressional Liaison at (703) 604-8324.

Sincerely,

Jon T. Rymer

cc: The Honorable Tom Coburn
    Ranking Member

DoD IG Responses to Post Hearing Questions for the Record for Senator Coburn for the
Hearing, "Improving Financial Management at the Department of Defense," May 13, 2014

1. **What is the cumulative cost and schedule overrun for each of the 10 Enterprise Resource Planning (ERP) systems that the Department has identified as critical to its financial management efforts? Additionally, for each system please identify any deficiencies that have been identified through system performance testing but not yet corrected, the impact of those deficiencies, and the date by which the services or components say the deficiencies will be corrected.**

DoD OIG prior audit coverage to date has addressed 7 of the 10 ERP systems that we considered critical to the Department's audit readiness efforts. We have issued a total of 16 audit reports from January 2008 through May 2014. We have not reviewed the remaining 3 ERPs—the Integrated Personnel Pay System-Army, the Air Force-Integrated Personnel Pay System, and the Global Combat Support System-U.S. Marine Corps—as they are support systems. In the next few months, we are planning to issue two additional ERP reports on the Defense Logistics Agency's Enterprise Business System and the Army's Global Combat Support System. See Attachment 1 for a listing of the DoD OIG reports issued.

The most recent information on cost and schedule overruns that we reported on can be found in Report No. DODIG-2013-111 issued on August 1, 2013, which updated our prior audit work reported in Report No. DODIG-2012-111 issued on July 13, 2012. In our first report (DODIG-2012-111), we identified cost and schedule overruns for 6 of the 10 ERPs. Specifically, we identified DoD life-cycle cost increases of $8.0 billion and schedule delays ranging from 1.5 to 12.5 years during system development and implementation. In our follow-on audit (DODIG-2013-111), we found that DoD had made progress and reported cost decreases totaling $680.9 million for four of the six ERPs and cost increases of $298.9 million for two systems. DoD also reported schedule delays for three of the six ERPs. As of June 2013, DoD reported cumulative cost increases of $7.6 billion and schedule delays continued to range from 1.5 to 12.5 years during system development and implementation for 6 of the 10 ERPs. See Attachment 2 for the cost and schedule overruns of each system.

The scope of our ERP audits have focused on whether the ERPs were configured to implement the U.S. Government Standard General Ledger at the transaction level using the DoD Standard Financial Information Structure to generate timely, accurate, and reliable financial management information. In addition, our audits focused on the DoD Business Enterprise Architecture end-to-end business processes. The top five pervasive issues we identified during those audits are that 1) oversight or guidance was not timely provided by the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer [OUSD(C)/CFO], Component Comptroller, or Component; 2) non-compliance with the U.S. Government Standard General Ledger;

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3) additional ERP functionality was needed, such as the Navy ERP requires the functionality to properly record and account for military equipment, the General Funds Enterprise Business System needs the capability to generate an Army-wide universe of real property assets and also needs to be used to record costs for construction-in-progress, and the Logistics Modernization Program needs to alert management once an activity's allotment authority recorded in the system has been exceeded; 4) lack of or non-implementation of Business Process Reengineering; and 5) lack of OUSD(C)/CFO validation of systems compliance.

The Department has relied on the Military Department's internal audit agencies and independent public accounting firms to test its automated systems. The Component's system managers would be in a better position to provide the deficiencies identified to date that were identified through system performance testing, the deficiencies not yet corrected, the impact of those deficiencies, and the date by which the services or components will correct the deficiency.

2. **For each of these ERPs, how many feeder systems are included in the design? How does the number of feeder systems impact or complicate data reliability?**

We have identified about 140 feeder systems and continue to work with the Department to assess the impact these systems have on the reliability of financial data. As the Department improves ERP capabilities and/or streamlines processes, we expect the number of feeder systems to decrease. The Department or Program Management Office for each ERP would be better suited to provide a listing of the feeder systems that are currently included in the design of each ERP. Additionally, some feeder systems are used solely by one component while others are shared by components, which could impact the count of feeder systems.

The *number* of feeder systems does not complicate data reliability; it is the *reliability* of the information in the feeder systems and whether those systems are tested and validated that complicates data reliability. The Department has a schedule for testing individual feeder systems, but until systems reliability is validated, there will continue to be concerns with data reliability of each Service ERP.

3. **Which of these ERPs are most at risk of not being able to support DOD's audit of its department-wide financial statements in FY 2018?**

The Service plans for completing deployment of their respective ERPs vary, and some projected dates extend beyond the FY 2014 Statement of Budgetary Resources (SBR) audit readiness goal. As a result, the FY 2014 SBR audit readiness goals include a combination of ERPs and legacy business and financial systems. The following ERPs should be included in the group of ERPs at a higher risk for failure to support the financial statements in FY 2018 for the following reasons:

Army:

- The General Funds Enterprise Business System continues to experience deficiencies despite spending $910 million on its development and implementation. Among other things, the system contains inaccurate posting logic, abnormal balances, and does not comply with the Standard Financial Information Structure, and the U.S. Government Standard General Ledger.

- The Logistics Modernization Program is at risk of not being able to support Army Working Capital Fund financial statements in FY 2018 as its readiness plans extend beyond FY 2015. Numerous system change requests are outstanding and funding for the changes has not been approved past FY 2015.

Navy:

- The Navy ERP is the Department of the Navy financial system of record and streamlines the Navy's business operations, namely financial and supply chain management. The Navy spent $870 million to develop and implement a system that may not produce accurate and reliable financial information. The Navy ERP may not correct the Navy's long-standing material weaknesses for complying with the Standard Financial Information Structure and the U.S. Government Standard General Ledger and its inaccurate reporting of military equipment on its financial statements.

Air Force:

- The Air Force will not rely on the Defense Enterprise Accounting and Management System (DEAMS) to be the system of record for at least the Air Force FY 2015 and 2016 Schedule of Budgetary Activity/Statement of Budgetary Resources efforts. Until the reporting module is ready, data from DEAMS will be reported through the Air Force's legacy system that DEAMS is planned to replace. Financial reporting through the legacy system adds risks because the Air Force must rely on the legacy system's processes to accomplish financial reporting tasks that DEAMS was designed to perform. The continued use of the legacy system means that DoD will not receive the full benefit of improved financial reporting. The May 2014 update to the Financial Improvement and Audit Readiness Plan indicates the full implementation date for DEAMS is in the first quarter of FY 2017.

- For the Air Force Integrated Personnel and Pay System, the updates to both the November 2013 and May 2014 Financial Improvement and Audit Readiness Plans did not contain milestones for the systems implementation. Since military payroll is material to several statements (SBR, SBA, and Statement of Net Cost), using the current legacy systems may adversely affect audit readiness.

Defense Logistics Agency (DLA):

- The DLA Enterprise Business System supports both DLA General Fund and Working Capital Fund business operations. How the Department approaches

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examinations of audit readiness of the Other Defense Organizations, such as DLA, will impact the amount of scrutiny and testing the Enterprise Business System receives. As mentioned earlier, we are planning to issue a report in the next few months on whether the Enterprise Business System implemented the Business Enterprise Architecture process to properly support the purchase of DLA goods and services.

In order for the Department to support an audit of its department-wide financial statements in FY 2018, it is essential that every ERP be in place and operating efficiently and effectively. However, for those instances where an ERP will not be fully deployed in time to support the FY 2018 financial statement audit, there must be in place effective internal controls over any manual processes or legacy systems that are being relied on in lieu of the ERP. Those ERPs that support the validation of the FYs 2015-2017 audit readiness efforts will receive increased scrutiny starting in FY 2015 with the audits of the Schedule of Budgetary Activity.

4. **You have stated that without these ERPs, DOD will be unable to produce reliable financial data and auditable financial statements without resorting to "heroic efforts," such as data calls and manual workarounds. What would these manual workarounds entail, and why are they not ideal?**

ERPs assist financial management professionals with producing the financial statements more efficiently, accurately, and consistently. They also provide a trail for management and the auditors to follow that links the business events to supporting documentation. The Department has established a DoD Standard Financial Information Structure to help uniformly apply policies, procedures, and data standards. However, DoD has not done a good job optimizing the inherent capability of ERPs to help achieve this standardization. Ideally, all inherent capabilities should be implemented in the Department's ERPs, but this has not happened. Financial managers throughout the Department must weigh the audit and operational risks of leaving some processes and systems "as-is" and relying on manual intervention, data calls, and journal vouchers. Although some manual workarounds and data entries will always be needed due to the timing of transactions, these workarounds should be minimized to the greatest extent possible. Business process reengineering is required to eliminate most of the manual "workarounds."

For instance, Report No. DODIG-2013-105 identified that the Navy's Office of Financial Management Operations used a process that involved data calls and manual entries from six systems to provide the military equipment summary value to the Defense Finance and Accounting Service for reporting purposes. For this process, the Navy had to use and reconcile property information from command-level property systems to provide a list of military equipment assets, values, and useful life information to the Office of Financial Management Operations. The current manual process is inefficient and the Navy cannot trace the military equipment summary value back to individual military equipment assets, resulting in an inadequate audit trail. If the Office of Financial Management Operations reengineered their business

processes to account for military equipment assets they could simplify the process by entering the military equipment asset information directly into the Navy ERP system when the property is acquired. This would allow all accounting functions for the assets to occur in the Navy ERP system and Navy officials could track its actual costs from acquisition through retirement. This would also document a clear audit trail in the system.

There is also increased cost of business operations associated with data calls, manual workarounds, journal vouchers, and re-work to research and correct errors in processing data. Additionally, manual workarounds create unnecessary delays, are prone to errors, and often do not provide an adequate audit trail over the process. Numerous journal vouchers may be needed to process data from other feeder systems into the accounting system for report compilation. These are done both systemically and manually and increase the risk of erroneous information being transmitted to the financial statements due to manual errors or out-of-date crosswalks. These heroic efforts are not ideal because they require a large amount of staff-hours to perform. This takes employee resources away from performing the accounting functions to keep the department current with ongoing accounting requirements. In addition, these efforts need to be repeated for the next reporting period and the data is not available to decision-makers on a recurring basis during the year.

5. **You have stated that DOD's improper payments estimate is not statistically valid. Given your extensive work on this issue, what do you believe is a more likely estimate of DOD's FY 2013 improper payments?**

It is not possible to provide a more likely estimate because the statistical unreliability of reported estimates was due to unknown data. Specifically, DoD did not have assurance it identified the complete universe of payments made during the year. As a result, DoD could not ensure that all required payments had the potential to be reviewed for improper payment reporting purposes, making their sample estimates statistically unreliable. Once the Department bases its estimates of improper payments on a complete universe of payments, the reliability of the estimate should improve.

Attachment 1: Listing of DoD OIG ERP Reports

DoD OIG Final Reports

	ERP Name	*Report No.*	*Report Title*	*Report Date*
1	Army ERP Strategy	DoDIG-2013-045	Army Business Systems Information Technology Strategy Needs Improvement	2/7/2013
2	GFEBS	D2008-041	Management of the General Fund Enterprise Business System	1/14/2008
3	GFEBS	D-2011-072	Previously Identified Deficiencies Not Corrected in the General Fund Enterprise Business System	6/15/2011
4	GFEBS	DODIG-2012-066	General Fund Enterprise Business System Did Not Provide Required Financial Information	3/26/2012
5	GFEBS	DODIG-2013-130	Army Needs to Improve Controls and Audit Trails for the General Fund Enterprise Business System Acquire-to-Retire Business Process	9/13/2013
6	LMP	D-2011-015	Insufficient Governance Over Logistics Modernization Program System Development	11/2/2010
7	LMP	DODIG-2012-087	Logistics Modernization Program System Procure-to-Pay Process Did Not Correct Material Weaknesses	5/29/2012
8	EBS	DODIG-2013-057	Enterprise Business System Was Not Configured to Implement the U.S. Government Standard General Ledger at the Transaction Level	3/20/2013
9	DAI	DODIG-2013-070	Defense Agencies Initiative Did Not Contain Some Required Data Needed to Produce Reliable Financial Statements	4/19/2013
10	LMP	DODIG-2014-066	Logistics Modernization Program System Not Configured to Support Statement of Budgetary Resources	5/5/2014
11	Navy ERP	DODIG-2012-051	Navy Enterprise Resource Planning System Does Not Comply With the Standard Financial Information Structure and U.S. Government Standard General Ledger	2/13/2012
12	DAI DEAMS EBS GFEBS LMP NAVY ERP	DODIG-2012-111	Enterprise Resource Planning Systems Schedules and Reengineering Weaknesses Increase Risks to DoD's Auditability Goals	7/13/2012
13	Navy ERP	DODIG-2013-105	Navy Did Not Develop Processes in the Navy Enterprise Resource Planning System to Account for Military Equipment Assets	7/18/2013
14	DAI DEAMS EBS GFEBS LMP NAVY ERP	DODIG-2013-111	Status of Enterprise Resource Planning Systems' Cost, Schedule, and Management Actions Taken to Address Prior Recommendations	8/1/2013

Attachment 1: Listing of DoD OIG ERP Reports

DoD OIG Final Reports

	ERP Name	*Report No.*	*Report Title*	*Report Date*
15	DEAMS	DODIG-2012-140	An Unreliable Chart of Accounts Affected Auditability of Defense Enterprise Accounting and Management System Financial Data	9/28/2012
16	DEAMS	DODIG-2014-068	Air Force Managers Did Not Implement Adequate Controls for the Defense Enterprise Accounting and Management System Order-to-Cash Business Process	5/1/2014

			On-going ERP Projects	
1	GCSS-Army	Project No. D2013-D000FL-0163.000 *(In Draft)*	Global Combat Support System-Army Did Not Comply With Treasury and DoD Financial Reporting Requirements	TBD
2	GFEBS	Project No. D2013-D000FL-0156.000 *(In Draft)*	Improvements Needed in the General Fund Enterprise Business System Budget-to-Report Business Process	TBD

Attachment 2: ERP Cost and Schedule Overruns

Table 1. Cost Changes in Millions

System Name	Original Life Cycle Cost Estimate	Life-Cycle Cost Estimate July 2012	Increase or Decrease as of July 2012	Life-Cycle Cost Estimate June 2013	Increase or Decrease from July 2012 Report	Cumulative Increase or Decrease Original Estimate to June 2013
Army:						
GFEBS	$1,353.9	$1,425.3	$71.4	$1,510.6	$85.3	**$156.7**
LMP	420.9	4,359.7	3,938.8	4,054.8	(304.9)	**3,633.9**
Navy:						
Navy ERP	1,632.9	2,237.3	604.4	2,085.2	(152.1)	**452.3**
Air Force:						
DEAMS	419.9	2,158.9	1,739.0	1,947.1	(211.8)	**1,527.2**
DoD:						
DAI	209.2	266.0	56.8	479.6	213.6	**270.4**
EBS-Core	2,134.8	3,325.3	1,190.5	3,325.3	0	**1,190.5**
EBS-EC	715.9	701.2	(14.7)	701.2	0	**(14.7)**
EBS-Procurement	360.6	774.4	413.8	762.3	(12.1)	**401.7**
Total	**$7,248.1**	**$15,248.1**	**$8,000.0**	**$14,866.1**	**($382.0)**	**$7,618.0**

Table 2. Schedule Changes

System Name	Original Full Deployment	Full Deployment Reported July 2012	Difference	Current Full Deployment as of June 2013	Additional Delay from July 2012 Report	Cumulative Difference
Army:						
GFEBS	December 2009	July 2012	2.5 years	July 2012	0	2.5 years
LMP	June 2004	September 2016	12.5 years	September 2016	0	12.5 years
Navy:						
Navy ERP	June 2011	August 2013	2.0 years	September 2013	1 month	2.1 years
Air Force:						
DEAMS	October 2009	April 2017	7.5 years	July 2017	3 months	7.7 years
DoD:						
DAI	October 2011	January 2016	4.5 years	Unknown	Unknown	4.5 years
EBS-Core	October 2005	July 2007	2.0 years	July 2007	0	2.0 years
EBS-EC	October 2012	June 2014	1.5 years	June 2014	0	1.5 years
EBS-Procurement	October 2011	September 2013	2.0 years	February 2014	5 months	2.4 years

Post-Hearing Questions for the Record
Submitted to Asif A. Khan
From Senator Tom Coburn

"Improving Financial Management at the Department of Defense"

May 13, 2014

1. **You have stated that DOD's improper payment estimate is not statistically valid. Given your extensive work on this issue, what do you believe is a more likely estimate of DOD's FY 2013 improper payments?**

GAO Response:

The deficiencies we identified during our review of the Department of Defense (DOD) improper payment efforts to implement legislative requirements to identify and estimate improper payments constitute significant impediments to determining a reliable estimate of DOD's fiscal year 2013 improper payments.[1] These impediments primarily relate to DOD's inability to (1) identify complete and accurate populations of payment transactions to serve as a basis from which to statistically select transactions for review and (2) maintain ~~supporting~~ documentation supporting its reported improper payment estimates. In addition, a flawed sampling methodology that does not provide a reasonable level of precision contributed to DOD's unreliable estimates. However, even with a statistically appropriate sampling methodology, until DOD completes actions to assure it has complete and valid populations for testing, neither the department nor GAO would be able to determine a likely or reasonable estimate of DOD's improper payments.

We recommended that DOD establish and implement procedures, such as reconciliations,[2] to ensure the completeness and accuracy of the sampled populations. In addition, we recommended that DOD develop and implement procedures to collect and maintain the documentation necessary to support improper payment estimates. Further, we recommended that DOD revise its sampling methodologies to produce statistically valid improper payment error rates and dollar estimates that take into account both the size and complexity of the transactions sampled. DOD generally agreed with our recommendations and reported that it was working with the Defense Finance and Accounting Service to (1) establish key quality assurance procedures, such as reconciliations, to ensure the completeness of payment populations; (2) reevaluate its sampling methodologies; and (3) implement the requisite document retention procedures for the fiscal year 2014 reporting

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[1]GAO, *DOD Financial Management: Significant Improvement Needed in Efforts to Address Improper Payment Requirements*, GAO-13-227 (Washington, D.C.: May 13, 2013).

[2]An effective reconciliation process involves comparing transactions to supporting documentation, systems of record, or both to ensure the completeness, validity, and accuracy of financial information. An effective reconciliation process also involves resolving any discrepancies that may be discovered and determining if unauthorized changes have occurred to transactions during processing.

cycle. Further, effective implementation of the department's Financial Improvement and Audit Readiness Plan[3] and related FIAR Guidance,[4] would help position DOD to perform testing to assess the extent of its improper payments.

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[3]DOD developed the FIAR Plan in 2005 as the department's strategic plan and management tool for guiding, monitoring, and reporting on the department's financial management improvement efforts. The National Defense Authorization Act for Fiscal Year 2010, Pub. L. No. 111-84, div. A, § 1003(a)(2) (Oct. 28, 2009), mandated that the FIAR Plan include the specific actions to be taken to correct the financial management deficiencies that impair the department's ability to prepare to prepare timely, reliable, and complete financial management information.

[4]Since 2010, the DOD Comptroller has issued and updated FIAR Guidance to implement the FIAR Plan. The FIAR Guidance provides a standardized methodology for DOD components to follow for achieving financial management improvements and auditability. The FIAR Guidance requires DOD components to identify and prioritize their business processes into assessable units, document and test related processes and controls, and develop appropriate corrective action plans. The FIAR Guidance also defines key control objectives for each assessable unit, including proper authorization, accurate recording, adequate supporting documentation, and accurate and timely reporting of obligation and disbursement (payment) transactions.