

NOT FOR PUBLICATION UNTIL RELEASED BY
THE SENATE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS

STATEMENT OF

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BEFORE THE

**SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
COMMITTEE**

ON

DEPARTMENT OF DEFENSE FINANCIAL ACCOUNTABILITY

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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

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.