

Statement of

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and

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before the

Senate Committee on Homeland Security  
and Governmental Affairs

Subcommittee on Federal Financial Management,  
Government Information, Federal Services,  
and International Security

September 15, 2011

**Embargoed until released**  
by the Senate Committee on  
Homeland Security and Governmental Affairs

Chairman Carper, Senator Brown, Members of the Committee, thank you for the opportunity to review our progress in improving financial management at the Department of Defense (DoD).

I am Robert Hale, Under Secretary of Defense (Comptroller) and Chief Financial Officer of the Department. Joining us at this hearing today is Beth McGrath, DoD's Deputy Chief Management Officer. She will describe the actions that have been taken to improve the systems that are a key component for effective financial management. We are also joined by the Service Assistant Secretaries (Financial Management and Comptroller) who have the responsibility for improving financial management within their Departments.

We last spoke to you approximately one year ago, and while a lot has changed since then, our basic strategic guidance has remained constant. Our basic priorities – including a focus on budgetary information and existence and completeness for material -- are still valid. We continue to make important progress but also face significant challenges in transforming all elements of the DoD business environment in order to produce high quality, timely and reliable financial information.

I begin our comments by reminding the committee of the Department's three goals for financial management:

First, we strive to acquire the resources that are necessary to meet national security objectives. This is the budget side of our mission, and it requires considerable management attention as we accommodate the far-reaching changes in the Budget Control Act of 2011.

But an enacted budget is only the beginning. Our second goal is equally important -- to ensure that we are using appropriated resources legally, effectively, and efficiently. This is the implementation side of financial management, and its magnitude within the Department of Defense is immense. Every business day, we obligate an average of \$2 billion to \$3 billion and handle hundreds of thousands of payment transactions in thousands of locations worldwide, including combat zones. So our second financial management goal is no small task, and it is in fact where we are placing a significant amount of urgency and emphasis across the DoD enterprise. The umbrella initiative is our Financial Improvement and Audit Readiness (FIAR) effort that will strengthen our controls and lend further credibility to our achievements, such as the success we have had in sustaining a low level of improper payments.

To meet our first two goals, we are also committed to a third objective, which is to maintain a world-class financial management workforce that is trained and motivated to meet

their responsibilities in support of the DoD mission. To facilitate their continued excellence, we are developing a framework to formally guide their training and career development.

Although these three objectives predated the arrival of our new Defense Secretary, they have already attracted his strong interest. As he wrote in a message to the entire Department, “We must continue to tackle wasteful and duplicative spending and overhead staffing. We must be accountable to the American people for what we spend, where we spend it, and with what result.” That same message expressed a strong commitment to achieving auditable financial statements.

Secretary Panetta has asked us to review our financial improvement strategy and to report back to him concerning both our progress and plans. That review is ongoing. The Secretary’s personal interest in these issues will be very helpful in the days ahead.

This morning, I will describe the challenges we face and how we are dealing with them. But to set the context, I would like to begin with the important accomplishments that we have made over the past year and – in particular -- our efforts to improve financial information as a necessary step for achieving auditable financial statements.

## **Where We Are Today**

To appreciate how far we have come, it is helpful to recall that less than two years have passed since the Administration took stock of previous efforts and established new priorities that would enable DoD’s functional communities to work together toward a common goal of financial auditability. That objective is now accepted as a high priority across the Department.

To move forward with this new, focused approach, we have made a number of substantial changes, beginning with clear but flexible guidance so components prepare to assert audit readiness by executing detailed plans for their discovery and remediation efforts.

In addition:

- We ensured that each Military Department has programmed adequate resources to move forward with this strategy.
- We have assembled teams within each Military Department that will be tasked with improving financial controls.
- We are requiring that Senior Executive performance plans involving functional business areas that generate business events with financial impact must include financial audit

goals among their criteria. This key initiative will help to establish audit requirements in business areas outside those of the Comptroller organization.

- In addition, we have maintained a close working relationship with key stakeholders and oversight bodies, including both the Government Accountability Office (GAO) and DoD's own Inspector General.

While many process changes have been made or are in the works, we also recognize that we need to show specific progress to ensure that we are moving toward auditable financial statements in accordance with established timelines. To that end, we launched an audit of the Marine Corps' Statement of Budgetary Resources (SBR), which we believe will lead to a positive audit opinion. If successful, this would be the first time that any Military Service has completed an audit of a financial statement. Moreover, it already provides important lessons that are useful to other Defense organizations.

Other efforts across the Department are validating and demonstrating progress as well:

- In August of this year we completed an examination and validation of each Military Department's funds distribution process, known in financial terms as "appropriations received." This effort was conducted by a public accounting firm and resulted in a clean opinion on the audit readiness of this process. A similar validation will take place DoD-wide and periodic validation of appropriations received will demonstrate that we are distributing and accounting for these distributions of funds carefully and in ways that ensure compliance with the laws you enact.
- This year the Defense Finance and Accounting Service (DFAS) underwent an audit of controls related to its key civilian pay system. They received a clean opinion from the auditor. DFAS is now executing a plan to expand the scope of the audit to the full civilian pay processes and controls. This approach is a model for all service providers in the Department, and USD(C) is coordinating an effort for other internal service providers to use this approach.
- The Defense Information Systems Agency (DISA) is undergoing an audit of its Working Capital Fund financial statements. While our priorities focus primarily on the Military Services and their general fund appropriations, major Defense Agencies continue to make progress on auditability, and we are working with each of them. DISA is one of the more advanced. This audit will be completed in a few months and we expect that it will result in a clean audit opinion.

- In June we began a public accounting firm (IPA) validation of the Army's organizations and bases that have implemented the business environment of the General Fund Enterprise Business System. This is a key effort to ensure that the new system is being used in a manner that is auditable.
- In July we began a public accounting firm validation of the Air Force's processes and controls to reconcile their accounts with Treasury. This "checkbook reconciliation" is an important building block for auditable financial statements.
- By the end of this calendar year we expect to begin several other validation efforts, including validations of the counts and locations of large portions of our military equipment and a first-ever validation of the budgetary information related to a major weapon system.
- Lastly, we have completed the business case analysis directed by the FY 2011 Defense Authorization Act and defined the way forward for auditing DoD balance sheets and full audits of all financial statements.

These improvements illustrate our progress, and they will help us build on our past achievements. For example, for the past three years, the Army Corps of Engineers has produced fully auditable financial statements and is maintaining them. Several Defense agencies maintain auditable statements -- including two within the Comptroller organization, the Defense Finance and Accounting Service and the Defense Contract Audit Agency. A number of the large trust funds managed by DoD are also auditable.

However, we recognize there is an enormous amount of work still ahead of us to achieve and sustain auditable financial statements. Improving our financial systems is an important component to our success. Regrettably, our current business environment does not always meet audit standards. Many of our systems are old and handle or exchange information in ways that do not readily support current standards. The systems were designed decades ago to meet budgetary rather than proprietary accounting standards. They tend to be non-standard and sometimes do not include strong financial controls. In these cases, the consistent application of internal controls becomes critical. Many of the legacy systems also do not record data at the transaction level, a capability essential to audit success.

To speak to this aspect of our program, I will now turn the floor over to my colleague, Beth McGrath.

## System Improvements

As Secretary Hale makes clear, improvements to our business systems, and the business environment in which those systems operate, are important to achieve the goals for auditability that the Department and Congress share. In pursuit of these goals, we are taking an enterprise approach to meet the challenges of implementing IT systems on time, within budget, and with needed capabilities and establishing effective governance over their operations.

To improve our financial systems, we have oriented them around end-to-end business processes that support audit goals, including Procure-to-Pay, Budget-to-Report, Order-to-Cash and Hire-to-Retire. Each of these has been identified/documentated in our Business Enterprise Architecture, whose success requires that we appropriately implement and utilize our Enterprise Resource Planning (ERP) systems, modernize legacy systems when necessary and supported by a business case, and aggressively sunset legacy systems that are obsolete, redundant, or not aligned with our business objectives. Our goal is to deliver a streamlined, 21<sup>st</sup>-century systems environment comprised of IT capabilities that work seamlessly together to support effective and efficient business processes and operations. The DCMO and the Military Department CMOs play an integral role in the governance processes overseeing the implementation of these systems and the processes they enable.

We have placed significant emphasis and effort in several key areas:

- Managing business processes end-to-end across the Department,
- Improving business systems acquisition,
- Implementing the Business Enterprise Architecture, and
- Improving process controls across functions and organizations.

First, we continue to mature our target systems architecture that is modeled on the premise of end-to-end business processes. Using this framework of end-to-end business processes, rather than an organizationally or functionally stovepiped approach, ensures that we think about our business in a holistic way, recognizing the connections and dependencies that each individual business area has on the others. From there, we can make targeted investments in IT systems – acquiring and utilizing ERP systems or other new systems where appropriate, modernizing existing systems to bring them into compliance with our standards and target environment, and retiring legacy systems whenever they are not needed anymore. This last point is critical as it means replacing systems that do not support commercial audit standards with those that will enable Services and Defense Agencies to meet clean audit goals. This will also minimize the number of required data exchanges and system-to-system interfaces, thus reducing the potential for error and increasing the degree of process standardization.

Second, we have taken steps to improve our current approach to acquiring and implementing IT systems, particularly in the business domain. Important revisions to the Department's standard acquisition process will be included in an update to the DoD Instruction 5000.2, "Operation of the Defense Acquisition System," for IT systems. These revisions will include an improved acquisition model for our defense business systems, called the Business Capability Lifecycle, which is in use today for a growing number of programs and is an essential pilot effort for our broader IT reform effort. The Deputy Secretary has made clear that one of his highest management priorities is improving the acquisition, development, and fielding of IT systems.

In addition to improving acquisition policy, the Department is working to improve specific acquisition outcomes of its business Major Automated Information System (MAIS) programs through more rigorous acquisition oversight and investment review. DOD's Program Priority/High Priority Performance Goal to "Reform the DOD Acquisition Process" includes new OMB-approved performance metrics for MAIS and business services. The Department is tying business outcomes to acquisition milestones and specifically requiring that individual programs, such as Army's General Fund Enterprise Business System (GFEBS) and Navy ERP, define the role that they play in their organizations' auditability efforts and end-to-end processes. For example, in the June 24, 2011 GFEBS Acquisition Decision Memorandum we explicitly required that the Army:

- Obtain the Under Secretary of Defense (Comptroller) (USD(C)) and Department of Defense (DoD) Deputy Chief Management Officer (DCMO) approval of the end-to-end process and system portions of the Army plan to achieve audit readiness by September 2017 as defined in Financial Improvement and Audit Readiness Guidance. Specifically, the Army plan must address the GFEBS role in achieving audit readiness in the work products defined in phases 1 and 3 of the FIAR Guidance Methodology.
- Obtain USD(C) concurrence that the end-to-end business systems and processes within Army control support auditable financial statements where GFEBS has been implemented and integrated. The USD(C) will rely on the opinion of an independent public accounting firm expressed in an examination of the Army audit readiness assertion of a GFEBS entity currently planned for December 31, 2012 and will allow for remaining minor system and process enhancements scheduled for completion within 12 months.

Third, we will continue to guide our system investments using the Business Enterprise Architecture (BEA), which defines the necessary data standards, business rules, performance metrics, and standard system configurations that will allow our systems to be interoperable. This will ensure that when data is exchanged between systems, it happens securely and maintains the integrity of the data.

Improved systems alone, however, will not eliminate our weaknesses or guarantee auditable statements. Achieving auditability requires that we apply a consistent level of process controls that cross organizations and functional areas. Business and financial information that is passed from system to system must also be subject to a control environment to ensure that only authorized personnel are using the system and that these systems protect data quality and integrity and that they maintain a compliant audit trail within the end-to-end business process. This process must be controlled at the transaction level, from the source to general ledger postings, accurate trial balances, and reliable period closeouts. Only by completing these steps can we prepare financial statements that an auditor can cost-effectively review and verify.

Mr. Chairman, the bottom line is this: In order to pass an audit we need a business environment that records the financial results of business events (such as contract signing) in a consistent and reliable manner. That means systems and processes, as Ms. McGrath has described.

### **Continuing Challenges Remain**

While systems are the most visible challenge, other challenges remain. We have confidence in a reasonable level of controls that exist within the various elements of our business, and we do know where we spend the dollars Congress appropriates. But there are enterprise-wide weaknesses in DoD financial management, and they demand an enterprise-wide business response. The lack of auditable financial statements for DoD as a whole reflects those weaknesses.

As I said at the outset, these challenges become especially daunting considering DoD's geographical dispersion and enormous size. Given those factors and our mission requirements, we are not able to deploy the vast numbers of accountants that would be required to reconcile our books manually, so fundamental changes will be required. I also mentioned the strong partnership with our oversight and audit stakeholders -- specifically the GAO and DoDIG, as well as more recently a cadre of quality Independent Public Accountants (IPAs) in commercial accounting firms who are evaluating us and making recommendations for improvement.

GAO recognizes the enormity of the task of changing the way we do business in order to achieve financial auditability. We are in general agreement with their assessment concerning five major challenges: Sustaining broad, committed leadership; maintaining a competent workforce; establishing effective governance, oversight and accountability; implementing IT systems on time, within budget, and with needed capabilities; and resolving weaknesses in internal control over financial management and reporting. I mentioned our actions related to a number of these already, but several warrant further comment.

We implemented a governance structure early in the current Administration and the structure has been effective in keeping the attention of senior leaders on financial management improvement. We recognize that this governance needs to move beyond maintaining focused attention on key issues and more toward making actual improvements and validating those improvements. To that end, we have begun making increasing use of IPAs to validate our progress and provide us advice. IPAs offer a major advantage to us -- they have actual experience in financial audits and can therefore provide us guidance that goes beyond what we can learn by devoting more resources to planning.

Workforce competency is also critical. We have a dedicated and professional workforce that is doing the job and supporting key mission needs around the world. This job and the business environment around them are changing, requiring both short-term and long-term changes. In the short term, we are delivering immediate practical training to both financial managers and non-financial operators. In the long term, we are taking steps to sustain our strong financial management workforce through a course-based certification program. One element of this program will be to ensure that financial managers are addressing skill and experience gaps such as we and GAO have observed related to financial statement audits. Our people have not always had training and experience in this area, and we intend to help them to get it through this program, as well as through the examination and audit of parts of our processes and organizations.

### **Better Financial Systems**

Ms. McGrath described our efforts to implement IT systems in a more timely manner. We have seen great desire within the Service IT acquisition communities to support prioritization of the capability needed for financial management improvement goals as part of this change.

We also need to improve our financial controls. Sound internal controls are the foundation of audit success. In the past we have asked operational organizations to self-assess

their controls to determine weaknesses impeding audit readiness. Since most people do not have the experience to evaluate controls, we have not made progress in this area fast enough. The primary improvement we have made in this area is to enlist more help from the Service audit agencies, using the results of IPA validations to inform these efforts. Service auditors have the qualified personnel to assess internal controls and to make sound recommendations for corrective actions. Each Service has committed more than 15 people who focus solely on evaluating controls at the operational level, recommending solutions for any issues identified, and then following up to ensure rapid implementation of solutions.

While none of these improvements alone will make us audit-ready, we feel that together they will enable us to meet our goals. The benefits to the Department, its mission, and the taxpayers are all obvious. This effort is consistent with the Administration's overall campaign to reduce waste across the Federal government. It will reinforce efforts to control improper payments. And it will continue our contributions to operational efficiencies across the Department.

## **Conclusion**

In summary, we believe we are making important progress, but we recognize the challenges associated with improving financial management in the Department of Defense and especially the obstacles to improving information and achieving audit readiness. To meet those challenges, we have developed an effective partnership between the CFO and DCMO communities that will help to enable successful implementation. We have also implemented a new, focused approach that includes near-term goals, in addition to the long-term goal of achieving auditable statements by the Congressional deadline of 2017. We also use and benefit from a constructive partnership with our auditors and oversight activities. We remain committed to fully auditable statements by 2017.

Mr. Chairman, this concludes our statement. We welcome your questions.