

Statement of

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and

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before the

Senate Committee on  
Homeland Security & Governmental Affairs

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Chairman Carper, Senator McCain, Members of the Subcommittee, thank you for the opportunity to testify today on financial management improvement efforts at the Department of Defense (DoD). We also want to thank Members of Congress for their support of our men and women in the military. We cannot meet the nation's security needs without your assistance.

One of the key reasons for seeking improved financial management information is to satisfy our duty as stewards of the resources entrusted to us by citizens. You represent those taxpayers, and your oversight and interest in this topic furthers our ability to achieve our shared goals.

### **CFO and DCMO: Partnership for Improvement**

We believe there are significant strengths of Defense financial management. Most importantly, Defense financial managers are successfully providing DoD's warfighters with the resources and financial services necessary to meet our national security objectives. We are doing this in Afghanistan and Iraq and around the world. DoD also has effective financial processes in many key areas. For example, our payment processes produce timely and accurate payments in a very high percentage of cases. Interest payments have been dramatically reduced in recent years, and our summary reconciliation rates with Treasury are very high. As we work to improve DoD financial management, we must be careful not to achieve those improvements at the expense of these successes.

We also understand that there are enterprise-wide weaknesses in DoD financial management that demand an enterprise-wide business response. The lack of auditable financial statements is an indication of those weaknesses.

We have put in place an organization and an effective governance model to address these enterprise-wide issues. The Deputy Secretary of Defense -- in his role as DoD's Chief Management Officer (CMO) -- is responsible for Department-wide business operations and management issues and is supported by the Deputy Chief Management Officer (DCMO). The Under Secretary of Defense (Comptroller) has responsibility for financial management policy and operations of the DoD for the Secretary and Deputy Secretary. The Comptroller has a lead role in efforts to improve financial information and achieve audit readiness, but we believe that the Comptroller community cannot improve financial management on its own. Rather, we believe the Department will achieve its financial management goals only through an active partnership between the Comptroller and the DCMO - a partnership that draws support from across the enterprise in acquisition, logistics, and other business areas, as well as the business communities that reside in the Military Departments. This partnership is building the future business processes and systems environment of DoD, with audit readiness and management information in mind.



## **Why Financial Audit Problems Persist**

Why hasn't DoD been able to produce financial statements that will withstand external audits?

To pass an audit, auditors require that an organization have a business environment – including systems and processes – that record the financial results of business events (such as contract signing) in a consistent and reliable manner. Our current business environment does not always meet that standard. Many of our systems are old and handle or exchange information in ways that do not readily support current audit standards. They were designed decades ago to meet budgetary rather than proprietary accounting standards and tend to be non-standard and without good financial controls. In these cases, the consistent application of required internal controls becomes critical. Many of the legacy systems also do not record data at the transaction level, even though that capability greatly facilitates an audit.

DoD's enormous size and geographical dispersion substantially complicate the challenges associated with meeting audit standards. We obligate an average of \$2 billion to \$3 billion every business day and handle hundreds of thousands of payment transactions. These financial transactions take place in thousands of locations worldwide, including in war zones. Because of our size and mission requirements, it is not feasible to deploy an army of accountants to manually reconcile our books.

There has been some progress toward improving financial information and audit readiness in several entities. For example, the Army Corps of Engineers has fully auditable financial statements and is maintaining them. Several Defense Agencies maintain auditable statements including the Defense Finance and Accounting Service and the Defense Contract Audit Agency. Several large trust funds managed by DoD are also auditable. But it is also clear that the most daunting challenges remain ahead, particularly the challenge of moving the military services toward auditability.

## **Our Current Approach—Improve the Quality of the Information We Use Every Day**

Given these daunting challenges, we decided that we needed to revise our approach to improving financial information and achieving audit readiness in order to afford DoD a better chance of overcoming the biggest obstacles.

Shortly after the new Defense team took office, we began consultations regarding a new approach with senior leaders in the Comptroller and DCMO organizations and in the Military Departments and Defense Agencies. We also discussed the revised strategy with the Office of Management and Budget (OMB), the Government Accountability Office (GAO), and some staff members in the Congress. In August of last year a memorandum was issued outlining the new approach.

This approach focuses on improving the quality, accuracy, and reliability of the financial and asset information that we use every day to manage the Department. Specifically, we are

focusing on two types of information – budgetary information and existence and completeness of assets.

Budgetary information is critical to leadership at all levels—program managers, program executive officers, base commanders, Service Chiefs, Service Secretaries, and the Secretary of Defense—as they make operational and resource allocation decisions. Our new focus on improving budgetary information will lead to audit readiness for our Statements of Budgetary Resources.

We also need to know the numbers and location of our critical mission assets in order to be able to operate effectively. The financial audit elements of “existence and completeness” translate directly into knowing “what we have” and “where it is,” so we can use the equipment in combat and ensure that our acquisition community is buying only what DoD needs.

The FY 2010 National Defense Authorization Act accommodates this approach to financial improvement and audit readiness. We appreciate the support of the Congress for our new approach.

### **System Improvements Are Critical to Success**

To achieve and sustain auditable financial statements, even using this new and focused approach, we must improve our financial systems.

To create a 21<sup>st</sup> century business environment capable of supporting audit readiness, the Department is working to implement Enterprise Resource Planning (ERP) systems and, at the same time, to modernize many legacy systems. Our goal is to deliver a streamlined systems environment comprised of IT systems 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.

We are focusing on three key areas: First, our current approach to acquiring and implementing IT systems can be improved. The Deputy Secretary has made clear that one of his highest management priorities is improving the acquisition, development, and fielding of IT systems. He has established an IT Acquisition Reform Task Force to lead this effort.

Second, we want to define a target systems architecture that is modeled on the premise of end-to-end business processes and uses the capability inherent in our new ERP systems to the maximum extent practicable. This will minimize the number of required data exchanges, reducing the potential for error. It will also reduce the development of unnecessary redundant capability.

Third, we will 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 and guarantee auditable statements. Achieving auditability requires that we apply a consistent level of process controls that cross organizations and functional areas. 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 the data quality and maintain a compliant audit trail within the end-to-end business process. This process must be controlled from the transaction level, through general ledger postings, accurate trial balances, and reliable period closeouts. Only by completing these steps can we prepare financial statements that an auditor can review and verify. Many elements of our current business environment must be changed to allow us to meet financial audit standards. In the midst of two wars and numerous military operations, it will be a major challenge to implement our new approach.

### **Implementation Is the Challenge**

We know from long experience in government that implementing any new approach is much more than half the problem. So immediately after establishing this approach, we began taking steps to implement it:

- First, we placed a priority on the effort. Financial improvement and audit readiness must be an agency-wide priority that has the support of senior leaders. This initiative is now one of DoD's top-ten business priorities, a key component of the Department's Strategic Management Plan, and was identified as one of the Department's High Priority Performance Goals with progress measurements described in the President's FY 2011 Budget's Analytic Perspectives volume.
- Second, we created a governance structure. We have a governance board co-chaired by the Chief Financial Officer (CFO) and DCMO that meets quarterly and includes the DCMOs from the Military Departments. The Chief Management Officer of the DoD and the Military Department CMOs have received personal briefings. The Department's Deputy Chief Financial Officer also conducts weekly meetings with the heads of financial operations in the Military Departments, and these meetings regularly discuss issues related to financial improvement and audit readiness.
- Third, we obtained resources. Nothing is harder in DoD than acquiring resources for business process improvements, because these dollars compete -- as they should -- with direct warfighter needs. But the Department has ensured that increased resources are devoted to high-priority financial improvement efforts at home, as well as improving financial controls over business operations in Afghanistan.

In order to demonstrate progress and to build confidence among stakeholders, our plan includes interim goals that can be achieved by FY 2012. There will be a DoD-wide examination

and validation of our funds control and distribution process (known in audit terms as “appropriations received”). Periodic validation of appropriations received will demonstrate to Congress that we are controlling our funds carefully and in ways that ensure we comply with the laws you enact. A clean opinion on the Marine Corps Statement of Budgetary Resources is a key interim goal. While challenging and difficult, we will learn much from this initiative, and we applaud the Marine Corps for this trail-blazing effort. We have also asked the Military Departments to identify areas that can be independently validated by FY 2012, including audit readiness for funds balance with Treasury (our “checkbook”) and a comprehensive review of organizations operating with our new ERPs. We’ve also asked that progress on these plans be part of performance evaluations, reinforcing both its priority and accountability for results.

We continue to build more detail into our plans and to push for execution of the existing plans. The FY 2010 National Defense Authorization Act (NDAA) requires that the CFO provide a semi-annual report on financial improvement and audit readiness in May and November. We are presently drafting the November 2010 report, which will provide considerably more detail than the first report last May. We will meet both the required deadline for this report and its associated detail. Further, the CMO’s statutory reports -- such as the Strategic Management Plan that addresses business operations and the Enterprise Transition Plan that captures information on systems investments and related progress -- will continue to be synchronized with financial improvement reporting.

The FY 2010 NDAA not only requires reports; it requires that DoD have fully auditable financial statements by 2017. Under current audit rules and in view of the timelines for reaching our target business systems environment, meeting that date would likely require the expenditure of large sums of DoD dollars to acquire and improve information – especially valuation information – that is rarely useful to DoD managers. We have concerns that the cost of recording, reporting, and auditing this historical information far exceeds any benefits it may provide.

DoD agrees with the need to establish a framework that provides improved cost and management information that will support better management of our assets and also support audits of the information. We are working with OMB, Treasury, and GAO to see if there are more cost-effective ways to reach full auditability, to include considering an interim shift to a cash basis of accounting and evaluating the capabilities inherent in ERP systems to capture the cost of new acquisitions. Draft language in the Senate authorization bill would require DoD to perform a business case analysis to weigh the costs and benefits of auditing asset historical values and determine the most cost-effective approach to resolve this issue. We will take into account these discussions with OMB, Treasury, and GAO in responding to this Congressional request.



## **Our Commitment**

We recognize the challenges associated with improving financial information and achieving audit readiness in the Department of Defense. But we have a new, focused strategy to take on these challenges, and we have formed a partnership between the CFO and DCMO communities to help us implement that strategy.

In closing, we want the Subcommittee to know that we are all personally committed to this effort as part of our overall commitment to providing the financial resources and business operations necessary to meet our national security objectives.