

Statement of

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Under Secretary of Defense (Comptroller)/
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Before the

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Committee on Homeland Security
and Governmental Affairs

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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.