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Statement of
The Honorable Jon T. Rymer
Inspector General,
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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

[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

[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

[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.