Statement of

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and

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before the

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Chairman McCaskill, Senator Ayotte, Members of the Subcommittee, thank you for the opportunity to testify today concerning financial management at the Department of Defense (DoD) and our ongoing efforts to improve financial operations. We should note that this is an area of interest to our new Secretary of Defense. Secretary Panetta has asked us to join with other Department leaders to review our plans for financial improvement and report back to him with any suggested improvements.

From our perspective, there are two principal reasons for striving to make DoD as efficient and effective a manager as possible. The first is to ensure that America's Servicemen and women have the resources they need to carry out their mission. The second reason is to satisfy our duty as stewards of the resources entrusted to us by the taxpayers.

As members of the U.S. Senate, you have a great interest in both purposes. Moreover, your oversight and interest in this subject is a great help to us as we go forward.

Background and Context

As we pursue these dual goals, we rely on the support of a dedicated professional work force of approximately 60,000 financial management personnel, who provide our warfighters with the resources and financial services they need to meet national security objectives in every area of the world, including Afghanistan and Iraq. We know that you appreciate their efforts as much as we do.

Today, the Department has effective financial processes in many key areas. As a result, our violations of the key financial laws are quite low, timely and accurate payments are produced in a very high percentage of cases, while interest payments have been dramatically reduced.

And in fact, there has been significant 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.

At the same time, it is clear that the most daunting challenges remain ahead, particularly the challenge of moving the Military Services toward auditability. Moreover, we know that 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.

The challenge is more daunting because of DoD's enormous size and geographical dispersion. For example, 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 war zones. Given our size and mission requirements, we are not able to deploy the vast numbers of accountants that would be required to fully meet audit standards.

To pass an audit, an organization is required to 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. 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.

An Enterprise-Wide Response

To address these enterprise-wide issues, we have put in place a strong governance model. As the Department's Chief Management Officer or CMO, the Deputy Secretary is responsible for Department-wide business operations and management issues. He is supported in this by the Deputy Chief Management Officer, or DCMO.

The Under Secretary of Defense (Comptroller) and Chief Financial Officer is responsible for financial management policy and operations for the Department. He has the lead in efforts to improve financial information and audit readiness. But the Comptroller organization cannot improve financial management on its own. The Department will achieve its financial management goals only through an active partnership involving both the Comptroller and the DCMO. We must also have help from those in acquisition, logistics, and other business areas, as well as the business communities that reside in the Military Departments.

To inject this holistic, integrated way of thinking into the existing fabric of defense management, the DCMO has established a framework for organizing our Business Enterprise Architecture, business processes, and systems environment into essential end-to-end business processes, such as Budget-to-Report, Order-to-Cash, and Procure-to-Pay. This enterprise-wide

approach is building the future business processes and systems environment of DoD, with audit readiness and management information in mind.

Improving the Quality of the Information We Use Every Day

To deal with these enterprise challenges -- and to improve financial information and achieve audit readiness -- we revised our approach from those pursued by DoD in the past.

Our strategy revision was shaped by senior leaders in the Comptroller and DCMO organizations and in the Military Departments and Defense Agencies. We also solicited input from the Office of Management and Budget (OMB), the Government Accountability Office (GAO), and Congressional staff.

In August 2009, we issued a memorandum outlining the new approach, which emphasizes improvements in the quality, accuracy, and reliability of the financial and asset information that we use every day to manage the Department. This approach leads to our current concentration on areas that are most important to defense managers while holding down costs in a period of budgetary constraints. Specifically, we are working on two types of information – budgetary information and existence and completeness of assets.

Budgetary information is critical to leadership at all levels, as people make operational and resource allocation decisions. Our new approach on improving budgetary information will lead to audit readiness for our Statements of Budgetary Resources (SBR).

We are also focusing on the accuracy in the numbers and locations of our mission critical assets. 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 organization is buying only what DoD needs.

We have not ignored other efforts necessary to achieve fully auditable statements. This spring we completed a business case analysis that was required by key stakeholders and included as a provision in the FY 2011 National Defense Authorization Act (NDAA). This analysis provides a roadmap to a cost-effective way for achieving auditability for financial statements beyond the SBR.

The FY 2010 NDAA and subsequent acts accommodated our new approach to financial improvement and audit readiness. We appreciate the support of the Congress and remain committed to have fully auditable statements by 2017.

System Improvements Are Critical to Success

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

To accomplish this, we must orient the DoD around end-to-end business processes that support audit goals, implement Enterprise Resource Planning (ERP) systems, leverage those investments to the maximum extent practicable, modernize legacy systems when necessary and supported by a business case, and also aggressively sunset legacy systems that are obsolete, redundant, or not aligned with our business objectives. Our goal is to deliver a streamlined, 21st-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 are focusing on three key areas:

First, 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.

Further, 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. The Department is more closely 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 last GFEBS Acquisition Decision Memorandum, signed June 24, 2011, we explicitly required that GFEBS:

- 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.

Second, we are defining a target systems architecture that is modeled on the premise of end-to-end business processes and uses the capability inherent in our ERP systems to the maximum extent practicable. This will minimize the number of required data exchanges and system-to-system interfaces, thus reducing the potential for error. It will also increase the degree of process standardization and cut down on unnecessary software development.

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, along with our Enterprise Transition Plan, 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 the data quality and 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 the 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. 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, implementation of our new approach will continue to be a major challenge.

Where We Are Today

Less than two years have passed since we took stock of our previous efforts and decided on new priorities designed to bring the various functional communities together to work toward the common goal of financial auditability. Financial auditability is now accepted as a high priority for the Department. To move forward with our new, focused approach, we have made many changes:

- We established a clear governance process with the Department's Chief Management Officer in the lead and the Under Secretary of Defense (Comptroller) and Deputy Chief Management Officer playing key roles.

- We established clear but flexible guidance, so the components can prepare to assert audit readiness by developing detailed plans for their discovery and remediation efforts.

- We have engaged the Department's CMO (the Deputy Secretary), as well as the Military Department CMOs (Under Secretaries) and the Service Vice Chiefs, in a personal commitment to support our goals.

- We have ensured that each Military Department has programmed adequate resources to move forward with this strategy.

- We established a clear and meaningful linkage between major business system investments and the goals of financial auditability.

- We are requiring Senior Executive performance appraisals to include financial audit goals among their criteria, including functional business areas that generate business events with financial impact. This key initiative will help establish audit requirements in business areas outside comptroller.

- We have begun efforts to establish a course-based certification program for defense financial managers that will permit us to emphasize education in key areas including auditability.

- We are assembling teams within each Military Department that will be tasked with improving financial controls.

- We have maintained a close working relationship with key stakeholders and oversight bodies, including GAO and the Department's Inspector General.

While we have made or are making many process changes, we also recognize that we must demonstrate specific progress to reassure ourselves, and the Congress, that we are actually

moving toward auditable financial statements. To that end, we launched an audit of the Marine Corps' Statement of Budgetary Resources. If successful, this would be the first time that any Military Service has completed an audit of a financial statement. We have already learned a great deal from this effort, and we believe that it will lead to a positive audit opinion.

We are also undertaking a number of other efforts to validate and demonstrate progress. In May of this year we began a DoD-wide examination and validation of our funds control and distribution process (known in audit terms as "appropriations received") by a public accounting firm. 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. In June we began a public accounting firm validation of the Army's organizations and bases that have implemented the General Fund Enterprise Business System business environment, a key effort to ensure that this 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 a key building block to 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 .

Conclusion

In sum, we recognize the challenges associated with improving financial information and achieving audit readiness at the Department of Defense. To meet that challenge, we have developed a workable and promising partnership between the CFO and DCMO communities that will help with 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 2017.

As we mentioned at the outset of this statement, we are also currently reviewing plans for financial management improvement at the request of Secretary Panetta. We will report back to him and solicit his guidance about future initiatives.

We would conclude by emphasizing that we are 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.