

THE DEPARTMENT OF DEFENSE: CHALLENGES IN FINANCIAL MANAGEMENT

HEARING

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT ORGANIZATION,
EFFICIENCY AND FINANCIAL MANAGEMENT

OF THE

COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

SEPTEMBER 23, 2011

Serial No. 112-110

Printed for the use of the Committee on Oversight and Government Reform



Available via the World Wide Web: <http://www.fdsys.gov>
<http://www.house.gov/reform>

U.S. GOVERNMENT PRINTING OFFICE

73-449 PDF

WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

DARRELL E. ISSA, California, *Chairman*

DAN BURTON, Indiana	ELLJAH E. CUMMINGS, Maryland, <i>Ranking Minority Member</i>
JOHN L. MICA, Florida	EDOLPHUS TOWNS, New York
TODD RUSSELL PLATTS, Pennsylvania	CAROLYN B. MALONEY, New York
MICHAEL R. TURNER, Ohio	ELEANOR HOLMES NORTON, District of Columbia
PATRICK T. McHENRY, North Carolina	DENNIS J. KUCINICH, Ohio
JIM JORDAN, Ohio	JOHN F. TIERNEY, Massachusetts
JASON CHAFFETZ, Utah	WM. LACY CLAY, Missouri
CONNIE MACK, Florida	STEPHEN F. LYNCH, Massachusetts
TIM WALBERG, Michigan	JIM COOPER, Tennessee
JAMES LANKFORD, Oklahoma	GERALD E. CONNOLLY, Virginia
JUSTIN AMASH, Michigan	MIKE QUIGLEY, Illinois
ANN MARIE BUERKLE, New York	DANNY K. DAVIS, Illinois
PAUL A. GOSAR, Arizona	BRUCE L. BRALEY, Iowa
RAÚL R. LABRADOR, Idaho	PETER WELCH, Vermont
PATRICK MEEHAN, Pennsylvania	JOHN A. YARMUTH, Kentucky
SCOTT DESJARLAIS, Tennessee	CHRISTOPHER S. MURPHY, Connecticut
JOE WALSH, Illinois	JACKIE SPEIER, California
TREY GOWDY, South Carolina	
DENNIS A. ROSS, Florida	
FRANK C. GUINTA, New Hampshire	
BLAKE FARENTHOLD, Texas	
MIKE KELLY, Pennsylvania	

LAWRENCE J. BRADY, *Staff Director*

JOHN D. CUADERES, *Deputy Staff Director*

ROBERT BORDEN, *General Counsel*

LINDA A. GOOD, *Chief Clerk*

DAVID RAPALLO, *Minority Staff Director*

SUBCOMMITTEE ON GOVERNMENT ORGANIZATION, EFFICIENCY AND FINANCIAL
MANAGEMENT

TODD RUSSELL PLATTS, Pennsylvania, *Chairman*

CONNIE MACK, Florida, <i>Vice Chairman</i>	EDOLPHUS TOWNS, New York, <i>Ranking Minority Member</i>
JAMES LANKFORD, Oklahoma	JIM COOPER, Tennessee
JUSTIN AMASH, Michigan	GERALD E. CONNOLLY, Virginia
PAUL A. GOSAR, Arizona	ELEANOR HOLMES NORTON, District of Columbia
FRANK C. GUINTA, New Hampshire	
BLAKE FARENTHOLD, Texas	

CONTENTS

	Page
Hearing held on September 23, 2011	1
Statement of:	
Easton, Mark, Deputy Chief Financial Officer, U.S. Department of Defense; Daniel Blair, Deputy Inspector General for Auditing, U.S. Department of Defense Office of Inspector General; and Asif Khan, Director of Financial Management and Assurance, Government Accountability Office	5
Blair, Daniel	19
Easton, Mark	5
Khan, Asif	40
Letters, statements, etc., submitted for the record by:	
Blair, Daniel, Deputy Inspector General for Auditing, U.S. Department of Defense Office of Inspector General, prepared statement of	21
Connolly, Hon. Gerald E., a Representative in Congress from the State of Virginia, followup questions and responses	87
Easton, Mark, Deputy Chief Financial Officer, U.S. Department of Defense, prepared statement of	8
Khan, Asif, Director of Financial Management and Assurance, Government Accountability Office, prepared statement of	42

THE DEPARTMENT OF DEFENSE: CHALLENGES IN FINANCIAL MANAGEMENT

FRIDAY, SEPTEMBER 23, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT ORGANIZATION,
EFFICIENCY AND FINANCIAL MANAGEMENT,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2154, Rayburn House Office Building, Hon. Todd Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts, Lankford, Towns, and Connolly.

Staff present: Molly Boyl, parliamentarian; Sharon Casey, senior assistant clerk; Justin LoFranco, deputy director of digital strategy; Mark D. Marin, director of oversight; Tegan Millspaw, research analyst; Jeff Wease, deputy CIO; Nadia A. Zahran, staff assistant; Jaron Bourke, minority director of administration; Beverly Britton Fraser, minority counsel; Jennifer Hoffman, minority press secretary; Carla Hultberg, minority chief clerk; and Adam Koshkin, minority staff assistant.

Mr. PLATTS. The committee will come to order.

Today's hearing will continue the focus on improving financial management throughout the Federal Government. I certainly want to welcome our witnesses and guests; and up front I want to say I appreciate the rearranging of everyone's schedule, as we were originally planning to be with you last week. I am glad it worked out to be with you today.

The Department of Defense is the largest department of the Federal Government and spent \$691 billion in 2010. Due to the size of its budget and the importance of its mission, it is imperative that DOD have proper financial management in place.

DOD, unfortunately, has never been able to produce auditable financial statements and has been on GAO's high-risk list since 1995 due to pervasive and systemic deficiencies regarding its financial management. In 2010, the Inspector General identified 13 areas of significant weaknesses in DOD's internal controls and financial management.

Despite numerous financial reforms, DOD continues to be susceptible to waste, fraud, and abuse. It is particularly susceptible to improper payments. The amount of improper payments issued by DOD is not specifically known, but both GAO and the Inspector General have raised concerns and identified areas where improper payments are known to occur. In particular, the Inspector General's office found that DOD was making significant overpayments

in high-dollar programs and that, unless the Department improves its oversight, it will continue to make significant improper payments.

In an attempt to improve financial management at DOD, Congress established a deadline to make all components of the Department ready to undergo a financial audit by 2017. This is a deadline that DOD is taking very seriously, and its efforts to improve financial management are admirable and certainly very much appreciated. However, there are numerous issues that the Department must address in order to be successful in meeting this deadline.

To meet the deadline, DOD developed the Financial Improvement and Audit Readiness plan. The plan is designed to improve and strengthen DOD's financial management through a series of gradual phases in benchmark goals. If the Department follows this plan successfully, it will be able to meet the deadline for audit readiness and significantly improve key weaknesses in its financial management.

Successful implementation of the plan remains in doubt, however. Already the Air Force has said it may have trouble meeting the 2017 deadline due to the fact that its financial management systems were created in the 1970's and need to be updated significantly.

GAO and OIG have found that system modernization is a challenge to DOD. There are also concerns that, while the Department may be able to devote enough resources to successfully produce a one-time auditable financial statement in 2017, it will not be able to develop systems sufficient to achieve auditable statements on a continuing basis; and that is something I definitely will be looking to touch on and the sustainability of the improvements in auditable financial statements, not just a heroic effort to meet a one-time obligation.

Strong financial management is crucial in order for a government to operate effectively, prevent waste, fraud, and abuse. DOD's increased focus on improving its financial management is, again, commendable and appreciated.

Today, we will hear from our witnesses about the challenges the Department faces in improving its financial management and producing auditable financial statements. I certainly look forward to your testimony, and this committee looks forward to continuing to work with you to increase efficiency, accountability, and good financial management at the Department of Defense.

Ultimately, improvements to DOD's financial management systems are critically important to protecting taxpayer dollars and, most importantly, to ensuring that we maximize our Nation's financial resources for many of the needs of our warfighters in harm's way who defend our freedoms with great courage and dedication.

And I, before yielding to the ranking member, would emphasize that, while we will be discussing some of the challenges within the Department on financial management and how we can partner with you, I also want to recognize the heroic efforts of all the men and women in uniform and all of our DOD civilian personnel who throughout the history of this Nation and as we speak have been heroic on the frontlines of democracy in defense of all of our free-

doms and the great blessings we as Americans enjoy. And, you know, if we are more successful in financial management, we can even better support those men and women in uniform in their heroic work.

With that, I am honored to yield to our ranking member, Mr. Towns from New York, for the purpose of an opening statement.

Mr. TOWNS. Thank you very much, Mr. Chairman, and also let me thank our witnesses for being here.

These are tough times in America. People are losing their jobs, and many others can't find work. Programs that support those most in need are being cut in order to save money. Every family in America is tightening its belt and keeping a tight rein on the checkbook because it gets more difficult every day to stay solvent. These families have a right to expect that our government will do the same.

For more than any other single government agency, it is the Department of Defense that justifies public skepticism about how they are government stewards of public funds, and it is the Department of Defense that this Congress should be holding accountable.

The Department has been required to produce auditable financial statements since 1997. We are now 14 years past this deadline, and the Department has still not met the requirement. This committee routinely examines the financial statements of other Federal agencies. In fact, 22 out of 24 agencies subject to the Chief Financial Officer [CFO] Act have produced clean audits of their financial statements, but not DOD.

I find it unacceptable that year after year a Federal agency that spends between \$2 and \$3 billion every day cannot keep track of the money that the American taxpayers has entrusted to it. What is worse is that the problems exist even though the Department has over 2,200 separate business systems in place to help account for finances.

Financial statements and unqualified audit opinions are excellent indications that an organization is performing efficiently as Congress intends. Unfortunately, due to pervasive deficiencies in internal controls and financial management that would not be tolerated in any other Federal agency or the private sector as well, we cannot be assured that funds entrusted to the Department are spent prudently or even correctly.

I hope that our witnesses today can shed some light on the current drive to generate financial statements at the Department of Defense that are auditable. I am especially interested in hearing how the Department plans to keep the leadership engaged in the financial management overhaul until you achieve success. I also want to know how you are going to keep people on task, day in and day out, until the Department has auditable financial statements.

And, most importantly, I would like to hear what the Department is doing to integrate its 2,200 separate business systems so that we don't have duplication and confusion that is currently present in your financial management structure today.

The deadline for accomplishing this is exactly 6 years away, on September 30, 2017. In the past, we have seen deadlines come and deadlines go with little change.

Today, we are joined by witnesses who are key players in helping the Department of Defense improve its financial management processes. I would like to thank you for your testimony in advance, and I am looking forward to hearing how the current initiatives will bring permanent and successful change to the financial management process by the 2017 deadline.

And, Mr. Chairman, I want to thank you for staying with it to try and make certain that we are able to get the information that we need so people have confidence in what they are doing as well.

Thank you very much, and I yield back.

Mr. PLATTS. I thank the gentleman.

The ranking member and I have been partners on this effort for almost a decade now. Because when I chaired from 2002—or 2003 to the end of 2006, Mr. Towns was my ranking member; and then he chaired the subcommittee, and I was his ranking member. Now we have switched places again, but we share the focus on good government and especially financial management and, in this case, with the Department.

We will keep the record open for 7 days for any of the committee members who want to submit their own opening statements and for any extraneous material that we will receive here today or thereafter.

We certainly welcome our witnesses: Mr. Mark Easton, who serves as Deputy Chief Financial Officer for the Department of Defense; Mr. Daniel Blair, who is the Department of Defense Deputy Inspector General for Auditing; and Mr. Asif Khan, Director of Financial Management and Assurance at GAO.

Pursuant to our committee rules, if I could ask all three of you to stand and we will swear you in.

Would you please raise your right hands?

[Witnesses sworn.]

Mr. PLATTS. Thank you. You may be seated. Let the record reflect that the witnesses answered in the affirmative.

Our understanding is our floor schedule is we may have votes around 11 o'clock; and, once we go over, we will be over there for a long time. So what our goal is is to hear your statements and then get to an exchange of Q and A so we can have as productive an exchange here this morning and conclude when we have to go over for votes so that you are not kept waiting.

And certainly with you and your staffs as well as with Members and our staffs, this is kind of, I would say, the public front of an ongoing effort to work with you previously and going forward, staff to staff or Members and staff, on this important issue.

And while we are grateful for all three of you being here, Mr. Blair and Mr. Easton, I want to especially thank you for your prior service in uniform. I love what I do, proud of what I do, but what I do pales in comparison to what you who and all who have and are wearing the uniform of our Nation's Armed Services. So, again, thanks for your service.

So, with that, Mr. Easton, if you would like to begin.

STATEMENTS OF MARK EASTON, DEPUTY CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF DEFENSE; DANIEL BLAIR, DEPUTY INSPECTOR GENERAL FOR AUDITING, U.S. DEPARTMENT OF DEFENSE OFFICE OF INSPECTOR GENERAL; AND ASIF KHAN, DIRECTOR OF FINANCIAL MANAGEMENT AND ASSURANCE, GOVERNMENT ACCOUNTABILITY OFFICE

STATEMENT OF MARK EASTON

Mr. EASTON. Chairman Platts, Ranking Member Towns, Mr. Lankford, members of the committee, thank you for the opportunity to speak with you today on the subject of financial management within the Department of Defense. I have submitted a statement for the record which I will summarize briefly this morning.

As Deputy Chief Financial Officer, I am responsible to our Chief Financial Officer for financial policy, systems compliance, and internal controls governing financial and accounting aspects of our business operations across the defense enterprise. I have dealt with these matters in various capacities for more than 38 years, both in uniform and as a civil servant. I am proud to be part of a financial management work force that is operating around the world providing mission support to our warfighters. This team is also solving today's problems while being called upon to learn new skills and lead change.

I also recognize that DOD financial management has remained on the GAO high-risk list since 1995. In my experience, a reasonable level of control exists across our enterprise, particularly at the local level, but in my current position I also see enterprise-wide weaknesses that demand an enterprise-wide response. The lack of auditable financial statements at DOD as a whole is a symptom of those weaknesses.

To provide some amount of context for my comments, I want to cover DOD's financial management goals.

First, we have to, obviously, acquire the resources that we need to meet national security requirements; and that is our budget role.

Second, we have to ensure that we are using those resources legally, effectively, and efficiently. The execution side of our business—and that is an immense challenge—that is where I spend my time and energy and where many of the challenges lie.

And the third is to ensure that we have a world-class financial management work force.

To meet current challenges and to improve financial information and achieve audit readiness, we have adopted a new approach with the team that we have in 2009. We feel that that approach unites the enterprise around financial and asset information that we use every day to manage, specifically, budgetary information and the physical existence and completeness of property.

Previous DOD teams have tried but with limited success. So it is fair to ask, why will this time be different? Simply put, we feel we have the right strategy, we have dedicated resources, we have absolute and solid leadership support and a governance process that will assign accountability for actions. 2017 is a long time from now, so we recognize that we have to show specific interim progress; and that is what we are, in fact, doing.

One test already under way is our audit of the Marine Corps statement of budgetary resources which we believe will result in a positive audit opinion. When successful, this will be the first military service ever to achieve an audit of a single financial statement.

But there are other events across the Department to include independent validation on specific things. For example, last month we completed an examination and validation by an independent public accountant of our funds distribution and control process, what we call appropriations received. That resulted—that segment resulted in a clean opinion.

The Defense Information Systems Agency is in the process of auditing its fiscal year 2011 books. We expect a clean opinion in that audit.

This year, our Defense Finance and Accounting Service, our primary service provider in that regard, conducted an audit of its civilian pay entitlement system and received a clean opinion. That system is used not only for defense but for several non-defense agencies.

And, finally, in July, we began—have not completed but began an audit of the Air Force's funds voucher Treasury reconciliation process, an indication that we can reconcile at least at the transaction level our checking account statement.

These are just a few examples. They build on past achievements, including auditable financial statements for the Army Corps of Engineers civil works projects and several defense agencies.

We also have a number of large trust funds that are currently auditable, and we will improve as we apply lessons learned from those recent experiences, as well as getting feedback from the Government Accountability Office and DOD IG. And I can assure you this is not the first time that this panel has met to work on this particular issue.

However, there is an enormous amount of work still to do to achieve and sustain auditable financial statements. It will require fundamental changes. The Government Accountability Office has identified significant specific challenges, and I wanted to talk to each of those.

The first is leadership or tone from the top. We've implemented a government structure early in the current administration, and it has kept the attention of senior leaders, and it will continue to do so.

Second is work force competency. As I said, we have a dedicated and professional work force who is on the job, doing the job, but financial audit competency is one that we need to continue to emphasize.

Third is information technology. Many of our IT systems are old, stove-piped, designed to conduct basic budgetary accounting but not to do the things that we need to do for full auditability.

Improved systems alone, however, will not eliminate our weaknesses or guarantee auditable statements. Achieving auditability requires a consistent—a fourth element—a consistent level of internal controls, and that may be the key foundational thing that we put as a priority.

Looking ahead, we are determined to meet the congressionally mandated deadline of 2017. It is an ambitious but an achievable goal. However, we think that this time will be different. We have a Chief Financial Officer in Secretary Hale who has thoughtfully assessed and applied the lessons learned of many of those false starts that you alluded to, while also seeking the advice and counsel of external stakeholders and oversight activities.

We also have the strong support and commitment of Secretary Panetta and anticipate an equivalent level of energy and interest throughout the Department.

Finally, from my perspective, there is clear value and critical importance in the public confidence that auditability would demonstrate.

Beyond that, the benefits to the Department, its mission, and to the taxpayers is very clear to me. This effort is consistent with the administration's overall campaign to reduce waste across the government. The American people have always supported our men and women in uniform, but that does not relieve us from the obligation to ensure that we are managing scarce resources carefully and effectively. We are committed to doing so. This commitment will be especially helpful in reinforcing our current efforts to combat improper payments. We have a solid program, but our quarterly results are questioned because of the many weaknesses that have been discussed.

In summary, we recognize the challenges associated with improving financial management in the Department. To meet those challenges we've developed promising partnerships across the enterprise to include our new chief management officers as well. We have implemented a new, focused approach that includes near-term goals in addition to the long-term goal of achieving auditable financial statements by 2017.

Mr. Chairman, this concludes my statement. I appreciate your comments and support for our men and women in uniform, and I look forward to your questions.

[The prepared statement of Mr. Easton follows.]

Chairman Platts, Ranking Member Towns, Members of the Committee, thank you for your invitation to speak before you today on the subject of Financial Management within the Department of Defense (DoD).

I am Mark Easton, the Deputy Chief Financial Officer for DoD. In this capacity, I am responsible to the Chief Financial Officer for the financial policy, systems compliance, and associated internal controls that govern the financial and accounting aspects of business operations across the Defense enterprise. I have had the privilege of serving our nation within DoD—both in uniform and as a Civil Servant—at various levels and in various capacities over the past 38 years. I am proud to be a part of a financial management workforce that is operating today around the world, providing mission support to our warfighters. I am also mindful of our public stewardship responsibility, and in that regard will be speaking of the efforts that are underway to strengthen DoD financial management, in order to improve the quality and timeliness of financial information for leadership decision-making, and ultimately demonstrate accountability with a clean financial opinion.

I also recognize that DoD financial management has remained on the GAO high-risk list since 1995. My experience in working within the Department over an extended period of time tells me that a reasonable level of controls exists within the various elements of our business especially with regard to local control of assets and expenditure of funds. My current position, however, provides me with a perspective that also recognizes enterprise-wide weaknesses in DoD business processes that negatively impact our financial management. These weaknesses go well beyond the financial management functional community, extending into all functional business areas throughout the enterprise. As such, they demand an enterprise-wide business response. The lack of auditable financial statements for DoD as a whole reflects those weaknesses.

DoD Financial Management Goals

To put this subject into context, I'd like to begin by highlighting 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 includes considerable interaction with Congress, as you know.

But an enacted budget is only the beginning. Our second goal is equally important and is where I spend most of my time and energy. That is to ensure that we are using appropriated resources legally, effectively, and efficiently. This is the execution 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 currently placing a significant amount of urgency and emphasis across the DoD enterprise. In this very diverse and complex business environment, standard and well-controlled processes and integrated, automated, and compliant systems are important. The umbrella initiative to bring these elements together in a manner that supports auditability is our Financial Improvement and Audit Readiness (FIAR) effort. I will discuss this in some detail later in my statement.

Our third objective is to maintain a world-class financial management workforce that is dedicated and motivated to meet its responsibilities in support of the DoD mission. The taxpayers -- and our Servicemen and women -- deserve nothing less. To facilitate its continued excellent service we have developed a framework to formally guide training and career development. It will focus on the key skills that our current and future financial management workforce will need for the 21st century business environment that is emerging. It is an environment that will demand key skills and practical experience in internal controls and financial audit. These skills will help personnel to understand and use modern business systems in maintaining more standard and better controlled processes that produce reliable financial information. It will also require an increased level of analytic skills in using this information to better inform decisions.

These three objectives support the overarching goal of strengthening DoD financial management. This goal is clearly reflected in the Department's Strategic Management Plan. Together, the initiatives under each objective combine to move us to financial auditability and a ticket off the GAO high risk list.

Although these three objectives predated the arrival of our new Defense Secretary, they have already attracted his strong interest. As he wrote in a recent message to the entire Department, "We also 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. While we have reasonable controls over much of our budgetary information, it is unacceptable to me that the Department of Defense cannot produce a financial statement that passes all financial audit standards."

Secretary Panetta has asked us to review our financial improvement strategy and to report back to him concerning both our progress and our further plans. That review is ongoing. I am confident that the Secretary's personal interest in these issues will be helpful in the days ahead. This is indicative of a sustained senior leadership focus that will remain constant.

The FIAR Strategy

To deal with these enterprise challenges -- and to improve financial information and achieve audit readiness -- we revised the approach that had been pursued by DoD in the past. Our new approach was shaped by senior leaders in the Comptroller and Chief Management Officer organizations and in the Military Departments and Defense Agencies. In addition, we solicited input from the Office of Management and Budget (OMB), from the Government Accountability Office (GAO), and from Congressional staff.

In August 2009, we issued a memorandum outlining the new approach, which emphasizes improvements in the completeness, accuracy, timeliness, and validity 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 constraint. 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 operational and resource allocation decisions are made. Our new approach on improving budgetary information will lead to audit readiness for our Statement of Budgetary Resources.

We are also focusing on the accuracy in the numbers and locations of 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.

The Fiscal Year (FY) 2010 National Defense Authorization Act (NDAA) and subsequent legislation accommodated our new approach to financial improvement and audit readiness. This spring we completed a business case analysis that was required by key stakeholders and which was included as a provision in the FY 2011 NDAA. The analysis provides a roadmap to a cost-effective way for achieving full financial statement auditability.

Putting the FIAR Strategy to Use: Current Status and Recent Accomplishments

Because it has been 17 years since the statutory requirement was levied and nearly 14 since an initial target date came and went, and many subsequent plans and commitments failed, it is fair to ask: "Why will this time be different?" Simply put, we have the right strategy; dedicated resources; solid leadership support throughout the Department; and established governance process with assigned accountability for action.

We also recognize that we need to show specific interim progress to reassure ourselves -- and the Congress -- that we are moving toward auditable financial statements in accordance with the established timelines. To that end, in Fiscal Year 2010 we launched an audit of the U.S. Marine Corps' Statement of Budgetary Resources, which we believe will lead to a positive audit opinion. When successful, this will 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 the funds distribution process, known in financial terms as "appropriations received," of each of the three Military Departments. This effort was conducted by an independent public accounting firm (IPA) and resulted in a clean opinion on the audit readiness of our appropriations received processes. 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.
- 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. Although large and complex in scope, DISA is an agency making advanced progress toward auditability. This audit will be completed in a few months, and we expect that it will result in a clean audit opinion.
- This year the Defense Finance and Accounting Service (DFAS) underwent an audit of controls related to its key civilian pay system. It 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 my office is coordinating an effort for other internal service providers to use it as well.
- In June we began an IPA validation of the Army's organizations and bases that have implemented their "target" business environment supported by their financial ERP, the General Fund Enterprise Business System or GFEBs. This is a key effort to ensure that the new system is being used in a manner that is auditable.

- In July we began an IPA validation of the Air Force's processes and controls to reconcile its 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 (referred to by auditors as "existence and completeness") of large portions of our military equipment.
- Lastly, we have completed the business case analysis directed by the FY 2011 NDAA and defined the way forward for auditing DoD balance sheets and full audits of all financial statements.

These accomplishments illustrate our progress in moving towards auditability and, more importantly, improving and sustaining key business process changes. They also build on some significant past achievements. For example, for the past three years, the U.S. 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. And we are getting better as we make use of relevant guidance from GAO and others. However, we recognize there is an enormous amount of work still ahead of us to achieve and sustain auditable financial statements.

Continuing Challenges Remain

As I said at the outset, these challenges become especially daunting considering DoD's geographical dispersion and sheer size. Given those factors and our unique 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 DoD Inspector General, as well as a cadre of quality IPAs who are evaluating us and making recommendations for improvement.

The GAO recognizes the enormity of the task of changing the way we do business in order to escape its high-risk list and to achieve financial auditability. We are in general agreement with its assessment concerning five major challenges: Sustaining broad, committed leadership; maintaining a competent workforce; establishing effective governance, oversight and accountability; implementing information technology (IT) systems on time, within budget, and with needed capabilities; and resolving weaknesses in internal control over financial

management and reporting. I'd like to briefly address each of these challenges, along with actions that we are taking to address them.

Leadership Commitment and Governance. 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, to providing more direct and specific oversight that is associated with leadership accountability. The Deputy Secretary called a meeting of the Office of the Secretary of Defense Principal Staff Advisors and Military Department Under Secretaries and Vice Chiefs and required their commitment to specific achievements in FY 2011 and FY 2012. We are now using those goals at all levels of governance to hold executives accountable, and we intend to follow up on a regular basis to celebrate successes and to address the causes of any missed goals. We feel that, with these improvements to our governance process and Secretary Panetta's involvement, we have the leadership commitment we need, and that leadership involvement will provide more effective oversight and accountability.

Workforce Competency. 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 are changing, and there are changes required of both a short-term and long-term nature. 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. A key focus of this program will be to ensure that financial managers are addressing the skill and experience gaps that we and GAO have observed related to financial statement audits. Our people have not 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.

Effectively Implementing Information Technology. Many of our business IT systems are old, functionally stove-piped, and were originally designed to capture financial transactions to conduct basic budgetary accounting. A key element to achieving and sustaining auditable financial statements is improving our financial systems. To accomplish this, we are re-orienting 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. In attacking this key area, the Comptroller is partnering with the DoD Deputy Chief Management Officer (DCMO) and the Military Department Chief Management Officers to oversee 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. Part of the changes in approach is requiring that individual programs, such as Army's General Fund Enterprise Business System and Navy ERP, define the role that they play in each organization's auditability efforts and end-to-end processes. Further, specific guidance is being provided to program managers which directly links their program schedules to events that demonstrate the capability to support the relevant financial improvement events in the FIAR plan.

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. Use of these systems allows auditors to rely on their inherent automated controls and supports readily available audit trails.

Third, we will continue to guide our system investments using the Business Enterprise Architecture, which defines the necessary data standards, business rules, performance metrics, and standard system configurations that will allow our systems to be interoperable.

Financial Controls. 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.

We also agree that we have more work to do in improving our financial controls. Sound internal controls over financial reporting are the foundation of audit success, but we have often found that they are poorly documented and inconsistently executed. In the past we have asked operational organizations to self-assess their controls to determine weaknesses impeding audit readiness. Because 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 already made in this area is to enlist more help from the Service audit agencies. They have the personnel qualified to assess internal controls and make sound recommendations for corrective actions. Each Service has committed more than 15 people who will 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.

These changes have strengthened our overall Managers Internal Control Program by more tightly integrating the financial reporting and financial systems elements into the FIAR program and emphasizing substance and risk assessments during visits by my staff to local commands. Sound internal controls must become a part of our day-to-day routine, not just an annual reporting requirement.

The Way Ahead for Financial Auditability

As I indicated earlier, we are determined to meet the congressionally mandated deadline of auditable statements by 2017. It is an ambitious goal, but it is achievable and more importantly, we see a clear roadmap to this goal. First and foremost, we have a Chief Financial Officer who has thoughtfully assessed and applied lessons learned, while also seeking the advice and counsel of our external stakeholders and oversight activities. Unlike past efforts, he has recognized that to mobilize the entire Defense establishment, we must start by focusing on information that is important to managing this enterprise while also accomplishing its mission. Under Secretary Hale has put into motion a winning strategy and we now are learning and applying lessons learned in executing this strategy. Further, we have the strong support and commitment of Secretary Panetta and anticipate an equivalent level of energy and interest throughout the Department.

How This Relates to Other Priorities

Finally, I want to say a word about additional benefits that will result from a stronger and better controlled business environment within DoD. From my perspective, there is clear value and critical importance in the public confidence that auditability would demonstrate. Beyond that, the benefits to the Department, its mission, and the taxpayers are significant. This effort is consistent with the Administration's overall campaign to reduce waste across the Federal government. In a time of concern about the level of Federal spending, we need to do our part at Defense. We know the American people have always supported Defense spending, but that does not relieve us of the obligation to manage scarce resources carefully and effectively. We are committed to doing so.

This dedication to efficient and effective financial management will continue our important contributions to the operational efficiencies that are being implemented across the Department. We are determined to see the job through and to achieve our objectives for the sake of the troops and the taxpayers.

In this regard, we believe that our aggressive program to improve financial information and to adopt commercial audit standards will reinforce current efforts to control improper payments, while also establishing an infrastructure that will allow us to do more in-depth analysis of source documentation where appropriate.

Controlling Improper Payments Is Currently a Strength

We have a fundamentally strong program to monitor, control, and report on improper payments, but our status on the GAO high-risk list and a lack of financial statement audit opinion creates an unacceptable level of skepticism. Improving internal controls as discussed above will strengthen the current program and contribute to increased confidence.

Improper payments occur when funds go to the wrong recipient, an ineligible recipient receives a payment, a recipient receives the incorrect amount of funds (including overpayments and underpayments), or documentation is not available to support a payment.

Based on our current reporting methods, we estimate that about one to two percent of our payments results in payments that are classified as improper. That is one to two percent too much. The only appropriate goal for improper payments is zero. Nevertheless, our improper payment percentage is low in comparison to overall federal levels, and many of our improper payments are quickly resolved.

Our success with improper payments is particularly noteworthy because of the size and complexity of the Department's payments. Last year DFAS, which handles nearly 90 percent of our total payments, disbursed a total of \$578 billion. DFAS processed more than 168 million pay transactions, 8.1 million travel payments, and 11.4 million commercial invoices. It also handled 255 million General Ledger transactions and nearly \$500 billion in military retirement and health benefits funds.

We are not only a huge organization; we are a highly complex organization. The contracts for major weapons are some of the most complex in the world and present significant payment challenges, such as those associated with progress payment terms that call for varying recoupment rates. Despite the volume and complexity of our activities, DFAS has worked hard and successfully to keep the incidence of improper payments in check. At the same time the organization has steadily reduced the cost of its operations in recent years by consolidating operations and improving productivity.

We have historically used post-payment statistical sampling for payments related to civilian pay, military pay, travel pay, military health benefits, and payments to our military retirees and retired annuitants. Each of these categories of payments represents an ongoing relationship with members where payment issues can be quickly identified and resolved. Underpayments are typically resolved by the next cycle and overpayments are quickly recovered.

Improper payment rates reported for FY 2010 were as follows: civilian pay, 0.3 percent; military pay, 0.6 percent; travel pay, 1.9 percent; military health benefits, 0.42 percent; and retiree/annuitant pay, 0.1 percent. We project similar rates for the year ending September 30, 2011.

Our improper payment program can be made better, specifically in the methodology that we use for detecting commercial payment improper payments. Historically, we have emphasized pre-payment screening for our commercial contract payments. Due to the complexity of these transactions and the widely dispersed payment systems that handle them, this method puts controls in place up-front and increases the likelihood that payments are accurate before they are released. To provide further assurance on our reporting and compliance with the Improper Payments Elimination and Recovery Act of 2010, we also are beginning to employ post-payment statistical sampling and will use this approach for reporting, effective in FY 2012.

The payment categories that I have just discussed are the largest ones in DoD and are handled primarily by DFAS. But payment operations occur in multiple organizations across the Department. And many of these organizations have implemented what we believe are strong programs to estimate, identify, report, eliminate, and recover improper payments.

Two noteworthy examples are the U.S. Army Corps of Engineers and the TRICARE Management Activity. The U.S. Army Corps of Engineers conducts statistical sampling for all commercial payments and a 100 percent review of all travel payments over \$2,500, as well as a statistical sampling of those below \$2,500. It has also used a recovery audit for FY 2010 that recaptured 99 percent of all overpayments.

At the TRICARE Management Activity, home of vital military health benefits programs, stringent contract performance standards are employed that involve stratified statistical sampling based on dollar amounts and payment types. The contractor actually making the payments is incentivized by contract terms to minimize any improper payments and penalized when performance standards are not met. In addition, as mentioned previously, the comprehensive annual post-payment audit by an external independent contractor established an improper payment rate of 0.42 percent as reported in FY 2010, representing about \$49.1 million in improper payments.

Conclusion

In summary, 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 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 the Congressional deadline of 2017. We also use and benefit from a constructive partnership with our auditors and

oversight activities. And make no mistake: We appreciate the support of the Congress, and we remain committed to fully auditable statements by 2017.

Mr. Chairman, this concludes my statement. I look forward to your questions.

Mr. PLATTS. Thank you, Mr. Easton.
Mr. Blair.

STATEMENT OF DANIEL BLAIR

Mr. BLAIR. Chairman Platts, Ranking Member Towns, and Mr. Lankford, good morning and thank you for the opportunity to appear today before you on behalf of the DOD IG to discuss financial management challenges facing the Department.

These challenges prevent DOD from collecting and reporting financial information that is accurate, reliable, and readily available for decisionmakers. Over the past few years, the Department has worked diligently to address its financial management challenges. However, more progress is required to be good stewards of the taxpayers' money.

Today, I will discuss three key challenges that must be addressed before DOD will be able to demonstrate sound financial management through a financial statement audit: first, improving data reliability; second, improving internal controls; and, third, effectively implementing new systems called Enterprise Resource Planning systems [ERPs.]

Reliable data are essential to making sound business decisions. However, we frequently identify financial data that are inaccurate and unreliable. Since fiscal year 2007 we have issued 89 reports that highlight data quality problems. Our audit of the controls over the Army's deployable disbursement system, which contains key information for \$13 billion of commercial payments, found that the system did not have reliable data for over 73 percent of the transactions that we reviewed.

Significant improvements must also be made in DOD's internal controls. As you know, these controls are the first line of defense to safeguard assets against fraud, waste, and abuse. Currently, longstanding internal control weaknesses are affecting the Department's ability to obtain a clean audit opinion. In addition, without strong internal controls, the Department is at high risk of making improper payments.

In fiscal year 2010, the Department reported nearly \$1 billion in estimated improper payments. However, DOD's estimation process did not review more than half of the first quarter of fiscal year 2010 gross outlays; and, therefore, we question the reliability of this estimate. Simply stated, the Department does not consistently know that it is paying the right person the right amount at the right time.

Our audit of the contracts supporting the Broad Area Maritime Surveillance Program found that the DOD personnel did not validate that the contractor was entitled to receive over \$329 million because none of the invoices were reviewed. My written statement for the record includes copies of two actual invoices that were paid under this contract.

Effectively implementing the Department's new ERP systems is a key component of its auditability strategy. These new systems are intended to eliminate many old legacy systems, provide useful, timely, and complete financial management data. However, unless the Department first improves its data quality and reengineers its underlying business practices, many of the intended benefits of

these new systems, estimated to cost over \$9 billion between fiscal years 2010 and 2017, will not be realized.

We've also noted that the milestones for 4 of the 11 ERP systems has begun to slip.

Further, we are concerned that other milestones for completing critical financial management improvement efforts are very close to the fiscal year 2017 deadline. Full deployment of some ERPs, as well as asserting audit readiness of the statement of budgetary resources, will not happen until fiscal year 2017, as some critical components will also not be validated prior to this date. Any delay in these milestones will likely prevent the Department from meeting its goal.

In closing, sound financial management is critical to providing effective stewardship over the billions of dollars that the Department receives annually. DOD must continue to improve data quality and its internal controls in order to reduce its vulnerability to improper payments.

While I recognize the significant effort that DOD leadership has put forth to resolve these longstanding financial management problems, frankly, much more remains to be done. Senior leaders in the Department and the Congress need reliable, timely financial information in order to make accurate decisions and to ensure that every dollar spent actually supports the warfighter and improves military readiness.

This concludes my statement today. I'd be happy to take any questions that you may have for me.

[The prepared statement of Mr. Blair follows:]

Chairman Platts, Ranking Member Towns, and distinguished members of the Subcommittee, good morning and thank you for the opportunity to appear before you on behalf of the Department of Defense (DoD) Office of Inspector General (IG) to discuss the pervasive financial management challenges within the Department and improvements that must be made. While financial management challenges within the Department have existed for a long time, the current economic uncertainty and fiscal constraints make resolving these weaknesses critically important. These weaknesses prevent DoD from collecting and reporting financial and performance information that is accurate, reliable, and timely and readily available for senior leadership and other decision makers including the Congress. Over the past few years, the Department has worked diligently to address its financial management challenges and improve the quality of its financial management information. However, much more progress is required in order to be good stewards of the taxpayer's money and have reliable financial information for decision makers to use on a daily basis.

Today I will discuss DoD IG's perspective on the status of the Department's financial management challenges and the Department's efforts to resolve them. I will highlight critical areas that must be resolved before the Department can have auditable financial statements and reliable financial management operations. In addition, I will also discuss the challenges the Department continues to face in improving its financial management operations.

Before discussing the challenges, I would like to acknowledge the efforts of the Department's senior leadership, including the Honorable Robert Hale, the Under Secretary of Defense (Comptroller) and Chief Financial Officer, to reform financial management within the Department. Transforming the financial management of the Department is certainly no easy task and cannot be accomplished overnight. Comptroller Hale and his senior leaders have demonstrated a commitment to improving financial management and have recognized some of the impediments and actions necessary to improving the Department's financial management data, processes, internal controls, and related financial systems.

A measure of DoD's ongoing progress in the area of financial management is the ability to obtain unqualified opinions on supporting financial statements. Currently, there are 14 DoD entities that are required to prepare annual financial statements. Of the 14 DoD entities, two have achieved an unqualified opinion on their financial statements; the Military Retirement Fund and the U.S. Army Corps of Engineers Civil Works. In addition, there are 54 Other Defense Organizations general fund entities that are not required to prepare annual financial statements, but support the DoD Agency-Wide financial statements. Of the 54 Other Defense Organizations, the Defense Commissary Agency, Defense Contract Audit Agency, Defense Finance and Accounting Service, and the DoD IG have also received unqualified opinions.

In Fiscal Year 2010, the DoD IG audited the U.S. Marine Corps' (USMC) Statement of Budgetary Resources (SBR),¹ the first Military Component to undergo such an audit. This effort resulted in a disclaimer of opinion because the USMC was unable to provide timely and relevant supporting documentation for accounting transactions and could not provide evidence to support the reconciliations for key accounts and accounting processes were being performed regularly. However, the USMC and the Department are learning from this audit experience and some improvements have been identified during the Fiscal Year 2011 audit. Unfortunately, some of the same challenges encountered during the Fiscal Year 2010 audit have affected the Fiscal Year 2011 audit. For example, the USMC was unable to reconcile its Fund Balance with Treasury to detail transaction files during the Fiscal Year 2010 audit. The USMC provided detail transaction files in June of 2011, approximately 9 months after the start of the Fiscal Year 2011 audit. These detail transaction files are essential to support the reconciliation process. Further, the USMC has continued to struggle to provide timely and reliable supporting documentation during the FY 2011 audit. We will continue to work with the Department to identify obstacles and make recommendations to resolve barriers to achieving auditable financial statements.

¹ Report No. D-2011-009, "Independent Auditor's Report on the United States Marine Corps General Fund FY 2010 and FY 2009 Combined Statement of Budgetary Resources,"

PERVASIVE FINANCIAL MANAGEMENT CHALLENGES WITHIN THE DEPARTMENT

Since the 1990s, the DoD IG has identified financial management as one of several key challenges within the Department. DoD's financial management challenges are so significant that they constitute one of the largest impediments to the U.S. Government's ability to obtain an opinion on its consolidated financial statements.

The Department continues to face a myriad of problems that adversely affect its ability to provide reliable, timely, and useful financial and managerial data needed to support operating, budgeting, and policy decisions. Gaps in the financial framework impact the accuracy, reliability and timeliness of budgetary accounting and financial reporting. The most significant challenge for financial management within the Department is meeting the statutory mandated September 30, 2017, deadline to ensure that the DoD financial statements are validated as audit ready as required by the National Defense Authorization Act for Fiscal Year 2010.² In order to meet the September 2017 deadline, the Department must continue to aggressively pursue improvements in 1) data quality, 2) internal controls, and 3) financial systems. The Department may need to revise its initiatives and milestones as additional deficiencies and corrective actions are identified as a result of DoD's Financial Improvement and Audit Readiness (FIAR) process.

Currently, at least 13 material internal control weaknesses continue to exist including deficiencies in financial management and feeder systems; Fund Balance with Treasury; Accounts Receivable; Inventory, and General Property, Plant, and Equipment. Additional internal control weaknesses may be added as we continue to assess DoD's performance, progress, risk, and the impact of financial management challenges. These material weaknesses are pervasive and affect nearly all aspect of DoD's financial management operations. While 2017 may seem like a long time from now, as I will discuss later in this testimony, there is little margin for error. Any significant setbacks will likely jeopardize the Departments ability to meet this important date.

² Public Law 111-84, Section 1003, "Audit Readiness of Financial Statements of the Department of Defense"

DoD's strategy for improving its financial management operations is contained in the Financial Improvement Audit Readiness (FIAR) Plan. The Comptroller is responsible for preparing and issuing the FIAR Plan Status Report on a biannual basis. The FIAR Plan has continued to evolve since it was first issued in 2005. From Fiscal Years 2010 through 2016, the Department estimates it will spend almost \$11.4 billion to improve its financial management operations, including the development of Enterprise Resource Planning (ERP) systems.³ The current FIAR priorities, established in August 2009, focus on improving the processes, controls, and systems that support information used most often to manage the Department. Those financial improvements should assist in achieving an unqualified audit opinion and in demonstrating to the taxpayer that the Department is a good steward of the taxpayer's dollars. The May 2011 FIAR Plan Status Report focused on the Statement of Budgetary Resources and the existence and completeness of critical military assets.

The May FIAR Plan Status Report currently includes the interim detailed milestones and supporting efforts for making financial improvements in four key areas: 1) appropriations received, 2) Statement of Budgetary Resources, 3) existence and completeness of mission critical asset, and 4) ERP systems implementation. The FIAR strategy only addresses achieving an audit opinion on the Statement of Budgetary Resources and asserting audit readiness for the existence and completeness of assets by 2017. The FIAR Plan does not include the detailed milestones and supporting efforts necessary to achieve an audit opinion on the other three financial statements: Balance Sheet, Statement of Net Cost or Statement of Changes in Net Position.

KEY FINANCIAL MANAGEMENT AREAS FOR REFORM

Three key areas to financial management reform are improving the quality of the data, internal controls, and financial systems.

³ An ERP is an automated system using commercial off-the-shelf software consisting of multiple, integrated functional modules that perform a variety of business related tasks such as general ledger accounting, payroll, and supply chain management.

Data Quality. Reliable data are necessary to make sound business decisions. However, we frequently identify financial data that are unreliable, incomplete, and inaccurate. As a result, DoD managers often cannot reconcile financial data or rely on this data to make sound business decisions. 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. The DoD IG has consistently issued reports identifying problems with unreliable data. In Fiscal Year 2012, the DoD IG plans to announce audits on this topic that will continue to make recommendations to improve the reliability of financial data in the Department.

From Fiscal Year 2007 through Fiscal Year 2011, 89 DoD IG reports have identified data quality problems. For example, in our audit of controls over the Army Deployable Disbursing System,⁴ we found that the system did not maintain accurate lines of accounting, accurate payment methods information, or complete fundamental payment information such as invoice line item information. As a result, the Army lacked a complete audit trail and could not reconcile information between the Army payment and accounting systems for 296 of the 402 commercial payments we reviewed. Further, the Army could not provide a complete universe of commercial payments made through the system.

In another example, our review of the reporting of obligations and expenditures for the Guam Realignment,⁵ found that the Department did not provide reliable cost information to Congress regarding the Calendar Year 2009 Guam realignment costs. Specifically, obligations were understated by over 10 percent (\$7.3 million of the \$60.3 million) while expenditures were overstated by over 35 percent (\$13.3 million of the \$35.6 million). These errors were caused by personnel inputting incorrect amounts or account numbers into the financial management systems that were not detected and corrected during the normal course of business. Without complete and reliable data, the ability of senior

⁴ Report No. D-2011-101, "Controls Over Army Deployable Disbursing System," August 17, 2011

⁵ Report No. D-2011-075, "DoD Official Need to Improve Reporting of Obligations and Expenditures for the Guam Realignment," June 17, 2011

leaders and Congress to make well-informed decisions about this key military realignment is severely affected. In addition, the Department will not have reliable historical cost data for planning future military realignments.

Internal Controls. Internal controls are an integral part of an organization's management which are designed to provide reasonable assurance of achieving: effective and efficient operations; reliability of financial reporting; and compliance with applicable laws and regulations. Internal controls include the plans, methods, and procedures used to meet missions, goals and objectives. Internal controls also serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal controls help senior leaders and managers achieve desired results through effective stewardship of taxpayer dollars.

Since the mid-1990s, the DoD IG has reported numerous material internal control weaknesses⁶ that impact the Military Services' and the Department's ability to achieve an unqualified financial statement opinion. In our most recent disclaimer of opinion on the Fiscal Year 2010 DoD Agency-wide financial statements,⁷ we reported the following 13 material internal control weaknesses:

- Financial Management Systems;
- Fund Balance with Treasury;
- Accounts Receivable;
- Inventory;
- Operating Materials and Supplies;
- General Property, Plant, and Equipment;
- Government Furnished Material and Contractor Acquired Material;
- Accounts Payable;
- Environmental Liabilities;
- Statement of Net Cost;
- Intragovernmental Eliminations;

⁶ Department of Defense Agency Financial Report for Fiscal Year 2010, November 15, 2010

⁷ Report No. D-2011-011, "Independent Auditor's Report on the DoD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements," November 15, 2010

- Other Accounting Entries; and
- Reconciliation of Net Cost of Operations to Budget.

Until the Department resolves these pervasive weaknesses, it will be very difficult for DoD to reliably assert that it is ready for audit by 2017.

Poor internal controls can have an adverse impact beyond DoD. For example, in April 2011, we reported on the absence of internal controls resulting in potential lost tax revenue as well as incorrect information regarding contractors support efforts in Southwest Asia. Specifically, we found that the Defense Finance and Accounting Service, the U.S. Army Financial Management Command, and the Financial Management Center did not establish standard operating procedures for Army Commercial Vendor Services personnel to correctly code the status of contractors or for Army Commercial Vendor Services offices to file Federal information returns.⁸ As a result, Army Commercial Vendor Services personnel incorrectly coded domestic contractors as foreign and did not take action to file Federal information returns for an estimated 316 incorrectly coded payments totaling \$351.92 million, to the Internal Revenue Service. Further, Army Commercial Vendor Services personnel did not comply with Federal laws to file Federal information returns, by not filing or using the Defense Finance and Accounting Service Tax Office to file returns to the Internal Revenue Service for 363 payments totaling up to \$37.54 million made to system-identified domestic contractors.

In addition, poor internal controls increase the risk of fraud, waste, and abuse. A joint investigation conducted by the Defense Criminal Investigative Service, Federal Bureau of Investigations, the U.S. Agency for International Development, and others disclosed that the Louis Berger Group, Inc., (LBG) a New Jersey-based engineering consulting company, charged inflated overhead rates that were used for invoicing on numerous government reconstruction contracts in Iraq and Afghanistan. From at least 1999 through August 2007, LBG intentionally overbilled the U.S. government, with an identified

⁸ Report No. D-2011-059, "Army Commercial Vendor Services Offices in Iraq Noncompliant with Internal Revenue Service Reporting Requirements," April 8, 2011

impact to DoD of \$70.9 million. The scheme was carried out by two former senior LBG employees who were responsible for ensuring the integrity of LBG's cost data used to calculate overhead rates that LBG charged the federal government. The contractor agreed to pay \$18.7 million in related criminal penalties and make full restitution to U.S. Agency for International Development. The civil settlement also required the company to pay the U.S. Government \$50.6 million to resolve allegations that LBG violated the False Claims Act. Although fraud is a deliberate act to deceive and circumvent controls, weak internal controls created an environment conducive to this fraudulent activity and the Department did not detect it in a timely manner.

Our audit work focusing on improper payments illustrates what can occur when the Department does not have adequate controls in place.

Improper Payments. Improper payments are often the result of unreliable data and poor internal controls. These conditions create an environment where fraud is more likely and, as a result, the Department lacks assurance that the billions of dollars it disbursements annually are made correctly. Simply stated, DoD does not consistently know that it is paying the right person, the correct amount, at the right point in time. An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments and underpayments made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for the incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review process is unable to discern whether a payment was proper as a result of insufficient or a lack of documentation, this payment must also be considered an error.⁹

⁹ M-11-16, "Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123," April 14, 2011

In Fiscal Year 2010, the Department reported nearly \$1 billion in estimated improper payments. However, based on our audit results, we are concerned with the accuracy and reliability of the Department's estimation process. Without a reliable process to review expenditures and identify the full extent of improper payments, the Department will not be able to improve internal controls aimed at reducing improper payments and improving financial management controls.

In our audit of the Department's review and reporting of improper payments, we found the Department's review process included less than half of the fiscal year 2010 first quarter gross outlays.¹⁰ Specifically, DoD did not review approximately \$167.5 billion of the \$303.7 billion in gross outlays for high dollar overpayments. Additionally, some overpayments that we or the Department identified were not reported, and the First Quarter FY 2010 High Dollar Overpayments Report did not include sufficient information about recoveries and corrective actions. The Overpayments Report was inaccurate and incomplete because the Comptroller and the Director, Defense Finance and Accounting Service, did not develop a sound methodology or perform adequate oversight for collecting and reporting comprehensive data.

Comptroller officials stated that the \$167.5 billion in outlays the Department did not examine for improper payments included internal and intragovernmental transfers. Those outlays were not subject to the OMB reporting requirements since the payments did not leave the Government. However, we later determined that Comptroller officials did not perform a reconciliation to determine whether these outlays were internal or intragovernmental transfers. A complete reconciliation is still needed to demonstrate that all outlays are being examined for overpayments and in order to accurately report the extent of the overpayments.

¹⁰ Report No. D-2011-050, "DOD Needs to Improve the High Dollar Overpayment Review and Reporting," March 16, 2011

The Department has a reported 75 percent recovery rate of the nearly \$1.3 billion for improper payments identified during 2004 through 2010.¹¹ While we commend the Department on aggressively pursuing recovery of identified improper payments amounts, unless DoD improves its methodology to review all its disbursements, it will continue to understate its estimate of overpayments and will likely miss opportunities to collect additional improper payments. However, based on our audit results, we are concerned with the accuracy and reliability of the Department's estimation process. Without a reliable process to review all expenditures and identify the full extent of improper payments, the Department will not be able to improve internal controls aimed at reducing improper payments.

We and other auditors continue to identify improper payments. For example, the Defense Contract Audit Agency estimated about \$6.4 billion of improper payments to contractors for the period from October 2005 to through March 2011.¹² These are costs paid to contractors that Defense Contract Audit Agency questioned because they do not comply with rules, regulations, laws and/or contract terms which meets the definition of an improper payment. These improper payments the audit agency identified are greater than the \$1.3 billion of improper payments the Department identified during 2004 to 2010.

The Department's financial management processes are not always adequate to prevent or detect improper payments. For example, in our recent audit of a contract supporting Broad Area Maritime Surveillance, we found DoD personnel did not validate that the contractor was entitled to \$329.3 million it received as of January 12, 2010.¹³ In this case, the contracting officer thought the Contracting Officer Representative was

¹¹ Defense improper payment recovery performance and figures are as reported on <http://paymentaccuracy.gov/>. DoD IG has not validated the reported Defense performance or figures. As required by Executive Order 13520 dated November 20, 2009, "Reducing Improper Payments," the U.S. Department of the Treasury, in coordination with the U.S. Department of Justice and Office of Management and Budget, established this website to create a centralized location to publish information about improper payments made to individuals, organizations, and contractors.

¹² DoD IG analysis of Inspector General, DoD Semiannual Reports to Congress, Appendix D, from October 1, 2005 through March 31, 2011. Figure cited excludes 10 percent of reported questioned cost as Defense Contract Audit Agency provides audit support to other Federal agencies and includes those questioned costs in its overall reporting figures.

¹³ Report No. D-2011-028, "Contract Oversight for the Broad Area Maritime Surveillance Contract Needs Improvement," December 23, 2010

reviewing contractor invoices; however, the Contracting Officer Representative never reviewed any invoices because she did not know it was her duty. Further, since mid 2009, the Defense Contract Audit Agency revoked the contractor's authority to directly bill the Government because of continuing systemic issues with the contractors billing system. Finally, the contractor invoices lacked any detail such as labor hours worked, travel incurred or items produced. When we received some details supporting these bills, we found that the Navy paid \$206,000 in questionable travel expenses such as for a golf outing and air shows in Paris, France, and Singapore.

See figures 1 and 2 for examples of inadequate information on invoices that were paid by the Department on this contract.

Figure 1.

COST VOUCHER (INTERIM)					
- CONTINUATION SHEET					
* = Required Fields					
Contract Number		Delivery Order		Voucher Number	
N0001908C0023				BVN0032	
Item No	Stock #	Unit Price	Unit of Measure	Qty. Invoiced	Amount
0001	NONE	\$22,627,631.34	EA	1	\$22,627,631.34
	Stock Type	ACRN			
	MG	AB			
	SDN				
	AAA				
	Description				
	COST PLUS ITEM				
TOTAL:					\$22,627,631.34

Figure 2.

COST VOUCHER (INTERIM)					
- CONTINUATION SHEET					
* = Required Fields					
Contract Number		Delivery Order	Voucher Number		
N0001908C0023			BVN0039		
Item No	Stock #	Unit Price	Unit of Measure	Qty. Invoiced	Amount
0001	NONE	\$21,797,900.3	EA	1	\$21,797,900.30
	Stock Type	ACRN			
	MG	AB			
	SDN				
	AAA				
		Description			
		COST PLUS ITEM			
TOTAL:					\$21,797,900.30

In another example, for construction contracts in Iraq and Afghanistan, we found that the Air Force improperly paid a bill for \$24.3 million for labor that was not specified in the base contract. Further, we found that the Air Force did not adequately verify that the Department actually received the goods and services listed. During this audit, we also found that invoice reviews did not always occur. The invoices we examined showed multiple discrepancies. One invoice showed a local construction inspector had 630 billable hours in a 27 day billing period. That person would have had to work on average 23.3 hours per day.¹⁴

In 2008, we reported that Government contractors responsible for processing TRICARE overseas health care claims made duplicate payments and overpayments to host-nation providers and to TRICARE beneficiaries.¹⁵ As a result, we estimated that TRICARE Management Agency made inaccurate payments totaling \$14.6 million for overseas health care claims during Fiscal Year 2004 and Fiscal Year 2005. We projected

¹⁴ Report No. D-2010-078, "Air Force Use of Time-and-Materials Contracts in Southwest Asia," August 16, 2010

¹⁵ Report No. D-2008-045, "Controls Over the TRICARE Overseas Healthcare Program," February 7, 2008

TRICARE Management Agency could put \$29.7 million of Defense Health Program funds to better use during the execution of the Fiscal Years 2008 through 2013 Future Years Defense Plan by strengthening internal controls, establishing sound contract surveillance plans, and improving recoupment procedures.

The DoD IG has reported previously about the Department's "pay and chase" practice, where contractors are paid the billed invoice amounts before determining what the correct billing amount should have been. For example, in March 2011 the DoD IG reported that in a contract for subsistence items in Afghanistan, the Department made improper payments by overpaying a contractor \$25.9 million for materiel costs and potentially overpaying \$98.4 million for transportation costs.¹⁶ This occurred because the Defense Logistics Agency was paying the contractor provisional transportation rates for moving food in Afghanistan based on a verbal change order in August 2005. The Defense Logistics Agency continued to pay higher transportation costs even though in 2008, the Defense Contract Audit Agency issued its report questioning provisional transportation costs. The Defense Logistics Agency stated it will resolve the improper payment issues by December 31, 2011.

Enterprise Resource Planning Systems. In an attempt to standardize and develop an effective financial management process throughout the Department, DoD has embarked on various efforts to implement new financial management systems and associated business processes; eliminating over 500 legacy systems that cost hundreds of millions of dollars annually to operate. Those efforts involve implementing new Enterprise Resource Planning (ERP) systems that were capable of handling financial transactions throughout an event's life cycle. An ERP is an automated system using commercial off-the-shelf software consisting of multiple, integrated functional modules that perform a variety of business related tasks such as general ledger accounting, payroll, and supply chain management. These ERP systems should provide the integration needed to minimize system interface problems and provide greater DoD financial visibility. However, based

¹⁶ Report No. D-2011-047, "Improvements Needed in Contract Administration of the Subsistence Prime Vendor Contract for Afghanistan," March 2, 2011

on DoD IG's audits of the General Fund Enterprise Business System and the Logistics Modernization Program, two ERPs that are critical to Army business improvement efforts, it appears DoD may be facing serious challenges in implementing critical ERPs. These systems experienced implementation problems that resulted in incurred cost and schedule growth and the lack of appropriate senior-level governance over their development, test, and implementation.

For example, in 2008 we reported that the Army did not effectively plan the acquisition of General Fund Enterprise Business System integration services which places the program at high risk for incurring schedule delays, exceeding planned costs, and not meeting program objectives.¹⁷ The Army's primary objectives for developing the General Fund Enterprise Business System are to improve financial performance, standardize business processes, ensure that capability exists to meet future financial management needs, and provide Army decision makers with relevant, reliable, and timely financial information. In 2011, the DoD IG reported that the Army estimated it will spend \$2.4 billion over the General Fund Enterprise Business System life cycle; however, the Army had not identified all of the requirements and costs associated with the project. In addition, the Army used unsupported and incomplete lifecycle cost estimates to determine the \$1.4 billion in cost savings and the Army used an inappropriate methodology to determine the estimated \$3.9 billion in benefits for implementing General Fund Enterprise Business System.¹⁸

In another audit of the General Fund Enterprise Business System, we found the Assistant Secretary of the Army (Financial Management and Comptroller) did not provide a detailed data conversion plan. Data conversion is the modification of existing data to enable it to operate with similar capabilities in a different environment. It is a significant part of the financial system implementation in terms of workload, complexity, risk, and cost and is one of the most frequently underestimated tasks. Inadequate planning for data conversion processes may lead to long-term repercussions, including failure to meet

¹⁷ Report No. D-2008-041, "Management of the General Fund Enterprise Business System," January 14, 2008

¹⁸ Report No. D-2011-072, "Previously Identified Deficiencies Not Corrected in the General Fund Enterprise Business System Program," June 15, 2011

program objectives, such as producing auditable financial statements. The General Fund Enterprise Business System Program Management Office provided a data conversion guide; however, the guide did not address data conversion for at least 49 non-Army systems that process Army data. In addition, the guide did not mention how the General Fund Enterprise Business System Program Management Office plans to handle historical transactional data, other than it will not convert it. Without converting historical transactional data for appropriations such as indefinite, multi-year, and no-year funds, the Army could potentially be using the General Fund Enterprise Business System and the legacy systems concurrently for many years.

The Army has also had challenges implementing the Logistics Modernization Program as the Army Working Capital Fund's target system for resolving its long-standing financial reporting problems by modernizing Army logistics business practices and meeting future military readiness requirements. The Logistics Modernization Program provides funds management, weapon system life cycle management, and material supply and service management capabilities. The Army reported to Congress that the Logistics Modernization Program would be the Army Working Capital Fund's system solution for obtaining auditable financial statements. However, in a report in 2011, the DoD IG stated that after more than ten years in development and a cost of \$1.1 billion, the Army has failed to deliver a system that is U.S. Standard General Ledger compliant. Army and DoD financial communities did not establish the appropriate senior-level governance needed to develop, test, and implement the Logistics Modernization Program financial management requirements and processes needed to record Army Working Capital Fund financial data at the transaction level. As a result, Logistics Modernization Program was not substantially compliant with the Federal Financial Management Improvement Act of 1996. The system also did not resolve any of the ten Army Working Capital Fund internal control weaknesses. Therefore, the Army will need to spend additional funds to

comply with U.S. Standard General Ledger requirements and achieve an unqualified audit opinion on its Army Working Capital Fund financial statements.¹⁹

We currently have five ongoing ERP audits, which should provide insight on the status and effectiveness of DoD ERP implementation efforts and provide recommendations that may be useful to DoD managers in mitigating the risks associated with ERP implementation. For four of those five ERP audits, we are focused on evaluating whether the systems comply with the Standard Financial Information Structure. The objective of the remaining ERP audit is to determine whether the appropriate internal controls are in place within the system to record the accounting transactions related to the purchase of goods and services with verifiable audit trails. In FY 2012, we plan to audit two more ERPs and six systems that support DoD financial system improvement efforts.

CHALLENGES TO MEET THE 2017 AUDITABILITY REQUIREMENT

While the Department continues to improve its financial management processes, DoD is far from reaching an unqualified opinion and much more work needs to be accomplished to have auditable financial statements by the 2017 deadline. We have identified future risks that could impact the ability to meet the ambitious 2017 auditability requirement. These risks are: heavy reliance on ERPs; change to accounting standard, and key events that take place close to the 2017 deadline.

Effective ERP Implementation. The successful implementation of ERPs is critical for DoD to meet milestones and transform processes, internal controls and systems needed to provide useful, timely, and complete financial management data and to achieve auditability. The May 2011 FIAR Plan Status Report recognizes that auditability is dependent on successfully deploying ERP systems and interfacing them with other business and financial systems. However, the May 2011 FIAR Plan Status Report did not identify all ERPs and did not include milestones and costs for all ERPs. Additionally, DoD has been unable to meet key milestones for four of eleven Enterprise Resources

¹⁹ Report No. D-2011-015, "Insufficient Governance Over Logistics Modernization Program System Development," November 2, 2010

Planning systems in the Department. Specifically, we found that the Defense Agencies Initiative and the Integrated Personnel Pay System-Army are missing from the list although they are mentioned in other sections of the Plan. The Navy's Future Personnel and Pay Solution, is not in the FIAR Plan at all. As those ERP efforts slip, they may jeopardize the Department's ability to meet the 2017 deadline.

The development, implementation and effectiveness of these ERP systems are questionable at this point. The numerous interfaces between the ERP systems and the existing systems may be overwhelming and currently may not be adequately defined. Each interface presents a risk of the system not functioning as designed thus corrupting data or not exchanging data. The Department needs to ensure ERP system development addresses required business processes and functions and meets established milestones. Further, these systems must actually produce reliable data.

Proposed Change to Accounting Standard. Recording and depreciating the complete cost of assets, including military equipment, has been a long standing challenge for the Department. To resolve this issue, DoD plans to ask the Federal Accounting Standards Advisory Board to allow the Department to expense military equipment rather than record it on the balance sheet. Further, some systems such as the General Fund Enterprise Business System, Navy Enterprise Resource Planning, and the Defense Enterprise Accounting and Management System are being developed assuming this proposed change in accounting standard will occur. If the accounting standard is not changed, additional systems revisions will be necessary before DoD will be auditable. While we cannot speak on behalf of the Federal Accounting Standards Advisory Board, implementing changes in accounting standards often take a long time. The Department will need to work with the Federal Accounting Standards Advisory Board at the earliest possible time to ensure a decision can be made in time for the Department to meet the 2017 deadline and successfully implement the required system changes, if the standard is not changed.

Key Events Take Place Close to the 2017 Deadline. The milestones for the completing some critical financial improvement efforts reported in the May 2011 FIAR Plan Status Report are currently very close to the September 30, 2017, deadline for DoD to validate the financial statements are audit ready. As a result, DoD may not have adequate time to take corrective actions if additional deficiencies are identified, or if ERP implementations are delayed. For example, full deployment of Global Combat Support System - Army is planned for the fourth quarter of Fiscal Year 2017. Also, the Air Force and Defense Logistics Agency do not plan on asserting audit readiness of their Statement of Budgetary Resources until the first and second quarters of Fiscal Year 2017, respectively, and do not plan on completing a validation of this audit readiness assertion until the third and fourth quarters. The Other Defense Organizations do not plan on asserting audit readiness of the Statement of Budgetary Resources until the fourth quarter of Fiscal Year 2017 and do not include any validation of their audit readiness assertion. These milestones may not leave sufficient time for the Statement of Budgetary Resources to be independently verified as being audit ready. Further, because these entities are material to the DoD Agency-wide financial statements, any delay in those statements would likely prevent the Statement of Budgetary Resources, at the DoD Agency-wide level, from being audit ready.

CONCLUSION

Auditable financial statements allow DoD to demonstrate that it has significantly improved financial management over the billions of dollars it receives annually. Although, the Department faces some daunting financial management challenges that must be resolved, the Department continues to make progress in improving its financial management. There is much more to do in order to overcome the pervasive, long standing financial management problems that I have describe today. It is important to note that obtaining and unqualified opinion on DoD's financial statements are a means to a more important end. The real benefit of the financial statement audit comes from the improved data quality, internal controls and systems that make an unqualified opinion possible. Because of these improvements the Department is better positioned to have

accurate and timely financial information on a daily basis to ensure that every dollar supports the warfighters, improves military readiness, and is readily available to key decision makers.

Currently, the Department is devoting significant resources to address these challenges and we are encouraged by the progress they have made. We will continue to provide oversight of these efforts and make recommendations to help move the Department toward meeting their goal of becoming auditable by 2017.

This concludes my statement today and I would be happy to take any questions the Committee may have for me.

Mr. PLATTS. Thank you, Mr. Blair.
Mr. Khan.

STATEMENT OF ASIF KHAN

Mr. KHAN. Chairman Platts, Ranking Member Towns, and Mr. Lankford, good morning. Thank you for having me here. It is a pleasure to be here to discuss DOD financial management and some of the issues they are facing in terms of getting auditable.

At the outset, I would like to thank you for holding this hearing. Focused attention is necessary to be able to solve these challenges.

In my testimony today, I will discuss the status of DOD financial management weaknesses and its effort to resolve them, the challenges DOD continues to face improving its financial management operations. My testimony is based on our prior work at DOD.

Regarding the status, for more than a decade, Congressman Platts, you mentioned, DOD has dominated GAO's list of programs and operations at high-risk due to their vulnerability to waste, fraud, and abuse and mismanagement. In the last 20 years, as a result of significant financial management weaknesses, none of the DOD military services—the Army, Navy, or the Air Force—have been able to prepare auditable financial statements.

DOD's past strategies for improving financial management have generally been ineffective, but recent initiatives are encouraging. Changes to DOD's plan, the Financial Management Improvement and Audit Readiness plan, the FIAR plan, if implemented effectively could result in improved financial management and progress toward auditability.

DOD faces many difficult challenges in overcoming its long-standing financial management weaknesses. I will highlight five of these significant challenges.

First, one of the toughest challenges is sustaining committed leadership. DOD's Comptroller has expressed commitment to the FIAR goals and has established a focused approach to achieving long-term goals that, if implemented correctly, will include interim goals to provide the opportunity for near-term successes on the way to long-term goals. However, within every administration—and, of course, between administrations—there are changes in senior leadership. Therefore, it is paramount for the FIAR plan and other current initiatives to be institutionalized at all working levels within DOD.

Second, weaknesses in DOD's internal controls over financial management are pervasive and a primary factor in the Department's inability to become auditable. DOD has efforts under way to address known internal control weaknesses. However, their effectiveness has not yet been seen. As discussed in our recent report, because of the lack of effective internal controls, the DOD Inspector General disclaimed the opinion of the Marine Corps' fiscal year 2010 Statement of Budgetary Resources, the SBR.

The third challenge I want to cover is a competent financial management work force. With the right skills and knowledge to implement the FIAR plan, analyzing the skills needed and building and retaining such work force are important actions now to ensure continued progress in implementing the goals of the FIAR plan.

The fourth challenge is to assure accountability and effective oversight. To improve efforts, DOD and its components have established senior executive committees and designated officials at appropriate levels to oversee financial improvement. It will be critical for senior leadership at each DOD component to ensure that responsible officials are held accountable to their component's progress. We recently reported that Navy and the Air Force oversight of their implementation plans was not effective, resulting in their incorrectly asserting that they were ready for audit. Both the DOD IG and the Comptroller made the final decision correctly to determine the plans were not ready.

Fifth, Enterprise Resource Planning [ERP], systems are expected to form a core of business information systems in DOD components. According to DOD, their successful implementation is not only critical for addressing long-term weaknesses in financial management but equally important for helping to resolve weaknesses in other high-risk areas such as business transformation, business system modernization, and supply chain management.

The components, however, have largely been unable to implement ERPs that deliver the needed capabilities on schedule and within budget. In a preliminary result from a current review, we identified issues related to ERPs deployed to DFAS, the Defense Finance and Accounting Services, by the Army and the Air Force. DFAS users of the ERP told me they needed to devise manual workarounds and software applications to perform routine tasks. To the degree that ERPs do not provide intended capabilities, the goal of DOD-wide audit readiness by fiscal year 2017 could be in jeopardy.

In closing, I am encouraged by the recent efforts and commitment DOD leaders have shown toward improving the Department's financial management. However, DOD continues to face significant challenges; and success may depend on DOD's ability to sustain and increase its current efforts, commitments, and momentum. Congressional oversight will play an indispensable role in assuming continued progress, and I commend you for holding this hearing.

Mr. Chairman, this concludes my statement. I'll be happy to answer any questions that you or the other Members may have. Thank you.

[The prepared statement of Mr. Kahn follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Government
Organization, Efficiency and Financial Management,
Committee on Oversight and Government Reform,
House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EDT
Friday, September 23, 2011

DOD FINANCIAL MANAGEMENT

Improved Controls, Processes, and Systems Are Needed for Accurate and Reliable Financial Information

Statement of Asif A. Khan, Director
Financial Management and Assurance





Highlights of GAO-11-933T, a testimony before the Subcommittee on Government Organization, Efficiency and Financial Management, Committee on Oversight and Government Reform, U.S. House of Representatives

Why GAO Did This Study

As one of the largest and most complex organizations in the world, the Department of Defense (DOD) faces many challenges in resolving serious problems in its financial management and related business operations and systems. DOD is required by various statutes to (1) improve its financial management processes, controls, and systems to ensure that complete, reliable, consistent, and timely information is prepared and responsive to the financial information needs of agency management and oversight bodies, and (2) to produce audited financial statements.

Over the years, DOD has initiated numerous efforts to improve the department's financial management operations and achieve an unqualified (clean) opinion on the reliability of its reported financial information. These efforts have fallen short of sustained improvement in financial management or financial statement auditability.

The Subcommittee has asked GAO to provide its perspective on the status of DOD's financial management weaknesses and its efforts to resolve them.

View GAO-11-933T. For more information, contact Asif A. Khan at (202) 512-9869 or khana@gao.gov.

September 23, 2011

DOD FINANCIAL MANAGEMENT

Improved Controls, Processes, and Systems Are Needed for Accurate and Reliable Financial Information

What GAO Found

DOD financial management has been on GAO's high-risk list since 1995 and, despite several reform initiatives, remains on the list today. Pervasive deficiencies in financial management processes, systems, and controls, and the resulting lack of data reliability, continue to impair management's ability to assess the resources needed for DOD operations; track and control costs; ensure basic accountability; anticipate future costs; measure performance; maintain funds control; and reduce the risk of loss from fraud, waste, and abuse. DOD spends billions of dollars each year to maintain key business operations intended to support the warfighter, including systems and processes related to the management of contracts, finances, the supply chain, support infrastructure, and weapon systems acquisition. These operations are directly impacted by the problems in financial management. In addition, the long-standing financial management weaknesses have precluded DOD from being able to undergo the scrutiny of a financial statement audit.

DOD's past strategies for improving its financial management were ineffective, but recent initiatives are encouraging. In 2005, DOD issued its Financial Improvement and Audit Readiness (FIAR) Plan for improving financial management and reporting. In 2009, the DOD Comptroller directed that FIAR efforts focus on financial information in two priority areas: budget and mission-critical assets. The FIAR Plan also has a new phased approach that comprises five waves of concerted improvement activities. The first three waves focus on the two priority areas, and the last two on working toward full auditability. The plan is being implemented largely through the Army, Navy, and Air Force military departments and the Defense Logistics Agency, lending increased importance to the commitment of component leadership.

Improving the department's financial management operations and thereby providing DOD management and Congress more accurate and reliable information on the results of its business operations will not be an easy task. It is critical that current initiatives related to improving the efficiency and effectiveness of financial management that have the support of the DOD's Deputy Chief Management Officer and Comptroller continue with sustained leadership and monitoring.

Absent continued momentum and necessary future investments, current initiatives may falter. Below are some of the key challenges that DOD must address for its financial management to improve to the point where DOD is able to produce auditable financial statements:

- committed and sustained leadership,
- effective plan to correct internal control weaknesses,
- competent financial management workforce,
- accountability and effective oversight,
- well-defined enterprise architecture, and
- successful implementation of the enterprise resource planning systems.

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here today to discuss the status of the Department of Defense's (DOD) efforts to improve its financial management operations and achieve audit readiness. At the outset, I would like to thank the Subcommittee for holding this hearing and to acknowledge the important role of such hearings in the oversight of DOD's financial management efforts.

DOD is one of the largest and most complex organizations in the world. For fiscal year 2012, the budget requested for the department was approximately \$671 billion—\$553 billion in discretionary budget authority and \$118 billion to support overseas contingency operations. The fiscal year 2012 budget request also noted that DOD employed over 3 million military and civilian personnel—including active and reserve service members. DOD operations span a wide range of defense organizations, including the military departments and their respective major commands and functional activities, large defense agencies and field activities, and various combatant and joint operational commands that are responsible for military operations for specific geographic regions or theaters of operation. To execute its operations, the department performs interrelated and interdependent business functions, including financial management, logistics management, health care management, and procurement. To support its business functions, DOD has reported that it relies on over 2,200 business systems,¹ including accounting, acquisition, logistics, and personnel systems.

The department's sheer size and complexity contribute to the many challenges DOD faces in resolving its pervasive, complex, and long-standing financial management and related business operations and systems problems. Numerous initiatives and efforts have been undertaken by DOD and its components to improve the department's financial management operations and to arrive at a point where the reliability of its financial statements and related financial management information would be sufficient to pass an audit with favorable (clean)

¹DOD excludes from its business systems those designated as national security systems under section 2222(j) of Title 10, United States Code. National security systems are intelligence systems, cryptologic activities related to national security, military command and control systems, and equipment that is an integral part of a weapon or weapons system or is critical to the direct fulfillment of military or intelligence missions.

audit opinions. To date, DOD has not achieved effective financial management capabilities or financial statement auditability.²

Today, I will discuss the status of DOD's financial management weaknesses, its efforts to resolve those weaknesses, and the challenges DOD continues to face in its efforts to improve its financial management operations. In addition, I will outline the status of the department's efforts to implement its Enterprise Resource Planning (ERP) systems,³ which represent a critical element of the department's Financial Improvement and Audit Readiness (FIAR) strategy. My statement today is based on our prior work related to the department's FIAR Plan⁴ and ERP implementation efforts.⁵ Our work was conducted in accordance with generally accepted government auditing standards and our previously published reports contain additional details on the scope and methodology for those reviews. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

²DOD's auditors have reported material financial management weaknesses in the following areas: (1) Financial Management Systems, (2) Fund Balance with Treasury, (3) Accounts Receivable, (4) Inventory, (5) Operating Materials and Supplies, (6) General Property, Plant, and Equipment, (7) Government-Furnished Material and Contractor-Acquired Material, (8) Accounts Payable, (9) Environmental Liabilities, (10) Statement of Net Cost, (11) Intragovernmental Eliminations, (12) Other Accounting Entries, and (13) Reconciliation of Net Cost of Operations to Budget.

³An ERP system uses commercial off-the-shelf (COTS) software consisting of multiple, integrated functional modules that perform a variety of business related tasks such as general ledger accounting, payroll, and supply chain management.

⁴GAO, *Financial Management: Achieving Financial Statement Auditability in the Department of Defense*, GAO-09-373 (Washington, D.C.: May 6, 2009).

⁵GAO, *DOD Business Transformation: Improved Management and Oversight of Business Modernization Efforts Needed*, GAO-11-53 (Washington, D.C.: Oct. 7, 2010); *Defense Logistics: Actions Needed to Improve Implementation of the Army Logistics Modernization Program*, GAO-10-461 (Washington, D.C.: Apr. 30, 2010); *DOD Business Transformation: Air Force's Current Approach Increases Risk That Asset Visibility Goals and Transformation Priorities Will Not Be Achieved*, GAO-08-866 (Washington, D.C.: Aug. 8, 2008); *DOD Business Systems Modernization: Important Management Controls Being Implemented on Major Navy Program, but Improvements Needed in Key Areas*, GAO-08-896 (Washington, D.C.: Sept. 8, 2008); and *DOD Business Transformation: Lack of an Integrated Strategy Puts the Army's Asset Visibility System Investments at Risk*, GAO-07-860 (Washington, D.C.: July 27, 2007).

Background

The department is facing near and long-term internal fiscal pressures as it attempts to balance competing demands to support ongoing operations, rebuild readiness following extended military operations, and manage increasing personnel and health care costs as well as significant cost growth in its weapon systems programs. For more than a decade, DOD has dominated GAO's list of federal programs and operations at high risk of being vulnerable to fraud, waste, abuse.⁶ In fact, all of the DOD programs on GAO's High-Risk List relate to business operations, including systems and processes related to management of contracts, finances, the supply chain, and support infrastructure,⁷ as well as weapon systems acquisition. Long-standing and pervasive weaknesses in DOD's financial management and related business processes and systems have (1) resulted in a lack of reliable information needed to make sound decisions and report on the financial status and cost of DOD activities to Congress and DOD decision makers; (2) adversely impacted its operational efficiency and mission performance in areas of major weapons system support and logistics; and (3) left the department vulnerable to fraud, waste, and abuse.

Because of the complexity and long-term nature of DOD's transformation efforts, GAO has reported the need for a chief management officer (CMO) position and a comprehensive, enterprisewide business transformation plan. In May 2007, DOD designated the Deputy Secretary of Defense as the CMO. In addition, the National Defense Authorization Acts for fiscal years 2008 and 2009 contained provisions that codified the CMO and Deputy Chief Management Officer (DCMO) positions, required DOD to develop a strategic management plan, and required the Secretaries of the military departments to designate their Undersecretaries as CMOs and to develop business transformation plans.

⁶DOD bears responsibility, in whole or in part, for 14 of the 30 federal programs or activities that GAO has identified as being at high risk of waste, fraud, abuse, and mismanagement. The seven specific DOD high-risk areas are (1) approach to business transformation, (2) business systems modernization, (3) contract management, (4) financial management, (5) supply chain management, (6) support infrastructure management, and (7) weapon systems acquisition. The seven governmentwide high-risk areas that include DOD are: (1) disability programs, (2) interagency contracting, (3) information systems and critical infrastructure, (4) information sharing for homeland security, (5) human capital, (6) real property, and (7) ensuring the effective protection of technologies critical to U.S. national security interests.

⁷Support infrastructure includes categories such as installations, central logistics, the defense health program, and central training.

Overview of DOD's Accounting and Finance Activities

DOD financial managers are responsible for the functions of budgeting, financing, accounting for transactions and events, and reporting of financial and budgetary information. To maintain accountability over the use of public funds, DOD must carry out financial management functions such as recording, tracking, and reporting its budgeted spending, actual spending, and the value of its assets and liabilities. DOD relies on a complex network of organizations and personnel to execute these functions. Also, its financial managers must work closely with other departmental personnel to ensure that transactions and events with financial consequences, such as awarding and administering contracts, managing military and civilian personnel, and authorizing employee travel, are properly monitored, controlled, and reported, in part, to ensure that DOD does not violate spending limitations established by statute or other legal provisions regarding the use of funds.

Before fiscal year 1991, the military services and defense agencies independently managed their finance and accounting operations. According to DOD, these decentralized operations were highly inefficient and failed to produce reliable information. On November 26, 1990, DOD created the Defense Finance and Accounting Service (DFAS) as its accounting agency to consolidate, standardize, and integrate finance and accounting requirements, functions, procedures, operations, and systems. The military services and defense agencies pay for finance and accounting services provided by DFAS using their operations and maintenance appropriations. The military services continue to perform certain finance and accounting activities at each military installation. These activities vary by military service depending on what the services wanted to maintain in-house and the number of personnel they were willing to transfer to DFAS. As DOD's accounting agency, DFAS records these transactions in the accounting records, prepares thousands of reports used by managers throughout DOD and by the Congress, and prepares DOD-wide and service-specific financial statements. The military services play a vital role in that they authorize the expenditure of funds and are the source of most of the financial information that allows DFAS to make payroll and contractor payments. The military services also have responsibility over most of DOD's assets and the related

information needed by DFAS to prepare annual financial statements required under the Chief Financial Officers Act.⁸

DOD accounting personnel are responsible for accounting for funds received through congressional appropriations, the sale of goods and services by working capital fund businesses, revenue generated through nonappropriated fund activities, and the sales of military systems and equipment to foreign governments or international organizations. DOD's finance activities generally involve paying the salaries of its employees, paying retirees and annuitants, reimbursing its employees for travel-related expenses, paying contractors and vendors for goods and services, and collecting debts owed to DOD. DOD defines its accounting activities to include accumulating and recording operating and capital expenses as well as appropriations, revenues, and other receipts. According to DOD's fiscal year 2012 budget request, in fiscal year 2010 DFAS

- processed approximately 198 million payment-related transactions and disbursed over \$578 billion;
- accounted for 1,129 active DOD appropriation accounts; and
- processed more than 11 million commercial invoices.

Pervasive Financial Management Problems Continue to Affect the Efficiency and Effectiveness of DOD Operations

DOD financial management was designated as a high-risk area by GAO in 1995. Pervasive deficiencies in financial management processes, systems, and controls, and the resulting lack of data reliability, continue to impair management's ability to assess the resources needed for DOD operations; track and control costs; ensure basic accountability; anticipate future costs; measure performance; maintain funds control; and reduce the risk of loss from fraud, waste, and abuse.

Other business operations, including the high-risk areas of contract management, supply chain management, support infrastructure management, and weapon systems acquisition are directly impacted by the problems in financial management. We have reported that continuing weaknesses in these business operations result in billions of dollars of wasted resources, reduced efficiency, ineffective performance, and

⁸Sec. 31 U.S.C. §3515(a),(c); OMB Bulletin No. 07-04, *Audit Requirements For Federal Financial Statements*, Appendix B (Sept. 4, 2007).

inadequate accountability. Examples of the pervasive weaknesses in the department's business operations are highlighted below.

- DOD invests billions of dollars to acquire weapon systems, but it lacks the financial management processes and capabilities it needs to track and report on the cost of weapon systems in a reliable manner. We reported on this issue over 20 years ago,⁹ but the problems continue to persist. In July 2010, we reported¹⁰ that although DOD and the military departments have efforts underway to begin addressing these financial management weaknesses, problems continue to exist and remediation and improvement efforts would require the support of other business areas beyond the financial community before they could be fully addressed.
- DOD also requests billions of dollars each year to maintain its weapon systems, but it has limited ability to identify, aggregate, and use financial management information for managing and controlling operating and support costs. Operating and support costs can account for a significant portion of a weapon system's total life-cycle costs, including costs for repair parts, maintenance, and contract services. In July 2010, we reported¹¹ that the department lacked key information needed to manage and reduce operating and support costs for most of the weapon systems we reviewed¹²—including cost estimates and historical data on actual operating and support costs. For acquiring and maintaining weapon systems, the lack of complete and reliable financial information hampers DOD officials in analyzing the rate of cost growth, identifying cost drivers, and developing plans for managing and controlling these costs. Without timely, reliable, and useful financial information on cost, DOD management lacks information needed to accurately report on acquisition costs, allocate resources to programs, or evaluate program performance.

⁹GAO, *Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources*, GAO/AFMD 90-23 (Washington, D.C.: Feb. 23, 1990).

¹⁰GAO, *Department of Defense: Additional Actions Needed to Improve Financial Management of Military Equipment*, GAO-10-695 (Washington, D.C. July 26, 2010).

¹¹GAO, *Defense Management: DOD Needs Better Information and Guidance to More Effectively Manage and Reduce Operating and Support Costs of Major Weapon Systems*, GAO-10-717 (Washington, D.C.: July 20, 2010).

¹²GAO reviewed the following seven major aviation systems: the Navy's F/A-18E/F; the Air Force's F-22A, B-1B, and F-15E; and the Army's AH-64D, CH-47D, and UH-60L.

-
- In June 2010, we reported¹³ that the Army Budget Office lacked an adequate funds control process to provide it with ongoing assurance that obligations and expenditures do not exceed funds available in the Military Personnel—Army (MPA) appropriation. We found that an obligation of \$200 million in excess of available funds in the Army's military personnel account violated the Antideficiency Act. The overobligation likely stemmed, in part, from lack of communication between Army Budget and program managers so that Army Budget's accounting records reflected estimates instead of actual amounts until it was too late to control the incurrence of excessive obligations in violation of the act. Thus, at any given time in the fiscal year, Army Budget did not know the actual obligation and expenditure levels of the account. Army Budget explained that it relies on estimated obligations—despite the availability of actual data from program managers—because of inadequate financial management systems. The lack of adequate process and system controls to maintain effective funds control impacted the Army's ability to prevent, identify, correct, and report potential violations of the Antideficiency Act.
 - In our February 2011 report¹⁴ on the Defense Centers of Excellence (DCOE), we found that DOD's TRICARE Management Activity (TMA) had misclassified \$102.7 million of the nearly \$112 million in DCOE advisory and assistance contract obligations. The proper classification and recording of costs are basic financial management functions that are also key in analyzing areas for potential future savings.

Without adequate financial management processes, systems, and controls, DOD components are at risk of reporting inaccurate, inconsistent, and unreliable data for financial reporting and management decision making and potentially exceeding authorized spending limits. The lack of effective internal controls hinders management's ability to have reasonable assurance that their allocated resources are used effectively, properly, and in compliance with budget and appropriations law.

¹³GAO, *Department of the Army—The Fiscal Year 2008 Military Personnel Army Appropriation and the Antideficiency Act*, B-318724 (Washington, D.C.: June 22, 2010).

¹⁴GAO, *Defense Health: Management Weaknesses at Defense Centers of Excellence for Psychological Health and Traumatic Brain Injury Require Attention*, GAO-11-219 (Washington, D.C.: Feb. 28, 2011).

**DOD's Past Strategies
for Improving
Financial
Management Were
Ineffective but Recent
Initiatives are
Encouraging**

Over the years, DOD has initiated several broad-based reform efforts to address its long-standing financial management weaknesses. However, as we have reported, those efforts did not achieve their intended purpose of improving the department's financial management operations. In 2005, the DOD Comptroller established the DOD FIAR Directorate to develop, manage, and implement a strategic approach for addressing the department's financial management weaknesses and for achieving auditability, and to integrate those efforts with other improvement activities, such as the department's business system modernization efforts. In May 2009,¹⁵ we identified several concerns with the adequacy of the FIAR Plan as a strategic and management tool to resolve DOD's financial management difficulties and thereby position the department to be able to produce auditable financial statements.

Overall, since the issuance of the first FIAR Plan in December 2005, improvement efforts have not resulted in the fundamental transformation of operations necessary to resolve the department's long-standing financial management deficiencies. However, DOD has made significant improvements to the FIAR Plan that, if implemented effectively, could result in significant improvement in DOD's financial management and progress toward auditability, but progress in taking corrective actions and resolving deficiencies remains slow. While none of the military services has obtained an unqualified (clean) audit opinion, some DOD organizations, such as the Army Corps of Engineers, DFAS, the Defense Contract Audit Agency, and the DOD Office of Inspector General, have achieved this goal. Moreover, some DOD components that have not yet received clean audit opinions are beginning to reap the benefits of strengthened controls and processes gained through ongoing efforts to improve their financial management operations and reporting capabilities. Lessons learned from the Marine Corps' Statement of Budgetary Resources audit effort can provide a roadmap to help other components better stage their audit readiness efforts by strengthening their financial management processes to increase data reliability as they develop action plans to become audit ready.

In August 2009, DOD's Comptroller sought to further focus efforts of the department and components, in order to achieve certain short- and long-

¹⁵GAO, *Financial Management: Achieving Financial Statement Auditability in the Department of Defense*, GAO-09-373 (Washington, D.C.: May 6, 2009).

term results, by giving priority to improving processes and controls that support the financial information most often used to manage the department. Accordingly, DOD revised its FIAR strategy and methodology to focus on the DOD Comptroller's two priorities—budgetary information and asset accountability. The first priority is to strengthen processes, controls, and systems that produce DOD's budgetary information and the department's Statements of Budgetary Resources. The second priority is to improve the accuracy and reliability of management information pertaining to the department's mission-critical assets, including military equipment, real property, and general equipment, and validating improvement through existence and completeness testing. The DOD Comptroller directed the DOD components participating in the FIAR Plan—the departments of the Army, the Navy, and the Air Force and the Defense Logistics Agency—to use a standard process and aggressively modify their activities to support and emphasize achievement of the priorities.

GAO supports DOD's current approach of focusing and prioritizing efforts in order to achieve incremental progress in addressing weaknesses and making progress toward audit readiness. Budgetary and asset information is widely used by DOD managers at all levels, so its reliability is vital to daily operations and management. DOD needs to provide accountability over the existence and completeness of its assets. Problems with asset accountability can further complicate critical functions, such as planning for the current troop withdrawals.

In May 2010, DOD introduced a new phased approach that divides progress toward achieving financial statement auditability into five waves (or phases) of concerted improvement activities (see appendix I). According to DOD, the components' implementation of the methodology described in the 2010 FIAR Plan is essential to the success of the department's efforts to ultimately achieve full financial statement auditability. To assist the components in their efforts, the FIAR Guidance, issued along with the revised plan, details the implementation of the methodology with an emphasis on internal controls and supporting documentation that recognizes both the challenge of resolving the many internal control weaknesses and the fundamental importance of establishing effective and efficient financial management. The FIAR Guidance provides the process for the components to follow, through their individual Financial Improvement Plan (FIP), in assessing processes, controls, and systems; identifying and correcting weaknesses; assessing, validating, and sustaining corrective actions; and achieving full auditability. The guidance directs the components to identify responsible

organizations and personnel and resource requirements for improvement work. In developing their plans, components use a standard template that comprises data fields aligned to the methodology. The consistent application of a standard methodology for assessing the components' current financial management capabilities can help establish valid baselines against which to measure, sustain, and report progress.

Numerous Challenges Must Be Addressed In Order For DOD to Successfully Reform Financial Management

Improving the department's financial management operations and thereby providing DOD management and the Congress more accurate and reliable information on the results of its business operations will not be an easy task. It is critical that the current initiatives being led by the DOD DCMO and the DOD Comptroller be continued and provided with sufficient resources and ongoing monitoring in the future. Absent continued momentum and necessary future investments, the current initiatives may falter, similar to previous efforts. Below are some of the key challenges that the department must address in order for the financial management operations of the department to improve.

Committed and sustained leadership. The FIAR Plan is in its sixth year and continues to evolve based on lessons learned, corrective actions, and policy changes that refine and build on the plan. The DOD Comptroller has expressed commitment to the FIAR goals, and established a focused approach that is intended to help DOD achieve successes in the near term. But the financial transformation needed at DOD, and its removal from GAO's high-risk list, is a long-term effort. Improving financial management will need to be a cross-functional endeavor; requiring improvements in some of DOD's other business operations such as those in the high-risk areas of contract management, supply chain management, support infrastructure management, and weapon systems acquisition. As acknowledged by DOD officials, sustained and active involvement of the department's CMO, the DCMO, the military departments' CMOs, the DOD Comptroller, and other senior leaders is critical. Within every administration, there are changes at the senior leadership; therefore, it is paramount that the current initiative be institutionalized throughout the department—at all working levels—in order for success to be achieved.

Effective plan to correct internal control weaknesses. In May 2009, we reported¹⁶ that the FIAR Plan did not establish a baseline of the department's state of internal control and financial management weaknesses as its starting point. Such a baseline could be used to assess and plan for the necessary improvements and remediation to be used to measure incremental progress toward achieving estimated milestones for each DOD component and the department. DOD currently has efforts underway to address known internal control weaknesses through three integrated programs: (1) Internal Controls over Financial Reporting (ICOFR) program, (2) ERP implementation, and (3) FIAR Plan. However, the effectiveness of these three integrated efforts at establishing a baseline remains to be seen. As discussed in our recent report,¹⁷ the lack of effective internal controls, in part, contributed to the DOD Inspector General issuing a disclaimer of opinion¹⁸ on the Marine Corps' fiscal year 2010 Statement of Budgetary Resources (SBR). The auditors reported that ineffective internal control and ineffective controls in key financial systems should be addressed to ensure the reliability of reported financial information.¹⁹ Examples of the problems identified include the following:

- The Marine Corps did not have effective controls in place to support estimated obligations, referred to as "bulk obligations," to record a payment liability, and, as a result, was not able to reconcile the related payment transactions to the estimates. The Marine Corps estimates obligations in a bulk amount to record payment liabilities where it does not have a mechanism to identify authorizing documentation as a basis for recording the obligations.

¹⁶GAO-09-373.

¹⁷GAO, *DOD Financial Management: Marine Corps Statement of Budgetary Resources Audit Results and Lessons Learned*, GAO-11-830 (Washington, D.C.: Sept. 15, 2011).

¹⁸In a disclaimer of opinion, the auditor does not express an opinion on the financial statements. A disclaimer of opinion is appropriate when the audit scope is not sufficient to enable the auditor to express an opinion, or when there are material uncertainties involving a scope limitation—a situation where the auditor is unable to obtain sufficient appropriate audit evidence.

¹⁹Internal control comprises the plans, methods, and procedures to provide reasonable assurance that objectives are being achieved in the following areas: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations.

-
- The auditors found ineffective controls over three major information technology systems used by the Marine Corps and reported numerous problems that required resolution.²⁰ For example, the auditors identified a lack of controls over interfaces between systems to ensure completeness of the data being transferred. System interface controls are critical for ensuring the completeness and accuracy of data transferred between systems.

The report also noted that the Marine Corps did not develop an overall corrective action or remediation plan that includes key elements of a risk-based plan. Instead, its approach focuses on short-term corrective actions based on manually intensive efforts to produce reliable financial reporting at year-end. Such efforts may not result in sustained improvements over the long term that would help ensure that the Marine Corps could routinely produce sound data on a timely basis for decision making. We previously reported that using principles of risk management helps policymakers make informed decisions about best ways to prioritize investments, so that the investments target the areas of greatest need.²¹ However, we found that the Marine Corps' SBR Remediation Plan focused on individual initiatives to address 70 auditor Notices of Findings and Recommendations that included 139 recommendations, without assessing risks, prioritizing actions, or ensuring that actions adequately responded to recommendations.²² Further, the plan did not identify

²⁰The three systems are the Marine Corps Total Force System (MCTFS), which is an integrated military personnel and payroll system; the Standard Accounting, Budgeting, Reporting System (SABRS), which is the Marine Corps' general ledger accounting system; and the Defense Departmental Reporting System (DDRS), which is a DOD-wide financial reporting system.

²¹GAO, *Defense Business Transformation: DOD Needs To Take Additional Actions to Further Define Key Management Roles, Develop Measurable Goals, and Align Planning Efforts*, GAO-11-181R (Washington, D.C.: Jan. 26, 2011); and *Risk Management: Strengthening the Use of Risk Management Principles at Homeland Security*, GAO-08-904T (Washington, D.C.: June 25, 2008).

²²The Marine Corps SBR Remediation Plan consists of a written plan covering the initial 11 financial statement process notices of findings and recommendations (NFR) to comply with DOD IG audit requirements and 59 additional NFRs that were addressed in separate plans of action and milestones.

resources, roles and responsibilities, or include performance indicators to measure performance against action plan objectives.²³

Given the current efforts, goals, and timeframes for achieving auditability of the Marine Corps' Fiscal Year 2011 SBR, the current approach is understandably focused on short-term actions. However, achieving financial accountability that is sustainable in the long term will require reliable financial systems and sound internal controls. An effective remediation plan would help ensure that audit recommendations are fully addressed to deal with the short-term and long-term goals.

The Marine Corps reported that actions on 88 of the 139 recommendations, including weaknesses related to accounting and financial reporting and information technology systems were fully implemented; however, the completeness and effectiveness of most Marine Corps' actions have not yet been tested. DOD Inspector General auditors told us that tests performed during the Marine Corps' fiscal year 2011 SBR audit effort will determine whether and to what extent the problems identified during the fiscal year 2010 SBR audit effort have been resolved. They also confirmed that as of August 25, 2011, the Marine Corps had remediated the problems on 11 of the information technology audit recommendations.

Because of the department's complexity and magnitude, developing and implementing a comprehensive plan that identifies DOD's internal control weaknesses will not be an easy task. But it is a task that is critical to resolving the long-standing weaknesses and will require consistent management oversight and monitoring for it to be successful.

Competent financial management workforce. Effective financial management in DOD will require a knowledgeable and skilled workforce that includes individuals who are trained and certified in accounting, well versed in government accounting practices and standards, and experienced in information technology. Hiring and retaining such a skilled workforce is a challenge DOD must meet to succeed in its transformation to efficient, effective, and accountable business operations. The National

²³Some of these elements are consistent with the FIAR Guidance requirements for a corrective action plan, such as identifying required resources and ensuring that actions address the identified deficiencies.

Defense Authorization Act for Fiscal Year 2006²⁴ directed DOD to develop a strategic plan to shape and improve the department's civilian workforce. The plan was to, among other things; include assessments of (1) existing critical skills and competencies in DOD's civilian workforce, (2) future critical skills and competencies needed over the next decade, and (3) any gaps in the existing or future critical skills and competencies identified. In addition, DOD was to submit a plan of action for developing and reshaping the civilian employee workforce to address any identified gaps, as well as specific recruiting and retention goals and strategies on how to train, compensate, and motivate civilian employees. In developing the plan, the department identified financial management as one of its enterprisewide mission-critical occupations.

In July 2011, we reported²⁵ that DOD's 2009 overall civilian workforce plan had addressed some legislative requirements, including assessing the critical skills of its existing civilian workforce. Although some aspects of the legislative requirements were addressed, DOD still has significant work to do. For example, while the plan included gap analyses related to the number of personnel needed for some of the mission-critical occupations, the department had only discussed competency gap analyses for 3 mission-critical occupations—language, logistics management, and information technology management. A competency gap for financial management was not included in the department's analysis. Until DOD analyzes personnel needs and gaps in the financial management area, it will not be in a position to develop an effective financial management recruitment, retention, and investment strategy to successfully address its financial management challenges.

Accountability and effective oversight. The department established a governance structure for the FIAR Plan, which includes review bodies for governance and oversight. The governance structure is intended to provide the vision and oversight necessary to align financial improvement and audit readiness efforts across the department. As noted in our recent

²⁴Pub. L. No. 109-163, div. A, § 1122, 119 Stat. 3136, 3452 (Jan. 6, 2006). The National Defense Authorization Act for Fiscal Year 2010 made this strategic plan into an annual requirement. Pub. L. No. 111-84, div. A, § 1108, 123 Stat. 2190, 2488 (Oct. 28, 2009), *codified at* 10 U.S.C. § 115b.

²⁵GAO, *DOD Civilian Personnel: Competency Gap Analysis and Other Actions Needed to Enhance DOD's Strategic Workforce Plans*, GAO-11-827T (Washington, D.C.: July 14, 2011).

report,²⁶ both DOD and the components have established senior executive committees as well as designated officials at the appropriate levels to monitor and oversee their financial improvement efforts. These committees and individuals have also generally been assigned appropriate roles and responsibilities. To monitor progress and hold individuals accountable for progress, DOD managers and oversight bodies need reliable, valid, meaningful metrics to measure performance and the results of corrective actions. In May 2009, we reported²⁷ that the FIAR Plan did not have clear results-oriented metrics. To its credit, DOD has taken action to begin defining results-oriented FIAR metrics it intends to use to provide visibility of component-level progress in assessment; and testing and remediation activities, including progress in identifying and addressing supporting documentation issues. We have not yet had an opportunity to assess implementation of these metrics—including the components' control over the accuracy of supporting data—or their usefulness in monitoring and redirecting actions.

Ensuring effective monitoring and oversight of progress—especially by the leadership in the components—will be key to bringing about effective implementation, through the components' FIPs. However, as noted in our recent report,²⁸ we found that weaknesses in the Navy and Air Force FIAR Plan implementation efforts indicate that the monitoring and oversight of such efforts have not been effective. More specifically, we found that component officials as well as the oversight committees at both the component and DOD levels did not effectively carry out their monitoring responsibilities for the Navy Civilian Pay and Air Force Military Equipment FIPs. For the two FIPs that we reviewed, neither individual officials nor the executive committees took sufficient action to ensure that the FIPs were accurate or complied with the FIAR Guidance. As a result, the Navy concluded that its Civilian Pay was ready for audit, as did the Air Force with respect to its Military Equipment, even though they did not have sufficient support to assert audit readiness.

²⁶GAO, *DOD Financial Management: Improvement Needed in DOD Components' Implementation of Audit Readiness Efforts*, GAO-11-851 (Washington, D.C.: Sept. 13, 2011).

²⁷GAO-09-373.

²⁸GAO-11-851.

On the other hand, once the Navy and Air Force submitted the FIPs to DOD in support of their audit readiness assertions, both the DOD Inspector General and the DOD Comptroller carried out their responsibilities for reviewing the FIPs. In their reviews, both organizations identified issues with the FIPs that were similar to those we had identified. The DOD Comptroller, who makes the final determination as to whether an assessable unit is ready for audit, concluded that neither of these FIPs supported audit readiness.

Effective oversight and monitoring would also help ensure that lessons learned from recent efforts would be sufficiently disseminated throughout the department and applied to other financial improvement efforts. In commenting on our report about the FIPs, the DOD Comptroller stated that it is critical that the department continues to look at how effectively it applies lessons learned.

Furthermore, effective oversight holds individuals accountable for carrying out their responsibilities. DOD has introduced incentives such as including FIAR goals in Senior Executive Service Performance Plans, increased reprogramming thresholds granted to components that receive a positive audit opinion on their Statement of Budgetary Resources, audit costs funded by the Office of the Secretary of Defense after a successful audit, and publicizing and rewarding components for successful audits. The challenge now is to evaluate and validate these and other incentives to determine their effectiveness and whether the right mix of incentives has been established.

Well-defined enterprise architecture. For decades, DOD has been challenged in modernizing its timeworn business systems. Since 1995, we have designated DOD's business systems modernization program as high risk. Between 2001 and 2005, we reported that the modernization program had spent hundreds of millions of dollars on an enterprise architecture and investment management structures that had limited value. Accordingly, we made explicit architecture and investment management-related recommendations. Congress included provisions in the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 that were consistent with our recommendations. In response, DOD continues to take steps to comply with the act's provisions and to satisfy relevant system modernization management guidance. Collectively, these steps address best practices in implementing the statutory provisions concerning the business enterprise architecture and review of systems costing in excess of \$1 million. However, long-standing challenges that we previously identified remain to be addressed. Specifically, while DOD

continues to release updates to its corporate enterprise architecture, the architecture has yet to be federated²⁹ through development of aligned subordinate architectures for each of the military departments. In this regard, each of the military departments has made progress in managing its respective architecture program, but there are still limitations in the scope and completeness, as well as the maturity of the military departments' architecture programs. For example, while each department has established or is in the process of establishing an executive committee with responsibility and accountability for the enterprise architecture, none has fully developed an enterprise architecture methodology or a well-defined business enterprise architecture and transition plan to guide and constrain business transformation initiatives. In addition, while DOD continues to establish investment management processes, the DOD enterprise and the military departments' approaches to business systems investment management still lack the defined policies and procedures to be considered effective investment selection, control, and evaluation mechanisms. Until DOD fully implements these longstanding institutional modernization management controls its business systems modernization will likely remain a high-risk program.

Successful implementation of the ERPs. The department has invested billions of dollars and will invest billions more to implement the ERPs. The implementation of an integrated, audit-ready systems environment through the deployment of ERP systems underlies all of DOD's financial improvement efforts and is crucial to achieving departmentwide audit readiness. According to DOD, the successful implementation of the ERPs is not only critical for addressing long-standing weaknesses in financial management, but equally important for helping to resolve weaknesses in other high-risk areas such as business transformation, business system modernization, and supply chain management. Successful implementation will support DOD by standardizing and streamlining its financial management and accounting systems, integrating multiple logistics systems and finance processes, providing asset visibility for accountable items, and integrating personnel and pay systems. Previously, we reported that delays in the successful implementation of ERPs have extended the use of existing duplicative, stovepiped systems, and have continued the funding of these systems longer than

²⁹A federated architecture consists of a family of coherent but distinct member architectures in which subsidiary architectures conform to an overarching corporate architectural view and rule set.

anticipated.³⁰ To the degree that these business systems do not provide the intended capabilities, DOD's goal of departmentwide audit readiness by the end of fiscal year 2017 could be jeopardized.

Over the years we have reported³¹ that the department has not effectively employed acquisition management controls to help ensure the ERPs deliver the promised capabilities on time and within budget. As we reported in October 2010, DOD has identified 10 ERPs—1 of which had been fully implemented—as essential to its efforts to transform its business operations.³² We are currently reviewing the status of two of these ERPs—the Army's General Fund Enterprise Business System (GFEBS) and the Air Force's Defense Enterprise Accounting and Management System (DEAMS). GFEBS is intended to support the Army's standardized financial management and accounting practices for the Army's general fund, except for funds related to the Army Corps of Engineers. The Army estimates that GFEBS will be used to control and account for approximately \$140 billion in annual spending. DEAMS is intended to provide the Air Force with the entire spectrum of financial management capabilities and is expected to maintain control and accountability for approximately \$160 billion. GFEBS is expected to be fully deployed during fiscal year 2012, is currently operational at 154 locations, including DFAS, and is being used by approximately 35,000 users. DEAMS is expected to be fully deployed during fiscal year 2016, is currently operational at Scott Air Force Base and DFAS, and is being used by about 1,100 individuals.

³⁰GAO, *DOD Business Transformation: Improved Management Oversight of Business System Modernization Efforts Needed*, GAO-11-53 (Washington, D.C.: Oct. 7, 2010).

³¹GAO-10-481; *DOD Business Systems Modernization: Navy Implementing a Number of Key Management Controls on Enterprise Resource Planning System, but Improvements Still Needed*, GAO-09-841 (Washington, D.C.: Sept. 15, 2009); GAO-08-896; GAO-08-866; *DOD Business Systems Modernization: Key Marine Corps System Acquisition Needs to Be Better Justified, Defined, and Managed*, GAO-08-822 (Washington, D.C.: July 28, 2008); GAO-07-860.

³²GAO-11-53. The 10 ERPs are as follows: Army—General Fund Enterprise Business System (GFEBS), Global Combat Support System-Army (GCSS-Army), and Logistics Modernization Program (LMP); Navy—Navy Enterprise Resource Planning (Navy ERP) and Global Combat Support System-Marine Corps (GCSS-MC); Air Force—Defense Enterprise Accounting and Management System (DEAMS) and Expeditionary Combat Support System (ECSS); Defense—Service Specific Integrated Personnel and Pay Systems and Defense Agencies Initiative (DAI); and Defense Logistics Agency—Business System Modernization (BSM). According to DOD, BSM was fully implemented in July 2007.

Our preliminary results identified issues related to GFEBs and DEAMS providing DFAS users with the expected capabilities in accounting, management information, and decision support. To compensate, DFAS users have devised manual workarounds and several applications to obtain the information they need to perform their day-to-day tasks. Examples of the issues in these systems that DFAS users have identified include the following:

GFEBs

- The backlog of unresolved GFEBs trouble tickets has continued to increase from about 250 in September 2010 to approximately 400 in May 2011. Trouble tickets represent user questions and issues with transactions or system performance that have not been resolved. According to Army officials, this increase in tickets was not unexpected since the number of users and the number of transactions being processed by the system has increased, and the Army and DFAS are taking steps to address issues raised by DFAS.
- Approximately two-thirds of invoice and receipt data must be manually entered into GFEBs from the invoicing and receiving system (i.e., Wide Area Work Flow).³³ DFAS personnel stated that manual data entry will eventually become infeasible due to increased quantities of data that will have to be manually entered as GFEBs is deployed to additional locations. Army officials acknowledged that there is a problem with the Wide Area Work Flow and GFEBs interface and that this problem reduced the effectiveness of GFEBs, and that they are working with DOD to resolve the problem.
- GFEBs lacks the ability to run ad hoc queries or search for data in the system to resolve problems or answer questions.³⁴ The Army has recognized this limitation and is currently developing a system enhancement that they expect will better support the users' needs.

³³Office of Federal Financial Management, *Core Financial System Requirements* (Washington, D.C.: January 2006) states that a Core financial system must deliver workflow capabilities including integrated workflow, workflow process definition and processing exception notices.

³⁴Office of Federal Financial Management, *Core Financial System Requirements*, states that a Core financial system must provide an integrated ad hoc query capability to support agency access to and analysis of system-maintained financial data.

DEAMS

- Manual workarounds are needed to process certain accounts receivable transactions such as travel debts. DFAS personnel stated that the problem is the result of the data not being properly converted from the legacy systems to DEAMS.
- DFAS officials indicated that they were experiencing difficulty with some of the DEAMS system interfaces.³⁵ For example, the interface problem with the Standard Procurement System has become so severe that the interface has been turned off, and the data must be manually entered into DEAMS.
- DFAS officials stated that DEAMS does not provide the capability—which existed in the legacy systems—to produce ad hoc reports that can be used to perform the data analysis need to perform daily operations.³⁶ They also noted that when some reports are produced, the accuracy of those reports is questionable.

The Army and Air Force have stated that they have plans to address these issues, and the Army has plans to validate the audit readiness of GFEBs in a series of independent auditor examinations over the next several fiscal years. For DEAMS, the DOD Milestone Decision Authority³⁷ has directed that the system is not to be deployed beyond Scott Air Force Base until the known system weaknesses have been corrected and the system has been independently tested to ensure that it is operating as intended.

³⁵Office of Federal Financial Management, *Core Financial System Requirements*, states that a Core financial system financial transaction can be originated using multiple external feeder applications. These feeder systems and the Core financial system must interface seamlessly so that data can move effectively between them. The Core system must be able to process and validate the data independent of origination. There must also be a process for handling erroneous input and correction.

³⁶Office of Federal Financial Management, *Core Financial System Requirements*, states that a Core financial system financial transaction must deliver an integrated ad hoc query capability to support agency access to and analysis of system maintained financial data.

³⁷The Milestone Decision Authority is the senior DOD official who has overall authority to approve entry of an acquisition program into the next phase of the acquisition process and is accountable for cost, schedule, and performance reporting, including congressional reporting.

Closing Comments

In closing, I am encouraged by the recent efforts and commitment DOD's leaders have shown toward improving the department's financial management. Progress we have seen includes recently issued guidance to aid DOD components in their efforts to address their financial management weaknesses and achieve audit readiness, and standardized component financial improvement plans to facilitate oversight and monitoring, as well as sharing lessons learned. In addition, the DOD Comptroller and DCMO have shown commitment and leadership in moving DOD's financial management improvement efforts forward.

The revised FIAR strategy is still in the early stages of implementation, and DOD has a long way and many long-standing challenges to overcome, particularly with regard to sustained commitment, leadership, and oversight, before the department and its military components are fully auditable, and DOD financial management is no longer considered high risk. However, the department is heading in the right direction and making progress. Some of the most difficult challenges ahead lie in the effective implementation of the department's strategy by the Army, Navy, Air Force, and DLA, including successful implementation of ERP systems and integration of financial management improvement efforts with other DOD initiatives.

GAO will continue to monitor the progress of and provide feedback on the status of DOD's financial management improvement efforts. We currently have work in progress to assess implementation of the department's FIAR strategy and efforts toward auditability. As a final point, I want to emphasize the value of sustained congressional interest in the department's financial management improvement efforts, as demonstrated by this Subcommittee's leadership.

Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the Subcommittee may have at this time.

For further information regarding this testimony, please contact Asif A. Khan, (202) 512-9869 or khana@gao.gov. Key contributors to this testimony include J. Christopher Martin, Senior-Level Technologist; F. Abe Dymond, Assistant Director; Gayle Fischer, Assistant Director; Greg Pugnetti, Assistant Director; Darby Smith, Assistant Director; Beatrice Alff, Steve Donahue; Keith McDaniel; Maxine Hattery; Hal Santarelli; and Sandy Silzer.

Appendix I: FIAR Plan Waves

The first three waves focus on achieving the DOD Comptroller's interim budgetary and asset accountability priorities, while the remaining two waves are intended to complete actions needed to achieve full financial statement auditability. However, the department has not yet fully defined its strategy for completing waves 4 and 5. Each wave focuses on assessing and strengthening internal controls and business systems related to the stage of auditability addressed in the wave.

Wave 1—Appropriations Received Audit focuses on the appropriations receipt and distribution process, including funding appropriated by Congress for the current fiscal year and related apportionment/reapportionment activity by the OMB, as well as allotment and sub-allotment activity within the department.

Wave 2—Statement of Budgetary Resources Audit focuses on supporting the budget-related data (e.g., status of funds received, obligated, and expended) used for management decision making and reporting, including the Statement of Budgetary Resources. In addition to fund balance with Treasury reporting and reconciliation, other significant end-to-end business processes in this wave include procure-to-pay, hire-to-retire, order-to-cash, and budget-to-report.

Wave 3—Mission Critical Assets Existence and Completeness Audit focuses on ensuring that all assets (including military equipment, general equipment, real property, inventory, and operating materials and supplies) that are recorded in the department's accountable property systems of record exist; all of the reporting entities' assets are recorded in those systems of record; reporting entities have the right (ownership) to report these assets; and the assets are consistently categorized, summarized, and reported.

Wave 4—Full Audit Except for Legacy Asset Valuation includes the valuation assertion over new asset acquisitions and validation of management's assertion regarding new asset acquisitions, and it depends on remediation of the existence and completeness assertions in Wave 3. Also, proper contract structure for cost accumulation and cost accounting data must be in place prior to completion of the valuation assertion for new acquisitions. It involves the budgetary transactions covered by the Statement of Budgetary Resources effort in Wave 2, including accounts receivable, revenue, accounts payable, expenses, environmental liabilities, and other liabilities.

Wave 5—Full Financial Statement Audit focuses efforts on assessing and strengthening, as necessary, internal controls, processes, and business systems involved in supporting the valuations reported for legacy assets once efforts to ensure control over the valuation of new assets acquired and the existence and completeness of all mission assets are deemed effective on a go-forward basis. Given the lack of documentation to support the values of the department's legacy assets, federal accounting standards allow for the use of alternative methods to provide reasonable estimates for the cost of these assets.

In the context of this phased approach, DOD's dual focus on budgetary and asset information offers the potential to obtain preliminary assessments regarding the effectiveness of current processes and controls and identify potential issues that may adversely impact subsequent waves.

GAO's Mission	The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.
Obtaining Copies of GAO Reports and Testimony	The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."
Order by Phone	<p>The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, http://www.gao.gov/ordering.htm.</p> <p>Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.</p> <p>Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.</p>
To Report Fraud, Waste, and Abuse in Federal Programs	<p>Contact:</p> <p>Web site: www.gao.gov/fraudnet/fraudnet.htm E-mail: fraudnet@gao.gov Automated answering system: (800) 424-5454 or (202) 512-7470</p>
Congressional Relations	Ralph Dawn, Managing Director, dawnr@gao.gov , (202) 512-4400 U.S. Government Accountability Office, 441 G Street NW, Room 7125 Washington, DC 20548
Public Affairs	Chuck Young, Managing Director, youngc1@gao.gov , (202) 512-4800 U.S. Government Accountability Office, 441 G Street NW, Room 7149 Washington, DC 20548



Mr. PLATTS. Thank you, Mr. Khan.

We will move into questions, and I yield myself 5 minutes to begin.

Just a statement up front, Mr. Easton. Your written statement and you said here today something that jumped out to me as a quote: "Why will this time be different?" And I think that is something the ranking member and I, because of for almost 10 years being involved in these issues, your acknowledgment that—you know, we've heard some good, encouraging words in the past. I have seen, as with DIMHRS, over \$1 billion spent on the issue. Yet, here we are still struggling to move forward—and I'll get into it if we have time a little later—have one branch already saying 6 years out they don't think they can meet the deadline, which that does concern me also from a leadership standpoint that they are saying that, you know, hey, we saved the world in World War II in 4 years; yet we can't, you know, get our books straight in another 6 years.

But I want to start with, first, the importance of this issue and why it is so important. You know, our hearings are not sexy, glamorous, exciting hearings, but they are so important because they are about the American people's money, how it is being handled and, in this case, how we make sure those funds are available for the warfighter.

Senator Coburn put out earlier this year a report on deficit reduction entitled, "Back in Black," and he referenced in there that the Marine Corps, through improved financial management, had saved an estimate about \$3 for every \$1—\$3 savings for every \$1 they spent on those improvements. Across the government, it actually seems to be about \$10 to \$1 savings. So, if we extrapolate that, we are talking probably at least \$25 billion or more in annual savings in just the Department of Defense; and given that we are moving through cuts of over \$400 billion to the Department in the coming 10 years and perhaps further cuts as part of the Budget Control Act, these type of savings are critically important.

I guess, Mr. Easton, I would ask you, do you think that Senator Coburn's number of at least \$3 to \$1 savings and perhaps as high as \$10 to \$1 is a legitimate number when we talk about what we may be able to save if we are successful in this effort?

Mr. EASTON. I'd be reluctant to specifically commit to a number. I think that there is clearly value in the importance of doing this.

For example, the Marine Corps has already demonstrated out-of-pocket costs relative to reducing their bill for finance and accounting services. I think that there has been identified in their business practices where they've become aware of how to use that information in a more timely manner to ensure that they can do that. So I am absolutely confident that the value is there.

I would be reluctant—as I said before, I try to stay on the financial execution side of the house, but that value proposition I think internally is one that we need to look very seriously at and act upon.

Mr. PLATTS. And even if it is half of that estimate and it is \$10 to \$15 billion in today's—in any economy, in any time, that is real money. It is the people's money and especially in a tight economy

and where we have, you know, trillion dollar plus deficits each and every year now.

Mr. EASTON. Absolutely, yes, sir.

Mr. PLATTS. Mr. Blair, I want to, again, kind of start more of the big picture. The FIAR, the Financial Improvement Audit Readiness, plan is so critical here and kind of the game plan of how do we get to, you know, a clean audit 2017.

Given that, I was I guess discouraged by reports from GAO that—and I think Mr. Khan just referenced Navy and Air Force—in at least two of the financial improvement plans that they've looked at were done not in compliance with the guidelines of FIAR; and not only were they not done in compliance with the guidelines which, again, are the critical game plan here, but the oversight that was put in place to try and make sure the compliance occurred, the oversight didn't occur from what GAO's report finds. So from your perspective as IG and then, Mr. Easton, yours as well, that is not encouraging. Am I missing something here or are we off to not a good step in this area, given the failure to comply with the FIAR guidelines?

Mr. BLAIR. Mr. Platts, I think that the key point here is the oversight that we provided over those FIAR package—FIAR assertion packages, it correctly concluded that the Department wasn't ready. We found in some situations that the Department's initiatives to review their business processes identified areas that need to be corrected. Those corrective actions hadn't been implemented. Yet the assertions continued to move forward, and the Department continues to say we are audit ready. And so I think we appropriately stepped in and said, stop, we don't think you are ready.

And I think what is happening now is that there is a learning process going on. And the Department's actually taking the results of its own review processes, the feedback that we give them, they are taking it very seriously, and they are now looking at what further improvements do we need to make before we come back and say, yes, we are ready for an audit.

Mr. PLATTS. And, Mr. Easton, maybe that is—if you can touch on what Mr. Blair just said, given that these are kind of early ones that were identified as challenges or problems, how do we make sure and are we taking proactive steps that the lessons of those FIPS—not being compliant, not being properly handled, moving forward anyway—that we don't continue to repeat those errors? Because, if we do, 2017, 2027, we will be here and—I have already got a lot of gray hair, but more gray hair—and still be talking the same issues. So how do we learn from those mistakes and not repeat them?

Mr. EASTON. We spend a lot of time in terms of trying to cross-fertilize, both at a senior level from a governance perspective as well as a working level, to be able to learn from what we found from the Marine Corps audit, learn from those packages. In both of those packages, the GAO identified we had, in fact, as Dan said, basically said you are not ready.

And so I think that what we are trying to do now, it goes back to the—a little bit of a competency issue. And I say competent meaning our people are some of the best people in government—I can assure you of that—but, at the same time, from a financial

audit perspective, we don't have those skill-sets. We are not viewing it in the way that a financial audit needs to view it and that management needs to view it.

So we are trying to be able to get in as early on in those things to be able to sort of mortarboard this up front to make sure that they are going to go into those process and apply the lessons up front. So that is what we are doing in that regard.

Mr. PLATTS. I want to yield to the ranking member but a quick follow up.

I know you've put in place in essence a certification program to try to get your financial management personnel more up to speed, I'll say. Is this going to be part of that, you know, that they understand the role that the FIAR compliance, you know, the guidelines play and that, as they move forward, they need to be looking to make sure they are in line with it?

Mr. EASTON. That is absolutely one of the key components. I guess the two things—the two real key things in the certification program we want to emphasize, this is one of them, to ensure that the quality of the information is good, and the second is analytical skills so that we can get the most out of the program; and so we will be including that.

Mr. PLATTS. Okay. Thank you.

I yield to the gentleman from New York.

Mr. TOWNS. Thank you very much, Mr. Chairman.

You know, I want you just to elaborate a little further, Mr. Easton, as to why this time is going to be different. I want to hear more about that.

Mr. EASTON. I think that what we have done in the past, because I have been involved—this is sort of a second career opportunity for me. Having been in the Department of Defense for 38 years, I spent most of my time in the logistics community, and so I was an operator. And as I got into the financial management community, one of the things that I found is that I had a much different perspective of what I thought financial—the quality of our financial information when I was in the logistics community, than when I was working in the financial management community.

So the key issue that I would like to use, using that as an example, you know, we have been trying to tackle this too much in the past as a financial management issue. It really reflects a weakness in our business enterprise. And so every contracting officer, every logistics officer, every personnel officer needs to understand how they do their job affects money and financial information. And so in focusing on the information that we all can agree upon, typically budgetary information and logistics property, I think we are trying to bring those communities together. And so I would characterize that as our primary weakness in past attempts, and that is why I think that this strategy will work.

Mr. TOWNS. Thank you very much.

Because I want you to know that this is not one of those "I got you" committees. This is one of those "I want to help you" committees. So that is the reason why we keep staying with this and seeing in terms of what we might be able to do. However, it is encouraging that, you know, President Obama and Secretary Panetta

have singled out financial management improvement as a top priority at the Department of Defense.

To quote the Secretary: "It is unacceptable to me that the Department of Defense cannot produce a financial statement that passes all financial audit standards." That will change, he said: "I have directed that this requirement be put in place as soon as possible. America deserves nothing less."

As long as leadership remains engaged, I can see this process going forward. Unfortunately, however, within every administration there are changes in senior leadership—and I am happy to hear that you've been around for 38 years, happy to hear that—which interrupts their involvement in financial improvement initiatives. Sometimes the interruptions are severe enough to derail the entire process.

GAO recommends that current initiatives be institutionalized throughout the Department at all working levels. In order for success to be achieved—and I want to go to you, Mr. Khan. Since this is your recommendation, please explain how you institutionalize financial management improvement so that it withstands changes at the senior level, who comes or who goes, that, regardless, that this will continue to move forward.

Mr. KHAN. Mr. Towns, that also touches upon oversight and accountability. That is going to go a long way to help institutionalize the tenets of the FIAR plan and buttressing the financial management within DOD.

Like we had mentioned in our report, one of the issues with the oversight of the two accessible units at the Navy civilian pay and the Air Force existence and completeness was that the oversight and responsibility at ground level, there was not really adequate acknowledgment that they were not really following the FIAR guidance. Once the oversight and the responsibilities are firmly institutionalized, there will be much more of check and balances within the government structure to make sure that things are not moving forward unless they are actually being done.

Mr. TOWNS. Let me ask you this. Do you think that the staff that is in place are really capable of carrying out this mission?

You know, sometimes we ask people to do things that they just can't do. And based on our own salary scale we watched that over at the SEC, that when we had people who were making very little money and competing with people that were making tons of money, and, of course, the stability in terms of the work force was not good because people would stay a little while and then leave. Do you see this as being a part of this as well?

Mr. KHAN. Like I mentioned in my testimony, competency of the financial management work force is very important for two reasons. DOD financial management is complex from a technical perspective. Working in those integrated systems is not easy. DOD is a complicated environment. So, therefore, training, getting the right skill-sets to be able to address the current challenges is critical.

I mean, we haven't done specific work on the competency of the skill-sets. However, there was a requirement from the National Defense Authorization Act of 2008 for DOD to go and do skill-set assessments under many different functions, financial management

being one of them, and that is an area which was not done. And I think it is being repeated again in the National Defense Authorization Act of 2011, that they go back and address the financial management skill-set issue. That is going to go a long way to answer the question that you have, sir.

Mr. TOWNS. Mr. Chairman, I know my time has expired, but let me—I guess to you, Mr. Easton. You know, when we stopped the draft, we had to create a bonus situation to be able to keep certain folks in the military that we need for these essential kind of jobs. Do you think that maybe we need to do something like that here to hold people that we need and that can help us with some kind of bonus program or something? Because, you know, this bothers me, the fact that, you know, we don't know how much money—and I am looking at this voucher here. I mean, this is very disturbing. I'd like you to answer that, but my time has expired.

Mr. EASTON. If I could redirect, I guess several of those things, in my estimation, tie together. I think that the key to really institutionalizing this is people, as you mentioned. I think we absolutely have the capability in our people to be able to do this.

I think that we need to ensure that we are not just talking at the senior level. We need to begin to institutionalize this by ensuring that, on the one hand, we are bringing people with the skill-sets in from the private sector. That is one thing that we are doing. I think that we need to factor this into the training programs.

There may be some opportunities to use bonus, things like that, but, at the same time—you know, we were at another session, and Congressman Conaway mentioned that he was in the field and a soldier—I think had mentioned that he's getting the word.

And so, you know, we need to, through training, we need through communication, be able to get the word so we are not—this is not just a Pentagon program. This is a program that has to be driven into the field. I think the institutionalization, as well as the leadership perspective, but we really have to get the word out. It has to become part of our DNA and culture in DOD.

Mr. PLATTS. Gentleman from Oklahoma, Mr. Lankford.

Mr. LANKFORD. Thank you, Mr. Chairman.

Thanks, y'all, for being here. I am sure this is your favorite part of the week. You've been looking forward to it all week, thinking I can't wait until Friday, I am going to do a congressional committee. And I appreciate your work and your service and for staying on top of this. You've probably spent a lot of time in a quiet office digging through financials and trying to track these things. So I appreciate your work on it.

You men know, we have the finest military in the world. No one does it better than us. No one's ever done it as good as we do it. We can park a satellite on the horizon and look through a tent and tell you exactly what is in it, but we can't track our finances. That is a focus on leadership, and I have appreciated everyone mentioning. It is just this consistent focus of, if we are going to do get this done, we've got to focus on this and get this done.

I do commend the President and I do commend Leon Panetta coming in and saying this has to be a focused priority. You all are saying exactly the same things. So I appreciate that. It is a focused leadership to be able to get this thing accomplished.

I do want to get a chance to ask a couple of specific questions, though.

Mr. Easton, you mentioned financial controls—in fact, all of you at some point mentioned something about financial controls. Give me some specific ideas that you are looking at at this point to saying we can improve financial controls by doing these things, so you have specific things already on the radar for that.

Mr. EASTON. We are going at the key processes. I mean, civilian pay—I mean something as simple as civilian pay where we look at and identify key controls. We try to standardize the processes as much as we can, but we identify key controls that, even if the time and attendance systems may be different, we have people thinking the same way to be able to implement key controls and be able to use them as well. Having a control is one thing but actually being able to do that. So civilian pay, military pay, and the procure-to-pay process, how we write contracts, and some of the issues that Dan mentioned in terms of the contracting process.

This is really a team sport. It is not just a financial issue. It is an issue of how we write contracts, how we administer contracts and keeping the focus on those controls throughout the process.

Those are a couple of examples that I would offer, and so it really is pretty basic, and it amounts to doing your job on a day-in-and-day-out basis.

Mr. LANKFORD. It is training the people. It is knowing what is the job, what is the task, and training people for that. And that is why it is challenging for me to look at and say, 6 years out, there is still some hesitancy to say can we get there in 6 years when it is the basics of defining out what the job is and training people to be able to do a job.

Mr. EASTON. And I think—and several people mentioned the Air Force as a high risk—identified some concerns with risk. I think that they link—and it is important to link the investment in our systems to this process as well, but getting back to the basics I think is something that we can do that will support this as well as to increase the likelihood that we will successfully do that system. We have had a problem in the past where we tend to look for a silver bullet, and when we look in the mirror, I think it is just a question of doing the basics well.

Mr. LANKFORD. Okay. Other comments about dealing with financial controls, specific ideas on that, what has to be done?

Mr. BLAIR. Mr. Lankford, I just want to leverage a little bit more on what Mr. Easton just said.

Really, financial management goes way beyond the traditional bean counters. If you look at how the Department executes a lot of its missions, it is done primarily through contracts; and one of the things that is a consistent theme in my testimony is a lack of effective contract oversight, effective contract administration. When so much of your money is going out that way and you don't have a good process in place to review all the vouchers and you don't have good edit checks in your systems to make sure that everything is done efficiently, those are two areas that I think the Department could significantly benefit from.

Mr. LANKFORD. Is that the training of the contracting officer or is that training of the person that is next after the contracting officer? Where is the gap there?

Mr. BLAIR. Sir, the gap is in both locations. It is the contract officer level when it comes to putting the contract in place, but it is also the contracting officer's representative who is the person on the ground who is supposed to be doing that oversight.

Mr. LANKFORD. Because we've had, obviously, numerous issues with a contracting officer writing out a contract, putting it out there, and then, as we go along, then the definitions change and the price skyrockets as the definitions of what we are really looking for change. So we really didn't get a good definition at the beginning.

And I am quite confident many of these systems are very complicated and it is hard to get it right the first time when things—as we go along. But it is also difficult when everyone as you go along says, oh, I'd like to also add this and we thought about this and can we change this. So is that a matter of getting contracting right at the beginning, I say again? Is that the bigger of the two issues or is the bigger issue the person that is behind it?

Mr. BLAIR. I don't think you can look at one as being bigger than the other.

Mr. LANKFORD. Okay.

Mr. BLAIR. I think they are both equally important. The requirements have to be correct in the beginning, and the oversight throughout the contract process has to be effective.

Mr. LANKFORD. Okay. Mr. Khan.

Mr. KHAN. Just to add to what Mr. Easton and Mr. Blair have mentioned, I think it is very important to have a baseline of all the internal control deficiencies currently to be able to build on; and, second, just like Mr. Blair has just mentioned—

Mr. LANKFORD. I am sorry to interrupt. Is the baseline—does a baseline like that exist?

Mr. KHAN. Not that we know of.

Mr. LANKFORD. Okay. So, at this point, part of the issue is just writing out where do we have the problems?

Mr. KHAN. Absolutely, and that is part of the—one of the basic FIAR plan tenets, that they have to do the discovery process. So that—

Mr. LANKFORD. We are set to have that part of the process complete by when? Obviously, getting the full list of where we have problems precedes solving problems.

Mr. EASTON. I think that we go through the discovery process. But in each of the segments—I mean, I think in many cases each of the components focusing on that have broken it up into segments and so those processes may take place at various times.

I guess I would emphasize, too, it is a process of really looking in the mirror and finding out how you are doing business today. I would assert that we have more control than we are willing to present, and it is a question of stepping back and looking at how we do business. And I can give you some examples in that regard, but we clearly have to do that.

Mr. LANKFORD. Okay. Thank you.

Mr. Khan, go ahead.

Mr. KHAN. Just to add to that, just like Mr. Easton and Mr. Blair have mentioned, I mean, many of these transactions originate in nonfinancial areas. Therefore, it is critical—the systems are going to be critical. The sooner they are implemented, this end-to-end process off a particular transaction cycle is going to be put into place. Controls are going to change along with the new system. So the sooner these systems are implemented, the better it is going to be, and it is going to go a long way to addressing the control weaknesses that we have right now.

Mr. LANKFORD. Okay. Thank you. Gentlemen, I appreciate that very much.

Mr. Chairman, I appreciate your patience with me going a little bit long.

Mr. PLATTS. No problem, and we are—because we still haven't had any vote bells go off, we are going to continue for my colleagues who—if your times allow, have a second round if you like. I am going to kick it off.

Before a question on a specific issue of improper payments, Mr. Easton, you mentioned in your testimony and Secretary Panetta taking a very hands-on approach to this, the importance of financial management and improvement, and you referenced that you are kind of preparing an update for him, where things stand and what your plans are, maybe similar to what you are sharing here today. But I guess, what is the timeframe for that to be provided? And if it is possible for a copy or a summation of what those plans are, if it is possible to have it shared with the committee as well, I think it would help us as we try to partner with you so we are all on the same page.

Mr. EASTON. Absolutely. We are in the process. Secretary Panetta and Mr. Hill are reviewing our current status and plans, much of the same things that we've talked about today, and so we would anticipate—I don't want to get out too far in front of my boss or his boss, but we would certainly want to share those with you and the committee.

Mr. PLATTS. That would be great. Thank you.

I want to turn to the specific issue of improper payments. You know, across the government, the official number, most recent, is \$125 billion of improper—when I share that number back home, my fellow citizens think I misspoke, that every year we are making improper payments of at least that. We think the real number is probably at least \$200 billion, because we don't account for maybe every improper payment made.

When it comes to DOD, I know, Mr. Easton, you I think reference a 1 to 2 percent rate, which, even in comparison, that would be a good percent, but given we are talking \$550 billion, that would still be billions of dollars of improper payments within the one department. But I guess what I want to is—Mr. Easton, you highlight that as a strength of where you are doing well.

Mr. Blair, Mr. Khan, IG GAO raise some specific concerns that there is not a real ability to accurately assess if that is the right amount, 1 to 2 percent, and specifically that there are hundreds of billions in outlays that were not assessed at all. And so how do we know what the real number is?

So I guess, Mr. Easton, we can start with you. How you think you come up with your number of that 1 to 2 percent; and then, Mr. Blair and Mr. Khan, if you could reference your concerns and where you differ here.

Mr. EASTON. We have about six major programs. DFAS, our finance and accounting operation, disburses about 90 percent of our dollars. So there is five or six primary programs that they report upon as well. Many of our payments—many of our payments are recurring payroll-related payments, contract payments. Admittedly, some of them are very, very complex.

The two areas of difference—I mean, I have to acknowledge the fact that, lacking a clean audit opinion, lacking and acknowledging comprehensive controls, there are weaknesses. I would say that we try to compensate for those weaknesses to the maximum extent possible and report accurately in each of those numbers, and that is why I consider it a strength.

However, the two areas of difference, just to mention two, is in the commercial pay area because of the difficulty—and, you know, we put so much emphasis in prepayment audits. We had not moved into a statistical sampling, and a lot of your \$125 billion is driven by legitimate statistical sampling. That was the point GAO has brought up with us at the time. OMB was on board with our approach. We've since changed that. So we've closed that one particular gap.

The issue relative to the DOD IG report—and Mr. Blair will comment more on that—was there was about a hundred and—I want to say \$130 billion, I believe, that were not included. Much of that number represented a transfer payment into a trust fund, and their point was accurate. In other words, we should be able to reconcile all outlays, but some of the outlays that were considered technically excluded then were not intended to be included. It was a difference of opinion, admittedly, between us and the IG.

Mr. PLATTS. Mr. Blair.

Mr. BLAIR. Mr. Easton's correct that we do differ on some of these issues. There are some areas where the Department did not do a very good analysis or did not do an analysis at all and really focused a lot in the contract and commercial payments areas; and, as I indicated before, that is where so much of the Department's dollars are going.

With regards to the transfer—was it a transfer, was it not a transfer—what we said to the Comptroller staff is, you know, we'd like to see a reconciliation so that you can show us what was a transfer, what was a real disbursement or a payment of a bill that was owed.

And one of the things that we wanted to do with our report was to say here are some ideas that we think you can incorporate in your next estimate methodology. The results of DCAA's audit, the results of our audits, those oftentimes point to areas where vulnerabilities exist.

The other thing that the Department can do is expand its methodology to look at the instances where they offset a future contract payment because of a prior improper payment or overpayment amount to include the results of when EFTs, electronic fund trans-

fers, are rejected because it went to the wrong place. That is another indication that it is an improper payment.

Also, to look at where there are recalls. A recall is a situation where the Department can go in and take the money back out of the bank account.

All of those are specific areas that weren't included, that if they were included would help develop a more robust methodology; and, as I indicated before, you don't know unless you look. And so the more introspections that the Department has, the better they are going to be able to improve their controls.

Mr. PLATTS. Mr. Khan, before you answer, if you want to—what you have to share, and specifically I know in 2009 GAO made I think 13 specific recommendations on this issue that maybe overlap or complement what Mr. Blair just referenced. Where do you think we are on those 13 specific recommendations and which, if any, that have not been followed that are most important that we've talked about?

Mr. KHAN. Congressman Platts, I will get you the specifics on the 13 recommendations for the record, though.

But just to add to what Mr. Easton and Mr. Blair have mentioned, our main concern is, again, that not all the transactions, especially about commercial pay, were included in the risk assessment calculation for internal—for improper payments.

Also, improper payments is an area which is self-reported; and, given the control environment within DOD itself, it may not be a complete number. Like we testified yesterday, that funds control and payments control is an issue that GAO is concerned about the completeness of the reporting of the anti-deficiency violations and the improper payments. So the lack of controls may not provide a complete picture to the officials within DOD from which they are reporting.

Mr. PLATTS. The question—I mean, the fact that we have improper payments at all and especially billions of dollars goes to the internal control issue. Years back when we created the Department of Homeland Security, this subcommittee, Mr. Towns and I, worked and we pushed through an actual audit on their internal controls to try to get bedrock in that new department so then we could—the feedback we've gotten from the Department is that was great for them because it really got them a good place to then build on.

I know the challenge would be dramatically greater here with the budget, you know, probably 13 times or so DHS's. So is it unrealistic of that type of approach here or some variation to try to get the bedrock on the internal control issue that relates to improper payments and, you know, ultimately to that clean audit?

Mr. EASTON. One of the areas that I think that I can point to in the past that have indicated why we haven't made progress is that we've looked at it from just a financial management perspective, and we've looked at it in narrow slices. What we've tried to do is to integrate internal controls, particularly internal controls of our financial reporting, into this plan. So we are trying to do, as part of this plan, do this. So we are not going to go after—just after improper payments or improper disbursements. We need to go after a good foundation to be able to build upon. So I think that we are trying to do that.

Mr. PLATTS. I mean, because, if you get there, that addresses the improper payments as well as giving you time-sensitive information, you know, as far as how you manage the resources, how you shift them between priorities, and so there is a whole host of benefits, including improper payments.

Mr. EASTON. Absolutely, and we are trying to—there is a couple of paradigms that I think that we are trying to shift and teach ourselves. You know, one is the difference between positive assurance and negative assurance, and both of these gentlemen have taught me well over the last several years is what we seek is positive assurance, to be able to say this is why management is confident. And then because problems will happen in an enterprise as large as the Department of Defense, but, at the same time, a sound basis of internal controls increases the likelihood that we will find a problem and deal with it quickly, but it also increases the credibility of those admittedly self-reported numbers.

Mr. PLATTS. Okay. Mr. Towns, I yield to you.

Mr. TOWNS. Thank you very much, Mr. Chairman.

Let me ask, is the problem that you have not been able to make a decision whether you want to use more outside auditors and/or to hire inside folks to be able to do—I mean, because when I look at the fact that you have these 2,200 different systems, I mean, is that part of the problem? I am trying to figure out how we get past that or what precipitated it.

Mr. EASTON. I think that we—I like to think of this as Henry Ford waking up. You know, he was managing Ford Motor Co. out of his pocket as an individual proprietorship, with no requirement to get a clean opinion, and then all of the sudden he's a multinational corporation. We have evolved over many years, and so the systems that have evolved, many of the systems—we don't have nearly that many financial systems, but we have that many systems feeding our financial numbers.

And so part of this process that will enable us is to increase—reduce the number of systems, improve the level of standardization. It will make an audit not only doable but also affordable. And so that is what we seek to do. I think that we got there just through evolution more than anything else and organizationally and growing without a thought process of this, you know, prior to the CFO Act. But that would be my assessment, sir.

Mr. TOWNS. One of the most pressing issues with DOD's financial management system has been that they are low tech. In your testimony, you note that many of these systems exchange information slowly and inaccurately, lack controls, and are nonstandard. It appears as if you have begun to remedy these problems by overhauling this system. I am especially encouraged by your recognition that these systems must be designed with a holistic rather than a stovepipe approach. Can you describe what this holistic approach to IT system comprises? What does that constitute?

Mr. EASTON. I think that we would describe that as being able to develop a framework for how we want to do business. That framework is embodied in our enterprise architecture, and this is a relatively new invention. We have begun on this around 2001.

We have an enterprise architecture that is essentially a set of end-to-end processes of how we would want to do business. And so

what we are trying to do is to take the systems that we are investing in, oftentimes an commercial off-the-shelf system, to ensure that it is complying with that set of ground rules. That is how we are trying to evolve and be able to deal with it on a holistic basis.

Mr. TOWNS. Let me ask this question. Then I am going to yield back. Is there anything that we can do on this side that we are not doing that would be helpful?

Mr. EASTON. I think—

Mr. TOWNS. I know you are not going to recommend more hearings. I understand that.

Mr. EASTON. If I did, I think my boss would shoot me.

But I think that sessions like this, your interest is very, very important; and I think that Mr. Blair and Mr. Khan mentioned that. That kind of focus I think does, in fact, help keep us focused.

As I look back, and I mentioned being in the Pentagon in the mid-90's, and these kinds of hearings occurred, but they did not occur with the frequency, the knowledgeable intent, and focus that we see them occurring now. And, from my perspective, that is very, very helpful.

Mr. TOWNS. Mr. Blair.

Thank you, Mr. Easton.

Mr. BLAIR. I don't want to say that I want to be up here on a regular basis testifying, but I think the tone from the top is very important to keeping the pressure on.

Other types of reporting sometimes become helpful tools to prod the Department to do certain things by certain points in time, and so you may want to look at some interim reporting mechanisms to closely track the milestones and where they are slipping. And I know that there is already some of those reporting requirements, but I think, between the two of those, the continued pressure and the tone from the top, as well as the reporting, along with the sustained leadership the Department has in place and a sustained consistent direction of how we are going to fix this problem, I think we are in a better situation now to see real improvement than we have been in the past.

Mr. TOWNS. Mr. Khan.

Mr. KHAN. Just to add to what Mr. Blair and Mr. Easton have said, GAO has highlighted that oversight and investment management in IT projects or ERP implementation is essential. By that I mean that when the ERPs are being implemented and moving to a next phase, there should be more questions asked that the ERP is meeting the intended functionality.

Like I mentioned in my testimony, many of the ERPs have slipped their timing or their timelines because they were not meeting their functionalities. So strengthening the oversight and investment management is critical.

Though we are seeing positive signs, and one of the ones, if I may highlight, is the milestone decision authority recently precluded DEANS, which is the Air Force general ledger system, from being deployed further from the Scotts Air Force Base until some of their implementation problems were addressed. So we are seeing some positive signs, but that is a critical area where they need to strengthen.

Mr. TOWNS. Okay. Thank you.

I yield back, Mr. Chairman.

Mr. PLATTS. I thank the gentleman.

Mr. Lankford.

Mr. LANKFORD. Thank you, Mr. Chairman.

Who is kind of living and breathing this all the time? Is there an individual or a group of individuals? Obviously—y'all, obviously, live with it a lot. But someone's got to wake up every morning thinking, how am I going to fix contracting? How am I going to fix training contracting officers? How are we going to chase this down? Somebody has to wake up thinking, when is the last time we went down to the line and talked to civilian employees about waste? When's the last time I sat down with a warfighter and said how do we really get receipts back? When is the last time that we actually sat down with a contractor and said did this work and getting feedback and evaluation and gathering those ideas on the ground? Who's kind of living and breathing that all the time?

Mr. EASTON. It takes place at a lot of levels. I guess I feel like I wake up thinking about it all the time.

Clearly, I have a leader for my FIAR team. I hired him with experience in financial audit to be able to do that. It really goes down into the field, and when I visit the field I am, quite frankly, more encouraged because those kinds of things are happening, but we need to make sure that they happen within the context of these kinds of outcomes.

Mr. LANKFORD. So is there—as far as comparing the education, for instance, I have heard very high praise on Veterans Affairs and how they are handling some of the training of their contracting officers. Is there that kind of conversation happening agency to agency? Or maybe y'all would look at it and say, I disagree, I don't think they are doing a good job either. But y'all may have a different opinion on that from what I am hearing. But is there that kind of conversation agency to agency saying how are you training people? It is something that we are trying to deal with as well the training, the equipping of the contracting officer.

Mr. EASTON. There's forums—I can speak to forums. OMB sponsors a CFO Council. There is an analogous group for the acquisition community and the HR community. Oftentimes, it is important to not only have those conversations across the functional areas but then within the organizations. Because these things really do, you know, have to fit together from an enterprise perspective. But those are—at least that is an example I could point to.

Mr. LANKFORD. Okay. Any comments on that?

Mr. KHAN. Just to add to that. I mean, it is very important to look at the financial management within the context of the business transformation or the enterprise transformation within DOD itself. So, just like Mr. Blair and Mr. Easton have mentioned, it has to be a multifunctional approach so that we avoid some of the silo'd initiatives in the earlier days. So, consequently, acquisitions—procurement, acquisitions, supply chain management, infrastructure development all has to be looked at collectively to be able to address these issues.

Mr. LANKFORD. Okay. While we are talking back and forth, too, there were several comments that were made, and Mr. Easton has a part of his testimony, a section about recovering improper pay-

ments and such. Obviously, that is important when we discover that is an improper payment to recover. As a part of this conversation as well how do we prevent those improper payments ever being done, and how are we doing on the progress on that?

Mr. BLAIR. Mr. Lankford, I think that is the key: Don't try to recover the money once it has gone out the door but try to prevent it up front. And that is what all the discussion this morning has been focusing on, internal controls. And when the Department has a solid set of internal controls that provide the positive assurance that Mr. Easton referred to earlier, when that is in place, then the number of improper payments is going to significantly decline. So it is very important for the Department to improve this internal control structure first, rather than to emphasize trying to recover the money after it has already gone out the door.

Mr. EASTON. But I might add that we have emphasized the prepayment checks. In fact, when GAO came in, that was our position, is that we would prefer to invest in stopping before, and I think the GAO position was, well, you should do both. And that is what we are currently doing with the commercial payments, but we had a business activity monitoring tool, an automated tool that was particularly critical because we had multiple entitlement systems, and so potentially a vendor could submit—as a weakness, could submit an invoice to two different systems, and we had to make sure that we were able to address that, address it before something like that happens, and it has produced good results.

Mr. LANKFORD. That is great.

One final question and I'd be glad to be able to yield back.

We are obviously gearing up for a large-scale single audit happening 6 years from now, on time, ready to go, well checked, all those wonderful things. What about 2017, 2018, 2019? Are the systems and the process and the conversation in place to say this is not going to be gear up for 20 years to get the check and then we will do this again 20 years from now? Or are these systems all gearing up and saying we will be prepared for an annual check from here on out?

Mr. EASTON. I think we certainly understand that this is an annual routine. This is not—again, from a Department of Defense cultural perspective, oftentimes you get into—in my experience in uniform, you get into where you, in one particular tour, you would experience inspection one time. I spoke to a group of marines, and as we go through auditing the Marine Corps statement of budgetary resources, a young marine raised his hand and said, sir, you mean we have to do this every year? And the answer is absolutely.

But the key to being able to do it every year and as the chairman mentioned the sustainability aspect is really based on the scale we operate systems and strong internal controls. And so that is what we have to be able to be building now.

Mr. LANKFORD. Culture change.

Mr. EASTON. Absolutely.

Mr. LANKFORD. Thank you. I yield back.

Mr. PLATTS. I thank the gentleman.

I yield to the gentleman from Virginia, Mr. Connolly.

Mr. CONNOLLY. Thank you, Mr. Chairman. Forgive me for being late. I had an amendment on the floor.

Mr. Easton, Congress first required DOD to audit its finances in 1997. How much has the DOD budget increased since 1997?

Mr. EASTON. I don't have the specific numbers off the top of my head, but significantly increased, particularly in the last 10 years since 2001.

Mr. CONNOLLY. Probably doubled, right?

Mr. EASTON. Yes, sir.

Mr. CONNOLLY. Plus wars. So, presumably, it is more imperative than ever, given the huge amounts of money we are talking about, that, in fact, DOD meet that requirement. Now, we are talking about extending it to 2017, which means we will have gone 20 years from the first congressional requirement to the actual deadline. From a confidence-building point of view, you think that is a problem for the Department of Defense?

Mr. EASTON. I think we know why we are not financially auditable. I wish that—and, as was mentioned earlier, Secretary Panetta has publicly said he finds it unacceptable, as do we. We have a plan, the complexity of what we need to do—and I venture to say that in 1997 the Department of Defense did not fully understand what it meant to become financially auditable. We do now. We have a plan, and I think we are committed to it. I wish we could deliver it tomorrow, but it will take time. I think that we are on the right track.

Mr. CONNOLLY. Good. Well, I just—I think on both sides of the aisle we share the same view that it is imperative that that be accomplished sooner rather than later in order to make sure there is public confidence in the vast amounts of money we are investing in defense.

DOD has 2,200 noninteroperable business management systems, and I know that Mr. Towns asked a question about this, but what progress are we achieving on trying to get that number down to ensure more efficiency and more accountability?

Mr. EASTON. We are making significant progress. I think with each of these—with each of these major systems, Enterprise Resource Planning systems, there is not just one or two, but there is tens of—you know, the Navy ERP, for example, when it was implemented at the Naval Air Systems Command, eliminated 60 systems. And so we have a significant ways to go, but we are making progress with each implementation at each individual activity.

Mr. CONNOLLY. I hope so.

DOD spends more than—given the fact that it has the largest budget, it spends more than any other Federal agency on outsourcing contracts. Contract management, especially given the growth in the budget that we talked about since 1997, obviously becomes even more important. Can you talk a little bit about the role of training contract managers and whether we've looked at ways to create a professional path that is more attractive and longer lasting so there is continuity built into large, long-run contracts?

Mr. EASTON. The acquisition community has developed—and I think that under the acquisition work force—has developed a framework to be able to develop a career pattern to be able to develop those capabilities.

Quite frankly, within the financial management community, we are trying to model that under the same kind of thing. But training

and awareness, not only of directly contract administration but issues associated with the financial weaknesses associated with the gaps, need to be included in that training. So I would absolutely agree.

Mr. CONNOLLY. I just—and maybe Mr. Blair and Mr. Khan wants to comment, but I have just got to tell you, as somebody who came from the Federal contracting world until I came here, I can remember one contract, not your agency, in which we had 14 managers in like a 3-year period, no continuity. Everyone had different expectations of what the contract really meant. Everyone had the wrong informal ways of changing scope. And, cumulatively, by the end of the contract, it had radically changed the nature of the contract. And it is very difficult for a conscientious contractor to try to provide quality service when the client, frankly, is so changeable.

Mr. Blair, Mr. Khan, if the chair would indulge, any comments on the whole contracting piece.

Mr. BLAIR. Mr. Connolly, I think you've identified a key part of the Department's business processes that has to improve. So much of what the Department does on a day-to-day basis it executes through contracts. Those contracts have to be well-defined in the beginning, the requirements have to be well-established in the beginning, and, equally important, throughout the life of the contract there has to be effective contract oversight so that the Department actually knows that it is getting what it pays for. The more improvement the Department can put in place in the requirements, in the oversight, the better off we are going to be to know that we are effectively spending our money.

Mr. KHAN. Just to add to what Mr. Blair said, like I had mentioned earlier on, that a lot of these financial management or transactions they originate in contracting and procurement. Therefore, just stepping away a little bit from contractor training from a contract execution perspective, but it is very important for the contracting personnel to have the training so that they enter the financial information correct in the systems. Because if it is not entered correctly, then correcting and rectifying it downstream, it is a challenge without reworking it.

Mr. CONNOLLY. Thank you very much.

Mr. Chairman, I want to thank you for holding a substantive, non-gotcha hearing which, of course, characterizes your leadership in this subcommittee.

Mr. PLATTS. Thank you, Mr. Connolly.

And, as I said earlier, that the issues we deal with, because accounting and things is not the most exciting but very important, and your participation, as well as Mr. Lankford and the ranking member, is much appreciated.

My understanding, we are probably going to have the first vote go up in 5 to 10 minutes, which means we have a chance to squeeze in a few more questions and if we could and maybe have one quick opportunity for each of my colleagues as well to wrap up, and we will likely follow up with you in writing. A number of issues, I know we are not going to get to, and that is a credit to the written statements that you provided, which gave a lot of good

detail, and your testimony here today that gave us a good ability to have an exchange.

I want to make sure I get in about the issue that has been mentioned a number of times and the training and the sustainability and that the systems we put in place—and it goes to Mr. Lankford—that we don't just have 2017 and, oh, we are good for 20 years and see what happens. But our goal is that when we get to 2017 that we have a work force that is well-trained and fully up to speed and moving forward with the FIAR guidelines, to have that audit be a clean audit and thereafter be able to do so. But the other is the systems we put in place in information technology.

When I first came along to this committee just as a ranking member—I mean as a member and then became the chair in January 2003, we were in the initial years of DIMHRS, the Defense Integrated Military Human Resource System, and it was promised as the savior of how it was going to help us get our hands around this, you know, personnel human resource systems in particular and all the expenditures related to it.

Last year, after I think 12 years of expenditures, over \$1 billion, it was basically cast aside. Admiral Mullen, Chairman of the Joint Chiefs, was quoted as saying it is a disaster.

I know there is a draft report that GAO has put out entitled Information Technology: OMB Needs to Improve Its Guidance on IT Investments. In that draft report from GAO, it references that, in the fiscal year 2011 expenditures, that governmentwide, it is just shy of \$79 billion in planned IT investments, of which almost half of those, \$37 billion, are Defense Department IT investments. And I think if I do my numbers correctly, maybe two-thirds are operations and maintenance of existing systems and a third is new investments.

Given the history of DIMHRS and \$1 billion of hard-earned taxpayer funds spent without a good return or perhaps any return in the end, what are we doing to make sure that the \$37 billion we are spending this year, some on existing, some on new investments, that we've learned the lessons of DIMHRS and that we are not getting far down the path and saying, you know what, this isn't going to do what we need to do and we start over again?

Mr. Easton, if you could take that.

Mr. EASTON. We are trying to apply the lessons, and I think that we are very deliberate, and there is a balance between holding these programs up and making sure that we are going to get our money's worth. But DIMHRS is a classic example of something that we cannot afford to repeat.

And in many cases, we—number one, we are trying to leverage something from the DIMHRS program. I certainly hope that we can. I don't know for sure if we will. But in at least one instance one of the components is stopping to say we are not sure we need a large system. We are not sure that we can make, you know, with a smaller investment to be able to get the capabilities.

It starts with applying the lessons and also ensuring that the specific problem that we are trying to solve and the specific functional advocate that is thinking about this all the time is involved and we don't just put this into a program and just expect things to happen. And so, you know, we are trying to apply that in our

investment review process to be able to make sure that that never happens again.

Mr. PLATTS. In that review process to learn the lessons, not repeat them, there are issues. When I see a number \$37 billion, perhaps maybe a third of which is new investment, are you also looking at making sure you are not being duplicative in those investments, that there is across-the-Department coordination of what you are doing, both that you are not duplicating efforts and that whatever different efforts are out there in the end will be able to talk to each other and be coordinated for the overall assessment?

Mr. EASTON. I co-chair an investment review board that partners with a weapons systems acquisition logistics, and I think that that makes sense. Because, in many cases, we said that we spend a lot of money in acquisition and logistics support functions.

We ask those specific questions. As systems come up to us for approval, whether it is a legacy system or a system that has to be modernized, if there is this question of why does the Air Force have this system and the Navy has the same system to do the same thing—and we've been able to make some successes, but, admittedly, that is still—that mindset is that everyone's special and we are trying to be able to do that and minimize that investment.

I should say as we go through the current budget process we are getting a lot of help in terms of reducing the amount of money that is invested in the business systems, and so we are going to have to make some hard decisions in that regard as well.

Mr. PLATTS. Mr. Blair, as we go forward and have the lessons of DIMHRS—and I know your office plays a role in auditing and kind of after the fact but also proactive—what role does the IG have in looking at those investment decisions, you know, proactively and prospectively so it is up front that you can help make sure the lessons learned are applied?

Mr. BLAIR. One of the things that we have ongoing right now are several audits of the ERP systems, and we are going to be starting in fiscal year 2012 doing audits of additional ERP systems. And it is important to note that these audits are not tail-end, gotcha-type things you should have done 10 years ago. What we are really doing, as the systems are being developed and as they are being rolled out in a staged manner, we are looking at the current scenario for the system and saying here's some areas that we think you need to correct before you roll it out any further.

GFEBs and LMP are two examples of systems where we've done a lot of audit work, and what I think is encouraging is the dialog that Mr. Easton and I have had over the past several weeks, especially on these systems, and how lessons learned can be taken from those ERPs to the other ERPs that are being developed so that the information that we are providing to them on one particular system can then be used to leverage and improve the rollout of other systems.

Mr. PLATTS. And, Mr. Khan, GAO I know has done a lot of work in this area of the investments. Have they done anything comprehensive that captures how much has been invested in IT in the broad sense, but specifically DOD, that was not productive and what the consequences of those failed investments were?

Mr. KHAN. Mr. Platts, I mean, we haven't gone down to that granular level of whether it has been productive or not. We did do a body of work last year which was focused on 10 business-related ERPs, and it was of concern. There were cost overruns and time slippages, and we had made several recommendations.

Like I mentioned early on to Mr. Towns' question, we have seen some positive signs and we hope to continue to see them in terms of investment management and milestone decisions.

An example I gave you was the Air Force's general ledger system where the milestone decision authority had made a decision to not give them permission to deploy that outside of Scotts Air Force Base until the current functionality was addressed. But there needs to be more oversight and hard questions to be asked before additional funding is given.

Mr. PLATTS. I am going to wrap up there, because I know votes are up. Mr. Towns, Mr. Connolly, do you have any other questions?

Mr. CONNOLLY. I just had one.

Mr. PLATTS. Just one.

Mr. CONNOLLY. Thank you.

As you know, we bifurcate Federal contracting training between the Defense Acquisition University and the Federal Acquisition Institute. Unfortunately, the FAI has only six employees and nowhere near the capacity to train contracting staff as needed by non-defense agencies. Do you believe if FAI could perhaps take some object lessons from how DAU operates and other opportunities from your point of view perhaps to scale up FAI in coordination with DAU?

Mr. EASTON. I am afraid I'd have to take that for the record and look into that from an acquisition perspective, and I'd be glad to do that.

Mr. CONNOLLY. I would welcome that. Thank you, Mr. Easton.

[The information referred to follows:]

CHARTS No.: HOGRGVTEFFICIENCY-01-001
Hearing Date: September 23, 2011
Committee: HOGRGVTEFFICIENCY
Member: Congressman Platts
Witness: DCFO Easton
Question: #1

Audit readiness

Question: At a September 8, 2011 hearing, Air Force comptroller Jamie Morin said that the Air Force would have trouble meeting the 2017 deadline for audit readiness due to its outdated bookkeeping system. Is the Air Force the only Department of Defense (DoD) component in danger of missing the 2017 deadline? If not, please provide a list of at-risk components, as well as an explanation of DoD efforts to ensure that each component will meet the deadline.

Answer: The 2017 deadline is an ambitious but achievable goal for all components. The recent directive by the Secretary of Defense to accelerate efforts across DoD for budgetary priorities to 2014 will increase the likelihood that all entities will also achieve the 2017 goal. The Department is committed to achieving these goals and has taken significant steps to ensure the goals are achieved by September 30, 2017, as directed by the Congress. These significant steps include:

- **Visible Leadership and Department-wide Audit Readiness Goal.** Auditability by 2017 is a Secretary of Defense designated priority and Strategic Management Goal.
- **Accountability and Incentives.** Overall accountability rests with the Deputy Secretary of Defense/CMO, while day-to-day responsibility has been placed on senior executives, both financial and functional, across the Department who are being held accountable for meeting audit readiness milestones and outcomes through organizational and individual performance plans and evaluations.
- **Broader Functional Community Support and Participation.** A streamlined approach with well defined short-term and long-term milestones focusing first on information most often used to manage the Department (Budgetary and Mission Critical Asset information) has better engaged the functional community.
- **Senior Leadership Oversight and Involvement.** Progress is reported and monitored by a formal and regularly scheduled FIAR governance process that involves the Deputy Secretary of Defense/CMO, USD(C), DoD Deputy CMO, Military Department CMOs and Financial Management/Comptrollers, and senior leaders from the functional communities.
- **Integrated Audit Ready Systems Environment Work.** The modernization of the Department's business and financial systems through the deployment of ERP systems utilizing process reengineering and business best practices is concurrently taking place and has been integrated into the Components' financial improvement plans.
- **Resources to Accomplish FIAR Goals and Objectives.** Resources of approximately \$200 million are being applied annually on DoD Component FIAR activity (excludes ERP resources).

CHARRTS No.: HOGRGOVTEFFICIENCY-01-002

Hearing Date: September 23, 2011

Committee: HOGRGOVTEFFICIENCY

Member: Congressman Platts

Witness: DCFO Easton

Question: #2

Logistics Modernization Program

Question: DoD has allocated \$1.08 billion to implement a Logistics Modernization Program that is supposed to help make the Army audit ready. However, the Office of the Inspector General (OIG) released a report in November 2010 finding that the program does not resolve internal control weaknesses and is not compliant with the U.S. Standard General Ledger. Is DoD working to resolve the issues raised by OIG?

Answer: The DoD is working to resolve the issues raised by OIG. Specifically, the Logistics Modernization Program plans to implement the required U.S. Standard General Ledger and DoD's Standard Financial Information Structure data elements in the system during Fiscal Year (FY) 2012. Currently the program is testing this implementation and anticipates LMP will implement the software changes in December 2011 with the first quarterly financial statement reporting in March 2012. Also, the internal control weaknesses identified in the November 2010 DoD Inspector General report have been addressed and corrective action will be implemented in FY 2012.

CHARTS No.: HOGRGVTEFFICIENCY-01-003
Hearing Date: September 23, 2011
Committee: HOGRGVTEFFICIENCY
Member: Congressman Platts
Witness: DCFO Easton
Question: #3

Improper Payments

Question: The amount of improper payments issued by the Department of Defense (DoD) is currently unknown. How is DoD identifying and reducing improper payments without knowing how much money has been issued improperly?

Answer: DoD has published its annual improper payment estimate in its annual Agency Financial Report (AFR) since Fiscal Year (FY) 2004. The six areas reported on are: Military Pay, Civilian Pay, Travel Pay, Military Retirement and Annuitant Pay, Military Health Benefits, and Commercial (Contract/Vendor) Pay.

The following represent the primary methods currently being used by Defense to identify and reduce improper payments:

- Statistically valid samples are used to identify improper payments for Military Pay, Civilian Pay, Travel Pay, and Military Retired and Annuitant Pay. The payment errors found in the samples are researched to determine the root causes of errors, and then specific corrective actions are implemented to help mitigate recurrence.
- The Military Health Benefits program also uses statistical sampling to identify improper payments. A third party contractor makes the benefit payments and is responsible for reimbursing the government for all improper payments identified and projected based on the sampling. In addition, a 100 percent post-payment audit is conducted by a different contractor to identify any improper payments not found in the sample.
- Commercial Pay improper payments are identified through Defense Finance and Accounting Service Internal Review auditors analyzing monthly extracts of invoice and disbursing data for payments made through various entitlement systems. In addition, internal recovery audit efforts, contract reconciliation, and contract close-out processes are also used to identify improper payments. Beginning in FY 2012, current methods will be supplemented with a statistical sampling approach, similar to that used in payroll and travel payments.
- Enhanced logic in the Business Activity Monitoring (BAM) tool has increased the number of manual input errors identified and potential improper payments prevented. The complexity of the contract financing terms makes the correct payment amount difficult to calculate, and is therefore subject to human error. BAM's improved logic

is the primary reason that commercial improper payments decreased significantly in the last 12 months.

CHARRTS No.: HOGRGOVTEFFICIENCY-01-004

Hearing Date: September 23, 2011

Committee: HOGRGOVTEFFICIENCY

Member: Congressman Platts

Witness: DCFO Easton

Question: #4

Improper Payments

Question: In 2009, the Government Accountability Office (GAO) identified significant weaknesses in DoD's process for identifying and resolving improper payments. GAO made 13 recommendations to improve the prevention of improper payments. Has DoD successfully implemented GAO's suggestions?

Answer: Yes, DoD has successfully implemented most of GAO's suggestions. Of the 13 recommendations contained in the report, DoD had 9 in place at the time the final report was issued in July 2009. One additional recommendation was completed and reported in the Agency Financial Report for Fiscal Year (FY) 2009.

The three remaining recommendations addressed the need for DoD to conduct individual program risk assessments to ensure all programs and activities had been reviewed to determine risk susceptibility. In FY 2006, the Office of Management and Budget instructed DoD that all Defense outlays were high risk due to the volume of outlays disbursed. Therefore, it has been the Department's position that individual program area risk assessments would be redundant, and would expend agency resources that could be better used in other areas.

A large portion of annual outlays are not subject to improper payment review, such as Intragovernmental payments and trust fund transfers. In addition, classified outlays are subject to review for improper payments, but not for public reporting.

CHARRTS No.: HOGRGOVTEFFICIENCY-01-005

Hearing Date: September 23, 2011

Committee: HOGRGOVTEFFICIENCY

Member: Congressman Platts

Witness: DCFO Easton

Question: #5

Risk Assessments

Question: In 2009, GAO found that DoD did not conduct risk assessments for all of its payment activities and \$322 billion in outlays was not assessed for improper payments at all. What percentage of outlays and payments are assessed by DoD for improper payments?

Answer: The vast majority of outlays are reviewed for improper payments reporting, including the substantive portion of the \$322 billion called out by the Government Accountability Office (GAO) based on data from Fiscal Year (FY) 2007. This figure represented our contract and vendor payments for that fiscal year, and \$232.8 million in improper payments (both overpayments and underpayments) were reported on those outlays in the FY 2007 Agency Financial Report (AFR).

The Department disagrees with statements by the DoD Inspector General and the GAO when they have stated that large portions of outlays are not reviewed for improper payments. This type of statement is misleading. Since FY 2006, DoD has reported annually to the OMB in its AFR for the following six areas:

- Military Pay
- Military Health Benefits
- Civilian Pay
- Military Retired & Annuitant Benefits
- Travel Pay
- Commercial Pay

And, in accordance with the *Improper Payments Elimination and Recovery Auditing Act of 2010*, DoD has begun implementing a statistical sampling plan for the Commercial Pay area.

Mr. CONNOLLY. Mr. Khan, GAO got a point of view about that?

Mr. KHAN. I do not. I don't think we have looked at it. I will take that for the record if there is any work that we have done.

Mr. CONNOLLY. I would just note for the record that we got a letter from Dan Gordon from OMB, very strange letter, given the fact that I am the author of the legislation, try to scale up FAI, indicating that we really didn't need to do much and we already were doing a fine job.

That is not true. It is shocking to me that OMB would send such a letter without at least first consulting with the author of the legislation. And I can just assure you this Member of Congress is going to aggressively continue to pursue trying to scale up FAI so that we have contracting—skilled contracting managers in place to manage complex, large, often systems-integration-type contracts for other Federal agencies besides DOD; and I'd appreciate you taking that word back.

Thank you so much.

Mr. PLATTS. I thank the gentleman.

There are a whole host of issues that we didn't get to, but we are going to need to wrap up here, and my understanding from the ranking member is we have 14 votes. So we will not be asking you to stay. You would have lunch and dinner and still be waiting, I think.

One issue in particular that I wanted to put out there is the Logistics Modernization Program with the Army. One of the things that jumped out in, Mr. Blair, your testimony about this program is that implemented I think over \$1 billion again invested; and yet, as you say in your testimony, the system also did not resolve any of the 10 Army working capital fund internal control weaknesses.

That is where—while I want to believe you, Mr. Easton, that—why should we, you know, this time think, hey, we are going to get it right? When I look at that, it makes me think we are back at DIMHRS 7 years ago and that we are spending a lot of money and we are not actually achieving the success we need.

So I want that to be on the radar. You know, again, that is a concern.

A final comment would be we are grateful for all three of you and your colleagues that are working hand in hand with you on this important issue. And, as Mr. Lankford said, we have the best military in the world, and it is tremendous in defending this country, but if we can get these issues right, we will have an even greater ability to provide the resources that that military needs to continue its heroic efforts on behalf of our Nation.

And I know each of you share this perspective that we really are about not that heroic effort to get a check but to put in place long-term solutions so that this is a systemic change in the mindset of the personnel, in the systems in place, in every aspect, that 2017 will be the start of a long history of DOD being able to say we know how much money we've got, we know where it is going, how it was used, year in and year out, day in and day out. Because that will better serve all the managers in DOD who are using those resources for the good of the military personnel.

We look forward to continuing to work with each of you and your offices going forward. As I said, Mr. Towns and I have been

partnering on this issue for almost a decade now, and hopefully neither one of us is going anywhere anytime soon. We might keep trading chairs sometimes. I don't know. Hopefully not anytime soon, changing our chairs here. But it is something that we very much believe in the importance of and as good partners we do right by the American people and our military personnel and their families.

So we will keep the record open for 2 weeks for additional information, and thank you, again, for your testimony.

This hearing stands adjourned.

[Whereupon, at 11:40 a.m., the subcommittee was adjourned.]

