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**DEPARTMENT OF DEFENSE
PERSPECTIVES ON FINANCIAL
IMPROVEMENT AND AUDIT READINESS
EFFORTS**

COMMITTEE ON ARMED SERVICES
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

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**DEPARTMENT OF DEFENSE PERSPECTIVES ON FINANCIAL
IMPROVEMENT AND AUDIT READINESS EFFORTS**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
Washington, DC, Tuesday, January 24, 2012.

The committee met, pursuant to call, at 10:34 a.m. in room 2118, Rayburn House Office Building, Hon. Howard P. “Buck” McKeon (chairman of the committee) presiding.

**OPENING STATEMENT OF HON. HOWARD P. “BUCK” MCKEON,
A REPRESENTATIVE FROM CALIFORNIA, CHAIRMAN, COM-
MITTEE ON ARMED SERVICES**

The CHAIRMAN. I would like to welcome everyone to today’s hearing on the “Department of Defense Perspectives on Financial Improvement and Audit Readiness Efforts.” We just heard from Representative Mike Conaway, the chairman of our Defense Financial Management and Auditability Reform Panel, who briefed the committee on the panel’s findings and recommendations contained in the panel’s final report.

He is our subject matter expert so I will not restate what he just said. Unfortunately our other subject matter expert, Rob Andrews, could not join us here today, but we are pleased to have our briefing be followed by today’s hearing so that the committee might also receive the Department’s perspectives on the report and its ongoing financial management reform efforts.

I would like to thank the Department’s witnesses that are here today as well as those who have testified in previous panel hearings.

The Department’s willingness to make time to testify in the many early morning hearings conducted by the panel is a testament to its commitment to achieving financial management reform. With that said, as pointed out in the panel’s report there is much work to be done for DOD [Department of Defense] to reach its financial improvement and audit readiness goals. But with the billions of dollars in budget cuts facing the Department and the need to have reliable information in order to make the tough decisions, DOD must take the necessary actions to overcome the challenges it faces.

The committee stands ready to support DOD in this effort and is interested in receiving feedback on the panel’s work to assist us in our oversight on this very important effort. We have with us here today the Honorable Robert F. Hale, Under Secretary of Defense (Comptroller) of the Department and the Honorable Elizabeth A. McGrath, Deputy Chief Management Officer of the Department of Defense. Let me conclude by saying two more things. Given the

change in defense strategy recently announced by the President and the significant budget cuts the Department has to implement, starting this year, all of us are anxious to learn more about the specific changes contained in the fiscal year 2013 budget request.

We will have that opportunity next month, but although we are joined today by Secretary Hale, I recognize that he is not at liberty to discuss these issues in advance of the President's release of the budget. Thank you again for joining us, nevertheless.

Lastly, following what must have been a difficult decision to resign from office, I want to wish our colleague, Representative Gabrielle Giffords, our very best in her recovery and make sure she knows that she will be missed.

She was a leader on this committee and a tireless advocate for our men and women in uniform. I know our last conversation in December during the—what do we call that when we all—the lame duck session at the end of the last Congress—a nightmare, yes—she came up to me on the floor and requested that as early as possible, as a committee, we visit Fort Huachuca in her district, which was very important to her. I am sorry that we haven't made that trip yet, but I think it is something that we should schedule as a trip to one of the bases that we have been trying to do.

And when we do, we should invite her if she is able, to accompany us on that visit. I know leaving public service and the constituents she has worked so hard for cannot have been an easy decision. She will continue to be in our thoughts and prayers as we move forward on our work in this committee.

Mr. Smith.

[The prepared statement of Mr. McKeon can be found in the Appendix on page 27.]

STATEMENT OF HON. ADAM SMITH, A REPRESENTATIVE FROM WASHINGTON, RANKING MEMBER, COMMITTEE ON ARMED SERVICES

Mr. SMITH. Thank you, Mr. Chairman. I appreciate those comments, and I certainly want to echo them. Gabby will be very much missed from this Congress and particularly from this committee. She worked tirelessly, as we all know on, gosh just about every conceivable issue that was before us; and worked with many different members—Democrat and Republican alike—on the issues that were important to her district and the issues that were important to the country. I have had the opportunity to visit Fort Huachuca on a couple of occasions and Davis-Monthan Air Force Base as well and they absolutely love her out there.

They know that she is working hard on their behalf and has done a fabulous job representing that district in Arizona. I think the encouraging thing is how much her physical condition has improved over the course of the last year. I think what she was mindful of, is that this is a, you know, a 2- to 3-year recovery period from this type of injury. She is going to continue to get better. But she needs to focus on that and focus on her health. And I think also the understanding was, you know, that there is a way to represent a district. It is the way she has represented it for her entire career, 100 percent and with just full on energy.

And if she couldn't do that, she didn't think it was fair to the people of her district to continue in that capacity. And I greatly admire that decision, even as I am very personally disappointed by it because we would love to have her back on this committee. But I think it is also important for everyone to remember what she said and in that announcement and has said since, this is an interruption, not an end. She wants to be back into public service in some capacity or another. Focused on her health right now, but as she said more than once, she will be back.

And we all look forward to her continuing in public service in any of a number of different possible capacities; great serving with her. Who knows, hopefully we may have that opportunity again at some point, and I thank the chairman for his kind words and appreciate Gabby's service on this committee during her time in Congress.

I had made opening remarks earlier about the auditing process—don't have anything further to say on that. I look forward to our witnesses' testimony, and I thank the chairman for holding this hearing and for his work on this important issue. I yield back.

The CHAIRMAN. Thank you.

Mr. Hale.

STATEMENT OF HON. ROBERT F. HALE, UNDER SECRETARY OF DEFENSE (COMPTROLLER), U.S. DEPARTMENT OF DEFENSE

Secretary HALE. Well, thank you, Mr. Chairman and members of the committee. Thank you for your interest in financial management at the Department of Defense. And we especially want to thank Chairman Conaway and his ranking associate, Congressman Andrews, and the members of the Defense Financial Management and Auditability Reform Panel for their support.

And let me say, everybody in the Department of Defense will miss Congresswoman Giffords. She was an able supporter of the Department, and we certainly wish her the best.

Ms. McGrath and I submitted a statement for the record that contains our reaction to the panel's recent report.

[The joint prepared statement of Secretary Hale and Ms. McGrath can be found in the Appendix on page 29.]

Secretary HALE. It also describes our overall approach to auditability. We will now deliver a joint oral statement that summarizes the key points. Let me start with the panel report. Most importantly, we find the panel's report balanced and constructive. It recognizes the progress we have made in overcoming historic impediments to audit readiness, and we are pleased that the report endorses our financial improvement and audit readiness, or FIAR [Financial Improvement and Audit Readiness] strategy, which is to focus first on the information DOD most uses to manage the Department, especially budgetary information and the accounts and locations of our assets.

The panel did identify five areas where action is still needed, and we would like to comment briefly on each of those. First, the panel concluded that we need sustained leadership. We fully agree with that. Today, we have the support from the Secretary himself, from the Deputy Secretary, and from many other key leaders in the De-

partment. But while we have strong senior leader support now, we know this support must be sustained as leaders change.

Our goal is to build up momentum so that this current FIAR effort will continue, and we are building that momentum by establishing a clear governance structure. We have that in place. Setting aside dedicated resources. We have in our future years defense plan money in each of the years in each of the departments, and money to help each of the defense agencies, and identifying short term and long term goals, which we have done. We also expect and welcome congressional oversight, which should help to sustain momentum.

A second factor identified by the panel involves the DOD Financial Management workforce. Our professionals are capably supporting key missions around the world. I am very proud of them. They are in Afghanistan. They are in all the hot spots as well as so many other places. But the business environment is changing and we need to change our training to match.

In the short term we are achieving practical training in audit readiness by using independent public accountants who have great expertise in this area. For the longer term, we are implementing a course-based certification program to ensure that financial managers have the skill and experience in key areas, including financial statement audits.

We appreciate congressional support for this program in the fiscal year 2012 Authorization Act. You provide us legal authority to put it in place. And we are working aggressively to get the certification program started. I had a briefing on it yesterday. We expect to have pilots in place by the end of the calendar year.

The third factor identified by the panel involves enterprise resource planning systems. This is a key area, and let me ask my colleague, Ms. McGrath, to address this important topic.

STATEMENT OF HON. ELIZABETH A. MCGRATH, DEPUTY CHIEF MANAGEMENT OFFICER, U.S. DEPARTMENT OF DEFENSE

Ms. MCGRATH. Mr. Chairman, other members of the committee, I too appreciate the opportunity to discuss the panel's report with you today and echo Mr. Hale's heartfelt thanks to Congressman Conaway and Mr. Andrews, for their focused attention to this important topic.

As the panel in the report notes, effective implementation of enterprise resource planning, or ERP systems, will not enable auditability by itself, but it will help to achieve the modern business environment needed to meet and sustain our goal of audit readiness. Both the panel and GAO [Government Accountability Office] recognize that the Department has improved the way we acquire and implement ERPs over the past 2 years. That said, they also believe that we can and need to do even better. The Department agrees.

We also agree with the panel that it is important to closely link our ERP efforts to audit readiness. To this end, we are employing a number of tools to establish and maintain the linkage. For example, we are tying business outcomes, including auditability to acquisition milestones, and requiring individual programs to define

what specific role they play in achieving those business outcomes. We have done this recently with both the Army and Navy's financial systems, the General Fund Enterprise Business System and the Navy Enterprise Resource Planning system, and the Army's logistic system, the Global Combat Support System.

We also share the same view as the panel with regard to the importance of overcoming challenges in acquiring ERPs, specifically in requirements definition and testing. To this end, we issued streamlined policy for the acquisition of business I.T. [Information Technology] systems that emphasize rigorous analyses of capability gaps, summarizing them as a problem statement, focusing also on incremental delivery of capability in 18 to 24 months, and using a business case and a program charter to streamline documentation.

Additionally, to help better define and stabilize requirements for our acquisition programs, we are driving better application of business process re-engineering, especially as a precursor to the acquisition of a business system or a capability. We are grateful that the panel's report emphasizes one of our toughest challenges, dealings with the problems inherent in implementing ERPs in a legacy environment.

The report rightly cites the difficulties associated with data conversion. Complications arise when the quality of the legacy data is not equal to what is required by a modern ERP system, and the need in some cases is to institute multiple interfaces to legacy systems. Our goal is to significantly reduce and/or eliminate as many interfaces as possible.

We are working aggressively to sunset our legacy systems wherever and whenever appropriate. The Navy ERP is a great example of how the implementation of a ERP can lead to the retirement of legacy systems. The system provides an integrated business management capability that modernizes, streamlines and standardizes how the Navy manages people, programs, money, equipment and supplies.

It has enabled inventory reduction, real-time visibility of assets, resources and inventory, and improved financial controls. It has approximately 66,000 users worldwide managing approximately \$62 billion. And it also has enabled the retirement of 27 legacy systems to date, with 69 more scheduled to be retired by 2016.

Furthermore, we appreciate Congress' recent change to our Business Systems Investment Review Board process, specifically Section 901 of the Fiscal Year 2012 National Defense Authorization Act, which enables visibility of the entire business portfolio, not just the modernization efforts. This will greatly assist our efforts to rationalize the legacy environment.

In closing, I thank the panel for its work and carefully considered recommendations. I would also like to thank the committee for its continued attention for both auditability and the DOD's broader business operations.

This concludes my statement. I look forward to your questions. [The joint prepared statement of Ms. McGrath and Secretary Hale can be found in the Appendix on page 29.]

Secretary HALE. Let me pick up with a couple other points, and then we will get to all of your questions.

And thank you, Beth.

Important as they are, improved financial systems by themselves aren't going to get us to auditable financial statements. We also need improved financial reporting controls. And that is a fourth concern expressed by the panel. Controls are a key to audit success, but sometimes we find that ours are inadequate, sometimes they are too variable across commands, or they are not adequately documented.

To address this problem, the services are enlisting help from their service audit agencies, their internal auditors. The audit agencies have people who are qualified to assess management controls and make sound recommendations. We also need the support of field commanders who can ensure that management control improvements actually occur. And we are seeking that support.

Better internal controls should help with improper payments. Our improper payment rates are actually lower than most civilian agencies, as measured as a share of our budget, even though those agencies have clean opinions. But we need to do more and we are taking the steps to lower improper payments even further. The same is true for unmatched disbursements and Anti-Deficiency Act Violations.

And fifth on the panel's list, we are taking actions to institutionalize these various improvements, and to raise awareness of the audit efforts in nonfinancial areas. We have a strategic management plan that clearly incorporates this initiative. The Secretary's directive on auditability issued last October certainly helped raise awareness. It has also created new goals for us.

The Secretary wants us to cut in half the time that we will spend getting our budget statement ready, the statement of budgetary resources for general funds. Specifically, he wants that statement be audit-ready by 2014, and he wants us to take other steps to increase audit readiness. We are carrying out Secretary Panetta's direction. An overview of our accelerated plan was submitted to the Secretary in December, and he approved it.

We are now developing the details where needed to ensure that we can execute the new plan and that we have a way to hold people accountable. We will be prepared to brief your staffs in March on the details and will provide more comprehensive information in the May version of the FIAR report.

Let me conclude by addressing our overall audit efforts. Our goal is to have all DOD financial statements audit-ready by 2017.

The key to achieving our 2017 goal is building a foundation. To do that, we need to carry out things we are doing right now, our current priorities, achieve auditable budget statements, and counts, and locations of assets. That foundation will greatly help us as we work toward asset valuation, which is the other major step that we have to carry out by 2017.

We also need to sustain effort in this area, and in that regard, there is one area where we could use your help. In the past year, we have had no fewer than four threats of a Government shut-down. It required enormous planning efforts. We were on a 6-month continuing resolution, also required a great deal of management attention.

Now the prospect of sequester is hanging over us. This uncertainty has drained valuable time and leadership attention for many

initiatives, including our commitment to audit readiness. Congress could help us a great deal by returning to a more orderly budget process.

Especially with regard to business processes, the Department of Defense is, if you will, more like an aircraft carrier than a speedboat. It doesn't change quickly. But we are building a foundation for auditability and we have created considerable momentum.

And, aircraft carriers, once again, started, also don't stop quickly. And because we are building a foundation and creating momentum, I am reasonably confident that we can meet our goal to have all DOD financial statements audit-ready by 2017.

Mr. Chairman, on the end, as I started—by expressing appreciation for the committee's interest in this topic and appreciation for the panel's suggestion and its recognition of our progress. That concludes our statement. We welcome your questions.

The CHAIRMAN. Thank you very much for your report and for your testimony.

I know you can't go into specifics of the upcoming budget request, but one of the critical factors for success in meeting your financial management and audit reform goals will be the availability of resources.

Do you have confidence that the fiscal year 2013 budget request will continue to provide resources required to meet your accelerated audit readiness goals? I know you just mentioned things that we could do to help, like returning to regular order.

Some of our Members may be wearing buttons today, listing 1,000 days since the Senate has passed a budget. It makes it very difficult to return to regular order when we pass the budget on our side, but are not able to get the Senate to function properly under regular order. So maybe it would be good if you get the opportunity to testify over there, you can make the same request of them.

I know we will be striving to get our budget passed and do it through regular order on our side here, and hopefully we will be able to get that done. I know we were told that the Secretary—they were going to give us the budget, and they have had to move it back for a week. But we have been able to adjust our schedule to keep on schedule, to get our work done. We will try to do your request.

I know a lot of people think that this will be a pretty much political year and will probably end up the year in another continuing resolution that is unfortunate. I hope that is not the case. And I hope we are able to return to regular order and we will be trying—if we could get all Congress to function the way our committee does, that would be a big step forward.

Anyway, if you can think of anything that we could do that we are not doing in regard to specific amounts that you need to make sure that you have the resources you need, be happy to hear them if you have any specifics other than what you already mentioned to us.

Secretary HALE. Mr. Chairman, I think we are going to be okay on resources. I will not go into specifics. It helps to have Secretary Panetta's support. It probably doesn't hurt to have the Comptroller's support. So I think we are going to be okay in terms of the

budget resources. It is not on my worry list. Sustained leadership is, but that is not. So I think we are okay.

The CHAIRMAN. Very good. Thank you.

Mr. Smith.

Mr. SMITH. Thank you, Mr. Chairman. First of all, I want to point up something you said near the end of your testimony and that is the, you know, four times when you were uncertain exactly how the money was going to be coming to you this year, the four threats of a Government shutdown.

I don't think there is a proper understanding in this body, or even nationally, the devastating impact that has on the ability of the Government, certainly DOD, having such a large budget. And that is the one that I am most intimately familiar with.

I remember meeting with folks over at the Pentagon as they were trying to figure out what they were going to do, which programs they could continue, where they could find the money to continue them, which ones were going to have to be suspended.

And I know out there in the private contractor world, they didn't hire people. They had a program. They knew it was supposed to be funded, but then maybe it wasn't going to be funded. So they had to ramp up. They were planning on hiring people to get ready to do this, but they didn't know if it was going to happen, so they couldn't hire them.

It is devastating when this body is unable to pass the normal appropriations and authorizing bills in some sort of regular order. We tend to think, here in the last couple of years, that that is just what happens. We can't get an agreement, so we do a C.R. [Continuing Resolution] and then maybe the C.R., you know, leads to a threatened shutdown and, well, that is just the way things go.

It is horrific in terms of its impact upon the ability of the Government to do its job; and again, not just DOD.

And while we are out there wrestling with constituents who are deeply dissatisfied with Government, its ability to do its job by whatever definition they have, understand that we are just crippling that by not being able to give all the departments some predictability about when they are going to get their money, whatever that amount of money is.

So I just wanted to place an extra little exclamation point on that. And, you know, I know this committee, you know, we passed our bill in May, waited for 6 months for the Senate to pass it. So I will say I think this committee did its job. But collectively as Congress, we need to do our job to enable you to do this.

And then I just have two questions. One, to just sort of frame this, I mean, it has been said in the press that, you know, the Pentagon doesn't know where it is spending its money because it can't audit properly. I think a lot of people don't know what that means in sort of concrete terms.

What is it that the Pentagon is unable to do, and how does that translate into the notion of knowing where you spend your money? Could you explain that a little bit in terms of just where the problem is at, the sort of what it is and what it isn't?

Secretary HALE. Well, I will try. First off, in—

Mr. SMITH. I am sorry. The microphone is sort of off to your side there, if you could get that over, that is great.

Secretary HALE. Better?

Mr. SMITH. Yes.

Secretary HALE. I will try. First off, I am fully committed to auditable statements for a variety of reasons, but the most important reason is we need to reassure the public and the Congress that we are good stewards of their funds and will never do it unless we can pass an audit. So I have committed a lot of effort to that.

That said, I believe that when it comes to knowing where we spend our money by appropriation, the way you appropriate it to us, we do have accurate information. Our systems are designed to do that. They do it pretty well.

And I would offer, as corroboration, the absence of problems. We do about 140 million accounting transactions a year in DOD. If we were off even by 1 percent, that would be more than a million incorrect transactions. You would see regular mispayments to contractors. And we have a few, but not many.

You would see regular mispayments to people or improper payments to personnel are a couple tenths of a percent, and they usually go away quickly. You would see unmatched disbursements in a wholesale basis. We are not seeing any of that. So I am confident that the data is reasonably accurate, but so we need to demonstrate that through an audit, and I am fully committed to doing it.

Mr. SMITH. In layman's terms, then—and I am not an accountant—what does it mean that you can't do an audit?

Secretary HALE. Well, let me try that. I do that with some humility, with Mr. Conaway here as a CPA [certified public accountant], because I am not. But basically an auditor wants to see for every entry in your budget statement—let me focus on that—they want to see an invoice. They want to see a receiving report that said you got the goods. They want to see a contract that matches the price and the invoice.

And we do with 140 million transactions a year. We can't quickly generate all that documentation in a manner that satisfies auditors. One of the big things the Enterprise Resource Planning systems will do for us is keep that information, particularly the receiving reports and the invoices in a manner that is electronically accessible.

Right now, you have to go out to the bases in some case. They prowl through your files, find that invoice, and there are thousands of them when they sample. We can't do it quickly enough. We can't balance—at a transaction level, with our Treasury account—the so-called funds balance with Treasury, which is required. And we should be able to do it.

So we can't reassure you, and we need to do that. But the absence of fundamental problems, it leaves me convinced that the basic data we are presenting to you when we show you the budget in a couple of weeks are accurate.

Mr. SMITH. Okay. I had another question, but I will hold off on that, and yield back. Thank you.

The CHAIRMAN. Thank you.

Mr. Bartlett.

Mr. BARTLETT. That is testimony to our inability to adequately communicate with our constituents the average constituent be-

believes that if we just didn't have any earmarks—and now we don't—that if we cut out foreign aid and if we cut out waste, fraud and abuse, we probably could have balanced the budget.

I am not sure we are going to cut out foreign aid, but they would certainly like us to cut out waste, fraud and abuse. And they have the perception that unless we can audit what we are doing, there is little chance that we are going to be able to cut out waste, fraud and abuse.

Can you, in a couple of minutes here, so we have a statement for the record, tell our constituents why it is so difficult for DOD to keep records that can be auditable? And then could you provide us a little one-pager that we can send to our constituents who wonder why half of the money in our discretionary spending cannot be audited?

Secretary HALE. Well, Mr. Bartlett, I will offer you an answer but not an excuse. We need to do this. And we need to move to do it quickly.

The reason is, at least partly, goes to the answer I just gave Mr. Smith, we don't have systems in place right now that allow us to quickly get the information that an auditor requires. As I said, they want an invoice, they want a receiving report, they want a contract. With 140 million transactions a year—and maybe 10,000–20,000 sampled transactions by an auditor, you have to have that in an automated form because they want it in a couple of weeks. And we don't have that right now. We also don't have internal controls that are adequate. I will give you a couple examples to try to make that a little more clear.

We went to some of our bases when the Marine Corps had its budgetary statement under audit, and the auditors found that we had not taken off people who had left the base. We had not taken them off access to our financial systems. They say, "Wait a minute. I mean, that is a fraud potential." That is pretty easy blocking and tackling, but we have got to get it done across the Department.

We also do something called bulk obligations of military personnel dollars. We obligate them broadly for, say, a whole command. This is efficient for us, saves us time. The auditors don't find that acceptable. They want to be able to track it back to the individual and be sure, you know, Sergeant Bob Hale really is a sergeant and is getting paid properly. So we have to change our businesses practices to avoid bulk obligations, or at least have the detail that they want.

Translating that for the American people, we will take a shot. But it is pretty technical stuff. It is just we got to get it done and we need to reassure you and the public that we are good stewards. And as I said before, I don't think we will ever do that unless we can pass what every viable company in America has to do and pass an audit.

If I have time, I will tell you a brief story. It was in 1994. I had taken over as the Air Force financial manager and I was trying to do audit then and I didn't get too far. I was talking to my wife about why our statements weren't auditable.

And first off, she is not an accountant, so I had to try to explain what audit meant. And I did that. And then she stopped me and she said, "Well Bob, if your statements aren't auditable, how do

you know people aren't stealing from you?" Financial statement audits aren't really designed to detect fraud. That is not what they are designed to do.

But I started to explain that and I just stopped and realized we aren't ever going to convince the American public we are good stewards until we do this. So we are trying. And I would like to be getting there faster, but I think we have made a fair amount of progress. And I will try for the one-pager.

Mr. BARTLETT. Can you give us a little one-pager in layman's language that they will understand of why it is so difficult?

[The information referred to can be found in the Appendix on page 43.]

Secretary HALE. I will try.

Mr. BARTLETT. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Mrs. Davis.

Mrs. DAVIS. Thank you, Mr. Chairman.

I would just ask you to follow up really on the question that I asked Mr. Conaway about how you move this in a way that the need for auditability becomes part of the culture in a way that the—and he mentioned the evaluations, and that is part of the report that they put forward and how important that is to senior leadership and what goes down the line.

But how do you tell people that this is really going to change? And I guess the other question that I have to ask myself is was this not in place before? What is changing?

Secretary HALE. Well, let me go to your first question. How do you do it? Tone at the top really helps. Secretary Panetta's endorsement of this has been of enormous advantage. I view it as a golden opportunity. I am looking how I can leverage that. And I think he is convinced that this is important, and that is beginning to circulate through the system.

We need to get this from being a comptroller issue to a commander's issue. It is the commanders that can make these changes that have to happen. I think that is starting to happen, but we haven't gotten there yet. We are doing a meeting I hope this afternoon with the Deputy's Management Action Group. We will have all the vice chiefs there. And one of the questions we are going to ask them is how do we do better at getting this to be a commander's issue.

As you heard Mr. Conaway say, we have asked that the performance plans for every member of the senior executive service who has any significant involvement with audit, their performance plans specify that this is one of the things that they have to do. That ties to bonuses. And so it is a step in the right direction.

We have to do all of that and more. Why haven't we done it before? I would just have to say that management attention has been variable. We haven't sustained it. And we are big and we are fighting wars and all the reasons or excuses that you hear, but we just have to sustain the attention and make this happen.

Mrs. DAVIS. Do you see a role for the personnel committee, as Mr. Conaway stated, to make certain that there is an acknowledg-

ment, and participation by all those involved, all the stakeholders involved in this?

Secretary HALE. So as I have said to Mr. Conaway, political appointees don't usually ask for hearings. However, I think it is appropriate that there be ongoing hearings. I will let you decide where that will be. I won't specify the organization.

But I think it is appropriate to have some ongoing oversight, perhaps particularly during the change of administration. And no matter what happens in the election, there will be change in senior leaders. That is just inevitable.

So I think it would be appropriate perhaps particularly during that period to have oversight hearings. And if you wanted to ask in your personnel role whether the members of the senior executive service at each department have this in there, I would welcome that. I think you will hear yes because we work carefully with the departments, but I think it would be a good question to ask.

Mrs. DAVIS. Ms. McGrath, did you have anything you would like to add?

Ms. MCGRATH. I would echo Mr. Hale's comments about the—you know, this has to come outside of just the comptroller community. And so we have embedded every functional area into the governance process of the Financial Improvement Audit Readiness. It is more than just he and I at the table and the accountants. It is everybody. We are cascading those into the performance plans, holding those members accountable.

And we are also tying, as I mentioned in my statement, the implementation of the various systems. These are logisticians now paying attention to audit as part of an acquisition decision. What business outcomes are we trying to achieve? Not only the logistics aspects, but also the audit piece so they are not separate. So I think we are taking a much more integrated approach to achieving collective business outcomes, as opposed to specific functional outcomes. And I think all of that has been very helpful.

Mrs. DAVIS. Okay.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman. Mr. Hale and Ms. McGrath, on the Panetta 60-day review of the 2014 statement of budgetary resources acceleration, can you give us kind of where we are right now? We are a little more than 90 days past that deal. Can you give us a sense of where that is going?

Secretary HALE. I can. First off, procedurally, we gave the Secretary 2 days before it was due a summary of the plan. He has approved it. We are now moving and well along with getting details, dates and who is responsible.

Some of that will get reviewed at what I hope will be this meeting this afternoon with our Chief Management Officer, Dr. Carter. And Ms. McGrath and I will be there for that. But let me try to be helpful. And at some point we need to share more details with you. I understand that. Let me try to be helpful and try to tell you where we are kind of by department.

The Marine Corps is in the best shape. There is a statement of budgetary resources actually under audit. I have got my fingers

crossed for a positive opinion. We will know by March, but we have learned a lot and they are clearly a lot better off. Your 8,000—400 analogy you used in terms of hours I think is characteristic. So they are furthest ahead. I am not too worried about them.

The Naval Service is in pretty good shape. They had intended to assert audit readiness on the statement of budgetary resources by 2014. They just have to do it. I don't want to understate the important of that.

The Army will have to speed up by about a year compared to their previous plan. They will need to be sure their GFEBS [General Fund Enterprise Business System] system, it is their ERP, is in place. And they are going to have to accelerate some of their data-cleaning efforts. Some of the older data that they had hoped would just sort of go away with time by 2017 won't by 2014.

The Air Force faces the biggest challenge of the military departments because it was depending on the DEAMS [Defense Enterprise Accounting and Management System] system, which they had hoped to have there by 2017—is not going to be there in large part by 2014. They are going to have to look at workarounds and maybe higher sample sizes or other approaches for some of their existing systems for a year or two. I don't mind that, so long as we have got a long-term plan to get off that. I don't want to do that on a permanent basis.

The defense agencies, only 3 of I think 26 defense agencies have clean audit opinions. We have got a big job there. They are smaller, so each one is not a problem. It is their number that is an issue. And I think they are challenging because of their number.

We have set up a small group in my office to try to help them, and we have set aside some money in this forthcoming budget to act as seed money to help them move ahead. Ask them to assert readiness for what is called appropriations received, their funds distribution by next March and audit readiness by 2014.

We need our service providers like DFAS [Defense Finance and Accounting Service] to be ready and our principal staff assistants, like me, to work with their defense agencies to make sure that they are moving ahead. So that is probably more detail than you want, but we are getting there in terms of this plan.

Mr. CONAWAY. Part of Secretary Panetta's charge was for the Deputy Secretary of Defense to set up a periodic review process on this issue so that we keep that sustained leadership emphasis on it. Has the Deputy had a chance to put something in place yet?

Secretary HALE. He has. He will use this Deputy's Management Action Group, which is all the under secretaries, the vice chiefs, the principal staff. The under secretaries from OSD [Office of the Secretary of Defense] are all represented on this group. And basically what Ash Carter has said to me is, you know, "Bob, tell me when you have something ready for me."

And so we have a meeting this afternoon that will go over the plan for acceleration. And also we are going to use that opportunity when we have all the vice chiefs there to say, "How do we get this out in the field? How do I get commanders involved?" I think they are starting to do that, but I would like their advice.

And, basically, Dr. Carter has said, "Come back to me when you are ready for another meeting when you have something meaning-

ful.” He didn’t want to schedule it every 2 months, and I think that is right. It is my job to tell him when we are ready to go. So yes, I think there is a process in place.

Mr. CONAWAY. Beth, do you want to add to that?

Ms. MCGRATH. I would just echo Mr. Hale. As was mentioned in our written statement, financial auditability remains a priority for the Department. We have cascading governance throughout the organization so that there is an appropriate level of accountability. And I think Mrs. Davis asked earlier what was missing or what is different. I think that that is a big factor.

Mr. CONAWAY. Thank you both again for testifying. Let me make one comment. We probably ought to modify the “unauditable” phrase by saying it is unauditable at rational costs. You could unleash enough auditors to redo every transaction, all 140 million transactions, and you could get an audit. That is not rational to do that.

So we may want to make sure people understand that unauditable means you can’t audit it at a cost to the system that makes sense. With those comments, I yield back.

The CHAIRMAN. Mr. Kissell.

Mr. KISSELL. Thank you, Mr. Chairman.

Secretary Hale, good to see you again. I remember when we traveled together before you made a statement. I think it was something like “you are not happy until everybody else is unhappy.” Is that correct?

Secretary HALE. Yes, that is one of the mottoes of the Comptroller. “We are not happy until you are not happy.”

Mr. KISSELL. Are we making progress towards making you happy?

Secretary HALE. Yes, I think so. I am not quite sure where you are going, but I think we have got the Department headed in the right direction on this and so I am pleased, but I recognize we have got a long way to go. And so I am also humble and I’d really like to underpromise and overdeliver for a change. We have been doing the opposite for 17 years, overpromising and underdelivering and we need to deliver.

Mr. KISSELL. I do want to follow up more specifically with—you talked about sustained leadership as being important to all of this. And this may have been discussed earlier and I missed it, but what area are you talking about that we need that sustained leadership? And how do you see that is working?

Secretary HALE. Well, it would be very helpful if—I am not predicting when Secretary Panetta will leave, but whenever he does if the next Secretary of Defense shared his commitment to this. It is critical that it also be shared by the service secretaries and chiefs. They have got a lot of the effort to do by the Comptroller and my job, by the DCMO [Deputy Chief Management Officer]. I mean frankly most comptrollers are budget junkies. I am too. We focus a lot on budgets. We have to, that is part of our job. And it can push out everything else because it can be so all consuming.

You know we need for the person who follows me, whenever that happens, to make sure they are still committed to pushing this process along toward auditability. So, it is sustained leadership at

the top, as well as getting our career people involved. But we need that sustained leadership has got to come from the top.

Mr. KISSELL. Thank you, sir.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Coffman.

Mr. COFFMAN. Thank you, Mr. Chairman.

Now, refresh me, what year again is the goal to be able to have auditable books for the Department of Defense?

Secretary HALE. It is audit-ready, which means we are ready to actually hire an auditor, going in there by 2017 for everything; 2014, for what I would say is the highest priority—the statement of budgetary resources for general funds.

Mr. COFFMAN. Now you said this is pretty complicated in that, you know, all these different echelons of command were not able to match our invoices up with our expenditures. Is that a correct statement?

Secretary HALE. Yes, I mean each one isn't complicated, pretty straightforward. It is. The problem is the numbers and the nature of the processes that we have, that don't make it easy.

Mr. COFFMAN. You know, let me tell you what isn't complicated and what I think—that unless the culture of the Department of Defense changes, then I think it is going to be very difficult to get auditable records. Here is, I think, the fundamental problem, and that is that commanders don't feel the responsibility. That in different echelons of command, there are always inspections that come down and the commanders are held accountable.

Even though there is the staff person may have a military occupational specialty, whether a logistician or some other field, where—let us say it is an infantry commander, in that instance they are held accountable. But in financial management, there is not that kind of inspection where the military commanders at the respective commands are held accountable. And so I think what we need to do is to change the culture of the Department of Defense to make military commanders at every echelon of command, vested in financial management.

So, somewhere in professional military education there is going to have to be some aspect to where they have knowledge of this; to where they are accountable. To where if they have folks that aren't keeping track, that aren't able to pass an inspection, that they don't think are going to be able to pass inspection, prior to that, relieving them and getting competent people in there. Until we change the culture in the Department of Defense and have military commanders at every echelon vested in financial management, I believe this problem is going to continue.

And I would love your—both of you—I would like your response to that?

Secretary HALE. I agree with you fully. We recognize, I said earlier we have got to get this out of the comptroller community and into the commander's community. The Comptroller should still be the source of information. What I would like to see is every commander say, "All right, I have got a senior staff meeting—"

Mr. COFFMAN. Absolutely.

Secretary HALE. You know, "What is the problem here?" And, "Comptroller, what have I got to do?"

Mr. COFFMAN. Right.

Secretary HALE. And then it is their job to say, "Okay, you know, we have got to fix the internal controls," which is the main thing they have got to do. We need to support the installation of these systems. And other steps that they will need to take. We are moving in the right direction. The fact that we have had several meetings now—it is not the first time that we have had a meeting with the vice chiefs, so I think we are moving in the right direction. I also don't think we are there yet. I think if you randomly pick commanders at bases and installations, they might have heard of it because of Secretary Panetta's statement, but I don't yet feel that widely they would feel responsible.

We have got to get there and that is one of the things I am going to ask this afternoon of our vice chiefs, how do I help do that? Or, how do you help me do that? I know they are out there talking about it because we are getting some feedback. Mr. Conaway had to leave but he has had some personal contacts at a base where the commander mentioned this. So, we are moving in the right direction, but we are not there yet. And I recognize that is a key thing that has to happen.

Ms. MCGRATH. I would just echo Mr. Hale. On the civilian side, we have taken steps to put the auditability goal on the civilian side. We don't have the same mechanism on the military side, although we are, I will say educating and teaching of professional military comptrollers. Again within the military comptroller community, the goal is to get it outside and more broadly aware and share the accountability across the military departments. That is why I said we are approaching this at every angle we possibly can through the systems implementation, IT rationalization. If we take away the legacy environment, that will enable stronger controls, because we will create a more integrated environment.

I think through all of these means and mechanisms, we can help change the culture. But I think it will take all of them along with the sustained leadership that Mr. Hale and others here have mentioned.

Mr. COFFMAN. And I can tell you, having served in both the Army and the Marine Corps, if the Secretary of Defense said today that military commanders at every level will be accountable to the financial management of their organizations, I think that this situation would change almost overnight where you would have military commanders all of the sudden studying to understand the financials of their organization in terms of, as was mentioned here today—tracking the money spent with the invoices paid.

Ms. MCGRATH. And that is in the intent with the more detailed FIAR report. It starts at high level auditability goals and cascades down to the military departments and then has to get down to the command level. For the department to achieve its auditability goals, it has to get down to the command level.

Mr. COFFMAN. Okay. Well, let me just say we have not taken that step and I will encourage the Secretary of Defense to do so. Mr. Chairman, I yield back.

Mr. BARTLETT. [Presiding.] Thank you.

Mr. Critz.

Mr. CRITZ. Thank you Mr. Chairman. Just so I understand because I have been one of those folks who have been pushing as well for auditable reports and in an earlier statement you said that your financial statements at this point are really accurate, that you felt very strongly about the information that is there, it is just not to the level to auditable. And of course my concern was that to get to auditable, helps you know what you have and in cases like when Congress doesn't pass a budget and you have to go to a continuing resolution, helps in your planning.

But from the statement you made earlier, maybe my thought was not as accurate as I thought it was and so I am asking, getting to the level of an auditable report accomplishes what?

Secretary HALE. Well I will reiterate what I said, I think the information we are going to supply you in a couple of weeks in the budget is accurate and I won't go through that answer again. But it is because of the absence of major problems. But you get several advantages from auditable state. First, it is the law. And I take that seriously and I know you do. Second, we will improve our business practices in ways that may make us better able to use resources.

Right now out of those 140 million transactions, as some get lost to us; and the money does not get obligated and expires and we can't make use of it. So, it will help us make better use of resources. But I would come back and we need better business practices to make sure that what I said is true, that things are accurate. But I will come back to the fundamental point. The reason we need to do this, is to reassure the American public, we are good stewards of the funds and Congress that we are good stewards of their funds.

And that is valuable in and of itself. And I think the single biggest thing that we will get out of auditable statements in my view.

Mr. CRITZ. Okay. And I look at it as a business model. And that is what I was trying to discern. Are we going to spend \$100 million to save \$50 million—is sort of, you know—that is where I am trying to get to—is that, you know, what are the personnel costs going to be to get to an auditable report? What is the time consumption and the—really you talk about from the Secretary on down—the dedication that has to be to this effort.

So, you know I believe wholeheartedly that we need these auditable reports because you should be able to come to Congress and the American people and say where you are spending the money and what you spent on it. But also from a planning standpoint, I thought it would be helpful, but especially when you have a C.R., where now you are starting to juggle things. And maybe I misinterpreted that. And I am happy to hear that you are very accurate.

Secretary HALE. I think we could manage if we had to, without it. We are managing and we did do it for 6 months. It had problems quite apart from our lack of knowledge of where the dollars were. But that doesn't take away, in my view, from the importance of getting this done—

Mr. CRITZ. Right.

Secretary HALE [continuing]. In order again, to reassure the public.

Ms. McGRATH. But if I could add, I think it affords you the opportunity in a more real-time manner to have the information. You have heard a lot about the processes and the internal controls. Those are things that we work through to get to the accuracy of the data. With a more sound controlled business environment, you actually then have an integrated capability to, in a more real-time fashion, get at the information that you are seeking. And so I do think that there is the real-time aspect that may or may not have a dollar value but affords the opportunity for that planning that you are talking about.

Mr. CRITZ. Good. Good.

From a personnel standpoint, what is the plan to either ramp up, redefine, or re-educate people so that we are getting to this point? And I heard you tell the chairman that you have the finances you need to implement this plan. So, could you just go through what is going to be happening at the civilian side? What might be happening on the uniform side to make this happen?

Secretary HALE. Well, in the financial community, I think we need a course-based certification program analogous to the Defense Acquisition Workforce Improvement Act. What it allows us to do—we have got a lot of training, but what we don't have is a framework that allows senior leaders to say, "Okay; on a certain job you need to have three or four courses and one of them on audit readiness." And that is not the only area where we need a better framework, but that framework will allow us to require that training.

You gave us the legal authority to impose that framework and we are moving to do that. In that process, audit readiness is a high priority for us. We are going to develop a short-course base—or an online course—that indicates the importance of audit readiness. And at more senior levels, will require more accounting knowledge so that people understand better the accounting system and what has to be done to be audit-ready.

So I think we are moving in the right direction in the financial community, both the military and civilian. This will apply equally to military and civilian. In the nonfinancial communities, they generally probably have the expertise. We need their attention and we are trying to get that. And it may be that we want to provide maybe one of these online courses for an hour on why audit is important. I think I need to think about whether that would be a good idea. And perhaps provide that to people who would be most involved.

So, training is an important part of this, and I think we are moving in the right direction.

Mr. BARTLETT. Thank you.

Mr. West.

Mr. WEST. Thank you, Mr. Chairman and Mr. Ranking Member, and thanks for the panel members being here. I want to dovetail off what Mr. Coffman kind of asked because it does cause me some concern. I spent a couple of days in the military myself and I understand at the lowest level if you have, you know, fiscal responsibility it should translate up to the highest levels. You know, at the age of 27, I had an artillery battery that was multimillion dollars. I am not a CPA, I am not an accountant. But we had systems in

place—monthly 10 percent inventories; weekly, monthly and quarterly budget reconciliations.

So at the end of 20 months, the command—I will never forget this, it was \$9.35 budget—hose for a hemi truck. And that was the only thing that was missing. And you know, I thought I would have to write a check for that. But the commander kind of laughed that off. But even as a battalion X.O. [executive officer], you know, I continued on to, you know, supervise commanders and make sure we had that reconciliation process as a battalion commander as well. Listening to what Mr. Coffman was talking about, you know, that was part of your evaluation as a commander on the green-suiter side.

And that went all the way up to division commanders, as well as corps commanders. Are we not enforcing a system of property management, fiscal responsibility, for our commanders? Because in my day as a young captain, you could get relieved if you are, you know, not fiscally responsible. So, is that still in place in the military, or has something changed where they are not doing regular inventories, reconciliations? That was part of the monthly USR [Unit Status Report] report that went up to division commanders.

Secretary HALE. I believe those are still in place, Mr. West, and I don't want to leave you with the impression that there is widespread fiscal irresponsibility in the Department of Defense. But financial statements audits require certain kinds of information be quickly available. As I mentioned, we have got 140 million transactions a year. For each one of those, I need an invoice; I need a contract; I need a receiving report. We can't produce that information that quickly.

And I agree with your suggestion and Mr. Coffman that changing that has to be part of the commander responsibility. We are going to have to add that to the list of things. But I think we are still out there checking for the stuff that we own.

I will say on property accountability, one of the problems we have seen, because that is one of the high priority areas, counts and locations of our assets, I think we know what we have got generally. We don't always get it into the system of record. And so the auditor goes out there and they look at our system, I mean they have got an excel spreadsheet over there and they know what they've got. But they look at the system of record and it is not there. And so we have got to get commanders to say, hey, you know, cuff records are okay, but you have got to get it into the system of record.

Mr. WEST. Could we institute, like I talked about, the weekly reconciliations or the 10-percent inventories? Is there some kind of means that we can come up with a 5- to 10-percent monthly reconciliation process so at least we can look and say, you know, "I am going to look at this percent of your invoices. Not everything within a month, but this percent," so at least we get this sense of urgency and a sense of recordkeeping and accountability? Because for me, I knew that if the boss above me asked that question and I did not have that signed off 10-percent inventory reconciliation, that is my job and I am gone.

Can we input something like that or in place something like that?

Secretary HALE. Yes. You don't wait until the end of the year. When you are doing this successfully, you are checking as you go along.

Mr. WEST. Yes.

Secretary HALE. A quarterly basis, perhaps. And if you are actually under audit, then the auditors are pulling a statistical sample and they are going out to the bases and saying, "Okay; show me that information on a, perhaps, quarterly basis." So as we get to the audit, yes, we will do just that.

Ms. MCGRATH. Sir, if I could add to echo Mr. Hale, though, those things are still certainly required within the Department. From an auditability perspective, we are looking at ensuring that we have established this referential integrity so you know what the, if you will, the paper trail is with strong internal controls and documented processes. Those are the areas that I think do need the commander's attention so that we document those processes—not that it is not being done. It perhaps could be documented more deliberately so that an auditor could see exactly what processes and internal controls we had in place.

Mr. WEST. Okay, well I tell you if you get a chance to go over to talk to General Gordon Sullivan, who used to be the Chief of Staff of the Army, that was my division commander, First Infantry Division, and he would embarrass you at the monthly USR if he looked at the numbers of your expenditures and you could not tell the story of what you were doing, as far as within your brigade, with the money you are spending. So, he can probably give you some good lessons learned.

Thank you very much, I yield back, Mr. Chair.

Mr. BARTLETT. Thank you.

Ms. Hanabusa.

Ms. HANABUSA. Thank you, Mr. Chair.

And thank you both for being here.

In reading the panel's report, and I believe Ms. McGrath has mentioned this term about three times in listening to her testimony, I would like an explanation of the concept of legacy systems?

Ms. MCGRATH. Concept of legacy systems?

Ms. HANABUSA. And it is throughout the report, as you know—

Ms. MCGRATH. Yes.

Ms. HANABUSA [continuing]. Justification for the ERPs because we replace so many legacy systems. So what are these legacy systems that we are replacing?

Ms. MCGRATH. There are thousands of legacy systems within the Department of Defense that perform numerous functions. They were not designed to be an integrated suite of capabilities. Many times there were local decisions made that enable local capability. And a commander had a need-to continue the example, if the commander had a need to perform a business function, he or she had the ability to, you know, procure a solution, an I.T. solution, to help solve a local problem.

The enterprise resource planning capabilities are integrated in an off-the-shelf integrated suite of capabilities, so it has financial and logistics and personnel modules within the box, if you will so that you can take a more integrated, holistic approach to your business environment. Most of the military departments in some way,

shape or form are procuring or pursuing an ERP for their future state business environment. In order to successfully do that, you must also retire and eliminate the legacy environment.

And there are many challenges associated with that. One is the change of management that we have talked about, taking people off the old and onto the new. Another big factor is the data. How are you going to move the data from the past to the present? And what is the best strategy to do that? Because also with the legacy environment, it allows you great flexibility to define the data as you needed to define it very locally. It did not take a corporate perspective.

And so there is a lot of, say, opportunities and implementation of the ERPs. But really to successfully implement those, you must also rationalize the legacy I.T. environment.

Ms. HANABUSA. And am I correct in saying that the legacy systems are probably one of your greatest barriers in terms of doing the audits?

Ms. MCGRATH. Yes.

Ms. HANABUSA. Now, like for example, Mr. Hale talked about the DEAMS system within the Air Force and there is a statement in here, and I don't know if you agree with it or not, but this is from the panel's report that they believe that the DEAMS system will support \$335 million in annual savings after it has been fully deployed by providing real-time visibility into costs and allowing timely reallocation of dollars. And it is like for fiscal year 2017 through fiscal year 2021, they are able to reduce unliquidated obligation and accounts receivable by \$1.67 billion.

So you can imagine as we are looking at the cutting, then when we see or I read something like this, I am very curious as to, one, whether you agree with these figures and how would, for example, the Air Force—because you mentioned DEAMS, Mr. Hale—expect to support \$335 million in annual savings?

Secretary HALE. Well it would be realized in their operation and maintenance budgets when it occurs. I think we will see some savings. We have got some; the Navy ERP has been around for a while now. I wouldn't say the savings are massive. When you talk to people, they are more excited about the better information and more timely information that they can get then they are about the number of people that they have been able to eliminate, which is one of the ways you save money. But I am willing to believe we will see some savings, but it is not the only reason we need these systems.

Ms. HANABUSA. And in looking at the chart that was an appendix to the report, the ERP system is actually identified as a different system in almost each of the divisions, like Army has the General Fund Enterprise Business System, Air Force has the DEAMS system, Navy has a Navy Enterprise Resource Planning system. So I am just curious, do you believe that in the future we are going to have a problem we may reduce the legacy to these different ERPs? But then are the ERPs then going to become a problem for us?

Ms. MCGRATH. So if—

Secretary HALE. Go ahead.

Ms. MCGRATH [continuing]. Mr. Hale doesn't mind?

Excuse me. The military departments having three—and those are predominantly the financial systems that you identified—the importance of the Department's ability, or an enabler for the Department to aggregate the information from those ERPs is the utilization of a standard. The standard financial information structure is a standard that has been defined and is being implemented within each of those ERPs.

So at the end of the day, we can aggregate the data from those different systems, using the standards that have been defined. If we did not have those same standards embedded in each of those solutions, then we would not be able to aggregate the data.

Ms. HANABUSA. So they would be speaking the same language for a layman?

Ms. MCGRATH. Exactly.

Ms. HANABUSA. Thank you very much.

Thank you, Mr. Chair.

Mr. BARTLETT. Thank you.

Our inauditability is interpreted by many of our constituents as opportunities for wholesale theft. If you can't audit the books how do you know that millions and maybe billions of money is not just being stolen? How can you assure our constituents that that is not now happening?

Secretary HALE. You sound like my wife, Mr. Chairman—same question she asked me.

First off, financial statement audits aren't really designed to find fraud. They take a very small sample. They are designed to determine whether the statements are materially correct. We have a lot of other procedures to try to eliminate fraud. The main one is two-person control over money. That is fundamental to everything we do.

You are not supposed to be disbursing or otherwise handling finances on your own. A second person needs to be involved so that the only way fraud can occur is collusion. I won't say it is perfect, but I don't think we have wholesale fraud. That is the main reason.

Then there are various checks. We have thousands of auditors who are looking over our shoulders. And one of their jobs certainly is to look for fraud and to try to see if there are any systematic problems. Maybe we aren't doing two-person control at some areas where we should be, so that we can correct that and minimize it.

So there is a number of ways we try to prevent fraud. I wouldn't say that financial statement audits are primarily designed to detect fraud.

Mr. BARTLETT. Thank you for your testimony. Thank you for your work in a very difficult area.

Our committee stands in adjournment.

[Whereupon, at 11:38 a.m., the committee was adjourned.]

A P P E N D I X

JANUARY 24, 2012

PREPARED STATEMENTS SUBMITTED FOR THE RECORD

JANUARY 24, 2012

Statement of Hon. Howard P. “Buck” McKeon
Chairman, House Committee on Armed Services
Hearing on
Department of Defense Perspectives on Financial
Improvement and Audit Readiness Efforts
January 24, 2012

I'd like to welcome everyone to today's hearing on "Department of Defense Perspectives on Financial Improvement and Audit Readiness Efforts." We just heard from Representative Mike Conaway and Representative Rob Andrews, the Chairman and Ranking Member of our Defense Financial Management and Auditability Reform Panel, who briefed the Committee on the panel's findings and recommendations, contained in the panel's final report. They are our subject matter experts, so I will not restate what they just said.

We are very fortunate to have our briefing be followed by today's hearing, so that the committee might also receive the Department's perspectives on the report and its ongoing financial management reform efforts. I would like to thank the Department's witnesses that are here today, as well as those who have testified in previous panel hearings. The Department's willingness to make time to testify in the many early morning hearings conducted by the panel is a testament to its commitment to achieving financial management reform.

With that said, as pointed out in the panel's report, there is much work to be done for DOD to reach its financial improvement and audit readiness goals. But, with the billions of dollars in budget cuts facing the Department and the need to have reliable information in order to make the tough decisions, DOD must take the necessary actions to overcome the challenges it faces. The committee stands ready to support DOD in this effort, and is interested in receiving feedback on the panel's work to assist us in our oversight of this very important effort. We have with us today:

- The Honorable Robert F. Hale, Under Secretary of Defense (Comptroller)
- The Honorable Elizabeth A. McGrath, Deputy Chief Management Officer, U.S. Department of Defense

Let me conclude by saying two more things. Given the change in defense strategy recently announced by the President and the significant budget cuts the Department has to implement, starting this year, all of us are anxious to learn more about the specific changes contained in the fiscal year 2013 budget request. We will have that opportunity next month, but although we are joined

today by Secretary Hale, I recognize that he is not at liberty to discuss these issues in advance of the President's release of the budget. Thank you again for joining us, nevertheless.

Lastly, following what must have been a difficult decision to resign from office, I want to wish our colleague, Representative Gabrielle Giffords, our very best in her recovery and make sure she knows that she will be missed. Gabby was a leader on the Armed Services Committee and a tireless advocate for our men and women in uniform. I know leaving public service and the constituents she worked so hard for cannot have been an easy decision. She will continue to be in our thoughts and prayers as we begin our work this year.

Statement of

The Honorable Robert F. Hale
Under Secretary of Defense (Comptroller)

and

The Honorable Elizabeth A. McGrath
Deputy Chief Management Officer
Department of Defense

before the

House Armed Services Committee

January 24, 2012

Embargoed until released
by the House Armed Services Committee

Mr. Chairman, Members of the Committee, thank you for your interest in financial management at the Department of Defense (DoD). We would particularly like to thank Chairman Conaway, his ranking associate Congressman Andrews, and all the members of the Defense Financial Management and Auditability Reform Panel. Their efforts have been helpful and constructive.

Ms. McGrath and I believe that we are making progress in improving DoD financial management and moving toward audit readiness. The personal commitment of Secretary Panetta has helped immeasurably and presents us with a golden opportunity to make continued progress. That said, there is much still to do and significant challenges lie ahead. The Panel's report highlights many of the challenges, and we agree with much of what is in that document.

Our statement today will focus on two related areas. First, at the request of the Panel, we will provide our perspectives on the panel's report, to include highlighting critical challenges and how we are addressing them. Second, we will convey our overall approach to auditability, including the key elements of our accelerated plan for achieving audit readiness for the Statement of Budgetary Resources (SBR) for general funds as well as our efforts to achieve audit readiness for all of DoD's financial statement audit readiness by 2017.

Perspectives on the Panel Report

We find the Panel's report both balanced and constructive and appreciate the Panel's recognition of the significant progress made in overcoming the historic impediments to audit readiness.

We are particularly pleased that the Panel endorses our strategy and the methodology associated with our Financial Improvement and Audit Readiness (FIAR) efforts. By focusing first on the financial information DoD most uses to manage -- particularly budgetary information and the counts and location of DoD assets -- we have achieved substantial "buy-in" and participation from both the financial and non-financial communities, enabling even greater progress.

The Panel report does express concern that, in order to achieve full auditability, we must do more than improve budgetary and asset information. Specifically, we must value all our assets at historical cost in order to achieve an auditable balance sheet. The report argues that our proposed method for valuation lacks sufficient detail. To an extent, this was intentional -- to keep the focus on our initial priorities. We do not want the Components to address balance sheet valuation until they achieve success on the SBR and on audits of the counts and location of assets (known to auditors as Existence and Completeness or E&C). The Components also need to have new financial systems in place before they approach asset validation. However,

recognizing the need for greater fidelity, we began to provide additional detail regarding asset valuation in our December 2011 updated FIAR guidance and will continue to develop our approach to valuation issues. Along with audit ready budget statements and E&C information, we believe that this guidance will help us move toward auditability for all our financial statements by 2017.

While we believe we have a way forward and have made significant progress since establishing our current strategic priorities, we accept the Panel's conclusion that we face significant challenges. The report identified five key areas where action is needed. The sections that follow describe each of these elements and the steps we are taking to mitigate and resolve them.

Sustained Leadership, Commitment, and Effective Oversight

The first of these elements is sustained leadership, commitment, and effective oversight. Senior leadership commitment is important for setting the tone and priority for audit readiness, and the Secretary's recent directive has done just that. Furthermore, the Department's Strategic Management Plan (SMP) extends the Secretary's focus with an explicit goal: "Strengthen DoD Financial Management to respond to warfighter needs and sustain public confidence through auditable financial statements."

To oversee the implementation of the Secretary's directive, we will continue to use the governance structure established early in the current Administration. That structure includes involvement by the Deputy Secretary, a FIAR governance board co-chaired by the Chief Financial Officer and the Deputy Chief Management Officer, and subsidiary governance groups. This structure has been effective in driving and keeping the attention of senior leaders focused on financial management improvement. We recognize that our governance process needs to focus more on specific progress and must hold individuals accountable for that progress.

We will ask the Components to continue to commit to specific outcomes for each of their plans, and we will ask the same of service providers who support auditability. Those goals will be used to hold executives accountable at all levels of governance, and we intend to follow up on a regular basis to recognize successes and to identify and resolve the causes of any missed goals. We will also continue to use outside auditors to verify progress. We feel that, with these improvements to our governance process -- and Secretary Panetta's involvement -- we have the leadership commitment we need for more effective oversight and accountability.

We are well aware of the need to establish critical momentum this year, to ensure sustained continuity despite any leadership changes that may occur. Constructive Congressional oversight can also help to maintain continuity in the FIAR efforts.

We do face a major problem, and we ask any help that you can provide. This past year's budget uncertainty -- including no fewer than four threats of a government shutdown, which in

some cases generated enormous planning efforts, and now the prospect of sequester -- has drained valuable time and leadership attention from many initiatives, including our commitment to audit readiness. The Congress could help us a great deal by returning to a more orderly budget process.

Workforce Competency

A second factor identified by the Panel involves DoD's professional financial management workforce. Today, our financial management team is capably supporting key mission needs around the world, but our business environment is changing, and we need to change our training to match that new environment. Financial management in the Department is moving away from a transaction-centric mission to one that focuses on analytical support for decision making -- all while the business environment is moving toward a more integrated setting.

We are taking steps to meet two new demands. In the short term we are delivering immediate practical training to both financial managers and non-financial operators on the importance of audit readiness. We are reinforcing these lessons through a partnership with the private sector personnel who are experienced in financial audits. Specifically, we are using examination engagements, which are an integral part of our audit readiness methodology, to get DoD personnel experience with the requirements for audit. These examinations are essentially small-scale audits of single business processes. The audit firms performing these engagements employ the same procedures used in audit, but on a smaller scope and scale. These "mock-audits" provide our employees with experience that cannot be taught.

For the long term, we are taking steps to sustain a strong defense financial management workforce through the establishment of a course-based certification program. This program will ensure that financial managers have the skill and experience in key areas of financial management, including financial statement audits. Some of our people have not had training and experience in audit areas, and we intend to help them get needed training through this program.

We appreciate Congressional passage of the law we needed to get this course-based certification program started. We received the required legislative authority as part of the Fiscal Year (FY) 2012 National Defense Authorization Act (NDAA), and we are now working aggressively to get the program started. Financial management is one of the first functional areas to have completed assessing core competencies, which will form the basis for this new certification program, and we are actively pursuing other planning. We expect to have pilots for this program in place by the end of this calendar year.

Implementation of Enterprise Resource Planning Systems

Fielding of Enterprise Resource Planning (ERP) systems represents another important element of DoD's audit readiness strategy and our overall effort to improve DoD's business

operations. While the effective implementation of ERPs will not by itself enable auditability, it will help to achieve the modern business environment we need to meet and sustain the statutory requirement for audit readiness. As we have stated in previous testimony before your Panel and as the Government Accountability Office (GAO) and the Panel's report recognize, the Department has made substantial progress over the past two years in improving the way that we acquire and implement these ERPs.

Despite these recent advances, significant challenges must still be overcome. We appreciate the time and attention the Panel has given to ERPs and the thoughtful recommendations in its report. Effective ERP implementation is, and will remain, one of the Department's top priorities. In an era of tight budgets, it is more important than ever to provide ERP users with accurate and timely business information.

Because of the importance of these systems, we would like to comment further on three of the key themes the Panel report highlights through its findings and recommendations regarding our ERPs:

- As stated in our FIAR plan, we agree with the Panel's findings that it is extremely important to link our audit readiness efforts more closely with our ERP acquisition and implementation efforts. We have taken steps to enhance this linkage. For example, as stated in previous testimony, the Department is tying business outcomes to acquisition milestones and requiring that individual programs -- such as the Army's General Fund Enterprise Business System, the Navy ERP, and more recently, the Army's Global Combat Support System -- define the role that they play in their organizations' auditability efforts and end-to-end processes in their Acquisition Decision Memorandums. We believe that this enhanced linkage is an important step forward.
 - As an example, the Marine Corps has experienced operational success with the Global Combat Support System-Marine Corps (GCSS-MC) and recently requested approval to accelerate deployment. GCSS-MC is a portfolio of systems that supports logistics elements of command and control, joint logistics interoperability, and secure access to and visibility of logistics data, which is needed for achieving a clean audit. The program is currently deployed to 10,000 users and is demonstrating business value in several areas. For example, "Time to First Supply Status," a primary measure for logistics responsiveness, has been reduced from over 36 hours to an average of 6.2 hours at the units using GCSS-MC. Additionally, "Order Shipment Times" has been reduced by 22.9 percent and "Maintenance Repair Cycle Time" has been reduced by 64 percent.

- Equally encouraging, the Navy Enterprise Resource Planning (Navy ERP) program achieved a final deployment decision and is currently deploying to the remaining sites within the Navy. Navy ERP is an integrated business management system that modernizes, streamlines, and standardizes how the Navy manages people, money, programs, equipment, and supplies. At present, there are approximately 66,000 users worldwide, managing approximately 47 percent of the Navy's Total Obligation Authority. Navy ERP has enabled the retirement of 27 systems to date, with 69 more to be retired by 2016. This has garnered a realized cost avoidance of \$116 million from FY 2008 to FY 2010. The program is demonstrating business value in several areas. For example, the deployment of Navy ERP is enabling inventory reductions, real-time visibility of fleet assets, resources, and inventory, and improved financial management controls.
- The Panel report also highlights many of the challenges the Department faces in the acquisition of ERPs, such as cost estimation, requirements definition, and testing. Again, we agree that these are important issues, and we are taking steps to address them, consistent with lessons learned and industry best practices. For example, the better application of business process reengineering (BPR) methodology that has resulted from the integration of BPR assessments into our Investment Review Board (IRB) process, was mandated by the FY 2010 NDAA and is helping to define better and more stable requirements for our acquisition programs. By applying BPR early and up front in a program's lifecycle, we can ensure that the program has clearly identified and defined the business problem that the solution is intended to solve and is appropriately applying process, organization, and other solutions besides technology.
- The staff of the Deputy Chief Management Officer is also working with the testing and evaluation community to improve procedures for testing business systems, particularly Commercial-Off-the-Shelf products like the ERPs that have been tailored to meet DoD's non-commercial requirements. Our communities are working to develop test scenarios that are more consistent with end-to-end business processes, such as procure-to-pay. The goal is to ensure that our testing is thorough, expeditious, and tied to specific business outcomes, such as auditability.
- Your report also describes the challenges of ERP implementation within DoD's legacy environment. We agree that this is a difficult issue. Our new systems are in various stages of development and implementation, and therefore many of our legacy systems cannot yet be retired. The Panel report highlights the difficulties of data conversion when the quality of the legacy data is not equal to what is required

by modern ERPs and the need, in some cases, to institute multiple interfaces to legacy systems. These changes -- from old legacy systems to new ERPs, and from less structured data sets that are not interoperable, to more structured data sets that allow information to be exchanged across systems, aggregated, and analyzed -- cause increased manual workarounds and the re-inputting of data, as the report noted.

We would like to thank Congress for the changes to DoD's business systems IRBs, embodied in Section 901 of the FY 2012 NDAA. We view these changes as an important step in helping the Department accelerate the transition away from our legacy environment. This revised approach requires that the IRBs oversee our entire portfolio of business systems -- not just systems under development or conducting modernization efforts, but legacy systems as well. The IRBs report directly to the Defense Business Systems Management Committee and the Deputy Secretary of Defense.

Internal Control Weaknesses

While critically important, improved financial systems will not by themselves eliminate our weaknesses and guarantee auditable statements. Achieving auditability also requires consistent process controls that cross organizations and functional areas. Business and financial information that is passed from system to system must be subject to a control environment. This environment ensures that only authorized personnel are using the system and that these systems protect the data quality and maintain an acceptable audit trail within the end-to-end business process. This process must be controlled at the transaction level, all the way from the source to the general ledger postings to accurate trial balances and reliable period closeouts. Only by completing these steps can we prepare financial statements that an auditor can review and verify without the need for audit sample sizes that are unaffordable. Many elements of our current business environment must be changed to allow us to meet these kinds of routine financial audit standards.

We also agree that we have more work to do in improving our financial reporting controls. Sound internal controls over financial reporting are the foundation of audit success, but we have sometimes found that ours are poorly documented and inconsistently executed.

What are we doing to address this problem? 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 to make sound recommendations for corrective actions. Each Service has developed a strategy and is applying significant personnel resources that will focus solely on evaluating controls at the operational level, recommend solutions for any issues identified, and then follow up to ensure rapid implementation of solutions.

Strengthening internal controls is critical for supporting financial auditability, and it will also further enhance the credibility of our reporting of key stewardship indicators such as improper payments. Because we put great management emphasis on payment excellence, our rates of improper payments are lower than most civilian agencies that have clean financial statement opinions. Our people have been focused on protecting federal funds, and we now ask them to apply that same rigor to all financial controls.

However, any amount of improper payments is too much. We can do better, specifically in the methodology that we use for detecting improper commercial payments. For example, to provide further assurance on our reporting and compliance with the Improper Payments Elimination and Recovery Act of 2010, we are now employing post-payment statistical sampling for all payment programs to include commercial pay. We will use this approach for reporting, effective this fiscal year, and use these reports to drive our improper payments closer towards zero.

A similar story emerges when we examine other indicators of financial management such as unmatched disbursements and Anti-Deficiency Act (ADA) violations. Over the past decade, DoD has markedly reduced its unmatched disbursements – only to see some recent increases caused by the time and training required to implement the new ERPs. While we have achieved substantial success, we can do more to reduce unmatched disbursements as we fix weaknesses caused by disconnected systems, inconsistent data, and poor management of system interfaces. In the case of ADAs, our violations are low compared to the non-defense agencies when ADAs are measured as a percentage of our budget. In the past couple of years we have also markedly reduced the number of ADA cases in the Department that take more than 15 months to process, and we think that timely enforcement will help deter violations. But again, we can and must do more to hold down ADA violations. We expect that the tightening of controls required to achieve auditable statements will help reduce the number of these violations.

Organizational Challenges

In the past, the effort to improve financial information was seen solely as a CFO effort. Because financial transactions occur throughout the organization, the reality is that process, control, and system improvements, as well as personnel training must occur throughout the organization. Human resource organizations, for example, must take the lead in ensuring the accuracy of pay transactions, while the acquisition community must ensure that contracts are recorded in a timely manner and that adjustments and modifications are properly accounted for.

Our FIAR strategy, which focuses on information we use to manage, has already raised awareness of the audit effort in non-financial areas. We are also taking steps to institutionalize that higher profile. For example, we are requiring that the performance plans for all members of the Senior Executive Service (SES) must include a goal related to audit if an SES member is involved in the audit process. Because SES bonuses will now be tied to audit success, this shift

will help ensure that audit concerns extend beyond the financial community. The attention and direction from the Secretary of Defense has helped to create awareness in non-financial communities. This leadership from the top of the organization was a critical missing piece of our effort, and its presence will speed our progress.

More fundamentally, we must transform the FIAR effort from a comptroller's issue to a commander's issue, with financial managers providing advice and coordination. We are moving in that direction, but we need to do more.

Overall Approach to Auditability

On October 13, 2011, Secretary Panetta issued a directive on auditability for DoD financial statements. The Secretary fully supported our overall approach to audit readiness, with its initial focus on the information we most use to manage, and supported our commitment to audit readiness for all DoD financial statements by 2017.

In his memo, Secretary Panetta also directed the Department to accelerate its efforts to achieve audit readiness, including cutting in half the time we had allotted to achieve an audit-ready Statement of Budgetary Resources for general funds. The Department is making several changes to meet Secretary Panetta's direction. We are also taking into account recent audits and examinations, including the Marine Corps audit of its Statement of Budgetary Resources, which have provided valuable lessons. In addition, the Panel's hearings and related testimony have proven timely and brought additional attention to bear, including suggestions on ways that the goals can be accelerated.

Based on these various inputs, we have created a plan for implementing the new timelines mandated by Secretary Panetta. The accelerated SBR plan will increase emphasis on interim milestones, including more attention to milestone details. The revised plan will also feature a heightened level of governance and accountability. Other changes as a result of the lessons learned and higher priorities include:

- More detailed integration of service provider plans (e.g., the Defense Finance and Accounting Service) with reporting Components;
- Shorter and more-focused discovery efforts to identify audit impediments;
- Concurrent work streams that were previously worked serially; and
- Increased emphasis on Defense Agency progress.

The Department is fully committed to meeting Secretary Panetta's ambitious goal. An overview of our accelerated plan was submitted to the Secretary in December, and we are now developing more details. In fact, Deputy Secretary Carter, along with the Service Under Secretaries and Vice Chiefs, will review the plan soon. Shortly after that, Secretary Panetta will

review the accelerated plan along with the Service Secretaries and Chiefs. These high-level reviews are indicative of the Department's commitment to audit readiness, and they may generate changes in the plans. We will provide more information after those reviews are complete, and we will provide full details in the next FIAR report to Congress in May.

We recognize that, in order to achieve audit readiness for all of our financial statements, we must go beyond our initial focus on audit readiness for budgetary statements and for asset counts and location. We are working to increase the detail regarding these other audit efforts, especially those related to asset valuation. We will continue to add detail over time as Components get closer to working on these initiatives.

But the key to achieving our 2017 goal is building a foundation using the current priorities and sustaining momentum. Auditable budget statements, and auditable counts and locations of assets, will build a strong foundation for full audit readiness. Involvement of commanders, and our governance structure and funding, will build momentum. With this wind behind our sails, we are reasonably confident that we can meet the 2017 goal for audit readiness for all DoD financial statements.

Conclusion

We appreciate the Committee's interest and the Panel's suggestions for financial management improvement at the Department of Defense – as well as the hard work of DoD financial management personnel across the organization. We are making significant progress. The Department's senior leadership not only supports this effort; they are accelerating our program. And the organization is responding.

With regard to business operations, the Department does not turn on a dime. It is more like an aircraft carrier than a speedboat. But once an aircraft carrier gets going, it is tough to alter its momentum. We have a clearly focused Strategic Management Plan that establishes the course, and current priorities and resources will help manage our speed. Accordingly, we are reasonably confident that we have the momentum to achieve the auditability goals that lie before us and to do so within the prescribed timeframe.

We welcome your questions.



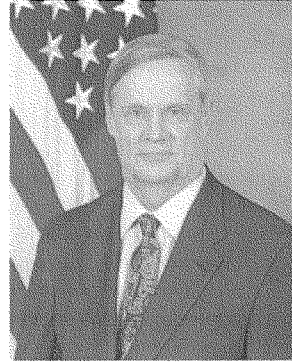
Robert F. Hale

**Under Secretary of Defense (Comptroller) and Chief
Financial Officer**



As Under Secretary of Defense (Comptroller), Robert F. Hale is the principal advisor to Secretary of Defense Robert M. Gates on all budgetary and fiscal matters, including the development and execution of the Defense Department's annual budget of more than \$600 billion. As Chief Financial Officer, Mr. Hale also oversees the Department's financial policy, financial management systems, and business modernization efforts.

At the time of his nomination by President Barack Obama in January 2009, Robert Hale was Executive Director of the American Society of Military Comptrollers (ASMC), the professional association of Defense financial managers. For three-and-a-half years, he led the society's certification program (the Certified Defense Financial Manager program), as well as training programs, a professional journal, and other activities, including ASMC's National Professional Development Institute, an annual conference which attracts more than 3,500 participants.



From 1994 to 2001, Mr. Hale served in the Pentagon as the Assistant Secretary of the Air Force (Financial Management and Comptroller), where he was responsible for annual budgets of more than \$70 billion, efforts to streamline Air Force financial management, and compliance with the Chief Financial Officers Act.

For the 12 years prior to his Air Force service, Mr. Hale headed the National Security Division at the Congressional Budget Office (CBO), developing quantitative analyses of major defense budget issues and testifying frequently before Congressional committees.

Earlier in his career, Mr. Hale was a senior fellow and head of the acquisition and grants management group at LMI, a consulting firm specializing in service to the Federal government. He also spent three years as an active duty officer in the U.S. Navy and served as a staff analyst and study director at the Center for Naval Analyses.

Mr. Hale graduated with honors from Stanford University with a B.S. in mathematics and statistics. He also holds a Master's degree in operations research from Stanford and an MBA from the George Washington University. He is a Certified Defense Financial Manager (CDFM), a fellow of the National Academy of Public Administration, and a past member of the Defense Business Board.



Elizabeth A. McGrath

Deputy Chief Management Officer for Department of Defense



Ms. Elizabeth (Beth) A. McGrath was sworn in as the Department's first Deputy Chief Management Officer, a Senate-confirmed and politically appointed position, on July 1, 2010. Ms. McGrath leads the Department's efforts to better synchronize, integrate and coordinate DoD business operations and serves as the Principal Staff Assistant (PSA) and advisor to the Secretary and Deputy Secretary of Defense for matters relating to management and improvement of business operations. Ms. McGrath is focused on achieving sustainable and enduring improvements and efficiency and effectiveness in the Department's business related enterprise policies, processes and systems. She also serves as the DoD Performance Improvement Officer and is responsible for formulating the legislatively mandated Departmental Strategic Management Plan.



Ms. McGrath serves as the Milestone Decision Authority for numerous business-focused Major Automated Information Systems (MAIS) and also executes the Department's primary governance body for business transformation, the Defense Business System Management Committee; establishes performance goals and measurements for the Department's business operations; implements the Department's Continuous Process Improvement efforts; and is the Vice-Chair of the Performance Accountability Council that is responsible to the President to reform the government-wide security clearance process. Her responsibilities require extensive integration and coordination across the Department as well as with many Federal agencies, such as the Office of Management and Budget, Director for National Intelligence and the Department of Veterans Affairs.

Previously, Ms. McGrath served as the Deputy Director for Systems Integration, Defense Finance and Accounting Service (DFAS) where she created a financial migration strategy that was executed with a collective budget of approximately \$1B. She managed the entire financial architecture supporting DoD-wide standard financial systems, integrating it with the Department's evolving target, enterprise architecture. Project scope included logistics, personnel, medical, acquisition and financial missions including many information technology solutions.

Prior to joining DFAS, Ms. McGrath served in a variety of program management roles culminating in Program Executive Office-level oversight responsibility. She possesses extensive knowledge of acquisition-related statutes, regulations and policies with over 20 years applied acquisition experience with Major Defense Acquisition Programs and MAIS. She served as the Business and Acquisition Manager on an international torpedo defense program with the United Kingdom and held numerous other financial, acquisition and program management positions within the Department of the Navy.

Ms. McGrath was awarded the Meritorious Executive Presidential Rank Award for Fiscal Year 2008 and the Office of the Secretary of Defense Exceptional Civilian Service Award in October 2008. She holds a bachelor's degree in Economics from George Mason University, is a graduate of the Federal Executive Institute, is certified Acquisition Level III in Program Management, Financial Management and Logistics and is a member of the DoD Acquisition Professional Community.

**WITNESS RESPONSES TO QUESTIONS ASKED DURING
THE HEARING**

JANUARY 24, 2012

RESPONSE TO QUESTION SUBMITTED BY MR. BARTLETT

Secretary HALE. Please see the attached document below. [See page 11.]

Achieving Auditability: Department of Defense

Since passage of the Chief Financial Officers Act of 1990, the Department of Defense (DoD) has expressed many times to the Congress its intentions to achieve auditable financial statements. The size and complexity of the DoD business environment, combined with other challenges, have made achieving auditable financial statements an elusive target. The Department is aggressively addressing these challenges. Department's commitment today is supported by significant changes and targeted actions that will enable it to meet this commitment.

✧ **The DoD Business Environment:**

Arguably the largest organization in the world, DoD completes millions of financial transactions daily. The sheer size and scope of the Department dwarfs other federal agencies and many multinational companies. In fiscal year 2011, DoD reported \$684 billion in net costs and \$2 trillion dollars in assets. It manages 3 million employees across 5,000 locations, and carries out missions all over the world. The Department's business operations are nearly as vast as its military, peacekeeping, and humanitarian operations. The sheer size of the department and its global footprint make achieving auditable financial statements difficult, but not impossible.

✧ **Challenges to Success and Targeted Actions:**

Resources: Achieving auditable financial statements was not viewed as a priority relative to competing operational needs. Adequate resources were not always targeted to auditability.

Action: The Department's leaders now see how having more accurate financial information supports DoD's need to drawdown troops and equipment, reprioritize missions, and cut expenses. Appropriate level of personnel, training, tools, and support are now being targeted to achieving auditable financial statements, and the Department plans to spend \$300 to \$400 million a year over the next six years on improving business operations and achieving auditable financial statements.

Strategy and Guidance: The Department's initial audit strategy focused on improving information important to running a company, such as historical costs of equipment. However, that kind of information is of very limited value to the daily operational needs of DoD managers.

Action: In August 2009, the Department moved from a traditional corporate strategy to a strategy that focuses on improving financial information most needed by managers. The new strategy puts improving the quality, accuracy, and reliability of budgetary information, and confirming the numbers and locations of assets as the Department's first priorities. Buy-in at all levels has increased, because managers now see how audit readiness benefits them day to day. To ensure everyone across the Department is approaching auditability the same way, DoD issued written guidance for how to assess and improve processes and controls, and maintain needed documentation. The Government Accountability Office has endorsed the new approach.

Systems: Many DoD computer systems are old and do not "talk" with other computer systems. Getting consistent information for a financial audit requires a lot of manual workarounds.

Action: New integrated systems that meet audit standards for tracking transactions are being put in place. Additionally, the Department is standardizing procedures across all missions, operations, and job functions.

Lack of Experience and Training: While the financial workforce is experienced, trained, and dedicated, they generally do not have direct experience in financial auditing.

Action: The Department is delivering immediate, practical training on the importance of audit readiness to financial managers as well as others who play a role. Small-scale audits of single business processes that reinforce training and give employees more audit experience are being completed. To help financial managers acquire skills and experience in key areas, including in financial audits, the Department is putting in place a course-based financial management certification program.

Enterprise-wide Action: Historically, achieving auditable financial statements was viewed as a Comptroller issue. People outside the Comptroller's office have not always been actively engaged or their leadership involved.

Action: In October 2011, Secretary Panetta directed that achieving auditable financial statements is an all hands effort. Leadership commitment from the highest level is setting the tone and priority for audit readiness, and awareness of the challenges facing DoD is growing.

Leadership Priority and Accountability: Sustained leadership, commitment, and accountability are required to achieve auditable financial statements.

Action: Both Secretary Panetta and Deputy Secretary Carter have reviewed plans for achieving auditable financial statements and are holding senior leaders from across the Department accountable for progress against those plans. The Department's tiered governance structure has been effective in driving and keeping the attention of senior leaders. Senior executives, both financial and functional, now have audit goals in their individual performance plans and annual evaluations. This helps ensure those under their leadership are getting the message that better control over financial assets has a big effect on mission success, and everyone has a part to play.

✧ **Continual Progress**

In Fiscal Year 2011, independent auditors issued clean opinions for Defense organizations totaling \$110 billion in budgetary resources, a dollar amount equivalent to many other federal agencies. The Marines Corps will soon be the first Military Service to receive an audit opinion on a financial statement, a significant step for the entire Department. The Army, Navy, and Air Force all obtained independent validation of their processes for recording funds received from Congress. Other accomplishments that demonstrate the Department is making progress include the Air Force receiving a validation of their funds reconciliation process, essentially accurately reconciling Air Force's checkbook. The full list of DoD entities having received opinions and other significant accomplishments are detailed in the semi-annual [FIAR Plan Status Report](#).

QUESTIONS SUBMITTED BY MEMBERS POST HEARING

JANUARY 24, 2012

QUESTIONS SUBMITTED BY MR. LANGEVIN

Mr. LANGEVIN. Secretary Hale, thank you for appearing before us today. I want to ask you about a personal concern of mine that I have been following since I was a new member on the House Intelligence Committee. Anyone who has worked with programs that are classified as Special Access, or SAPs as they are known, soon learns that due to their highly classified nature, there is little opportunity for the normal budgetary oversight process to be applied with serious rigor. How does the Department conduct budgetary oversight of highly classified programs and what will you do to ensure that they do not become black holes on the balance sheets as you move the Department towards auditability?

Secretary HALE. The intelligence committees have been big advocates for financial auditability for the very reason that you have highlighted. All of the military departments have included special access programs, that will have to be addressed using financial auditors with the appropriate access and clearance, in their plans for full auditability. The same thing applies to our Defense Agencies in this community. In this regard, we work very closely with the Office of the Director of National Intelligence (ODNI) to make sure these programs meet the same financial reporting and audit readiness requirements as unclassified programs. In fact, ODNI is helping to support timelines that will allow each of these agencies to assert financial audit readiness for all of their statements by FY 2014.

Mr. LANGEVIN. Secretary Hale, according to the May 2010 Financial Improvement and Audit Readiness Plan Status Report, the Air Force noted that its Statement of Budgetary Resources audit readiness will be dependent on the deployment of several enterprise resource planning systems. The Defense Enterprise Accounting and Management System (DEAMS) ERP is not scheduled to be fully deployed until the 4th Quarter of FY2016, and no deployment date was provided for the Expeditionary Combat Support System (ECSS). Can you explain how the Air Force plans to achieve the Secretary of Defense's October 31st directive to advance the SBR audit readiness date to 2014?

Secretary HALE. The earlier plan reflected a built-in dependency on the future system that is no longer relevant to the new timeline. These system modernization initiatives are still important to our long-term business process improvements as well as cost-effective sustainability of audit readiness. The Air Force has adjusted their plan to address processes and controls as well as improving interfaces between its current systems. Improving controls and interfaces around the systems will be an investment that aids the implementation of the future systems and improves the likelihood of successful system implementation.

They will also consider cost-effective upgrades to existing systems to meet the new timeline. An example of this would be improving the ledger posting logic.

Mr. LANGEVIN. Secretary McGrath, I also thank you for appearing before us today. As the Department's Deputy Chief Management Officer, what actions have you taken or do you plan to take in order to avoid ERP schedule delays and cost increases of the past? Given the current fiscal constraints, these are liabilities that can no longer be accepted. Additionally, what mechanisms do you have in place or actions have you taken to ensure these ERP systems will be implemented with the capabilities needed to ultimately enable the DOD to achieve audit readiness by 2014?

Ms. McGRATH. As DCMO, I have personally taken a number of actions to improve the acquisition of our ERP systems. For example, I have been a champion within the Department for the development and use of the Business Capability Lifecycle (BCL), which is an alternative and improved acquisition process for defense business systems. BCL is tailored to the unique characteristics of IT acquisitions—especially Commercial-Off-the-Shelf systems such as ERPs—and provides a more flexible and streamlined process to rapidly deliver capability to the users and reduce unnecessary documentation requirements. BCL is showing positive results on a number of programs and a number of other major programs are in the process of transitioning to the use of BCL as they enter the acquisition process or begin work on their next increment of capability. Additionally, as Milestone Decision Authority for a number of these ERP programs, I am conducting rigorous acquisition oversight

to ensure that these programs are positioned for success, including ensuring that they have appropriate metrics in place to better hold them accountable for performance. Through this oversight, I am closely watching their cost and schedule parameters and more closely tying business and financial management outcomes with acquisition milestone decisions to ensure that they deliver the results that we need from a business perspective.

With regard to the mechanisms in place to ensure that each of the ERP systems are implemented with sufficient audit capabilities, in addition to the linkage of financial management outcomes with acquisition decisions discussed above, each of the system acquisition programs has included the requirements of the Federal Financial Management Improvement Act in the system requirements. The testing of these requirements is part of the system acceptance process. Additionally, my office has begun an independent assessment of every ERP and business system that needs to be compliant with Standard Financial Information Structure (SFIS) and United States Standard General Ledger (USSGL) requirements. These reviews look at the underlying system's SFIS configuration, its USSGL posting logic, its ability to interface using SFIS, and its financial reporting capability. These tests give us confidence that the software is largely audit-ready.

However, the new systems cannot achieve audit readiness on their own. They must be well integrated with many other systems to create a well controlled end-to-end business process. Many elements of the larger business environment, including processes and controls, must also be changed to allow us to meet financial audit standards.

QUESTIONS SUBMITTED BY MR. SCHILLING

Mr. SCHILLING. In your testimony, you both indicated that you received input from multiple sources on DOD's audit issues. You also noted the work you are doing on workforce competency, and you mentioned the need to change training to match the new business environment.

- How extensively have you worked with the business community to bring in a different perspective towards addressing DOD's auditability and the overall DOD professional financial management workforce?
- How have you worked with the private sector on the long-term goal of establishing a course-based certification program?
- Is the private sector working with you on the pilot programs you mentioned in your testimony?

Secretary HALE. We rely heavily on the expertise of public accounting firms, who are experienced in financial audits, to incorporate best practices from public and private sectors. In addition, we are using examination engagements, which are an integral part of our audit readiness methodology, to get DOD personnel experience with the requirements for audit. These examinations are essentially small-scale audits of single business processes. The public accounting firms performing these engagements employ the same procedures used in audit, but on a smaller scope and scale. These "mock-audits" provide our employees with experience that cannot be taught.

In support of the DOD Financial Management (FM) Certification Program and professional development of the financial management workforce, we sought out advice and assistance from members of the DOD Audit Advisory Committee (DAAC), who are distinguished representatives of the private sector audit, accounting, and financial communities. When briefed on the initial design of the DOD FM Certification Program, the committee members applauded the Department's efforts with the Certification Program and noted that this is exactly what is needed.

We also sought out lessons learned and best practices from various Big 4 accounting firms and a small Certified Public Accountant (CPA) firm, all with experience in accounting and auditing practices, and several financial management professional associations, to obtain information on competencies, knowledge, skills, and abilities aligned with audit readiness and financial management practices. Additionally, we researched and reviewed knowledge level and education requirements as well as learning objectives associated with accredited test-based certification programs.

We will continue to involve the representatives from the private sector as resources for the pilot and implementation of the DOD FM Certification Program. Their support is critical to ensuring the certification program benefits and long-term goals are achieved and the Department of Defense benefits by the increased capability of the workforce.

Mr. SCHILLING. You mentioned that the DOD has taken into account recent audits and examinations, specifically by the Marine Corps' audit of its Statement of Budgetary Resources. Further, you point to some of the lessons learned from these reviews.

- Can you elaborate on some of the most substantial and important lessons learned?
- How should the other components and branches implement these lessons?

Secretary HALE. We are continuing to learn not only from the U.S. Marine Corps (USMC) audit, but also from recent assertions and the clean opinion on the Defense Information Systems Agency Working Capital Fund financial statement audit. Some of the key lessons learned include the importance of being able to provide a full universe of transactions to support balances, periodically reviewing and revising estimates, and performing reconciliations on a regular basis and not only during an audit. Recent efforts continue to demonstrate improvement in both understanding and application in these areas. In addition, the Defense Finance and Accounting Service has enhanced electronic document retention, management, and retrieval capability. This capability has proven effective in the current USMC Statement of Budgetary Resources audit and is available to support future audits across DOD.

We are sharing the lessons learned from these experiences and transferring this knowledge to both support the current plan and provide a better sense of remedial actions required. To implement the lessons, Components must change current business processes where they have the same weakness. We continue to work closely with all Components, including Service Providers, in applying these lessons learned as we continue to make progress.

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- How extensively have you worked with the business community to bring in a different perspective towards addressing DOD's auditability and the overall DOD professional financial management workforce?
- How have you worked with the private sector on the long-term goal of establishing a course-based certification program?
- Is the private sector working with you on the pilot programs you mentioned in your testimony?

Ms. MCGRATH. We leverage the expertise of public accounting firms, experienced in financial audits, to incorporate best practices from the public and private sectors. In addition, we have incorporated examination engagements as an integral part of our audit readiness methodology, to provide DOD personnel applied experience with the requirements for audit. These examinations employ the same procedures used in audit, but on a smaller scope and scale.

Additionally, the DOD Financial Management (FM) Certification Program and professional development initiatives take advantage of the extensive audit experience of the members of the DOD Audit Advisory Committee (DAAC), who are distinguished representatives of the private sector audit, accounting, and financial communities.

The Department also sought out lessons learned and best practices from various Big 4 accounting firms and a small Certified Public Accountant (CPA) firm, all with experience in accounting and auditing practices, and several financial management professional associations, to obtain information on competencies, knowledge, skills, and abilities aligned with audit readiness and financial management practices. Additionally, the Comptroller's staff researched and reviewed knowledge level and education requirements, as well as learning objectives associated with accredited test-based certification programs.

The Department will continue to involve the representatives from the private sector as resources for the pilot and implementation of the DOD FM Certification Program. Their support is critical to ensuring the certification program benefits and long-term goals are achieved and the Department of Defense benefits by the increased capability of the workforce.

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Ms. McGRATH. We are continuing to learn not only from the USMC audit, but also from recent assertions and the clean opinion on the DISA Working Capital Fund financial statement audit. Some of the key lessons learned include the importance of being able to provide a full universe of transactions to support balances, periodically reviewing and revising estimates, and performing reconciliations on a regular basis and not only during an audit. Recent efforts continue to demonstrate improvement in both understanding and application in these areas. In addition, DFAS has enhanced electronic document retention, management and retrieval capability. This capability has proven effective in the current USMC SBR audit and is available to support future audits across DOD.

We leverage our governance structures and communications mechanisms to share the lessons learned from these experiences and transfer this knowledge to both support the current plan and provide a better sense of remedial actions required. To implement the lessons, Components must change current business processes where they have the same weakness. We continue to work closely with all Components, including Service Providers, in applying these lessons learned as we continue to make progress.

