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**DEPARTMENT OF DEFENSE UPDATE ON
THE FINANCIAL IMPROVEMENT AND
AUDIT REMEDIATION PLAN**

COMMITTEE ON ARMED SERVICES
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

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ONE HUNDRED FIFTEENTH CONGRESS

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**DEPARTMENT OF DEFENSE UPDATE ON THE FINANCIAL
IMPROVEMENT AND AUDIT REMEDIATION PLAN**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
Washington, DC, Wednesday, January 10, 2018.

The committee met, pursuant to call, at 10:00 a.m., in room 2118, Rayburn House Office Building, Hon. William M. “Mac” Thornberry (chairman of the committee) presiding.

**OPENING STATEMENT OF HON. WILLIAM M. “MAC” THORN-
BERRY, A REPRESENTATIVE FROM TEXAS, CHAIRMAN, COM-
MITTEE ON ARMED SERVICES**

Chairman THORNBERRY. The committee will come to order.

The committee welcomes Mr. David Norquist, the Under Secretary of Defense, Comptroller, and Chief Financial Officer as our witness today. The topic is the audit of the Department of Defense which, by law, begins this fiscal year. And I would just say it is not by accident that the committee will start our year on this topic.

Requiring that the Department conduct an audit has been a bipartisan priority of this committee for some time. The Chief Financial Officer Act of 1990 required all Federal departments conduct an annual financial audit, and partly out of frustration with the lack of progress toward that end at the Department of Defense, the 2010 NDAA [National Defense Authorization Act] required the financial statements of the Department be ready for audit by September 30, 2017.

This committee’s Panel on Defense Financial Management and Auditability Reform put close scrutiny on the Department’s efforts and issued a number of recommendations that have enabled us to arrive at this point. The 2014 NDAA again required a full audit be conducted of the Department’s fiscal year 2018 financial statements, the results of which are to be delivered next year.

I want to commend Chairman Conaway for his expertise and his persistence on this issue, as well as Mr. Courtney, who was also a member of the audit panel several years ago. They will both be glad to know that we have had additional members join this committee in recent years, who can also contribute their background and experience to this issue as it moves ahead.

This issue is important. Members of this committee hear evidence every week that we are not providing our military with the funding they need to carry out the missions they have been assigned. We must spend more. At the same time, we have a responsibility to the American people to see that each of their tax dollars being spent to protect them is being spent in a transparent way with appropriate accountability.

We should never assume that an audit will solve all the problems of waste and inefficiency, but it seems to me that an essential requirement of spending money smarter is knowing with certainty how it is being spent.

It is likely that the result of the first audit will not be pretty. But those results will help direct us all, Congress and the Department, on where we need to apply our efforts to improve.

This issue is important. And this committee will continue to pursue it. The ranking member is recognized.

[The prepared statement of Mr. Thornberry can be found in the Appendix on page 39.]

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

Mr. SMITH. Thank you, Mr. Chairman.

And by and large, I would simply repeat word for word the opening statement of the chairman, so in the interest of time I will not do that. And will simplify it by saying that this is enormously important. There are a lot of concerns at the Pentagon, and there are really two big issues here. One, as the chairman mentioned, we are in a time of very tight resources and very great needs. And that means we have to get everything we can out of every dollar we spend. There are many, many issues that this committee has covered to make that clear.

And second, if we cannot explain where we spend the money in the Pentagon, we are failing in that first mission. I know it is a lot of money. I know it is a big bureaucracy. I know there is a lot going on, but we ought to be able to do an audit that tells us where we are spending the money. It is just that simple. And, you know, that is your mission. That is the Pentagon's mission.

I too want to specifically thank Mr. Conaway for his great leadership on this issue. Who knew having an accountant on the committee would be critical. Well, actually, most people should have known that. But he has done a great job on this issue, and appreciate his leadership. And I just hope that—you know, I think everybody on this committee would just feel great if at some point this year we can say the Pentagon has been audited. It has happened some 20 years after we started trying to make it happen. I think we are close. I think we can get there.

I look forward to hearing your testimony about how we are progressing in that. And I thank the chairman for his leadership on this very important issue.

[The prepared statement of Mr. Smith can be found in the Appendix on page 40.]

Chairman THORNBERRY. I thank the gentleman.

Mr. Norquist, welcome. Without objection, your full written statement will be made part of the record, and you are recognized to make any oral comments you wish to make.

STATEMENT OF DAVID L. NORQUIST, UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER, DEPARTMENT OF DEFENSE

Secretary NORQUIST. Thank you, Mr. Chairman.

Chairman Thornberry, Ranking Member Smith, and members of the committee, thank you for the opportunity to provide an overview of the Department's financial statement audit progress and plans. I appreciate your committee's long and unwavering support for this effort. I also want to thank Congressman Conaway for his leadership over the years related to the audit. His direction of the committee's 2011 Panel on Financial Management and Auditability helped the Department maintain its focus on audit.

When the President made a promise to the American people to rebuild the U.S. Armed Forces, he also made a commitment to start the audit. Inside the Department of Defense, Secretary Mattis and Deputy Secretary Shanahan have set a tone from the top that embraces the audit as part of their vision to bring business reform to the Department of Defense. I know you have had many hearings where witnesses have told you that they support the start of an audit eventually. This hearing is different. We have started the audit.

But we are only able to have today's hearing with the Department of Defense under its first full financial statement audit because of this committee's continued support. I should note that audits themselves are not new to the Department of Defense. Numerous audits covering program performance and contract costs are completed each year by the Government Accountability Office, the Defense Contract Audit Agency [DCAA], the Department of Defense Office of the Inspector General, and the service audit agencies.

For example, DCAA employs over 4,000 auditors to perform contract audits that are focused on identifying inappropriate charges by contractors to the government. However, this is the first time that the Department is undergoing a full financial statement audit. A financial statement audit is comprehensive, it occurs annually, and it covers more than financial management.

For example, financial statement audits include verifying count, location, and condition of military equipment, real property, and inventory. It tests the security vulnerabilities of our business systems, and it validates the accuracy of personnel records and actions, such as promotions and separations.

The Department of Defense anticipates that this spring and early summer we will have approximately 1,200 financial statement auditors assessing whether our books and records present a true and accurate picture of our financial condition and results of our operations in accordance with accounting standards. These financial statement audits complement but are distinct from program performance or contract audits.

Based on my experience at the Department of Homeland Security, it will take time to implement all the processes and system changes necessary to pass the audit. It took the Department of Homeland Security, a relatively new and smaller enterprise, about 10 years to get its first clean opinion. But we do not have to wait for a clean opinion to see the benefits of the audit. The financial statement audit helps drive enterprise-wide improvements to standardize our business processes and improve the quality of our data.

Just like private sector companies and other Federal agencies, the Department of Defense [DOD] prepares financial statements

every year to report its assets, liabilities, revenues, and expenses. Though not a corporation, DOD owes accountability to the American people. The taxpayers deserve the same level of confidence as a shareholder that DOD's financial statements present a true and accurate position—picture of its financial condition and operations. Transparency, accountability, and business process reform are some of the benefits of a financial statement audit.

Regarding transparency, the audit improves the quality of our financial statements and the underlying data that we make available to the public, including a reliable picture of our assets, liabilities, and spending. And DOD's progress towards a positive audit opinion will also directly contribute to an audit opinion on the entire Federal Government's assets and liabilities.

With regard to accounting, the audit will highlight areas where we need to improve our accountability over assets and resources. For example, during initial audit, the Army found 39 Black Hawk helicopters that had not been properly recorded in its property system. The Air Force identified 478 buildings and structures at 12 installations that were not in its real property system. By fixing the property records, we can help demonstrate the accountability of our assets.

In other cases, as the Department invests in new business systems, we will be able to obtain independent auditor feedback on that system's compliance so we can better hold those vendors accountable for their solutions.

Third, the combination of better data, business process re-engineering, and the use of modern data analytics directly supports Congress' vision of the chief management officer position and the Department's effort to bring business reforms to its operations. These reforms will lead to business operation savings that can be reinvested in lethality.

The cost of performing the audit will be about \$367 million in fiscal year 2018. This amount covers the audit fees to the independent public accounting firms, about \$181 million, and the infrastructure, including the cost of the government salaries of the people supporting the audit of about \$186 million. The \$181 million in audit contract costs is 1/30th of 1 percent of the DOD budget. And as a percentage of revenue, it is equal to or less than what a Fortune 100 company such as General Electric, Procter & Gamble, or IBM [International Business Machines] pays for their auditors. In addition, we anticipate spending about \$551 million in 2018 fixing problems identified by the auditors.

The DOD consolidated audit will likely be one of the largest audits ever undertaken, and comprises more than 24 standalone audits and an overarching, consolidated audit. DOD is currently sustaining clean opinions for nine standalone audits. Our audits are conducted by IPA [independent public accounting] firms with the DOD IG [Department of Defense Inspector General] performing the consolidated audit, and all the contract audits have been awarded and the auditors have begun to arrive.

In order to track progress, the Department has established a tool and a process to capture, prioritize, assign responsibility for, and develop corrective actions for audit findings. Each year, the auditors will assess and report on whether the Department has success-

fully addressed the findings. Going forward, we will measure progress and report on it towards achieving a positive opinion by using the number of findings resolved.

In closing, I want to thank this committee for its continued focus on the importance of a DOD audit. Your insight through the years has been—your oversight through the years has been a catalyst, and we appreciate the partnership we enjoy with you and with the committee staff on this important process. With your oversight and under this administration's leadership, we are now and will continue to be a department that is not only under audit, but improving year after year.

As we move forward, your continued support for budget stability, related information technology and funding to remediate audit findings remains critical in moving the Department towards achieving a positive opinion. I thank you and I look forward to your questions.

[The prepared statement of Secretary Norquist can be found in the Appendix on page 41.]

Chairman THORNBERRY. Thank you, sir. And I appreciate your differentiating what we are talking about here, a full financial audit with contract audits. I might just highlight that we had a number of provisions to reform the contract audit process in the last year's defense authorization bill, and hopefully that will improve as well.

I just want to ask you one question. I was interested to read where a retired general says basically this audit is not worth doing.

Secretary NORQUIST. Uh-huh.

Chairman THORNBERRY. As you highlight, it requires going and checking the real property, you have got to check and see whether all the weapons and equipment are accounted for, the various records and so forth, it is going to be expensive. And as—his point basically is it is not worth the cost.

Now, you are doing it because the law requires you to, I understand. But what would be your response to the argument that the cost is more than the benefit of doing a full financial audit of the Department?

Secretary NORQUIST. Sure. I would first respond, he noted that the—referred to the audit as costing over \$800 to \$900 million. The amount we are paying the IPAs, \$181 million, is 1/30th of 1 percent of the budget. This is not a significant—I mean, any number then in the millions is a large number, but on the scale of the enterprise, that type of money for accountability is money well spent.

The additional money, the \$500 to \$600 million we have talked about, is to fix problems that we find. Now, this is always a choice going forward. If we can live with the problem, we can fix it. But I do not think operating in ignorance of the problem is the right way forward.

I fully support the committee and the legislative direction. Conduct the audit, do the findings. Some of the things I will point out is the article said that it is expensive because it covers so much. And the answer is, yes, that is the point.

You know, one of the things that the law requires is that we do information security of our business systems. This is the FISMA [Federal Information Security Management Act] and FISCAM

[Federal Information System Controls Audit Manual] standards. The audits are done to those. We will be able to understand the weaknesses and do more to hold people accountable for closing cybersecurity vulnerabilities in our systems. You would want that anyhow. You would want that done under any circumstance. And when we find those, you will want the Department to be closing them.

The other comment that he talked about, there are other ways to do this. Yes, there are. And you talked about contract audits. While the defense financial statement is large, 1,200 auditors, we have 4,000 who look at contractors. So on the scale of what we spend looking at contractors, the size of the team that will be looking at the government is appropriate and proportionate.

Lastly, I think the biggest concern I have is the statement that they make that the Department is not a corporation and does not need to undergo a strict financial audit. Well, first of all, the law requires a financial audit. And more importantly, I think the taxpayers deserve at least the same level of confidence as a shareholder in the use of their money.

Chairman THORNBERRY. Thank you.

Mr. Smith.

Mr. SMITH. I do not have a question. I just want to totally agree with your remarks that you just made. You know, to say that it is not worth doing is like saying, hey, we have screwed it up so bad for so long that, you know, the cost of fixing it has just become overwhelming, so just let us keep screwing it up. And I get that the upfront cost is going to be enormous.

Secretary NORQUIST. Uh-huh.

Mr. SMITH. But long term, the benefits are exactly as you described. You know, if we got to sort of suck it up for a couple of years and absorb some cost to get back on track, it is going to make significant improvements. All of the work on acquisition reform that I know the chairman and I and many others have done can be so much better informed if we have this information. All right. We can say, well, gosh, here is an area that we—instead of—so when we pass legislation aimed at making the acquisition process better, if we have this full audit, that legislation has a much better chance of actually accomplishing that task.

So, yeah, it is pretty bad, and in some ways you would like to just sort of close your eyes and say, let us just not deal with it. But it is just too important for all the reasons you stated.

Secretary NORQUIST. Uh-huh.

Mr. SMITH. So I completely agree with that statement. I applaud your commitment to doing this, and stand ready to have the committee help you in any way we can.

So I will yield back my time. If you have a comment, you may, but I have nothing further.

Secretary NORQUIST. My only comment is to reinforce your point about the better data to support information. I mean, the primary thing an audit promises is better data accuracy and accountability. And when many of the other reforms depend on the accuracy of that data, not having it complicates those efforts.

Chairman THORNBERRY. Mr. Jones.

Mr. JONES. Mr. Chairman, thank you.

I have been here 22 years, and this is the best news of hoping for something good to come from this effort. And I commend my friends on my side and other side who worked with the chairman and ranking member to put this effort together.

I never will forget Donald Rumsfeld, the former Secretary of State—excuse me, Defense, Defense—sitting where you are telling this committee that he will account for every dollar of the taxpayer and how it is going to be spent at the Department of Defense. He might have meant well, but it never happened, obviously, because that is why you are here today. Because we have never been able to do anything to take a problem and even in a small way make it better.

I got one question. It does deal not directly with you, but because of your position and your oversight. Of all the articles I have seen about waste—

Secretary NORQUIST. Uh-huh.

Mr. JONES [continuing]. In the 22 years I have been here, probably this is in the top four or five. It is from 2 years ago. “U.S. Army fudged its accounts by trillions of dollars, auditors found.” “The Defense Department Inspector General in a June report [2 years ago] said the Army made a \$2.8 trillion in wrongful adjustments to accounting entries in one quarter alone in 2015, and \$6.5 trillion for the year. Yet the Army lacked receipts and invoices to support these numbers or simply made them up.”

This would be something, I would think, would be under your department’s jurisdiction, if it happened within the system. This is one of those things that I would like to ask you, how in the world do you fix a problem when you keep funding the problem?

And there has got to be—you fellows, CPAs [certified public accountants] and accountants, can give me some assurance that when stories like this go public and the taxpayer reads it, Mr. Norquist, that is why they are so frustrated with Congress and why we have an 18 percent approval rating.

So I would hope that this would be a kind of a situation that you can, in a short period of time, give me some hope that this would be dealt with, and somebody—instead of saying that, well, this happened and that happened, but we keep funding it. I just do not know how you catch up when you keep funding the problem.

Secretary NORQUIST. So let me address that, because that is a very important one. One of the issues you are talking about relates to journal vouchers, which occurs after the money is spent. So when you see an article that says trillions of dollars, and you realize we only receive about \$600 billion in a year, there is something—there is a mismatch in the story. And what this refers to is, we have systems that do not automatically pass data from one to the other. So the Army goes in, and others, at the end of their financial statements, finds the number from their property book, and writes it into their general ledger. That is called a journal voucher entry. Depending on the amount of property, that can be hundreds of billions of dollars.

Because they do not have adequate support for that journal voucher, the whole entry is considered unsupported. Now, from a management point of view, this is bad. It is not the same thing as not being able to account for money that Congress has given you

to spend, but it is still a problem that needs to be fixed. And part of that relates to systems that were built as stovepipes. In the private sector, they would all talk to each other. You would not let them field the system that did not automatically pass up its data. So we are addressing exactly that type of challenge.

And one of my concerns is, only by eliminating the types of ones that are just an entry issue can you find underlying issues that are hidden among inaccurate data. So it is important. I would not want the taxpayer to confuse that with not—with a loss of something like a trillion dollars. That would not be accurate. But it is an accounting problem that does need to be solved because it can help hide other underlying issues.

Mr. JONES. Thank you very much. I am going to tell you that I might not be here when you resolve the problem, but I will still be reading the paper. I wish you and your staff the very best. Thank you.

Secretary NORQUIST. Thank you, sir.

Chairman THORNBERRY. Mr. Carabajal.

Mr. CARBAJAL. Thank you, Mr. Chairman.

Thank you, Mr. Norquist, for being here today. You know, this is my first year in Congress, and I will tell you that oftentimes I am asked for my observations. I served in local government for over 24 years. And the most shocking thing about being in Congress is that there has never been a comprehensive audit of the DOD.

Secretary NORQUIST. Uh-huh.

Mr. CARBAJAL. It is just outright ridiculous. There is no other way of putting it. And it has been said that if you cannot measure it, you cannot evaluate it.

Secretary NORQUIST. Uh-huh.

Mr. CARBAJAL. And I think this is one of the most significant issues facing the American people and having trust in our being able to adequately fund our military and our Department of Defense. I think if we do not get it together, we are going to lose the American people's trust in what we are trying to do here.

There is no question as to how daunting this task is going to be. The stakes are high. Last year, Congress approved almost \$700 billion for the Department of Defense, and we owe it to the taxpayers to provide oversight and accountability over their tax dollars.

Mr. Norquist, in your written testimony, you mentioned that for years, the Department has received disclaimer of opinion on DOD-wide financial statements because it was not able to provide the evidence to support its financial information, and that these disclaimers were based on management's assertions and not based on independent audit testing.

Can you provide some clarification and detail on this issue? What do you mean when you say it was based on management assertions and not independent audit testing? Because, it is my understanding, audits such as the one conducted for fiscal year 2015 was conducted by independent public accountants. If you could shed some light on that I would greatly appreciate it.

Secretary NORQUIST. Sure, I would be happy to. There are a number of parts of the Department of Defense that have been under audit for a number of years, Defense Finance and Account-

ing Service, the commissaries, our pension plan and so forth, and many of those receive clean audit opinions, but it is not the entire Department. It is not even the majority of the Department. And so when you do not have an auditor's opinion, management is not able to represent that everything is in order. And so the IG [Inspector General] does not even begin the testing. They just said, then you failed.

This is one of the reasons why I have been a strong advocate and supporter of the audit. When I was at the Department of Homeland Security, when I arrived as a CFO [chief financial officer] there, they had actually already had the audit the first year. With the amount of information you received from the audit as management in order to fix things was tremendous. And so I understand your concern of, you know, an entity that does not have an audit, that will provide a lot of useful information. And I think operating without it, there is a limit to how much you can reform and fix without that independent check validating that what was done was done correctly and effectively. And I think that is the biggest transition that we are going to see from this year to previous years.

Mr. CARBAJAL. Thank you. Once we see a Department of Defense audit for fiscal year 2018, how will DOD track its process for correcting errors? Specifically, how will the audit remediation process be executed? And what is the timeline for analysis, execution, and implementation of lessons learned from the audit?

Secretary NORQUIST. So here is how we will do that. We have set up a dataset where every time there is a finding by the auditor, what they call an NFR, notice of finding and recommendations, and it is made up of several conditions, the auditors will enter that into the database. So we will have their view for every entity of each of the findings. And they will have codes according to the type. Was it against an IT [information technology] system? Was it related to property? We will then have an organization or individual associated with that NFR and the responsibility to correct it.

This is important because it gets us past the habit of saying, does the Department have a clean opinion? No. And then no one feeling that they individually are accountable. Here, all these findings will be associated with an organization, office, or individual who will be responsible for the corrective action plan. And I will be able to come back and report to you each year which of those were closed and which of those were not, who we should write to and say, well done, good job, and who either needs more help or more encouragement to get their piece of it done. But we will be able to track it finding by finding and hold accountable over time. And this is, again, one of the tools that the audit gives us.

As we move from the higher level, it is hard to solve to very specific things. One of the things I like about that is you may have a large number of findings, and somebody says, well, why do I need to fix my piece, look at how big the problem is. And this is—yes, but there are two assigned to you. If you can fix those two, that is all that you need to do. And then as more people do that, the whole organization moves in the right direction. So we will have that information for you, sir.

Mr. CARBAJAL. Thank you. Mr. Chairman, I yield back.

Chairman THORNBERRY. Mr. LoBiondo.

Mr. LOBIONDO. Thank you, Mr. Chairman.

I would like to join with my colleagues in saying how much we look forward to your efforts and wish you good luck.

Secretary NORQUIST. Thank you.

Mr. LOBIONDO. It is certainly long overdue. And I want to take the opportunity to thank and applaud Mr. Conaway for being so dogged in this with his hard work.

And with that, I yield my time to Mr. Conaway.

Mr. CONAWAY. Thank you, Frank.

David, please pass on to your team a thank you for where you have gotten us to today. The thousands and thousands of man-hours, people-hours, however you want to refer to it, that got you to—however flawed we are at this point, we are far, far better off than when I first took up this task, and I for one have seen that progress. And so thank your team for it. Got a long, long way to go.

We do not want to overpromise and under-deliver. The 2018 audit is unlikely to be a clean opinion, given the scope of what all has to be done, but we are so much further along based on the leadership that you and your team have provided and the hard work of the folks who every day get up and go to work to face this daunting problem that does not—it is like Sisyphus, trying to push that rock up the hill every day and you get up the next morning and it is all the way back down at the bottom. So please tell—thank you.

Secretary NORQUIST. Sure.

Mr. CONAWAY. Part of what we will try to do is to keep that process moving forward and not, you know, do anything that hampers, from a legislative standpoint, because we are frustrated that it had not gotten done sooner. We just have to recognize that it is getting done.

Would you—you talked about findings, and that has got a certain definition to you. Would you explain to the committee what a finding really is, what that means from an auditor's standpoint and why that is important that those get fixed?

Secretary NORQUIST. Sure. So what the auditor does is, they are holding the Department accountable against certain well-recognized standards. And so the finding can consist of, you were unable to produce the records to support this transaction. Or we looked at your property system and it indicated you should have 100 of these, and when we walked the floor and looked at inventory, there were 95. They are basically things that are wrong in the way that either we are accounting for our assets or recording. And so then those are items that are priorities for us to fix.

Mr. CONAWAY. So would those also include weaknesses in internal controls? You mentioned a circumstance where you had trillions of dollars of journal entries going back and forth. That is typically a failure of internal controls. So the auditors are looking at your internal control system. Those findings would include weaknesses or failures within the internal control system?

Secretary NORQUIST. Correct.

Mr. CONAWAY. All right. While we are not going to get all the way to a clean opinion soon—

Secretary NORQUIST. Uh-huh.

Mr. CONAWAY [continuing]. You mentioned a couple of reasons why we have made—why it was important that we do this add value along the way. Can you expand on the 39 helicopters or the 400 buildings and—

Secretary NORQUIST. Sure.

Mr. CONAWAY [continuing]. And why not knowing—I mean, we obviously knew—the pilots that were flying those 39 helicopters knew they were there, but somewhere further up the management chain they disappeared from the inventory and may not have been known that they were there. Four hundred buildings may not seem like a big deal because they were not moving, but at some point in time we have to address, you know, a BRAC [base realignment and closure] or something of that nature.

Can you talk to us about value added along this path over the next couple of years that we will get as a result of doing these audits?

Secretary NORQUIST. Absolutely. You know, in order to get a clean opinion, there is a number of steps you have to solve. But even along the way, fixing the pieces along the way produce a tremendous benefit. So if you think of the inventory in a warehouse of how many spare parts or munitions that you have, or the helicopters. Those had been delivered by the vendor but had not been recorded in the property system, which meant folks who were anticipating using them were waiting to take advantage of it. Or if you have, the case of the buildings, the person on the base may know they are there, but somebody at headquarters trying to figure out do we have enough square footage where we need to do things, is operating with incomplete information. So as the leadership mentioned at the beginning, accurate data helps drive more accurate decision making.

There is a couple other benefits. For example, DISA [Defense Information System Agency], one of the agencies that received a clean opinion on one of its funds, a modified on the other, was able to return \$230 million to the services. It lowered its bills to them and allowed them to spend that money on operations and readiness, because it had a more accurate understanding and better management of its finances.

Likewise, in terms of identifying errors, the Navy changed its process of how it handed information to DFAS [Defense Finance and Accounting Services] to be more automated, reducing how much work DFAS had to do for them. That saved them \$65 million.

So while we are focused primarily on data accuracy, there are financial savings that come, and then there are other things, which is just a benefit for the men and women of the Armed Forces.

The Air Force, when they were doing a walk-through, discovered their enlistment records were being set up incorrectly for new recruits, as to whether they were 6- or 4-year enlistment. So they were updating, manually, hundreds of records every year as people arrived basically because the entry was done incorrectly at the beginning.

They went back into the system change to try—to make sure that did not happen, freed up a lot of labor hours, reduced by 80 percent the manpower accuracy issues. So it benefits the troops in better pay and benefits accuracy.

Mr. CONAWAY. Thank you. Mr. Chairman, I yield back.

Chairman THORNBERRY. Mr. O'Halleran.

Mr. O'HALLERAN. Thank you, Mr. Chairman.

First of all, I want to thank all those that have worked on this over the past decades. And as a new person, just like Mr. Carbajal and all us front row people, I am kind of—after having read the information on this, I am kind of shocked.

Secretary NORQUIST. Uh-huh.

Mr. O'HALLERAN. You know, as a new person here, to look at decade after decade and trillions of dollars after trillions of dollars, and apparently no real rush to get to the point where we have an audit, a meaningful audit, is disturbing. But I do want to thank you for being here today to discuss this critical issue for our warfighters and American taxpayers, and thank you for your service.

I want to echo my colleagues who have rightfully stated that proper financial oversight is long overdue at DOD. Waste, fraud, abuse have no place in any agency, especially not when it comes to guaranteeing our national security and readiness. Every dollar wasted or fraudulently spent is a dollar lost to our warfighters. They deserve better. And I look forward to working with you and the rest of this committee to increase transparency and financial integrity.

I also share concerns about what we can expect from this process. As you know, the GAO [Government Accountability Office] has stated DOD has not yet demonstrated that its leadership has the ability to achieve effective financial management reform. The DOD lacks a sufficient cadre of financial managers with qualifications and level of expertise needed to lead reform throughout the Department.

Additionally, having looked at what occurred in the financial industry over time—

Secretary NORQUIST. Uh-huh.

Mr. O'HALLERAN [continuing]. I have concerns about how we are going about—go about guaranteeing that this marriage between the DOD and the different auditors is one that is going to be transparent enough for us to understand that the taxpayer is getting the appropriate audits that we should be getting. Because, as you know, what occurred in the financial industry was that, basically, the auditors did what the people being audited wanted them to do so that they can get the next contract the next time it was around or keep that contract. I really want to know how we are going to watch that issue.

And, Mr. Norquist, has DOD developed not only a process to guarantee that we are getting what we say we are going to get, but brought on additional personnel who demonstrated financial management experience? What barriers continue to impact DOD's ability to attract, retain, and develop qualified personnel? And retain is a very important issue when it comes to these types of things. And how will we verify the audits in the long term?

Secretary NORQUIST. So let me cover a couple of points that you brought up, and I will start first with the independence of the auditors, because that is a central one that we had to address at the very beginning. The auditors do not report to the Army, the Navy,

Air Force. They do not report to me. They report to the IG. The IG is the contracting officer, oversees them, and makes the decisions about what they do, and so they have the same protected independence of the IG.

But it is also a reason why we split the audit into lots of pieces. One is an auditor cannot audit an agency if they have consulting work there. And so finding an audit firm who had no consulting work anywhere in the Department of Defense would be somewhat limited. But if you break it Army, Navy, Air Force, DISA, Working Capital Fund, so forth, you will find firms that are, and you will find multiple ones so you can have competition.

So part of the having the 24 or more separate audits is, first, you get people who are independent. And second, we have sustained the competition, that if there is an auditor who is not performing, the IG has multiple other auditors with DOD audit experience that they can go look to. So we thought through—because there was the question, why do you not just use one large audit? And my answer is, you have created a monopoly. We would never, after they learned our business process, be able to find another auditor who could compete, and then I would be explaining to you why the audit costs went through the ceiling.

So I think we tried to pay attention to the concerns that you have raised, and I think the IG function is a tremendous help for us in maintaining that independence.

Mr. O'HALLERAN. Just to that point, because my time is running short. I appreciate the IG and its independence, but in the long run, the IG has been around for a long time.

Secretary NORQUIST. Uh-huh.

Mr. O'HALLERAN. And a lot of things have been going on for a long time, whether it is fraud or abuse or just lack of information.

Secretary NORQUIST. Uh-huh.

Mr. O'HALLERAN. And it has not come to anybody's attention of how to correct that. And so just the idea that the IG is going to be the independent evaluator of the process does not guarantee the taxpayer of America that this relationship is not going to be one that is controlled by those that know and can manipulate the system versus those that are responsible for making sure that we get what we are paying for, and it is verifiable. So I would like to talk to you a little bit more in depth about just where that goes.

And I yield back.

Chairman THORNBERRY. Chairman Conaway.

Mr. CONAWAY. So thank you.

David, DFAS is an integral part of several of the accounting systems. Can you talk to the committee about the audit of DFAS per se, but also the conflict between the services that DFAS provided to the Army, Navy, Marine Corps, that on a standalone basis, if those were audited separately going into DFAS, to audit that service that was provided would be really disruptive and inefficient? Can you talk to the committee about how the team is looking at solving that issue with respect to DFAS?

Secretary NORQUIST. Sure. So we have a number of places where an audit of one of our entities would extend into another. So if you think of the Army, Navy, and the Air Force have financial management processes that extend into the Defense Finance and Account-

ing Service. So the way that we address that is we have what—the acronym is SSAE [Statement on Standards for Attestation Engagements] 16. It is basically an audit of that organization's support to the others that external auditors can rely on. Otherwise, we would be paying for the three or four different auditors to all show up and re-audit a single step.

It is interesting it shows up in DFAS. It also shows up with ammunition storage where the—several different services' ammunition are held in one place, and the answer is rather than each auditor coming in, we will do a similar thing over ammunition storage and say, you can all rely on this audit piece so you do not have duplication of work.

Mr. CONAWAY. So you talked about the accountability that you are going to create with this database findings that are out there. Can you talk to us about the accountability piece? You have got two groups of folks that will be responsible for correcting or addressing the findings. You have got civilian folks as well as uniform people. Can you talk to us about the carrots and sticks that you have got available to you to hold people accountable within your system for getting those findings resolved to the satisfaction of the auditor?

Secretary NORQUIST. Absolutely. I think there is a limit to them, and we may need to work with this committee on alternatives and additions going forward. But this is actually one of the first things that the Secretary of Defense brought up with me, even before I was nominated, to say, "How do you motivate people in a Federal agency to stay focused on fixing things when you lack some of the incentives and controls you have in the private sector?"

So I think there is a couple things. One is being able to clearly identify who is accountable is one of the first steps, and so that is the part of it that the database gives us so the people know who it is on. The second is audit support shows up in people's performance evaluations, so there is no way around that comment being made about your contribution or your success. So that helps to drive it. Both the civilian and the military will have—there are limits to how far we can go, compared to a private sector, but I think the transparency and the accountability, knowing—one of your biggest challenges, no one thinks it is their responsibility. And so fixing that and being very clear whose responsibility it is helps to drive that performance improvement. But there are limits to this that I recognize.

Mr. CONAWAY. Well, it is a—that database has been—is a big improvement from where we have been in the past, because sometimes the tasks are just so daunting that you could get away with not addressing it. But having it broken down into, relatively speaking, bite-size pieces, I think we will see progress over the coming future.

To Mr. O'Halleran's issue. These CPA firms that provide the audit are held to professional standards by their own industry and by the very State boards of accountancy. So it is not like you have got a group of folks out there who are not without oversight from professional standards that they would have to ascribe to if they working in a private secretary audit as well?

Secretary NORQUIST. Correct. And they are, in fact, audited on whether or not they met those audit standards. And they will have to produce, to an external firm, evidence that they did their audits to an acceptable standard.

Mr. CONAWAY. So while not perfect, we are all humans and there have been some audit failures in the past. Nevertheless, there are professionals and professional standards that those folks are held to?

Secretary NORQUIST. Correct.

Mr. CONAWAY. Just a quick anecdote. Part of the issue has been over this timeframe is making sure you had the right tone from the top. Leon Panetta started that, and I think it has been transitioned to the new administration this time really, really well.

I was encouraged by the experience I had in Hawaii awhile back. I was at a—touring the USS *Texas*, which is a submarine. We were in the galley doing a townhall meeting for the enlisted guys, and somewhere during that conversation one of the petty officers asked me, he said, Congressman, how is the audit going of the Department of Defense? Which I thought was—two things: you guys planted that guy down there because you knew I was going to be onboard that ship, or you have got some really bright enlisted guys who are paying attention to conversations that are going on throughout the food chain of the Department of Defense. And if the issue of auditability has gotten all the way down to a petty officer in the bowels of the USS *Texas*, then we must be making some progress.

So, with that, I yield back.

Chairman THORNBERRY. Mrs. Davis.

Mrs. DAVIS. Thank you very much, Chairman. And thank you as well, Mr. Norquist, in the efforts that are going in there. It has been a longstanding problem, and we all know that.

I wanted you to just speak a little bit, and I think we have addressed a few of the process issues, but particularly the concerns around cultural resistance to change. And if you could, I think one of the things that we are very aware of right now in any large bureaucracy, that there are a lot of issues, retribution for people who are trying to do the right thing and other people do not want them to is a concern. Sexual harassment at the Pentagon is a big concern, as you have probably noticed through numerous reports.

So I wonder if you could just speak to—you know, there are all these issues that go on in people's workplaces, and that cultural resistance to change is one that really has to be monitored closely. And how are you dealing with that? How are you expecting to be able to bring everybody to the table on these issues and get the kind of buy-in that is necessary without individuals picking one another off.

Secretary NORQUIST. The cultural resistance—I mean, no one wants to be audited. I do not know how many witnesses you have had come excitedly, tell you, hey, I am under audit today. But it is also that in order to fix the findings, we are taking systems and processes that were built to maximize support to one thing and requiring them to pay attention to the functions around them that they work with. And that can be a challenge because somebody says, well, this is how it disrupts it.

So there is a couple of factors that go into this. The first is the tone from the top, and that comes from the Secretary and the Deputy Secretary who are unambiguously clear, this is about accountability, and they have sent letters to the workforce that emphasize, this is about doing your job the way you are supposed to. These are what the accounting standards and the property standards and everything come from. You are responsible for this. So it is very clear, running up your chain, to say, I do not want to do this is not going to run into success.

The other one is Congress has been very clear. Because the other place you go is to say, tell them to make them stop, right? And the likelihood of someone coming to Congress and saying, please make them stop the audit, and getting a warm and fuzzy hearing is pretty limited. So those two things help create the realization that the organization will need to change.

The second part of that process is explaining to them the benefit of the change. In many cases, we have labor-intensive processes where data is transferred from one place to the other, and you have to fix errors because it was not done right at the beginning. Or it was only filled in with the fields the people at the beginning needed. Well, if you can explain that when you get that fixed, you are going to spend less time doing this and more time on the things that you believe is your core mission.

So, yes, it is a little bit of work, and certainly the first year of an audit, when you are asked for records you do not necessarily have easy access to and you have to spend some time finding them, is a challenge. But over time, this will make your life easier. And we have to work that office by office and organization by organization. But, as you pointed out, this is as much changing people's views about how to do things so that they understand the importance.

The third factor is the audit is annual. You know, if you did this once and came back in 10 years, I do not know you have the same incentive to cultural change as the realization is they are coming back in 6 to 9 months. So you can make the change or you can watch them find the same things again. So that third factor—what makes the financial statement a lot different is it repeats. And they are not going to change the questions; they are just expecting you to change your ability to provide an answer.

Mrs. DAVIS. Do you anticipate any need for a feedback system so everyone who is engaged in this can be giving their input all along the way, and some of that may be anonymous?

Secretary NORQUIST. Yes. We need a feedback. And one of the things that I have tried to draw attention to is, because the audit is going to repeat, what is important is that we be able to sustain this. So if you are given a task where the resistance is this is just way too labor intensive, stop. Let us figure out why answering that auditor request is labor intensive and fix the way we store the data or do the check so we can answer them efficiently every year. I would rather take the finding the first year than do some Herculean expensive effort that I am going to have to repeat the next year.

So if we are not able to find the records efficiently, let us create a data warehouse, let us put the records where they can be easily

searched so next year it is a very quick process. We want to make this efficient over time, and that is another way of reducing some of the resistance so it is not—you know, the people have a way of saying, hey, I do not understand why this is happening this way. And the answer is maybe we can do it differently. But we are still going to have to meet the standards of the audit.

Mrs. DAVIS. Thank you. And just speaking of the auditors—and obviously you are going to be using a lot of different ways of responding to some of the concerns that have been existing for some time. Is there anything in the training or preparation as you move forward that needs to be changed and that you are addressing as it relates to the way that people are approaching it?

Secretary NORQUIST. So there has been a lot of effort on that. My predecessor, Bob Hale, set up a relatively robust training program for the financial management community that has been focused on introducing audits and audit readiness as a result of the input from committees and others. Extending that thoroughly through the logistics and the other organizations is probably one of our challenges. There has been some training, but those areas are as equally affected.

Chairman THORNBERRY. Mrs. Hartzler.

Mrs. HARTZLER. Thank you, Mr. Chairman.

Thank you, Mr. Norquist. This is a very encouraging day. It is a day that we have been waiting on for a long time. I certainly want to commend the chairman and ranking member and certainly my colleague, Representative Conaway, for his leadership on this, because certainly we are facing so many threats around the world, and we need more dollars to modernize and to increase our readiness. But at the same time, I hear back home concerns about waste. And any time there is waste, we need to make sure that it is rooted out, and that we are investing our precious defense dollars where they need to go. And so this process that you are leading is critical in this effort.

And so you noted that one of the chief benefits of the audit process is improved accountability of the assets and resources. So I was wondering, are classified assets part of the audit process?

Secretary NORQUIST. Yes. Classified programs are included. I will also tell you that—all of the intelligence, defense intelligence agencies, have standalone full-scope audits, and most of them have been under audit for 3 years. But being a classified program does not exempt you from the scope of the audit.

Mrs. HARTZLER. Okay. And then will there be a separate addendum then that we in Congress will be able to access to look at that portion or how will that—how will there be accountability for the classified side?

Secretary NORQUIST. Sure. So for the standalone audits, those are classified, the ones of an intelligence organization. For the others, how that shows up, I would rather talk to you in a closed forum.

Mrs. HARTZLER. Okay.

Secretary NORQUIST. But we address all of the classified programs as they are in the scope of the audit.

Mrs. HARTZLER. How about OCO [overseas contingency operations]?

Secretary NORQUIST. OCO would be in the scope of the audit, yes.

Mrs. HARTZLER. Okay. Very good. In your testimony, you said something here that caught my attention, and of course, the cost you anticipate is \$367 million, which we have already talked about the long-term benefit of that investment in getting this—a handle on everything. But you go on to say, you anticipate spending about \$551 million this year, in fiscal year 2018, fixing problems identified.

So could you expound on what problems you anticipate and what the presumptions were to come up with that figure? Where do you get \$551 [million] for fixing problems?

Secretary NORQUIST. Sure. So the number comes from talking to the services about what funding they have planned for this year and what did they have in the budget to address these requirements. And the types of requirements we are talking about is systems that have been already fielded for whom the—either they are not storing the data properly or they are not transmitting it properly, reducing manual passages between systems. So some of those changes are in there. Improvements in the way they inventory or store things.

One of the steps that is involved, the accuracy of the property records. So each one of those places where they are improving their process or changing the underlying system or clearing up old records so that—those are the things that are driving those types of costs.

Mrs. HARTZLER. So it sounds like the services already have a handle on what they know are problems?

Secretary NORQUIST. Correct.

Mrs. HARTZLER. And then they put a price tag to that. So most of that, it sounds like, is computer software?

Secretary NORQUIST. Not most of it. That is just a piece of it.

Mrs. HARTZLER. What?

Secretary NORQUIST. It is a piece of it. It is not most of it, but the systems are certainly a piece of it.

Mrs. HARTZLER. Can you give a more specific breakdown on that? So you anticipate you are going to have to purchase so many more computer systems that talk to each other, and you say record management. So are you putting man-hours? Do you anticipate additional personnel to create written records? I mean, get more specific, please.

Secretary NORQUIST. Sure. So I may have to give you some of this for the record, but I will try and talk you through what I can at this level.

So when you are going through the audit and you—for many of them, they have either done some work in advance or, in some cases, the auditors have done preliminary work on their statement of budget activities, other pieces, before we got to the full scope audit. So they have some indication of the types of challenges they face, and they have developed corrective action plans for those.

Some of those corrective action plans include modifying one system to allow them to be audit compliant and allow them to turn off systems that are not. So there are financial system costs that

improve the accuracy of the data, and in the long term may save us money as we turn off the legacy systems.

The second is improving their processes that allow them to be more accountable for their property. And so they may be changing the way they store the information or they store the assets to support the accountability, depending on some of them may be switching to barcoding things that were not, so that they can have clearer accountability of the status of each asset, where they know where they are. Some of it is the documentation behind it, making sure that is centralized in a way that they can respond and make sure it is complete.

If you need it broken down further, I will probably have to go back and get the details behind it, but that is the types of—at a high level, the changes they are doing.

Mrs. HARTZLER. My time is almost gone. I would just say we need to watch this.

Secretary NORQUIST. Uh-huh.

Mrs. HARTZLER. And do not let them get more money for something that simply should be their job—doing their job.

Secretary NORQUIST. Correct. Uh-huh.

Mrs. HARTZLER. Okay. Thank you.

I yield back.

Chairman THORNBERRY. Ms. Shea-Porter.

Ms. SHEA-PORTER. Thank you.

And I also want to thank you, Mr. Norquist. I am very excited about this. We have hoped this and—for this for years, and I wanted to ask you a couple of questions about it. In, I think it was 2007 maybe, I was sitting here on this committee, and we had found out that a lot of the weapons, the guns, that had been sent to Iraq were not traceable anymore. I remember the person, I cannot recall his name, but saying, well, we did not have enough auditors. And I said something along the lines of, well, should we not have auditors in order—when we are spending this kind of money? So this sounds familiar to you, I am sure.

So how did you decide on the number of auditors, and what will you do if you discover that you need more?

Secretary NORQUIST. Sure. So the number of auditors is our estimate based on what the contractors have proposed to do. They were given the scope of it. Those contracts, I believe, allow for them to make adjustments over time so that if there is a requirement for more. One of the things we want to do is make the best use of their time and their benefit to the taxpayer.

So unlike some audits where as soon as they run into a problem they get to stop and say, there is a problem, I am done, the IG can say, hey, you know, it would be useful to us if you dug deeper into the root cause behind it, and that way we make sure we are not just fixing the symptoms and so they can drill down.

And so my view is, the auditor piece of this is like the reconnaissance; it is the guys who go out front and find you the issues, and that is a tremendous value to us. So if we need additional ones, I am not hesitant to make sure we can get access to that.

Ms. SHEA-PORTER. So they will not be constrained financially if they need that. You will not run up against a wall where there is

just no money left in the budget for them to put more people in if they need to?

Secretary NORQUIST. It would have to be something in the way that the contract had been written, but we would realign funds if we needed to. If the IG said they needed additional resources, I will help the IG.

Ms. SHEA-PORTER. Okay. That is pretty essential, because I have a feeling it is going to be deeper and longer than you think.

Secretary NORQUIST. Absolutely. Correct.

Ms. SHEA-PORTER. Now, my understanding is, right now, you are talking about \$870 million, and that is just for 2018?

Secretary NORQUIST. That is for 2018.

Ms. SHEA-PORTER. Okay. So how is the CR [continuing resolution] going to be impacting that?

Secretary NORQUIST. So the CR creates pressure on us funding-wise. And so I am not going to stand in front of you and say if I do not get it, we are going to stop the audits. We will not. We are going to go ahead with the audit.

What it does, disruption-wise, is many of the people that I need focused on audit remediation are focused on trying to split contracts to accommodate the funding levels of the CR and the next increment. And so many of the people that we need to have focusing on this are the ones who are also affected by the incremental nature of a CR. It also creates pressure more on the remediation side than the audit because we are significantly below either what this committee recommended or the President, and we have to make tradeoffs within that space. But we will still proceed with the audit.

Ms. SHEA-PORTER. Okay. And then the other question I had is you talked about contractors having growing pains. Now—and I think this article, you also said, that we should not be looking for like billions of savings, but there has always been kind of one of those understandings that if we actually did monitor these contracts over time, that the waste and fraud and et cetera, delays, actually does add up to billions.

So how will they experience growing pains? And why do you not think that ultimately, over a period of time, we actually could save really significant numbers?

Secretary NORQUIST. Okay. Are you talking about saving numbers by auditing contractors or—

Ms. SHEA-PORTER. If we do this work now. And so what will you be doing to make sure, for example, that contractors come in on time, we do not have cost delays?

Secretary NORQUIST. Okay.

Ms. SHEA-PORTER. I know that we have our work to do for the oversight, but I just want to know how you think your role will play out.

Secretary NORQUIST. Sure. So let me break that into three parts. First is the piece, which is the program manager overseeing it. That is not in the scope of the financial statement audit, but we support them with better quality data.

The second, not inside this audit, but we have the Defense Contract Audit Agency that looks directly at billing. And they recovered in 2016, I think, like \$3.6 billion by looking at billings that

were coming in and questioning charges. That keeps up. That we will continue to do.

The third is the financial statement audit, which focuses really on the Department and indirectly on the contractors, but it is our payments to them. That one I think the place you are going to see the biggest opportunity reform over time is by allowing us to operate more like a business.

And so you think about improvements and the accuracy and the completeness of financial systems and the role of the chief management officer [CMO] in trying to bring business reforms, being able to put in front of the CMO information closer to what their commercial counterpart would have, allows them to make decisions. You are a \$600 billion enterprise, better decision making can make you make better use of the dollars on a very large scale.

So I think you will see that type of advantage in driving reform within the organization as we are able to do more in estimating costs or reforming the way we do something internally. So I think those are some of the three. There will be some cost avoidance when you have better security of your systems against intrusion. You will avoid costs that you otherwise would have inflicted.

Ms. SHEA-PORTER. I am hoping that we will have more clarity when we have to make decisions. We will have more data to help us, right?

Secretary NORQUIST. Yes, yes.

Ms. SHEA-PORTER. Okay. Thank you very much. I yield back.

The CHAIRMAN. Mr. Byrne.

Mr. BYRNE. Thank you, Mr. Norquist. Many of us are familiar with the audit function in the private sector. In preparing for this, I came across an acronym called an IPA, which, from my understanding, is a really good type of beer. But I think you mean something different. These are major, highly reputable, private sector accounting firms to perform audits for large organizations across the world. Have I got that right?

Secretary NORQUIST. Correct. Ernst & Young, KPMG. Large recognized firms.

Mr. BYRNE. And there is a set of auditing standards that is peculiar to the Pentagon and peculiar to government. In general, what standards do they use when they perform their audit?

Secretary NORQUIST. So there is a Federal board that sets the auditing standards, and they basically start with the commercial standards and then they add some modifications. For example, to defend the power of the purse of Congress, we have budgetary rules that do not exist in the private sector.

Mr. BYRNE. Right.

Secretary NORQUIST. They have a series of accounting standards for how we account for obligations, disbursements, commitments, things that matter to us in managing the money inconsistent with Congress. So there are changes. All the other Federal agencies follow them as well, but there is an accounting standards board that does that.

Mr. BYRNE. Okay. Let me talk you to about continuing resolutions for a second.

Recently, the Secretary of the Navy has said publicly that since the Budget Control Act was passed, the Navy itself, the Navy

alone, has lost—or we have wasted \$4 billion as a result of continuing resolutions and budget uncertainty.

Do you believe the audit will show inefficiencies like this in business operations across the Department due to continuing resolutions?

Secretary NORQUIST. I think the audit will show you some of the—yes, the problems that will come out of business, out of the disruption from the CR. And I think one of the ways that that shows up, if you think about it is, normally, you have a year to spend money. And one of the things we tend not to like about Federal agencies is that the 4th quarter, because the way Federal money works, if you do not spend it, you lose it. This sort of unusual thing that we do in the Federal Government.

Well, the CR says wait, wait, wait. And then when you are down to only a couple months left in the year, okay, here, have it all.

Mr. BYRNE. Right.

Secretary NORQUIST. Spend, spend, spend. And that, if you negotiate a good price, you may now be outside the window of when you negotiate an effective price. Your plans for contracting, and so forth, get compressed.

So I think some of those disruptions that you see that are driven by the CR, the audit will help be able to figure out, either how to manage it or what the consequences are.

Mr. BYRNE. Well, it would be helpful to us as the people that pass continuing resolutions to have that highlighted in your audit report so that we know that continuing resolutions have tangible, negative results, not just to the operations, but to the expenditure of money for the entire Pentagon in each of the constituent services.

I might add that during another part of my life, I was asked to take over the Alabama 2-year college system at a time in which there were two criminal investigations going on and the Birmingham News won the Pulitzer Prize reporting on corruption in it. And we used both the internal audit function and the external audit function, not just to remedy what had happened, but also to change the culture within the Alabama 2-year college system.

Do you believe that there will be some, I am not saying wholesale change, but some change in the culture of the Pentagon as a result of these audits?

Secretary NORQUIST. Absolutely. That is the point.

Mr. BYRNE. Good. Can you elaborate a little bit about how that would manifest itself?

Secretary NORQUIST. Sure. I think that what you find is there are folks who are doing their mission, and at least one of their missions is to make sure information is updated for others to use. When their time is tight, that step gets skipped, and they do the others. Well, then others who rely on the information have to either redo it themselves, or function with incomplete information. Knowing that that is going to be audited and somebody is going to point out that difference creates an incentive to make sure that you do the complete function and you get those items done. It should reduce the amount of phone calls the person gets to answer the question because somebody can rely on the system now, but that type of culture change is important in an organization that has

such a spread of functions and has to rely on those types of datasets to be able to make decisions.

Mr. BYRNE. Well, I just want to say, Dr. Wenstrup and I were just talking. This may be one of the most important things that we accomplish during our terms here in Congress. So I think you will see a lot of support for your activities here on this committee and throughout Congress. And I appreciate what you are doing.

With that, Mr. Chairman, I yield back.

Secretary NORQUIST. Thank you for your support. I appreciate it.

The CHAIRMAN. Mr. Suozzi.

Mr. SUOZZI. Thank you, Mr. Chairman. Mr. Norquist, I am very excited about the work that you are doing. It is a gargantuan, mammoth, really big task that you have ahead of you. And, you know, I am trained as a CPA and as an attorney, and I was a mayor of a small city and a county executive of a large county that did not have proper inventory or procedures and processes in place. I went through this on a much smaller scale.

And when I first came to Congress, I would hear my colleagues asking about different weapon systems and different pieces of equipment. And I did not know what we owned. And I tried to get my staff to figure out what we owned by working together with the DOD and other people, and it was very hard to get the limited information we got. There is 14,500 aircraft in the U.S. military, for example. You know, how many ships do we have, how many armored vehicles, so on and so forth. Will we have a comprehensive inventory at the end of this process that tells us what we own?

Secretary NORQUIST. So this is the important way of how we implement the audit. It is possible to have that without making it easily accessible, and my concern is you miss some of the benefit of the audit. So one of the changes we want to drive is not only to have the accurate count, but to have it easily researchable. In other words, in the dataset where somebody can run the report and say to the Secretary of Defense, here is what you have, here is where they are, and here is whether or not they are in maintenance because they are not working, or here is whether they are working.

Mr. SUOZZI. Go ahead. Finish what you—

Secretary NORQUIST. So the idea is we will have the count, but what we want to do is be more like a business, which is, go beyond the mere standards of the audit to using that to drive business intelligence so that the leadership will have timely and accurate information, not just about the dollars, but about the facilities, the equipment, the military supplies behind those dollars.

Mr. SUOZZI. So each piece of equipment will be rated, for example, as far as its condition?

Secretary NORQUIST. I am not quite sure. I think the audit has to do with impaired or not impaired, meaning is it usable but we will have those. Now, it has to be material enough, right? The audit does not worry—

Mr. SUOZZI. Yeah.

Secretary NORQUIST [continuing]. About small items. But the larger-end items would certainly be things that we should be able to have timely and accurate reporting on.

Mr. SUOZZI. What percentage of the overall audit would you say is going to be devoted to inventory as opposed to procedure and process and financial statements?

Secretary NORQUIST. Well, if you walk through, they will do inventory, they will do property, meaning buildings and other large items. They will also do pay and personnel, some of those types of things. So over time, that may be more labor intensive than most of the other pieces.

Mr. SUOZZI. Yeah.

Secretary NORQUIST. But it is one of many items, but it is on our property line as one of our largest.

Mr. SUOZZI. So is it half the task? Is it a quarter of the task?

Secretary NORQUIST. I am guessing, but probably a quarter of the labor hours would be spent looking at those types of items, yes.

Mr. SUOZZI. And will there be a physical visiting of the sites to actually identify the pieces by the auditors or will that be done by our in-house, by the people who work for the DOD?

Secretary NORQUIST. By the auditors. And they will do it two ways, what they call book to floor and floor to book, which is, they will look at what your records says—

Mr. SUOZZI. Yeah.

Secretary NORQUIST [continuing]. And then they will see if that is what you really have in inventory.

Mr. SUOZZI. Right.

Secretary NORQUIST. And they will look at what you have in inventory and see if that is what your records say. That way they are checking it both directions to make sure that they both align.

Mr. SUOZZI. This is a very exciting task that you are going to accomplish. Do you think that the audit of the inventory of equipment, of properties, of buildings, will be conducted by the end of the calendar year of 2018, or it will be some time off into the future after that?

Secretary NORQUIST. So they will go through the audit this spring and summer. They will publish their reports starting about November 15, this being a first year audit, may take them a little bit of extra time. And they will do this every year. So they will do a sample. So they may pick certain pieces of equipment the first year, and then pick a different set the next year. But the findings they have on one are often the same for the other. So as soon as we see them, it gives the agency a clear idea of what they—

Mr. SUOZZI. Oh, so they only give you a sample inventory of what we own?

Secretary NORQUIST. It is statistically significant. And the way they do their sample—

Mr. SUOZZI. Yeah, I know.

Secretary NORQUIST [continuing]. Is use statistical sampling to be able to have a level of confidence in it. So that they will be on site, counting things, checking numbers.

Mr. SUOZZI. Will we be able to find out from you, if I reach out to you afterwards, what you are going to be doing, what the sample size will be and what it will be of?

Secretary NORQUIST. We should be able to have the information and the sample size. I do not know if it will tell us exactly what they counted, but it will tell us the sample sizes, yes.

Mr. SUOZZI. Okay. All right. Thank you very much.
I yield back.

The CHAIRMAN. Mr. Kelly.

Mr. KELLY. Thank you, Mr. Chairman. And thank you, Mr. Norquist, for being here. I, again, want to echo a thank you to Chairman Conaway for his efforts in getting this to come. It is a massive undertaking, long overdue. It is going to be very, very difficult.

I hope that we will focus on the things that improve the processes going forward. And some of those, number one, is OCO. There is a lot of room, even when people are trying to do that right, for abuses that are intentional and unintentional, and I am more concerned about the unintentional where people just do not know. How far back are you going to the start of the audit, like as far as OCO and those things?

Secretary NORQUIST. So when you look at dollars in fiscal year 2018, they will be auditing money received in fiscal year 2018. When you look at assets acquired, it does not matter when the asset was acquired. They will look for existence in completeness of those assets.

Mr. KELLY. Okay. Very good. And then just from having served quite a long time, I understand the process, "at the end of the year, spend all the money or you lose it." That needs to be a recommendation that you do not lose it so that we can spend that money wisely. Maybe not in operations or maintenance, but there is some things, acquisitions, that it is important to be able to carry that money forward as long as it is earmarked or allocated to a source, even though it is not spent yet, rather than having to rush and spend it on things that you do not need. Because you do not need to go buy all these pens to stack up somewhere for people to pilfer, because those little things add up.

And I guess my final point is, I am sure you will look at things like OCIE [organizational clothing and individual equipment] turn-in, where we turn in equipment and those kinds of things, and the write-offs and how you do that, and also like tool droppages. Those things that, you know, you come back from a field exercise in the Guard, and you do all these tool droppages to make sure that you get your equipment back, when maybe that is not the right way.

So you will be looking at processes like that to make sure that people are adhering to the right way to do that and holding people accountable when they are accountable or service members as opposed to just saying, "Okay, it is within the dollars." Is that correct?

Secretary NORQUIST. It will hold people accountable because we will look at disposable equipment. It depends on the size of the equipment. The audit does not go down to very small items. But did you properly dispose of it? Did you record it? And, you know, and then we will start to be able to clearly see, did you get paid for the disposal, because some of this equipment we do get money for when we dispose of it.

Mr. KELLY. I guess my final question goes as to, the GAO indicates that the DOD lacks a sufficient number of financial managers. And what are you doing or what areas has the Department done to take care of, or to acquire these?

Secretary NORQUIST. So this is a challenge. I mean, when you have an organization that most of it has never been under audit, and Federal employees do not, themselves, conduct financial statement audits the way commercial enterprises do. So you may have CPAs, but you often have CPAs who do not have exposure to some of those other practices. And so over time, we have been able to grow that a couple of ways.

The first is, the agencies that went under audit first, like the Corps of Engineers, Corps of Engineers has a clean opinion. It had a number of people who have now been through an audit multiple times, know what it looks like, have been part of fixing things, they are now helping the Army get through the larger audits. So some of them we have grown by leading with certain examples. Some we have just gone out and hired, and then the third focus is training. We have a robust training program where we have been emphasizing audit standards, audit readiness, internal controls, all of those pieces, whereas in, you know, a decade or two ago, it all would have been budget type of topics and not accounting-related topics because that was the almost exclusive focus of a lot of the financial management community.

Mr. KELLY. Mr. Chairman, I have no more questions. I yield back my time.

The CHAIRMAN. Mr. Norquist, I want to interject on one point Mr. Kelly raised. I am also very concerned that we are going to be so late in the fiscal year with a final appropriation. And the needs are so great that there is going to be inevitable problems as a result. And I am thinking about the audit. You are going to find things and you may not have, there may not be enough time to fix the things you find by the time the money is—so I think my staff has reached out to yours to work together to see about some greater flexibility in spending money after the end of the fiscal year.

I think about our maintenance problems. They are enormous. And we do not want to waste money, but we also have got to get our ships and planes fixed.

Secretary NORQUIST. Absolutely.

The CHAIRMAN. And so I think this is an area—and there is a lot of concern in Congress about accountability for the money and, you know, I understand that. But I think this is an area where a number of us in Congress working with you and the Department can have a better—especially this year, because we are going to be so late. So I just want to mention that because you all were discussing it, even though it is a little different from the topic here.

Mr. Panetta.

Mr. PANETTA. Thank you, Mr. Chairman.

Mr. Norquist, thank you very much for being here, taking the time, your testimony. But also thank you for helping us do our job and giving the people, providing them with accountability, providing the accountability to the American taxpayer. I appreciate that. Obviously, you have a tremendous amount of experience in doing what you are doing, 28 years. You actually were the CFO. You audited the DHS [Department of Homeland Security].

Secretary NORQUIST. Mm-hmm.

Mr. PANETTA. That is correct. In the 6 months that you have been in this position, what has been the biggest lesson you have

learned so far? And do you foresee any other potential delays besides the worrying about budget stability and funding, as you mentioned in your last sentence, in your last paragraph of your statement. Is there any other delays that you foresee that will prevent you from doing your job?

Secretary NORQUIST. Sir, I will tell you, the thing that surprised me the most was how many people who have been working this issue were eager for it to finally start. I have to tell you, for an accountant to be told to put together all these controls and all this stuff, and then say we are not doing the audit this year. And then each year you repeat that. You start to get to wondering, is it ever going to happen? So this built-up sense of "No, it is happening, it is happening this year, and everything that you have done up until now matters." The reaction I would get in rooms from the folks who have been working on this was really reenergizing, right. The sense of excellent, right. There have been a lot of folks wondering if they have been working in vain, but now the realization, No, everything that you did to get ready to get these pieces in place will matter and pay off. So I think that was a very pleasant surprise on moving forward.

I think the biggest concern in the long run is going to be the systems because they take the longest to fix. Policies, procedures, even cultural changes we can do more quickly, but some of the system interfaces may take some more time. And so one of the things I would encourage the committee, as you go through each year's budget review, when somebody comes in and asks for money for a business system, make sure you understand, is it compliant? Have they prioritized the things related to the audit? Or have they sort of pushed those things down on their to-do list in place of something else?

So often they do not give—I do not want to say they do not get much attention because I know there are staff who spend a tremendous amount of time on this, but they are not sexy or glamorous, but making sure that the funding for those and the things that are being done, the system is phased out, those are the ones that will take us some time. But I think they have some tremendous long-term improvements for the Department.

Mr. PANETTA. Great. Once again, thank you, and good luck.

Secretary NORQUIST. Well, thank, you sir.

Mr. PANETTA. I yield back. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Lamborn.

Mr. LAMBORN. Thank you, Mr. Chairman. Thank you for having this hearing. And Mr. Norquist, I apologize, I am probably going to be covering ground you have already covered. I was in another committee where we had a markup and I just got here now. But from the 30,000-foot level, I really like that the audit will result in more accountability and more transparency, but the other thing that I think would be accomplished, I think is real important, and I would like to get your thoughts, and that is, reform. Uncovering where maybe we do not have the best practices in place, where there might be waste or duplication.

Can you reassure, not just the members of this committee, but by extension, the rest of our colleagues in Congress and the American taxpayers that you think that this audit will uncover where

we are not spending money in the best way possible, so we can either lower the budget and accomplish the same thing or invest in more lethal capability for the DOD.

Secretary NORQUIST. I think it is very essential in its contribution to reform. And I am very excited about the possibility and how it is going to reinforce reform. So Deputy Secretary Shanahan has got the lead for bringing business process reform to the Department. He set up organizations within the Department that are working on this issue. I support them through the audit by helping to make sure that they have the business data they need to make those reform decisions. So as you look across organizations and you are comparing what do we pay in electrical rates across all of our different facilities? Why? What are the highest ones, why are they paying a higher rate, and what is the difference? What are the lower? So instead of somebody saying, everyone, cut your number by 10 percent, we focus on those places where the costs seem out of line with the rest of the enterprise.

That type of financial data, the accuracy of that, being able to pull it from multiple systems and have confidence in it is what the audit gives you, and it is an enabler to reform. And so I am sure we will find within the financial processes by removing places where we have to rework data because the accuracy will allow it to go faster, savings. But I am more excited, in the long run, about what it allows the Department to do to function like a business.

Mr. LAMBORN. Thank you. And I know that chairman and my colleague on my left here and many others have really been pushing for greater effectiveness and efficiency in how the dollars are spent. We have that trust to the American taxpayer. So will the outcome be not just that we find, hopefully, these efficiencies, but it is done in a way that the American people know that we are finding these, and the entire Congress knows that we are finding these efficiencies?

Secretary NORQUIST. Yes. So we will make sure, I mean, the financial statement is public, so what the auditors find and what they then announce is closed, meaning what they fixed, will be known. But I will also make a point of letting the committee know, here is how the reform has changed things, and here is the way that our businesses run differently.

For some of them, like the working capital funds, they bill for their services so we can look at the rates they charge. Are they able to reduce their cost of operating because those are set up closer to a business-type function, and we will be able to use that there as well.

Mr. LAMBORN. Well, thank you for that. And I really appreciate it. The military of our country is held in the highest esteem by the American people. The only criticism that I will sometimes hear is, are we spending the dollars the most effective way. And people are concerned about that. So thank you so much for what you are doing.

Mr. Chairman, I yield back.

The CHAIRMAN. Mr. Veasey.

Mr. VEASEY. Thank you, Mr. Chairman. Mr. Norquist, I wanted to specifically ask you about just some of the issues that the outside auditors have that were brought in. Someone had asked the

question a little bit earlier, but one of the reports that I read said that they, I guess, that they were having some challenges being able to make final conclusions. Can you talk about some of the issues that the outside auditors that were brought in had?

Secretary NORQUIST. Okay. So is there a particular one that you are thinking about or you just want me to walk through the challenges they face in general?

Mr. VEASEY. Yes, just in general.

Secretary NORQUIST. Okay. So the first challenge an auditor faces in general is—and this is true for government and commercial—they are required to be independent, which means the people showing up did not used to work for you, so they have got to understand your business processes. And, so, we have put together, in our different organizations, guides that welcome them and say, here is how we are structured. Here is what we do. When we spend money, the document looks like this, so they can start to recognize them, that they know what they are testing for the adequacy of.

We have been doing the security clearances because a lot of them require security clearances to be able to do their work and get them through. A number of them are out doing site visits to get to understand what is going on at the different places. The Air Force auditor is at Tinker Air Force Base this week. The Navy auditor is at Naval Air Station Jacksonville and others in the fall to just see what the operations look like.

So there is an orientation that they go through before they plan the audit to make sure that their audit is consistent, and then there are security clearances that we have been getting them through so they can start in a timely manner. Those are all some of the key pieces. There will be a challenge on the volume. You know, this is not just a large audit for us, it is a large audit for them, but they have all scaled up for that challenge.

Mr. VEASEY. What about training and sustaining a workforce to be able to work specifically on financial management, and what have you, within DOD? Like, what are some of challenges around that? Because I would think just being able to have a full-time staff, you know, work solely on this, because this is obviously a big issue, must be a challenge in and of itself.

Secretary NORQUIST. It is. And we have had to realign folks internally to be able to provide the time and attention on this to support them. You know, these are some of the functions that over time when people took cuts, they sort of said, Well, I can reduce this, because it is not an audit and accountability. Some of those functions are being restored.

When we are doing internal tradeoffs on that, we are basically operating underneath the reduction accounts that the legislation has put in place. But those are realigning forces within it. I will tell you that over time, what I likely come back to you with is shifting some of the work where we hired an outside firm as a consultant to something run by a Federal employee by trading off contracting dollars for Federal employer dollars, because we are going to need those capabilities in house.

So in some cases, we hired the expertise and we may change the balance of that over time as we realize this function is going to

stay, and we want to make sure a Federal employee is able to do that on a sustained basis.

There still is always a use for skilled experts on the outside on particular topics, but you want to change that dependency over time.

Mr. VEASEY. Thank you. Mr. Chairman, I yield back.

The CHAIRMAN. Mr. Conaway.

Mr. CONAWAY. Thank you. Two other things real quick. The Department is constantly facing funding challenges, et cetera, et cetera. David, do you think you have got the right position or strength in position to be able to maintain and protect the funding to get all of this done? Because it is going to be setting priorities and trading these dollars that are going to be needed to get this done over time versus spending them somewhere else of importance within the Department.

Do you think you have the right support from the Secretary and others to be able to make a cogent argument that you need these funds to continue the audits and continue the fixes?

Secretary NORQUIST. I do. I have the full support of the Secretary and the Deputy Secretary. I will tell you at the President's budget level or the committee level, I am very comfortable. If you start talking about a CR that runs through the year, we are in a very different place, and that just creates challenges because of very tough tradeoffs across the Department. I will fight to protect this, but we have readiness issues and others that I would have to be paying attention to as well.

Mr. CONAWAY. And at the BCA [Budget Control Act] levels would be disaster.

Secretary NORQUIST. That would be a disaster.

Mr. CONAWAY. Okay. And on the database of findings, there will be some findings that are more important than others.

Secretary NORQUIST. Hmm-hmm.

Mr. CONAWAY. So when it first comes out, just the scope of the number of findings will probably be startling. Will the CPA firms grade those findings as to ones that are, for lack of a better phrase, really critical or systemic versus ones that are easily fixed that should go away shortly? Is there going to be some sort of a grade there that would help bifurcate it into places so we could better understand just the sheer number?

Secretary NORQUIST. So they will score it and weight it with terms like material deficiencies and others that relate to its size compared to the financial statement. That is not necessarily its importance to the Department in terms of fixing. They may decide that there is a cyber vulnerability that has very little dollar value that we think is a security issue that makes it one of the first things we fix, or we may see a change where the savings are there, and we want to do that fix first.

So we will have their scores in terms of how they categorize it, but then we will need to prioritize, within the Department, which of these reforms are most important to get done to support the chief management officer to save the taxpayers money. And some of the later ones, even if they are large dollar values, like valuation of old military equipment, if we do not think that is data that peo-

ple are going to use right away, we may wait on some of those reforms to prioritize the other things first.

Mr. CONAWAY. So on the assignment of responsibility to fix, it will come with a timeframe that is rational and expected to be met?

Secretary NORQUIST. Generally, I would expect the timeframe to come from the corrective action plan, where we will check, is this a reasonable timeframe? But some of these will take some period of time, but you can see the reductions and the conditions within it that will show you they are making progress.

Mr. CONAWAY. Thank you. Mr. Chairman, I yield back.

The CHAIRMAN. Mr. Langevin.

Mr. LANGEVIN. Thank you, Mr. Chairman.

Mr. Norquist, thank you for your testimony and for the work that you are doing, and will continue to do. I think it is vitally important for the Department, and ultimately for the taxpayer, to make sure that we are spending dollars the way they should be spent, and we are getting the most for them. And this auditing function is something that I have had a longstanding interest in. And I remember years ago serving on the Intelligence Committee, and we had somebody from DOD there. And I asked the question, "well, you know, what about the auditing function to make sure that we are spending dollars wisely?" And it was then that I became aware that we do not do the auditing function.

So, long overdue, and I'm glad we are finally getting to this point. So many of the questions I had have, for the most part, been addressed, but I did have one area I just wanted to delve into just a little deeper.

And so while conducting an audit of this magnitude, I guess I want to know how you plan to deal with the significant complexities that it may present dealing with, for example, old contracts, or contracts for systems not designed with an audit in mind, or auditing, particularly, the classified portion of the budget. This is a particular area of interest that I would have, and where there is, you know, by design, there is not much transparency into black projects and programs for security reasons.

How do you deal with those issues, and does guidance for new contracts provide for the eventuality of an audit? So if you can take those on.

Secretary NORQUIST. Sure. So there are a couple of pieces. So the first one you bring up is in contracts. And there are some issues where in order to, for example, property value, military equipment, we need the contractor to give us their invoices set up a certain way so we can see the pieces that are included. Older contracts do not have that. So you look at which ones do you modify, which ones do you build on, and are there some places where you do an alternate way of valuing that equipment. There is different methodologies you can do to do valuation. And you try and decide from an accuracy and a taxpayer point of view, what is the best use of taxpayer money, how do we do that most efficiently?

Some equipment, if you think it is going to go out of inventory, you might decide I am not going to spend a lot of energy on it over the next couple of years. It will not be here anymore. So that is not as essential, it is not a highest priority.

With regard to systems, I think you have to look at each system and ask the question, Can I fix it to do what we need it to do through a software patch or upgrade? Can I replace it by moving its work to something else? Or do I have to work around it in some sort of manual form until that system is eventually retired and a follow-on? Each of the services, each of the organizations is going through that.

Defense DAI [Defense Agencies Initiative] is the name of an accounting system that has been implemented across 20 defense-wide organizations. So in that case, the answer was just turn them all off. We are just going across the defense-wide entities and we are just turning off and replacing those. In the services, there is a lot more of consolidating. They are going from several accounting systems down to fewer that are compliant and support an opinion.

With regard to the classified, I may need to talk to you offline about how we handle that. I would just assure you a couple things: One is, classified programs are included in the audit. We have cleared auditors and cleared IGs and others who can do this. And as you mentioned, from the intelligence community, they always see standalone opinions, and so they actually have been under audit for 3 years now. And I have been meeting with them, getting an update on their lessons learned and their issues and how they have been progressing. But those are published on a classified form, and the Members of Congress are entitled to look at those.

Mr. LANGEVIN. And for the classified programs going forward, will those all be in-house auditors, and not outside contractors?

Secretary NORQUIST. Can I address all of those in a different format? At a certain point, I am going to run into classification concerns, so let me just assure you that they are included, and then we can talk about the mechanics of it in a different way.

Mr. LANGEVIN. Sure. I would like to do that. Very good. Well, thank you very much for the work you are doing.

With that, Mr. Chairman, I yield back.

The CHAIRMAN. Mr. McEachin.

Mr. MCEACHIN. Thank you, Mr. Chairman, and thank you, Mr. Norquist, for being here.

It is my understanding that the Army, Navy, Air Force, Defense Health Programs, Defense Logistics Agency, U.S. Special Operations Command, and Transportation Command still have not received a clean audit opinion from the DOD IG. Can you talk about how you approach auditing these divisions of DOD over the course of fiscal year 2018 in doing the audit process?

Secretary NORQUIST. Sure. As you pointed out, there are some that have and then there is a series that have not. Some of those like DLA [Defense Logistics Agency] have begun the audit. So DLA was under audit this previous year in fiscal year 2017, as was—DISA [Defense Information Systems Agency] was under audit in 2016, and the U.S. Marine Corps went under audit this year for the first time in 2017.

So some of them have a year or two of experience. The Army, Navy, and Air Force, what they are doing is they are splitting their audits into two parts. They basically have a section of the Army that is funded through what are called general funds, meaning appropriations directly from Congress. And another that is what is

called working capital fund, meaning it bills for its services so it looks more like a company.

These have different accounting systems. And so while the same auditor does both, they have split the opinion into two parts, because the way they function is different. But that will also allow us to see the progress within each of those organizations. So that split occurs in the Army, the Navy, and the Air Force. The other ones, most of them get standalones. If they are too small, they will be covered by the IG rather than get a standalone opinion. They will all be rolled together by the IG to give an opinion on the Department as a whole.

Mr. MCEACHIN. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. Mr. Norquist, you referenced this earlier but I want to ask again. In these efforts, do you have the support of the Secretary of Defense and the Deputy Secretary? Because what you have talked about is cultural change, it is prioritizing dollars, it involves a number of things that, if they are not supported by the top leadership, are not going to happen.

Secretary NORQUIST. Absolutely. The tone from the top is excellent.

The CHAIRMAN. Well, the first conversation I had with the Secretary after he was nominated to be Secretary, he brought this up on his own. So my experience with him is that he believes this is very important, and I just think it is, you have got to have that support from him to make this successful, I think.

You good? Mr. Conaway.

Mr. CONAWAY. I just want to brag on the chairman for having the very first hearing of calendar 2018 on this issue, and highlight that. And I appreciate your keen continued support for getting this done. And that tone from the top that you set is much appreciated. So I yield back.

The CHAIRMAN. Well, I appreciate it, but I think all members, as I said at the beginning, this has been a bipartisan priority for years, and we are going to stand there right with you, Mr. Norquist, to make sure it actually occurs.

Secretary NORQUIST. Thank you, Mr. Chairman.

The CHAIRMAN. With that, the hearing is adjourned.

[Whereupon, at 11:34 a.m., the committee was adjourned.]

A P P E N D I X

JANUARY 10, 2018

PREPARED STATEMENTS SUBMITTED FOR THE RECORD

JANUARY 10, 2018

**Statement of Chairman William M. “Mac” Thornberry
House Armed Services Committee Hearing:
“Department of Defense Update on the Financial Improvement and
Audit Readiness Plan”
January 10, 2018**

The Committee welcomes Mr. David Norquist, the Under Secretary of Defense (Comptroller) and Chief Financial Officer, as our witness today. The topic is the audit of the Department of Defense, which by law begins this fiscal year.

Requiring that the Department conduct an audit has been a bipartisan priority of this Committee for some time. The Chief Financial Officers Act of 1990 required that all federal departments conduct an annual financial audit and partly out of frustration with a lack of progress toward that end, the 2010 NDAA required that the financial statements of the Department be ready for audit by September 30, 2017 and codified the plan for doing so. This Committee's Panel on Defense Financial Management and Auditability Reform put close scrutiny on the Department's efforts and issued a number of recommendations that have enabled us to arrive at this point. The FY 2014 NDAA again required a full audit be conducted of the Department's FY 2018 financial statements, the results of which are to be delivered next year.

I want to commend Chairman Conaway for his expertise and his persistence on this issue, as well as Mr. Courtney, who was also a member of the Audit Panel. They will both be glad to know that we have had additional Members join this Committee in recent years who can also contribute their background and expertise to this issue as it moves ahead.

This issue is important. Members of this Committee hear evidence every week that we are not providing our military with the funding they need to carry out the missions they have been assigned. We must spend more. At the same time, we have a responsibility to the American people to see that each of their tax dollars being spent to protect them is being spent in a transparent way with appropriate accountability.

We should never assume that an audit will solve the problems of waste and inefficiency. But it seems to me that an essential requirement of spending money smarter is knowing with certainty how it is being spent.

It is likely that the result of the first audit will not be pretty, but those results will help direct us all – Congress and the Department – on where we need to apply our efforts to improve. This is important, and this Committee will continue to pursue it.

Statement of Ranking Member Adam Smith
House Armed Services Committee Hearing:
“Department of Defense Update on the Financial Improvement and
Audit Readiness Plan”
January 10, 2018

I thank the Chairman for holding this important and timely hearing, and I appreciate Mr. David Norquist, the Comptroller and Chief Financial Officer for the Department of Defense for appearing before this Committee to discuss this important issue. Your knowledge of the Financial Improvement and Audit Readiness effort is essential as we work to develop the National Defense Authorization Act (NDAA) for FY 2019.

We can all agree the Department of Defense’s development and execution of an enterprise-wide audit will have a valuable impact on the Department and its internal operations. Creating sound financial management systems and controls will benefit the Department’s ability to control costs and anticipate future costs, thereby shaping the Department’s strategic and budgetary planning process. Improved financial management systems and controls will also help ensure accountability, measure performance, and enhance the Department’s ability to prevent and detect fraud, waste, and abuse.

Congress has moved this effort forward by requiring DOD to develop and maintain a plan to ensure all DOD financial statements are validated as audit-ready by September 30, 2017, as part of the National Defense Authorization Act for FY 2010. In 2011, the House Armed Services Committee formed a panel on Defense Financial Management and Auditability Reform and conducted a six-month review to examine the progress and impediments to reaching this goal. In FY2014, Congress also required a full audit of the Department’s FY 2018 financial statements.

While the Department of Defense has certified its audit readiness and is taking the necessary steps to begin the audit, it could, and probably, will be, years before we see a clean audit of the Pentagon.

To quote GAO, “without accurate, timely, and useful financial information, the Department is severely hampered in making sound decisions affecting the department’s operations.” To say you have your work cut out for you is an understatement, but we appreciate DOD’s continued commitment to this challenging task. The Department of Defense has the largest budget and this audit will give taxpayers more confidence in knowing their dollars are being spent wisely. Our service members and the taxpayers deserve to have trust not only in DOD’s superior mission capabilities but also in its financial management.

Embargoed Until Release By The
House Armed Services Committee

Testimony

Before the
House Armed Services Committee

Department of Defense Update on the
Financial Improvement and Audit Remediation (FIAR) Plan

By
The Honorable David L. Norquist,
Under Secretary of Defense (Comptroller) and Chief Financial Officer
Department of Defense

January 10, 2018

Introduction

Chairman Thornberry, Ranking Member Smith, and members of the Committee, thank you for the opportunity to provide an overview of the Department's financial statement audit progress and plans. I appreciate your Committee's long and unwavering support for this effort. I also want to thank Congressman Conaway for his leadership over the years related to this audit. His direction of the Committee's 2011 panel on Financial Management and Auditability helped the Department maintain its focus on audit.

When the President made a promise to the American people to rebuild the U.S. Armed Forces, he also made a commitment to start the audit. Inside DoD, Secretary Mattis and Deputy Secretary Shanahan have set the tone from the top that embraces the audit as part of their vision to bring business reform to the Department of Defense.

I know you have had many hearings where witnesses have told you that they support the start of an audit eventually. This hearing is different. **We have started the audit.** But we are only able to have today's hearing with DoD under its first full financial statement audit because of this Committee's continued support.

Audits are not new to the Department of Defense. Numerous audits covering program performance and contract costs are completed each year by the Government Accountability Office (GAO), the Defense Contract Audit Agency (DCAA), the Department of Defense Office of the Inspector General (DoD OIG), and the services' audit agencies. For example, the DCAA employs over 4,000 auditors to perform contract audits that are focused on identifying inappropriate charges by contractors to the Government. However, this is the first time that the Department is undergoing a full financial statement audit. **A financial statement audit is comprehensive. It occurs annually and it covers more than financial management.** For example, financial statement audits include:

- Verifying count, location and condition of our military equipment, real property and inventory
- Testing security vulnerabilities in our business systems
- Validating accuracy of personnel records and actions such as promotions and separations

The DoD anticipates having approximately **1,200 financial statement auditors** assessing whether our books and records present a true and accurate picture of our financial condition and results of our operations in accordance with accounting standards. These financial statement audits complement but are distinct from audits of program performance or contract costs.

Based on my experience at the Department of Homeland Security, it will take time to implement all the process and system changes necessary to pass the audit. It took the Department of Homeland Security, a relatively new and much smaller enterprise, about ten years to get to its first clean opinion. But **we don't have to wait for a clean opinion to see the benefits of the audit**. The financial statement audit helps drive enterprise-wide improvements to standardize our business processes and improve the quality of our data.

Why DoD Must Be Audited and What That Means

Just like private sector companies and other federal agencies, the DoD prepares financial statements every year to report its assets, liabilities, revenues, and expenses. Though not a corporation, **DoD owes accountability to the American people**. The taxpayers deserve the same level of confidence as a shareholder that DoD's financial statements present a true and accurate picture of its financial condition and operations. Transparency, accountability and business process reform are some of the benefits from the financial statement audit:

- 1) Transparency: the audit improves the quality of our financial statements and underlying data available to the public, including a reliable picture of our assets, liabilities and spending. DoD's progress towards a positive audit opinion will also

directly contribute to an audit opinion on the entire federal government's assets and liabilities.

- 2) **Accountability:** the audit will highlight areas where we need to improve our accountability over assets and resources. For example, during an initial audit, the Army found 39 Blackhawk helicopters that had not been recorded in the property system. Also, the Air Force identified 478 buildings and structures at twelve installations that were not in its real property system. By fixing the property records, we can demonstrate full accountability of our assets. In other cases, as the Department invests in new business systems, we will be able to obtain independent auditor feedback on the system's compliance so we can better hold vendors accountable for their solutions.
- 3) **Business Process Reform:** the combination of better data, business processes reengineering and the use of modern data analytics directly supports Congress' vision of the Chief Management Officer position and DoD's efforts to bring business reform to its operations. These reforms will lead to business operations savings that can be reinvested in lethality.

The cost of performing the audit will be \$367 million in FY 2018. This amount covers the audit fees to the Independent Public Accounting (IPA) firms (\$181 million) and infrastructure to support the audits (\$186 million). The \$181 million in audit contract costs is approximately 1/30th of 1% of DoD's budget and, as a percentage of revenue, is equal to or less than what Fortune 100 companies such as General Electric, Proctor & Gamble and International Business Machines Corporation (IBM) pay their auditors. In addition, we anticipate spending about \$551 million in FY 2018 fixing problems identified by the auditors.

How We Got Here?

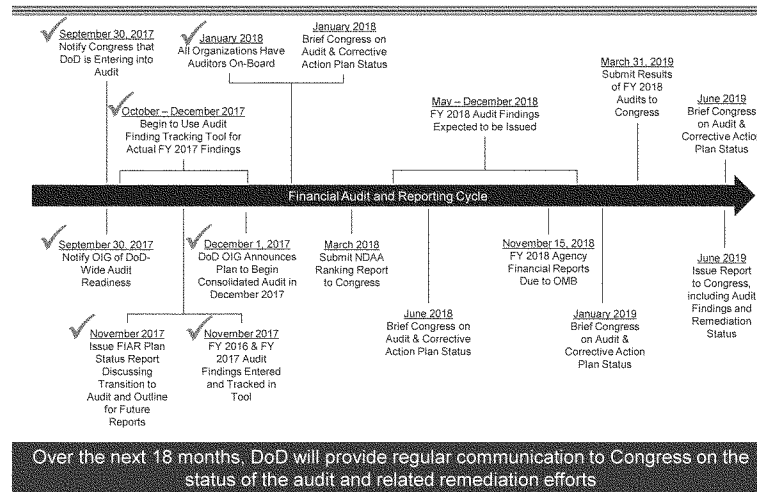
The financial statement audit requirement was initially established in 1990 when Congress passed the Chief Financial Officer Act, which, as amended, required the 24 largest federal agencies to complete independent annual financial statement audits. As you are aware, until this year DoD was the only large federal agency not under full financial statement audit. The size and complexity of our enterprise, combined with the pace of our military operations, made meeting this requirement challenging.

In a move that helped keep the Department on course, the National Defense Authorization Act for FY 2014 mandated that DoD conduct an audit in Fiscal Year 2018. Consistent with this requirement, we provided notification to Congress, in September 2017, that the Department was starting a full financial statement audit for FY 2018. Consequently, the DoD OIG announced the start of the FY 2018 financial statement audit in December 2017.

How the Audit Will be Conducted

The DoD consolidated audit will likely be one of the largest audits ever undertaken and comprises more than 24 stand-alone audits and an overarching consolidated audit. DoD is currently sustaining clean opinions for nine stand-alone audits. Audits will be conducted by the IPA firms with the DoD OIG performing the consolidated audit. All audit contracts have been awarded and auditors have begun to arrive.

Fiscal Year 2018 Timeline



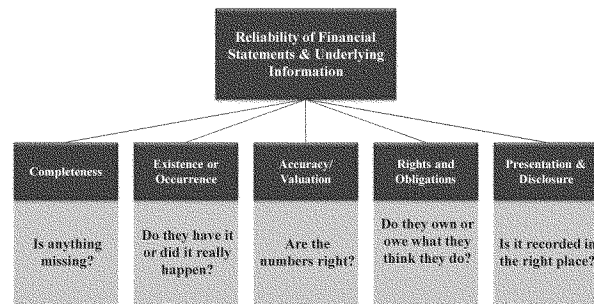
During an audit, the auditors will select line items on the financial statements based on materiality and risk, such as Property, and they will ask for a listing of items or transactions that make up the total amount on the financial statements. For example, for Property, the listing should have all the buildings, equipment, and software that equal the total amount of property.

The auditors will then pick samples from the listing for testing. Testing will include physically verifying that the property exists and is accurately recorded in the property system.

Once the auditors have completed testing, they will evaluate the results to determine if the financial statements are presented fairly in all material respects in accordance with accounting standards. The auditors will report any problems they find at the end of the audit cycle and will reevaluate the status of corrective actions annually.

The pictorial below depicts the focus areas for financial statement auditors.

What Is a Financial Statement Auditor Looking for?



Measuring Progress

For years, the Department received a disclaimer of opinion on the DoD-wide financial statements from the DoD OIG. This means the Department could not adequately support the accuracy of our financial information or fully account for our assets, spare parts and other inventory items. These disclaimers were based on management's assertions, and not based on independent audit testing. Beginning this year, audit opinions will be based on comprehensive auditor testing and will result in actionable feedback.

In order to track progress, the Department has established a tool and a process to capture, prioritize, assign responsibility for, and develop corrective actions to address audit findings. Each year, the auditors will assess and report on whether the Department has successfully addressed the findings. **Going forward, we will measure and report progress toward achieving a positive audit opinion using the number of audit findings resolved.**



As we move forward, your continued support for budget stability, information technology and funding to remediate audit findings remains critical in moving the Department towards achieving a positive opinion.

I look forward to providing you with an update as we progress with our first full financial statement audit. I'll be ready to discuss what we've learned and where our focus will be in the second year of our annual audit cycle.

I look forward to your questions.

David L. Norquist
Under Secretary of Defense (Comptroller) Chief Financial Officer

David L. Norquist was sworn in as the Under Secretary of Defense (Comptroller)/Chief Financial Officer on June 2, 2017 and serves as the principal advisor to the Secretary of Defense on all budgetary and financial matters, including the development and execution of the Department's annual budget of more than \$600 billion. Mr. Norquist has over 28 years of experience in federal financial management and is a Certified Government Financial Manager (CGFM).

Prior to his current role in the Department of Defense he was a Partner with Kearney and Company, a CPA firm that provides audit, accounting and consulting services to the Federal government. His career as a federal employee included providing financial management leadership at virtually every level at which the Federal government spends or oversees the expenditure of money. This includes eight years with the Department of the Army working at Army Headquarters, at a Major Command and at a field site; five years as professional staff on the House Appropriations Committee, Subcommittee on Defense; and four years as Deputy Under Secretary of Defense in the office of the Comptroller.

From 2006 to the end of 2008, Mr. Norquist served as the first Senate confirmed Chief Financial Officer for the Department of Homeland Security. As CFO, he established a formal process to eliminate pervasive weaknesses in DHS's financial statement and put DHS on its path to a clean audit opinion. From FY 2006 to FY 2008, DHS reduced the number of material weaknesses by 40% and the number of department-wide audit disclaimer conditions by 70%.

Mr. Norquist holds both a BA in Political Science and a Master of Public Policy from the University of Michigan and an MA in National Security Studies from Georgetown University. He co-authored DHS: The Road to a 'Clean' Opinion, Journal of Government Financial Management (Summer 2014) and is author of The Defense Budget: Is it Transformational? Joint Force Quarterly (Summer 2002).

He and his wife Stephanie reside in Virginia with their three children.

QUESTIONS SUBMITTED BY MEMBERS POST HEARING

JANUARY 10, 2018

QUESTIONS SUBMITTED BY MR. LANGEVIN

Mr. LANGEVIN. While conducting an audit of this magnitude, how do you plan to deal with the significant complexities it may present—for example, contracts and systems not designed with an audit in mind, or auditing the classified portion of the budget? Does guidance for new contracts provide for the eventuality of an audit?

Secretary NORQUIST. The consolidated Department of Defense (DOD or Department) audit will likely be one of the largest audits ever undertaken. The Department has been working for many years to appropriately plan for this audit. To prepare for the significant complexities that come with an audit of this size, DOD has specifically focused on:

a) Breaking the audit down into manageable pieces: To help manage the audit of a large-scale organization with operations around the world, the Department's audit will be divided into more than 24 stand-alone audits of major components, and an overarching consolidated audit. This structure will allow larger DOD components to directly manage their individual stand-alone audits, and will allow the DOD's consolidated auditor to rely on the work performed by stand-alone auditors. Given the large number of audit requests and the complexities and findings expected during the initial audits, distributing and tracking the responsibility to respond to all of these items across the individual stand-alone audits are critical to success. Utilizing a pool of qualified independent public accounting firms to perform the various stand-alone audits also fosters competition, driving down audit costs for the Department and preserving auditor independence restrictions.

b) Establishing an infrastructure to support the audit: The Department has put people, processes, and systems in place to directly support the audit. Furthermore, this infrastructure includes protocols for ensuring classified programs are also subject to audit, while maintaining appropriate safeguards over our classified information. My staff will reach out to yours to arrange a secure meeting to discuss the details on how our classified programs will be audited. In recent years, the Military Services and select defense agencies have undergone limited-scope financial audits or examinations that tested this infrastructure and provided feedback on areas for improvement. DOD will only be able to take full advantage of the audit by having adequate audit infrastructure in place.

c) Leveraging audit results to drive necessary changes to our contracts, systems and processes: To take full advantage of the independent auditor feedback, the Department has established a tool and a process to capture, prioritize, assign responsibility for, and develop corrective actions to address audit findings. This tool and process will allow leaders to track and demonstrate progress implementing fixes that respond to auditor findings while improving management and data for the Department. For example, the Department is using auditor feedback to explore methods for standardizing the structure of future contracts to facilitate greater accountability over equipment in the possession of contractors and accounting for the value of our property and inventory.

QUESTIONS SUBMITTED BY MR. CONAWAY

Mr. CONAWAY. Section 803 of the fiscal year 2018 NDAA authorizes the Secretary of Defense to use qualified private audit companies, as opposed to the Defense Contract Audit Agency, for performance of certain incurred cost audits. a) Do you see value to this approach? b) How does leveraging qualified private entities to conduct the incurred cost audits of defense contractors support the Department of Defense's vision of an audit? c) Please provide an update on how the Department is implementing section 803 of the fiscal year 2018 NDAA.

Secretary NORQUIST. a) *Do you see value to this approach?* I do see value in the Congressional approach and DCAA is committed to executing the Congressional intent to establish private sector audit capacity for the performance of incurred cost audits. Although DCAA already had processes in place to eliminate the incurred cost backlog, this provision will also allow DCAA to draw on this private audit capacity if they experience a surge in audit requirements to avoid future backlogs. DCAA will be able to accomplish its high risk more complex effort supporting the

contracting community. The Department will monitor its cost/benefit to ensure the expected value is received.

b) How does leveraging qualified private entities to conduct the incurred cost audits of defense contractors support the Department of Defense's vision of an audit? The objectives are different between the DOD financial audits and the DCAA contract audits. In addition to evaluating the DOD financial statements, the financial audits look at DOD systems and processes to ensure that we have reliable financial information to use for decision-making. Contract audits evaluate DOD contractor books and records to ensure the Department is paying fair and reasonable prices for its goods and services. The DOD incurred cost audit does indirectly support the financial audit as it facilitates more timely and effective contract closeout that supports the Department's financial statement audit. As stated above, by leveraging the qualified private auditors, DCAA will maintain currency on its incurred cost audit requirements facilitating more timely contract close-out and reduce expiring funds.

c) Please provide an update on how the Department is implementing section 803 of the fiscal year 2018 NDAA. The Department is currently developing a plan to include qualified private auditors in the incurred cost audit process to maintain an appropriate mix of Government and private sector capacity to eliminate any backlog of incurred cost audits and remain current. The plan to implement Section 803 also includes DCAA coordinating with DCMA and the services to develop a comprehensive plan for executing the Section 803 requirements and the identification of additional resources needed for the development of an infrastructure to support the use of qualified private auditors. DCAA has already provided initial guidance to its staff on the one-year requirement for completing its incurred cost audits and the 60-day requirement for completing its adequacy review of the incurred cost proposals.

Mr. CONAWAY. The fiscal year 2017 House Armed Services Committee NDAA Report called on the Department of Defense to "leverage greater certified public accountant experience and Federal financial management experience" for follow-on contract awards supporting "implementation, operation, and full utilization" of Enterprise Resource Planning ("ERP") systems with the Army, Navy, and Air Force. This remains an important area of focus with the emphasis on audit reform. a) Can you comment on this approach and on the advantages of the federal government leveraging contractors who are certified public accountants? b) Are there particular advantages in using auditors with federal financial management experience?

Secretary NORQUIST. a) Leveraging greater certified public accountant experience and federal financial management experience to support the success of ERP implementation and operations is important to the Department of Defense. Because sustainable audit success depends, to a great extent, on compliant auditable business feeder and financial systems, having experienced contractor support versed in federal accounting and audit standards will enable the Department to have better insight into ERP performance, gaps in compliance, and root-cause analysis. This, combined with independent auditor feedback on the systems' compliance, means that the Department can respond to audit findings that much more quickly and adroitly.

b) There are advantages in using auditors with federal financial management experience to perform the Department's financial statement audit. Federal agencies must follow accounting standards, promulgated by the Federal Accounting Standards Advisory Board, that are specific to the federal government. Additionally, the Office of Management and Budget prescribes the form and content of federal financial statements, which are different from both commercial and state and local reporting formats. Also, auditors performing federal financial statement audits must comply with Generally Accepted Government Auditing Standards issued by the Government Accountability Office. Experience with these federal-specific requirements allows auditors to better identify findings and to provide best-practice based recommendations based on their prior experience working with federal agencies.