

Statement

of

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

before the

U.S. House of Representatives  
Armed Services Committee  
Panel on Defense Acquisition Reform

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Mr. Chairman, Members of the panel, thank you for the opportunity to appear before this Defense Acquisition Reform Panel. I want to start by thanking the Members of the Congress for their support of our men and women in the military. We cannot meet the nation's national security needs without your assistance.

While the panel is focusing on acquisition reform, it has also addressed various financial issues, including efforts in the Department of Defense (DoD) to improve financial information and achieve audit readiness. I will confine my prepared remarks to the financial improvement and audit readiness issues. I would be glad to discuss other issues during the hearing.

### **Strengths of Defense Financial Management**

I want to start by indicating what I believe are the strengths of defense financial management. Most importantly, defense financial managers are successfully providing DoD's warfighters with the resources and financial services necessary to meet our national security objectives. We are doing this around the world, including in Afghanistan and Iraq. I base this important conclusion on my own 30 years of experience in defense financial management and on numerous conversations with defense commanders. We do need to improve certain aspects of DoD financial management, but we must be careful not to achieve those improvements at the expense of meeting our fundamental mission.

DoD also has effective financial processes in key areas. Our payment processes produce timely and accurate payments in a very high percentage of cases. Interest payments have been dramatically reduced in recent years, and our summary reconciliation rates with Treasury are very high.

Importantly, DoD has a sound process for funds distribution and associated controls. This process has been periodically validated by external auditors. It ensures that funds are distributed in accordance with laws and regulations. After distribution, laws that are regularly enforced require that funds be obligated exactly as distributed. I believe this should reassure the Congress that DoD is obligating its appropriations in accordance with the laws you enact.

In addition, the approximately 50,000 men and women in DoD financial management are, I believe, some of the best-trained in government. DoD has an extensive and effective training program for its financial managers. This training program, along with a significant measure of dedication, permits these men and women to help meet our national security objectives even though they are dealing with one of the largest and most complex budgets in the world. I might add that over the past decade this dedicated group has found ways to accomplish much more work with the same number of people. Since FY 2000, defense budgets have risen about 70 percent after adjustment for inflation, and we are contending with the many financial complications associated with two wars. Yet during this period there has been no significant increase in the number of DoD financial managers. Rather, DoD has reduced back-room accounting and finance functions in order to meet increased needs for operational financial managers.

### **Why Audit Problems Persist**

So if we can successfully support the Department's mission, why have we failed to achieve auditable financial statements?

To pass an audit, auditors require that an organization have a business environment – including systems and processes – that leads to recording the financial results of business events (such as contract signing) in a consistent and reliable manner. Our business environment does not always meet that

standard. Our systems are old and handle or exchange information in ways that do not pass current audit standards. Our legacy systems tend to be non-standard and sometimes do not have good financial controls. In these cases, the consistent application of required internal controls becomes critical. Those DoD organizations that have achieved financial auditability have been small enough to be able to overcome these deficiencies.

DoD's enormous size and geographical dispersion greatly complicates the challenges associated with meeting audit standards. We obligate an average of \$2 to \$3 billion dollars every business day and handle hundreds of thousands of payment transactions. Some of these financial transactions take place in war zones. Because of our size and mission requirements, it would be exorbitantly costly to deploy an army of accountants to solve our problems manually.

### **Some Progress Has Been Made But Major Problems Remain**

We have made some progress toward improving financial information and audit readiness. The Army Corps of Engineers has fully auditable financial statements and is maintaining them. Several defense agencies maintain auditable statements including the Defense Finance and Accounting Service and the Defense Contract Audit Agency. Several large trust funds managed by DoD are auditable. The United States Marine Corps has asserted audit readiness for its Statement of Budgetary Resources and an audit of the Fiscal Year (FY) 2010 statement has begun.

But major problems remain. When I took over the Chief Financial Officer (CFO) job about a year ago, I quickly became convinced that the Department did not have a common goal or priorities in the audit readiness area. Instead, the military departments were pursuing their own initiatives and doing so with widely varying degrees of commitment and resources. With this approach, I concluded that the Department as a whole would never achieve success. Also, the Department's dates for achieving audit readiness were not credible. My own staff did not believe them.

Worse yet, DoD was investing significant time and money improving information that is not used by defense managers. The best example is the valuation of military weapons. Over the past decade the Department invested substantial resources in an unsuccessful effort to identify the historical costs of many of its weapons, including modifications. Under current rules, we must produce auditable information about historical costs of weapons in order to achieve a clean audit opinion. Yet in more than 30 years of experience working on defense policy and budget issues, I have never used the historical costs of weapons to make decisions. Nor have I known anyone else who used this information. To varying degrees, this same indictment applies to much of the valuation information on the balance sheet. In DoD, we just do not use most of this information to manage.

In my view, DoD needed a new and coordinated approach to financial improvement and audit readiness backed by realistic milestones and reasonable levels of resources.

### **Our New Approach—Improve the Quality of the Information We Use Every Day**

Shortly after I was sworn in as DoD's CFO, I began consultations regarding a new approach with senior leaders in my office and in the military departments and defense agencies. We also discussed a new approach with the Office of Management and Budget (OMB), the Government Accountability Office, and some staff members in the Congress. In August of last year I issued a memorandum outlining the new approach.

This approach focuses on improving the quality, accuracy and reliability of the financial and asset information that we use every day to manage the Department. Specifically, we plan to focus on two types of information – budgetary information and existence and completeness of assets.

Budgetary information is critical to leadership at all levels—program managers, program executive officers, base commanders, Service Chiefs, Service Secretaries, and the Secretary of Defense—as they make operational and resource allocation decisions. So our new approach focuses on improving budgetary information, which should lead to audit readiness for our Statements of Budgetary Resources.

While we rarely need to know the historical costs of weapons and equipment, we do need to know their numbers and their location. The financial audit elements of “existence and completeness” translate directly into knowing what we have and where it is so we can use the equipment in combat and ensure that our acquisition community is buying only what DoD needs. Existence and completeness, one of the key elements on the balance sheet, is the second of the two priority areas under our new approach.

The FY 2010 National Defense Authorization Act accommodates this new approach in the audit readiness legislation. We appreciate the support of the Congress for our new approach.

I know from long experience in government that implementing any new approach is much more than half the problem. So immediately after establishing this approach, I began taking steps to implement it:

- First, we placed a reasonable priority on the effort. Financial improvement and audit readiness must be an agency-wide priority that has the support of senior leaders. This initiative is now one of DoD’s top-ten business priorities.
- Second, we created a governance structure. We have a governance board chaired by the CFO that meets quarterly and includes the Deputy Chief Management Officers (CMOs) throughout the Department. I have personally briefed the Chief Management Officer of the DoD on this topic and each of the Service CMOs. My Deputy Chief Financial Officer conducts weekly meetings with the heads of financial operations in the military departments, and these meetings regularly discuss issues related to financial improvement and audit readiness.
- Third, we obtained resources. Nothing is harder in DoD than acquiring resources for business process improvements, because these dollars compete, as they should, with direct warfighter needs. But I have ensured that increased resources are devoted to high-priority financial improvement efforts, including operations in Afghanistan.
- Fourth, we made the improvement of audit readiness among individual DoD components a DoD High Priority Performance Goal, with progress measurements described in the President’s FY 2011 Budget’s Analytic Perspectives volume.

In order to demonstrate progress, our plan includes interim goals that can be achieved by FY 2012. We plan a DoD-wide examination and validation of our funds control and distribution process (known in audit terms as “appropriations received”). Periodic validation of appropriations received will reassure the Congress that we are controlling our funds carefully and in ways that ensure we comply with the laws you enact. A clean opinion on the Marine Corps Statement of Budgetary Resources is a key interim goal. We will learn much from this effort. I have also asked the military departments to

identify areas that can be validated by FY 2012, including audit readiness for funds balance with Treasury.

We owe the Congress more detail on our plan. The FY 2010 National Defense Authorization Act requires that the CFO provide a semi-annual report on financial improvement and audit readiness in May and November. We are still finalizing the May 2010 report, which will provide considerably more detail. While I am not prepared to discuss those details today, I expect that we will meet the required deadline for this report and its associated detail.

The FY 2010 National Defense Authorization Act not only requires reports; it requires that DoD have fully auditable financial statements by 2017. Under current audit rules, meeting that date would require the expenditure of large sums of DoD dollars to acquire and improve information – especially valuation information – that is rarely useful to DoD managers. My understanding is that non-defense financial managers are expressing similar concern about the costs of maintaining these types of information in audit-ready status even though the information is rarely used to manage. The CFO Council is reviewing alternative federal reporting models that can increase transparency while maintaining sound internal controls. After that review is complete, and after consulting with the appropriate stakeholders, I expect to identify and report to the Congress on a feasible approach to achieving fully auditable statements. For now, we are focusing on improving the financial information that we use to manage.

### **Major Challenges Remain**

I am under no illusions that it will be easy to achieve auditability even for the budgetary and existence and completeness information that we use to manage. Formidable challenges remain.

Achieving these goals requires that we apply a consistent level of process controls that cross organizations and functional areas. Financial information that is passed from system to system must also be subject to a control environment to ensure that only authorized personnel are using the system and that these systems protect the data quality and maintain a compliant audit trail within the end-to-end business process. This process must be controlled from the transaction level, through general ledger postings, accurate trial balances, and reliable period closeouts. Only by completing these steps we can prepare financial statements that an auditor can review and verify. Many elements of our current business environment must be changed to allow us to meet financial audit standards. In the midst of two wars and numerous military operations, it will be a major challenge to find the time and resources to accomplish these goals.

Specifically, we need new systems that make it easier to achieve and sustain consistent business processes and controls. It will be either impossible or too costly to meet these key goals with existing systems. Each of the military departments is in the process of installing a new enterprise resource planning (ERP) system that would greatly facilitate audit readiness. ERP implementation is under the overall control of the Chief Management Officers, and this is a principal area where financial improvement depends on the successful efforts of the CMOs. DoD has multiple large programs, and each of them must be scrutinized to ensure that the implementation approach balances cost and risk appropriately. While progress is being made, we must not underestimate the difficulty of installing new ERP systems successfully.

## **My Commitment**

Based on long experience, I recognize the challenges associated with improving financial information and achieving audit readiness in the Department of Defense. But I believe we have taken the necessary steps to succeed for the information we use to manage. Most importantly, we have focused financial improvement and audit readiness efforts on information we use to manage. Now we have a business case for devoting time and resources.

Next we have accorded the initiative a reasonable priority within the Department – making it one of our top ten business priorities (referred to by the Administration as High Priority Performance Goals). We have identified longer term goals as well as interim goals that permit us to demonstrate progress. We have a governance structure in place that includes the CMOs and have increased the resources we are devoting to the effort. We are required to provide regular reports to Congress, and we live up to that requirement, beginning with our May 2010 report that will provide more details on the new plan.

I want the Panel to know that I am personally committed to this effort as part of my overall commitment to providing the financial resources and services necessary to meet our national security objectives.