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Statement of
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Defense Financial Management and Auditability Reform Panel
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on

"DoD's Efforts to Improve Payment and Funds Control"

Chairman Conaway, Ranking Member Andrews, and distinguished members of the Panel, good morning and thank you for the opportunity to appear before you on behalf of the Department of Defense (DoD) Office of Inspector General (IG) to discuss specific financial management challenges within the Department and improvements for internal controls that must be made. While financial management challenges within the Department have existed for a long time, the current economic uncertainty and fiscal constraints make resolving these weaknesses critically important. Over the past few years, the Department has worked diligently to address its financial management challenges and improve the quality of its financial management information. However, much more progress is required in order to be good stewards of the taxpayer's money and have reliable financial information for decision makers to use on a daily basis.

Today I will discuss DoD IG's perspective on the Department's financial management challenges in improper payments, potential anti-deficiency act violations, and problem disbursements. I will also offer a brief summary of other financial management challenges that must be addressed before the Department will be ready to pass a financial statement audit.

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

DEPARTMENT EXPERIENCES CHALLENGES IN IMPROPER PAYMENTS, ANTIDEFICIENCY ACT, AND PROBLEM DISBURSEMENTS

Since the 1990s, the DoD IG has identified financial management as one of several key challenges within the Department. The Department continues to face a myriad of

problems that adversely affect its ability to provide reliable, timely, and useful financial data needed to support operating, budgeting, and policy decisions. These challenges create an environment where improper payments, Antideficiency Act violations and other problem payments are more prevalent. The current financial management environment also makes the Department more vulnerable to fraud, waste and abuse.

Improper Payments. Improper payments have been a longstanding problem within the Department. The DoD IG has worked closely with the Department to identify improper payments and make recommendations to improve controls that will reduce improper payments. Specifically, since Fiscal Year 2007, DoD IG has issued at least 27 reports addressing actual or potential improper payments made throughout the Department. In Fiscal year 2012, the DoD IG plans to announce audits on this topic that will continue to make recommendations to improve processes and controls related to payments made by the Department. While the Department made strides to improve the identification and reporting of improper payments and took many corrective actions to implement recommendations made by the DoD IG, more work is needed to improve controls over payments processed throughout the Department.

Improper payments are often the result of unreliable data and poor internal controls. These conditions create an environment where fraud is more likely and, as a result, the Department lacks assurance that the billions of dollars it disburses annually are made correctly. Simply stated, DoD does not consistently know that it is paying the right person, the correct amount, at the right point in time. An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements.¹ Incorrect amounts are overpayments and underpayments (including inappropriate denials of payment or service). An improper payment includes any payment that was made to an ineligible recipient or for an ineligible service, duplicate payments, payments for services not received, and payments that are for the incorrect amount. In addition, when an

¹ M-11-16, "Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123," April 14, 2011

agency's review process is unable to discern whether a payment was proper as a result of insufficient or a lack of documentation, this payment must also be considered an error.

Incomplete Reporting of Improper Payments. The Department has a reported 75 percent recovery rate of the nearly \$1.3 billion for improper payments identified during 2004 through 2010.² While we commend the Department on aggressively pursuing recovery of identified improper payments, unless the DoD improves its methodology to review all its disbursements, it will continue to understate its estimate of overpayments and will likely miss opportunities to collect additional improper payments. In Fiscal Year 2010, the Department reported nearly \$1 billion in estimated improper payments. However, based on our audit results, we are concerned with the accuracy and reliability of the Department's estimation process. Without a reliable process to review all expenditures and identify the full extent of improper payments, the Department will not be able to improve internal controls aimed at reducing improper payments.

In our audit of the Department's review and reporting of improper payments, we found the Department's review process included less than half of the Fiscal Year 2010 first quarter gross outlays.³ Specifically, DoD did not review approximately \$167.5 billion of the \$303.7 billion in gross outlays for high dollar overpayments. Additionally, some overpayments that we or the Department identified were not reported, and the First Quarter FY 2010 High Dollar Overpayments Report did not include sufficient information about recoveries and corrective actions. The Overpayments Report was inaccurate and incomplete because the Comptroller and the Director, Defense Finance and Accounting Service, did not develop a sound methodology or perform adequate oversight for collecting and reporting comprehensive data.

² Defense improper payment recovery performance and figures are as reported on <http://paymentaccuracy.gov/>. DoD IG has not validated the reported Defense performance or figures. As required by Executive Order 13520, November 20, 2009, "Reducing Improper Payments," the U.S. Department of the Treasury, in coordination with the U.S. Department of Justice and Office of Management and Budget, established this website to create a centralized location to publish information about improper payments made to individuals, organizations, and contractors.

³ Report No. D-2011-050, "DOD Needs to Improve the High Dollar Overpayment Review and Reporting," March 16, 2011

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

We and other auditors continue to identify improper payments. For example, the Defense Contract Audit Agency estimated about \$6.4 billion of improper payments to contractors for the period from October 2005 to through March 2011.⁴ These are costs paid to contractors that Defense Contract Audit Agency questioned because they do not comply with rules, regulations, laws and/or contract terms which meets the definition of an improper payment. These improper payments the audit agency identified are greater than the \$1.3 billion of improper payments the Department identified during 2004 to 2010.

Weak Internal Controls Lead to Improper Payments. Adequate internal controls are key to mitigating the risks that make improper payments more likely. While management and oversight organizations can identify instances where improper payments may have occurred, internal controls are the first line of defense to prevent or detect improper payments. These controls are the responsibility of DoD's leadership and, when effective provide, reasonable assurance that the disbursements made are for the correct amount and to the correct entity.

The Department's financial management processes are not always adequate to prevent or detect improper payments. For example, in our recent audit of a contract supporting Broad Area Maritime Surveillance, we found DoD personnel did not validate that the

⁴ DoD IG analysis of Inspector General, DoD Semiannual Reports to Congress, Appendix D, from October 1, 2005 through March 31, 2011. Figure cited excludes 10 percent of cited questioned cost as Defense Contract Audit Agency provides audit support to other Federal agencies and includes those questioned costs in its overall reporting figures.

contractor was entitled to \$329.3 million it received as of January 12, 2010.⁵ In this case, the contracting officer thought the Contracting Officer Representative was reviewing contractor invoices; however, the Contracting Officer Representative never reviewed any invoices because she did not know it was her duty. Further, since mid 2009, the Defense Contract Audit Agency revoked the contractor's authority to directly bill because of continuing systemic issues with the contractor's billing system. Finally, the contractor invoices lacked any detail such as labor hours worked, travel incurred or items produced. When we received some details on supporting these invoices, we found that the Navy paid \$206,000 in questionable travel expenses such as for a golf outing and air shows in Paris, France, and Singapore.

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

Figure 1.

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

⁵ Report No. D-2011-028, "Contract Oversight for the Broad Area Maritime Surveillance Contract Needs Improvement," December 23, 2011

Figure 2.

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

The DoD IG has reported previously about the Department’s “pay and chase” practice, where contractors are paid the billed invoice amounts before determining what the correct billing amount should have been. For example, in March 2011 the DoD IG reported that in a contract for subsistence items in Afghanistan, the Department made improper payments by overpaying a contractor \$25.9 million for materiel costs and potentially overpaying \$98.4 million for transportation costs.⁶ This occurred because the Defense Logistics Agency was paying the contractor provisional transportation rates for moving food within Afghanistan based on a verbal change order in August 2005. The Defense Logistics Agency continued to pay higher transportation costs even though in 2008, the Defense Contract Audit Agency issued its report questioning provisional transportation costs. The Defense Logistics Agency stated it will resolve the improper payment issues by December 31, 2011.

⁶ Report No. D-2011-047, “Improvements Needed in Contract Administration of the Subsistence Prime Vendor Contract for Afghanistan,” March 2, 2011

In another example, for construction contracts in Iraq and Afghanistan, we found that the Air Force improperly paid a bill for \$24.3 million for labor that was not specified in the base contract. Further, the Air Force did not adequately verify that the Department actually received the goods and services listed. During this audit, we also found that invoice reviews did not always occur. The invoices we examined showed multiple discrepancies. For example, one invoice showed a local construction inspector had 630 billable hours in a 27 day billing period. In order for this invoice to be legitimate, the inspector would have had to work on average 23.3 hours per day.⁷

In 2008, we reported that Government contractors responsible for processing TRICARE overseas health care claims made duplicate payments and overpayments to host-nation providers and to TRICARE beneficiaries.⁸ As a result, we estimated that TRICARE Management Agency made inaccurate payments totaling \$14.6 million for overseas health care claims during Fiscal Year 2004 and Fiscal Year 2005. We projected the TRICARE Management Agency could put \$29.7 million of Defense Health Program funds to better use during the execution of the Fiscal Years 2008 through 2013 Future Years Defense Plan by strengthening internal controls, establishing sound contract surveillance plans, and improving recoupment procedures.

Potential Antideficiency Act Violations in the Department. The Department's claimed actual Antideficiency Act violation performance of only 20 cents per \$1,000 is notable; however, we are concerned by the large number of "near misses" or potential Antideficiency Act violations that are averted because we specifically identify them and the Department takes corrective action to eliminate them. Control environment weaknesses impair the Department's ability to timely and reliably determine the amount of funds that it has available to spend and, as a result, the Department remains at risk of overobligating and overexpending its appropriations in violation of the Antideficiency Act.

⁷ Report No. D-2010-078, "Air Force Use of Time-and-Materials Contracts in Southwest Asia," August 16, 2010

⁸ Report No. D-2008-045, "Controls Over the TRICARE Overseas Healthcare Program," February 7, 2008

The Antideficiency Act prohibits federal agencies from obligating or expending federal funds in advance of or in excess of an appropriation, apportionment, or certain administrative subdivisions of those funds.⁹ Among other things, the Act requires agencies to report to the President and Congress all relevant facts and a statement of actions taken, and to transmit a copy of each report to the Comptroller General on the same date the report is transmitted to the President and Congress. Federal employees who violate the Antideficiency Act may be subject to administrative discipline including, when circumstances warrant, suspension from duty without pay or removal from office. In addition, employees may also be subject to fines, imprisonment, or both.

“Near Misses.” Since 2005, the Department has accounted for 68 percent of the Antideficiency Act violations within the federal government. Specifically, of the 120 actual Antideficiency Act violations reported by Federal agencies from Fiscal Year 2005 through Fiscal Year 2010, 82 were reported by the Department.¹⁰ Since 2005, DoD IG issued 49 audit reports that identified over 900 potential Antideficiency Act violations, valued at over \$2.3 billion, which the Department needed to further investigate and take corrective action, as appropriate, when an actual Antideficiency Act violation occurred. Four of our identified potential Antideficiency Act violations were eventually reported by the Department as actual Antideficiency Act violations, totaling approximately \$57 million. The Department is either still reviewing the remaining potential Antideficiency Act violations, or was able to take corrective actions to remedy the potential Antideficiency Violations, such as applying available appropriate funding.

These “near misses” illustrate the risk that Antideficiency Act violations can materialize if management does not establish adequate internal controls and does not take a proactive approach to detecting and resolving potential Antideficiency Act violations. Had DoD IG not performed these audits, or performed that body of work at a later time, those potential Antideficiency Act violations could have become actual reportable violations.

⁹ 31 U.S.C. §§ 1341, 1517(a)

¹⁰ DoD IG analysis of GAO “Antideficiency Act Reports” for Fiscal years 2005 through 2010 from reports required by section 1401 of the Consolidated Appropriations Act, 2005, P.L. 108-447, 118 Stat. 2809, 3192 (12/8/2004) <http://www.gao.gov/ada/antideficiencyrpts.htm>

Rather than rely on oversight organizations to find potential Antideficiency Act violations, the Department needs to improve its controls to prevent and detect these potential and actual violations.

Lack of Adequate Internal Controls, Inadequate Training, and Poor Training Contribute to Potential ADA Violations. In reviewing our 49 audits that identified potential Antideficiency Act violations, we found that many of these potential violations were the result of poor internal controls, training, or guidance. Adequate internal controls are essential to mitigate potential Antideficiency Act violations from occurring. Unfortunately, internal controls do not always exist or do not effectively detect or prevent potential Antideficiency Act violations.

For example, we found that inappropriate financing of an Army training contract caused a \$23 million potential Antideficiency Act violation.¹¹ In July 2009, the contracting officer at the Tank-Automotive Command Contracting Center awarded a contract for Instructor Services for the Mine Resistant Ambush Protected Vehicle. The contract had a 6 month base period from July 2009 to January 2010 and a 6 month option from January 2010 to July 2010. The Contracting Center officials stated the contract was set up in this fashion because only the initial 6 months of the Fiscal Year 2009 money for the contract was available. However, \$23 million of additional Fiscal Year 2009 money became available and the contracting officer exercised the contract option starting in January 2010. The problem is that the Army could not use \$23 million of Fiscal Year 2009 money to fund a contract option starting 4 months after Fiscal Year 2010 started because the need for the funds existed in the prior year.

In another example, in a recent report on Navy ship Maintenance we identified how contracting officers in the Navy caused a potential violation of the Antideficiency Act.¹² On September 28, 2005, a contracting officer in Bahrain awarded a contract for \$7 million to overhaul 2 Patrol Coastal class ships. The contracting officer used Fiscal

¹¹ D-2011-036 Competition Should Be Used for Instructor Services for the Mine Resistant Ambush Protected Vehicles, February 3, 2011

¹² Report No. D-2011-043, "Improvements Needed on the Fleet and Industrial Supply Center, Sigonella, Ship Maintenance Contracts in Southwest Asia," February 22, 2011

Year 2005 money. Then in October 2005 an Administrative Contracting Officer in Dubai split the original contract in to 2 separate contracts, one for each ship. The administrative contracting officer then signed one contract on October 18, 2005 to overhaul one ship using \$3.5 million of Fiscal Year 2005 money and signed another contract on March 12, 2006, for overhaul of the second ship using \$3.5 million of Fiscal Year 2005 money. The contract file showed that this was done because Fiscal Year 2006 money was not available to overhaul the second ship. In this case, the contracting officers should have initially awarded two separate contracts to overhaul these ships and used Fiscal Year 2005 money for one ship and Fiscal Year 2006 money for a second ship. The Navy agreed that this was a funding problem and initiated an investigation.

We found a Navy contracting officer did not properly manage an indefinite-delivery, indefinite quantity contract for the maintenance of engines for mine countermeasures ships because the contracting officer “parked” approximately \$20.3 million in Navy Operations and Maintenance funds when he issued task orders to obligate funds before specific requirements were identified.¹³ In addition, the task orders for engineering services did not specify the need for engineering services. Eventually, the Contracting Officers’ Representative issued technical instructions that defined the maintenance requirements for approximately \$19.2 million of the “parked” funds. The remaining \$1.1 million in Navy Operations and Maintenance funds were invalid Fiscal Years 2007, 2008, and 2009 funds and, if expended, could result in potential Antideficiency Act violations. The contracting officers disregarded the fundamental guiding principles of funds management by banking funds for future use and before requirements were determined. The Navy initiated corrective action by deobligating the old funds.

Misinterpretation or Unclear Understanding of Rules are Contributing Factors. A misinterpretation or lack of clear understanding of fiscal law can cause potential Antideficiency Act violations to occur. Over 600 of the over 900 potential Antideficiency Act violations were identified in our series of audits on the Department’s

¹³ Report No. D-2010-087, “Weaknesses in Oversight of Naval Sea Systems Command Ship Maintenance Contract in Southwest Asia,” September 27, 2010

purchases made through other agencies. We found that misinterpretations or unclear understanding of the fiscal law contributed to many of those potential Antideficiency Act violations from interagency purchases. In addition, the Department's accounting systems do not identify the billions of dollars used to procure goods and services through other Federal agencies. We have found that when the Department sends funds to the other Federal agencies such as the General Services Agency, Department of Interior and the Department of Energy, it does not adequately track those funds. In essence, funds were "parked" at the other agencies and potential Antideficiency Act violations occurred because both DoD and non-DoD organizations were unaware of, misinterpreted, or did not comply with the bona fide needs rule¹⁴ and purpose statute when making purchases through non-DoD agencies. Specifically, DoD organizations used prior year funds to purchase current year requirements, and in some instances, used the wrong types of funds to procure goods and services. One of the key contributing factors that enabled these potential Antideficiency Act violations to occur was the vague and incomplete Military Interdepartmental Purchase Requests prepared by DoD organizations when transferring funds to non-DoD agencies. Additionally, DoD organizations made advance payments to non-DoD agencies for goods and services not yet received. As a result of this series of audits, the Director, Defense Procurement and Acquisition Policy implemented guidance to clarify the requirements on the Department when procuring goods and services through interagency acquisitions.

In our joint audit with the Department of State Inspector General on the Afghan National Police Training efforts, we identified almost \$75 million in potential Antideficiency Act violations.¹⁵ Using DoD funds, the Department of State moved expired funds to new Afghan National Police training requirements, and obligated funds outside the scope of reimbursable agreement. For example, the Department of State used \$11.9 million of

¹⁴ Bona Fide Need Rule (also known as the "time statute"). US Code, Title 31, Section 1502(a) - the balance of an appropriation or fund limited for obligation to a definite period is available only for payment of expenses properly incurred during the period of availability, or to complete contracts properly made within that period of availability and obligated consistent with section 1501 of this title.

¹⁵ DoD IG Report No. D-2011-102/Department of State IG Report No. AUD/CG-11-44, "Afghan National Police Training Program Would Benefit From Better Compliance With the Economy Act and Reimbursable Agreements," August 25, 2011

DoD funds to pay a contractor claim from before the 2006 agreement with DoD for the training effort. By incorrectly obligating DoD funds, the Department of State might have improperly augmented both DoD and Department of State appropriations, which could result in potential Antideficiency Act violations. Finally, Department of State officials' failure to return to DoD obligated funds unlikely to be expended will result in DoD being unable to obligate and expend funds for other Afghan National Police requirements because the funds would have already either expired or been canceled.

Problem Disbursements. While no universal definition of “problem” disbursements exists, generally unmatched disbursements, negative unliquidated obligations, and aged in-transit disbursements that are greater than 60 days old are considered to be “problem” disbursements. Similar to improper payments and potential Antideficiency Act violations, problem disbursements also frequently result from poor internal controls.

For example, reconciliation of the Fund Balance with Treasury account is a basic internal control to ensure all disbursements are properly accounted for. Fund Balance with Treasury is an asset account that reflects the available budgetary spending authority of a Federal agency. In general terms, Fund Balance with Treasury is similar to a checking account that needs to be reconciled regularly to ensure errors are researched and resolved in a timely manner. The inability to reconcile the Fund Balance with Treasury account has been a longstanding problem throughout the Department which increases the risk that problem disbursements will be made and not corrected in the normal course of business. As of September 30, 2010, the Department reported that its Fund Balance with Treasury totaled \$521.6 billion, which represents 27 percent of the Department's total assets.¹⁶ Timely and effective reconciliations decrease the risk of fraud, waste, and mismanagement of funds and enhance the Government's ability to monitor budget execution. To assist the Department in improving the reliability of its Fund Balance with Treasury financial reporting, the DoD IG has issued at least 20 reports since Fiscal Year 2007 related to accounting and reconciling Fund Balance with Treasury. In addition,

¹⁶ Report No. D-2011-011, Independent Auditor's Report on the DOD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements, November 15, 2010.

DoD IG plans to perform additional audits in Fiscal Year 2012 and make recommendations that identify other areas for improvement.

The Other Defense Organizations¹⁷ must contend with an additional challenge in performing Fund Balance with Treasury reconciliations because 54 Other Defense Organizations general fund entities are included in U.S. Treasury Index 97 account, a comingled account that does not specifically identify each agency, program, activity, or funds share of the U.S. Treasury account. Regular reconciliations are essential to maintain reliable financial information. Defense Finance and Accounting Service Indianapolis developed the Cash Management Report to allocate the U.S. Treasury totals to the individual Other Defense Organizations. However, DoD IG recently identified significant problems with the completeness and accuracy of the Cash Management Report. These problems undermine the reliability of the Cash Management Report as a Fund Balance with Treasury reconciliation tool.

During our recent audit, we found that the Cash Management Report was not complete or accurate.¹⁸ Specifically, the Cash Management Report did not attribute approximately \$10.5 billion in transactions to the Other Defense Organizations responsible for reconciling and accounting for the transactions. The \$10.5 billion consisted of:

- \$9.04 billion in variances between the amounts reported on the Cash Management Report and the amounts reported by the U.S. Treasury, of which \$517 million existed prior to October 2004,
- \$704.5 million in unmatched disbursements and collections reported on the Cash Management Report that were not charged to the specific Other Defense Organizations that were responsible for the transactions, and
- \$749.1 million in unmatched disbursement and collection transactions that Defense Finance and Accounting Service Indianapolis did not include on the Cash Management Report because the transactions were being held in suspense accounts as a result of not having the necessary information to properly record the transactions.

¹⁷ Other Defense Organizations cover the activities funded with Defense-wide appropriations. This includes Defense agencies, programs, activities, and funds such as Defense Finance and Accounting Service, Chemical and Biological Defense Program, TRICARE Management Activity, and DoD Education Benefits Fund, and not required by the Office of Management and Budget to undergo standalone financial statement audits.

¹⁸ Report No. D-2011-098, "Defense Finance and Accounting Service Needs to Improve Controls Over the Completeness and Accuracy of the Cash Management Report," August 16, 2011

Fund Balance with Treasury Impact on the Financial Statements. Since Fund Balance with Treasury is the largest line item on the Other Defense Organizations General Fund financial statements, these deficiencies will also have a significant negative effect on the ability to obtain an unqualified opinion on the DoD Agency-Wide financial statements until a reliable reconciliation process is implemented. Implementing a reliable Fund Balance with Treasury reconciliation process, will help the Department identify and resolve unmatched disbursements at the detailed transaction level. By performing this research, agencies can resolve the issues that prevented the transactions from being properly matched to the corresponding obligation within agency accounting records.

In Fiscal Year 2010, the DoD IG audited the U.S. Marine Corps' (USMC) Statement of Budgetary Resources (SBR),¹⁹ the first Military Component to undergo such an audit. This effort resulted in a disclaimer of opinion because the USMC was unable to provide timely and relevant supporting documentation for accounting transactions and could not provide evidence to support the reconciliations for key accounts and accounting processes were being performed regularly. However, the USMC and the Department are learning from this audit experience and some improvements have been identified during the Fiscal Year 2011 audit. Unfortunately, some of the same challenges encountered during the Fiscal Year 2010 audit have affected the Fiscal Year 2011 audit. For example, the USMC was unable to reconcile its Fund Balance with Treasury to detail transaction files during the Fiscal Year 2010 audit. The USMC finally provided detail transaction files in June of 2011, approximately 9 months after the start of the Fiscal Year 2011 audit. These detail transaction files are essential to support the reconciliation process. Further, the USMC has continued to struggle to provide timely and reliable supporting documentation during the FY 2011 audit. We will continue to work with the Department to identify obstacles and make recommendations to resolve these barriers to achieving auditable financial statements.

¹⁹ Report No. D-2011-009, "Independent Auditor's Report on the United States Marine Corps General Fund FY 2010 and FY 2009 Combined Statement of Budgetary Resources," November 8, 2010

SUMMARY OF FINANCIAL MANAGEMENT CHALLENGES THAT MUST BE ADDRESSED TO PASS A FINANCIAL STATEMENT AUDIT

While the Department continues to improve its financial management processes, DoD is far from reaching an unqualified opinion, and much more work needs to be accomplished to have auditable financial statements by the 2017 deadline. We have identified future risks that could impact the Department's ability to meet the ambitious 2017 auditability requirement. These risks are: data quality, internal control weaknesses, heavy reliance on Enterprise Resource Planning Systems (ERP),²⁰ and key events that take place close to the 2017 deadline.

Data Quality. Reliable data are necessary to make sound business decisions and support management representations about the accuracy of financial information reported to Congress and the taxpayer. However, the DoD IG frequently identifies financial data that are unreliable, incomplete, and inaccurate. As a result, DoD managers often cannot reconcile financial data or rely on this data to make sound business decisions. Poor financial data also impedes the Department's ability to obtain unqualified financial statement audit opinions. From Fiscal Year 2007 through Fiscal Year 2011, 89 DoD IG reports have identified data quality problems. For example, in our audit of controls over the Army Deployable Disbursing System,²¹ we found that the deployable disbursing system did not maintain accurate lines of accounting, accurate payment methods information, or complete fundamental payment information such as invoice line item information. As a result, the Army lacked a complete audit trail and could not reconcile information between the Army payment and accounting systems for 296 of the 402 commercial payments we reviewed. Further, the Army could not provide a complete universe of commercial payments made through the system.

Internal Controls Weaknesses. Internal controls are an integral part of an organization's management which are designed to provide reasonable assurance of

²⁰ An ERP is an automated system using commercial off the shelf software consisting of multiple, integrated functional modules that perform a variety of business related tasks such as general ledger accounting, payroll, and supply chain management.

²¹ Report No. D-2011-101, "Controls Over Army Deployable Disbursing System," August 17, 2011

achieving: effective and efficient operations; reliable financial reporting; and compliance with applicable laws and regulations. Internal controls include the plans, methods, and procedures used to meet missions, goals and objectives. Internal controls also serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal controls help senior leaders and managers achieve desired results through effective stewardship of taxpayer dollars.

Since the mid-1990s, the DoD IG has reported numerous material internal control weaknesses²² that impact the Military Services' and the Department's ability to achieve an unqualified financial statement opinion. In our most recent disclaimer of opinion on the Fiscal Year 2010 DoD Agency-Wide financial statements,²³ we reported the following 13 material internal control weaknesses:

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

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

²² Department of Defense Agency Financial Report for Fiscal Year 2010, November 15, 2010

²³ Report No. D-2011-011, "Independent Auditor's Report on the DoD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements," November 15, 2010

Effective ERP Implementation. The successful implementation of Enterprise Resource Planning (ERP) systems are critical for DoD to meet milestones and transform processes. Internal controls and systems are needed to provide useful, timely, and complete financial management data and to achieve auditability. The May 2011 Financial Improvement and Audit Readiness (FIAR) Plan Status Report recognizes that auditability is dependent on successfully deploying ERP systems and interfacing them with other business and financial systems. However, the May 2011 FIAR Plan Status Report did not identify all ERP systems and did not include milestones and costs for all ERPs. Additionally, DoD has been unable to meet key milestones for four of eleven ERP systems in the Department. Specifically, we found that the Defense Agencies Initiative and the Integrated Personnel Pay System-Army are missing from the ERP systems list although they are mentioned in other sections of the Plan. The Navy's Future Personnel and Pay Solution, is not in the FIAR Plan at all. As those ERP system efforts slip, they may jeopardize the Department's ability to meet the 2017 deadline.

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

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

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

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

CONCLUSION

Sound financial management is critical to providing effective stewardship over the billions of dollars the Department receives annually. The Department needs accurate and timely financial information on a daily basis to ensure that every dollar supports the warfighters, improves military readiness, and is readily available to key decision makers. Although the Department faces some daunting financial management challenges that must be resolved, the Department continues to make progress in improving its financial management. There is much more to do in order to overcome the pervasive, long standing financial management problems that I have describe today. A comprehensive collection and analysis of improper payment is one means to provide effective financial stewardship as well as implementing a thorough process to track appropriations, obligations, and expenditures to mitigate the risk for Antideficiency Act violations.

Currently, the Department is devoting significant resources to address these challenges and we are encouraged by the progress they have made. We will continue to provide oversight of these efforts and make recommendations to help move the Department towards improved financial management.

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