

Statement of

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and

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before the

Senate Armed Services Committee

Subcommittee on  
Readiness and Management Support

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Chairman McCaskill, Senator Ayotte, Members of the Subcommittee, thank you for the opportunity to provide you with an update on our efforts for improving financial operations at the Department of Defense (DoD).

It has been approximately eight months since our last status report to this Subcommittee. In that time, we have continued to solidify plans and to make progress in financial management across the entire Defense organization. The job is not yet done, and there are still major challenges that we face, as highlighted in recent GAO reports, but we are confident that we are on the right track.

As you know, there are two critical reasons for striving to make DoD as efficient and effective as possible. One is to ensure that America's Servicemen and women have everything they need to defend the United States and its interests around the world. The other reason is to satisfy our duty as stewards of the resources entrusted to us by the taxpayers.

Today, the Department is able to account for the funds that are appropriated for its use by Congress, but – unlike most other government agencies -- we cannot yet account for those funds to an auditable standard. The explanation has much to do with the unique size and mission of DoD and its elements. Moreover, until fairly recently, there has been neither sustained attention nor a DoD-wide plan that could be implemented. Today we have both and are moving forward, as you should expect. As the people's elected representatives, you are entitled to know that the Department of Defense strives to meet the same exacting standards for financial management as other major government organizations.

### **Setting the Foundation**

Achieving this important objective at DoD is no routine task. It requires an enterprise-wide response and an effective strategy. Initially, DoD's approach varied by Military Service and often concentrated on improving the kind of information that is helpful in managing a private sector company – that is, the “book value” of assets. In fact, this sort of information is of very limited value in meeting the daily informational needs of DoD managers. As a result, in August 2009, we revised our audit strategy to focus on the financial information that is actually needed by Defense managers. It puts priority on (1) improving the quality, accuracy, and reliability of budgetary information; and (2) confirming the numbers and locations of assets.

This change has been endorsed by the Government Accountability Office, among others, and it has led to improved buy-in at all levels in the Department. Managers at DoD now see that audit readiness has day-to-day implications for their work. To ensure the adoption of a consistent approach to auditability, we have issued clear guidance indicating how to assess and improve processes and controls and how to maintain needed documentation.

As appreciation for the value of auditability has spread throughout our organization, there is recognition that it requires an investment in resources. Despite leaner budgets, the Department now plans to sustain the required level of resources each year over the next five

years to improve business operations—providing the appropriate levels of training, tools and support—that will allow us to achieve and sustain auditable financial statements.

In addition, we have a governance structure in place that is keeping the attention of senior leaders focused on business and financial management improvement. We recognize that our governance process needs to focus more on specific progress and must hold individuals accountable for that progress. Each of the Defense Components is committed to specific outcomes for their respective plans, and we are requiring the same of service providers who support auditability. Those goals will be used to hold executives accountable at all levels. We will continue to use outside auditors to verify progress. Leveraging this senior leadership commitment will strengthen our current governance process and ensure both accountability and long-term continuity.

### **Major Accomplishments During the Past Year**

Secretary Panetta's direct engagement on this issue has been one of the most significant developments of the past year. In October, he issued a directive stating that the achievement of auditable financial statements "is a priority for me and will be an 'all hands' effort across the Department." Even more important, he has made it clear that the current lack of auditable statements is unacceptable.

Last fall – in his first appearance before the House Armed Services Committee -- Secretary Panetta also directed the Department to accelerate the time needed to achieve audit readiness for the Statement of Budgetary Resources for general funds so that "by 2014 we will have the ability to conduct a full-budget audit." He added, "I've directed the DoD Comptroller to revise the current plan within 60 days to meet these new goals and still achieve the requirement of overall audit readiness by 2017."

This leadership commitment from the highest level of DoD is setting the tone and accelerating audit readiness of the Statement of Budgetary Resources. Plans to significantly accelerate our efforts have been developed and are underway. Auditability is now a goal that every commander, every manager, and every functional specialist must understand and embrace to improve efficiency and accountability within the Department of Defense.

Following the Secretary's lead, the Service Secretaries and Chiefs of Staff of the Military Services have committed themselves to specific near-term goals in support of their plans for achieving auditable financial statements. Their commitment is mirrored in major commands.

For example, General Gary North, Commander of Pacific Air Forces, said it well in a memorandum to his command in March. He wrote, "The Air Force's ability to undergo and obtain a clean audit opinion of our financial statements is a direct reflection of how well we manage the entire Air Force." He added, "PACAF/FM will take the lead and develop Audit Readiness Working Groups within PACAF with the objective of developing internal and

management control programs to assist the base level functional areas achieve audit readiness.”

In September, the Commander of Naval Air Systems included a similar message among his Commander’s Intents. Key actions include the need to “standardize financial processes in accordance with the Navy’s Financial Improvement Program to provide accurate and auditable information that supports program execution decisions.”

Secretary Panetta and Deputy Secretary Carter have reviewed these and similar commitments across DoD and are holding senior leaders accountable – both civilian and military – for progress against those plans. In addition, Senior Executives in every area now have audit goals in their individual performance plans and annual evaluations, and we are working to include these goals in General and Flag Officer performance plans as well. This helps to ensure that everyone under their leadership will understand that better control over financial resources has a significant effect on mission success and that everyone has a role to play in this process.

We are working very hard to fulfill the Secretary’s pledge. We are reasonably confident that we can meet his expectations and yours.

### **Providing New Tools and Training to the field**

The Military Departments and Defense Agencies have the lead in reaching auditability, and they are all taking action to make that happen. Their senior representatives are with us today, and we won’t repeat their individual messages.

We are also taking proactive steps DoD-wide. For example, we are providing our commanders with an Audit Readiness Checklist which is providing Defense managers with a tool akin to the operational readiness checklists employed by military commanders. It provides leaders with a definitive list of questions to help ensure that their organizations have the records needed for sound resource decisions and to make certain that the Department has the records to succeed in coming audits. The checklist provides commanders with the basic actions an organization should take to determine whether they are audit-ready and to identify areas for improvement, if needed.

The checklist also helps commanders to assess the efficiency of their organizations and to validate how well each function performs. For example, current evidence shows widespread weakness in providing support for our cost information. We understand that unless we can prove the soundness of our financial decisions, funding could be at risk. The checklist provides actions a Defense organization can use to prove that its financial information is accurate. With each command giving the management of money the same attention it gives to other important assets, the Department can achieve Secretary Panetta’s audit readiness goal. Our current culture already values operational or mission readiness. We need a similar view of our

business readiness—one that highlights efficiency and resource stewardship-- in every field organization.

Another important DoD-wide development is the progress we have made in instituting a course-based certification program for Defense financial management professionals. As you know, we announced our plans last year, having in mind a certification program similar to the one in the Defense acquisition community. Since our announcement, we have developed a framework for the program and carried out the many steps necessary to bring it to reality. We intend to introduce pilot versions of the program for several Components this year, with large-scale implementation beginning next year.

We have support for the program across the Department, and Congress has indicated its support by providing the necessary legal authority in the FY 2012 National Defense Authorization Act. We thank you for this sign of approval and encouragement.

We also have made significant progress in training both financial managers and non-financial managers on the importance of audit readiness. We are reinforcing these lessons through a partnership with private sector auditors who are experienced in financial audits. We are using examination engagements that are an integral part of our audit readiness methodology to familiarize DoD personnel with the requirements for audits. These examinations are essentially small-scale or “mock” audits of single business processes. The audit firms performing these engagements employ the same procedures used in an actual audit, but on a smaller scope and scale. These exercises provide our employees with experience that is otherwise difficult to gain.

In addition, the DoD Financial Improvement and Audit Readiness (FIAR) Directorate has developed a series of professional development training courses designed to enhance Department-wide knowledge and understanding of goals and priorities, as well as instructions to become audit-ready and to reinforce the Department’s internal control over financial reporting requirements. In FY 2011, nearly 1,000 DoD personnel received this training. Additional professional development courses have been added since, including “FIAR 100” which focuses on training DoD senior leaders, enabling them to understand the impact of operations on financial management and audit readiness, as well as to identify initiatives they can undertake to assist the Department with its auditability objectives.

## **Making Progress**

All of these efforts have contributed to sustaining positive audit opinions as well as breaking new ground since we last spoke with this committee:

- The Defense Information Systems Agency (DISA) achieved a clean opinion on their \$6.6 billion working capital fund operations for FY 2011, and they are moving forward with an audit of their FY 2012 general fund business.

- Contract Resource Management of the Tricare Management Activity received an unqualified opinion on its FY 2011 financial statements.
- The Medicare-Eligible Retiree Health Care Fund received a qualified opinion on its FY 2011 financial statement.
- In November 2011, an examination of five business processes at the initial General Fund Enterprise Business Systems (GFEBS) Wave 1 sites rendered a qualified opinion, establishing a benchmark for expanding the Army's audit readiness program.
- In November 2011, a commercial audit examination validated that the Air Force could successfully balance their Treasury funds at the transaction level.
- In January 2012, an examination validated Navy's existence and completeness audit readiness assertion for ships and submarines, Trident missiles, and satellites.

The U.S. Marine Corps will be the first Military Service to receive an audit opinion on a financial statement, which will be a significant step not only for the Marines, but for the entire Department. While the Marine Corps will not receive an opinion on the FY 2011 Statement of Budgetary Resources, the significant progress made to date has led the Department of the Navy and the Department of Defense Inspector General to agree to move quickly to an audit of the FY 2012 budget statement.

The full list of DoD entities that have received opinions and other significant accomplishments will be published in our semi-annual FIAR Plan Status Report. In FY 2011, for example, independent auditors issued clean opinions for Defense organizations totaling \$110 billion in budgetary resources, an amount equivalent to the budgets of nearly half of the non-Defense agencies across government. But there is much more to be done.

### **Business Transformation and Financial Management**

In addition to our important financial management advancements, over the past year the Department has taken a number of steps to improve its overarching business environment, from releasing enhanced strategic guidance for its business operations, to furthering the establishment of a performance culture through performance management and improvement practices, to delivering tangible, improved business outcomes into the hands of our warfighters in areas such as energy efficiency, maintenance cycle time, and in-theater business intelligence.

The Department continues to improve key enablers of its business operations, including financial management and auditability, the Business Enterprise Architecture (BEA) and defense business systems environment. The Armed Services Committees have been extremely helpful in providing the Department with tools to improve these areas. We appreciate this opportunity to update you on our progress.

## **Governance of Business Systems Investments**

One significant development in the management of the Department's defense business systems environment is the change to the investment management process that Congress passed as Section 901 of the FY 2012 National Defense Authorization Act (NDAA). In response to Section 901, we are creating a single Investment Review Board (IRB) and investment management process to review and certify the planning, design, acquisition, development, deployment, operation, maintenance, modernization, and project cost benefits of all defense business systems that have total costs greater than \$1 million across the current future-year defense program, including legacy systems. This is in contrast to our current process that includes multiple, functionally-oriented IRBs that review only development or modernization investments over \$1 million. While we were pleased with the Department's FY 2011 progress in eliminating 120 legacy systems, we anticipate that the changes introduced by Section 901 will help to further accelerate the transition away from our legacy environment. Effective governance of our defense business systems environment is crucial to our overarching business improvement initiatives. Because of this critical link, we can ensure there is strong integration between our broader business governance and our investment management process.

Implementation of Section 901 is underway and is being conducted in phases, so that we may provide for an orderly transition from our current governance process to the new one. To accomplish the legislative mandate, the Department created an Investment Review Framework that requires Components to create organizational execution plans for their portfolio of investments that are aligned to functional strategies approved by the IRB. The investment review process will employ a structured methodology for classifying and assessing business investments via multiple views, including:

- An organizational view that promotes visibility across business mission areas for DoD components.
- A functional view that seeks to eliminate redundancy and enhance interoperability.
- An end-to-end view that enables visibility from a process perspective across the Department's business enterprise.

We look forward to updating you further on the implementation of this important legislation.

## **Business Enterprise Architecture**

The BEA, guided by the Department's strategic priorities, is an integrated information architecture that provides guidance for the Department's business operations and helps guide and constrain our investments in business systems. The BEA defines the Department's target business environment, including the necessary data standards, business rules, processes, and performance metrics that will allow our systems to be interoperable. Beginning with BEA 1.0 in 2003, the Department has released improved versions of the BEA. The Department released BEA 9.0 on March 16, 2012.

BEA 9.0 continues to refine end-to-end process definitions and associated details for processes that support audit goals. Using this framework of end-to-end business processes, rather than an organizationally or functionally stove-piped approach, ensures we think about our business in a holistic way, recognizing the connections and dependencies each individual business area has on the others. This end-to-end approach will also help to minimize the number of required data exchanges and system-to-system interfaces, reducing the potential for error and increasing process standardization, which is essential to a clean audit.

BEA 9.0 also improves the usability of the architecture, consistent with industry leading practices. BEA 9.0 applies open (vice proprietary) standards and protocols to architecture development and common business process modeling notations. This will make it easier for the Department to ensure compliance with the BEA and interoperability between its systems, continuing the thrust toward enabling auditability. To implement these new approaches, DoD Components have been directed to use these specified standards, and the end-to-end process framework, in the development of subordinate enterprise and solution architectures that are federated or asserting compliance with the BEA. Implementation and adoption is ongoing throughout the Department.

### **Business Capability Lifecycle and Acquisition of Defense Business Systems**

Another significant development in management of the Department's defense business systems environment has been adoption of a new acquisition model for defense business systems, the Business Capability Lifecycle (BCL). BCL provides a comprehensive process that aligns requirements, investment, and acquisition processes for defense business systems under an integrated governance framework and focuses on incremental delivery of capability, within eighteen to twenty-four months of program initiation. The BCL approach is tailored to accommodate the unique characteristics of IT acquisition. It also ensures that we deliver new capabilities to Department users more quickly, including capabilities instrumental to our audit efforts. BCL's incremental approach also maintains better control over cost, schedule and performance requirements.

The Under Secretary of Defense (Acquisition, Technology & Logistics) issued BCL policy on June 23, 2011 and the Defense Enterprise Accounting and Management System (DEAMS) was the first program to achieve an acquisition decision under BCL policy. Through the use of BCL, DEAMS has integrated traditionally stove-piped processes and enabled tight integration between the functional sponsor and the program office.

BCL is being incorporated into the next update of the DoD 5000.02 acquisition instruction and the Defense Acquisition Guidebook. We continue to conduct targeted outreach with Program Managers, Functional Sponsors, and Program Executive Officers on the BCL policy, and are working with the Defense Acquisition University to embed BCL into appropriate curriculum. And finally, we are in the process of transitioning several major IT programs to BCL.



## **Business Process Reengineering**

A fourth important development in management of our defense business systems environment has been the introduction of new Business Process Reengineering (BPR) requirements into the Department's IRB process. Section 1072 of the FY 2010 NDAA stipulated that investments may not be certified to obligate funds through the Department's IRB process without having reengineered their business processes and reduced unique requirements and system interfaces. Conducting appropriate BPR throughout a defense business system's acquisition or modernization lifecycle is critical to improving requirements definition and stabilization for our acquisition programs and the overall performance of our defense business systems. By applying BPR early and up front in a program's lifecycle, we can ensure the program has clearly identified and defined the business problem the solution is intended to solve, and that the solution appropriately applies changes to people, process and organization, in addition to a materiel technology solution.

The Department implemented this requirement through an assessment process tied to the Department's IRB governance framework. As the DCMO and Military Department CMOs conducted BPR reviews, they incorporated lessons learned into revised and improved implementation guidance. During FY 2011, assessments were completed for all 160 IRB certification actions. Going forward, BPR will be required in the Department's new IRB process.

## **Business Systems Implementation**

As discussed above, the Department has continued to mature Business Transformation related processes, architectural framework, and governance that support our transition to a more modern and disciplined business environment. This transition is driven by a number of activities to include the implementation of selected Military Service or Agency Enterprise Resource Planning Systems (ERPs), modernizing legacy systems when supported by a business case and aggressively sun-setting legacy systems that are not aligned with our business objectives. The implementation of these new systems is a key enabler for executing important process and control changes as well.

Today, DoD is implementing multiple ERPs across the Military Departments and Defense Agencies to serve as the business backbone of their operations. Each of these implementations is at a different stage of its lifecycle and most have experienced challenges as they have moved from design to implementation. Broadly, we continue to improve our oversight of these programs in a number of ways, including putting in place more rigorous performance measures that broaden the discussion from standard acquisition measures to key technical and business measures. This has led to a closer link between the information technology programs and the business outcomes that they are helping to enable. Additionally, we are applying lessons learned across all of the programs in the portfolio and incorporating recent GAO and DoDIG findings, which have highlighted deficiencies in compliance, shortcomings in change management or training and difficulties in management of data quality and interfaces that have created inefficiencies and labor intensive rework. We acknowledge that there have been and

continue to be issues and, as GAO has noted, DoD governance has taken appropriate action to limit the pace of deployment. We are committed to working through every significant deficiency in order to realize the long term value of these investments.

In several cases there have been issues associated with ERP compliance with basic requirements (or standards) such as the U.S. Standard General Ledger (USSGL) and the DoD Standard Financial Information Structure (SFIS). Each instance of non-compliance is investigated and addressed. But many situations result from the evolution of standards and the time it takes for those standards to work their way into use. In short, they are matters of timing. We understand that these basics are the key to both reporting accuracy and interoperability and are working to develop processes to ensure that changes are better communicated and controlled. Some SFIS and USSGL compliance deficiencies have been identified, many have already been corrected, and plans are in place to correct outstanding instances of non-compliance. Despite these challenges, the more disciplined transaction processing capability will, over time, result in improved data quality and integrity compared to our existing legacy processes. That is an important element of context often lacking in discussion of problems associated with implementing our ERPs.

There is also a perception that the way DoD has implemented ERPs creates duplication or overlapping capabilities. These investments are reviewed with a goal of avoiding and eliminating redundancy. With the implementation of Section 2222 of the NDAA 2012, we expect to achieve an even more robust business IT portfolio management process. We believe our current ERP implementations provide opportunities to replace redundant legacy systems and represent an appropriate mix of capabilities at the operational level where specific business operations or missions are supported.

The Department has made notable progress over the past two years. A few noteworthy examples follow.

- The Marine Corps' Global Combat Support System (GCSS-MC) is supporting USMC budgetary auditability while also delivering tangible operational value including:
  - "Time to First Supply Status," a primary measure for logistics responsiveness, has been reduced from over 36 hours to an average of 10 hours.
  - "Order Shipment Times" for GCSS-MC users has been reduced by 26 percent.
  - "Maintenance Repair Cycle Time" has been reduced by 43 percent in the last two months from a baseline of 40 days.
  - During Operation Tomodachi, the 2011 earthquake and tsunami humanitarian assistance and disaster relief efforts in and around Japan, the GCSS-MC system provided critical real-time in transit visibility for high priority parts.
- The Air Force's Defense Enterprise Accounting and Management System (DEAMS) is currently fielded at Scott Air Force Base and the Defense Finance and Accounting Service Limestone, Maine and is delivering tangible business value:

- Reduced late interest payments within the U.S. Transportation Command from approximately \$161.00 per \$1 million to approximately \$7.00 per \$1 million.
- The Defense Logistics Agency's (DLA) EProcurement program provides key capabilities in a single integrated procurement process solution in support of sustainment logistics. EProcurement recently exceeded all key performance parameters during performance stress tests, including:
  - System was designed to process 8,500 solicitations per day and exceeded the threshold by more than 90 percent during development testing.
  - System was also designed to evaluate 23,000 proposals per day and during development testing exceeded the threshold by 100 percent.

DoD's modernized systems environment, including each of the Department's ERPs provides the opportunity for improved effectiveness and efficiency of budgeting and financial accounting operations by providing users with standardized financial and business processes, a single authoritative data source, and real-time posting to external sources. In the past, we had to rely on manually-generated summary information; we now have much more access to transaction-level data that will help support future audits and provide leaders with information for better business decisions. These programs and their organizational sponsors are committed to realizing this significant potential.

While the effective implementation of ERPs will not achieve auditability by itself, it will help to provide the modern business environment we need to meet and sustain the statutory requirement for audit readiness.

## **Conclusion**

Madame Chairman, we are making significant progress. While we are mindful of the work that remains, we are reasonably confident that we will achieve our audit goals. As we look ahead, we appreciate the support we have received here in Congress. Your constructive criticism and continuing oversight are helping to sustain our progress.

We also welcome your help with what has been a major problem for financial management at DoD. We refer to the budgetary uncertainty that we have encountered in the recent past, including no fewer than four threats of government shutdown last year, which generated time-consuming and unproductive planning efforts. Now the shadow of possible sequestration is falling across our path. Dealing with these uncertainties drains valuable time and leadership attention from important initiatives, including our commitment to audit readiness. Congress could help a great deal by returning to a more orderly budget process.

Thank you again for your interest in this vital subject. We welcome your questions.