

**Senate Armed Services Committee
Subcommittee on Readiness
Written Statement for the Record
The Honorable David L. Norquist
20 November 2019**

Chairman Sullivan, Ranking Member Kaine, distinguished members of the committee, thank you for the opportunity to testify before you today on the Department of Defense financial statement audit. On November 15th, we completed our second Department-wide audit, which is one element of a broader reform agenda in support of the National Defense Strategy’s third line of effort: to reform the Department for greater performance and affordability.

There are three major questions about the audit I would like to address: 1) why do we have an audit; 2) what are the results of this year’s audit; and 3) how does the audit and other reforms benefit American taxpayers?

WHY DO WE HAVE AN AUDIT?

Simply put, we conduct an annual financial statement audit in accordance with the Government Management Reform Act of 1994 because it is the most efficient way to evaluate an extraordinarily large and complex organization. DoD employs nearly three million service members and civilians and operates in over 160 countries on all seven continents, spanning about 30 million acres of land. While a typical commercial airline manages between 300 and 1600 aircraft, the Military Services fly approximately 16,000 aircraft. DoD maintains approximately 573,000 facilities, including 267,000 buildings, 184,000 structures, and 122,000 linear assets across more than 4,500 sites. It’s not just the scale but the breadth of our mission. We run one of the largest health care systems in the country, which covers more than

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| <p style="text-align:center">A Major Undertaking</p> <p>The FY 2019 Audit involved:</p> <ul style="list-style-type: none">• \$2.9 trillion in assets and \$2.8 trillion in liabilities• About 1,400 auditors• More than 600 site visits to military bases, depots, and warehouses• Auditors requested over 200,000 items |
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nine million people. Our bases are like small cities that contain similar amenities and services like police stations, fire stations, grocery stores, hospitals, and schools. And we manage \$292 billion in inventory, more than six times the size of Walmart, the world's largest retail company. In total, DoD manages nine supply chains with about five million items. Financial statement audits are a proven commercial solution that use independent auditors to provide sample-based assessments of complex operations. A financial statement audit includes:

- Verifying count, location and condition of our military equipment, property, materials, and supplies;
- Testing security vulnerabilities in our business systems; and
- Validating the accuracy of records and actions, such as promotions and separations.

To do this work, the auditors went through billions of transactions, pulled samples, and then tested them for accuracy and completeness. For example, for each payment to a contractor, auditors check to see if there is an invoice, a receiving report, and a matching contract. The auditors also confirm that they were approved at the right level, and recorded accurately and timely. Likewise, for each payment to an employee, military or civilian, auditors ask for proof that it was the correct payment for that employee. With respect to real property, the auditors asked the Services for their database of real property—to include buildings, underground water pipes, fence lines, etc.—and pulled a sample from that report. They then went to a select number of bases with that list and, for those items, checked what was supposed to be on each base. The auditors confirmed that it was there and what condition it was in and whether they had the records to demonstrate that they owned it. The auditors also looked around the base for any other property and checked to see if it was recorded. They did the same thing with inventory, going to warehouses, pulling samples of spare parts, and looking for completeness and accuracy. The results offer us independent feedback on how to improve our stewardship, and we are eager to receive this feedback.

WHAT ARE THE RESULTS OF THIS YEAR'S AUDIT?

For the FY 2019 audit, more than 1,400 auditors reviewed billions of transactions from the more than 1,700 active accounts DoD manages. Consistent with last year, auditors reported:

- No evidence of fraud;
- No significant issues with amounts paid to civilian or military members;
- DoD could account for the existence and completeness of major military equipment; and
- All organizations with a clean opinion last year kept their clean opinion this year.

In addition:

- One more organization, the Defense Commissary Agency (DeCA), moved up to an unmodified (or clean) opinion in FY 2019; and
- Of the 2,377 findings in FY 2018, the Department was successful in closing more than 550, or 23% of the findings.

The specific details are as follows:

- Six DoD organizations sustained their unmodified, or clean, opinions, which is the highest rating: U.S. Army Corps of Engineers (USACE) Civil Works; Military Retirement Fund (MRF); Defense Health Agency – Contract Resource Management (DHA – CRM); Defense Finance and Accounting Service – Working Capital Fund (DFAS); the Defense Contract Audit Agency (DCAA); and the DoD Office of Inspector General (DoD OIG), which will conclude in January.
- This is the 24th consecutive unmodified opinion for the Military Retirement Fund. The fund's nearly \$900 billion represents approximately 30 percent of DoD's total assets.
- The Medicare-Eligible Retiree Health Care Fund (MERHCF) received a modified opinion, which means its financial statements are accurate with only modest exceptions.
- The remaining organizations received disclaimed audit opinions, which means the auditors did not have enough evidence to provide an opinion.
- No organization received an adverse opinion (i.e., were outright wrong).

Defense Commissary Agency



DeCA progressed from a qualified opinion in FY 2018 to an unmodified (or clean) opinion this year.

The audit went deeper this year. Auditor sample selections and information the Department submitted to auditors, called “Provided by Client” requests, rose from 40,000 in the FY 2018 audit to 45,000 this year. As a result, findings from all audits are also expected to increase.

The FY 2019 audit reports are complete and available for your review on our public website [<https://comptroller.defense.gov/odcfo/afr2019.aspx>]. Auditors and the DoD Office of Inspector General will complete their contractual deliverables and provide detailed findings into our corporate database by the end of January. At that point, we will begin anew to address those findings, making needed improvements to our systems and processes. Unlike periodic program audits, the repetitive nature of these audits will go deeper each year while also providing us feedback that tells us if the fixes are in fact addressing the root cause and being sustained. That is part of the value that these audits provide. You will be able to see our progress—first in the form of findings being remediated, then through a reduced number of what auditors refer to as material weaknesses, and, ultimately, through organizations moving from a disclaimer of opinion to a positive audit opinion. The FY 2019 audit demonstrated progress but we have more to do.

HOW DOES THE AUDIT BENEFIT AMERICAN TAXPAYERS?

The audit saves money by improving inventory management, identifying vulnerabilities in cybersecurity, and providing better data for decision-making.

Inventory

The audit is helping us improve the accuracy of our inventory. It's necessary to know exactly what spare parts you have and where they are in order to improve readiness. For example, at the Navy, Fleet Logistics Center Jacksonville conducted a 10-week exploratory assessment of material held within two active aviation squadrons and one building. They identified \$81 million worth of active material not tracked in the system that was available for immediate use, decreasing maintenance time and filling 174 requisitions, including 30 high-priority. They also eliminated unneeded equipment freeing up approximately 200,000 square feet (~4.6 acres).

There was also confirmations of excellence. Auditors performed more than 60 site visits in which, for the items tested, no exceptions were noted (i.e., a 100% pass rate). These site visits were performed to confirm the existence and completeness of a broad range of assets including, but not limited to, inventory, real property, ordnance, and/or military equipment.

Super Hornet Tailhooks – NAS Lemoore



At Naval Air Station Lemoore, located in California, 7 Super Hornet Tailhook sub-assemblies were turned in for repair. The tailhook is a “carcass constrained” item, and will be returned back to fleet once repaired. More than 580 consumable and repairable items valued at \$14 million have been identified.

IT Security

The audit is helping us close vulnerabilities in our IT systems. Access controls, our biggest area of improvement, is an important part of National Security, especially since there is no doubt that potential adversaries are seeking to gain access to our systems in the hope of stealing sensitive information or planting harmful software that could erode our advantage on future battlefields. Access controls also reduce the risk of fraud, waste, and abuse by preventing individuals from committing fraud or improperly accessing sensitive information and concealing those acts by changing system records. For example, four years ago, Army auditors found 29 problems with regard to the Logistics Modernization Program. All of those issues were fixed. This year, auditors at Picatinny Arsenal in Morris County, New Jersey, tested 60 IT application controls for the procurement, revenue, and inventory business process in the Logistics Modernization Program and found them to be effective with no exceptions noted.

MORE THAN 60 SITES ACHIEVED A 100% PASS RATE



At Tooele Army Depot in Utah, auditors tested 3.5 million items of Operating Materials and Supplies for completeness and found no exceptions.

Data Analytics

Historically, the Department's data was scattered across hundreds of systems making it difficult to access information and answer basic business questions in a timely fashion. We have developed a single authoritative source for audit and business data analytics. This big data platform, ADVANA, currently hosts over 15 billion transactions, has over 7,000 users, 250+ dashboards, ingests data automatically from over 120 DoD source systems, reconciles over \$1 trillion dollars in financial transactions, and has the flexibility to support analytics in the areas of audit, financial operations, cost management, and performance management.

We are also already seeing the benefits of better data. For example, the Department, using the ADVANA tool, recently automated the quarterly review

process of its obligations. This workflow tool eliminated inefficiencies and provided analysts time and insight to identify a cumulative \$316 million in high-risk funds, allowing for a better use of those resources before expiring or canceling.

Costs

I'm often asked if the money we are spending on the audit is worth it when we have so many other priorities. The two main costs for the audit itself are the fees to the Independent Public Accounting firms (\$195 million) and infrastructure to support the audits (about \$250 million). The \$195 million in audit contract costs is approximately 1/30th of one percent of DoD's budget and, as a percent of revenue, is equal to or less than what many of the top Fortune 100 companies pay their auditors. Additionally, findings from the audits help the Department identify areas that need improvement and validate the effectiveness of corrective actions. Since we spent nearly \$500 million in FY 2019 fixing audit problems, that feedback is critical. The total cost of performing the FY 2019 audit, including remediation, remained consistent with the FY 2018 audit, slightly less than \$1 billion. Arguably, much of this work would need to be completed regardless of whether the annual financial statement audits were required.

We expect the costs of the audit itself to remain relatively consistent over the next few years, but as our ability to support the audit improves and our reform efforts take hold, the cost to execute the audit will go down and the dividends from business reforms will continue to grow.

DOD REFORM AGENDA

The audit is a foundational element of a broader landscape of business reform described in the National Defense Strategy. We are moving forward on multiple fronts, such as improving our enterprise buying power; consolidating IT; realigning and reforming our healthcare; reforming how we conduct background investigations; eliminating duplicative and inefficient business systems; and identifying efficiencies within the Defense Wide organizations.

Buying Power

The goal of Category Management is to negotiate pricing for the category as a whole – increasing economies of scale – resulting in lower pricing. Category Management and the audit are mutually supporting. Category Management centralizes purchases and increases inventory transparency supporting the audit. The audit provides better transaction data, increasing the transparency of what we are buying – both quantities and prices. This information then indicates what items are good candidates for Category Management. For example, the Army programmed \$1.6 billion in savings from professional services contracts in the FY 2020-2024 FYDP as a result of employing category management. Similarly, a review of Cisco routers uncovered \$61 million worth of equipment in a warehouse that DoD was paying to maintain as if they were installed. Some of the routers had been marked for disposal, but the DoD was still paying to maintain them. An interim contract is now in place, lowering customer prices.

IT Consolidation

DoD has more than 2,500 data centers, 355 cloud efforts, 48,000 applications, 11,000 circuits, and 1,850 business systems. Standardizing and modernizing the IT environment of networks, services, data centers, and leveraging Enterprise capabilities eliminates duplicative systems, and allows the Department to focus finite cyber resources across fewer areas, ultimately shrinking DoD's cyber threat. This has saved us \$63 million through FY 2020 and will save us another \$73 million through FY 2024. Additionally, in the defense agencies, we are consolidating 44 networks and 22 service desks into a single Enterprise service provider for Common Use IT and are closing 71 legacy data centers (18 closed; six more by the end of December).

Healthcare

Reform isn't only about savings, in healthcare it's about restoring military readiness and providing quality care for over nine million eligible individuals. In implementing the FY 2017 NDAA provisions (Sections 702, 703, and 721), we are strengthening the readiness of our military's medical force, while improving health care quality for our military and their families. Our largest undertaking is the ongoing consolidation of the Medical Treatment Facilities (MTFs) under the authority, direction and control of the Defense Health Agency. When complete, DoD will have a unified medical delivery system that more efficiently integrates purchased care and MTFs.

Background Investigations

DoD assumed responsibility for the majority of the background investigations for the federal government. We began with a backlog of 725,800 in April 2018 and have lowered the backlog by 437,800 as of October 2019. We are adopting continuous monitoring in lieu of periodic reinvestigations. Continuous monitoring is a vetting and adjudication process to use technology to evaluate security clearance holders on an ongoing basis, instead of more expensive periodic investigations.

Looking For Savings

In the Army, Secretary Esper established the "Night Court" process that the Army used to cut approximately \$2.5 billion per year in order to free up funding for higher modernization priorities. We are now conducting a similar Defense-Wide Review to take a close look at all DoD activities that do not fall under the Military Departments (e.g., the Defense Agencies and Field Activities, the Office of the Secretary of Defense, the Joint Staff, the Inspector General, and SOCOM). The purpose is to identify time, money, and manpower to put back into top priorities in the FY 2021 President's Budget in support of the National Defense Strategy.

Through the audit and these broader reform initiatives, we are looking for savings, large and small, to reinvest back into the lethality and readiness of our military forces.

LOOKING FOR SAVINGS, LARGE AND SMALL

From



Printed & Stored Maps

To



Maps Printed On-Demand

Previously, DLA stored 130 million physical maps in its warehouses. By moving to Print on Demand mapping, DoD **saved \$10 million** in FY 2018 by reducing physical inventory by 95%, removing 130 million physical maps, and **freeing up over 180,000 square feet of space**. The new model uses digitized mapping that reduces shipping and storing. The next step is to adopt this new model across the Military Services.

CONCLUSION

The audit, resulting findings, and our subsequent corrective actions are doing exactly what they are supposed to do—find issues, validate efficient and effective processes, and help us focus limited resources on where we are most vulnerable or inefficient. We will keep this up every year, and this is how we will build a mechanism for sustaining improvements, move closer to a clean opinion, and continue to improve the efficiency of the Department.

I would remiss if I did not mention the harmful impacts of the ongoing Continuing Resolution (CR). The Department and the White House have both expressed the urgent need for Congress to pass the FY2020 authorization and appropriation bills in order for the government to be funded at the levels of the bipartisan budget deal passed this summer. The CR stopgap measures are wasteful to the taxpayer and damages the gains our military has made in readiness and modernization over the last few years. In order for us to pivot towards planning for a future high-end fight against great power competition, as the National Defense Strategy guides us, DoD must have the ability to better align our funding towards the prioritized accounts and programs. Under a CR, we are unable to

begin new programs or projects, production rates for weapons, equipment and munitions cannot be increased, and a CR disrupts major exercises and training events. Ultimately, a CR is good for the enemy, not the men and women of the United States military. The Administration urges Congress to come to agreement as quickly as possible consistent with the budget deal reached in the summer.

In closing, I would like to thank President Trump for his commitment to the audit, Secretary Esper for his steady support, the Inspector General for his partnership, and the DoD leadership and workforce for embracing this complex and important effort. I would also like to thank Congress and this committee, both the Members and your staff, for your commitment to this massive undertaking and the role you have played in making an annual financial statement audit a regular way of doing business. Most importantly, thank you for your support for our men and women in uniform. Our collective efforts help ensure they have the resources to do their jobs and return home safely.

The Department of Defense is one of the most complex enterprises in the world. In partnership with Congress, we must continually improve our business practices in order to reduce costs and maintain our competitive edge. Each of us owes it to the American taxpayers to be as responsible in spending their money as they were in earning it. As we undertake these financial audits in support of the National Defense Strategy, we will strive to make that an enduring legacy of this Administration.