

Statement of

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before the

Committee on Oversight and Government Reform
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Chairman Platts, Ranking Member Towns, Members of the Committee, thank you for your invitation to speak before you today on the subject of Financial Management within the Department of Defense (DoD).

I am Mark Easton, the Deputy Chief Financial Officer for DoD. In this capacity, I am responsible to the Chief Financial Officer for the financial policy, systems compliance, and associated internal controls that govern the financial and accounting aspects of business operations across the Defense enterprise. I have had the privilege of serving our nation within DoD—both in uniform and as a Civil Servant—at various levels and in various capacities over the past 38 years. I am proud to be a part of a financial management workforce that is operating today around the world, providing mission support to our warfighters. I am also mindful of our public stewardship responsibility, and in that regard will be speaking of the efforts that are underway to strengthen DoD financial management, in order to improve the quality and timeliness of financial information for leadership decision-making, and ultimately demonstrate accountability with a clean financial opinion.

I also recognize that DoD financial management has remained on the GAO high-risk list since 1995. My experience in working within the Department over an extended period of time tells me that a reasonable level of controls exists within the various elements of our business especially with regard to local control of assets and expenditure of funds. My current position, however, provides me with a perspective that also recognizes enterprise-wide weaknesses in DoD business processes that negatively impact our financial management. These weaknesses go well beyond the financial management functional community, extending into all functional business areas throughout the enterprise. As such, they demand an enterprise-wide business response. The lack of auditable financial statements for DoD as a whole reflects those weaknesses.

DoD Financial Management Goals

To put this subject into context, I'd like to begin by highlighting the Department's three goals for financial management:

First, we strive to acquire the resources that are necessary to meet national security objectives. This is the budget side of our mission, and it includes considerable interaction with Congress, as you know.

But an enacted budget is only the beginning. Our second goal is equally important and is where I spend most of my time and energy. That is to ensure that we are using appropriated resources legally, effectively, and efficiently. This is the execution side of financial management, and its magnitude within the Department of Defense is immense. Every business day, we obligate an average of \$2 billion to \$3 billion and handle hundreds of thousands of

payment transactions in thousands of locations worldwide, including combat zones. So our second financial management goal is no small task, and it is in fact where we are currently placing a significant amount of urgency and emphasis across the DoD enterprise. In this very diverse and complex business environment, standard and well-controlled processes and integrated, automated, and compliant systems are important. The umbrella initiative to bring these elements together in a manner that supports auditability is our Financial Improvement and Audit Readiness (FIAR) effort. I will discuss this in some detail later in my statement.

Our third objective is to maintain a world-class financial management workforce that is dedicated and motivated to meet its responsibilities in support of the DoD mission. The taxpayers -- and our Servicemen and women -- deserve nothing less. To facilitate its continued excellent service we have developed a framework to formally guide training and career development. It will focus on the key skills that our current and future financial management workforce will need for the 21st century business environment that is emerging. It is an environment that will demand key skills and practical experience in internal controls and financial audit. These skills will help personnel to understand and use modern business systems in maintaining more standard and better controlled processes that produce reliable financial information. It will also require an increased level of analytic skills in using this information to better inform decisions.

These three objectives support the overarching goal of strengthening DoD financial management. This goal is clearly reflected in the Department's Strategic Management Plan. Together, the initiatives under each objective combine to move us to financial auditability and a ticket off the GAO high risk list.

Although these three objectives predated the arrival of our new Defense Secretary, they have already attracted his strong interest. As he wrote in a recent message to the entire Department, "We also must continue to tackle wasteful and duplicative spending and overhead staffing. We must be accountable to the American people for what we spend, where we spend it, and with what result. While we have reasonable controls over much of our budgetary information, it is unacceptable to me that the Department of Defense cannot produce a financial statement that passes all financial audit standards."

Secretary Panetta has asked us to review our financial improvement strategy and to report back to him concerning both our progress and our further plans. That review is ongoing. I am confident that the Secretary's personal interest in these issues will be helpful in the days ahead. This is indicative of a sustained senior leadership focus that will remain constant.

The FIAR Strategy

To deal with these enterprise challenges -- and to improve financial information and achieve audit readiness -- we revised the approach that had been pursued by DoD in the past. Our new approach was shaped by senior leaders in the Comptroller and Chief Management Officer organizations and in the Military Departments and Defense Agencies. In addition, we solicited input from the Office of Management and Budget (OMB), from the Government Accountability Office (GAO), and from Congressional staff.

In August 2009, we issued a memorandum outlining the new approach, which emphasizes improvements in the completeness, accuracy, timeliness, and validity of the financial and asset information that we use every day to manage the Department. This approach leads to our current concentration on areas that are most important to Defense managers while holding down costs in a period of budgetary constraint. Specifically, we are working on two types of information – budgetary information and existence and completeness of assets.

Budgetary information is critical to leadership at all levels as operational and resource allocation decisions are made. Our new approach on improving budgetary information will lead to audit readiness for our Statement of Budgetary Resources.

We are also focusing on the accuracy in the numbers and locations of mission critical assets. The financial audit elements of “existence and completeness” translate directly into knowing “what we have” and “where it is,” so we can use the equipment in combat and ensure that our acquisition organization is buying only what DoD needs.

The Fiscal Year (FY) 2010 National Defense Authorization Act (NDAA) and subsequent legislation accommodated our new approach to financial improvement and audit readiness. This spring we completed a business case analysis that was required by key stakeholders and which was included as a provision in the FY 2011 NDAA. The analysis provides a roadmap to a cost-effective way for achieving full financial statement auditability.

Putting the FIAR Strategy to Use: Current Status and Recent Accomplishments

Because it has been 17 years since the statutory requirement was levied and nearly 14 since an initial target date came and went, and many subsequent plans and commitments failed, it is fair to ask: “Why will this time be different?” Simply put, we have the right strategy; dedicated resources; solid leadership support throughout the Department; and established governance process with assigned accountability for action.

We also recognize that we need to show specific interim progress to reassure ourselves -- and the Congress -- that we are moving toward auditable financial statements in accordance with the established timelines. To that end, in Fiscal Year 2010 we launched an audit of the U.S. Marine Corps' Statement of Budgetary Resources, which we believe will lead to a positive audit opinion. When successful, this will be the first time that any Military Service has completed an audit of a financial statement. Moreover, it already provides important lessons that are useful to other Defense organizations.

Other efforts across the Department are validating and demonstrating progress as well:

- In August of this year we completed an examination and validation of the funds distribution process, known in financial terms as "appropriations received," of each of the three Military Departments. This effort was conducted by an independent public accounting firm (IPA) and resulted in a clean opinion on the audit readiness of our appropriations received processes. A similar validation will take place DoD-wide and periodic validation of appropriations received will demonstrate that we are distributing and accounting for these distributions of funds carefully and in ways that ensure compliance with the laws you enact.
- The Defense Information Systems Agency (DISA) is undergoing an audit of its Working Capital Fund financial statements. While our priorities focus primarily on the Military Services and their general fund appropriations, major Defense Agencies continue to make progress on auditability, and we are working with each of them. Although large and complex in scope, DISA is an agency making advanced progress toward auditability. This audit will be completed in a few months, and we expect that it will result in a clean audit opinion.
- This year the Defense Finance and Accounting Service (DFAS) underwent an audit of controls related to its key civilian pay system. It received a clean opinion from the auditor. DFAS is now executing a plan to expand the scope of the audit to the full civilian pay processes and controls. This approach is a model for all service providers in the Department, and my office is coordinating an effort for other internal service providers to use it as well.
- In June we began an IPA validation of the Army's organizations and bases that have implemented their "target" business environment supported by their financial ERP, the General Fund Enterprise Business System or GFEBS. This is a key effort to ensure that the new system is being used in a manner that is auditable.

- In July we began an IPA validation of the Air Force's processes and controls to reconcile its accounts with Treasury. This "checkbook reconciliation" is an important building block for auditable financial statements.
- By the end of this calendar year we expect to begin several other validation efforts, including validations of the counts and locations (referred to by auditors as "existence and completeness") of large portions of our military equipment.
- Lastly, we have completed the business case analysis directed by the FY 2011 NDAA and defined the way forward for auditing DoD balance sheets and full audits of all financial statements.

These accomplishments illustrate our progress in moving towards auditability and, more importantly, improving and sustaining key business process changes. They also build on some significant past achievements. For example, for the past three years, the U.S. Army Corps of Engineers has produced fully auditable financial statements and is maintaining them. Several Defense Agencies maintain auditable statements, including two within the Comptroller organization, the Defense Finance and Accounting Service and the Defense Contract Audit Agency. A number of the large trust funds managed by DoD are also auditable. And we are getting better as we make use of relevant guidance from GAO and others. However, we recognize there is an enormous amount of work still ahead of us to achieve and sustain auditable financial statements.

Continuing Challenges Remain

As I said at the outset, these challenges become especially daunting considering DoD's geographical dispersion and sheer size. Given those factors and our unique mission requirements, we are not able to deploy the vast numbers of accountants that would be required to reconcile our books manually. So fundamental changes will be required. I also mentioned the strong partnership with our oversight and audit stakeholders -- specifically the GAO and DoD Inspector General, as well as a cadre of quality IPAs who are evaluating us and making recommendations for improvement.

The GAO recognizes the enormity of the task of changing the way we do business in order to escape its high-risk list and to achieve financial auditability. We are in general agreement with its assessment concerning five major challenges: Sustaining broad, committed leadership; maintaining a competent workforce; establishing effective governance, oversight and accountability; implementing information technology (IT) systems on time, within budget, and with needed capabilities; and resolving weaknesses in internal control over financial

management and reporting. I'd like to briefly address each of these challenges, along with actions that we are taking to address them.

Leadership Commitment and Governance. We implemented a governance structure early in the current Administration and the structure has been effective in keeping the attention of senior leaders on financial management improvement. We recognize that this governance needs to move beyond maintaining focused attention on key issues, to providing more direct and specific oversight that is associated with leadership accountability. The Deputy Secretary called a meeting of the Office of the Secretary of Defense Principal Staff Advisors and Military Department Under Secretaries and Vice Chiefs and required their commitment to specific achievements in FY 2011 and FY 2012. We are now using those goals at all levels of governance to hold executives accountable, and we intend to follow up on a regular basis to celebrate successes and to address the causes of any missed goals. We feel that, with these improvements to our governance process and Secretary Panetta's involvement, we have the leadership commitment we need, and that leadership involvement will provide more effective oversight and accountability.

Workforce Competency. We have a dedicated and professional workforce that is doing the job and supporting key mission needs around the world. This job and the business environment are changing, and there are changes required of both a short-term and long-term nature. In the short term, we are delivering immediate practical training to both financial managers and non-financial operators. In the long term, we are taking steps to sustain our strong financial management workforce through a course-based certification program. A key focus of this program will be to ensure that financial managers are addressing the skill and experience gaps that we and GAO have observed related to financial statement audits. Our people have not had training and experience in this area, and we intend to help them to get it through this program, as well as through the examination and audit of parts of our processes and organizations.

Effectively Implementing Information Technology. Many of our business IT systems are old, functionally stove-piped, and were originally designed to capture financial transactions to conduct basic budgetary accounting. A key element to achieving and sustaining auditable financial statements is improving our financial systems. To accomplish this, we are re-orienting the DoD around end-to-end business processes that support audit goals, implement Enterprise Resource Planning (ERP) systems, leverage those investments to the maximum extent practicable, modernize legacy systems when necessary and supported by a business case, and also aggressively sunset legacy systems that are obsolete, redundant, or not aligned with our business objectives. In attacking this key area, the Comptroller is partnering with the DoD Deputy Chief Management Officer (DCMO) and the Military Department Chief Management Officers to oversee the implementation of these systems and the processes they enable.

We are focusing on three key areas:

First, we have taken steps to improve our current approach to acquiring and implementing IT systems, particularly in the business domain. Part of the changes in approach is requiring that individual programs, such as Army's General Fund Enterprise Business System and Navy ERP, define the role that they play in each organization's auditability efforts and end-to-end processes. Further, specific guidance is being provided to program managers which directly links their program schedules to events that demonstrate the capability to support the relevant financial improvement events in the FIAR plan.

Second, we are defining a target systems architecture that is modeled on the premise of end-to-end business processes and uses the capability inherent in our ERP systems to the maximum extent practicable. Use of these systems allows auditors to rely on their inherent automated controls and supports readily available audit trails.

Third, we will continue to guide our system investments using the Business Enterprise Architecture, which defines the necessary data standards, business rules, performance metrics, and standard system configurations that will allow our systems to be interoperable.

Financial Controls. Improved systems alone, however, will not eliminate our weaknesses or guarantee auditable statements. Achieving auditability requires that we apply a consistent level of process controls that cross organizations and functional areas. Business and financial information that is passed from system to system must also be subject to a control environment to ensure that only authorized personnel are using the system and that these systems protect the data quality and maintain a compliant audit trail within the end-to-end business process. This process must be controlled at the transaction level, from the source to the general ledger postings, accurate trial balances, and reliable period closeouts. Only by completing these steps can we prepare financial statements that an auditor can cost-effectively review and verify. Many elements of our current business environment must be changed to allow us to meet financial audit standards. In the midst of two wars and numerous military operations, implementation of our new approach will continue to be a major challenge.

We also agree that we have more work to do in improving our financial controls. Sound internal controls over financial reporting are the foundation of audit success, but we have often found that they are poorly documented and inconsistently executed. In the past we have asked operational organizations to self-assess their controls to determine weaknesses impeding audit readiness. Because most people do not have the experience to evaluate controls, we have not made progress in this area fast enough. The primary improvement we have already made in this area is to enlist more help from the Service audit agencies. They have the personnel qualified to assess internal controls and make sound recommendations for corrective actions. Each Service has committed more than 15 people who will focus solely on evaluating controls at the

operational level, recommending solutions for any issues identified, and then following up to ensure rapid implementation of solutions.

These changes have strengthened our overall Managers Internal Control Program by more tightly integrating the financial reporting and financial systems elements into the FIAR program and emphasizing substance and risk assessments during visits by my staff to local commands. Sound internal controls must become a part of our day-to-day routine, not just an annual reporting requirement.

The Way Ahead for Financial Auditability

As I indicated earlier, we are determined to meet the congressionally mandated deadline of auditable statements by 2017. It is an ambitious goal, but it is achievable and more importantly, we see a clear roadmap to this goal. First and foremost, we have a Chief Financial Officer who has thoughtfully assessed and applied lessons learned, while also seeking the advice and counsel of our external stakeholders and oversight activities. Unlike past efforts, he has recognized that to mobilize the entire Defense establishment, we must start by focusing on information that is important to managing this enterprise while also accomplishing its mission. Under Secretary Hale has put into motion a winning strategy and we now are learning and applying lessons learned in executing this strategy. Further, we have the strong support and commitment of Secretary Panetta and anticipate an equivalent level of energy and interest throughout the Department.

How This Relates to Other Priorities

Finally, I want to say a word about additional benefits that will result from a stronger and better controlled business environment within DoD. From my perspective, there is clear value and critical importance in the public confidence that auditability would demonstrate. Beyond that, the benefits to the Department, its mission, and the taxpayers are significant. This effort is consistent with the Administration's overall campaign to reduce waste across the Federal government. In a time of concern about the level of Federal spending, we need to do our part at Defense. We know the American people have always supported Defense spending, but that does not relieve us of the obligation to manage scarce resources carefully and effectively. We are committed to doing so.

This dedication to efficient and effective financial management will continue our important contributions to the operational efficiencies that are being implemented across the Department. We are determined to see the job through and to achieve our objectives for the sake of the troops and the taxpayers.

In this regard, we believe that our aggressive program to improve financial information and to adopt commercial audit standards will reinforce current efforts to control improper payments, while also establishing an infrastructure that will allow us to do more in-depth analysis of source documentation where appropriate.

Controlling Improper Payments Is Currently a Strength

We have a fundamentally strong program to monitor, control, and report on improper payments, but our status on the GAO high-risk list and a lack of financial statement audit opinion creates an unacceptable level of skepticism. Improving internal controls as discussed above will strengthen the current program and contribute to increased confidence.

Improper payments occur when funds go to the wrong recipient, an ineligible recipient receives a payment, a recipient receives the incorrect amount of funds (including overpayments and underpayments), or documentation is not available to support a payment.

Based on our current reporting methods, we estimate that about one to two percent of our payments results in payments that are classified as improper. That is one to two percent too much. The only appropriate goal for improper payments is zero. Nevertheless, our improper payment percentage is low in comparison to overall federal levels, and many of our improper payments are quickly resolved.

Our success with improper payments is particularly noteworthy because of the size and complexity of the Department's payments. Last year DFAS, which handles nearly 90 percent of our total payments, disbursed a total of \$578 billion. DFAS processed more than 168 million pay transactions, 8.1 million travel payments, and 11.4 million commercial invoices. It also handled 255 million General Ledger transactions and nearly \$500 billion in military retirement and health benefits funds.

We are not only a huge organization; we are a highly complex organization. The contracts for major weapons are some of the most complex in the world and present significant payment challenges, such as those associated with progress payment terms that call for varying recoupment rates. Despite the volume and complexity of our activities, DFAS has worked hard and successfully to keep the incidence of improper payments in check. At the same time the organization has steadily reduced the cost of its operations in recent years by consolidating operations and improving productivity.

We have historically used post-payment statistical sampling for payments related to civilian pay, military pay, travel pay, military health benefits, and payments to our military retirees and retired annuitants. Each of these categories of payments represents an ongoing relationship with members where payment issues can be quickly identified and resolved. Underpayments are typically resolved by the next cycle and overpayments are quickly recovered.

Improper payment rates reported for FY 2010 were as follows: civilian pay, 0.3 percent; military pay, 0.6 percent; travel pay, 1.9 percent; military health benefits, 0.42 percent; and retiree/annuitant pay, 0.1 percent. We project similar rates for the year ending September 30, 2011.

Our improper payment program can be made better, specifically in the methodology that we use for detecting commercial payment improper payments. Historically, we have emphasized pre-payment screening for our commercial contract payments. Due to the complexity of these transactions and the widely dispersed payment systems that handle them, this method puts controls in place up-front and increases the likelihood that payments are accurate before they are released. To provide further assurance on our reporting and compliance with the Improper Payments Elimination and Recovery Act of 2010, we also are beginning to employ post-payment statistical sampling and will use this approach for reporting, effective in FY 2012.

The payment categories that I have just discussed are the largest ones in DoD and are handled primarily by DFAS. But payment operations occur in multiple organizations across the Department. And many of these organizations have implemented what we believe are strong programs to estimate, identify, report, eliminate, and recover improper payments.

Two noteworthy examples are the U.S. Army Corps of Engineers and the TRICARE Management Activity. The U.S. Army Corps of Engineers conducts statistical sampling for all commercial payments and a 100 percent review of all travel payments over \$2,500, as well as a statistical sampling of those below \$2,500. It has also used a recovery audit for FY 2010 that recaptured 99 percent of all overpayments.

At the TRICARE Management Activity, home of vital military health benefits programs, stringent contract performance standards are employed that involve stratified statistical sampling based on dollar amounts and payment types. The contractor actually making the payments is incentivized by contract terms to minimize any improper payments and penalized when performance standards are not met. In addition, as mentioned previously, the comprehensive annual post-payment audit by an external independent contractor established an improper payment rate of 0.42 percent as reported in FY 2010, representing about \$49.1 million in improper payments.

Conclusion

In summary, we recognize the challenges associated with improving financial management in the Department of Defense and especially the obstacles to improving information and achieving audit readiness. To meet those challenges, we have developed a workable and promising partnership between the CFO and DCMO communities that will help with implementation. We have also implemented a new, focused approach that includes near-term goals, in addition to the long-term goal of achieving auditable statements by the Congressional deadline of 2017. We also use and benefit from a constructive partnership with our auditors and

oversight activities. And make no mistake: We appreciate the support of the Congress, and we remain committed to fully auditable statements by 2017.

Mr. Chairman, this concludes my statement. I look forward to your questions.

Office of the Under Secretary of Defense (Comptroller)

MARK E. EASTON

Deputy Chief Financial Officer



Mr. Easton assumed his current position as the Deputy Chief Financial Officer (DCFO), Office of the Under Secretary of Defense (Comptroller) in May 2009. Mr. Easton is the principal advisor to the Department of Defense (DoD) Comptroller/Chief Financial Officer (CFO) and senior staff on all issues involving the amended CFO Act of 1990 and related financial management reforms. He is responsible at the executive level for ensuring DoD budget and financial execution in support of national security objectives, particularly as it relates to finance/accounting policy and systems, management control systems, and general business transformation programs. Further, he ensures DoD complies with legislative and executive financial management mandates leading to the effective and efficient use of DoD resources.

Prior to becoming the Department's DCFO, he served five years as the Deputy Assistant Secretary of the Navy and Director for Financial Operations, within the Office of the Assistant Secretary of the Navy, Financial Management and Comptroller. In this position, he was responsible for Department of the Navy financial improvement initiatives that involve systems and processes employed by the 9,000 Navy-Marine Corps financial managers. He was appointed as a member of the Senior Executive Service in January 2003, serving initially as Director, Defense Finance and Accounting Service Cleveland and the Senior Navy Client Executive for DFAS.

He retired as a Captain in September 2002, following a 29-year career in the Navy Supply Corps, serving in assignments both afloat and ashore. At Sea, he served as the Supply Officer in the Battleship, USS New Jersey. Ashore he was the Commander of DFAS Pacific, providing support for all four military services from locations in Hawaii and Japan. Prior to this assignment he served as the Executive Assistant and Naval Aide to the Assistant Secretary of the Navy, Financial Management and Comptroller.

A native of Kansas City, Mo., he holds a Bachelors of Science in Economics from Miami University (Ohio) and a Master of Business Administration from the University of Michigan. He has completed the Executive Development Program at the Northwestern University Kellogg Graduate School of Business and is a graduate of the National Defense University's Industrial College of the Armed Forces. He is a Certified Defense Financial Manager.

Mr. Easton has received various personal awards, including the Defense Superior Service Medal and two Navy Civilian Superior Service Awards.