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Department of Defense
OFFICE OF PREPUBLICATION AND SECURITY REVIEW

House Armed Services Committee
Hearing on Audit of the Department of Defense
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Joint Written Statement for the Record, on behalf of All Witnesses, by
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Chairman Smith, Ranking Member Rogers, distinguished members of the Committee, I appreciate the opportunity to testify before you today on the Department of Defense (DoD) financial statement audit, a key priority for the Department.

I am joined by my esteemed Military Department colleagues, each serving in the capacity of performing the duties of their respective Assistant Secretary for Financial Management and Comptroller: Mr. Wesley Miller, representing the U.S. Army; Ms. Alaleh Jenkins, representing both the U.S. Navy and U.S. Marine Corps; and Mr. Stephen Herrera representing the U.S. Air Force and U.S. Space Force. We welcome your questions on the status of our respective financial statement audits and greatly appreciate the Committee's continued investment in our journey.

Leaders and financial managers throughout the DoD are embracing our audit responsibilities and, as good stewards of taxpayer dollars working to increase transparency in how we manage the resources entrusted to us. We appreciate your support in holding us accountable for these shared values. We are keenly aware that the DoD is the primary obstacle to the U.S. Government achieving a clean audit opinion—something we would all like to see. Our governance structure is supported by leaders at every level who welcome the scrutiny and understand the value of audit. A strong tone-at-the-top continually reinforces the importance of accountability in support of the mission, people, and resources.

The audit is not just an accounting exercise. It is a top-down and bottom-up review of the DoD enterprise and our ability to accurately and timely account for our resources. Auditors physically verify that assets in our system exist. We receive both quantifiable and non-quantifiable benefits from the audit in the form of improved visibility of our assets to help optimize the warfighter's posture; improved visibility of our financial resources to support decision-making and

investment decisions; and streamlined business processes that support more compliant systems and lead to cost avoidance and operational efficiency. We are committed to integrating audit remediation efforts into our daily business operations, corporate culture, and policies. We are in a cyclical process of collecting auditor feedback and aligning that feedback, or findings, to operational priorities. We remediate the findings by implementing corrective action plans, and then we monitor those results. We will use remediation results to progressively move the Military Departments and the Department as a whole from a disclaimer, to a modified, and finally to a sustained unmodified audit opinion.

We are working closely with other federal agencies and oversight bodies, such as the Department of the Treasury, the Government Accountability Office (GAO), and the Office of Management and Budget; as well as the larger audit community, such as the Federal Accounting Standards Advisory Board, and industry partners such as the American Society of Military Comptrollers and the Association of Government Accountants. We are grateful for the continued cooperation and responsiveness of our DoD Office of Inspector General (DoD OIG) and the many independent public accountants (IPAs) with which we work. The willingness of all of these groups to share feedback and best practices is helping us prioritize and resolve some of our more complex audit issues.

Making Progress

Having just completed our third annual consolidated audit, the Department continues to make steady progress toward not just an unmodified audit opinion but, more importantly, improved financial management and data integrity for decision-making. As a reminder of what is at stake, the DoD employs nearly 3 million service members and civilians. We manage one of the federal government's largest real property portfolios, consisting of more than 603,000 assets located on over 4,600 sites worldwide. Our bases operate like small cities, with law enforcement, hospitals, grocery stores, schools, transportation systems, and housing. We run one of the largest health care systems in the country, supporting more than 9 million people. As a comparison, we manage \$310 billion in inventory, nearly seven times the size of Walmart's inventory. And while a typical commercial airline manages between 300 and 1,600 aircraft, we fly roughly 16,000 aircraft. This amounted to \$817 billion in gross costs last fiscal year, which would have easily placed DoD at the top of the Global 100 list if government entities were included

Each year, independent public accounting firms conduct more than 24 standalone audits of DoD entities. The DoD OIG oversees the work of these auditors and issues the overarching consolidated audit opinion on the Department as a whole. In fiscal year (FY) 2020, these audits required more than 1,400 auditors, over 100 in-person site visits, despite a COVID environment, and approximately 530 virtual site visits to review DoD business processes and activities.

Eight DoD entities representing 35 percent of DoD's \$3.1 trillion in total assets received unmodified (or clean) opinions in FY 2020.¹ Every entity that achieved an unmodified opinion in FY 2019 sustained a clean opinion in FY 2020, while the Defense Information Systems Agency Working Capital Fund joined these ranks for the first time. The Military Retirement Fund and the Defense Finance and Accounting Service Working Capital Fund achieved their 26th and 21st consecutive unmodified opinions, respectively.

Auditors issued more than 3,400 notices of findings and recommendations, or NFRs, during the FY 2020 audits. They also looked to see whether we had successfully closed past findings. As of early April, auditors had validated the successful closure of 23 percent of the prior year findings. We are pleased to note that even though the year was marked by many COVID-19 challenges, our closure rate was on-pace with the closure rate achieved the year before. This tells us our corrective action plans are effectively addressing root causes.

Following the initial FY 2018 audit, DoD emphasized auditor findings as a way to prioritize corrective actions and measure progress. In FY 2020, however, the Department began using material weaknesses to prioritize corrective actions, improve operational value, and strategically move the Department closer to an unmodified opinion. Material weaknesses are issues that, if left unaddressed, have the potential to lead to significant, erroneous reporting and are the specific issues cited in the DoD OIG's audit report that are preventing DoD from achieving an unmodified opinion. The Department's FY 2020 audit report noted 26 Departmental material weaknesses. The auditors found no new material weaknesses at the Department-level, and we successfully downgraded two material weaknesses. This is one reason we can say this year's audit report was better than last year's audit report. In addition to improved opinion counts, material weakness

¹ 44.5 percent received positive opinions inclusive of the modified opinion received by the Medicare-Eligible Retiree Health Care Fund.

reductions, and NFR closures, our collective efforts resulted in an improved rating for “DoD Financial Management” in GAO’s 2021 High Risk List.

Driving Change

Most importantly, the audits are driving the cultural changes needed to achieve our business reform goals. Perhaps no better example of the benefit of audit exists than in the improvements we are seeing in our data, which, second to our women and men in uniform, is maybe our most valuable and strategic asset. The audits demand information technology (IT) system improvements and data consolidation that is arming decision-makers with real-time, Department-wide views, and advanced data analytic capabilities. We are now able to use dashboards, metrics, and analytics to support efficiencies, sustain improvements, and harness the power of data for better decision-making.

At the risk of sounding dramatic, the audit is also driving improved national security. Auditors test our processes and procedures for controlling who can access our systems, what levels of access they have, what procedures they can perform, and who can access system coding and configuration capabilities. We already know DoD systems are primary targets for hacks and cyberattacks, both foreign and domestic. The audits test our IT controls and provide us direct and specific feedback on where we must improve security and controls.

Benefiting the Taxpayers

Even with all this good news, it is reasonable to ask, “how does this benefit the taxpayer and is it worth all the money we are spending on the audits?” Annually, we pay the IPAs roughly \$185 million for audits and examinations, less than 1 percent of our total annual budgetary resources. This is well within industry standards, and the return on investment is remarkable. The DoD audit is driving efficiency that reduces administrative costs, improves inventory management, and many other benefits.

The Army deployed an automated solution that saved 60,000 labor hours to record approximately 2,000 real property assets transferred to Army. The Navy launched a campaign to locate untracked or excess material, and Navy commands identified more than \$3.2 billion in material not visible to the organization that is now available for redeployment. The Air Force developed and deployed the innovative Theater Integrated Combat Munitions System (TICMS). In addition to reducing the Air Force’s overall IT footprint and driving modernization by

migrating eight disparate systems into one, TICMS is boosting operational readiness through enhanced accountability of munitions-related assets. This system will save the Air Force system maintenance dollars while better tracking the location and quantity of its munitions.

Embracing technology, such as artificial intelligence and robotic process automation, or “bots,” is helping us increase the timeliness and accuracy of our transactions and allowing us to meet increasing audit demands. Over the past year, the Department saw a marked increase in the use of bots across all of our business lines. As of March 2021, DoD had 323 bots deployed across all business lines, 60 percent of which were aligned to financial management processes, with 16 percent directly supporting compliance or audit response activities.

The audit is giving taxpayers improved accountability for the assets entrusted to us, transparency in our use of these assets, and is pushing the DoD and the U.S. Government closer to a clean opinion. We believe the return on investment will continue to grow as audits mature, root causes to problems are addressed, and our data are made more reliable and timely. I am fully confident the DoD audit offers a positive return on investment for American taxpayers.

The Military Departments

Now that we have highlighted our overall audit results, I would like to spend a few minutes on the status of each Military Department and their planned approach for audit over the next few years.

In FY 2020, the Army made significant progress, as evidenced by its audit metrics. The number of auditor findings for IT dropped by 30 percent. It used workflow technology to validate and improve the quality of 50,000 real property asset records. Improved data analytics helped it identify "ghost" general equipment assets, such as tanks and helicopters that should be removed from the system, and machine logic is helping the Army address and reduce unmatched transactions between systems, resulting in better asset management.

The Army has developed an audit roadmap that identifies milestones to remediate material weaknesses. Over the next two years, the Army will focus on remediating Fund Balance with Treasury issues, the most material item on the financial statements. Fund Balance with Treasury is an asset account showing available budget spending authority that must be reconciled monthly with Department of the Treasury records, much as one balances their personal

checkbook to their bank's records. Establishing beginning balances is also a near-term priority and essential to achieving an opinion. The Army's third priority is the completeness of property, plant, and equipment and inventory populations, which ensures they have accountability and supporting documentation for all of their assets and transactions. The Army's ability to provide appropriate evidential matter to the auditors to support the execution of our financial activities continues to improve. Finally, the Army is also working on its longer-term ERP, Enterprise Resource Planning, modernization strategy.

The audit of the Department of the Navy (DON) is premised on optimizing the financial systems environment, enhancing processes, and investing in its workforce. Focusing on these three components directly benefits the DON mission, Sailors, and Marines by strengthening readiness and lethality. Underlying these elements are the FY 2021 priorities Acting Secretary of the Navy Harker issued earlier this year, which focuses on downgrading Navy material weaknesses and developing the right environment to sustain them.

Optimizing the financial systems environment entails the DON consolidating its accounting systems into just one unclassified system for each Service—the Defense Agencies Initiative (DAI) for the Marine Corps and Navy ERP for the Navy—currently planned for October 2021 and October 2022, respectively. This reduces complexity, increases audibility, shrinks operating costs, and minimizes cyber vulnerabilities. The DON is also using bots to automate manual processes.

Data as a strategic asset is a major contributor to the DON's audit effort. A common operating picture, using dashboards for real-time insights, metrics, and analytics, is propelling the DON into a decision-making culture focused on scalable, data-driven analytics to meet pressing business and audit needs. The DON also established a dedicated office to drive change management and improve DON financial data analytics and business intelligence. The DON's Jupiter platform hosts multiple applications that leverage real-time financial execution data to support information at the speed of relevance.

Just as data is a strategic asset, so is the DON workforce. The DON is investing in its workforce through upskilling and employing best practices. Ensuring the workforce has the skillsets necessary to execute or improve processes is critical. A modern, analytical workforce will sustain improvements and provide even greater outcomes for the DON's mission.

At the beginning of FY 2021, the Department of the Air Force established a multi-year audit roadmap and integrated master schedule that collect objective data inputs from across the organization to manage near- and long-term audit goals. These tools add increased transparency, consistency, and accountability in assessing the Air Force's audit progress. Leveraging this matured, data-driven approach, the Air Force is making a conscious decision to prioritize reductions of its most significant material weaknesses over the next 18 months. This includes the reported value of its military equipment (both in production and in use) and the balance of Air Force cash accounts with the Department of the Treasury, which together represent nearly 70 percent of the assets reported on its financial statements. In addition, the Air Force remains focused on establishing the completeness and accuracy of its legal liabilities and implementing a fully compliant management internal control program. These four material weaknesses are targeted for downgrade by the end of FY 2022.

The Fourth Estate

The Fourth Estate, which comprises the other Defense organizations, Defense Agencies, and DoD Field Activities, is also making steady progress. The Defense Logistics Agency had two of its material weaknesses downgraded. Auditors have thus far validated the closure of roughly 30 percent of Fourth Estate prior-year audit findings. The closure rate for IT findings alone rises to 78 percent for Fourth Estate entities audited as part of the consolidated audit. Each entity under standalone audit has developed an audit roadmap with targeted auditability timelines and major milestones, and we are closely monitoring progress.

Of the 25 DoD service provider IPA examinations of system controls (which includes 2 examinations where the Army acts as a service provider), 12 resulted in an unmodified opinion, an increase of 1 over last year. The Defense Finance and Accounting Service, one of our major service providers, is championing financial excellence through transparency of our financial data and helping lead efforts to reconcile our fund balance to the Department of Treasury records. A project to resolve our aged statement of differences—similar to reconciling hundreds of checking accounts each with billions of dollars in them and going back over the last 10 years—has resulted in a 99 percent reduction in total differences from \$2.7 billion in December 2018 to \$5.9 million in September 2020. Aged balances in our suspense accounts was similarly reduced from \$23.4 billion in September 2018 to \$439.4 million in September 2020, a 98 percent decrease.

Conclusion

The audit is all encompassing. It acts as a catalyst to drive reform and innovation to best support our mission readiness and lethality. It reinforces accountability to taxpayers, and generates detailed findings and recommendations to further guide corrective actions. The output of our effort is a clean audit opinion, but its effects are even greater—better systems, better data, financial management excellence, an analytical workforce, and improved transparency enabling faster insights so that we can develop focused, sustainable, solutions for the Department’s complex problems.

The annual audit regimen has set the Department on an irreversible course in support of business reform, reinforcing accountability to taxpayers, and directly contributing to enhanced military readiness. Ultimately, success is in the hands of the DoD workforce, and our personnel is already realizing the importance and benefits of these audits. By continuing to equip the workforce with the resources and tools it needs to respond to auditor requests and remediate audit findings, the Department will achieve its audit goals of business excellence, and sustain an improved level of business proficiency for the benefit of the warfighter and the American people.

I suspect we all look forward to the day when we hear on the evening news or the drive home, “For the first time in history, the U.S. Government achieved a clean audit opinion.” We need hearings like this. We need to be asked hard questions about the assets entrusted to us, and we welcome your continued collaboration and oversight. You and your colleagues have continued to stress the importance of these audits and the need for continued progress. We appreciate the confirmation questions you have posed to nominees that reinforce that message. The DoD IG and GAO have recognized our strong tone-at-the-top and that is due, in part, to you holding us accountable. We look forward to your questions.