

Statement of
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for a Hearing on

Beyond the Budget: Addressing
Financial Accountability in the
Department of Defense

Before the Subcommittees on
Government Operations and the Federal Workforce
and
National Security, the Border, and Foreign Affairs
U.S. House of Representatives
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Chairmen Sessions and Grothman, Ranking Members Mfume and Garcia, and members of the subcommittees, thank you for inviting me to appear before you today to discuss the financial management challenges facing the DoD. I am Brett Mansfield, the Deputy Inspector General for Audit at the DoD Office of Inspector General (DoD OIG). Today I will discuss the DoD's efforts to obtain a clean audit opinion and some of its associated longstanding challenges, the importance of internal controls and their impact on financial reporting and operational readiness, and the need to have a persistent, all-hands approach to addressing these longstanding financial management and internal control challenges. I will also provide some examples of ongoing and recently completed work within the DoD OIG that is separate from the required Chief Financial Officer (CFO) Act financial statement audits and that we believe will provide insights to aid the DoD in meeting both its operational and financial management goals.

The DoD OIG has issued a disclaimer of opinion on the DoD Agency-Wide financial statements each year since FY 1996—meaning the DoD OIG could not opine on whether the DoD's financial statements were presented fairly and in accordance with Generally Accepted Accounting Principles (GAAP). Although the DoD began submitting Agency-Wide financial statements for audit in 1996, the National Defense Authorization Act for FY 2002 limited the audit procedures the DoD OIG was permitted to perform on the financial statements. Specifically, the Act only allowed the DoD OIG to perform the procedures required by generally accepted government auditing standards, which incorporates GAAP, and limited the DoD OIG to auditing only the information that DoD management stated was ready for audit. It was not until FY 2018 that the DoD asserted its readiness for audit.

Since FY 2018, the DoD OIG has performed an annual audit of the DoD Agency-Wide financial statements and overseen independent public accountants (IPAs) as they perform audits

of the DoD Components' financial statements. Specifically, the DoD OIG oversees the audits of the nine CFO Act-required DoD reporting entities. The defense intelligence component IGs oversee the required financial statement audits of the DoD intelligence agencies and provide the results to the DoD OIG. In addition, as of FY 2023, the DoD elected to have audits performed on the financial statements of an additional 20 reporting entities.

The DoD OIG, defense intelligence component OIGs, and IPAs oversaw and conducted audits of the DoD Agency-Wide and DoD Component-level financial statements to:

- express an opinion on whether the Agency-Wide and associated Component-level financial statements were presented fairly and in accordance with GAAP;
- report any material weaknesses or significant deficiencies in internal control over financial reporting; and
- report on compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements.

During the most recent audit, issued on November 15, 2022, DoD reporting entities received 9 unmodified (clean) opinions, 1 qualified opinion, and 16 disclaimers of opinions for FY 2022.¹

Figure 1 shows the results of the FY 2022 audit efforts.

¹ In FY 2022, 26 reporting entities received financial statement audits. In FY 2023, 29 reporting entities are receiving financial statement audits—the OMB exempted the U.S. Marine Corps from preparing audited financial statements in FY 2022, and the DoD added two new stand-alone audits in FY 2023.

Figure 1. FY 2022 DoD Reporting Entity Financial Statement Audit Results

| Fiscal Year 2022 Audit Results | | | |
|---|---|--|---------------------------------------|
| Military Retirement Fund ³ | U.S. Army Corps of Engineers – Civil Works ³ | DHA-CRM | DISA Working Capital Fund |
| Defense Commissary Agency ² | DFAS Working Capital Fund ² | Defense Contract Audit Agency ² | DoD OIG |
| NRO ² | | | |
| Medicare-Eligible Retiree Health Care Fund | | | |
| | | | |
| Army General Fund ³ | Army Working Capital Fund ³ | Navy General Fund ³ | DON Working Capital Fund ³ |
| Air Force General Fund ³ | Air Force Working Capital Fund ³ | DLA Working Capital Fund | DLA General Fund |
| DLA Transaction Fund | Defense Health Program | DISA General Fund | USSOCOM |
| USTRANSCOM | NSA ² | DIA ² | NGA ² |
| U.S. Marine Corps General Fund ^{1,3} | | | |
| Unmodified | Qualified | Adverse | Disclaimer |

¹ OMB Bulletin No. 22-01 lists the U.S. Marine Corps as a DoD Component that is required to prepare audited financial statements; however, for FY 2022, the OMB exempted the U.S. Marine Corps from preparing audited financial statements, as it is under a 2-year audit cycle that is scheduled to be completed in November 2023. Therefore, we did not consider any results from the U.S. Marine Corps audit when issuing our disclaimer of opinion on the DoD Agency-Wide financial statements.

² The DoD OIG does not oversee the financial statement audits of these DoD reporting entities.

³ The OMB requires the DoD to submit audited financial statements for these nine DoD reporting entities.

Source: The DoD OIG.

While the DoD has not received a clean opinion on its overall financial statements, it has made progress in that multiple components have consistently obtained an unmodified opinion; for instance, this was the 13th clean opinion for the Defense Health Agency (DHA)–Contract Resource Management, the 15th clean opinion for the U.S. Army Corps of Engineers–Civil Works, the 23rd clean opinion for the Defense Finance and Accounting Service (DFAS) Working Capital Fund, and the 28th clean opinion for the Military Retirement Fund. While these are positive results, they did not extend across the DoD, as there were another 16 entities that have received disclaimers of opinion each of the past 5 years, with 8 of these being CFO Act-required reporting entities.

When conducting an audit, auditors consider whether management has designed appropriate internal controls and whether those controls are operating effectively. However, auditors do not provide an opinion on the overall effectiveness of internal controls. Instead, auditors issue notices of findings and recommendations (NFRs) throughout the audit to communicate to management:

- identified weaknesses and inefficiencies in the financial processes,
- the impact of the weaknesses and inefficiencies,
- the reason the weaknesses and inefficiencies exist, and
- recommendations on how to correct the weaknesses and inefficiencies.

NFRs provide the DoD a road map of areas that need to be addressed. Examples of NFRs from FY 2022 include issues related to the DoD's ability to account for and value its assets, reconcile its Fund Balance with Treasury, and maintain Federal Financial Management Improvement Act-compliant systems.

In addition, auditors evaluate and classify deficiencies in internal controls based on how severe the deficiency is at both the entity level and agency-wide level. During the most recent audit the DoD OIG identified 28 material weaknesses and 3 significant deficiencies at the DoD Agency-Wide level. Of the material weaknesses and significant deficiencies identified:

- 19 material weaknesses and 3 significant deficiencies were repeated from FY 2021;
- 6 prior-year material weaknesses were modified;
- 3 material weaknesses were new; and
- 1 significant deficiency was downgraded to a control deficiency.²

While it is easy to compare the number of material weaknesses over time, it is not an effective way of measuring progress. For example, the total number of material weaknesses did not change between FYs 2021 and 2022, but this is because the DoD OIG combined three prior-year material weaknesses into other repeat material weaknesses and identified three new material weaknesses in FY 2022. Meaning, the weaknesses were not resolved between FY 2021 and 2022, only re-categorized. In addition, the DoD's number of material weaknesses has increased from 20 in FY 2018 to 28 in FY 2022.

A more effective way of measuring progress might include measuring the percentage of balances that are ready to be tested. For example, prior to FY 2021, auditors of the Defense Information Systems Agency General Fund could not perform normal audit tests and procedures due to scope limitations over the Accounts Payable and Accounts Receivable line items, which directly contributed to two material weaknesses. Defense Information Systems Agency

² A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that are important enough to bring to management's attention but less severe than a material weakness. A control deficiency is a weakness or deficiency that auditors bring to the attention of management that typically does not have an impact on the financial statements, but could improve the business processes of the agency.

management implemented corrective actions in FY 2022 that significantly reduced the limitations and allowed the auditors to conduct audit tests and procedures on large-scale representative samples in their audit tests and procedures. Reducing or eliminating scope limitations significantly improved the auditability of the Defense Information Systems Agency and demonstrated progress; however, due to the results of the testing, material weaknesses remained.

Financial Management Challenges Are Not New at the DoD

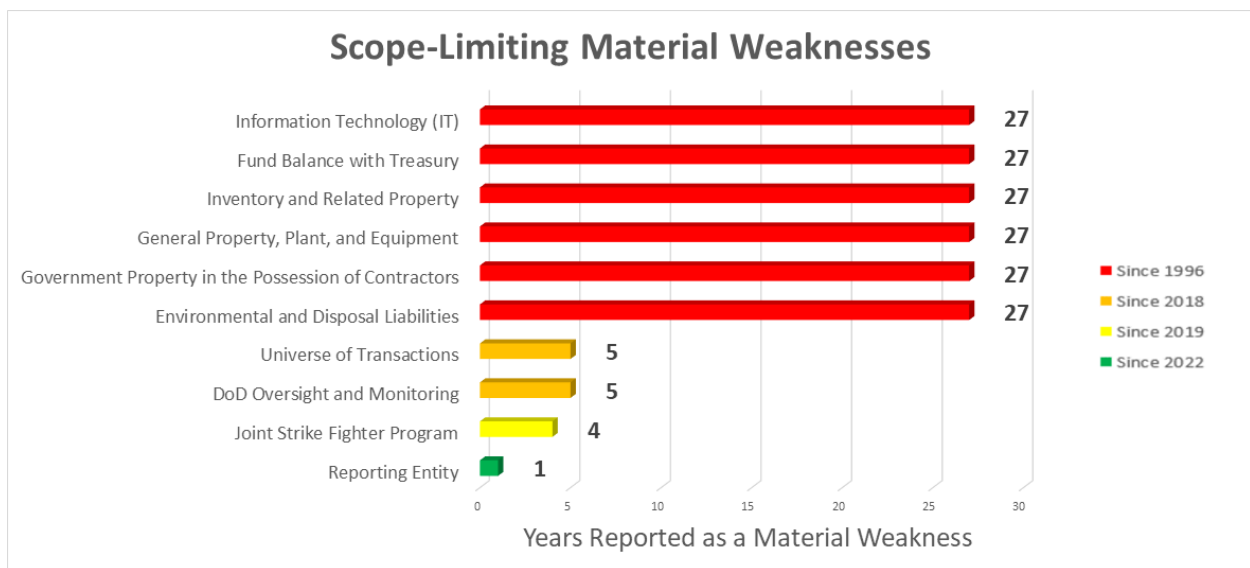
While there has been some positive movement, my testimony here today regarding the financial management challenges that the DoD faces is not significantly different than the 2014 testimony of the Honorable Jon Rymer, then-DoD IG, when he testified before the Senate Homeland Security and Governmental Affairs Committee about improving financial accountability at the DoD. At that time, IG Rymer testified that the DoD had to aggressively pursue improvements in (1) data quality and timeliness, (2) internal controls, and (3) financial systems. These issues still exist today and are only a few of the financial management challenges the DoD continues to face.

In our first audit opinion of the DoD FY 1996 Agency-Wide financial statements, we identified material weaknesses that still existed in FY 2022 such as information technology, real property, and inventory. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD (OUSDC)/CFO established the Financial Improvement and Audit Readiness (FIAR) Directorate in 2005 to manage, integrate, and implement DoD-wide financial improvements related to many of these known roadblocks to its auditability. In its first FIAR report, dated December 2005, the DoD acknowledged that information technology, Fund Balance With Treasury, Inventory and Operating Materials and Supplies, Real Property, and

Government property in the possession of contractors were significant roadblocks to obtaining a clean audit opinion.

Of the 28 material weaknesses identified at the DoD Agency-Wide level in FY 2022, the DoD OIG considers 16 weaknesses to be scope-limiting in that they prevent auditors from performing the necessary procedures to draw a conclusion on the financial statements. We consolidated the 16 weaknesses into 10 categories, which are listed in Figure 2. These categories represent longstanding weaknesses within the DoD, some of which we have been reporting for more than 20 years. The first three categories align with the Secretary of Defense’s three FY 2023 financial statement audit priorities—Establish User Access Controls, Create a Universe of Transactions, and Improve Fund Balance with Treasury.

Figure 2. Scope-limiting Material Weaknesses Timeline



Source: The DoD OIG.

Each of these categories is discussed in more detail in Report No. DODIG-2023-070, “Understanding the Results of the Audit of the FY 2022 DoD Financial Statements,” issued on May 6, 2023. This report—which we issue annually—summarizes, in terms understandable to

non-auditors, the findings of the DoD's financial statement audits, the progress made by the DoD, and the additional actions the DoD should take to address the overall findings of the audit. In this year's report, we focused on these scope-limiting material weaknesses, and the challenges the DoD faces in addressing them on its journey toward a clean audit opinion and the fiscal accountability reflected thereby.

While some material weaknesses are financial in nature, such as unsupported accounting adjustments, many others also affect DoD operations. For example, Government property in the possession of contractors is a financial issue, but also tied to readiness and supply chain management. In fact, many DoD operational systems are the primary source for information reported on its financial statements. As a result, it is important to note that good financial management is not just a financial management community responsibility. Rather, it is a whole-of-DoD effort that requires consistent attention from operators, CIOs, and the financial management community to get it right.

Intersection Between Financial Management Challenges and Operations

There is a clear intersection between information relied on for operational decisions and financial reporting. I will now highlight a few of these critical intersections. These are representative examples, not a complete list.

Information Technology Systems: Financial statement audits involve reviewing information technology systems. Many of the systems crucial to financial management and reporting are also used for operational purposes. For example, the Defense Property Accountability System is used by over 30 DoD entities to track property, and also provides financial data for multiple Component and the DoD Agency-Wide financial statements. Testing

during the financial statement audits of DoD information technology systems can identify vulnerabilities in those systems and result in recommendations to improve the DoD's cybersecurity. Without effective internal controls and proper cybersecurity, the systems that the DoD relies on to conduct military operations could be compromised, which could undermine DoD operations.

During the FY 2022 financial statement audit, auditors determined that the DoD lacked effective internal controls for its information systems, which limited the auditors' ability to rely on information obtained from the systems. These longstanding information technology challenges—which include weak access controls, insufficient interface controls, and lapses in segregation of duties—continue to impair the DoD's ability to provide reliable, timely, and useful financial information needed for decision making and financial reporting.

As deficiencies in information systems are identified, it is important that the DoD consider how the controls can be implemented across the DoD, on both financial and operational systems. While the DoD CIO has engaged in developing corrective actions for financial system deficiencies, we are still seeing Components developing unique solutions rather than focusing on DoD-wide corrective actions.

Inventory and Related Property: Inaccurate information in financial reporting of inventory can have significant consequences. For example, if a Military Service's inventory records are not accurate the Service may order parts that it does not need, wasting funds. Conversely, if the Service inventory inaccurately shows sufficient spare parts for an aircraft the Service may not order needed spare parts, resulting in the inability to repair aircraft rapidly, which can degrade operational readiness.

During the FY 2022 financial statement audit, we determined that the DoD was unable to substantiate the existence and completeness of inventory reported on the financial statements or did not properly account for or value its inventory. This, too, is not a new issue. The DoD OIG has been reporting issues related to inventory accountability in the financial statements for over 20 years. For example, in a 1996 DoD OIG report, we found that the physical count of Defense Mapping Agency inventory differed from the quantities in its accountable records, unit costs of Defense Mapping Agency products were incorrect and lacked supporting documentation, and inventory on hand exceeded inventory use history.³ In a more recent example, we found that DoD personnel did not have the required records for thousands of defense items that they received and transferred at Jasionka, Poland, as part of the security assistance provided to Ukraine.⁴ Specifically, we observed that DoD personnel did not fully implement standard operating procedures to account for defense items and could not confirm the quantities of defense items received against the quantity of items shipped for three of five shipments reviewed. In both examples, there was a breakdown in operational procedures that led to the lack of accountability for DoD inventory.

Government Property in the Possession of Contractors: As of FY 2022, multiple Components across the DoD did not have processes and internal controls in place to track and report Government property in the possession of contractors. In some cases, the contracts did not require the contractor to provide the DoD with inventory reports. Similar to inventory, inaccurate information in financial reporting of Government property in the possession of contractors can have significant operational consequences.

³ Report No. 96-088, "Inventory at Defense Mapping Agency," March 26, 1996.

⁴ DODIG-2023-084, "Evaluation of Accountability Controls for Defense Items Transferred Via Air to Ukraine within the U.S. European Command Area of Responsibility," June 8, 2023.

During the Audit of Management of Government-Owned Property Supporting the F-35 Program, we found that DoD officials did not account for and manage, as required, F-35 Program Government property in the possession of contractors. Rather the DoD relied on the contractor and its subcontractor, which valued the 3.45 million pieces of property at \$2.1 billion. This occurred because F-35 Program officials did not maintain a record of government-furnished property, include a complete list of government-furnished property in the contract, or coordinate with the Defense Contract Management Agency (DCMA) to contractually transition contractor-acquired property to government-furnished property.⁵

In 2019, financial statement auditors found that neither the Navy nor the Air Force recorded the assets held by a contractor-managed global spare parts pool for the Joint Strike Fighter program on their financial statements. Furthermore, the assets were not recorded in the DoD Agency-Wide financial statements. While the DoD recognizes the need to improve its tracking of this information, as of FY 2022, the DoD was still not properly accounting for, managing, or recording Joint Strike Fighter (JSF) Program assets in a financial management system or reporting the assets on its financial statements.

To address process weaknesses and internal control deficiencies on both the financial and operational side, the DoD has implemented hundreds of corrective actions. While there is often a misunderstanding that financial management is only the responsibility of the financial management community, financial management and good financial stewardship is everyone's responsibility and must be built into operational business processes and internal controls.

⁵ DODIG-2019-062, "Audit of Management of Government-Owned Property Supporting the F-35 Program (DODIG-2019-062)," March 13, 2019.

Challenges Beyond Material Weaknesses

Financial management is more than business processes, internal controls, and financial reporting; it is also the day-to-day management of taxpayer resources and the consistency with which the DoD demonstrates its commitment to being a good steward. In the last year alone, we have reported on issues related to the tracking and reporting of supplemental funds, the difficulties obtaining fair and reasonable pricing, and accountability of equipment provided to the DoD through Presidential Drawdown Authority. The DoD OIG has also issued several reports related to tracking and reporting on supplemental funds provided to the DoD for purposes such as the COVID-19 pandemic, Afghanistan, and Ukraine.

Historically, we have noted significant issues with the tracking and reporting of supplemental funds. The DoD OIG has issued two management advisories that identified several areas of concern that directly impact the DoD's ability to transparently track and report the supplemental appropriations for Ukraine. Findings included that the systems used did not feed directly into Advana, the official reporting system for Ukraine supplemental appropriations, and the DoD lacked standard operating procedures for reporting the information. The OUSD(C)/CFO has continued to implement and improve procedures for reporting on the execution of the \$20.1 billion in funds appropriated to the DoD to provide assistance to Ukraine.⁶ Continuing its efforts to improve its tracking of supplemental funds should increase the traceability, transparency, and reporting of Ukraine supplemental funds execution.

Another challenge the DoD faces is evaluating prices to ensure the final agreed-to price is fair and reasonable, referred to as price reasonableness. In the last 5 years, the DoD OIG has

⁶ DODIG-2022-133, "Management Advisory: The DoD's Use of Additional Ukraine Supplemental Appropriations Act, 2022 Funds," Sept. 19, 2022.

issued 10 reports that addressed price reasonableness and the DoD OIG’s Defense Criminal Investigative Service has completed 46 investigations related to defective pricing. Table 1 shows the 10 audit reports that addressed price reasonableness and identifies whether the DoD obtained a fair and reasonable price along with challenges related to obtaining reasonable prices.

Table 1. Audit Reports and Challenges to Price Reasonableness Determination

| Report Number | Obtained a Fair and Reasonable Price | Challenges to Price Reasonableness Determination | | | |
|----------------|--------------------------------------|--|--|---|--|
| | | Sole-Source Environment ¹ | Statutory Limitations on Obtaining Cost/Price Data | Inadequate Internal Controls Over Pricing | Contract Requirements Are Not Well Defined |
| DODIG-2018-108 | No | | | X | |
| DODIG-2019-060 | No | X | X | | |
| DODIG-2019-112 | No | | | X | |
| DODIG-2020-060 | No | | | X | X |
| DODIG-2020-095 | Undetermined ² | X | X | | |
| DODIG-2021-045 | Yes ³ | | | | |
| DODIG-2021-053 | Undetermined ² | X | X | X | |
| DODIG-2022-043 | No | X | X | | |
| DODIG-2022-104 | Undetermined ² | X | X | | X |
| DODIG-2023-006 | No | | | X | |

¹ Sole-source refers to an agency purchasing supplies or services after soliciting and negotiating with only one source.

² We did not make an overall determination as to whether the price obtained was fair and reasonable.

³ We determined that the DoD obtained fair and reasonable prices on 19 of the 23 contracts that we reviewed. We also determined that the DoD did not obtain fair and reasonable prices on four contracts; however, this was a result of supply shortages during the COVID-19 pandemic.

Source: The DoD OIG.

Within these 10 audit reports, the DoD OIG made 66 recommendations related to price reasonableness, of which 17 remained open as of June 9, 2023. These recommendations reached beyond the financial management community, further demonstrating that financial management and good financial stewardship is everyone’s responsibility.

More recently, during press statements made on May 18, 2023, and again on June 20, 2023, regarding the valuation of equipment provided to Ukraine under Presidential Drawdown

Authority, the DoD Deputy Press Secretary reported, “During our regular oversight process of presidential drawdown packages, the Department discovered inconsistencies in equipment valuation for Ukraine. In some cases, ‘replacement cost’ rather than ‘net book value’ was used, therefore overestimating the value of the equipment drawn down from U.S. stocks.” Various media outlets referred to the valuation change as a \$6.2 billion “accounting error.” Reports such as these can contribute to the public and Congress’s lack of confidence in the DoD’s ability to adequately manage the funds entrusted to it.

While we are fully committed to independently and fairly auditing the DoD’s financial statements, we also have a number of performance audits ongoing and planned that will address financial management challenges discussed in this testimony. For example, as a supplement to the financial statement work, we announced the Audit of the DoD Plans to Address Long-Standing Issues with Outdated Financial Management Systems (Project No. D2023-D000FV-0087.000), Audit of Financial Improvement and Audit Readiness (FIAR) Contracts for DoD Components and Agencies (Project No. D2022-D000FS-0137.000), Review of the DoD’s Use of Statement on Standards for Attestation Engagements Number 18 (SSAE-18) (Project No. D2023-D000FI-0040.000), and are considering audits related to the accuracy of the information contained in and reported through Advana and the management, tracking, and reporting of Government property in the possession of contractors. Further, we have continued our efforts related to funding to assist Ukraine with the Audit of the DoD’s Execution of Funds to Assist Ukraine (Project No. D2023-D000FL-0046.000) and we plan to announce, in the near future, work related to the DoD’s revaluation of equipment provided to Ukraine under Presidential Drawdown Authority. We are also conducting an audit related to price reasonableness, Audit of

C-17 Spare Parts Pricing (Project No. D2022-D000AH-0142.000) and are preparing to announce a project on pricing of the Airborne Fire Control Radar Systems on the F/A-18 Hornet.

As I close today, I think it is important to remember that achieving a clean financial statement opinion on the DoD Agency-Wide financial statements is a long-term and continuous effort for the DoD. The DoD has made progress in many areas, especially those directly under the charge of the financial management community. However, overcoming the DoD's financial management challenges will require personnel across all functional areas within the DoD, to include acquisition, sustainment, security, readiness, information technology, and policy. The DoD must work together to integrate the policies, business practices, and systems of its vastly divergent Components. We believe it is imperative that the DoD focus on developing and implementing consistent and sustainable DoD-wide processes and internal controls, which will improve operational effectiveness and efficiencies and ultimately result in clean financial statements. As for the DoD OIG, we are committed to doing our part as well, by providing meaningful independent oversight of the DoD and being transparent with our findings and recommendations.