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DOD'S EFFORTS TO IMPROVE PAYMENT AND FUNDS CONTROL

HEARING

BEFORE THE

PANEL ON DEFENSE FINANCIAL MANAGEMENT AND AUDITABILITY REFORM

OF THE

COMMITTEE ON ARMED SERVICES
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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DOD'S EFFORTS TO IMPROVE PAYMENT AND FUNDS CONTROL

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
PANEL ON DEFENSE FINANCIAL MANAGEMENT AND AUDITABILITY REFORM,
Washington, DC, Thursday, September 22, 2011.

The panel met, pursuant to call, at 8:01 a.m. in room 2212, Rayburn House Office Building, Hon. K. Michael Conaway (chairman of the panel) presiding.

OPENING STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE FROM TEXAS, CHAIRMAN, PANEL ON DEFENSE FINANCIAL MANAGEMENT AND AUDITABILITY REFORM

Mr. CONAWAY. Call the meeting to order. Welcome to today's hearing on DOD's [Department of Defense] efforts to improve payment and funds control. Previous hearings have covered DOD's efforts to improve financial management, achieve audit readiness.

Improving financial management controls is critical to safeguarding taxpayer dollars and preventing waste, fraud, and abuse. Today we will examine the Department's efforts to address improper payments, Antideficiency Act violations, and other types of disbursements that increase the risk of fraudulent or erroneous payments and impact the ability to report reliable information on our financial statements.

Billions of taxpayer dollars are wasted each year when the Federal Government makes payments in incorrect amounts to the wrong entities and to entities that are not eligible to receive those payments. In fiscal year 2010, the Federal agencies reported an estimated $125 billion in improper payments, of which a billion was reported by Department of Defense. Under any other circumstance, a billion would be considered a staggering amount. Yet both the DOD Office of Inspector General and GAO [Government Accountability Office] have reported that DOD may not be reporting or capturing the full extent of its improper payments.

Properly identifying and reporting the amount of the improper payments is a critical step on the way to developing actions needed to prevent and recover these payments. The Antideficiency Act prohibits executive agencies from incurring obligations or making expenditures that exceed their appropriations. That is one of the major laws—major ways in which Congress exercises its constitutional control of the purse.

In September 2008, GAO reported that as a result of continuing financial management weaknesses, including difficulties in ensur-

ing the proper authorization, processing and recording of payments, DOD's ability to timely and reliably determine the amounts of funds that it has available to spend is impaired, and the Department remains at risk of overobligating and overspending its appropriations in violations of the Antideficiency Act. In fact, according to DOD—sorry, GAO, DOD reported 64 ADA [Antideficiency Act] violations from fiscal year 2007 through mid-September 2011, totaling about $927 million.

DOD has taken actions to improve its financial management system, yet as illustrated by the examples—certain examples, there is still much work to be done. With budget deficits in the trillions, the Government can ill afford to not properly account for all of our taxpayer resources because of poor management controls.

I want to thank our witnesses in advance for their testimony. We have today Mark Easton, Deputy Chief Financial Officer for the Department of Defense; we have got Daniel Blair, Deputy Inspector General for auditing, Department of Defense; and Asif Khan, Director of Financial Management and Assurance from GAO.

Now I will turn to Rob Andrews for any comments he wants to make.

[The prepared statement of Mr. Conaway can be found in the Appendix on page 27.]

STATEMENT OF HON. ROBERT ANDREWS, A REPRESENTATIVE FROM NEW JERSEY, RANKING MEMBER, PANEL ON DEFENSE FINANCIAL MANAGEMENT AND AUDITABILITY REFORM

Mr. ANDREWS. Chairman, good morning. I would like to thank you and our colleagues for assembling a really first-rate panel.

We have heard from all three of these gentlemen in various iterations over the last couple years, and I look forward to this morning's testimony.

I think the chairman set the context exactly right for this discussion. If you exclude the OCO [Overseas Contingency Operations] accounts, the overseas accounts in Iraq and Afghanistan, and you look at real dollar defense budgets, the defense budget is 40 percent higher than it was in 2001 in real dollars. We have essentially the same end strength, the same number of ships, the same number of airplanes, which sort of begs the question, where is this money, and what have we gotten for it?

Now, I don't think there is a preordained right answer to what the level should be. Actually, the best answer I have ever heard was given by then-Marine Commandant General Krulak a few years ago before the committee when someone asked him what he would do with the last dollar he had to spend. And he said, I would spend it on, after he or she has completed their mission successfully, bringing my last Marine home safely. Pretty good answer, I thought.

So, with that spirit in mind, in looking at this 40 percent real growth over time, we have a lot of important decisions to make. We can't make good decisions without accurate data. And we can't have accurate data without auditable financial statements.

The chairman talked about the alarming level of inappropriate payments. When I say "inappropriate," I don't mean necessarily

criminal or nefarious, but, you know, paying too much for the right thing or paying something for the wrong thing. And so I think we have assembled—I know we have assembled—three individuals that have great expertise in addressing this problem and pointing us in the right direction.

And Mr. Chairman, I am looking forward to hearing what they have to say and then engaging with our colleagues in some good questions to further edify the effort.

So, good morning, and I look forward to hearing what you have to say.

Mr. CONAWAY. Thanks, Rob.

One quick anecdote. I was on a trip last week out in the hither lands at a DOD facility. We finished the tour, and a couple of the guys who were leading the tour were walking, the three of us were walking off, and they were having a brief conversation. And I wasn't paying much attention, but the phrase "ERP" [Enterprise Resource Planning] came into their conversation. This is between those two. So I kind of stepped into it.

I said, what are you guys talking about? And they were talking about they were going to, over the next 3 or 4 weeks, they were going to have to put in an extensive amount of work to get converted to whatever the ERP thing they were working on.

I said, well, what do you think about that? They were very complimentary. They had no reason to know why I had a keen interest in it. They said, you know, it is going to be better on the other side. It will help us work our work better.

So, Mark, pass on to the rest of the squad, it is filtering all the way down to buy-in by folks who are actually having to, at the point end of that sword, to have to put it together. So I was very encouraged by their comments that they were sold out to the advantages of getting it done in their particular deal.

So, with that, Mark, you want to start us this morning?

STATEMENT OF MARK EASTON, DEPUTY CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF DEFENSE

Mr. EASTON. Thank you, sir.

Chairman Conaway, Ranking Member Andrews, members of the panel, thank you for your continued interest in DOD financial management and for providing me an opportunity to relate it to issues like improper payments, problem disbursements, and Antideficiency Act violations.

I submitted a more detailed statement for the record, but in the interest of time, I will summarize briefly so that we will have as much time as possible for questions.

As the deputy chief financial officer, my responsibilities at DOD involve financial policies, systems compliance, and internal controls, among a lot of other things. I have dealt with these kinds of things in various capacities in the field, both in uniform and as a civil servant and in the field particularly. So I appreciate your comments relative to getting the word out.

I am proud to be part of a financial management workforce that is supporting the warfighter around the world. But I am also mindful of our stewardship responsibility and the fact that DOD finan-

cial management has remained on the GAO high-risk list since 1995.

My experience tells me that a reasonable level of controls do exist within DOD, especially in the local control of assets and expenditure of funds. But my current position also provides me with a broader perspective that must acknowledge enterprise-wide weaknesses that negatively impact our financial management capabilities and demand an enterprise-wide response. The lack of auditable financial statements are clearly a symptom of those weaknesses.

As we have talked to you many times in this forum, DOD has a challenging business environment, a combination of size, complexity, and geographical dispersion. How well we manage within that environment depends on how well the people, processes, and systems that have to deal with that interact and work together.

People are really the key, particularly now. We have a dedicated and experienced workforce, and we rely heavily on those traits of dedication and technical expertise. We depend on them not only to support today's mission, which has been expanding over the last 10 years particularly, and to deal with today's problems, but also to be able to acquire new skills and to lead change throughout the enterprise.

Another key business element is processes. And this is an area that I think you are going to hear a lot of issues across the board. But the one thing that we do agree on is the need for increased and improved internal controls, more standard processes. That is the key to being able to produce higher quality financial information for both reporting and decisionmaking.

And the third factor, Mr. Chairman, is the one you mentioned about ERPs. Clearly, our size and complexity demands that we have automated, integrated systems. It is key to particularly being able for us to support auditability and sustain those changes. The bottom line is that a stronger business environment is really the key. It will reduce the likelihood of improper payments and problem disbursements that we have experienced and minimize the risk of ADA violations.

I would assert that we manage these three risk factors well, despite current weaknesses, but we have to do much, much better. Let me highlight each of these areas very briefly.

First, improper payments. The Defense Finance and Accounting Service—and you heard from Martha Smith last week—handles about 90 percent of all our payments. We use post-base statistical sampling on five of the six major programs that we have. And we plan to expand—and this is an area of contention—but we plan to expand that to our commercial payment area, post-payment statistical sampling, in addition to being able to act on issues that we receive in terms of notifications from vendors to be able to recapture those—capture those resources.

We use the processes to be able to identify root causes and act on those causes. As you mentioned, the Government-wide error rate with the $120 billion that are reported of improper payments, you know, we represent roughly half of that as a percentage, and about $1 billion. The elements that we are emphasizing through

auditability, and this is the linkage that I will keep am coming back to, strong internal controls will further reinforce this program.

Turning to problem disbursements, and to try to use a plain English analogy, we have thousands of people writing checks and thousands of individual accounts. One digit or one problem on any one of those transactions oftentimes doesn't prevent that payment from being disbursed, but it does prevent it from being able to return and being posted to your checking account. We put problem disbursement—essentially, that is what a problem disbursement is—we put problem disbursements into three categories: unmatched, which is a case that we have an obligation, and that disbursement cannot find its way back to that obligation, so we have an unmatched condition. The second is something we call a negative unliquidated obligation, which means it did find that original obligation, but the dollar value exceeded that. And then the third, you might refer to it as float in your own checking account, where you have written checks, we call that in-transits. Once those in-transits reach a particular age, they essentially fall into the categories of problem disbursements.

Across the board, we have made significant progress. For example, in 1999, overage problem disbursements since then have been reduced by 82 percent; negative unliquidated obligations have been reduced by 97 percent.

Antideficiency Act violations are another matter. They can occur for a number of reasons: a violation of purpose, time, or amount. We first strive to prevent the occurrences. And as you heard Secretary Hale say, the only right goal for Antideficiency Act violations is zero. But when they do occur, we need to track them, track the ongoing investigation, and make sure that we reach a conclusion and report promptly. Each ADA case is unique, but there are recurring themes. And frequently, they reveal a need to increase the level of training and awareness, because it is a very, very complex business environment.

Over the past 4 years, a total of 123 cases were identified through audits or through self-reporting, and we would like do more through self-reporting, having management assume that responsibility; 48 cases were investigated and found to be actual violations and were reported; 37 cases were investigated and found to be no violations; and 38 are currently under investigation as potential violations. It is important to note that it is not—once we begin an investigation, we may reach the conclusion that it is not a violation in the course of the investigation. We have been able to minimize, and the number of Antideficiency Act violations have been relatively stable despite a very, very porous business environment.

Our current emphasis on internal controls as part of our audit readiness program should contribute to timelier investigation—excuse me, timelier identification, that is really the key, and more efficient investigation of those cases. Secretary Hale has placed significant emphasis on ensuring that we are reporting in a more timely manner. We inherited approximately—we have reduced the number of overage cases—these are cases that are too old, past the 1 year time frame to investigate and report—we have reduced that number by 60 percent.

In summary, please be assured that my colleagues and I are fully committed to fulfilling our stewardship responsibility to the taxpayer. We recognize the benefits of a stronger and better controlled business environment. One that supports auditable financial statements will increase public confidence in our reporting and will reduce the incidents of improper payments and problem disbursements. Most importantly, they will provide better information for us to get more out of the program.

We are building a business environment, those people, processes, and systems, that will attack the causes, not just the symptoms. And finally, we are maintaining a strong working relationship with key stakeholders, to include my colleagues on the panel today, GAO and DOD IG [DOD Office of Inspector General]. Their feedback, while sometimes painful, is important to our overall efforts to strengthen financial management.

Mr. Chairman, this concludes my statement, and I sincerely appreciate the time that you and your distinguished panel have invested to better understand our challenges and support our efforts to address them.

[The prepared statement of Mr. Easton can be found in the Appendix on page 29.]

Mr. CONAWAY. Thanks, Mark. Daniel.

STATEMENT OF DANIEL BLAIR, DEPUTY INSPECTOR GENERAL FOR AUDITING, U.S. DEPARTMENT OF DEFENSE

Mr. BLAIR. Chairman Conaway, Ranking Member Andrews, and distinguished members of the panel, good morning, and thank you for the opportunity to appear here before you on behalf of the DOD IG to talk about improper payments, Antideficiency Act violations, and other problem disbursements.

In the current economic environment, it is important for DOD to know that every payment that it makes goes to the right person for the right amount and at the right time. Over the past few years, the Department has worked hard to address its financial management challenges and has recognized some of the impediments that need to be resolved. However, more progress needs to be made in order to be good stewards of the taxpayers' money.

Since fiscal year 2007, DOD IG has issued 27 audit reports addressing improper payments. These payments are often the result of unreliable data and poor internal controls, and they create an environment where fraud and waste are more likely.

In fiscal year 2010, the Department reported nearly $1 billion of estimated improper payments. However, we found the Department's process did not review more than half of the fiscal year 2010 gross outlays and therefore question the reliability of this estimate.

Without strong internal controls, the Department is at risk of making improper payments. For example, our audit of a contract supporting Broad Area Maritime Surveillance found that DOD personnel did not validate that a contractor was entitled to receive over $329 million because none of the invoices were reviewed. We also found that the Navy paid this contractor $206,000 for questionable travel expenses, such as a golf outing and air shows in Paris and Singapore.

We have concerns about the large number of potential Antideficiency Act, or ADA, violations that are averted because we identify them during the course of our audit, and the Department takes appropriate corrective actions to remedy these situations. Since 2005, we have issued 49 reports that have identified over 900 potential ADA violations, valued at over $2.3 billion, which the Department needed to investigate and resolve.

We found that the Department often sends money to other Federal agencies to fulfill contracting needs. And this money may be used beyond the time and purpose limitations of the appropriation. A joint audit that we did with the State Department IG recently on the Afghan National Police Training efforts identified almost $75 million in potential ADA violations. Using Defense Department funds, the State Department re-obligated funds outside the scope of the reimbursable agreement and moved expired funds to cover new requirements.

Fund Balance with Treasury reconciliations are a basic control to ensure that all disbursements are properly accounted for, and they help to identify problem disbursements. As you know, generally Fund Balance with Treasury is similar to a checking account that needs to be reconciled on a regular basis. However, the Department oftentimes struggles to consistently reconcile these accounts, which last year totaled over $521 billion.

Currently, 54 other defense organizations share a commingled Fund Balance with Treasury account and must rely primarily on balances in the Cash Management Report when reconciling to the U.S. Treasury. However, we recently found that the cumulative balances on the Cash Management Report were over $9 billion different than amounts reported by the U.S. Treasury and included $1.45 billion in unmatched transactions.

During fiscal year 2010, the Marine Corps' financial statement audit of its Budgetary Resources, Statement of Budgetary Resources, the Marine Corps was unable to support its Fund Balance with Treasury reconciliations. However, starting in June of this year, the Marine Corps has been able to provide detailed transaction files supporting its reconciliation process. So there is an obvious note of improvement that has taken place since the last year's audit.

Before closing, I also want to briefly mention three key challenges that must be addressed before the Department's financial statements become auditable by the 2017 deadline. These three areas are improving data reliability, improving internal controls, and effectively implementing new systems. These challenges must be resolved before this ambitious plan can become a reality.

We frequently identify financial data that is incomplete and inaccurate. And as a result, DOD decisionmakers and other leaders cannot rely on this data to make sound business decisions. The Department also faces pervasive internal control weaknesses that hamper its financial management efforts. While DOD's new systems are a key component of its auditability strategy, unless the Department first improves the quality of the data and reengineers its processes, many of the intended benefits of these systems will not be realized.

In closing, sound financial management is critical to providing effective stewardship over billions of dollars the Defense Department receives annually. While I recognize that there is significant effort that the DOD leadership is putting in at this point to resolve financial management problems, frankly, much more remains to be done. Senior leadership in the Department and other stakeholders, including Congress, need reliable financial information on a daily basis to ensure that every dollar supports the warfighter and improves military readiness.

This concludes my statement, and I would be happy to answer any questions that you may have.

[The prepared statement of Mr. Blair can be found in the Appendix on page 40.]

Mr. CONAWAY. Thank you, Daniel.

Asif.

STATEMENT OF ASIF A. KHAN, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. KHAN. Mr. Chairman, Ranking Member Andrews, and members of the panel, good morning.

It is my pleasure to be here today to provide our perspectives on the status of Department of Defense funds control and payment controls.

As a steward of public resources, DOD is responsible and accountable for using public funds for the purposes and within the timeframes and amounts prescribed by law, making payments to the right parties in the correct amount, identifying and recouping any improper payments, and accurately recording and reporting on its transactions on the use of public funds.

I would like to thank the panel for holding this important hearing. Having assurance that these basic controls and processes are working correctly is a fundamental prerequisite for overall financial reliability and reporting. In my testimony today, I will discuss the weaknesses in DOD's funds control and payment controls and their impact on the reliability of DOD financial information. I will also discuss the Department's efforts to estimate its improper payments. My statement today is based primarily on our prior work. In addition, it includes relevant information from reports issued by the DOD Inspector General.

First, regarding funds control, for years GAO has reported pervasive weaknesses in DOD's controls over its funds and the reliability of its financial reporting. For example, in 2008, like you had mentioned, Mr. Conaway, we had reported that DOD's complex and inefficient payment processes, unintegrated business systems, and weak internal controls impaired its ability to maintain proper funds controls, putting DOD at risk of overobligating or overspending its appropriations. These conditions have hindered its ability to ensure that transactions are accurately recorded, sufficiently supported, properly executed, and effectively monitored. In other words, at any given time, DOD does not have sufficient reliable information available to provide assurance that its obligations and disbursements are within budget and legal limits.

Funds control weaknesses place DOD at risk of violating the Antideficiency Act, enacted to prevent agencies from incurring obligations or making expenditures in excess or in advance of appropriations. The ADA requires DOD to report on its ADA violations. For the 5-year time period from fiscal year 2007 through September 15, 2011, DOD reported 64 ADA violations, with a total dollar amount of just over $927 million. However, DOD's reporting of ADA violations may not be complete as a result of other pervasive internal control weaknesses.

In addition, DOD has a category of disbursement it refers to as problem disbursements. They include disbursements paid that have not been matched to their related obligation records as a result of breakdowns in both fund control and payment controls. DOD has been reporting hundreds and millions of dollars in unmatched disbursements over 120 days old in recent fiscal years.

Problem disbursements increase the risk of making fraudulent or erroneous payments without detection. In addition, problem disbursements impair the reliability of DOD financial statements and DOD's ability to control its disbursements, a key aspect of funds control.

These and other weaknesses over financial reporting have prevented the military services, and DOD overall, from preparing a reliable Statement of Budgetary Resources, the SBR, since they were first required in 1998. For instance, like Mr. Blair mentioned, the Marine Corps received a disclaimer of opinion on its fiscal year 2010 SBR due to serious control weaknesses. Also, funds control and other weaknesses are currently hindering Navy's audit readiness related to its Funds Balance with Treasury. Controls over Fund Balance with Treasury are similar to reconciling a checkbook with a bank statement and a key step in preparing the SBR.

Finally, regarding improper payments, DOD reported for fiscal year 2010 that it made an estimated $1 billion in improper payments. However, these estimates do not include amounts from its commercial payment programs, which account for approximately one-third of the value of DOD payments. Our prior work and reports issued by the DOD IG have highlighted the Department's longstanding and significant problems with estimating and preventing improper payments.

Specific weaknesses in DOD's payment controls include inadequate payment processing, inadequate support documentation for expenditures, financial systems deficiencies, and also weak contract audit and payment controls. We have also reported on weaknesses in DOD processes for assessing the risk of improper payments and in reporting estimated amounts of improper payments.

In closing, Mr. Chairman, DOD continues to face difficult challenges. If DOD is to achieve its stated goal of audit readiness for its consolidated financial statement by the end of fiscal year 2017, it is critical for the Department to closely monitor its progress. It is also critically important for DOD to focus on the basics, such as correctly recording obligations, performing key reconciliations, and making accurate payments.

Mr. Chairman, Ranking Member Andrews, and members of this panel, this concludes my prepared statement. I would be happy to answer any questions that you may have at this time. Thank you.

[The prepared statement of Mr. Khan can be found in the Appendix on page 61.]

Mr. CONAWAY. All right.

Thank you, gentlemen.

We are going to reverse order on our side.

Todd for 5 minutes.

Mr. YOUNG. Thank you, Mr. Chairman.

Thank you to all of our witnesses for your service and appearance here this morning. I wanted to direct my line of inquiry to ERP implementation, something all of you touched on at various levels of detail.

DOD we know is investing billions of dollars in modernizing these business systems. And there have been some challenges, understandably at some level in terms of implementing these systems in a timely fashion and within budget. It was Mr. Blair, I believe, in his testimony, who said that DOD has been unable to meet key milestones for 4 of the 11 ERP systems in the Department.

So I am curious what impact you project that any continued slippages will have in terms of the Department's efforts to improve its funds control and payment processes, firstly. And then, secondarily, what, if anything, is being done and can be done to mitigate those slippages in your interface with the vendors or internally?

Mr. BLAIR. One of the things that is important to note is how critical the ERP systems are to the Department's fund balance—or not just fund balance, but to auditability of all of its statement. And as you noted, some of them have slipped. And I think that because it is such an integral part of the auditability efforts, this slippage is of serious concern. It could have a profound impact upon whether or not the Department is able to meet its auditability goal.

What we have done at the IG is to increase the number of audits that we are doing of these systems, because what we are starting to see is that there are some consistent themes in LMP [Logistics Modernization Program], for example, or GFEBS [General Fund Enterprise Business System], where some of the same problems exist in those systems, where they are not compliant with the standard general ledger, for example. And we are making recommendations to the Department to fix these, but also to look at how they are implementing other ERPs so they can take the lessons learned from one and apply it to all, as appropriate.

Mr. YOUNG. Thank you.

Mr. Easton.

Mr. EASTON. We appreciate the question. I think that with I would say most the of the ERPs—we have still got a couple of ERPs from Air Force coming along—but most of the ERPs we are beginning to more effectively apply lessons learned. And I would look for some of the slippages in schedule to be mitigated, if only for the fact that we are very close to the end of the program in many regards. We are directly linking those things to audit readiness.

I would venture to say that some of our previous experience and some of the cause is the fact that we had the acquisition program delivering a system without the business community fully engaged and being able to link the kinds of things that we talked about. So I think that we have done a much better job of being able to say,

you know, these are the problems that we are trying to solve relative to problem disbursements.

Having said that, we are putting these ERPs into an environment that is sort of flawed. And so the interfaces that exist now, hopefully many of them will go away, we will begin to improve that process as well. So bottom line is that we are getting better, but it is a critical enabler.

Mr. YOUNG. You share that assessment, Mr. Khan?

Mr. KHAN. Mr. Young, I just want to mention two things as far as the ERP slippage is concerned. The impact is going to be more cost, obviously, because there are cost overruns. And it is going to require more money in terms of using legacy systems. And the impact of using legacy systems on a go-forward basis is going to be on improper payments and ADA violations, because the underlying cause is weak controls. If we continue forward with the legacy systems, it is going to perpetuate the weak controls, causing more improper payments or continuing to have them and also ADA violations as the status quo.

Mr. YOUNG. So to take that to the next level, you say if we continue on with the legacy systems, it would require additional appropriations by Congress, additional investments to move past some of those systems, right? Otherwise we can experience additional data exchange challenges and corrupt data and what not, right? So we are just going to have to weigh that trade-off.

Mr. KHAN. I mean, that is a correct consequence that you have laid out.

Mr. YOUNG. Okay.

Mr. KHAN. It is going to cost more to maintain the legacy systems, certainly, and operate them. And at the same time, additional money is going to be spent on developing the ERPs.

Mr. YOUNG. Thank you all.

I yield back.

Mr. CONAWAY. Thanks, Todd.

Rob, 5 minutes, or Joe.

Mr. ANDREWS. Recognize Mr. Courtney.

Mr. CONAWAY. In spite of rewarding bad behavior, we will go with Joe Courtney.

Mr. COURTNEY. Thank you, Mr. Chairman.

Over the weekend, I was at an Indian event, the Mohegan Indian event, where they gave me a new name. It was Two Iron Fish instead of Two Subs, which Mr. Conaway would appreciate that. Mr. Blair, your testimony you talked about the 27 audits that have taken place since 2007. What triggers those? Is that just sort of random, or is it whistleblower complaints, or is it a regular process? I mean, what—maybe you could just help me with that.

Mr. BLAIR. Our audits start from a wide variety of sources. Some of them are whistleblowers. Some are as a result of our annual planning efforts. Some of them are as of a result of outreach to the Department, and we ask them, what are your areas of concern? So we put that all together; we do our annual audit plan. And so that is how we come up with the wide variety of the audits that we do.

Mr. COURTNEY. So if we fast-forward to 2017 and we get to a place where it is auditable systems, what does that mean for your

office? Does that allow you to be less random in terms of trying to find where the problems are?

Mr. BLAIR. There is no doubt that when we get to the 2017 date that we are going to have to approach this with a large number of our resources. And it will reduce the number of audits that we can do in other areas. I do have a fairly large number of staff who are financial statement auditors. And they will be the ones that will be leading the 2017 effort. But it will impact some of the other work that we have been able to do. But what I am hoping is that as we go forward over the next several years, there will be more and more corrections that will be made, less audits are needed in those other areas, so that we will be able focus those resources appropriately on this effort.

Mr. COURTNEY. So when you, on page three of your testimony, talked about we found the Department's review process included less than half of fiscal 2010's first quarter gross outlays, I mean, help me. I read that as saying that basically we don't know about where the other half is in terms of accuracy as far as payments. And will that change once we get to 2017, assuming, you know, we hit that date?

Mr. BLAIR. Mr. Easton and I were talking about that before we started this morning. And one of the things that we agree on is the need to expand the methodology that they are using to identify improper payments and to go into those other gross outlays in subsequent years that they didn't look at in fiscal year 2010. And the more you look, the more you are going to find. The more you find, the more corrections that can be made to prevent that going forward. So I think that is the ultimate goal.

Mr. COURTNEY. Go ahead, Mr. Easton.

Mr. EASTON. Can I follow up? On that particular issue, I guess going back to your broad question in 2017, I would like to see an environment where management assumes responsibility for those internal controls. I would like to be able to go to Dan and say, you know, you are going to have to put your resources in a financial audit. That will mean because we have recognized and acknowledged and implemented controls so that you don't have to make these specific kind of things. On that particular issue of improper payments, and this was an issue that, quite frankly, we did not agree with the segment of outlays that was in the testimony were intergovernmental outlays, essentially, and some in the intelligence community that were not included, and we did not plan to include those. And so there was a difference of opinion there. There is much that we agree on, and that particular area that we did not agree.

But an audit will allow us to be able to combine the internal control perspective, the coverage perspective, so that we don't have these disagreements in the future.

Mr. COURTNEY. Thank you.

I yield back, Mr. Chairman.

Mr. CONAWAY. Thank you.

Scott.

Mr. RIGELL. Thank you, Mr. Chairman.

I appreciate the panel coming in this morning. Having been in the business for about 25 years, I have certainly been embarrassed

from time to time to learn that our business had overpaid a vendor twice. And I will even confess that in our campaign, in the blur of life, we also paid twice there on occasion. So when you look at the magnitude of the Department of Defense, it is not at all surprising that this is a challenge.

Having said that, the testimony this morning, and particularly, Mr. Blair, for some reason, I just focused in on what you both said and what you have written in your testimony. There is a part of me that gets extremely frustrated as a fellow American to hear this. And the business side of me says, hey, what a great opportunity to make things better. There is no shortage of places to look.

I share your view that we have severely, in some cases, understated the amount of overpayment. And at some point, if you could, I don't want to spend too much time on this, but if you could help us quantify that, what your view is; what, you know, if it is not a billion in the DOD, what is it? It is certainly higher.

One thing that seems to be absent in the reports that we are hearing this morning is tying in accountability. This is going to be a common theme that I am going to bring pretty much each and every session. When we read about these overpayments—and I am not looking for a scapegoat. I am not looking to just fire someone to fire someone, but there does seem to be a lack of accountability of the personnel. And we need to say, is it that the process has not been clearly communicated? Have we not trained our people well? Or, if we have done all of that and we just have some people who are not performing well, have we held them accountable?

There is a sense, and you know this just as a fellow American here, that our Government is not holding people accountable. We want to promote the people who are doing well, reward them, have more of an entrepreneurial approach in Government and also work with and, if necessary, fire someone who is not performing well.

So, Mr. Blair, if you could comment, please, on, what are the barriers to better performance? Is it the resources that we are not funding our auditors enough? Because it seems to me you would get a good marginal return on allocating more money to this, certainly with the numbers that I have seen. And then please comment on the accountability part, both for our personnel and for the vendors who—some who deliberately are stealing from the American taxpayer.

Mr. BLAIR. With regard to resources, I mean, I think that certainly the DOD IG has sufficient resources to fulfill the audit mission that we have. There is no lack of opportunities for us to audit. Because we always end up at the end of every year with more audits than we have staff for, so we have to roll some options forward and do them in subsequent years.

I think the Department is dedicating a lot of resources to improving financial management. And I think it is important to note that. To make real sustainable progress in financial management, I think more resources may have to be dedicated to that in the future. And that is a question that the senior leadership in the Department are going to have to wrestle with; how much can they afford to put in this area versus other areas?

As with regard to accountability, I agree with some of the statements that you have made. It is very difficult to hold people ac-

countable in the Federal Government. We oftentimes find that when we get in and do our audits and we zero in on the office or the person that was responsible, we have found that they left. They have retired. They have gone to another job. But what we are doing is making a more concerted effort, starting in this fiscal year, in our audit reports to include recommendations that the Department review the actions of specific individuals and take appropriate action, as necessary, to hold people accountable.

Mr. RIGELL. Thank you, Mr. Blair.

And so you said we have the resources, but it is because maybe the person has moved on. And I think we should work together to help identify maybe the systemic challenges, the whole process.

And one thing that is somewhat unique to the military is, you know, every time I meet a senior officer, for example, I say, well, how long are you going to be here in Hampton Roads? Well, 2 years, 2 years. And I have known that every time—you know, let's say you hire somebody to fix the Department, the first thing they say is, well, boy, what I inherited was really, really, but I will fix it for you. And then they move on.

So I wonder if we should consider for these positions keeping them in the job 6 years and 8 years, and to build a base to where they could be held accountable in the most positive sense of the word.

And I would like to circle back around—we will do this off line, my time is running out here—but I would really like to know the names of some of these companies who have just had these egregious examples of overcharging. Because if you really circle back around, every dollar that is spent for a golf outing in Paris and France and Singapore, I am sure there is a young lance corporal in Helmand Province that could use a little more support. So we need to go after these guys and hold them accountable. And if they steal from us, put them in jail. And conversely, the people who are doing a good job, we promote them. And I just want to build more of that culture in our Government.

I yield back. Thank you, Mr. Chairman.

Mr. CONAWAY. Thanks, Scott.

Rob.

Mr. ANDREWS. Thank all the witnesses.

Mr. Khan, I want to get into your description of the violation in June 2010 involving the Army's overobligation of fiscal year 2008 MPA [Military Personnel, Army] Army appropriation, which Mr. Conaway and I and others have written a letter about to try to get some more information. Now, I know that we don't have the facts yet on this, so I am not asking you to draw a conclusion. But I am asking you to generate some hypotheses as to how this might happen based upon your experience. My understanding is what happens here is that it is discovered, you eventually discover that there is a $200 million transfer by the DOD from the Working Capital Fund to the Army MPA fund. Is that what happens?

Mr. KHAN. That is correct.

Mr. ANDREWS. And then you say, well, gee, why did this transfer happen? Essentially, the answer is, well, because we overobligated the MPA fund by $200 million. Right? Is something wrong with that? Is that what happens?

Mr. EASTON. That is in process. I think that there was using their transfer authority to transfer money. At the time, I think the Army's perspective was that they knew that they needed that money. They had not already overobligated. That is their perspective, but that is under investigation right now.

Mr. ANDREWS. Okay. So it is not established that they overobligated the $200 million?

Mr. EASTON. It is being investigated right now.

Mr. ANDREWS. Let me just say this. Assuming that it were, that it was the case, and it may not be, but assuming it was the case, what hypotheses could you generate, Mr. Khan, as to why that happened?

Mr. KHAN. I think it has been established that it was overobligated.

Mr. ANDREWS. Whether it has or hasn't, if it were true——

Mr. KHAN. Right.

Mr. ANDREWS [continuing]. Typically, what might the reasons be that something like that would happen?

Mr. KHAN. I mean, pure and simple, there was a lack of communication between the Army budget office and the program office. The Army budget office was using estimates or what is known as bulk obligations on a different set of projections than what was actually taking place in the field.

This is going back to 2008, when there was an uptick in recruitment, fuel costs were going up. However, the budget estimates that the Army budget office was using was still using old numbers. So, consequently, there was a mismatch——

Mr. ANDREWS. So they are assuming that they can hire people and move them around in vehicles at a cost that is actually too low.

Mr. KHAN. That is correct.

Mr. ANDREWS. So they hire too many people and they drive too many miles, and they overexpend the account by $200 million.

Mr. KHAN. And it was specifically related to permanent change of stations, PCS [permanent change of station] moves, where they are moving people around the country. And there was an uptick in that also.

Mr. ANDREWS. Now, this is not a rhetorical question, but how does that happen? I mean, and I think it goes to Mr. Rigell's question that somebody was figuring this out assuming, you know, $2 gasoline instead of $4 gasoline. Who did that, and how did it happen? Do we know?

Mr. KHAN. It is a flaw in the estimation process. And really underlying that is a lack of connection, lack of a good process which connects where the estimates are being created and where the actual expenses are taking place.

Mr. ANDREWS. But in plain English, doesn't somebody say, gee, you estimated someone is going to drive—fill their tank with 20 gallons last week, and you estimated it was going to cost $40, and it cost $80. I mean, doesn't somebody somewhere along the way figure that out and say, I wonder if all these projections are therefore flawed? How can you make $200 million worth of that mistake? Anybody want to take a whack at that one? That is a rhetorical question.

Mr. EASTON. There is no good answer to that. I think someone should have known. Those accounts, number one, I think are basically viewed as an entitlement. In other words, we are supporting the mission. We are managing them centrally, and we are executing them decentrally without good connectivity. We have had MILPERS [Military Personnel], ADAs across the board——

Mr. ANDREWS. No one is questioning that when someone has a permanent change of station, that their family should be moved. It is an entitlement, absolutely. But that is not the issue. The issue is whomever is calculating the cost of the moving van, the other stuff that is going on, is wildly out of whack here. And I think it goes to the earlier question about accountability. I would ask that, consistent with the privacy obligations of the Department, with the chairman's consent, that you give us a blow-by-blow of what investigation took place, who was held accountable for that decision, and what happened to them, again consistent with your Privacy Act obligations. I think we would like to know that, just kind of see what happened here.

I yield back on that.

[The information referred to can be found in the Appendix on page 97.]

Mr. KHAN. Mr. Andrews, I just wanted to add one point that in DOD there are a lot of estimates. And estimates are not a bad thing as long as they are trued up. It is not a perfect system. It is like Chairman Conaway had mentioned; it is a large and complex organization with antiquated systems. So estimating——

Mr. ANDREWS. Let me ask just one quick follow-up, if I could, and I should know this answer. The $200 million is off a base of how large an account? How large is that account?

Mr. KHAN. It is around $43 million—I am sorry, $43 billion.

Mr. ANDREWS. Okay. So $4 billion is 10 percent of the account, and $400,000 is 1—$400 million is 1 percent of the account. So this is one half of 1 percent? That is a small number, but that is a pretty big number, one half of 1 percent. That is more than a rounding error. It is outside the standard deviation, I would think, for an account that size.

Mr. KHAN. It is material.

Mr. ANDREWS. Yeah, it is material. It is one half of 1 percent, but on a $43 billion account, that is pretty serious money. So I think we would like that kind of report, again consistent with your Privacy Act obligations.

Mr. CONAWAY. Thanks, Rob.

And we will reward bad behavior on our side.

Steven.

Mr. PALAZZO. Thank you, Mr. Chairman.

I appreciate you all coming out this morning. I think you all know this is an extremely difficult job, and an important issue that we are going to—it is pretty difficult to implement, but it is not impossible.

So we are here to keep putting the pressure on everybody to make sure it becomes a reality. I had some stock questions, but my colleagues brought up some points, so I am going to kind of deviate from them. I will submit those for the record or something.

When we are talking about ERP, I have never met an ERP that actually was on time, within budget, and to the owner's satisfaction. Can you kind of tell me, have you all had any success stories where we have had an IT [information technology] integration that actually worked? And who actually comes up with these timelines? I am sure it is probably a joint between the person, the consultant selling the service and this product and the owner that is wanting to purchase it. But why does it always seem that that is where our time slippage comes from? Is it just unrealistic expectations? Or is it just one of those things that you can just never grasp, and this is going to become a reality for all ERP implementations?

We will start with Mr. Easton.

Mr. EASTON. I think it is a combination of things. I think that we have typically unrealistic schedule estimates, overestimates when it comes to savings associated with those. We don't spend enough time up front in terms of really thinking through the changes in the business that we need to make prior to implementing. And so, as a result, I think that—and at the same time, we have a tendency not to want to stop. In other words, once we are going on the wrong direction, we should stop.

The one example that I would say has been in general more successful has been the DLA [Defense Logistics Agency] enterprise business system, in which case they did have to make several starts and stops, and they incremented on small scales. And I think in general that tended to be more successful. But your track record that you point out, I think, both within the Government as well as private sector, is accurate.

Mr. BLAIR. I would have to agree with much of what Mr. Easton said. The Department is the one who sets the milestone dates. And those dates are often driven by a lot of external factors. The 2017 date I think is putting a lot of pressure on the interim milestone dates, especially as it relates to the ERPs.

As we go through and audit the ERPs and we identify problems, we oftentimes make recommendations that the Department not further implement the system until the problems are addressed. To this point, I have not seen where the Department has weighed in on the side of caution. Rather, they more frequently push forward with implementation, with the idea that they are going to fix it later. And I am not aware of any success stories, as you asked earlier, about ERPs being done on time and within, you know, cost or schedule. I think this is a very consistent challenge that the Department has to address.

Mr. KHAN. Sir, like you pointed out, ERPs are a challenge to implement, even in a commercial environment. ERP software is very sensitive. It is very complicated. So it has to be done right.

There are three observations that we have, GAO has, as far as ERP implementations within the DOD environment. The first one is requirements. It is critical that the upfront, like Mr. Easton had mentioned, the upfront user requirements are correctly identified so that additional work, slippages, do not come about in terms of modifying the software once you begin to implement that. So that is critical.

The other one is, like I had mentioned before, that there are several legacy systems within DOD. They have got data which has to

be fed into the ERPs. Data conversion is a challenge. It is unwieldy. I mean, it has to be done somehow, but that is also a cause of slippages.

And the third one, which is linked to the antiquated systems, the legacy systems, is the interface, how the older systems, some of them, they can't be pulled away, like MOCAS [Mechanization of Contract Administration Services], at least in the near term. They have to interface with the ERPs. And that can really complicate matters.

Mr. PALAZZO. Kind of running out of time. Real quick, if there is a repeat offender, someone that is constantly overcharging the Government, what mechanism do we have in place, one—and real quick, and whoever is the resident expert can pick this—to actually seek reimbursement? And also, how do we debar Federal contractors from doing business with the Federal Government? That is a loaded question.

Mr. EASTON. This is a little bit beyond my area of expertise, but I think that that was what I was going to say. There are legal procedures that we can take relative to debarment. We can serve to be able to recover those and offset those costs to be able to get that money back, because frequently we are doing business multiple times with the same people. But we aggressively go after those folks and then use the contract administration folks to be able to take the legal action as appropriate. I defer.

Mr. PALAZZO. I am out of time, but thank you. I appreciate it.

Mr. CONAWAY. Thanks, Steven.

The Department reported in 2010 improper payments of about $1.069 billion. Half of that, though, was in personnel or military pay. Walk us through—there are certain areas, I guess, like commercial pay, which is not represented on that list of five, you would expect problems with. But you would think you would get the pay right. What is in that $500 million number?

Mr. EASTON. In general, I think that we do get the pay right the vast majority of the times. You know, many of those improper payments are in fact underpayments. You know, we get situations, particularly—there are two situations I would point out. In other words, we will report payments based on information that we don't have. Members have not provided us information, say if they get married, that they are entitled to basic housing allowance or a particular thing. If we don't have that information, there is a lag, in other words, until we get that information. So when we actually are able to catch up we pay that.

Mr. CONAWAY. Would that be considered an improper payment?

Mr. EASTON. Yes.

Mr. CONAWAY. Even though you are not—okay.

Mr. EASTON. Absolutely. And that is that we did not pay that on time. So we keep track of those things.

The other thing, from a military personnel perspective, sort of Reserve leave in terms of when reservists go on and off of Active Duty and their leave has to catch up. And that is recorded as an improper payment.

Mr. CONAWAY. Okay.

Mr. EASTON. We pay I would say 97 percent, you know, on time. But still, and Mr. Andrews raised a question, these are big dollars

that are reflected. But it is an ongoing relationship. We recover money quickly, and we catch up quickly if we underpay.

Mr. CONAWAY. I guess I would put those in two different categories. If a member hasn't reported something to you and you have got a back pay for something, I wouldn't put that in the improper payment category because you didn't know. Anyway, we can talk about that one.

Looking at the problem disbursements, I got a chart from April 2011 which shows for unmatched disbursements a total of $111 million, almost ununderstandable descriptor called negative unliquidated obligations. I have no clue what it means, but it is 10 million bucks. Zero for the Air Force by the way.

So, congratulations, Air Force, whoever is out there.

And anyway, and then aged in-transit float. When you say "aged," what is the date on that aging?

Mr. EASTON. Over 60 days.

Mr. CONAWAY. Over 60 days. Why is the Army so much bigger in their unmatched disbursements than everybody else?

Mr. EASTON. A primary driver right now is the implementation of their ERP GFEBS, the General Funds Enterprise Business System that they are implementing. That is driving a significant number of unmatched disbursements. And these are disbursements that are recorded. And if the Army were here, they would say that in some cases, they would disagree with the reporting number. We are in the process of trying to sort that out. That has been a longstanding, as I look back on the reports that have been made on improper payments, you know, it gets into some of the cataloguing issues as the driver.

Mr. CONAWAY. So how often do you pull that report?

Mr. EASTON. Every month.

Mr. CONAWAY. Every month?

Mr. EASTON. Every month.

Mr. CONAWAY. So, at some point, you would expect the Army to catch up and that number to drop when they get the GFEBS.

Mr. EASTON. Absolutely. And we put that in the FIAR [Financial Improvement and Audit Readiness] plan, because we want people to be tracking those. We want people to understand why we are making these changes, and not just systems changes but control changes towards auditability that should begin to reflect in those statistics.

Mr. CONAWAY. All right.

Mark, in your statement—let me see here—you are talking about Funds Balance with Treasury. You said that they are not recorded or were improperly recorded either at Treasury or in our general ledger. How would they get improperly recorded at Treasury?

Mr. EASTON. They would be—they should be recorded correctly at Treasury.

Mr. CONAWAY. Right.

Mr. EASTON. In other words, by the time that disbursement, you know, oftentimes does not get back and reconciled into the particular chart of accounts where the transaction was initiated. That is really the key. In other words, oftentimes the transactions will in fact be recorded at Treasury, but at an appropriation level, but

what we need do is record it into the individual account and chart of accounts.

Mr. CONAWAY. Help me understand. I guess I had assumed that Treasury was just your bank, and the bank didn't really care. As long as you had money in there, they would clear the transactions in and out. Is there a recording that goes on at Treasury within an appropriation category, or why is it that you are reconciling over there?

Mr. EASTON. In other words, we are reconciling; we are reconciling with Treasury. And Treasury has the transaction recorded in a vast majority of times. So I may have misspoke on that particular issue.

Mr. CONAWAY. That is fine. What happens at year end? We are on a cash basis, and we have got all these transactions out there that we are not sure about. How does that get reflected in the financial statements that we will soon be seeing November 15ish?

Mr. EASTON. The transactions are reflected and in some cases in an undistributed category. And so I think in the financial statements, and I can get back to you with specifics, they would offset receivables and payables. And I think that my fellow—I think that that would be how they would be recorded, but they would be disclosed.

[The information referred to can be found in the Appendix on page 97.]

Mr. CONAWAY. Okay.

Mr. EASTON. Those quantities would be disclosed in the footnotes.

Mr. CONAWAY. All right.

We will go a second round.

Rob, you have any questions?

Mr. ANDREWS. I really don't have a second round question, but just want to comment that—well, I guess I would ask each panelist to comment on this, that if you had to identify the greatest impediment toward zeroing out these improper payments, if we could only do one thing, what is the thing that you would have us do to zero out the improper payments?

What do you think, Mr. Easton?

Mr. EASTON. I think the internal control emphasis is really what we need. I mean, systems clearly creates a lot of the problems. And the issue of accountability that you raised, I think the environment makes it very, very difficult to specifically hold people accountable. But we need to do a better job of that as well. But internal controls and making sure that we get the people to focus on those controls.

Mr. ANDREWS. Mr. Blair, what do you think?

Mr. BLAIR. I agree with some of what Mr. Easton said, but I want to add a little more specificity to it. I think the internal controls are key. And there are some specific things that I think need to be done. More importantly, you need to do an in-depth analysis of all of the disbursements so you have a better idea of where your payments are going. But there has to be controls over all of the payments. Some of the things that I cited in my testimony, the examples, those are examples where there is oftentimes an inadequate or absent review process over the payments that are made, those contract invoices that are paid. And that is a specific control.

Mr. ANDREWS. Specifically referring to the commercial payment problem?

Mr. BLAIR. Yes, sir.

Mr. ANDREWS. Okay.

Mr. Khan, what do you think?

Mr. KHAN. I just want to say that two important elements, like I have mentioned in my oral statement, funds control and payments control. They have to be strengthened if you have to reach auditability.

And another point I just want to bring out that both funds control and payments control originate in nonfinancial areas. Typically, they originate in procurement. So it is critical in terms of, sir, accountability. I mean, responsibility has to be taken by other functions. It all ends up in financial management, where it has to be corrected. But procurement has to have the training to be able to——

Mr. ANDREWS. We don't want to create a shoot-the-messenger problem.

Mr. KHAN. Exactly.

Mr. ANDREWS. The financial people are actually doing their job reporting the problem. We want to get to the source of why the problem was created in the first place. I do understand that. Thank you very much.

Mr. CONAWAY. There was a bit of a disagreement between—on the commercial pay category for estimating improper payments.

Mr. Kahn, your team had a vision or view that was different than what the Department of Defense had. Did you all reconcile that? Are you comfortable now that those are being estimated, improper payments, that you used the right methodology?

Mr. KHAN. Yes. I mean, the commercial pay was not picked up for 2010. And based on what the comptroller, Mr. Hale, has recently said, commercial pays are going to be picked up for estimating improper pays.

Mr. EASTON. We are going to continue. The difference of opinion—and at the time—and there was a GAO report in 2008 or 2009, I believe. We were complying with the OMB [Office of Management and Budget] guidance at the time. Subsequent legislation up here made it very, very clear that we want you to do statistical sampling to be able to support those estimates. But I want to make sure that we are clear that there is a significant amount of prepayment checks that we do. In fact, we emphasize—this is why I wanted to emphasize the people aspect. I mean, we put a lot of people and a lot of eyes on it. But admittedly, much like everything, it is a team sport. And so it goes to the contracting officer, contract administration, contract audit. There is a lot of aspects to be able to do that. But that is the key issue, and I think we resolved it.

Mr. CONAWAY. Good.

Just one quick—Mark, you had mentioned that—the internal control would be owned by you in 2017. I would posit that the internal control is owned by management today.

Mr. EASTON. Absolutely.

Mr. CONAWAY. I wanted to make sure I understood that.

Mr. EASTON. I meant—I guess the key issue that I would have—and we have this discussion with my colleagues all the time. Too

often—and this gets into the people and the culture—you know, we have relied on the auditors to come in and tell us what the issues are. Sort of detective controls. You know, back in 1982, even going back to 1950 if I look at the GAO report, clearly management has to assume responsibility. So what I would want—and we had a recent case where we were talking about the improper payments, high dollar value that were reported, management should have done a more aggressive job, saying this is what—this is why we feel the way we feel, as opposed to waiting for the auditors to come in. It is a change in mindset and it is something that goes along—that management responsibility that is associated with the audit is something that we have got to change.

Mr. CONAWAY. Thank you.

Gentlemen, thank you for coming this morning. I want to thank our panel members as well. Anything—all right.

Mark, Daniel, Asif, any final comments?

All right. Thank you, boys.

We are adjourned.

[Whereupon, at 9:01 a.m., the subcommittee was adjourned.]

A P P E N D I X

SEPTEMBER 22, 2011

PREPARED STATEMENTS SUBMITTED FOR THE RECORD

SEPTEMBER 22, 2011

Opening Statement of Congressman Mike Conaway, Chairman, Defense Financial Management and Auditability Reform Panel

Hearing on
DOD's Efforts to Improve Payment and Funds Control

September 22, 2011

I'd like to welcome everyone to today's hearing on DOD's Efforts to Improve Payment and Funds Control. The previous hearings have covered DOD's efforts to improve financial management and achieve audit readiness. Improving financial management controls is critical to safeguarding taxpayer dollars and preventing waste, fraud, and abuse. Today, we will examine DOD's efforts to address improper payments, anti-deficiency act violations, and other types of disbursements that increase the risk of fraudulent or erroneous payments and impact the ability to report reliable information on the financial statements.

Billions of taxpayer dollars are wasted each year when the Federal Government makes payments in incorrect amounts, to the wrong entities, and to entities that are not eligible to receive the payments. In fiscal year 2010, federal agencies reported an estimated $125 billion in improper payments, of which, $1 billion was reported by DOD. Under any other circumstance, $1 billion would be considered a staggering amount. Yet, both the DOD Office of Inspector General and the GAO have reported that DOD may not be capturing the full extent of its improper payments. Properly identifying and reporting the amount of improper payments is a critical step on the way to developing the actions needed to prevent and recover these payments.

The Anti-deficiency Act prohibits executive agencies from incurring obligations or making expenditures that exceed their appropriations. This is one of the major laws in which Congress exercises its constitutional "control of the public purse". In September 2008, GAO reported that, "As a result of continuing financial management weaknesses, including difficulties in ensuring the proper authorization, processing, and recording of payments, DOD's ability to

timely and reliably determine the amount of funds that it has available to spend is impaired, and the department remains at risk of overobligating and overexpending its appropriations in violation of the [Anti-deficiency Act]." In fact, according to GAO, DOD reported 64 Anti-deficiency Act violations from fiscal year 2007 through mid-September 2011, totaling about $927 million.

DOD has taken actions to improve its financial management system, yet as illustrated by the examples above, there is still much work to be done. With budget deficits in the trillions of dollars, the government can ill afford to waste taxpayer resources because of poor financial management controls.

I would like to thank our witnesses in advance for their testimony and agreeing to be with us at such an early hour. We have with us today:

Mr. Mark E. Easton
Deputy Chief Financial Officer
Department of Defense

Mr. Daniel Blair
Deputy Inspector General for Auditing
Department of Defense

Mr. Asif A. Khan
Director, Financial Management and Assurance
Government Accountability Office

Let me now turn to Rob Andrews for any remarks he would like to make.

Statement of

Mark Easton
Deputy Chief Financial Officer
Department of Defense

before the

House Armed Services Committee

Defense Financial Management and
Auditability Reform Panel

September 22, 2011

Embargoed until released by the
House Armed Services Committee

Chairman Conaway, Ranking Member Andrews, Members of the Panel, thank you for your invitation to speak before you today on three specific subjects relating to Financial Management within the Department of Defense (DoD): Improper Payments, Problem Disbursements, and Anti-Deficiency Act (ADA) violations.

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 on 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 broader perspective that must recognize enterprise-wide weaknesses in DoD business processes that negatively impact our financial management capabilities. These weaknesses go well beyond the financial management 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

As part of the DoD Comptroller's Strategic Management Plan for Fiscal Years 2011 through 2017, the Department has three comprehensive strategic goals for financial management that covers our business from planning to execution including the quality of our workforce:

1. Acquire the resources necessary to meet national security objectives;
2. Ensure the legal, effective, and efficient use of those resources; and
3. Maintain a capable financial management workforce.

Each goal is equally important and mutually supporting. The outcome of any one goal impacts the success of the other two. I spend much of my time and energy on the second goal— working to develop an improved business infrastructure in order to strengthen financial management capability within the Department. Much like the nation's interstate highway system that supports the efficient movement of commerce, this business infrastructure carries the Department's transactional business across functional areas and through a myriad of systems and organizations. When working well, these transactions provide the audit trails that also support financial auditability. You've asked some specific questions about improper payments, problem disbursements, and ADA violations. Many of the root causes behind these areas reflect problems within our business infrastructure. To better understand some of the challenges associated with our business, I'd like to provide some basic context.

DoD Business is High-Volume, Complex, and Diverse

To say that we have a challenging business environment is an understatement. It is not merely our size; it is a combination of size, complexity, and the geographical dispersion of our numerous Components. The complexity is apparent in the large number of transactions and dollar values that flow through DoD processes each day. But the essence of our business today involves people, processes and systems and how effectively they can work together.

The people part of this equation represents both a strength and an opportunity for improvement. We have a dedicated, experienced workforce that is supporting key mission needs around the world; in fact, in the very decentralized non-standard way we often do business, we rely heavily on its dedication and technical experience. However, this business environment must change, and our workforce must help lead this change. The business environment must necessarily become more standard, better controlled and more automated. Our training must also be dynamic enough to continue to meet both this evolving business need and, more importantly, our increasingly demanding mission requirements. We have increased our training efforts to ensure that we equip our existing staff and future personnel with the right tools. Our goal is to train and sustain our strong financial management workforce through a centrally managed, course-based certification program.

Another key business element involves processes and internal controls. Our business processes must become better documented and better controlled. This goes hand-in-hand with system implementation, where a properly implemented, compliant system will enforce standards and facilitate many of these controls. But it also goes well beyond the systems. Processes must be documented along with operating procedures that are routinely followed. The level of standardization and the degree to which key controls are clearly identified and

routinely tested directly contributes to the reliability, and auditability of those processes. This is an area that we continue to improve upon. This is critically important to resolving impediments to sound, reliable processes that produce accurate and timely financial information for both reporting and decision-making.

The final element is implementation of improved business systems including Enterprise Resource Planning (ERP) systems within the Department of Defense Components. System automation and integration is important for efficient management of the volume and complexity of transactions across the Department. We obligate an average of $2 billion to $3 billion each business day and manage hundreds of thousands of payment transactions in thousands of locations globally, including combat zones. Many of our business systems that process these transactions are old and we are transitioning. Large, integrated systems replacing them represent commercial off-the-shelf software that embodies best practices but also requires significant business process reengineering to effectively implement and use this capability. The magnitude and complexity of DoD business processes makes this transition from legacy to modern ERP system problematic and in some cases is exacerbating problems associated with our day-to-day process flow. Over time however, these systems are the key to sustaining our financial improvement and audit readiness efforts. This improved business systems environment will also help the Department to improve the efficiency of its payment integrity efforts.

Improper Payments

DoD has been estimating and reporting improper payments using statistical sampling since Fiscal Year 2004 for five of our six programs: Military Pay, Civilian Pay, Military Retiree and Annuitant Benefits, Military Health Benefits, and Travel Pay. For the sixth program, Commercial Pay, we performed statistical sampling until Fiscal Year 2006. Beginning that fiscal year, we began reporting commercial improper payments under the Recovery Auditing section of our annual Agency Financial Report in accordance with Office of Management and Budget (OMB) Circular A-136. The guidance at the time emphasized recovery of erroneous payments. Our assessment was that statistical sampling limited our recovery efforts to items identified in the sample. By reporting our actual Commercial Pay improper payments, we believe the result was more accurate than a statistical sampling. In addition, we were able to recover a greater portion of overpayments, both monetarily and by occurrence.

To meet current requirements of the *Improper Payments Elimination and Recovery Act of 2010*, we are now in the process of implementing a full statistical sampling and review effort for Commercial Pay. We plan to continue our current comprehensive prepayment review

efforts in Commercial Pay, supplementing them with statistical samplings and reviews beginning in Fiscal Year 2012 that will provide annual estimates that meet or exceed OMB statistical parameters.

As you know, the government-wide error rate for Fiscal Year 2010 was 5.49 percent, while the Department's overall error rate was substantially less than half that amount. Our focus is on reduction and prevention of improper payments. We strive to reduce error rates by identifying root causes for all categories of improper payments. We then target the root causes with specific corrective actions that have effectively reduced error rates over time in most areas.

One of our objectives is to improve transparency in support of the Open Government Initiative. Currently, the DoD Improper Payment reporting is submitted annually to OMB for inclusion in OMB government-wide materials, and for posting to websites like Performance.gov. In addition, the DoD Annual Financial Report is published on the Comptroller's public website each year, and includes information on DoD's improper payment performance as well. We plan to post the latest High Dollar Overpayment report to the Comptroller's public web site by September 30th which will be for Quarter 3, FY 2011, and continue to post quarterly thereafter.

All overpayments are established as receivables to recoup the debt as soon as possible. Fortunately, DoD is able to offset overpayments from a pending invoice for the same vendor through its ability to look across payment systems. Each overpayment is also researched to determine why it occurred. Based on this research, corrective action is taken to minimize the likelihood of recurrence. For example, personnel may require additional training, procedures need to be more clearly documented, or a broader system solution may be appropriate.

We have continued to refine and improve our payment integrity efforts over the years. I'm not satisfied with any amount of improper payments, but I know that perfection is not realistic in any large enterprise, especially one as large and complex as DoD. We have a variety of payment types and we believe that we have a fundamentally sound approach to attacking each category. We also know that we need to continue to be vigilant and ready to seize opportunities for improvement when presented.

Problem Disbursements

I would like to begin the discussion of problem disbursements by clarifying DoD terminology and definitions for categories of disbursement transactions that differ from the Government Accountability Office (GAO). Going back to our analogy of transactions flowing

through our various systems, think of this like a check that a citizen might write and that is being cleared though our Federal Reserve processes and finally posted to his or her personal account. For DoD disbursements, this is much the same, except you have literally thousands of people writing checks and thousands of individual accounts because each appropriation, each year, and each individual activity has a separate account. Just one missed digit can delay the accurate posting. Simply put, that is what a problem disbursement really is and within DoD, we have specific definitions for different kinds of problem disbursements.

DoD problem disbursements are technically referred to as unmatched disbursements (UMDs) and negative unliquidated obligations (NULOs).

- An UMD is a disbursement that has not been matched to the corresponding obligation.
- A NULO is a disbursement that was matched to the corresponding obligation but the disbursement amount is greater than the obligation amount.
- Overaged problem disbursements are transactions that fail to post properly and remain uncorrected for 120 days.

These transactions are the result of an error or deficiency that has occurred at some point in the procure-to-pay process. Typically, the error is not significant enough to have precluded the disbursement, but it has prevented proper accounting. We measure the success of correcting problem disbursements in two sub-categories: Less than 120 days and overaged. We have made significant progress in reducing the number of problem disbursements since we began to metric them in 1999, reducing overaged UMDs through July 2011 by 83 percent or $1.68 billion, and reducing overaged NULOs through July 2011 by 97 percent or $1.53 billion. Our goal is to reduce these kinds of anomalies to a level that is not material to our business. We're not there yet, but we are moving in the right direction. However, the implementation of modern financial systems, including ERPs, has recently increased the level of problem disbursements, due to issues with data quality and systems interfaces. In their mature and stable end-state, these systems will provide an automated, integrated environment that will significantly reduce the number of problem disbursements.

We also have a category of transactions called "in-transits." These are disbursements that have been processed by the Treasury but are not yet posted in the accounting records. This condition is part of normal processing that can take up to 60 days. The processing timeframe is dependent upon several factors including the location of the accounting and

disbursing activities, the origin of the transaction (internal or external to DoD), and the availability of an automated interface. The transaction is en route and the transit time does not indicate that an error has occurred in the payment process. However, if the transaction is not processed within established timeframes, it may result in a problem disbursement. Therefore, we closely monitor in-transit processing timeframes. While the most recent data shows that in-transits have decreased during the month of July 2011, we have not reduced the overall balance since inception. In discussions with the Services, the processing delays are directly related to ongoing system implementations.

As my GAO colleagues have reported, prior to December 1996, we aggregated the amounts of in-transit transactions with UMDs and NULOs for monthly problem disbursement reporting. Since that time we have maintained separate categories for in-transits and excluded them from our external problem disbursement reporting. However, we continue to track and measure performance for internal reporting in all of these categories and ensure that both internal and external reporting is available to provide full disclosure for Congress and auditors.

Transactions including collections, disbursements, and related adjustments are reported to the Department of Treasury and increase or decrease our Fund Balance with Treasury account. Changes to this account are required to be reported monthly on Statements of Transactions and Statements of Accountability. Problem disbursements cause us to be out of balance with Treasury's records and we must reconcile the differences. Reconciliation requires us to identify transactions that are not recorded or were improperly recorded either at Treasury or within our general ledger. In the reconciliation process, all differences must be identified and explained, accountability assigned, and the proper adjustments made to correct the records. For these reasons, reducing problem disbursements is a critical element for reconciling our Funds Balance with Treasury and ultimately achieving auditability.

Antideficiency Act Violations

The Antideficiency Act is actually a collection of statutes codified in several sections of Title 31 of the United States Code. Violations can occur for many reasons that are routinely related to as "PTA," or purpose, time and amount. Compliance requires timely investigation and reporting of ADA violations. We first strive to prevent the occurrence of ADA violations, and we track the ongoing investigations to ensure that they are completed in a timely fashion.

While each ADA case is unique and requires a thorough investigation, there are recurring themes that transcend most. These include: 1) Lack of understanding of fiscal law; 2) business complexity; and 3) operational or mission urgency that may have driven a quick, but

erroneous decision. Each case requires analysis to determine the circumstances, identify root causes, determine required accounting adjustments, and assign responsibility to include disciplinary action if appropriate. In the vast majority of cases, there is no willful intent, but it is critical that corrective actions be taken in a timely manner and that appropriate lessons are learned and applied.

From Fiscal Years 2008 through 2011, a total of 123 potential ADA cases were identified through Service or DoD Inspector General audits, or through self-reporting. Of this total, 48 cases were investigated and found to be ADA violations and reported to Congress; 37 cases were investigated and found to be non-violations; and 38 are currently under investigation as potential violations. To further improve progress of evaluating potential ADA violation cases on time, we streamlined the evaluation process and expanded the availability of ADA investigator training courses. In Fiscal Year 2009 we started with a baseline of 25 overaged investigations and set a goal to reduce that number -- to 10 cases this year and 5 in FY 2012. We anticipate meeting our goal this fiscal year. Several of the 10 overage cases that will continue into FY 12 are currently under consideration by the Office of the Secretary of Defense Office of General Counsel as to their dispensation and will be closed or reported to Congress within the next several months.

In the terms of ADA violations, I believe that this outcome indicator, relative to our size and complexity, represents one of our strengths. I call it a strength because we have been able to minimize these violations despite the many shortcomings that exist in our current business environment. The number of cases that we report annually has been stable. We continue to emphasize timely action in investigating and reporting these cases and while progress has been made, there continue to be opportunities for improvement. Our overage cases have dropped from 25 in Fiscal Year 2009 to 10 in Fiscal Year 2011, a reduction of 60 percent. From Fiscal Year 2005 to Fiscal Year 2010, 85 cases have been reported to Congress with a total value of $960 million dollars. Relative to our budgetary authority, this represents 0.0263 percent, or 26 cents out of every $1000 of spending. While some taxpayers may not fully appreciate the nuances of fiscal law, our investigations reveal that this does not necessarily mean fraud, but in most cases it is simply a matter of the wrong "color" (appropriation) of money being used, or an issue associated with the timing of the need. Having said that, I fully recognize that there is an issue of public confidence and that we must work to minimize the occurrences of these violations. The only correct goal is zero. Please be assured, my colleagues and I are fully committed to fulfilling our stewardship responsibility to the taxpayer.

How Reducing Improper Payments, Problem Disbursements and ADA Violations Relates to Other Priorities

Finally, I want to say a word about the additional benefits that will result from a stronger and better controlled business environment within DoD that will help us reduce improper payments, problem disbursements and ADA violations. From my perspective, there is clear value and critical importance in the public confidence that better business processes – leading to auditability -- would demonstrate. But even beyond the very high priority of auditability, 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 also continue our important contributions to the operational efficiencies that are being implemented across the Department. Better financial information will allow us to monitor accomplishment of these efficiencies and ensure that we are getting the most out of the scarce taxpayer dollars available. We are determined to see our financial stewardship responsibilities through and to achieve our objectives in support of our men and women in uniform--and on behalf of the taxpayers.

In this regard, we believe that our programs to measure and reduce improper payments and minimize problem disbursements and ADA violations are generally strong. The current reporting efforts reflect a business environment that is in transition. The transition to better controlled processes and improved integrated, automated, and compliant systems will produce even better results, and those results will be received with an increased level of confidence. Most importantly, this transition will produce higher quality and more timely financial information that will allow us to get more out of each Defense dollar.

Conclusion

In summary, we recognize the challenges we face with improving financial management in the Department of Defense and especially the obstacles associated with implementation of modern financial systems and ERPs within the Components. We believe that an automated, integrated environment will improve the timeliness of information that is needed to flow between disparate business activities by increasing interoperability and improving our business

processes. We are committed to using scarce resources effectively and efficiently. These types of improvements will help us achieve our goals and, most importantly, audit readiness.

Transforming the Department's business systems and processes is an ongoing effort. We have maintained a close working relationship with key stakeholders and oversight bodies, including GAO and the Office of the Inspector General. Our partnership with the Office of the Chief Management Officer and Deputy Chief Management Officer is essential to ensure that policy is aligned with the evolution of technology. We strive to get the best value of every dollar invested in system modernization, and we expect a significant return on these investments in the future. It will improve the efficiency and reliability of our transactional processes and those processes will be financially auditable.

We are committed to improving Defense financial management as part of our overall commitment to meet our national security objectives. We appreciate the support of the Congress and recognize that we cannot achieve our goals without your continued support.

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.

September 22, 2011

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Statement of
Daniel R. Blair
Deputy Inspector General for Auditing
Department of Defense Inspector General

before the

Defense Financial Management and Auditability Reform Panel
of the House Armed Services Committee

on

"DoD's Efforts to Improve Payment and Funds Control"

Chairman Conaway, Ranking Member Andrews, and distinguished members of the Panel, good morning and thank you for the opportunity to appear before you on behalf of the Department of Defense (DoD) Office of Inspector General (IG) to discuss specific financial management challenges within the Department and improvements for internal controls that must be made. While financial management challenges within the Department have existed for a long time, the current economic uncertainty and fiscal constraints make resolving these weaknesses critically important. Over the past few years, the Department has worked diligently to address its financial management challenges and improve the quality of its financial management information. However, much more progress is required in order to be good stewards of the taxpayer's money and have reliable financial information for decision makers to use on a daily basis.

Today I will discuss DoD IG's perspective on the Department's financial management challenges in improper payments, potential anti-deficiency act violations, and problem disbursements. I will also offer a brief summary of other financial management challenges that must be addressed before the Department will be ready to pass a financial statement audit.

Before discussing the challenges, I would like to acknowledge the efforts of the Department's senior leadership, including the Honorable Robert Hale, the Under Secretary of Defense (Comptroller) and Chief Financial Officer, to reform financial management within the Department. Transforming the financial management of the Department is certainly no easy task and cannot be accomplished overnight. Comptroller Hale and his senior leaders have demonstrated a commitment to improving financial management and have recognized some of the impediments and actions necessary to improving the Department's financial operations.

DEPARTMENT EXPERIENCES CHALLENGES IN IMPROPER PAYMENTS, ANTIDEFICIENCY ACT, AND PROBLEM DISBURSEMENTS

Since the 1990s, the DoD IG has identified financial management as one of several key challenges within the Department. The Department continues to face a myriad of

problems that adversely affect its ability to provide reliable, timely, and useful financial data needed to support operating, budgeting, and policy decisions. These challenges create an environment where improper payments, Antideficiency Act violations and other problem payments are more prevalent. The current financial management environment also makes the Department more vulnerable to fraud, waste and abuse.

Improper Payments. Improper payments have been a longstanding problem within the Department. The DoD IG has worked closely with the Department to identify improper payments and make recommendations to improve controls that will reduce improper payments. Specifically, since Fiscal Year 2007, DoD IG has issued at least 27 reports addressing actual or potential improper payments made throughout the Department. In Fiscal year 2012, the DoD IG plans to announce audits on this topic that will continue to make recommendations to improve processes and controls related to payments made by the Department. While the Department made strides to improve the identification and reporting of improper payments and took many corrective actions to implement recommendations made by the DoD IG, more work is needed to improve controls over payments processed throughout the Department.

Improper payments are often the result of unreliable data and poor internal controls. These conditions create an environment where fraud is more likely and, as a result, the Department lacks assurance that the billions of dollars it disburses annually are made correctly. Simply stated, DoD does not consistently know that it is paying the right person, the correct amount, at the right point in time. An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements.[1] Incorrect amounts are overpayments and underpayments (including inappropriate denials of payment or service). An improper payment includes any payment that was made to an ineligible recipient or for an ineligible service, duplicate payments, payments for services not received, and payments that are for the incorrect amount. In addition, when an

[1] M-11-16, "Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123," April 14, 2011

agency's review process is unable to discern whether a payment was proper as a result of insufficient or a lack of documentation, this payment must also be considered an error.

Incomplete Reporting of Improper Payments. The Department has a reported 75 percent recovery rate of the nearly $1.3 billion for improper payments identified during 2004 through 2010.[2] While we commend the Department on aggressively pursuing recovery of identified improper payments, unless the DoD improves its methodology to review all its disbursements, it will continue to understate its estimate of overpayments and will likely miss opportunities to collect additional improper payments. In Fiscal Year 2010, the Department reported nearly $1 billion in estimated improper payments. However, based on our audit results, we are concerned with the accuracy and reliability of the Department's estimation process. Without a reliable process to review all expenditures and identify the full extent of improper payments, the Department will not be able to improve internal controls aimed at reducing improper payments.

In our audit of the Department's review and reporting of improper payments, we found the Department's review process included less than half of the Fiscal Year 2010 first quarter gross outlays.[3] Specifically, DoD did not review approximately $167.5 billion of the $303.7 billion in gross outlays for high dollar overpayments. Additionally, some overpayments that we or the Department identified were not reported, and the First Quarter FY 2010 High Dollar Overpayments Report did not include sufficient information about recoveries and corrective actions. The Overpayments Report was inaccurate and incomplete because the Comptroller and the Director, Defense Finance and Accounting Service, did not develop a sound methodology or perform adequate oversight for collecting and reporting comprehensive data.

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[2] Defense improper payment recovery performance and figures are as reported on http://paymentaccuracy.gov/. DoD IG has not validated the reported Defense performance or figures. As required by Executive Order 13520, November 20, 2009, "Reducing Improper Payments," the U.S. Department of the Treasury, in coordination with the U.S. Department of Justice and Office of Management and Budget, established this website to create a centralized location to publish information about improper payments made to individuals, organizations, and contractors.

[3] Report No. D-2011-050, "DOD Needs to Improve the High Dollar Overpayment Review and Reporting," March 16, 2011

Comptroller officials stated that the $167.5 billion in outlays the Department did not examine for improper payments included internal and intragovernmental transfers. Those outlays were not subject to the OMB reporting requirements since the payments did not leave the Government. However, we later determined that Comptroller officials did not perform a reconciliation to determine whether these outlays were internal or intragovernmental transfers. A complete reconciliation is still needed to demonstrate that all outlays are being examined for overpayments and to accurately report the extent of the overpayments.

We and other auditors continue to identify improper payments. For example, the Defense Contract Audit Agency estimated about $6.4 billion of improper payments to contractors for the period from October 2005 to through March 2011.[4] These are costs paid to contractors that Defense Contract Audit Agency questioned because they do not comply with rules, regulations, laws and/or contract terms which meets the definition of an improper payment. These improper payments the audit agency identified are greater than the $1.3 billion of improper payments the Department identified during 2004 to 2010.

Weak Internal Controls Lead to Improper Payments. Adequate internal controls are key to mitigating the risks that make improper payments more likely. While management and oversight organizations can identify instances where improper payments may have occurred, internal controls are the first line of defense to prevent or detect improper payments. These controls are the responsibility of DoD's leadership and, when effective provide, reasonable assurance that the disbursements made are for the correct amount and to the correct entity.

The Department's financial management processes are not always adequate to prevent or detect improper payments. For example, in our recent audit of a contract supporting Broad Area Maritime Surveillance, we found DoD personnel did not validate that the

[4] DoD IG analysis of Inspector General, DoD Semiannual Reports to Congress, Appendix D, from October 1, 2005 through March 31, 2011. Figure cited excludes 10 percent of cited questioned cost as Defense Contract Audit Agency provides audit support to other Federal agencies and includes those questioned costs in its overall reporting figures.

contractor was entitled to $329.3 million it received as of January 12, 2010.[5] In this case, the contracting officer thought the Contracting Officer Representative was reviewing contractor invoices; however, the Contracting Officer Representative never reviewed any invoices because she did not know it was her duty. Further, since mid 2009, the Defense Contract Audit Agency revoked the contractor's authority to directly bill because of continuing systemic issues with the contractor's billing system. Finally, the contractor invoices lacked any detail such as labor hours worked, travel incurred or items produced. When we received some details on supporting these invoices, we found that the Navy paid $206,000 in questionable travel expenses such as for a golf outing and air shows in Paris, France, and Singapore.

See figures 1 and 2 for examples of inadequate information on invoices that were paid by the Department on this contract.

Figure 1.

COST VOUCHER (INTERIM)

- CONTINUATION SHEET

* = Required Fields

Contract Number	Delivery Order	Voucher Number
N0001908C0023		BVN0032

Item No	Stock #	Unit Price	Unit of Measure	Qty. Invoiced	Amount
0001	NONE	$22,627,631.34	EA	1	$22,627,631.34
	Stock Type	ACRN			
	MG	AB			
	SDN				
AAA					
Description					
COST PLUS ITEM					
				TOTAL:	$22,627,631.34

[5] Report No. D-2011-028, "Contract Oversight for the Broad Area Maritime Surveillance Contract Needs Improvement," December 23, 2011

Figure 2.

COST VOUCHER (INTERIM)

- CONTINUATION SHEET

* = Required Fields

Contract Number	Delivery Order	Voucher Number
N0001908C0023		BVN0039

Item No	Stock #	Unit Price	Unit of Measure	Qty. Invoiced	Amount
0001	NONE	$21,797,900.3	EA	1	$21,797,900.30
	Stock Type	ACRN			
	MG	AB			
	SDN				
	AAA				
		Description			
	COST PLUS ITEM				
				TOTAL:	$21,797,900.30

The DoD IG has reported previously about the Department's "pay and chase" practice, where contractors are paid the billed invoice amounts before determining what the correct billing amount should have been. For example, in March 2011 the DoD IG reported that in a contract for subsistence items in Afghanistan, the Department made improper payments by overpaying a contractor $25.9 million for materiel costs and potentially overpaying $98.4 million for transportation costs.[6] This occurred because the Defense Logistics Agency was paying the contractor provisional transportation rates for moving food within Afghanistan based on a verbal change order in August 2005. The Defense Logistics Agency continued to pay higher transportation costs even though in 2008, the Defense Contract Audit Agency issued its report questioning provisional transportation costs. The Defense Logistics Agency stated it will resolve the improper payment issues by December 31, 2011.

[6] Report No. D-2011-047, "Improvements Needed in Contract Administration of the Subsistence Prime Vendor Contract for Afghanistan," March 2, 2011

In another example, for construction contracts in Iraq and Afghanistan, we found that the Air Force improperly paid a bill for $24.3 million for labor that was not specified in the base contract. Further, the Air Force did not adequately verify that the Department actually received the goods and services listed. During this audit, we also found that invoice reviews did not always occur. The invoices we examined showed multiple discrepancies. For example, one invoice showed a local construction inspector had 630 billable hours in a 27 day billing period. In order for this invoice to be legitimate, the inspector would have had to work on average 23.3 hours per day.[7]

In 2008, we reported that Government contractors responsible for processing TRICARE overseas health care claims made duplicate payments and overpayments to host-nation providers and to TRICARE beneficiaries.[8] As a result, we estimated that TRICARE Management Agency made inaccurate payments totaling $14.6 million for overseas health care claims during Fiscal Year 2004 and Fiscal Year 2005. We projected the TRICARE Management Agency could put $29.7 million of Defense Health Program funds to better use during the execution of the Fiscal Years 2008 through 2013 Future Years Defense Plan by strengthening internal controls, establishing sound contract surveillance plans, and improving recoupment procedures.

Potential Antideficiency Act Violations in the Department. The Department's claimed actual Antideficiency Act violation performance of only 20 cents per $1,000 is notable; however, we are concerned by the large number of "near misses" or potential Antideficiency Act violations that are averted because we specifically identify them and the Department takes corrective action to eliminate them. Control environment weaknesses impair the Department's ability to timely and reliably determine the amount of funds that it has available to spend and, as a result, the Department remains at risk of overobligating and overexpending its appropriations in violation of the Antideficiency Act.

[7] Report No. D-2010-078, "Air Force Use of Time-and-Materials Contracts in Southwest Asia," August 16, 2010
[8] Report No. D-2008-045, "Controls Over the TRICARE Overseas Healthcare Program," February 7, 2008

The Antideficiency Act prohibits federal agencies from obligating or expending federal funds in advance of or in excess of an appropriation, apportionment, or certain administrative subdivisions of those funds.[9] Among other things, the Act requires agencies to report to the President and Congress all relevant facts and a statement of actions taken, and to transmit a copy of each report to the Comptroller General on the same date the report is transmitted to the President and Congress. Federal employees who violate the Antideficiency Act may be subject to administrative discipline including, when circumstances warrant, suspension from duty without pay or removal from office. In addition, employees may also be subject to fines, imprisonment, or both.

"Near Misses." Since 2005, the Department has accounted for 68 percent of the Antideficiency Act violations within the federal government. Specifically, of the 120 actual Antideficiency Act violations reported by Federal agencies from Fiscal Year 2005 through Fiscal Year 2010, 82 were reported by the Department.[10] Since 2005, DoD IG issued 49 audit reports that identified over 900 potential Antideficiency Act violations, valued at over $2.3 billion, which the Department needed to further investigate and take corrective action, as appropriate, when an actual Antideficiency Act violation occurred. Four of our identified potential Antideficiency Act violations were eventually reported by the Department as actual Antideficiency Act violations, totaling approximately $57 million. The Department is either still reviewing the remaining potential Antideficiency Act violations, or was able to take corrective actions to remedy the potential Antideficiency Violations, such as applying available appropriate funding.

These "near misses" illustrate the risk that Antideficiency Act violations can materialize if management does not establish adequate internal controls and does not take a proactive approach to detecting and resolving potential Antideficiency Act violations. Had DoD IG not performed these audits, or performed that body of work at a later time, those potential Antideficiency Act violations could have become actual reportable violations.

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[9] 31 U.S.C. §§ 1341, 1517(a)

[10] DoD IG analysis of GAO "Antideficiency Act Reports" for Fiscal years 2005 through 2010 from reports required by section 1401 of the Consolidated Appropriations Act, 2005, P.L. 108-447, 118 Stat. 2809, 3192 (12/8/2004) http://www.gao.gov/ada/antideficiencyrpts.htm)

Rather than rely on oversight organizations to find potential Antideficiency Act violations, the Department needs to improve its controls to prevent and detect these potential and actual violations.

Lack of Adequate Internal Controls, Inadequate Training, and Poor Training Contribute to Potential ADA Violations. In reviewing our 49 audits that identified potential Antideficiency Act violations, we found that many of these potential violations were the result of poor internal controls, training, or guidance. Adequate internal controls are essential to mitigate potential Antideficiency Act violations from occurring. Unfortunately, internal controls do not always exist or do not effectively detect or prevent potential Antideficiency Act violations.

For example, we found that inappropriate financing of an Army training contract caused a $23 million potential Antideficiency Act violation.[11] In July 2009, the contracting officer at the Tank-Automotive Command Contracting Center awarded a contract for Instructor Services for the Mine Resistant Ambush Protected Vehicle. The contract had a 6 month base period from July 2009 to January 2010 and a 6 month option from January 2010 to July 2010. The Contracting Center officials stated the contract was set up in this fashion because only the initial 6 months of the Fiscal Year 2009 money for the contract was available. However, $23 million of additional Fiscal Year 2009 money became available and the contracting officer exercised the contract option starting in January 2010. The problem is that the Army could not use $23 million of Fiscal Year 2009 money to fund a contract option starting 4 months after Fiscal Year 2010 started because the need for the funds existed in the prior year.

In another example, in a recent report on Navy ship Maintenance we identified how contracting officers in the Navy caused a potential violation of the Antideficiency Act.[12] On September 28, 2005, a contracting officer in Bahrain awarded a contract for $7 million to overhaul 2 Patrol Coastal class ships. The contracting officer used Fiscal

[11] D-2011-036 Competition Should Be Used for Instructor Services for the Mine Resistant Ambush Protected Vehicles, February 3, 2011

[12] Report No. D-2011-043, "Improvements Needed on the Fleet and Industrial Supply Center, Sigonella, Ship Maintenance Contracts in Southwest Asia," February 22, 2011

Year 2005 money. Then in October 2005 an Administrative Contracting Officer in Dubai split the original contract in to 2 separate contracts, one for each ship. The administrative contracting officer then signed one contract on October 18, 2005 to overhaul one ship using $3.5 million of Fiscal Year 2005 money and signed another contract on March 12, 2006, for overhaul of the second ship using $3.5 million of Fiscal Year 2005 money. The contract file showed that this was done because Fiscal Year 2006 money was not available to overhaul the second ship. In this case, the contracting officers should have initially awarded two separate contracts to overhaul these ships and used Fiscal Year 2005 money for one ship and Fiscal Year 2006 money for a second ship. The Navy agreed that this was a funding problem and initiated an investigation.

We found a Navy contracting officer did not properly manage an indefinite-delivery, indefinite quantity contact for the maintenance of engines for mine countermeasures ships because the contracting officer "parked" approximately $20.3 million in Navy Operations and Maintenance funds when he issued task orders to obligate funds before specific requirements were identified.[13] In addition, the task orders for engineering services did not specify the need for engineering services. Eventually, the Contracting Officers' Representative issued technical instructions that defined the maintenance requirements for approximately $19.2 million of the "parked" funds. The remaining $1.1 million in Navy Operations and Maintenance funds were invalid Fiscal Years 2007, 2008, and 2009 funds and, if expended, could result in potential Antideficiency Act violations. The contracting officers disregarded the fundamental guiding principles of funds management by banking funds for future use and before requirements were determined. The Navy initiated corrective action by deobligating the old funds.

Misinterpretation or Unclear Understanding of Rules are Contributing Factors. A misinterpretation or lack of clear understanding of fiscal law can cause potential Antideficiency Act violations to occur. Over 600 of the over 900 potential Antideficiency Act violations were identified in our series of audits on the Department's

[13] Report No. D-2010-087, "Weaknesses in Oversight of Naval Sea Systems Command Ship Maintenance Contract in Southwest Asia," September 27, 2010

purchases made through other agencies. We found that misinterpretations or unclear understanding of the fiscal law contributed to many of those potential Antideficiency Act violations from interagency purchases. In addition, the Department's accounting systems do not identify the billions of dollars used to procure goods and services through other Federal agencies. We have found that when the Department sends funds to the other Federal agencies such as the General Services Agency, Department of Interior and the Department of Energy, it does not adequately track those funds. In essence, funds were "parked" at the other agencies and potential Antideficiency Act violations occurred because both DoD and non-DoD organizations were unaware of, misinterpreted, or did not comply with the bona fide needs rule[14] and purpose statute when making purchases through non-DoD agencies. Specifically, DoD organizations used prior year funds to purchase current year requirements, and in some instances, used the wrong types of funds to procure goods and services. One of the key contributing factors that enabled these potential Antideficiency Act violations to occur was the vague and incomplete Military Interdepartmental Purchase Requests prepared by DoD organizations when transferring funds to non-DoD agencies. Additionally, DoD organizations made advance payments to non-DoD agencies for goods and services not yet received. As a result of this series of audits, the Director, Defense Procurement and Acquisition Policy implemented guidance to clarify the requirements on the Department when procuring goods and services through interagency acquisitions.

In our joint audit with the Department of State Inspector General on the Afghan National Police Training efforts, we identified almost $75 million in potential Antideficiency Act violations.[15] Using DoD funds, the Department of State moved expired funds to new Afghan National Police training requirements, and obligated funds outside the scope of reimbursable agreement. For example, the Department of State used $11.9 million of

[14] Bona Fide Need Rule (also known as the "time statute"). US Code, Title 31, Section 1502(a) - the balance of an appropriation or fund limited for obligation to a definite period is available only for payment of expenses properly incurred during the period of availability, or to complete contracts properly made within that period of availability and obligated consistent with section 1501 of this title.

[15] DoD IG Report No. D-2011-102/Department of State IG Report No. AUD/CG-11-44, "Afghan National Police Training Program Would Benefit From Better Compliance With the Economy Act and Reimbursable Agreements," August 25, 2011

DoD funds to pay a contractor claim from before the 2006 agreement with DoD for the training effort. By incorrectly obligating DoD funds, the Department of State might have improperly augmented both DoD and Department of State appropriations, which could result in potential Antideficiency Act violations. Finally, Department of State officials' failure to return to DoD obligated funds unlikely to be expended will result in DoD being unable to obligate and expend funds for other Afghan National Police requirements because the funds would have already either expired or been canceled.

Problem Disbursements. While no universal definition of "problem" disbursements exists, generally unmatched disbursements, negative unliquidated obligations, and aged in-transit disbursements that are greater than 60 days old are considered to be "problem" disbursements. Similar to improper payments and potential Antideficiency Act violations, problem disbursements also frequently result from poor internal controls.

For example, reconciliation of the Fund Balance with Treasury account is a basic internal control to ensure all disbursements are properly accounted for. Fund Balance with Treasury is an asset account that reflects the available budgetary spending authority of a Federal agency. In general terms, Fund Balance with Treasury is similar to a checking account that needs to be reconciled regularly to ensure errors are researched and resolved in a timely manner. The inability to reconcile the Fund Balance with Treasury account has been a longstanding problem throughout the Department which increases the risk that problem disbursements will be made and not corrected in the normal course of business. As of September 30, 2010, the Department reported that its Fund Balance with Treasury totaled $521.6 billion, which represents 27 percent of the Department's total assets.[16] Timely and effective reconciliations decrease the risk of fraud, waste, and mismanagement of funds and enhance the Government's ability to monitor budget execution. To assist the Department in improving the reliability of its Fund Balance with Treasury financial reporting, the DoD IG has issued at least 20 reports since Fiscal Year 2007 related to accounting and reconciling Fund Balance with Treasury. In addition,

[16] Report No. D-2011-011, Independent Auditor's Report on the DOD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements, November 15, 2010.

DoD IG plans to perform additional audits in Fiscal Year 2012 and make recommendations that identify other areas for improvement.

The Other Defense Organizations[17] must contend with an additional challenge in performing Fund Balance with Treasury reconciliations because 54 Other Defense Organizations general fund entities are included in U.S. Treasury Index 97 account, a comingled account that does not specifically identify each agency, program, activity, or funds share of the U.S. Treasury account. Regular reconciliations are essential to maintain reliable financial information. Defense Finance and Accounting Service Indianapolis developed the Cash Management Report to allocate the U.S. Treasury totals to the individual Other Defense Organizations. However, DoD IG recently identified significant problems with the completeness and accuracy of the Cash Management Report. These problems undermine the reliability of the Cash Management Report as a Fund Balance with Treasury reconciliation tool.

During our recent audit, we found that the Cash Management Report was not complete or accurate.[18] Specifically, the Cash Management Report did not attribute approximately $10.5 billion in transactions to the Other Defense Organizations responsible for reconciling and accounting for the transactions. The $10.5 billion consisted of:

- $9.04 billion in variances between the amounts reported on the Cash Management Report and the amounts reported by the U.S. Treasury, of which $517 million existed prior to October 2004,
- $704.5 million in unmatched disbursements and collections reported on the Cash Management Report that were not charged to the specific Other Defense Organizations that were responsible for the transactions, and
- $749.1 million in unmatched disbursement and collection transactions that Defense Finance and Accounting Service Indianapolis did not include on the Cash Management Report because the transactions were being held in suspense accounts as a result of not having the necessary information to properly record the transactions.

[17] Other Defense Organizations cover the activities funded with Defense-wide appropriations. This includes Defense agencies, programs, activities, and funds such as Defense Finance and Accounting Service, Chemical and Biological Defense Program, TRICARE Management Activity, and DoD Education Benefits Fund, and not required by the Office of Management and Budget to undergo standalone financial statement audits.

[18] Report No. D-2011-098, "Defense Finance and Accounting Service Needs to Improve Controls Over the Completeness and Accuracy of the Cash Management Report," August 16, 2011

Fund Balance with Treasury Impact on the Financial Statements. Since Fund Balance with Treasury is the largest line item on the Other Defense Organizations General Fund financial statements, these deficiencies will also have a significant negative effect on the ability to obtain an unqualified opinion on the DoD Agency-Wide financial statements until a reliable reconciliation process is implemented. Implementing a reliable Fund Balance with Treasury reconciliation process, will help the Department identify and resolve unmatched disbursements at the detailed transaction level. By performing this research, agencies can resolve the issues that prevented the transactions from being properly matched to the corresponding obligation within agency accounting records.

In Fiscal Year 2010, the DoD IG audited the U.S. Marine Corps' (USMC) Statement of Budgetary Resources (SBR),[19] the first Military Component to undergo such an audit. This effort resulted in a disclaimer of opinion because the USMC was unable to provide timely and relevant supporting documentation for accounting transactions and could not provide evidence to support the reconciliations for key accounts and accounting processes were being performed regularly. However, the USMC and the Department are learning from this audit experience and some improvements have been identified during the Fiscal Year 2011 audit. Unfortunately, some of the same challenges encountered during the Fiscal Year 2010 audit have affected the Fiscal Year 2011 audit. For example, the USMC was unable to reconcile its Fund Balance with Treasury to detail transaction files during the Fiscal Year 2010 audit. The USMC finally provided detail transaction files in June of 2011, approximately 9 months after the start of the Fiscal Year 2011 audit. These detail transaction files are essential to support the reconciliation process. Further, the USMC has continued to struggle to provide timely and reliable supporting documentation during the FY 2011 audit. We will continue to work with the Department to identify obstacles and make recommendations to resolve these barriers to achieving auditable financial statements.

[19] Report No. D-2011-009, "Independent Auditor's Report on the United States Marine Corps General Fund FY 2010 and FY 2009 Combined Statement of Budgetary Resources," November 8, 2010

SUMMARY OF FINANCIAL MANAGEMENT CHALLENGES THAT MUST BE ADDRESSED TO PASS A FINANCIAL STATEMENT AUDIT

While the Department continues to improve its financial management processes, DoD is far from reaching an unqualified opinion, and much more work needs to be accomplished to have auditable financial statements by the 2017 deadline. We have identified future risks that could impact the Department's ability to meet the ambitious 2017 auditability requirement. These risks are: data quality, internal control weaknesses, heavy reliance on Enterprise Resource Planning Systems (ERP),[20] and key events that take place close to the 2017 deadline.

Data Quality. Reliable data are necessary to make sound business decisions and support management representations about the accuracy of financial information reported to Congress and the taxpayer. However, the DoD IG frequently identifies financial data that are unreliable, incomplete, and inaccurate. As a result, DoD managers often cannot reconcile financial data or rely on this data to make sound business decisions. Poor financial data also impedes the Department's ability to obtain unqualified financial statement audit opinions. From Fiscal Year 2007 through Fiscal Year 2011, 89 DoD IG reports have identified data quality problems. For example, in our audit of controls over the Army Deployable Disbursing System,[21] we found that the deployable disbursing system did not maintain accurate lines of accounting, accurate payment methods information, or complete fundamental payment information such as invoice line item information. As a result, the Army lacked a complete audit trail and could not reconcile information between the Army payment and accounting systems for 296 of the 402 commercial payments we reviewed. Further, the Army could not provide a complete universe of commercial payments made through the system.

Internal Controls Weaknesses. Internal controls are an integral part of an organization's management which are designed to provide reasonable assurance of

[20] An ERP is an automated system using commercial off the shelf software consisting of multiple, integrated functional modules that perform a variety of business related tasks such as general ledger accounting, payroll, and supply chain management.

[21] Report No. D-2011-101,"Controls Over Army Deployable Disbursing System," August 17, 2011

achieving: effective and efficient operations; reliable financial reporting; and compliance with applicable laws and regulations. Internal controls include the plans, methods, and procedures used to meet missions, goals and objectives. Internal controls also serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal controls help senior leaders and managers achieve desired results through effective stewardship of taxpayer dollars.

Since the mid-1990s, the DoD IG has reported numerous material internal control weaknesses[22] that impact the Military Services' and the Department's ability to achieve an unqualified financial statement opinion. In our most recent disclaimer of opinion on the Fiscal Year 2010 DoD Agency-Wide financial statements,[23] we reported the following 13 material internal control weaknesses:

- Financial Management Systems;
- Fund Balance with Treasury;
- Accounts Receivable;
- Inventory;
- Operating Materials and Supplies;
- General Property, Plant, and Equipment;
- Government Furnished Material and Contractor Acquired Material;
- Accounts Payable;
- Environmental Liabilities;
- Statement of Net Cost;
- Intragovernmental Eliminations;
- Other Accounting Entries; and
- Reconciliation of Net Cost of Operations to Budget.

Until the Department resolves these pervasive weaknesses, it will be very difficult for DoD to reliably assert that it is ready for audit by 2017.

[22] Department of Defense Agency Financial Report for Fiscal Year 2010, November 15, 2010
[23] Report No. D-2011-011, "Independent Auditor's Report on the DoD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements," November 15, 2010

Effective ERP Implementation. The successful implementation of Enterprise Resource Planning (ERP) systems are critical for DoD to meet milestones and transform processes. Internal controls and systems are needed to provide useful, timely, and complete financial management data and to achieve auditability. The May 2011 Financial Improvement and Audit Readiness (FIAR) Plan Status Report recognizes that auditability is dependent on successfully deploying ERP systems and interfacing them with other business and financial systems. However, the May 2011 FIAR Plan Status Report did not identify all ERP systems and did not include milestones and costs for all ERPs. Additionally, DoD has been unable to meet key milestones for four of eleven ERP systems in the Department. Specifically, we found that the Defense Agencies Initiative and the Integrated Personnel Pay System-Army are missing from the ERP systems list although they are mentioned in other sections of the Plan. The Navy's Future Personnel and Pay Solution, is not in the FIAR Plan at all. As those ERP system efforts slip, they may jeopardize the Department's ability to meet the 2017 deadline.

The development, implementation and effectiveness of these ERP systems are questionable at this point. The numerous interfaces between the ERP and the existing systems may be overwhelming and currently may not be adequately defined. Each interface presents a risk of the system not functioning as designed thus corrupting data or not exchanging data. The Department needs to ensure ERP system development addresses required business processes and functions and meets established milestones. Further, these systems must actually produce reliable data.

In our audit of the General Fund Enterprise Business System, we found the Assistant Secretary of the Army (Financial Management and Comptroller) did not provide a detailed data conversion plan. Data conversion is the modification of existing data to enable it to operate with similar capabilities in a different environment. It is a significant part of the financial system implementation in terms of workload, complexity, risk, and cost and is one of the most frequently underestimated tasks. Inadequate planning for data conversion processes may lead to long-term repercussions, including failure to meet program objectives, such as producing auditable financial statements. The General Fund

Enterprise Business System Program Management Office provided a data conversion guide; however, the guide did not address data conversion for at least 49 non-Army systems that process Army data. In addition, the guide did not mention how the General Fund Enterprise Business System Program Management Office plans to handle historical transactional data, other than it will not convert it. Without converting historical transactional data for appropriations such as indefinite, multi-year, and no-year funds, the Army could potentially be using the General Fund Enterprise Business System and the legacy systems concurrently for many years.

Key Events Take Place Close to the 2017 Deadline. The milestones for completing some critical financial improvement efforts reported in the May 2011 FIAR Plan Status Report are currently very close to the September 30, 2017, deadline for DoD to validate the financial statements are audit ready. As a result, DoD may not have adequate time to take corrective actions if additional deficiencies are identified, or if ERP implementations are delayed. For example, full deployment of Global Combat Support System - Army is planned for the fourth quarter of Fiscal Year 2017. Also, the Air Force and Defense Logistics Agency do not plan on asserting audit readiness of their Statement of Budgetary Resources until the first and second quarters of Fiscal Year 2017, respectively and do not plan on completing a validation of this audit readiness assertion until the third and fourth quarters. The Other Defense Organizations do not plan on asserting audit readiness of the Statement of Budgetary Resources until the fourth quarter of Fiscal Year 2017 and do not include any validation of their audit readiness assertion. These milestones may not leave sufficient time for the Statement of Budgetary Resources to be independently verified as being audit ready. Further, because these entities are material to the DoD Agency-wide financial statements, any delay in those statements would likely prevent the Statement of Budgetary Resources, at the DoD Agency-wide level, from being audit ready.

CONCLUSION

Sound financial management is critical to providing effective stewardship over the billions of dollars the Department receives annually. The Department needs accurate and timely financial information on a daily basis to ensure that every dollar supports the warfighters, improves military readiness, and is readily available to key decision makers. Although the Department faces some daunting financial management challenges that must be resolved, the Department continues to make progress in improving its financial management. There is much more to do in order to overcome the pervasive, long standing financial management problems that I have describe today. A comprehensive collection and analysis of improper payment is one means to provide effective financial stewardship as well as implementing a thorough process to track appropriations, obligations, and expenditures to mitigate the risk for Antideficiency Act violations.

Currently, the Department is devoting significant resources to address these challenges and we are encouraged by the progress they have made. We will continue to provide oversight of these efforts and make recommendations to help move the Department towards improved financial management.

This concludes my statement today and I would be happy to take any questions the Panel may have for me.

Biographies

Daniel R. Blair
Deputy Inspector General for Auditing

Mr. Blair became the Deputy Inspector General for Auditing on November 7, 2010. Prior to accepting this position, Mr. Blair held the position of Principal Assistant Inspector General for Auditing from February 14, 2010. Mr. Blair also served as the Principal Deputy Assistant Inspector General for the Defense Business Operations Directorate. In this capacity, he focused on a wide variety of financial management challenges facing the Department of Defense (DoD) and led numerous financial statement, systems, and financial related audits. Mr. Blair joined the Office of Inspector General (OIG) in September 2006 and became a member of the Senior Executive Service in June 2008.

Prior to joining the DoD OIG, Mr. Blair worked at the Government Accountability Office (GAO) for 16 years. While at GAO, he served as an Assistant Director in the Financial Management and Assurance and the Financial Markets and Community Investment Teams. As such, he led numerous audit teams focusing extensively on risks to the bank insurance fund, the Government-wide challenges of implementing the Credit Reform Act, improper payments, and property accountability. Prior to GAO, Mr. Blair worked for 3 years in public accounting performing a variety of accounting, auditing, and management advisory services. Mr. Blair also served as an Army Military Police platoon leader at Ft. McNair, and as a K-9 platoon leader and Deputy Provost Marshal at Ft. Myer.

Mr. Blair received a Bachelor of Arts Degree in Criminal Justice from St. Anselm College in Manchester, New Hampshire, and a Certificate in Accounting from the University of Virginia. He is a Certified Public Accountant in the state of Virginia.

United States Government Accountability Office

GAO

Testimony

Before the Panel on Defense Financial Management and Auditability Reform, Committee on Armed Services, House of Representatives

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DOD FINANCIAL MANAGEMENT

Weaknesses in Controls over the Use of Public Funds and Related Improper Payments

Statement of Asif A. Khan, Director
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U.S. Government Accountability Office
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Accountability * Integrity * Reliability

Highlights

Highlights of GAO-11-950T, testimony before the Panel on Defense Financial Management and Auditability Reform, Committee on Armed Services, House of Representatives

DOD FINANCIAL MANAGEMENT

Weaknesses in Controls over the Use of Public Funds and Related Improper Payments

Why GAO Did This Study

The Department of Defense (DOD) is required to design and implement effective internal controls, including controls over its use of public funds ("funds controls") and controls over its payment processes ("payment controls"). As a steward of the public's resources, DOD is responsible and accountable for (1) using public funds efficiently and effectively and for the purposes and within the time frames and amounts prescribed by law, (2) making payments to the right parties in the correct amount within allowable time frames and recouping any improper payments, and (3) accurately recording and reporting on its transactions and use of public funds.

GAO's testimony focuses on (1) challenges DOD faces in its funds control, and their effect on the reliability of DOD's financial information, especially the budgetary information in DOD's Statement of Budgetary Resources and (2) weaknesses in DOD's payment controls that put the department at risk of making improper payments.

This statement is based on our prior work (see Related GAO Products) and reports issued by the department's Inspector General (DOD IG). The panel requested that GAO provide its perspective on the status of DOD's process for identifying and reporting on improper payments, examples of Antideficiency Act violations within DOD along with the causes of these violations, and the effect of problem disbursements on DOD's ability to report reliable information on its financial statements.

View GAO-11-950T. For more information, contact Asif Khan at (202) 512-9869 or khana@gao.gov.

What GAO Found

For years, GAO and DOD IG have reported on DOD's inability to provide effective funds control and report reliable financial information, including budgetary information. In 2008, GAO reported that DOD's complex and inefficient payment processes, nonintegrated business systems, and weak internal controls impair its ability to maintain proper funds control, putting DOD at risk of overobligating or overspending its appropriations. Specifically, DOD's weak internal control environment has hindered its ability to ensure that transactions are accurately recorded, sufficiently supported, and properly executed by trained personnel subject to effective supervision. Funds control weaknesses place DOD at risk of violating the Antideficiency Act (ADA), specifically through overobligations and overexpenditures. DOD reported ADA violations from fiscal year 2007 through September 15, 2011, with a total dollar amount of $927.4 million.

DOD has identified payment transactions and related accounting steps as "problem disbursements." Problem disbursements include unmatched disbursements (UMD) that represent disbursements that have been paid by an accounting office but that have not been matched to the correct obligation records. DOD reports that it has reduced overaged UMDs from $666.5 million to $109.6 million between second quarter of fiscal year 2009 to the same time in fiscal year 2011. These and other weaknesses have prevented DOD from reporting reliable financial information, including budgetary information in an auditable Statement of Budgetary Resources. Although DOD has dedicated significant resources to remediate its identified weaknesses, it faces significant challenges to address those persistent weaknesses.

DOD reported for fiscal year 2010 that it made an estimated $1 billion in improper payments. However, this estimate is incomplete because DOD did not include estimates from its commercial payment programs, which account for approximately one-third of the value of DOD payments. Further, both GAO and the DOD IG have reported on weaknesses in DOD's payment controls, including weaknesses in its process for assessing the risk of improper payments and reporting estimated amounts of them. DOD's problem disbursements continue to be a concern and are a contributing factor to the department's funds control issues. The department's weak controls over payments increase the risk of inaccurate cost information and improper payments. Given DOD's stated goal of achieving audit readiness on its consolidated financial statements by the end of fiscal year 2017, it will be critical that the department continue to ensure that steady progress is being made. Moreover, for DOD to move forward, it will be important that the department resolve its problems with multiple, disparate nonintegrated systems to ensure that whatever systems solutions are chosen will provide the underlying foundation for auditable financial statements.

Chairman Conaway, Ranking Member Andrews, and Members of the Panel:

It is a pleasure to be here today to discuss the Department of Defense's (DOD) controls over the use of public funds and their effect on the reliability of DOD's reported budgetary information and DOD's efforts to account for and control improper payments.

DOD is one of the largest and most complex organizations in the world. For fiscal year 2012, the budget requested for the department was approximately $671 billion—$553 billion in spending authority for its operations and an additional $118 billion to support overseas contingency operations, such as those in Iraq and Afghanistan. DOD's fiscal year 2012 budget request also noted that it employed over 3 million military and civilian personnel—including active and reserve service members. DOD operations span a wide range of defense organizations, including the military services, large defense agencies and field activities, and various combatant and joint operational commands that are responsible for military operations for specific geographic regions or theaters of operation. To execute its operations, the department performs interrelated and interdependent business functions, including financial management, logistics management, health care management, and procurement. To support its business functions, DOD has reported that it relies on over 2,200 business systems,[1] including accounting, acquisition, logistics, and personnel systems.

Like all executive agencies of the federal government, DOD is required to design and implement effective internal controls,[2] including controls over

[1]DOD excludes from its business systems those designated as national security systems under section 2222(j) of Title 10, United States Code. National security systems are information systems where the function, operation, or use of which involves intelligence activities, cryptologic activities related to national security, command and control of military forces, equipment that is an integral part of a weapon or weapon system or is critical to the direct fulfillment of military or intelligence missions (unless used for routine administrative and business applications), or is protected at all times by classification procedures in the interest of national defense or foreign relations, as authorized by law or executive order.

[2]Internal control represents an organization's plans, methods, and procedures used to meet its missions, goals, and objectives and serves as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, abuse, and mismanagement.

its use of public funds ("funds controls") and controls over its payment processes ("payment controls"). As a steward of the public's resources, DOD is responsible and accountable for (1) using public funds efficiently and effectively and for the purposes and within the time frames and amounts prescribed by law, (2) making payments to the right parties in the correct amount within allowable time frames and recouping any overpayments, and (3) accurately recording and reporting on its transactions and use of public funds.

Due to longstanding and pervasive weaknesses in DOD's internal control, we have designated DOD's financial management as one of DOD's programs at high risk of waste, fraud, abuse, or mismanagement.[3] DOD's past initiatives to strengthen its internal control, become auditable, and improve its financial management have fallen short. While current efforts offer some encouragement, GAO and DOD auditors continue to find significant deficiencies in internal control that contribute to DOD's inability to achieve effective financial management capabilities and prepare auditable financial statements. Under the DOD Financial Improvement and Audit Readiness (FIAR) Plan, first issued by the DOD Comptroller in 2005, DOD has begun to dedicate significant resources to remediate identified weaknesses.

Today, I will discuss the challenges DOD faces in its funds control and their effect on the reliability of DOD's financial information, especially the budgetary information in DOD's Statement of Budgetary Resources (SBR), which the department has identified as its highest priority in achieving auditability, as well as its ability to reduce the risk of overobligating or overexpending resources. I will also discuss the weaknesses in DOD's payment controls that put the department at risk of making improper payments. My statement today is based primarily on our prior work and includes DOD-reported information that we monitor as part of our annual audit of the Consolidated Financial Statements of the U.S. Government.[4] In addition, my statement includes information from reports issued by the department's Inspector General (DOD IG) that I present because, while we did not independently validate the IG's methodology, the findings are similar to ours on relevant aspects of DOD's funds and payment controls. Our work, on which this statement is based, was

[3]GAO *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: Februar, 2011).

[4]See a list of Related GAO Products at the end of this statement.

conducted in accordance with generally accepted government auditing standards. Our previously published reports contain additional details on the scope and methodology for those reviews. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Budget and Accounting Procedures Act of 1950 and the law commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA)[5] placed primary responsibility for establishing and maintaining internal control on the head of the agency. Internal control is an integral component of an organization's management that when properly implemented and operating effectively provides reasonable assurance[6] that the following objectives are being achieved: (1) effectiveness and efficiency of operations; (2) reliability of financial reporting; and (3) compliance with laws and regulations.

Within this broad framework of internal control, DOD must design and implement effective funds control, payment controls, and internal control over financial reporting.[7] Auditors of DOD's financial statements are to assess the effectiveness of these controls as part of the financial statement audit. However, DOD has acknowledged that long-standing weaknesses in its internal controls, its business systems, and its processes have prevented auditors from determining the reliability of DOD's financial statement information, including the budgetary information included in DOD's SBR. Moreover, we have previously reported that a weak overall control environment and poor internal controls limit DOD's ability to prevent and detect fraud, waste, abuse, and improper payments.

[5]31 U.S.C. § 3512(c), (d).

[6]The concept of reasonable assurance recognizes that no matter how well designed and operated, internal control cannot provide absolute assurance that an entity's objectives will be met. Management should design and implement internal control based on the related costs and benefits.

[7]Additional information about requirements and standards for funds and payment controls, and internal control over financial reporting is provided in app. I.

Because budgetary information is widely and regularly used for management, the DOD Comptroller designated as one of DOD's highest priorities the improvement of its budgetary information and processes underlying the SBR. The financial information in the SBR is predominantly derived from an entity's budgetary accounts, which are used by agencies to account for and track the use of public funds, in accordance with budgetary accounting rules.[8] The SBR is designed to provide information on authorized budgeted spending authority and links to the Budget of the United States Government (President's Budget), including the source and availability of budgetary resources, and how obligated resources have been used.[9] According to the Office of Management and Budget, the SBR was added as a basic federal financial statement so that the underlying budgetary accounting information is audited and is, therefore, more reliable for routine management use and budgetary reporting, such as the President's Budget.

In the FIAR Plan, DOD states that it expects to obtain five benefits from its planned efforts to achieve an auditable SBR. According to DOD, its efforts will

- improve the visibility of budgetary transactions, ensuring a more effective use of resources;
- provide operational efficiencies through more readily available and accurate cost and financial information;
- improve financial stewardship through reduced improper payments;
- improve budget processes and controls, thus reducing violations of funds control laws; and
- link execution to the President's Budget, thus providing more consistency with the financial environment.[10]

[8]Budgetary accounting rules are incorporated into generally accepted accounting principles (GAAP) for the federal government. For additional information on the two methods of tracking the use of public funds, see app. III to GAO, *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP (Washington, D.C.: September 2005).

[9]Budgetary resources include the amount available to enter into new obligations and to liquidate them. Budgetary resources are made up of new budget authority (including direct spending authority provided in existing statute and obligation limitations) and unobligated balances of budget authority provided in previous years.

[10]DOD, Office of the Under Secretary of Defense (Comptroller)/CFO, *Financial Improvement and Audit Readiness (FIAR) Plan Status Report* (May 2011).

Serious DOD Funds Control Challenges

For years, GAO and DOD IG have reported on DOD's inability to provide effective funds control and report reliable financial information, including budgetary information. In 2008, we reported that DOD's complex and inefficient payment processes, nonintegrated business systems, and weak internal controls impair its ability to maintain proper funds control, putting DOD at risk of overobligating or overspending its appropriations.[11] Specifically, DOD's weak internal control environment has hindered its ability to ensure that transactions are accurately recorded, sufficiently supported, and properly executed by trained personnel subject to effective supervision. Further, these weaknesses impair DOD's ability to ensure that amounts recorded as disbursements[12] are matched to the corresponding recorded obligations,[13] resulting in "unmatched disbursements."[14] These and other weaknesses have prevented DOD from reporting reliable financial information, including budgetary information in an auditable SBR, which DOD's FIAR Plan seeks to address through a multiyear effort across the military services and defense agencies. For example, we recently reported that inadequate processes, systems controls, and controls for accounting and reporting prevented the Marine Corps from passing an audit of its fiscal year 2010 SBR, the first SBR of a military service that DOD is attempting to successfully audit since the SBR was first required in 1998.[15] Although DOD has dedicated significant resources to improving its financial

[11]GAO, *DOD Financial Management: Improvements Are Needed in Antideficiency Act Controls and Investigations,* GAO-08-1063 (Washington, D.C.: Sept. 26, 2008).

[12]A disbursement is an amount paid by a federal agency, by cash or cash equivalent, to liquidate obligations, such as payment for goods received under a contract. Disbursements often are referred to as "expenditures" or "outlays."

[13]An obligation is a definite commitment that creates a legal liability of the government for the payment of appropriated funds for goods and services ordered and received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Obligations include, for example, the awarding of contracts and grants.

[14]Unmatched disbursements refer to disbursements and collections that have been received by the accounting station, attempted to be matched to an obligation in the accounting system, but were not matched because an obligation was not identified in the accounting system.

[15]GAO, *DOD Financial Management: Marine Corps Statement of Budgetary Resources Audit Results and Lessons Learned,* GAO-11-830 (Washington, D.C. Sept. 15, 2011.), *Department of Defense: Status of Financial Management Weaknesses and Actions Needed to Correct Continuing Challenges,* GAO/T-AIMD/NSIAD-99-171 (Washington, D.C.: May 4, 1999).

management, including addressing known weaknesses in its funds control, neither the department nor its auditors have been able to verify that weaknesses have been sufficiently corrected in order to pass an audit. These weaknesses present challenges for DOD in: (1) reducing its risk of overobligating and overexpending[16] its appropriations in violation of the law and making effective use of budgetary resources; (2) improving its ability to eliminate unmatched disbursements and other significant problem disbursements; and (3) producing reliable budgetary information.

Funds Control Weaknesses Can Place DOD at Risk of Overobligation and Overexpenditure and Violations of the Law

We have reported that the department is at risk of overobligating and overexpending its appropriations because of its weaknesses in identifying and training its personnel who are responsible for funds control and carrying out supervisory duties, its challenges in properly supporting and accounting for its transactions, and its poor financial systems. These weaknesses have contributed to 64 DOD-reported instances of overobligation or overexpenditure of funds in violation of the law totaling $927.4 million from fiscal year 2007 through September 15, 2011. However, there may be other violations that may not be detected, investigated, and reported because of the weaknesses in DOD's funds control and financial management overall. According to DOD, the most frequent causes of DOD's overobligations and overexpenditures include inadequate internal controls and standard operating procedures, not following prescribed internal controls and standard operating procedures, lack of appropriate training, and inadequate supervisory involvement or oversight.[17] Examples of reported weaknesses in DOD's funds control include:

- Inadequately trained funds control personnel. In 2008, we reported that DOD had not effectively identified and established training programs for departmental personnel who carry out DOD's funds

[16]Overobligation or overexpenditure of an appropriation or fund occurs when an officer or employee of the United States has made or authorized an obligation, such as a contract, or an expenditure, respectively, in excess of the amount available in the applicable appropriation account or fund.

[17]DOD Financial Management Regulation 7000.14-R (DOD FMR), Vol. 14, Ch. 2, Antideficiency Act Violations, Para. 020301 (November 2010). DOD's FMR also describes common types of overobligations and overexpenditures, such as the improper use of operations and maintenance funds by program and contracting officials for military construction or procurement activities. *Id.* at para. 020402.B.

control.[18] According to DOD, its funds control system relies extensively on the department's ability to (1) identify individuals who are performing key funds control roles, such as certifying officers,[19] contracting officers, program managers, funds certifying officials, and other departmental accountable officials,[20] who incur obligations and make disbursements and perform related duties, and (2) ensure that those individuals have received the training necessary to fulfill their responsibilities in compliance with the DOD Financial Management Regulation (FMR). We made recommendations to DOD in our report to improve its process and system of identifying and training its key funds control personnel, which DOD agreed to implement, and last year DOD revised the policies in its FMR on this aspect of its funds control. We have not assessed the effectiveness of DOD's actions. However, as I testified before this Panel in July 2011, DOD has not completed a competency analysis of its financial management personnel and still has significant work to do to address this challenge to achieving its financial improvement goals.[21]

- Unsupported transactions. We have reported that DOD components have significant weaknesses in their ability to properly support transactions in order to reliably determine whether their obligations and disbursements are being used for authorized purposes and within the amounts and time frames established by law. For example, we recently reported that the auditors who attempted to audit the Marine Corps fiscal year 2010 SBR were unable to conduct the audit

[18]GAO-08-1063.

[19]Disbursements may be made only on vouchers certified by the head of an agency or a certifying officer designated by the head of the agency. 31 U.S.C. § 3325(a). By law, certifying officers are responsible for, among other things, (1) the correctness of the facts in the certificate, voucher, and supporting documentation; (2) the correctness of computations on the voucher; and (3) the legality of a proposed payment under the appropriation or fund involved. 31 U.S.C. § 3528.

[20]A departmental accountable official is an individual who is responsible in the performance of his/her duties for providing a certifying officer with information, data, or services that the certifying officer relies upon in the certification of vouchers for payment. Departmental accountable officials may include resource managers, fund holders, and funds certifying officials, who are responsible for the proper assignment of funding on an obligation document before the obligation is incurred and for maintaining a system of positive funds control. Departmental accountable officers also may include officers and employees who enter into obligations, such as contracting officers, and who make payment eligibility determinations.

[21]GAO, *DOD Financial Management: Numerous Challenges Must Be Addressed to Achieve Auditability*, GAO-11-864T (Washington, D.C.: July 28, 2011).

because, among other internal control deficiencies, the Marine Corps lacked documentation to support its transactions, which put the Marine Corps at risk of not being able to verify whether payments were made in the appropriate amount for authorized purposes, and to the appropriate parties.[22] In its Agency Financial Report for Fiscal Year 2010,[23] DOD officials stated that one of 13 material weaknesses that prevent an audit of its financial statements will be resolved by 2017 by implementing processes and systems that can provide necessary transaction-level supporting documentation for its disbursements and collections.

- Inadequate recording of transactions. DOD faces challenges in properly recording its obligations and disbursements in its accounting and other business systems that impair its ability to track and control the use of public funds. According to DOD's FMR, obligations and expenditures are required to be recorded accurately and promptly, even if the recording results in a negative amount in the appropriation, fund, or other accounting level.[24] Last week, we reported that the auditors of the Marine Corps' fiscal year 2010 SBR found that the Marine Corps inappropriately used "bulk obligations" to record estimated liabilities that the Marine Corps did not match to actual payments due to weak internal controls.[25] As discussed below, a similar practice by the military departments led to overobligations in violation of the law. Further, DOD reported in its Agency Financial Report for Fiscal Year 2010 that another of 13 material weaknesses that prevented an audit of its financial statements relates, in part, to the department's inability to properly record payments due from other agencies and the public.[26]
- Ineffective business systems. In our 2008 report on DOD's funds control, we found that DOD's nonintegrated and outdated business systems, including its financial systems and other systems that provide most of DOD's financial data to the financial systems, were a key impediment to effective funds control, and we noted that DOD had long-term plans to implement modernized, fully integrated, and

[22]GAO-11-830.

[23]DOD, *Agency Financial Report for FY 2010, addendum A, table 2a-1* (Nov. 15, 2010).

[24]DOD FMR, Vol. 14, Ch. 2, Para. 0203 (November 2010).

[25]GAO-11-830.

[26]DOD, *Agency Financial Report for FY 2010, addendum A, table 2a-1*.

reliable business systems.[27] However, as I stated before this panel in July, DOD faces significant challenges in its effort to implement these new systems over the next several years.[28] In its Agency Financial Report for Fiscal Year 2010 and its FIAR Plan, DOD acknowledges the challenges related to weaknesses in DOD's financial management systems. For example, in DOD's annual statement on the status of its internal controls included in its Agency Financial Report, DOD reported that the department is not in conformance with internal control requirements because of a material weakness in its financial management systems. DOD's FIAR Plan states that implementing modernized, effective, and integrated business systems that reliably support financial needs of the department are critical to achieving the department's financial improvement and audit readiness efforts.

DOD's ineffective funds control has resulted in overobligations and overexpenditures in violation of the Antideficiency Act (ADA).[29] As we reported in 2008, weaknesses in DOD's funds control impaired its ability to accurately detect, investigate, and report such violations.[30] Under the ADA, agencies are prohibited from, among other things, incurring obligations or making expenditures in excess or in advance of appropriations or in excess of apportionments or formal subdivisions of those apportionments.[31] When DOD determines that a violation of the ADA has occurred, the department is to immediately report to the President and Congress all relevant facts and a statement of actions

[27]GAO-08-1063. The DOD FMR describes requirements and assigns responsibilities for implementing financial management systems as part of DOD's funds control. DOD FMR, Vol. 14, Ch. 1, Administrative Control of Funds, Para. 010210 (Jan. 2009).

[28]GAO-11-864T.

[29]31 U.S.C. §§ 1341-42, 1349-51, 1511-19.

[30]GAO-08-1063.

[31]Under law, an apportionment is the action by which the Office of Management and Budget (OMB) distributes amounts available for obligation, including budgetary reserves established pursuant to law, in an appropriation or fund account. An apportionment divides amounts available for obligation by specific time periods (usually quarters), activities, projects, objects, or a combination thereof. The amounts so apportioned limit the amount of obligations that may be incurred. An apportionment may be further subdivided by an agency into allotments, suballotments, and allocations. In apportioning any account, some funds may be reserved to provide for contingencies or to effect savings made possible pursuant to the Antideficiency Act. Funds apportioned to establish a reserve must be proposed for deferral or rescission pursuant to the Impoundment Control Act of 1974 (2 U.S.C. §§ 681–688).

taken and submit a copy to the Comptroller General at the same time. According to copies of ADA violation reports received by the Comptroller General, and as shown in table 1, DOD reported 64 ADA violations from fiscal year 2007 through September 15, 2011, with a total dollar amount of $927.4 million. However, due to DOD's weaknesses in its funds control process, including the weaknesses described above related to DOD's challenges in controlling and recording obligations and disbursements and detecting violations, this listing may not be complete because all ADA violations may not have been identified or reported. For example, GAO identified a violation in June 2010 involving the Army's overobligation of its fiscal year 2008 Military Personnel–Army (MPA) appropriation, as evidenced by a $200 million transfer DOD made to the MPA account from DOD's working capital fund, which has not yet been reported by DOD.[32] Mr. Chairman, Ranking Member Andrews, I know that you and other members of Congress recently sent a letter to the DOD Comptroller asking for an explanation of why DOD has not reported this and other potential ADA violations. Such an explanation could provide greater transparency over the accuracy of reported numbers and amounts of violations.

[32]GAO, *Department of the Army—The Fiscal Year 2008 Military Personnel, Army Appropriation and the Antideficiency Act*, B-318724 (Washington, D.C.: June 22, 2010). OMB policy requires DOD to report violations found by GAO. OMB Cir. No. A-11, section 145.8. Further, on March 30, 2011, we issued a legal opinion in which we concluded that an Enhanced Use Lease entered into by the U.S. Army violated the ADA by including a clause in the escrow agreement whereby the government indemnified an escrow agent against all liabilities arising under the escrow agreement. GAO- B-321387, *Department of the Army—Escrow Accounts and the Miscellaneous Receipts Statute* (Mar. 30, 2011). DOD has not yet reported this violation to GAO. For additional information on this lease and the related ADA violation, see GAO, *Defense Infrastructure: The Enhanced Use Lease Program Requires Management Attention*, GAO-11-574 (Washington, D.C.: June 30, 2011). For additional information on this lease and the related ADA violation, see also GAO, *Defense Infrastructure: The Enhanced Use Lease Program Requires Management Attention*, GAO-11-574 (Washington, D.C.: June 30, 2011).

Table 1: Anti-deficiency Act Violations Reported by the Department of Defense (Fiscal Year 2007 through September 15, 2011)

	Reported violations	
Military service	**Number**	**Amount (dollars in millions)**
Army	31	$548.0
Navy	15	237.6
Marine Corps	3	5.1
Air Force	12	129.5
Defense agencies	3	7.2
Total	**64**	**$ 927.4**

Source: DOD.

Note: The data are unaudited information GAO extracted from Antideficiency Act reports received by GAO from DOD as of September 15, 2011. Because of the time required to investigate potential violations, the violations generally occurred 2 or more years prior to the dates of the reports.

Because the ADA prohibits, and effective funds control should prevent, overobligations and overexpenditures of public funds, the number and dollar amount of ADA violations are an indicator of the status of DOD's funds control. However, the nature of reported violations can also indicate systemic weaknesses in DOD's funds control. The following ADA violations involved systemic breakdowns in the controls necessary to track actual amounts of obligations incurred against amounts of available funding:

- As noted above, we found in June 2010 that the Army Budget Office lacked an adequate funds control process to provide it with ongoing assurance that obligations and expenditures do not exceed funds available in the fiscal year 2008 Military Personnel–Army (MPA) appropriation.[33] We found that the Army's total obligations against the fiscal year 2008 MPA appropriation exceeded the amount available in the account, as evidenced by the Army's need to transfer $200 million from the Defense Working Capital Fund, Army appropriation to cover the shortfall. The overobligation likely stemmed, in part, from lack of communication between the Army budget office and program managers so that the Army budget office's accounting records reflected estimates instead of actual amounts until it was too late to control the incurrence of excessive obligations in

[33]B-318724.

violation of the act. Thus, at any given time in the fiscal year, the Army budget office did not know the actual obligation and expenditure levels of the account. The Army budget office explained that it relies on estimated obligations—despite the availability of actual data from program managers—because of inadequate financial management systems.

- Similarly, in 2008, Navy officials reported an ADA violation in the Military Personnel–Navy (MPN) appropriation in the amount of $183 million. The violation occurred when the Bureau of Naval Personnel (BUPERS) overobligated the fiscal year 2008 MPN appropriation due to its inability to accurately track the status of obligations and identify the need for additional funding.

To its credit, the department has issued and periodically updated policies that address responsibilities for preventing and identifying ADA violations.[34] DOD's guidance also describes frequent causes of violations within the department and explains the actions necessary to avoid them, including emphasizing management and supervisory duties, training of key funds control personnel, and effective systems and procedures.

Efforts to Address DOD's "Problem" Disbursements

Basic controls to match payments with the obligation records and account for and reconcile payments are not effective within the department. DOD has identified payment transactions and related accounting steps as "problem disbursements" and monitors them through management tracking reports as it attempts to correct them. Problem disbursements include unmatched disbursements (UMD) that represent disbursements that have been paid by an accounting office but that have not been matched to the correct obligation records. For example, if one or more of the accounting line elements for each transaction, such as appropriation, fiscal year, and program code do not match the information in the accounting records, then the transaction is considered unmatched. For a description of two examples of DOD's problem disbursements, see appendix II.

[34]DOD FMR, Vol. 14, Ch. 2 (November 2010). The guidance also describes common types of violations, including the use of appropriations for improper purposes, such as the use of operations and maintenance funds for military construction and procurement activities, which cannot be corrected by adjusting DOD's accounts to charge the correct appropriation.

Problem disbursements increase the risk of making fraudulent or erroneous payments without detection. In addition, problem disbursements impair the reliability of DOD financial statements and DOD's ability to control its disbursements, a key aspect of funds control. According to DOD's tracking reports, the department has made progress in addressing problem disbursements, but the department has not achieved its goals in this area.

As we reported in 2003, the Defense Finance and Accounting Service (DFAS) expanded its use of existing financial management performance metrics to include special measures for the recording of payments, including the amount of disbursements that are not matched to the corresponding obligations, or UMDs.[35] DOD, in its May 2011 FIAR Plan Status Report[36] on the implementation of its FIAR Plan, included a metric on UMDs. This metric tracks UMDs that are over 120 days old, which DOD refers to as "overaged UMDs."[37] As stated in that report, DOD's goal is to have no UMD amounts greater than 120 days old. According to the report, the benefit of reducing UMDs, especially overaged UMDs, is greater accuracy of DOD components' account balances on management reports and the SBR. Reduction of the amount of UMDs will allow DOD to have more accurate information about the obligations that have been liquidated, improving its budgetary accounting. The presence of UMDs prevents the department from having accurate information about the amount of funds available for obligation and expenditure to carry out its mission, thus increasing the risk of possible ADA violations. The following table appears in the May 2011 status report on the FIAR Plan for overaged UMDs and indicates that, from the second quarter of fiscal year

[35]GAO, *Financial Management: DOD's Metrics Program Provides Focus for Improving Performance*, GAO-03-457 (Washington, D.C.: Mar. 28, 2003). We monitor the DFAS tracking reports as part of our annual audit of the *Consolidated Financial Statements of the U.S. Government*.

[36] DOD FIAR Plan Status Update, app. I (May 2011).

[37]For this metric, UMDs are defined as disbursements that cannot be matched to an obligation in the accounting system. According to DOD's Financial Management Regulation 7000.14-R, vol. 3, ch. 11, "collocated" offices have a total of 90 days to research and resolve a UMD and "noncollocated" offices have a total of 120 days to research and resolve a UMD.

2009 through the second quarter of fiscal year 2011, DOD is making progress at reducing overaged UMDs:[38]

Table 2: DOD Reported Unmatched Disbursements over 120 Days as of May 2011 (dollars in millions)

	Fiscal year 2009		Fiscal year 2010		Fiscal year 2011
DOD component	**Second quarter**	**Fourth quarter**	**Second quarter**	**Fourth quarter**	**Second quarter**
Army	$6.5	$54.6	$156.4	$4.8	$36.7
Navy	565.4	496.6	559.4	23.2	40.9
Air Force	94.6	68.5	3.4	0.5	2.8
Defense Logistics Agency	0.00	0.00	40.6	32.8	29.2
Total	**$666.5**	**$619.7**	**$759.8**	**$61.3**	**$109.6**

Source: DOD.

Note: Unaudited data are from FIAR Plan Status Report as of May 2011.

In the results section accompanying this table, DOD officials noted Army's UMDs reportedly increased due to systems issues with recording obligations and lines of accounting in its Enterprise Resource Planning (ERP) systems.[39]

DOD's Funds Control Weaknesses and Problem Disbursements Impair the Reliability of DOD's Financial Information

As we and DOD's auditors have reported, DOD's funds control and related internal control weaknesses and problem disbursements have impaired its ability to produce reliable financial information for reporting, especially the reliability of the department's SBR, as well as its other budgetary information. For example, we reported in 1999 that the reliability of DOD's budgetary information reported in its SBR was impaired.[40] In 2009, the DOD Comptroller directed that the department's

[38]DOD's corrective actions have included the implementation of a process to match proposed disbursements with corresponding obligations before making payments, which Congress has required by law since 1995 for certain large disbursements. This process, known as prevalidation, checks whether DOD organizations have recorded obligations properly in an official accounting system as well as reserved sufficient funds in accounting records to cover the proposed disbursement before payments are made.

[39]An Enterprise Resource Planning (ERP) solution is an automated system using commercial off-the-shelf (COTS) software consisting of multiple, integrated functional modules that perform a variety of business-related tasks such as general ledger accounting, payroll, and supply chain management. ERP systems represent a critical element of DOD's FIAR strategy.

[40]GAO/T-AIMD/NSIAD-99-171.

components focus their efforts on budgetary information and the ability to prepare an auditable SBR as one of two first priorities that are now being implemented through the DOD's FIAR Plan, its FIAR Guidance, and the components' individual financial improvement plans. As a pilot, DOD designated the Marine Corps SBR as the first military service SBR to undergo an audit. However, as we reported last week, the Marine Corps was unable to undergo an audit of its fiscal year 2010 SBR due to serious control weaknesses that prevented the auditors from performing the audit.[41] Although we found that the Marine Corps was able to address some of these weaknesses, many remained unresolved. We found that the Marine Corps did not develop an effective overall corrective action plan to address the 70 audit findings and related 139 recommendations that identified risks, prioritized actions, and identified required resources needed to help ensure that actions adequately respond to recommendations. Instead, its approach to addressing auditor findings and recommendations for its prior and current audit efforts focuses on short-term corrective actions necessary to support heroic efforts to produce reliable financial reporting at year-end. Such approach may not result in sustained improvements over the long term that would help ensure that the Marine Corps could routinely produce sound data on a timely basis for decision making and reporting. We also reported key lessons learned from this pilot that, if effectively shared with the other military services, could help them to address similar known challenges in preparing reliable SBRs.

The SBR is designed to provide information on budgeted spending authority reported in the President's Budget, including budgetary resources, availability of budgetary resources, and how obligated resources have been used. Both Congress and the administration use this information to make decisions about the amounts of appropriations DOD needs to carry out its operations. However, as we stated in our February 2011 High-Risk Series: An Update, DOD's pervasive control weaknesses adversely affect DOD's ability to, among other things, anticipate future costs and claims on the budget.

[41]GAO-11-830.

Risk of DOD Improper Payments

DOD, in its Agency Financial Report for Fiscal Year 2010, reported that it made an estimated $1 billion in improper payments[42] under five of its programs.[43] However, this estimate is incomplete because DOD did not include estimates from its commercial payment programs, which account for approximately one-third of the value of DOD payments. Further, both we and the DOD IG have reported on weaknesses in DOD's payment controls, including weaknesses in its process for assessing the risk of improper payments and reporting estimated amounts of them. DOD's payment controls are hindered by problems related to inadequate payment processing, poor financial systems, and inadequate supporting documentation.

Weaknesses in DOD's Payment Controls

In our February 2011 High-Risk Series: An Update, we identified various DOD high-risk areas, including contract management (designated in 1992) and financial management (designated in 1995), that we have previously reported make the department vulnerable to improper payments.[44] DOD's contract management weaknesses, such as ineffective oversight, increase the risk that DOD will pay more than the value of the goods delivered or services performed. Financial management deficiencies have adversely affected the department's ability to control costs, to ensure basic accountability, and to prevent and detect fraud, waste, and abuse, and represent a significant obstacle to achieving an unqualified opinion on DOD's and the U.S. government's consolidated financial statements. In addition, the DOD IG recently

[42]An improper payment is defined as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payment for services not received, and any payment that does not account for credit for applicable discounts. OMB guidance also instructs agencies to report payments for which insufficient or no documentation was found as improper payments.

[43]DOD, *Agency Financial Report for FY 2010, addendum A*. In its improper payment reporting, DOD identifies the primary causes of improper payments for each of the five programs. For example, DOD reports that underpayments accounted for $338.8 million (67 percent) of the $505.9 million in improper payments for the Military Pay program. According to the information provided by DOD, most of these underpayments ($207 million) occurred within the Army Reserve and Army National Guard, most of which involved unpaid leave not used before members were discharged or deactivated back to Reserve from Active duty status.

[44]GAO-11-278.

reported their assessment that DOD's risk of making improper payments is high.[45] This assessment was based on control deficiencies identified by the Defense Finance and Accounting Service (DFAS) as well as prior assessments made by GAO and DOD IG.

Our prior work and reports issued by DOD IG have highlighted the department's long-standing and significant problems with estimating and preventing improper payments. Specific weaknesses in DOD's payment controls include inadequate payment processing, inadequate supporting documentation for expenditures, financial system deficiencies, and weak contract audit and payment controls. For example:

- Inadequate payment processing. The DOD IG reported that the U.S. Marine Corps Forces Special Operations Command did not have effective controls over the reporting and processing of baseline and contingency funds, resulting in improper payments. [46] Specifically, the DOD IG reported that the command did not have effective controls over the recording and processing of 35,699 transactions.[47] Of the 320 sample transactions,[48] 245 had one or more deficiencies. In addition, of the 29 travel vouchers with deficiencies or unsupported expenses, the payments made on 10 vouchers were improper payments. According to the DOD IG report, the improper payments occurred because the certifying officers and departmental accountable officials approved the travel vouchers with deficiencies and unsupported expenses without thoroughly reviewing them.
- Inadequate documentation. As we reported last week, we continue to find that the Navy and Marine Corps have issues with maintaining adequate documentation for their transactions.[49] On the basis of the

[45]DOD, Inspector General, *DOD Needs to Improve High Dollar Overpayment Review and Reporting*, D-2011-050 (Arlington, Virginia: March 16, 2011).

[46]DOD, Inspector General, *U.S. Marine Corps Forces Special Operations Command Needs to Improve Controls Over Financial Transactions*, D-2011-086 (Arlington, Virginia: July 20, 2011).

[47]The 35,699 transactions were valued at $131.8 million in obligations and $54.1 million in expenditures from October 1, 2008 to October 16, 2009.

[48]The 320 sample transactions included obligations valued at $83.8 million and expenditures of $20.6 million.

[49]GAO, *DOD Financial Management: Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan*, GAO-11-932T (Washington, D.C.: Sept. 15, 2011).

sample of items we tested for an ongoing audit, the Navy did not maintain adequate documentation for us to independently validate its efforts to research and resolve differences between its Fund Balance with Treasury balances with the records of the Department of the Treasury, which is a process similar to reconciling a checkbook with a bank statement. Some payments are considered improper payments due to insufficient or missing documentation. In July 2011, the DOD IG reported that DFAS made potentially improper payments of $4.2 million from January 2005 through December 2009 related to active duty military personnel.[50] According to the report, DOD did not ensure that the Defense Joint Military Pay System–Active Component contained only valid active-duty military accounts. For example, the DOD IG found that this system contained military personnel that received payments after their reported date of death.

- Financial system deficiencies. In 2009, we reported that DOD traced the root cause of many improper payments in its military and civilian pay to the inaccurate or untimely reporting of entitlement data to DOD's automated systems on such areas as time and attendance, personnel actions, and pay allowances.[51] We reported that DOD had described steps to monitor and track these improper payments; however, it was unclear whether these actions would address the root causes of these deficiencies. In August 2011, the DOD IG reported that the Army's controls over its Deployable Disbursing System[52] (DDS) payments were inadequate and resulted in, among other things, improper payments.[53] The DOD IG found that the Army was at risk of improper payments because its Financial Management Centers did not effectively review user access to DDS or oversee the payment process. The DOD IG reported that the Army's disbursing personnel made nine duplicate payments to vendors and did not collect on these improper payments. Two of the duplicate payments were referred by

[50]DOD, Inspector General, *Active Duty Military Personnel Accounts Were Generally Valid and Secure, but DOD May Have Made Improper Payments*, D-2011-093 (Arlington, Virginia: July 27, 2011).

[51] GAO, *Improper Payments: Significant Improvements Needed in DOD's Efforts to Address Improper Payment and Recovery Auditing Requirements*, GAO-09-442 (Washington, D.C.: July 29, 2009).

[52]DFAS developed the Deployable Disbursing System to fulfill a need for a tactical disbursing system and to maintain accountability of U.S. Treasury funds.

[53]DOD, Inspector General, *Controls Over Army Deployable Disbursing System Payments Need Improvement*, D-2011-101 (Arlington, Virginia: Aug. 17, 2011).

the DOD IG to the Defense Criminal Investigative Service because of the suspicious and potentially fraudulent nature of the payments.

- Weak contract audit and payment controls. As we testified in February 2011, our 2009 audit work identified, among other weaknesses in DOD's contract payment controls, weaknesses in contract auditing, which increase the risk of improper payments.[54] In 2009, we reported on audit quality problems at Defense Contract Audit Agency (DCAA) offices nationwide, including compromise of auditor independence, insufficient audit testing, and inadequate planning and supervision.[55] In addition, DCAA's management environment and quality assurance structure were based on a production-oriented mission that put DCAA in the role of facilitating DOD contracting without also protecting the public interest. At that time, we found serious quality problems in the 69 audits and cost-related assignments we reviewed, resulting in DCAA rescinding over 80 audit reports and removing over 200 DOD contractors from direct billing privileges, which allow them to submit invoices for payment without review by the government.

Concerns over Incomplete DOD Reviews and Reporting on Improper Payments

The Improper Payments Information Act of 2002 (IPIA)[56] requires DOD to annually identify programs and activities susceptible to significant improper payments, estimate amounts improperly paid under those programs and activities, and report on these estimates and the actions to reduce improper payments. In July 2009, we reported that DOD did not conduct risk assessments on all of its payment activities, as $322 billion in agency outlays were excluded from the amounts DOD assessed.[57] While DOD components conducted risk assessments for six payment activities totaling about $493 billion in fiscal year 2007, we identified an additional $322 billion in outlays reported in DOD's SBR[58] that had not been assessed. Also, the DOD IG recently reported that DOD's First

[54]GAO, *Contract Audits: Role in Helping Ensure Effective Oversight and Reducing Improper Payments*, GAO-11-331T (Washington, D.C.: Feb. 1, 2011).

[55]GAO, DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform, GAO-09-468 (Washington, D.C.: Sept. 23, 2009).

[56]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002), as amended by the Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, 124 Stat. 2224 (July 22, 2010).

[57]GAO-09-442.

[58]DOD's SBR for fiscal year 2007 reported gross outlays of about $815 billion.

Quarter FY 2010 High Dollar Overpayments Report[59] (Overpayments Report) did not accurately portray the department's risk of high-dollar overpayments.[60] The DOD IG reported that the Overpayments Report was incomplete because not all DOD payments were examined. DFAS reviews for high dollar overpayments excluded approximately $167.5 billion or 55 percent of DOD's total $303.7 gross outlays.[61] DOD's inability to identify and reconcile total payments to its SBR affected the reliability and completeness of its estimates for and reviews of improper payments.

In addition to not conducting risk assessments for all of its agency outlays, we reported that DOD had neither established a methodology to estimate nor had it estimated the amount of improper payments for commercial pay—its largest payment activity.[62] [63] At the time of our report, DOD officials stated that reporting commercial improper payments under both IPIA and the Recovery Auditing Act[64] would create duplicative reporting. We disagreed with DOD officials stating that the department

[59]Executive Order 13520, *Reducing Improper Payments* (Nov. 20, 2009), requires that the head of each agency report quarterly on high dollar overpayments identified and recovered. The report is also to include the actions taken to prevent high dollar overpayments.

[60]A high-dollar improper payment is defined as any overpayment that is in excess of 50 percent of the correct amount of the intended payment where (1) the payment to an individual exceeds $5,000 as a single payment or in cumulative payments for the quarter or (2) the payment to an entity exceeds $25,000 as a single payment or in cumulative payments for the quarter.

[61]DOD's Comptroller reported gross outlays of $303.7 billion for the first quarter of fiscal year 2010 in DOD's SBR.

[62]GAO-09-442.

[63] DOD separates its payment of commercial invoices into two business lines—(1) contract pay—which pays invoices for larger, more complex contracts and (2) vendor pay—which processes payments for smaller, less complex contracts, purchase orders, and other miscellaneous payments.

[64]At the time of our report, agencies were required to report on their efforts to recover overpayments made to contractors under section 831 of the National Defense Authorization Act for Fiscal Year 2002, formerly codified at 31 U.S.C. §§ 3561-67, commonly known as the Recovery Auditing Act. This provision was repealed and replaced by the Improper Payments Elimination and Recovery Act of 2010 with a more comprehensive recovery audit program requirement. Pub. L. No. 111-204, § 2(h), 124 Stat. 2224, 2228 (July 28, 2010). For more details on these requirements, see GAO, *Improper Payments: Recent Efforts to Address Improper Payments and Remaining Challenges*, GAO-11-575T (Washington, D.C.: Apr. 15, 2011).

could leverage the results from its existing Recovery Auditing Act processes identifying actual commercial under- and overpayments to develop its statistical sampling methodology and enhance the reported estimate.

The DOD Comptroller testified in May 2011 that DOD had not estimated the amount of improper payments for commercial pay because the department uses prepayment screening, both automated and manual, to prevent improper payments.[65] He added that one especially important tool to prevent commercial pay improper payments is the department's Business Activity Monitoring (BAM)[66] software program introduced in August 2008. However, the DOD IG reported, among other things, that the BAM tool had a false positive[67] rate of more than 95 percent and that the BAM review methodology was not standardized across payment systems or even within the same office. The large number of payments flagged for review (false positives) made it difficult to conduct the appropriate research in a timely manner without delaying payment. The IG reported that the lack of a standardized methodology could lead to DFAS not detecting and preventing improper payments due to poor quality review. The Comptroller stated, in his May 2011 testimony, that in view of legislative changes and more recent OMB guidance, DOD plans to do postpayment statistical sampling for commercial payments for those systems not currently covered by the BAM tool to supplement its prepayment measures.

Concluding Observations

Although DOD has dedicated significant resources under its FIAR Plan to remediate its identified financial management weaknesses, it faces significant challenges in addressing those persistent weaknesses. DOD's large number of nonintegrated business systems, complex and inefficient payment processes, and weak internal controls put the department at risk

[65]DOD, *Statement of The Honorable Robert F. Hale, Under Secretary of Defense (Comptroller) before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate* (Washington, D.C.: May 25, 2011).

[66]BAM is a tool that runs a discrete number of tests to identify potential improper payments before disbursement.

[67]A false positive is a payment flagged as a potential improper payment that after review is determined to be proper.

of overobligating or overspending its appropriations. DOD has been addressing its problem disbursements, but they are a contributing factor to the department's funds control issues. The department's weak controls over payments increase the risk of inaccurate cost information and improper payments. Given DOD's stated goal of achieving audit readiness on its consolidated financial statements by the end of fiscal year 2017, it will be critical that the department continue ensure that steady progress is being made. Moreover, for DOD to move forward, it will be important for the department to resolve its problems with multiple, disparate nonintegrated systems and to ensure that whatever systems solutions are chosen will provide the underlying foundation for auditable financial statements.

Mr. Chairman and members of the panel, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the panel may have at this time.

For further information regarding this testimony, please contact Asif A. Khan, (202) 512-9869 or khana@gao.gov. Key contributors to this testimony include F. Abe Dymond, Assistant Director; Daniel Egan; Maxine Hattery; Robert Sharpe; and Sandra Silzer.

Appendix I: Requirements and Standards for Federal Agencies' Internal Controls

Congress has long recognized the importance of internal control, beginning with the Budget and Accounting Procedures Act of 1950, over 60 years ago. The 1950 act placed primary responsibility for establishing and maintaining internal control squarely on the shoulders of agency management. In 1982, Congress enacted the law commonly known as the Federal Managers' Financial Integrity Act (FMFIA), and the Office of Management and Budget (OMB) issued Circular No. A-123 to require each agency to establish and maintain internal control systems that would enable obligations and costs to be recorded in compliance with applicable law; funds, property, and other assets to be safeguarded; and revenues and expenditures applicable to agency operations to be properly recorded and accounted for. Within this broad framework of internal control required by FMFIA, the Department of Defense, like other executive-branch agencies, must also design and implement effective systems of funds control, payment controls, and internal control over financial reporting. Auditors of DOD's financial statements assess the effectiveness of these four types of internal controls in varying degrees as part of the financial statement audit. Further, one financial statement, the Statement of Budgetary Resources, was designed for the purpose of reporting on agencies' use of federal funds and to subject agencies' funds control to audit. Listed below is a brief description of the four types of controls.

Internal Control

Internal control represents an organization's plans, methods, and procedures used to meet its missions, goals, and objectives and serves as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, abuse, and mismanagement. Internal control is to provide reasonable assurance that an organization's objectives are achieved through (1) effective and efficient operations, (2) reliable financial reporting, and (3) compliance with laws and regulations. Safeguarding of assets is a subset of all these objectives.

Funds Control

The purpose of funds control is to implement controls that restrict both obligations[1] and disbursements[2] from exceeding appropriations and

[1]An obligation is a definite commitment that creates a legal liability of the government for the payment of appropriated funds for goods and services ordered and received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Obligations include, for example, the awarding of contracts and grants.

supporting the proper preparation and execution of the budget. Funds control systems must be able to accurately record obligations, collections, and disbursements against appropriations and the accounts established to track the status of appropriations. An agency's fund control system is the primary tool for ensuring that the agency complies with congressional spending mandates, and is, therefore, central to Congress's ability to exercise its constitutional power of the public purse. In the executive branch of the federal government, funds control requirements are implemented by executive agencies consistent with policies and guidance issued by OMB, the Department of the Treasury (Treasury), and the head of each executive agency. According to OMB Circular No. A-11, proper funds control should include the following elements:

- agency regulations that are required by, and designed to ensure compliance with the prohibitions contained in, the Antideficiency Act (ADA), which are described below;[3]
- the purpose of funds control is to implement controls that restrict both obligations and expenditures from exceeding appropriations and related administrative accounts, as well as hold officers and employees accountable when they violate the restrictions; and
- the funds control systems must operate within the internal control systems, including the objective of complying with laws and regulations.

[2]A disbursement is an amount paid by a federal agency, by cash or cash equivalent, during the fiscal year to liquidate obligations, such as payment for goods received under a contract. Disbursements often are referred to as "expenditures" or "outlays."

[3]The ADA is one of the major laws in the statutory scheme by which the Congress exercises its constitutional control of the public purse. Despite the name, it is not a single act, but rather a series of related provisions that evolved over a period of time in response to various abuses. As late as the post-Civil War period, it was not uncommon for agencies to incur obligations in excess, or in advance, of appropriations. Perhaps most egregious of all, some agencies would spend their entire appropriations during the first few months of the fiscal year, continue to incur obligations, and then return to the Congress for appropriations to fund these "coercive deficiencies." These were obligations to others who had fulfilled their part of the bargain with the United States and who now had at least a moral—and in some cases also a legal—right to be paid. The Congress felt it had no choice but to fulfill these commitments, but the frequency of deficiency appropriations played havoc with the United States' budget. The Congress expanded the ADA several times throughout the 20th century to require and enforce apportionments and agency subdivisions of apportionments to achieve more effective control and conservation of funds. The ADA contains both affirmative requirements and specific prohibitions. For a more detailed description of the requirements for funds control systems under the Antideficiency Act and other fiscal statutes, see GAO, *DOD Financial Management: Improvements Are Needed in Antideficiency Act Controls and Investigations,* GAO-08-1063 (Washington, D.C.: Sept. 28, 2008).

The ADA prohibits federal officers and employees from

- making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law, 31 U.S.C. § 1341(a)(1)(A);
- involving the government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law, 31 U.S.C. § 1341(a)(1)(B);
- accepting voluntary services for the United States, or employing personal services not authorized by law, except in cases of emergency involving the safety of human life or the protection of property, 31 U.S.C. § 1342; and
- making obligations or expenditures in excess of an apportionment or reapportionment, or in excess of the amount permitted by agency regulations, 31 U.S.C. § 1517(a).

Once it is determined that there has been a violation, the agency head "shall report immediately to the President and Congress all relevant facts and a statement of actions taken," and they shall transmit a copy to the Comptroller General at the same time. OMB has issued further instructions on preparing the reports, which may be found in OMB Circular No. A-11, Preparation, Submission, and Execution of the Budget, § 145.

Internal Control over Financial Reporting

Internal control over financial reporting should assure the safeguarding of assets from waste, loss, unauthorized use, or misappropriation as well as assure compliance with laws and regulations pertaining to financial reporting. Financial reporting includes annual financial statements of an agency as well as other significant internal or external financial reports. Other significant financial reports are defined as any financial reports that could have a material effect on a significant spending, budgetary, or other financial decision of the agency or that is used to determine compliance with laws and regulations on the part of the agency. An agency needs to determine the scope of financial reports that are significant, that is, which reports are included in the assessment of internal control over financial reporting. In addition to the annual financial statements, significant reports might include: quarterly financial statements; financial statements at the operating division or program level; budget execution reports; reports used to monitor specific activities such as specific revenues, receivables, or liabilities; reports used to monitor compliance with laws and regulations such as the Anti-Deficiency Act.

Payment Controls

Payment controls, as a discrete subset of internal controls and funds control, establish an effective system of internal controls needed to maintain accountability over resources, including identifying, reporting, and reducing improper payments and problem disbursements, and recouping improper payments when they are made. Controls should ensure payments and collections are timely and accurate and that public funds are used properly for the payments. Managers are responsible for ensuring that internal controls are established and functioning properly. Managers with responsibilities for determining entitlement, authorizing and executing payments and collections shall

- create, document, and maintain an organizational structure and business processes that appropriately segregates assigned duties, emphasizes adherence to policies and procedures, and employs sound internal accounting and system access controls;
- implement finance and accounting systems that comply with the federal financial management systems requirements, keep disbursement (entitlement), and accounting records accurate and in balance from contract execution through closeout, and monitor the causes of late payments and interest penalties incurred;
- establish systematic controls that capture adequate audit trails to allow the tracing from source documents of financial events to general ledger account balances through successive levels of summarization and financial reports/statements;
- ensure data is processed using accurate coding and errors are researched and corrected;
- employ systems that ensure the authenticity of data that are electronically transmitted, including the electronic signature and ensure controls provide reasonable assurance that deliberate or inadvertent manipulation, modification, or loss of data during transmission is detected; and
- validate cash management and payment performance quality and effectiveness on an annual basis: and periodically test effectiveness of internal controls, document results of testing, and take necessary corrective actions.

Appendix II: DOD "Problem Disbursements"

The Department of Defense's (DOD) disbursement posting policy is in Chapter 11 of Volume 3 of its Financial Management Regulation (FMR).[1] According to Chapter 11, DOD's policy is that a disbursement be matched to its corresponding, detail-level obligation and be recorded as promptly as current systems and business practices reasonably permit. DOD recognizes that while most obligations and disbursements are matched automatically, some obligations and disbursements are required to be manually matched, mainly due to nonautomated processes or the rejection of transactions by automated systems.

As defined by DOD, problem disbursements include unmatched disbursements and negative unliquidated obligations. The definitions for these terms are also in Volume 3, Chapter 11 of the DOD FMR.

Unmatched Disbursement (UMD)	• An unmatched disbursement is defined as a disbursement transaction that has been received and accepted by an accounting office, but has not been matched to the correct detail obligation. This includes transactions that have been rejected back to the paying office or central disbursement clearing organization by an accounting office.
Negative Unliquidated Obligation (NULO)	• A negative unliquidated obligation is a disbursement transaction that has been matched to a cited detail obligation (unlike unmatched disbursements), but the total recorded disbursement(s) exceed the recorded obligation.

Chapter 11 also prescribes the requirements for researching UMDs and NULOs. For example, prevalidation is defined as a procedure that requires a proposed payment be identified/matched to its applicable proper supporting obligation that has been recorded in the official accounting system and that the line(s) of accounting cited on the payment match the data recorded in the accounting system. As stated in Chapter 11, prevalidation procedures help better ensure that contracts are not overpaid.

[1]DOD Financial Management Regulation 7000.14R, Vol. 3, Ch. 11, Unmatched Disbursements, Negative Unliquidated Obligations, and In-Transit Disbursements (November 2010).

Related GAO Products

DOD Financial Management: Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan. GAO-11-932T. Washington D.C.: September 15, 2011.

DOD Financial Management: Marine Corps Statement of Budgetary Resources Audit Results and Lessons Learned. GAO-11-830. Washington, D.C.: September 15, 2011.

DOD *Financial Management: Numerous Challenges Must Be addressed to Achieve Auditability,* GAO-11-864T. Washington D.C.: July 28, 2011.

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He is a Certified Public Accountant and a Certified Government Financial Manager.

WITNESS RESPONSES TO QUESTIONS ASKED DURING THE HEARING

SEPTEMBER 22, 2011

RESPONSE TO QUESTION SUBMITTED BY MR. CONAWAY

Mr. EASTON. In general, these transactions (often referred to as undistributed disbursements and collections) reflect outlays that have not been recorded in the lower level field accounting systems, but have been recorded against the Agency-compiled Department of Defense (DoD), Office of Management and Budget (OMB), and Department of the Treasury (Treasury) financial reports. These transactions have been recorded on a cash basis by Treasury, either through a disbursement or a collection. If the correct accrual has been established, the dollar value of these transactions is "offset" against these payables (for disbursements) or receivables (for collections). There are two categories of undistributed transactions: supported and unsupported. Some additional detail is provided in the paragraphs below.

Supported undistributed disbursements or collections typically represent transactions that will properly post, however with a lag in time. Supported undistributed disbursements are offset against accounts payable and undistributed collections are offset against accounts receivable. Adjusting entries are made at the Departmental level using Treasury United States Standard General Ledger accounts.

Unsupported undistributed balances represent balances that Treasury has reported, but DoD does not have support to accurately identify the outlays. Current DoD guidance is to record the unsupported undistributed disbursements as disbursements in transit, which offsets the nonfederal accounts payable. Unsupported undistributed collections are recorded in nonfederal other liabilities. Effective with the first quarter of Fiscal Year (FY) 2012, the unsupported undistributed disbursements will be recorded against accounts payable, and unsupported undistributed collections will be recorded against accounts receivable. New reporting attributes have been approved that will allow these balances to be identified within the trial balance.

OMB Circular A–136, "Financial Reporting Requirements," does not address or require any disclosures, including the amount, for undistributed disbursements or collections recorded in the financial statements and footnotes. As such, DoD does not disclose the balances in the financial statement footnotes. However, DoD includes in Note 1, "Significant Accounting Policies," a disclosure discussing the treatment for undistributed disbursement and collection. This disclosure has been included in the DoD financial statements since FY 2004. [See page 20.]

RESPONSE TO QUESTION SUBMITTED BY MR. ANDREWS

Mr. EASTON. Because the final, formal investigation is not yet complete, accountability and discipline is yet to be determined. The information below provides additional detail.

A preliminary Antideficiency Act (ADA) investigation report was initiated on November 19, 2009, following the Government Accountability Office (GAO) Decision B–318724, "Department of the Army—The Fiscal Year 2008 Military Personnel, Army Appropriation and the Antideficiency Act," dated June 22, 2010. The preliminary investigation resulted in a potential ADA violation of $200 million, and the Army initiated a formal ADA investigation in March of 2010. The Army completed the formal ADA investigation in January 2011, and during the next six months maintained a dialogue with the Department of Defense Office of the General Counsel. During this period the case was further refined to ensure that all relevant information had been included; this has been particularly critical in supporting assignment of individual responsibility/accountability. We anticipate an advanced decision in the near term. A final legal decision (referred to as an "advance" decision) is required prior to completing the ADA report and administering discipline. Once the responsible individual(s) has been named, and discipline imposed, the report will be finalized and reported to Congress, in accordance with OMB Circular A–11. Due to this requirement, and to ensure legal right to due process, the disciplinary phase of the ADA process may further delay formal submission. We estimate the final completion date to be December 2011. This formal report will establish individuals responsible and the discipline administered.

In its decision of June 22, 2010, the GAO concluded the Army violated the Antideficiency Act in the Fiscal Year 2008 Military Personnel, Army appropriation because total obligations exceeded funds available within the appropriation. This was caused because, as stated in GAO's decision, "Army Budget's accounting records, for a period of time, reflected estimated obligations instead of actual obligations until it was too late to control the incurrence of obligations in violation of the Antideficiency Act." The Army's investigation finds that Army program managers within the Deputy Chief of Staff (DCS G–1) did not record actual obligations in a timely manner, and instead used estimates as the basis for recording obligations. The Army Budget Office and DCS G–1 personnel routinely reconciled obligation estimates to actual disbursements, adjusting obligation estimates as necessary, and worked with Defense Finance and Accounting Service personnel to ensure the most accurate actual information was used to update recorded estimates. A violation occurred because total disbursements exceeded estimated obligations and funds available within the subdivision provided to DCS G–1. [See page 16.]

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