Statement of
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Office of Management and Budget,
Before the
Subcommittee on Government Efficiency and Financial Management
Committee on Government Reform
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Thank you, Mr. Chairman, for the opportunity to appear before you today to testify on financial management at the Department of Homeland Security (DHS). As you know, the enactment of the Homeland Security Act of 2002 (P.L. 107-296) represents an historic moment of almost unprecedented action by the Federal Government to fundamentally transform how the nation will protect itself from terrorism. Rarely in our country's past has such a large and complex reorganization of government entities occurred with such a singular and urgent purpose.

The government is undertaking a unique effort to transform a distinct group of agencies with multiple missions, values, and cultures into a strong and effective cabinet department whose mission is to analyze threats and intelligence, guard U.S. borders and airports, protect the nation's critical infrastructure, and coordinate the country's response for future emergencies. This unique opportunity, however, comes with many challenges, including those related to the new department's stewardship obligation to use tax dollars appropriately and to ensure accountability to the President, the Congress, and the American people.

The Homeland Security Department's charge to have a premier financial management organization is no different than the objective this Administration and the Congress have set before each of the departments and agencies in the executive branch. However, the merger of 22 disparate entities, each with different missions, cultures, programs and operating systems, greatly complicates the task and places the Department at higher risk for ineffective and inefficient financial management.

But with great challenge comes great opportunity—both the opportunity to reengineer and develop seamless systems and processes that support day-to-day operations and the opportunity to provide analysis and insight about the financial implications of program decisions that will ultimately assist this Administration, the Congress, and other decision-makers in evaluating the value and cost of federal programs.

Overview of DHS Financial Management Challenges

The creation of the Department of Homeland Security marks one of the largest and most complex mergers ever undertaken by the Federal Government. Yet, in the face of the many challenges involved with its creation, DHS has demonstrated a strong commitment to financial excellence and should be recognized for its efforts during the past year.

Even before the creation of the Department of Homeland Security on March 1, 2003, individuals from the affected finance and budget offices formed an interagency task force, consisting of senior and mid-level management, which met regularly to identify issues and begin developing solutions to many of the challenges facing the new Department. To ensure a smooth transition, this task force worked with OMB and others to: identify key financial, logistical, and human resources that would be transferred to the new Department; develop interim management directives that would provide at least temporary direction to the new Department; analyze the affects of moving the smaller components into the larger components; study the capabilities of the financial management systems in place at its largest components; and identify the audit scope of the new Department and its legacy agencies.

DHS has worked with the Financial Accounting Standards Advisory Board (FASAB) to develop guidance on a financial statement presentation that is consistent with current accounting standards. The Department has also consulted OMB to ensure that performance reporting for fiscal year 2003 is meaningful to the reader of the performance and accountability report. Further, OMB has worked with the Department on a myriad of technical financial issues, such as the appropriate presentation of Customs revenue, which has been delegated to DHS but whose collection remains a responsibility of the Department of the Treasury.

DHS has shown commitment to preparing audited financial statements in its first year of existence to demonstrate accountability to the Congress and the American people, even though the Accountability of Tax Dollars Act of 2002 allows the Department to request a waiver from this requirement. This commitment, coupled with the preparation of quarterly financial statements, shows the Department's determination to be fiscally responsible from its inception, accounting for all transferred assets, liabilities, and operations. DHS' goal is to obtain an unqualified (clean) opinion for fiscal year 2003 and, if events permit, to issue its performance and accountability report on an accelerated timeframe.

As with any merger, some of the new Department's efforts must focus on the most immediate challenges. Other efforts, however, by their nature will take several years to successfully develop and implement. The startup of DHS, unlike other agencies that carry out programs through grants or other third parties, is largely a salaries and expense agency with its own personnel and assets carrying out its vast responsibilities. Cost control and asset management, coupled with the need to successfully blend individuals from departments and agencies with different cultures, values, and missions, are critical to its effectiveness and efficiency. Although the creation of DHS began just over six months ago, it is off to a good start with regard to its financial management.

One of the first challenges DHS must overcome is to obtain a clean audit opinion on its financial statements, which will demonstrate tangible evidence of its efforts to create a premier financial management organization. Reaching that goal, however, will require a cooperative effort among the 22 entities that were transferred to the Department mid-year.

Many issues have been raised regarding the proper accounting treatment of the new Department's financial activity and its presentation in the financial statements that must be addressed. OMB has worked, and continues to work, with DHS to resolve these issues in a timely manner. Undoubtedly, new issues will surface, but we look forward to working with DHS to address them together.

DHS must also begin to address the longstanding weaknesses inherited from its components, such as weak financial accounting and reporting processes, inadequate information technology (IT) systems functionality and security controls, ineffective real and personal property processes, and insufficient internal controls over duties and taxes. The Department has inventoried these weaknesses and developed corrective action plans, although these weaknesses are not yet resolved.

DHS has already taken steps to integrate the diverse financial and performance information systems. It has identified the financial management systems to which the smaller component agencies may migrate beginning October 1. However, this step is just the first of many in a long process to streamline the Department's systems. The Chief Financial Officer (CFO) must also identify the Department's IT assets and then, in conjunction with each program, determine what IT assets are needed to meet mission requirements. The CFO must work with the Chief Information Officer (CIO) to identify a financial management system or systems to meet user needs, whether it be commercial-off-the-shelf, internally developed, or a hybrid of the two.

Establishing Sound Financial Management and Business Processes

The push to create a citizen-centered, results-oriented government has been exacerbated by the demands on available resources. It is necessary for financial managers to provide its management, this Administration, the Congress and other decision-makers with quality, timely information and analysis that better informs about the financial implications of program decisions and the impact of those decisions on agency performance goals and objectives. To this end, we believe that DHS must focus its attention on four critical areas:

- Ensuring top leadership drives the transformation to a single agency, single vision/goal
- Creating the financial organization that adds value and supports the Department's mission
- Establishing seamless financial systems and businesses processes
- Providing meaningful information to decision-makers by routinely generating reliable cost and performance information analysis

Ensuring Top Leadership. Leadership is critical to establishing sound financial management within the Department. The merger of 22 disparate entities into a single financial organization must begin with a clear vision of performance and expectations that is communicated throughout the organization at all levels. To be successful, DHS' top leadership must make attaining that vision a priority, and the message must be reinforced in both words and actions.

A vision of fundamentally improved financial management and the uncompromising organization-wide pursuit of that vision are critical within the culture of DHS. A foundation of control and accountability that supports external reporting and performance management, as well as using training to change the organizational culture and engage program managers, serves to provide necessary clear and strong executive leadership. Additionally, it is also important to have a financial management team, with the right mix of skills and competencies that is dedicated to the transformation process to ensure changes are thoroughly implemented and sustained over time.

Creating the Financial Organization. A premier financial organization must recognize that it exists to provide quality, timely and relevant information about the financial implications of program decisions and the impact of those decisions on agency performance goals and objectives. To accomplish this purpose, leading financial organizations must serve their customers both internally and externally, aligning their mission and organizational structure to better support the entity's mission and objectives. DHS should take all necessary steps toward creating a financial team that supports the overall missions, goals, and objectives of the Department.

Seamless Financial Systems and Business Processes. Building a premier financial organization will also require DHS to establish seamless financial systems and business processes to enable it to successfully fulfill its mission and achieve its goals and objectives. At the earliest opportunity, DHS must determine the essential system and process infrastructure that it requires throughout the organization. This infrastructure must also be flexible enough to support information needs at the detailed program level.

To this end, it is crucial that DHS give careful thought to its IT modernization efforts. OMB's experience with federal agencies has shown that attempts to modernize IT environments require specific blueprints, models that simplify the complexities of how agencies operate today, how they want to operate in the future, and how they will get there. In the absence of such blueprints, there is often unconstrained investment and systems that are duplicative and ineffective. Certain enterprise architectures offer such blueprints. If managed properly, architectures can clarify and help optimize the interdependencies and interrelationships among enterprise operations and the underlying IT infrastructure and applications that support them. The development, implementation, and maintenance of such an architecture, inclusive of robust financial functionality, are recognized hallmarks of successful public and private organizations.

Providing Meaningful Information. In seeking to create a premier financial organization, DHS must also pursue means that will permit it to routinely generate reliable cost and performance information analysis. Such analytics combined with other value-added activities will support the agency's mission and goals. This capability is a requirement for "getting to green" on the *Improved Financial Performance* initiative of the President's Management Agenda, and it gets to the heart of first-class financial management.

The creation of DHS provides an opportunity to reengineer much of the management reporting formats produced by its components to meet the needs of its users. As DHS looks to develop a new strategic plan that will outline its goals and objectives, its financial organization should design reporting formats that are aligned to measure performance in executing its strategy.

H.R. 2886, "Department of Homeland Security Financial Accountability Act"

Similar to the Committee, OMB has high expectations of solid financial management practices for this new Department, especially in light of its unique role and function within the Federal Government. To that end, we appreciate your efforts in introducing H.R. 2886, the "Department of Homeland Security Financial Accountability Act," and we look forward to discussing several issues of this legislation with you.

Fiscal Year 2003 Financial Reporting and Audit. Preparation of audited financial statements is a crucial step in DHS's path to financial management excellence. The Department of Homeland Security Financial Accountability Act (H.R. 2886), however, contains a provision that would lift the requirement of DHS to prepare and submit audited financial statements for any fiscal year before fiscal year 2004. It is our understanding that this provision is intended to provide DHS with adequate time to meet this requirement. (A similar provision is not included in the Senate companion bill, S. 1567.)

Much work has already been done toward the completion of the fiscal year 2003 financial statement process at DHS. As the Department's acting Inspector General recently communicated to the Committee on Government Reform, the fiscal year 2003 audit is very much in progress. This effort has not only involved the Department and its auditors but also the 22 legacy agencies, the Financial Accounting Standards Advisory Board, and others. It is our understanding from discussions with the Office of the Chief Financial Officer that DHS intends to see this process to its conclusion.

OMB commends DHS for its recognition of the value that is provided in this initial year by preparing and undergoing an audit of financial statements, and it is the position of OMB that this process be completed to gain full benefit. We would ask the Committee to allow the Department to continue the fiscal year 2003 financial reporting and audit process.

Internal Control Audit Opinion. H.R. 2886 also contains a requirement for DHS to "include in each performance and accountability report an audit opinion of the Department's internal controls over its financial reporting." It is our understanding that this requirement is intended to hold Federal agencies to the same standards for financial accountability as the private sector. At the present time, however, no other sectors are required to obtain an audit opinion on internal control.

While SEC registrants will be subjected in the future to such a requirement under Section 404 of the Sarbanes-Oxley Act (enacted July 2002), the effective date has been delayed as a result of public comments. The provision was originally planned for fiscal years ending on or after September 15, 2003, but was deferred to fiscal years ending on or after June 15, 2004, for large US companies, and April 15, 2005, for smaller US companies and foreign companies. This deferral recognized the following concerns (as outlined in a May 29, 2003, speech by SEC Deputy Chief Accountant Scott A. Taub):

- cost and time needed to properly implement the rules;
- uncertainty and disagreements about the level of work required to comply with the internal control requirement;
- whether sufficient time was permitted to resolve uncertainties adequately; and
- whether the professional auditing standards needed revision.

These same concerns would also apply to federal agencies.

The Administration acknowledges that obtaining an audit opinion on internal control is a potentially useful, yet very significant, undertaking. While we agree that an opinion level internal control audit could have merit, a review of this magnitude will require the allocation of additional resources and sufficient time to coordinate among agency Chief Financial Officers, Inspectors General, and independent public auditors.

Three agencies (General Services Administration, Nuclear Regulatory Commission, and Social Security Administration) have voluntarily elected to obtain audit opinions on internal control; however, cabinet departments and other agencies covered by the Chief Financial Officers Act (CFO Act) are not currently required to obtain such an opinion. This provision, if enacted, would impose a more stringent requirement on DHS than other Federal departments and agencies. OMB recommends that a cost-benefit study of the internal control audit provision be performed jointly by the CFO Council and the President's Council on Integrity and Efficiency to provide the necessary insight as to the cost and proper timing of such a requirement.

Applying the CFO Act to DHS. It is OMB's position that the substantive provisions of the CFO Act should apply to the new Department of Homeland Security as they do every other major Department and agency of the Federal Government. However, the CFO Act specifies an organizational structure – direct reporting of the CFO to the agency head – that is inconsistent with the structure Congress endorsed when it passed the Homeland Security Act of 2002. The Homeland Security Act enacted the President's proposal to consolidate management responsibilities at the new Department under the Under Secretary for Management. The Administration believes that with a strong and competent leader in the position of Under Secretary for Management, sound management policies and practices receive maximum standing within the agency. Requiring the CFO at the Department of Homeland Security to report directly to the Secretary of Homeland Security would dilute this principle.

The Administration is also working with Congress to reduce the number of officials subject to confirmation by the Senate, and therefore opposes making the CFO subject to confirmation by the Senate. In this vein, Congress agreed last fall that through passage of the Homeland Security Act, the Department of Homeland Security CFO would not be subject to Senate confirmation. This action does not compromise the applicability of the qualification requirement for CFOs as articulated by the Act.

I hope we can work together to apply the substantive provisions of the CFO Act to the new Department of Homeland Security, while remaining faithful to the President's original proposal to create the new Department, as well as the Homeland Security Act of 2002.

Conclusion

Establishing sound financial management and business processes within the Department of Homeland Security will not occur overnight. Rather, such a transformation will take several years to achieve. OMB believes that DHS has demonstrated a commitment to sound financial management, and its focus on implementing the most effective and efficient systems and processes is the beginning to achieve this outcome.

Thank you, Mr. Chairman. I look forward to answering your questions.