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## DOD FINANCIAL MANAGEMENT

# Numerous Challenges Must Be Addressed to Improve Reliability of Financial Information

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Highlights of [GAO-11-835T](#), a testimony before the Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

## Why GAO Did This Study

As one of the largest and most complex organizations in the world, the Department of Defense (DOD) faces many challenges in resolving serious problems in its financial management and related business operations and systems. DOD is required by various statutes to (1) improve its financial management processes, controls, and systems to ensure that complete, reliable, consistent, and timely information is prepared and responsive to the financial information needs of agency management and oversight bodies, and (2) produce audited financial statements.

Over the years, DOD has initiated numerous efforts to improve the department's financial management operations and achieve an unqualified (clean) opinion on the reliability of its reported financial information. These efforts have fallen short of sustained improvement in financial management or financial statement auditability.

The Subcommittee has asked GAO to provide its perspective on the status of DOD's financial management weaknesses and its efforts to resolve them; the challenges DOD continues to face in improving its financial management and operations; and the status of its efforts to implement automated business systems as a critical element of DOD's Financial Improvement and Audit Readiness strategy.

View [GAO-11-835T](#) or key components. For more information, contact Asif A. Khan at (202) 512-9095 or [khana@gao.gov](mailto:khana@gao.gov).

July 27, 2011

## DOD FINANCIAL MANAGEMENT

### Numerous Challenges Must Be Addressed to Improve Reliability of Financial Information

## What GAO Found

DOD financial management has been on GAO's high-risk list since 1995 and, despite several reform initiatives, remains on the list today. Pervasive deficiencies in financial management processes, systems, and controls, and the resulting lack of data reliability, continue to impair management's ability to assess the resources needed for DOD operations; track and control costs; ensure basic accountability; anticipate future costs; measure performance; maintain funds control; and reduce the risk of loss from fraud, waste, and abuse. DOD spends billions of dollars each year to maintain key business operations intended to support the warfighter, including systems and processes related to the management of contracts, finances, supply chain, support infrastructure, and weapon systems acquisition. These operations are directly impacted by the problems in financial management. In addition, the long-standing financial management weaknesses have precluded DOD from being able to undergo the scrutiny of a financial statement audit.

DOD's past strategies for improving financial management were ineffective, but recent initiatives are encouraging. In 2005, DOD issued its Financial Improvement and Audit Readiness (FIAR) Plan for improving financial management and reporting. In 2009, the DOD Comptroller directed that FIAR efforts focus on financial information in two priority areas: budget and mission-critical assets. The FIAR Plan also has a new phased approach that comprises five waves of concerted improvement activities. The first three waves focus on the two priority areas, and the last two on working toward full auditability. The plan is being implemented largely through the Army, Navy, and Air Force military departments and the Defense Logistics Agency, lending increased importance to the committed leadership in these components.

Improving the department's financial management operations and thereby providing DOD management and Congress more accurate and reliable information on the results of its business operations will not be an easy task. It is critical that current initiatives related to improving the efficiency and effectiveness of financial management that have the support of the DOD's Deputy Chief Management Officer and Comptroller continue with sustained leadership and monitoring.

Absent continued momentum and necessary future investments, current initiatives may falter. Below are some of the key challenges that DOD must address for its financial management to improve to the point where DOD is able to produce auditable financial statements:

- committed and sustained leadership,
- effective plan to correct internal control weaknesses,
- competent financial management workforce,
- accountability and effective oversight,
- well-defined enterprise architecture, and
- successful implementation of the enterprise resource planning systems.

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Chairman McCaskill, Ranking Member Ayotte, and Members of the Subcommittee:

It is a pleasure to be here today to discuss the status of the Department of Defense's (DOD) efforts to improve its financial management operations and achieve audit readiness. At the outset, I would like to thank the Subcommittee for holding this hearing and to acknowledge the important role of such hearings in the oversight of DOD's financial management efforts.

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 discretionary budget authority and \$118 billion to support overseas contingency operations. The fiscal year 2012 budget request also noted that DOD 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 departments and their respective major commands and functional activities, 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,<sup>1</sup> including accounting, acquisition, logistics, and personnel systems.

The department's sheer size and complexity contribute to the many challenges DOD faces in resolving its pervasive, complex, and long-standing financial management and related business operations and systems problems. Numerous initiatives and efforts have been undertaken by DOD and its components to improve the department's financial management operations and to arrive at a point where the reliability of its financial statements and related financial management

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<sup>1</sup>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 intelligence systems, cryptologic activities related to national security, military command and control systems, and equipment that is an integral part of a weapon or weapons system or is critical to the direct fulfillment of military or intelligence missions.

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information would be sufficient to pass an audit with favorable (clean) audit opinions. To date, DOD has not achieved effective financial management capabilities or financial statement auditability.<sup>2</sup>

Today, I will discuss the status of DOD's financial management weaknesses, its efforts to resolve those weaknesses, and the challenges DOD continues to face in its efforts to improve its financial management operations. In addition, I will outline the status of the department's efforts to implement its Enterprise Resource Planning (ERP) systems,<sup>3</sup> which represent a critical element of the department's Financial Improvement and Audit Readiness (FIAR) strategy. My statement today is based on our prior work related to the department's FIAR Plan<sup>4</sup> and ERP implementation efforts.<sup>5</sup> Our work was conducted in accordance with generally accepted government auditing standards and 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

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<sup>2</sup>DOD's auditors have reported material financial management weaknesses in the following areas: (1) Financial Management Systems, (2) Fund Balance with Treasury, (3) Accounts Receivable, (4) Inventory, (5) Operating Materials and Supplies, (6) General Property, Plant, and Equipment, (7) Government-Furnished Material and Contractor-Acquired Material, (8) Accounts Payable, (9) Environmental Liabilities, (10) Statement of Net Cost, (11) Intragovernmental Eliminations, (12) Other Accounting Entries, and (13) Reconciliation of Net Cost of Operations to Budget.

<sup>3</sup>An ERP system uses 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.

<sup>4</sup>GAO, *Financial Management: Achieving Financial Statement Auditability in the Department of Defense*, [GAO-09-373](#) (Washington, D.C.: May 6, 2009).

<sup>5</sup>GAO, *DOD Business Transformation: Improved Management and Oversight of Business Modernization Efforts Needed*, [GAO-11-53](#) (Washington, D.C.: Oct. 7, 2010); *Defense Logistics: Actions Needed to Improve Implementation of the Army Logistics Modernization Program*, [GAO-10-461](#) (Washington, D.C.: Apr. 30, 2010), *DOD Business Transformation: Air Force's Current Approach Increases Risk That Asset Visibility Goals and Transformation Priorities Will Not Be Achieved*, [GAO-08-866](#) (Washington, D.C.: Aug. 8, 2008), *DOD Business Systems Modernization: Important Management Controls Being Implemented on Major Navy Program, but Improvements Needed in Key Areas*, [GAO-08-896](#) (Washington, D.C.: Sept. 8, 2008), and *DOD Business Transformation: Lack of an Integrated Strategy Puts the Army's Asset Visibility System Investments at Risk*, [GAO-07-860](#) (Washington, D.C.: July 27, 2007).

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objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

The department is facing near and long-term internal fiscal pressures as it attempts to balance competing demands to support ongoing operations, rebuild readiness following extended military operations, and manage increasing personnel and health care costs as well as significant cost growth in its weapon systems programs. For more than a decade, DOD has dominated GAO's list of federal programs and operations at high risk of being vulnerable to fraud, waste, abuse.<sup>6</sup> In fact, all of the DOD programs on GAO's High-Risk List relate to business operations, including systems and processes related to management of contracts, finances, supply chain, and support infrastructure,<sup>7</sup> as well as weapon systems acquisition. Long-standing and pervasive weaknesses in DOD's financial management and related business processes and systems have (1) resulted in a lack of reliable information needed to make sound decisions and report on the financial status and cost of DOD activities to Congress and DOD decision makers; (2) adversely impacted its operational efficiency and mission performance in areas of major weapons system support and logistics; and (3) left the department vulnerable to fraud, waste, and abuse.

Because of the complexity and long-term nature of DOD's transformation efforts, GAO has reported the need for a chief management officer (CMO) position and a comprehensive, enterprisewide business transformation plan. In May 2007, DOD designated the Deputy Secretary of Defense as the CMO. In addition, the National Defense Authorization Acts for Fiscal Years 2008 and 2009 contained provisions that codified the CMO and

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<sup>6</sup>DOD bears responsibility, in whole or in part, for 14 of the 30 federal programs or activities that GAO has identified as being at high risk of waste, fraud, abuse, and mismanagement. The eight specific DOD high-risk areas are (1) approach to business transformation, (2) business systems modernization, (3) contract management, (4) financial management, (5) supply chain management, (6) support infrastructure management, and (7) weapon systems acquisition. The seven governmentwide high-risk areas that include DOD are: (1) disability programs, (2) interagency contracting, (3) information systems and critical infrastructure, (4) information sharing for homeland security, (5) human capital, (6) real property, and (7) ensuring the effective protection of technologies critical to U.S. national security interests.

<sup>7</sup>Support infrastructure includes categories such as installations, central logistics, the defense health program, and central training.

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Deputy CMO (DCMO) positions, required DOD to develop a strategic management plan, and required the Secretaries of the military departments to designate their Undersecretaries as CMOs and to develop business transformation plans.

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## Overview of DOD's Accounting and Finance Activities

DOD financial managers are responsible for the functions of budgeting, financing, accounting for transactions and events, and reporting of financial and budgetary information. To maintain accountability over the use of public funds, DOD must carry out financial management functions such as recording, tracking, and reporting its budgeted spending, actual spending, and the value of its assets and liabilities. DOD relies on a complex network of organizations and personnel to execute these functions. Also, its financial managers must work closely with other departmental personnel to ensure that transactions and events with financial consequences, such as awarding and administering contracts, managing military and civilian personnel, and authorizing employee travel, are properly monitored, controlled, and reported, in part, to ensure that DOD does not violate spending limitations established in legislation or other legal provisions regarding the use of funds.

Before fiscal year 1991, the military services and defense agencies independently managed their finance and accounting operations. According to DOD, these decentralized operations were highly inefficient and failed to produce reliable information. On November 26, 1990, DOD created the Defense Finance and Accounting Service (DFAS) as its accounting agency to consolidate, standardize, and integrate finance and accounting requirements, functions, procedures, operations, and systems. The military services and defense agencies pay for finance and accounting services provided by DFAS using their operations and maintenance appropriations. The military services continue to perform certain finance and accounting activities at each military installation. These activities vary by military service depending on what the services wanted to maintain in-house and the number of personnel they were willing to transfer to DFAS. As DOD's accounting agency, DFAS records these transactions in the accounting records, prepares thousands of reports used by managers throughout DOD and by the Congress, and prepares DOD-wide and service-specific financial statements. The military services play a vital role in that they authorize the expenditure of funds and are the source of most of the financial information that allows DFAS to make payroll and contractor payments. The military services also have responsibility over all DOD assets and the related information

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needed by DFAS to prepare annual financial statements required under the Chief Financial Officers Act.<sup>8</sup>

DOD accounting personnel are responsible for accounting for funds received through congressional appropriations, the sale of goods and services by working capital fund businesses, revenue generated through nonappropriated fund activities, and the sales of military systems and equipment to foreign governments or international organizations. DOD's finance activities generally involve paying the salaries of its employees, paying retirees and annuitants, reimbursing its employees for travel-related expenses, paying contractors and vendors for goods and services, and collecting debts owed to DOD. DOD defines its accounting activities to include accumulating and recording operating and capital expenses as well as appropriations, revenues, and other receipts. According to DOD's fiscal year 2012 budget request, in fiscal year 2010 DFAS

- processed approximately 198 million payment-related transactions and disbursed over \$578 billion;
- accounted for 1,129 active DOD appropriation accounts; and
- processed more than 11 million commercial invoices.

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## Pervasive Financial Management Problems Continue to Affect the Efficiency and Effectiveness of DOD Operations

DOD financial management was designated as a high-risk area by GAO in 1995. Pervasive deficiencies in financial management processes, systems, and controls, and the resulting lack of data reliability, continue to impair management's ability to assess the resources needed for DOD operations; track and control costs; ensure basic accountability; anticipate future costs; measure performance; maintain funds control; and reduce the risk of loss from fraud, waste, and abuse.

Other business operations, including the high-risk areas of contract management, supply chain management, support infrastructure management, and weapon systems acquisition are directly impacted by the problems in financial management. We have reported that continuing weaknesses in these business operations result in billions of dollars of wasted resources, reduced efficiency, ineffective performance, and

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<sup>8</sup>Sec. 31 U.S.C. §3515(a),(c); PMB Bulletin No. 07-04, *Audit Requirements For Federal Agencies Statements*, Appendix B (Sept. 2004).

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inadequate accountability. Examples of the pervasive weaknesses in the department's business operations are highlighted below.

- DOD invests billions of dollars to acquire weapon systems, but it lacks the financial management processes and capabilities it needs to track and report on the cost of weapon systems in a reliable manner. We reported on this issue over 20 years ago,<sup>9</sup> but the problems continue to persist. In July 2010, we reported<sup>10</sup> that although DOD and the military departments have efforts underway to begin addressing these financial management weaknesses, problems continue to exist and remediation and improvement efforts would require the support of other business areas beyond the financial community before they could be fully addressed.
- DOD also requests billions of dollars each year to maintain its weapon systems, but it has limited ability to identify, aggregate, and use financial management information for managing and controlling operating and support costs. Operating and support costs can account for a significant portion of a weapon system's total life-cycle costs, including costs for repair parts, maintenance, and contract services. In July 2010, we reported<sup>11</sup> that the department lacked key information needed to manage and reduce operating and support costs for most of the weapon systems we reviewed<sup>12</sup>—including cost estimates and historical data on actual operating and support costs. For acquiring and maintaining weapon systems, the lack of complete and reliable financial information hampers DOD officials in analyzing the rate of cost growth, identifying cost drivers, and developing plans for managing and controlling these costs. Without timely, reliable, and useful financial information on cost, DOD management lacks information needed to accurately report on acquisition costs, allocate resources to programs, or evaluate program performance.

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<sup>9</sup>GAO, *Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources*, GAO/AFMD 90-23 (Washington, D.C.: Feb. 23, 1990).

<sup>10</sup>GAO, *Department of Defense: Additional Actions Needed to Improve Financial Management of Military Equipment*, [GAO-10-695](#) (Washington, D.C. July 26, 2010).

<sup>11</sup>GAO, *Defense Management: DOD Needs Better Information and Guidance to More Effectively Manage and Reduce Operating and Support Costs of Major Weapon Systems*, [GAO-10-717](#) (Washington, D.C.: July 20, 2010).

<sup>12</sup>GAO reviewed the following seven major aviation systems: the Navy's F/A-18E/F; the Air Force's F-22A, B-1B, and F-15E; and the Army's AH-64D, CH-47D, and UH-60L.



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- In June 2010, we reported<sup>13</sup> 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 Military Personnel–Army (MPA) appropriation. We found that an obligation of \$200 million in excess of available funds in the Army’s military personnel account violated the Antideficiency Act. The overobligation likely stemmed, in part, from lack of communication between Army Budget and program managers so that Army Budget’s accounting records reflected estimates instead of actual amounts until it was too late to control the incurrence of excessive obligations in violation of the act. Thus, at any given time in the fiscal year, Army Budget did not know the actual obligation and expenditure levels of the account. Army Budget explained that it relies on estimated obligations—despite the availability of actual data from program managers—because of inadequate financial management systems. The lack of adequate process and system controls to maintain effective funds control impacted the Army’s ability to prevent, identify, correct, and report potential violations of the Antideficiency Act.
  - In our February 2011 report<sup>14</sup> on the Defense Centers of Excellence (DCOE), we found that DOD’s TRICARE Management Activity (TMA) had misclassified \$102.7 million of the nearly \$112 million in DCOE advisory and assistance contract obligations. The proper classification and recording of costs are basic financial management functions that and are also key in analyzing areas for potential future savings.

Without adequate financial management processes, systems, and controls, DOD components are at risk of reporting inaccurate, inconsistent, and unreliable data for financial reporting and management decision making and potentially exceeding authorized spending limits. The lack of effective internal controls hinders management’s ability to have reasonable assurance that their allocated resources are used effectively, properly, and in compliance with budget and appropriations law.

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<sup>13</sup>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).

<sup>14</sup>GAO, *Defense Health: Management Weaknesses at Defense Centers of Excellence for Psychological Health and Traumatic Brain Injury Require Attention*, [GAO-11-219](#) (Washington, D.C.: Feb. 28, 2011).

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## DOD's Past Strategies for Improving Financial Management Were Ineffective but Recent Initiatives Are Encouraging

Over the years, DOD has initiated several broad-based reform efforts to address its long-standing financial management weaknesses. However, as we have reported, those efforts did not achieve their intended purpose of improving the department's financial management operations. In 2005, the DOD Comptroller established the DOD FIAR Directorate to develop, manage, and implement a strategic approach for addressing the department's financial management weaknesses and for achieving auditability, and to integrate those efforts with other improvement activities, such as the department's business system modernization efforts. In May 2009,<sup>15</sup> we identified several concerns with the adequacy of the FIAR Plan as a strategic and management tool to resolve DOD's financial management difficulties and thereby position the department to be able to produce auditable financial statements.

Overall, since the issuance of the first FIAR Plan in December 2005, improvement efforts have not resulted in the fundamental transformation of operations necessary to resolve the department's long-standing financial management deficiencies. However, DOD has made significant improvements to the FIAR Plan that, if implemented effectively, could result in significant improvement in DOD's financial management and progress toward auditability, but progress in taking corrective actions and resolving deficiencies remains slow. While none of the military services has obtained an unqualified (clean) audit opinion, some DOD organizations, such as the Army Corps of Engineers, DFAS, the Defense Contract Audit Agency, and the DOD Inspector General, have achieved this goal. Moreover, some DOD components that have not yet received clean audit opinions are beginning to reap the benefits of strengthened controls and processes gained through ongoing efforts to improve their financial management operations and reporting capabilities. Lessons learned from the Marine Corps' Statement of Budgetary Resources audit can provide a roadmap to help other components better stage their audit readiness efforts by strengthening their financial management processes to increase data reliability as they develop action plans to become audit ready.

In August 2009, the DOD Comptroller sought to further focus efforts of the department and components, in order to achieve certain short- and long-

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<sup>15</sup>GAO, *Financial Management: Achieving Financial Statement Auditability in the Department of Defense*, [GAO-09-373](#) (Washington, D.C.: May 6, 2009).

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term results, by giving priority to improving processes and controls that support the financial information most often used to manage the department. Accordingly, DOD revised its FIAR strategy and methodology to focus on the DOD Comptroller's two priorities—budgetary information and asset accountability. The first priority is to strengthen processes, controls, and systems that produce DOD's budgetary information and the department's Statements of Budgetary Resources. The second priority is to improve the accuracy and reliability of management information pertaining to the department's mission-critical assets, including military equipment, real property, and general equipment, and validating improvement through existence and completeness testing. The DOD Comptroller directed the DOD components participating in the FIAR Plan—the departments of the Army, Navy, Air Force and Defense Logistics Agency—to use a standard process and aggressively modify their activities to support and emphasize achievement of the priorities.

GAO supports DOD's current approach of focusing and prioritizing efforts in order to achieve incremental progress in addressing weaknesses and making progress toward audit readiness. Budgetary and asset information is widely used by DOD managers at all levels, so its reliability is vital to daily operations and management. DOD needs to provide accountability over the existence and completeness of its assets. Problems with asset accountability can further complicate critical functions, such as planning for the current troop withdrawals.

In May 2010, DOD introduced a new phased approach that divides progress toward achieving financial statement auditability into five waves (or phases) of concerted improvement activities (see appendix I). According to DOD, the components' implementation of the methodology described in the 2010 FIAR Plan is essential to the success of the department's efforts to ultimately achieve full financial statement auditability. To assist the components in their efforts, the FIAR guidance, issued along with the revised plan, details the implementation of the methodology with an emphasis on internal controls and supporting documentation that recognizes both the challenge of resolving the many internal control weaknesses and the fundamental importance of establishing effective and efficient financial management. The FIAR Guidance provides the process for the components to follow, through their individual financial improvement plans (FIP), in assessing processes, controls, and systems; identifying and correcting weaknesses; assessing, validating, and sustaining corrective actions; and achieving full auditability. The guidance directs the components to identify responsible organizations and personnel and resource requirements for improvement

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work. In developing their plans, components use a standard template that comprises data fields aligned to the methodology. The consistent application of a standard methodology for assessing the components' current financial management capabilities can help establish valid baselines against which to measure, sustain, and report progress.

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## Numerous Challenges Must Be Addressed in Order for DOD to Successfully Reform Financial Management

Improving the department's financial management operations and thereby providing DOD management and the Congress more accurate and reliable information on the results of its business operations will not be an easy task. It is critical that the current initiatives being led by the DOD Deputy Chief Management Officer and the DOD Comptroller be continued and provided with sufficient resources and ongoing monitoring in the future. Absent continued momentum and necessary future investments, the current initiatives may falter, similar to previous efforts. Below are some of the key challenges that the department must address in order for the financial management operations of the department to improve to the point where DOD may be able to produce auditable financial statements.

**Committed and sustained leadership.** The FIAR Plan is in its sixth year and continues to evolve based on lessons learned, corrective actions, and policy changes that refine and build on the plan. The DOD Comptroller has expressed commitment to the FIAR goals, and established a focused approach that is intended to help DOD achieve successes in the near term. But the financial transformation needed at DOD, and its removal from GAO's high-risk list, is a long-term endeavor. Improving financial management will need to be a cross-functional endeavor. It requires the involvement of DOD operations performing other business functions that interact with financial management—including those in the high-risk areas of contract management, supply chain management, support infrastructure management, and weapon systems acquisition. As acknowledged by DOD officials, sustained and active involvement of the department's Chief Management Officer, the Deputy Chief Management Officer, the military departments' Chief Management Officers, the DOD Comptroller, and other senior leaders is critical. Within every administration, there are changes at the senior leadership; therefore, it is paramount that the current initiative be institutionalized throughout the department—at all working levels—in order for success to be achieved.

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**Effective plan to correct internal control weaknesses.** In May 2009, we reported<sup>16</sup> that the FIAR Plan did not establish a baseline of the department's state of internal control and financial management weaknesses as its starting point. Such a baseline could be used to assess and plan for the necessary improvements and remediation to be used to measure incremental progress toward achieving estimated milestones for each DOD component and the department. DOD currently has efforts underway to address known internal control weaknesses through three interrelated programs: (1) Internal Controls over Financial Reporting (ICOFR) program, (2) ERP implementation, and (3) FIAR Plan. However, the effectiveness of these three interrelated efforts at establishing a baseline remains to be seen. Furthermore, DOD has yet to identify the specific control actions that need to be taken in Waves 4 and 5 of the FIAR Plan, which deal with asset accountability and other financial reporting matters. Because of the department's complexity and magnitude, developing and implementing a comprehensive plan that identifies DOD's internal control weaknesses will not be an easy task. But it is a task that is critical to resolving the long-standing weaknesses and will require consistent management oversight and monitoring for it to be successful.

**Competent financial management workforce.** Effective financial management in DOD will require a knowledgeable and skilled workforce that includes individuals who are trained and certified in accounting, well versed in government accounting practices and standards, and experienced in information technology. Hiring and retaining such a skilled workforce is a challenge DOD must meet to succeed in its transformation to efficient, effective, and accountable business operations. The National Defense Authorization Act for Fiscal Year 2006<sup>17</sup> directed DOD to develop a strategic plan to shape and improve the department's civilian workforce. The plan was to, among other things; include assessments of (1) existing critical skills and competencies in DOD's civilian workforce, (2) future critical skills and competencies needed over the next decade, and (3) any gaps in the existing or future critical skills and competencies identified. In

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<sup>16</sup>[GAO-09-373](#).

<sup>17</sup>Pub. L. No. 109-163, div. A, § 1122, 119 Stat. 3136, 3452 (Jan. 6, 2006). The National Defense Authorization Act for Fiscal Year 2010 made this strategic plan into a permanent annual requirement. Pub. L. No. 111-84, div. A, § 1108, 123 Stat. 2190, 2488 (Oct. 28, 2009), *codified at* 10 U.S.C. § 115b.

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addition, DOD was to submit a plan of action for developing and reshaping the civilian employee workforce to address any identified gaps, as well as specific recruiting and retention goals and strategies on how to train, compensate, and motivate civilian employees. In developing the plan, the department identified financial management as one of its enterprisewide mission-critical occupations.

In July 2011, we reported<sup>18</sup> that DOD's 2009 overall civilian workforce plan had addressed some legislative requirements, including assessing the critical skills of its existing civilian workforce. Although some aspects of the legislative requirements were addressed, DOD still has significant work to do. For example, while the plan included gap analyses related to the number of personnel needed for some of the mission-critical occupations, the department had only discussed competency gap analyses for 3 mission-critical occupations—language, logistics management, and information technology management. A competency gap for financial management was not included in the department's analysis. Until DOD analyzes personnel needs and gaps in the financial management area, it will not be in a position to develop an effective financial management recruitment, retention, and investment strategy to successfully address its financial management challenges.

**Accountability and effective oversight.** The department established a governance structure for the FIAR Plan, which includes review bodies for governance and oversight. The governance structure is intended to provide the vision and oversight necessary to align financial Improvement and audit readiness efforts across the department. To monitor progress and hold individuals accountable for progress, DOD managers and oversight bodies need reliable, valid, meaningful metrics to measure performance and the results of corrective actions. In May 2009, we reported<sup>19</sup> that the FIAR Plan did not have clear results-oriented metrics. To its credit, DOD has taken action to begin defining results-oriented FIAR metrics it intends to use to provide visibility of component-level progress in assessment; and testing and remediation activities, including progress in identifying and addressing supporting documentation issues.

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<sup>18</sup>GAO, *DOD Civilian Personnel: Competency Gap Analysis and Other Actions Needed to Enhance DOD's Strategic Workforce Plans*, [GAO-11-827T](#) (Washington, D.C.: July 14, 2011).

<sup>19</sup>[GAO-09-373](#).

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We have not yet had an opportunity to assess implementation of these metrics—including the components’ control over the accuracy of supporting data—or their usefulness in monitoring and redirecting actions.

Ensuring effective monitoring and oversight of progress—especially by the leadership in the components—will be key to bringing about effective implementation, through the components’ Financial Information Plans, of the department’s financial management and related business process reform. If the department’s future FIAR Plan updates provide a comprehensive strategy for completing Waves 4 and 5, the plan can serve as an effective tool to help guide and direct the department’s financial management reform efforts.

Effective oversight holds individuals accountable for carrying out their responsibilities. DOD has introduced incentives such as including FIAR goals in Senior Executive Service Performance Plans, increased reprogramming thresholds granted to components that receive a positive audit opinion on their Statement of Budgetary Resources, audit costs funded by the Office of the Secretary of Defense after a successful audit, and publicizing and rewarding components for successful audits. The challenge now is to evaluate and validate these and other incentives to determine their effectiveness and whether the right mix of incentives has been established.

**Well-defined enterprise architecture.** For decades, DOD has been challenged in modernizing its timeworn business systems. Since 1995, we have designated DOD’s business systems modernization program as high risk. Between 2001 and 2005, we reported that the modernization program had spent hundreds of millions of dollars on an enterprise architecture and investment management structures that had limited value. Accordingly, we made explicit architecture and investment management-related recommendations. Congress included provisions in the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 that were consistent with our recommendations. In response, DOD continues to take steps to comply with the act’s provisions and to satisfy relevant system modernization management guidance. Collectively, these steps address best practices in implementing the statutory provisions concerning the business enterprise architecture and review of systems costing in excess of \$1 million. However, long-standing challenges that we previously identified remain to be addressed. Specifically, while DOD

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continues to release updates to its corporate enterprise architecture, the architecture has yet to be federated<sup>20</sup> through development of aligned subordinate architectures for each of the military departments. In this regard, each of the military departments has made progress in managing its respective architecture program, but there are still limitations in the scope and completeness, as well as the maturity of the military departments' architecture programs. For example, while each department has established or is in the process of establishing an executive committee with responsibility and accountability for the enterprise architecture, none has fully developed an enterprise architecture methodology or a well-defined business enterprise architecture and transition plan to guide and constrain business transformation initiatives. In addition, while DOD continues to establish investment management processes, the DOD enterprise and the military departments' approaches to business systems investment management still lack the defined policies and procedures to be considered effective investment selection, control, and evaluation mechanisms. Until DOD fully implements these longstanding institutional modernization management controls its business systems modernization will likely remain a high-risk program.

**Successful implementation of the ERPs.** The department has invested billions of dollars and will invest billions more to implement the ERPs. DOD officials have said that successful implementation of ERPs is key to transforming the department's business operations, including financial management, and in improving the department's capability to provide DOD management and Congress with accurate and reliable information on the results of DOD's operations. DOD has stated that the ERPs will replace over 500 legacy systems. The successful implementation of the ERPs is not only critical for addressing long-standing weaknesses in financial management, but equally important for helping to resolve weaknesses in other high-risk areas such as business transformation, business system modernization, and supply chain management.

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<sup>20</sup>A federated architecture consists of a family of coherent but distinct member architectures in which subsidiary architectures conform to an overarching corporate architectural view and rule set.



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Over the years we have reported <sup>21</sup> that the department has not effectively employed acquisition management controls to help ensure the ERPs deliver the promised capabilities on time and within budget. Delays in the successful implementation of ERPs have extended the use of existing duplicative, stovepiped systems, and continued funding of the existing legacy systems longer than anticipated. Additionally, the continued implementation problems can erode savings that were estimated to accrue to DOD as a result of modernizing its business systems and thereby reduce funds that could be used for other DOD priorities.

To help improve the department's management oversight of its ERPs, we have recommended<sup>22</sup> that DOD define success for ERP implementation in the context of business operations and in a way that is measurable. Accepted practices in system development include testing the system in terms of the organization's mission and operations—whether the system performs as envisioned at expected levels of cost and risk when implemented within the organization's business operations. Developing and using specific performance measures to evaluate a system effort should help management understand whether the expected benefits are being realized. Without performance measures to evaluate how well these systems are accomplishing their desired goals, DOD decision makers including program managers, do not have all the information they need to evaluate their investments to determine whether the individual programs are helping DOD achieve business transformation and thereby improve upon its primary mission of supporting the warfighter.

Another key element in DOD efforts to modernize its business systems is investment management policies and procedures. We reported in June 2011<sup>23</sup> that DOD's oversight process does not provide sufficient visibility

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<sup>21</sup>GAO-10-461; *DOD Business Systems Modernization: Navy Implementing a Number of Key Management Controls on Enterprise Resource Planning System, but Improvements Still Needed*, GAO-09-841 (Washington, D.C.: Sept. 15, 2009); GAO-08-896; GAO-08-866; *DOD Business Systems Modernization: Key Marine Corps System Acquisition Needs to Be Better Justified, Defined, and Managed*, GAO-08-822 (Washington, D.C.: July 28, 2008); GAO-07-860.

<sup>22</sup>GAO, *DOD Business Transformation: Improved Management and Oversight of Business Modernization Efforts Needed*, GAO-11-53 (Washington, D.C. Oct. 7, 2010).

<sup>23</sup>GAO, *Department of Defense: Further Actions Needed to Institutionalize Key Business Systems Modernization Management Control*, GAO-11-684 (Washington, D.C.: June 29, 2011).

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into the military department's investment management activities, including its reviews of systems that are in operations and maintenance made and smaller investments. As discussed in our information technology investment management framework and previous reports on DOD's investment management of its business systems,<sup>24</sup> adequately documenting both policies and associated procedures that govern how an organization manages its information technology projects and investment portfolios is important because doing so provides the basis for rigor, discipline, and repeatability in how investments are selected and controlled across the entire organization. Until DOD fully defines missing policies and procedures, it is unlikely that the department's over 2,200 business systems will be managed in a consistent, repeatable, and effective manner that, among other things, maximizes mission performance while minimizing or eliminating system overlap and duplication. To this point, there is evidence showing that DOD is not managing its systems in this manner. For example, DOD reported that of its 79 major business and other IT investments, about a third are encountering cost, schedule, and performance shortfalls requiring immediate and sustained management attention. In addition, we have previously reported<sup>25</sup> that DOD's business system environment has been characterized by (1) little standardization, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, and (4) manual data entry into multiple systems. Because DOD spends billions of dollars annually on its business systems and related IT infrastructure, the potential for identifying and avoiding the costs associated with duplicative functionality across its business system investments is significant.

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## Closing Comments

In closing, I am encouraged by the recent efforts and commitment DOD's leaders have shown toward improving the department's financial management. Progress we have seen includes recently issued guidance

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<sup>24</sup>GAO, *Business Systems Modernization: DOD Needs to Fully Define Policies and Procedures for Institutionally Managing Investments*, [GAO-07-538](#) (Washington, D.C.: May 11, 2007); *Business Systems Modernization: Air Force Needs to Fully Define Policies and Procedures for Institutionally Managing Investments*, [GAO-08-52](#) (Washington D.C.: Oct. 31, 2007); *Business Systems Modernization: Department of the Navy Needs to Establish Management Structure and Fully Define Policies and Procedures for Institutionally Managing Investments*, [GAO-08-53](#) (Washington, D.C.: Oct. 31, 2007).

<sup>25</sup>GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, [GAO-11-318SP](#) (Washington, D.C.: Mar. 1, 2011).

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to aid DOD components in their efforts to address their financial management weaknesses and achieve audit readiness; standardized component financial improvement plans to facilitate oversight and monitoring; and the sharing of lessons learned. In addition, the DCMO and the DOD Comptroller have shown commitment and leadership in moving DOD's financial management improvement efforts forward.

The revised FIAR strategy is still in the early stages of implementation, and DOD has a long way and many long-standing challenges to overcome, particularly with regard to sustained commitment, leadership, and oversight, before the department and its military components are fully auditable, and DOD financial management is no longer considered high risk. However, the department is heading in the right direction and making progress. Some of the most difficult challenges ahead lie in the effective implementation of the department's strategy by the Army, Navy, Air Force, and DLA, including successful implementation of ERP systems and integration of financial management improvement efforts with other DOD initiatives.

GAO will continue to monitor the progress of and provide feedback on the status of DOD's financial management improvement efforts. We currently have work in progress to assess implementation of the department's FIAR strategy and efforts toward auditability.

As a final point, I want to emphasize the value of sustained congressional interest in the department's financial management improvement efforts, as demonstrated by this Subcommittee's leadership.

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

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# Appendix I: FLAR Plan Waves

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The first three waves focus on achieving the DOD Comptroller's interim budgetary and asset accountability priorities, while the remaining two waves are intended to complete actions needed to achieve full financial statement auditability. However, the department has not yet fully defined its strategy for completing waves 4 and 5. Each wave focuses on assessing and strengthening internal controls and business systems related to the stage of auditability addressed in the wave.

**Wave 1—Appropriations Received Audit** focuses on the appropriations receipt and distribution process, including funding appropriated by Congress for the current fiscal year and related apportionment/reapportionment activity by the OMB, as well as allotment and sub-allotment activity within the department.

**Wave 2—Statement of Budgetary Resources Audit** focuses on supporting the budget-related data (e.g., status of funds received, obligated, and expended) used for management decision making and reporting, including the Statement of Budgetary Resources. In addition to fund balance with Treasury reporting and reconciliation, other significant end-to-end business processes in this wave include procure-to-pay, hire-to-retire, order-to-cash, and budget-to-report.

**Wave 3—Mission Critical Assets Existence and Completeness Audit** focuses on ensuring that all assets (including military equipment, general equipment, real property, inventory, and operating materials and supplies) that are recorded in the department's accountable property systems of record exist; all of the reporting entities' assets are recorded in those systems of record; reporting entities have the right (ownership) to report these assets; and the assets are consistently categorized, summarized, and reported.

**Wave 4—Full Audit Except for Legacy Asset Valuation** includes the valuation assertion over new asset acquisitions and validation of management's assertion regarding new asset acquisitions, and it depends on remediation of the existence and completeness assertions in Wave 3. Also, proper contract structure for cost accumulation and cost accounting data must be in place prior to completion of the valuation assertion for new acquisitions. It involves the budgetary transactions covered by the Statement of Budgetary Resources effort in Wave 2, including accounts receivable, revenue, accounts payable, expenses, environmental liabilities, and other liabilities.

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**Wave 5—Full Financial Statement Audit** focuses efforts on assessing and strengthening, as necessary, internal controls, processes, and business systems involved in supporting the valuations reported for legacy assets once efforts to ensure control over the valuation of new assets acquired and the existence and completeness of all mission assets are deemed effective on a go-forward basis. Given the lack of documentation to support the values of the department's legacy assets, federal accounting standards allow for the use of alternative methods to provide reasonable estimates for the cost of these assets.

In the context of this phased approach, DOD's dual focus on budgetary and asset information offers the potential to obtain preliminary assessments regarding the effectiveness of current processes and controls and identify potential issues that may adversely impact subsequent waves.

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