



Testimony

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Organization, Efficiency and Financial Management,  
Committee on Oversight and Government Reform,  
House of Representatives

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**DOD FINANCIAL  
MANAGEMENT**

**Improved Controls,  
Processes, and Systems Are  
Needed for Accurate and  
Reliable Financial  
Information**

Statement of Asif A. Khan, Director  
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Highlights of [GAO-11-933T](#), a testimony before the Subcommittee on Government Organization, Efficiency and Financial Management, Committee on Oversight and Government Reform, U.S. House of Representatives

### 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) to produce audited financial statements.

Over the years, DOD has initiated numerous efforts to improve the department's financial management operations and to try to 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.

View [GAO-11-933T](#). For more information, contact Asif A. Khan at (202) 512-9869 or [khana@gao.gov](mailto:khana@gao.gov).

## DOD FINANCIAL MANAGEMENT

### Improved Controls, Processes, and Systems Are Needed for Accurate and Reliable 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, the 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 its 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 commitment of component leadership.

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 have the support of DOD leaders and that of 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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Mr. Chairman 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 information would be sufficient to pass an audit with favorable (clean)

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

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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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## 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, the 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 Deputy Chief Management Officer (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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<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 seven 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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## 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 by statute 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 most of DOD's assets and the related

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information 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); OMB Bulletin No. 07-04, *Audit Requirements For Federal Financial Statements*, Appendix B (Sept. 4, 2007).

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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 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 Office of 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 effort 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, DOD's 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, the Navy, and the Air Force and the 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 Plan (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

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organizations and personnel and resource requirements for improvement 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 DCMO 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.

**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 effort. Improving financial management will need to be a cross-functional endeavor; requiring improvements in some of DOD's other business operations such as 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 CMO, the DCMO, the military departments' CMOs, 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 integrated programs: (1) Internal Controls over Financial Reporting (ICOFR) program, (2) ERP implementation, and (3) FIAR Plan. However, the effectiveness of these three integrated efforts at establishing a baseline remains to be seen. As discussed in our recent report,<sup>17</sup> the lack of effective internal controls, in part, contributed to the DOD Inspector General issuing a disclaimer of opinion<sup>18</sup> on the Marine Corps' fiscal year 2010 Statement of Budgetary Resources (SBR). The auditors reported that ineffective internal control and ineffective controls in key financial systems should be addressed to ensure the reliability of reported financial information.<sup>19</sup> Examples of the problems identified include the following:

- The Marine Corps did not have effective controls in place to support estimated obligations, referred to as "bulk obligations," to record a payment liability, and, as a result, was not able to reconcile the related payment transactions to the estimates. The Marine Corps estimates obligations in a bulk amount to record payment liabilities where it does not have a mechanism to identify authorizing documentation as a basis for recording the obligations.

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

<sup>17</sup>GAO, *DOD Financial Management: Marine Corps Statement of Budgetary Resources Audit Results and Lessons Learned*, [GAO-11-830](#) (Washington, D.C.: Sept. 15, 2011).

<sup>18</sup>In a disclaimer of opinion, the auditor does not express an opinion on the financial statements. A disclaimer of opinion is appropriate when the audit scope is not sufficient to enable the auditor to express an opinion, or when there are material uncertainties involving a scope limitation—a situation where the auditor is unable to obtain sufficient appropriate audit evidence.

<sup>19</sup>Internal control comprises the plans, methods, and procedures to provide reasonable assurance that objectives are being achieved in the following areas: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations.

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- The auditors found ineffective controls over three major information technology systems used by the Marine Corps and reported numerous problems that required resolution.<sup>20</sup> For example, the auditors identified a lack of controls over interfaces between systems to ensure completeness of the data being transferred. System interface controls are critical for ensuring the completeness and accuracy of data transferred between systems.

The report also noted that the Marine Corps did not develop an overall corrective action or remediation plan that includes key elements of a risk-based plan. Instead, its approach focuses on short-term corrective actions based on manually intensive efforts to produce reliable financial reporting at year-end. Such efforts 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. We previously reported that using principles of risk management helps policymakers make informed decisions about best ways to prioritize investments, so that the investments target the areas of greatest need.<sup>21</sup> However, we found that the Marine Corps' SBR Remediation Plan focused on individual initiatives to address 70 auditor Notices of Findings and Recommendations that included 139 recommendations, without assessing risks, prioritizing actions, or ensuring that actions adequately responded to recommendations.<sup>22</sup> Further, the plan did not identify

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<sup>20</sup>The three systems are the Marine Corps Total Force System (MCTFS), which is an integrated military personnel and payroll system; the Standard Accounting, Budgeting, Reporting System (SABRS), which is the Marine Corps' general ledger accounting system; and the Defense Departmental Reporting System (DDRS), which is a DOD-wide financial reporting system.

<sup>21</sup>GAO, *Defense Business Transformation: DOD Needs To Take Additional Actions to Further Define Key Management Roles, Develop Measurable Goals, and Align Planning Efforts*, [GAO-11-181R](#) (Washington, D.C.: Jan. 26, 2011); and *Risk Management: Strengthening the Use of Risk Management Principles at Homeland Security*, [GAO-08-904T](#) (Washington, D.C.: June 25, 2008).

<sup>22</sup>The Marine Corps SBR Remediation Plan consists of a written plan covering the initial 11 financial statement process notices of findings and recommendations (NFR) to comply with DOD IG audit requirements and 59 additional NFRs that were addressed in separate plans of action and milestones.

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resources, roles and responsibilities, or include performance indicators to measure performance against action plan objectives.<sup>23</sup>

Given the current efforts, goals, and timeframes for achieving auditability of the Marine Corps' Fiscal Year 2011 SBR, the current approach is understandably focused on short-term actions. However, achieving financial accountability that is sustainable in the long term will require reliable financial systems and sound internal controls. An effective remediation plan would help ensure that audit recommendations are fully addressed to deal with the short-term and long-term goals.

The Marine Corps reported that actions on 88 of the 139 recommendations, including weaknesses related to accounting and financial reporting and information technology systems were fully implemented; however, the completeness and effectiveness of most Marine Corps' actions have not yet been tested. DOD Inspector General auditors told us that tests performed during the Marine Corps' fiscal year 2011 SBR audit effort will determine whether and to what extent the problems identified during the fiscal year 2010 SBR audit effort have been resolved. They also confirmed that as of August 25, 2011, the Marine Corps had remediated the problems on 11 of the information technology audit recommendations.

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

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<sup>23</sup>Some of these elements are consistent with the FIAR Guidance requirements for a corrective action plan, such as identifying required resources and ensuring that actions address the identified deficiencies.

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Defense Authorization Act for Fiscal Year 2006<sup>24</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 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>25</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. As noted in our recent

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<sup>24</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 an annual requirement. Pub. L. No. 111-84, div. A, § 1108, 123 Stat. 2190, 2488 (Oct. 28, 2009), *codified at* 10 U.S.C. § 115b.

<sup>25</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).



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report,<sup>26</sup> both DOD and the components have established senior executive committees as well as designated officials at the appropriate levels to monitor and oversee their financial improvement efforts. These committees and individuals have also generally been assigned appropriate roles and responsibilities. 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>27</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. 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' FIPs. However, as noted in our recent report,<sup>28</sup> we found that weaknesses in the Navy and Air Force FIAR Plan implementation efforts indicate that the monitoring and oversight of such efforts have not been effective. More specifically, we found that component officials as well as the oversight committees at both the component and DOD levels did not effectively carry out their monitoring responsibilities for the Navy Civilian Pay and Air Force Military Equipment FIPs. For the two FIPs that we reviewed, neither individual officials nor the executive committees took sufficient action to ensure that the FIPs were accurate or complied with the FIAR Guidance. As a result, the Navy concluded that its Civilian Pay was ready for audit, as did the Air Force with respect to its Military Equipment, even though they did not have sufficient support to assert audit readiness.

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<sup>26</sup>GAO, *DOD Financial Management: Improvement Needed in DOD Components' Implementation of Audit Readiness Efforts*, [GAO-11-851](#) (Washington, D.C.: Sept. 13, 2011).

<sup>27</sup>[GAO-09-373](#).

<sup>28</sup>[GAO-11-851](#).

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On the other hand, once the Navy and Air Force submitted the FIPs to DOD in support of their audit readiness assertions, both the DOD Inspector General and the DOD Comptroller carried out their responsibilities for reviewing the FIPs. In their reviews, both organizations identified issues with the FIPs that were similar to those we had identified. The DOD Comptroller, who makes the final determination as to whether an assessable unit is ready for audit, concluded that neither of these FIPs supported audit readiness.

Effective oversight and monitoring would also help ensure that lessons learned from recent efforts would be sufficiently disseminated throughout the department and applied to other financial improvement efforts. In commenting on our report about the FIPs, the DOD Comptroller stated that it is critical that the department continues to look at how effectively it applies lessons learned.

Furthermore, 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>29</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. The implementation of an integrated, audit-ready systems environment through the deployment of ERP systems underlies all of DOD's financial improvement efforts and is crucial to achieving departmentwide audit readiness. According to DOD, 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. Successful implementation will support DOD by standardizing and streamlining its financial management and accounting systems, integrating multiple logistics systems and finance processes, providing asset visibility for accountable items, and integrating personnel and pay systems. Previously, we reported that delays in the successful implementation of ERPs have extended the use of existing duplicative, stovepiped systems, and have continued the funding of these systems longer than

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<sup>29</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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anticipated.<sup>30</sup> To the degree that these business systems do not provide the intended capabilities, DOD's goal of departmentwide audit readiness by the end of fiscal year 2017 could be jeopardized.

Over the years we have reported<sup>31</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. As we reported in October 2010, DOD has identified 10 ERPs—1 of which had been fully implemented—as essential to its efforts to transform its business operations.<sup>32</sup> We are currently reviewing the status of two of these ERPs—the Army's General Fund Enterprise Business System (GFEBS) and the Air Force's Defense Enterprise Accounting and Management System (DEAMS). GFEBS is intended to support the Army's standardized financial management and accounting practices for the Army's general fund, except for funds related to the Army Corps of Engineers. The Army estimates that GFEBS will be used to control and account for approximately \$140 billion in annual spending. DEAMS is intended to provide the Air Force with the entire spectrum of financial management capabilities and is expected to maintain control and accountability for approximately \$160 billion. GFEBS is expected to be fully deployed during fiscal year 2012, is currently operational at 154 locations, including DFAS, and is being used by approximately 35,000 users. DEAMS is expected to be fully deployed during fiscal year 2016, is currently operational at Scott Air Force Base and DFAS, and is being used by about 1,100 individuals.

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<sup>30</sup>GAO, *DOD Business Transformation: Improved Management Oversight of Business System Modernization Efforts Needed*, [GAO-11-53](#) (Washington, D.C.: Oct. 7, 2010).

<sup>31</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>32</sup>[GAO-11-53](#). The 10 ERPs are as follows: Army—General Fund Enterprise Business System (GFEBS), Global Combat Support System-Army (GCSS-Army), and Logistics Modernization Program (LMP); Navy—Navy Enterprise Resource Planning (Navy ERP) and Global Combat Support System-Marine Corps (GCSS-MC); Air Force—Defense Enterprise Accounting and Management System (DEAMS) and Expeditionary Combat Support System (ECSS); Defense—Service Specific Integrated Personnel and Pay Systems and Defense Agencies Initiative (DAI); and Defense Logistics Agency—Business System Modernization (BSM). According to DOD, BSM was fully implemented in July 2007.

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Our preliminary results identified issues related to GFEBs and DEAMS providing DFAS users with the expected capabilities in accounting, management information, and decision support. To compensate, DFAS users have devised manual workarounds and several applications to obtain the information they need to perform their day-to-day tasks. Examples of the issues in these systems that DFAS users have identified include the following:

### **GFEBs**

- The backlog of unresolved GFEBs trouble tickets has continued to increase from about 250 in September 2010 to approximately 400 in May 2011. Trouble tickets represent user questions and issues with transactions or system performance that have not been resolved. According to Army officials, this increase in tickets was not unexpected since the number of users and the number of transactions being processed by the system has increased, and the Army and DFAS are taking steps to address issues raised by DFAS.
- Approximately two-thirds of invoice and receipt data must be manually entered into GFEBs from the invoicing and receiving system (i.e., Wide Area Work Flow).<sup>33</sup> DFAS personnel stated that manual data entry will eventually become infeasible due to increased quantities of data that will have to be manually entered as GFEBs is deployed to additional locations. Army officials acknowledged that there is a problem with the Wide Area Work Flow and GFEBs interface and that this problem reduced the effectiveness of GFEBs, and that they are working with DOD to resolve the problem.
- GFEBs lacks the ability to run ad hoc queries or search for data in the system to resolve problems or answer questions.<sup>34</sup> The Army has recognized this limitation and is currently developing a system enhancement that they expect will better support the users' needs.

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<sup>33</sup>Office of Federal Financial Management, *Core Financial System Requirements* (Washington, D.C.: January 2006) states that a Core financial system must deliver workflow capabilities including integrated workflow, workflow process definition and processing exception notices.

<sup>34</sup>Office of Federal Financial Management, *Core Financial System Requirements*, states that a Core financial system must provide an integrated ad hoc query capability to support agency access to and analysis of system-maintained financial data.

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## DEAMS

- Manual workarounds are needed to process certain accounts receivable transactions such as travel debts. DFAS personnel stated that the problem is the result of the data not being properly converted from the legacy systems to DEAMS.
- DFAS officials indicated that they were experiencing difficulty with some of the DEAMS system interfaces.<sup>35</sup> For example, the interface problem with the Standard Procurement System has become so severe that the interface has been turned off, and the data must be manually entered into DEAMS.
- DFAS officials stated that DEAMS does not provide the capability—which existed in the legacy systems—to produce ad hoc reports that can be used to perform the data analysis need to perform daily operations.<sup>36</sup> They also noted that when some reports are produced, the accuracy of those reports is questionable.

The Army and Air Force have stated that they have plans to address these issues, and the Army has plans to validate the audit readiness of GFEBS in a series of independent auditor examinations over the next several fiscal years. For DEAMS, the DOD Milestone Decision Authority<sup>37</sup> has directed that the system is not to be deployed beyond Scott Air Force Base until the known system weaknesses have been corrected and the system has been independently tested to ensure that it is operating as intended.

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<sup>35</sup>Office of Federal Financial Management, *Core Financial System Requirements*, states that a Core financial system financial transaction can be originated using multiple external feeder applications. These feeder systems and the Core financial system must interface seamlessly so that data can move effectively between them. The Core system must be able to process and validate the data independent of origination. There must also be a process for handling erroneous input and correction.

<sup>36</sup>Office of Federal Financial Management, *Core Financial System Requirements*, states that a Core financial system financial transaction must deliver an integrated ad hoc query capability to support agency access to and analysis of system maintained financial data.

<sup>37</sup>The Milestone Decision Authority is the senior DOD official who has overall authority to approve entry of an acquisition program into the next phase of the acquisition process and is accountable for cost, schedule, and performance reporting, including congressional reporting.

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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 to aid DOD components in their efforts to address their financial management weaknesses and achieve audit readiness, and standardized component financial improvement plans to facilitate oversight and monitoring, as well as sharing lessons learned. In addition, the DOD Comptroller and DCMO 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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Mr. Chairman and Members of the Subcommittee, 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.

For further information regarding this testimony, please contact Asif A. Khan, (202) 512-9869 or [khana@gao.gov](mailto:khana@gao.gov). Key contributors to this testimony include J. Christopher Martin, Senior-Level Technologist; F. Abe Dymond, Assistant Director; Gayle Fischer, Assistant Director; Greg Pugnetti, Assistant Director; Darby Smith, Assistant Director; Beatrice Alff; Steve Donahue; Keith McDaniel; Maxine Hattery; Hal Santarelli; and Sandy Silzer.

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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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