

**HOUSE ARMED SERVICES COMMITTEE**

**PANEL ON DEFENSE FINANCIAL MANAGEMENT AND AUDITABILITY REFORM**

**FINDINGS AND RECOMMENDATIONS**

**January 24, 2012**

**Mr. K. Michael Conaway, Chairman**  
**Mr. Scott Rigell**  
**Mr. Steven Palazzo**  
**Mr. Todd Young**

**Mr. Robert Andrews, Ranking Member**  
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## INTRODUCTION

The House Armed Services Committee Panel on Defense Financial Management and Auditability Reform (the Panel) was appointed by Chairman Howard P. “Buck” McKeon and Ranking Member Adam Smith in July 2011 to carry out a comprehensive review of the Department of Defense’s (DOD’s) financial management system.<sup>1</sup> The review was initiated to oversee the DOD financial management system’s capacity for providing timely, reliable, and useful information for decision-making and reporting. It is imperative that the DOD has reliable information to manage its resources, especially as the Department<sup>2</sup> absorbs greater than \$450 billion in budget cuts over the next decade and faces the possibility of an estimated \$488 billion in further cuts as a result of sequestration. The Panel performed a six-month review, holding eight hearings and two briefings covering a broad range of issues in defense financial management. The Panel received comments from the Department and various stakeholder communities on the draft report prior to approving this final report on its findings and recommendations. The Panel’s recommendations will be provided to the full committee.

The Panel examined the DOD’s: Financial Improvement and Audit Readiness (FIAR) strategy and methodology; challenges in achieving FIAR objectives; financial management workforce competencies; and implementation efforts for Enterprise Resource Planning systems (ERPs).

### **Financial Improvement and Audit Readiness Strategy and Methodology**

The Panel sought to determine whether the DOD’s FIAR strategy for improving its financial management and producing auditable financial statements by September 30, 2017 is appropriate. The Panel found that, although the strategy needs more detail and refinement, the DOD has a reasonable strategy and methodology. On October 13, 2011, the Secretary of Defense directed the Department to advance the audit readiness target date for the Statement of Budgetary Resources (SBR)<sup>3</sup> for General Fund activities from 2017 to 2014,<sup>4</sup> and he directed the DOD Comptroller to revise the current plan accordingly within 60 days. The Panel commends

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<sup>1</sup> For purposes of this report, the DOD’s “financial management system” refers to the processes (whether automated or manual) for initiating, authorizing, recording, and reporting the DOD’s operations and activities and for maintaining accountability for the related assets, liabilities, equity, and budgetary resources.

<sup>2</sup> Throughout the Panel’s Report, “the Department” refers to the Department of Defense.

<sup>3</sup> An SBR provides information about how budgetary resources were made available as well as their status at the end of the covered period.

<sup>4</sup> The Secretary of Defense also directed the Department to: increase emphasis on accountability for assets; execute a full review of the Department’s financial controls over the next two years and establish interim goals against which the Department can assess progress; ensure mandatory training for audit and other key financial efforts, and establish by the end of CY 2012 a pilot certification program for financial managers—similar to the one now in place for acquisition managers; appropriately resource efforts to meet these goals; and meet the legal requirement to achieve full audit readiness for all DOD financial statements in 2017.

the Secretary of Defense's unprecedented leadership in prioritizing the Department's FIAR objectives, and the Panel applauds the Secretary's commitment to accelerating the SBR goal<sup>5</sup> amid the many challenges that the DOD faces in reaching it. At the same time, the Department must continue to work toward achieving auditability on the full set of financial statements in 2017. The Panel is concerned that the DOD has not yet fully defined all of the elements of the strategy necessary to achieve audit readiness on all financial statements in 2017. The Panel is also concerned that certain DOD components may not be effectively implementing the FIAR strategy and methodology. According to the Department, the DOD components are applying lessons learned from their audit readiness efforts. The Panel acknowledges the DOD components' efforts, but notes that they must continue to demonstrate improvement in their understanding and implementation of the audit readiness methodology for the Department to achieve its auditability goals. A key barometer for assessing whether the Department will achieve its audit readiness goals is its demonstrable ability to meet interim milestones. As reflected in its May 2011 and November 2011 FIAR Plan Status Reports, some of the interim milestones were missed. Slippages of interim milestones will not necessarily compromise audit readiness objectives. However, the Department must make every effort to remediate missed interim milestones and to apply lessons-learned toward achieving successive milestones on schedule.

### **Challenges to Achieving Financial Management Reform and Auditability**

The DOD is one of the largest and most complex organizations in the world. In fiscal year 2011, the DOD reported \$684 billion in net cost of operations and \$2 trillion in assets. The Department's size and complexity contribute to complicated and pervasive challenges to its financial management processes and related business operations and systems. The following objectives must be met for the DOD to improve financial management and to achieve auditability: sustaining leadership, commitment, and effective oversight; resolving long-standing internal control weaknesses; managing the organizational challenges associated with the DOD's operations being spread across a wide range of defense organizations, functional activities, defense agencies, and field activities; ensuring workforce competencies; and implementing Enterprise Resource Planning (ERP) systems. Effective leadership and oversight are instrumental to effectuating and sustaining substantial financial management improvement. The DOD has taken some positive steps in this regard. However, more must be done to ensure that there is effective leadership focused on, and involved in, financial improvement and audit readiness efforts to include: ensuring that senior leaders are held accountable when audit readiness goals are not met and, conversely, rewarded when goals are achieved.

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<sup>5</sup> Section 1003 of the National Defense Authorization Act for Fiscal Year 2012 requires that the May 2011 semi-annual FIAR Plan Status Report include a plan, including interim objectives and a schedule of milestones for each military department and for the defense agencies, to support the SBR auditability goal of 2014 set by the Secretary of Defense. Subsequent semi-annual FIAR Plan Status Reports shall explain how the Department has progressed toward meeting the milestones established in the plan. Pub. L. No. 112-81, (2011).

The Panel has concerns regarding the DOD's progress in addressing internal control weaknesses. Since the mid-1990s, the DOD Office of Inspector General (OIG) has reported numerous material internal control weaknesses that affect the Department's ability to achieve an unqualified financial statement opinion. In addition, the DOD's financial management has been on the Government Accountability Office's (GAO's) list of federal programs and operations at high risk to fraud, waste, abuse, and mismanagement since 1995. The DOD must develop comprehensive corrective action plans to address its pervasive and long-standing weaknesses. Section 1003 of the National Defense Authorization Act for Fiscal Year 2012 requires that the semi-annual FIAR Plan Status Reports include corrective action plans for weaknesses or deficiencies identified in the execution of the FIAR Plan.

Many DOD organizations play a key role in the Department's financial improvement and audit readiness efforts. For example, the majority of transactions recorded in accounting systems are initiated within military commands or non-financial functional communities, such as acquisition, logistics, and personnel. The Panel is encouraged by the testimony provided by the Naval Air Systems Command (NAVAIR) Commander, regarding NAVAIR's efforts to standardize its business processes, and the testimony of military service logisticians, regarding their roles in the efforts to improve financial management and achieve audit readiness.<sup>6</sup> However, the Panel believes that continued emphasis must be placed on fully engaging the functional communities in the audit readiness effort. As indicated by the Air Force's testimony,<sup>7</sup> one of its biggest challenges lies in reinforcing the importance of FIAR roles and responsibilities within the logistics and acquisition communities. In addition, the Defense Finance and Accounting Service (DFAS), which provides finance and accounting services to the DOD components, has a significant role in processing the financial information that is reported in the DOD components' financial statements. According to the DOD, in fiscal year 2011, DFAS processed 172 million pay transactions, paid 11.8 million commercial invoices, and made \$608 billion in disbursements. Because DFAS activities are integral to producing the DOD components' financial statements, internal control weaknesses at DFAS must be addressed.

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<sup>6</sup> Testimony of Vice Admiral David Architzel, Commander, Naval Air Systems Command, Lieutenant General Mitchell Stevenson, Deputy Chief of Staff, G-4, United States Army, and Major General Judith Fedder, Director of Logistics, Deputy Chief of Staff, Logistics, Installations and Mission Support, United States Air Force delivered at the Panel's September 15, 2011 hearing entitled, "Organizational Challenges in Achieving Sound Financial Management and Audit Readiness."

<sup>7</sup> Testimony of Major General Judith Fedder, Director of Logistics, Deputy Chief of Staff, Logistics, Installations and Mission Support, United States Air Force delivered at the Panel's September 15, 2011 hearing entitled, "Organizational Challenges in Achieving Sound Financial Management and Audit Readiness."

## **Financial Management Workforce**

The DOD's financial management workforce needs specific skills to perform various duties that include: proprietary<sup>8</sup> and budgetary accounting, information systems, internal control, audit readiness, and related functions. Ensuring that the financial management workforce is adequately staffed, proficiently skilled, and well-trained is instrumental to the DOD's improvement efforts. The DOD has indicated that, in general, it has the appropriate staffing levels to achieve effective financial management. The Department must continuously monitor staffing levels and their resourcing to maintain an effective financial management workforce with the right skills mix. The DOD has not yet performed a complete department-wide systematic competency assessment (e.g., an analysis of the workforce abilities, knowledge bases, and skill sets that are currently needed or that will be needed in the future).<sup>9</sup> Without this analysis, the DOD will be limited in its identification of weaknesses in its financial management workforce and its determinations as to what education, training and hiring remediation plans may be needed. The Panel also recognizes the importance of having personnel within the Department's functional communities who are skilled in the performance of financial management-related tasks, since these communities generate and maintain much of the financial information that is critical to the financial results of DOD operations. In addition, implementing effective training programs will be especially important as the DOD transitions to increased usage of ERP systems, which are used by both financial and functional communities, and which require personnel to obtain proficiency in skills that are not required in the legacy operating environment.

## **Enterprise Resource Planning (ERP) System Implementation Efforts**

The DOD maintains that successful implementation of ERP systems is critical to transforming its business and logistical operations and that such implementation is key to improving financial management and achieving audit readiness. ERPs are intended to: standardize and streamline financial management and accounting systems within DOD services and agencies; integrate multiple logistics systems and financial processes; provide asset visibility for accountable items; and integrate personnel and pay systems. The DOD has invested billions of dollars in its ERP efforts, and billions more will be needed to fully deploy these systems. The Panel acknowledges that the DOD has taken positive steps to improve the implementation of its ERPs. In addition, the Panel is encouraged by the commitment exhibited by DOD personnel in the field to implement the ERPs. However, the Panel has a number of concerns regarding these

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<sup>8</sup> "Proprietary accounting" is usually based on Generally Accepted Accounting Principles, which follow established conventions such as the recognition of transactions on an accrual basis instead of recognition based on strict association with the obligation or expenditure of appropriated funds. (See GAO-05-734SP Budget Glossary).

<sup>9</sup> Section 1053 of the National Defense Authorization Act for Fiscal Year 2012 requires that the DOD strategic workforce plan includes a separate chapter to specifically address the shaping and improvement of the Department's financial management workforce, including military and civilian personnel. Pub. L. No. 112-81, (2011).

systems. First, it is concerned about reported ERP schedule delays and cost overruns and the reliability of ERP schedule and cost estimates. Second, the Panel is concerned that the ERPs may not provide capabilities needed for achieving FIAR objectives. The GAO and the DOD OIG have reported weaknesses in ERP functionality. Other concerns include: whether the DOD has effective processes in place to properly convert data from legacy system environments into ERP environments; and whether the DOD has too many interfaces between legacy systems and ERPs. The number of interfaces is driven by the number of legacy systems. The Panel is concerned that problems associated with these interfaces could be compromising to functionality. The DOD should make every effort to reduce reliance on legacy system activities that can be effectively and efficiently conducted by ERP systems. The DOD should complete and validate its business process re-engineering analysis to ensure that those business processes that will be supported by ERPs will be as streamlined and efficient as practicable and that the need to tailor ERPs to meet unique requirements or to incorporate unique interfaces has been eliminated or reduced to the extent practicable.

Finally, because the House Armed Services Committee plays a distinct role in overseeing the various activities of the Department of Defense, each of which demands proper stewardship of taxpayers' investments and of the public trust, the Panel recommends that the committee (or appropriate subcommittees) conduct regular hearings and staff briefings to further monitor the progress of the Department's FIAR efforts.

## **PART I: THE FINANCIAL IMPROVEMENT AND AUDIT READINESS STRATEGY AND METHODOLOGY**

The DOD has undertaken numerous efforts to address its financial management weaknesses and to achieve audit readiness, but it has not yet produced financial statements that can reliably support an unqualified or “clean” audit opinion for the Department as a whole. According to the GAO, deficient financial and related business management systems and controls have “adversely affected DOD’s ability to control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; prevent and detect fraud, waste and abuse; [and] address pressing management issues.” For these reasons, the DOD’s financial management has been on the GAO’s list of federal programs and operations at high risk to fraud, waste, abuse, and mismanagement since 1995.<sup>10</sup>

The DOD is required by various statutes<sup>11</sup> to improve its financial management processes, controls, and systems and to produce audited financial statements. The National Defense Authorization Act for Fiscal Year 2010 requires that the DOD’s financial statements be made ready for audit no later than September 30, 2017. The DOD’s FIAR Plan: (1) defines the Department’s strategy and methodology for improving financial management and controls; and (2) summarizes the Department’s progress toward achieving FIAR objectives.<sup>12</sup> The FIAR Plan’s strategy and methodology build upon the Department’s approach to preparing consolidated financial statements. The DOD has been required, since 1997, to prepare and issue annual department-wide audited financial statements. Additionally, pursuant to various statutes and DOD policies, certain DOD components, including the military departments, are required to prepare and issue annual audited financial statements. The Office of the Secretary of Defense (OSD) consolidates the components’ financial statements to prepare the department-wide financial statements. As reflected in Office of Management and Budget (OMB) requirements and DOD policies for the preparation and audit of agency financial statements, the DOD and its components must: (1) prepare financial statements consistent with Generally Accepted Accounting Principles (GAAP); and (2) establish and maintain effective internal controls over

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<sup>10</sup>See [http://www.gao.gov/highrisk/risks/dod-management/financial\\_management.php](http://www.gao.gov/highrisk/risks/dod-management/financial_management.php); see also U.S. Government Accountability Office Testimony before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate, entitled “Department of Defense Financial Management Improvement and Audit Readiness Efforts Continue to Evolve,” September 29, 2010, pp. 1-2.

<sup>11</sup> These statutes include the Chief Financial Officers Act of 1990, the Government Management Reform Act of 1994, the Federal Financial Management Improvement Act of 1996, and various provisions in multiple defense authorization and appropriation acts.

<sup>12</sup> The first FIAR Plan was issued in December 2005. In 2010, the DOD revised its FIAR Plan to support the DOD Comptroller’s direction to focus on budget information and information pertaining to mission critical assets. The National Defense Authorization Act for Fiscal Year 2010 requires the DOD to update and report on the FIAR Plan twice a year—no later than May 15 and November 15—and to provide each report to the congressional defense committees.

financial reporting and compliance. The DOD OIG is responsible for auditing the financial statements in accordance with Generally Accepted Government Auditing Standards (GAGAS), which require auditors to determine if the financial statements are fairly presented and properly supported by the agency's accounting records.

In 2009, the DOD Comptroller directed that the Department's FIAR efforts prioritize the improvement of processes and controls regarding information used to manage the Department. The first priority focuses on processes, controls, and systems that produce budgetary information and that support the Department's SBR. According to the DOD, the benefits of focusing improvement efforts on budgetary information and the SBR include: (1) improved transactional transparency and more effective use of budgetary resources; (2) operational efficiencies supported by access to reliable cost and financial information; (3) improved fiscal stewardship (i.e., ensuring that funds appropriated, obligated, and expended are reported accurately, reliably, and in a timely manner); and (4) improved budget processes and controls that reduce violations of the Anti-Deficiency Act (ADA). The second priority focuses on improving the accuracy and reliability of management information pertaining to mission-critical assets (e.g., military equipment, real property, inventory, operating material and supplies, and general equipment), validated through existence and completeness testing. According to the DOD, the benefits of focusing improvement efforts on mission critical asset information include: (1) more accurate, and thereby more reliable, logistical supply chain inventory systems; (2) improved acquisition, maintenance, and retirement processes for mission-critical assets; (3) more effective utilizations of those assets; and (4) better controls over the assets for preventing their misuse, theft, or loss.

The DOD's framework for executing its FIAR strategy includes four waves of financial improvement activities that move the Department toward achieving financial statement auditability. The first three waves focus on achieving the DOD Comptroller's interim budgetary and asset accountability priorities, while the remaining wave is intended to complete actions needed to achieve full financial statement auditability, except for legacy asset valuation. The scope and focus of each wave may be described briefly as follows:

**Wave 1 – Appropriations Received Audit** - focuses on the Appropriations receipt and distribution process, including apportionment/re-apportionment and allocation/sub-allocation<sup>13</sup> of appropriated funds.

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<sup>13</sup> "Apportionment" is the action by which the OMB distributes amounts available for obligation, including budgetary reserves established pursuant to law, in an appropriation or fund account and "re-apportionment" is a revision of a previous apportionment or fund account. Once the OMB apportions funds, it is the agency's responsibility to allocate the funds in accordance with its funds control system and regulations. (See GAO-05-734SP Budget Glossary). In the case of the DOD, the DOD Comptroller allocates DOD's budget authority to the various military services and defense agencies. Once the services and defense agencies receive their allocations of funds, their comptrollers will sub-allocate the funds to major commands or program executive offices, which will subsequently allot funds to their subordinate program offices for execution (i.e., obligate funds to a contract and approve expenditures of obligated funds).

**Wave 2 – Statement of Budgetary Resources (SBR) Audit** - focuses on all processes, internal controls, systems, and documentation supporting budgetary data (e.g., the status of funds received, obligated, or expended). Significant end-to-end business processes in this wave include procure-to-pay (from issuing a contract to the receipt of goods and services to the disbursement of funds), hire-to-retain (from recording personnel information in the system to making payroll disbursements to paying retirement benefits), budget-to-report (from receiving the budget to reporting budgetary activity in the SBR) processes. In addition, Fund Balance with Treasury (the DOD's account balance with Treasury) is a component of the SBR.

**Wave 3 – Mission-Critical Assets Existence and Completeness Audit** - focuses efforts 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 actually exist; all of the reporting entities' assets are recorded in those systems of record; reporting entities have the ownership rights to report these assets; and the assets are consistently categorized, summarized, and reported.

**Wave 4 – Full Audit Except for Legacy Asset Valuation** - focuses on the proprietary side of budgetary transactions covered by the SBR of Wave 2, including: accounts receivable, revenue, accounts payable, expenses, environmental liabilities, and other liabilities. This wave also includes efforts to support the valuation and reporting of new asset acquisitions. The reporting entities will identify the dates by which they will be able to establish processes and practices for valuing future acquisitions. These dates will depend primarily on when the SBR is audit ready and when ERPs are implemented. All assets acquired before that date (referred to as legacy assets), will not be subject to audit readiness efforts for valuation.

The DOD's methodology for executing its strategy is outlined in the DOD's FIAR Guidance.<sup>14</sup> The FIAR Plan's methodology prescribes the processes that key component organizations<sup>15</sup> must follow in executing efforts to: assess processes, controls, and systems; identify and correct weaknesses; assess, validate, and sustain corrective actions; and achieve full auditability. The DOD's organizational components are responsible for developing and implementing financial improvement plans (FIPs) to both guide and document their audit readiness efforts in accordance with the FIAR Guidance.

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<sup>14</sup> DOD, *Financial Improvement and Audit Readiness (FIAR) Guidance* (December 2011).

<sup>15</sup> Per the DOD FIAR Guidance, immaterial reporting entities need to become audit ready. These entities will be a part of the Department's consolidated financial statement audit, but they do not report their milestone progress to the FIAR Directorate. The entities are not required to undergo standalone financial statement audits. In addition, the Defense Intelligence Agencies (e.g., the National Security Agency, the Defense Intelligence Agency, and the National Geospatial-Intelligence Agency) follow the Office of the Director of National Intelligence audit readiness guidance.

The National Defense Authorization Act for Fiscal Year 2010 requires DOD financial statements to be validated as audit ready no later than September 30, 2017. The Ike Skelton National Defense Authorization Act for Fiscal Year 2011 took the additional step of requiring the DOD Comptroller to establish interim milestones for achieving audit readiness. As a result, each military department, defense agency, and defense field activity must develop interim milestones for: (1) achieving audit readiness for each major element of the SBR, including civilian pay, military pay, supply orders, contracts, and Fund Balance with Treasury; and (2) addressing the existence and completeness of each major category of DOD assets, including military equipment, real property, inventory, and operating materials and supplies. These interim milestones and the milestones for other assessable units<sup>16</sup> identified by the DOD component, along with the DOD component's progress in achieving the milestones, are now required to be included in the semi-annual FIAR Plan Status Reports.<sup>17</sup> Section 1003 of the National Defense Authorization Act for Fiscal Year 2012 requires that a detailed description of the subordinate activities necessary to accomplish these interim milestones be included in the semi-annual FIAR Plan Status Reports. The FIAR Plan also includes audit readiness timelines for the SBR and the existence and completeness of mission critical assets. On October 13, 2011, the Secretary of Defense advanced the audit readiness target date for Statements of Budgetary Resources from 2017 to 2014,<sup>18</sup> and he directed the DOD Comptroller to revise the current plan accordingly within 60 days.<sup>19</sup> The Panel appreciates Secretary Panetta's commitment to accelerating this goal.

The FIAR Plan's strategy and methodology provide a reasonable approach for achieving auditability for the SBR and existence and completeness of mission critical assets (Waves 1-3). The recently updated FIAR Guidance details the strategy and methodology for completing Wave 4. However, according to the Department, DOD components continue their focus on implementing the requirements of Waves 1, 2, and 3. The Department added that DOD components will not address the Wave 4 requirements in their financial improvement plans until

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<sup>16</sup> An assessable unit can be any element of the financial statements, such as a line item or a class of assets (e.g., civilian pay or military equipment), or it can be a process or system that helps produce the financial statement (e.g., implementation of a new financial management system at a military installation). The components have flexibility to determine appropriate assessable units based on their differing missions and business operations. (See FIAR Guidance December 2011).

<sup>17</sup> See FIAR Plan Status Report, May 2011 <http://comptroller.defense.gov/fiar/plan.html> (Army: pages II-6, II-9; Navy: pages III-7, III-10, Air Force: pages IV-5, IV-9)

<sup>18</sup> Section 1003 of the National Defense Authorization Act for Fiscal Year 2012 requires that the May 2011 semi-annual FIAR Plan Status Report include a plan, including interim objectives and a schedule of milestones for each military department and for the defense agencies, to support the SBR auditability goal of 2014 established by the Secretary of Defense. Subsequent semi-annual FIAR Plan Status Reports shall explain how the Department has progressed toward meeting the milestones established in the plan. Pub. L. No. 112-81, (2011).

<sup>19</sup> The Secretary of Defense also directed the Department to: increase emphasis on accountability for assets; execute a full review of the Department's financial controls over the next two years and establish interim goals against which the Department can assess progress; ensure mandatory training for audit and other key financial efforts, and establish by the end of CY 2012 a pilot certification program for financial managers—similar to the one now in place for acquisition managers; appropriately resource efforts to meet these goals; and meet the legal requirement to achieve full audit readiness for all DOD financial statements by 2017.

they have completed Waves 1, 2, and 3. The FIAR Plan does not reflect a complete analysis of how Wave 4 relates to the steps covered by Waves 1, 2 and 3. For example, by testing certain information on the SBR (e.g., delivered orders-unpaid) in Wave 2, assurance can be obtained on the reliability of data in the Balance Sheet (e.g., accounts payable) in Wave 4. In addition, the FIAR Plan does not address the process for ensuring that the DOD components' financial information will be properly consolidated into the DOD's financial statements. The Panel is concerned that a lack of analysis of the interdependencies among Waves, 1, 2, and 3 and Wave 4 and the lack of an articulated process for addressing financial statement consolidation may affect the Department's ability to achieve full financial statement auditability in 2017.

In the previous version of the FIAR Guidance,<sup>20</sup> the DOD included a Wave 5 (Full Financial Statement Audit) as part of its audit readiness strategy. This wave was to focus on the valuation of legacy assets after controls over the valuation of new assets and accounting for all mission critical assets were deemed effective on a prospective basis. However, based on a business case analysis,<sup>21</sup> the DOD plans to accept the recorded historical acquisition cost of real property, general equipment, inventory, and operating materials and supplies. As a result, it does not plan to subject these assets to its audit readiness efforts. The DOD believes that the historical cost information is not useful for decision-making and it is not cost-effective to value these assets. The DOD recognizes that this approach could result in less than a clean opinion on its initial balance sheet audits. The DOD believes that the benefit of receiving an unqualified opinion does not justify the cost of valuing existing assets or the cost of auditing those amounts when such information is not used within the Department. The DOD notes that, over time, the existing assets will become fully depreciated or consumed, in the case of inventory and operating material and supplies, and therefore less material to the amounts reported on the financial statements. As this happens, the Department would move closer to an unqualified opinion. The Panel acknowledges the cost-benefit considerations of obtaining auditable historical asset cost information. However, federal accounting standards allow for the use of alternative methods to provide reasonable estimates for the costs of these assets. The DOD should re-evaluate its position of accepting historical asset costs when the Department nears auditability on its financial statements.

Another challenge that will need to be addressed within Wave 4 is the valuation of military equipment. On the basis of its business case analysis, the DOD plans to request that the Federal Accounting Standards Advisory Board (FASAB) change the federal accounting standards to allow it to expense the costs of military equipment,<sup>22</sup> rather than capitalize those costs on the balance sheet.<sup>23</sup> The DOD OIG noted, in its testimony before the Subcommittee on

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<sup>20</sup> DOD, Fiscal Year 2010 *Financial Improvement and Audit Readiness (FIAR) Guidance* (May 15, 2010).

<sup>21</sup> FIAR Plan Status Report, May 2011, Appendix 3. Business Case Analysis For Valuing Assets.

<sup>22</sup> Examples of military equipment include ships, submarines, aircraft, satellites, and combat vehicles.

<sup>23</sup> In terms of its accounting treatment, expensing the military equipment acquisition costs would result in the expenditure being recorded in the current period in the statement of net cost. In contrast, capitalizing the military

Government Organization, Efficiency and Financial Management, House Committee on Oversight and Government Reform, on September 23, 2011, that some systems, such as the General Fund Enterprise Business System (GFEBs), the Navy Enterprise Resource Planning (Navy ERP), and the Defense Enterprise Accounting and Management System (DEAMS), are being developed with the assumption that this proposed change will occur. The DOD OIG added that, if the accounting standard is not changed, additional systems revisions will be necessary before the DOD will become auditable. The DOD OIG also noted that the Department will need to work closely with the FASAB to ensure that a timely decision can be made. If the standard in question is not changed, the Department will need sufficient time to implement the necessary system changes and meet the 2017 deadline. The DOD plans to propose the accounting standard change to the FASAB in fiscal year 2013.

The Panel is concerned that some of the FIPs implemented by DOD components may not be consistent with the FIAR strategy and methodology. Without properly implementing the FIAR methodology, DOD components may be asserting audit readiness prematurely, which, in turn, might increase the length of the validation phase.<sup>24</sup> The GAO noted, in testimony before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Senate Committee on Homeland Security and Governmental Affairs, on September 15, 2011, that certain DOD components experienced challenges in implementing the FIAR Guidance.<sup>25</sup> Specifically, the Navy and the Air Force had not adequately developed FIPs in accordance with the FIAR Guidance. The GAO reported that these services did not conduct sufficient internal control and substantive testing<sup>26</sup> and that they reached conclusions that were not supported by the testing results. The DOD agreed that there was room for improvement in the planning and execution of its audit readiness efforts. The DOD added that the FIPs that the GAO reviewed were prepared before the issuance of the May 2010 FIAR Guidance. The DOD further noted that corrective actions for these FIPs are under way and that recent FIPs for other assessable units demonstrate improvement in understanding and application of the audit readiness guidance. Improved implementation of the audit readiness methodology will be critical to having DOD financial statements validated as audit ready in 2017. For example, the Air Force asserted audit readiness for the existence and completeness of military equipment in December 2010. However, the DOD OIG and the DOD FIAR

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equipment acquisition costs would result in the expenditure being recorded as an asset on the balance sheet and the cost of the expenditure would then be spread over the useful life of the military equipment through the recording of depreciation on the statement of net cost.

<sup>24</sup> During this phase, the OUSD(C) and the DOD OIG review management's assertion documentation, and auditors perform an examination on the audit readiness assertion. (See FIAR Guidance December 2011).

<sup>25</sup> GAO, *DOD Financial Management: Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan*, GAO-11-932T (Washington, D.C.: September 15, 2011) and GAO, *DOD Financial Management: Improvement Needed in DOD Components' Implementation of Audit Readiness Effort*, GAO-11-851 (Washington, D.C.: September 13, 2011).

<sup>26</sup> Substantive tests are performed to obtain evidence on whether amounts reported on the financial statements are reliable.

Directorate's<sup>27</sup> review of the audit readiness assertion took 7 months, 5 months longer than the FIAR Guidance's suggested time period for performing the review. The Navy submitted its audit readiness assertion for Civilian Pay in the second quarter of fiscal year 2010, but because of the additional corrective actions required, the Navy will re-assert audit readiness in the second quarter of fiscal year 2012, nearly two years after the initial audit readiness assertion was submitted. The Panel acknowledges the DOD's more recent efforts, but the DOD should ensure that all of the FIPs implemented by DOD components are adequately aligned with the FIAR methodology.

The Panel is concerned that there are key financial improvement activities scheduled to be completed near, or during, 2017. The DOD OIG testified that, since the milestones for completing some critical financial improvement efforts are very close to the 2017 auditability deadline, the DOD may not have adequate time to take corrective actions, if deficiencies are identified late in the milestone process or if ERP implementations are delayed.<sup>28</sup> For example, the full deployment of the Army's Global Combat Support System is planned for the fourth quarter of fiscal year 2017. Also, the Air Force plans to assert audit readiness for the existence and completeness of mission critical assets in the fourth quarter of fiscal year 2016. In addition, the Other Defense Organizations (ODOs)<sup>29</sup> do not plan on asserting audit readiness for the existence and completeness of mission critical assets until fiscal year 2017.

Although DOD efforts to date have not produced clean audit opinions for the military services or a fully reformed financial management system, the Department has made some progress toward these goals. Eight departmental components<sup>30</sup> have received clean audit opinions and the U.S. Marine Corps' (USMC's) SBR is currently undergoing an audit.<sup>31</sup> In

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<sup>27</sup> The FIAR Directorate (a program management office): provides day-to-day management of the FIAR Plan; assists the DOD components by evaluating FIP plans, products and deliverables; provides subject matter experts to assist in DOD component FIP activities, utilizing financial, accounting, and auditing personnel; embeds teams to develop, improve, and execute FIPs; develops and issues detailed financial improvement and audit preparation methodologies and guidance; provides training to the DOD components; and publishes the FIAR Plan Status Report.

<sup>28</sup> Testimony of Mr. Daniel Blair, Deputy Inspector General for Auditing, Department of Defense Office of Inspector General delivered at the Panel's September 22, 2011 hearing entitled, "DOD's Efforts to Improve Payment and Funds Control."

<sup>29</sup> For purposes of the FIAR Plan, the ODOs include: the U.S. Special Operations Command; the U.S. Transportation Command; Defense Agencies; DOD Field Activities; the Chemical Biological Defense Program; the Military Retirement Fund; the Medicare-Eligible Retiree Health Care Fund; and other various organizations and accounts that receive DOD appropriated funds.

<sup>30</sup> The DOD organizations that received unqualified opinions in fiscal year 2011 include: the U.S. Army Corps of Engineers – Civil Works, the Defense Contract Audit Agency, the Defense Commissary Agency, the Defense Finance and Accounting Service, the DOD Office of Inspector General, TRICARE Management Activity - Contract Resource Management, Military Retirement Fund, and the Defense Information Systems Agency (DISA) – Defense Working Capital Fund.

<sup>31</sup> The USMC underwent the first audit of its SBR in fiscal year 2010. However, the USMC was unable to provide sufficient audit evidence to allow the auditors to complete the audit by the OMB deadline for executive agencies, November 15, 2010. As a result, the auditors issued a disclaimer of opinion. Furthermore, the auditors identified pervasive internal control weaknesses which affected the recorded FY 2010 beginning balances and carried forward to FY 2010 activity. In response, the USMC developed a remediation plan and began taking action to correct

addition, the military departments' assertions on audit readiness for appropriations received (Wave 1) were validated as audit ready by an independent public accounting firm. The Panel recognizes these achievements and encourages the DOD to continue to apply the lessons learned from these efforts to its financial improvement and audit readiness process. However, the Panel is concerned that some of the interim milestones included in the May 2011 FIAR Plan Status Report have been missed. The DOD Comptroller testified that he recognizes that the DOD needs to increase the pace of implementation, but that he believes that the Department has achieved key goals, at least in fiscal year 2010.<sup>32</sup> Slippages of interim milestones will not necessarily compromise audit readiness objectives. However, the Department must make every effort to remediate missed interim milestones and to apply lessons-learned toward achieving successive milestones on schedule.

With the exceptions of the Department of the Navy and the Defense Logistics Agency (DLA), resource scarcity has historically impeded FIAR efforts. The Department has since committed greater resources to these efforts, and funding levels have significantly increased in the Army and the Air Force. For example, funding for Army audit readiness efforts went from \$9 million in fiscal year 2010 to \$46 million in fiscal year 2011. The DOD estimates that it now has appropriate levels of committed resources for its FIAR efforts. The President's budget request identified \$216 million for these purposes in fiscal year 2012. The Panel expects the DOD to safeguard these funds for its FIAR efforts.

### Recommendations

Recommendation 1.1: The Department's FIAR strategy for Wave 4 (Full Audit Except for Legacy Asset Valuation) should include a complete analysis of interdependencies among Waves 1-3 and Wave 4.

Recommendation 1.2: The Department should establish a DOD Financial Reporting element, or wave, that includes a process for consolidating the components' financial information into the DOD's agency-wide financial statements. The Department should report this element's audit readiness progress in the FIAR Plan Status Report.

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weaknesses. As a result of the progress made in correcting its deficiencies, the auditor proceeded with the FY 2011 SBR audit. The USMC received a disclaimer of opinion by the November 15, 2011 due date, but work is continuing toward a potential "out of cycle" opinion.

<sup>32</sup> Testimony of The Honorable Robert Hale, Under Secretary of Defense (Comptroller) delivered at the Panel's July 28, 2011 hearing entitled "DOD's Plans for Financial Management Improvement and Achieving Audit Readiness."

Recommendation 1.3: The DOD should re-evaluate its position on accepting historical asset costs when the Department nears auditability on its financial statements in light of certain allowances in federal accounting standards. The findings of a re-evaluation may support the development of an audit readiness strategy for valuing legacy asset balances.

Recommendation 1.4: The Department should: (1) analyze the causes of FIAR Plan implementation difficulties; (2) develop and implement corrective action plans to address identified weaknesses or deficiencies; and (3) develop a communications plan to circulate any resulting lessons-learned throughout the Department.

Recommendation 1.5: The Under Secretary of Defense (Comptroller) (USD(C)), in consultation with the Deputy Chief Management Officer (DCMO) of the Department of Defense, the secretaries of the military departments, and the heads of the defense agencies and field activities should incorporate risk mitigation plans to support the meeting of future interim milestones in the FIAR Plan.

Recommendation 1.6: The FIAR Governance Board should attest to whether the DOD is on track to achieve audit readiness in 2017 in each FIAR Plan Status Report.

Recommendation 1.7: The House Armed Services Committee (or appropriate subcommittees) should conduct regular hearings and staff briefings to further monitor the progress of the DOD's FIAR efforts.

## **PART II: CHALLENGES TO ACHIEVING FINANCIAL MANAGEMENT REFORM AND AUDITABILITY**

The DOD is one of the largest and most complex organizations in the world. In fiscal year 2011, the DOD reported \$684 billion in net cost of operations and \$2 trillion in assets. The Department's enormous size and complexity contribute to complicated and pervasive challenges to its financial management processes and related business operations and systems. These practices, operations, and systems span a wide organizational range, including the military departments, their respective major commands and functional activities, defense agencies, and field activities. To support operations, the Department performs interrelated and interdependent business functions, including financial management, acquisition and contract management, logistics management, and human resource management.

The following challenges must be addressed for the DOD to improve financial management and to achieve auditability:

### **Sustained Leadership, Commitment, and Effective Oversight**

Effective leadership and oversight are instrumental to effectuating and sustaining substantial financial management improvement. Financial management reform is a long-term undertaking, and it requires the involvement of DOD leadership within, and outside of, the traditional domain of financial management operations. Leadership should extend from the Secretary of Defense, the Department's Chief Management Officer (CMO), its Deputy Chief Management Officer, the military departments' respective Chief Management Officers, the DOD Comptroller, the military departments' Assistant Secretaries (Financial Management and Comptroller) and senior officials into other functional areas such as logistics and acquisitions. The GAO noted, in testimony before the Panel, that the current FIAR Plan must become institutionalized at all working levels throughout the Department so that it may survive the normal course of changeover at the senior leadership levels.<sup>33</sup> The benefits of financial management improvement and audit readiness should grow over time, and they can only be realized through the Department's embrace of a long-term cultural commitment to sustaining progress as detailed in the FIAR Plan. The DOD Comptroller testified that, perhaps, his biggest concern is sustaining commitment to the FIAR effort over time. The DOD Comptroller added that: "Sustained leadership over a couple of administrations will be required to make this happen."<sup>34</sup>

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<sup>33</sup> Testimony of Mr. Asif Khan, Director, Financial Management and Assurance, Government Accountability Office, entitled "*DOD Financial Management: Numerous Challenges Must Be Addressed to Achieve Auditability*", GAO-11-864T page 10 delivered to the Panel on July 28, 2011.

<sup>34</sup> Testimony of The Honorable Robert Hale, Under Secretary of Defense (Comptroller) delivered at the Panel's July 28, 2011 hearing entitled, "DOD's Plans for Financial Management Improvement and Achieving Audit Readiness."

The DOD requires that senior executive performance appraisals include financial audit goals among their evaluation criteria. The requirement includes appraisals of senior executives in functional areas having a financial impact. The Panel considers this a positive step. However, the effectiveness of this initiative will depend on whether evaluation criteria can be objectively measured and whether evaluated performances are appropriately rewarded or held accountable. The DOD must also improve oversight of the FIAR effort. The Department established a governance structure for the FIAR Plan, which includes review committees for governance and oversight. The GAO reported<sup>35</sup> that the OSD and the DOD components have established senior executive committees and designated other officials to oversee their financial improvement efforts. However, the GAO found that oversight responsibilities were not effectively carried out, resulting in ineffective implementation of FIPs and insufficient evidence to support conclusions of audit readiness. The GAO reported that, for the two FIPs it reviewed, neither the designated officials, nor the executive committees, involved took sufficient action to ensure that those FIPs complied with the FIAR Guidance. Effective oversight mechanisms must be put into place to ensure that DOD components are complying with the FIAR Guidance.

## **Workforce Competencies**

The financial management workforce needs to be well-grounded in specific skills to perform duties that include: proprietary and budgetary accounting, information systems, internal control, audit readiness, and related functions. Ensuring that the financial management workforce is adequately staffed, skilled, educated, and trained is key to the DOD's ability to improve financial management. The DOD has not yet performed a complete department-wide systematic competency assessment, analyzing the types and ranges of abilities, knowledge bases, and skills of the present workforce or of those that will be needed in the future. Without this analysis, the DOD may not be able to identify the capability gaps in its financial management workforce or determine what training and hiring remediation plans might be needed. The National Defense Authorization Act for Fiscal Year 2006<sup>36</sup> directed the DOD to develop a strategic plan to shape and improve its civilian workforce. The plan was required to include, among other things, assessments of: (1) critical skills and competencies of the existing civilian employee workforce; (2) future critical skills and competencies needed over the next decade; and (3) gaps in the existing or projected workforce competencies. In July 2011, the GAO reported<sup>37</sup> that, although the DOD's 2009 civilian workforce plan addressed some of these legislative requirements, such as assessing the critical skills of its existing workforce, the DOD still had

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<sup>35</sup> GAO, *DOD Financial Management: Improvement Needed in DOD Components' Implementation of Audit Readiness Effort*, GAO-11-851 page 25 (Washington, D.C.: September 13, 2011).

<sup>36</sup> Pub. L. No. 109-163, § 1122 (2006). The National Defense Authorization Act for Fiscal Year 2010 made this strategic plan submission into a permanent annual requirement. Pub. L. No. 111-84, § 1108 (2009), codified at 10 U.S.C. § 115b.

<sup>37</sup> GAO, *DOD Civilian Personnel: Competency Gap Analyses and Other Actions Needed to Enhance DOD's Strategic Workforce Plans*, GAO-11-827T (Washington, D.C.: July 14, 2011).

significant work to do. For example, the GAO noted that the Department only discussed competency gap analyses for 3 of its 22 mission-critical occupations. A competency gap analysis for financial management was not included.<sup>38</sup> Section 1053 of the National Defense Authorization Act for Fiscal Year 2012 requires that the DOD strategic workforce plan include a chapter to specifically address the shaping and improvement of the financial management workforce of the Department of Defense, including military and civilian personnel.

## **Implementation of Enterprise Resource Planning (ERP) Systems**

The ERPs are intended to: standardize and streamline financial management and accounting systems within DOD services and agencies; integrate multiple logistical systems and financial processes; provide asset visibility for accountable items; and integrate personnel and pay systems. Successful implementation of the ERPs is critical for addressing long-standing weaknesses in financial management and for achieving audit readiness. Yet, over the years, several ERPs have been plagued by schedule delays and cost overruns. The Panel is concerned that the DOD may not implement these ERPs within the timeframes needed to achieve the financial improvement and audit readiness goals. The GAO reported<sup>39</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.” The GAO also reported that delays in ERP implementation have necessitated the extended use of legacy systems and continued funding for these legacy systems longer than planned. The DOD OIG noted, in testimony before the Panel, that “The development, implementation and effectiveness of these ERP systems are questionable at this point.”<sup>40</sup> The DOD OIG added that the numerous interfaces between the ERPs and the existing systems may be overwhelming, and that, at the present time, they may not be adequately defined.<sup>41</sup>

## **Internal Control Weaknesses**

The Panel has concerns, regarding the DOD’s progress in addressing long-standing internal control weaknesses. Since the mid-1990s, the DOD OIG has reported numerous material internal control weaknesses<sup>42</sup> that affect the Department’s ability to achieve an unqualified

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<sup>38</sup> Recommendations related to workforce competency are offered in Part III of the report.

<sup>39</sup> GAO, *DOD Financial Management: Improved Controls, Processes, and Systems Are Needed for Accurate and Reliable Financial Information*, GAO-11-933T page 18 (Washington, D.C.: Sept. 23, 2011).

<sup>40</sup> Testimony of Mr. Daniel Blair, Deputy Inspector General for Auditing, Department of Defense Office of Inspector General delivered at the Panel’s September 22, 2011 hearing entitled, “DOD’s Efforts to Improve Payment and Funds Control” page 17.

<sup>41</sup> Recommendations related to the implementation of ERP systems are offered in Part IV of this report.

<sup>42</sup> A “material weakness” is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. (See American Institute of Certified Public Accountants Codification of Statements on Auditing Standards under AU 325.06).

financial statement opinion.<sup>43</sup> In addition, according to the GAO, deficient financial and related business management systems and controls have “adversely affected DOD’s ability to control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; prevent and detect fraud, waste and abuse; [and] address pressing management issues.” For these reasons, the DOD’s financial management has been on the GAO’s list of federal programs and operations at high risk to fraud, waste, abuse, and mismanagement since 1995.<sup>44</sup>

The GAO also reported<sup>45</sup> that a lack of effective internal controls contributed, in part, to the DOD OIG issuing a disclaimer of opinion on the Marine Corps’ fiscal year 2010 Statement of Budgetary Resources. The auditor’s report 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 focused on short-term corrective actions based on manually intensive efforts to produce reliable financial reporting at year-end. The GAO noted that, given the current efforts, goals, and timeframes for achieving auditability of the Marine Corps’ fiscal year 2011 SBR, the current approach was understandably focused on short-term actions. However, the GAO added that such efforts may not result in sustained improvements over the long-term that would help the Marine Corps to routinely produce sound data on a timely basis for decision-making.

Weaknesses in controls over recording, accounting, and reporting of financial information also jeopardize the DOD’s responsibility to safeguard taxpayer dollars and increase the risks of mismanagement, waste, abuse, or fraud. On September 22, 2011, the Panel held a hearing to examine DOD efforts to address improper payments, Anti-Deficiency Act violations, and problem disbursements. The Panel recognizes that the DOD is taking action to address these issues, but it asserts that more action is needed.

- **Improper Payments.** The DOD must improve its processes for identifying and reporting improper payments. Properly identifying and reporting improper payments is critical to preventing or recovering these payments. For fiscal year 2010, federal agencies reported an estimated \$125.4 billion in improper payments,<sup>46</sup> of which, \$1 billion was reported by

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<sup>43</sup> In the DOD OIG’s most recent disclaimer of opinion on the Fiscal Year 2011 DOD Agency-Wide financial statements, it reported the following 13 areas having material internal control weaknesses: Financial Management Systems; Fund Balance with Treasury; Accounts Receivable; Inventory; Operating Materials and Supplies; General Property, Plant, and Equipment; Government Property in Possession of Contractors; Accounts Payable; Environmental Liabilities; Statement of Net Cost; Intragovernmental Eliminations; Accounting Entries; and Reconciliation of Net Cost of Operations to Budget.

<sup>44</sup> [http://www.gao.gov/highrisk/risks/dod-management/financial\\_management.php](http://www.gao.gov/highrisk/risks/dod-management/financial_management.php).

<sup>45</sup> GAO, *DOD Financial Management: Improved Controls, Processes, and Systems Are Needed for Accurate and Reliable Financial Information*, GAO-11-933T pages 11 – 13 (Washington, D.C.: September 23, 2011).

<sup>46</sup> An “improper payment” is any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate

the DOD.<sup>47</sup> Both the DOD OIG and the GAO reported that the DOD may not be capturing the full extent of its improper payments. In 2011, the DOD OIG reported that the DOD's First Quarter FY 2010 High Dollar Overpayments Report (the Overpayments Report) was inaccurate and incomplete.<sup>48</sup> Specifically, the DOD did not review approximately \$167.5 billion of the \$303.7 billion in gross outlays for high dollar overpayments. Additionally, the Overpayments Report did not include sufficient information about recoveries and corrective actions. In a July 2009 report, examining the DOD's fiscal year 2007 improper payment and recovery auditing reporting, the GAO found that the DOD's process for addressing the Improper Payments Information Act of 2002 (IPIA)<sup>49</sup> requirements had significant weaknesses.<sup>50</sup> For example, the DOD did not conduct risk assessments for all of its payment activities and \$322 billion in outlays were excluded from the amounts assessed. For those payment activities reviewed, the DOD assessed the risk of improper payments as low, despite recognized financial management weaknesses, and the DOD could not provide documentation supporting their methodology or rationale for the low risk level assessment. The GAO also found that the DOD did not estimate improper payments for commercial pay according to IPIA requirements. Its largest payment activity contained outlays of \$340.3 billion. The GAO found that the DOD, in general, developed statistically valid sampling methodologies and estimated improper payment amounts for its remaining five payment activities.<sup>51</sup>

In testimony before the Senate Committee on Homeland Security and Governmental Affairs' Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, dated May 25, 2011, the DOD Comptroller indicated that both audits referred to above are overstated and, in some cases, misleading. For example, the DOD Comptroller noted that of the \$167.5 billion in payments, cited by the DOD OIG as not having been reviewed, \$27.3 billion were transfers between government agencies, and, according to the OMB guidance, such transfers are not subject to review for improper payments. The DOD Comptroller further indicated that another

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payment, payment for services not received, and any payment that does not account for credit for applicable discounts. OMB guidance also instructs agencies to report payments for which insufficient or no documentation was found as improper payments. The term "payment" means any payment or transfer of federal funds (including a commitment for future payment, such as cash, securities, loans, loan guarantees, and insurance subsidies) to any non-federal person or entity that is made by a federal agency, a federal contractor, a federal grantee, or a governmental or other organization administering a federal program or activity. (Appendix C of OMB Circular A-123).

<sup>47</sup> GAO, *Status of Fiscal Year 2010 Federal Improper Payments Reporting*: GAO-11-443R (Washington, D.C.: March 2011).

<sup>48</sup> DOD OIG Report, *DOD Needs to Improve High Dollar Overpayment Review and Reporting*, D-2011-050 (March 16, 2011).

<sup>49</sup> Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).

<sup>50</sup> GAO, *Improper Payments: Significant Improvements Needed in DOD's Efforts to Address Improper Payment and Recovery Auditing Requirements*, GAO-09-442 (Washington, D.C.: July 2009)

<sup>51</sup> The five payment activities include: civilian pay, military health benefits, military pay, military retirement pay, and travel pay.

\$73.1 billion of that amount involved routine annual transactions from the Treasury to the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund accounts. The DOD Comptroller also asserted that the amounts referred to by the DOD OIG and the GAO, as being excluded from the DOD's improper payment assessment, were subject to other analyses, such as prepayment reviews. The DOD Comptroller added that the DOD is taking steps, based on the Improper Payments Elimination and Recovery Act of 2010 (IPERA)<sup>52</sup> to initiate a statistical sampling program for commercial payments. The Panel acknowledges the DOD's efforts to initiate statistical sampling for commercial payments, but the DOD should evaluate its entire methodology for identifying and reporting improper payments.

- **Anti-Deficiency Act Violations.** The DOD's poor internal controls continue to put it at risk of violating the ADA. The DOD OIG noted, in testimony before the Panel, that the DOD's control environment weaknesses impair the Department's ability to determine the amount of funds that it has available to spend, and, as a result, the Department remains at risk of overobligating and overexpending its appropriations in violation of the Anti-Deficiency Act.<sup>53</sup> The DOD OIG added that a lack of adequate controls and training contribute to potential ADA violations. The GAO noted, in testimony before the Panel, that the Department is at risk of overobligating and overexpending its appropriations because of weaknesses in: training personnel responsible for funds control and for carrying out supervisory duties, properly supporting and accounting for its transactions, and poor financial systems.<sup>54</sup> In June 2010, the GAO reported<sup>55</sup> that the Army Budget Office lacked an adequate funds control process for assuring that obligations and expenditures do not exceed funds available in the Military Personnel—Army appropriation. The GAO found that the Army's total obligation against the fiscal year 2008 Military Personnel—Army appropriation exceeded the amount available in the account, as evidenced by the Army's need to transfer \$200 million from the Defense Working Capital Fund, Army appropriation to cover the shortfall. The GAO reported that this overobligation likely stemmed, in part, from a lack of communication between Army budget and program managers. The Army Budget Office's accounting records reflected estimates instead of actual amounts until it received disbursement data from DFAS, which is often weeks or even months after the Army incurs each obligation. Thus, it was too late to control the incurrence of excessive obligations in violation of the

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<sup>52</sup> Pub. L. No. 111-204, 124 Stat. 2224 (July 22, 2010).

<sup>53</sup> Testimony of Mr. Daniel Blair, Deputy Inspector General for Auditing, Department of Defense Office of Inspector General delivered at the Panel's September 22, 2011 hearing entitled, "DOD's Efforts to Improve Payment and Funds Control."

<sup>54</sup> Testimony of Mr. Asif Khan, Director, Financial Management and Assurance, Government Accountability Office delivered at the Panel's September 22, 2011 hearing entitled, "DOD's Efforts to Improve Payment and Funds Control."

<sup>55</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).

ADA. The Army Budget Office explained that it relies on estimated obligations, despite the availability of actual data from program managers, because it relies on inadequate financial management systems. The DOD testified that its ADA violation levels are low and much lower than those of non-defense agencies.<sup>56</sup> The DOD also stated, in testimony before the Panel, that it has been able to minimize ADA violations despite difficulties in its current business environment.<sup>57</sup> The DOD added that, from fiscal year 2005 to fiscal year 2010, 85 cases have been reported to Congress with a total value of \$960 million dollars, which, relative to its budget authority, represents 26 cents out of every \$1,000. However, according to the GAO, there may be other violations that have not been detected, investigated, and reported because of weaknesses in the DOD's funds control and financial management processes.<sup>58</sup> The DOD should continue its efforts to improve its funds controls in order to reduce the risk of overobligating and overexpending its appropriations.

- **Problem disbursements.** Problem disbursements are specific disbursements that have not been properly matched with corresponding obligations. These disbursements can increase the risks of: (1) fraudulent or erroneous payments being made without detection; and (2) accumulated disbursements exceeding appropriated amounts and other legal spending limits. Problem disbursements also impede the DOD's ability to perform proper Fund Balance with Treasury reconciliations, affecting the DOD's ability to report reliable information on its financial statements. The amounts reported have declined in recent years, but occurrences of these types of transactions continue. The DOD stated, in testimony before the Panel, that problem disbursements cause the DOD to be out of balance with Treasury records and that reducing problem disbursements is a critical element for reconciling its Fund Balance with Treasury and ultimately achieving auditability.<sup>59</sup> The DOD added that it has seen some recent increases in problem disbursements due to issues with data quality and systems interfaces as the ERPs are implemented. However, the DOD projected that as its ERP systems mature and stabilize, these systems will provide an automated, integrated environment that will significantly reduce the number of problem disbursements. The Panel acknowledges the DOD's progress in addressing problem disbursements, but it asserts that further progress in reducing problem disbursement amounts must be made to safeguard taxpayer resources and to achieve auditability.

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<sup>56</sup> Testimony of The Honorable Robert Hale, Under Secretary of Defense (Comptroller) delivered at the Panel's July 28, 2011 hearing entitled, "DOD's Plans for Financial Management Improvement and Achieving Audit Readiness."

<sup>57</sup> Testimony of Mr. Mark Easton, Deputy Chief Financial Officer, Department of Defense delivered at the Panel's September 22, 2011 hearing entitled, "DOD's Efforts to Improve Payment and Funds Control."

<sup>58</sup> GAO, *DOD Financial Management: Weaknesses in Controls over the Use of Public Funds and Related Improper Payments*, GAO-11-950T page 6 (Washington, D.C.: September 22, 2011).

<sup>59</sup> Testimony of Mr. Mark Easton, Deputy Chief Financial Officer, Department of Defense delivered at the Panel's September 22, 2011 hearing entitled, "DOD's Efforts to Improve Payment and Funds Control."

The table below indicates disbursement amounts reported as of April 2011.

Disbursements by Military Department (Dollars in Millions)				
	Army	Navy	Air Force	Total
Unmatched Disbursements <sup>a</sup> (120 days or older)	66.35	43.45	1.26	111.06
Negative Un-Liquidated Obligations <sup>b</sup> (not resolved within 120 days)	9.45	0.83	0	10.28
Aged In-Transit Disbursements <sup>c</sup>	2,296.07	82.04	772.03	3,150.14
<b>Total</b>	<b>2,371.87</b>	<b>126.32</b>	<b>773.29</b>	<b>3,271.48</b>

<sup>a</sup> Unmatched disbursements are disbursements that have been received by the accounting office to be matched to an obligation, but were not matched because a matching obligation was not identified in the accounting system.

<sup>b</sup> Negative Un-Liquidated Obligations are disbursements that have been received and posted to specific obligations by the accounting office, but the recorded disbursements exceeded the recorded obligations (i.e., more funds have been paid out than were obligated).

<sup>c</sup> Aged In-Transit Disbursements are disbursements that have not been received or processed by the accounting office within 60 days. In-transit disbursements are disbursements that have been reported to the Treasury and charged against the Department's fund balance, but they have been neither received, nor processed, by the accounting office for recording against the applicable obligation.

## Organizational Challenges

DOD operations are conducted by a wide range of defense organizations, including the military departments, their respective major commands and functional activities, defense agencies, and field activities. The Panel held a hearing on September 15, 2011 to detail challenges faced by a select cross-section of DOD organizations, each of which plays a key role in the DOD's FIAR Plan. These organizations represented the logistics community, military commands, and DFAS.

- Logistics.** One of the priorities of the DOD's FIAR Plan is to improve the accuracy and reliability of management information, pertaining to mission-critical assets (e.g., military equipment, real property, inventory, operating materiel and supplies, and general equipment) validated through existence and completeness testing. The benefits of focusing improvement efforts on mission critical asset information include: (1) more accurate, and thereby more reliable, logistical supply chain inventory systems; (2) improved acquisition, maintenance, and retirement processes for mission-critical assets;

(3) more effective utilizations of those assets; and (4) better controls over the assets for preventing their misuse, theft, or loss. The logistics community plays a key role in improving the accuracy and reliability of mission critical asset information. Logistics personnel perform inventories and associated reconciliations, and they update logistics systems' records. The same systems used for logistical operations are also used to provide asset information for reporting in the financial statements. Logistical operations include: material readiness and product support; supply chain integration, distribution, planning and programming, and logistics systems management; maintenance of weapons systems and military equipment; depot maintenance management, including planning, performance and capabilities; and total life cycle management or sustainment.

The Panel is encouraged by the testimony provided by the logisticians, regarding their role in efforts to improve financial management and to achieve audit readiness. For example, the Army testified that it launched a Property Accountability Campaign in July 2010.<sup>60</sup> The Army added that, from the beginning of the campaign through the third quarter of fiscal year 2011, it recorded a considerable amount of equipment that it had on-hand into its inventory records. Most of this equipment was redistributed to fill Army shortages, thus negating the need to purchase more equipment to address these shortfalls. However, engaging the functional communities in the audit readiness effort must continue to be prioritized. As indicated by the Air Force's testimony,<sup>61</sup> one of its biggest challenges is reinforcing the importance of FIAR roles and responsibilities within the logistics and acquisition communities. The Air Force added that it is working to illustrate the connection between the Air Force asset inventories and the financial statements in briefings and memoranda, and by including audit readiness objectives in the performance plans of senior executives.

- **Military Components.** The majority of transactions recorded in accounting systems are initiated by military commands, installations, and bases, etc. For the DOD to achieve FIAR objectives, internal controls over these transactions and their related accounting must be improved at these locations. The Panel is encouraged by the testimony provided by the NAVAIR Commander on its audit readiness efforts.<sup>62</sup> NAVAIR is one of five Navy systems commands, and it manages about \$42 billion in funding. NAVAIR's mission is to provide full life-cycle support to naval aviation aircraft, weapons and

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<sup>60</sup> Testimony of Lieutenant General Mitchell Stevenson, Deputy Chief of Staff, G-4, United States Army delivered at the Panel's September 15, 2011 hearing entitled, "Organizational Challenges in Achieving Sound Financial Management and Audit Readiness."

<sup>61</sup> Testimony of Major General Judith Fedder, Director of Logistics, Deputy Chief of Staff, Logistics, Installations and Mission Support, United States Air Force delivered at the Panel's September 15, 2011 hearing entitled, "Organizational Challenges in Achieving Sound Financial Management and Audit Readiness."

<sup>62</sup> Testimony of Vice Admiral David Architzel, Commander, Naval Air Systems Command delivered at the Panel's September 15, 2011 hearing entitled, "Organizational Challenges in Achieving Sound Financial Management and Audit Readiness."

systems operated by sailors and Marines. This support includes: research, design, development, and systems engineering; acquisition; test and evaluation; training facilities and equipment; repair and modification; and in-service engineering and logistical support.

The NAVAIR Commander noted that NAVAIR is working to standardize its business processes in accordance with the Navy's FIP. NAVAIR is currently focusing its work on civilian pay, travel, appropriations received (funds receipt and distribution), and reimbursable work orders. As NAVAIR progresses, it will expand its efforts to contract pay, transportation of things, and other business processes. The Panel notes that lessons learned at NAVAIR should be shared with other military commands (and vice versa).

- **DFAS.** The DFAS provides finance and accounting services to the DOD and its components. According to the DOD, in fiscal year 2011, the DFAS processed 172 million pay transactions, paid 11.8 million commercial invoices, and made \$608 billion in disbursements. Since DFAS activities are integral to the financial activities reported in the DOD components' financial statements, internal control weaknesses at DFAS must be addressed for the DOD to achieve auditability. DFAS is considered a service organization<sup>63</sup> for the military services and other defense organizations. A service organization is an organization or segment of an organization that provides services to user entities, which are likely to be relevant to those user entities' internal controls over financial reporting. Per the FIAR Guidance, service providers working with user entities are responsible for audit readiness efforts surrounding service provider systems and data, processes and controls, and supporting documentation that have a direct effect on user entities' auditability. The FIAR Guidance also calls for the service provider to incorporate the interrelationships among user entity end-to-end processes and service provider processes, systems, controls, transactions and documentation. For example, the civilian pay process includes processes, systems, controls, transactions and documentation among user entities and the service provider (i.e., the DFAS). Therefore, it is critical that these organizations provide documentation, demonstrating that controls are properly designed and operating effectively and that transactions are properly posted to the accounting records. According to the DOD, the DFAS underwent an audit, and it received a clean opinion over its controls related to its key civilian pay system.<sup>64</sup> The DFAS is now executing a plan to expand the scope of the audit to the full civilian pay

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<sup>63</sup> The term "service organization" is defined by the American Institute of Certified Public Accountants (AICPA) Statements on Standards for Attestation Engagements (SSAE) no. 16. The AICPA is the organization representing the accounting profession. The AICPA sets ethical standards for the profession and U.S. auditing standards for audits of private companies, non-profit organizations, federal, state and local governments.

<sup>64</sup> Testimony of Mr. Mark Easton, Deputy Chief Financial Officer, Department of Defense before the Subcommittee on Government Organization, Efficiency, and Financial Management, Committee on Oversight and Government Reform delivered at the Subcommittee's September 23, 2011 hearing entitled, "The Department of Defense: Challenges in Financial Management."

processes and controls. The DFAS should undergo an audit of all its major processes that materially<sup>65</sup> impact its users. Timelines for establishing effective controls should be reported in future FIAR Plan Status Reports for all major processes.

### Recommendations

Recommendation 2.1: The Department should include objective and measurable criteria regarding FIAR-related goals in its senior personnel performance plans and evaluations. Performance evaluated on the basis of such criteria should be appropriately rewarded or held accountable. Evaluated performances should be documented and tracked to measure progress over time.

Recommendation 2.2: To improve oversight of the FIAR effort, the Department should require each DOD component senior executive committee to review its corresponding component's audit readiness assertion packages for compliance with the FIAR Guidance prior to submission of those packages to the OUSD(C) for validation.

Recommendation 2.3: The Department should develop comprehensive corrective action plans to address existing material weaknesses and those identified during the FIAR effort.

Recommendation 2.4: To reduce improper payments, the Department should re-evaluate its methodology for identifying and reporting improper payments.

Recommendation 2.5: To reduce Anti-Deficiency Act violations, the Department should:

- Perform an analysis of the causes for its ADA violations and then develop and implement procedures to address identified causes.
- Ensure that key funds control personnel are adequately trained to prevent, detect, and report ADA violations.

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<sup>65</sup> An impact would be “material” if the magnitude of an item’s omission or misstatement in a financial statement that, in the light of surrounding circumstances, make it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item. (See GAO-08-585G GAO/PCIE Financial Audit Manual).

Recommendation 2.6: To reduce problem disbursements, the Department should address the underlying causes of problem disbursements in its efforts to develop and implement ERPs.

Recommendation 2.7: The Department should identify and institutionalize best practices, as applicable, throughout the DOD to reinforce the full engagement of those functional communities outside of the financial management community in audit readiness efforts.

Recommendation 2.8: The Department should develop a forum in which the military commands can share lessons learned from their respective audit readiness efforts.

Recommendation 2.9: The DOD Comptroller should include milestones along with the status of DOD financial service provider efforts to achieve effective controls over the major processes that affect DOD customers in the FIAR Plan Status Reports. These milestones should be consistent with the customer organizations' audit readiness milestones.

### PART III: THE FINANCIAL MANAGEMENT WORKFORCE

The DOD’s financial management workforce needs specific skills to perform various duties that include proprietary and budgetary accounting, information systems, internal control, audit readiness, and related functions. Ensuring that the financial management workforce is adequately staffed, proficiently skilled, and well-trained is essential to the DOD’s improvement efforts.

The DOD currently has about 48,000 civilian employees and 10,000 military personnel in its financial management workforce. Of the 48,000 civilian employees, 11,000 are within the DFAS and the remaining 37,000 are outside of the DFAS. (See the table below for a breakout of the civilian financial management workforce by job series as of the second quarter of fiscal year 2011). The financial management workforce size has grown recently. From fiscal years 2002 through 2008 the workforce had about 31,000 non-DFAS employees. Levels increased to 35,000 in fiscal year 2009, and then to 37,000 in fiscal year 2010. The DFAS financial management workforce ranged from approximately 9,800 to 11,500 during this period. However, the DFAS’ overall workforce has not grown.

Series	Description	DFAS	Non-DFAS	Total
501	Financial Administration and Program	2,200	13,085	15,285
503	Financial Clerical and Assistance	204	2,537	2,741
505	Financial Manager	3	640	643
510	Accounting	2,916	3,098	6,014
511	Auditing	82	7,005	7,087
525	Accounting Technician	3,756	1,076	4,832
530	Cash Processing	18	299	317
540	Voucher Examining	8	169	177
544	Civilian Pay	303	177	480
545	Military Pay	1,459	685	2,144
560	Budget Analysis	16	7,120	7,136
561	Budget Clerical and Assistance	0	852	852
599	Student Trainee	22	404	426
5XX	TOTAL	10,987	37,147	48,134

Source: [www.fedscope.opm.gov](http://www.fedscope.opm.gov) and the DOD components’ input to the FY 2010 Environmental Forecast, July 2011.

The DOD and the military departments indicated that, in general, they have adequate staffing levels to achieve effective financial management. The Army and the Air Force further indicated that they may be able to reduce the size of the workforce as ERP systems are

implemented.<sup>66</sup> The Department must continuously monitor staffing levels and their resourcing to maintain an effective financial management workforce with the right skills mix.

The DOD has not yet performed a complete department-wide systematic competency assessment (e.g., an analysis of the workforce abilities, knowledge bases, and skill sets that are currently needed or that will be needed in the future). Without this analysis, the DOD will be limited in its identification of weaknesses in its financial management workforce and its determinations as to what education, training and hiring remediation plans may be needed. The National Defense Authorization Act for Fiscal Year 2006<sup>67</sup> directed the DOD to develop a strategic plan to shape and improve its civilian workforce. The plan was required to include, among other things, assessments of: (1) critical skills and competencies of the existing civilian employee workforce; (2) future critical skills and competencies needed over the next decade; and (3) gaps in the existing or projected workforce competencies. In July 2011, the GAO reported<sup>68</sup> that, although the DOD's 2009 civilian workforce plan addressed some legislative requirements, such as assessing the critical skills of its existing workforce, the DOD still had significant work to do. For example, the GAO noted that the Department had only discussed competency gap analyses for 3 of its 22 mission-critical occupations. A competency gap analysis for financial management was not included. Section 1053 of the National Defense Authorization Act for Fiscal Year 2012 requires that the DOD strategic workforce plan include a chapter to specifically address the shaping and improvement of the financial management workforce, including military and civilian personnel.

The Army indicated, in testimony before the Panel, that it performed a financial management workforce functional review, which identified potential redundancies and efficiencies to be gained.<sup>69</sup> The Army plans to use this information in its next review, which will be focused on new business processes as the Army's ERP systems become more broadly fielded across its commands. According to the Army, the financial management workforce functional review will support the Army Civilian Workforce Transformation Strategy by capturing critical skills and competencies in the Army's civilian workforce. The Army added that it will also identify future skills and competencies needed over the next decade and expose potential gaps between existing and future critical skills and competencies. The DOD indicated, in testimony

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<sup>66</sup> Testimony of The Honorable Mary Sally Matiella, Assistant Secretary of the Army (Financial Management and Comptroller) and The Honorable Jamie M. Morin, Assistant Secretary of the Air Force (Financial Management and Comptroller) delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

<sup>67</sup> Pub. L. No. 109-163, §1122 (2006). The National Defense Authorization Act for Fiscal Year 2010 made this strategic plan submission an annual requirement. Pub. L. No. 111-84, §1108 (2009), codified at 10. U.S.C. §115b.

<sup>68</sup> GAO, *DOD Civilian Personnel: Competency Gap Analyses and Other Actions Needed to Enhance DOD's Strategic Workforce Plans*, GAO-11-827T page 5 (Washington, D.C.: July 14, 2011).

<sup>69</sup> Testimony of The Honorable Mary Sally Matiella, Assistant Secretary of the Army (Financial Management and Comptroller) delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

before the Panel, that it plans to develop competency assessment tools to assess the proficiency of its workforce, identify any systemic competency gaps, and develop plans to close those gaps, as required annually by the Department's Civilian Strategic Human Capital Plan.<sup>70</sup> The Panel acknowledges the Army's efforts to perform financial management workforce reviews and the DOD's plans to perform a competency assessment. However, the DOD must implement its competency assessment department-wide as soon as practicable, so that it may facilitate the development of timely and effective financial management recruitment and training programs.

The DOD testified before the Panel that it uses contractors to fill skill sets that are missing from its existing workforce.<sup>71</sup> The DOD added that it is using contractor support to supplement its workforce in the area of audit readiness. The Panel received testimony on the importance of hiring, or contracting the services of, Certified Public Accountants (CPAs) with financial statement audit experience.<sup>72</sup> The CPAs who have federal financial statement audit experience are trained to apply the judgment needed to apply government auditing standards in making the decisions on the internal controls and documentation necessary to prepare the DOD for a financial statement audit.

The Panel also recognizes the importance of having personnel within the Department's functional communities who are skilled in the performance of financial management-related tasks. Functional communities, such as the logistics and acquisitions communities, generate and maintain financial information that is critical for the accurate and reliable reporting of the financial results of DOD operations. For example, logistics personnel are responsible for entering asset information into inventory records, conducting inventories, and performing reconciliations. Acquisition personnel enter obligations for contracts into the accounting system. The DOD must ensure that these personnel receive financial management training as part of the Department's FIAR efforts.

Implementing effective training programs will be especially important as DOD transitions to increased usage of ERP systems. The Army testified that its GFEBS ERP system requires personnel to obtain proficiencies in skills that are not required in the legacy operating environment and that many of the more than 70,000 eventual users of GFEBS will not reside in

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<sup>70</sup> Testimony of Ms. Sandra Gregory, Special Assistant to the Under Secretary of Defense (Comptroller), Office of Financial Workforce Management delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

<sup>71</sup> Testimony of Ms. Sandra Gregory, Special Assistant to the Under Secretary of Defense (Comptroller), Office of Financial Workforce Management delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

<sup>72</sup> Testimony of Ms. JoAnn Boutelle, Partner, Deloitte & Touche LLP and Mr. Mark Keeley, Partner, PricewaterhouseCoopers LLP delivered at the Panel's November 17, 2011 hearing entitled, "Industry Perspectives on Achieving Audit Readiness."

the Army's financial management community.<sup>73</sup> The Army added that the majority of users operate among the acquisition, logistics, public works, and property management communities. The Air Force acknowledged that a skill shift will be needed to accommodate implementation of its ERPs and that this shift would include workforce elements outside of the financial management community.<sup>74</sup>

The DOD stated, in testimony before the Panel, that the financial management community lacks a department-wide framework that prioritizes training types at various points throughout one's federal career.<sup>75</sup> To remedy this shortcoming, the DOD is taking steps to establish a course-based certification program that will provide such a framework. Earlier this year, Under Secretary Hale briefed the committee's staff on the Financial Management Certification Program; a proposal to address improvements in the financial management workforce. The proposal was subsequently supported by authority granted in Section 1051 of the National Defense Authorization Act for Fiscal Year 2012. The proposal aims to close the gap between the competencies required of the financial management workforce and its current capacity to meet those requirements. The DOD's overall approach for the certification program is modeled on the Defense Acquisition Workforce Certification Program. The program would be mandatory for DOD civilian employees and military personnel in financial management positions. The program would: (a) establish three tiered, competency-based financial management position levels; (b) emphasize improving audit readiness and analytical competencies; and (c) require continuing education for maintaining certification.

The DOD also testified that it would like to implement a pilot program similar to the Information Technology Exchange Program (ITEP). Section 1110 of the National Defense Authorization Act for Fiscal Year 2010 authorized a pilot program for the temporary exchange of information technology personnel between the DOD and the private sector.<sup>76</sup> Exchanges can range from three months to one year, and they may be extended in three month increments up to an additional year, if all parties agree. The DOD asserts that a similar exchange program involving the Financial Improvement and Audit Readiness Directorate would benefit the Department's FIAR Plan. According to the DOD, the benefits of such an arrangement would include: sharing best practices, partnering to address common challenges, and enhancing

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<sup>73</sup> Testimony of The Honorable Mary Sally Matiella, Assistant Secretary of the Army (Financial Management and Comptroller) delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

<sup>74</sup> Testimony of The Honorable Jamie M. Morin, Assistant Secretary of the Air Force (Financial Management and Comptroller) delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

<sup>75</sup> Testimony of Ms. Sandra Gregory, Special Assistant to the Under Secretary of Defense (Comptroller), Office of Financial Workforce Management delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

<sup>76</sup> Testimony of Ms. Sandra Gregory, Special Assistant to the Under Secretary of Defense (Comptroller), Office of Financial Workforce Management delivered at the Panel's October 6, 2011 hearing entitled, "Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?"

competencies. The Panel supports improving workforce competencies, and it welcomes the sharing of greater detail on the proposed program with the committee.

### Recommendations

Recommendation 3.1: The Department should assess its financial management workforce and that of all other functional areas performing financial management-related functions regarding: (1) critical skills and competencies of the existing civilian employee workforce; (2) critical skills and competencies that may be needed over the next decade; (3) gaps between current requirements and existing workforce competencies; and (4) gaps between projected requirements and existing workforce competencies. The assessment should include federal civilian, military, and contracted personnel performing financial management-related functions.

Recommendation 3.2: The Department should utilize the expertise of CPAs with financial statement audit experience in its audit readiness efforts as conducted by the federal civilian workforce or contracted personnel, as appropriate.

Recommendation 3.3: The Department should develop and implement effective financial training programs for personnel serving in functional communities outside of the financial management community.

Recommendation 3.4: The Department should develop and implement effective ERP training programs for personnel within and outside of the financial management community who utilize, or will be expected to utilize, an ERP system in their day-to-day operations. In developing these training programs, the Department should implement lessons learned from previous training provided to ERP users.

Recommendation 3.5: The Department should develop its proposal for an exchange program between the DOD and the private sector. In doing so, the Department should develop specific criteria, regarding the personnel to be exchanged and the organizations that would participate. The Department should then submit its proposal to the congressional committees of jurisdiction for consideration.

## **PART IV: THE ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM IMPLEMENTATION EFFORTS**

The DOD maintains that successful implementation of ERP systems is critical to transforming its business and logistical operations and that such implementation is essential to improving financial management and to achieving audit readiness. ERPs are intended to: standardize and streamline financial management and accounting systems within DOD services and agencies; integrate multiple logistics systems and financial processes; provide asset visibility for accountable items; and integrate personnel and pay systems. The DOD has invested billions of dollars in its ERP efforts, and billions more will be needed to fully deploy these systems. According to the May 2011 FIAR Plan Status Report, total estimated costs for ERPs from fiscal year 2012 through fiscal year 2016 are approximately \$6.4 billion.<sup>77</sup>

The National Defense Authorization Act for Fiscal Year 2008 designated the Deputy Secretary of Defense as the Department's CMO, created the DCMO position, and designated the undersecretaries of each of the military departments as the CMOs for their respective departments. The DOD DCMO and the military departmental CMOs are responsible for overseeing the implementation of ERPs. The DOD DCMO and the military departmental CMOs (and their respective deputies) are also expected to support business system modernization efforts in a manner that synchronizes these efforts with the financial improvement activities of reporting entities. Linking these initiatives has been difficult because of the functional compartmentalization of these efforts.

To support its business functions, the DOD relies on about 2,200 business systems, including: accounting, acquisition, logistics, and personnel systems. A challenge to implementing financial management improvements lies in making the disparate ERP systems interoperable with all of the necessary legacy systems, as well as with emerging ERP applications across the Department, and having them provide the level of visibility needed to make enterprise decisions. The DOD is in the process of developing and implementing a Business Enterprise Architecture (BEA)<sup>78</sup> to guide future business system investment, as well as an Enterprise Transition Plan to get the DOD from the "as-is" systems environment to a more efficient state.<sup>79</sup> To support that process, the DOD purchased commercial ERP systems. The

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<sup>77</sup> See May 2011 FIAR Plan Status Report, p. I-15, II-3, III-2, IV-3, V-7 for estimated ERP costs by fiscal year and by DOD component.

<sup>78</sup> The BEA defines the necessary data standards, business rules, performance metrics, and standard system configurations that will allow the DOD's systems to be interoperable.

<sup>79</sup> See GAO, *Organizational Transformation: Military Departments Can Improve Their Enterprise Architecture Programs*, GAO-11-902 (Washington, D.C.: September 2011) for assessment of the status of the military departments' architecture programs.

DOD stated that its ERPs will replace more than 500 legacy systems that cost hundreds of millions of dollars to operate annually.<sup>80</sup>

ERPs are integrated computer-based systems used to manage internal and external resources, including tangible assets, financial resources, materials, and human resources. ERPs have software architectures to facilitate the flow of information between all business functions inside the boundaries of the organization and to manage connections to outside stakeholders. ERPs are connected to a centralized database, utilizing a common computing platform, so that they can consolidate various business operations into a uniform and enterprise-wide system environment. The primary ERP developers are the commercial entities SAP and Oracle, but other providers include Microsoft, NetSuite, IBM, and Epicore.

The following is a brief summary of the ERPs that are currently being developed and deployed by the DOD:

Army –

- The General Fund Enterprise Business System (GFEBS) will support standardized financial management and accounting practices for the Army's general fund.
- The Global Combat Support System-Army (GCSS-Army) will integrate multiple logistics functions by replacing numerous legacy systems and interfaces. The system will provide tactical units with a common authoritative source for financial and related non-financial data, such as information related to the maintenance and transportation of equipment.
- The Logistics Modernization Program (LMP) will provide order fulfillment, demand and supply planning, procurement, asset management, material maintenance, and financial management capabilities for the Army's working capital fund.
- The Army Enterprise System Integration Program (AESIP) will provide a single source management platform and support interoperability among the various Army ERPs.

Navy –

- The Navy Enterprise Resource Planning System (Navy ERP) will standardize: acquisition; financial management; maintenance plant and wholesale supply; and workforce management capabilities at Navy commands.
- The Global Combat Support System-Marine Corps (GCSS-MC) will provide deployed units with enhanced capabilities in the areas of warehousing, distribution, logistical planning, depot maintenance, and improved asset visibility.

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<sup>80</sup> See Appendix C for the number of legacy systems that are planned to be retired and replaced by ERPs, along with projected cost savings and/or cost avoidance estimates.

#### Air Force –

- The Defense Enterprise Accounting and Management System (DEAMS) will provide the Air Force with a spectrum of financial management capabilities regarding its general fund, including: collections; commitments and obligations; cost accounting; general ledger; funds control; receipts and acceptance; accounts payable and disbursement; billing; and financial reporting.
- The Expeditionary Combat Support System (ECSS) will provide the Air Force a single, integrated logistics system—including transportation, supply, maintenance and repair, engineering and acquisition—for both the Air Force’s general and working capital funds. Additionally, ECSS will provide the financial management and accounting functions for the Air Force’s working capital fund operations.
- NexGenIT comprises commercial off-the-shelf software that will perform real estate portfolio and lease management, space management (moves, adds and changes), and maintenance management for real property throughout the Air Force.

#### Other DOD ERPs –

- The Defense Agencies Initiative (DAI) will modernize the defense agencies’<sup>81</sup> financial management processes by streamlining financial management capabilities and transforming budgetary, financial, and accounting operations. When the DAI is fully implemented, it is expected to have the capability to control and account for appropriations and working capital and revolving funds held by those defense agencies utilizing the system.
- The Enterprise Business System (EBS) is the successor to the DLA’s Business System Modernization (BSM) effort. BSM focused on DLA’s operations in five core business processes: order fulfillment; demand and supply planning; procurement; technical/quality assurance; and financial management. In September 2007, the name of the program was changed to the Enterprise Business System as it entered its second phase, and, according to the agency, EBS will further enhance DLA’s supply chain management of nearly 6 million hardware and troop support items.

After many years and several hundreds of millions of dollars invested, the DOD halted its effort to implement a department-wide integrated personnel and pay system, the Defense Integrated Military Human Resource System (DIMHRS). Instead, each military department is

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<sup>81</sup> The DAI is scheduled to be implemented in the following defense agencies during fiscal years 2011 through 2013: the Uniform Services University of the Health Services; the Missile Defense Agency; the Defense Threat Reduction Agency; the Defense Information Systems Agency; the Defense Technology Security Administration; the Chemical Biological Defense Program; the TRICARE Management Agency-Headquarters; the Defense Media Agency; the Defense Information Systems Agency-General Fund; the Defense Acquisition University; the Defense POW/Missing Personnel Office; the Defense Advanced Research Projects Agency; the Defense Security Service; the Office of Economic Adjustment; and the Center for Countermeasures; and National Defense University. Source: GAO, *DOD Business Transformation: Improved Management Oversight of Business System Modernization Efforts Needed*, GAO-11-53 (Washington D.C.: October 7, 2010).

developing an Integrated Personnel and Pay System (IPPS), leveraging the work of DIMHRS, to consolidate a number of their respective legacy systems into a centralized system for personnel and pay-related services.

ERP implementation is a critical element in the military departments' audit readiness plans. The military departments reported in the May 2010 FIAR Plan Status Report the following ERP dependencies:

Military Department	Statement of Budgetary Resources (SBR)	Existence and Completeness of Mission Critical Assets
Army	SBR audit readiness is dependent on GFEBS.	Inventory and Operating, Material, & Supplies (OM&S) audit readiness are dependent on deployment of three ERPs (GFEBS, LMP, and GCSS-Army).
Navy	SBR auditability is to be achieved in the legacy and ERP environments.	Inventory and OM&S audit readiness are dependent on deployment of Navy ERP.
Air Force	SBR audit readiness is dependent on DEAMS and ECSS. <sup>82</sup>	Inventory and OM&S audit readiness are dependent on deployment of ECSS.

Source: FIAR Plan Status Report, May 2010, pp. 25, 28, 31, 45, 48, and 51.

The FIAR Plan includes audit readiness timelines for the SBR, existence and completeness of mission critical assets, and ERP milestones. On October 13, 2011, the Secretary of Defense directed the Department to advance the audit readiness target date for Statements of Budgetary Resources from 2017 to 2014, and he directed the DOD Comptroller to revise the FIAR Plan accordingly. The following is a summary of mission critical asset existence and completeness audit readiness timelines and other ERP milestones included in the May 2011 and November 2011 FIAR Plan Status Reports:

- Army
  - Mission Critical Asset Existence and Completeness by 3<sup>rd</sup> Quarter FY 2015
  - ERP Systems:
    - GFEBS fully deployed by 4<sup>th</sup> Quarter FY 2012<sup>83</sup>
    - LMP fully deployed in 1<sup>st</sup> Quarter FY 2011

<sup>82</sup> The Panel was informed that the plan to achieve audit readiness on the SBR by 2014 will likely need to rely on legacy systems. However, the Panel has not received the full details of the plan to date.

<sup>83</sup> The May 2011 FIAR Plan Status Report listed the GFEBS full deployment date as the 2<sup>nd</sup> Quarter Fiscal Year 2012. The full deployment date was revised to the 4<sup>th</sup> Quarter Fiscal Year 2012 in the November 2011 FIAR Plan Status Report.

- GCSS-A fully deployed by 4<sup>th</sup> Quarter FY 2017
- Navy
  - Mission Critical Asset Existence and Completeness by 2<sup>nd</sup> Quarter FY 2015
  - ERP System:
    - Navy ERP fully deployed by 4<sup>th</sup> Quarter FY 2013
- Air Force
  - Mission Critical Asset Existence and Completeness by 4<sup>th</sup> Quarter FY 2016
  - ERP Systems:
    - DEAMS fully deployed by 4<sup>th</sup> Quarter FY 2016
    - ECSS (full deployment date not provided, see discussion below)
    - IPSS-Air Force full deployed by 4<sup>th</sup> Quarter FY 2016

The FIAR Plan Status Report does not fully assess the status of the ERPs. For example, the Navy did not list its pay and personnel solution in the FIAR Plan Status report. The Navy stated, in testimony before the Panel, that its pay and personnel system was downgraded from a Milestone B<sup>84</sup> program to a Pre-Milestone A<sup>85</sup> program and that current work is focused on addressing the system's most pressing business problems and auditability issues.<sup>86</sup> Although information was provided for select ERPs in the May 2011 FIAR Plan Status Report, full deployment dates for certain ERPs were not included. The Army noted that, for IPSS-Army, it is revising the system development strategy, and it is working to establish a Milestone B decision date (entry into the engineering and manufacturing development phase). The Air Force did not provide a full deployment date for ECSS. ECSS is one of the systems that the Air Force purportedly needs for its SBR and existence and completeness of mission critical assets audits. Neither the Army, nor the Air Force, provided additional detail on how they plan to meet audit readiness timelines, in light of the uncertain deployment statuses of these ERPs.

The Air Force issued a stop work order on September 14, 2011 for Pilot D (Mobile Supply Chain) of the ECSS program. According to the Air Force, the ECSS program has been restructured several times over the last two years, and each restructuring has resulted in program cost increases and schedule delays. The Air Force noted that the program's performance and, more specifically, contractor performance did not meet the service's expectations. The contractor has reportedly changed its program leadership and implemented a recovery plan to preserve the program's schedule. According to the Air Force, the recovery plan has improved program performance, but it has not achieved the caliber of performance expected by the Air

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<sup>84</sup> Milestone B authorizes product development of the program based on well-defined technology and a reasonable system design plan.

<sup>85</sup> Milestone A authorizes acquisition of the program and permission to begin planning and development of the system technology.

<sup>86</sup> Testimony of Mr. Eric Fanning, Deputy Under Secretary of the Navy and Deputy Chief Management Officer delivered at the Panel's October 27, 2011 hearing entitled, "Department of Defense's Enterprise Resource Planning (ERP) System Implementation Efforts."

Force. As of September 2011, the Air Force was approximately six months behind the program's next scheduled event; the deployment of the succeeding software block (Pilot C). In testimony before the Panel, the Air Force stated that it is engaged in a strategic reassessment of the program.<sup>87</sup> A joint OSD-Air Force team subsequently made recommendations on the way ahead for this program to the Milestone Decision Authority. Once a review of the recommendations is complete, the Air Force will make appropriate program changes. Alternatives under consideration include: building on the current ERP software, leveraging other service/defense agency solutions, and/or modifying legacy capability.

Because ERPs are instrumental to resolving the DOD's financial management weaknesses and to achieving audit readiness, the Panel is concerned about reported ERP schedule delays and cost overruns. The Panel questions whether ERP schedule and cost estimates are reliable. In October 2010, the GAO reported<sup>88</sup> that, based upon data provided by DOD, six of the nine ERPs that the DOD identified as critical to transforming its business operations experienced schedule delays ranging from 2 to 12 years. Five of those ERPs incurred cost increases totaling an estimated \$6.9 billion. The GAO also reported that four ERP programs—DEAMS, ECSS, GFEBS, and GCSS-Army—were not following best practices for developing reliable schedules and cost estimates. More specifically, none of these programs had developed a fully integrated master schedule that reflected all developmental activities. In addition, none of these programs established a valid critical path or conducted a schedule risk analysis.<sup>89</sup> The GAO further reported that cost estimates for ECSS, GFEBS, and GCSS-Army did not include sensitivity analyses, while cost estimates for GFEBS did not include risk and uncertainty analyses. GAO, OMB, and DOD guidance<sup>90</sup> stipulate that risk and uncertainty analyses should be performed to determine the level of risk associated with the dollar estimate. A sensitivity analysis would assist decision makers in determining how changes to assumptions or key cost drivers (such as labor or equipment costs) could affect the cost estimate. In addition, in a June 2011 report,<sup>91</sup> the DOD OIG reported that the Army had not identified all of the requirements and costs associated with GFEBS. The Panel requested updated schedule and cost estimate information on the ERP systems included in the GAO's 2010 report.

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<sup>87</sup> Testimony of Mr. David Tillotson III, Deputy Chief Management Officer, Department of the Air Force delivered at the Panel's October 27, 2011 hearing entitled, "Department of Defense's Enterprise Resource Planning (ERP) System Implementation Efforts."

<sup>88</sup> GAO, *DOD Business Transformation: Improved Management Oversight of Business System Modernization Efforts Needed*, GAO-11-53 (Washington D.C.: October 7, 2010).

<sup>89</sup> A "critical path" is the longest duration path through a sequenced list of activities within a schedule. A schedule risk analysis uses statistical techniques to predict a level of confidence in meeting a completion date. (See GAO-11-53).

<sup>90</sup> GAO, *Cost Estimating and Assessment Guide Best Practices for Developing and Managing Capital Program Costs*, GAO-09-3SP (Washington, D.C.: March 2009). OMB Revised Circular No. A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs* (Oct. 29, 1992); and DOD Instruction 7041.3, *Economic Analysis for Decision Making* (Nov. 7, 1995).

<sup>91</sup> DOD Inspector General, *Previously Identified Deficiencies Not Corrected in the General Fund Enterprise Business System Program*, D-2011-072 (Arlington, Virginia: June 15, 2011).

The Panel is concerned that the requirements process for ERPs is misaligned. In testimony before the Panel, DOD and GAO witnesses indicated that issues surrounding systems requirements are causes of delay in ERP implementation.<sup>92</sup> The witnesses indicated that, in some cases, the requirements process is under-inclusive, and, in other cases, the requirements process is over-inclusive. For example, the Army DCMO indicated that under-inclusiveness contributed to delays in implementing GFEBs. Conversely, the DOD DCMO stated that there is a tendency to over-require. She added that this tendency is supported by an institutional mindset that there is only one opportunity to establish requirements. Under-inclusiveness may render ERP system capacities inadequate or under-utilized. Over-inclusiveness may render these systems cumbersome or overly complex.

The Panel is also concerned that ERPs may not provide the capabilities needed for achieving FIAR objectives. The GAO testified that some ERPs do not function as intended.<sup>93</sup> Consequently, DOD components must continue to rely on legacy systems and manual processes. For example, officials at the Joint Munitions and Lethality Life Cycle Management Command sites told the GAO that LMP—unlike the legacy systems that will be replaced once LMP is deployed—did not enable the command to ship, receive, inventory, or perform stock movements for ammunition. LMP program management officials told the GAO that the omission of an ammunition-specific functionality was identified in 2009, and that remedial development began in January 2010, and that it plans to deliver this functionality by March 2011. The Army has mitigation plans to address this functionality gap. The Joint Munitions and Lethality Life Cycle Management Command planned to hire 172 additional personnel to perform manual data entry until the software can perform the required functions. In a November 2010 report,<sup>94</sup> the DOD OIG stated that after more than 10 years in development and a cost of \$1.1 billion, the Army's LMP system was not compliant with the U.S. Government Standard General Ledger, which supports the consistent recording of financial information and the preparation of standard reports required by the OMB and the Department of the Treasury. The DOD is required by law<sup>95</sup> to maintain financial management systems that “comply substantially” with the Standard General Ledger, which contains two series of accounts: budgetary accounts used to recognize and track budget approval and execution; and proprietary accounts used to recognize and track assets, liabilities, revenues, and expenses. The DOD OIG found that LMP did not contain 42 general

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<sup>92</sup> Testimony of the Honorable Elizabeth McGrath, Deputy Chief Management Officer, Department of Defense, Mr. Mark Lewis, Deputy Chief Management Officer, Department of the Army, and Mr. Asif Khan, Director, Financial Management and Assurance, Government Accountability Office delivered at the Panel's October 27, 2011 hearing entitled, “Department of Defense's Enterprise Resource Planning (ERP) System Implementation Efforts.”

<sup>93</sup> Testimony of Mr. Asif Khan, Director, Financial Management and Assurance, Government Accountability Office delivered at the Panel's October 27, 2011 hearing entitled, “Department of Defense's Enterprise Resource Planning (ERP) System Implementation Efforts.”

<sup>94</sup> DOD Inspector General, *Insufficient Governance Over Logistics Modernization Program System Development*, D 2011-015 (Arlington, Virginia: Nov. 2, 2010).

<sup>95</sup> Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, div. A, title VIII, § 803, 110 Stat. 3009, 3009-390 (Sept. 30, 1996).

ledger account codes necessary to record the Army working capital fund financial transactions. As a result, LMP cannot record all working capital fund transactions correctly.

The GAO also testified that preliminary results from its ongoing ERP review noted that GFEBs and DEAMS were not always providing DFAS with expected capabilities in accounting, management information, and decision support.<sup>96</sup> To compensate, DFAS users have devised manual workarounds and several applications to obtain the information needed to perform day-to-day tasks. Examples of the problems include: approximately two-thirds of invoice and receipt data must be manually entered into GFEBs from the invoicing and receiving system due to interface problems; and procurement data must be manually entered into DEAMS because of interface problems with the Standard Procurement System. The Army and the Air Force stated that they plan to address these issues, and the Army plans to validate the audit readiness of GFEBs through a series of independent auditor examinations over the next several fiscal years. For DEAMS, the DOD Milestone Decision Authority<sup>97</sup> has directed that the system will not be deployed beyond Scott Air Force Base until: (1) known system weaknesses have been corrected, and (2) the system has been independently tested to ensure that it is operating as intended.

The Panel acknowledges the conversion of data from the legacy systems to the new ERP systems is a difficult and challenging undertaking for the Department. Each military department has taken its own approach to data conversion. For example, the Air Force is converting data from the legacy systems to DEAMS as it is being deployed, while the Army does not plan to convert data from its legacy systems to GFEBs before GFEBs is fully deployed. The Panel is concerned that poor execution of data conversion, regardless of the approach, could cause delays in fully implementing the ERPs. The DOD OIG's audit of GFEBs found that the Army did not have a comprehensive data conversion plan.<sup>98</sup> The DOD OIG noted that inadequate planning for data conversion processes may have repercussions, including failure to meet FIAR objectives. According to the DOD OIG, the GFEBs Program Management Office provided a data conversion guide. However, the guide did not cover data conversion for at least 49 non-Army systems that process Army data, and the guide did not convey how the Army plans to handle unconverted, historical, transactional data. The DOD OIG noted that without converted, historical, transactional data for appropriations, the Army could potentially be using GFEBs and the legacy systems concurrently for many years.

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<sup>96</sup> Testimony of Mr. Asif Khan, Director, Financial Management and Assurance, Government Accountability Office delivered at the Panel's October 27, 2011 hearing entitled, "Department of Defense's Enterprise Resource Planning (ERP) System Implementation Efforts."

<sup>97</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.

<sup>98</sup> Testimony of Mr. Daniel Blair, Deputy Inspector General for Auditing, Department of Defense Office of Inspector General delivered at the Panel's September 22, 2011 hearing entitled, "DOD's Efforts to Improve Payment and Funds Control" and DOD Inspector General, *Previously Identified Deficiencies Not Corrected in the General Fund Enterprise Business System Program*, D-2011-072 (Arlington, Virginia: June 15, 2011).

The DOD OIG also testified that the development, implementation, and effectiveness of the ERP systems are questionable at this point.<sup>99</sup> The DOD OIG added that the numerous interfaces between ERPs and legacy systems may be overwhelming, and they may not be adequately defined. The GAO identified interface problems occurring between legacy systems and GFEBS and DEAMS. The Panel is concerned that there may be too many interfaces between legacy systems and ERPs. The number of interfaces is driven by the number of legacy systems. The Panel is concerned that problems associated with these interfaces could be compromising to functionality. The DOD should make every effort to reduce reliance on those legacy system activities that can be effectively and efficiently conducted by ERP systems. The DOD should complete and validate its business process re-engineering analysis to ensure that those business processes supported by the ERPs will be as streamlined and efficient as practicable and that the need to tailor ERPs to meet unique requirements or to incorporate unique interfaces has been eliminated or reduced to the extent practicable.

Because most financial information is maintained in computer systems, the controls over how those systems operate are integral to the reliability of financial data. If auditors are able to place reliance on information system controls,<sup>100</sup> the extent of substantive testing can be significantly reduced. For example, an independent public accounting firm indicated, in testimony before the Panel, that in a first year audit, it spent 8,000 hours testing 800 payroll sample items across the United States because the data was generated from a system that did not have sufficient internal controls.<sup>101</sup> In the second year audit, the auditor was able to place some reliance on information system controls, which allowed it to perform much less test work and to reduce the time spent testing to roughly 400 hours. The FIAR Guidance calls for the DOD components to test information system controls for key systems and processes. As indicated in testimony, testing for logical security controls<sup>102</sup> should occur early in the developmental process. Unfortunately, the witness pointed out that the DOD tends to focus on functionality, and only at the end of the developmental process does it consider control issues. The DOD should continue to subject its systems, whether they are legacy systems or ERPs, to information systems controls testing, but it must also ensure that a priority is placed on this testing and that sufficient numbers of appropriately skilled personnel exist within the test and evaluation community. In

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<sup>99</sup> Testimony of Mr. Daniel Blair, Deputy Inspector General for Auditing, Department of Defense Office of Inspector General delivered at the Panel's September 22, 2011 hearing entitled, "DOD's Efforts to Improve Payment and Funds Control."

<sup>100</sup> Information system controls consist of those internal controls that are dependent on information systems processing and include general controls (entitywide, system, and business process application levels), business process application controls (input, processing, output, master file, interface, and data management system controls), and user controls (controls performed by people interacting with information systems). (See GAO-09-232G Federal Information System Controls Audit Manual).

<sup>101</sup> Testimony of Mr. Mark Keeley, Partner, PricewaterhouseCoopers LLP delivered at the Panel's November 17, 2011 hearing entitled, "Industry Perspectives on Achieving Audit Readiness."

<sup>102</sup> Logical security controls limit or detect access to computer resources (e.g. data, programs), thereby protecting them against unauthorized modification, loss, and disclosure. (See GAO-09-232G Federal Information Systems Controls Manual).

addition, when implementing ERPs, the DOD should ensure that the systems satisfy the computer control objectives established by the Federal Information Systems Control Audit Manual (FISCAM).<sup>103</sup>

### **Actions Taken by DOD**

The Panel acknowledges that the DOD has taken positive steps to improve the implementation of its ERPs. The DOD noted, in testimony before the Panel, that the ERPs cannot achieve auditability for the Department without additional improvements to its overarching business environment.<sup>104</sup> To achieve these broader improvements, the DOD placed significant emphases in the following areas:

- Orienting the BEA around end-to-end processes;
- Improving the usability and implementation of the BEA; and
- Improving business systems acquisition.

The DOD stated that it has oriented its BEA and oversight processes around end-to-end business processes that support audit goals, including Procure-to-Pay, Budget-to-Report, Order-to-Cash and Hire-to-Retire. The BEA is designed to serve as an integrated information architecture that will provide a blueprint for business system modernization investments. It is also intended to be used to assist the Department's governance process to guide and constrain investments. The BEA defines the necessary data standards, business rules, performance metrics, and standard system configurations that will allow the DOD's systems to be interoperable. The DOD added that department-wide application of the BEA will ensure that when data is exchanged between, or among, systems, it will happen securely and with the integrity of the data intact. The DOD stated that it is implementing the BEA across the Department consistent with industry leading practices, which will make it easier for the Department to eventually comply with the BEA and support system interoperability. However, the GAO has reported that the BEA has not yet been effectively implemented across the entire Department.<sup>105</sup>

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<sup>103</sup> The FISCAM presents a methodology for performing information system (IS) control audits of federal and other governmental entities in accordance with professional standards.

<sup>104</sup> Testimony of the Honorable Elizabeth McGrath, Deputy Chief Management Officer, Department of Defense delivered at the Panel's October 27, 2011 hearing entitled, "Department of Defense's Enterprise Resource Planning (ERP) System Implementation Efforts."

<sup>105</sup> See GAO, *Department of Defense: Further Actions Needed to Institutionalize Key Business System Modernization Management Controls*, GAO-11-684 (Washington, D.C.: June 2011) and GAO, *Organizational Transformation: Military Departments Can Improve Their Enterprise Architecture Programs*, GAO-11-902 (Washington, D.C.: September 2011).

The DOD testified that it has taken steps to improve its current approach to acquiring and implementing business information technology (IT) systems.<sup>106</sup> According to the DOD, it has created an improved acquisition model for its defense business systems, called the Business Capability Lifecycle (BCL), which is currently used in a growing number of programs and is an essential pilot effort for its broader IT reform effort. The DOD noted that the BCL is a comprehensive process that aligns the requirements, investments, and acquisition processes for defense business systems under an integrated governance framework and that focuses on the incremental delivery of capability within 18 months of program initiation. The DOD added that this new, incremental acquisition approach will help put capabilities in the hands of the Department's information system users more quickly, including capabilities instrumental to its audit efforts.

The DOD also noted that it is working to improve specific acquisition outcomes of its business Major Automated Information System (MAIS) programs through more rigorous acquisition oversight and investment review. The DOD added that this includes creating better outcome-focused measures of success for the implementation of specific ERP programs, thus enhancing its ability to monitor progress toward clean audit goals. The DOD stated that it is also tying business outcomes to acquisition milestones and requiring that individual programs, such as the Army's GFEBS and the Navy ERP, define the roles that they play in their respective organizations' auditability efforts and end-to-end processes. For example, the DOD will require that GFEBS obtain the USD(C)'s concurrence that the Army's end-to-end business systems and processes involving GFEBS support auditable financial statements. The USD(C) will rely on an independent public accounting firm's examination of the Army's audit readiness assertion of a GFEBS entity that is currently planned for December 31, 2012. The DOD will allow for remaining minor system and process enhancements scheduled for completion within 12 months after that examination.

The DOD also noted objectives to comply with the Department's Standard Financial Information Structure (SFIS) and the United States Standard General Ledger (USSGL). To achieve these objectives, the Department has initiated independent assessments of every applicable system. SFIS and USSGL provide a uniform Chart of Accounts and technical guidance for the standardization of the Department's agency accounting. Importantly, SFIS allows revenues and expenses to be reported by program-- as opposed to appropriation-- categories. According to the DOD, its assessments will look at the underlying systems' SFIS configurations, USSGL posting logic, ability to interface using SFIS, and financial reporting capabilities. The DOD added that this will ensure compliance with all appropriate SFIS business rules. The DOD further noted that throughout these reviews, it will continue to work closely

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<sup>106</sup> Testimony of the Honorable Elizabeth McGrath, Deputy Chief Management Officer, Department of Defense delivered at the Panel's October 27, 2011 hearing entitled, "Department of Defense's Enterprise Resource Planning (ERP) System Implementation Efforts."

with the DOD Inspector General, program offices, and the Office of the Under Secretary of Defense (Comptroller) to correct deficiencies that have been identified.

### Recommendations

Recommendation 4.1: The Department should include additional details on ERP programs in the FIAR Plan Status Reports, including full deployment dates, when known, and key milestone dates. These status reports should describe the risks and potential consequences of: (1) failing to satisfy outstanding ERP functionality requirements; or (2) incurring future ERP milestone delays. The status reports should describe the mitigation measures taken by the Department to reduce these risks. The status reports should also explain any actual schedule slippages or cost increases and the actions taken by the DOD to remedy any such development.

Recommendation 4.2: The ERP program offices should integrate FIAR milestones into their program schedules. ERP program managers should be evaluated on their ability to maintain FIAR milestones as well as program acquisition-related milestones.

Recommendation 4.3: The Department should develop ERP-related schedule and cost estimates based on best practices for future ERP deployments.<sup>107</sup>

Recommendation 4.4: The Department should evaluate changes to ERP requirements as those systems are developed, implemented, and utilized.

Recommendation 4.5: The Department should evaluate its requirement process for ERP systems. The Department should assess the decision-making process, regarding ERP requirements, at every level of authority. The Department should then determine what, if any, changes may be needed.

Recommendation 4.6: The Department should establish risk mitigation plans to address actual and potential weaknesses or deficiencies associated with the development, implementation, or utilization of its ERP systems that could affect the achievement of FIAR goals. At a minimum, each risk mitigation plan should: (1) identify measures for resolving any such weaknesses or deficiencies; (2) assign responsibilities within the Department to implement such measures; (3)

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<sup>107</sup> GAO, *Cost Estimating and Assessment Guide Best Practices for Developing and Managing Capital Program Costs*, GAO-09-3SP (Washington, D.C.: March 2009).

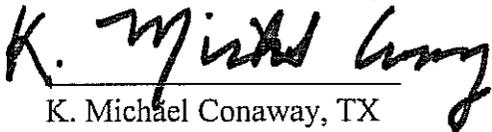
specify implementation steps for such measures; (4) provide timeframes for implementing such measures; and (5) identify any alternative arrangements outside of the ERP environment that may be necessary for meeting FIAR objectives.

Recommendation 4.7: The Department should evaluate lessons learned from previous data conversion efforts, and it should incorporate these lessons into its ERP data conversion plans. The Department should update its ERP data conversion plans periodically. Updates should include assessments of: the progress made in converting data into the ERP environment; whether that progress supports the satisfaction of existing requirements; and whether additional data conversion requirements would facilitate the achievement of FIAR objectives. The Department should also assess the merits of designating a senior official (such as the CMO or the DCMO) to be responsible for the coordination and managerial oversight of data conversion.

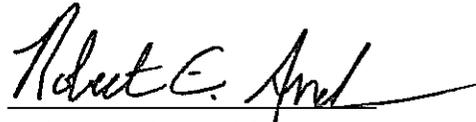
Recommendation 4.8: The Department should: (1) evaluate the causes of system interface problems; (2) determine whether the number of interfaces can be reduced (e.g., by incorporating activities performed by legacy systems into the ERPs); and (3) determine what improvements can be made to support more effective interfaces between systems.

Recommendation 4.9: The DOD DCMO, in coordination with the Director for Operation Test and Evaluation and the Deputy Assistant Secretary of Defense for Development Test and Evaluation, should assess information system control testing needs for all ERPs being developed by the DOD and determine whether appropriate workforce levels and corresponding skill sets exist within the Department's developmental and operational test communities. The Department should take actions to address any identified shortfalls.

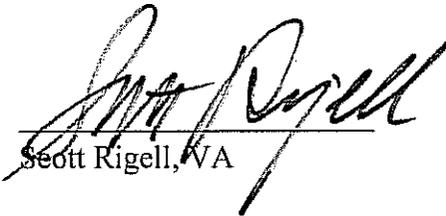
HOUSE ARMED SERVICES COMMITTEE  
PANEL ON DEFENSE FINANCIAL MANAGEMENT AND AUDITABILITY REFORM



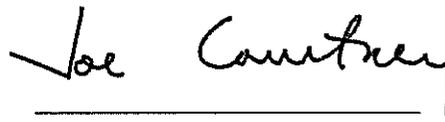
K. Michael Conaway, TX  
Chairman



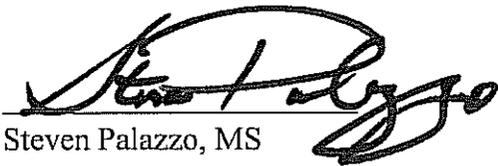
Robert Andrews, NJ  
Ranking Member



Scott Rigell, VA



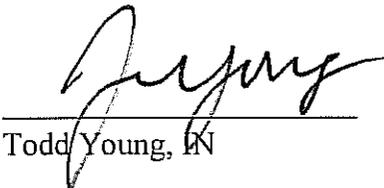
Joe Courtney, CT



Steven Palazzo, MS



Tim Ryan, OH



Todd Young, IN

## Appendix A: Panel on Defense Financial Management and Auditability Reform Work Plan

### Panel Members

Mike Conaway, TX, Chairman  
Scott Rigell, VA  
Steve Palazzo, MS  
Todd Young, IN

Robert Andrews, NJ, Ranking Member  
Joe Courtney, CT  
Tim Ryan, OH

The Panel will examine the effectiveness of the Department of Defense's (DOD) financial management system to deliver timely, reliable, and useful information for decision making and reporting. In doing so, the panel will evaluate: (1) the challenges to achieving financial management reform and auditability and (2) DOD's efforts to resolve these issues.

In examining DOD's financial management system, the panel will focus on six primary areas:

1. Are DOD's financial improvement and audit readiness strategy and methodology appropriate?
  - a. Is the goal of audit readiness by 2017 not aggressive enough or too aggressive?
  - b. Do the strategy and methodology sufficiently address the necessary steps for achieving financial improvement and audit readiness?
  - c. Does DOD have a realistic approach to achieve auditability on the full set of financial statements (which includes asset valuation) by 2017?
  - d. How do DOD's organizational structure and many diverse functional areas present challenges to achieving audit readiness?
2. Is DOD effectively implementing its financial improvement and audit readiness strategy and methodology?
  - a. Is DOD making progress in achieving its short-term and long-term audit readiness milestones?
  - b. Do DOD and its components have the appropriate level of resources to implement the financial improvement and audit readiness effort?
  - c. What are the factors preventing DOD from being auditable?
  - d. Have lessons learned from audits of DOD components (e.g. the USMC Statement of Budgetary Resources audit and the Army Corps of Engineers audit) been implemented by other components?
3. Are the Enterprise Resource Planning (ERP) efforts addressing DOD's fundamental financial management weaknesses?
  - a. How is implementation of ERP intended to improve DOD's financial management?
  - b. What is the scope required for DOD's ERP efforts?

- c. What are the resources required for DOD's ERP efforts?
  - d. What is the impact of the ERP delays and cost overruns on DOD financial management reform and audit readiness milestones?
- 4. Does DOD's financial management workforce (including those individuals involved in the audit readiness effort) have the appropriate skills, incentives, and numbers needed for effective financial management?
- 5. What changes are necessary to ensure that DOD improves its financial management, including removing the financial management area from the GAO high risk list, and achieves audit readiness as quickly as practicable?
- 6. What congressional action may be needed to help DOD improve its financial management and achieves audit readiness by 2017?

## Appendix B: Panel Events

DATE	TITLE	WITNESSES
July 13, 2011	Member Business Meeting	N/A
July 21, 2011	DOD Financial Management & Auditability Overview Brief	The Honorable Robert F. Hale
July 28, 2011	DOD's Plans for Financial Management Improvement and Achieving Audit Readiness	The Honorable Robert F. Hale The Honorable Elizabeth A. McGrath Mr. Asif A. Khan
September 8, 2011	Department of Defense Component Audit Efforts	The Honorable Mary Sally Matiella The Honorable Gladys J. Commons Ms. Caral E. Spangler The Honorable Jamie M. Morin Mr. Wesley C. Miller
September 15, 2011	Organizational Challenges in Achieving Sound Financial Management and Audit Readiness	Vice Admiral David Architzel Lieutenant General Mitchell H. Stevenson Major General Judith Fedder Ms. Martha Smith
September 22, 2011	DOD's Efforts to Improve Payment and Funds Control	Mr. Mark Easton Mr. Daniel R. Blair Mr. Asif A. Khan
October 6, 2011	Is the Financial Management Workforce Positioned to Achieve DOD's Financial Improvement Goals?	Ms. Sandra A. Gregory The Honorable Mary Sally Matiella The Honorable Gladys J. Commons The Honorable Jamie M. Morin
October 27, 2011	DOD's Enterprise Resource Planning (ERP) System Implementation Efforts	The Honorable Elizabeth A. McGrath Mr. Mark R. Lewis Mr. Eric Fanning Mr. David Tillotson III Mr. Asif A. Khan
November 3, 2011	DOD's November 2011 Financial Improvement and Audit Readiness (FIAR) Plan Status Report Briefing	Mr. Mark Easton Mr. Joseph Quinn
November 17, 2011	Industry Perspectives on Achieving Audit Readiness	Ms. JoAnn Boutelle Ms. Tracy E. Porter Mr. Mark Keeley
January 24, 2012 (Full Committee Open Briefing)	Recommendations of the Defense Financial Management and Auditability Reform Panel	The Honorable K. Michael Conaway The Honorable Robert Andrews
January 24, 2012 (Full Committee Hearing)	Department of Defense Perspectives on Financial Improvement and Audit Readiness Efforts	The Honorable Robert F. Hale The Honorable Elizabeth A. McGrath

**Appendix C: ERP Schedule – Legacy Systems to be Retired and Estimated Cost Savings/Cost Avoidance**

ERP System	Number of Legacy Systems that will be Retired	Estimated Cost Savings/Cost Avoidance Once Systems Implemented
<b>Army</b>		
The General Fund Enterprise Business System (GFEBS)	The fielding of GFEBS has resulted in 13 legacy systems being retired and an additional six systems being partially subsumed. Upon completion of fielding GFEBS, an additional 55 legacy systems will be retired and 39 systems partially subsumed.	The cost savings/avoidance associated with GFEBS implementation is estimated to be \$60 million.
The Global Combat Support System-Army (GCSS-Army)	The fielding of GCSS-A will result in seven legacy systems being retired.	<p>The cost savings/avoidance is estimated to be \$9 million.</p> <p>In addition, the implementation of GCSS-Army is estimated to generate over \$8 billion in net benefits. The net benefits are the difference between total benefits and the cost of developing, implementing and sustaining GCSS-Army between now and 2027. The net benefits include inventory reductions, reparables tracking, costs of reorder (acquisition costs), legacy systems operation and upgrades and productivity enhancements. Benefits slowly begin to be accrued in 2013, with a rapid increase beginning in 2017 (when legacy systems are shut down) and break even in 2019.</p>
The Logistics Modernization Program (LMP)	The fielding of LMP will result in two legacy systems being retired.	The cost saving/avoidance is estimated to be \$313 million.
Integrated Personnel and Pay System (IPPS)	The fielding of IPPS-Army will result in 56 legacy systems being retired.	The cost savings/avoidance has not yet been finalized. It is pending the completion/approval of the cost-

		benefit analysis.
<b>Navy</b>		
The Navy Enterprise Resource Planning System (Navy ERP)	27 legacy systems have been retired to date, with 69 more to be retired by 2016.	<p>The retirement of 27 legacy systems to date, with 69 more to be retired by 2016 has garnered a realized cost avoidance of \$116 million through FY08-10 with an expected cumulative cost savings and cost avoidance total of \$682 million through FY2016.</p> <p>The deployment of the Single Supply Solution enables projected inventory savings of \$276 million through FY2017 and expected cost avoidance of \$456 million for FY2018-FY2023.</p>
The Global Combat Support System-Marine Corps (GCSS-MC)	The fielding of GCSS-MC will result in four legacy systems being retired.	<p>The cost savings/avoidance is estimated to be \$214 million. This includes approximately \$4 million/year for the retirement of the legacy systems.</p> <p>These cost savings come largely from the elimination of legacy systems and the reduction of secondary reparables and repair part inventories. In addition, inherent benefits from GCSS-MC in integrating management across the logistics chain include: improved supply and maintenance asset visibility; refined planning and forecasting; improved equipment readiness; reduced equipment procurement; and the transition of capabilities from tail-to-tooth. While these benefits are significant, they have not yet been quantified.</p>
Future Pay and Personnel Solutions (FPPS)	FPPS will retire five Navy legacy personnel systems.	The retirement of five Navy legacy personnel systems will

		result in avoiding approximately \$22 million in maintenance costs annually.
<b>Air Force</b>		
The Defense Enterprise Accounting and Management System (DEAMS)	DEAMS will replace nine legacy systems.	<p>When DEAMS is operating at full capacity, the Air Force expects to save on average \$18 million annually from the replacement of legacy information technology systems.</p> <p>In addition, the Air Force expects that DEAMS will support \$335 million in annual savings after DEAMS has been fully deployed by providing real-time visibility into costs and allowing timely reallocation of dollars. This translates to an ability to reduce unliquidated obligations and accounts receivable by \$1.67 billion from FY2017-FY2021.</p>
The Expeditionary Combat Support System (ECSS)	ECSS is scheduled to replace 240 legacy logistical systems.	<p>The Air Force estimates information technology savings of \$2 billion (10 year lifecycle costs) after ECSS is fully deployed.</p> <p>In addition, when ECSS is fully developed and fielded, the estimated 10-year supply chain benefits would total \$9 billion.</p>
Integrated Personnel and Pay System (IPPS)	IPPS-AF is expected to replace 20 legacy personnel & pay systems.	The Air Force estimates saving \$60 million annually on sustainment costs after IPPS-AF is fully deployed.
<b>Other DOD ERPs</b>		
The Defense Agencies Initiative (DAI)	The fielding of DAI will result in six legacy systems being retired.	The cost savings/cost avoidance once systems are implemented is estimated to be \$37.4 million.
The Enterprise Business System (EBS)	EBS has resulted in two legacy systems being retired.	The total cost savings/avoidances is estimated to be \$1.7 billion over the life cycle

		(FY99-FY17). The \$1.7 billion is the total benefits for BSM which includes IT cost avoidance, reduction in inventory investment, and workforce efficiency. Of this total savings/avoidance, \$475 million is attributable specifically to IT cost avoidances.
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Source: Department of Defense. The estimates reflected above were provided by various official sources within the Department of Defense.

## Appendix D: Acronym List

ADA	Anti-Deficiency Act
BEA	Business Enterprise Architecture
BSM	Business System Modernization
BCL	Business Capability Lifecycle
CPA	Certified Public Accountant
CMO	Chief Management Officer
DAI	Defense Agencies Initiative
DCMO	Deputy Chief Management Officer
DEAMS	Defense Enterprise Accounting and Management System
DFAS	Defense Finance and Accounting Service
DIMHRS	Defense Integrated Military Human Resource System
DOD	Department of Defense
DLA	Defense Logistics Agency
EBS	Enterprise Business System
ECSS	Expeditionary Combat Support System
ERP	Enterprise Resource Planning
FASAB	Federal Accounting Standards Advisory Board
FIAR	Financial Improvement and Audit Readiness
FIP	Financial Improvement Plan
FISCAM	Federal Information Systems Control Audit Manual
ERP	Enterprise Resource Planning
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GCSS-Army	Global Combat Support System-Army
GCSS-MC	Global Combat Support System-Marine Corps
GFEBs	General Fund Enterprise Business System
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPIA	Improper Payments Information Act of 2002
IPPS	Integrated Personnel and Pay System
IT	Information Technology
LMP	Logistics Modernization Program
NAVAIR	Naval Air Systems Command
Navy ERP	Navy Enterprise Resource Planning
ODO	Other Defense Organizations
OIG	Office of Inspector General
OSD	Office of the Secretary of Defense
OMB	Office of Management and Budget

OM&S	Operating, Material, & Supplies
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
SBR	Statement of Budgetary Resources
SFIS	Standard Financial Information Structure
USD(C)	Under Secretary of Defense (Comptroller)
USMC	United States Marine Corps
USSGL	United States Standard General Ledger