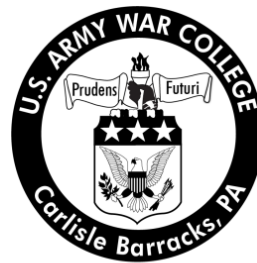


Strategy Research Project

Is DOD on the Right Path to Financial Auditability?

by

Colonel Eric F. Zellars
United States Army



United States Army War College
Class of 2012

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USAWC STRATEGY RESEARCH PROJECT

IS DOD ON THE RIGHT PATH TO FINANCIAL AUDITABILITY?

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ABSTRACT

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To make every dollar count, the Department of Defense (DOD) must be able to account for every dollar. The ability to achieve an unqualified audit opinion has eluded the Department since its inception, but now this goal may be within reach. DOD has a responsibility to account for taxpayers' dollars and produce timely, reliable, and accurate financial information that informs financial decisions made by political and military leaders. Several congressional representatives summed up the importance of an unqualified audit opinion by asserting that DOD has an obligation to get its fiscal house in order. Additionally these congressional representatives suggest that an unqualified financial audit opinion assures taxpayers of DOD's commitment to spend their money wisely. As national security debates focus on weapon systems, digital warfare, non-conventional threats, hybrid threats, and the size and shape of our force, leaders are emphasizing the importance of financial management and audit readiness. Achieving an unqualified audit opinion will not be easy, but the Department is on the right path to accomplishing this goal by 2017.

IS DOD ON THE RIGHT PATH TO FINANCIAL AUDITABILITY?

As a matter of principle and political reality, the Department of Defense cannot go to America's elected representatives and ask for increases [in funding] each year unless we have done everything possible to make every dollar count.

—Former Secretary of Defense Robert M. Gates

To make every dollar count, the Department of Defense (DOD) must be able to account for every dollar. The ability to achieve a clean audit has eluded the Department since its inception, but now this goal may be within reach. DOD has a responsibility to account for taxpayers' dollars and produce timely, reliable, and accurate financial information that informs financial decisions made by our political and military leaders. In 2004, Horton C. Westergard asserted in his Strategic Research Project (SRP) "Auditable Financial Statements for DOD: Are we there yet?" that, despite legislative mandates and DOD's formidable efforts to achieve auditability, DOD was not there yet. He concluded: "When [DOD] will arrive is at best an educated guess."¹ Also in 2004, former Secretary of Defense Rumsfeld predicted it would take 8 years or more to achieve business transformation goals and systematic improvements needed for DOD to become auditable. The Government Accountability Office concurred.² Over the past 8 years, the Department has worked hard to achieve its auditability goals: It created the appropriate organizational structure for oversight and readiness; it focused on reengineering legacy business processes; and it leveraged the most advanced system technology available—Enterprise Resource Planning (ERP) systems. Achieving an unqualified audit opinion on all of DOD's financial statements will not be easy; however, it is on the right path to accomplishing this goal by fiscal year (FY) 2017.

This SRP investigates DOD's path to financial auditability: It defines auditability, discusses the importance of achieving an unqualified audit opinion, and examines why achieving an unqualified audit is difficult for DOD. Then it surveys the history of financial management improvement efforts, cites Congressional legislation mandating financial reform, and examines DOD's current efforts to achieve an unqualified audit opinion. It concludes with recommendations for DOD to continue its momentum beyond getting an unqualified audit opinion.

What is an Audit Opinion?

An audit opinion provides the public with an independent, third-party assessment as to whether the agency's financial information is presented fairly. There are four types of audit opinions: *Unqualified (clean)*, *Qualified*, *Disclaimer*, and *Adverse*. An *Unqualified* audit opinion means that the auditor believes the financial information presented by the agency is fairly presented – which is our goal for all agencies. *Qualified*, *Disclaimer* or *Adverse* opinions indicate that financial reporting issues have been identified or the auditor could not render an opinion.³

In FY 2010, “21 of the 24 CFO [Certified Financial Officers] Act agencies received a clean audit opinion—the highest number of clean opinions the Federal Government has achieved since the passage of the CFO Act.”⁴ However, DOD and Department of Homeland Security received a disclaimer opinion in 2010. Both Departments continue to execute remedial actions and pursue newly revised plans to achieve full auditability by FY 2017.⁵ The table below shows positive results of the most recent audit opinions by department. Nevertheless, the “Goliath” in the room is DOD, which represents nearly 20% of the total President's budget for FY 2012. DOD is on the right path; but it has a significant amount of work to do before it achieves an unqualified audit opinion.

2010 Financial Audit Results	
Department Agencies	Audit Opinion
<u>Department of Agriculture</u>	Clean
<u>Department of Commerce</u>	Clean
<u>Department of Defense</u>	Disclaimer
<u>Department of Education</u>	Clean
<u>Department of Energy</u>	Clean
<u>Department of Health and Human Services</u>	Clean
<u>Department of Homeland Security</u>	Disclaimer
<u>Department of Housing and Urban Development</u>	Clean
<u>Department of Justice</u>	Clean
<u>Department of Labor</u>	Clean
<u>Department of State</u>	Clean
<u>Department of the Interior</u>	Clean
<u>Department of The Treasury</u>	Clean
<u>Department of Transportation</u>	Clean
<u>Department of Veterans Affairs</u>	Clean
<u>Environmental Protection Agency</u>	Clean
<u>General Services Administration</u>	Clean
<u>National Aeronautics and Space Administration</u>	Qualified
<u>National Science Foundation</u>	Clean
<u>Nuclear Regulatory Commission</u>	Clean
<u>Office of Personnel Management</u>	Clean
<u>Small Business Administration</u>	Clean
<u>Social Security Administration</u>	Clean
<u>U.S. Agency for International Development</u>	Clean

Table 1 – 2010 Financial Audit Results⁶

Why is an Unqualified Audit Opinion Important for DOD?

Congressional leaders have emphatically explained why an unqualified audit opinion is important:

Our country is in a debt crisis that continues to have a negative effect on our economy and, if not properly dealt with, could have devastating consequences [to our National Security]. DOD's...reliance on an outdated and cumbersome system to manage financial records could put at risk future investments in DOD programs. We have an obligation to limit wasteful spending to get our nation's fiscal house in order, and [with] a

clean financial audit...we are [able] to assure the American taxpayers that their [money is] being spent wisely.⁷

Since 1995, DOD has been on the Government Accountability Office's (GAO) list of high-risk management issues. According to GAO, wide-ranging deficiencies in financial management processes, systems, and controls prevent DOD from achieving an unqualified audit opinion. Additionally, GAO asserts that these deficiencies impede leaders' ability to track and control costs, to account for taxpayers' dollars, and to anticipate future costs of required capabilities to meet the goals of the National Defense Strategy.⁸ In his opening remarks to the House Armed Services Committee, Secretary of Defense Leon Panetta acknowledged his understanding of the importance of achieving an unqualified audit opinion and accelerated DOD's goal from FY 2017 to FY 2014, to produce an auditable Statement of Budgetary Resources (SBR). The goal for achieving full auditability of the remaining financial statements—the Statement of Net Cost; the Balance Sheet; and the Statement of Changes in Net Position—remains FY 2017. Secretary Panetta has declared that, in a time of fiscal austerity, it is imperative that DOD maximizes the value of every dollar Congress appropriates. Therefore, DOD must demonstrate its ability to account for spending; to identify waste; and to improve the way the Pentagon does business by achieving an unqualified audit opinion.⁹ However, Secretary Panetta understands that achieving an unqualified audit opinion is not merely a bureaucratic requirement. It demonstrates that DOD has a reliable capability to understand costs, to control costs, and to make well-informed decisions. U.S. taxpayers merit this assurance of DOD's fiscal stewardship—and not just in times of fiscal austerity. The bottom line is:

As the current mission in Iraq ends, as we continue to transition security responsibility in Afghanistan, and as we near our goal of dismantling al-

Qaeda, the Department [faces] a new fiscal reality at home. As part of the debt ceiling agreement reached in August [2011], the Department must find more than \$450 billion in savings over the next decade. Our challenge is taking a force that has been involved in a decade of war, and ensuring that we build the military we need to defend our country for the next decade even at a time of fiscal austerity.¹⁰

Why is it Difficult for DOD to Achieve an Unqualified Audit Opinion?

It is not surprising that DOD struggles to get an unqualified audit opinion. DOD is exceptionally complex. GAO claims that DOD is one of the largest and most complex organizations in the world. DOD's fiscal year 2012 budget request cited \$671 billion in obligation authority.¹¹ According to DOD's financial report, "every business day, [DOD] obligates an average of \$2 billion to \$3 billion and handles hundreds of thousands of payment transactions in thousands of locations worldwide, including war zones."¹² Moreover, the Department estimates it will employ more than 3 million military and civilians in 2012. DOD is substantially larger and more complex than any of the three largest Fortune 500 companies: Wal-Mart (2.1 million personnel and \$421 billion in revenue); Royal Dutch Shell (97K personnel and \$378 million in revenue); and Exxon Mobile (103K personnel and \$354 million in revenue).¹³

Beyond managing bureaucratic complexities, inconceivably large budgets, and millions of daily transactions, DOD must deal with a complex mix of appropriations. Appropriations are categories or groupings of funds authorized by congress to be used for specific purposes by various departments or agencies of the government. These funds, once appropriated by Congress, cannot be used for other purposes. Complex spending provisions defined in appropriation law stringently governs the purpose for appropriated funds, the period that funds are used, and the amount of funds available for use complicates government spending and accounting.

To deal with the complexities of appropriation funding, voluminous accounting transactions, and human resources, DOD relies on more than 2,200 business systems and processes, primarily operating in a stove-piped, non-integrated enterprise. Additionally, many of DOD's financial management processes "such as accounts receivable and accounts payable, do not comply with Generally Accepted Accounting Principles (GAAP)."¹⁴ The Department's Inspector General (DOD IG) found that DOD's major auditability weaknesses fall into two major categories: non-compliant systems and non-compliant financial business processes.¹⁵ Because of DOD's size, complexity, non-compliant systems and business processes, GAO maintains that improving DOD's financial management operations and achieving an unqualified opinion will not be easy.¹⁶

History of Financial Management Improvement

Nonetheless, attempts to provide timely, accurate, and reliable financial statements to DOD leaders and Congress have led to a constant evolution of public laws, financial improvement strategies, and improved automated systems.¹⁷ For example, in 1949, the 81st Congress enacted Public Law 216, Section 406—Management of Funds. The legislation was drafted for the explicit "purpose of facilitating the economical and efficient operation of the Department of Defense."¹⁸

Furthermore, in May 1955, Lieutenant Colonel Carl Freedman documented the need for improving financial management strategy in the Army. He claimed that the complexity and size of the Army—with a total annual obligation authority, in 1955, of approximately \$17.2 billion—required a systematic process to improve the management of taxpayers' money.¹⁹ Additionally, he noted that "in view of this tremendous management job, it seems obvious that the Army needs something more than a

checkbook and bank statement to manage its financial affairs.”²⁰ He concludes by recommending that commanders (managers) of an organization this large and complex need the best systems and processes available.²¹ Certainly, according to Freedman, no business person “in a comparable situation would accept anything less.”²²

To dramatize the critical need for better financial management, Freedman uses an example of an ammo shortage at the beginning of the Korean War. Congress and the public wanted to know what happened to \$30 billion appropriated to the Army to resolve the ammo shortage. Freedman insisted that there was no way to determine how the money was spent, because “the Army’s budgeting and accounting systems were not designed to produce easily understood facts and figures to show specifically for what the [financial resources] were used.”²³ To address these and other financial management short-comings the Army developed a financial management plan with “the primary objective...to provide all levels of command ... better control of [monetary] resources and operations...for [reporting], justifying [requirements]...,and the cost of operations.”²⁴ To achieve this objective, Army leaders adopted standard business processes, acknowledging that “individual, [stove-piped] financial systems... [must] synchronize with each other, and...be compatible with the Army programming process.”²⁵ While Freedman’s proposal suggested a logical solution to an enterprise-wide problem, it failed to gain traction with the very leaders who concurred with the existing problems and required fixes. Throughout this analysis, the reader will discern a common thread that suggests transformational change in DOD must be leader driven from the top of the organization, beginning with the Secretary of Defense. The need for

leadership's direct involvement in DOD's financial management transformation is as urgent today as it was in 1955 or DOD is destined to repeat lessons not yet learned.

Congressional Legislative Mandates

Since 1955, Congress enacted several public laws designed to improve financial management operations and prescribe requirements for auditable financial statements. Each legislative act provides comprehensive direction along DOD's path to auditable financial statements.

Initially, the Federal Managers Financial Integrity Act (FMFIA) of 1982 laid the foundation for financial management reform by:

Requiring each agency to establish controls that reasonably ensure: obligations and costs comply with applicable law; assets are safeguarded against waste, loss, unauthorized use or misappropriation; and revenues and expenditures are properly recorded and accounted for. In addition, the agency head must annually evaluate and report on the systems of internal accounting and administrative control.²⁶

This legislation has profoundly influenced DOD's development of accounting system to enhance the timeliness, reliability, and accuracy of financial information at virtually every level of the federal government.

The Chief Financial Officers (CFO) Act of 1990 followed the FMFIA. Its primary intent was to provide for the "production of complete, reliable, timely, and consistent financial information for use by the executive branch of the government and the Congress in the financing, management, and evaluation of Federal programs."²⁷ A major requirement of the CFO Act was to validate the merits of providing auditable financial statements and subjecting them to an independent audit.²⁸ Additionally, the Government Management Reform Act (GMRA) of 1994 expanded on the CFO Act by

requiring 24 agencies (including DOD) to produce audited financial statements beginning in fiscal year 1996.

The Federal Financial Management Improvement Act (FFMIA) of 1996 complemented the CFO Act and GMRA; it required DOD to adopt financial management systems that comply with the Federal financial management systems requirements, the Federal Accounting Standards Advisory Board (FASAB), and the U.S. Standard General Ledger (USSGL) at the transaction level. Furthermore, it required financial management systems to have general and application controls in place to support management decisions.²⁹

Finally, following a of series additional legislation, the NDAA of 2010 mandated that:

- The Chief Management Officer of the Department of Defense shall, in consultation with the Under Secretary of Defense (Comptroller), develop and maintain a plan known as the Financial Improvement and Audit Readiness Plan (FIAR).
- Correct the financial management deficiencies impairing the Department of Defense's capability to prepare timely, reliable, and complete financial management information; and ensure the financial statements of the Department of Defense are...ready for audit by not later than September 30, 2017.³⁰

DOD is required by various statutes to improve its financial management processes and produce audited financial statements to ensure that complete, reliable, consistent, and timely information is responsive to the information needs of decision-makers. However,

the process of achieving an unqualified audit opinion for DOD is not revolutionary; it is evolutionary. The best policies, people, processes, and system capabilities have evolved to provide decision-makers with timely, reliable, accurate, and audited financial statements to make informed fiscal decisions.

DOD's Current Efforts to Achieve a Clean Audit Opinion

A recent GAO report cited six key impediments to DOD's goal to achieve an unqualified audit opinion: lack of committed and sustained leadership; insufficient accountability and effective oversight; no effective plan to correct internal control weaknesses; lack of competent financial management workforce; lack of a well defined enterprise architecture; and failure to implement Enterprise Resource Planning (ERP) systems.³¹ Committed and sustained leadership is the center of gravity for DOD to achieve an unqualified audit opinion by 2017.

The Senate, the DOD Comptroller, and the Secretary of Defense addressed the leadership deficiency and are focused on eliminating impediments to DOD's goal to achieve an unqualified audit opinion. Accountability and oversight began with the Senate confirmation of Beth McGrath as the DOD's first Deputy CMO (DCMO) in 2010, two years after legislatively authorizing the position. In this position, McGrath will provide strategic guidance to improve managerial performance, to reform business processes, and to integrate DOD's business systems.³² Moreover, she will provide oversight for the implementation of the Financial Improvement and Audit Readiness (FIAR) plan. Additionally, each military department Under Secretary will assume Service-level CMO responsibilities and be accountable for meeting FIAR milestones on schedule. The CMOs reside organizationally at the apex of DOD's audit readiness

governance; their oversight and accountability extends throughout their organizations as they follow the FIAR roadmap to achieve audit readiness.

Secretary Panetta addressed the need for a competent financial management workforce by mandating the establishment of a professional certification program to train financial managers—similar to the one now in place for acquisition managers. This certification program will have a significant impact on sustaining DOD’s goals of achieving an unqualified audit opinion; furthermore, it will increase the competencies and capabilities of the financial management workforce.³³

The final two impediments—develop an enterprise business architecture and implement ERP systems—recently became the responsibility of the DCMO. The DCMO’s office is responsible for creating and maintaining a DOD-wide Business Enterprise Architecture (BEA), previously a function of the disestablished Business Transformation Agency (BTA). An effective BEA is essential for achieving the goal to become fully auditable and to leverage the \$5.8 billion investment in the implementation of 10 critical ERPs.

In 2010, following GAO’s report, the Chief Financial Officer (CFO), Secretary Robert Hale announced a new strategy to achieve an unqualified audit opinion. His new strategy identifies six significant initiatives that will facilitate DOD’s efforts to produce auditable financial statements: “visible leadership and department wide audit readiness goals; accountability and incentives; broader functional community support and participation; senior leadership oversight and involvement; placed greater emphasis on business process reengineering and financial system development using ERP systems; and resources to accomplish FIAR goals and objectives.”³⁴ GAO supports Hales new

strategy of prioritizing focus areas for improvement. Furthermore, GAO states that by executing Hale's initiatives, DOD will continue its momentum towards achieving an unqualified audit opinion on all its financial statements.³⁵ Panetta concurs that "the Department's new [strategy] to financial improvement and audit readiness has put [DOD] on the path to auditability."³⁶

The Services' Current Efforts to Achieve a Clean Audit Opinion

Most recently, the Marine Corps became the first military service to undergo an independent audit of its entire Statement of Budgetary Resources (SBR) for FY 2010; this statement is one of the four statements submitted for an audit. Although the Marine Corps received a disclaimer of opinion on the SBR, it was an excellent learning opportunity.³⁷ Mark Easton, Deputy Chief Financial Management Officer for DOD, suggested the Marines have "taken the beach. They must hold their position and begin to move inland by refining business processes and systems, while continuing to press forward to their final objective—an unqualified audit opinion on their FY 2011 SBR."³⁸ While the Marine Corps is moving forward, the rest of the Navy is preparing for an SBR audit in 2013. The Navy stands to benefit from the Marine Corps' lessons learned.

Moreover, in July 2011, the Honorable Jamie M. Morin, Assistant Secretary of the Air Force (Financial Management and Comptroller), testified before the Senate Armed Services Committee, Subcommittee on Readiness and Management Support to address the Air Force's Financial Improvement Program's (FIP) progress and challenges. She reported that the "Under Secretary of the Air Force...and the Vice Chief of Staff...wrote to the leadership of our Air Force Major Commands emphasizing the importance of audit readiness."³⁹ Notably, the Air Force is the first military service to receive an unqualified audit opinion for their Funds Balance with Treasury (FBwT)

reconciliation process: “This is analogous to balancing the Air Force checkbook, albeit on approximately 1.1 million transactions per month.”⁴⁰ It is also a significant step toward achieving an unqualified audit opinion on the Air Force’s financial statements. The Air Force continues to make progress and Morin claims that their suite of ERPs “serves as the foundation for audit readiness.”⁴¹ According to Morin, delays in the deployment of these “systems will clearly have a material impact on our [financial] statements and...will [impact the Air Force’s] audit readiness [plan].”⁴² The Air Force is on the right path towards meeting DOD’s audit readiness goals.

While the Air Force is flying high, the Army is marching steadily towards auditability. The Office of the Assistant Secretary of the Army (Financial Management and Comptroller) (ASA [FM&C]) developed its first Financial Improvement Plan (FIP) in 1998. This FIP cited requirements to achieve an unqualified (clean) audit opinion in accord with the CFO Act. Today the Army’s FIP has incorporated the requirements specified in the current FIAR Plan. Like the other services, the Army has made significant strides toward achieving auditability with plans that focus on improving business processes and deploying ERPs, such as the General Fund Enterprise Business System (GFEBS). This system provides capabilities for appropriately processing financial transactions in accord with GAAP and FFMIA (1996) standards. In August 2011, an independent public accounting firm issued an unqualified audit opinion on the Army’s and other Services’ Appropriations Received section of the SBR: “Appropriations Received is an important section of the SBR, and the clean opinions validate that the Military Departments have reliable and auditable processes, controls,

and systems in place to record annual appropriations from Congress. This is a significant step on the road to achieving a fully auditable SBR.”⁴³

The Impact of Enterprise Resource Planning (ERP) Systems on Audit Readiness

However, as previously stated, achieving auditability will not be possible for most of DOD unless financial systems are modernized. ERPs are essential enablers for achieving financial modernization and an unqualified audit opinion. They enable and enforce standard processes, best practices, internal controls, and GAAP requirements needed to meet DOD’s FIAR goals. Financial systems were once the weakest link in the DOD’s strategy, but no longer. Ten critical ERPs represent the centerpiece of DOD’s strategy to achieve an unqualified audit opinion. According to Harold W. Lord, if you want to know what the strategy is, just follow the funding flow: “[Strategy] is what gets funded.”⁴⁴ Since these 10 critical ERPs have been funded with a \$5.8 billion investment, it is clear that DOD is executing a strategy to transform financial management and achieve an unqualified audit opinion. Each ERP is essential to the transformation of DOD’s financial management enterprise. The Department has correctly linked means (funding for ERP technology) to the desired ends (an unqualified audit opinion on all financial statements for DOD). The Department’s Inspector General noted that the implementation of integrated, audit-ready financial management ERPs serve as the cornerstone of DOD’s financial management improvement efforts and is crucial to achieving auditability. Moreover, the most recent FIAR plan linked the success of audit readiness directly to implementation and deployment of ERPs. Integral to DOD’s strategy are Service specific ERPs that are being acquired by the aforementioned \$5.8 billion investment.

The Department of the Army has at least three of the 10 critical ERPs. GFEBS, one of the 10 critical ERPs, will subsume several legacy financial systems currently in use today. GFEBS will replace the Army's most widely used financial system, the Standard Finance System (STANFINS). Still in use, STANFINS was developed and deployed to Army users in 1970. It remains operational today. GFEBS, along with the Global Combat Support System-Army (GCSS-A) and the Logistics Modernization Program (LMP), which are also on the list of critical ERPs, will replace hundreds of stove-piped systems throughout the Army as it reorients its enterprise to a more integrated systems enterprise. GFEBS will be fully deployed in 2012.⁴⁵

The Navy's Enterprise Resource Planning (Navy ERP) system is also one of the critical systems essential in DOD's audit readiness plan. The Navy ERP will integrate a host of business management solutions and functions including financial and non-financial capabilities required to achieve an unqualified audit opinion. The Navy ERP uses a commercial off-the-shelf (COTS) product that enables the Navy to consolidate, standardize, and streamline many of its business activities and stove-piped systems into one integrated financial management solution. The Navy ERP will incorporate standard business processes, eliminate redundancies, and create efficiencies while reducing many older, more costly non-integrated systems and non-standardized business processes across its many commands. This system meets the Navy's mandate for audit readiness and improves the Navy's stewardship of the taxpayer's money. The Navy will complete its ERP deployment by 2013.⁴⁶

The U.S. Air Force (USAF) is developing the Defense Enterprise Accounting and Management System (DEAMS), another ERP critical to the achievement of DOD's goal

to become fully auditable by 2017. General John W. Handy, former commander of the United States Transportation Command (USTRANSCOM) expressed his frustration with the lack of timely, reliable, and accurate information:

I'm challenged with...the lack of integrated financial systems, limited visibility of financial data and broken audit trails...my ability to make efficient business decisions and fulfill my fiduciary responsibilities is limited by long-term issues stemming from outdated financial systems.⁴⁷

DEAMS uses COTS software from Oracle and provides a single enterprise financial management system shared by all USAF major commands. The Air Force initially deployed DEAMS to Scott Air Force Base in July 2007; it will complete deployment in calendar year (CY) 2015.⁴⁸ DEAMS is capable of integrating enterprise-wide information to provide accurate, reliable, and timely information to decision-makers, like General Handy.

While some ERPs have Service-specific applications each is capable of complying with DOD's BEA, which enforces standard data structures and field names and thus facilitate easy aggregation of financial information for improved Congress and DOD decision-making. Moreover, most of the 10 ERPs run the same software applications (i.e. SAP [Systems Applications and Programs] or PeopleSoft), making required system interface less complex and making data aggregation straightforward. However, ERP implementation is not the singular answer to audit readiness. There implementation must be complemented with aggressive leadership, re-engineered cross-organizational end-to-end business processes, standardized business processes that comply with generally accepted accounting principles, and trained financial managers that are fully and immersed in audit readiness preparation and execution.

Once these challenges are resolved, the results will be a DOD that can attain an unqualified audit opinion on all of its.

What's the – “So What”

DOD must assure congress and the taxpayers that it is a good steward of fiscal resources. Furthermore, Congress and DOD must have access to timely reliable, and auditable financial information to make the best fiscal decisions that maximizes limited fiscal resources. The opinion of a veteran financial manager in the following paragraph best illuminates the “So What.”

In 2011, during an efficiency drill, the former Secretary of Defense Robert M. Gates, tasked the military services to identify billions of dollars in savings, which the Department would reinvest to increase combat capabilities. Peggy Johnson, a recently retired financial management professional from the Office of the Secretary of Defense (OSD) eloquently addressed the quality of this drill in the FIAR blog on “milSuite.” She asserted that the services’ struggles to implement proper accounting practices in accordance with generally accepted accounting principles (GAAP) prevented them from reliably responding to the Secretary’s requests. She believes that GAAP compliance and a clean audit opinion is the best way to provide users of financial information with a reasonable assurance of its accuracy and reliability. Auditable financial statements assure Congress that financial information is reliable, accurate, and trustworthy. Furthermore, an unqualified audit opinion on DOD’s financial statement assures the American people that DOD is exercising prudent stewardship over taxpayers’ money. Johnson concludes that without reliable and accurate financial data, the best decision maker can only make a good guess regarding efficiencies. “Therefore...some may consider the decisions made in this current efficiency review as no more than a relative

good guess. Defense leaders must assure Congress, taxpayers, and other decision-makers that DOD's financial decision-making is more than a good guess: An unqualified audit opinion by an independent auditor will provide this essential assurance.⁴⁹

Conclusion and Recommendations

Westergard's 2004 Strategy Research Paper "Auditable Financial Statements for DOD: Are we there yet?" answered this question with a resounding "No!" His answer to when DOD will be auditable, in Westergard's words "is at best an educated guess." He recommended three conditions for DOD to achieve auditability: Ensure top leadership support; fully develop DOD-wide Business Enterprise Architecture; Control the money—in other words, improve internal controls. Coincidentally, Westergard noted that Secretary Rumsfeld estimated in 2004 that it would take about 8 years or more to achieve DOD's financial management and business transformation goals. Moreover, according to Westergard, the "GAO acknowledged this was 'not an unrealistic estimate' based on their...experience with other federal agencies."⁵⁰

It seems that Westergard, Rumsfeld, and GAO's estimates were all about right. DOD has made significant progress in the past 8 years and is on the right path to producing auditable financial statements. Teresa McKay, Director of the Defense Finance and Accounting Service, best explains where DOD is today and offers insights on the road ahead:

The Department continues to resolve its financial management challenges by moving away from "stove-piped" financial and accounting systems and toward end-to-end business processes that cross multiple disciplines. The Department's top priority is to achieve audit readiness of the Statement of Budgetary Resources (SBR). Focusing on the financial information people use to manage and make day-to-day decisions.... This approach improves business operations, the quality and integrity of financial information, and ultimately allows DOD's financial statements to be reliable and auditable.⁵¹

Nevertheless, for DOD to achieve full auditability by 2017 it must insist on comprehensive business process re-engineering, aggressive implementation of ERP systems, and a steadfast commitment to purge stove-piped processes and systems from its enterprise.

To assure on-going progress and continued success DOD should act on the following three recommendations:

- Focus on business process re-engineering: Effectively use Lean Six Sigma (LSS) black belts to re-engineer business processes throughout DOD, taking into account the impact of the critical ERPs. Hammer and Champy define business process reengineering as the “fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance such as cost, quality, service, and speed.”⁵² LSS teams should examine business processes throughout DOD to ensure re-engineering efforts and ERPs achieve DOD’s measures of performance. Moreover, new business processes must maximize ERP system technology to yield dramatic improvements that support the warfighter.
- Use LSS teams to develop “digital smart books” that specify standard business processes and best practices for their organizations. LSS teams must post these “digital smart books” on DOD collaboration sites, such as Army Knowledge Online (AKO) to ensure lessons learned are not re-learned in DOD’s pursuit of audit readiness. This information will enable DOD organizations to share best practices, to enhance change management efforts, and to help individual

employees adapt to the new technology and new business processes in a continually changing environment.

- Do not expend finite resources on inefficient and ineffective business processes—eliminate them. Business process re-engineering practitioners such as Hammer, Champy, and Davenport insist that information technology should influence, but never drive re-engineering of business processes. Hammer believes that many business processes are non-value-added, increase cost, and weaken internal controls. LSS teams should recommend eliminating non-value added processes.

DOD certainly cannot afford to wait two more decades before effectively re-engineering non-value-added end-to-end business processes. By aggressively implementing these recommendations DOD will take advantage of its investments in technology, gain a competitive advantage in an era of significant budgetary constraints, and continue its critical progress along the path to an unqualified audit opinion.

Endnotes

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