



## Testimony

Before the Committee on Homeland  
Security and Governmental Affairs,  
U.S. Senate

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# DOD FINANCIAL MANAGEMENT

## Effect of Continuing Weaknesses on Management and Operations and Status of Key Challenges

Statement of Asif A. Khan, Director,  
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# GAO Highlights

Highlights of [GAO-14-576T](#), a testimony before the Committee on Homeland Security and Governmental Affairs, U.S. Senate

## Why GAO Did This Study

Given the federal government's continuing fiscal challenges, it is more important than ever that the Congress, the administration, and federal managers have reliable, useful, and timely financial and performance information to help ensure fiscal responsibility and demonstrate accountability, particularly for the federal government's largest department, the Department of Defense. GAO has previously reported that serious and continuing deficiencies in DOD's financial management make up one of three major impediments to achieving an opinion on the U.S. government's consolidated financial statements.

GAO's statement focuses on (1) the effect of continuing financial management challenges on DOD management and operations and (2) DOD's efforts to improve financial management and its remaining challenges. GAO's statement is primarily based on previously issued reports, including GAO's updates on DOD high-risk areas and its audit reports on DOD's financial management, inventory management and asset visibility, weapon system costs, business transformation, and business system modernization.

## What GAO Recommends

GAO has previously made numerous recommendations for improving financial systems and business systems that provide financial information as well as related processes and internal controls. DOD has generally agreed with GAO's recommendations and is taking actions to address many of them.

View [GAO-14-576T](#). For more information, contact Asif A. Khan at (202) 512-9869 or [khana@gao.gov](mailto:khana@gao.gov).

May 13, 2014

## DOD FINANCIAL MANAGEMENT

### Effect of Continuing Weaknesses on Management and Operations and Status of Key Challenges

#### What GAO Found

Long-standing weaknesses in the Department of Defense's (DOD) financial management adversely affect the economy, efficiency, and effectiveness of its operations. The successful transformation of DOD's financial management processes and operations will allow DOD to routinely generate timely, complete, and reliable financial and other information for day-to-day decision making, including the information needed to effectively (1) manage its assets, (2) assess program performance and make budget decisions, (3) make cost-effective operational choices, and (4) provide accountability over the use of public funds. Examples of the operational impact of DOD's financial management weaknesses include

- the inability to properly account for and report DOD's total assets—about 33 percent of the federal government's reported total assets—including inventory (\$254 billion) and property, plant, and equipment (\$1.3 trillion);
- the inability to accurately estimate the extent of its improper payments because of a flawed estimating methodology, which also limits corrective actions;
- inconsistent and sometimes unreliable reports to the Congress on estimated weapon system operating and support costs, limiting visibility needed for effective oversight of these costs; and
- continuing reports of Antideficiency Act violations—75 such violations reported from fiscal year 2007 through fiscal year 2012, totaling nearly \$1.1 billion—which emphasize DOD's inability to ensure that obligations and expenditures are properly recorded and do not exceed statutory levels of control.

DOD has numerous efforts under way to address its long-standing financial management weaknesses. The Congress has played a major role in many of the corrective actions by mandating them in various fiscal year National Defense Authorization Acts. However, improving the department's financial management operations and thereby providing DOD management and the Congress more accurate and reliable information on the results of its business operations will not be an easy task. Key challenges remain, such as identifying and mitigating risks to achieving the goals of DOD's Financial Improvement and Audit Readiness (FIAR) effort and successfully implementing the FIAR Guidance at the DOD component level, modernizing DOD's business information systems, and improving the financial management workforce.

DOD is monitoring its component agencies' progress toward audit readiness. However, as dates for validating audit readiness approach, DOD has emphasized asserting audit readiness by a certain date instead of making sure that effective processes, systems, and controls are in place, without which it cannot ensure that its components have improved financial management information for day-to-day decision making. While time frames are important to measuring progress, DOD should not lose sight of the ultimate goal of implementing lasting financial management reform to ensure that it can routinely generate reliable financial management and other information critical to decision making and effective operations.

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Chairman Carper, Ranking Member Coburn, and Members of the Committee:

Thank you for the opportunity to be here today to discuss continuing Department of Defense (DOD) financial management challenges and the implications for its management and operations and audit readiness. Having sound financial management practices and reliable, timely financial information is important to ensure accountability over DOD's extensive resources in order to efficiently and economically manage the department's assets, budgets, mission, and operations. Accomplishing this goal is a significant challenge given the worldwide scope of DOD's mission and operations; the diversity, size, and culture of the organization; and its reported trillions of dollars of assets and liabilities and its hundreds of billions of dollars in annual appropriations.

Given the federal government's continuing fiscal challenges, it is more important than ever that the Congress, the administration, and federal managers have reliable, useful, and timely financial and performance information to help ensure fiscal responsibility and demonstrate accountability, particularly for the federal government's largest department. Serious, continuing deficiencies in DOD's financial management have precluded it from producing financial statements that can be audited, and these deficiencies constitute one of three major impediments to achieving an opinion on the U.S. government's consolidated financial statements. Our report on the U.S. government's fiscal year 2013 financial statements highlighted significant DOD weaknesses that contributed to our disclaimer of opinion.<sup>1</sup> They include the following:

- The inability to determine that DOD's total assets were properly reported. For fiscal year 2013, DOD accounted for about 33 percent of the federal government's reported total assets, including inventory (\$254 billion) and property, plant, and equipment (\$1.3 trillion).
- Unreliable reported estimates of environmental cleanup and disposal liabilities (\$58.4 billion) and retiree health care liabilities (\$1.1 trillion).
- Ineffective financial management processes and controls.

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<sup>1</sup>GAO, *Financial Audit: U.S. Government's Fiscal Years 2013 and 2012 Consolidated Financial Statements*, [GAO-14-319R](#) (Washington, D.C.: Feb. 27, 2014).

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- Financial management systems that do not comply with the Federal Financial Management Improvement Act of 1996 (FFMIA).<sup>2</sup>

In addition to the impact on the auditability of the U.S. government's consolidated financial statements, these problems impede DOD's ability to produce timely and accurate financial management information to assist in day-to-day decision making and also significantly impair efforts to improve the economy, efficiency, and accountability of the department's operations. Key areas of concern relate to ineffective asset control and accountability, which affect DOD's visibility over weapon systems and inventory;<sup>3</sup> unreliable budget information, which affects DOD's ability to effectively measure performance, reduce costs, and maintain adequate control of its funds (funds control); and ineffective business systems and processes, which impair DOD's ability to achieve accountability and transparency over its operations and accurately report on the results of operations. DOD is addressing these issues through its Financial Improvement and Audit Readiness (FIAR) Plan, which is DOD's strategic plan and management tool for guiding, monitoring, and reporting on the department's financial management improvement efforts.

To encourage progress, the National Defense Authorization Act (NDAA) for Fiscal Year 2010 mandated that DOD develop and maintain the FIAR Plan to, among other things, describe the specific financial management improvement actions to be taken and costs associated with ensuring that its department-wide financial statements are validated as audit ready by September 30, 2017.<sup>4</sup> In October 2011, the Secretary of Defense directed the department to accelerate audit readiness efforts for key elements of

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<sup>2</sup>Pub. L. No. 104-208, div. A, title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996). DOD's financial management systems are required by FFMIA to comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the *U.S. Standard General Ledger* at the transaction level.

<sup>3</sup>DOD describes asset visibility as the ability to provide timely and accurate information on the location, quantity, condition, movement, and status of items in its inventory, including assets in transit.

<sup>4</sup>Pub. L. No. 111-84, § 1003(a), 123 Stat. 2190, 2439-40 (Oct. 28, 2009). As defined in DOD's FIAR Guidance, validation of audit readiness occurs when the DOD Comptroller examines a DOD component's documentation supporting its assertion of audit readiness and concurs with the assertion. This takes place after the DOD Comptroller or independent auditor first reviews the documentation and agrees that it supports audit readiness. A component asserts audit readiness when it believes that its documentation and internal controls are sufficient to support a financial statement audit that will result in an audit opinion.

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its financial statements. Subsequently, the NDAA for Fiscal Year 2013 added that the FIAR Plan must also describe the steps to be taken, with associated costs, to ensure that the department's Statement of Budgetary Resources (SBR) is validated as audit ready no later than September 30, 2014.<sup>5</sup>

My statement today focuses on two topics:

- the effect of continuing financial management weaknesses on DOD management and operations and
- DOD's actions to improve its financial management and achieve audit readiness, and its remaining challenges.

My statement is primarily based on previously issued reports, including our reporting on DOD high-risk areas and our audit reports on DOD's financial management, inventory management controls and asset visibility, weapon system costs, business transformation, business system modernization, improper payments, military payroll, and audit risk. A list of related products is included at the end of this statement. This statement also is based on our ongoing analyses of the Army's SBR audit readiness efforts and the Defense Finance and Accounting Service's (DFAS) audit readiness efforts for DOD payments to contractors, or "contract pay." We expect to report the final results from this work in June 2014. For our analyses, we reviewed Army and DFAS documentation, such as departmental guidance and Army and DFAS action plans and statuses, and met with component officials to discuss the basis and timing of their audit readiness assertions. We discussed the preliminary results of our work with cognizant DOD officials.

The work on which this statement is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Additional information on our scope and

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<sup>5</sup>Pub. L. No. 112-239, § 1005(a), 126 Stat. 1623, 1904 (Jan. 2, 2013). The SBR provides information about budgetary resources made available to an agency as well as the status of those resources at a specific point in time.

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methodology is available in the previously issued products cited in this statement.

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## Background

In the face of continuing reports of financial management weaknesses across the federal government, including wasteful spending, poor management, and losses totaling billions of dollars, the Chief Financial Officers (CFO) Act of 1990 was signed into law.<sup>6</sup> The act focuses on

- establishing a leadership structure;
- improving systems of accounting, financial management, and internal control; and
- enabling effective management and oversight through the production of complete, reliable, timely, and consistent financial information.

With the foundation of the CFO Act and the Government Management Reform Act of 1994 (GMRA), with its goal “to provide a more effective, efficient and responsive government,”<sup>7</sup> along with other federal agency management reform legislation, such as the Government Performance and Results Act of 1993<sup>8</sup> (GPRA) and FFMIA, a framework was put in place to improve stewardship, accountability, and transparency in the executive branch. Major goals of the reform legislation have included the following:

- **Strengthening internal control.** Accountability is part of the organizational culture that goes well beyond receiving an unmodified or “clean” audit opinion on agency financial statements; the underlying premise is that agencies must become more results oriented and focused on internal control. Thousands of internal control problems have been identified and corrected in executive branch agencies over the past two decades. A disciplined and structured approach to assessing and dealing with internal controls over the critical flow of funds through the entire agency provides a mechanism that over time mitigates potential damaging breakdowns in financial integrity and mismanagement of funds. Such breakdowns can affect the ability of

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<sup>6</sup>Pub. L. No. 101-576 (Nov. 15, 1990).

<sup>7</sup>Pub. L. No. 103-356 (Oct. 13, 1994).

<sup>8</sup>Pub. L. No. 103-62 (Aug. 3, 1993).

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the agency or entity to carry out its mission and can severely damage public confidence.

- **Accurate accounting and financial reporting.** The CFO Act and FFMIA provide for financial management systems that support reliable financial reporting on the results of operations on a day-to-day basis. This functionality, in turn, supports management decision making on budgets, programs, and overall mission performance and goals. Accurate accounting and financial reporting are also a major element of any effort to achieve auditable financial statements.
- **Improving performance information.** A key goal of much of the federal management reform legislation enacted over the past 25 years, such as the CFO Act and GPRA, is the ability to have reliable information to measure performance against mission goals. Federal agencies have made progress in the preparation of annual performance and accountability reports (PAR).<sup>9</sup> By linking financial and performance information, the PARs provide important information about the return on the taxpayers' investment in agency programs and operations.
- **Enhancing transparency.** Achieving clean audit opinions evidencing sound financial management practices is an overall outcome of effective implementation of these reforms. For example, the achievement of a clean audit opinion on the first-ever annual financial statements for the Troubled Asset Relief Program (TARP) was a significant accomplishment.<sup>10</sup> This provided important accountability and transparency to the public regarding TARP activities.

Many of the problems that preceded passage of the CFO Act also led us to issue our first high-risk list in 1990, designating certain DOD and other federal programs as high risk because of their vulnerability to fraud, waste, abuse, and mismanagement.<sup>11</sup> DOD areas designated as high risk

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<sup>9</sup>A PAR describes an agency's performance measures, results, and accountability processes for the fiscal year. This information enables the President, the Congress, and the American people to assess the agency's accomplishments each fiscal year.

<sup>10</sup>TARP is a federal program established by the Secretary of the Treasury under authority provided by the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, div. A (Oct. 3, 2008), and intended to restore liquidity and stability to the financial system of the United States via the purchase of assets from financial institutions.

<sup>11</sup>See GAO, *High-Risk Series: An Overview*, [GAO/HR-95-1](#) (Washington, D.C.: Feb. 1, 1995) and *High-Risk Series: An Update*, [GAO-13-283](#) (Washington, D.C.: February 2013).

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in 1990 included Supply Chain Management and Weapon System Acquisition, followed by Contract Management in 1992, Financial Management and Business Systems Modernization in 1995, Support Infrastructure Management in 1997, and Business Transformation in 2005.<sup>12</sup>

As we reported in our latest high-risk update, DOD is one of the few federal entities that cannot accurately account for its spending or assets and it is the only federal agency that has yet to receive an opinion on at least one of its department-wide financial statements. Without accurate, timely, and useful financial information, DOD is severely hampered in making sound decisions affecting its operations. Further, to the extent that current budget constraints and fiscal pressures continue, the reliability of DOD's financial information and ability to maintain effective accountability for its resources will be increasingly important to the federal government's ability to make sound resource allocation decisions. Effective financial management is also fundamental to achieving DOD's broader business transformation goals in the areas of asset management, acquisition and contract management, and business systems modernization.

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## Effect of Continuing Financial Management Weaknesses on DOD Management and Operations

As we have previously reported, long-standing weaknesses in DOD's financial management adversely affect the economy, efficiency, and effectiveness of the department's operations.<sup>13</sup> DOD's pervasive financial and related business management and system deficiencies continue to adversely affect its 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. As we have previously recommended, the successful transformation of DOD's financial management processes and operations is necessary for DOD to routinely generate timely, complete, and reliable financial and other information for

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<sup>12</sup>The DOD Personnel Security Clearance Program was added to GAO's high-risk list in 2005, but it was subsequently removed in 2011.

<sup>13</sup>GAO, *DOD Financial Management: Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan*, [GAO-11-932T](#) (Washington, D.C.: Sept. 15, 2011), and *DOD Financial Management: Numerous Challenges Must Be Addressed to Improve Reliability of Financial Information*, [GAO-11-835T](#) (Washington, D.C.: July 27, 2011).



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day-to-day decision making, including the information needed to effectively (1) manage its assets, (2) assess program performance and make budget decisions, (3) make cost-effective operational choices, and (4) provide accountability over the use of public funds.

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## Asset Management

Since 1990,<sup>14</sup> we have identified DOD supply chain management as a high-risk area in part because of ineffective and inefficient inventory management practices and procedures, weaknesses in accurately forecasting demand for spare parts, and challenges in achieving widespread implementation of key technologies aimed at improving asset visibility.<sup>15</sup> These factors have contributed to the accumulation of billions of dollars in spare parts that are excess to current needs, wasting valuable resources. DOD has made moderate progress in addressing its supply chain management weaknesses, but several long-standing problems have not yet been resolved. To provide high-level strategic direction, DOD issued its Logistics Strategic Plan in July 2010, which among other things, established a goal to improve supply chain processes, including inventory management practices and asset visibility.

With respect to inventory management, in November 2010, as required by the Congress, DOD issued its Comprehensive Inventory Management Improvement Plan, which is aimed at reducing excess inventory by improving inventory management practices. We reported in 2012 and 2013 that DOD had made progress in reducing its excess inventory and

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<sup>14</sup>GAO, High Risk: Letter to Congressional Committees Identifying GAO's Original High Risk Areas, (Jan.23, 1990) and [GAO-13-283](#).

<sup>15</sup>GAO, *Defense Logistics: Army Should Track Financial Benefits Realized from its Logistics Modernization Program*, [GAO-14-51](#) (Washington, D.C.: Nov. 13, 2013); *Defense Logistics: A Completed Comprehensive Strategy is Needed to Guide DOD's In-Transit Visibility Efforts*, [GAO-13-201](#) (Washington, D.C.: Feb. 28, 2013); *Defense Logistics: DOD Has Taken Actions to Improve Some Segments of the Materiel Distribution System*, [GAO-12-883R](#) (Washington, D.C.: Aug. 3, 2012); *Defense Inventory: Actions Underway to Implement Improvement Plan, but Steps Needed to Enhance Efforts*, [GAO-12-493](#) (Washington, D.C.: May 3, 2012); *Defense Logistics: Improvements Needed to Enhance DOD's Management Approach and Implementation of Item Unique Identification Technology*, [GAO-12-482](#) (Washington, D.C.: May 3, 2012); *Defense Logistics: DOD Needs to Take Additional Actions to Address Challenges in Supply Chain Management*, [GAO-11-569](#) (Washington, D.C.: July 28, 2011); and *DOD's 2010 Comprehensive Inventory Management Improvement Plan Addressed Statutory Requirements, But Faces Implementation Challenges*, [GAO-11-240R](#) (Washington, D.C.: Jan. 7, 2011).

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implementing its Comprehensive Inventory Management Improvement Plan.<sup>16</sup> DOD established overarching goals in the plan to reduce the enterprise-wide percentages of on-order excess inventory, those items already purchased that may be excess due to subsequent changes in requirements, and on-hand excess inventory, those items categorized for potential reuse or disposal. Since DOD was exceeding its initial goals for reducing excess inventory, we recommended that DOD's efforts would benefit from establishing more challenging, but achievable, goals for reducing excess inventory and that the department periodically reexamine and update its goals. DOD agreed with our recommendations and revised its on-hand excess inventory goal from 10 percent of the total value of inventory to 8 percent in fiscal year 2016. However, DOD did not make any changes to its on-order excess inventory goals and maintained that its current goals of 6 percent of the total value of on-order inventory in 2014 and 4 percent in 2016 were sufficient. Our work determined that DOD has made progress in reducing on-hand and on order excess inventory. For example:

- Data from the end of fiscal year 2009 showed that of the about \$94.5 billion in on-hand inventory, 9.4 percent, or about \$8.8 billion, was excess. DOD's most recent fiscal year-end data from September 2013, showed that of the about \$98.9 billion in on-hand inventory, 7.3 percent was considered excess.
- Data from the end of fiscal year 2009 through 2013 showed that the department had reduced its percentage of on-order excess inventory from \$13.6 billion to about \$10.2 billion, from 9.5 to 7.9 percent, with \$812 million considered as excess.

With respect to asset visibility, we found that DOD needs to take additional actions to improve asset visibility, to include completing and implementing its strategy for coordinating improvement efforts across the department for asset tracking and in-transit visibility.<sup>17</sup> In February 2013, we reported that DOD had taken steps to improve in-transit visibility of its assets through efforts developed by several of the defense components, but no one DOD organization was fully aware of all such efforts across

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<sup>16</sup>GAO, *Defense Inventory: Actions Underway to Implement Improvement Plan, but Steps Needed to Enhance Efforts*, [GAO-12-493](#) (Washington, D.C.: May 2012), and [GAO-13-283](#).

<sup>17</sup>[GAO-13-283](#).

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the department, because they are not centrally tracked.<sup>18</sup> In 2012, DOD began developing a strategy for asset visibility and in-transit visibility; however, as of February 2013 this strategy did not include all key elements of a comprehensive strategic plan. We recommended that the department finalize its strategy and in doing so ensure complete, accurate, and consistent information for all in-transit visibility efforts is captured, tracked, and shared, and the strategy contains all of the key elements of a comprehensive strategic plan, including resources and investments and key external factors. DOD agreed with our recommendation and revised and finalized its asset visibility strategy. We are currently reviewing the new strategy and the department's efforts to improve asset visibility.

In 2012, we reviewed DOD's efforts to incorporate Item Unique Identification (IUID) technology into supply chain management and found a number of implementation challenges.<sup>19</sup> IUID technology allows DOD to label an item and assign a unique number to the item, could improve the accountability of property and equipment, and could enable DOD to track equipment as it moves between its components. Challenges we identified include incomplete information on the number of items that need to be marked with IUID labels, difficulties in collecting information on IUID implementation costs, and the lack of an overarching schedule for the integration of IUID into DOD's information technology systems. DOD is revising its supply chain management policy and guidance to better include IUID use, but has not fully defined requirements for using these data, nor developed complete, integrated master schedules for integrating IUID department-wide and within components' systems. We recommended that DOD complete its implementation and management framework for IUID by incorporating key elements of a comprehensive management approach, such as a complete analysis of the return on investment, quantitatively-defined goals, and metrics for measuring progress. DOD generally agreed with our recommendations and is taking action to address them. We are continuing to monitor DOD's progress in

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<sup>18</sup>GAO, *Defense Logistics: A Completed Comprehensive Strategy is Needed to Guide DOD's In-Transit Visibility Efforts*, [GAO-13-201](#) (Washington, D.C.: Feb. 28, 2013).

<sup>19</sup>GAO, *Defense Logistics: Improvements Needed to Enhance DOD's Management Approach and Implementation of Item Unique Identification Technology*, [GAO-12-482](#) (Washington, D.C.: May 3, 2012).

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implementing a comprehensive management approach for using IUID technology.

Effective asset management controls are essential for asset accountability and safeguarding and financial reporting on asset values. DOD primarily relies on various logistical systems to carry out both its stewardship and financial reporting responsibilities for an estimated \$1.5 trillion in physical assets, ranging from enormous inventories of ammunition, stockpile materials, and other military items to multimillion-dollar weapon systems. These systems are the primary source of information for maintaining visibility over assets to meet military objectives and readiness goals and for financial reporting. However, our prior reports and DOD Inspector General (IG) reports have shown that these systems have serious weaknesses that in addition to hampering financial reporting, impair DOD's ability to (1) maintain central visibility over its assets; (2) safeguard assets from physical deterioration, theft, or loss; and (3) prevent the purchase of assets already on hand. Collectively, these weaknesses can seriously diminish the efficiency and economy of the military services' support operations.

For example, we have continued to monitor the implementation of the Army's Logistics Modernization Program (LMP) system, which supports both inventory management and financial reporting.<sup>20</sup> In November 2013, we reported that the Army's LMP, which replaced two aging Army systems, is supporting the Army's industrial operations.<sup>21</sup> However, the current system—LMP Increment 1—does not support certain critical requirements, such as automatically tracking repair and manufacturing operations on the shop floor of depots and arsenals. In addition, according to Army officials, the current system will not enable the Army to generate auditable financial statements by 2018, the statutory deadline for this goal. The Army is in the process of developing LMP Increment 2 to, among other things, address some of the identified weaknesses and

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<sup>20</sup>LMP is intended to provide a solution that streamlines the maintenance, repair, and overhaul; planning; finance; acquisition; and supply of weapon systems, spare parts, services, and material for the Army's working capital fund (which funds repairs and spare parts at cost plus a user fee) to Army commands. LMP is intended to enable worldwide, real-time, total asset visibility of inventory, including contractor-managed inventories. It also is intended to provide an anticipatory logistics planning tool that should result in reduced stock levels.

<sup>21</sup>[GAO-14-51](#).

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expects to complete fielding by September 2016. To determine whether the Army is achieving its estimated financial benefits in LMP, we recommended that the Army develop and implement a process to track the extent of financial benefits realized from the use of LMP during the remaining course of its life cycle. The Army agreed with our recommendation and stated that it would develop a process to track the extent of financial benefits recognized within LMP. We are continuing to monitor the Army's actions.

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## Program Performance and Budgeting

Reliable performance and budget information are essential to ensure that DOD has effectively budgeted for its needs so that operations can proceed smoothly to meet mission readiness demands. Accurate and timely performance and budget information also is critical to effective oversight and decision making on DOD's numerous reform initiatives.

The following examples illustrate some of the serious weaknesses we have identified in our past work on DOD's performance management and budget information.

- In our February 2014 report on the audit of the U.S. government's consolidated financial statements, we discussed as a material weakness,<sup>22</sup> DOD's inability to estimate with assurance key components of its environmental and disposal liabilities.<sup>23</sup> Deficiencies in internal control supporting the process for estimating environmental and disposal liabilities could result in improperly stated liabilities as well as adversely affect the ability to determine priorities for cleanup and disposal activities and to appropriately consider future budgetary resources needed to carry out these activities. In addition, DOD could not support a significant amount of its estimated military postretirement health benefits liabilities for federal employee and veteran benefits. These unsupported amounts related to the cost of direct health care provided by DOD-managed military treatment

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<sup>22</sup>A material weakness is a deficiency, or 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. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

<sup>23</sup>[GAO-14-319R](#).

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facilities. Problems in accounting for liabilities affect the determination of the full cost of the federal governments operations and the extent of its liabilities. DOD is addressing these issues through its implementation of its FIAR Plan.

- In June 2013, we reported<sup>24</sup> that problems with the accuracy of outstanding work orders at fiscal year-end for the Army's Industrial Operations activities resulted in inaccurate budget estimates.<sup>25</sup> To the extent that Industrial Operations does not complete work at year-end, the work and related funding are carried over into the next fiscal year. Carryover is the reported dollar value of work that has been ordered and funded by customers but not completed by Industrial Operations at the end of the fiscal year. We found that the Army did not adequately evaluate program needs and performance management constraints or the budgetary impact of the implementation of its LMP when budgeting for its Industrial Operations. As a result, unreliable information on the scope of work and the lack of available parts affected mission readiness. Further, the overstated Industrial Operations carryover amounts resulted in unreliable estimates of Operations and Maintenance funding levels. For example, the Industrial Fund carryover amounts more than doubled from fiscal years 2006 through 2012, exceeding budget estimates by more than \$1.1 billion each year. We made three recommendations aimed at implementing the Army's planned corrective actions to (1) establish a timetable for implementing new policy guidance, (2) improve the budgeting for new orders, and (3) establish procedures for evaluating work orders received to ensure that resources are available to perform the work. DOD agreed with our recommendations and has actions planned or under way to address them.
- The Office of Management and Budget (OMB) requires<sup>26</sup> that federal agency budget submissions reflect anticipated reductions in improper

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<sup>24</sup>GAO, *Army Industrial Operations: Budgeting and Management of Carryover Could Be Improved*, [GAO-13-499](#) (Washington, D.C.: June 27, 2013).

<sup>25</sup>The Army operates 13 Industrial Operations activities that provide depot maintenance and ordnance services.

<sup>26</sup>Office of Management and Budget, *Preparation, Submission, and Execution of the Budget*, OMB Circular No. A-11, § 31.8 (July 26, 2013).

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payments<sup>27</sup> in their PARs or agency financial reports (AFR)<sup>28</sup> pursuant to legal requirements for the estimation of improper payments.<sup>29</sup> For years, DOD has reported over \$1 billion annually in improper payments. Improper payments degrade the integrity of government programs, compromise citizens' trust in government, and drain resources away from the missions and goals of the government. As we reported in May 2013, although DOD has reported billions of dollars in improper payments, it does not know the extent of its improper payments because of flaws in its estimating methodology.<sup>30</sup> We found that DOD's improper payment estimates reported in its fiscal year 2011 AFR were neither reliable nor statistically valid because of long-standing and pervasive financial management weaknesses and significant deficiencies in the department's procedures to estimate improper payments. The flawed methodology for estimating improper payments also limits the effectiveness of DOD's corrective actions. We recommended that DOD take steps to (1) improve improper payment estimating procedures, such as developing valid sampling methodologies and error projections; (2) identify programs susceptible to improper payments and perform a risk assessments; (3) develop and implement corrective action plans in accordance with best practices; (4) implement recovery audits; and (5) ensure the accuracy and completeness of improper payment and

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<sup>27</sup>The term improper payment means any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments), and includes payments to an ineligible recipient, any payment for an ineligible good or service, any duplicate payment, any payment for a good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts. According to guidance from OMB, agencies should also report as improper payments any payments for which insufficient or no documentation is found.

<sup>28</sup>DOD's AFRs provide an overview of the department's financial information and performance goals and objectives. Additional information, such as the department's reporting on improper payments, is in Addendum A to its AFR.

<sup>29</sup>Federal agencies are required to estimate and report annually on their improper payments under the Improper Payments Information Act of 2002, Pub. L. No. 107-300 (Nov. 26, 2002), *as amended by* Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204 (July 22, 2010), *and* Improper Payments Elimination and Recovery Improvement Act of 2012, Pub. L. No. 112-248 (Jan. 10, 2013), *and codified as amended at* 31 U.S.C. § 3321 note.

<sup>30</sup>GAO, *DOD Financial Management: Significant Improvements Needed in Efforts to Address Improper Payment Requirements*, [GAO-13-227](#) (Washington, D.C.: May 13, 2013).



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recovery audit reporting. DOD agreed with our recommendations and cited planned actions to address them.

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## Cost-effective Choices

Reliable information on the cost of operations is critical to provide accountability for and to efficiently and economically manage DOD's vast resources. Reliable cost information is essential for making important decisions, such as reallocating resources to fighting forces and considering whether to continue, modify, or discontinue programs and activities. However, DOD's legacy financial management systems were not designed to capture the full cost of its activities and programs, and DOD's enterprise resource planning (ERP) systems<sup>31</sup> continue to experience schedule slippages and cost overruns and are not estimated to be fully implemented until the end of fiscal year 2016 or later.<sup>32</sup>

As our prior work has found, to effectively, efficiently, and economically manage DOD's programs, its managers need reliable cost information for (1) evaluating programs (for example, measuring actual results of management's actions against expected savings or determining the effect of long-term liabilities created by current programs); (2) making cost-effective choices, such as whether to outsource specific activities and how to improve efficiency through technology choices; and (3) controlling costs for its weapon systems and business activities funded through working capital funds. The lack of reliable, cost-based information has hampered DOD in each of these areas, as described in the following examples.

- In a February 2014 report on our audit of the U.S. government's consolidated financial statements, we reported that DOD was responsible for the majority of the federal government's inventories and property, plant, and equipment and that DOD did not maintain adequate systems or have sufficient records to provide reliable information on these assets. Further, deficiencies in internal control over such assets could affect the federal government's ability to fully

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<sup>31</sup>An ERP system is an automated system using commercial off-the-shelf software consisting of multiple, integrated functional modules that perform a variety of business-related tasks, such as general ledger accounting, payroll, and supply chain management.

<sup>32</sup>GAO, *DOD Financial Management: Reported Status of Department of Defense's Enterprise Resource Planning Systems*, [GAO-12-565R](#) (Washington, D.C.: Mar. 30, 2012).



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know the assets it owns, including their location and condition, and its ability to (1) safeguard assets from physical deterioration, theft, or loss; (2) account for acquisitions and disposals of such assets and reliably report asset balances; (3) ensure that the assets are available for use when needed; (4) prevent unnecessary storage and maintenance costs or purchase of assets already on hand; and (5) determine the full costs of programs that use these assets.<sup>33</sup> DOD is addressing these issues through implementation of its FIAR Plan.

- With the nation facing fiscal challenges and the potential for tighter defense budgets, the Congress and DOD have placed more attention on controlling the billions of dollars spent annually on weapon system operating and support costs, including costs for repair parts, maintenance, and personnel, which account for 70 percent of the total costs of a weapon system over its life cycle. The Selected Acquisition Report (SAR) is DOD's key recurring status report on the cost, schedule, and performance of major defense acquisition programs and is intended to provide authoritative information for congressional oversight of these programs. Oversight of operating and support costs is important because many of the key decisions affecting these life cycle costs are made during the acquisition process. In February 2012, we reported that DOD's reports to the Congress on estimated weapon system operating and support costs are often inconsistent and sometimes unreliable, limiting visibility needed for effective oversight of these costs.<sup>34</sup> To enhance the visibility of weapon system costs during acquisition, we recommended that DOD improve its guidance to program offices on cost reporting and also to improve its process for reviewing these costs prior to final submission of the SAR to the Congress. DOD concurred with our recommendations and noted actions it was taking to address them. We are continuing to monitor DOD's progress in addressing our recommendations.
- In December 2012, DOD canceled the Air Force's Expeditionary Combat Support System after having spent more than a billion dollars and missing multiple milestones, including failure to achieve deployment within 5 years of obligating funds. The system was to

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<sup>33</sup>[GAO-14-319R](#).

<sup>34</sup>GAO, *Defense Logistics: Improvements Needed to Enhance Oversight of Estimated Long-term Costs for Operating and Supporting Major Weapon Systems*, [GAO-12-340](#) (Washington, D.C.: Feb. 2, 2012).

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provide the Air Force with a single, integrated logistics system that was to control and account for about \$36 billion of inventory. We issued several reports on this system and found that among other things, the program was not fully following best practices for developing reliable schedules and cost estimates.<sup>35</sup> We also reported that independent Air Force technical evaluations identified operational deficiencies that impaired the system's efficiency and effectiveness in accounting for business transactions and reporting reliable financial information.

- Accurate and complete cost information also is key to making effective and economical investment decisions. We reported that one-time implementation costs for Base Realignment and Closure (BRAC) 2005 grew from \$21 billion originally estimated by the BRAC Commission in 2005 to about \$35.1 billion, or by 67 percent, through fiscal year 2011, primarily because of higher-than-anticipated military construction costs.<sup>36</sup> Military construction costs for the BRAC 2005 round increased from \$13.2 billion based on original estimates by the BRAC Commission to \$24.5 billion, an 86 percent increase, through fiscal year 2011, while over the same period, general inflation increased by 13.7 percent. In certain cases, DOD did not include some significant military construction requirements that were needed to implement the recommendations as envisioned, resulting in the identification of additional requirements and related cost increases after the recommendations were approved by the BRAC Commission. Consequently, the increase of \$11.3 billion in military construction

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<sup>35</sup>GAO, *Information Technology: OMB and Agencies Need to More Effectively Implement Major Initiatives to Save Billions of Dollars*, [GAO-13-796T](#) (Washington, D.C.: July 25, 2013); *Major Automated Information Systems: Selected Defense Programs Need to Implement Key Acquisition Practices*, [GAO-13-311](#) (Washington, D.C.: Mar. 28, 2013); *DOD Financial Management: Challenges in Attaining Audit Readiness and Improving Business Processes and Systems*, [GAO-12-642T](#) (Washington, D.C.: Apr. 18, 2012); *DOD Financial Management: Implementation Weaknesses in Army and Air Force Business Systems Could Jeopardize DOD's Auditability Goals*, [GAO-12-134](#) (Washington, D.C.: Feb. 28, 2012); and *DOD Business Transformation: Improved Management Oversight of Business System Modernization Efforts Needed*, [GAO-11-53](#) (Washington, D.C.: Oct. 7, 2010).

<sup>36</sup>GAO, *Military Bases: Opportunities Exist to Improve Future Base Realignment and Closure Rounds*, [GAO-13-149](#) (Washington, D.C.: Mar. 7, 2013), and *Military Base Realignments and Closures: Updated Costs and Savings Estimates from BRAC 2005*, [GAO-12-709R](#) (Washington, D.C.: June 29, 2012).

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costs drove about 80 percent of the total cost increases of \$14.1 billion for BRAC 2005. Further, because some additional requirements were driven by events after the BRAC Commission's approval, the Congress had limited visibility into the potential costs of the original recommendations. Another reason we identified for the growth in implementation costs over DOD's initial BRAC estimates was that DOD had difficulties accurately anticipating information technology requirements for many recommendations, leading to significantly understated information technology costs for some BRAC recommendations—particularly those that involved missions with considerable reliance on such capabilities. We made 10 recommendations for improving the BRAC process. DOD concurred with 3 of our recommendations, partially concurred with 2, and did not concur with 5 of them. In disagreeing with certain recommendations, DOD expressed concern that our recommendations precluded optimizing military value and stated that the current process was sufficient to address our concerns. We continue to believe that although DOD's BRAC process was fundamentally sound, our recommendations did not preclude opportunities for improvements or the potential for cost savings.

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## Accountability over Use of Public Funds

We recently reported that our analysis of 333 reports related to DOD funds control issued in fiscal years 2007 through 2013 identified over 1,000 funds control weaknesses related to (1) training, supervision, and management oversight; (2) proper authorization, recording, documentation, and reporting of transactions; and (3) business system compliance with federal laws and accounting standards.<sup>37</sup> We found that these weaknesses led DOD to make program and operational decisions based on unreliable data and impaired DOD's ability to improve its financial management. Specifically, fundamental weaknesses in funds control significantly impaired DOD's ability to (1) properly use resources, (2) produce reliable financial reports on the results of operations, and (3) meet its audit readiness goals as discussed in the following examples.

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<sup>37</sup>GAO, *DOD Financial Management: Actions Under Way Need to Be Successfully Completed to Address Long-standing Funds Control Weaknesses*, [GAO-14-94](#) (Washington, D.C.: Apr. 29, 2014).

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- Continuing reports of violations of the Antideficiency Act (ADA) and other fiscal laws, such as the Purpose Statute,<sup>38</sup> underscore DOD's inability to assure that obligations and expenditures are properly recorded and do not exceed statutory levels of control.<sup>39</sup> The ADA requires, among other things, that no officer or employee of DOD incur obligations or make expenditures in excess of the amounts made available by appropriation, by apportionment, or by further subdivision according to the agency's funds control regulations. According to copies of ADA violation reports we reviewed, DOD reported 75 ADA violations from fiscal year 2007 through fiscal year 2012, totaling nearly \$1.1 billion. We received reports of 2 additional ADA violations in 2013 totaling \$148.6 million. However, we determined that the number of violations and dollar amounts reported may not be complete because of weaknesses in DOD's funds control and monitoring processes that may not have allowed all violations to be identified or reported. For example, DOD IG reports issued in fiscal years 2007 through 2012 identified \$5.5 billion in potential ADA violations that required further investigation to determine whether an ADA violation had, in fact, occurred, or if adjustments could be made to avoid a violation. Further, while DOD's Financial Management Regulation (FMR)<sup>40</sup> limits the time from identification to reporting of ADA violations to 15 months,<sup>41</sup> our analysis identified several examples of time spans for investigations of potential ADA violations taking several additional months to several years before determinations of actual violations were reported. For example, as of September 30, 2013, three of the DOD IG-reported potential violations totaling \$713.1 million could not be fully corrected and, consequently, resulted in \$108.8 million in actual, reported ADA violations. To the

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<sup>38</sup>31 U.S.C. 1301(a) (appropriations shall be applied only to the objects for which the appropriations were made, except as otherwise provided by law).

<sup>39</sup>31 U.S.C. §§ 1341-42, 1349-52, 1511-19. DOD categorizes violations of various fiscal laws and violations of the ADA collectively as ADA violations. For example, DOD has reported violations of the Purpose Statute as ADA violations. In some cases, reports of ADA violations included both ADA and other fiscal law violations.

<sup>40</sup>DOD FMR, vol. 14, ch. 1, "Administrative Control of Funds" (January 2009). DOD's FMR is issued under the authority of DOD Instruction 7000.14, *Department of Defense Financial Management Policy and Procedures* (rev. Sept. 17, 2008). The DOD FMR directs statutory and regulatory financial management requirements, systems, and functions for all appropriated and nonappropriated working capital, revolving, and trust fund activities

<sup>41</sup>DOD, FMR, vol. 14, ch. 7, "Antideficiency Act Report," § 070102 (November 2010).

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extent that ADA violations are not identified, corrected, and reported, DOD management decisions are being made based on incomplete and unreliable data.

- DOD has stated that its major financial decisions are based on budgetary data (e.g., the status of funds received, obligated, and expended). We have found that the department's ability to improve its budgetary accounting has historically been hindered by its reliance on fundamentally flawed financial management systems and processes and transaction control weaknesses. In its November 2013 AFR,<sup>42</sup> DOD self-reported 16 material weaknesses in financial reporting, noting that it has no assurance of the effectiveness of the related controls. These weaknesses affect reporting on budgetary transactions and balances, including budget authority, fund balance, outlays, and categories of transactions, such as civilian pay, military pay, and contract payments. As a result, we have concluded that DOD's reports on budget execution and reports on the results of operations that could have a material effect on budget, spending, and other management decisions are unreliable.

For example, we found that DOD continues to make billions of dollars of unsupported, forced adjustments, or "plugs," to reconcile its Fund Balance with Treasury (FBWT).<sup>43</sup> In the federal government, an agency's FBWT accounts are similar in concept to corporate bank accounts. The difference is that instead of a cash balance, FBWT represents unexpended budget authority in appropriation accounts. Similar to bank accounts, the funds in DOD's appropriation accounts must be reduced or increased as the department spends money or receives collections that it is authorized to retain for its own use. For fiscal year 2012, DOD agencies reported making \$9.2 billion in unsupported reconciling adjustments to agree their fund balances with the Department of the Treasury's (Treasury) records. DOD's unsupported reconciling adjustments to agree its fund balances to Treasury records grew to \$9.6 billion in fiscal year 2013. We recommended that the Navy develop and implement standard

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<sup>42</sup>Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *United States Department of Defense, Agency Financial Report, for Fiscal Year 2013*.

<sup>43</sup>GAO, *DOD Financial Management: Ongoing Challenges with Reconciling Navy and Marine Corps Fund Balance With Treasury*, [GAO-12-132](#) (Washington, D.C.: Dec. 20, 2011).

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operating procedures for performing FBWT reconciliations with Treasury records and that it provide training on the new procedures to personnel performing FBWT reconciliations. The Navy has actions under way to address our recommendations.

- Further, we have reported that over the years, DOD has recorded billions of dollars of disbursement and collection transactions in suspense accounts because the proper appropriation accounts could not be identified and charged, generally because of coding errors.<sup>44</sup> Accordingly, Treasury does not accept DOD reporting of suspense transactions, and suspense transactions are not included in DOD component FBWT reconciliations. We have concluded that it is important that DOD accurately and promptly charge transactions to appropriation accounts since these accounts provide the department with legal authority to incur and pay obligations for goods and services. We recommended that the Navy perform periodic testing of systems for reporting transactions to Treasury and prioritize and address identified deficiencies. The Navy agreed with our recommendations and has actions under way to address them. We are monitoring the Navy's progress.

While DOD has actions under way to address its department-wide funds control weaknesses, several are not expected to be completed until 2017. Until fully resolved, these weaknesses will continue to adversely affect DOD's ability to achieve its goals for financial accountability, including the ability to produce consistent, reliable, and sustainable financial information for day-to-day decision making. Sustained leadership commitment will be critical to achieving success. In commenting on our most recent report released this week, DOD stated that while our report recommended no new actions based on the numerous actions that DOD already has under way, the department's commitment to building a stronger business environment via its people, processes, and systems remains paramount.<sup>45</sup>

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<sup>44</sup>GAO-12-132.

<sup>45</sup>GAO-14-94.

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## DOD's Actions to Improve Financial Management and Achieve Audit Readiness, and Remaining Challenges

Collectively, DOD's major financial management reform efforts are being managed under the FIAR effort as well as several other interdependent efforts, such as DOD's Civilian Workforce Plan and business systems modernization.<sup>46</sup> With the FIAR Plan's emphasis on audit readiness, it is important to note that financial statement audits are not just about validating the amounts and activity reported on the statements. They also provide a framework for assessing and improving internal controls and compliance with laws and regulations; developing effective, integrated financial management systems directed at providing reliable, useful, and timely information for decision making; demonstrating stewardship and accountability over federal programs and resources; and enabling a greater focus on managing the costs of government. Improving the department's financial management operations and thereby providing DOD management and the Congress more accurate and reliable information on the results of its business operations continues to be a difficult task. Below are some of the key challenges we have identified in prior work that DOD must address to improve its financial management and mitigate the operational effects mentioned previously as well as enable DOD to produce auditable financial statements

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## FIAR Plan Implementation

In 2005, the Under Secretary of Defense Comptroller/CFO (DOD Comptroller) established the FIAR Directorate, consisting of the FIAR Director and his staff, to develop, manage, and implement a strategic approach for addressing financial management deficiencies, achieving audit readiness, and integrating those efforts with other initiatives. In accordance with the NDAA for Fiscal Year 2010, DOD provides reports to relevant congressional committees on the status of DOD's implementation of the FIAR Plan twice a year—no later than May 15 and November 15.<sup>47</sup> In August 2009, the DOD Comptroller sought to focus FIAR efforts by giving priority to improving processes and controls that support the financial information most often used to manage the department. Accordingly, the DOD Comptroller revised the FIAR Plan strategy to focus on two priorities—budgetary information and asset

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<sup>46</sup>DOD's Civilian Workforce Plan encompasses a department-wide effort to ensure that each of DOD's 24 mission areas, including financial management, has the right mix of civilian and military personnel with the right skills and qualifications to effectively perform required mission duties.

<sup>47</sup>Pub. L. No. 111-84, §1003(b).

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accountability. The first priority was to strengthen processes, controls, and systems that produce DOD's budgetary information. The second priority was to improve the accuracy and reliability of management information pertaining to the department's mission-critical assets, including military equipment, real property, and general equipment. In May 2010, the DOD Comptroller first issued the FIAR Guidance, which provided the standard methodology for the components to implement the FIAR Plan. According to DOD, the components' successful implementation of this methodology is essential to the department's ability to achieve full financial statement auditability.

In October 2011, the Secretary of Defense directed the department to achieve audit readiness for its SBR for general fund accounts by the end of fiscal year 2014,<sup>48</sup> and the NDAA for Fiscal Year 2012 required that the next FIAR Plan update include a plan to support this goal.<sup>49</sup> Further, the NDAA for Fiscal Year 2013 made the 2014 target for SBR auditability an ongoing component of the FIAR Plan by amending the NDAA for Fiscal Year 2010 such that it now explicitly refers to describing the actions and costs associated with validating as audit ready both DOD's SBR by the end of fiscal year 2014 and DOD's complete set of financial statements by the end of fiscal year 2017.<sup>50</sup>

In response to component difficulties in preparing for a full SBR audit, the November 2012 FIAR Plan Status Report and the March 2013 FIAR Guidance included a revision to narrow the scope of initial audits to only current-year budget activity and expenditures on a Schedule of Budgetary Activity. Under this approach, beginning in fiscal year 2015, reporting entities are to undergo an examination of their Schedules of Budgetary Activity reflecting the amount of SBR balances and associated activity related only to funding approved on or after October 1, 2014. As a result, the Schedules of Budgetary Activity will exclude unobligated and unexpended amounts carried over from prior years' funding as well as information on the status and use of such funding in subsequent years

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<sup>48</sup>An agency's general fund accounts are those accounts in the U.S. Treasury that hold all federal money not allocated by law to any other fund account.

<sup>49</sup>Pub. L. No. 112-81, div. A, § 1003 (Dec. 31, 2011).

<sup>50</sup>Most recently, the NDAA for Fiscal Year 2014, Pub. L. No. 113-66, § 1003 (Dec. 26, 2013), mandates that a full audit of DOD's financial statements occur for fiscal year 2018, and that it be completed by March 31, 2019.



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(e.g., obligations incurred and outlays). These amounts will remain unaudited. Over the ensuing years, as the unaudited portion of SBR balances and activity related to this funding decline, the audited portion is expected to increase. However, the NDAA for Fiscal Year 2010, as amended by the NDAA for Fiscal Year 2013, requires that the FIAR Plan describe specific actions to be taken and the costs associated with ensuring that DOD's SBR is validated as ready for audit by not later than September 30, 2014. We have reported that because the audit of the Schedule of Budgetary Activity is an incremental step building toward an audit-ready SBR, the FIAR Plan does not presently comply with this requirement.<sup>51</sup> Furthermore, all material amounts reported on the SBR will need to be auditable in order to achieve the mandated goal of full financial statement audit readiness by September 30, 2017. It is not clear how this can be accomplished if activity related to funding provided prior to October 1, 2014, remains unaudited.

The FIAR Guidance sets out a mandatory set of five standardized phases for achieving audit readiness that DOD components are required to apply to each assessable unit.<sup>52</sup> In the first two phases, Discovery and Corrective Action, the components identify, assess, and correct or mitigate deficiencies in the processes and controls of the assessable units related to preparing auditable financial statements, line items, or transactions and the activities that feed into them. In the Assertion/Evaluation phase, the component asserts audit readiness<sup>53</sup> and the FIAR Directorate reviews and gives the component feedback on its state of audit readiness. In the Validation phase, the FIAR Directorate reviews the component's examination report and documentation supporting successful remediation of deficiencies, and determines the reporting entity's audit readiness state. In the Audit phase, an independent auditor or the DOD Office of Inspector General (OIG), performs an audit of the financial statements or specified elements and issues an opinion on whether they are fairly presented in accordance with

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<sup>51</sup>[GAO-14-94](#).

<sup>52</sup>DOD defines an assessable unit as any part of the financial statements, such as a line item or a class of assets, a class of transactions, or a process or a system, that helps produce the financial statements.

<sup>53</sup>A management assertion, according to the November 2013 FIAR Guidance, is a written declaration that the subject matter (assessable unit) is audit ready in conformity with the internal control and supporting documentation criteria based upon the FIAR methodology.

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generally accepted accounting principles. We found that while DOD has made progress toward financial audit readiness, according to DOD's November 2013 FIAR Plan Status Report, milestone dates for the Navy have slipped and SBR milestone dates for the Army and defense agencies have been compressed, making it questionable whether corrective actions for these DOD components will be completed by September 2014 for all assessable units.<sup>54</sup> Further, the Air Force has revised its milestone dates for achieving SBR audit readiness to the third quarter of fiscal year 2015. With a reported \$187.8 billion in fiscal year 2013 General Fund budgetary resources, the Air Force is material to DOD's SBR, and if the Air Force cannot meet DOD's September 2014 SBR audit readiness goal, DOD will not be able to meet its goal. This in turn raises substantial concerns about DOD's ability to undergo an audit on a full set of financial statements for fiscal year 2018.

In addition, our recent reports have identified several major challenges to DOD's ability to successfully implement the FIAR Plan and meet its audit readiness goals. The following discussion summarizes these challenges.

**Process for identifying and mitigating risks to the FIAR effort.** In August 2013, we reported that DOD's FIAR effort would benefit from a risk management strategy to help program managers and stakeholders make decisions about assessing risk, allocating resources, and taking actions under conditions of uncertainty.<sup>55</sup> In January 2012, DOD identified six department-wide risks to the FIAR Plan's implementation: (1) lack of DOD-wide commitment, (2) insufficient accountability, (3) poorly defined scope and requirements, (4) unqualified or inexperienced personnel, (5) insufficient funding, and (6) information systems control weaknesses. DOD officials stated that risks are discussed on an ongoing basis during various FIAR oversight committee meetings; however, the risks DOD initially identified were not comprehensive, and DOD provided no evidence of efforts to identify additional risks. Further, we found little evidence that DOD analyzed risks it identified to assess their magnitude or that DOD developed adequate plans for mitigating the risks. DOD's risk mitigation plans, published in its FIAR Plan Status Reports, consisted of brief, high-level summaries that did not include critical management information, such as specific and detailed plans for implementation,

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<sup>54</sup>GAO-14-94.

<sup>55</sup>GAO-13-123.

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assignment of responsibility, milestones, or resource needs. In addition, information about DOD's mitigation efforts was not sufficient for DOD to monitor the extent of progress in mitigating identified risks. We concluded that without effective risk management at the department-wide level to help ensure the success of the FIAR Plan implementation, DOD is at increased risk of not achieving its audit readiness goals. We recommended that the department design and implement department-level policies and detailed procedures for FIAR Plan risk management that incorporate the five guiding principles for effective risk management. DOD acknowledged that it does not have a risk management program that is specifically related to its FIAR effort and cited planned actions that if effectively and efficiently implemented, would address some aspects of the five guiding principles of risk management that are the basis for our recommendations. We are continuing to monitor DOD's actions on our recommendation.

**Component implementation of the FIAR Guidance.** The FIAR Guidance provides a methodology for DOD components to use in developing and implementing their Financial Improvement Plans (FIP).<sup>56</sup> The guidance details the roles and responsibilities of the DOD components, and prescribes a standard, systematic process for assessing processes, controls, and systems. DOD's ability to achieve department-wide audit readiness greatly depends on its military components' ability to effectively develop and implement FIPs in compliance with the FIAR Guidance. However, we have reported on concerns with the department's efforts to implement this methodology. For example, our review of the Navy's civilian pay and Air Force's military equipment audit readiness efforts identified significant deficiencies in the components' execution of the FIAR Guidance, resulting in insufficient testing and unsupported conclusions.<sup>57</sup> We recommended that DOD take various actions to improve the development, implementation, documentation, and oversight of DOD's financial management improvement efforts. DOD generally concurred with recommendations and noted actions being taken to implement them. We are continuing to monitor Navy and Air Force audit readiness actions.

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<sup>56</sup>A FIP is a framework for planning and tracking the steps and supporting documentation necessary to achieve auditability within the FIAR methodology.

<sup>57</sup>[GAO-11-851](#).

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In reviews of other DOD components, we also found internal control weaknesses in DOD's procedures for maintaining accountability for billions of dollars in funds and other resources. For example, the Army and DFAS could not readily identify the full population of payroll accounts associated with the Army's \$46 billion active duty military payroll because of deficiencies in existing procedures and nonintegrated personnel and payroll systems.<sup>58</sup> We recommended that the Army identify documents needed to support military payroll transactions affecting the pay of millions of active duty Army military personnel and that it develop and implement procedures for maintaining those documents. As a first step, the Army has developed a matrix of supporting documents for its military pay. However, the Army has not yet completed action to populate a central repository with these records.

Preliminary results from our ongoing work to assess the Army's progress in implementing its FIP for budget execution to help guide its SBR readiness efforts indicate that the Army did not fully complete certain tasks in accordance with the FIAR Guidance to ensure that its FIP adequately considered the scope of efforts required for audit readiness. For example, the Army did not consider the risks associated with excluding prior year balances and current year activity associated with legacy systems and did not adequately identify significant SBR activity attributable to service-provider business processes and systems or obtain sufficient information to assess their audit readiness. These activities may continue to represent material portions of future SBRs, which if not auditable, will likely affect the Army's ability to achieve audit readiness goals as planned. Our review of the Army's monthly tests to assess the effectiveness of selected budget execution controls show that the Army identified extensive deficiencies, such as a lack of appropriate reviews or approvals, and had an average failure rate of 56 percent for control tests from June 2012 through May 2013, the period covered by our review. Further, the Army's corrective actions were not linked to specific corrective action plans to address the causes of identified deficiencies. The deficiencies and gaps we have identified in our preliminary findings throughout various phases of the Army's SBR audit readiness efforts demonstrate a focus on meeting scheduled milestone dates and asserting audit readiness instead of completing actions to resolve extensive control deficiencies.

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<sup>58</sup>[GAO-12-406](#).

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Further, the military services rely heavily on DOD's internal service providers to perform a variety of accounting, personnel, logistics, and system operations. For example, DFAS performs accounting and disbursement functions for the military services and defense agencies. The FIAR Guidance requires the service providers to have their control activities and supporting documentation examined by the DOD IG or an independent auditor in accordance with Statement on Standards for Attestation Engagements (SSAE) No.16 so that components have a basis for relying on the service provider's data for their financial statement audits.<sup>59</sup> In August 2013, we reported that DOD did not have an effective process for identifying audit-readiness risks, including risks associated with its reliance on service providers for much of its components' financial data, and it needed better department-wide documentation retention policies.<sup>60</sup> We identified two DOD component agencies—the Navy and the Defense Logistics Agency (DLA)—that had established practices consistent with risk management guiding principles. Because effective service-provider controls are critical to ensuring improvements in DOD funds control, we recommended that DOD consider and incorporate, as appropriate, Navy and DLA practices in department-level policies and procedures. DOD agreed with our recommendation and is taking actions to address it.

DOD has identified contract pay as a key element of its SBR. DFAS, the service provider responsible for disbursing nearly \$200 billion annually in the department's contract pay, has asserted that its processes, systems, and controls over contract pay are suitably designed and operating effectively to undergo an audit. Preliminary results from our ongoing assessment of DFAS's implementation of its FIP for contract pay audit readiness indicate that DFAS has numerous deficiencies that have not yet been remediated. For example, DFAS did not adequately perform certain planning activities, such as assessing dollar activity and risk

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<sup>59</sup>In accordance with SSAE No. 16, *Reporting on Controls at a Service Organization*, the auditors of each of these external service organizations issued reports concerning the design and operating effectiveness of the service organizations' internal control over the processing of user transactions. Services provided by an external service organization are considered to be part of a user entity's information system relevant to the user entity's financial reporting if the services affect classes of transactions that are significant to the user entity's financial statements as well as the financial reporting process used to prepare the financial statements.

<sup>60</sup>GAO, *DOD Financial Management: Ineffective Risk Management Could Impair Progress toward Audit-Ready Financial Statements*, [GAO-13-123](#) (Washington, D.C.: Aug. 2, 2013).

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factors of its processes, systems, and controls, which resulted in the exclusion of three key processes from the FIP, such as the reconciliation of its contract pay data to components' general ledgers. As a result, DFAS did not obtain sufficient assurance that the contract disbursements it processed were accurately recorded and maintained in the components' general ledgers and that the status of DOD's contract obligations was up-to-date. Although DFAS has asserted audit readiness for contract pay, until it corrects the weaknesses we identified, its ability to process, record, and maintain accurate and reliable contract pay transaction data is questionable. Therefore, our preliminary results indicate that DFAS does not have assurance that its FIP will satisfy the needs of DOD components or provide the expected benefits to department-wide efforts to assert audit readiness for contract pay as a key element of the SBR.

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## Modern Business Information Systems

In May 2014, we reported that DOD continued efforts to improve its business enterprise architecture (BEA)—a modernization blueprint—and transition plan and modernize its business systems and processes, consistent with key statutory provisions.<sup>61</sup> However, we found that even though DOD has spent more than 10 years and at least \$379 million on the architecture, DOD has not yet demonstrated that the BEA has produced business value for the department. For example, while DOD has established a tool that can assist in identifying potential duplication and overlap among business systems, the department has not demonstrated that it has used this information to reduce duplication and overlap. Accordingly, we recommended that the department develop guidance requiring military departments and other defense organizations to use existing BEA content to more proactively identify potential duplication and overlap. DOD agreed with our recommendation. Collectively, the limitations described in our May 2014 report put the billions of dollars spent annually on approximately 2,100 business system investments that support DOD functions at risk.

Further, DOD has identified several, multifunctional ERP systems as critical to its financial management improvement efforts. In a 2012 report on four of these ERPs, we found deficiencies in areas such as data quality, data conversion, system interfaces, and training that affect their

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<sup>61</sup>GAO, *Defense Business Systems: Further Refinements Needed to Guide the Investment Management Process*, [GAO-14-486](#) (Washington, D.C.: May 12, 2014). The relevant legal requirements are codified, as amended, at 10 U.S.C. § 2222.

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capability to perform essential business functions.<sup>62</sup> DFAS personnel also reported difficulty in using the systems to perform day-to-day activities. We recommended that DOD ensure that (1) any future system deficiencies identified through independent assessments are resolved or mitigated prior to further deployment of the systems, (2) timelines are established and monitored for those issues identified by DFAS that are affecting their efficient and effective use, and (3) training on actual job processes are provided in a manner that allows users to understand how the new processes support their job responsibilities and the work they are expected to perform.<sup>63</sup> DOD partially concurred with our first recommendation, stating that based on the nature of an identified system deficiency, it will determine whether to defer system implementation until it is corrected. DOD agreed with our recommendations to establish and monitor timelines and provide training on user roles and responsibilities. We are continuing to monitor DOD's actions.

If these business systems do not provide the intended capabilities on schedule, DOD's goal of establishing effective financial management operations and becoming audit ready could be jeopardized. We recently reported that the Air Force did not meet best practices in developing a schedule for the Defense Enterprise Accounting and Management System (DEAMS) program.<sup>64</sup> We believe that this raises questions about the credibility of the deadline for acquiring and implementing DEAMS to provide needed functionality for financial improvement and audit readiness. We recommended that the Air Force update the cost estimate as necessary after implementing our prior recommendation to adopt scheduling best practices. DOD concurred with our recommendation.

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## Competent Financial Management Workforce

A key principle for effective workforce planning is that an agency needs to define the critical skills and competencies that it will require in the future to meet its strategic program goals. Once an agency has identified critical skills and competencies, it can develop strategies to address gaps in the number of personnel, needed skills and competencies, and deployment of the workforce.

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<sup>62</sup>[GAO-12-134](#).

<sup>63</sup>[GAO-12-134](#).

<sup>64</sup>GAO, *DOD Business System Modernization: Air Force Business System Schedule and Cost Estimates*, [GAO-14-152](#) (Washington, D.C.: Feb. 7, 2014).



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In April 2014, we reported<sup>65</sup> that DOD is addressing financial management workforce competencies and training through complementary efforts by (1) the Office of the Under Secretary of Defense for Personnel and Readiness (Personnel and Readiness) to develop a strategic civilian workforce plan that includes financial management,<sup>66</sup> pursuant to requirements in the NDAA for Fiscal Year 2010, as amended,<sup>67</sup> and (2) the DOD Comptroller to develop and implement a Financial Management Certification Program, pursuant to requirements in the NDAA for Fiscal Year 2012.<sup>68</sup> Financial management personnel are expected to possess the competencies that are relevant to and needed for their assigned positions. These competencies include fundamentals of accounting, accounting analysis, budget execution, financial reporting, and audit planning and management, among others. Personnel and Readiness is currently working on a competency assessment tool that will be used by the department, including the financial management functional community. The tool is to capture information related to competencies, such as proficiency level, importance, and criticality, and to identify any gaps in support of the Comptroller's Financial Management Certification Program. Phased implementation of the program began in June 2013, and the current target date for full implementation is the end of fiscal year 2014. The certification program is to be mandatory for DOD's approximately 54,000 civilian and military financial management personnel and may take up to 2 years to complete, depending on the extent to which an individual's prior course work and level of experience to meet the new certification requirements. In April 14, 2014, the Deputy CFO stated that the newly implemented Financial Management Certification Program has already enrolled 22,300 financial managers and certified over 30.<sup>69</sup>

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<sup>65</sup> [GAO-14-94](#).

<sup>66</sup>The details of DOD's financial management workforce assessment are contained in the *Fiscal Year 2010 Department of Defense Strategic Workforce Plan*, app. B-15, Financial Management.

<sup>67</sup> See Pub. L. No. 111-84, § 1108(a)(1), (Oct. 28, 2009), *codified as amended at* 10 U.S.C. § 115b.

<sup>68</sup> Pub. L. No. 112-81, div. A, § 1051, (Dec. 31, 2011), *codified at* 10 U.S.C. § 1599d.

<sup>69</sup> [GAO-14-94](#).



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Without a competent workforce and effective implementation of financial management processes, systems, and controls, DOD and its components are at risk that DOD's other financial management reform activities will not be successful, resulting in incomplete and unreliable data for decision making. To the extent that these challenges are not addressed, DOD financial management will continue to be at high risk for waste, fraud, abuse, and mismanagement.

In conclusion, while DOD has several financial management improvement efforts under way and is monitoring progress against milestones, as the dates for validating audit readiness approach, DOD has emphasized asserting audit readiness by a certain date over making sure that effective processes, systems, and controls are in place to ensure that its components have improved financial management information for day-to-day decision making. However, several significant factors—including DOD component milestone slippages in meeting audit readiness dates; continuing, uncorrected DOD-wide financial management weaknesses; and inadequate risk management efforts—make it increasingly unlikely that DOD's SBR will be audit ready by September 2014. While establishing and working toward milestones are important to measure progress, DOD should not lose sight of the ultimate goal of implementing lasting financial management reform to ensure that it has the systems, processes, and personnel to routinely generate reliable financial management and other information critical to decision making and effective operations for achieving its missions. Overcoming DOD's long-standing financial management challenges will require strong commitment and top leadership support.

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Chairman Carper, Ranking Member Coburn, and Members of the Committee, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

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## GAO Contacts and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact me at (202) 512-9869 or [khana@gao.gov](mailto:khana@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. GAO staff members who made key contributions to this testimony include Gayle L. Fischer (Assistant Director), Gregory Marchand (Assistant General Counsel), Arkelga Braxton, Michael Bingham, Francine DeVecchio, Jason Kirwan, Susan Mata, Sheila D. M. Miller, Roger Stoltz, and Heather Rasmussen.

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