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DOD FINANCIAL MANAGEMENT

Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan

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GAO

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Ongoing Challenges in Implementing the Financial Improvement and Audit Readiness Plan

Why GAO Did This Study

The Department of Defense (DOD) has initiated several efforts over the years to address its long-standing financial management weaknesses and ultimately achieve unqualified (clean) opinions on its financial statements. In 2005, the DOD Comptroller first issued the Financial Improvement and Audit Readiness (FIAR) Plan for improving financial management and reporting. In May 2010, the DOD Comptroller issued the FIAR Guidance to provide standardized guidance to DOD components for developing Financial Improvement Plans (FIP) to implement the FIAR Plan.

GAO's testimony focuses on (1) progress made by the DOD Comptroller in developing and issuing the FIAR Guidance, (2) challenges faced by DOD components in implementing the FIAR Guidance, and (3) improvements needed in DOD's oversight and monitoring of FIAR implementation efforts.

This statement is based on four audits that were undertaken at the request of this subcommittee and other congressional requesters to evaluate the progress DOD is making in implementing its FIAR Plan and FIAR Guidance. GAO addresses findings and recommendations from two reports being issued this week (GAO-11-830 and GAO-11-851) and preliminary information from two ongoing audits. Each audit demonstrates some of the challenges DOD faces in improving its financial management and achieving the goal of auditable financial statements by 2017.

What GAO Found

In a report issued this week, GAO concluded that the FIAR Guidance provides a reasonable methodology for the DOD components to follow in developing and implementing their FIPs. It details the roles and responsibilities of the DOD components, and prescribes a standard, systematic process components should follow to assess processes, controls, and systems, and identify and correct weaknesses in order to achieve auditability. The FIAR Guidance also requires the components to prepare and implement corrective action plans for resolving the deficiencies identified during testing and to document the results, which is consistent with federal internal control standards and related guidance.

DOD's ability to achieve audit readiness is dependent on the components' ability to effectively develop and implement FIPs in compliance with the FIAR Guidance. However, GAO's review of various DOD component efforts to achieve audit readiness found that the components experienced challenges in implementing the FIAR Guidance. Specifically:

- The Navy and the Air Force had not adequately developed the two FIPs that GAO reviewed in accordance with the FIAR Guidance. As a result, they did not conduct sufficient control and substantive testing, and reached conclusions that were not supported by the testing results.
- Auditors of the Marine Corps' Statement of Budgetary Resources (SBR) issued a disclaimer of opinion because the Marine Corps did not provide timely and relevant supporting documentation for accounting transactions and also reported that internal control weaknesses should be addressed.
- GAO's preliminary work on the Navy's and Marine Corps' Fund Balance with Treasury (FBWT) reconciliation processes identified issues with their ability to reconcile FBWT—a key step in preparing the SBR.
- Based on preliminary results, GAO identified issues in the implementation of two enterprise resource planning (ERP) systems by the Army and the Air Force. DOD has acknowledged that effective implementation of integrated systems is crucial to achieving departmentwide audit readiness.

Although DOD and its military components had established organizational structures for monitoring and oversight of audit readiness efforts, GAO found that oversight responsibilities were not effectively carried out, resulting in the ineffective implementation of FIPs and unsupported conclusions of audit readiness. For the two FIPs that GAO reviewed, neither the designated officials nor the executive committees took sufficient action to ensure that the FIPs complied with the FIAR Guidance. Effective oversight would also help ensure that lessons learned from recent efforts would be disseminated throughout the department so that others could avoid similar problems. For example, the Marine Corps' SBR audit effort provide valuable lessons that, if effectively communicated and implemented, can provide a roadmap to help other DOD components achieve audit readiness. GAO recommends actions for components to comply with the FIAR Guidance, for the Marine Corps to develop appropriate corrective action plans, and for DOD to ensure that the services consider lessons learned. DOD concurred with GAO's recommendations related to implementing the component FIPs and with three of four recommendations related to the Marine Corps SBR. Further details on DOD's comments can be found in GAO's reports.

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Chairman Carper, Ranking Member Brown, and Members of the Subcommittee:

It is a pleasure to be here today to discuss the status of the Department of Defense's (DOD) efforts to implement its Financial Improvement and Audit Readiness (FIAR) Plan to improve its financial management operations. Given the federal government's fiscal challenges, there is a significant need for transparency and for the Congress, the administration, and federal managers to have reliable, useful, and timely financial and performance information, particularly for the government's largest department. For more than a decade, DOD has been on GAO's list of federal programs and operations at high risk of being vulnerable to fraud, waste, and abuse.[1] Despite several reform initiatives, DOD's financial management remains on GAO's high-risk list today. Long-standing and pervasive weaknesses in DOD's financial management and related business processes and systems have (1) resulted in a lack of reliable information needed to make sound decisions and report on the financial status and cost of DOD activities to Congress and DOD decision makers; (2) adversely affected its operational efficiency and mission performance in areas of major weapons system support and logistics; and (3) left the department vulnerable to fraud, waste, and abuse. In addition, these long-standing financial management weaknesses have precluded DOD from being able to successfully undergo the scrutiny of a financial statement audit.[2] The National Defense Authorization Act (NDAA) for Fiscal Year 2010 mandated that DOD be prepared to validate (certify)

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

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

that its consolidated financial statements are ready for audit by September 30, 2017.[3]

In 2005, the DOD Comptroller established the DOD Financial Improvement and Audit Readiness (FIAR) Directorate to develop, manage, and implement a strategic approach for addressing the department's financial management weaknesses and for achieving auditability, and to integrate those efforts with other improvement activities, such as the department's business system modernization efforts. Also in 2005, the DOD Comptroller first issued the FIAR Plan for improving financial management and reporting. The NDAA for Fiscal Year 2010 mandated that the FIAR Plan include the specific actions to be taken to correct the financial management deficiencies that impair the department's ability to prepare timely, reliable, and complete financial management information. In May 2010, the DOD Comptroller issued the FIAR Guidance to provide standardized guidance to DOD components for developing Financial Improvement Plans (FIP) to implement the FIAR Plan. In September 2010, we reported that the department needed to focus on implementing its FIAR Plan and that the key to successful implementation would be the efforts of the DOD military components and the quality of their individual FIPs.[4]

My testimony today will focus on three key issues:

(1) progress made by the DOD Comptroller in developing and issuing the FIAR Guidance to assist DOD components in implementing the FIAR Plan;

(2) challenges in the implementation of the FIAR Guidance at the Navy, Air Force, and Marine Corps; and

(3) improvements needed in DOD's oversight and monitoring of FIAR implementation efforts.

My statement is based on four audits that we have undertaken at the request of this subcommittee and other congressional requesters to

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[3]Pub. L. No. 111-84, div. A, § 1003(a), (b), 123 Stat. 2190, 2439-40 (Oct. 28, 2009).

[4]GAO, *Department of Defense: Financial Management Improvement and Audit Readiness Efforts Continue to Evolve*, GAO-10-1059T (Washington, D.C.: Sept. 29, 2010).

evaluate the progress DOD is making in implementing its FIAR Plan and related Guidance. Two of the reports have been issued this week,[5] and we are addressing preliminary findings for the other two reports, which are in process. Each report demonstrates some of the challenges DOD faces in improving its financial management, including its ability to achieve the goal of reliable financial information and auditable financial statements by 2017:

- The first report discusses the methodology reflected in DOD's FIAR Guidance, whether selected military component FIPs adhered to the FIAR Guidance, and DOD's oversight and monitoring of the FIP process.[6] The published report includes details on the scope and methodology for this review.

- The second report addresses why auditors were unable to complete an audit of one of DOD's financial statements, the Statement of Budgetary Resources (SBR), for one military service, the U.S. Marine Corps.[7] This report also includes details on the scope and methodology for this review.

- The remaining two ongoing audits address (1) a key process for DOD's components—the Fund Balance with Treasury (FBWT) reconciliation—which illustrates one of many of the department's challenges and (2) the implementation of comprehensive, integrated business systems called enterprise resource planning (ERP) systems,[8] which DOD considers a key element to improving financial management and achieving auditability. We discussed with DOD officials the preliminary findings from these two ongoing audits that are included in this testimony and considered their comments in this statement. We plan to issue these reports in October 2011.

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[5]GAO, *DOD Financial Management: Improvement Needed in DOD Components' Implementation of Audit Readiness Efforts*, GAO-11-851 (Washington, D.C.: Sept. 13, 2011); and *DOD Financial Management: Marine Corps Statement of Budgetary Resources Audit Results and Lessons Learned*, GAO-11-830 (Washington, D.C.: Sept. 15, 2011).

[6]GAO-11-851.

[7]GAO-11-830.

[8]An ERP solution is an automated system using commercial off-the-shelf (COTS) software consisting of multiple, integrated functional modules that perform a variety of business-related tasks, such as general ledger accounting, payroll, and supply chain management.

For our work on the FBWT reconciliation, we analyzed Navy and Marine Corps policies and procedures covering the various FBWT reconciliation steps, and met with Navy, Marine Corps, and Defense Finance and Accounting Service (DFAS) officials, and performed walkthroughs of the Navy and Marine Corps FBWT processes. For our work on ERP systems, we focused on the status of two systems by reviewing the Army and Air Force Test and Evaluation Commands' reports on the systems and interviewing various DOD officials, including system users at DFAS.

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

Background

Over the years, DOD has initiated several broad-based reform efforts to address its long-standing financial management weaknesses. However, as we have reported, those efforts did not achieve their intended purpose of improving the department's financial management operations.[9] The FIAR Plan, which was first prepared in 2005, is DOD's strategic plan and management tool for guiding, monitoring, and reporting on the department's financial management improvement efforts. As such, the plan contains an incremental approach for addressing the department's financial management weaknesses and achieving financial statement auditability. The plan focuses on three goals: (1) achieve and sustain assurance on the effectiveness of internal controls, (2) develop and implement financial management systems that support effective financial management, and (3) achieve and sustain financial statement audit readiness.

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

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[9]GAO, *Financial Management: Achieving Financial Statement Auditability in the Department of Defense*, GAO-09-373 (Washington, D.C.: May 6, 2009); *DOD Financial Management: Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform*, GAO-02-537T (Washington, D.C.: Mar. 20, 2002); *Defense Management: Actions Needed to Sustain Reform Initiatives and Achieve Greater Results*, GAO/NSIAD-00-72 (Washington, D.C.: July 25, 2000).

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

In May 2010, DOD issued a revised FIAR Plan in which it introduced a new phased approach toward achieving financial statement auditability. This approach consists of five waves (or phases) of concerted improvement activities. The first two waves involve budgetary information—appropriations received[10] and the SBR. According to DOD, the components' implementation of the methodology described in the May 2010 FIAR Plan is essential to the success of the department's efforts to ultimately achieve full financial statement auditability.[11]

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[10]"Appropriations received" is an element of the SBR that represents appropriated funds made available for use by DOD components.

[11]As we have reported (GAO-11-851), the department has not yet fully defined its strategy for completing all actions necessary to achieve the FIAR goals, including actions related to the auditability of most of the department's consolidated financial statements such as the Balance Sheet and the Statement of Net Cost, and significant audit areas such as equipment valuation.

DOD's FIAR Guidance Provides a Reasonable Methodology

Consistent with prior GAO recommendations[12] and the NDAA for Fiscal Year 2010, DOD issued the FIAR Guidance in May 2010, which details the methodology for components to follow in order to achieve financial management improvements and auditability. The FIAR Guidance requires components to identify and prioritize their processes into assessable units.[13] For each assessable unit, a component is required to prepare a FIP in accordance with the steps outlined in the FIAR Guidance. For example, civilian and military pay are two assessable units for which each DOD component, such as the Army, Navy, and Air Force, must develop and implement plans in accordance with the FIAR Guidance to ensure that their civilian and military pay can be audited. The steps required for these plans include assessing processes, controls, and systems; identifying and correcting weaknesses; assessing, validating, and sustaining corrective actions; and ultimately achieving audit readiness. After a component completes its evaluation of the effectiveness of corrective actions for each assessable unit, it must determine whether each assessable unit is ready for audit. For example, the Air Force, based on its implementation of the FIAR Guidance and its FIP, planned to conclude during fiscal year 2011 whether or not its FBWT Reconciliation is reliable and ready for audit. Once a component's management determines that an assessable unit is ready for audit, the DOD Comptroller and DOD Inspector General (IG) must review the related FIP documentation to determine if they agree with management's conclusion of audit readiness.

In our report issued this week, we concluded that the FIAR Guidance provides a reasonable methodology for the DOD components to follow in developing and implementing their FIPs.[14] However, as described later in this statement, we found that implementation of the FIAR Guidance for the two assessable units we reviewed was not effective. The FIAR Guidance details the roles and responsibilities of the DOD components, and prescribes a standard, systematic process that components should follow to assess processes, controls, and systems, and identify and correct weaknesses in order to achieve auditability for each of their

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[12]GAO-09-373.

[13]An assessable unit can be any part of the financial statements, such as a line item or a class of assets (e.g., civilian pay or military equipment), a class of transactions, or it can be a process or a system that helps produce the financial statements.

[14]GAO-11-851.

assessable units. Overall, the procedures required by the FIAR Guidance are consistent with selected procedures for conducting financial statement audits, which include the following:

- **Conducting internal control and substantive testing**. Internal control testing focuses on assessing the effectiveness of controls that would prevent or detect potential misstatements in the financial statements. Substantive tests are performed to obtain evidence on whether amounts reported on the financial statements are reliable.

- **Reconciling the population of transactions to be tested**. To conduct internal control and substantive testing, a sample of the data transactions is typically selected for testing. An organization must be able to identify the complete population of transactions so that a sample can be selected and tested.

- **Conducting tests of information systems controls**. The components are required to identify, document, and test both general and application controls for key systems that process transactions. General controls[15] are the policies and procedures that apply to all or a large segment of an entity's information systems and help ensure their proper operation. Application controls, sometimes referred to as business controls, are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of data during application processing and reporting.

The FIAR Guidance also requires the components to prepare and implement corrective action plans for resolving the deficiencies identified during testing and to document the results, which is consistent with federal internal control standards and Office of Management and Budget (OMB) guidance.[16]

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[15]The objectives of general controls include safeguarding data, protecting application programs, and ensuring continued computer operations in case of unexpected interruptions.

[16]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999); and OMB Circular No. A-123, Appendix A, *Internal Control Over Financial Reporting.*

Challenges for DOD Components' Implementation of FIAR Guidance

Although the FIAR Guidance provides a reasonable methodology for improving financial management within the department, DOD's ability to achieve audit readiness is highly dependent on the components' ability to effectively develop and implement FIPs in compliance with the FIAR Guidance. Our reviews of various DOD component efforts to achieve audit readiness found that the components faced challenges in effectively implementing the FIAR Guidance, resulting in unsupported conclusions of audit readiness for Navy Civilian Pay, Air Force Military Equipment, and the Marine Corps SBR. Our preliminary work also found that a key element of basic financial management—reconciling the FBWT account—was not being done properly on a regular basis and the weaknesses were not properly identified or corrected by the Navy or the Marine Corps. Finally, to achieve fundamental improvements in financial management, DOD recognizes the importance of transforming its business operations through the implementation of ERP systems. Our preliminary work on two key ERPs that have been partially deployed found significant issues in both systems.

FIPs for Navy Civilian Pay and Air Force Military Equipment Were Incomplete and Ineffective

Our review of the FIPs for Navy Civilian Pay and Air Force Military Equipment found that neither FIP complied with the FIAR Guidance and contained unsupportable conclusions.[17] We found similar deficiencies in both FIPs, which included the following:

- The Navy and Air Force did not conduct sufficient control and substantive testing, and contained unsupportable conclusions that the amounts being reported for Navy Civilian Pay and Air Force Military Equipment were reliable.

- The Navy and Air Force did not complete reconciliations of the population of transactions. As a result, the components could not ensure that their testing results could be projected to the populations of Navy civilian pay transactions and Air Force military equipment.

- The Navy and Air Force did not fully test information systems controls. The Navy's system testing did not include essential areas such as periodic reviews of user access authorizations and logs of changes to security access authorizations. The Air Force's FIP did not include

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[17]GAO-11-851.

any documentation of control testing for the two systems that maintain its military equipment data.

- The Navy and Air Force did not fully develop and implement corrective action plans to address deficiencies they identified during testing. The Navy had not developed any corrective action plans at the time that it incorrectly concluded that its civilian pay was ready for audit. The Air Force had developed some plans related to its military equipment weaknesses but not for all deficiencies identified, and moreover, it had not implemented any of the corrective actions at the time that it stated that its military equipment was ready for audit. Both components stated that they planned to complete corrective actions in the future.

Because of the deficiencies we identified, neither FIP that we reviewed provided sufficient support for the components' conclusions that the balances for Navy Civilian Pay and Air Force Military Equipment were ready for audit. Our report includes recommendations for DOD to ensure that components' FIPs comply with the FIAR Guidance. Navy officials stated that they were taking action to address the issues identified and planned to submit a revised FIP by March 2012. Air Force officials also indicated that they were taking action to address the issues identified.

Marine Corps Statement of Budgetary Resources Was Not Auditable

After DOD established budgetary information as a priority in its FIAR Plan, the Marine Corps was identified as the pilot military service for an audit of the SBR. The SBR is designed to provide information on authorized budgeted spending authority and links to the Budget of the United States Government (President's Budget), including budgetary resources, availability of budgetary resources, and how obligated resources have been used.[18] Because the Marine Corps is a military service within the Department of the Navy, its success in achieving audit readiness is intended to pave the way for the Navy to undergo an SBR

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[18]Budgetary resources include the amount available to enter into new obligations and to liquidate them. Budgetary resources are made up of new budget authority (including direct spending authority provided in existing statute and obligation limitations) and unobligated balances of budget authority provided in previous years.

audit. However, the DOD IG issued a disclaimer of opinion[19] on the Marine Corps' fiscal year 2010 SBR because the Marine Corps did not provide timely and relevant supporting documentation for accounting transactions and disbursements in key areas, which prevented the auditors from completing the audit by the November 15, 2010, reporting deadline. In addition, the auditors reported that ineffective internal control and ineffective controls in key financial systems should be addressed to ensure the reliability of reported financial information.[20] The auditors identified 70 findings and made 139 recommendations to address the issues. Examples of the problems identified include the following:

- The DFAS location in Cleveland, Ohio, (DFAS–CL)—which performs accounting, disbursing, and financial reporting services for the Marine Corps—did not have effective procedures in place to ensure that supporting documentation for transactions was complete and readily available to pass basic audit transaction testing. For example, the auditors found that DFAS staff had only retained selected pages of the documents supporting payment vouchers, such as the voucher cover sheet, and did not have the purchase order, receiving report, and the invoice to support payments made.

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

- The auditors found ineffective controls over three major information technology (IT) systems used by the Marine Corps and reported

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

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

numerous problems that required resolution.[21] For example, the auditors identified a lack of controls over interfaces between systems to ensure completeness of the data being transferred. System interface controls are critical for ensuring the completeness and accuracy of data transferred between systems.

Further, in addressing the 70 audit findings and related 139 recommendations, we found that the Marine Corps did not develop an effective overall corrective action plan that identified risks, prioritized actions, and identified required resources in order to help ensure that actions adequately respond to recommendations.[22] Instead, its approach to addressing auditor findings and recommendations for its prior and current audit efforts focuses on short-term corrective actions necessary to support heroic efforts to produce reliable financial reporting at year-end. Such efforts may not result in sustained improvements over the long term that would help ensure that the Marine Corps could routinely produce sound data on a timely basis for decision making. While the Marine Corps has implemented an extensive SBR remediation effort that is focused on individual initiatives to address the 70 audit findings and 139 related recommendations, such an approach could result in inefficiencies and ineffectiveness. As of July 18, 2011, the Marine Corps reported that actions on 88 of the 139 recommendations, including weaknesses related to accounting and financial reporting and IT systems, were fully implemented. However, the completeness and effectiveness of the Marine Corps' actions have not yet been tested. DOD IG auditors told us that tests performed during the Marine Corps' fiscal year 2011 SBR audit effort will determine whether and to what extent the problems identified during the fiscal year 2010 SBR audit effort have been resolved. They also confirmed that as of August 25, 2011, the Marine Corps had remediated the problems on 11 of the IT audit recommendations.

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

[22]Some of these elements are consistent with the FIAR Guidance requirements for a corrective action plan, such as identifying required resources and ensuring that actions address the identified deficiencies.

Furthermore, as described in our report being released this week, we found that the design of many of the Marine Corps actions relied on monitoring, a detective control; high-level initial fixes that did not address root causes; and other actions that were not consistent with the related auditors' recommendations.[23] For example:

- Marine Corps remediation actions for 22 of the 56 accounting and financial reporting recommendations rely on issuing guidance, monitoring, or both, in an attempt to quickly address identified weaknesses. However, correcting underlying causes requires process improvements and in some cases, system changes.

- Remediation actions for 20 of the 139 recommendations were not consistent with the related recommendations. For example, the auditors identified unliquidated obligations on old contracts for which performance was substantially complete. The auditors found that the Marine Corps did not have an effective process for reviewing undelivered orders and unliquidated obligations, and recommended that they strengthen these controls, whose weaknesses were the root cause of the finding. In response, Marine Corps officials stated that they had implemented a robust review process for validating obligations. However, the auditors reported that the Marine Corps developed effective written procedures but found problems with the implementation of those procedures. Thus, the Marine Corps did not fully address the recommendation or root cause of the problem.

- The Marine Corps disagreed with six auditor recommendations to strengthen SABRS system controls over information processing. For example, for three recommendations related to password and log-on controls, the Marine Corps action states that the Defense Information System Agency (DISA) and not DFAS is responsible for the actions. However, Marine Corps officials told us they had not contacted DISA officials to ensure that they would address the recommendations.

Our report includes recommendations to the Secretary of the Navy to direct the Marine Corps to develop a comprehensive, risk-based corrective action plan, confirm that corrective actions fully address auditor findings, and work more closely with service providers, such as DFAS, to clarify their roles and responsibilities on corrective actions that require

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[23]GAO-11-830.

cross-component work. In commenting on our report, the Navy said that it is working to address the auditor-identified deficiencies. Further details on the Navy's comments and our evaluation of them can be found in our report.

Issues with Navy and Marine Corps Processes for Reconciling Fund Balance with Treasury (FBWT)

Reconciling the FBWT account is a key financial management control. FBWT is an asset account that reflects the available budget spending authority of federal agencies. Reconciling a FBWT account with Treasury records is a process similar in concept to reconciling a check book with a bank statement. However, within the large, complex DOD environment, the FBWT reconciliation involves reconciliations between several different systems, such as the DOD components' general ledgers, the DOD-wide general ledger, DOD's cash accountability system, and Treasury records. FBWT reconciliations are a key internal control for ensuring that all receipt and disbursement transactions have been properly recorded in federal agency accounting records. Effective fund balance reconciliations serve as a detective control for identifying unauthorized and unrecorded transactions at a federal agency or at the U.S. Treasury.

A successful audit of the SBR is dependent on an auditable FBWT, which includes the ability to reconcile the FBWT account with the Treasury records. However, our preliminary work has identified issues with the Navy and Marine Corps' implementation of effective processes for reconciling their FBWT, including issues related to financial management systems and certain policies and procedures, training, and supervisory review and approval. For example:

- DOD has not tested application controls over the Defense Cash Accountability System (DCAS)—the department's system of record for all cash activity. Navy, Marine Corps, and DFAS officials stated that they have identified over 650 system deficiencies that affect DCAS data reliability, and that over 200 of the identified deficiencies affect audit readiness. They identified the top 20 deficiencies that require immediate attention; however, they stated that a time frame for addressing these top 20 issues had not yet been established.

- DFAS did not maintain adequate documentation for the sample of items we tested to enable an independent evaluation of its efforts to research and resolve differences.

- Navy and DFAS policies and procedures did not contain detailed information on the roles and responsibilities of organizations and

personnel and the process for identifying, researching, and resolving discrepancies, including maintaining required supporting documentation. The policies and procedures also did not require supervisory review and approval of reconciliation efforts and results.

Navy, Marine Corps, and DFAS officials acknowledged that existing policies and procedures are inadequate. They also stated that the base realignment and closure changes in 2006 through 2008 resulted in a loss of experienced DFAS-CL personnel and that the remaining staff have not received the needed training. Navy officials stated that they are currently developing a Plan of Actions and Milestones (POAM) to address weaknesses that affect the Navy and Marine Corps' audit readiness, including reconciling FBWT records.

We will report more fully on these issues, including actions DOD is taking to address them, in our forthcoming report.

Issues with Implementation of Two of DOD's Enterprise Resource Planning (ERP) Systems

The implementation of an integrated, audit-ready systems environment through the deployment of ERP systems underlies all of DOD's financial improvement efforts and is crucial to achieving departmentwide audit readiness. According to DOD, the successful implementation of the ERPs is not only critical for addressing long-standing weaknesses in financial management, but equally important for helping to resolve weaknesses in other high-risk areas such as business transformation, business system modernization, and supply chain management. Successful implementation will support DOD by standardizing and streamlining its financial management and accounting systems, integrating multiple logistics systems and finance processes, providing asset visibility for accountable items, and integrating personnel and pay systems. Previously, we reported that delays in the successful implementation of ERPs have extended the use of existing duplicative, stovepiped systems, and have continued the funding of these systems longer than anticipated.[24] To the degree that these business systems do not provide the intended capabilities, DOD's goal of departmentwide audit readiness by the end of fiscal year 2017 could be jeopardized.

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

Over the years, we have reported that DOD has not effectively employed management controls to ensure that the development and implementation of ERPs deliver the promised capabilities on time and within budget. As we reported in October 2010, DOD has identified 10 ERPs—1 of which had been fully implemented—as essential to its efforts to transform its business operations.[25] We are currently reviewing the status of two of these ERPs—the Army's General Fund Enterprise Business System (GFEBS) and the Air Force's Defense Enterprise Accounting and Management System (DEAMS). GFEBS is intended to support the Army's standardized financial management and accounting practices for the Army's general fund, except for funds related to the Army Corps of Engineers. The Army estimates that GFEBS will be used to control and account for approximately $140 billion in annual spending. DEAMS is intended to provide the Air Force with the entire spectrum of financial management capabilities and is expected to maintain control and accountability for approximately $160 billion. GFEBS is expected to be fully deployed during fiscal year 2012, is currently operational at 154 locations, including DFAS, and is being used by approximately 35,000 users. DEAMS is expected to be fully deployed during fiscal year 2016, is currently operational at Scott Air Force Base and DFAS, and is being used by about 1,100 individuals.

Our preliminary results identified issues related to GFEBS and DEAMS providing DFAS users with the expected capabilities in accounting, management information, and decision support. To compensate, DFAS users have devised manual workarounds and several applications to obtain the information they need to perform their day-to-day tasks. The Army and Air Force have stated that they have plans to address these issues, and the Army has plans to validate the audit readiness of GFEBS in a series of independent auditor examinations over the next several

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

fiscal years. For DEAMS, the DOD Milestone Decision Authority[26] (MDA) has directed that the system is not to be deployed beyond Scott Air Force Base until the known system weaknesses have been corrected and the system has been independently tested to ensure that it is operating as intended. Examples of the issues in these systems that DFAS users have identified include the following:

GFEBS

- The backlog of unresolved GFEBS trouble tickets has continued to increase from about 250 in September 2010 to approximately 400 in May 2011. Trouble tickets represent user questions and issues with transactions or system performance that have not been resolved. According to Army officials, this increase in tickets was not unexpected since the number of users and the number of transactions being processed by the system has increased, and the Army and DFAS are taking steps to address issues raised by DFAS.

- Approximately two-thirds of invoice and receipt data must be manually entered into GFEBS from the invoicing and receiving system (i.e., Wide Area Work Flow).[27] DFAS personnel stated that manual data entry will eventually become infeasible due to increased quantities of data that will have to be manually entered as GFEBS is deployed to additional locations. Army officials acknowledged that there is a problem with the Wide Area Work Flow and GFEBS interface and that this problem reduced the effectiveness of GFEBS, and that they are working with DOD to resolve the problem.

- GFEBS lacks the ability to run ad hoc queries or search for data in the system to resolve problems or answer questions.[28] The Army has

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

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

[28]Office of Federal Financial Management, *Core Financial System Requirements* state a Core financial system must provide an integrated ad hoc query capability to support agency access to and analysis of system-maintained financial data.

recognized this limitation and is currently developing a system enhancement that they expect will better support the users' needs.

DEAMS

- Manual workarounds are needed to process certain accounts receivable transactions such as travel debts. DFAS personnel stated that the problem is the result of the data not being properly converted from the legacy systems to DEAMS.

- DFAS officials indicated that they were experiencing difficulty with some of the DEAMS system interfaces.[29] For example, the interface problem with the Standard Procurement System has become so severe that the interface has been turned off, and the data must be manually entered into DEAMS.

- DFAS officials stated that DEAMS does not provide the capability—which existed in the legacy systems—to produce ad hoc reports that can be used to perform the data analysis needed to perform daily operations.[30] They also noted that when some reports are produced, the accuracy of those reports is questionable.

DFAS users also told us that the training they received focused more on how GFEBS and DEAMS were supposed to operate, rather than providing DFAS personnel training about how to use these systems to perform their day-to-day operations. The Army acknowledged that from a DFAS perspective, the training should have shown DFAS how they could use GFEBS to perform tasks such as the reconciliation of accounts. To help address this training issue, DFAS is in the process of developing courses and desk guides suitable for DFAS employees who use GFEBS and DEAMS on a day-to-day basis.

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

[30]Office of Federal Financial Management, *Core Financial System Requirements* state that a Core financial system financial transactions must deliver an integrated ad hoc query capability to support agency access to and analysis of system maintained financial data.

We will report more fully on these issues, including DOD's actions to address them, in our forthcoming report.

Improved Monitoring and Oversight of Component Financial Improvement Plans (FIP) Are Needed

In one report we issued this week, we found that weaknesses in the Navy and Air Force FIAR Plan implementation efforts indicate that the monitoring and oversight of such efforts have not been effective.[31] Although we found that DOD and its military components had established appropriate organizational structures for monitoring and oversight of audit readiness efforts, oversight responsibilities were not always effectively carried out. Both DOD and the components have established senior executive committees as well as designated officials at the appropriate levels to monitor and oversee their financial improvement efforts. These committees and individuals have also generally been assigned appropriate roles and responsibilities. However, we found that component officials as well as the oversight committees at both the component and DOD levels did not effectively carry out their monitoring responsibilities for the Navy Civilian Pay and Air Force Military Equipment FIPs. Specifically, for these two FIPs that we reviewed, neither individual officials nor the executive committees took sufficient action to ensure that the FIPs were accurate or complied with the FIAR Guidance. As a result, the Navy concluded that its civilian pay was ready for audit, as did the Air Force with respect to its military equipment, even though they did not have sufficient support to assert audit readiness.

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

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

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[31]GAO-11-851.

applies lessons learned. For example, the results of the Marine Corps' SBR audit effort provide valuable lessons on preparing for a first-time financial statement audit. As we recently testified, lessons learned from this audit effort can provide a roadmap to help other DOD components achieve audit readiness.[32] While this audit effort provided numerous issues for the other military services to consider in their audit readiness efforts, we identified and reported on five overall lessons that are critical to success.[33] Specifically, the Marine Corps' SBR experience demonstrated that prior to asserting financial statement audit readiness, DOD components must be able to perform the following procedures;

- **Confirm completeness of populations of transactions and address any abnormal transactions and balances**. The Marine Corps SBR auditors made multiple requests for transaction-level detail for key SBR accounts. Navy officials told us that they identified problems with the way transactions map to general ledger accounts, which makes it difficult to identify transaction populations. Navy officials noted that these problems impeded the Marine Corps SBR audit effort and also prevent the reconciliation of Unadjusted to Adjusted Trial Balances, FBWT reconciliations, and overall funds control.

- **Test beginning balances**. A first-year SBR audit requires substantial testing to confirm beginning balances. Navy officials noted that earlier audit readiness efforts were not sufficient to confirm beginning balances, and problems identified with the assignment of general ledger account numbers and mapping of transactions to the proper accounts will need to be resolved to ensure the auditability of beginning balances.

- **Perform key reconciliations**. The Marine Corps did not have processes in place to reconcile key accounts such as FBWT. In addition, the Marine Corps had to make repeated attempts before it could reconcile the Unadjusted Trial Balance to the Adjusted Trial Balance. This reconciliation is an important step to verify that the SBR is accurate.

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[32]GAO, *DOD Financial Management: Numerous Challenges Must Be Addressed to Improve Reliability of Financial Information*, GAO-11-835T (Washington, D.C.: July 27, 2011).

[33]GAO-11-830.

- **Provide timely and complete response to audit documentation requests**. The auditors reported that the Marine Corps, through its service provider, DFAS, did not consistently provide timely and accurate audit documentation. Without such documentation, the auditors were unable to determine whether a given transaction was authorized, whether the goods or services were received, whether the invoice was approved for payment, or whether the funds disbursed were correct.

- **Verify that key IT systems are compliant and auditable**.[34] The auditors informed the Marine Corps of numerous control weaknesses they identified in key systems, including some DOD-wide systems, which affected auditability. The auditability of key systems, including military payroll systems, accounting systems, and financial reporting systems, is essential to achieving and sustaining an audit opinion.

These five critical lessons from the Marine Corps SBR audit effort are all addressed in the FIAR Guidance as procedures that must be performed before an assessable unit can be considered ready for audit. As the Army, Navy, and Air Force move forward in developing and implementing their FIPs, in our report we recommend that they take into account the lessons learned during the course of pilot audit efforts, such as the Marine Corps SBR. Navy financial management officials indicated that they are aware of the Marine Corps lessons and that they are updating their audit readiness plan to address all five critical lessons. Army and Air Force officials indicated their awareness of some of these findings but only provided information on their efforts regarding FBWT reconciliations and ERP implementations. As noted above, DOD generally agreed with the need to effectively communicate lessons learned among its components. Our report more fully describes DOD's comments and our evaluation of them.

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[34]DOD financial management systems are required by the Federal Financial Management Improvement Act of 1996 (FFMIA) to comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level. Pub. L. No. 104-208, div. A, title VIII, § 803, 110 Stat. 3009, 3009-390 (Sept. 30, 1996).

Concluding Observations

With the FIAR Plan and related FIAR Guidance, DOD has established a reasonable strategy and methodology for improving its financial management. However, it faces considerable implementation challenges and has much work to do if it is to meet the goal of audit readiness by the end of fiscal year 2017. These challenges, as we have previously testified, include (1) maintaining committed and sustained leadership; (2) developing and implementing an effective plan to correct internal control weaknesses; (3) establishing accountability and effective oversight to monitor progress; and (4) successfully implementing ERP systems consistent with an effective corporate enterprise architecture.[35] It is critical that DOD's current initiatives be continued and provided with sufficient resources. Oversight and monitoring will also play a key role in ensuring that DOD's plans are implemented as intended and that lessons learned are identified and effectively disseminated. Absent continued momentum and necessary future investments, the current initiatives may falter, similar to previous efforts. Continued congressional oversight will be an important factor in helping to ensure the department's success.

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

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. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. GAO staff who made key contributions to this testimony include Abe Dymond, Assistant Director; Francine Delvecchio; Kristi Karls; Sheila Miller; Heather Rasmussen; and David Yoder.

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[35]GAO-11-835T.