



# NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

## THESIS

**EXAMINATION OF SUCCESS FACTORS IN GETTING  
AND SUSTAINING CLEAN AUDIT OPINIONS WITHIN  
DOD COMPONENTS**

by

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December 2006

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**EXAMINATION OF SUCCESS FACTORS IN GETTING AND SUSTAINING  
CLEAN AUDIT OPINIONS WITHIN DOD COMPONENTS**

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## **ABSTRACT**

Over the last fifteen years, beginning with the Chief Financial Officers Act of 1990, the Federal government and specifically, the Department of Defense have been in an ambitious financial reform effort. However, the Government Accountability Office, the efficiency, economy and effectiveness experts who report to the U.S. Congress continue to criticize the DoD's efforts at reform. This paper applies a specific methodology to determine if success factors, i.e. factors that substantially contribute to achieving a "clean" audit opinion within governmental organizations, exist within DoD components. This thesis seeks to answer two questions: whether DoD agencies with clean, disclaimed, or qualified audit opinions display common success factors, found in prior research, that contribute to clean audit opinions and whether the DoD, as a whole, exhibits those success factors as well. The benefits of this study include contributing to DoD's efforts to achieve clean audit opinions and the benefits contained therein. Moreover, this paper seeks to extend the examination of DoD components that are required to submit independent, audited financial statements. Finally, this paper provides specific recommendations based upon common strategies of unqualified-audit DoD agencies to those DoD components that have yet to obtain a clean audit opinion.

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## EXECUTIVE SUMMARY

Over the last fifteen years, beginning with the Chief Financial Officers Act of 1990 (CFO Act), the Federal government and specifically, the Department of Defense (DoD) have been engaged in an ambitious financial reform effort. However, the Government Accountability Office (GAO) continues to criticize DoD's efforts at reform. To answer the question of whether the DoD is making positive strides in complying with the CFO Act, this study investigated selected reporting entities that comprise the Department of Defense to determine if those components are making progress in gaining or sustaining clean audit opinions. If a critical mass of Defense components achieves auditable financial statements, then the DoD should logically follow.

This research uses Douglas A. Brook's study *Audited Financial Statements: Getting and Sustaining "Clean" Opinions*, as its methodology. Financial management policy documents were reviewed and financial management officials were interviewed either by telephone or via e-mail. The DoD components who responded to this study were: the U.S. Army, U.S. Air Force, U.S. Navy, the Defense Finance and Accounting Service, the Military Retirement Fund, the Defense Commissary Agency, the Defense Information Systems Agency and the Defense Logistics Agency.

This thesis addresses two questions: whether DoD components with clean, qualified or disclaimed audit opinions display the success factors that contribute to clean audits found by Brook and secondly, whether those common traits may be prescriptive for the DoD as a whole. Specifically, six success factors found in organizations with successful audit outcomes were examined: leadership commitment, positive resourcing, partnering with auditors (the Department of Defense Inspector General or DoD IG), cooperation with non-financial managers, short-term systems and extraordinary effort.

## Findings

All three services (the Army, the Air Force, and the Navy) were all graded positively on leadership commitment. However, expanded leadership commitment is essential to: focus the audit readiness effort, assign resources, and approve the auditability plan.

The U.S. Army and the U.S. Air Force respondents expressed mild dissatisfaction with the funding effort for financial management reform. If leadership commits to a goal of financial management improvement and audit readiness but under-resources the effort, delay and loss of impetus is risked.

All three uniformed services were graded negatively for success factor partnering with Inspector General. It is not because the services have been neglecting this relationship; it is that the relationship is still in its infancy. Culture change, a shifting of the mission, and a learning curve of new skill sets are all causes of the tentative relationship between accounting staffs and the DoD IG.

The lack of partnering with the DoD IG is a contentious issue. Supporters of the status quo say partnering with the DoD IG would undermine the independence of the IG and make their assertions suspect.

All three services were graded as absent for the success factor: cooperation of non-financial managers. The reasons for this uncooperativeness were given as follows: lack of education, prioritization, and organizational biases. All respondents, whether successful or not in auditability, reported that educating non-financial managers and the non-financial workforce was their number-one obstacle in success factor cooperation of non-financial managers.

The Army and the Navy were graded negatively for the presence of success factor short-term systems. Each service opposed short-term systems on philosophical grounds. The Army and Navy reported that short-term systems would detract from the effort to develop a core financial management system. While both services have directed their financial modernization effort into Enterprise Resource Planning (ERP) systems, the successfully audited components have some counterpoints worth considering.

Both the Army and the Air Force were graded negatively for success factor: extraordinary effort. The Navy was graded positively but the respondent for the Navy said that extraordinary effort was not the Navy's goal; a deliberate, incremental approach was the goal.

### Recommendations

Congress should fence-off funding for business transformation. Appropriating money for financial management transformation will send a message that the goals of auditability--transparency, reliability and timeliness--are not simply unfunded mandates levied on a financially-constrained DoD. With Congressional funding, the services would have resources legally set aside for business modernization not under the control of DoD. The services could continue to pursue independent paths to auditability but a lack of resources would cease to be an obstacle.

The DoD must ensure that resources are applied not only to the shorter-term auditability effort but also the longer-term audit-readiness sustainability effort. Recognition that these are two separate but complementary efforts is an important factor as well.

This research concludes that utilizing the DoD IG as advisors will strengthen the audit readiness efforts of the components. The DoD IG's expertise is only partially exploited when utilized only after the financial statements are completed. Mini-audits throughout the year and an expanded, continuous DoD IG-led education effort would help components immeasurably.

Accountants and comptrollers should take the lead in educating non-financial managers. However, both the MRF and the DeCA respondents went a step further: if cooperation could not be gained voluntarily, organizational leaders should compel cooperation.

The lack of non-financial manager cooperation reported across the three uniformed service components is troubling. This is especially true when the fact that Brook found that organizations with cooperation of non-financial managers received 2.63 clean opinions across three years and components without that

cooperation received 0 clean opinions across that same time period. Clearly, this cooperation is essential and needs to be cultivated across the DoD.

The FIAR education plan must also receive greater emphasis. The current educational component of the FIAR Plan is clearly inadequate given the lack of awareness of its existence across the DoD. The lack of education reported by all respondents for the DoD IG and non-financial management remains an ongoing concern. This lack of education applies to financial managers as well. Proprietary or financial accounting skill sets must be stressed; not simply budgetary skill sets.

All three successful components point out that short-term systems or workarounds are inevitable and useful. The DoD must highlight to its components that short-term systems or workarounds are essential and inevitable in the quest for audit readiness. The continued operation of legacy financial systems requires that workarounds be utilized not shunned.

The fact that the uniformed service components of the DoD reported that extraordinary effort was not their strategy is disappointing. This fact is troubling because successful DoD components report there is no way to achieve auditability without extraordinary/Herculean efforts. The DoD must emphasize to its components that extraordinary effort is the norm.

### Conclusion

As illustrated in its components above, the DoD still has leadership and management challenges in its quest for financial improvement and auditability. In its results-driven approach to financial management reform vis-à-vis the F Improvement and Audit Readiness (FIAR) Plan, the DoD incurs the risk of presiding over a stove-piped approach. The DoD needs to strengthen its leadership role in light of the six success factors listed above to ensure auditability across its twenty-four components.

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Boys, thank you for understanding our time apart. I hope you understand the pride and deep satisfaction I receive from giving my work my utmost effort. I thank God that I am privileged to serve in the United States Navy. Whatever you do, strive to become good men and good citizens.

Lastly, to my beautiful wife, Kari, you are my rock and my shield. I love you very much.

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## LIST OF ABBREVIATIONS

ACE	Audit Committee Executives
AFIR&I	Air Force Information Reliability & Improvement
AICPA	American Institute of Certified Public Accountants
ASA (FM&C)	Assistant Secretary of the Army (Financial Management & Comptroller)
ASAF (FM&C)	Assistant Secretary of the Air Force (Financial Management & Comptroller)
ASN (FM&C)	Assistant Secretary of the Navy (Financial Management & Comptroller)
BMMP	Business Management Modernization Plan
BTA	Business Transformation Agency
C-ERP	Converged Enterprise Resource Program
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFO Act	Chief Financial Officers Act of 1990
COTS	Commercial Off The Shelf
DAI	Defense Agencies Initiative
DEAMS	Defense Enterprise Accounting and Management System
DeCA	Defense Commissary Agency
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DLA	Defense Logistics Agency
DOA	Department of the Army
DOAF	Department of the Air Force
DoD	Department of Defense
DODIG	Department of Defense Inspector General
DON	Department of the Navy
DONFIP	Department of the Navy Financial Improvement Plan
ERP	Enterprise Resource Plan
FFMIA	Federal Financial Management Improvement Act of 1996

FIAR	Financial Improvement and Audit Readiness Plan
FIP	Financial Improvement Plan
FM	Financial Management
FY	Fiscal Year
FYDP	Future Years' Defense Plan
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GFEBs	General Fund Enterprise Business System
GMRA	Government Management Results Act of 1994
GPRA	Government Performance Results Act of 1993
GWOT	Global War On Terror
IG	Inspector General
MRF	Military Retirement Fund
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
PART	Program Assessment Rating Tool
SFIS	Standard Financial Information Structure
USA	United States Army
USAF	United States Air Force
USN	United States Navy
USSOCOM	United States Special Operations Command

# I. INTRODUCTION

## A. BACKGROUND

Over the last fifteen years, beginning with the Chief Financial Officers Act of 1990 (CFO Act), the Federal government and specifically, the Department of Defense (DoD) have been engaged in an ambitious financial reform effort. However, the Government Accountability Office (GAO), the efficiency, economy, and effectiveness experts who report to the U.S. Congress, continue to criticize DoD's efforts at reform. In fact, Comptroller General David M. Walker states that the DoD's deficiencies represent the largest obstacle to producing reliable government-wide financial statements.<sup>1</sup>

This paper applied a specific methodology to determine if success factors, i.e. factors that substantially contribute to achieving an unqualified or "clean" audit opinion within governmental organizations, exist within DoD components.

Several components within DoD have achieved and continue to achieve unqualified or "clean" opinions in audits performed either internally or by the DoD Inspector General's office (DODIG) or the Government Accountability Office (GAO). To answer the question of whether the DoD is making positive strides in complying with the CFO Act, this study investigated the Defense components that comprise the Department of Defense and determined if those components are making progress in gaining or sustaining clean audit opinions themselves. If a critical mass of Defense components achieves auditable financial statements, then the DoD should logically follow.

### 1. The Problem

DoD still has billions of dollars in disbursements that do not match to specific obligations. There continue to be overpayments to defense contractors who may or may not be delivering service for payment. Anti-deficiency Act

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<sup>1</sup> Mandel and McIntire Peters, "Fiscal Responsibility", GOVEXEC, p. 1, October, 2006.

violations (either over-obligating funds or obligating funds before spending authority is received) still occur. A 2001 GAO study stated:

Ineffective asset accountability and the lack of effective internal controls continue to adversely affect visibility over its [DoD's] estimated \$1 trillion investment in weapon systems and inventories...Further, unreliable cost and budget information related to nearly a reported \$1 trillion of liabilities and about \$347 billion of net costs negatively affects DoD's ability to effectively measure performance, reduce costs, and maintain adequate funds control.<sup>2</sup>

A 2004 GAO study phrased it more succinctly: "To date, none of the military services has passed the test of an independent financial audit because of pervasive weaknesses in internal control and processes and fundamentally flawed business systems."<sup>3</sup> Clearly, implementation of business and financial reform efforts are viewed as inconsistent and uncoordinated.

## **2. CFO Act of 1990**

The CFO Act of 1990 was enacted not only to improve financial management and internal controls of the Executive branch of the U.S. government but also to improve public accountability. GAO criticism leads to the conclusion that timely, reliable, and comprehensive financial information is still not available within the DoD.

The Act establishes "a leadership structure (Chief Financial Officers at all Executive branch components), provides for long-range planning, requires audited financial statement, and strengthens accountability reporting."<sup>4</sup> The Act was intended to provide audited financial statements and clearly defined practices to provide timely, useful financial information to agency leadership.

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<sup>2</sup> GAO, "Integrated Approach, Accountability, and Incentives are Keys to Effective Reform", 2001.

<sup>3</sup> GAO, "Department of Defense: Financial and Business Management Transformation Hindered by Long-Standing Problems", 4-5, 2004.

<sup>4</sup> GAO/AFMD-12.19.4,6, September, 1991.

### 3. What is a “Clean” Opinion

An “unqualified” or “clean” audit opinion is based upon the finding by the auditor that the financial statements fairly represent the finances of the component according to Generally Accepted Government Auditing Standards (GAGAS). GAGAS incorporate the standards and reporting requirements of the American Institute of Certified Public Accountants (AICPA). The goal of GAGAS is to mirror the standards of auditing for public companies except for deviations approved by the Comptroller General.<sup>5</sup> This is one of the primary goals of the CFO Act of 1990.

A typical “unqualified” audit opinion contains three paragraphs. The first paragraph is a statement that the financial statements of the entity have been audited and are the responsibilities not of the auditing firm but rather of the organization being audited.

The second paragraph states that the audit has been conducted according to Generally Accepted Government Auditing Standards. GAGAS refer to:

- a. Auditors’ professional qualifications and the quality of their work
- b. performance of field work and the characteristics of meaningful reporting<sup>6</sup>

The third paragraph gives the auditor’s opinion with regard to the financial statements. Sometimes the auditor may include explanatory paragraphs describing how the audit opinion was reached.<sup>7</sup>

In addition to an unqualified or clean opinion, there are three other opinion categories. The four opinion categories are listed as follows:

- a. Unqualified Opinion- that the financial statements present fairly, in all material respects, the financial position and prospects of the entity, in conformance with Generally Accepted Accounting Principles (GAAP) [and GAGAS].
- b. Qualified Opinion- that, except for the matters given “qualified” opinions, the financial statements present fairly, in all material

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<sup>5</sup> GAO-03-673G, 77, 2003.

<sup>6</sup> Ibid. 3, 2003.

<sup>7</sup> Gibson, 2007, p. 50.

respects, the financial position and prospects of the entity in conformance with GAAP [and GAGAS].

c. Adverse Opinion- that the financial statements do not present fairly the financial position and future prospects of the entity in conformance with GAAP [and GAGAS].

d. Disclaimer of Opinion- that the auditor cannot express an opinion of the financial statements due to lack of information or the scope of the audit is insufficient.<sup>8</sup>

#### **4. Laws Requiring DoD Financial Management Reform**

The current reform effort within the DoD is in response to several acts passed by Congress mandating financial management reform. A brief overview of these laws is provided below:

The Government Performance and Results Act of 1993 (GPRA) was enacted because Congress determined two things:

a. Federal managers are seriously disadvantaged in their efforts to improve program efficiency and effectiveness because of insufficient articulation of program goals and inadequate information on program performance.

b. Congressional policymaking, spending decisions and program oversight are seriously handicapped by insufficient attention to program performance and results.<sup>9</sup>

The aims of the Act were to: systematically hold Federal components accountable for achieving program results; initiate program performance reform by setting program goals, measuring program performance against those goals, and reporting publicly on their progress; improve Federal program effectiveness and public accountability by focusing on results, service quality, and customer satisfaction; help Federal managers improve service delivery by requiring that they plan and by providing them with feedback, improve congressional decision-making by providing more objective information on the relative effectiveness and

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<sup>8</sup> Gibson, 2007, p. 50.

<sup>9</sup> <http://www.whitehouse.gov/omb/mgmt-gpra/gplaw2m.html>, 1, April, 2006.

efficiency of Federal programs and spending; and improve internal management of the Federal Government.<sup>10</sup>

The Federal Financial Management Improvement Act of 1996 (FFMIA) was enacted by Congress because it was found that most Federal components still weren't following Federal accounting standards. Also, Congress found that financial management information was still insufficient for Federal agency executives to make timely, fact-based financial decisions. Specifically, the Act:

- a. Provides for consistency of accounting by an agency from one fiscal year to the next and uniform accounting standards throughout the Federal Government;
- b. Requires Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, to the citizens, the Congress, the President, and agency management, so that programs and activities can be considered based on their full costs and merits;
- c. Increases the accountability and credibility of federal financial management;
- d. Improves performance, productivity and efficiency of Federal Government financial management;
- e. Establishes financial management systems to support controlling the cost of Federal Government;
- f. Builds upon and complements the Chief Financial Officers Act of 1990 (Public Law 101-576; 104 Stat. 2838), the Government Performance and Results Act of 1993 (Public Law 103-62; 107 Stat. 285) and the Government Management Reform Act of 1994 (Public Law 103-356; 108 Stat. 3410); and
- g. Increases the capability of components to monitor execution of the budget by more readily permitting reports that compare spending of resources to results of activities.<sup>11</sup>

The Government Management Reform Act of 1996 (GMRA) expanded the Chief Financial Officers Act. GMRA requires the twenty-four agencies

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<sup>10</sup> <http://www.whitehouse.gov/omb/mgmt-gpra/gplaw2m.html>, 2, April, 2006

<sup>11</sup> [http://www.whitehouse.gov/omb/financial/ffs\\_ffmia.html](http://www.whitehouse.gov/omb/financial/ffs_ffmia.html), 2, April, 2006.

responsible for ninety-nine percent of federal spending to prepare annual audited financial statements.<sup>12</sup>

The Government Performance and Results Act of 1993 (GPRA), the Federal Financial Management Improvement Act of 1996 (FFMIA) and the Government Management Reform Act of 1994 (GMRA) were all efforts to raise efficiency and effectiveness within the Federal Government. FFMIA required all Federal agency managers to evaluate the effectiveness of their management controls. The GMRA required all government components to produce annual agency-wide financial statements beginning in 1996. The passage of the GPRA necessitates that Federal components effectively plan, budget, execute, evaluate, and account for resources appropriated to Federal programs. Reform continued apace.

##### **5. Why Must the DoD Achieve A “Clean” Audit Opinion?**

The immediate answer is because the CFO Act of 1990 and the Government Management Reform Act of 1994 demand it. However, the DoD recognizes the benefits of the legislation. In the Financial Improvement and Audit Readiness Plan (FIAR Plan), the DoD delineates the benefits expected by obtaining a clean audit opinion. The DoD states, “Good financial management relies on decisions that make the best use of every dollar spent. Good financial decisions depend on timely, reliable, and accurate financial information.”<sup>13</sup> These words could be taken out of any accounting text. Clearly, the DoD is cognizant of the positive aspects of this daunting effort.

Douglas Brook, in his study, *Audited Financial Statements: Getting and Sustaining “Clean” Opinions* provided the foundational methodology for this study. He examined twenty-four Federal agencies and determined six success factors common to all who achieved clean audit opinions.

Brook sees obtaining a clean auditing opinion as a “threshold issue.” By obtaining a clean audit opinion, the DoD will have relevant and reliable financial

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<sup>12</sup> <http://www.dod.mil/comptroller/icenter/inforef/legislatemain.htm>, November 2006.

<sup>13</sup> Financial Improvement and Audit Readiness Plan, 5, December 2005.

information. Relevant and reliable financial information will lead to better management of resources, better management in general, greater oversight of decision-making, and better performance.<sup>14</sup> Both internal and external stakeholders in the DoD will have more confidence that resources given to the DoD are effectively and efficiently managed if the DoD consistently achieves a clean audit opinion.

A clean opinion will inspire confidence among the various stakeholders in DoD. Congress will have confidence that money is being spent appropriately. The general public will be comfortable that the DoD conforms to the same standards as American businesses do. Secondly, a clean opinion will allow the DoD to objectively monitor its own financial performance and make decisions knowing that its financial information is reliable and relevant. For instance, the General Accounting Office, in 2001, estimated that DoD was unable to reconcile an estimated \$3.5 billion difference between its available fund balances according to its records and the U.S. Treasury's at the end of fiscal year 2000.<sup>15</sup> Therefore, the attempt to get clean audit opinions on its finances will also allow the DoD to effectively monitor its own agents in support of organizational goals.

The Financial Improvement and Audit Readiness Plan of 2006 intends to improve financial management within the DoD by improving internal controls, resolving material weaknesses in auditing reports, and advancing the Department's fiscal stewardship. The FIAR relies on the DoD Enterprise Transition Plan and Component Transition Plans which were developed to modernize existing accounting systems and develop new systems.

The FIAR identifies progress to date, lays out quarterly milestones and tasks for achieving improved financial information on 71% of the DoD's assets and 80% of the DoD's liabilities.<sup>16</sup>

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<sup>14</sup> Brook, 11, 2001.

<sup>15</sup> GAO-01-681T, 3, May 8, 2001.

<sup>16</sup> Defense Financial Improvement and Audit Readiness Plan, p. 7, December 2005.

## **6. Defense Financial Improvement and Audit Readiness Plan**

In December of 2005, DoD published the Defense Financial Improvement and Audit Readiness Plan. The FIAR is a comprehensive and evolving plan to systematically improve the financial statements of the Department of Defense. Implicit in the language of the FIAR Updates is that DoD is anxious to comply with the CFO Act of 1990, namely, to achieve a clean audit opinion to satisfy internal and external stakeholders.

The June 2006 Update to the FIAR notes that there are 954 key milestones to be achieved. However, the FIAR Update also observes that these key milestones are evolving and their total number will change.

The FIAR targets four key balance sheet entries for immediate attention: Military Equipment, Real Property, Medicare-eligible Retiree Health Care Fund, and Environmental Liabilities. The FIAR is an incremental approach which is attempting to address material weakness in financial reporting: a key component of audit readiness.

The DoD is seeking to make short-term gains in critical areas while eschewing the “quick fix” that will appease critics in the short-term but may not contribute to sound decision-making in the long run. The words “incremental approach” are repeated throughout. Ostensibly, this is to emphasize the long-term nature of this effort and to assuage critics that this effort must be allowed a flexible timeline.

## **B. RESEARCH QUESTIONS**

This thesis intends to address two questions: whether DoD components with clean, qualified or disclaimed audit opinions display the success factors that contribute to clean audits found by Brook and whether DoD exhibits those success factors as well. Finally, this thesis will explore whether there are other common threads that bind the successful the DoD components that may be prescriptive for the DoD as an enterprise organization.

### **Primary Question**

Can the success factors identified by Brook be found in the DoD components attaining unqualified audit opinions?

### **Secondary Questions**

- a. If the success factors are absent, what are the likely consequences for the FIAR and the DoD's quest for a clean audit opinion?
- b. Do the organizational factors identified by Brook as affecting the likelihood of gaining an unqualified opinion apply to DoD?

## **C. BENEFITS OF STUDY**

This thesis contributes to the examination of the DoD's efforts to achieve clean audit opinions and the benefits contained therein. Brook, in his study of other Federal government components, identified several success factors that materially contribute to achieving unqualified audit opinions. However, Brook did not apply this methodology only to DoD components. This study intends to examine only DoD components in order to look beyond the organizational constraints that hinder other studies. By examining exclusively DoD components, this study blunts the justification that DoD and its components are too distinct and complex to move quickly to achieve audit readiness and financial management reform. Brook's methodology also needs a fresher look in the light of several DoD components having successfully achieved and maintained successful audit opinions. According to the respondents, maintaining a clean audit is a much different challenge than obtaining a clean audit. Components with clean audits had definite ideas regarding the actions and managerial decisions that contributed to their success.

## **D. THESIS SCOPE**

It is impractical to undertake a study of the entire Department of Defense due to the sheer size and complexity of that organization. In order to reduce the

scope of the paper, this study sought to examine the twenty-four DoD components required to submit independent audited financial statements. Of these twenty-four components, nine respondents agreed to participate in the study. From these nine respondents, this paper gained a cross-section of the twenty-four components. Three of the respondents were the uniformed military components: the U.S. Army, U.S. Air Force, and the U.S. Navy. Three of the respondents have successfully achieved and sustained clean audits: the Defense Finance and Accounting Service, the Military Retirement Fund and the Defense Commissary Agency. The three other respondents were: the Defense Information Service, the Defense Logistics Agency and U.S. Special Operations Command.

In this way, this paper gained a microcosm of the Department of Defense. Responses from business-like components (DLA, DeCA, DFAS and MRF), large components with business-like entities within them (USA, USAF, USN and USSOCOM), and largely non-business components like DISA were examined.

The period of relevance for this study covers the financial reform efforts of the DoD components achieving “unqualified” opinions and mentioned specifically in the December 2005 FIAR Plan. This paper will report on the steps taken by these successfully audited components to achieve the clean audit opinions and will also examine the other DoD component efforts at effecting financial reform/auditability.

This thesis is not a case study of the DoD components identified nor is it a case study of DoD’s financial reform efforts as a whole. Rather, it seeks to further substantiate Brook’s hypothesis in light of more data and seeks to apply that hypothesis to DoD’s efforts at financial reform. If the research indicates that DoD lacks some of the success factors detailed therein, this thesis seeks to offer prescriptive proposals to enhance the probability of success in the DoD’s efforts.

Data for this study was derived from DoD guidance, testimonies, briefings, and a business literature review. The analysis was also based on several interviews with subject-matter expert personnel in the components described below.

The results of this research are to assist the DoD in increasing the probability of success in its financial reform efforts. This research intends to provide a “checklist” for DoD managers in leading financial reform efforts in execution of the Financial Improvement and Audit Readiness plan.

## **E. METHODOLOGY**

A literature review was conducted of relevant business, governmental, and public corporation topics. Internet sites, journal articles, testimonies, instructions, and books were also reviewed.

This research uses Brook’s study *Audited Financial Statements: Getting and Sustaining “Clean” Opinions*, as its methodology for examining the DoD components who responded to this study: the U.S. Army, U.S. Air Force, U.S. Navy, the Defense Finance and Accounting Service, the Military Retirement Fund, the Defense Commissary Agency, the Defense Information Systems Agency and the Defense Logistics Agency.

Brook identified six “Key Management Strategies and Tactics” that materially contribute to obtaining and sustaining clean audit opinions. This author extended that research by applying the Brook methodology to the nine respondent components then applying the methodology DoD-wide.

Verifying or disputing the extension of the above thesis to these DoD components will validate the course charted by the Business Transformation Agency in its efforts to reform DoD finances and reporting.

## **F. ORGANIZATION OF STUDY**

Chapter II details the methodology used in examining the respondent DoD components. It provides a description of the Brook hypothesis and a discussion of each success factor contained in the Brook hypothesis. Chapter II then describes how this study modified and applied the Brook hypothesis to create a questionnaire used to interview the DoD financial executives responding to this study.

Chapter III presents the data gained by interviewing the DoD financial executives responding to the study. It is organized by component and further sub-divided by each success factor. Comparisons are then made between component groupings: uniformed services and components achieving clean opinions.

Chapter IV draws conclusions and presents findings in light of the data contained in Chapter III. The presence or absence of the Key Management Strategies and Tactics identified in Chapter II will be assessed and commented upon.

Chapter IV will present a series of recommendations applicable to DoD functional and line managers. Organizational constraints notwithstanding, this study makes a strong case that leadership involvement and managerial decision-making are critical to success in achieving and sustaining an unqualified audit opinion. It also assists DoD leaders by highlighting a set of key tenets that will help guide their decision-making on the path to financial reform.

## II. THESIS METHODOLOGY

Chapter II is an overview of the methodology used by this study to collect and sort data regarding various DoD components' audit readiness efforts. This chapter discusses the origin of the research methodology, a discussion of the six managerial decision-making areas broken into two parts: Brook's findings and this study's use of the six success factors, and, lastly, commentary on the scope of the data collected is presented.

All discussions of the research method and the six success factors are taken directly from Dr. Douglas A. Brook's dissertation, *Business-style Financial Statements under the CFO Act: An Examination of Audit Opinions (2001)*. All charts in Chapter II are this author's presentation of Brook's statistical findings.

### A. BROOK'S FINDINGS AND THIS STUDY

Brook examined twenty-four departments and components within the Federal government over three years (FY1996 to FY1999) to determine if there were common themes or factors in earning and sustaining unqualified or "clean" audit opinions. The examination of those organizations revealed both organizational constraints and managerial decisions and attitudes that were statistically found to have a positive relationship with the outcomes of the audit opinion.

His research method consisted of interviews with financial managers in the organizations studied, statements made by the leaders of those organizations in congressional testimony, and conversations with the auditors of the organizations studied. Once the research areas were established, Brook undertook three approaches to research the data: extensive study of government documents and public records, interviews with key financial managers within the organizations targeted by the CFO Act of 1990, and lastly, analytical case studies of selected components.

This study uses the Brook construct of six success factors found in organizations with successful audit outcomes. Those strategies are: leadership

commitment, positive resourcing, partnering with auditors (the Inspector General), cooperation with non-financial managers, short-term systems and extraordinary effort. Brook's six success factors are examined below.

The section below is divided into six topics, each with two sub-headings: Brook's findings on each success factor and the current study's use of each success factor. Included in Brook's findings for each success factor is a chart representing Brook's statistical data indicating the likelihood of obtaining an unqualified opinion associated with that particular managerial strategy. Included in the current study sub-heading for each success factor is a discussion of the subordinate questions asked to verify the presence or absence of each factor.

## **1. Leadership Commitment**

### ***a. Brook's Findings***

The first managerial strategy positively contributing to an unqualified opinion is leadership commitment. Leadership commitment is central to any enterprise but is especially critical in leading organizational change. Measuring the extent of that commitment was problematic.

When leadership commitment was present, positive auditing results were also found in the prior research. The conclusion on leadership commitment was that when leadership commitment was verified in concrete and substantial ways, unqualified opinions were the most likely of the three possible outcomes: unqualified, qualified, and disclaimed opinion. The chart below shows that, in the presence of leadership commitment, the number of clean audits per agency was 2.86 from FY1996 to FY1999, while the number of clean audits per agency without that factor was 0.83

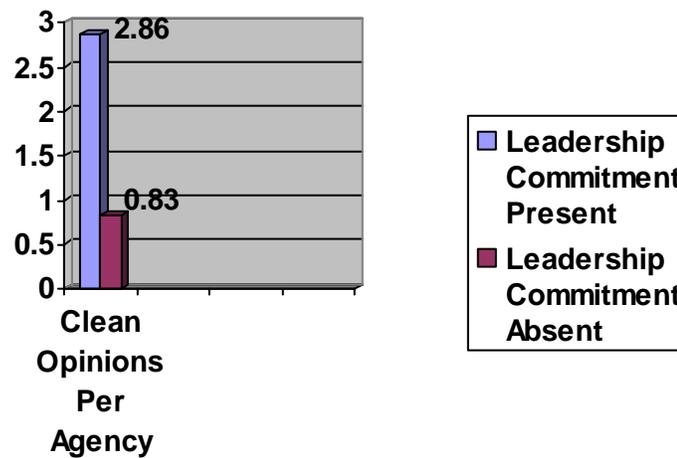


Figure 2-1. Leadership Commitment Effect on Audit Opinions  
Source: Author's Representation of Brook Data

**b. Current Study**

This study utilized subordinate questions designed to draw out responses that indicated, in concrete terms, whether agency leadership commitment could be discerned by the respondents.

In determining the agency leader's commitment, questions posed sought verifiable evidence. Was the leader's commitment committed to paper? Were there public statements or testimony given to reassure external stakeholders of the agency head's commitment? Was there proof that the agency leader demanded the same level of commitment from his managers? These questions are scrutinized below.

Aware that priorities change and managing a complex organization demands shifting and varying levels of effort, subordinate questions sought to determine if obtaining a clean audit opinion was ever placed on a list of the agency leader's priorities. Did internal correspondence ever reflect the leader's commitment to obtaining a successful audit opinion? Recognizing that rhetoric designed to satisfy external critics and internal memoranda to facilitate understanding of the agency leader's objectives often differ, questions requested respondents look at internal and external briefings. Lastly, the questions sought to inquire whether the senior executive demanded periodic reports and briefings.

Secondly, in looking at leadership commitment, did the agency's leader follow up with actions designed to communicate his or her commitment to achieving an unqualified audit opinion? Did the agency head demand periodic reports, communicating the importance of the task? Key actions investigated included whether the agency head empowered the Chief Financial Officer in the agency when internal disputes arose over resource allocations.

## 2. Positive Resource Allocation

### a. Brook's Findings

This inclusive term is meant to describe whether the organization being studied diverted resources, i.e., people and money, to the project of obtaining and maintaining a clean audit opinion. The application of resources to the goal of a clean audit can be examined in three categories: systems, manpower resources, and contract services.

Below is a representation of the statistical information in the Brook study regarding positive resource allocation. Components with the positive presence of this factor received 2.09 clean audit opinions per agency (out of twenty-four sampled) from FY1996 to FY1999, and components without the presence of the factor received 1.33 clean audit opinions per agency.

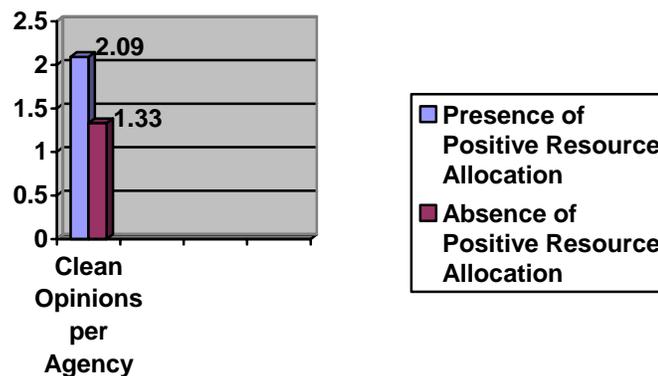


Figure 2-2. Positive Resource Allocation Effect on Audit Opinions  
Source: Author's Representation of Brook Data

**b. Current Study**

This study looked at two components when assessing whether the positive application of resources was directed at systems. The first was whether the organization chose to upgrade its financial management systems. The second issue was whether audit training was given to the finance department within the agency.

In upgrading the financial management software, the organization commits to rethinking the uses of financial information. In purchasing modern software, the organization recognizes that financial information, in order to be useful, must be all-inclusive and developed for use by all departments. Accounting tools conceived and developed in the 1960's and implemented in the 1970's have not and were not intended to support modern managerial data requirements and reporting requirements. Managers from all departments must make resource decisions based upon financial information that allows holistic decision-making to be accomplished.

Secondly, audit training for the finance department within the organization deepens the knowledge base of the employees. Instead of simply managing numbers and reports, the finance department can grasp the end result of their products and perhaps forestall difficulties in reporting by recognizing weaknesses within their own financial reporting systems.

Manpower resources are the means by which an organization uses its people, either permanent employees or temporary employees, to produce the financial reports required by the auditing entity. From counting inventory to preparing the financial statements themselves, organizations that apply significant manpower resources to achieving clean audits consistently achieved those results at a greater rate than those organizations not applying significant manpower resources.

Lastly, those organizations purchasing contract services fared better than those who neglected this resource. Contract resources can provide the necessary expertise to either train staff members of the organization or perform the highly specialized tasks of audit preparation. Some companies

utilize the contractor services as a stop-gap measure until their own staff members can perform the work required or as additional manpower to attack problem areas discovered by their own internal auditing departments.

The argument taken up in this paper is that the decision to apply additional manpower, systems, and contractor resources in the current austere fiscal environment requires even more commitment from the executive leadership of the agency. This commitment takes two forms: the positive application of resources themselves and insulating financial management from the effects of downsizing and resource constraints.

As a last test of commitment in this program resources area, this study asked whether financial managers had complained about a lack of resources. If so, were the complaints ever addressed?

### **3. Partnering With Inspector General**

#### **a. *Brook's Findings***

From his research, Brook determined that "Partnering with the Inspector General" or partnering with the internal audit team was yet another critical factor in obtaining an unqualified audit opinion. Collaboration between the accounting and auditing staffs was critical.

Presented below is the statistical information found by Brook. His finding was that components with a history of "partnering" or close cooperation between the auditing and accounting staffs had 2.09 "clean" opinions per agency from FY1996 to FY1999, and components without that close cooperation had only 1.33 "clean" opinions per agency.

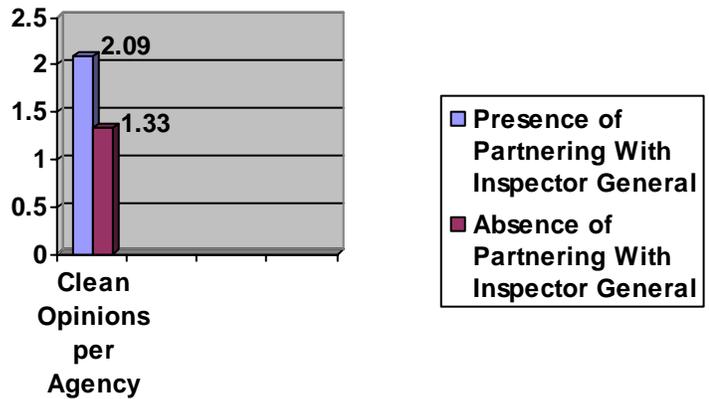


Figure 2-3. Partnering with Inspector General Effect on Audit Opinions  
 Source: Author's Representation of Brook Data

**b. Current Study**

This study asked four questions: Were there any prior relationships between the accounting and auditing staffs? Was there any history of mistrust? Can the interviewee point to any Inspector General or audit staff exhibiting a “gotcha” mentality? Is there a history of “partnering” with the auditing staff?

In determining whether there were any prior relationships between the accounting staff and the auditing staff, this study sought to establish whether the working relationships previously established had a positive effect on obtaining an unqualified opinion. In fact, previous working relationships did have a positive effect on gaining and/or sustaining an unqualified audit opinion. The corollary is that personal relationships between divisions facilitate problem-solving and speedy reconciliation of differences.

In investigating whether there had been a history of mistrust or a “gotcha” mentality among the internal auditing staff, the goal was to discover the nature of the working relationships between the accounting and non-financial divisions of the entity and the internal auditing staff. A history of mistrust would surely preclude problem-solving in the quest for an unqualified audit opinion.

Lastly, a history of “partnering” between the accounting and auditing staffs would surely be an indicator of anticipated audit success. Mini-audits, integrated process-action teams, and a history of negotiation were all positive

indicators a history of partnership. According to research, this in turn, led to a greater likelihood of success in obtaining and sustaining a positive audit opinion.

#### 4. Cooperation of Non-financial Managers

##### a. Brook's Findings

Cooperation of non-financial managers was critical in gaining and sustaining unqualified audit opinions. Unless the non-financial agency leadership throughout the organization understood the value proposition of a clean audit opinion, i.e. understood the intent and importance of auditable financial statements, unqualified audit opinions were unlikely.

Brook found that components who secured the cooperation of non-financial managers received 2.63 clean opinions per agency from FY1996 to FY1999, while components who failed to secure that cooperation received 0 clean opinions per agency. Clearly, this support is vital in the unqualified audit opinion effort.

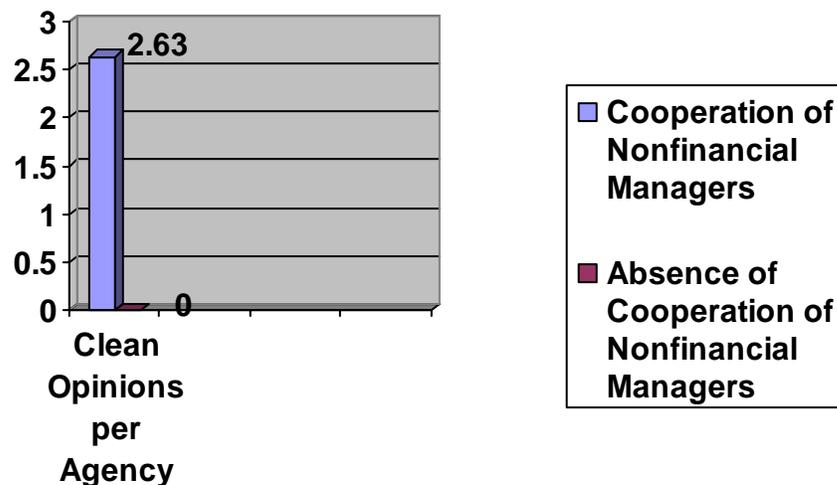


Figure 2-4. Cooperation of Non-financial Managers Effect on Audit Opinions

Source: Author's Representation of Brook Data

**b. Current Study**

In determining whether or not cooperation from the non-financial managers was present, this study looked at four factors: the history of overcoming agency problems with non-financial managers, whether the accounting leadership had actively secured the cooperation of operating and program managers in the process of obtaining an unqualified opinion, were recognition programs in place for financial and non-financial employees to spur success in pursuing auditable financial statements, or lastly, had the accounting division overcome the apathy or passive resistance on the part of non-financial leaders.

This paper investigated whether there was a history of inclusiveness in problem-solving at the agency level. Conversely, did the agency have a corporate mentality of: operations staff taking care of operations and accounting/auditing staffs taking care of the books? In the words of the Deputy Comptroller at Defense Logistics Agency, “we had to get across that everything we did, from ordering new products to equipping the soldier in the field, was, in essence, a financial event.”<sup>17</sup>

Overcoming agency problems cannot be achieved unless the whole agency is aligned toward that goal. Not only do the accounting and auditing staffs have to cooperate, but the agency leadership must ensure that all divisions and departments understand the goals and also agree that the stated goals of the organization are important enough to merit their time and energy.

Also examined was whether there were recognition programs in place for financial and non-financial staff members in the pursuit of auditability. People are motivated by intrinsic and extrinsic rewards. Aligning personal goals to organizational goals in the Federal Government requires more creativity in designing rewards unique to government service:

This would include investments in such areas as the following: career development; work design and enhanced working conditions; dissemination of high performance models involving enhanced culture and empowerment; and improved systems for

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<sup>17</sup> DLA interview, October 30, 2006.

rewards that satisfy public service motives through such steps as increased investments in recognition systems for excellence in service delivery and for dissemination of information about service accomplishments. (Piffner and Brook, 2000)

The question for the agency is whether agency leadership has made efforts to motivate employees outside of promotion or punishment.

As a last measure of the degree of cooperation from non-financial managers, this study examined whether the financial managers themselves thought that they had overcome non-financial leadership's disinterest, resistance, or lack of interest. If the financial leadership feels that they are not being supported and the lack of auditable financial statements bears them out, the perceived lack of support must have some basis in truth.

## **5. Short-term Systems**

### ***a. Brook's Findings***

The success factor labeled "short-term systems" refers to the effort to align existing financial accounting systems and procedures to the effort to attain financial auditability. The overall goal is to further overcome the financial systems' deficiencies where those deficiencies contribute to a lack of internal controls and reliable financial information.

Components who reported employing "short-term systems" or workarounds received 2.75 clean audit opinions per agency from FY1996 to FY1999, while those components who reported taking the longer-term, comprehensive=systems approach, received only 0.6 clean audit opinions per agency.

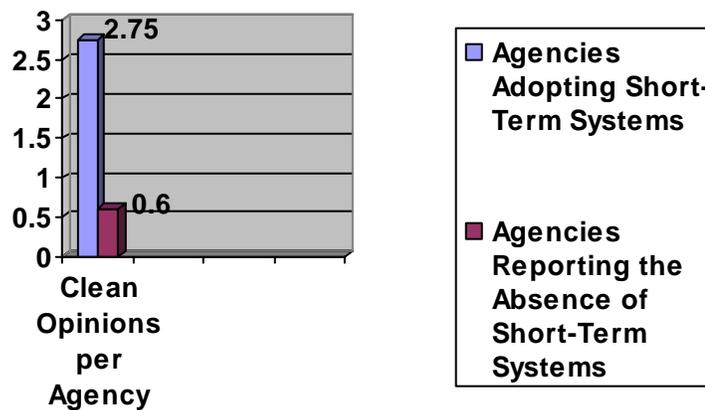


Figure 2-5. Short-term Systems' Effect on Audit Opinions  
 Source: Author's Representation of Brook Data

**b. Current Study**

Components examined were found to have taken two approaches to aligning financial systems: investment in fixing and integrating their core accounting systems or building a separate financial information system(s) that serves only the information needs of the financial statements, the so-called “workarounds.”

Components choosing to invest in overcoming existing financial system deficiencies clearly made the decision that “workarounds” may have been expedient but did not serve long-term agency goals. Certainly, investing in the long-term is the braver choice. Choosing to upgrade, update and expand current systems is more comprehensive in scope.

Components reported that the longer-term goals of producing reliable financial statements, reducing material weakness in internal control, and complying with the Federal Financial Management Integrity Act (FFMIA) were the components that chose to take the more comprehensive approach. Financial managers taking this long-term approach also reported that they believe it is more difficult to get and, more importantly, to sustain clean audit opinions outside of the integrated systems approach.<sup>18</sup>

<sup>18</sup>Brook, 2001, p. 33

Conversely, choosing to create short-term “workarounds” is a more limited decision that is narrowly focused on obtaining auditability as quickly as possible--making the longer-term goals of system integration with budgeting, logistics, and other information management systems a secondary consideration. Components examined reported building “huge Excel spreadsheets” as financial system workarounds. The goal in doing so was the immediate focus on auditability.

## 6. Extraordinary Effort

### a. Brook’s Findings

This success factor looked at the lengths to which the agency went to ensure audit success over a short period of time. Brook found a strong correlation between those components exhibiting extraordinary effort and positive audit outcomes.

Below is the graphical representation of Brook’s findings when examining the success factor “extraordinary effort.” Components that could demonstrate extraordinary effort received 2.04 clean opinions per agency from FY1996 to FY1999, while components in which extraordinary effort as absent received only 0.75 clean opinions per agency.

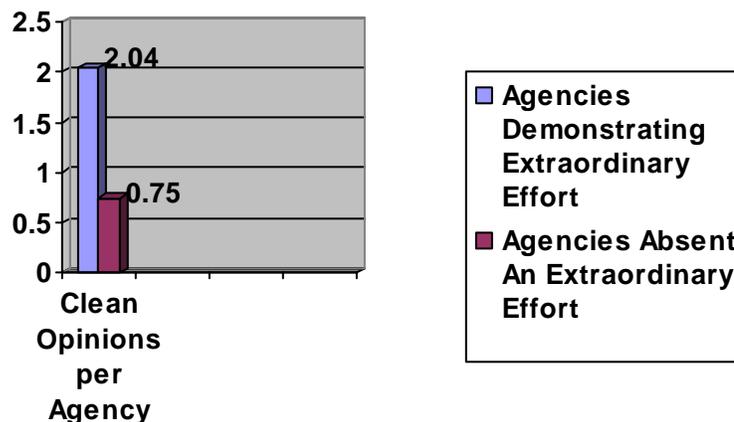


Figure 2-6. Extraordinary Effort Effect on Audit Opinions  
Source: Author’s Representation of Brook Data

**b. Current Study**

This study asked questions such as: did senior financial managers exert extraordinary effort over a short period of time; did the agency hire a large number of people to accomplish tasks that the current systems and procedures cannot manage; had the agency hired small private-sector accounting firms in a less-than-two-year effort; did task forces of extra people or people pulled from non-financial sections within the agency count inventories, research acquisition histories or enter data; and did the agency spend money on contractors and commercial, off-the-shelf software to achieve auditability. This study found that components who could answer “yes” to those questions were more likely to gain and sustain unqualified audit opinions.

Senior financial managers who were observed by agency employees to have exerted “extraordinary” effort provided both an example and an impetus to the effort to achieving auditability. Employee-evaluated effort of senior-level managers could be used as a proxy to gauge the effort of the employees themselves.

Organizations whose mission is not inherently financial, such as the Defense Information Systems Agency as contrasted to an organization such as DFAS (which is almost exclusively financial), would logically seek outside expertise to help align the financial systems of the agency to achieve auditability. Successful components recognized this fact and hired private-sector firms whose expertise is in auditing financial statements to align their financial systems.

Successful organizations also created groups or “task forces” to focus on the work-a-day, but vital, tasks that enable the organization to both tighten internal controls and reduce material weakness in financial statements. These tasks include, but are not limited to: counting inventories, research disparate financial records, or simply entering data into the financial management systems.

Lastly, components that hired contractors or purchased commercial-off-the-shelf (COTS) financial systems fared much better than components that relied on existing systems and internal manpower to achieve

auditability. This decision speaks to the problem of time versus resources. Successful components acknowledge that fact and sacrifice resources to gain time.

## **B. APPLICATION OF THE BROOK HYPOTHESIS FOR THIS STUDY**

This study is an attempt to apply Brook's methodology to the twenty-four Defense components required by the Department of Defense to provide stand-alone financial statements. This list is drawn from the Department of Defense Comptroller website from the list of budgetary materials for 2006. A list of those components is provided in Appendix A. This is the population from which this study drew a sample.

Respondents were given either an e-mail questionnaire to fill out or engaged in a telephone interview with the researcher. The questions that comprised the questionnaire were open-ended questions designed to solicit information regarding the six success factors detailed above as having a positive influence on gaining and sustaining a "clean" audit opinion. Accordingly, for each success factor, a topic question was posed of the respondent. The questions are listed below with their corresponding "success factor:"

- Leadership Commitment
  - How would you describe your Agency's leadership's commitment to obtaining a "clean" audit opinion?
- Positive Resource Allocation
  - Were there ever resource allocation shifts made to aid in the effort to gain a "clean" audit opinion?
- Partnering with Inspector General
  - Describe the relationship between the accounting staff and the Inspector General (internal auditing) staff?
- Cooperation of Non-financial Managers
  - Did the effort to achieve a "clean" audit opinion ever resonate throughout the non-financial leadership of the Agency?

- Short-term Systems
  - Were short-term (workaround) systems ever employed to bring financial statements up to date and auditable?
- Extraordinary Effort
  - What adjectives would you use to describe the effort to achieve a “clean” audit opinion?

To draw out the respondents on the above questions and to develop a type of objective scoring criteria, subordinate questions for each success factor were developed. These subordinate questions were created using Brook’s supporting criterion when determining the presence or absence of a success factor at the respondent’s organization. A detailed list of the six success factors and their subordinate questions drawn from evidence of the presence/absence of the success factors is provided in Appendix B.

In order to objectively score each respondent in each of the six success factors a methodology was developed. This study sought to assign a “yes” or a “no” to whether the success factor was present. In order to do so, the subordinate question responses were tallied. If a simple majority of the responses or the data supported answering in the affirmative to the subordinate questions, then the agency received a “yes” for that success factor.

The six success factors “yes” or “no” scores were then applied to each respondent and the results noted on a simple spreadsheet. The spreadsheet is reproduced in Appendix C.

The spreadsheet is intended to compare the presence or absence of each success factor across the respondent components and the audit opinions of those components. The predictive power of Brook’s research is presented.

Nine components are represented in the data in Chapter III. These nine represent a significant cross-section of the population of the 24 reporting Defense components. Most importantly, the three uniformed services representing a majority of the financial and physical assets of the Department of Defense were included.

Also represented in this study are three components that have gained and sustained unqualified opinions for at least the last two fiscal years. These components served both to validate the responses given by all components and to confirm the areas of emphasis chosen by this paper.

Of the nine respondent components, eight were interviewed by telephone and e-mailed questionnaires. One agency responded via emailed questionnaire only.

It was not practical in this study to attempt interviews with multiple individuals within all components due to time constraints and data sorting. Rather, a modified Delphi survey technique was used. The Delphi technique questions informed experts independently regarding a common question and then collects the responses for a collective review. This study utilized the Delphi technique by creating a common set of questions used to interview informed financial management experts within the twenty-four DoD components required to submit independent audited financial statements. Respondents reviewed a standard set of open-ended questions designed to draw out responses under the six success factor topics. The intent was to gain a consensus of both successful and unsuccessful audit components regarding the understanding and usefulness of those six managerial decisions.

Key participants were pre-selected for accounting and comptrollership expertise. Respondents ranged from Accounting Division Chiefs to Service Assistant Secretaries for Financial Management and Comptroller. All have spent careers both in government service and in the private sector preparing financial statements themselves and managing accounting and internal auditing staffs producing and asserting those financial statements.

### **III. DATA PRESENTATION AND ANALYSIS**

Chapter III is a presentation and discussion of the data collected from DoD respondents taken from the list of 24 components required to submit independent financial statements to the DoD. The list of components and their 2005 audit opinion is presented in Figure 3-1.

In all, there were nine components that responded to requests for information. Therefore, Chapter III is organized to discuss the respondents' decision-making in light of the six success factors.

The first section is a discussion of the three uniformed components: the United States Army, the United States Air Force and the United States Navy. The second section is a comparison of the three uniformed services and their varying attitudes towards the six success factors. The third section discusses the responses from components receiving disclaimed audits but responding positively to the study's questions. The fourth section is a discussion of the responses from three components receiving unqualified audits: the Defense Finance and Accounting Service, the Military Retirement Fund and the Defense Commissary Agency. The fifth section of Chapter III is a comparison of the responses from the successfully audited DoD components. The last section in Chapter III is a summary table of the nine respondents with regard to the six success factors and their audit opinion results from 2005.

<b>AGENCY</b>	<b>2005 AUDIT OPINION</b>
Army General Fund	Disclaimed
Army Working Capital Fund	Disclaimed
Navy General Fund	Disclaimed
Navy Working Capital Fund	Disclaimed
Air Force General Fund	Disclaimed
Air Force Working Capital Fund	Disclaimed
U.S. Army Corps of Engineers (Civil Works)	Disclaimed
Defense Logistics Agency	Disclaimed
Defense Information Systems Agency	Disclaimed
Defense Security Service	Disclaimed
Defense Threat Reduction Agency	Disclaimed
Defense Advanced Research Projects Agency	Disclaimed
Chemical Biological and Defense Program	Disclaimed
Missile Defense Agency	Disclaimed
Services Medical Activity	Disclaimed
Tricare Management Activity	Disclaimed
U.S. Special Operations Command	Disclaimed
Marine Corps Working Capital Fund	Disclaimed
Marine Corps General Fund	Disclaimed
Defense Finance and Accounting Service	Unqualified
Defense Contract Audit Agency	Unqualified
Defense Commissary Agency	Unqualified
Military Retirement Fund	Unqualified
DoD Medicare-eligible Retiree Health Care Fund	Qualified

Figure 3-1. Universe of Potential Respondents

**A. “BIG THREE: ARMY, NAVY, AND AIR FORCE”**

The three main financial reporting entities of the DoD are the Department of the Army, the Department of the Navy and the Department of the Air Force, each operating its own Working Capital Fund and General Fund. These three reporting entities constitute the vast majority of assets under management for the DoD. The Financial Summary Tables Fiscal Year 2006 for the Department of Defense show that the total budget authority of each Department was \$99.87 billion, \$125.4 billion, and \$127.4 billion respectively. These three totals account for over 77% of the DoD’s budget. It is instructive to look at these three reporting

entities because, without them achieving auditability, there is no likelihood of the DoD achieving auditability--let alone a clean opinion as a whole. Gibson describes the materiality concept as “the relative size and importance of an item to a firm.”<sup>19</sup> Since the majority of the DoD’s assets are controlled and reported by the above three entities, it would follow that the DoD is most concerned with the financial statements of these three uniformed services when applying resources to achieve the aims of the CFO Act of 1990.

The results of the research conducted in these three entities are summarized below. Objective score totals were applied to each success factor to determine the presence of each success factor for each service component.

**1. Department of the Army**

The Department of the Army’s (DOA) results are shown below in Figure 3-2. Of the six success factors used to evaluate managerial decision-making, the Department of the Army scored positive on success factor: leadership commitment. A brief reporting of each success factor is provided below.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION FOR 2005?
DOA	YES	NO	NO	NO	NO	NO	Disclaimed
scores	5/8 Positive	1/6 Positive	2/5 Positive	1/7 Positive	1/3 Positive	2/6 Positive	

Figure 3-2. Summary of The Department of the Army’s Respondent Results

**a. Leadership Commitment**

The Department of the Army was graded positively for success factor leadership commitment. This was determined by five of eight positive determinations for subordinate questions in this area.

The respondent for the DOA described the department’s commitment to an unqualified audit opinion as secondary. “The plan is not

<sup>19</sup> Gibson, 17, 2007.

focused primarily at achieving a clean audit, but is focused on implementing compliant systems, sustainable business processes and efficient/effective internal controls. Successful completion of those things will culminate in useful business information for managers.”<sup>20</sup> The DOA’s position is that focusing on an unqualified audit opinion will lead to short-term goal-setting at a detriment to the proper goal of sustainability.

However, in the *Army CFO Strategic Plan, 10<sup>th</sup> Edition*, auditability is specifically mentioned as a goal. The opening paragraph on the Army CFO website states, “The CFO Strategic Plan also serves as the Army’s road map to achieving a favorable audit opinion on its annual financial statements.”<sup>21</sup>

Also, the Army Audit Committee Executives (ACE) committee was formed to discuss progress on actions necessary to achieve sustainable processes, develop Enterprise Resources Programs (ERPs), and to address corrections for material internal-control weaknesses. Despite forming a committee to study the material weaknesses in the Army’s financial control systems, resource estimates are only now being identified to correct deficiencies.

**b. Positive Resource Allocation**

The DOA received a negative grade for positive resource allocation. This organization received a score of one of six for subordinate question positives under positive resource allocation.

The DOA reported that a mid-range improvement plan was formulated within the past several years to address the effort to gain a clean audit opinion. Nevertheless, there were no actual resources shifted or allocated to achieve the opinion. The effort was, subsequently, abandoned.

The lesson of the folly in attempting a heroic effort to achieve an unqualified opinion in 2007 is still with ASA (FM&C). There is anecdotal evidence of a study completed in either 2001 or 2002 to determine the effort

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<sup>20</sup>DOA interview, October 31, 2006.

<sup>21</sup> <http://www.asafm.army.mil/fo/fod/cfo/cfo.asp>, October, 2006.

required to achieve a clean audit opinion. Additionally, resources have not been available for continuing financial improvement efforts. However, ASA (FM&C) is currently identifying resource estimates to achieve sustainability, systems compliance, and internal control.

The DOA reports that no resources will be provided specifically to achieve an unqualified audit opinion as the audit opinion is not the focus of the effort. In addition, due to the Global War on Terror, resources have not generally been available for these financial improvement efforts, but progress still continues.<sup>22</sup>

The Army has reported that any progress made on its Federal Information Processing (FIP) has been paid for strictly out of other funding accounts. The Army has purchased a commercial-off-the-shelf (COTS) system called the General Fund Enterprise Business System (GFEBS) based upon civilian software. This system is and is intended to be all-inclusive financial management software under the DoD Enterprise Resource Planning system. GFEBS is intended to modernize legacy financial management systems by updating general ledger management, payment management, receivable management, funds management, cost management, and reporting.<sup>23</sup>

**c. *Partnering With Inspector General***

The Army received a grade of “absent” when reporting on the success factor of partnering with the Inspector General. The respondent described a “strained relationship when describing issues having to do with audit readiness.”<sup>24</sup>

The contention is that the DoD IG has a different idea of what constitutes audit readiness and efforts to gain a common understanding have been only partially successful. Specifically, the respondent contends that the comptroller division understands functionally what the implications and

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<sup>22</sup>DOA interview, October 31, 2006.

<sup>23</sup> <http://www.asafm.army.mil/fo/fod/fincom/brfs/sro/gfebs.ppt#263,1>, Current Financial Operations Initiatives, October, 2006.

<sup>24</sup>DOA interview, October 31, 2006.

requirements of the CFO Act are and has complied through the Financial Improvement Plan; the audit community has applied a different definition and has not confirmed that the Army's accounts are ready for audit.

The Army Audit Agency (AAA) is the internal auditor for the Department of the Army. The AAA has been working to assist the Assistant Secretary of the Army (Financial Management and Comptroller) to prepare financial statements for auditability. The AAA has conducted pre-audits to reconcile accounts. The AAA and the Internal Review offices are becoming more involved in completing compliance and validation reviews.

To summarize, the respondent from the ASA (FM&C) office has diverging views regarding audit readiness with the audit community collectively: the GAO, the DODIG, the Army Audit Agency, and the Internal Review staff. The relationship between the audit community and the comptroller staff is not ideal from a collaborative standpoint.

***d. Cooperation of Non-financial Managers***

The Department of the Army was also graded as absent on the success factor of cooperation of non-financial managers. The contention is not that other Army components are actively opposing financial management reform but that financial management reform has fallen to near the bottom of the priority list. The respondent mentioned several reasons for this: the war, constrained resources, and ongoing communication efforts.

The respondent within the ASA (FM&C) office reports that senior leadership outside of the financial community understands the importance of financial management reform, but that the Global War on Terror in Afghanistan and Iraq takes precedence in effort and resources.

The respondent also mentioned that financial reform will continue to experience "slow-moving progress as long as funding remains constrained."<sup>25</sup> No resources will be provided solely for the purpose of obtaining an audit. Because the Army is in the midst of the GWOT, resources have not generally

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<sup>25</sup> DOA interview, October 31, 2006.

been available for these financial improvement efforts, but progress still continues. Constrained resources, at least for financial management reform, continue to plague the Department of the Army.

The last reason given for the absence of the success factor cooperation of non-financial managers was the degree of success in educating those non-financial managers in the value of auditable financial statements and financial management reform. The education effort includes making operational leaders aware of their role in financial management and assuring those leaders that financial information will be used for future decision-making. The respondent maintains that the effort to educate is present, but it is clear that the effort needs to continue.

**e. *Short-term Systems***

DOA also received a grade of absent for the success factor short-term systems. The reasons for this grade include: the philosophy that short-term systems are detrimental to the effort to achieve sustainability for the audited statements and the lack of resources dedicated to transforming the financial management systems.

The Army's plan is not focused primarily on achieving a clean audit but is focused on implementing compliant systems, sustainable business processes and efficient/effective internal controls.<sup>26</sup> Short-term workarounds are an anathema to that thought process. ASA (FM&C) is busy developing Enterprise Resource Planning or ERP systems so none of that directorate's resources (time and people) are being used to develop short-term system solutions.

The Army has been ensuring its Financial Improvement Plan (FIP) is integrated with and conforms to the DoD Financial Improvement and Audit Readiness (FIAR) Plan. The respondent's view of the FIAR is that it is "tracking tool" for the Office of the Secretary of Defense (OSD) to check milestone dates. Furthermore, the opinion is that the FIAR plan is not mature enough to work as

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<sup>26</sup>DOA interview, October 31, 2006.

an integrated plan but has support within the DoD (both service and DoD staff components) to develop it more fully as such.<sup>27</sup>

***f. Extraordinary Effort***

This research grades the Department of the Army as absent when the success factor extraordinary effort was considered. This absent evaluation was due to the respondent's judgment that the heroic efforts to achieve an unqualified opinion in 2007 were abandoned as "fantasy" Although efforts have been made to leverage the DoD's FIAR Plan and align modernization plans to the FIAR Plan, the bulk of the Army's effort has been focused on studying the problem and determining what resources would be required rather than putting significant resources into solutions in achieving auditability.

It is important to note, the Department of the Army has made positive progress in modernizing financial management systems. In December 2003, the Army commissioned a study entitled "Enhancing the Army Management Control Process" by KPMG, a private accounting firm, to assess weaknesses in management controls within the payroll process. The Army has also created task forces to oversee financial-systems modernization efforts such as the Army Audit Committee Executives (ACE). COTS or commercial-off-the-shelf software has been contracted for use to implement the General Fund Enterprise Business System, or GFEBS.

However, the effort cannot be characterized as extraordinary. The critical distinction is that the Army has no intention of focusing on the narrow goal of audit readiness. The focus of effort is rather on a multi-year process of modernizing financial management systems compliant with DoD Comptroller objectives contained within the FIAR Plan. The timeframe for audit readiness quoted by the respondent within the Assistant Secretary of the Army for Financial Management and Comptroller's office is in the 2011-and-beyond range.<sup>28</sup>

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<sup>27</sup>Ibid, October 31 2006.

<sup>28</sup> Email, 12 October 2006.

## 2. Department of the Navy

The Department of the Navy (DON) results are shown in Figure 3-3. Of the six success factors used to evaluate the DON effort to achieve an unqualified audit opinion, three were graded as positive: Leadership Commitment, Positive Resource Allocation, and Cooperation of Non-financial Managers. Below is a short summary of the six success factors.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION?
DON	YES	YES	NO	NO	NO	YES	Disclaimed
scores	6/8 POSITIVE	5/6 POSITIVE	1/5 POSITIVE	3/7 POSITIVE	1/3 POSITIVE	3/6 POSITIVE	

Figure 3-3. Summary of The Department of the Navy's Respondent Results

### a. Leadership Commitment

The Department of the Navy (DON) received a positive grade for leadership commitment. The reasons supporting this grade are: senior-executive-level commitment to business transformation, internal and external communications supporting an unqualified opinion, and the personnel and resource decisions made supporting business transformation.

The respondent in office of the Assistant Secretary of the Navy (Financial Management and Comptroller), reported that business transformation had the commitment of the highest levels of the secretariat. As most of the senior civilian leadership of the Navy has worked in the private sector, business transformation efforts have been warmly received and enthusiastically endorsed.

Internal and external communications from the DON suggest that Navy leadership is committed to both business transformation and, in turn, building audit readiness. Although the current focus is on transforming business and financial management systems, as late as Fall 2005, one of the stated purposes of the Navy's modernization effort was, in fact, audit readiness:

The Assistant Secretary of the Navy (Financial Management and Comptroller) is working closely with the Under Secretary of Defense (Comptroller) to support the goal of a clean audit opinion on Department of Defense-wide financial statements and recently has developed a strategy that emphasizes business process transformation as the key to audit readiness.”(Veit, 2005, Fall, p. 11)

Whatever the reason for the subtle shift in relegating audit readiness to a subordinate goal encompassed by the goal of business transformation, clearly the Navy recognizes the need to transform its financial management practices to ensure they are capable of withstanding external audit.

***b. Positive Resource Allocation***

The Department of the Navy also received a positive grade for the presence of success factor positive resource allocation. The combination of financial management system investments, contractor utilization and application of other resources all contributed to this positive grading.

Resources have been centrally budgeted to support business transformation efforts. This construct makes the DON unique among the uniformed services. Despite the fact that the funding does not have audit preparedness as its object, the method of funding is a strong indicator of DON leadership’s commitment to stream-lining and integrating processes and systems.

The Navy has aligned its own Financial Improvement Plan or FIP with the DoD FIAR Plan. Specifically, the Navy has developed an Enterprise Resource Plan or ERP. Derived from a COTS business solution developed by SAP, the Navy’s ERP is intended to replace the disparate business solutions recently converged.

The Navy’s ERP had been successfully introduced in four system commands: the Naval Air Systems Command, the Navy Supply Systems Command, the Naval Sea Systems Command, and the Space and Naval Warfare Systems Command. These four commands had successfully introduced

COTS business solutions and the Navy has now leveraged these successes enterprise-wide into a single Converged Enterprise Resource Program or C-ERP. The COTS financial systems have also been systematically conformed to the DoD Standard Financial Information Structure or SFIS. This standard is intended to ensure that although the DoD components are seeking service-specific solutions to business and financial systems modernization, these solutions will be comparable and scalable to achieve interoperability and consistent reporting across the DoD.

***c. Partnering With Inspector General***

The Department of the Navy received a negative grade when considering the success factor partnering with the Inspector General. The reasons for this determination are as follows: institutional biases, past relationships, and no history of collaborative problem-solving.

The respondent for the Navy reported a prior adversarial relationship with the Inspector General. The interviewee also mentioned that a better path to success for the Navy is for auditors and those being audited to partner and become allies. Auditors would point out non-compliant or inefficient conditions non-judgmentally; those audited would not assume a defense posture and would “open their books” to the auditors.<sup>29</sup>

The respondent regarded the traditional role of the Inspector General staff as hindering the relationship between comptrollers and auditors, internal or otherwise. Institutionally, the IG staff is set up and excels at conducting program audits. However, the IG staff, like the rest of the Navy, is not educated in and has no experience in financial audits.<sup>30</sup> This inexperience cannot but hinder collaboration efforts between the auditing and accounting staffs at all levels.

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<sup>29</sup> Questionnaire, November 6, 2006.

<sup>30</sup> Interview, October 15, 2006.

**d. Cooperation of Non-financial Managers**

The Navy was graded negatively for the success factor cooperation of non-financial managers. While the Navy has been successful with enterprise-level business modernization efforts such as Naval Aviation Enterprise and Sea Enterprise, the progress towards audit readiness has not resonated with the operational Navy.

A respondent for the Navy mentioned that while the Secretary of the Navy understood and supports the progress made in business modernization, uniformed Navy personnel are moving more slowly from awareness of the need for financial management reform to discovery of the relevance for their particular Navy branch.

While the non-financial branches in the Navy are slow to understand financial management reform relevance, financial middle managers have not necessarily been the best ambassadors of reform. Since financial managers have been focused on budgetary accounting, they have neither the accounting tools nor the training to exploit the benefits of proprietary accounting. Furthermore, since they themselves are ill-equipped to utilize proprietary accounting, budgeting personnel cannot reasonably be expected to espouse benefits they themselves neither fully understand nor appreciate.

Lastly, the Navy respondent contends that since a clean audit opinion is not mission-critical to Navy operations, that audit opinion will be perceived as less important than immediate operational concerns and the need to modernize business processes. In order to be successful, the Navy must make the audit opinion relevant to the mission. According to the respondent, the Navy is moving that way.<sup>31</sup>

**e. Short-term Systems**

The Department of the Navy received a grade of absent for success factor short-term systems. Short-term systems are not the route the

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<sup>31</sup> DON interview, October 15, 2006.

DON wishes to take in order to modernize financial management and business systems.

The Navy, as well as the other uniformed services, had, previous to 2005, made statements committing to obtaining an unqualified audit opinion by 2007. However, when Navy financial leadership looked at the complexity of the financial systems, the cost to attain auditability, and the value proposition of attaining auditability versus lasting financial improvement, audit readiness was abandoned as the primary goal.

Specifically, the Navy believes that following its business transformation strategy and improving and integrating business systems is the most efficient way to produce auditable financial statements.<sup>32</sup> This belief is based on the assumption that auditability will follow improved financial reporting rather than the other way around.

***f. Extraordinary Effort***

The Department of the Navy received a grade of present when considering the success factor extraordinary effort. The score was divided between positive and negative responses to subordinate questions within this success factor. However, the aggregate efforts to date add up to extraordinary effort.

The Navy respondent characterized the funding effort to improve financial management as an incremental investment. Once the Financial Improvement Plan becomes a reality, the dollars invested in improvement will become overhead in the cost of doing business.

The Navy has applied extraordinary effort in its efforts to modernize business practices. Beyond the FIP is the Enterprise Resource Planning described earlier. The four pilot programs launched by the four Navy systems commands have been annexed either partially or wholly into the Navy's Converged ERP thereby demonstrating a significant commitment to modernize.

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<sup>32</sup> DON interview, November 6, 2006.

### 3. Department of the Air Force

The Department of the Air Force’s (DOAF) results are shown below in Figure 3-4. Of the six success factors used to evaluate managerial decision-making, the Department of the Air Force scored positive on two success factors: leadership commitment and short-term systems. A brief reporting of each success factor is provided below.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION?
DOAF	YES	NO	NO	NO	YES	NO	Disclaimed
scores	5/8 POSITIVE	3/6 POSITIVE	1/5 POSITIVE	3/7 POSITIVE	3/3 POSITIVE	2/6 POSITIVE	

Figure 3-4. Summary of The Department of the Air Force’s Respondent Results

#### a. Leadership Commitment

The Department of the Air Force was positively graded when considering the factor leadership commitment. The Deputy Assistant Secretary for Financial Operations reports that the Secretary of the Air Force, Mr. Wynne, is “totally behind the effort” to modernize and improve financial management systems.<sup>33</sup> The Air Force respondent has also reported that the Air Force Secretary has made resource decisions to support the effort to improve financial systems. Numerous public statements and internal decisions have been made supporting the effort to improve the Air Force’s financial statements and reporting systems. The respondent also stated that the Secretary and Chief of Staff of the Air Force were in the process of releasing the new Air Force Strategic Plan incorporating financial management improvement as one of seven strategic goals.

The Secretary of the Air Force also meets once a month with his direct reports regarding the Air Force Information Reliability and Integration (AFIR&I) Action Plan. This is the Air Force’s Financial Improvement Plan (FIP).

<sup>33</sup>DOAF interview, November 1, 2006.

The Secretary chairs the meetings, looking for solutions for improving the financial reporting and for meeting milestones in the AFIR&I action plan.

However, the Air Force also makes the critical declaration that auditability is merely a metric. The true goal, according to the respondent, is accurate, timely, and meaningful financial information.

***b. Positive Resource Allocation***

The Department of the Air Force was negatively graded for the success factor positive resource allocation. The reasons for this grade were the constrained resources within the department, working within existing manpower levels, and the education effort that must be undertaken to change accounting philosophies.

The Air Force respondent also reported constrained resources as a limiting factor in the movement to improve financial management within the Department of the Air Force. When questioned about complaints regarding a lack of resources for this report, the respondent answered, “No, not all the resources we want.” He then modified the response to include: we have all the resources we need, not always what I’ve asked for...our fair share.”<sup>34</sup> The implication is that financial management reform efforts compete for resources within the Air Force budget and are not budgeted separately.

The respondent answered negatively the question regarding temporary labor for producing financial statements and other tasks required for achieving a clean audit opinion. The Air Force is working primarily through its existing workforce to attain financial management reform. The response reflected the belief that the Air Force had the internal expertise necessary to change the “way we’re doing business.”<sup>35</sup> The Air Force has made personnel changes within the financial directorate, not in hiring extra people but in redirecting people within the directorate.

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<sup>34</sup>DOAF Interview, November 1, 2006.

<sup>35</sup> Ibid, November 1, 2006.

Lastly, while the Air Force has not been conducting audit training for its financial directorate people, it has been contemplating the change in thinking required by the financial improvement plan. The change must occur between thinking like budgetary accountants to thinking like proprietary accountants--a significant shift. Budgetary accountants are only concerned that account totals match and that resources are properly accounted for. Proprietary accountants go beyond budgetary accounting and are concerned with demonstrating value for resources expended and properly accounting for liabilities.

***c. Partnering With Inspector General***

The Department of the Air Force received a negative grade when considering the success factor partnering with the Inspector General. The reasons for assigning this grade are: independence of the Inspector General, disagreement on strategy, and the rigid standards imposed upon the Air Force Inspector General directorate.

The Air Force respondent was insistent that a close collaborative relationship with the Inspector General staff was a paradigm shift and that the independence of the IG staff was an asset that would necessarily be compromised should that staff seek a more collaborative role with the financial management directorate.

The respondent also reported a difference in strategy between the financial management directorate and the Inspector General staff. The strategy discussed was the Financial Improvement Plan or the Air Force Information Reliability and Integration (AFIR&I) Action plan. The specific issue being discussed is what constitutes audit readiness. The Air Force respondent maintains that the relationship between the audit community (including the Air Force Inspector General staff) and the financial management directorate is evolving and becoming more collaborative, but further negotiation remains.

The last reason for the lack of partnering with the Inspector General (IG) is that the rigid standards imposed upon the IG render a closer relationship

difficult at best. Their argument is if the IG staff were complicit in readying the financial statements for audit and then confirmed that the assertion packages were ready for independent audit, then the Inspector General's attestation would be tainted and suspect.

**d. Cooperation of Non-financial Managers**

The Department of the Air Force was negatively graded for the success factor cooperation of non-financial managers. The Air Force financial community, like the financial communities in the other uniformed services, has difficulty in convincing non-financial leadership of the importance of financial management reform. Immediate concerns--such as the war effort and rebuilding infrastructure--trump financial management concerns.

The respondent notes that financial constraints have actually helped build the case for the need to reform. Ensuring value for dollars spent is a theme that has helped build consensus among financial and non-financial leaders. The respondent has been called in to meetings of all kinds: acquisition, personnel and logistics. Cooperation and understanding have been building but the burden for building up these relationships falls upon the Financial Management and Comptroller directorate.

In summary, financial management has not always been appreciated and continues to under-appreciated. A sustained effort is required to convince non-financial managers of the importance of financial management and financial management reform.

**e. Short-term Systems**

The Air Force was positively graded for the success factor short-term systems. The respondent reported that a combination of short-term and core financial system upgrades were in progress. The ASAF (FM&C) expects quick returns from developing short-term workarounds to aging financial systems but stresses that the long-term, core financial system is coming. Also contributing to the positive grade were the hiring of a private accounting firm to

assist in the effort to modernize and the hiring of contractors to assist in preparing financial statements.

The Air Force has financial systems that were designed in the 1960's and built in the 1970's. Modernizing the core financial system is part of the long-term effort in financial management reform.

The Defense Enterprise Accounting and Management System (or DEAMS) is the integrated system intended to be the core financial system of the future. Jointly developed by the Air Force, the Defense Finance and Accounting Service, and the U.S. Transportation Command, DEAMS is intended to provide increased financial information flow, improve oversight, and provide a platform for future expansion. DEAMS is a COTS system developed by Oracle Federal Financial.

The Air Force has hired the private firm BearingPoint, Inc., to assist in the modernization effort. BearingPoint is an accounting and management consulting firm that is helping the Air Force with supply-chain management and with purchasing and training Air Force personnel in the management of those systems.

The respondent also confirmed that the Air Force was investing in processes, systems, and people to achieve financial management modernization. Contracted personnel form a part of this effort.

***f. Extraordinary Effort***

The Air Force's effort to modernize cannot be considered an extraordinary effort. Although the Air Force hired a consulting firm to assist in the effort and purchased a COTS system to replace aging financial systems, the strategy of the Air Force to modernize precludes a positive grade in this area.

The Air Force has created financial task forces called Integrated Process Teams--comprised of financial experts, Information Technology experts and functional experts--to examine the financial processes that encompass the financial management effort. These process teams make recommendations for improvement to the executive panel that supervises the financial management

modernization effort. The teams are chartered to examine processes and suggest improvements. These improvement efforts are contained within the Air Force Information Reliability and Integration Action Plan. Since this AFIR&I action plan has been formed and continuously updated for over two years and has an implementation and completion timeframe extending to 2017, the effort cannot be considered extraordinary.

The strategy of the Air Force precludes an extraordinary effort at achieving an unqualified audit opinion. Like the other uniformed services, the Air Force has looked past auditability and has adopted financial transparency as the goal. The intended result of this sustained effort is accurate, timely, meaningful financial information.

## **B. ANALYSIS OF THE THREE SERVICES**

Comparison between services yields significant contrasts and highlights the strengths of the different approaches to financial management modernization. Below is a discussion of the three services broken up by success factor.

### **1. Leadership Commitment**

All three service components reported senior-level leadership commitment. Although senior-level commitment is to business-system and financial-management modernization and not audit readiness, commitment at this senior level is encouraging. Support at this senior level is understandable in that senior executives are more often than not drawn from the private business sector where terms such as unqualified audit opinions, six-sigma, lean, and Enterprise Resource Planning or ERP are commonplace. However, the fact that these business professionals come from the private sector as political appointees works against them in a system where political appointees depart every two years or so.

All three services report having formed senior working groups such as the Army's ACE or Audit Committee Executives representing each functional organization within the Army.

All respondents reported that the service secretaries review the Financial Improvement Plans quarterly. The Air Force had the strongest response in reporting that the Secretary of the Air Force meets monthly with his assistant secretaries and direct reports. The key here is that financial improvement planning in the form of the Air Force Information Reliability and Integration (AFIR&I) Action Plan is briefed monthly at those meetings.

## **2. Positive Resource Allocation**

Out of the three services polled, only the Department of the Navy reported success in funding the modernization effort. Both the Army and the Air Force reported having to create funding for financial improvement and business modernization out of other accounts. The Navy's method of centrally funding the Financial Improvement Plan has to be considered the model for all the services. When facing ever-constrained resources, the obvious temptation is to sacrifice possible future gains in applying resources to financial reform at the risk of short-changing operational concerns in the present.

Constrained resources are a reality for the armed services. However, both the Army and the Air Force cited this as a reason for being mildly dissatisfied with the level of funding that was provided for business transformation. The Army went a step further; the Army respondent stated "in the midst of the Global War on Terror, resources have not generally been available for these financial improvement efforts."<sup>36</sup>

Constrained resources must not be considered solely in the light of external pressures applied to the armed services. In fact, the Army's budget has increased substantially over the last seven years. According to the Army's budget materials, the Army's budget request for Fiscal Year 2007 is \$111.8 billion, 60% more than the budget request for FY2001 of \$70.8 billion. The purpose in quoting these figures is not to challenge the Army's decision-making but rather to highlight that internal priorities also dictate the resources applied and pace of financial reform efforts.

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<sup>36</sup> DOA questionnaire, October 31, 2006.

Although the Navy centrally funds the financial improvement effort, further investigation reveals that Navy funding levels are not significantly higher than the other services when funding for the Navy-Marine Corps Internet (NMCI) is discounted. Specifically, the BTA website lists the Navy funding for business modernization at over \$2 billion for FY06 and \$2.1 billion for FY07. See Figure (3-6) However, when the Navy's funding for the Navy-Marine Corps Internet is subtracted from that spending, \$1.6 billion and \$1.7 billion respectively (See Figure 3-7), the Navy's funding for business systems modernization funding efforts fall to almost mirror the Air Force's spending and are less than the Army's spending.

Component	FY05 & Earlier	FY06	FY07	Total
Army	2,172.2	520.4	719.5	3,412.1
Navy	6,410.4	2,032.5	2,142.2	10,585.1
Air Force	840.3	352.0	457.5	1,649.8
DLA	1,469.2	303.6	157.5	1,930.3
DFAS	29.5	7.4	6.7	43.6
<b>Component Total (millions)</b>	<b>10,936.5</b>	<b>3,247.0</b>	<b>3,512.9</b>	<b>17,696.5</b>

Figure 3-5. Summary by Component of Business Modernization Resources

Source: From U.S. Department of Defense, 2006, November 17

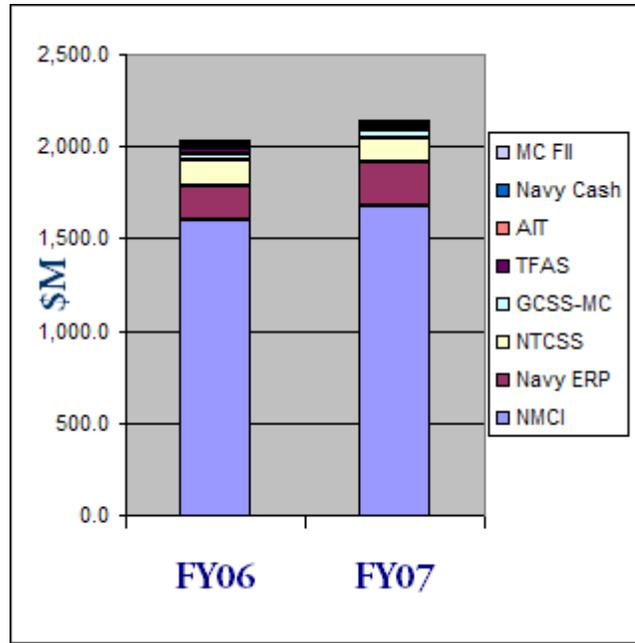


Figure 3-6. Summary of Navy ERP Funds  
 Source: U.S. Department of Defense, 2006, November 17

### 3. Partnering With Inspector General

All three services were graded negatively when considering the success factor partnering with the Inspector General. This is not surprising when considering the following factors: Inspector General traditional institutional bias, the maintained independence of the Inspector General staff, and the lack of proprietary accounting familiarity within both the auditing and accounting staffs.

The Inspector General staffs' role within the DoD and the component services has been one of auditing contracts and asserting budgetary accounting. Breaking that paradigm is particularly difficult considering that, according to the respondents, the collaboration efforts between the accounting/comptroller staffs and the Inspector General staffs are just gaining ground. New roles being assigned to the Inspector General staffs are completing compliance and validation reviews of efforts to comply with the CFO Act of 1990. Time to grow into these roles is not unexpected.

The Air Force respondent stated that the independence from the Inspector General staff was to be respected and not dismissed lightly in pursuit of

teamwork and collaboration with the accounting and comptroller staffs. His point was akin to the scandalous conduct of the accounting firm Arthur Andersen LLP in asserting the controls for Enron while consulting on and taking part in the fraudulent bookkeeping being perpetrated on stockholders.

Lastly, the lack of training and tools available for the Inspector General staffs in proprietary accounting make collaboration efforts less valuable. The same lack of experience in proprietary accounting hinders the efforts of the accounting staffs, as well. The shift in paradigm for both the accounting/comptroller staffs and the Inspector General staffs is enormous since budgetary accounting rule sets are not being replaced, only augmented by proprietary accounting thinking.

#### **4. Cooperation of Non-financial Managers**

All three services were negatively graded for the success factor cooperation of non-financial managers. The reasons for this resonated across all three respondents: lack of education, prioritization, and organizational biases.

Respondents consistently emphasized that a lack of education was a root cause for difficulty in implementing financial reform. Lack of education is exhibited by both financial management personnel and others. Respondents mentioned that since they themselves have been nurtured and trained in a budgetary accounting world, they sometimes lack the proper skill sets and awareness of proprietary accounting benefits. Since they lack the awareness, it is unlikely these budgetary accountants will be able to champion the benefits of proprietary accounting and the need for financial reform.

Also, respondents stated that operational personnel have trouble seeing the long-term benefits of financial management reform when resources are strained to the utmost on urgently needed infrastructure recapitalization efforts. The Army, in particular, has maintained that, "Any initiative with the word 'financial' in it falls on deaf ears to the non-financial communities." This short-term thinking is understandable while we are in the midst of a Global War on Terror and the continued War in Iraq.

Lastly, organizational biases play a role in the lack of cooperation of non-financial managers. The Navy has alleviated this problem somewhat by using the enterprise pilots in the four systems commands. The Navy has consolidated the four pilots into one ERP system called C-ERP. C-ERP, or Converged ERP, is chartered to support the whole Navy. As such, the systems commands have been heading financial initiatives that resonate throughout the operational Navy.

However, the Air Force and Army have a personnel advantage over the Navy. Their professional military accountants and comptrollers are able to trumpet the message of financial reform benefits throughout the operational Army and Air Force

The Navy has no uniformed military accountants and comptrollers. Naval officers filling these billets are often learning while on the job; they cannot be good advocates for reform while simply learning the parameters of the system they are supposed to execute.

## **5. Short-term Systems**

While the Army and Navy were graded absent for the success factor short-term systems, the Air Force was graded positively. The respondents for the Army and Navy responded that short-term systems were eschewed for philosophical reasons while the Air Force respondent reported it was utilizing a combination of short-term solutions and longer-term integrated financial-system solutions.

The Army and Navy have chosen to focus on Enterprise Resource Programming systems for their respective Financial Improvement Programs. The Navy had the successful pilot programs initiated by the systems commands that have been subsumed by the Navy's enterprise-wide ERP. Both the Army and Navy believe it would be counter-productive to the more desirable sustainable effort to improve financial reporting.

The Air Force has reportedly utilized a combination approach in dealing with short-term systems. Along with their ERP financial management system

called DEAMS, the Air Force believes in generating quick returns with short-term systems while the long-term effort is being developed and implemented.

Despite the successes achieved with short-term systems with other DoD components, the services' rationale for choosing the integrated long-term solution is difficult to argue with. It is consistent with their sustainability argument that the only way to build strong and enduring financial management processes is with integrated systems. The further argument the Navy has made is that the short-term workarounds will achieve only short-term auditability that is unlikely to be sustained without heroic efforts year after year.

## **6. Extraordinary Effort**

Of the three services, only the Navy was graded positively on the success factor extraordinary effort. While all three services reported using COTS software and hiring private-sector consulting firms to assist in their respective FIPs, the Navy's transformation efforts only can be labeled extraordinary effort.

Although all three services maintain it is their intention to fund a deliberate, incremental funding approach to business systems and financial management modernization, the Navy's pilot project approach to fielding modernized financial management software can be labeled as extraordinary effort. The combination of purchasing COTS software, hiring private-sector consulting firms, and creating the task forces such as Naval Aviation Enterprise and Sea Enterprise enable the Navy to test systems solutions and if successful, apply them Navy-wide. It is a positive action approach that allows testing and fielding in a more rapid manner--in contrast to the Army's more deliberate feasibility studies and hesitation in fully funding ERP solutions.

## **C. OTHER RESPONDENTS WITH DISCLAIMED OPINIONS**

Three respondent components that were graded mostly positive using the Brook methodology but earned disclaimed audit opinions were: the Defense Information Systems Agency (DISA), the Defense Logistics Agency (DLA) and United States Special Operations Command (USSOCOM). These three

components reported positively for most of the six success factors but were still unsuccessful in achieving audit readiness. Their results are listed below in Figure 3-7.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION FOR 2005?
DISA	YES	YES	YES	NO	NO	YES	Disclaimed
	7/8 POSITIVE	4/6 POSITIVE	4/5 POSITIVE	3/7 POSITIVE	0/3 POSITIVE	4/6 POSITIVE	
DLA	YES	YES	YES	YES	YES	YES	Disclaimed
	7/8 POSITIVE	5/6 POSITIVE	3/5 POSITIVE	5/7 POSITIVE	3/3 POSITIVE	5/6 POSITIVE	
USSOCOM	YES	YES	YES	YES	NO	YES	Disclaimed
	6/8 POSITIVE	5/6 POSITIVE	5/5 POSITIVE	5/7 POSITIVE	1/3 POSITIVE	4/6 POSITIVE	

Figure 3-7. Summary of Other Respondent Results for Components Earning Disclaimed Opinions

This apparent disparity casts doubt upon the predictive ability of the Brook methodology. Reconciling the fact that these three components scored positively in the six success factors but have yet to receive clean audit opinions is problematic. There must be other success factors not considered by this study that have affected these components' ability to gain audit readiness. Below is a discussion of the three components and their responses to the six success factors.

All three respondents were graded positively for the success factor leadership commitment. The DISA's respondent stated that the DISA's CFO, Mr. Jimaye Sones, is the component's driving force to achieve auditability. USSOCOM's respondent reported that the comptroller for USSOCOM is "on a mission"<sup>37</sup> to achieve auditability and presses forward with remediation efforts despite encountering uninformed resistance from other managers within USSOCOM. The DLA has reported that uninformed and civilian leadership at the DLA has attended every audit readiness meeting and audit readiness is part of the strategic plan briefed monthly.

<sup>37</sup> USSOCOM interview, November 8, 2006.

The DISA, the DLA, and USSOCOM were also graded positively for the presence of success factor positive resource allocation. The respondent for the DLA reported that the component asked for and received additional funding in order to modernize thirty year-old legacy systems as part of operations and management funds. All three components also reported adding additional personnel, both contracted and temporary, to accomplish the tasks necessary to improve the reporting systems feeding the financial statements.

The three respondent components were also graded positively for success factor partnering with the Inspector General. The DLA reported that the current relationship with the DoD IG has improved greatly despite having no history of partnering with that organization. USSOCOM reported success while establishing a partnership with the DoD IG and “learning to speak each others’ language.”<sup>38</sup> Lastly, the DISA reported that the DoD IG had assisted with review of the remediation contracts with outside agencies to assist in correcting internal controls within the DISA. The DISA respondent did report that the relationships with the DoD IG and regional Inspector General teams were still being formulated due to the need for the Inspector General staffs to maintain their independence.

Two of three components were rated positively for success factor cooperation of non-financial managers. The DISA was graded negatively for this success factor. The primary reason for this negative grade was that the DISA reported that its strategic business units “were still trying to find the balance in prioritizing goals and that financial managers and the DISA’s regional accountants were still trying to convince non-financial managers of the importance of audit readiness.”<sup>39</sup>

Two of three respondent components were graded negatively for success factor short-term systems. USSOCOM and the DISA were graded negatively for the same reason: reliance on legacy systems. USSOCOM relies on financial management information from the uniformed services because most of USSOCOM’s equipment comes from the uniformed services. As such,

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<sup>38</sup> Ibid, November 8, 2006.

<sup>39</sup> DISA interview, October 23, 2006.

USSOCOM cannot begin to modify its financial management systems until the uniformed services make significant headway in doing so. The DISA is also relying on legacy systems to accomplish audit readiness. The DISA respondent also indicated that financial management systems improvement would not be considered until the DoD implements the Defense Agencies Initiative (DAI). This initiative is designed to be a single financial management systems standard for 28 DoD components.<sup>40</sup>

Lastly, all three respondent components were graded positively for success factor extraordinary effort. The DISA, the DLA, and USSOCOM all reported hiring a private auditing firm to assist in the audit readiness effort. All three also described the formation of audit committees meeting quarterly, sometimes monthly, in order to track progress toward a clean audit. Due to financial managers' influence at all three components, all three respondents answered positively when questioned about applying heroic efforts to the audit readiness goal.

#### **D. THREE ILLUSTRATIVE RESPONDENT COMPONENTS**

The next three responding components provide illustrative confirmation of this paper's methodology. All three responding components reported strong support across the six attributes and all three received unqualified audit opinions for FY2005 and, recently, for FY2006. This outcome is expected per Brook's findings.

All three components, the Defense Finance and Accounting Service (DFAS), the Military Retirement Fund (MRF), and the Defense Commissary Agency (DeCA) for the most part responded enthusiastically to the six success factors comprising the methodology for study in this paper. The success factors resonated in the responses given in the interviews and confirmed the relevance and predictive ability of the Brook thesis. Exceptions are noted below.

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<sup>40</sup> [http://www.dod.mil/dbt/products/Sept-06-BEA\\_ETP/etp/App\\_E/QuadCharts/DAI\\_Chart.html](http://www.dod.mil/dbt/products/Sept-06-BEA_ETP/etp/App_E/QuadCharts/DAI_Chart.html), November, 2006.

## 1. DFAS

The results for the Defense Finance and Accounting Service or DFAS are shown in Figure 3-8. The DFAS was an instructive organization to study because it had received unqualified opinions for each of the last six years: FY2001 through FY2006. Although the DFAS is the one of the most business-like organizations this paper examines, the responses from these successfully audited agencies are critical.

The DFAS is not only committed to achieving clean audit opinions of its own. The organization is vital in assisting client Defense components in aligning their financial processes and statements as well.

The DFAS is responsible not only for personnel pay but also conducts transactions for client Defense components. The DFAS maintains accounts for Defense appropriations, processes Defense contractor invoices and maintains accounting over foreign military sales.

The DFAS therefore plays not only an active role but also an advisory role to client Defense components in gaining and sustaining clean audit opinions themselves. In fact, the Chief Financial Executive for the Defense Commissary Agency or DeCA maintained that the DFAS was a “critical partner” in achieving audit success for the DeCA.<sup>41</sup>

Below, in Figure 3-8, is the summary of grading for the DFAS. The DFAS earned positive scores for all success factors except for short-term systems. A brief reporting of each success factor is provided below.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION FOR 2005?
DFAS	YES	YES	YES	YES	NO	YES	Unqualified
scores	6/8 POSITIVE	4/6 POSITIVE	4/5 POSITIVE	6/7 POSITIVE	1/3 POSITIVE	5/6 POSITIVE	

Figure 3-8. Summary of the Defense Finance and Accounting Service Respondent Results

<sup>41</sup>DeCA interview, November 13, 2006.

**a. Leadership Commitment**

The DFAS earned a positive grade for leadership commitment. The respondent for the DFAS was adamant that leaders within an organization were essential to audit readiness for three reasons: ownership of the auditability plan, building a cohesive team, and defining the process goal.

The interviewee for the DFAS maintained that corporate leadership must own the auditability plan. The key to ownership, in her opinion, was two-fold: understanding the auditability process and approving the auditability plan.

When senior leaders understand the auditability process, they are in positive and informed control of the process. Once leaders are informed, they are able to make critical decisions and support key players in the auditability process. Leaders who understand the process and demand updates are in a position to sustain corporate focus on the goal.

Approving the auditability plan also places senior leaders in an ownership role. In the interviewee's opinion, owning the auditability process pays multiplying dividends. If the senior leadership is focused on auditability and aligns rewards and effort toward that goal, the organization will follow.

The respondent for the DFAS gave a second reason why leadership commitment was central: when leaders are more involved, cohesiveness and shared responsibility result. With these positive attributes, the organization is less likely to waste resources in pursuing the audit readiness goal. The reason for less waste is that the leadership understands, tracks, and focuses the organization on the auditability goal.

The last reason given for the centrality of leadership commitment is that the "definition" stage of the auditability process is most significant. The respondent went so far as to say that leaders must define the resources and define the process at the outset, otherwise sustainability of a clean audit opinion becomes less likely.

**b. Positive Resource Allocation**

The DFAS also received a positive evaluation for success factor positive resource allocation. The reasons for this positive grade were: implementing a new system at the outset of planning for auditability, devoting resources at the outset to build a sustainability plan concurrent with the auditability plan, and applying resources to education continually.

The respondent for the DFAS insisted that planning for and applying resources to sustainment efforts while planning for the initial audit is critical. Her question was, “Do you want a whole new audit each time?”<sup>42</sup>

The interviewee also made clear there were two different challenges presented between gaining an unqualified audit the first time versus sustaining the effort. The DFAS’s challenge in sustainment is that improving on a baseline each year is more difficult than establishing a baseline effort of auditable financial statements.

The reasons sustaining the effort were more difficult included: knowledge transfer among arriving and departing employees, process changes, financial systems changes, business changes, difficulty of sustaining the required energy level, maintenance of focus, the issue of auditors getting savvier, and the increasing constraints of regulatory actions. She calls this the “reality curve.”<sup>43</sup> She describes the ever-changing reality this way to sum up the multitude of factors that challenge the way the agency organizes its auditability effort each year.

Lastly, the interviewee stated her position that resources of people and effort must be applied continually to the goal of attainment and the goal of sustainment of the positive audit opinion. Not applying resources continually, in her opinion, affects the extraordinary effort success factor.

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<sup>42</sup> DFAS Interview, November 13, 2006.

<sup>43</sup> DFAS Interview, 13 November 2006

**c. Partnering With Inspector General**

The DFAS was graded positively for the success factor partnering with the Inspector General. The interviewee for the DFAS was enthusiastic about both the Department of Defense's Inspector General staff and the internal auditing staff within the DFAS. With regard to the DoD IG, the respondent stated that the IG staff was improving at a rapid rate and growing into its new role of asserting readiness for independent audits.

The DoD IG staff is much improved according to the respondent. The DoD IG is exploring and establishing its new role while maintaining its independence within the Department of Defense. The interview subject summed up by stating that she felt the DoD IG and internal auditing staff were finally realizing that "they were on the same team" and had an equal stake in ensuring the DFAS maintained auditability.

Lastly, the DFAS respondent said that the auditing staff and the DODIG were embarking on a significant learning curve. Tasks being mastered included: understanding what constituted "materiality" establishing new lines of dialogue, and validating internal controls to build robustness in the financial management systems.

**d. Cooperation of Non-financial Managers**

The DFAS scored positively for the attribute cooperation of non-financial managers. The respondent places responsibility for ensuring the cooperation of non-financial managers squarely on the accounting staff.

The respondent reasoned that, since the accounting staff had the subject-matter expertise, it was up to the accounting staff to educate non-financial divisions within the organization. Her idea was that "if they [non-financial managers] do not understand, then you [the organization] won't get to solutions until you get them to see the vision and their part in that solution."<sup>44</sup>

The respondent stated that unless the organization has committed non-financial management and divisions, the process will be slowed, if not

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<sup>44</sup> DFAS Interview, 13 November 2006.

abandoned. As controllers of resources and bases of influence, non-financial managers will hinder the effort should they not grasp the immediacy and importance of audit readiness.

**e. *Short-term Systems***

The DFAS also graded as absent for the success factor short-term systems. Although the respondent acknowledged the necessity and utility of short-term systems, she was cautious about their misuse.

The respondent's experience caused her to state that short-term systems or workarounds may not save the organization money in the long-run. Workarounds are, by definition, augments to or replacements for the integrated legacy system. As a direct result of this fact, the workarounds cause more labor and resources to be expended. If workarounds are utilized for an extended period, the respondent feared they would complicate the goal of audit readiness. Further, workarounds could render the process of attaining that auditability goal more difficult, if not ultimately impossible.

The respondent additionally recognized the necessity of workarounds in any organization. However, her argument was that the goal of sustainability in audit opinions should include eliminating the need for workarounds.

Lastly, the respondent was careful to distinguish between workarounds and analysis "tools," as she called them. She maintained that workarounds were necessary but potentially cumbersome and costly. However, analysis tools are designed for the specific purpose of understanding and working specific problem areas in managerial information. The DFAS, for instance, uses an analysis tool called CCAS. It is utilized by DFAS to identify variances in fund balances and to assist in explaining those variances. The DFAS interviewee maintained that workarounds disguised the shortcomings of the legacy financial systems, while the stand-alone analysis tools such as CCAS are for such specific purposes as to render them independent from core financial management systems.

**f. Extraordinary Effort**

The DFAS also scored positively for success factor extraordinary effort. However, the respondent judged the need for extraordinary effort in a negative light. Her feeling was that the necessity for extraordinary effort was detrimental to the organization in that that level of effort will result in increased risk. The respondent's idea was that working toward the goal of sustainability in audit readiness in tandem with attaining audit readiness year after year should render extraordinary effort superfluous.

Her cure for extraordinary effort consisted of several actions: staying in touch with external auditors and customers, documenting processes, and leveraging all of the organization's assets.

By staying in touch with auditors and customers, the respondent held that the organization could avoid large surprises. Indeed, the new accounting cycle of 21 days makes this consistent communication almost a necessity. With independent auditors starting testing controls in the second, third, and fourth quarters of the fiscal year, continuous communication is paramount.

Documenting processes, systems, methods, and procedures leads to a better ability to assert the readiness for audit, in her opinion. In this way, the organization can insulate itself against relying on the knowledge of its people and instead rely on its process. By documenting and educating personnel on the process, the respondent felt that an organization could protect itself against personnel losses, personnel rotations, and the necessity of re-learning the organization's financial management systems: all root causes of the necessity for Herculean effort.

Lastly, the interviewee confirmed that an organization had to leverage all of its assets to build and maintain auditability. Again, she cautioned that utilizing these assets came with a price. She specifically mentioned utilizing contractors and COTS systems.

The DFAS did and does utilize contract personnel to perform specialized tasks and contribute to the increased workload of achieving

auditability year after year. However, the respondent cautioned that over-reliance on contractor personnel could cause a loss of corporate knowledge. Her concern was that when the contractors left the organization, so would the knowledge. Her cure for this was the documentation process. Again, if you improve the process, the loss of key personnel should have a mitigated effect.

COTS financial systems can cause as many problems as they solve. Newer, more stringent financial management systems mean an increase in the number and specificity of controls. More controls force accountants and financial managers to look deeper into organizational processes and practices. The more interrelated and sophisticated the accounting software and processes become, the easier it is to “lock up” your systems.<sup>45</sup> Again, process documentation is the cure.

## 2. MRF

The Military Retirement Fund (or MRF) is an entity with a great many future liabilities (future pensions) and very few transactions. A majority of employees working for the MRF are actuaries working to account for, invest, and report on the funds needed to pay present and future liabilities. The MRF responded positively to five of six success factors. The one success factor scored negatively was partnering with Inspector General. However, all six attributes are briefly discussed below.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION FOR 2005?
MRF	YES	YES	NO	YES	YES	YES	Unqualified
scores	5/8 POSITIVE	4/6 POSITIVE	2/5 POSITIVE	5/7 POSITIVE	2/3 POSITIVE	5/6 POSITIVE	

Figure 3-9. Summary of The Military Retirement Fund Respondent Results

<sup>45</sup> DFAS Interview, November 13, 2006.

**a. Leadership Commitment**

The Military Retirement Fund was graded positively for leadership commitment. The reason for this assessment is the MRF respondent's view that senior executive leadership has supported audit readiness as a goal over the objections of non-financial managers throughout the Department of Defense.

Objections cited by this interviewee were that financial management reforms have become too expensive and have gone too far. Non-financial managers, according to the respondent, believe that the pace of financial management reform has out-stripped its utility. He believes that the message of the usefulness and centrality of auditable financial statements has not been completely understood. The respondent argued that the communications effort can be likened to a significant culture change. Changing peoples' attitudes is a challenging obstacle to financial management reform.

**b. Positive Resource Allocation**

The MRF also received a positive grade for positive resource allocation. Although the MRF has not dedicated its own resources to modernizing financial management systems and the educational effort, it has leveraged the work of the Department of Defense in these areas. The respondent specifically credited the DoD's Financial Improvement and Audit Readiness (FIAR) Plan with significant strides in these two efforts.

The respondent for the MRF credits the FIAR Plan with both demanding standardized results and dictating focus areas and with leaving the process improvements up to the components who are expert in their own missions and processes. The respondent sees this as a more efficient and effective process than waiting to build consensus on solutions and standards.

The DoD has also leveraged contract personnel to build and deliver training courses to change the expectations and skill sets of financial management and non-financial management personnel alike. The MRF's respondent believes the DoD has taken the correct path of people and process improvement.

**c. Partnering With Inspector General**

The Military Retirement Fund was graded negatively on success factor partnering with the Inspector General. The contributing causes of this grade were: culture change within the DoD Inspector General staff, the transitioning mission of the Inspector General, and the need to maintain independence within the IG staff. These themes were echoed earlier in this paper but are confirmed yet again by another Defense agency.

The mission of the DoD Inspector General has changed significantly. From merely auditing contracts to being actively engaged in financial management improvement and reform is a large step.

The financial executive from the MRF who responded to this study likened the transition to that of the Internal Revenue Service. “Those guys [DODIG] were feared [...] theirs was very much a ‘gotcha’ role.”<sup>46</sup> Transforming that image has been a goal of the DODIG according to the MRF respondent.

The MRF financial executive also reported that the DODIG has taken on a more “partnering” role within the Department of Defense. According to the respondent, the IG staff is much more cooperative and more likely to engage in advance discussions regarding asserting financial statements as audit-ready. Although the IG staff retains the right to give the assertion opinion on an agency’s financial statements, they have taken on a more informal advisory role within the DoD.

As mentioned earlier in this paper, the Inspector General staff’s need to maintain its independence as an outside auditor has rendered cultural change tentative according to the interviewee. The respondent lauds the efforts of the IG because of its difficult and often contradictory roles.

**d. Cooperation of Non-financial Managers**

The Military Retirement Fund also received a positive grade for success factor cooperation with non-financial managers. However, the

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<sup>46</sup> MRF Interview, November 13, 2006.

respondent saw cooperation of non-financial managers, for the most part, as compelled cooperation rather than willing cooperation.

Echoing the comments of his fellow respondents, this interviewee placed the onus of educating and winning over non-financial managers upon the accounting and comptroller leadership. He mentioned that the Chief Financial Officer for the DoD had challenged those two communities to increase value added to non-financial leadership. The respondent accepted that educator role to be a positive force in proving the financial manager's value to the whole organization.

**e. *Short-term Systems***

The MRF earned a positive grade for success factor short-term systems as well. However, the interviewee saw a direct linkage in the number of short-term (workaround) systems and the extraordinary efforts required attaining auditability year after year. The respondent saw workarounds as temporary fixes undertaken in order to accomplish the task of achieving audit readiness. He lamented the fact that the number of workarounds contributed enormously to the workload endured by accounting staffs.

The respondent mentioned that the MRF personnel had to collect over 14,000 samples or documents to prove auditability. This effort, as he sees it, causes the MRF personnel to place their hopes in future financial management systems that will substantially decrease the field-work required.

**f. *Extraordinary Effort***

Lastly, the Military Retirement Fund was graded as present for the success factor extraordinary effort. The respondent saw continued extraordinary effort but not to the same degree as that required to attain auditability. The trends he noticed were: an increase in expertise in achieving auditability was coupled with a decrease in reliance upon short-term systems and that heroic effort was becoming less and less necessary as expertise increased among accounting and auditing staffs.

### 3. DeCA

The Defense Commissary Agency's results are shown in Figure 3-10. The DeCA was graded positively across all six success factors. The DeCA is a model agency which achieved laudable results in gaining and sustaining clean audit opinions despite facing increased resource constraints and utilizing legacy financial systems. The DeCA has received consecutive clean audit opinions for the last five years--starting with FY2001 up to and including FY2006. A brief summary of all six success factors is discussed below.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION FOR 2005?
DeCA	YES	YES	YES	YES	YES	YES	Unqualified
scores	6/8 POSITIVE	4/6 POSITIVE	4/5 POSITIVE	6/7 POSITIVE	3/3 POSITIVE	5/6 POSITIVE	

Figure 3-10. Summary of The Defense Commissary Agency Respondent Results

#### a. Leadership Commitment

The DeCA was positively graded for the presence of success factor leadership commitment. The respondent for the DeCA held very strongly the idea that attaining and sustaining a clean audit opinion was unthinkable without leadership commitment starting from the very top. Mr. Patrick Nixon, formerly the Chief Executive Officer and now the Director of the DeCA arrived at the same time as the goal of attaining auditable financial statements. The respondent, from the beginning, said the effort to attain auditability was championed by the CEO/Director, Mr. Nixon. In fact, this past July, at the Defense Finance Conference, Mr. Nixon presented a briefing on this very subject. His talk was entitled, "Defense Commissary Agency: The Premier Benefit of a Global Force."

The interviewee agreed most strongly that leadership commitment was the number-one success factor she could name. The respondent for the

DeCA mentioned three attributes in talking about leadership commitment: buy-in at every level, quarterly process reviews, and personal accountability.

Buy-in at every level was ensured through feed-back mechanisms that were new to the DeCA in 2001. Stores had not been given financial statements before but were now receiving performance numbers that allowed for comparison. Zone managers, regional directors, and headquarters staff were forced to reinvent themselves and develop skill sets within.

Quarterly process reviews were another performance metric instituted under Mr. Nixon. These processes were reviewed and compared across store, zone (eight to twelve stores), and region. In stock rates, customer satisfaction and other performance measures were instituted that tied store performance to enterprise goals, something that had never been seen before at the DeCA.

Lastly, the respondent reported that personal accountability was the most effective tool used to ensure commitment was shared at every leadership level in the DeCA. Her phrase, “you got sent to Siberia if you weren’t performing,”<sup>47</sup> spoke volumes about the intensity of leadership commitment and focus.

***b. Positive Resource Allocation***

The DeCA received a positive score on the success factor positive resource allocation. This score was awarded despite the fact that the DeCA had sustained a serious setback in finances at exactly the same time as the effort to achieve auditability began. Despite that, the DeCA committed itself to applying the resources it had and achieved significant success.

The DeCA is taking part in the Defense Agency Initiative designed to bring updated financial management software from COTS technology. However, it must be noted that the DeCA achieved its auditability goals with legacy systems.

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<sup>47</sup> DeCA Interview, November 13, 2006.

The DeCA was forced to pay for financial improvements within the existing budget. Contract employees, temporary uniformed military accountants and process improvements were all “taken out of hide” as the interviewee explained it.

Compounding the difficulty in affording modernization was the budget reality across all of DoD. Constrained resources and the Global War on Terror have diverted funds away from bases here in the United States. The interviewee explained that services traditionally provided to the DeCA such as armed escorts for money transfers, grass cutting, and utilities dried up as the military base budgets became more and more limited.

On top of these difficulties was that the facilities portion of the DeCA was broken. There were, in FY2000 and FY2001, not enough funds to recapitalize the physical property of the DeCA. The five percent surcharge added to each customer’s grocery bill was going to operating costs--not infrastructure as intended when the surcharge was created.

Additionally, the DeCA was forced to accept a reduction in their Defense Working Capital Fund. The size of the cut was \$130 Million. The respondent stated “that amount may not seem like much in the Defense world, but it came out of our \$1 Billion appropriation, a thirteen-percent cut.”<sup>48</sup>

Despite all of these challenges, the DeCA met and continues to meet its auditability goals. The respondent insisted that the DeCA’s achievements were accomplished through embracing the challenges, especially the increased accountability rules, instead of seeking relief from legislation or giving in to frustration at the external factors and large barriers to success.

***c. Partnering With Inspector General***

The DeCA also received a positive grade for partnering with Inspector General. The respondent credits the audit committee for nurturing this cooperative spirit within the organization.

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<sup>48</sup> DeCA Interview, November 13, 2006.

The Defense Commissary Agency has two auditing arms: the internal inspector General office and the Office of Internal Review. The Inspector General's mandate is uncovering and confronting fraud, waste, and abuse of government funds and property. The office for internal review conducts audits of the financial systems and statements throughout the year. The internal auditing staff's schedule is dictated by the Government Accountability Office's information requests and the Inspector General staff's uncovering of suspect systems controls.

**d. Cooperation of Non-financial Managers**

The DeCA received a positive grade for success factor cooperation of non-financial managers. The respondent noted that compelling cooperation was part of the audit readiness strategy, but involving non-financial managers in the change process was a strategic choice as well.

The audit committee holds monthly meetings and involves, as a matter of policy, functional managers in creating and implementing solutions. The DeCA's contracted external auditing firm, KPMG LLC, issues recommendations that the DeCA must then consider and if concurred with, acted upon. As a matter of policy, functional managers are the personnel given responsibility for implementing process improvements suggested by KPMG.

The respondent was proud to note that the DeCA continues to have very few non-concurrences to KPMG recommendations. She notes this to emphasize that the DeCA did not shrink from the challenges it faced.

**e. Short-term Systems**

The DeCA was graded positively for success factor short-term systems. The DeCA has made and continues to make extensive use of short-term systems or workarounds in their financial management.

The reason for such heavy reliance upon workarounds is that the DeCA's financial management systems are archaic and aren't very well-suited for

modern managerial decision-making needs. The lack of available data and lack of suitable formats made workarounds inevitable.

The case-in-point mentioned by the interviewee was the fact that store managers received two payroll reports monthly. These reports were simply insufficient to assist the manager in improving efficiency. The workaround systems created in Microsoft Excel format now give productivity ratios for individual stores and compare stores with their peers. In fact, the DeCA has made significant steps to keep pace with industrial standards in the private market-place. The interviewee hastened to add that the DeCA compared most favorably with industry effectiveness and efficiency measures against its private-sector peers.<sup>49</sup>

***f. Extraordinary Effort***

This research awarded a positive grade for the DeCA in the success factor extraordinary effort. The reasons for awarding this grade were: extraordinary effort over a short period of time, application of personnel, use of contractors and COTS software investment, and task force creation.

The respondent for the DeCA reported enthusiastically regarding the ongoing “Herculean effort” within the accounting staffs. Responding to the newly compacted twenty-one-day reporting period each month, accounting staff spend most holiday weekends readying financial statements for auditability. The interviewee could not give enough credit to the accounting staff for sustained effort in maintaining the focus on auditability.

Another reason the DeCA was awarded a positive grade for extraordinary effort was the application of extra manpower to problem financial-reporting focus areas within the organization. The respondent reported hiring temporary personnel and borrowing manpower from non-financial divisions to accomplish the laborious tasks of ensuring audit readiness, such as: counting inventory, verifying physical assets, updating information technology systems, and validating financial records.

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<sup>49</sup> DeCA Interview, November 13, 2006.

The last reason for the Defense Commissary Agency's positive grade was the creation of task forces designed to eliminate weaknesses in financial reporting. Under the direct guidance of the DeCA's audit committee, task forces were created. These task forces were built from all disciplines within the DeCA staff and, most importantly, included functional managers who actually owned the processes being strengthened.

When KPMG, the DeCA's independent auditing contractor, reported material weaknesses in "mini audits" conducted mid-year and immediately prior to issuing their official audit report. The DeCA was very proactive in correcting discrepancies and embracing these criticisms as opportunities to improve. This level of communication, openness and decisive action secured the DeCA's control over its financial management reform processes and all but guaranteed an unqualified audit opinion.

## **E. COMPARISON OF THE THREE ILLUSTRATIVE RESPONDENT COMPONENTS**

All three respondent components: the Defense Finance and Accounting Service, the Military Retirement Fund, and the Defense Commissary Agency performed extremely well when evaluated against the six success factors. This result conformed to expectations in that these three have received clean audit opinions for several years.

These three components shared similar opinions regarding the value of financial management reform and the pursuit of audit readiness. In fact, of the three evaluations, only two success factors were graded negatively out of 18 possible. Below are observations that echo among the three interviews categorized by success factor.

### **1. Leadership Commitment**

All three respondents placed strong emphasis on the primacy of leadership commitment in attaining and sustaining a clean audit opinion. Leadership commitment is essential to: focus the effort, assign resources, and approve the auditability plan.

Senior leaders must understand the auditability process in order to communicate it to the organization. The respondents from the DeCA and the DFAS were particularly insistent that unless leaders were personally committed, the organization was unlikely to sustain the effort to achieve audit readiness.

Resource assignment is a critical policing type of function only leaders within the organization can accomplish. The respondents saw this function: the resource allocation decision-making as signaling to the organization that audit readiness was and remains a priority goal of the agency.

Approving the auditability plan is most critical, argues the respondent from the DFAS. She saw the “definition stage” as most important because if sustainability resources are not considered in tandem with attainment resources, the effort is handicapped. The DFAS interviewee also said that senior leaders understanding and approval of the auditability plan is vital; fewer resources will be wasted because senior leadership has the unique opportunity to align the organization behind the planned effort.

By approving the auditability plan, senior leadership makes resource determinations and emphasizes that audit readiness is a priority for the organization. The respondent from the Military Retirement Fund saw resource prioritization as the key function of senior leadership. He also saw senior leaders as solely responsible for compelling cooperation from unconvinced managers because only they had the authority to do so.

## **2. Positive Resource Allocation**

All three respondents agreed that positive resource allocation was an important factor in the audit readiness plan. However, two interesting ideas about positive resource allocation came from the DFAS and DeCA respectively. The DFAS interviewee clearly stated that sustainability resources must be allocated along with attainment resources. The DeCA respondent’s point was that monetary resources or the lack thereof cannot be construed as an excuse for failing to plan for or achieve auditability.

The respondent for the DFAS was adamant that resources must be allocated to improving processes. Her concern was that as challenges to sustaining audits emerge: knowledge transfers, process change, systems upgrades, business changes, and personnel changes all contribute to challenges in maintaining auditability. Her solution was to invest in process improvements and document processes so that as circumstances change, the organization can rely on the process- and financial-management system to keep pace--not the fallible personnel who run them.

The DeCA's respondent took the opposite view: that automation first is not appropriate. In her experience, focusing on the people behind the effort is what pays immediate dividends and causes lasting improvement.

The DeCA's respondent took that thought a step further to argue that a lack of dedicated resources and an atmosphere of constrained resources should not be an excuse for failing to plan for audit readiness or even achieve audit readiness. Her view was that organizations have a wealth of resources besides money for systems improvement, and that aligning those resources was the true locus of effort to achieve auditability.

### **3. Partnering With Inspector General**

All three components recognized that the auditing function within the DoD was undergoing tremendous changes. Culture change and mission change were at the heart of this upheaval. However, all three iterated that the auditing staffs and, in particular, the Department of Defense Inspector General staff were responding positively and meaningfully to adjust and make the most of their new roles as co-participants in the auditability process.

While all respondents concluded that partnership with the internal auditing or Inspector General staff was important, the MRF interviewee had the most to say about this issue. He acknowledged that while the Department of Defense Inspector General (or DoD IG) was undergoing tremendous cultural and mission change, it was the responsibility of the accountants and comptrollers of the organization to communicate and lead change.

His premise was that the accountants and comptrollers were the subject-matter experts in the goal of auditability; so, those personnel must take the lead. In his opinion, accountants must and should bring increased value to the organization by inserting themselves in traditionally non-financial processes to prove the ability to contribute.

#### **4. Cooperation of Non-financial Managers**

All three respondents agreed that the cooperation of non-financial managers was important. The DFAS interviewee explained that if non-financial managers were not a part of the process, then they would slow down the process.

Both the MRF interviewee and the interviewee for the DeCA believed that cooperation, if not voluntary, should be compelled. Two ways to compel cooperation from non-financial managers is to educate or provide adverse consequences for failing to cooperate. Again, the MRF respondent believed that it was the responsibility of the financial experts, the accountants and comptrollers, to prove the value of auditability. The DeCA respondent noted that the DeCA would punish uncooperative non-financial managers by “sending them to Siberia:” a euphemistic expression for adversely affecting the career progression of problematic managers.

#### **5. Short-term Systems**

All three interviewees recognized the inevitability of workarounds or short-term systems and acknowledged their usefulness. However, both the DFAS and the MRF respondents were negative in their views towards the implications of workarounds.

The respondent for the MRF pointed to the fact that legacy systems are rendered inadequate by new legislation. Older systems weren't built to capture the data required to satisfy modern reporting requirements. In his view, workarounds meant a tremendous amount of busywork: translating data, compiling data, and formatting the data required to present necessary reports.

The DFAS respondent also took a dim view of workarounds, albeit recognizing their usefulness. She said the goal of building sustainability within the audit readiness plan should eliminate the need for workarounds.

## **6. Extraordinary Effort**

The three respondents all agreed that extraordinary effort was the rule rather than the exception. The most direct reason for the need for extraordinary effort is the compressed accounting schedule. The DFAS respondent mentioned that the twenty-one-day reporting schedule meant that her independent auditor firm, UKW, was testing internal controls in the second, third, and fourth quarters consecutively. The DeCA respondent stated that her accounting staff spent most holiday weekends at DFAS Columbus readying financial statements for audits.

All three respondents also stated that the Herculean effort did not end when auditability was attained. Sustaining a clean audit opinion presented its own challenges. The DFAS respondent put it succinctly when she stated “establishing the baseline is an achievement, but improving upon that baseline while people are changing, rules are changing, and the business changes all present unique, but no less strenuous challenges as well.”<sup>50</sup>

## **F. SIX SUCCESS FACTORS FOR ALL RESPONDENTS**

Financial management executives from the nine respondent components were interviewed via telephone and/or email. Below, Figure 3-11 gives the summary grading of the six success factors for the nine respondent components and their 2005 independent audit results.

In examining the figure below, it becomes clear that the Brook methodology isn't 100% predictive. Although the three uniformed services predictably had disclaimed audit opinions, the three smaller components with disclaimed opinions (DISA, DLA, and USSOCOM) scored positively according to the Brook methodology. The three components both scoring positively and

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<sup>50</sup> DFAS interview, November 13, 2006.

earning unqualified opinions (DFAS, MRF and DeCA) tended to confirm the validity of the Brook methodology.

AGENCY	LEADERSHIP COMMITMENT	POSITIVE RESOURCE ALLOCATION	PARTNERING WITH INSPECTOR GENERAL	COOPERATION OF NON-FINANCIAL MANAGERS	SHORT-TERM SYSTEMS	EXTRAORDINARY EFFORT	AUDIT OPINION FOR 2005?
USAF	YES	NO	NO	NO	YES	NO	Disclaimed
	5/8 POSITIVE	3/6 POSITIVE	1/5 POSITIVE	3/7 POSITIVE	3/3 POSITIVE	2/6 POSITIVE	
USA	YES	NO	NO	NO	NO	NO	Disclaimed
	5/8 POSITIVE	1/6 POSITIVE	2/5 POSITIVE	1/7 POSITIVE	1/3 POSITIVE	2/6 POSITIVE	
USN	YES	YES	NO	NO	NO	YES	Disclaimed
	6/8 POSITIVE	5/6 POSITIVE	1/5 POSITIVE	3/7 POSITIVE	1/3 POSITIVE	3/6 POSITIVE	
DISA	YES	YES	YES	NO	NO	YES	Disclaimed
	7/8 POSITIVE	4/6 POSITIVE	4/5 POSITIVE	3/7 POSITIVE	0/3 POSITIVE	4/6 POSITIVE	
DLA	YES	YES	YES	YES	YES	YES	Disclaimed
	7/8 POSITIVE	5/6 POSITIVE	3/5 POSITIVE	5/7 POSITIVE	3/3 POSITIVE	5/6 POSITIVE	
USSOCOM	YES	YES	YES	YES	NO	YES	Disclaimed
	6/8 POSITIVE	5/6 POSITIVE	5/5 POSITIVE	5/7 POSITIVE	1/3 POSITIVE	4/6 POSITIVE	
DeCA	YES	YES	YES	YES	YES	YES	Unqualified
	6/8 POSITIVE	4/6 POSITIVE	4/5 POSITIVE	6/7 POSITIVE	3/3 POSITIVE	5/6 POSITIVE	
DFAS	YES	YES	YES	YES	NO	YES	Unqualified
	6/8 POSITIVE	4/6 POSITIVE	4/5 POSITIVE	4/7 POSITIVE	1/3 POSITIVE	5/6 POSITIVE	
MRF	YES	YES	NO	YES	YES	YES	Unqualified
	5/8 POSITIVE	4/6 POSITIVE	2/5 POSITIVE	5/7 POSITIVE	2/3 POSITIVE	5/6 POSITIVE	

Figure 3-11. The Six Success Factor Grades for All Respondents

### G. OTHER FACTORS

Only the Military Retirement Fund respondent answered positively when questioned as to other factors contributing to a successful audit. He included “a fertile environment”<sup>51</sup> to the list. His suggestion was that the organizational culture must undergo a shock in order to gain the impetus to change. He said that the shock could be monetary, legislative, or catastrophic. Monetary shocks could be severe budget cuts. He described legislative shocks as laws passed

<sup>51</sup> MRF Interview, November 13, 2006.

targeting financial reporting within the organization. Lastly, catastrophic shock could include wars or the imminent threat of the organization's demise.

## **IV. CONCLUSION**

### **A. SUMMARY OF FINDINGS AND RECOMMENDATIONS**

This study has examined the goal of audit readiness and business systems modernization for the Department of Defense. The audit readiness goal has been scrutinized through the lens of the six success factors previously identified in the Brook methodology. As such, this study sought to answer two questions:

- Can the success factors identified by Brook be found in the DoD components attaining unqualified audit opinions?
- Can the success factors identified by Brook be found within the DoD at the enterprise-level?

The answer to the first question is presented below in Sections One through Six. The answer to the second question is answered in Section Seven below.

The three uniformed services: the U.S. Army, the U.S. Air Force, and the U.S. Navy have all been examined through scoring representative responses to questionnaires and interviews. Secondly, this study examined three components: DISA, DLA and USSOCOM who reacted more positively to the Brook methodology but still have disclaimed opinions. Lastly, as the previous six organizations do not, as yet, have clean audit opinions, this study also examined three components which have achieved clean audit opinions: the Defense Finance and Accounting Service, the Military Retirement Fund, and the Defense Commissary Agency.

Six of the nine components: the U.S. Army, the U.S. Air Force, the U.S. Navy, DeCA, DFAS, and MRF all conform to Brook's methodology. However, three of the components: DLA, DISA, and USSOCOM did not. Speculating on the reason for this disparity in data is difficult.

There are three possible reasons for this disparity in data: the data is flawed, the methodology is flawed or the application of the methodology is flawed. Each reason requires a brief explanation.

The tendency to self-report more positively may be the cause if flawed data is the culprit. Interviewees try to guess where the interviewer's emphasis resides and will exceed reality when reporting their organization's performance.

A flawed methodology could be a cause of non-conforming results. The Brook methodology may be incomplete or not one hundred percent predictive. It may be that these six success factors are necessary but insufficient in and of themselves. Other factors may have to be considered in order to gain a more clear understanding of why some DoD components succeed where others fail.

Lastly, it may be that the Brook methodology was too narrowly applied. Given time and resource constraints, a modified Delphi technique was the only viable research option. However, if more respondents from other areas of expertise were interviewed, perhaps the data results would have been different. A second flawed technique may have been the scoring of success factors. If a component received a four out of six possible for positive resource allocation but still hasn't been audited successfully, perhaps the other two subordinate questions were the essential factors.

In conclusion, more study is needed to confirm these suppositions. DoD is a complex organization. A more comprehensive study with more respondents is needed to shed more light on the above hypotheses.

This data collection effort was designed to bring to light accomplishments and attitudes concerning the six success factors: leadership commitment, positive resource allocation, partnering with Inspector General, cooperation of non-financial managers, short-term systems, and extraordinary effort. A brief summary of conclusions follows organized by success factor.

## **1. Leadership Commitment**

### ***a. Finding***

All three services (the Army, the Air Force, and the Navy) were all graded positively on success factor: leadership commitment. However, leadership commitment understood in light of the judgments of the three

successful components (the DFAS, the MRF and DeCA) has specific characteristics.

***b. Recommendation***

The three successful respondents emphasized that leadership is essential to: focus the audit readiness effort, assign resources, and approve the auditability plan. It is in the first two tasks that specific recommendations can be found.

Focusing the audit readiness effort could be a challenge for the Navy. The Navy has four pilot programs under the control of the four systems commands. Although the Navy is confident that this strategy can be fed into its Financial Improvement Program, there is risk in having four semi-autonomous pilot programs occurring simultaneously. As the DFAS respondent cautioned, a waste of resources might result and slow down the audit-readiness goal if senior leadership should lose focus on the desired result.

The second task that the successful components insist is critical for senior leadership is assigning resources. If leadership commits to a goal of financial management improvement and audit readiness but under-funds the effort, delay and loss of impetus is certain to result. The U.S. Army and the U.S. Air Force respondents expressed mild dissatisfaction with the funding effort for financial management reform. The conclusion to be made is that these two entities are incurring risk in this area.

**2. Positive Resource Allocation**

***a. Finding***

Two uniformed services (the U.S. Air Force and the U.S. Army) expressed mild dissatisfaction with the funding efforts within their organizations. It is clear that resources and effort have been applied but the Army, in particular, mentioned that financial improvement falls to the bottom of the funding priority list--especially during the current Global War on Terror and the War in Iraq.

***b. Recommendation***

The DeCA's respondent provided a counterpoint in this discussion of positive resource allocation. Her experience at the DeCA indicates that the lack of monetary resources should not confound the financial-improvement effort. Her view was that organizations should leverage the myriad non-financial resources at their disposal. Finally, she recommended that organizations use the pervasive lack of financial resources and use that lack to make the argument for the need for financial-management reform.

Congress should fence-off funding for business transformation. While two of three "Big Three" components (USA and USAF) reported that funding for business transformation had been and continues to be taken "out of hide," funding for business transformation will continue to receive short shrift in times of national crisis or war. With Congressional funding, the services would have resources legally set aside for business modernization not under the control of DoD. The services could continue to pursue independent paths to auditability but a lack of resources would cease to be an obstacle.

Appropriating money for financial management transformation will send a message to the services that the goals of auditability--transparency, reliability and timeliness--are not simply unfunded mandates levied on a financially-constrained DoD.

As a positive example, the Department of the Navy has budgeted funds over the Future Years Defense Plan or FYDP for the Department of the Navy Financial Improvement Plan (or DONFIP). The Navy feels confident that the funding stream for this effort will be consistent. However, if Financial Management leadership within the Navy is unsuccessful in maintaining enthusiasm and support for the DONFIP, the business management will incur risk.

### **3. Partnering With Inspector General**

#### ***a. Finding***

All three uniformed services were graded negatively for success factor partnering with Inspector General. It is not because the services have been neglecting this relationship; it is that the relationship is still in its infancy. Culture change, a shifting of the mission, and a learning curve of new skill sets are all causes of the tentative relationship between accounting staffs and the DoD IG.

#### ***b. Recommendation***

The conclusion offered by the respondent from the Military Retirement Fund is simple: challenge the accounting and comptroller staffs, as subject-matter experts, to educate others and lead the modernization effort. He opined that financial managers must insert themselves into traditionally non-financial processes and prove their ability to contribute.

### **4. Cooperation of Non-financial Managers**

#### ***a. Finding***

All three services were graded as absent for the success factor: cooperation of non-financial managers. The reasons for this uncooperativeness were given as follows: lack of education, prioritization, and organizational biases.

#### ***b. Recommendation***

For the first two causal factors, the successful components' respondents had a simple answer: have accountants and comptrollers take the lead in educating non-financial managers. However, both the MRF and the DeCA respondents went a step further: if cooperation could not be gained voluntarily, organizational leaders should compel cooperation. The DeCA

interviewee's joke about sending underperforming managers to Siberia is relevant here.

The Defense Business Transformation Agency should develop and fund a comprehensive communications education effort behind the goal of auditability within the DoD. All respondents, whether successful or not in auditability, reported that educating non-financial managers and the non-financial workforce was their number-one obstacle in success factor cooperation of non-financial managers. Mr. Engelbrektsson, Deputy Comptroller for the Defense Logistics Agency, said it best when he stated "Everything we do here [in DLA] is a financial event, from tents, boots, and medical supplies."<sup>52</sup> If the FM community within the DoD could convince its various components' managers of that fact, auditability and the benefits that it connotes would follow.

Organizational bias can be alleviated by changing the processes to achieve auditable financial statements. The DFAS respondent places primary emphasis on engineering the processes to produce the desired results. This would decrease the effect of uncooperative non-financial managers and insulate the accounting staffs from knowledge transfers when personnel rotate in and out of the organization.

## **5. Short-term Systems**

### ***a. Finding***

The Army and the Navy were graded negatively for the presence of success factor short-term systems. Each service opposed short-term systems on philosophical grounds. The Army and Navy reported that short-term systems would detract from the effort to develop a core financial management system. While both services have directed their financial modernization effort into Enterprise Resource Planning or ERP systems, the successful components have some counterpoints worth considering.

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<sup>52</sup> DLA interview, 30 October 2006.

**b. Recommendation**

All three successful components point out that short-term systems or workarounds are inevitable and useful. While the DeCA respondent was enthusiastic about the use and need for workarounds, the other two respondents were less positive in their comments.

The other two respondents from the MRF and DFAS agreed that workarounds were a necessary component of successful audit readiness planning. However, these two respondents agreed with the Army and Navy that a successful, sustainable core financial management system upgrade would obviate the need for workarounds. Further, these two respondents stated that workarounds may cause more effort to be expended in the long-run as workarounds, by definition, require more operator interface. Summing up, the successful respondents agree in principal with the services that workarounds are counter to the long-term effort but acknowledge short-term systems' usefulness in achieving the auditability goal.

**6. Extraordinary Effort**

**a. Finding**

Both the Army and the Air Force were graded negatively for success factor: extraordinary effort. The Navy was graded positively but the respondent for the Navy said that extraordinary effort was not the Navy's goal; a deliberate, incremental approach was the goal.

**b. Recommendation**

All three successful agency respondents caution that extraordinary effort is the rule--not the exception. Furthermore, the DFAS respondent added that sustaining an audit opinion was as difficult if not more difficult a task than obtaining a clean audit.

The essential criticism of the uniformed services' view of extraordinary effort is that their incremental, deliberate approach assumes a fixed

goal. This fixed goal is simply not the case according to the DFAS respondent: “The problems with sustaining an audit are numerous: knowledge transfers when personnel leave, processes change, systems change, your business changes, there is not the same energy level year after year, the auditors change and become savvier, etc.”<sup>53</sup>

## **7. DoD at the Enterprise Level**

Consistent themes and insights gained from examining the nine respondent components may be applied to DoD. Below are the six success factors and their application to DoD.

### **a. Leadership Commitment**

As illustrated in its components above, the DoD still has leadership and management challenges in its quest for financial improvement and auditability. In its results-driven approach to financial management reform vis-à-vis the FIAR Plan, the DoD incurs the risk of presiding over a “stove-piped”<sup>54</sup> approach feared by the Department of the Navy respondent.

Risks in this approach include: inadequate safeguards to ensure financial statements uniformity and inadequate safeguards to ensure sustainability. Standard Financial Information Structure (SFIS) is the standard imposed by the DoD to ensure enterprise-wide conformity in financial statements. However, SFIS is an evolving standard that is only Phase I complete as of May 2005.<sup>55</sup>

As the DFAS respondent pointed out, leadership commitment means: focusing the auditability effort, assigning the resources, and approving the auditability plan. The DoD needs to strengthen its leadership role in order to ensure auditability across the twenty-four components.

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<sup>53</sup> DFAS interview, November 13, 2006.

<sup>54</sup> DON interview, November 6, 2006.

<sup>55</sup> Wenrich, 23, 2005.

***b. Positive Resource Allocation***

The DoD must ensure that resources are applied not only to the shorter-term auditability effort but also the longer-term audit-readiness sustainability effort. Recognition that these are two separate but complementary efforts is an important factor as well.

***c. Partnering With Inspector General***

The lack of partnering with the DoD IG is a contentious issue. Supporters of the status quo say partnering with the DoD IG would compromise the independence of the IG and make their assertions suspect. The IG must remain independent of the organizations it is auditing in order to keep its opinions above reproach.

However, this research concludes that utilizing the DoD IG as advisors will only strengthen the audit readiness efforts of the components. The DoD IG's expertise is only partially exploited when utilized only after the financial statements are completed. Mini-audits throughout the year and an expanded education effort from the DoD IG would help components immeasurably.

***d. Cooperation of Non-financial Managers***

The lack of non-financial manager cooperation reported across the three uniformed service components is troubling. This is especially true when the fact that Brook found that organizations with cooperation of non-financial managers received 2.63 clean opinions across three years and components without that cooperation received 0 clean opinions across that same time period. Clearly, this cooperation is essential and needs to be cultivated across the DoD.

The advice given by the MRF respondent is particularly relevant here. Financial Managers across the DoD must embark upon a robust education effort designed to exemplify the benefits of business modernization and audit-readiness.

The FIAR education plan must also receive greater emphasis. The current educational component of the FIAR Plan is clearly inadequate given the lack of awareness of its existence across the DoD.

Additionally, despite the service components' apparent focus on sustainability issues, the lack of education reported by all respondents for the DoD IG and non-financial management remains an ongoing concern. This lack of education also applies to financial managers and the DoD IG as well. Accounting skill sets must be stressed; not simply budgetary skill sets.

**e. *Short-term Systems***

The DoD must highlight to its components that short-term systems or workarounds are essential and inevitable in the quest for audit readiness. The continued operation of legacy financial systems requires that workarounds be utilized not shunned.

It is true that short-term systems demand more effort. However, workarounds fulfill a need that should not be ignored. It is possible to decouple the effort to achieve auditability while designing and building comprehensive financial management systems.

**f. *Extraordinary Effort***

The uniformed service components of the DoD also reported that extraordinary effort was not their strategy. This is troubling because successful DoD components report there is no way to achieve auditability without extraordinary/Herculean efforts. The DoD must emphasize to its components that extraordinary effort is the norm and that the results will justify the means.

The DeCA respondent reported that the Office of Management and Budget's Program Assessment Rating Tool (PART) judgment of the DeCA was "very motivating to the DeCA."<sup>56</sup> The PART review helps identify a program's strengths and weaknesses to inform funding and management decisions aimed

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<sup>56</sup> DeCA interview, November 13, 2006.

at making the program more effective.<sup>57</sup> The DoD also undergoes PART reviews yearly.

The DoD must realize that it is no longer simply judged on its components' effectiveness. It is being rigorously judged on its ability to tie budgetary resources to component effectiveness. Extraordinary effort is required of all its components.

## **B. LIMITATIONS OF STUDY**

This study was conducted by use of interviews and/or questionnaires to financial management executives within the respondent organizations. The enormous complexity of the DoD and its components' financial management systems rendered a comprehensive study impractical.

This study is limited in that all components required to submit independent financial statements did not respond to requests for information. Therefore, this study relies on the concept of "materiality" as it applies in accounting. This study deems the respondent organizations as constituting materiality because the respondent organizations--USAF, USN, USA, DLA, DISA, USSOCOM, DeCA, DFAS, and DCAA--constitute the majority of assets under management in the DoD. The positive and negative responses given in this study will, by virtue of the size and assets under management of the respondents, constitute success or failure of the DoD to achieve the aims of the CFO Act of 1990.

The conclusion to be gained from the extension of the Brook methodology is that it is not 100% predictive. The tendency for respondent components to self-report positively must be considered a constraint of the paper.

Unfortunately, there is no test for intentions or probability in the outcomes of the DoD's efforts to achieve auditability. Subjective grading was therefore used to score agency responses to the questions designed to draw out the presence or absence of the six success factors discussed in Chapter II.

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<sup>57</sup> <http://www.whitehouse.gov/omb/part>, November 2006.

### **C. TOPICS FOR FUTURE STUDY**

The Brook methodology should be extended and updated to all twenty-four entities required to provide the DoD with independent audited financial statements. Statistical analysis of the above research should be undertaken to further validate the applicability of the six success strategies in achieving auditability.

Research should be conducted into the effectiveness of the educational effort behind the FIAR Plan. The BTA has contracted for development and teaching of the required skill sets to senior financial and non-financial leadership within DoD components. Studying the effectiveness of the educational effort would help the DoD provide new financial skill sets to more of its uniformed and civilian leadership.

This study should be expanded to include the opinions and attitudes of uniformed leadership, the DoD IG, and component internal auditing staffs. A more complete and clearer idea of the presence or absence of Brook's six success factors would result.

A study should be undertaken which investigates the changes that the DoD IG has undergone and its blueprint for the future. The DoD IG has undergone changes that require new skill sets and organizational culture. Analysis of the DoD IG's new mission focus and plan for change would assist the DoD in its effort to modernize its business practices across all of its components.

**APPENDIX A. SUMMARY OF DOD COMPONENTS AND THEIR  
AUDIT OPINIONS**

<b>AGENCY</b>	<b>2005 AUDIT OPINION</b>
Army General Fund	Disclaimed
Army Working Capital Fund	Disclaimed
Navy General Fund	Disclaimed
Navy Working Capital Fund	Disclaimed
Air Force General Fund	Disclaimed
Air Force Working Capital Fund	Disclaimed
Military Retirement Fund	Unqualified
DoD Medicare-eligible Retiree Health Care Fund	Qualified
U.S. Army Corps of Engineers (Civil Works)	Disclaimed
Defense Logistics Agency	Disclaimed
Defense Finance and Accounting Service	Unqualified
Defense Information Systems Agency	Disclaimed
Defense Contract Audit Agency	Unqualified
Defense Commissary Agency	Unqualified
Defense Security Service	Disclaimed
Defense Threat Reduction Agency	Disclaimed
Defense Advanced Research Projects Agency	Disclaimed
Chemical Biological and Defense Program	Disclaimed
Missile Defense Agency	Disclaimed
Services Medical Activity	Disclaimed
Tricare Management Activity	Disclaimed
U.S. Special Operations Command	Disclaimed
Marine Corps Working Capital Fund	Disclaimed
Marine Corps General Fund	Disclaimed

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## APPENDIX B. SUCCESSFUL AGENCY QUESTIONNAIRE

This questionnaire is designed to solicit pertinent information regarding contributing factors in gaining and sustaining a “clean” audit opinion in your agency. Six factors previously identified in research as contributing either directly or indirectly in obtaining and sustaining a “clean” audit opinion are: Leadership Commitment, Positive Resource Allocation, Partnering with Inspector General, Cooperation of Non-financial Managers, Short-term Systems and Extraordinary Effort. In an effort to elicit responses either supporting or weakening these factors, the following questions are respectfully submitted. The questions below pertain to the time of the effort made to obtain a clean audit opinion.

### Background Information

Name:

Position:

Length of Service in current position:

### Leadership Commitment

**How would you describe your Agency leadership’s commitment to obtaining a “clean” audit opinion?**

1. Was the commitment to obtaining a “clean” audit opinion ever on the Agency Head’s list of priorities?
2. Was the effort to obtain the clean audit opinion prominent in internal correspondence during the time leading up to the audit opinion?
3. Was the effort to obtain a clean opinion included in any public statements by the leadership of the Agency?
4. In internal or external briefings, was the effort to obtain a clean audit opinion given a high priority?
5. Were personnel and resource decision meetings made supporting the effort to produce financial reports?
6. Did the Agency head empower the CFO in internal disputes over resource constraints?

7. Did the Agency head compel cooperation by other entities within the organization?

8. Can you think of anything else that convinced you of the Agency head's commitment to obtaining a clean audit opinion?

#### Positive Resource Allocation

**Were there ever resource allocation shifts made to aid in the effort to gain a clean audit opinion?**

9. Did the Agency, during the time of preparing for the audit, invest in financial system upgrades?

10. Did the Agency ever utilize contractor support in its efforts to obtain a clean audit opinion?

11. Did the Agency ever conduct audit training for its financial management employees?

12. Did the Agency ever employ additional temporary labor to either produce the financial statements, count inventory or other tasks related to achieving the clean audit opinion?

13. Did the financial managers within the Agency ever complain about a lack of resources during the lead-up to the audit? Were those complaints ever addressed?

14. Did the Agency ever apply other resources not mentioned above to the effort?

#### Partnering with the Inspector General

**Describe the relationship between the accounting staff and the Inspector General (internal auditing) staff.**

15. Were there prior working relationships between the financial managers and the auditing department?

16. Had there ever been a history of distrust between these two departments?

17. Had anyone in the financial management department ever complained of a "gotcha" mentality in the internal auditing department?

18. Was there any history of “partnering” with the auditing staff, i.e. joint approaches to defining problems and proposing solutions, interim reviews or “mini-audits,” or negotiated agreements?

19. Were there any other partnerships or official/nonofficial efforts at partnership between the auditing staff and other departments within the Agency?

#### Cooperation of Non-financial Managers

#### **Did the effort to achieve a clean audit opinion ever resonate throughout the non-financial leadership of the Agency?**

20. Was the Financial Management department able to secure the willing cooperation of operating and program managers?

21. Were there any prior personal relationships between members of the Financial Management department and Operating and Program managers?

22. Were non-financial managers ever convinced of the value of financial reporting?

23. Was cooperation or compliance induced through senior-level directives or exercising leverage over budgets or resource-allocation decisions?

24. Were recognition programs for both financial and non-financial managers employed?

25. Are financial managers still attempting to overcome non-financial manager disinterest, resistance, or lack of interest?

26. Did the Agency’s desire for a clean audit opinion resonate with the non-financial managers? How could you tell?

#### Short-term Systems

#### **Were short-term (workaround) systems ever employed to bring financial statements up-to-date and auditable?**

27. Did the Agency undertake to replace the core financial management and accounting operating system or were short-term “workaround” systems employed?

28. What was the reasoning behind this decision?

29. Were there any other short-term organizational solutions applied?

## Extraordinary Effort

### **What adjectives would you use to describe the effort to achieve a clean audit opinion?**

30. Did senior financial managers exert extraordinary effort over a short period of time to achieve a clean audit opinion?
31. Were large numbers of personnel either pulled off of other projects or were temporary personnel hired to handle tasks that the regular system could not manage?
32. Did the Agency ever hire a small, private-sector accounting firm to assist in the effort?
33. Were task forces created with temporarily-assigned people either internal to the Agency or temporary hires to count inventories, research acquisition histories, or enter data?
34. Was money spent on contractors and commercial-off-the-shelf software to organize the effort?
35. Were there any other essential factors that this questionnaire overlooked that contributed either directly or indirectly to the attainment of a clean audit opinion for your agency?

## APPENDIX C. COMPONENT SCORING SHEET

### Leadership Commitment

**How would you describe senior leadership’s role in preparing for auditability?**

- Was the commitment to obtaining a “clean” audit opinion ever on the Agency Head’s list of priorities?
- Was the effort to obtain the clean audit opinion prominent in internal correspondence during the time leading up to the audit opinion?
- Was the effort to obtain a clean opinion included in any public statements by the leadership of the Agency?
- In internal or external briefings, was the effort to obtain a clean audit opinion given a high priority?
- Were personnel and resource decision meetings made supporting the effort to produce financial reports?
- Did the Agency head empower the CFO in internal disputes over resource constraints?
- Did the Agency head compel cooperation by other entities within the organization?
- Can you think of anything else that convinced you of the Agency head’s commitment to obtaining a clean audit opinion?

Subordinate Question 1 POS/NEG	Subordinate Question 2 POS/NEG	Subordinate Question 3 POS/NEG	Subordinate Question 4 POS/NEG	Subordinate Question 5 POS/NEG	Subordinate Question 6 POS/NEG	Subordinate Question 7 POS/NEG	Subordinate Question 8 POS/NEG	Grade	Presence of Factor (Y/N)
								/8	

### Positive Resource Allocation

**Were there ever resource allocation shifts (people or money) made to aid in the effort to gain a clean audit opinion?**

- Did the Agency, during the time of preparing for the audit, invest in financial system upgrades?
- Did the Agency ever utilize contractor support in its efforts to obtain a clean audit opinion?

- Did the Agency ever conduct audit training for its financial management employees?
- Did the Agency ever employ additional temporary labor to either produce the financial statements, count inventory or other tasks related to achieving the clean audit opinion?
- Did the financial managers within the Agency ever complain about a lack of resources during the lead-up to the audit? Were those complaints ever addressed?
- Did the Agency ever apply other resources not mentioned above to the effort?

Subordinate Question 1 POS/NEG	Subordinate Question 2 POS/NEG	Subordinate Question 3 POS/NEG	Subordinate Question 4 POS/NEG	Subordinate Question 5 POS/NEG	Subordinate Question 6 POS/NEG	Grade	Presence of Factor (Y/N)
						/6	

### Partnering with IG

#### **Describe the relationship between the accounting staff and the Inspector General (internal auditing) staff.**

- Were there prior working relationships between the financial managers and the auditing department?
- Had there ever been a history of distrust between these two departments?
- Had anyone in the financial management department ever complained of a “gotcha” mentality in the internal auditing department?
- Was there any history of “partnering” with the auditing staff, i.e. joint approaches to defining problems and proposing solutions, interim reviews or “mini-audits,” or negotiated agreements?
- Were there any other partnerships or official/nonofficial efforts at partnership between the auditing staff and other departments within the Agency?

Subordinate Question 1 POS/NEG	Subordinate Question 2 POS/NEG	Subordinate Question 3 POS/NEG	Subordinate Question 4 POS/NEG	Subordinate Question 5 POS/NEG	Grade	Presence of Factor (Y/N)
					/5	

Cooperation of Non-financial Managers

**How involved were non-financial managers in the process? Was it an agency-wide effort or contained within the FM's office?**

- Was the Financial Management department able to secure the willing cooperation of operating and program managers?
- Were there any prior personal relationships between members of the Financial Management department and Operating and Program managers?
- Were non-financial managers ever convinced of the value of financial reporting?
- Was cooperation or compliance induced through senior-level directives or exercising leverage over budgets or resource-allocation decisions?
- Were recognition programs for both financial and non-financial managers employed?
- Are financial managers still attempting to overcome non-financial manager disinterest, resistance, or lack of interest?
- Did the Agency's desire for a clean audit opinion resonate with the non-financial managers? How could you tell?

Subordinate Question 1 POS/NEG	Subordinate Question 2 POS/NEG	Subordinate Question 3 POS/NEG	Subordinate Question 4 POS/NEG	Subordinate Question 5 POS/NEG	Subordinate Question 6 POS/NEG	Subordinate Question 7 POS/NEG	Grade	Presence of Factor (Y/N)
							17	

Short-term Systems

**Were short-term (workaround) systems ever employed to bring financial statements up to date and auditable?**

- Did the Agency undertake to replace the core financial management and accounting operating system, or were short-term "workaround" systems employed?
- What was the reasoning behind this decision?
- Were there any other short-term organizational solutions applied?

Subordinate Question 1 POS/NEG	Subordinate Question 2 POS/NEG	Subordinate Question 3 POS/NEG	Grade	Presence of Factor (Y/N)
			/3	

Extraordinary Effort

**What adjectives would you use to describe the effort to achieve a clean audit opinion?**

- Did senior financial managers exert extraordinary effort over a short period of time to achieve a clean audit opinion?
- Were large numbers of personnel either pulled off of other projects or were temporary personnel hired to handle tasks that the regular system could not manage?
- Did the Agency ever hire a small, private-sector accounting firm to assist in the effort?
- Were task forces created with temporarily-assigned people either internal to the Agency or temporary hires to count inventories, research acquisition histories, or enter data?
- Was money spent on contractors and commercial-off-the-shelf software to organize the effort?
- Were there any other essential factors that this questionnaire overlooked that contributed either directly or indirectly to the attainment of a clean audit opinion for your agency?

Subordinate Question 1 POS/NEG	Subordinate Question 2 POS/NEG	Subordinate Question 3 POS/NEG	Subordinate Question 4 POS/NEG	Subordinate Question 5 POS/NEG	Subordinate Question 6 POS/NEG	Grade	Presence of Factor (Y/N)
						/6	

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