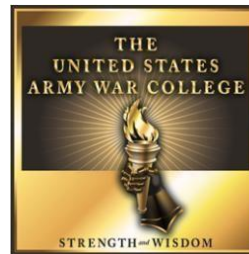


Audit Readiness: The Costs and Culture

by

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United States Army War College
Class of 2015

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Abstract

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Over the last 60 years, the Department of Defense (DoD) has demonstrated a lack of commitment toward achieving financial improvement, accountability, and audit readiness. The DoD has spent billions attempting to meet the Congressional mandate of audit ready financial statements by September 30, 2017. It does not appear the DoD will be able to make this deadline. In these fiscally constrained times, DoD leadership must work toward changing the culture in regards to financial management. One way to do this is to implement a clear concise vision and utilize Kotter's eight steps for cultural change in conjunction with Schein's embedding and reinforcing mechanisms to implement a lasting culture change. Now is the time for the DoD to implement change due to the reduction of financial resources in accordance with the Budget Control Act of 2011 and a new Secretary of Defense that actively supports financial improvement. Without changing the cost culture first, the expenditures towards achieving audit readiness will not be worth the cost.

Audit Readiness: The Costs and Culture

Congress mandated in the National Defense Authorization Act (NDA) of 2010, that the Department of Defense (DoD) must have auditable financial statements by September 30, 2017. To meet this federal mandate, the DoD has spent billions of dollars to revise and implement new financial information technology systems and miscellaneous costs associated with such a large undertaking. The Government Accountability Office (GAO) and the DoD Inspector General performed numerous audits in order to determine the vulnerabilities and weaknesses that are preventing the DoD from being audit ready. They have found that despite the billions spent on updated financial and management systems, these systems are behind schedule, over cost, and are not performing the intended functions to ensure audit readiness. However, the root problem goes well beyond underperforming financial management systems. In order to meet the requirement of auditable financial statements, the DoD needs to address the culture associated with financial improvement and audit readiness. To do this effectively, the DoD should utilize a vision statement, clear steps to leading change, and embedding mechanisms geared toward creating a culture where financial improvement and accountability is a priority. Two factors make it the opportune time for the DoD to tackle this much needed change in culture. The Department is facing a reduction in resources due to the Budget Control Act (BCA) of 2011 and the new Secretary of Defense is an advocate for financial responsibility. These two factors might make it possible for the DoD to achieve an improved cost culture.

What is audit readiness?

Audit readiness, also known as auditability, is an organization's ability to state its financial statements are ready for an independent audit, free from material

misstatements, there are sufficient internal controls associated with financial reporting, and all required documents are available to support those assertions.¹ The purpose of an independent audit of an entity's financial statements is to obtain the auditor's opinion on whether the financial statements were prepared accordingly.² During a financial audit, there are four types of auditor's opinions: Unqualified (clean), Qualified, Adverse, and Disclaimer. In the most recent financial statement audit, the DoD received a disclaimer opinion on its fiscal year (FY) 13 financial statements. The goal is to achieve an unqualified opinion.³

Why is the DoD community working toward auditability?

Since 1950, Congress mandated the executive branch provide auditable financial statements in a series of public laws. With these laws, Congress intended to improve financial management and reporting and funds accountability in the federal government, to include the DoD. Most of these laws enforce the need for proper controls and funds management to ensure taxpayer dollars are properly accounted and protected.

Starting with the Budget and Accounting Procedures Act of 1950, executive agencies were required to create and maintain accounting systems and adequate internal controls. Further, the act required the head of each agency to prepare audited financial statements of business functions.⁴ The Federal Managers Financial Integrity Act (FMFIA) of 1982 amended the Budget and Accounting Procedures Act of 1950. The FMFIA required each agency establish and report annually on their system of internal controls over accounting and administrative functions.⁵ Circular A-123 implemented FMFIA of 1982 by providing updated requirements regarding management's assurance on internal controls over financial reporting.⁶

The Chief Financial Officers (CFO) Act of 1990 required all executive agencies to have reliable and complete financial information. According to the GAO this act established a new era in federal and financial control management.⁷ Specifically, the CFO Act of 1990 required executive agencies to produce auditable financial statements with the intent to improve internal controls, provide consistent reliable financial information for decision makers, and to reduce fraud, waste, and abuse of government funds.⁸ The Government Management Reform Act (GMRA) of 1994 extended the due date for audited financial statements to March 1, 1997.⁹ The Federal Financial Management Improvement Act (FFMIA) of 1996 required agencies to have financial management systems that have appropriate internal controls to protect data so managers can make accurate decisions using the data.¹⁰

In 2010, the DoD still did not have financial statements ready for audit as required by GMRA of 1994, thirteen years behind schedule. In the NDAA of 2010, Congress mandated the DoD Chief Management Officer and the Under Secretary of Defense (Comptroller) correct financial management deficiencies by establishing and maintaining a Financial Improvement and Audit Readiness (FIAR) Plan and financial statements must be ready for audit by September 30, 2017.¹¹

What are the benefits of being audit ready?

If the DoD is audit ready, they are communicating to Congress and the taxpayer that the Department is confident it can account for all dollars and assets. Congress will have assurance the DoD is using budgetary resources for the allocated programs. Also, the Department will have increased credibility with Congress when the DoD testifies on the effects of budget cuts and sequestration. With better accountability over financial transactions, inventory, and assets, the DoD will better safeguard resources against

fraud, waste, and abuse. Further, taxpayer confidence that the DoD properly uses funds will increase.

What has the DoD completed at the Service Level?¹²

In 2010, the Marine Corps submitted their Statement of Budgetary Resources (SBR) to GAO for audit and received a disclaimer due to a lack of supporting documentation, poor internal controls, and weakness in their financial systems.¹³ The SBR includes beginning balances, current year transactions, and transactions from prior years executed in the current year.¹⁴ The GAO made 139 recommendations for improvement.¹⁵ While making recommended changes, the Marine Corps submitted their Schedule of Budgetary Activity (SBA)¹⁶ for audit in 2012, ahead of the rest of the military services. The SBA is part of the SBR, but it only covers current fiscal year funding. According to the DoD office of the Inspector General (DoDIG) opinion, the Marine Corps SBA was prepared fairly in all material respects.¹⁷ However, in March 2015, the DoDIG revoked their clean opinion of the Marine Corps SBA audit after discovering previously un-identified Treasury suspense accounts containing Marine Corps transactions not reflected in the audited SBA.¹⁸

As of 30 September 2014, the military services asserted they will be ready for a SBA audit for fiscal year 2015 funds.¹⁹ Per DoD FIAR guidance, all military services should be ready for a SBR audit by September 30, 2014. However, the DoD has backed down to a SBA audit after lessons learned during the SBR audit of the Marine Corps.²⁰ With the slippage in schedule, it appears unlikely the DoD will be ready for a full financial audit by September 30, 2017.

How much has this effort cost?

The GAO conducted multiple audits on the DoD's ability and progress toward auditable financial statements. The GAO continues to find weaknesses in the DoD's financial management systems as an impediment to the DoD's ability to produce audit ready financial statements.²¹ The GAO has listed DoD business system modernization as a high risk area since 1995 due to "size and complexity of DoD, the large and complex systems to be developed, and the significant efforts needed to establish effective and efficient business systems Department wide."²² The GAO continues to report the DoD systems are "overly complex and error prone, characterized by (1) little standardization across the Department, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, and (4) the need for data to be entered manually into multiple systems."²³ As these issues impact the Department's ability to produce auditable financial statements, the DoD is attempting to modernize these financial systems and fix these vulnerabilities. According to GAO:

For fiscal year 2012, the department requested about \$17.3 billion to operate, maintain, and modernize its business systems. DoD has reported that it relies on 2,258 business systems, including 335 financial management systems, 709 human resource management systems, 645 logistics systems, 243 real property and installation systems, and 281 weapon acquisition management systems.²⁴

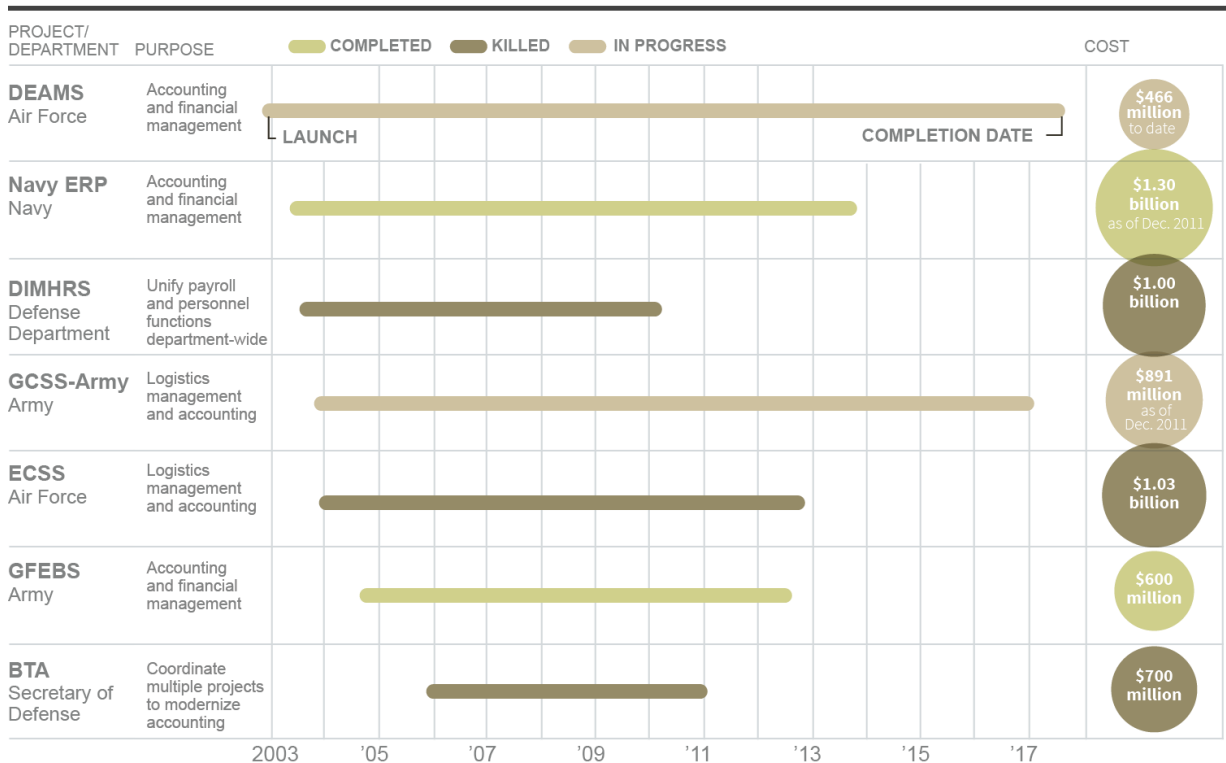
The DoD is implementing Enterprise Resource Planning (ERP) systems to modernize and integrate business and financial data that is usable for management and accounting purposes. The DoD maintains that implementing modern ERP systems is essential for auditability of the financial statements. However, GAO has issued many reports that discuss the DoD's weaknesses in implementing ERP systems, to include delays in implementation and budget overruns. These delays in ERP implementation

result in continued spending on the “existing duplicative, stovepiped systems” and “can erode savings that were estimated to accrue to DoD as a result of modernizing its business systems and thereby reduce funds that could be used for other DoD priorities.”²⁵

The DoD has fully implemented some of the new ERP systems, while others are ongoing or cancelled by the DoD or the military service. The figure below shows three of the cancelled ERP systems. The total amount spent on these three canceled ERP systems was \$2.37 billion dollars. The DoD continues to use the legacy systems and has not implemented the required functions of the cancelled systems.

Missed targets

The Pentagon has spent billions of dollars over the past decade to modernize its accounting systems, but many of these projects have ended in failure or fallen short of expectations



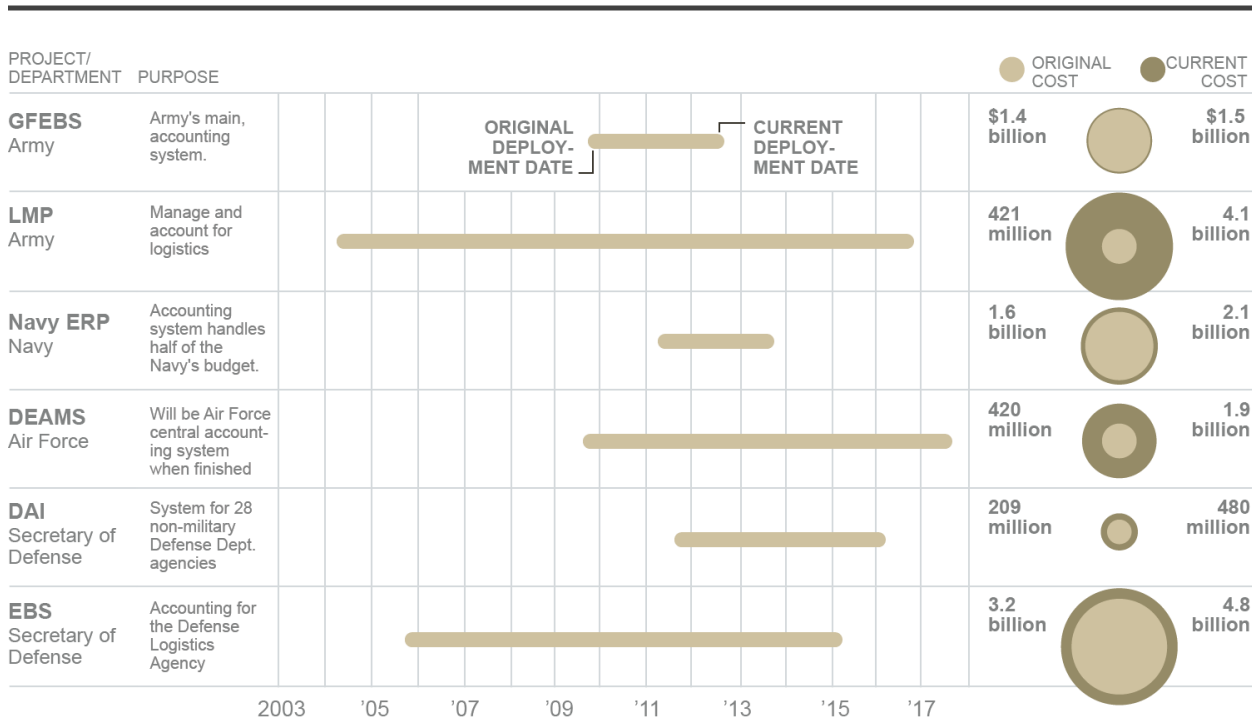
Sources: GAO; Defense Department inspector general; military services

Figure 1. Cost of newly implemented, ongoing, or canceled ERP systems²⁶

Further, those systems the DoD implemented or are still in progress have experienced significant delays and cost overruns. In Figure 2 below, six of the major ERP systems the DoD is implementing have cost overruns of \$7.63 billion as of 2013. The DoD had not fully implemented five of these ERP systems at the time of the report, so additional cost overruns could, and most likely will, accumulate.

The long march

Multiple efforts to modernize Defense Department accounting are taking much longer, and costing a lot more, than originally projected



Sources: Defense Department Comptroller's Financial Improvement and Audit Readiness Status Reports for 2012 and 2013.

Figure 2. Cost and timeline overruns²⁷

In response to the 2012 GAO report on the Army and Air Force financial management systems, Senator John McCain stated "By 2016, the Department of Defense plans to spend more than \$11 billion to improve its financial management operations. But GAO's report highlights DoD's new enterprise resource planning systems are still lacking, despite this enormous investment."²⁸ The tables above from

Reuters also highlight the ineffectiveness and inefficiencies of the DoD's ERP system implementation. The DoD continues to spend billions of dollars attempting to address the financial management system deficiencies identified by the GAO, but does not appear to be making progress in addressing weaknesses and deficiencies that prevent the DoD from producing auditable financial statements.

In addition to the costs associated with these financial systems, there are numerous other costs associated with achieving DoD auditable financial statements. These costs are harder to quantify but include personnel costs implementing the systems, management meetings regarding how to produce audit ready financial statements, financial management experts researching and understanding the requirements for auditable financial systems, and training costs for all levels of the DoD. There are costs associated with having the services' auditors, the GAO, and DoDIG review the DoD's current financial situation and identify areas for improvement. Additionally, when it comes time to audit the services financial statements, the DoD will need to hire government contractors capable of conducting independent audits on the financial statements or use DoDIG.²⁹ Reported in the November 2014 FIAR report, the DoD spent \$630 million on audit readiness in FY 2014, not including the deployment of ERP systems.³⁰ The DoD plans to spend \$3.572 billion during FY 2014-2019 on audit readiness, again, not including ERP deployment.³¹

What is really going on?

Reuters determined during interviews with DoD officials "the Pentagon is continually thwarted by a lack of accountability for failures, rivalry among and within various branches of the department, resistance to changes, and an incentive to spend."³² The services design and implement individual financial systems rather than

working together to implement common systems. The DoD attempted to implement a personnel system across the services, but ultimately cancelled the Defense Integrated Military Human Resource System after “competing demands from military services ultimately rendered the system useless.”³³

These problems go beyond the IT systems needed to implement auditable financial statements. The DoD lacks a true cost culture, where financial improvement, costs savings, and financial management are as important as achieving the mission. Currently, the DoD emphasizes “meeting the established obligation and expenditure rates.”³⁴ This behavior does not always provide the best value for the government, instead emphasizing the need to spend money, not spend money judiciously.³⁵ Setting up a true cost culture is much broader than audit readiness, but having auditable financial statements will help the DoD understand defense costs and result in an increased emphasis in using DoD resources wisely.³⁶

DoD leadership recognizes the need for an improved cost culture and is starting to discuss the required change. The Strategic Management Plan for FY 2013-2014 states “Developing a strong cost culture is critical to delivering value to the Warfighter” which comes directly from the 2010 Defense Quadrennial Review goal of “Reform the Business and Support Functions for the Defense Enterprise.”³⁷ “A cost culture means the Department will not only utilize budget data as a measure of performance but also use cost data to develop a true understanding of operations business expenditures.”³⁸ Auditable financial statements make the budget data more reliable.

In the risk adverse DoD culture, the mission is first and the financial impact secondary.³⁹ The DoD’s Deputy Chief Management Officer recognized that to truly

establish a cost culture, DoD employees must understand each decision has a financial impact, stating “We execute from an end-to-end perspective. There’s nothing that is just financially focused. There’s nothing that is just personnel focused. Every personnel action has a financial transaction.”⁴⁰

Supporting organizations are also arguing the DoD has a cost culture problem and the financial management systems need improvement. The DoD implemented the Defense Business Board to advise the Department on better business practices utilized in the private sector. This board reviewed more than 300 reports from independent organizations on the DoD’s acquisition practices. They found “the acquisition system is hampered by a ‘stovepiped’ structure that involves three separate processes for defining requirements, conducting acquisitions and managing budgets--adding bureaucratic complexity to any acquisition.”⁴¹ In a separate report, the Defense Business Board recommended the DoD sustain a culture of cost management, not view it as an initiative.⁴²

The Association of Military Comptrollers conducted a survey of civilian and uniformed members of the DoD financial community in 2011. This survey focused on “cost management and the development of the cost warriors who help change the DoD from a culture that values spending every dollar to one that values cost awareness and best value.”⁴³ The respondents said the current financial management tools “are only marginally effective for developing a culture of savings, because they are disjointed and do not provide the right information for making and tracking cost decisions.”⁴⁴ These findings relate directly to the lackluster implementation of the multiple ERP systems, thus making audit readiness challenging, if not impossible. Further, respondents

indicated there is an over emphasis on meeting execution metrics and “Every respondent who mentioned end-of-year expenses opined that they are not well managed because of a focus on spending all the dollars, not saving dollars at year’s end.”⁴⁵ The respondents agreed the culture of the Department needs to change from one that is a spend culture to one that emphasizes cost management and obtaining the best value. To accomplish this culture change, they are looking to senior leadership to show them the way and implement the change in a top down manner.⁴⁶

Top leadership in the DoD needs to implement changes to the financial management culture in the Department, creating and emphasizing a culture that values cost management. Reuters reported “until recently, lack of interest or attention from the very top - from secretaries of defense and the civilian secretaries of the individual military services - has meant that no one steps in to impose order and consistency.”⁴⁷ Without consistent leadership the implementation of accounting systems is likely to continue down the same path, littered with duplicative systems between the services, systems unable to deliver promised functionalities, and wasted funding on these systems. As a result, audit readiness will continue to slip past the congressionally mandated date. Additionally, the cost culture in the Department will not improve, potentially wasting limited resources on poor financial management practices.

Specifically in regards to audit readiness, it is in the Secretary of Defense’s power to implement changes that force the military services to properly account for their budget, assets, and real property. The Secretary of Defense can also implement standards for the new accounting systems, to include common systems across the services. However, the Secretary of Defense cannot withhold funding if the services do

not meet Congress' audit readiness deadline. As Congress determines appropriations, only Congress has the power to withhold funding as punishment for disregarding or missing the deadline.⁴⁸

Should Congress withhold funding, national security could be at risk. Withholding funding would impact research and development and the acquisition of major programs. Due to the long lead time needed for these activities, this might also directly impact DoD readiness and national defense. The American public will not tolerate a loss of American life or property because the Congress withheld funding for what they view as an accounting issue. This cycle is difficult to break, as it demonstrates the lack of commitment to auditable financial statements when physical security is in jeopardy. Further, it demonstrates there is not a real emphasis on creating a cost culture by Congress and the DoD. The Department needs a cost culture that rewards frugality and transparency over costs.⁴⁹ A major shift in the DoD culture from mission no matter the cost to mission completion with financial judiciousness is required.

Is audit readiness worth the cost?

The DoD is spending billions on financial management systems and audit readiness efforts, yet has not produced auditable financial statements. The manpower needed to get the DoD to audit readiness is significant, and one could argue there are other more important DoD missions that the DoD could be resourcing, instead of using those resources to obtain auditable financial statements.

However, the entire financial management culture needs improvement. The DoD needs to create a culture emphasizing cost saving measures in order to efficiently utilize funds and get the best value for the government. The Principal Deputy Assistant Secretary of Defense for Logistics and Materiel Readiness stated,

Our imperative stems from a passion to preserve warfighter readiness. The days of bounty are long over for Defense. It is urgent that we act now on a culture of cost consciousness to build more capacity per dollar to maintain our strategic advantage . . . Our collective commitment to controlling costs, increasing productivity, and providing greater value to the warfighter and the taxpayer animates recent management approaches to improve financial improvements and productivity.⁵⁰

This cost culture will result in improved support and resources for the warfighter.

By becoming cost conscious and focused on financial management improvement, the DoD will still be able to accomplish its mission at a better value to the taxpayer.

Until the DoD has auditable financial statements, the Congress and the U.S. taxpayer will have no assurances on what the DoD is spending money on. The Congress appropriates funds for specific requirements, and without financial statements, it is impossible for Congress to know how much of the budget the DoD is using as directed. Further, it is hard for the DoD to determine if it used funds for fraudulent or wasteful purposes or identify errors in pay, inventory, or supplies.⁵¹

If the DoD does not meet the audit readiness deadline, there will likely be no consequences. After spending billions of dollars to attempt to implement these new financial ERP systems, many of these systems are behind schedule or are not able to maintain the intended financial data. As a result, the DoD is unlikely to meet the September 2017 deadline. However, if history is any indication, nothing will happen to the DoD except Congress extending the deadline. For this reason, the DoD has little incentive to change the culture within the Department to properly implement new methods and controls to ensure a cost culture that improves financial management and auditable financial statements. As there are no consequences to achieving audit readiness it does not appear the current method for achieving audit readiness is worth the cost to the DoD.

On the other hand, if accurate and reliable financial systems ensured financial transparency and the assurance that funds are properly used, then the DoD would know where funds are going and be able to properly identify efficiencies and duplicate programs. This would result in the DoD redirecting resources to other valid DoD needs. The DoD currently faces sequestration and the reduction of funds by Congress. The services continue to complain about the impact such reductions would have on their operations. However, the services do not know where their funds actually go. If the DoD implemented better accounting, the DoD might discover they have more money than they realize as less would be lost to fraud, waste, and abuse. Audit readiness is worth the cost once, and if, the DoD improves the cost culture.

How to change the culture?

Former Secretary of Defense Robert Gates, when he led an initiative to determine how the DoD managed resources, stated:

My staff and I learned that it was nearly impossible to get accurate information and answers to questions such as “how much money did you spend” and “how many people do you have? . . . The efficiencies project also showed that the current apparatus for managing people and money across the DoD enterprise is woefully inadequate.⁵²

Based on this observation from the former Secretary of Defense, it is apparent the DoD is in need of leadership and guidance to change the culture in regards to financial improvement and audit readiness. With the competing interests of the services, it will require leadership from above to implement a cultural change. This is something financial management professionals already realized and expressed in the American Society of Military Comptrollers financial management survey in 2011.⁵³ Many financial management professionals are willing to do the hard work to change the cost culture to

one where savings are valued over expenditure of budget. They desire strong leadership from the top with a vision of how to get them there.

In his book *Leading Change*, Kotter outlines eight steps for creating major change in an organization.⁵⁴ These steps are applicable to the DoD when attempting to implement a cost culture. Additionally, the DoD should implement what organizational psychologist Edgar Schein called embedding and reinforcing mechanisms in his book, *Organizational Culture and Leadership*.⁵⁵ Embedding mechanisms are initiatives that ingrain the desired change into an organization and reinforcing mechanisms are quicker and easier actions that support the embedding mechanisms but do not result in real culture change on their own.⁵⁶ Kotter's steps, implemented in conjunction with embedding and reinforcing mechanisms should put the DoD on the path to lasting culture change. This paper will highlight key Kotter and Schein steps/mechanisms, though all are necessary for implementing cultural change.

Table 1. Kotter's 8 steps to leading change and Schein's embedding and reinforcing mechanisms⁵⁷

Eight steps for change	Embedding Mechanisms	Reinforcing Mechanisms
<ol style="list-style-type: none"> 1. Establishing a Sense of Urgency 2. Creating the Guiding Coalition 3. Developing a Vision and Strategy 4. Communicating the Change Vision 5. Empowering Broad-Based Action 6. Generating Short-Term Wins 7. Consolidating Gains and Producing More Change 8. Anchoring New Approaches in the Culture 	<ol style="list-style-type: none"> 1. What leaders pay attention to, measure, and control on a regular basis 2. How leaders react to critical incidents and organizational crises 3. Observed criteria by which leaders allocate scarce resources 4. Deliberate role modeling, teaching, and coaching 5. Observed criteria by which leaders allocate rewards and status 6. Observed criteria by which leaders recruit, select, promote, retire, and excommunicate organizational members 	<ol style="list-style-type: none"> 1. Organization design and structure 2. Organizational systems and procedures 3. Organizational rites and rituals 4. Design of physical space, facades, and buildings 5. Stories, legends, and myths about people and events 6. Formal statements of organizational philosophy, values, and creed

A Sense of Urgency

The first of Kotter's eight steps is creating a sense of urgency.⁵⁸ The BCA of 2011 challenges the DoD to change how it manages its resources due to the imposed series of automatic spending cuts to defense and domestic spending.⁵⁹ The DoD warns these indiscriminate cuts will impact national security.⁶⁰ Now that the cuts are beginning to take effect, the DoD is looking for ways to identify efficiencies and reduce costs.

Additionally, in February 2015, Congress swore in a new Secretary of Defense, Ashton Carter, who is a proponent of financial improvement. In his Senate Armed Services Committee hearing, Carter stated:

But I cannot suggest support and stability for the defense budget without at the same time frankly noting that not every defense dollar is spent as well as it should be. The taxpayer cannot comprehend, let alone support the defense budget, when they read of cost overruns, lack of accounting and accountability, needless overhead, and the like. This must stop. Every company, state, and city in the country has had to lean itself out in recent years, and it should be no different for the Pentagon.⁶¹

The Punctuated-Equilibrium Theory explains that policy is generally stable and changes incrementally due to culture and the conservative nature of politics, but occasionally there are large shifts due to a change in society or government.⁶² These large shifts in policy are not only consistent with "environmental jolts" like the BCA, but also with leader succession within the organization.⁶³ The DoD has potentially outgrown the structure and culture that governs how it handles financial improvement.⁶⁴ Carter could serve as the internal change that "pulls parts and actions out of alignment" to propel the Department forward and initiate transformation in the cost culture.⁶⁵

The Department is entering a time where there is a sense of urgency toward improving the financial culture due to the current fiscal environment and a new Secretary of Defense that supports financial improvement. Implementing a cost culture

will change the way the Department views spending and having auditable financial statements should help the DoD identify specific savings. Further, with auditable financial statements, the DoD will be more credible when explaining the effects of sequestration on the Department.

Developing and Communicating the Vision

Changing a culture, especially one as complex as how the DoD manages its finances, requires a clear vision. According to Kotter, transformation efforts quickly become confusing projects that “go in the wrong direction or nowhere at all,” without a vision.⁶⁶ Further, leadership will never capture the “hearts and minds” without a lot of credible and constant communication from the leadership.⁶⁷ A review of the DoD Comptroller’s and the Financial Improvement and Audit Readiness websites reveals these departments do not have a vision or mission statements.⁶⁸ Without a clear, purpose driven vision and corresponding mission statement, the DoD has not provided the services with a shared picture of the direction the audit readiness program plans to go. In order to facilitate a change in culture regarding financial improvement and audit readiness throughout the DoD, the Secretary of Defense in conjunction with the DoD Comptroller needs to issue a vision statement clearly articulating the direction with clarity of purpose, or commander’s intent.⁶⁹ This guidance needs to identify how business practices and roles and responsibilities need to change and how the DoD will utilize financial systems differently.⁷⁰ With a clear understanding of the commander’s intent the subordinate services can use critical and creative thinking to achieve the stated vision.

Once this vision is established, leadership must communicate it as much as possible using as many venues as possible.⁷¹ Without credible communication on the

vision, the culture of the DoD will not improve. This goes beyond words; top leadership must also demonstrate the vision in their everyday interactions.⁷²

Generating Short Term Wins

Kotter also advocates for generating short term wins which help the organization understand change is possible, value added, and contributes to a positive climate toward the change.⁷³ Supporters of DoD's audit readiness initiatives can point to this step and say that having financial statements ready for a SBA audit September 30, 2014 is a short term win. In fact, the latest FIAR report from November 2014 highlights the achievement of having the SBA ready for audit.⁷⁴

Directly related to this is the embedding mechanism "How leaders react to critical incidents and organizational crises." How a leader handles a perceived crisis reveals the leader's underlying assumptions. People who work together through the crisis are more likely to learn and retain knowledge.⁷⁵ The DoD leadership, through its actions, has reinforced a lack of urgency regarding the federally mandated audit ready financial statements by missing all congressionally mandated dates for the past 60 years. Former Secretary of Defense Panetta implemented the goal of having the SBR audit by September 30, 2014. When it became obvious the DoD would miss the goal, they changed the goal to a SBA audit instead. Instead of a short term win advocated by Kotter, this continues the message that audit ready financial statements are a moving target and there are no consequences to missing deadlines. If the DoD really wants to change the culture regarding financial improvement and audit readiness then senior leadership needs to react differently to missed deadlines and goals, even if they are internally set.

Anchoring the Change

In order for change to last, the organization must ensure the new practices are rooted into the norms and values of the organization and not dependent on one leader or leadership team.⁷⁶ According to Kotter, “Culture changes only after you have successfully altered people’s actions, after the new behavior produces some group benefits for a period of time, and after people see the connection between the new action and performance improvement.”⁷⁷ While organizations can and should use embedding and reinforcing mechanisms during all steps of Kotter’s leading change, these mechanisms play an important part of anchoring the change as they entrench the change in the culture.

Two related embedding mechanisms; “How leaders allocate rewards and status” and “How leaders recruit, select, promote, and attrit personnel” are essential for changing culture.⁷⁸ Making financial improvement a part of the annual performance evaluation and rewarding this behavior demonstrates a commitment to the importance of these goals and ensure that individuals implement them. Currently, “Mission readiness is the overriding standard for military commanders. Once they receive designated funds, however, most do not care about auditability, efficiency and fiscally sound practices because they are not measured on those attributes.”⁷⁹ Measuring both military and civilians on aspects of financial improvement should ensure progress in this area and is the most important embedding mechanism for changing a culture. Further, tying personnel actions such as promotions to financial improvement will ensure the DoD workforce internalizes the change in culture.

Another embedding mechanism is “What leaders pay attention to, measure, and control on a regular basis.” Consistency of the message, not the intensity, is important

for changing a culture.⁸⁰ If leaders are inconsistent in what they pay attention to, subordinates will use their experience to determine what is important.⁸¹ In October 2011, the Secretary of Defense issued a clear, concise, two page memo articulating the importance of financial improvement and goals for achieving audit readiness. Former Secretary of Defense Panetta stated in this memo, “I will engage in this effort personally--auditability is a goal that every commander, every manager, and every functional specialist must understand and embrace to improve efficiency and accountability at the DoD.”⁸² On December 9, 2013, Secretary of Defense Chuck Hagel released a YouTube video, linked on the FIAR website, articulating audit readiness is a high priority for him and senior DoD leadership and that audit readiness should be a high priority for “each of us.”⁸³

By only issuing two formal messages the DoD did not really implement the embedding mechanism of what leaders pay attention to, measure and control on a regular basis. Instead, the DoD relied on the reinforcing mechanism of the use of formal statements of organizational philosophy, creeds, and charters with these two communications methods. The Secretary of Defense, Comptroller, and DoD leaders must focus on cost culture in their daily interactions in order to allow change to take root in the culture. Reinforcing mechanism of organizational systems and procedures can institutionalize the embedding mechanism of what leaders pay attention to by establishing processes that ensure things the leader values are completed.⁸⁴ For example, meetings regarding Audit Readiness and Financial Improvement and the creation of FIAR guidance are positive steps.

The next embedding mechanism, the “leader’s use of deliberate role-modeling, teaching, and coaching” relates to the visible behavior during informal messages, not just staged or taped messages.⁸⁵ If DoD leadership increases their communication regarding the importance of financial improvement and audit readiness, this will also demonstrate the importance of these concepts. The Secretary of Defense, the DoD Comptroller, and all the Service Chiefs must continuously and publicly articulate their commitment to, and the importance of, financial improvement and audit readiness in order to implement the embedding mechanism of deliberate role-modeling, teaching, and coaching. Not only should top leadership emphasize the importance of financial management improvement, they must lead by example. Kotter states “Nothing undermines the communication of a change vision more than behavior on the part of key players that seems inconsistent with the vision.”⁸⁶

Recommendations for the DoD and/or services

The DoD will have a difficult time becoming audit ready until it improves its financial management culture. Once the DoD creates a cost culture then there should be improvements in implementing financial systems and auditable financial statements. The following recommendations will assist the DoD in accomplishing this change in culture and obtain auditable financial statements.

The DoD should utilize embedding and reinforcing mechanisms to change the financial management culture within DoD from one of expenditure based to a culture that emphasizes and embraces cost control and effectiveness.

The Secretary of Defense in conjunction with the DoD Comptroller should issue a clear concise vision statement describing the commander’s intent in regards to financial improvement and audit readiness separate and apart from guidance and policy for

achieving audit readiness. This shared vision will help the services know the direction required and facilitate culture change.

1. DoD senior leadership should increase their public messages regarding the importance of financial improvement and audit readiness. Everyone in the DoD should understand why audit readiness is important and how they personally contribute to financial improvement.
2. The DoD should implement cost culture goals into the annual performance appraisal for all employees. These measures should be used during promotions, hiring, and attrition actions. Further, the DoD should hold people accountable when the DoD misses audit readiness goals.
3. The DoD should concentrate resources on achieving unqualified opinions on all SBA audits this and subsequent years. The DoD should start fresh on current efforts and not try to determine previous years funding. In other words, the DoD should start with a clean slate. Using the new DoD ERP systems and ensuring adequate internal controls, the DoD should be able to account for all funding from this date forward.

Conclusion

Over the last 60 years, the DoD has demonstrated a lack of commitment toward achieving financial improvement, accountability, and audit readiness. This is not a part of the DoD culture, where the mission comes first. The DoD has spent billions in attempting to meet the Congressional mandate of audit ready financial statements by September 30, 2017. However, it does not appear the DoD will be able to make this deadline. In these fiscally constrained times, the DoD can no longer afford to foster this attitude. Instead, senior DoD leadership must work toward changing the culture in

regards to financial management. One way to do this is to implement a clear concise vision and utilize Kotter's eight steps for cultural change in conjunction with embedding and reinforcing mechanisms to implement a lasting culture change. Now is the time for the DoD to implement change due to the reduction of financial resources in accordance with the BCA of 2011 and a new Secretary of Defense that actively supports financial improvement. Without changing the cost culture first, the expenditures towards achieving audit readiness will not be worth the cost.

Endnotes

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