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**NAVAL
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MONTEREY, CALIFORNIA

THESIS

**AN EXAMINATION OF THE DEPARTMENT OF
DEFENSE FINANCIAL IMPROVEMENT AND AUDIT
READINESS PLAN USING A BALANCED SCORECARD**

by

Xyrone R. Ocampo

June 2011

Thesis Co-Advisors:

Douglas A. Brook
Donald E. Summers

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**AN EXAMINATION OF THE DEPARTMENT OF DEFENSE FINANCIAL
IMPROVEMENT AND AUDIT READINESS PLAN USING A BALANCED
SCORECARD**

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Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

from the

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ABSTRACT

This thesis analyzes the Department of Defense (DoD) Financial Improvement and Audit Readiness (FIAR) Plan using the Balanced Scorecard. Using Niven's methodology of applying the Balanced Scorecard to the nonprofit and government sectors, the purpose of the thesis is to determine if the Balanced Scorecard can assist in execution of the FIAR Strategy to achieve the goal of asserting financial audit readiness by 30 September 2017. The analysis produced a Strategy Map and Balanced Scorecard, which translated the FIAR Strategy into practical objectives, performance measures, targets and initiatives. The thesis revealed that the Balanced Scorecard can be used to assist in FIAR Strategy execution, including recommendations provided to DoD leadership on ways to improve the FIAR Plan.

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TABLE OF CONTENTS

I.	INTRODUCTION.....	1
A.	PURPOSE.....	1
B.	BACKGROUND.....	1
C.	RESEARCH QUESTIONS.....	6
D.	THESIS SCOPE AND CLARIFICATION.....	6
E.	THESIS ORGANIZATION.....	7
II.	LITERATURE REVIEW.....	9
A.	THE PROBLEM OF THE DEPARTMENT OF DEFENSE.....	9
B.	STATUTES AND REGULATIONS IMPROVING FINANCIAL ACCOUNTABILITY.....	11
1.	CFO Act of 1990.....	12
2.	Government Performance and Results Act of 1993.....	13
3.	Government Management Reform Act of 1994.....	14
4.	Federal Financial Management Improvement Act of 1996.....	14
5.	OMB Circular A-123.....	14
6.	National Defense Authorization Act of 2010.....	15
7.	OMB Circular A-136.....	15
C.	PAST DOD EFFORTS.....	15
D.	PRIVATE SECTOR ORGANIZATION FINANCIAL DELIVERABLES.....	18
E.	DEPARTMENT OF DEFENSE FINANCIAL DELIVERABLES.....	20
F.	THE GOAL: FINANCIAL AUDIT READINESS.....	22
G.	CHAPTER SUMMARY.....	23
III.	THE FINANCIAL IMPROVEMENT AND AUDIT READINESS (FIAR) PLAN.....	25
A.	BACKGROUND OF RECENT FIAR EFFORT.....	25
B.	FIAR GUIDANCE.....	26
C.	THE FIAR PURPOSE, GOALS, AND PRIORITIES.....	26
D.	FIAR STAKEHOLDERS.....	27
1.	FIAR Governance Board.....	28
2.	DoD Audit Advisory Committee.....	28
3.	FIAR Directorate.....	28
4.	FIAR Committee.....	29
5.	FIAR Subcommittee.....	30
6.	Reporting Entities.....	30
7.	Service Providers.....	32
E.	OTHER MAJOR ELEMENTS OF THE FIAR PLAN.....	32
1.	Strategic Management Plan (SMP).....	33
2.	Enterprise Transition Plan (ETP).....	36
3.	Business Enterprise Architecture (BEA).....	37
F.	FIAR STRATEGY AND METHODOLOGY.....	37

1.	FIAR Strategy	37
2.	FIAR Methodology	41
G.	PAST AND FUTURE ACCOMPLISHMENTS	43
H.	CHAPTER SUMMARY.....	46
IV.	THE BALANCED SCORECARD	47
A.	INTRODUCTION.....	47
B.	FACTORS FUNDAMENTAL TO THE SUCCESS OF AN ORGANIZATION	48
1.	The Increased Role of Intangible Assets in Value Creation	48
2.	Avoiding the Over-Reliance on Financial Measures of Performance	49
3.	The Challenge of Executing Strategy.....	50
C.	FOUR PERSPECTIVES OF THE BALANCED SCORECARD	51
1.	Customer Perspective	52
2.	Internal Business Processes Perspective	53
3.	Financial Perspective	53
4.	Employee Learning and Growth Perspective.....	54
D.	THE BALANCED SCORECARD IS THREE TOOLS IN ONE.....	54
1.	The Balanced Scorecard as a Communication Tool.....	54
a.	<i>The Strategy Map</i>	56
2.	The Balanced Scorecard as a Measurement System	58
3.	The Balanced Scorecard as a Strategic Management System	58
a.	<i>The Translation of Strategy</i>	59
b.	<i>Cascading the Scorecard</i>	59
c.	<i>Strategic Resource Allocation</i>	59
d.	<i>Strategic Learning</i>	60
E.	MODIFYING THE BALANCED SCORECARD TO FIT THE GOVERNMENT SECTOR	60
F.	CHAPTER SUMMARY.....	61
V.	ANALYSIS	63
A.	INTRODUCTION.....	63
B.	METHODOLOGY	63
1.	Prior to Developing the Balanced Scorecard: The Planning Phase.....	64
a.	<i>Develop the Rationale and Communicate the Rationale to Employees</i>	64
b.	<i>Get Buy-In from the Executives</i>	64
c.	<i>Develop the Balanced Scorecard Team</i>	65
d.	<i>Determine Where Within the Organization to Implement the Balanced Scorecard</i>	65
e.	<i>Determine What Resources Are Needed for the Balanced Scorecard</i>	66
f.	<i>Have a Training Plan and Communication Plan</i>	67
2.	The Development Phase	67
a.	<i>Gather and Distribute Background Information</i>	68

	<i>b.</i>	<i>Provide a Balanced Scorecard Education.....</i>	<i>68</i>
	<i>c.</i>	<i>Develop or Confirm Mission, Values, Vision, and Strategy..</i>	<i>68</i>
	<i>d.</i>	<i>Conduct Executive Interviews</i>	<i>71</i>
	<i>e.</i>	<i>Develop the Strategy Map</i>	<i>71</i>
	<i>f.</i>	<i>Executive Workshop</i>	<i>71</i>
	<i>g.</i>	<i>Gather Employee Feedback.....</i>	<i>71</i>
	<i>h.</i>	<i>Develop Performance Measures.....</i>	<i>71</i>
	<i>i.</i>	<i>Executive Workshop</i>	<i>72</i>
	<i>j.</i>	<i>Gather Employee Feedback.....</i>	<i>72</i>
	<i>k.</i>	<i>Establish Targets and Prioritize Initiatives.....</i>	<i>73</i>
	<i>l.</i>	<i>Gather Data for the First Balanced Scorecard Report.....</i>	<i>73</i>
	<i>m.</i>	<i>Hold the First Balanced Scorecard Meeting</i>	<i>73</i>
	<i>n.</i>	<i>Develop the Ongoing Balanced Scorecard Implementation Plan.....</i>	<i>73</i>
C.		APPLYING NIVEN’S METHODOLOGY TO DEVELOP THE FIAR STRATEGY BALANCED SCORECARD.....	73
	1.	The Planning Phase.....	74
	<i>a.</i>	<i>Develop the Rationale for Using the Balanced Scorecard</i>	<i>74</i>
	<i>b.</i>	<i>Gain Senior Leadership Support and Sponsorship</i>	<i>74</i>
	<i>c.</i>	<i>Form the Balanced Scorecard Team.....</i>	<i>74</i>
	<i>d.</i>	<i>Decide Where in the Organization to Build the Balanced Scorecard.....</i>	<i>74</i>
	<i>e.</i>	<i>Determine the Resource Requirements and Availability.....</i>	<i>75</i>
	<i>f.</i>	<i>Develop a Training and Communication Plan for Balanced Scorecard Implementation</i>	<i>75</i>
	2.	The Development Phase	76
	<i>a.</i>	<i>Gather and Distribute Background Information.....</i>	<i>77</i>
	<i>b.</i>	<i>Develop or Confirm Mission, Values, Vision, and Strategy..</i>	<i>77</i>
	<i>c.</i>	<i>Develop the Strategy Map</i>	<i>79</i>
	<i>d.</i>	<i>Develop Performance Measures.....</i>	<i>84</i>
	<i>e.</i>	<i>Establish Targets and Prioritize Initiatives.....</i>	<i>86</i>
D.		THE DELIVERABLE: THE FIAR BALANCED SCORECARD.....	94
E.		FIAR STRATEGY ANALYSIS.....	95
F.		CHAPTER SUMMARY.....	97
VI.		RESULTS, RECOMMENDATIONS AND CONCLUSIONS	99
	A.	ANSWERING THE RESEARCH QUESTIONS	99
	1.	Can a Balanced Scorecard Be Used as an Effective Strategic Management Tool for DoD Organizations to Complement the FIAR to Achieve Audit Readiness?	99
	2.	Can the Balanced Scorecard Also Be an Effective Strategic Management Tool at the Service Component Level When Used With the FIAR?	99
	3.	What Challenges Could Hinder Balanced Scorecard Success? ...	100
B.		RECOMMENDATIONS.....	101
C.		RECOMMENDATIONS FOR FURTHER STUDIES	102

D. THESIS CONCLUSION	103
LIST OF REFERENCES.....	105
INITIAL DISTRIBUTION LIST	111

LIST OF FIGURES

Figure 1.	The FIAR Governance extends from the top level leadership with the Chief Management Officer (CMO) down to the executors of the FIAR with the reporting entities and service providers (From DoD, 2010b, p.i).	32
Figure 2.	The five SMP business goals align with the DoD strategic goals as defined in the QDR. (From DoD, 2010e, p.2)	33
Figure 3.	The SMP objectives, measures, and initiatives translate the DoD’s strategic goals and objectives as defined in the 2010 QDR (From DoD, 2010e, p.19).	34
Figure 4.	The SMP uses an alphanumeric organizing taxonomy structure to represent the goals, objectives, and performance measures (From DoD, 2010e, p.9).	35
Figure 5.	The DoD Strategic Management Plan, made up of a “family of plans.” (From DoD, 2010b, p.8; DoD, 2010e, p.3).	36
Figure 6.	The five wave FIAR path towards achieving audit readiness (From DoD, 2010b, p.ii)	41
Figure 7.	FIAR methodology key phases and tasks (From DoD, 2010b, p.iv).	43
Figure 8.	The Balanced Scorecard (From Niven, 2008, p.12).	52
Figure 9.	An example of a Strategy Map. (From http://www.resilient-strategies.com/triple-bottom-line/)	57
Figure 10.	An example of a Balanced Scorecard complementing the Strategy Map in Figure 9 (From http://www.resilient-strategies.com/triple-bottom-line/)	57
Figure 11.	The government sector Balanced Scorecard (From Niven, 2008, p.32).	61
Figure 12.	Graphical representation of the FIAR Strategy (From DoD, 2010b, p.ii).	79
Figure 13.	The Strategy Map using Niven’s methodology (After Niven, 2008, pp.150–205).	83
Figure 14.	The completed FIAR Strategy Balanced Scorecard.	95

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LIST OF TABLES

Table 1.	List of organizations that have adopted the use of a Balanced Scorecard (From http://www.balancedscorecard.org).....	2
Table 2.	Material weaknesses present in the DON internal control measures (After DON, 2006/2010).....	5
Table 3.	DoD material weaknesses reported in the 2006 and 2010 DoD AFR (After DoD, 2006/2010a).....	11
Table 4.	Federal agencies with Chief Financial Officers (CFOs) in the CFO Council (From www.cfoc.gov).....	13
Table 5.	DoD financial statement audit opinions and results in December 2005 (From DoD, 2005b).....	44
Table 6.	FY2009 Financial statement audit results. Since the first FIAR published in December 2005, the Office of the Inspector General and the U.S. Army Corps of Engineers-Civil Works received an unqualified opinion, while the TRICARE Contract Resource Management received a qualified opinion (From DoD, 2005b and DoD 2010d).....	45
Table 7.	FIAR priority audit readiness assertions. Although not all of the statements may receive favorable audit opinions, the DoD entities have made major progress by achieving audit readiness assertions (From DoD, 2010a/2010d).....	45
Table 8.	FIAR professional development courses available (From DoD, 2010d).....	76
Table 9.	List of codes and their meanings for the FIAR Balanced Scorecard.....	80
Table 10.	Strategic goals of the May 2010 FIAR Guidance (From DoD, 2010b, p.i).....	80
Table 11.	Potential strategic objectives for Strategy Map.....	81
Table 12.	Objectives developed for the Strategy Map.....	82
Table 13.	Balanced Scorecard measures developed using the Strategy Map developed in Figure 13.....	85
Table 14.	Performance measures chosen with coding and targets.....	86
Table 15.	Proposed initiatives developed from the objectives, performance measures and targets.....	87
Table 16.	Reporting entities receiving unqualified audit opinions in FY 2010 (From DoD, 2011b, p.5).....	101

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LIST OF ACRONYMS AND ABBREVIATIONS

ABC	Activity-based Costing
ADA	Anti-Deficiency Act
AFR	Agency Financial Report
APR	Annual Performance Report
APSR	Accountable Property Systems of Record
AT&L	Acquisition, Technology and Logistics
BEA	Business Enterprise Architecture
BEIS	Business Enterprise Information Services
BEP	Business Enterprise Priorities
BMMP	Business Management Modernization Program
BTA	Business Transformation Agency
CBM	Core Business Missions
CBO	Congressional Budget Office
CFO	Chief Financial Officer
CFO Act	Chief Financial Officers Act of 1990
CMO	Chief Management Officer
CO	Customer Objective
DCMO	Deputy Chief Management Officer
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DoD	Department of Defense
DoDIG	Department of Defense Inspector General
E&C	Existence and Completeness

EL&G	Employee Learning and Growth
EO	Employee Learning and Growth Objective
ERP	Enterprise Resource Planning
ETP	Enterprise Transition Plan
EVA	Economic Value Added
FASB	Financial Accounting Standards Board
FFMIA	Federal Financial Management Improvement Act of 1996
FIAR	Financial Improvement and Audit Readiness
FIC	Force and Infrastructure Categories
FIP	Financial Improvement Plan
FM	Financial Management
FMFIA	Federal Managers' Financial Integrity Act of 1982
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GMRA	Government Management Reform Act of 1994
GPRA	Government Performance and Results Act of 1993
I	Initiative
ICOFR	Internal Controls of Financial Reporting
IP	Internal Processes
KCO	Key Control Objectives
KSD	Key Supporting Documents
MD&A	Management's Discussion and Analysis
NDAA	National Defense Authorization Act
OAI	Other Accompanying Information

ODO	Other Defense Organizations
OMB	Office of Management and Budget
OUSD(C)	Office of the Under Secretary of Defense Comptroller
P.L.	Public Law
PM	Performance Measure
PO	Internal Process Objective
QDR	Quadrennial Defense Review
RO	Resource Management Objective
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SEC	Securities and Exchange Commission
SFIS	Standard Financial Information Structure
SG	Strategic Goal
SMP	Strategic Management Plan
SRDS	Strategic Resource Decision System
USD(C)	Under Secretary of Defense Comptroller

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I. INTRODUCTION

A. PURPOSE

The purpose of the research is to analyze the Department of Defense's (DoD) Financial Improvement and Audit Readiness (FIAR) Plan through use of the Balanced Scorecard framework. Initially published in December 2005, the FIAR is the DoD's strategy towards achieving audit readiness. The FIAR provides a timeline and milestones to improve financial management in order to achieve audit readiness and, ultimately, a clean audit opinion (Office of the Under Secretary of Defense Comptroller, n.d.). The Balanced Scorecard, a strategic management framework developed in 1987 by Arthur Schneiderman and popularized in 1992 by Robert S. Kaplan and David P. Norton, is used by numerous organizations throughout the world to help in achieving success in business operations (Schneiderman, 2006; Niven, 2008). Table 1 lists many of the organizations that have adopted the use of the Balanced Scorecard. The importance of using the Balanced Scorecard approach to analyze the FIAR is that it may provide DoD leadership a meaningful tool to translate the vision of achieving audit readiness into meaningful tasks at all levels of the agency.

B. BACKGROUND

The fiscal condition of the United States today requires better financial accountability. The nation is struggling from a recent recession triggered by a large decline in housing prices coupled with a financial crisis, events that have not been seen since the Great Depression (Congressional Budget Office, 2011). The Congressional Budget Office (CBO) estimates large annual budget deficits for each of the next ten years (CBO, 2011). With Bush-era tax cuts extended for two more years to boost a sluggish economy (Montgomery, Murray & Branigin, 2010), the federal government may not be able to close the budget deficits anytime soon. Furthermore, a continuing global war on terrorism has placed additional demands on the nation's resources. It is therefore imperative for the federal government to become a better steward of taxpayer dollars.

Organization	Sector
Ann Taylor Stores	Retail
Army Medical Service Corps	Government
Bonneville Power Administration	Utilities
British Telecommunications Worldwide	Telecommunications
California State University system	Higher Learning
Caterpillar, Inc.	Manufacturing
Citizen Schools	Middle Schools
City of Charlotte	Local Government
Daimler Chrysler	Manufacturing
Defense Logistics Agency	Government
Defense Finance and Accounting Service	Government
Equifax, Inc.	Financial Services
ExxonMobil Corp.	Energy
Fannie Mae	Banking
Ford Motor Company	Manufacturing
General Electric Company	Manufacturing
Hilton Hotels Corp.	Hospitality
Honeywell	Manufacturing
IBM	Information Technology
Ingersoll-Rand	Manufacturing
KeyCorp	Financial Services
May Institute	Health Care
MDS	Health and Life Science
Mobil N. American Marketing & Refining	Energy
National Reconnaissance Office	Government
NCR Corp.	Information Technology
Pfizer Inc.	Pharmaceuticals
Royal Canadian Mounted Police	Government
Sears Roebuck & Company	Retail
Siemens AG	Manufacturing
T. Rowe Price Investment Technologies	Financial Services
UK Ministry of Defence	Government
United Way of Southeastern New England	Humanitarian
University of Washington	Higher Education
UPS	Shipping
US Army Medical Command	Health Care
Verizon Communications Inc.	Telecommunications
Walt Disney World Company	Entertainment
Wells Fargo Bank	Banking

Table 1. List of organizations that have adopted the use of a Balanced Scorecard (From <http://www.balancedscorecard.org>).

One of the ways to become a better steward of taxpayer dollars would be to manage financial resources accurately and in a reliable manner. Managing financial resources accurately and reliably requires proper internal control procedures and capable financial management systems, which the DoD as a whole still lacks. Incorporating the

right internal controls and financial management systems into the day-to-day operations of the DoD is essential to being able to produce accurate and reliable financial information. This should result in better utilization of the taxpayer dollars.

Private sector companies produce financial statements at the end of their reporting periods. These financial statements—comprised of a balance sheet, income statement, and statement of cash flows—are used by stakeholders such as investors and creditors to make business, investment and resource allocation decisions. In order for stakeholders to make sound financial decisions and minimize risk, the companies are held accountable for ensuring these financial statements are produced to fairly represent the business operations. These companies' financial statements must comply with business accounting system standards, such as U.S. Generally Accepted Accounting Principles (GAAP), and are audited by independent auditors.

The drive for better accountability and the financial management practices of the private sector in producing reliable financial information for stakeholders has captured the attention of public policymakers within the federal government. On November 15, 1990, the Chief Financial Officers Act (CFO Act) was signed into law by President George H.W. Bush. The CFO Act was passed to make the federal government a more fiscally conscious entity. Although the goal of the CFO Act was to have executive agencies produce a set of audited financial statements, the CFO Act also included three other important provisions:

- Systematic measurement of performance
- Development of cost information
- Integration of Systems--budget, program, and financial (Steinhoff & Cherbini, 2010, pp. 11–12)

Coupled with a well-designed system of internal controls, these three provisions were intended to help increase financial stewardship (Steinhoff & Cherbini, 2010). As Steinhoff and Cherbini state, “The CFO Act was designed to enable agencies to manage the cost of government through access to reliable, relevant and timely financial

information that is integrated with program and budget information to allow the systematic measurement of cost and performance.” Although audited financial statements are used to exhibit past performance of the federal government, the value lies within the actions they trigger to correct both financial and internal control deficiencies. (Steinhoff & Cherbini, 2010, p.12)

As one of the federal agencies required by statute to produce audited financial statements, the Department of Defense has yet to produce an “audit ready” consolidated financial report. Similar to a private enterprise, the DoD must produce a set of financial statements that fairly represents its operations in a timely manner. This set of financial statements must conform to GAAP for federal reporting entities, whose purpose is similar to U.S. GAAP, but is established by the Federal Accounting Standards Advisory Board (FASAB) (Federal Accounting Standards Advisory Board, n.d.). The DoD must also have its financial statements audited in accordance with Generally Accepted Government Auditing Standards (GAGAS), standards that are codified by the Comptroller General of the United States (Government Accountability Office, 2011d). However, the size and complexity of the DoD organization, coupled with fundamentally flawed business systems and long-standing internal control weaknesses, continue to hamper the agency’s ability to achieve a financial audit readiness status (GAO, 2010b).

The main tool the Department of Defense uses to address financial system improvement and audit readiness is the FIAR. This plan, first published in December 2005, was developed as a pathway towards achieving audit readiness. A dynamic plan, the FIAR has since gone through nine updates, known as FIAR Plan Status Reports (PSR), mainly to adapt to priority changes and report accomplishments. According to §1003 of the National Defense Authorization Act (NDAA) of 2010, the Office of the Undersecretary of Defense Comptroller (OUSDC), on behalf of the Chief Management Officer (CMO), must update Congress twice annually on the FIAR Plan via the FIAR PSR. (NDAA, 2009)

Although the FIAR was introduced fifteen years past the introduction of the CFO Act, DoD’s efforts to achieve financial statement audit readiness are not new. Preceding

the FIAR Plan, the DoD developed “Business Rules” that were designed to guide agency components to achieve audit readiness via a phased approach. Since the 2005 FIAR Plan introduction, the refined “Business Rules” integrated with the plan and is now known as the FIAR Methodology. (Department of Defense, 2010b, pp. iii–iv)

Twenty years have elapsed since the passage of the CFO Act in 1990, and the Department of Defense has yet to produce a set of audit ready agency-wide financial statements. However, no punitive consequences have resulted. The NDAA of 2010 (§1003) increases pressure by holding the DoD CMO responsible for developing and maintaining the FIAR plan and producing audit ready financial statements by 30 September 2017 (NDAA, 2009). The NDAA does this by making the FIAR plan a statutory mandate and providing several specific provisions that require follow-up. Such provisions include providing Congress with a plan of action to correct deficiencies and a list of impediments with a plan to address these impediments (NDAA, 2009).

Since the FIAR was first published in December 2005, the DoD Inspector General (DoDIG) reported at least nine material weaknesses present in the Department of the Navy’s (DON) internal control measures (Department of the Navy, 2006). However, the DON’s most recent annual financial report still had nine material weaknesses present (DON, 2010). Table 2 shows a comparison of material weaknesses noted on the DoDIG’s audit opinions. The lack of progress leaves room to question the FIAR effectiveness.

<i>2006 Material Weaknesses</i>	<i>2010 Material Weaknesses</i>
Accounting and Financial Management Systems	Financial Management Systems
Fund Balance with Treasury	Fund Balance with Treasury
Accounts Receivable	Accounts Receivable
Inventory and Related Property, Net	Inventory and Related Property, Net
General Property, Plant, and Equipment	General Property, Plant, and Equipment
Accounts Payable	Accounts Payable
Environmental Liabilities	Statement of Net Cost
Problem Disbursements	Problem Disbursements
Unobligated Balance	Unobligated Balance

Table 2. Material weaknesses present in the DON internal control measures (After DON, 2006/2010).

The Balanced Scorecard is used in this thesis to analyze the FIAR. The Balanced Scorecard provides a different approach to understanding the DoD leadership's visions and strategies and attempts to translate them into actionable tasks. Since the introduction of the Balanced Scorecard, numerous organizations have achieved success in improving business operations through its use. Although the Balanced Scorecard has already been used in several organizations within the Department of Defense (e.g., Army Medical Service Corps, Defense Finance and Accounting Service), no documented evidence was found that specifically uses the Balanced Scorecard to focus on the FIAR or the financial management realm of the Department of Defense.

Applying the Balanced Scorecard is not an attempt to offer a substitute for the FIAR. Rather, the Balanced Scorecard provides an alternative method of analyzing the FIAR in order to improve its effectiveness by providing a relevant, coherent approach of translating the FIAR into actionable items at every level of the DoD.

C. RESEARCH QUESTIONS

The research is conducted to answer this primary research question: Can a Balanced Scorecard be used as an effective strategic management tool for the DoD organization to complement the FIAR to achieve audit readiness?

In addition, the research was conducted to answer these secondary research questions: Can the Balanced Scorecard also be an effective strategic management tool at the service component level when used with the FIAR? What challenges could hinder Balanced Scorecard success?

D. THESIS SCOPE AND CLARIFICATION

The scope of this thesis:

- Focuses on the Department of Defense executive level, unless stated otherwise.
- Focuses on the Department of the Navy when analyzing the component level.

- Limits information analysis to public electronic items and published literature.
- Focuses on the author's efforts only when developing the Balanced Scorecard. Thus, conditions requiring group work as part of the methodology are assumed to be met through the author's efforts.

For clarification, "private sector organizations" refer to publicly and privately held business firms, whereas "public sector organizations" refer to organizations within the federal government. The terms "FIAR Plan" and "FIAR" are used interchangeably, and the strategy map and scorecard are collectively known as the "Balanced Scorecard."

E. THESIS ORGANIZATION

There are five chapters that follow this introductory chapter. Chapter II is the literature review, which defines the DoD's problems in achieving audit readiness, lists the statutes and regulations pertaining to the FIAR effort, and describes past attempts in achieving audit readiness. Chapter II also describes financial statements that the DoD needs to have audit ready, and compares the statements with private sector financial statements. Chapter III explains the FIAR. Included in Chapter III are the FIAR guidance, purpose, goals, and priorities. Additionally, Chapter III explains the FIAR strategy and methodology, the FIAR stakeholders, as well as the FIAR accomplishments to date. Chapter IV describes the Balanced Scorecard by first identifying the organizational success factors that call for the Balanced Scorecard. Chapter IV then describes the four perspectives of the Balanced Scorecard and the role of the Balanced Scorecard in the organization. Chapter V first introduces Niven's methodology in developing the Balanced Scorecard for public sector organizations, and is followed by the development of a Balanced Scorecard for the FIAR strategy using Niven's methodology. With the development of the FIAR Balanced Scorecard, Chapter V analyzes the FIAR strategy to answer the research questions in Chapter VI. The final chapter, Chapter VI, answers the research questions, suggests recommendations to DoD leadership and for further study, and concludes the thesis.

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II. LITERATURE REVIEW

Chapter II provides the background necessary to understand the FIAR Plan. It begins by describing the problems that the Department of Defense has faced with respect to achieving financial statement auditability. This chapter then describes the statutes and regulations that mandate financial management improvement and drive the need for audit readiness. Afterwards, this chapter explains past DoD efforts in achieving audit readiness. A description of the basic financial deliverables in both the private and public sectors follows. The private sector financial deliverables section is provided to understand the fundamental requirements of financial statements. The DoD financial deliverables section describes—as its role as a public sector agency—the deliverables needed to be produced as audit ready. Lastly, the chapter concludes with an understanding of the DoD’s financial management goals in achieving DoD financial statement auditability.

A. THE PROBLEM OF THE DEPARTMENT OF DEFENSE

The Department of Defense is one of four federal executive agencies not to receive an unqualified (clean) audit opinion for FY 2010, nor has it achieved financial statement audit readiness (GAO, 2011c, p.2; DoD, 2010a, p.44). Since the FIAR Plan was first published in December 2005, the agency has received a disclaimer opinion in each of the annual DoD Agency Financial Reports (AFR) (DoD, 2006–2010a). A disclaimer opinion is given to an audited entity when an auditor cannot express an opinion on the financial statements, due to either material uncertainties or material restrictions on the scope of the audit (Stickney, Weil, Schipper & Francis, 2010). Although the Government Accountability Office (GAO) recognizes the numerous efforts initiated by the DoD to improve financial management weaknesses and achieve audit readiness (DoD, 2010b, p.i), it is the DoD’s size and complexity that contribute to the long-standing and pervasive financial management problems (GAO, 2010b, p.1).

The main problems preventing the DoD from achieving audit readiness are the persistent material weaknesses in financial management and related business processes

and systems (DoD, 2010, pp.3–4). A material weakness is a “deficiency or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected in a timely basis” (DoD, 2010b, p.AVII-3). Two categories of material weaknesses exist; noncompliant systems and legacy financial processes. Most financial management related legacy systems currently used in the DoD are considered noncompliant because the systems cannot meet the current requirements needed to trace transactional information to the source. Whereas smaller organizations are able to meet the current requirements through successfully applied compensating controls, larger organizations such as the military departments cannot. The legacy financial processes, such as determining accounts receivable or accounts payable, are the other material weakness category. These legacy financial processes do not comply with basic accounting principles because they are dependent on the noncompliant systems to record financial information (DoD, 2010a, p. 20). As of the end of FY 2010, the DoD estimates there are 2,080 systems that support its business functions (DoD, 2010b, p.1).

Table 3 shows a comparative list of material weaknesses preventing financial audit readiness for the DoD from two different years (2006 and 2010). Note that the number of material weaknesses increases from 12 to 14 weaknesses, with 11 of the material weaknesses the same for both observed years (DoD, 2006; DoD, 2010a). The “Statement of Financing” material weakness on the 2006 list was consolidated into the “Reconciliation of Net Cost of Operations to Budget” material weakness in accordance with an Office of Management and Budget (OMB) Circular A-136 revision (DoD, 2007).

<i>2006 Material Weaknesses</i>	<i>2010 Material Weaknesses</i>
Financial Management Systems	Financial Management Systems
Fund Balance with Treasury	Fund Balance with Treasury
Statement of Financing	Accounts Receivable
Inventory	Inventory
Operating Materials and Supplies	Operating Materials and Supplies
General Property, Plant, and Equipment	General Property, Plant, and Equipment
Government-Furnished and Contractor Acquired Material	Government-Furnished and Contractor Acquired Material
Accounts Payable	Accounts Payable
Environmental Liabilities	Environmental Liabilities
Statement of Net Cost	Statement of Net Cost
Intragovernmental Eliminations	Intragovernmental Eliminations
Other Accounting Entries	Other Accounting Entries
	Reconciliation of Net Cost of Operations to Budget
	Contingent Legal Liabilities

Table 3. DoD material weaknesses reported in the 2006 and 2010 DoD AFR (After DoD, 2006/2010a).

B. STATUTES AND REGULATIONS IMPROVING FINANCIAL ACCOUNTABILITY

The push for financial accountability is not new. In fact, the need for financial accountability dates back to the founding of the United States of America. The framers included a clause in the Constitution to account for financial accountability, which states, "...a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." (U.S. Const. art. I,§9)

In order to understand the DoD’s effort towards financial improvement and audit readiness, it is important to review the key statutes and regulations that require improved financial accountability. The statutes are the CFO Act of 1990, the Government Performance and Results Act of 1993, the Government Management Reform Act of 1994, the Federal Financial Management Improvement Act of 1996, and the National Defense Authorization Act of 2010. The regulations that require improved financial accountability are the OMB Circular A-123 and OMB Circular A-136. Each will be summarized below, focusing on their relevancy to financial accountability.

1. CFO Act of 1990

On November 15, 1990, the Chief Financial Officers Act of 1990 (CFO Act) was signed into law. The purpose as stated in the CFO Act is threefold:

(1) Bring more effective general and financial management practices to the Federal Government through statutory provisions which would establish in the Office of Management and Budget a Deputy Director for Management, establish an Office of Federal Financial Management headed by a Controller, and designate a Chief Financial Officer in each executive department and in each major executive agency in the Federal Government.

(2) Provide for improvement, in each agency of the Federal Government, of systems of accounting, financial management, and internal controls to assure the issuance of reliable financial information and to deter fraud, waste, and abuse of Government resources.

(3) Provide for the production of complete, reliable, timely and consistent financial information for use by the executive branch of the Government and the Congress in the financing, management, and evaluation of Federal programs. (CFO Act, 1990)

Since the passage of the CFO Act, the executive branch established all of the offices in purpose (1), along with the Chief Financial Officers Council (CFO Council) whose function is to “advise and coordinate the activities of the agencies of its members on such matters as consolidation and modernization of financial systems, improved quality of financial information, financial data and information standards, internal controls, legislation affecting financial operations and organizations, and any other financial management matter (31 USC §901 SEC. 302).” This Council is comprised of the Deputy Director for Management of the Office of Management and Budget (serves as council chairperson); Controller of the Office of Federal Financial Management of OMB; Fiscal Assistant Secretary of Treasury; and the Chief Financial Officers of 24 federal agencies. The federal agencies are listed in Table 4.

Department of Agriculture	Department of Transportation
Department of Commerce	Department of the Treasury
Department of Defense	Department of Veterans Affairs
Department of Education	Environmental Protection Agency
Department of Energy	National Aeronautics and Space Administration
Department of Health and Human Services	Agency for International Development
Department of Homeland Security*	General Services Administration
Department of Housing and Urban Development	National Science Foundation
Department of the Interior	Nuclear Regulatory Commission
Department of Justice	Office of Personnel Management
Department of Labor	Small Business Administration
Department of State	Social Security Administration*

*Not part of the original CFO Act. Federal Emergency Management Agency was included but later removed.

Table 4. Federal agencies with Chief Financial Officers (CFOs) in the CFO Council (From www.cfoc.gov).

The CFO Act also requires that OMB submit to appropriate congressional committees a financial status report and 5-year financial management plan. Furthermore, the CFO Act requires agency heads to submit to the Director of OMB a financial statement for the previous fiscal year. Lastly, the act also requires that each financial statement submitted to the Director of OMB shall be audited in accordance with GAGAS. (CFO Act, 1990)

2. Government Performance and Results Act of 1993

The Government Performance and Results Act (GPRA) of 1993 requires agency heads to implement accountability systems by submitting to OMB strategic plans for program activities to include a mission statement, goals and objectives. The mission statement should cover the major functions and operations of the agency. The goals of the objectives should be quantifiable unless authorized by the Director of OMB, outcome-related, and focused on the major functions and operations of the agency. Furthermore, the act requires agency heads to submit to the President and to Congress a performance report of the previous fiscal year. (GPRA, 1993)

3. Government Management Reform Act of 1994

The Government Management Reform Act (GMRA) of 1994 was enacted to provide a more effective, efficient, and responsive government (GMRA, 1994). With respect to financial audit guidance, the GMRA extends the CFO Act to require all agencies listed in Table 4 to submit an audited annual financial report for the preceding fiscal year to the Director of OMB. Furthermore, the person who audits the agency financial report shall submit a report of the audit to the head of the agency in accordance with GAGAS. (GMRA, 1994)

4. Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires the DoD to establish and maintain financial management systems that comply with federal financial management system requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level (FFMIA, 1996). Furthermore, auditors are required to report whether the agency's financial management systems are in compliance. If agency financial management systems are not in compliance, the facts pertaining to the failure to comply must be documented. The agency head must then provide a remediation plan to have the financial management systems comply within three years from the date the systems were reported as noncompliant. (FFMIA, 1996)

5. OMB Circular A-123

OMB Circular A-123 is a memorandum published by the OMB Director called Management's Responsibility for Internal Control. This memorandum provides direction for the CFOs of the federal agencies to comply with both the Sarbanes-Oxley Act of 2002 and the Federal Managers Financial Integrity Act (FMFIA) of 1982. The purpose of the Circular was to improve the internal controls over financial reporting (ICOFR) (OMB, 2004). By improving the ICOFR, the agency raises the standards on how internal control is managed, and ultimately increases the effectiveness of internal control as stated in the ICOFR statement of assurance. Agency heads and financial managers must develop

appropriate, cost-effective internal control for results-oriented management, assess the adequacy of their ICOFR and identify needed improvements, take corrective action and annually report internal control via management assurance statements. (OMB, 2004)

6. National Defense Authorization Act of 2010

The National Defense Authorization Act (NDAA) of 2010 emphasizes the importance of audit readiness. It mandates the FIAR plan and provides specific requirements of the plan, to include actions to be taken and costs associated with correcting financial management deficiencies. Furthermore, the NDAA sets a specific date for the DoD to produce audit ready financial statements not later than 30 September 2017. (NDAA, 2009)

7. OMB Circular A-136

OMB Circular A-136 is called the Financial Reporting Requirements and provides the financial reporting guidance for each federal agency to follow. This regulation is updated when major changes in legislation or accounting principles occur. (OMB, 2010)

C. PAST DOD EFFORTS

Recent efforts to achieve financial improvement and audit readiness within the DoD can be traced back to 2003. At that time, the DoD Principal Deputy Under Secretary (Comptroller) testified to Congress that the department had a plan to achieve an unqualified, or clean, audit opinion on its fiscal year 2007 consolidated financial statements (GAO, 2004a, p.2). A few months earlier, the Comptroller directed the appropriate components to submit comprehensive midrange financial improvement plans. The emphasis was placed on trying to link the midrange financial improvement plans to the Business Management Modernization Program (BMMP). The BMMP was a DoD initiative aimed at overseeing and implementing the department's Business Enterprise Architecture (BEA) (GAO, 2004a, p.2).

Congress directed the Government Accountability Office (GAO) in November 2003 to determine if the efforts to achieve a clean opinion by fiscal year 2007 remained consistent with the long-term goals of the DoD's BEA. GAO first officially contacted the Comptroller staff in December 2003 to inquire about the status of the departmental plan. All components' plans had not been received, so GAO delayed inquiry into the status of the plan until April 2004. On April 2004, GAO determined a review of departmental plans was still premature, so GAO opted to ask three questions instead (GAO, 2004a, pp.2-3):

- Does the DoD have a comprehensive, integrated plan for obtaining an unqualified audit opinion on the department's fiscal year 2007 consolidated financial statements?
- Has the DoD Comptroller established effective processes and procedures for monitoring the implementation of the plan(s) to increase the likelihood of sustainable progress and to ensure that component auditability assertions are supported?
- Has the DoD established a clear link between DoD component improvement efforts and the department's BMMP? (GAO, 2004a)

GAO determined that the DoD did not have a comprehensive, integrated plan to achieve a clean audit opinion by fiscal year 2007. Although the DoD Comptroller did receive most of the financial improvement inputs from the component level, an integrated plan consisting of a strategy, milestones, and cost estimates did not exist. GAO also determined that the DoD did not have adequate control measures to provide oversight in efforts to achieve a clean audit opinion. Lastly, there was little evidence of a linkage between financial improvement efforts and the BMMP. (GAO, 2004a)

In FY 2004, the GAO made several recommendations to the DoD for successful reform (GAO, 2004b, p.i). These included (1) an integrated business transformation strategy, (2) sustained leadership and resource control, (3) clear lines of responsibility and accountability, (4) results-oriented performance, (5) appropriate incentives and

consequences, (6) an enterprise architecture to guide reform efforts, and (7) effective monitoring and oversight (GAO, 2004b, p.i). The GAO also recommended that a senior management position should be established to oversee business transformation within the department (GAO, 2004b, p.i).

On 7 October 2005, then Deputy Secretary of Defense, Gordon England, established the Defense Business Transformation Agency (BTA). The mission of the BTA was to guide the transformation of business operations throughout the DoD and to deliver enterprise-level capabilities that align to warfighter needs. The BTA's responsibilities included developing processes to implement and maintain the BEA, developing, maintaining and executing the Enterprise Transition Plan (ETP), along with other efforts aimed at integrating business systems. (DoD, 2008a)

In 2006, the DoD leadership recognized that one of the Department's six Business Enterprise Priorities (BEPs) - Financial Visibility- required more attention in order to ensure successful business transformation. This Financial Visibility area of focus strives to answer the question, "How are we investing our funds to best enable the warfighting mission?" The end result will attempt to help provide the right equipment to the right people in the right place at the right time and have them fully funded and ready to operate. (McGrath, 2006)

Three initiatives were used to improve Financial Visibility: The Business Enterprise Information Services (BEIS), the Standard Financial Information Structure (SFIS), and the Strategic Resource Decision System (SRDS). The BEIS is a program built upon an existing infrastructure that serves as a single, centralized source to improve financial visibility. That is, the BEIS attempts to provide a standard system to allow an audit ready format. The SFIS is a comprehensive data structure that categorizes financial information to support budgeting and financial management efforts. The SFIS, which should standardize financial reporting data across the DoD, attempts to integrate appropriate financial and business information into a standard transaction. The SRDS focuses on the sources of authoritative resourcing information to assist in programming,

budgeting and acquisition. This focus allows for accurate and traceable data for OMB to use when developing the President's budget. (McGrath, 2006)

D. PRIVATE SECTOR ORGANIZATION FINANCIAL DELIVERABLES

It is important to understand financial statements in the private sector organizations before understanding what audit ready financial statements the DoD needs to produce.

After the end of an annual fiscal period, private sector organizations produce annual reports to shareholders. These annual reports communicate business activities and include the goals and objectives of the organizations, major accomplishments during the previous year, notes to further clarify information, and other financial information in the form of three primary financial statements. These three primary financial statements are the balance sheet, the income statement, and the statement of cash flows. (Stickney et al., 2010) Each one is explained below.

The balance sheet, also known as the statement of financial position, shows a snapshot of the organization's productive resources and means for financing the resources (Stickney et al., 2010). This information is presented in the basic accounting equation format, i.e., *assets = liabilities + owner's equity*. The assets, which are economic resources used by the company to provide future economic benefit, are either funded through liabilities (e.g., creditor's capital) or through owner's equity (e.g., shareowners' capital). This balance sheet snapshot usually occurs at the end of a fiscal reporting period and includes snapshots of the same date for the past two years for comparison. (Stickney et al., 2010)

The income statement, also called a profit and loss statement, provides profitability information. Whereas a balance sheet shows a snapshot of financial information at one point in time, the income statement shows financial amounts throughout a period of time, typically the fiscal period. The income statement information follows the format of revenues minus expenses. Revenues are the addition of assets into the organization. Expenses are the outflow of assets of the organization. When the

revenues of the organization exceed the expenses, the organization earns a profit. Conversely, when the expenses exceed the revenues, the organization incurs a net loss. (Stickney et al., 2010)

The statement of cash flows is the third primary financial statement. This statement reports the cash generated or used by the organization in the operating, investing, and financing aspects of the business. It explains the change in cash from the beginning of the reporting period to the end of the reporting period. The statement of cash flows shows how the organization generates the cash and where it spends the cash during the fiscal period. (Stickney et al., 2010)

In combination, all three primary financial statements can tell the story of business activities occurring within the fiscal period, and help stakeholders understand the financial condition of the organization and how the organization is managed. The value of the information combined in all three of the primary financial statements, integrated with the rest of the annual report, provides data in a context to stakeholders to help enable financial decisions and manage risk. However, the annual report to shareholders provides no value and increases risk if the information presented is not credible, reliable, and timely.

In order to ensure that the organization is providing credible, reliable, and timely information, the financial statements must comply with set business standards. Within the United States, these standards are known as the generally accepted accounting principles, also known as U.S. GAAP. These standards are determined by an independent group, the Financial Accounting Standards Board (FASB), and are legally enforced by the Securities and Exchange Commission (SEC). (Stickney et al., 2010)

Regulatory bodies like the SEC require that publicly held organizations obtain an audit by an independent external auditor. Even privately held companies may require audits by the creditors that fund them. Examples of these independent external auditors include PricewaterhouseCoopers, Deloitte Touche Tohmatsu, Ernst & Young, and KPMG. These audits usually involve three main criteria:

- An assessment of the organization's accounting system capability to gather, measure, and process transactional data properly.
- An assessment of the accounting system's operational effectiveness.
- A determination of whether the financial reports comply with the set business standards. (Stickney et al., 2010)

The auditor determines the first assessment by observing the internal controls and procedures built into the accounting system. The auditor determines the second assessment by examining actual transactions. The auditor uses a combination of other audit procedures to acquire the third determination (Stickney et al., 2010). The conclusions of the auditor appear as an audit opinion as part of the annual report to shareholders.

E. DEPARTMENT OF DEFENSE FINANCIAL DELIVERABLES

The Department of Defense produces a consolidated financial statement at the end of a fiscal reporting period, similar to the private sector, called the *Department of Defense Agency Financial Report (AFR)*. However, the DoD's consolidated financial statements are not yet audit ready. This section of the chapter describes the parts that make up the DoD's financial statements, compares and contrasts them with the private sector's financial deliverables, and finally identifies the challenges DoD still faces to reach financial audit readiness.

The DoD's financial reporting consists of three components. The first component, called the AFR, is published no later than 15 November following the end of the fiscal year (OMB, 2010). The AFR provides an overview of the Department's financial information, performance goals and objectives, and priorities in response to challenges encountered in national defense. The second component, called the *Annual Performance Report (APR)*, provides the detailed performance information and a description of results by performance measures and is published within the Congressional Budget Justification report submitted to Congress in early February after the end of each fiscal year (OMB, 2010). The third component is called the *Summary of Performance and Financial*

Information and summarizes the DoD's financial and performance information from the AFR and APR, making the information more transparent and accessible to Congress, the public, and other key constituents (OMB, 2010). The AFR format complies with the criteria found in the Office of Management and Budget's (OMB) Circular No. A-136, "Financial Reporting Requirements" (OMB, 2010).

The AFR is comprised of four sections. In the first section, an agency head message highlights the mission, goals and accomplishments and assesses whether the financial data are reliable. The second section, called the Management's Discussion and Analysis (MD&A) section, describes the mission of the agency, organizational structure, messages from agency leadership, accomplishments within the past year, as well as agency challenges and initiatives. Similar to the annual report to shareholders used in the private sector, the MD&A provides pertinent information on how the organization conducted its business activities throughout the year. (OMB, 2010)

The third section is the Financial Information section. This section includes the Independent Auditor's Report, the primary financial statements and notes to assist in amplifying financial statement information. The following are the statements federal agencies use:

- *Balance Sheet*- The balance sheet functions similar to the private organization's definition of the balance sheet. However, unlike the private sector's use of the basic accounting identity (Assets = Liabilities + Owner's Equity), the DoD uses the equation Assets = Liabilities + Net Position. This financial statement is audited.
- *Statement of Net Cost*- Required by GPRA, this statement shows the net cost of operations for the reporting entity. This financial statement is audited.

- *Statement of Changes in Net Position*- This reports any changes in net position during the reporting period, affected either by cumulative results of operations or unexpected appropriations. This financial statement is audited.
- *Statement of Budgetary Resources (SBR)*- This statement provides information about how budgetary resources were made available. This financial statement is audited.
- *Notes to the Financial Statements*
- *Required Supplementary Stewardship Information (RSSI)*- This section is not audited.
- *Required Supplementary Information (RSI)*- This section is not audited. (OMB, 2010)

The last section, called *Other Accompanying Information (OAI)*, contains the appendices and addendums that provide further information not contained in the first three sections. This section is typically comprised of a glossary and links to other sites, but may carry other information, depending on the fiscal year the AFR was published. (OMB, 2010)

Financial statements must comply with certain standards, similar to a private organization. Whereas the private sector uses U.S. GAAP as its business standard, the public sector uses GAGAS, a set of auditing standards governed by the Comptroller General of the United States. (GAO, 2011d)

F. THE GOAL: FINANCIAL AUDIT READINESS

The National Defense Authorization Act of 2010 requires the Department of Defense to have financial statements validated as audit ready not later than 30 September 2017. What exactly does this require? OMB Bulletin No. 07-04 provides the answer.

OMB Bulletin No. 07-04 provides minimum requirements for audits of federal financial statements. It implements audit provisions from the CFO Act of 1990, the

GMRA of 1994, and the FFMIA of 1996. It also defines auditing terminology and statutes, delineates responsibility, and establishes communication procedures between the auditor and federal entity. (OMB, 2007) Some of the requirements in the OMB Bulletin No. 07-04 include:

- All audit reports be submitted to the agency heads in time for the agency heads to submit their audited financial statements no later than 45 days after the fiscal year-end.
- Annual Financial Statement format is in compliance with OMB Circular A-136 (Financial Reporting Requirements)
- Audits be performed annually
- Audits be in compliance with GAGAS
- Must conform with misstatement procedures
- Must conform to FFMIA of 1996 and OMB Circular No. A-123 (Management's Responsibility for Internal Control) (OMB, 2007)

With the statutory requirements in place and a deadline less than seven years away, a plan is needed to meet those requirements. The DoD's plan is the Financial Improvement and Audit Readiness Plan.

G. CHAPTER SUMMARY

This chapter began with facts about the current health of the United States fiscal environment to put into perspective the importance of financial accountability needed within the Department of Defense. The chapter then discussed the problem of the DoD with respect to audit readiness. Financial management system weaknesses stemming from several material weaknesses are one factor preventing the DoD from achieving audit readiness. Statutes such as the CFO Act of 1990, GPRA, GMRA, FFMIA, and NDAA of 2010 drive financial audit readiness requirements. Past DOD efforts included an unsuccessful attempt starting in 2003 with a goal of achieving a clean audit opinion for the fiscal year 2007 financial statements. However, the BTA was formed in 2005 to align

business capabilities with warfighters' needs. This step included introducing an Enterprise Transition Plan to reduce the existing financial management system weaknesses. Financial statements between the private sector and public sector were described and compared. Finally, a description of the requirements needed to qualify as audit ready were presented.

The following two chapters, Chapters III and IV, introduce the FIAR and Balanced Scorecard, respectively. The role of the FIAR relating to achieving the DoD's goal of financial audit readiness, as well as the detailed breakdown of the FIAR, is discussed. Similarly, the Balanced Scorecard is described to understand the effectiveness of the strategic management tool.

III. THE FINANCIAL IMPROVEMENT AND AUDIT READINESS (FIAR) PLAN

This chapter describes the FIAR Plan in detail. This is the plan the Department of Defense has implemented to define its strategy and methodology for improving financial management and controls (GAO, 2010b). The chapter begins with a background of the most recent FIAR effort that led to the development of the FIAR Guidance. It then introduces the FIAR Guidance and its comprehensive layout of the FIAR Plan. The chapter then describes the details surrounding the FIAR Plan to understand the supporting elements that assist in the execution of the FIAR. These details include the purpose, goals, and priorities, the FIAR stakeholders, the roles of the Strategic Management Plan, the Enterprise Transition Plan, and the Business Enterprise Architecture, and the FIAR strategy and methodology. The chapter finishes with a brief timeline of previous and future accomplishments leading to audit readiness.

A. BACKGROUND OF RECENT FIAR EFFORT

On August 2009, soon after Senate confirmation, the Under Secretary of Defense Comptroller/Chief Financial Officer (USD[C]/CFO) conferred with several top defense officials to help shape his priorities and objectives for financial improvement and audit readiness. Through meetings with the Deputy Secretary of Defense, reporting entities, the DoD Office of the Inspector General, the OMB, the GAO, and Congress, the USD(C)/CFO established two high priority categories for reporting entities to focus their efforts: *budgetary information* and *mission critical asset information*. (DoD, 2010b, p.3) The objective of focusing efforts into these two categories is to have the reporting entities focus on improving internal controls, processes and supporting information used to manage the DoD, while having the ability to work on financial improvements that facilitate achieving unqualified opinions in the financial statements (DoD, 2010b, p.3).

Pursuant to §1003 of the NDAA of 2010, the FIAR Directorate—a program management office, which assists reporting entities to develop, monitor, and publish audit readiness plans (DoD, 2010b, p.2,14)—produces annual guidance that standardizes FIAR

efforts, known as the FIAR Guidance, and is explained in detail in the following sections. (DoD, 2010b, p.i) Additionally, FIAR progress must be documented twice a year, no later than 15 May and 15 November, through FIAR Plan Status Reports (NDAA, 2009).

B. FIAR GUIDANCE

The FIAR Guidance, published in May 2010, is the all-inclusive document to execute the FIAR Plan. Although the original FIAR Plan was published in December 2005, the FIAR Guidance supersedes it by combining previous memoranda, directives, meeting decisions, and emails into one comprehensive document. The FIAR Guidance functions as a handbook for all involved in the DoD audit readiness initiatives. It is published once a year and is updated on an annual basis. (DoD, 2010b)

The FIAR Guidance is similar to prior FIAR publications because of the information contained within. This information includes the following:

- Executive Summary
- Purpose, Goals, and Priorities
- Key Personnel
- Strategy and Methodology (DoD, 2010b)

The Executive Summary includes the purpose of the document, describes the purpose of the FIAR, and gives a broad overview of the rest of the guidance (DoD, 2010b). The following sections will describe the rest of the bullets in detail.

C. THE FIAR PURPOSE, GOALS, AND PRIORITIES

The FIAR Plan, which provides the pathway to agency-wide financial audit readiness, is the DoD's comprehensive working guidance. According to the original FIAR published in December 2005, the purpose of the FIAR is to establish a roadmap to improve internal controls, resolve material weaknesses, and advance the DoD's fiscal stewardship (DoD, 2005b). The desired end state is sound financial management practices that ultimately result in unqualified audit opinions. (DoD, 2005b)

The goals of the FIAR describe the desired end state and are based on supporting the OUSD(C) priority objective to “improve business and financial processes, controls, systems and data to achieve accurate, reliable and timely financial and managerial information for decision makers and citizens” (DoD, 2010d). Specifically, these goals are to achieve and sustain audit readiness, achieve and sustain unqualified assurance on effectiveness of internal controls, and to attain FFMIA compliance. (DoD, 2010d)

Although the goals seem broad, efforts to achieve these goals remain continuous with the two high priorities that focus on processes, controls, and systems supporting information most often used in managing the DoD. These two priorities, budgetary information and mission critical information, are now defined. Budgetary information refers to those processes, controls, and systems that report budgetary information (e.g., status of funds received, obligated or expended) (DoD, 2010b, p.3). Mission critical asset information refers to the information essential to effectively manage the Department’s mission critical assets. These assets include military equipment (e.g., ships and aircraft), real property (e.g., land and buildings), inventory (e.g., fuel and supplies), operating materials and supplies (e.g., ammunition), and general equipment (e.g., cranes, tools, and test equipment) (DoD, 2010b, p.4). By prioritizing budgetary information, both the objective of improving information most often used in managing the DoD and the goal of obtaining auditable financial statements will be accomplished (DoD, 2010d). By prioritizing mission critical asset information, there would be improvement in two assertions (Existence and Completeness, described later) that auditors test in a full financial statement audit. (DoD, 2010d)

D. FIAR STAKEHOLDERS

Stakeholders are a critical component of the FIAR because they either shape and manage the FIAR or execute the FIAR. These stakeholders include the FIAR Governance Board, the DoD Audit Advisory Committee, the FIAR Directorate, the FIAR Committee, the FIAR Subcommittee, the reporting entities and the service providers. Since the FIAR is an evolving plan, each stakeholder plays an integral role in ensuring the effectiveness of the FIAR.

1. FIAR Governance Board

Although each component is responsible for its own oversight of the FIAR efforts, the DoD has a governing body that is held accountable for the overall FIAR effort, known as the FIAR Governance Board. Established in FY2010, this Governance Board is chaired by the USD(C)/CFO; includes the Deputy Secretary of Defense Chief Management Officer (DCMO); and replaces a former group called the Financial Management Leadership Council by extending participation to include the Military Department DCMOs. The board's purpose is to transform budget, finance and accounting operations and either eliminate or replace financial management systems inconsistent with transformation. It also serves the role of providing visible leadership commitment needed to achieve FIAR goals and objectives. The FIAR Governance Board meets quarterly and updates progress in the FIAR Plan Status Report. (DoD, 2010b, p.11)

2. DoD Audit Advisory Committee

The DoD Audit Advisory Committee provides independent advice to the Secretary of Defense via the USD(C)/CFO regarding DoD financial management issues. These issues include financial reporting processes, internal controls, audit processes, and compliance with law. This committee includes five experts in the audit, accounting and financial communities as defined by the Federal Advisory Act of 1972. The Committee meets approximately four times a year (DoD, 2010b, p.11).

3. FIAR Directorate

The FIAR Directorate is a program management office established by the OUSD (C). The responsibility of the FIAR Directorate is to provide audit readiness guidance to the Department, and does so by managing and updating the FIAR Plan (DoD, 2010b, p.14) The goals of the FIAR Directorate are to achieve and sustain both audit readiness and unqualified assurance of the effectiveness of the internal controls, and to attain FFMIA compliance for financial management systems that support effective financial management (DoD, 2010b, pp.i-ii).

Additionally, the FIAR Directorate performs the following duties:

- Recommends strategic direction to the DCFO and USD(C)/CFO
- Assists the service components where possible
- Develops and issues detailed financial improvement and audit preparation methodologies and guidance
- Organizes and convenes cross-component financial and functional working groups to assist in developing the audit readiness methodology and process
- Utilizing experienced financial, accounting and auditing personnel, embeds teams to develop, improve and execute Financial Improvement Plans (FIPs) and provide training to components
- Biannually, publishes the FIAR Plan Status Reports
- Maintains the FIAR Planning Tool, which is used by the components to manage their FIPs
- Monthly, provides detailed reviews of the component FIPs supported by the OUSD Acquisition, Technology, and Logistics (AT&L) and provides feedback to the components as needed
- Develops metrics for monitoring and reporting progress (DoD, 2010b)

4. FIAR Committee

The FIAR Committee oversees the management of the FIAR Plan. The committee is comprised of senior representatives of the OUSD (AT&L), the Military Departments, the Defense Logistics Agency (DLA), the BTA, and the Defense Finance and Accounting Service (DFAS). The FIAR Committee is chaired by the DoD Deputy CFO and is advised by the Deputy Inspector General for Auditing. The committee meets monthly (DoD, 2010b, p.12).

5. FIAR Subcommittee

The FIAR Subcommittee assists the FIAR Directorate and USD(C)/CFO in developing guidance and resolutions to issues in many facets of the FIAR Plan. Comprised of senior accountants, financial managers, management analysts, and auditors, the FIAR Subcommittee also assists the FIAR Committee and is expected to use a comprehensive perspective in shaping the FIAR Plan (DoD, 2010b, p.13).

6. Reporting Entities

Reporting entities are those organizations that must comply with FIAR Guidance, and are the executors of the plan. As defined by the FIAR Guidance, reporting entities are those agency entities that prepare stand-alone financial statements that comprise the agency-wide financial statements. Reporting entities include the military components in addition to other defense organizations (ODOs). (DoD, 2010b, p.16)

With a complex reporting structure, the DoD includes many reporting entities that prepare stand-alone financial statements. From a financial statement perspective, it is not efficient to apply the same audit strategy to all the differing reporting entities. Therefore, reporting entities are organized into three categories to increase efficiency of the annual financial statement audits. (DoD, 2010b, p.51)

Category 1 includes all reporting entities that are required to undergo annual audits on their stand-alone financial statements by OMB Bulletin No. 07-04 or the Senate Select Committee on Intelligence. These entities include the Military Departments, the Military Retirement Fund, U.S. Army Corps of Engineering, the National Reconnaissance Office, the Defense Intelligence Agency, the National Geospatial-Intelligence Agency and the National Security Agency. These reporting entities are required to follow the FIAR Guidance, including the FIAR Methodology, and report their progress to the FIAR Directorate. (DoD, 2010b, p.51)

Category 2 includes other reporting entities that are material to the Department's consolidated financial statements, but not included in Category 1. These entities include the Defense Contract Audit Agency, the Defense Finance and Accounting Service, and

the Defense Commissary Agency (DoD, 2010b, p.52). These entities may elect to, but are not required to undergo annual financial statement audits on their stand-alone financial statements; instead, they will be part of the Department's consolidated audit. These agencies are also required to follow the FIAR Guidance, and report their audit readiness progress to the FIAR Directorate. (DoD, 2010b, p.51)

Category 3 includes all remaining reporting entities. Category 3 reporting entities are not material to the Department and are not required to undergo stand-alone financial statement audits, but may elect to do so. (DoD, 2010b, p.51)

Major commands within the reporting entities, such as the Naval Facilities Engineering Command (NAVFAC), the U.S. Army Materiel Command (AMC), and the Naval Sea Systems Command (NAVSEA), are involved with the financial transactions within the components. In fact, it is within the major command level where business events occur that trigger financial transactions. Therefore, they execute the FIAR Plan and FIPs, test and strengthen internal controls, and correct deficiencies. (DoD, 2010b, p.16)

The management of reporting entities is responsible for assertions that, in addition to conformity with GAAP, ensure accuracy of the financial statements. These assertions include the following:

- *Value* of the recorded transaction
- *Completeness* of records
- *Existence* of recorded items
- *Presentation and Disclosure* in accordance with the requirements
- *Rights* to recorded assets and liabilities (DoD, 2010b, p.61)

These terms are explained in more detail in the FIAR Strategy section of this thesis.

7. Service Providers

Service providers are those entities engaged by the reporting entity to assist in either manual or automated processing of financial information. Service providers are responsible for the systems and data, processes and controls, and supporting documentation that affect reporting entities' audit readiness efforts (FIAR Guidance, 2010).

One can argue that leadership within all levels of the DoD is critical to ensuring the FIAR Plan is executed properly. Each of the different levels of the agency explained above define the FIAR Governance and can be viewed hierarchically as depicted in Figure 1.



Figure 1. The FIAR Governance extends from the top level leadership with the Chief Management Officer (CMO) down to the executors of the FIAR with the reporting entities and service providers (From DoD, 2010b, p.i).

E. OTHER MAJOR ELEMENTS OF THE FIAR PLAN

Three other elements of the FIAR Plan are important to define prior to describing the FIAR Strategy and Methodology. Although these elements do not fall directly under

the financial management responsibility, they are each linked to the financial improvement effort. Thus, it is the responsibility for the military CMOs to manage the resources necessary to employ these elements. (DoD, 2010b, p.8) These elements are the Strategic Management Plan (SMP), the Enterprise Transition Plan (ETP), and the Business Enterprise Architecture (BEA). The SMP, BEA, and ETP provide a guide, blueprint, and roadmap, respectively, for defense business transformation (Business Transformation Agency, n.d.).

1. Strategic Management Plan (SMP)

The DoD's SMP is "the highest-level plan for improving DoD's business operations" (DoD, 2010e, p.1). Established by §904 of the 2008 NDAA, the SMP provides an executive overview of the department's performance management framework and facilitates the DoD to prioritize its business operations and improvement efforts. Released on 30 December 2010, the FY2011 SMP aligns five business goals with the overarching strategic goals and objectives of the department, as documented in the 2010 Quadrennial Defense Review (QDR) (see Figure 2). (DoD, 2010e, p.2)

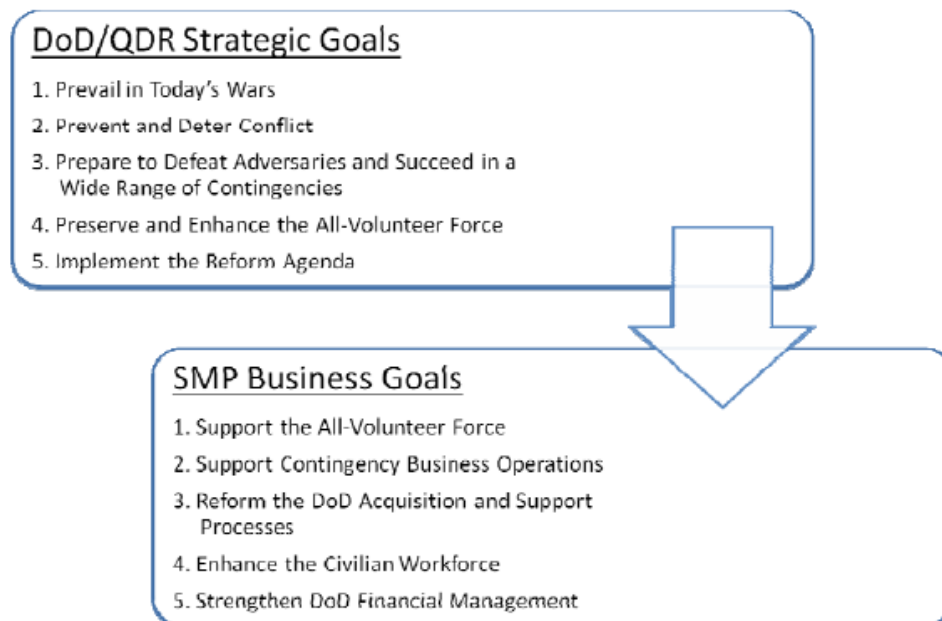


Figure 2. The five SMP business goals align with the DoD strategic goals as defined in the QDR. (From DoD, 2010e, p.2)

Although the five business goals within the SMP remain long-term, the objectives, performance measures, and initiatives may change based on changes in priority (DoD, 2010e, p.2). These changes in priority would originate from directional changes in the QDR and the requirements of the OMB’s High Priority Performance Goals, GAO’s High Risk Areas, or other Congressional action (DoD, 2010e, p.2). Figure 3 shows the SMP’s current objective, performance measures and initiatives, which are aligned with the department’s strategic goal and objectives from the 2010 QDR.

Strategic Management Plan			QDR Mapping	
SMP Objective	Performance Measure	Initiatives	DoD Strategic Goal	DoD Objective
Acquire the resources necessary to meet national defense objectives and Ensure the legal, effective, and efficient use of DoD resources.	*5.5.1-2U: Percent DoD Statement of Budgetary Resources Appropriations Received (line 3A) validated (USD(C/CFO))	Continue to execute the Financial Improvement and Audit Readiness (FIAR) strategy	5. Implement the Reform Agenda	DoD Strategic Objective 5.5-2U/2V: Improve financial management and increase efficiencies in headquarters and administrative functions, support activities, and other overhead accounts.
	*5.5.2-2U: Percent of DoD Funds Balance with Treasury validated (USD(C/CFO))	Ensure synchronization of Enterprise Transition Plan milestones to support a revised FIAR strategy		
	*5.5.3-2U: Percent of DoD Statement of Budgetary Resources validated (USD(C/CFO))	Develop alternative methods for asset valuation and conduct business case to select the appropriate approach		
	*5.5.4-2U: Percent of DoD mission-critical assets (Real Property, Military Equipment, General Equipment, Operating Materials and Supplies, and Inventory balances) validated for existence and completeness (USD(C/CFO))	Continue Configuration Control Board (CCB) process for Defense Joint Military Pay System (DJMS), Marine Corps Total Force System (MCTFS), and DCPS		
	5.5.5-2U: Percent of improper military pay payments (USD(C/CFO))	Continue development of the Military Services' Integrated Personnel and Pay Systems		
	5.5.6-2U: Percent of improper civilian pay payments (USD(C/CFO))	Continue resolution of the primary military and civilian pay improper payment errors		
	5.5.7-2U: Number of late formal Anti-Deficiency Act investigations from the FY 2009 baseline of 25 (USD(C/CFO))	Fiscal Law training is required on a more frequent basis		

Figure 3. The SMP objectives, measures, and initiatives translate the DoD’s strategic goals and objectives as defined in the 2010 QDR (From DoD, 2010e, p.19).

The SMP uses an organizing taxonomy structure to facilitate alignment of DoD business operations with strategic goals. This structure follows the conventional strategic

planning hierarchy of business goals-objectives-measures-initiatives (DoD, 2010e, pp.2–3). As an example, in Figure 3, an alphanumeric code “5.5.1-2U,” is used. Figure 4 illustrates the use of the code. The first, second, and third digits represent the DoD’s strategic goal, objective, and measure, respectively. The fourth alphanumeric code represents the Forces & Infrastructure Categories (FIC), a code that links resource allocation to the strategic objectives. Collectively, these alphanumeric numbers demonstrates the connection between strategy, performance and budget. (DoD, 2010e, pp.8–9)

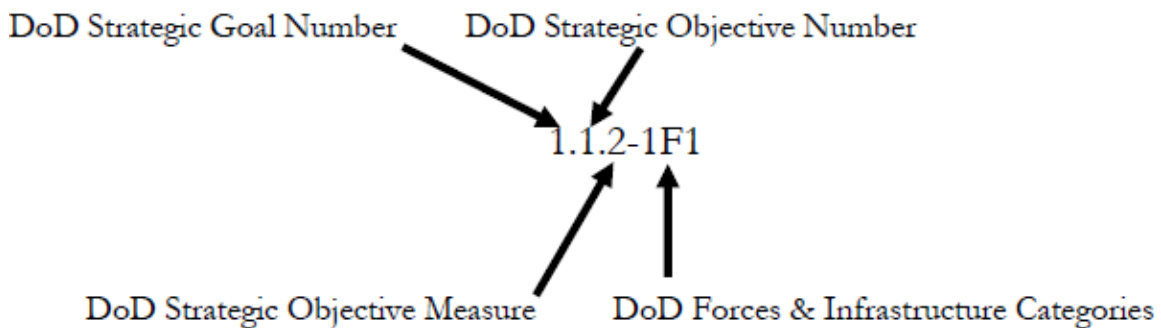


Figure 4. The SMP uses an alphanumeric organizing taxonomy structure to represent the goals, objectives, and performance measures (From DoD, 2010e, p.9).

Figure 5 illustrates how the FIAR Plan relates to the rest of the DoD SMP. (DoD, 2010e) The SMP’s fifth business goal, “Strengthen DoD Financial Management,” is represented by the “5 Financial Mgmt” box in Figure 5 and includes the FIAR Plan as part of its “family of plans” (DoD, 2010e, p.3). The “family of plans” concept is used by the DoD due to the size and complexity of the department (DoD, 2010e, p.3). The two SMP initiatives related to the FIAR Plan—*executing the FIAR strategy* and *ensuring synchronization between the ETP* (which is defined shortly) *and the FIAR strategy*—are the link between the FIAR efforts and the rest of the DoD’s strategy (DoD, 2010e, p.19).

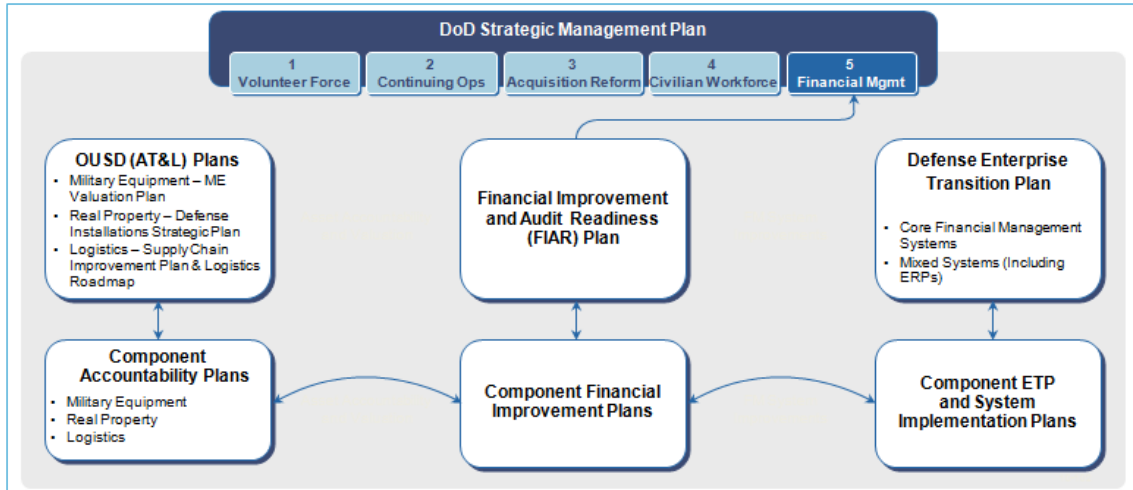


Figure 5. The DoD Strategic Management Plan, made up of a “family of plans.” (From DoD, 2010b, p.8; DoD, 2010e, p.3).

2. Enterprise Transition Plan (ETP)

The ETP was established pursuant to the NDAA of FY 2005 to improve existing business systems or develop new ones. The concept of the ETP is to act as the business systems roadmap that takes the department from its current business systems environment to what the future business environment should be. This future business environment is defined by the BEA (described in the next section). (DoD, 2011)

The ETP contains three requirements pursuant to the NDAA of 2005. These requirements are:

- an acquisition strategy for new business systems that make up the target enterprise architecture, to include milestones, performance measures, and a statement of financial and nonfinancial resource requirements
- a list of legacy business systems not expected to be part of the target business system environment
- a list of legacy business systems expected to be a part of the target business system environment (DoD, 2011)

Key to achieving financial improvement and audit readiness is having modernized business and financial management systems. The ETP provides the path to modernizing these systems, and is driven by the integration between the FIAR Plan coupled with each of the components' FIPs (DoD, 2011).

3. Business Enterprise Architecture (BEA)

The BEA is an integrated information architecture that guides the business system modernization investments and is produced by the Business Transformation Agency annually (DoD, 2011; BTA, n.d.). The BEA, guided by SMP priorities, defines DoD's future business environment. Along with the laws, standards, and other requirements that govern the BEA, entities expected to invest more than \$1 million have to comply with the BEA. (DoD, 2011, pp.5–6)

The BEA relates to the FIAR Plan through the SMP. Financial management is one of the five core business missions (CBM) whose functions and processes provide end-to-end support to the warfighter and articulates business transformation requirements through the SMP into the BEA. The SMP then sets priorities to focus the efforts of in business transformation. (BTA, n.d.)

F. FIAR STRATEGY AND METHODOLOGY

The FIAR strategy and methodology have evolved since the first FIAR Plan was published in December 2005. The current strategy strives to provide a path balancing short-term accomplishments while keeping focus on long-term goals (DoD, 2010b, p.ii). The current methodology, described later in this section, strives to provide a set of rules or tasks needed to conform to audit ready requirements.

1. FIAR Strategy

The current section defines the FIAR strategy in two ways. The first part of the section answers the question, "What is the strategy?" and the second part of the section answers the question, "How is the strategy implemented?"

What is the FIAR strategy? The FIAR strategy provides a path that balances the short-term accomplishments while maintaining focus on the long-term goal of achieving audit readiness. Furthermore, the FIAR strategy must incorporate the FIAR priorities of improving both budgetary information and mission critical asset information. The characteristics of the FIAR strategy are:

- *Incremental and prioritized-* The incremental approach strives to accomplish milestones on an incremental basis. Key milestones are determined by merging a known discrepancy with a target date and are recorded as accomplished in the semiannual FIAR Plan Status Reports. The prioritized approach is used by choosing several focus areas as higher priority items and moving on other focus areas once the initial focus areas are corrected.
- *Guided by a FIAR Methodology (Business Rules)-* The FIAR must comply with the Business Rules determined by the DoD that uses a phased approach to achieving audit readiness.
- *Integrated with the implementation of OMB Circular A-123, Appendix A-* The OMB Circular A-123 Appendix A is the guidance DoD uses to ensure compliance with the Federal Managers' Financial Integrity Act of 1982 and is able to produce Internal Control over Financial Reporting (ICOFR) deliverables.
- *Integrated with the implementation of FFMIA-* The FIAR integrates efforts with the BTA to ensure financial management systems are in compliance with FFMIA of 1996.
- *Integrated with the modernization of business and financial systems-* Integration with modern business and financial systems is performed through keeping the efforts of the FIAR Plan, the ETP, and the ICOFR requirements aligned.

- *Based on decentralized, reporting entity-level execution-* In order to execute in a decentralized, entity-level reporting manner, a FIAR subcommittee is used to communicate with the FIAR Director the entity-level needs. These needs are then aligned with the broader agency-wide requirements.
- *Comprehensive by focusing improvements on policies, processes and controls, systems and data, audit evidence, and human capital-* The comprehensive approach is performed through extensive FIAR process of identifying the discrepancy, understanding the value of the discrepancy to management, determining the barriers, finding a way ahead, managing risk, and understanding the role of the ETP in finding the solution. (DoD, 2010b, p.5)

How is the FIAR strategy implemented? To achieve audit readiness, each financial statement line item, comprised of numerous inputs, must conform to accounting and auditing rules (DoD, 2010b). The FIAR strategy groups and prioritizes the business processes whose activity results end up as inputs to the financial statement line items into five waves (DoD, 2010b). These five waves are listed below and include a brief description of the scope and focus:

- *Wave 1—Appropriations Received Audit-* This wave focuses on the appropriations receipt and distribution process, which includes all current fiscal year funding appropriated by Congress, apportionment and re-apportionment activity provided by the OMB, as well as allotment and sub-allotment activity.
- *Wave 2—Statement of Budgetary Resources (SBR) Audit-* This wave includes all processes, internal controls, systems and supporting documentation that must be audit ready before the SBR can be audited. Significant processes, include end-to-end processes like “Procure-to-Pay” in addition to Fund Balance with Treasury reporting and reconciliation.

- *Wave 3—Mission Critical Assets E&C Audit-* This wave focuses on the Existence and Completeness (E&C) financial statement assertions, but also includes the Rights assertion and portions of the Presentation and Disclosure assertion. Reporting entities must ensure that all assets recorded in their accountable property systems of record (APSR) exist (Existence), all of the reporting entities' assets are recorded in their APSR (Completeness), reporting entities have the right to report all assets (Rights), and assets are consistently categorized, summarized and reported period to period (Presentation and Disclosure). The asset categories included in this wave include Military Equipment, Real Property, Inventory, Operating Materials and Supplies and General Equipment.
- *Wave 4—Full Audit Except for Legacy Asset Valuation-* This wave includes the proprietary side of budgetary transactions covered in Wave 2, including Accounts Receivable, Revenue, Accounts Payable, Expenses, Environmental Liabilities, and Other Liabilities. Furthermore, this wave includes the valuation assertion for new asset acquisitions. At the completion of Wave 4, reporting entities should be fully audit ready except for the historical cost of legacy assets.
- *Wave 5—Full Financial Statement Audit-* This wave focuses on the valuation assertion for legacy assets. Determining the acquisition cost of legacy assets is the final wave because this sequencing ensures control over the valuation assertion for new assets are in place on a go-forward basis before addressing legacy assets. The acquisition cost of legacy assets is dependent upon adequate supporting documentation to evidence appropriate cost accumulation by asset. Alternatively, reporting entities may prepare or provide documentation supporting estimates used to determine asset cost, including documentation supporting the basis of the estimate (techniques used, data elements considered, assumptions made,

etc.). Successful completion of this wave will allow reporting entities to successfully undergo full-scope financial statement audits (DoD, 2010b, pp.ii–iii).

Figure 6 shows each of the waves, from the first wave representing short term accomplishment and the fifth wave representing audit readiness (DoD, 2010b, p.ii). The first three waves should be performed concurrently, as they all focus on the FIAR priorities of budgetary information and mission critical asset information (DoD, 2010b, p.ii). Chapter 4 of the FIAR Guidance provides additional details of the FIAR strategy.



Figure 6. The five wave FIAR path towards achieving audit readiness (From DoD, 2010b, p.ii)

2. FIAR Methodology

Prior to the FIAR Plan being published in December 2005, a set of “Business Rules” was required for reporting entities to follow in order to achieve auditability. These rules were used to evaluate the audit readiness prior to having an actual financial statement audit performed. These rules were then integrated with key tasks of underlying detailed activities and resulting work products, which then became the present day FIAR methodology (DoD, 2010b, p.iii).

By definition, the FIAR methodology is a set of steps reporting entities must follow to achieve audit readiness. The methodology prepares reporting entities to have successful financial statement audits by incorporating not only required standards, but also by taking auditors’ requirements into consideration. Such auditor requirements include two primary areas, internal controls and supporting documentation (DoD, 2010b, p.iii). In order for reporting entities to achieve audit readiness, they must:

- Design and implement control activities to limit the risk of material misstatements by meeting Key Control Objectives (KCO)
- Support account balances with sufficient and appropriate audit evidence, defined as Key Supporting Documents (KSD), supplemented with the reporting entities' own documentation requirements (DoD, 2010b, pp.iii–iv)

The FIAR methodology is comprised of phases and key tasks that all reporting entities must use when making their Financial Improvement Plans (FIPs). The phases are defined as follows:

- *Evaluation and Discovery*- Management documents its business and financial environment, defines and prioritizes its processes into assessable units, assesses risks and tests controls, evaluates supporting documentation, identifies weaknesses and deficiencies, and defines its audit readiness environment.
- *Corrective Action*- Management develops and executes corrective action plans (CAPs) that include implementation of the audit ready environment, solutions to resolve deficiencies and weaknesses, identification of resources required and committed, and tests and strengthens internal controls.
- *Evaluation*- Management evaluates corrective action effectiveness through testing and determines whether it is ready to assert audit readiness.
- *Assertion*- Management prepares documentation and asserts audit readiness to the OUSD(C) and DoD IG.
- *Sustainment*- Management maintains audit readiness through risk based periodic testing of internal controls utilizing the OMB Circular A-123, Appendix A, and timely resolves any identified weaknesses (e.g., before the next annual reporting cycle).

- *Validation-* OUSD(C) and DoD IG review management’s assertion, and auditors perform an examination on audit readiness assertion.
- *Audit-* Reporting entity engages an auditor and supports the audit of assessable unit or financial statements (DoD, 2010b, p.18).

Figure 7 shows the standard phases and key tasks used in the FIAR methodology. As mentioned before, this process is used by reporting entities to achieve audit readiness by developing their FIPs using this methodology. Chapter III of the FIAR Guidance explains in detail the process for reporting entities to follow.

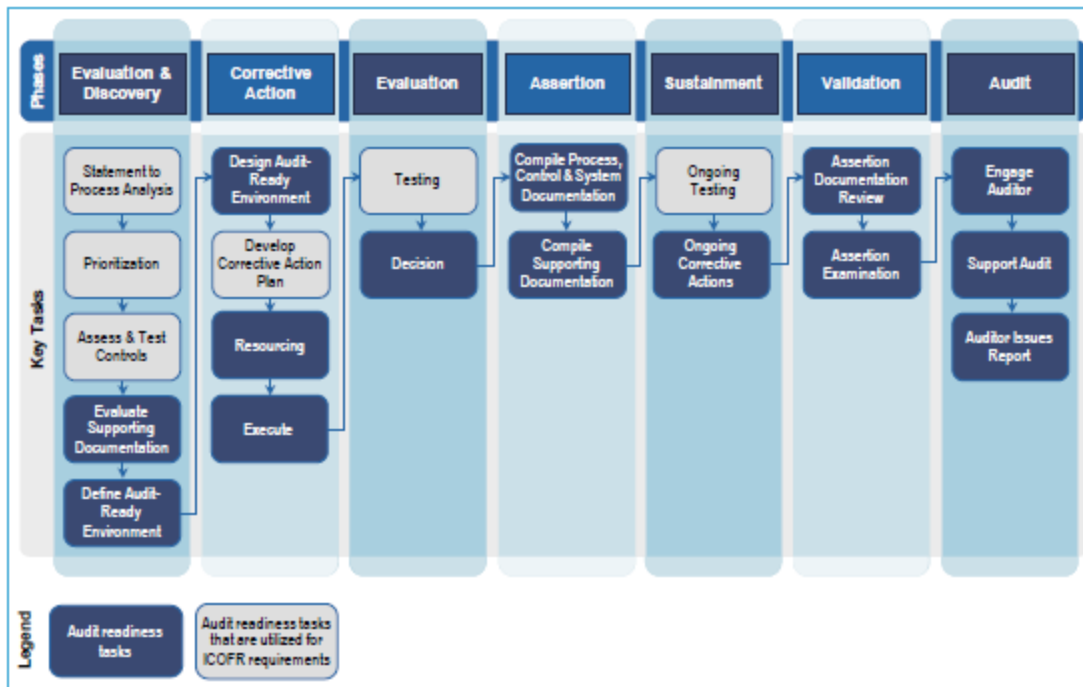


Figure 7. FIAR methodology key phases and tasks (From DoD, 2010b, p.iv).

G. PAST AND FUTURE ACCOMPLISHMENTS

This section describes the past accomplishments, from when the initial FIAR Plan was published in December 2005 until the most recent update in the FIAR Plan Status Report published in November 2010. It is important to understand the progression of the FIAR in order to analyze, in the next chapters, what strategies and methods have or have not worked.

In December 2005, the original FIAR Plan reported 16 percent of DoD assets and 48 percent of DoD liabilities having received an unqualified audit opinion. Additionally, 29 percent of DoD liabilities have received a qualified audit opinion. Table 5 shows audit opinions received, as reported in December 2005.

DoD Reporting Agency	Audit Opinion
Defense Commissary Agency	Unqualified
Defense Contract Audit Agency	Unqualified
Defense Finance and Accounting Service	Unqualified
Defense Threat Reduction Agency	Unqualified
Military Retirement Fund	Unqualified
Medicare-Eligible Retiree Health Care Fund	Qualified
DoD-Wide Financial Statement Line Items	Audit Results
Appropriations Received	Favorable
Federal Employee Compensation Act Liabilities	Favorable
Investments	Favorable

Table 5. DoD financial statement audit opinions and results in December 2005 (From DoD, 2005b).

The DoD measured progress by measuring key milestones achieved per month. These metrics were used to update OMB to show progress in improving financial performance (DoD, 2005b). The DoD's achievement goals were to achieve independently verified information for 71 percent of assets and 80 percent of liabilities by 2010 (DoD, 2005b).

As of the most recent FIAR Status Report published in November 2010, the report did not break down the accomplishments as a percentage of assets and liabilities. Rather, it stated what agencies received audit opinions. Tables 6 and 7 show the results of the most recent audit opinions conducted in FY2009 and the FIAR priority audit readiness assertions, respectively (DoD, 2010d). The U.S. Marine Corps was recognized as making significant progress, as it was the first service component to have a financial statement subject to audit (DoD, 2010d). Metrics have changed since 2005 and are now measured in capabilities achieved.

DoD Reporting Agency	Audit Opinion
Defense Commissary Agency	Unqualified
Defense Contract Audit Agency	Unqualified
Defense Finance and Accounting Service	Unqualified
Office of the Inspector General	Unqualified
Military Retirement Fund	Unqualified
U.S. Army Corps of Engineers-Civil Works	Unqualified
Medicare-Eligible Retiree Health Care Fund	Qualified
TRICARE Contract Resource Management	Qualified

Table 6. FY2009 Financial statement audit results. Since the first FIAR published in December 2005, the Office of the Inspector General and the U.S. Army Corps of Engineers-Civil Works received an unqualified opinion, while the TRICARE Contract Resource Management received a qualified opinion (From DoD, 2005b and DoD 2010d).

Component	Audit Readiness Assertions	Date
All Financial Statements		
DISA - WCF	All Financial Statements	3Q 2010
Statement of Budgetary Resources (SBR) Audit		
USMC	SBR	4Q 2008
Navy	Appropriations Received	2Q 2009
Navy	Civilian Pay	3Q 2010
Air Force	Appropriations Received	4Q 2010
Air Force	Rescissions	4Q 2010
Air Force	Non-expenditure Transfers	4Q 2010
DLA	Appropriations Received	4Q 2010
Mission Critical Asset Existence and Completeness Audit		
Navy	Military Equipment	4Q 2010
Navy	OM&S-Ordnance	4Q 2010

Table 7. FIAR priority audit readiness assertions. Although not all of the statements may receive favorable audit opinions, the DoD entities have made major progress by achieving audit readiness assertions (From DoD, 2010a/2010d).

H. CHAPTER SUMMARY

Chapter III described the FIAR Plan. The FIAR Guidance, required by the NDAA of 2010 and published in May 2010, now serves as the comprehensive tool for executing the FIAR Plan. The purpose, goals, and priorities of the FIAR are mainly to achieve audit readiness in DoD financial statements while prioritizing budgetary information and mission critical asset information. Numerous standards and statutes govern the FIAR Plan. As the standards and statutes change, they are reflected in the FIAR Status Reports published semiannually. Strong leadership is essential to make the FIAR Plan successful, and must have support from all levels of the DoD. This support is provided in the FIAR Governance. The FIAR strategy uses a five wave approach, where short-term accomplishments are performed in the first three waves and the long-term goals are included in the latter waves. The Strategic Management Plan is the highest level plan to improve business operations and bases its objectives, measures and initiatives on the strategic goals mentioned in the QDR. The Enterprise Transition Plan provides a roadmap for modernizing or creating new business and financial systems needed to improve financial management and audit readiness. The future business systems environment is detailed in the Business Enterprise Architecture. The FIAR Plan, the SMP, the ETP and the BEA need to be synchronized. The FIAR methodology uses a standard seven-phase approach that all reporting entities must use when developing their financial improvement plans. Lastly, the DoD has achieved progress in financial management since 2005, but it still has much to accomplish prior to its deadline for achieving audit readiness before FY 2018.

The next chapter will describe the Balanced Scorecard. The Balanced Scorecard will then be used to analyze the progress in improving financial management and internal controls.

IV. THE BALANCED SCORECARD

Chapter IV describes the Balanced Scorecard. This chapter focuses on the question of what is the Balanced Scorecard, leaving the next chapter to answer how to use the Balanced Scorecard. The chapter begins with an introduction, describing the origins and background of the Balanced Scorecard. Prior to going into detail on the Balanced Scorecard, the following section discusses three factors that are fundamental to the success of an organization: the increased role of intangible assets in value creation, the over-reliance on financial performance measures, and the challenge of executing strategy. The next section describes how the Balanced Scorecard normally views strategies through four different perspectives: a financial perspective, an employee learning and growth perspective, a customer perspective, and a process perspective. The following section explains how the Balanced Scorecard is essentially three tools in one: a communication tool, a measurement tool, and a strategic management tool. The chapter concludes with the chapter summary, wrapping up the details of the Balanced Scorecard to proceed to the following chapter that analyzes the FIAR using the Balanced Scorecard tool.

A. INTRODUCTION

As organizations mature, management must be able to measure performance effectively in order to gauge the health of the organization. Leading industries at the turn of the twentieth century used financial performance measures that complemented the strategy of the businesses. Financial performance measures were the yardstick of success for machine-heavy industries, such as the automobile industry, where competition was based on economies of scale. Financial measures evolved through innovation to make more informed decisions such as activity-based costing (ABC) or economic value added (EVA). However, with the rapid change in the global business environment, shifting from tangible to intangible assets dominating the balance sheet, the need for better performance measures becomes apparent. (Niven, 2008, p.6).

The current Balanced Scorecard was developed in the early 1990's by Robert Kaplan, an accounting professor from Harvard, and David Norton, a business consultant based in Boston. They conducted a research project with twelve companies to discover new methods of performance measurement. The twelve companies believed that their financial measures of performance were hindering their ability to create value. Kaplan and Norton postulated that financial performance measures were not as modern as the current business enterprise (Niven, 2008, p.11). Though the original intent of the Balanced Scorecard was to balance a firm's historical financial data with the drivers of future value (Niven, 2008, p.20), more companies are now using the Balanced Scorecard as a means to bind short-term actions with their strategy. Since 1996, when Kaplan and Norton published the Balanced Scorecard book, over half of all Fortune 1000 companies have adopted the Balanced Scorecard (Niven, 2008, p.12).

B. FACTORS FUNDAMENTAL TO THE SUCCESS OF AN ORGANIZATION

Before describing the Balanced Scorecard in detail, it is necessary to identify the factors that are fundamental to the success of an organization, because these factors helped create the need for the Balanced Scorecard (Niven, 2008, p.3). The three factors are:

- The increasing role of intangible assets in creating value in today's economy
- Avoiding a long-standing over-reliance on financial measures of performance to gauge success
- The challenge of executing strategy (Niven, 2008, p.3)

Each of these factors is described below.

1. The Increased Role of Intangible Assets in Value Creation

The value for intangible assets has increased within the past 30 years (Niven, 2008, p.7). Niven (2008) tells a story where, in 1970, timber ships arriving in the London

docks took 108 men about five days to fully offload, equating to 540 man days (p.3). Today, those timber ships now take one day to offload, which seems far more productive than before. The increase in productivity is due to primarily three factors: containerization, better processes, and modern technology. Of those three factors, two of them—process and technology—are created from a powerful intangible asset: brain power. (Niven, 2008, p.4)

Tangible assets, such as buildings and vehicles, have accounted for a relatively smaller portion of assets in a balance sheet, giving way to intangible assets—such as ideas and proprietary methods—labeled as goodwill. Also, intangible items are booked in the financial statements as goodwill only after acquisitions, whereas intangible items originating within the organization are not. Thus, current accounting methods make it difficult to capture the value of intangible assets accurately. Specifically, there are challenges surrounding valuation of human capital as an intangible asset. According to former Comptroller General of the United States, David M. Walker, “Human capital management is a pervasive challenge in the federal government. At many agencies, human capital shortfalls have contributed to serious problems and risks.” (Niven, 2008, p.5)

Modern performance management systems must be able to identify, describe, monitor, and fully harness intangible assets that drive success (Niven, 2008, p.5). The Balanced Scorecard framework aims to fulfill those capabilities.

2. Avoiding the Over-Reliance on Financial Measures of Performance

Financial performance measures have been the measure of performance for most of the past century, although they may not be compatible with today’s organizations. According to Niven (2008, p.6), many question the use of financial performance measurement and suggest it serves as a metric for financial stewardship vice as a means to determine future performance. He lists five criticisms of financial measures:

- *Financial measures are not consistent with the business realities of today-* The main driver creating value nowadays is employee knowledge (intangible assets) and not inventory or plant, property and equipment assets (tangible assets)
- *Financial measures have a backward-looking approach-* This can be explained by the fact that strong financial history is not indicative of future performance
- *Financial measures have a tendency to reinforce functional silos-* Financial statements tend to categorize by functional areas. What they fail to capture are the values within the cross-functional areas
- *Financial measures sacrifice long term thinking-* When financial resources diminish, the first things cut within the budget are either training or employees. Although this has a positive impact in the short-term, cutting training or employees may not help increase value in the long-term
- *Financial measures are not relevant to many levels of the organization-* Financial information, as it is compiled into higher level requirements, tends to become less useful for the lower level decision-makers (Niven, 2008, p.7)

3. The Challenge of Executing Strategy

Although it seems quite challenging to craft an organization's strategy, it is more difficult to execute the strategy. According to Charan and Colvin (1999), approximately 70 percent of Chief Executive Officers (CEOs) fail not in the crafting of strategy, but in the execution of strategy. Niven (pp. 9–11) points out four barriers that impede strategy execution. They are:

- *The Vision Barrier-* Organizational leaders are finding it difficult to communicate their strategy and vision to their main constituents—the employees. Although earlier organizations used to be successful with

lower level employees not needing to know the strategy of the organization, today's businesses are different.

- *The People Barrier*- Financial incentives can distort an organization's strategic vision. With poorly designed incentive plans, managers may sacrifice long-term value-creating goals and initiatives and opt for short-term financial targets that pay monetary awards. Strategy cannot be executed properly with efforts continually focused on a short-term basis.
- *The Management Barrier*- Managers within an organization are managing more reactively than proactively. That is, they are "fighting fires" more than they are stepping back and managing from the perspective of the objectives and strategy of the organization.
- *The Resource Barrier*- Nearly 60 percent of organizations do not link budgets to strategy. One can perceive that organizations not linking their budget to strategy demonstrate bad priorities (Niven, 2008, pp.9–11)

C. FOUR PERSPECTIVES OF THE BALANCED SCORECARD

The Balanced Scorecard normally views a strategy from four perspectives. That is, as each strategy is evaluated to determine the objectives needed, it should be broken down into four perspectives. This allows for better progress measurement when considering different stakeholders' needs by focusing on more than just one side of the strategy. Figure 8 shows how the four perspectives are interrelated with one another. The four perspectives are listed below, followed by a detailed version of each perspective:

- Customer Perspective
- Internal Business Processes Perspective
- Financial Perspective
- Employee Learning and Growth Perspective (Niven, 2008, p.13)

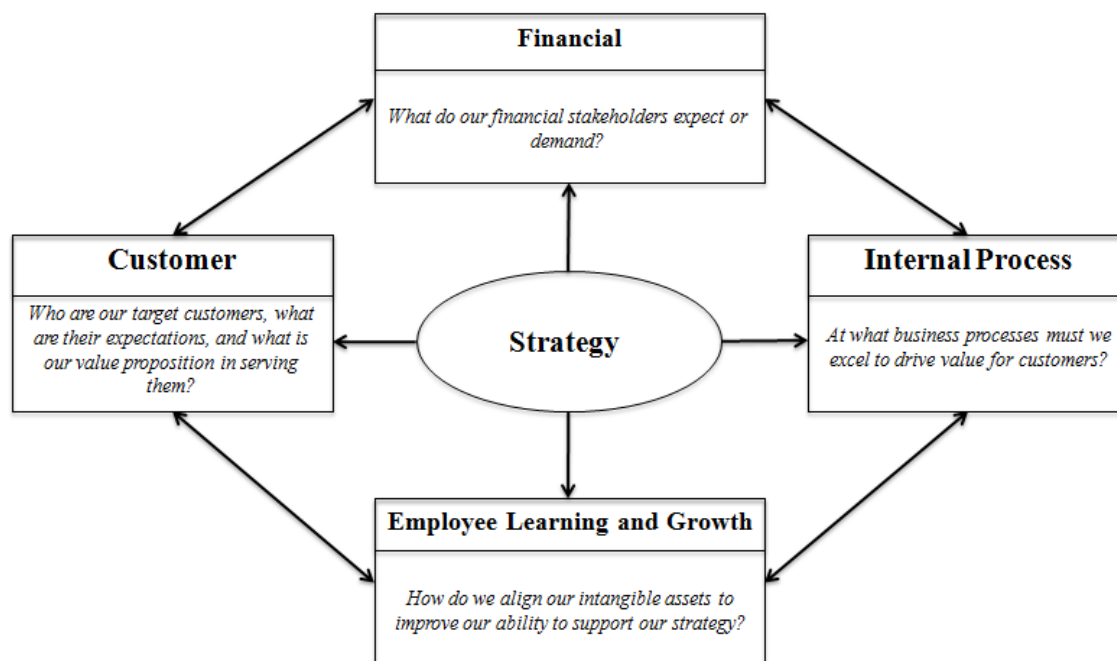


Figure 8. The Balanced Scorecard (From Niven, 2008, p.12).

1. Customer Perspective

The customer perspective tries to answer three questions: “Who are our customers?” “What do the customers expect or demand from the organization?” and, “What is the value proposition in serving them?” The following paragraphs will explain each question.

“Who are our customers?”- It is important to understand who the target audience is when considering each strategy. According to Niven (2008), most organizations state they know who their target audience is yet their actions prove otherwise. For example, if a business states its target audience as “younger women with low income,” yet sells from their inventory high end men’s apparel as one of its options, the actions do not reflect the stated target audience. The negative effect of not knowing the target audience is a lack of differentiation amongst the organization’s competitors (Niven, 2008, p.17).

“What do the customers expect or demand from the organization?”- This question determines what product or products the organization needs to deliver to the

customer in order to satisfy the customers' desires. Constant feedback and communication between the organization and customers is an effective method for answering this question. (Niven, 2008, p.17)

“What is the value proposition in serving them?”- This question can also be rephrased as “How can the organization stand out amongst the other competitors?” or “What can the organization provide that no other organization can provide?” In order to answer this question successfully, an organization must understand its core competencies (Niven, 2008, p.17) and be able to focus its efforts on such core competencies. Niven presents evidence to demonstrate that if an organization were to be evaluated on several categories, the organization must excel in at least one category (the category best affected by the core competency) and maintain at least the standard of the other categories (Niven, 2008, p.18).

2. Internal Business Processes Perspective

The internal business processes perspective tries to determine which processes an organization must focus on to create the value proposition for the customer. An organization can attempt to determine the processes by asking, “Does the organization need to create new processes or upgrade existing processes?” These processes must then be used to develop objectives needed to be met to execute the strategy. (Niven, 2008, p.18)

3. Financial Perspective

The financial perspective allows organizations to develop objectives for the strategy with the end in mind. Although the earlier part of this chapter indicated that financial measures were relied on too much, the financial perspective must still be considered, but should not be the only consideration. The financial perspective differs between the for-profit sector and the nonprofit or public sector. Whereas a for-profit organization would develop objectives such as “increase revenue” or “increase shareholder value,” a nonprofit or public sector organization would develop objectives such as “contain costs” or “utilize assets effectively” (Niven, 2008, p.18).

4. Employee Learning and Growth Perspective

The employee learning and growth perspective is essentially the enabler of the other perspectives. The objectives developed in this perspective tend to fill the gaps between the present condition of the organization and where the organization needs to be, based on development of the customer and internal business process objectives. This perspective is often the last one to develop, but it is important that it does not get overlooked. (Niven, 2008, p.19)

Although the Balanced Scorecard uses four perspectives, organizations do not have to limit themselves when creating their Balanced Scorecard. Therefore, one must be careful not to refer to each of the perspectives as quadrants, which normally implies a limit of four perspectives. Rather, organizations may use more or less than the four perspectives based on the need for different perspectives (Niven, 2008, p.14).

D. THE BALANCED SCORECARD IS THREE TOOLS IN ONE

The Balanced Scorecard can be considered three tools in one (Niven, 2008, p.13). Each of the tools is listed below, followed by a detailed explanation of each:

- Communication Tool
- Measurement System
- Strategic Management System (Niven, 2008, p.13)

1. The Balanced Scorecard as a Communication Tool

The Balanced Scorecard is an effective communication tool because it translates strategy into actionable tasks. The Balanced Scorecard does this in a form called a Strategy Map. The Strategy Map is explained in detail in the next section.

Before the Strategy Map section is introduced, as with most tools, the Balanced Scorecard must define key terms. These key terms are very important to define because they must not be used interchangeably when developing the Balanced Scorecard. These key terms are:

- *Objective*- A statement, normally starting with a verb that states what action is needed to be done well in order to implement the strategy (Niven, 2008, p.15). For example, “Improve customer satisfaction.”
- *Measure*- A typically quantitative device used to monitor progress (Niven, 2008, p.15). For example, if the objective were to “improve customer satisfaction,” the measure could be “comment cards with positive reviews.”
- *Target*- The desired result of a performance measure. Targets, used synonymously with the term goals, must be predetermined using information of value such as actual performance results. For instance, having a target of building a ship in less than two years has little meaning, unless compared to historical records where a similar ship was built in less than one year, and the best shipyard building a ship in less than six months. With this information, one can set a realistic target of five months to become the reference point to guide actions and decisions. Thus, setting targets communicates improvements vice the status quo (Niven, 2008, pp.240–241).
- *Initiative*- The specific programs, activities, projects, or actions an organization engages in to help ensure it meets or exceeds the performance targets (Niven, 2008, p.245). These initiatives provide a linkage to strategic objectives, measures, and targets. An example of an initiative is upgrading financial management databases (Niven, 2008, p.246).

These terms can be confused with one another and used interchangeably. However, as each term is linked with one another, a logical process must be used to develop each objective, measure, target, and initiative. In the next chapter, the FIAR will

be dissected and categorized into each of these terms to view each strategy using the Balanced Scorecard. Objectives and measures will be described more below, and targets and initiatives will be described more in Chapter V.

a. The Strategy Map

One of the most integral parts of the Balanced Scorecard is its use as a communication tool. The Strategy Map is a one-page graphical representation of what an organization must do well in each of the four perspectives in order to successfully execute the strategy (Niven, 2008, p.15). The role of the Strategy Map is to communicate the strategic destination (Niven, 2008, p.19). Strategy Maps are comprised entirely of objectives, and it is the role of the measures to show the progress in achieving these objectives. Figure 9 shows a generic Strategy Map, sampled from the Resilient Strategies website, an organization that uses the Balanced Scorecard. Notice that each perspective contains the objectives that function as pathways. These objectives, found in the blue ovals, connect with other objectives through the use of arrows that provide a simple, illustrated representation of the strategic flow. In the example, the objectives become clear with the help of performance measures. The performance measures that are developed from these objectives are listed in the Balanced Scorecard (Figure 10). Notice that although the Strategy Map appears chronological in nature, the objectives do not have to be performed sequentially. Rather, they may be performed concurrently with all other objectives.

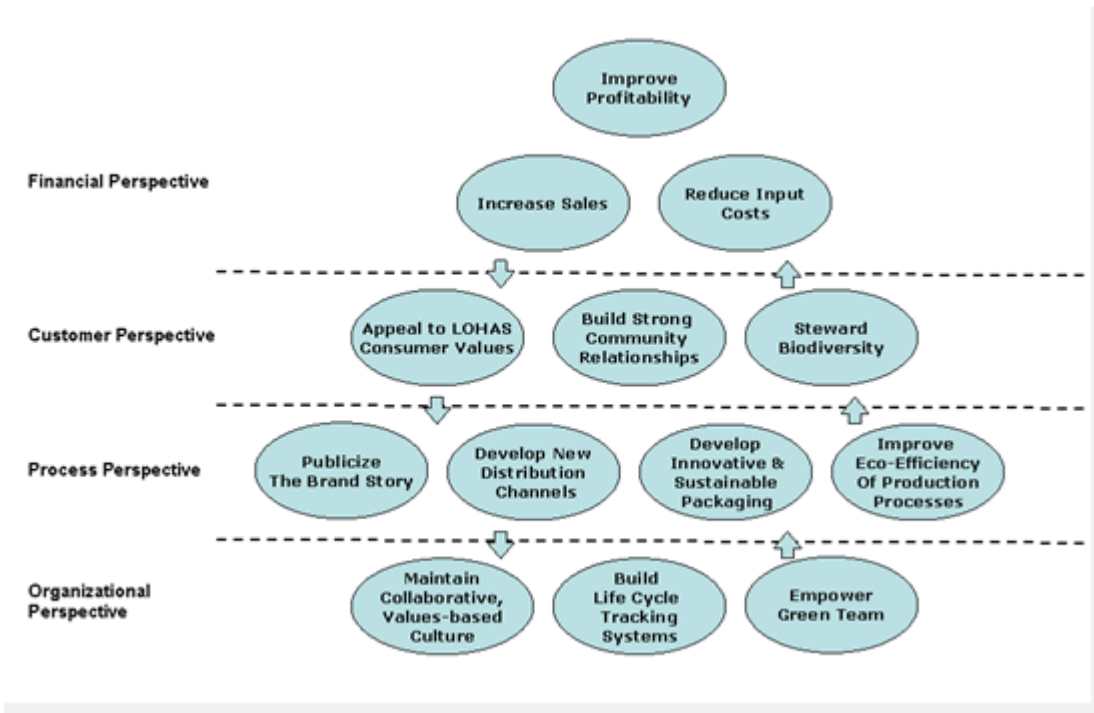


Figure 9. An example of a Strategy Map. (From <http://www.resilient-strategies.com/triple-bottom-line/>).

	3-5 Year Perspective			Annual Perspective			
Perspectives	Objectives	Measures	Target	Plans & Projects	Milestones	Account-ability	Resource Allocation
Financial	1. Improve profitability 2. Reduce input costs 3. Increase sales	\$/qtr \$/qtr \$/qtr	\$x ...				
Customer	1. Steward rainforest biodiversity 2. Build community relationships 3. Appeal to LOHAS values	Acreage protected Negative incidents Customer sentiment				
Process	1. Improve process 2. Develop packaging 3. Develop channels 4. Publicize brand	Life Cycle Analysis # stores Social network activity	Project X Project Y	Opex People
Organization	1. Empower green team 2. Build mgt system 3. Maintain culture	Completion of training IT milestones Culture survey	Project A Project B Project C Project D	Capex Opex People

← Strategic
Operational →

Figure 10. An example of a Balanced Scorecard complementing the Strategy Map in Figure 9 (From <http://www.resilient-strategies.com/triple-bottom-line/>).

2. The Balanced Scorecard as a Measurement System

The Balanced Scorecard provides a framework to link employee action to the leader's visions and strategies (Niven, 2008, p.19). It does this by first developing the Strategy Map that lays out the strategy of going from where the organization is to where it needs to be. The Strategy Map is comprised entirely of objectives. These objectives are then broken down into measures that allow the progress of the objectives to be quantified. These measures are what comprise the Balanced Scorecard. That is, the Balanced Scorecard contains the performance measures that monitor progress, allowing the organization to remain on track. (Niven, 2008, p.20)

The Balanced Scorecard is a system comprised of both the Strategy Map of objectives and the Balanced Scorecard of measures. The system, however, is not called both the Strategy Map and Balanced Scorecard framework because the Strategy Map originated from the efforts of the early Balanced Scorecard adopters. These early adopters initially struggled to envision the Balanced Scorecard without a clear path of objectives, which facilitated the creation of the Strategy Map (Niven, 2008, p.20). For the remainder of this thesis, the Balanced Scorecard will refer to both the Balanced Scorecard and the Strategy Map.

3. The Balanced Scorecard as a Strategic Management System

The third type of tool the Balanced Scorecard functions as is a strategic management system. Although not initially intended by Kaplan and Norton to be such a tool, many organizations have noticed that the Balance Scorecard has evolved into an effective strategic management system. Recall earlier in the chapter how four barriers impeded strategy execution: the vision barrier, people barrier, resource barrier, and management barrier (Niven, 2008, pp.9–11). The Balanced Scorecard as a strategic management tool allows organizations to align short term actions with strategy. The following Balanced Scorecard methods allow organizations to overcome barriers, and are explained in detail:

- Overcoming the vision barrier through *the translation of strategy*
- *Cascading the scorecard* overcomes the people barrier
- *Strategic resource allocation* overcomes the resource barrier
- *Strategic Learning* overcomes the management barrier (Niven, 2008, pp.21–23)

a. *The Translation of Strategy*

Through the Balanced Scorecard, an organization clearly defines the vision statements into clear actionable items. For instance, when the leader of an agency preaches “better improvement in internal controls,” the Balanced Scorecard translates that statement into clearer objectives, such as “document all transactions.” These objectives are then broken down into measures in order to gauge progress, such as “percentage of purchases documented.” Even further, targets and initiatives such as “100% transactions documented by 30 September 2017” and “upgrading inventory control software,” respectively, even further clarify the strategic vision into actionable items. (Niven, 2008, p.21).

b. *Cascading the Scorecard*

Cascading the Balanced Scorecard allows all levels of the organization to be personally involved with the strategy. Cascading the scorecard drives the concept down the organization. This provides the opportunity for all employees to identify ways that each can create value within the organization. Instead of focusing on achieving short-term financial targets, allowing inputs from all levels gives employees the ability to focus on decisions needed to create future value (Niven, 2008, p.21).

c. *Strategic Resource Allocation*

Strategic resource allocation is the process of apportioning financial and human resources efficiently. When developing the Balanced Scorecard, the organization not only creates objectives, measures, and targets, but also the initiatives to enable action.

Only those initiatives that use resources to achieve targets related to the strategy are used, avoiding initiatives that use resources that have no link to the organizational strategy (Niven, 2008, pp.21–22).

d. Strategic Learning

Strategic learning shifts the thought process in traditional decision-making by taking advantage of the use of knowledge management. Now that organizations are abundant with knowledge workers, they can use the Balanced Scorecard to help make implicit knowledge held by the employees explicit. This is done through methods like cascading the Scorecard. With the implicit knowledge now exposed to all in the decision-making process, strategic learning avoids decision-making using only limited information, such as actual versus budget variance (Niven, 2008, pp.22–23).

E. MODIFYING THE BALANCED SCORECARD TO FIT THE GOVERNMENT SECTOR

Now that the Balanced Scorecard is described, it is necessary to tailor it for use in the government sector. Figure 11 shows the Balanced Scorecard tailored for the public and nonprofit sector, and can be compared to the for-profit template shown in Figure 8 (Niven, 2008, p.32). Fitting in the public and nonprofit sector category, the government sector Balanced Scorecard is modified using the following actions:

- *Mission moves to the top of the Balanced Scorecard-* Because the government agency strives to serve the public, the mission plays a very important role. (Niven, 2008, pp.31–33)
- *Customer perspective is elevated-* Whereas in the for-profit sector, the bigger priority is to enhance shareholder value, the government sector exists to serve the public. Therefore, the customer should be placed at the top to symbolize that customers are the highest priority. (Niven, 2008, pp.33–34)

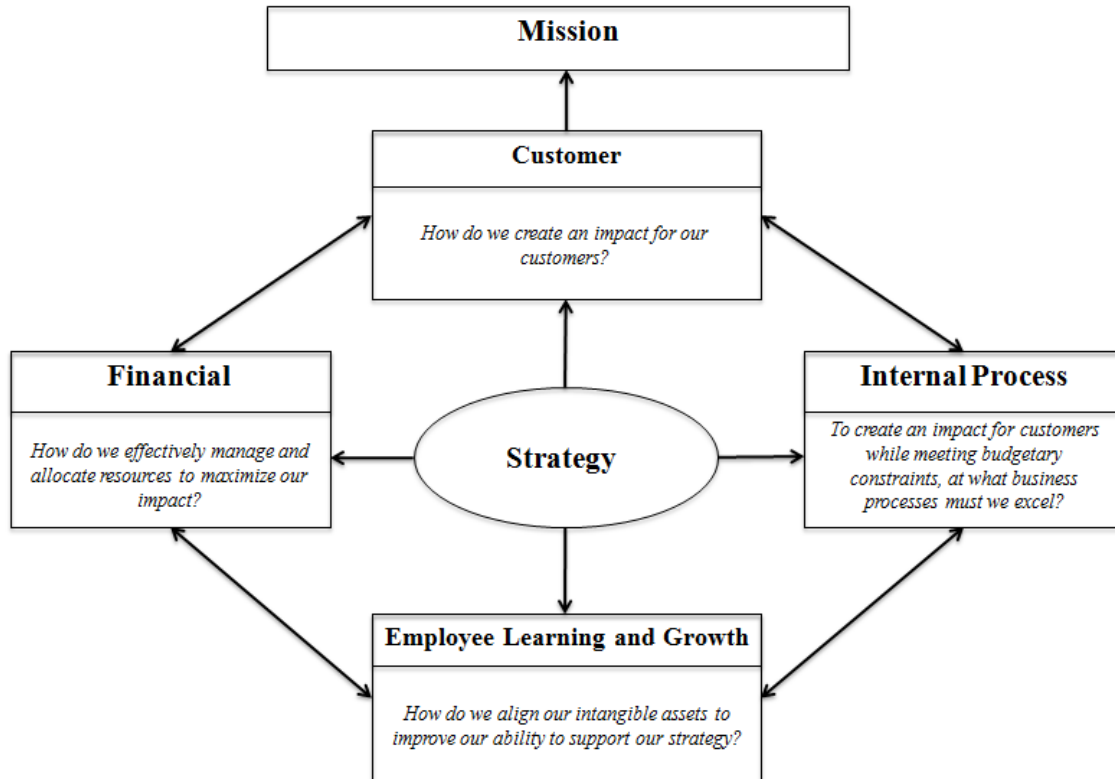


Figure 11. The government sector Balanced Scorecard (From Niven, 2008, p.32).

F. CHAPTER SUMMARY

Chapter IV focused on what the Balanced Scorecard is and its value to organizations willing to improve. The Balanced Scorecard originated in the early 1990's and has evolved into a more versatile tool than originally designed. The need for the Balanced Scorecard arose with the increase in intangible assets, organizations relying too much on financial metrics, and the difficulties of executing strategies.

The Balanced Scorecard is comprised of a Strategy Map section and a Balanced Scorecard section. Both of these sections are viewed in four perspectives: a financial perspective, customer perspective, internal business processes perspective, and an employee learning and growth perspective. The Strategy Map section provides a graphical representation of the objectives needed to guide the strategic direction using the

four perspectives. The Balanced Scorecard section lists the measures, targets, and initiatives created from the objectives in the Strategy Map also using the four perspectives.

The Balanced Scorecard is a versatile tool. As the Balance Scorecard is being developed, it serves three functions: as a communication tool, a measurement tool, and a strategic management tool. It functions as a communication tool by communicating the visions and strategies of the top-level leadership into actionable items for all employees. It functions as a measurement tool by providing performance measures to gauge the achievement of objectives. It also functions as a strategic management tool by overcoming strategic barriers through its effectiveness in translating the strategy, communicating down and within all levels of the organization, allocating resources properly, and through strategic learning.

The Balanced Scorecard adapts to the public and nonprofit sectors through two modifications. These modifications consist of placing the mission at the top of the scorecard to signify that mission is very important. Furthermore, the customer perspective is placed in the top-center, as seen in Figure 11, to signify the importance of the customer.

The information in this chapter provides the background of what the Balanced Scorecard can do to assist in implementing the FIAR more effectively. With the SMP's statutory requirements in section 904 of the FY 2008 NDAA, coupled with the FIAR's requirements in section 1003 of the FY 2010 NDAA, it seems fitting to use the Balanced Scorecard as a strategic management tool to help translate the FIAR strategy into actionable items. With the end of FY 2017 deadline of achieving the DoD audit readiness fast approaching, the Balanced Scorecard provides an alternative method of evaluating execution of the FIAR Plan.

V. ANALYSIS

Chapter V analyzes the FIAR using the Balanced Scorecard. The purpose of this chapter is threefold. The first purpose is to describe the methodology of developing the Balanced Scorecard for a government organization. The second purpose is to develop a Balanced Scorecard tailored to the FIAR strategy using the methodology described in the first part of the chapter. The third purpose is to use the Balanced Scorecard developed for the FIAR and provide the analysis needed to answer the thesis research questions.

A. INTRODUCTION

The Balanced Scorecard is used to execute the organization's strategy by translating the strategy, mission, values and vision into actionable items, using performance measures to gauge the progress. With these descriptions in mind, a Balanced Scorecard centered on the FIAR strategy will be created that addresses the research questions below:

- Can a Balanced Scorecard be used as an effective strategic management tool for DoD organizations to complement the FIAR to achieve audit readiness?
- Can the Balanced Scorecard also be an effective strategic management tool at the service component level when used with the FIAR?
- What challenges could hinder Balanced Scorecard success?

B. METHODOLOGY

The methodology that will be used in implementing the FIAR strategy into a Balanced Scorecard is from Paul R. Niven's *Balanced Scorecard: Step-By-Step for Government and Nonprofit Agencies* book. Niven's methodology is set up so any nonprofit or government organization can follow the process to develop its own Balanced Scorecard and modify terms or concepts as needed. The process is explained below.

There are two phases in the Balanced Scorecard development process: the planning phase and the development phase (Niven, 2008, p.74). The first phase, known as the planning phase, occurs before the construction of the Balanced Scorecard, and requires fulfilling several prerequisites prior to entering the second phase. The second phase is the development phase, where the Balanced Scorecard is built. (Niven, 2008, pp.74–75)

1. Prior to Developing the Balanced Scorecard: The Planning Phase

The planning phase lays the foundation for the construction of a Balanced Scorecard. The more enthusiastic and well thought out the planning phase is, the easier the development phase will be (Niven, 2008, p.74). The steps of the planning phase are:

a. Develop the Rationale and Communicate the Rationale to Employees

Before a Balanced Scorecard is developed, the organization has to understand why the Balanced Scorecard is needed (Niven, 2008, pp.47–49). Similar to choosing a hammer and not a screwdriver to hit a nail, the organization has to determine why the Balanced Scorecard is the right tool. One must avoid vague reasons like “we need to go from good to better,” as it is difficult to implement the reason into tasks (Niven, 2008, p.49). Instead, reasons like “The Balanced Scorecard will be used to improve execution of the FIAR Strategy” would be easier to translate.

Once the rationale of using the Balanced Scorecard over other tools is determined, it must be communicated to all the relevant stakeholders in the organization. Decisions and employee support come easier when everyone understands the reason why a new initiative is introduced (Niven, 2008, p.50).

b. Get Buy-In from the Executives

Without executive buy-in, the rest of the organization will not consider the Balanced Scorecard a priority either (Niven, 2008, p.50). As senior executives and

managers set the tone of the organization, they must support the Balanced Scorecard initiative and help sell it to those executing the strategy (Niven, 2008, p.51).

c. Develop the Balanced Scorecard Team

The team should consist of five to seven people. Convening a meeting becomes more difficult with more people involved. Conversely, a team with too few people would not capture all the perspectives within the organization. As a good rule of thumb, each department should have a representative in the Balanced Scorecard team (Niven, 2008, p.58). The team should include an executive sponsor who would be a high level executive that can provide the human and financial resources when needed. The team should also include a team champion, who is the executive sponsor's right hand person that ensures the Balanced Scorecard is implemented as planned (Niven, 2008, pp.61-62). The role of the rest of the team members is to assist in developing the Strategy Map and the Balanced Scorecard (Niven, 2008, p.62).

d. Determine Where Within the Organization to Implement the Balanced Scorecard

Implementation can occur at the highest level where strategy is generated, or at a lower level to be used as a "pilot program" (Niven, 2008, p.65). Having a large organization provides more options at which level to implement the scorecard. According to Niven (2008, p.65), the best place to first implement the Balanced Scorecard is at the executive level, for three reasons. First, everyone in the organization can see the top-level priorities and can collaborate with other departments to focus on such priorities. Second, it is easier to communicate to all employees from the executive level. Third, it is easier to cascade the Balanced Scorecard to lower levels. (Niven, 2008, p.65)

Implementing the scorecard at a lower level may be another option if an organization decides on a "pilot program" first or lacks executive support. Either way, the merits of the Balanced Scorecard can be realized at a lower level first and subsequently adopted at a different organizational level. Should this route be taken, representatives

implementing the Balanced Scorecard should openly communicate with others in the organization to ensure that the Balanced Scorecard initiative is aligned with organizational-level strategy. (Niven, 2008, p.65)

e. Determine What Resources Are Needed for the Balanced Scorecard

An organization must also ask the question, “What will the cost be to implement the Balanced Scorecard?” (Niven, 2008, p.71) Both financial and human resources must be considered, and there is not a definitive answer to this question. Here are several factors to consider when determining how much to budget for the Balanced Scorecard:

- Employee time- These costs may be front loaded when first developing the scorecard and tapered after implementation.
- Consulting costs- These costs may be the difference between a well-developed and not-so-well-developed scorecard.
- Software- Used for scorecard reporting, software is available in the market ranging from a few hundred to several thousand dollars.
- Education materials- These costs may range from a few books on Balanced Scorecard distributed throughout the organization on up to sending several employees to Balanced Scorecard conferences.
- Logistical expenses- These costs may include sending the scorecard team off-site to avoid on-the-job distractions.
- Organizational restructuring- In order to maintain a healthy Balanced Scorecard initiative, organizations may need to commit employees full time to monitor the program. (Niven, 2008, pp.71–72)

f. Have a Training Plan and Communication Plan

Because a first impression is a lasting impression, it is important to develop a sound training plan. In order to implement the Balanced Scorecard successfully, an organization needs to start with support from all levels and particularly from the executive levels. The support is difficult to obtain when initial training is poorly given. Poor training results in employees not fully understanding the Balanced Scorecard concepts. Therefore, a comprehensive training plan is needed to ensure scorecard success. (Niven, 2008, pp.82–83)

In order to have a sound training plan, parts of the plan must have certain characteristics or be taken into consideration. First, training events should be efficient, effective, and engaging (Niven, 2008, p.84). Effective implies sticking to and accomplishing training objectives. Efficient training implies following an agenda with minimal resources used. Engaging implies keeping the training interesting. Second, the employees should be assessed to determine their knowledge level of the Balanced Scorecard, and the training they receive should be tailored to adapt to a range of different learning styles (Niven, 2008, pp.85–87). Third, conducting training should expect to be front-heavy in the beginning of implementation yet still be done throughout the Balanced Scorecard process (Niven, 2008, p.93).

It is also important to develop an open communication plan. The Balanced Scorecard is considered a change initiative to an organization. Therefore, the leadership and scorecard team must communicate the purpose frequently to the rest of the company. The communication plan should include who will communicate and how often, and what communication vehicles are to be used (Niven, 2008, pp.97–102).

2. The Development Phase

This phase provides the process needed to develop a comprehensive Balanced Scorecard. The steps of the development phase are:

a. *Gather and Distribute Background Information*

Balanced Scorecard development teams must have the necessary information to construct the scorecard. Information collected should contain but not be limited to the following:

- Organizational charter
- Mission
- Core values
- Vision statement
- Strategic Plan
- Past consulting studies
- Performance reports
- Third-party ratings or assessments (Niven, 2008, p.75)

Also included in Niven's methodology are steps facilitating communication with organizational executives and employees. These steps (f, g, i and j) are by no means mandatory but are included and recommended to emphasize the importance of communication between the scorecard developers and executives (Niven, 2008, pp.75–78).

b. *Provide a Balanced Scorecard Education*

At least those selected for the Balanced Scorecard team should be educated on how to use the scorecard. Several resources, ranging from publications to conferences are available on the subject. (Niven, 2008, pp.75–76)

c. *Develop or Confirm Mission, Values, Vision, and Strategy*

These components should be readily available to everyone in the organization, if not publicly visible. Each of these is important when executing strategy because they guide the organization to the destination. If they are not available, they

should be developed and aligned with one another. If they are available, the organization must determine whether or not these missions, values, visions, and strategies are up-to-date and aligned with one another. (Niven, 2008, p.76)

The *mission* answers the following questions: Who are you? Whom do you serve? Why do you exist as an organization? What are the long term outcomes to determine your success? The mission is the reason why the organization exists. Typically communicated via a mission statement, the mission must be simple and clear, inspire change, be long term in nature, and be easy to comprehend and communicate. (Niven, 2008, pp.105-108)

If a mission exists already, the following questions should be answered to determine its validity: Is the mission up to date? Is the mission relevant to the customers and constituents? Who is being served? (Niven, 2008, p.112)

The mission's relevance to the Balanced Scorecard is that the scorecard translates the mission into the objectives and measures in the four perspectives (Niven, 2008, pp.112–114).

The *values* of an organization are the guiding principles of how it conducts its operations. These values must be timeless in that the values should not change frequently. Decisions made in the organization should not violate the values of the organization. For instance, if one of the values of an organization is to be an eco-friendly company, and the organization is given an opportunity of acquiring a company known for its poor eco-friendly practices, then the organization should not acquire the company. (Niven, 2008, pp.114–117)

The Balanced Scorecard uses values to align the actions across all levels of the organization. The values create guidance on how the initiative is to be implemented. This guidance is important, especially when cascading the Balanced Scorecard down the organization. (Niven, 2008, pp.118–119)

The *vision* of an organization provides a conduit from where the organization presently stands to where it needs to be. It presents a word picture of the

future of the organization. The organization's vision is communicated via a vision statement, and if effective, should compel the employees to take action. The vision statement should be concise, inspirational, consistent with the mission and values, and verifiable (Niven, 2008, pp.120–124). One such example that includes all vision statement elements is former President Kennedy's State of the Union address on 25 May 1961, when he stated, "...I believe that this nation should commit itself to achieving this goal, before this decade is out, of landing a man on the Moon and returning him safely to the Earth..." (Niven, 2008, p.121) On 20 July 1969, that vision became reality.

The Balanced Scorecard quantifies the milestones on the path to achieving the vision. With terms like "what gets measured gets done," it is important to have the right measures to describe the vision. (Niven, 2008, pp.126–127)

Understanding *strategy* is a complex process. Although there are numerous ways to define strategy, Niven defines strategy as "a representation of broad priorities adopted by an organization in recognition of its operating environment and in pursuit of its mission" (Niven, 2008, p.133). A strategy sets the direction and provides context for developing the objectives and measures for the Balanced Scorecard. One element of good strategy is that it differentiates an organization from other organizations. Another is that strategy determines what a company should not do instead of what it should to accomplish the mission. Still another is that it must have continuity. In other words, strategies should evolve to meet environmental changes, but not so frequently that the strategy cannot be executed properly. (Niven, 2008, pp.132–133)

With a brief background in the mission, values, vision, and strategy of an organization are, it is now appropriate to recap their relevance to the Balanced Scorecard process. The mission begins the process, guided by the values and vision of the organization. The strategy is then translated by developing the objectives on the Strategy Map. The strategy is further translated into measures and targets from the objectives developed in the Strategy Map, and placed on the Balanced Scorecard. Finally, the initiatives are developed to achieve the targets. (Niven, 2008, p. 134)

d. Conduct Executive Interviews

This step clarifies the intentions of the executive level on whether the mission, values, vision and strategy developed or existing are aligned. The Balanced Scorecard team should gain clarity of the executives' intentions prior to developing the Strategy Map and Balanced Scorecard. By asking the right questions, the interviews should provide better information to develop the Balanced Scorecard. (Niven, 2008, p.76)

e. Develop the Strategy Map

With the feedback received during the interview process, combined with the necessary background information, the Strategy Map is ready to be constructed. This Strategy Map should be one page long and capture the highest priority objectives from each perspective. (Niven, 2008, p.76)

f. Executive Workshop

The Executive Workshop is used to gain confirmation from the executive level that the Strategy Map reflects their intentions (Niven, 2008, p.76).

g. Gather Employee Feedback

This step is recommended yet optional. The purpose of this step is to get the perspective from those who will execute the strategy. The feedback will be considered when developing the performance measures (Niven, 2008, pp.76–77).

h. Develop Performance Measures

The Balanced Scorecard team conducts this step by translating the objectives from the Strategy Map into measures that are tracked. These measures establish accountability in the organization as well as gauge the progress of achieving the objectives. When developing the measures, it is important to ensure the measurements chosen relate to the outcome, or else the organization risks resources on performing measures that have little or no value. (Niven, 2008, p.210)

Three types of performance measures are mentioned here: input measures, output measures, and outcome measures. Input measures provide a limited amount of information for decision-making, but do keep a good job of tracking what is put into the effort (Niven, 2008, p.211). Also known as activity measures, output measures track the results generated, such as customers served or machines fixed. This performance measure helps more quantitatively than qualitatively. In other words, an output measure may tell how many customers were served but it does not tell how many customers are better off (Niven, 2008, p.211). The last type of measure is the outcome measure. This type of measure tells if the customer is better off, so it focuses more on results based than activity based performance (Niven, 2008, p.211).

Other performance measures are used in the Balanced Scorecard as well, called lead and lag indicators. Lagging indicators are those measures that focus on the results at the end of a time period, and normally characterize historical performance (Niven, 2008, p.215). Lagging indicators give the ability to monitor whether the initiative you are using is working. Leading indicators are those measures that “drive” the performance of lag measures (Niven, 2008, p.215). By using leading indicators, organizations can determine how to adjust their performance to be more successful in achieving the goal. It is good to have a mix of both leading and lagging indicators for the scorecard to be balanced. (Niven, 2008, p.214)

i. Executive Workshop

This step gives the executive level the opportunity to confirm and commit to the measures developed (Niven, 2008, p.77).

j. Gather Employee Feedback

This step provides the opportunity for the employees executing the strategy to understand the measures developed (Niven, 2008, p.77).

k. Establish Targets and Prioritize Initiatives

Establishing targets provide levels of measures to be reached. The initiatives bring the targets to fruition. (Niven, 2008, p.77)

l. Gather Data for the First Balanced Scorecard Report

This step recommends scheduling the first meeting about 60 days after the Balanced Scorecard implementation and gathering available data for the meeting. It is anticipated that 100% of the data will not be available, though the data that are available will provide a starting point for future meetings. (Niven, 2008, p.77)

m. Hold the First Balanced Scorecard Meeting

Holding the first meeting provides the ability to analyze, discuss, and learn from the available data gathered in the previous step. These actions are essential to strategy execution and allow the organization to realize the benefits of the tool by remaining focused and aligned. (Niven, 2008, p.78)

n. Develop the Ongoing Balanced Scorecard Implementation Plan

The Balanced Scorecard implementation plan is a tool used to schedule the previously mentioned thirteen steps. The deliverables from this step include a one-page Strategy Map and a scorecard that includes the measures, targets, and initiatives. (Niven, 2008, p.78)

C. APPLYING NIVEN’S METHODOLOGY TO DEVELOP THE FIAR STRATEGY BALANCED SCORECARD

This section uses Niven’s methodology to develop a Balanced Scorecard for use in analyzing the FIAR Strategy. To remain within the scope of this thesis, steps *b, d, f, g, i, j, l, m, and n* of the development phase will not be performed in the development of the FIAR strategy Balanced Scorecard. Furthermore, the remaining steps of the development phase are performed as per Niven’s methodology, but presented in a more practical format.

1. The Planning Phase

a. Develop the Rationale for Using the Balanced Scorecard

The rationale for using the Balanced Scorecard for the FIAR strategy is to provide an alternative translation of the strategy while still keeping the same priorities, goals, and objectives as intended by the DoD leadership.

b. Gain Senior Leadership Support and Sponsorship

The use of the Balanced Scorecard over other strategy execution tools would most likely gain executive level support, if it were briefed to the FIAR Governance Board for three reasons. First, the board is chaired by the USD(C)/CFO and consists of the department CMOs. Since CMOs have cross-functional responsibilities, the Balanced Scorecard's utility would meet the needs in different functional areas. Second, the board's role is to provide visible leadership commitment needed to achieve FIAR goals and objectives. Supporting an initiative such as the Balanced Scorecard would promote visible leadership. Third, the Governance Board meets on a quarterly basis. The frequency of meetings is conducive to hearing Balanced Scorecard updates. (DoD, 2010b, p.11)

c. Form the Balanced Scorecard Team

The Balance Scorecard team should consist of the USD(C)/CFO as the executive sponsor to the program, and the Deputy CFO as the team champion to manage the scorecard. The team members should consist of a representative from each of the military departments and the DoD support agencies.

d. Decide Where in the Organization to Build the Balanced Scorecard

Developing the Balanced Scorecard at the DoD financial management executive level can prove very beneficial because of the knowledge of department level priorities. Additionally, it may be relatively easier to cascade the FIAR strategy directly from the SMP and down to subordinate levels.

e. Determine the Resource Requirements and Availability

With the current FIAR organizational structure (e.g., FIAR Governance Board, FIAR Directorate), the functional relationships needed to develop and implement the FIAR Balanced Scorecard exist. Therefore, the burden of gathering those involved with the Balanced Scorecard processes should be minimal. However, the added employee time, consulting costs, software costs, education material and logistical costs are difficult to quantify and may vary.

f. Develop a Training and Communication Plan for Balanced Scorecard Implementation

Although this step is reserved for the DoD's plans for training and communication, it is worthy to mention here about the plan for implementing the FIAR. Appendix 5 of the November 2010 FIAR Plan Status Report provides a list of professional development courses pertaining to FIAR employee learning. The courses are described in detail and shown in Table 8, categorized by applicable DoD employees involved with FIAR execution.

Recommended as FIAR Competencies for Target Audiences	FIAR Course	Course Description
NonFinancial Managers (FMs) and Senior Leaders throughout DoD	100 – Overview of FIAR	Basic, high-level overview of FIAR to enhance awareness and buy-in for FIAR support/success
NonFMs and FMs needing basic training	101 - Introduction to the FIAR Guidance and ICOFR	Basic introduction to FIAR Guidance (goals, roles and responsibilities of audit readiness) plus auditors perspective toward ICOFR
NonFMs and FMs involved with the FIAR or ICOFR at Reporting Entities and their Service Providers	102 - FIAR Methodology for Reporting Entities and ICOFR Deliverables	FIAR methodology and audit execution for Reporting Entities including ICOFR documentation, testing and corrective action plans
NonFMs and FMs involved with FIAR as Service Providers or at Reporting Entities	103 - FIAR Methodology for Service Providers	In-depth review of the Service Provider's role in audit readiness
NonFMs and FMs involved in appropriations received - wave 1 - Audits, as Service Providers or at Reporting Entities	201 - FIAR Appropriations Received (Wave 1)	In-depth review of scope considerations associated with preparing for Appropriations Received (Wave 1) audits
NonFMs and FMs involved in Statement of Budgetary Resource - Wave 2 - Audits, as Service Providers or at Reporting Entities	202 - FIAR Statement of Budgetary Resources (Wave 2)	In-depth review of scope considerations associated with preparing for Statement of Budgetary Resources (Wave 2) audits
NonFMs and FMs, Involved in Existence and Completeness of Mission Critical Assets - Wave 3 - Audits, as Service Providers or at Reporting Entities	203- FIAR Existence and Completeness of Mission Critical Assets (Wave 3)	In-depth review of scope considerations associated with preparing for Existence and Completeness of Mission Critical Assets (Wave 3) audits
IT & Systems Personnel or Others involved with Systems in Audit Readiness Tasks as Service Providers or at Reporting Entities	301 - FIAR Information Technology Controls and Audit Readiness	In-depth review of management's responsibilities for IT controls when preparing for a financial statement audit

Table 8. FIAR professional development courses available (From DoD, 2010d).

2. The Development Phase

Only applicable steps of Niven’s methodology are conducted for this phase to stay aligned with the scope of the thesis. The author’s goal for the development phase is to not

go step by step, as an organization would to execute the methodology properly, but to conduct the steps needed to produce the Strategy Map and Balanced Scorecard.

a. Gather and Distribute Background Information-

The following sources of information are used:

- Strategic Management Plan for FY2011 published December 2010
- FY2005-FY2010 DoD AFRs published November 2005–2010
- The following GAO reports: Financial Management Improvement and Audit Readiness Efforts Continue to Evolve (GAO-10-1059T), DoD Business Transformation: Improved Management Oversight of Business System Modernization Efforts Needed (GAO-11-53), Defense Business Transformation: DOD Needs to Take Additional Actions to Further Define Key Management Roles, Develop Measurable Goals, and Align Planning Efforts (GAO-11-181R)
- The FY 2011 Enterprise Transition Plan
- The Business Enterprise Architecture 8.0
- The March 2010 Congressional Report on Defense Business Operations
- Updated FIAR Guidance published May 2010
- FIAR Plan Status Report updated November 2010
- OMB Circular A-123

b. Develop or Confirm Mission, Values, Vision, and Strategy

The mission statement, values, and strategy are found in the May and November 2010 FIAR Plan Status reports, the DoD website, and the FIAR Guidance, respectively. The vision statement could not be found, so an assumption was made based on statutory requirements.

OUSD(C) Mission Statement:

The first FIAR mission statement in its current form was published on the May 2010 FIAR Plan Status Report (DoD, 2010c) and is:

to improve business and financial processes, controls, systems and data to achieve accurate, reliable and timely financial and managerial information for decision makers and citizens. (OUSD[C], n.d.)

DoD Core Values

The core values of the Department of Defense are *leadership*, *professionalism*, and *technical know-how* (DoD, n.d.). Core values are not found in the FIAR guidance or plan status report.

Vision

According to the FIAR Plan, the USD(C) provides the vision, goals and priorities of the plan and the Deputy Secretary of Defense/CMO approves them (DoD, 2010d, p.13). The FIAR Plan does not explicitly state what the vision is, so an assumption of the vision is made based on what a vision should provide. Since the vision provides a word picture of where the organization should be at certain time horizons, the “strategic goals” in the FIAR Guidance fit the description (DoD, 2010b, p.i). The strategic goals are:

- Achieve and sustain audit readiness
- Achieve and sustain unqualified assurance on the effectiveness of internal controls (DoD, 2010b, p.i)

Therefore, combined with statutory requirements, the assumed vision is “for the DoD to achieve and sustain both audit readiness and assurance on the effectiveness of internal controls no later than 30 September 2017 (DoD, 2010d).”

Strategy

As a review, the FIAR Strategy focuses on two key priorities: *budgetary information* and *information on mission critical assets* (DoD, 2010b, p.ii). With the key priorities known, the component level strategy planners develop their financial improvement plans (FIPs) (DoD, 2010b, p.14). Furthermore, the strategy flows in waves, as shown in Figure 12, where the management ensures that necessary internal controls are

in place prior to asserting audit readiness for each wave (DoD, 2010b, p.ii–iii). The key priorities, the wave process, and the component FIPs encompass the FIAR strategy.



Figure 12. Graphical representation of the FIAR Strategy (From DoD, 2010b, p.ii).

c. Develop the Strategy Map

The goal when developing the Strategy Map is to be able to deliver a powerful one-page document that includes the priority objectives needed to align with the mission of the FIAR Plan. Additionally, the priority objectives should also align the core values to be able to meet the vision of having improved processes and achieving audit readiness by 30 September 2017.

Use of Coding to Represent a Taxonomy Organization Structure

Similar to the use of a taxonomy organization structure used in the SMP, the author uses a similar structure, which will be called coding, for two reasons. First, the use of a taxonomy structure allows an abbreviated method of understanding the link between goals, objectives, performance measures and initiatives. Second, the ability to use a taxonomy organization structure should ease development of the Balance Scorecard. The author uses the following codes on Table 9 to develop the Balanced Scorecard.

Code	Meaning
SG	Strategic Goal
RO	Resource Objective
CO	Customer Objective
PO	Internal Processes Objective
EO	Employee Learning and Growth Objective
PM	Performance Measure
I	Initiative

Table 9. List of codes and their meanings for the FIAR Balanced Scorecard.

The focus of the FIAR Guidance is to achieve two strategic goals. These two strategic goals are coded in Table 10.

Code	Meaning
SG1	Achieve and sustain audit readiness
SG2	Achieve and sustain unqualified assurance on the effectiveness of internal controls

Table 10. Strategic goals of the May 2010 FIAR Guidance (From DoD, 2010b, p.i).

Development of Priority Objectives

To develop the priority objectives, each publication in the “Gather and distribute background information” section was scanned for possible objectives. Table 11 lists the possible objectives, categorized by the perspective that best suits the objective and includes the source of the objective. Not applicable (N/A) sources refer to objectives determined by author with no definitive source.

Perspective	Objective	Source
Customer	Pay people and vendors on time and accurately	FY2010 Congressional Report, p.66
	Achieve financial audit readiness	FIAR Guidance, p.i
	Eliminate material weaknesses	DoD AFR
	Achieve unqualified audit opinion	FIAR Guidance
Internal Processes	Improve management of Enterprise Resource Planning (ERP) systems	GAO-11-53
	Develop plan to conduct audits for military intelligence programs	GAO-10-1059T, p.6
	Develop asset valuation methods for military-specific items	GAO-10-1059T, p.13
	Improve relationship with auditors	N/A
	Improve processes, controls, and supporting information that is most often used to manage the department	OMB Circular A-123/FIAR Guidance, p.3
Employee Learning & Growth	Champion a strong Financial Management workforce	FY2010 Congressional Report, p.66
	Train FIAR executors in FIAR Plan	N/A
	Examine cost and benefits of alternative approaches to value DoD assets	GAO-11-363T. P.7
	Provide training for ERP/BEA/ETP	N/A
	Improve defining responsibility requirements for CMOs and DCMOs	GAO-11-181R, p.3
Resource Management	Acquire and make use of needed resources	FY2010 Congressional Report, p.66
	Lower administrative costs	FY2010 Congressional Report, p. 63
	Maximize resource efficiency	N/A
	Obtain resources to support financial improvement initiatives	GAO-10-1059T, p.10
	Increase cost avoidance	FY2010 Congressional Report, p. 46

Table 11. Potential strategic objectives for Strategy Map.

Eleven objectives were chosen to develop the Strategy Map. Objectives selected were based on 1) the existing need for the objective relative to other objectives, 2) the magnitude of risk posed to the department, and 3) alignment to the mission,

strategy, values and vision of the FIAR Plan. Objective quantity selected was based on 1) having at least one per perspective and 2) how many would be enough to meet the requirement to answer the research questions. With the scope of the thesis, the number of objectives chosen should be sufficient to show the effectiveness of the scorecard, yet few enough to keep it simple. Each objective is given a code, which is used for the Strategy Map, for organization, and is categorized into one of the two strategic goals,. Table 12 shows the list of objectives chosen, including the source document for the need of the objective.

Perspective	Code	Objective	Source
Customer	CO1	Achieve financial audit readiness	FIAR Guidance, p.i
	CO2	Eliminate material weaknesses	DoD AFR
Internal Processes	PO1	Develop asset valuation methods for military-specific items	GAO-10-1059T, p.13
	PO2	Improve relationship with auditors	N/A
	PO3	Improve processes, controls, and supporting information that is most often used to manage the department	OMB Circular A-123/FIAR Guidance, p.3
	PO4	Improve management of Enterprise Resource Planning (ERP) systems	GAO-11-53
Employee Learning & Growth	EO1	Train FIAR executors in FIAR Plan	N/A
	EO2	Provide training for ERP/BEA/ETP	N/A
	EO3	Improve defining responsibility requirements for CMOs and DCMOs	GAO-11-181R, p.3
Resource Management	RO1	Obtain resources to support financial improvement initiatives	GAO-10-1059T, p.10
	RO2	Increase cost avoidance	FY2010 Congressional Report, p. 46

Table 12. Objectives developed for the Strategy Map.

Four perspectives are used to represent the FIAR Plan. The names of the first three perspectives—customer, internal processes and employee learning and growth—remain original from the standard Balanced Scorecard. The fourth perspective—financial perspective—is changed to “resource management” perspective to show that both human and financial resources should be considered to determine the resources needed for the FIAR Strategy. Figure 13 shows the Strategy Map created.

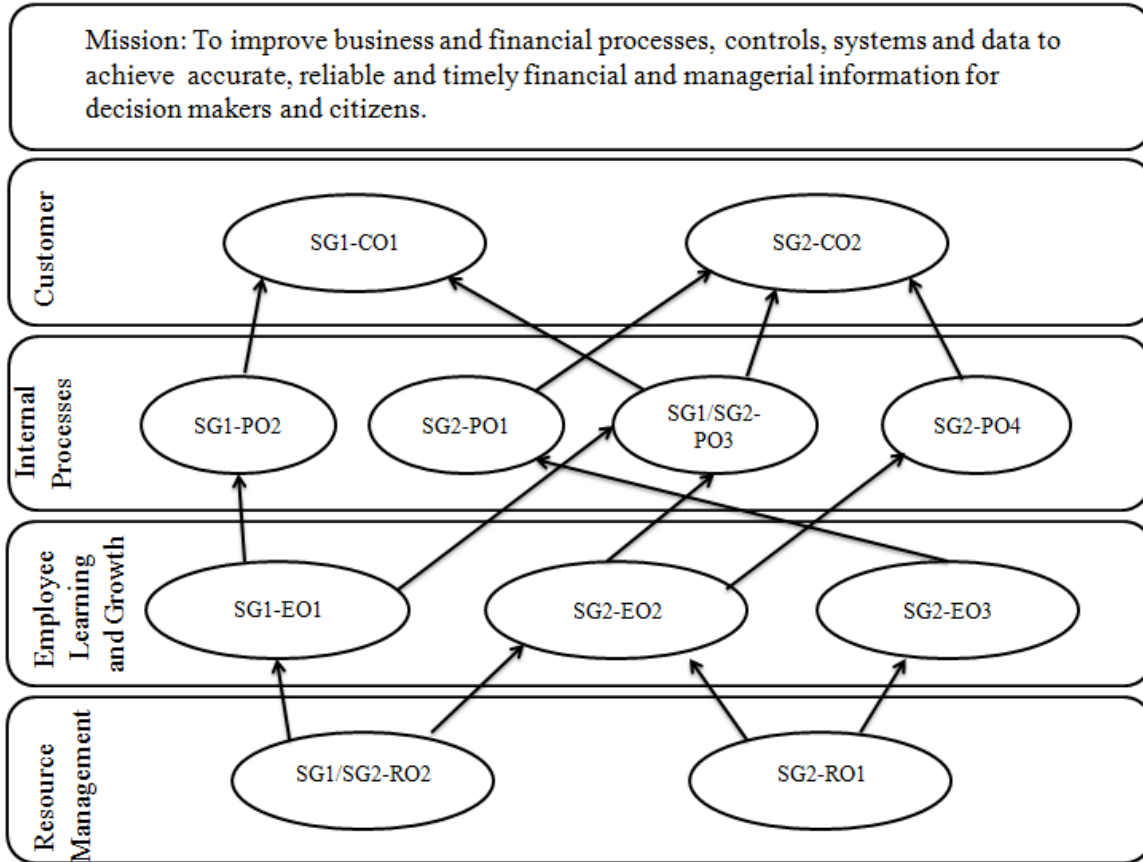


Figure 13. The Strategy Map using Niven’s methodology (After Niven, 2008, pp.150–205).

The rationale in developing the Strategy Map was to focus on the pathway of the two FIAR strategic goals. These pathways are described in the following paragraphs. The arrows on Figure 13 assist in the logic flow.

Strategic Goal 1 (SG1): Achieve and Sustain Audit Readiness Path

The flow of achieving and sustaining an audit readiness path begins at the resource management perspective and ends at the customer perspective. The path begins at “increase cost avoidance” (RO2), the objective that focuses on efficiency methods. Through freeing up resources by avoiding costly business practices, more financial resources can be used to fund “training the FIAR executors” (EO1). As the FIAR executors become more knowledgeable in the FIAR Plan, they may “improve the

processes, controls and supporting information needed to manage the department” (PO3) and be able to “establish a good relationship with the auditors” (PO2) to further the understand requirements for audit readiness. Focusing on these objectives should improve the chances to “achieve financial audit readiness” (CO1).

Strategic Goal 2 (SG2): Achieve and Sustain Unqualified Assurance on the Effectiveness of Internal Controls Path

Similar to the first strategic goal, the path starts at the resource management perspective. By “increasing cost avoidance” (RO2) and “obtaining resources to support financial improvement initiatives,” (RO1) the department can focus efforts to accumulate enough resources needed to achieve the remaining objectives. Furthermore, the pathway to achieving a more effective internal control organization is to focus efforts on boosting employee knowledge by “training them on the Business Enterprise Architecture, the Enterprise Resource Planning systems and the Enterprise Transition Plan.” (EO2) Employee training, coupled with further “defining the roles and responsibilities of the CMOs and DCMOs in the organization,” (EO3) can not only “improve the processes, controls, and supporting information that is most often used to manage the department” (PO3), but also “improve management of the ERP systems” (PO4). Focusing effort on process (PO3) and management (PO4) improvements, along with “developing asset valuation methods for military-specific items” (PO1) should help in “eliminating material weaknesses” (CO2). As a large factor in preventing an unqualified assurance on the department’s effectiveness on internal controls, material weakness should be a focus in the DoD.

d. Develop Performance Measures

In performance measure (PM) development, the goal is to determine the best measures for the Strategy Map objectives. Table 13 shows three potential measures to represent each objective (represented by a code). Each measure is also categorized by PM type and whether it is a leading or lagging indicator. The intent was to have a balanced amount of input, output, and outcome PM types to have both activity-based

measures (represented by inputs and outputs) and result-based measures (represented by outcomes). (Niven, 2008, p.211) The intent was also to have a balanced amount of lead and lag indicators to keep the right mix of driving and historical measures, respectively (Niven, 2008, pp.213–214). The measures chosen to represent the objectives are in bold font.

Objective Code	PM Type/ Indicator	Measure 1	Measure 2	Measure 3
CO1	Outcome/ Lag	% of financial statements audit ready	% of waves completed	# of statements completed
CO2	Outcome/ Lag	# of material weaknesses reported on AFR	# of financial statement line items validated	# of financial statements audit-ready
PO1	Input/ Lead	\$ saved from asset valuation	# of methods developed	ROI (eg \$ saved/hours spent in effort)
PO2	Input/ Lead	Hours spent with auditors	# of auditor assists scheduled	# of auditor seminars scheduled
PO3	Input/ Lead	% in compliance with ICOFR	% in compliance with SMP measures	# of processes/internal controls improved
PO4	Input/ Lead	# of months of slippage	# of GAO recommendations implemented	# of ERPs online
EO1	Output/ Lag	People trained	Courses taken per person	# of FIAR tests passed
EO2	Output/ Lag	People trained	Courses taken per person	# of ERP/BEA/ETP tests passed
EO3	Output/ Lead	CMO/DCMO hours committed to role	# of problems resolved	\$ saved from problems resolved
RO1	Input/ Lag	\$ available for financial improvement	\$ de-obligated for financial improvement	# of personnel devoted to financial improvement
RO2	Input/ Lag	\$ in LCCE reduced	# of months early ERP systems online	# of legacy systems replaced

Table 13. Balanced Scorecard measures developed using the Strategy Map developed in Figure 13.

For practical purposes, the rationale in choosing the each of the performance measures is described after the development of the initiatives.

e. Establish Targets and Prioritize Initiatives

This step defines the targets that signify when an objective is met. The chosen performance measures, shown in Table 14, are coded and given a target, taking into consideration the 30 September 2017 deadline and the background publications.

Objective Code	PM Type/ Indicator	Chosen Measure	PM Code	Target
CO1	Outcome/ Lag	% of financial statements audit ready	PM1	25% /yr
CO2	Outcome/ Lag	# of material weaknesses reported on AFR	PM2	0
PO1	Input/ Lead	# of methods developed	PM3	≥1
PO2	Input/ Lead	# of auditor assists scheduled	PM4	≥1 /yr
PO3	Input/ Lead	% in compliance with SMP measures	PM5	25% /yr
PO4	Input/ Lead	# of months of slippage	PM6	0
PO4	Input/ Lead	# of GAO recommendations implemented	PM7	14
EO1	Output/ Lag	People trained	PM8	100%
EO2	Output/ Lag	People trained	PM8	100%
EO3	Output/ Lead	# of problems resolved	PM9	≥1 /yr
EO3	Output/ Lead	\$ saved from problems resolved	PM10	1% Budget Authority /yr
RO1	Input/ Lag	\$ available for financial improvement	PM11	100% in FIAR PSR
RO2	Input/ Lag	# of months early ERP systems online	PM12	1
RO2	Input/ Lag	# of legacy systems replaced	PM13	500

Table 14. Performance measures chosen with coding and targets.

After target development, six initiative recommendations are listed in Table 15. Of the six initiative recommendations, the first initiative listed, “continue the

five-wave process and FIAR methodology,” is an existing initiative. The other six recommendations strive to create new entities or enhance current efforts. The initiatives are given codes to facilitate Balance Scorecard development.

Objective Code	PM Code	Target	Initiative Recommended	Initiative Code
CO1	PM1	25% /yr	Continue 5-wave process and FIAR methodology	I1
CO2	PM2	0	Continue 5-wave process and FIAR methodology	I1
PO1	PM3	≥1	Create audit tracking office	I2
PO2	PM4	≥1 /yr	Create audit tracking office	I2
PO3	PM5	25% /yr	Continue 5-wave process and FIAR methodology/ Create audit tracking office	I1-I2
PO4	PM6	0	Create FIAR IT Program Office	I3
PO4	PM7	14	Create FIAR IT Program Office	I3
EO1	PM8	100%	Create training office	I4
EO2	PM8	100%	Create training office	I4-I3
EO3	PM9	≥1 /yr	Enhance CMO personnel	I5
EO3	PM10	1% Budget Authority /yr	Enhance CMO personnel	I5
RO1	PM11	100% in FIAR PSR	Create FIAR Comptroller	I6
RO2	PM12	1	Create FIAR IT Program Office	I3
RO2	PM13	500	Create FIAR IT Program Office	I3

Table 15. Proposed initiatives developed from the objectives, performance measures and targets.

Developing the FIAR Balanced Scorecard: From the Strategy Map to Initiatives

The rationale for developing the FIAR Strategy Balanced Scorecard can best be described starting from the mission, values, vision and strategy and ending with the initiatives developed. The mission statement, “to improve business and financial processes, controls, systems and data to achieve accurate, reliable and timely financial and managerial information for decision makers and citizens,” is essentially two objectives. The first part of the mission is incorporated into the scorecard through an internal process objective (PO3) and the second can be achieved by accomplishing the two customer perspective objectives (CO1 and CO2).

The DoD core values—*leadership, professionalism and technical know-how*—should be adhered to throughout the FIAR execution. However, these core values are assimilated into the scorecard through EO3, PO2, and EO2 objectives, respectively.

The vision, “for the DoD to achieve and sustain both audit readiness and assurance on the effectiveness of internal controls no later than 30 September 2017,” is integrated into the scorecard through the use of the strategic goals (SG1 and SG2), and guides the objective choices in the Strategy Map. Additionally, the author took into consideration the FY 2017 goal date when developing the “per year” targets.

The FIAR strategy is still the focal point of the Balanced Scorecard. Each objective, measure, and initiative chosen is congruent with the strategy. Rather, they all surround and enhance the focus of FIAR strategy efforts. This should be evident in the following paragraphs.

The description of the chosen measures, targets and initiatives is described along with their objectives. Categorized by perspective, the descriptions start with the resource management perspective and end with the customer perspective.

Resource Management Perspective

The first objective, “obtain the resources to support financial improvement initiatives” (RO1), is measured by the “dollars available for financial improvement” (PM11). The target, “100% in the FIAR PSR,” refers to Appendix 4 of the November

2010 FIAR Plan Status Report (DoD, 2010d). The DoD, along with the Defense Logistics Agency (DLA) and the Navy, Army, and Air Force components, have provided funding amounts from FY 2010 to FY 2015 (DoD, 2010d). These funding amounts provide the resources necessary to fund audit readiness, audit/validation, and financial systems (such as ERPs) (DoD, 2010d, p.12). By developing a performance measure, the priority to keep track of the resources and ensure the resources are available is elevated.

To achieve the first objective, a “FIAR Comptroller position initiative” (I6) is recommended. In the FIAR Guidance (2010b), there is no explicit description of personnel who manage the resources that fund the FIAR effort. Although it states that the Chief Management Officers and Deputy CMOs “marshal” resources across the Department in support of financial improvement efforts (DoD, 2010b, p.11), a position within the FIAR Governance should be specifically defined to manage the FIAR resources. This position should be able to oversee the FIAR funding and also provide the ability needed to transfer or reprogram resources to the FIAR effort.

The second resource management objective, “increase cost avoidance” (RO2), is given two performance measures. The PMs, “the number of months early that the ERP systems are online” (PM12) and the “number of legacy systems replaced” (PM13), are given targets of “one month” and “nine systems,” respectively. First, the objective “increase cost avoidance” is used because it looks at resources through a different perspective. That is, through an opportunity cost. Resources that may have been used somewhere else were freed up through good decisions. The example that triggered this to be an objective was in the March 2010 Congressional Report on Defense Business Operations (2010f, p.46) that stated the benefit of implementing the Navy ERP will produce a cost avoidance of \$536 million from FY 2010–FY 2015. The one-month target of achieving PM12 tries to set a standard. The motive in choosing one month is because, according to an October 2010 GAO report, six of nine ERPs have had schedule slippages, comparing dates of when an ERP should be fully deployed to the revised deployment date (GAO, 2010b, pp.16–17). Achieving any date earlier than the projected date would be considered an ideal target. The second target, having to replace 500 legacy systems,

refers to an October 2010 GAO report that states that nine ERPs are scheduled to replace over 500 legacy business systems (GAO, 2011a, summary page). The benefit of achieving the objective is to speed up ERP implementation, bringing the department closer to achieving audit readiness.

The initiative recommended to increase cost avoidance is to “create a FIAR Information Technology (IT) program office” (I3). This program office would be a repository for all things ERP related with respect to FIAR efforts. By creating this program office, subject matter experts could pool their knowledge to better synchronize ERP implementation with the FIAR Strategy. This FIAR IT program office would also help address the 14 GAO recommendations related to business system modernization requiring action (GAO, 2011a).

Employee Learning and Growth (EL&G) Perspective

The first objective, “train FIAR executors about the FIAR Plan” (EO1), uses a PM labeled “people trained” (PM8) with a target of 100 percent. For all personnel involved in the FIAR, it is important to understand the reason for the FIAR efforts, especially their role in the process. Fortunately, professional development courses, introduced in Appendix 5 of the November 2010 FIAR PSR, are available.

The second objective, “provide training on the Enterprise Resource Planning system, the Business Enterprise Architecture, and the Enterprise Training Plan” (EO2), uses the same PM and target as the first objective (PM8 and 100 percent, respectively). Similar in purpose to the first EL&G objective, all personnel involved in the FIAR effort should also have a basic understanding of how the ERP, BEA, and ETP relate to the FIAR.

The initiative recommended to facilitate the first two EL&G objectives is to “create a training office” (I4). Having a training office would formalize the process of developing DoD employees. Providing training incentives, such as certificates of achievement or certifications, can promote morale in the department, as well as hold

personnel accountable for actions related to the FIAR. For EO2, the FIAR IT program office initiative (I3) can combine efforts with the training office to teach personnel on the ERP/BEA/ETP.

The third EL&G objective, “improve defining responsibility requirements for CMOs and DCMOs” (EO3), is chosen in response to the October 2010 GAO report that states a need for DoD to define specific roles and responsibilities for the CMOs and military department CMOs (GAO, 2010b, pp.13–14). Two performance measures are introduced to gauge the progress of the objective. The first PM, “number of problems resolved” (PM9), and the second PM, “dollars saved from problems resolved” (PM10), are given the targets of “greater than one per year” and “one percent of budget authority per year,” respectively. These measures and targets are chosen in response to the voids that GAO points out in their report (GAO, 2010b, p.14). The targets may seem impractical or irrelevant to those who do perform the effort, but logical units (problems solved per given time and percentage of money responsible for) are provided.

The initiative recommended to achieve EO3 is to “enhance CMO personnel” (I5). This initiative includes either adding more personnel to the CMO and military CMO staff or redirecting more effort to the CMO role. As most of the CMOs have other roles and responsibilities to fulfill, devoting their time to FIAR governance may be challenging. According to the October 2010 GAO report, “sustained and active involvement of the CMOs and other senior leaders is critical in enabling a process that DOD can more timely identify and address cross-functional issues and ensure that other business functions, such as acquisition and logistics, fully acknowledge and are held accountable for their roles and responsibilities in achieving the department’s financial management improvement goals and audit readiness.” (GAO, 2010b, p.14)

Internal Processes (IP) Perspective

The first IP objective is to “develop asset valuation methods for military-specific items” (PO1). The PM and target are the “number of methods developed” (PM3) and “greater than or equal to one,” respectively. There are two reasons for choosing PO1. First, the October 2010 GAO report states that it is “willing to work with the department

to revisit the question of how DoD reports assets in its financial statements to address unique aspects of military assets not currently reflected in traditional financial reporting models.” (GAO, 2010b, p.13) Second, Wave five of the current FIAR strategy focuses on valuation of legacy assets (DoD, 2010b, p.iii). The PM and target were chosen because at least one method should be developed to value military-specific items.

The second IP objective is to “improve relationship with auditors” (PO2). The PM and target for the objective are the “number of auditor assists scheduled” (PM4) and “greater than or equal to one per year,” respectively. The objective was chosen to understand and establish rapport with the auditor. Since auditors are the evaluators of the FIAR efforts, the executors must embrace the way auditors think. According to Kristek (2008), auditors are a management tool that should be used (p.35). The PM and target were chosen to signify that at least one attempt to have an auditor assist in the FIAR effort should be conducted for consistency.

The third IP objective is to “improve processes, controls, and supporting information that are most often used to manage the department” (PO3). The PM and target chosen for the objective are as a “percent in compliance with SMP measures” (PM5) and “25 percent a year,” respectively. This objective represents half of the mission statement and, when achieved, significantly improves the DoD’s compliance with the ICOFR process as defined in OMB Circular A-123. The measure can further be divided into the SMP measures shown in Figure 3. The target of achieving 25 percent in compliance with SMP measures per year seems realistic given the timeframe between now and the end of FY 2017.

The fourth IP objective is to “improve management of ERP systems” (PO4). Two performance measures and hence two targets were chosen to gauge this objective. The first PM for this objective is the “number of months of slippage” (PM6) and the target for the PM is “zero.” The second PM is the “number of GAO recommendations implemented” (PM7) and the target is “14 recommendations.” The objective was chosen as a response to the GAO report on DoD Business Transformation (GAO-11-53) that states 19 recommendations were given by GAO to DoD, five that were

addressed, and 14 not yet fully implemented (GAO, 2011a, summary page). Furthermore, six of the nine ERPs yet to be implemented have had schedule delays ranging from two to twelve years, and five ERPs have incurred cost increases from \$530 million to \$2.4 billion (GAO, 2011a, summary page). Both PMs and their targets are chosen to address the management issues related to the ERP systems.

Three initiatives address helping achieve the four internal processes objectives. For the first three IP objectives (PO1, PO2 and PO3), the initiative recommended is to “create an audit tracking office” (I2) that would be used to manage the audit efforts. These audit efforts would consist of monitoring compliance with current guidelines (e.g., OMB Circular A-123) as well as liaising with outside entities where networking is crucial (e.g., auditors and GAO). The second initiative described earlier, to “create a FIAR IT program office,” can assist in managing the ERP systems (PO4). The third initiative is not really new. Rather, it is a continuation of executing the current FIAR strategy by “performing the five-wave process and FIAR methodology.” This initiative would enhance achievement of objective PO3.

Customer Perspective

The first customer objective is to “achieve financial audit readiness” (CO1). The PM and target for this objective are “percent of financial statements audit ready” (PM1) and “25 percent per year,” respectively. The objective, which focuses the DoD’s effort to comply with the CFO Act and provide audit ready financial statements, was chosen with the taxpayer and Congress in mind. A target of 25 percent of financial statements audit ready per year seems practical because of the time available between now and the FY 2017 deadline.

The second customer objective is to “eliminate material weaknesses” (CO2). The PM and target for eliminating material weaknesses are “number of material weaknesses reported on AFR” (PM2) and “zero,” respectively. This objective was chosen with the warfighter in mind. The warfighter deserves greater DoD support to perform his or her mission by eliminating material weaknesses. The fewer the material weaknesses present in the department, the lower the risk of fraud, waste, abuse, and mismanagement

(GAO, 2010b, p.23). Thus, fewer material weaknesses translates to better management of resources and ultimately more resources available to the warfighter. Having a target of zero material weaknesses seems challenging, as evidenced by the number of material weaknesses present in the DoD's Agency Financial Reports. However, the elimination of material weaknesses has to be achieved in order to improve FIAR efforts.

For these two customer objectives, the initiative recommended is to "continue the 5-wave process and FIAR methodology" (I1). The GAO reported in October 2010 that the revised FIAR strategy represents a reasonable approach to date (DoD, 2010b, p.12). This seems the most practical way with the amount of work already invested.

D. THE DELIVERABLE: THE FIAR BALANCED SCORECARD

With the description of how the Balanced Scorecard was created, the elements above are combined into the final product: the FIAR Strategy Balanced Scorecard, shown in Figure 14. Analysis is provided in the next section.

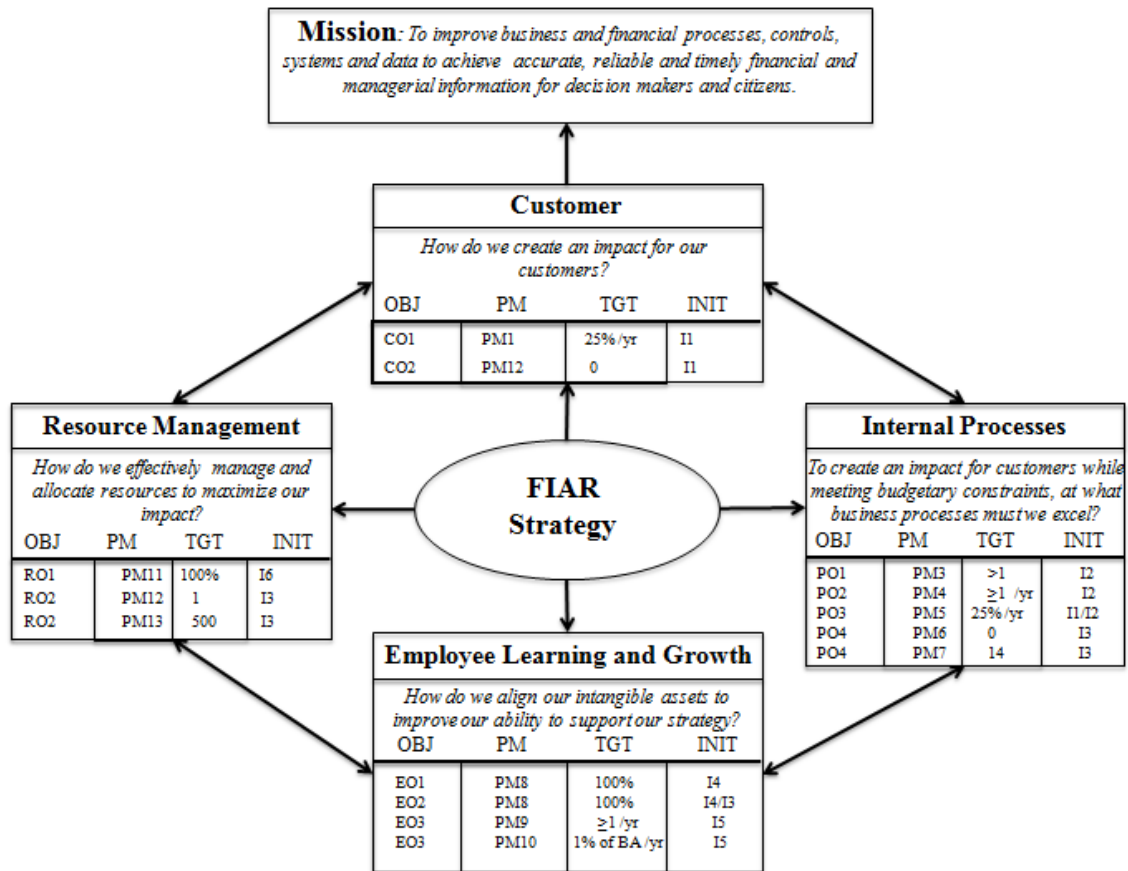


Figure 14. The completed FIAR Strategy Balanced Scorecard.

E. FIAR STRATEGY ANALYSIS

With the Balanced Scorecard and Strategy Map developed, the next step is to analyze how the Balanced Scorecard compares to real world execution. Niven's methodology in developing the FIAR Balanced Scorecard was used prior to the publishing of the most recent FIAR Plan Status Report in mid-May 2011. The May 2011 FIAR PSR is now available and indicates the following:

- Response to objective PO1 (Develop asset valuation methods for military-specific items): the DoD conducted a business case analysis to determine the cost-benefit on achieving auditable Balance Sheet asset values. The DoD determined that the cost of obtaining legacy asset valuation was expensive compared to the value the information provided to DoD

decision makers (DoD, 2011b, p.3). Furthermore, the DoD, working with OMB, will ask FASAB to modify accounting standards to allow the expensing of military equipment acquisition costs and require military equipment quantity reporting in the Required Supplementary Information (RSI) of the DoD financial statements (DoD, 2011b, p.3). This action would fulfill meeting the objective of PO1.

- Response to objective RO2 (Increase cost avoidance): The Army completed employing its Logistics Modernization Program (ERP) in Quarter 1 of FY 2011, three months earlier than planned (DoD, 2011b, p.I-7). This action would fulfill the Army component's objective RO2.
- Response to PO4 (Improve management of ERP systems): in page I-7 to I-8, the need for improvement for implementing management systems is apparent, as evidenced by components shifting milestones to later dates (DoD, 2011b, p.I16).
- Response to EO1 (Train FIAR executors in FIAR Plan): The May 2011 FIAR PSR describes the different forums that communicate the FIAR (DoD, 2011b, p.I-16). Additionally, efforts have been attempted to train the FIAR executors by estimating 650 people will have taken courses by approximately July 2011 (DoD, 2011b, p.I-17). Attempts to further teach FIAR to the service academies and Naval Postgraduate School are in the planning stages (DoD, 2011b, p.I-38).
- Of the eleven objectives addressed in the FIAR Balanced Scorecard, at least four were addressed in the May 2011 FIAR Plan Status Report. A fifth objective, PO3 (improve processes, controls, and supporting information that are most often used to manage the department) could also be measured to show the percentage of compliance of SMP measures. (DoD, 2011b, p.III-3)

- Also, the Department of the Navy’s SBR strategy includes a tenet that “establishes an audit support infrastructure” (DoD, 2011b, p.III-3) whose purpose provides functions similar to the proposed initiative of “creating an audit tracking office” (I2).

F. CHAPTER SUMMARY

This chapter developed a Balanced Scorecard for the FIAR strategy using Niven’s methodology applied to a nonprofit or government agency. The methodology consists of two phases—a planning phase and a development phase. Both phases were followed to rationally consider factors needed to develop the Strategy Map and Balanced Scorecard. The deliverables produced—the Strategy Map and Balanced Scorecard—were used to analyze the FIAR by comparing the Balanced Scorecard to the May 2011 FIAR PSR and provide the information needed to answer the research questions in the next chapter.

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VI. RESULTS, RECOMMENDATIONS AND CONCLUSIONS

This chapter answers the primary and secondary research questions using the analysis provided in Chapter V, provides recommendations to DoD leadership, provides recommendations for future studies, and concludes the thesis.

A. ANSWERING THE RESEARCH QUESTIONS

The following research questions are answered:

1. Can a Balanced Scorecard Be Used as an Effective Strategic Management Tool for DoD Organizations to Complement the FIAR to Achieve Audit Readiness?

Yes. First, Niven's methodology provides a step-by-step approach to analyze the FIAR strategy and could be applied to any level of the DoD organization. Using available online references and publications, the author created a Strategy Map and Balanced Scorecard that contain objectives, performance measures, targets and initiatives developed to enhance FIAR strategy execution. Second, during the FIAR analysis and SMP analysis, there were striking similarities between both DoD plans and the Balanced Scorecard elements. For instance, the SMP, which derives its objectives and goals from the QDR, lists its objectives, performance measures, and initiatives and links these with the QDR's goals and objectives. Third, through cascading the scorecard, the Balanced Scorecard can seamlessly be used from the SMP and applied at the DoD level using the Niven methodology. The versatility of the Balanced Scorecard allows other plans such as the Enterprise Transition Plan to integrate with FIAR efforts by using a methodology that nurtures thought when translating to different organizational levels.

2. Can the Balanced Scorecard Also Be an Effective Strategic Management Tool at the Service Component Level When Used With the FIAR?

The Balanced Scorecard can be an effective strategic management tool at the service component level when executing the FIAR. Following Niven's methodology to

develop the Balanced Scorecard, service components can combine current FIPs with existing mission statements, values, visions and strategies. This combined information, coupled with the FIAR Plan's cascaded objectives, measures and initiatives, should provide the ingredients necessary for a comprehensive Balanced Scorecard. Using the Department of the Navy (DON) as an example, the DON currently has its plan in achieving audit readiness. Aligning with the DoD's five-wave FIAR strategy, the DON currently focuses its efforts on its SBR audit readiness plan to achieve the FIAR Wave 2 requirements (DoD, 2011b, p.III-9). The mission statement found on the Assistant Secretary of the Navy (Financial Management & Comptroller) website (<http://www.finance.hq.navy.mil/FMC/PDF/FMCmissionstatement.pdf>), the Navy core values of honor, courage and commitment, and the vision of achieving a combined Navy-Marine Corps audit-ready SBR assertion by 31 December 2012 (DoD, 2011b, p.III-2) could all be combined to develop the DON Balanced Scorecard. This information could then be used to create the objectives, performance measures and initiatives needed to assert audit readiness for the DON SBR. The DON could further refine the objectives using the lessons learned from the Marine Corps' FY 2010 SBR audit (DoD, 2011b, p. III-2). Additionally, DFAS—one of the DON's service providers—may be able to assist in developing the Balanced Scorecard and provide its lessons learned as it has used the scorecard since 2001 (<http://www.dfas.mil/dfas/pressroom.html>).

3. What Challenges Could Hinder Balanced Scorecard Success?

A few challenges could hinder Balanced Scorecard implementation from being successful. First, full executive support must be available to communicate the plan to use the Balanced Scorecard. If the executive support “sells” the use of the scorecard as an alternative analysis of the FIAR instead of a replacement for it, the executors of the FIAR strategy may be more inclined to embrace the Balanced Scorecard. This idea of an enhancement to the FIAR strategy rather than a replacement for the strategy must be clear, as the idea of changing the FIAR strategy direction continually may cause reluctance to embracing the strategy altogether. Second, a Balanced Scorecard must be kept alive in order to be effective. Meeting agendas pertaining to strategy must be

centered on the Balanced Scorecard. Training of the FIAR Plan and the Balanced Scorecard’s role within the FIAR Plan must be continuous and up to date. Third, adequate human and financial resources must be available to ensure support of the Balanced Scorecard initiative. Lastly, the Balanced Scorecard helps to develop a plan to execute strategy. A well-developed plan provides no value if the plan is not executed.

B. RECOMMENDATIONS

By developing the FIAR Strategic Map and Balanced Scorecard and analyzing the FIAR Strategy, several recommendations may prove useful for DoD leadership that are not in the FIAR Guidance. Here are the recommendations:

The first recommendation is to develop a Balanced Scorecard for the FIAR strategy. Looking at the reporting entities who received an unqualified opinion for their financial statements in FY 2010 in Table 16, 50 percent have an accessible Balanced Scorecard in their website (DoD, 2011b, p.5). The Defense Contract Audit Agency does not have a published Balanced Scorecard but does have a strategic plan with goals, strategies and objectives (<http://www.dcaa.mil/>). The presence of a Balanced Scorecard or scorecard-like characteristics may suggest a correlation between achieving unqualified audit opinions and utilizing the scorecard.

FY2010 Unqualified Audit Opinions	Existing Balanced Scorecard?
U.S. Army Corps of Engineers-Civil Works	Yes
Defense Contract Audit Agency	
Defense Commissary Agency	Yes
Defense Finance and Accounting Service	Yes
Office of the Inspector General	
Military Retirement Fund	

Table 16. Reporting entities receiving unqualified audit opinions in FY 2010 (From DoD, 2011b, p.5).

The second recommendation is to consider the initiatives mentioned in the Balanced Scorecard development process. These initiatives were created using a logical process, and were based on the author’s perspective. The logic flow can be found in Chapter V. Here are the recommended initiatives:

- Creation of an audit-tracking office
- Creation of a FIAR Information Technology (IT) program office
- Creation of a training office within the FIAR Governance
- Enhance the Chief Management Officer staff
- Create a FIAR Comptroller

The third recommendation is to determine how to cascade the current FIAR Plan into levels below the component executive level. Current FIAR strategy used the FIPs to make the strategy, but after the component executive level, a definitive method for cascading down to the lowest functional level was not evident. The FIAR Guidance only provides FIP templates for standardization amongst all components.

The fourth recommendation is to consider modifying the FIAR mission statement. Although the current mission statement provides two important objectives related to the FIAR strategy, it lacks a mission statement and a list of core functions. The recommendation for a more complete mission statement is:

The OUSD(C) mission is to oversee the financial management activities relating to CFO programs and operations of the DoD and manage the budgets, appropriations and expenditures which support the nation's warfighters, two wars and other worldwide operations. Furthermore, the OUSD(C) strives to improve business processes and financial systems and to produce accurate, reliable and timely financial and managerial information for decision makers and citizens.

C. RECOMMENDATIONS FOR FURTHER STUDIES

Studies may be derived from this thesis to further understand the role of the Balanced Scorecard in executing the FIAR strategy. Each of these studies is described below.

A study may be performed that examines executive support in implementing the FIAR. This would require interviewing different levels of management to determine where the commitment or lack of commitment is in executing the FIAR strategy.

Another study may look into where, within the DoD, the Balanced Scorecard is being used, what can be learned from those who use it, and how it has changed the strategy execution for those who have used it.

D. THESIS CONCLUSION

This thesis has looked into implementing the Balanced Scorecard in order to help execute the FIAR strategy. Through a comprehensive literature review, a Strategy Map and Balanced Scorecard were developed to understand how the Balanced Scorecard could assist in executing the FIAR strategy.

This thesis introduced an alternative tool to execute the FIAR strategy. By pooling the knowledge of the appropriate people within the DoD, a collaborative effort to develop a sound Strategy Map and Balanced Scorecard would prove useful when trying to execute the FIAR strategy.

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