

# Breaking the cycle of failed audits

at the DoW



## A bold, pragmatic, and tenacious approach is required to achieve clean audit opinions by FY28

A sense of urgency is mounting over the inability of multiple entities within the US Department of War (DoW) to receive clean audit opinions as time is running out to meet the fiscal year 2028 (FY28) deadline.

Accountability and fiscal responsibility are certainly important goals—and a priority for the American public, Congressional leaders, and the Executive branch, including the President and Secretary of War. More concerning, however, are the implications of these audit failures for the warfighter. Every dollar not going directly to improve warfighter readiness or effectiveness—or worse, every dollar that works against it—can threaten the DoW's mission.



While a clean audit is the goal, it's really a by-product of effective financial processes and controls. It's evidence of an organization that's able to identify, prioritize, and maximize resources that directly support the warfighter and strengthen our military by matching threats to capabilities.

There are no shortcuts or accounting tricks to financial operational excellence. But there are proven approaches, methodologies, and technology accelerators that can help the DoW complete the transformation needed to operate with the speed and agility required of today's military, to address today's security threats, improve efficiency and transparency, provide more timely, accurate, and reliable financial intelligence—and break the cycle of failed audits.

## **Understanding the challenges**

The DoW Inspector General has cited outdated financial management systems, inadequate controls over financial data and accounting records, and a shortage of skilled personnel as the main impediments to achieving clean audit opinions.<sup>1</sup> Let's take a quick look at each of these:

#### Outdated financial data management systems

In our work at the DoW and other government agencies, it's not unusual to find organizations that still rely on accounting, enterprise resource planning (ERP), or financial planning and analysis (FP&A) systems that are 15, 20, or even 30 or more years old. Data is scattered and siloed, often the result of siloed operations across functional domains. We often see improvised customizations or addons and multiple manual processes designed to keep these aging systems—and the finance operations that rely on them—functioning. If there are more modern solutions, we often find overly customized implementations with dependencies on vendors incentivized to continue the status quo.

## Inadequate controls over financial data and accounting records

It's not only the technologies that have aged, but also the business practices and governance policies and controls surrounding them. In many cases, auditors have to perform additional workarounds to review, monitor, and audit data from ERP systems because they can't rely on the data coming out of them given the organization's outdated business processes or technology-based controls. This ineffectiveness is often rooted in organizational silos and a lack of clear messaging guiding the organization.

#### **Shortage of skilled workers**

People with the IT skills to maintain legacy, on-premise systems are becoming increasingly scarce. But so, too, is the pool of available workers who understand—and who are willing to perform—the finance and accounting tasks that rely on legacy technologies and processes. Attracting and retaining top-tier talent can be challenging when they lack access to the tools and methods they consider essential for performing their jobs and advancing their careers. Budgetary and headcount constraints only compound the challenge of filling these roles. DoW organizations have yet to embrace the managed services model or Finance-asa-Service (FaaS), which can provide costeffective and sustainable options to address talent shortages.

Aging technologies and processes and the lack of skilled workers aren't just impediments to a clean audit; they can result in expensive inefficiencies and a lack of transparency that together can hamper agility, create waste, and leave organizations vulnerable to fraud and cyberattacks. Unaddressed vulnerabilities and the inability to detect anomalies in real time can have catastrophic consequences—especially in the DoW.



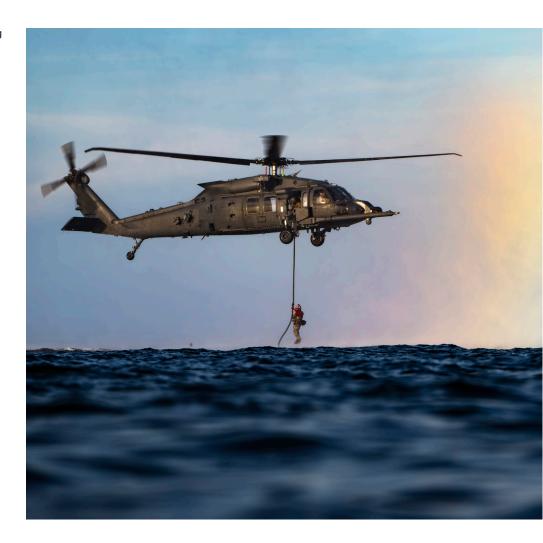
<sup>1. &</sup>quot;Pentagon fails 7th audit in a row eyes passing grade by 2028," Ashley Roque, Breaking Defense, November 15, 2024.

### **Finance transformation**

With these impediments in mind, it's clear that the inability of DoW agencies and military departments (MILDEPS) to obtain a clean opinion is just one symptom of a much larger systemic affliction involving technologies, processes, governance, controls, people, and culture. Treating the symptom without treating the root cause—even if successful in the short run—is inevitably unsustainable. This is where finance transformation becomes not just relevant, but essential.

Finance transformation is designed to bring the finance function into today's world. It's enabled by powerful, modern, and leading technologies and practices that are designed to reduce or eliminate vulnerable and error-prone manual processes and to process and validate all data and transactions according to pre-defined, industry-standard rules and exception criteria. It can help you apply security and governance policies and procedures consistently and reliably, minimize human error, and maintain compliance with a wide range of regulatory requirements—including auditability.

It's also designed to increase the value finance brings to the table, elevating finance's visibility and responsibilities from discipline-specific expertise to a key component of an organization's strategic leadership by providing more timely and trustworthy financial intelligence to improve overall organizational decision-making and effectiveness.



## Can it be done?

Given the size of the DoW—and even the size of individual entities within it it's clear that finance transformation isn't a simple endeavor. Anyone naively assuming the DoW can be treated like any other Federal agency is in for quite a surprise. Its physical assets—which are scattered across the globe comprise almost 68 percent of the Federal government's physical assets.<sup>2</sup>

The most recent DoW audit examined \$4.1 trillion in assets and \$4.3 trillion in liabilities.3 and the DoW budget is larger than that of the next 10 countries combined.4 This begs the question: Is it even possible for DoW entities to make the transformation necessary to obtain and sustain clean audit opinions by FY27 or FY28?

The answer is a resounding "yes." Our recent success working with two DoW entities that received clean audit opinions in FY25 demonstrates that the DoW can achieve this goal by modernizing and simplifying financial reporting processes and reimagining data governance strategies.

As with any complex large-scale project, success requires prioritization, a clear methodology, technology accelerators, and skilled and experienced people. But given the deadline and the enormity of the challenge, it also requires a bold, pragmatic, and tenacious approach. Ours is based on five core principles:

#### Don't let the perfect become the enemy of the good.

You don't have to change the weather to turn a headwind into a tailwind: you just have to move in the right direction. You must prioritize pragmatism over perfection. This isn't a science project. It's a business system. The goal must be to design a practical, effective, and reliable solution on time and on budget without overengineering.

#### Start with a recognition of reality instead of utopian controls.

Statement of Federal Financial Accounting Standards (SFFAS) 48 and 50 provide a one-time, cost effective "free pass" that can accelerate audit compliance and give you more time for sustainable financial transformation. They allow you to take a substantive testing approach instead of audit control reliance. They provide an opportunity to break the cycle of audit failures by establishing a new baseline for capital assets—and DoW organizations need to seize this opportunity.

#### Take advantage of every tool at your disposal.

Leverage technology accelerators to help streamline data migration across systems, consolidating data into a single view of the truth, paving the way for artificial intelligence (AI), and machine learning (ML)—and enhanced visibility, improved auditability, and data-driven decision-making. You must shift the audit burden to vendors where appropriate and hold them accountable. And embrace disclaimers from prior audits as opportunities to zero-out stale balances and avoid wasting time on controls that fail on data that is no longer relevant.

#### Don't be afraid to be honestor ruthless.

Given the complexity of financial transformation, course corrections are virtually guaranteed, but the inertia of the sunk cost fallacy can often keep efforts heading in the wrong direction. Vendors will often fight to perpetuate dependency on their solutions even when it's clear they're ineffective. There must be no sacred cows to protect and you must ensure that nothing is immune from questioning. You must identify underperforming legacy technology or process investments and stop throwing good money after bad.

#### Multitasking and an agile mindset are required.

Given the tight deadlines, you must be able to execute multiple efforts in parallel across six areas: transactions that affect fund balance with treasury (FBWT), financial reporting, baselines for capital assets, inventory and related property, IT issues, and entity-level controls. You must know when and where testing is required to enable auditors to appropriately plan for the scope of a two-year cycle. Agile methodologies—and an agile mindset are essential for success.

<sup>&</sup>quot;DoW Fails To Obtain A Clean Audit Yet Again," Steel Rose, Forbes, December 3, 2024.

"Pentagon fails 7th audit in a row eyes passing grade by 2028," Ashley Roque, Breaking Defense, November 15, 2024.

"US spent more on military in 2022 than next 10 countries combined," Dave Lawler, Axios, April 27, 2023

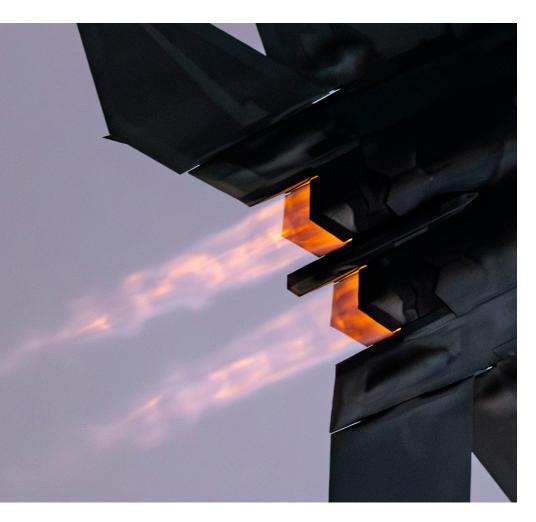


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## Why KPMG

With an approach based on these principles, KPMG has successfully brought the United States Marine Corps (USMC) and the Defense Logistics Agency (DLA) National Defense Stockpile Transaction Fund (NDSTF) to a clean opinion. Our methodologies and technology accelerators make our approach scalable to any size organization within the DoW. We have a deep appreciation for the mission and a clear understanding that directing every dollar possible directly to the warfighter is paramount.



#### We're experienced

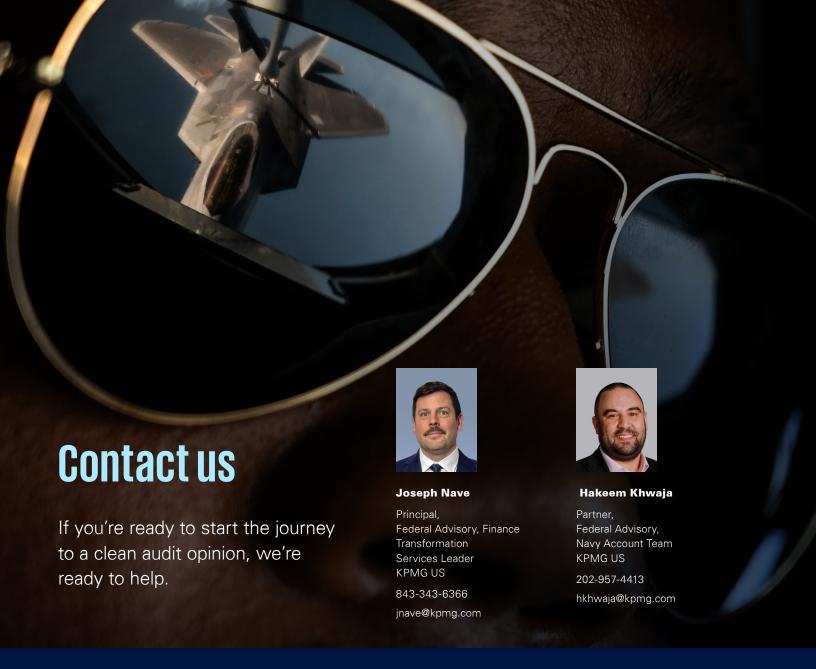
We're a multidisciplinary organization with a deep bench of professionals highly skilled in accounting, risk, compliance, data and AI, cybersecurity, technology architecture and infrastructure design, business process design, and people and change management—the experience and skills required to help DoW organizations meet the clean audit mandate.

#### We're objective

We've been engaged by regulatory bodies and financial institutions of all sizes and complexity in both the public and private sectors at all levels of the organization, from the board to the first line of defense. This access has afforded us privileged insights that have shaped our approach and given us perspective and a level of objectivity that few can match.

#### We're collaborative

Because each organization is unique, we take a collaborative, client-centric approach. We'll work closely with you to understand your specific needs and tailor our solutions to meet them. We see our role as a trusted partner, drawing upon our multidisciplinary skills and experiences to foster an exchange of ideas that challenge assumptions and spark innovation.



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