

## 2.C STRATEGY

Since 2005, when the first FIAR Plan was published, the Department’s strategy for achieving improved financial information and auditability has evolved to be more focused, effective, and consistent across the reporting entities. The FIAR Strategy (Strategy) incorporates refinements and remains:

- Incremental and prioritized;
- Guided by a Methodology (Business Rules);
- Integrated with the requirements of OMB Circular A-123, Appendix A;
- Integrated with the implementation of the CFO Act and Federal Financial Management Improvement Act (FFMIA) (DoD FMR Vol.1 Chap 3);
- Integrated with the modernization of business and financial systems;
- Based on decentralized, reporting entity-level execution; and
- Comprehensive by focusing improvements on policies, processes and controls, systems and data, audit evidence, and human capital.

A clear, comprehensive strategy for achieving audit readiness is critical to ensuring that limited resources are assigned effectively to facilitate sustained and measurable progress. The Strategy provides a critical path for the Department, while balancing short-term accomplishments with the long-term goal of achieving an unqualified opinion on the Department’s financial statements.

Each of the Department’s material financial statement line items is affected by unique and complex accounting and auditing challenges that must be overcome to achieve auditability and reliable financial information. **The Strategy groups and prioritizes the material business processes (that result in activity reported on various financial statement line items) within four waves, and then summarizes the steps each reporting entity must take to address each wave.** The waves and steps are prioritized based on the OUSD(C) priorities, known challenges, and the related dependencies of financial statements, line items and business processes on one another. The Strategy “waves” representing significant levels of effort and accomplishments are noted on **Figure 5**.



**Figure 5. FIAR Strategy includes Four Prioritized Waves to Achieve Full Financial Statement Audit**

The Department’s Strategy draws from the strengths of several alternative approaches and groups individual end-to-end processes into one or more waves. It provides coverage of all financial statements, while prioritizing and improving information most often used by DoD management and the warfighter. Furthermore, as depicted in **Figure 5**, the four waves will lead to interim audit-ready milestones and ultimately to a full-scope financial statement audit. Reporting entities must identify and implement a combination of control activities and supporting documentation to demonstrate that the FROs relevant to the subject matter, assertion, or processes (e.g., contract pay) have been achieved. **The first three waves should be performed concurrently because they focus on both of the OUSD(C)’s priorities, budgetary information and mission critical asset information.** Once reporting entities achieve audit readiness for Waves 1, 2 and 3, they should commence Wave 4 audit readiness activities.

The following sections discuss critical aspects of each wave, including the key capabilities that must be achieved to demonstrate audit readiness and related success criteria and challenges.

### 2.C.1 Wave 1 – Appropriations Received Audit

Accurate and timely recording of appropriations and other budget activity is critical because it provides the budget authority needed to commit, obligate, and expend funds. Absent accurate and timely budget authority information, the Department’s ability to fund its mission and operational requirements could be jeopardized and could affect the Department’s ability to defend the Nation and its allies. Inaccurate budget authority information could also result in over-obligation and expenditures resulting in Antideficiency Act violations.

Recognizing the importance of budgetary information, on August 11, 2009, the OUSD(C) established the Department’s financial improvement priorities. The goal of one of the priorities is accurate and reliable budgetary information, as validated by an SBR audit.

A key element of the SBR is the appropriations receipt and distribution process, which reflects the current fiscal year’s appropriated funds. It also includes apportionment and re-apportionment activity by OMB as well as allotment and some sub-allotment activity. Recognizing the importance of the Department’s ability to record properly such funding activity in budget and accounting systems, the OUSD(C) directed that appropriations received and funds distribution be prepared for audit.

Wave 1 processes and related controls include activities performed to control and record transactions related to: (1) the receipt of the budget (“Appropriations Received”); and (2) the distribution of the budget to the major command level. Once Wave 1 related processes and controls have achieved audit readiness, it will demonstrate to Congress and the public that the Department’s annual funding has been accurately recorded, controlled, and allocated, and that the funds have been accurately recorded in its financial statements. Successful achievement of Wave 1 will also instill more congressional confidence in the Department’s budget processes and budget requests. The processes in this wave include Budget-to-Report, including Fund Balance with Treasury (FBWT).

Although this assertion covers controls that are in place to prevent over-issuance of budget authority, it does not include controls required to prevent over-obligation of budget authority. Controls to prevent over-obligation of appropriated funds are addressed in Wave 2, SBR Audit, which covers all processes, internal controls, systems and supporting documentation that must be audit ready before the entire SBR can be audited.

The goal of audit readiness is for the reporting entity to design and implement a combination of control activities and supporting documentation to demonstrate that the FROs relevant to the subject matter, assertion, or processes (e.g., contract pay) have been achieved.

#### 2.C.1.1 Key Capabilities, Capability Measures, and Success Criteria

##### KEY CAPABILITIES AND CAPABILITY MEASURES

Reporting entities must achieve key capabilities while working to complete Wave 1. Reaching these key capabilities demonstrates a reporting entity’s Appropriations Received audit readiness. The key capabilities are aligned with the capability measures, as shown in **Figure 6**. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress towards achieving these capabilities.

Key Capabilities	Definitions/Capability Measures
1. Identify a complete transaction population, which is reconciled to the general ledger and financial statements	Reporting entities must prepare a listing of all transactions for the Appropriations Received assessable unit for the assertion period and demonstrate that the sum of the transactions agrees to the general ledger, trial balance, and/or financial statement balance for the assertion period. For example, for Wave 1, the reporting entity must develop a listing of all funding transactions (recorded in PBAS), document which general ledger accounts make up the sum of the individual funding transactions, and reconcile amounts reported in the general ledger and financial statements to the sum of the individual balances. Furthermore, the reporting entity must document any reconciling items/differences that exist, and be able to explain and correct the differences via appropriate adjusting entries.

Key Capabilities	Definitions/Capability Measures
2. Effective controls over recording Appropriations	<p><b>Reporting entities must demonstrate that control activities for recording Appropriations were suitably designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved.</b> See Wave 1 FROs in <b>Appendix C</b>, for a complete listing of relevant FROs.</p> <ul style="list-style-type: none"> <li>• % of appropriation financial reporting objectives assessed</li> <li>• % of appropriation control activities determined effective</li> </ul>
3. Retain and make available supporting documentation to meet audit standards	<p><b>Reporting entities must ensure that sufficient, relevant and accurate documentation is readily available for an Appropriations Received audit.</b> See Wave 1 KSDs, in <b>Appendix C</b>, for minimum documentation requirements.</p> <ul style="list-style-type: none"> <li>• % of supporting documentation assessed</li> <li>• % of supporting documentation determined sufficient</li> </ul>

**Figure 6. Appropriations Received Key Capabilities**

**SUCCESS CRITERIA**

To achieve audit readiness for Appropriations Received, a reporting entity must demonstrate an effective combination of control activities and supporting documentation that limits the risk of material misstatements by meeting the FROs defined in Appendix C. Reporting entities must address the following:

- For Financial Reporting Objectives where control activities are used to achieve audit readiness, reporting entities must be able to demonstrate that the control activities were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved.
- Reporting entities must be able to support account transactions and balances with sufficient, relevant and accurate audit evidence, defined as KSDs in Appendix C, supplemented with the reporting entity’s own documentation requirements.

**2.C.1.2 Common Challenges**

Each wave contains accounting and auditing challenges that must be resolved for reporting entities to become audit ready. For example, during Wave 1 reporting entities must ensure that:

- They are capable of supporting the completeness of funds distributed to the major commands or equivalent. Reporting entities must demonstrate completeness of funds distribution by reconciling the current year budget authority apportioned and allotted to U.S. Standard General Ledger accounts 4510 and 4610 to the fund distribution system. The reconciliation must identify current year budget authority as an element of the entire balance, which includes beginning balances, reductions for executed funds, and upward/downward adjustments, recorded in these accounts.
- Internal controls and supporting documentation are appropriately evaluated and maintained for all material funds sub-allotted to other DoD organizations (e.g., U.S. Army Corps of Engineers (USACE), Naval Facilities Engineering Command (NAVFAC)).

**2.C.2 Wave 2 – SBR Audit**

The SBR presents all budgetary resources that a reporting entity has available, the status of those resources at period end, a reconciliation of changes in obligated balances from the beginning to the end of the period, and cash collections and disbursements for the period reported. A Wave 2 SBR audit includes all processes, internal controls, systems and supporting documentation that must be audit ready before the SBR can be audited. Significant processes in this wave include Procure-to-Pay, Hire-to-Retire, Order-to-Cash, and Budget-to-Report, including FBWT.

### 2.C.2.1 Key Capabilities, Capability Measures, and Success Criteria

#### KEY CAPABILITIES AND CAPABILITY MEASURES

The FIAR Directorate has defined key capabilities that reporting entities must achieve to complete Wave 2. These are major capabilities that reporting entities must achieve and sustain to demonstrate SBR audit readiness. The key capabilities are aligned with the capability measures, as shown in Figure 7. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress in achieving these capabilities.

Key Capabilities	Definitions/Capability Measures
1. Identify a complete transaction population, which is reconciled to the general ledger and financial statements	<p>Reporting entities must prepare a listing of transactions for the assessable unit for the assertion period and demonstrate that the sum of the transactions agrees to the general ledger, trial balance, and/or financial statement balance for the assertion period. For example, if a reporting entity is asserting audit readiness of its Reimbursable Work Orders (RWO) for FY 2011, the reporting entity must develop a listing of all RWOs for FY 2011, document which general ledger accounts make up the sum of the individual RWO transactions, and reconcile amounts reported in the general ledger and financial statements to the sum of the individual balances. Furthermore, the reporting entity must document any reconciling items/differences that exist, and be able to explain and correct the differences via appropriate adjusting entries.</p>
2. Effective FBWT transaction-level reconciliations and reporting to Treasury	<p>Reporting entities must demonstrate that control activities for FBWT were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 SBR FROs Table in Appendix C for a complete listing of relevant FROs.</p> <ul style="list-style-type: none"> <li>• % of FBWT financial reporting objectives assessed</li> <li>• % of FBWT control activities determined effective</li> </ul>
3. Effective controls over recording and maintaining obligations	<p>Reporting entities must be able to demonstrate that control activities for recording obligations were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 SBR FROs Table in Appendix C for a complete listing of FROs relevant to the obligations incurred.</p> <ul style="list-style-type: none"> <li>• % of obligation financial reporting objectives assessed</li> <li>• % of obligation control activities determined effective</li> </ul>
4. Effective controls over recording receipt of goods or services	<p>Reporting entities must be able to demonstrate that control activities for recording receipt of goods or services were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 SBR FROs Table in Appendix C for a complete listing of relevant FROs.</p> <ul style="list-style-type: none"> <li>• % of receipt financial reporting objectives assessed</li> <li>• % of receipt control activities determined effective</li> </ul>
5. Effective controls over recording disbursements	<p>Reporting entities must be able to demonstrate that control activities for recording disbursements were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. See Wave 2 SBR FROs Table in Appendix C for a complete listing of FROs relevant to disbursements/outlays.</p> <ul style="list-style-type: none"> <li>• % of disbursement financial reporting objectives assessed</li> <li>• % of disbursement control activities determined effective</li> </ul>
6. Retain and make available supporting documentation to meet audit standards	<p>Reporting entities are responsible for ensuring that sufficient, relevant and accurate supporting documentation is readily available for all material line items. See Wave 2 SBR KSDs Table, in Appendix C, for minimum documentation requirements.</p> <ul style="list-style-type: none"> <li>• % of supporting documents assessed</li> <li>• % of supporting documents determined sufficient (adequately retained and readily available)</li> </ul>

Figure 7. SBR Key Capabilities

## SUCCESS CRITERIA

To achieve SBR audit readiness, a reporting entity, in coordination with its service provider(s) must demonstrate an effective combination of control activities and supporting documentation that limits the risk of material misstatements by meeting the FROs defined in **Appendix C**.

Reporting entities must address the following:

- For Financial Reporting Objectives where control activities are used to achieve audit readiness, reporting entities must be able to demonstrate that the control activities were suitability designed and operating effectively to provide reasonable assurance that the FROs in **Appendix C** were achieved.
- Reporting entities must be able to support account transactions, and balances with sufficient, relevant and accurate audit evidence, defined as KSDs in **Appendix C**, supplemented with the reporting entity's own documentation requirements.

### 2.C.2.2 Common Challenges

Each wave contains accounting and auditing issues that must be resolved for reporting entities to progress towards audit readiness. For example, during Wave 2 reporting entities must address:

- **Beginning balances for FBWT.** Given the long life of Federal appropriations, reporting entities must keep a minimum of 6 to 10 years of documentation to support all funding, collections, disbursements, adjustments, and reconciliation activity (note: document retention requirements for audit are different from National Archives and Records Administration (NARA) retention requirements).
- **Complexities surrounding shared Treasury accounts.** Reporting entities sharing Treasury accounts must work with their service provider to ensure that internal controls and supporting documentation are in place to support an SBR audit, especially to ensure suspense account items are assigned to the correct reporting entity.
- **Reconciliation and traceability of interagency agreements, including Military Interdepartmental Purchase Requests (MIPR).** Due to the limited capabilities of existing accounting systems, reporting entities are not always able to capture sufficient trading partner information needed to reconcile intragovernmental transactions and balances. Additionally, some reporting entities have difficulty in tracing recorded interagency agreements back to originating source documentation (e.g., interagency agreement, invoices, receiving reports).
- **Accounts Payable Accruals.** Because goods/services are partially or fully delivered in advance of invoices, reporting entities should design effective accrual processes to ensure that goods or services received are recorded in the SBR in the proper period.
- **Dependencies on service provider(s) processes and controls for efficient and effective execution of its end-to-end business processes.**

As reporting entities continue to work on Wave 2, additional accounting and auditing issues may be identified. Reporting entities should report issues in their FIPs, allowing them to track progress for resolution and assign resources and dependencies based on related key tasks.

### 2.C.3 Wave 3 – Mission Critical Asset Existence & Completeness (E&C) Audit

Mission Critical Asset E&C audit focuses primarily on the E&C financial statement assertions, but also includes the Rights assertion and portions of the Presentation and Disclosure assertion. That is, **reporting entities must ensure that all assets recorded in their APSR exist (Existence), all of the reporting entities' assets are recorded in their system (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 are RP, INV, OM&S, and GE.** This will allow the Department and its reporting entities to demonstrate the E&C of its assets before focusing on the reported value of the assets.

### 2.C.3.1 Key Capabilities, Capability Measures, and Success Criteria

#### KEY CAPABILITIES AND CAPABILITY MEASURES

The FIAR Directorate has defined key capabilities that reporting entities must achieve to successfully complete Wave 3. These are key capabilities the reporting entities must achieve and sustain to demonstrate E&C audit readiness. The key capabilities are aligned with the capability measures, as shown in **Figure 8**. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress towards achieving these capabilities.

Key Capabilities	Definitions/Capability Measures
1. Identify a complete transaction population, which is reconciled to the general ledger and financial statements	<p>Reporting entities must prepare a listing of transactions for the assessable unit for the assertion period and demonstrate that the sum of the transactions agrees to the general ledger, trial balance, and/or financial statement balance for the assertion period. For example, if a reporting entity is asserting audit readiness of its General Equipment for FY 2011, the reporting entity must complete a reconciliation of the General Equipment assets recorded in its APSR to its general ledger and amounts reported in the financial statements. Furthermore, the reporting entity must document any reconciling items/differences that exist, and be able to explain and correct the differences via appropriate adjusting entries.</p>
2. Effective physical inventories that meet audit standards	<p>Reporting entities must design and implement physical inventory count procedures and documentation that will withstand audit scrutiny. See DoDI 4140.1 R, 4000.25-M, 4000.25-2M, 5100.76-M, 4165.14, and 5000.64 for the Department's instructions for physical inventory counts.</p> <ul style="list-style-type: none"> <li>• % of assets subject to physical inventory within the required time span</li> </ul>
3. Effective controls over recording asset acquisitions, disposals and transfers	<p>Reporting entities must demonstrate that control activities for recording asset acquisitions, disposals, and transfers were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved. Adjustments to physical inventory counts are an indication of the effectiveness of controls over recording acquisitions, disposals, and transfers of assets.</p> <ul style="list-style-type: none"> <li>• % of physical inventory adjustments</li> </ul>
4. Retain and make available supporting documentation to meet audit standards	<p>Reporting entities must ensure that sufficient, relevant and accurate supporting documentation is readily available for an E&amp;C audit. See Wave 3 KSDs Table, in Appendix C, for minimum documentation requirements.</p> <ul style="list-style-type: none"> <li>• % of supporting documents assessed</li> <li>• % of supporting documents determined sufficient (adequately retained and readily available)</li> </ul>
5. Effective controls over financial and management data in the Accountable Property Systems of Record	<p>Reporting entities must ensure the sufficiency and accuracy of Financial and Management data in preparation for an E&amp;C audit. See Wave 3 Financial Management Data Table in Appendix C for minimum data fields validation requirements.</p> <ul style="list-style-type: none"> <li>• # of data fields "blank" out of total data fields</li> </ul>
6. Effective processes, controls and system improvements	<p>Reporting entities must design and implement corrective actions to remediate weaknesses in processes, internal controls, and supporting financial related systems.</p> <ul style="list-style-type: none"> <li>• % of corrective actions complete (per FIPs)</li> <li>• % of assessable units validated</li> </ul>

**Figure 8. Mission Critical Asset E&C Key Capabilities**

## SUCCESS CRITERIA

To achieve E&C audit readiness, a reporting entity, in coordination with its service provider(s) must demonstrate that an effective combination of control activities and supporting documentation exists to limit the risk of material misstatements by meeting the FROs defined in Appendix C. Reporting entities must address the following:

- For Financial Reporting Objectives where control activities are used to achieve audit readiness, reporting entities must be able to demonstrate that the control activities were suitability designed and operating effectively to provide reasonable assurance that the FROs in Appendix C were achieved.
- Reporting entities must be able to support account transactions, and balances with sufficient, relevant and accurate audit evidence, defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.

### 2.C.3.2 Common Challenges

Each wave is subject to accounting and auditing issues that must be resolved to progress towards audit readiness. For example, during Wave 3 reporting entities must address:

- **Units of Measure** – Implementing standard definitions for units of inventory and assets to ensure that item counts are accurate (e.g., will airframes be separately counted from engines or the two items together comprise one asset record within the APSR?).
- **Rights to Assets** – Work with leading OSD offices to implement business rules around co-located facilities (joint basing) and assets purchased by others (e.g., USMC aircraft).
- **Reworked Assets** – Implement a standard and consistent method for tracking and reporting assets that are removed from a larger asset, reworked or otherwise modified and then integrated into a different asset (e.g., aircraft engines).
- **Physically Isolated Assets** – Implement techniques and methods for demonstrating the existence of assets that are not easily inspected (e.g., assets located in space or underwater).
- **Dependencies on service provider(s) processes and controls** for efficient and effective execution of its end-to-end business processes.

### 2.C.4 Wave 4 – Full Financial Statement Audit

Assertions for this wave include all material reporting entity line items, account balances and financial transactions impacting the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position not covered by Waves 2 or 3 (e.g., Environmental and Disposal Liabilities, **Accounts Receivable-Intragovernmental, Investments, Other Liabilities, etc.**). The FIAR priorities require reporting entities to devote their resources and efforts towards completing Waves 1 through 3 before beginning work on Wave 4. Nevertheless, much of the work required to complete Waves 1 through 3 impacts the requirements and objectives for Wave 4. For example, the following interdependencies will be leveraged to accelerate progress in Wave 4:

- Delivered Orders, reported on the SBR (covered in Wave 2), equate to a portion of Accounts Payable reported on the Balance Sheet
- Spending Authority from Offsetting Collections, reported on the SBR (covered in Wave 2), includes some of the amounts reported in Accounts Receivable – Intragovernmental on the Balance Sheet
- Unobligated Balances and Unpaid Obligations, reported on the SBR (covered in Wave 2), correlate to FBWT reported on the Balance Sheet
- Obligations Incurred, reported on the SBR (covered in Wave 2), equates to a substantial portion of Gross Costs reported on the Statement of Net Cost

In addition, this wave requires that the valuation assertion for fixed assets, (i.e., General Equipment, Real Property, Internal Use Software, Inventory, and Operating Materiel and Supplies) be achieved. One significant and potentially very costly challenge in Wave 4 is obtaining auditable values for the significant amount of existing DoD assets located worldwide and procured many years ago, well before passage of the CFO Act and other legislation mandating auditability. To address and overcome this impediment to achieving auditability, OUSD Comptroller and Acquisition, Technology and Logistics (AT&L) jointly issued a memorandum, "Elimination of Military Equipment Definition and Increase to Capitalization Thresholds for General Property, Plant & Equipment" (as of September 20, 2013) and related "General Equipment Valuation Guidance" to assist reporting entities' valuation efforts and meet the congressionally mandated objective of asserting full financial statement audit readiness by the end of FY 2017. The changes outlined in the memorandum require reporting entities to conduct valuations using adequate supporting documentation for all new General Property, Plant and Equipment (G-PP&E)<sup>3</sup> acquisitions accepted by DoD and placed into service as of October 1, 2013 and after. Reporting entities must value their assets in accordance with the Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standard Number 6 (SFFAS No. 6), *Accounting for Property, Plant and Equipment*. If existing business processes or systems limit full compliance with SFFAS No. 6, reporting entities must report their asset values in accordance with SFFAS No. 35, *Estimating the Historical Cost of Property, Plant and Equipment*, where applicable.

In addition, for G-PP&E assets acquired prior to October 1, 2013 that have a positive net book value (NBV) on or after September 30, 2017, reporting entities must report the value of the assets (in accordance with SFFAS No. 6 or SFFAS No. 35) and maintain adequate supporting documentation to support the financial reporting of these assets by September 30, 2017. Once reporting entities have successfully established values for both new asset acquisitions as well as existing assets with a positive NBV as of September 30, 2017, reporting entities must be able to provide documentation to support its fully depreciated assets. Reporting entities should develop execution strategies and methodologies to satisfy this reporting requirement and incorporate these activities into their Financial Improvement Plans.

The memorandum also contains requirements for reporting entities to increase the capitalization threshold of their General Equipment, Internal Use Software and Real Property assets. These changes are prospective and apply to asset acquisitions and subsequent acquisitions accepted by DoD and placed into service October 1, 2013 and after. Please see the OUSDC and AT&L Memorandum, "Elimination of Military Equipment Definition and Increase to Capitalization Thresholds for General Property, Plant and Equipment" referenced above for the specific capitalization thresholds. The DoD FMR will be updated to reflect the new capitalization thresholds as well.

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<sup>3</sup> Per the September 20, 2013 OUSDC and AT&L memorandum, the Department has rescinded the current definition of Military Equipment (referenced in the OUSD AT&L memorandum, dated, January 24, 2007". Reporting entities must combine Military Equipment (ME), previously reported as a separate category of G-PP&E and General Equipment (GE) into a single category titled, "General Equipment". An update to Note 10 of the financial statements will reflect this change.