

DEPARTMENT OF THE NAVY

AUDIT OPINION



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

FEB 14 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND
CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 1999 Department of the Navy General Fund Financial Statements (Project No. OFC-2114)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Naval Audit Service (NAS) the audit of the FY 1999 Department of the Navy General Fund financial statements. Summarized as follows are the NAS disclaimer of opinion on the FY 1999 Department of the Navy General Fund financial statements and the results of our review of the NAS audit. The information provided in this memorandum contains reasons for the NAS disclaimer. We endorse the disclaimer of opinion expressed by NAS.

Disclaimer of Opinion. The NAS disclaimer of opinion on the FY 1999 Department of the Navy General Fund financial statements, dated February 10, 2000, states that NAS was unable to express an opinion on the financial statements. We concur with the NAS disclaimer of opinion. The Department of the Navy did not provide the FY 1999 principal statements in time for us to perform the necessary audit work. In addition, the Department of the Navy did not provide the management representation letter. However, NAS identified the following deficiencies that precluded an audit opinion.


- The Department of the Navy did not have transaction-driven standard general ledger accounting systems that could accurately report the value of assets and liabilities. We were unable to verify off-line calculations and adjustments to compute estimates of key line-item values.
- Accounting systems did not contain sufficient audit trails to enable transaction-level verification and, therefore, we could not ascertain the reliability of amounts reported on the principal statements.
- Department of the Navy financial and non-financial feeder systems and processes did not collect and record financial data on the full accrual accounting basis. Financial data were based on budgetary information and were adjusted for known accruals; therefore, we were unable to verify reported amounts.
- Data and analyses to support significant estimates of environmental liabilities were not available for audit in time to perform sufficient audit reviews.

Internal Controls. The NAS determined that internal controls did not provide reasonable assurance that resources were properly managed and accounted for, that the Department of the Navy complied with applicable laws and regulations, and that the FY 1999 Department of the Navy General Fund financial statements contained no material misstatements. For example, the Department of the Navy did not have adequate controls to include all operating materials and supplies in the reported values. The Department of the Navy and the Defense Finance and Accounting Service recognized many of the financial reporting weaknesses and reported them in their FY 1999 Annual Statements of Assurance.

Compliance With Laws and Regulations. The NAS identified areas of noncompliance with laws and regulations. Under the Federal Financial Management Improvement Act of 1996, the NAS work showed that financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For example, the Department of the Navy did not have integrated financial management systems from which to extract financial data for use in preparing financial statements and had to rely on a manual data call process that was error prone. As a result, the Department of the Navy was unable to provide detailed accounting records of the acquisition and disposition of personal property. Details on the adequacy of internal controls and compliance with laws and regulations are discussed in the NAS report.

Review of Naval Audit Service Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent audit work that NAS conducted, we reviewed the audit approach and planning and monitored progress at key points. We also performed other procedures to determine the fairness and accuracy of the approach and conclusions.

We reviewed the NAS work on the FY 1999 Department of the Navy General Fund financial statements from March 1, 1999, through February 10, 2000, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the NAS disclaimer of opinion or its related evaluation of internal controls and compliance with laws and regulations.



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for Auditing

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Report on Auditor's Opinion

We attempted to audit the FY 1999 Department of the Navy **Consolidated Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing (the Principal Statements)** in accordance with generally accepted government auditing standards. Our auditing procedures included an evaluation of related internal controls and compliance with laws and regulations. As the Chief Financial Officer of the Department of the Navy, the Assistant Secretary of the Navy (Financial Management and Comptroller) is responsible for these financial statements, for establishing and maintaining internal controls, and for complying with laws and regulations applicable to Department of the Navy financial accounting and reporting.

Disclaimer of Opinion. We are unable to express an opinion on the Department of the Navy Principal Statements for the fiscal year ended 30 September 1999. The Department of the Navy did not provide us with the Principal Statements for FY 1999 in time for us to perform the necessary audit work. In addition, the Department of the Navy did not provide the Management Representation Letter. However, the following deficiencies would have precluded an audit opinion.

- The Department of the Navy did not have transaction-driven standard general ledger accounting systems that could accurately report the value of assets and liabilities. We were unable to verify off-line calculations and adjustments to compute estimates of key line item values.
- Accounting systems did not contain sufficient audit trails to enable transaction level verification and, therefore, we could not ascertain the reliability of amounts reported on the Principal Statements.
- Department of the Navy financial and non-financial feeder systems and processes did not collect and record financial data on the full accrual accounting basis. Financial data was based on budgetary information and adjusted for known accruals, therefore, we were unable to verify reported amounts.
- Data and analyses to support significant estimates of environmental liabilities were not available for audit in time for us to perform sufficient reviews.

Financial data in the Overview and the Supplemental Financial and Management Information sections of the Department of the Navy Annual Financial Report was derived from the same sources as the Principal Statements and, therefore, may not be reliable.

Except for the limitations on the scope of our work on the Principal Statements described above, we did our work in accordance with generally accepted government auditing standards and the OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements."

Required Supplementary Stewardship Information. The Required Supplementary Stewardship Information (including National Defense Property, Plant, and Equipment; Heritage Assets; and Stewardship Land) is not a required part of the basic financial statements, and we do not express an opinion on such information. However, we applied limited procedures prescribed by professional standards to the stewardship information. As a result of the limited procedures, we identified unresolved issues regarding whether material changes should be made to stewardship information for conformance with generally accepted accounting principles.

Audit Opinion

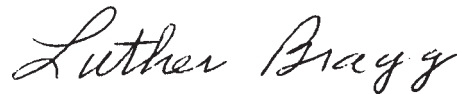
Required Supplementary Information for Deferred Maintenance. **The Required Supplementary Information for Deferred Maintenance is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. We did not apply to the information certain limited procedures prescribed by professional standards because the official accounting guidance regarding the measurement criteria and reporting placement of deferred maintenance on the financial statements was not fully developed.**

Internal Controls. **Internal controls consist of the following components: control environment; risk assessment; control activities; information and communication; and monitoring. Effective implementation of these controls provides reasonable assurance that accounting data are accumulated, recorded, and reported properly by management and that assets are safeguarded. Management is responsible for internal controls. We performed applicable tests of the internal controls to determine whether the controls were effective and working as designed. However, these tests did not provide sufficient evidence to support an opinion on internal controls; therefore, we do not express an opinion on internal controls.**

Internal controls were not adequate to ensure that resources were properly managed and accounted for, that the Department of the Navy complied with applicable laws and regulations, and that the Principal Statements were free of material misstatements. Internal controls did not ensure that assets and liabilities were properly accounted for and valued, and that accounting transactions were accurate and properly supported. The Department of the Navy and Defense Finance and Accounting Service have recognized these weaknesses and reported them in their FY 1999 Assurance Statements on Management Controls.

Compliance with Laws and Regulations. **Our objective was to assess compliance with laws and regulations related to the Principal Statements for FY 1999 and not to express an opinion. Therefore, we do not express an opinion on compliance with laws and regulations.**

The Department of the Navy did not fully comply with laws and regulations that had a direct and material effect on its ability to determine financial statement amounts. Department of the Navy financial management systems were not in substantial compliance with Federal financial management system requirements; applicable Federal accounting standards; and the U.S. Government Standard General Ledger at the transaction level, as required by the Federal Financial Management Improvement Act of 1996. For example, financial management systems were not integrated; did not maintain adequate audit trails; and did not value and depreciate property, plant, and equipment in accordance with Statement of Federal Financial Accounting Standards No. 6. In addition, the Department of the Navy did not fully comply with the Chief Financial Officers Act, the Federal Managers' Financial Integrity Act of 1982, the Government Performance and Results Act of 1993, and OMB Bulletin No. 97-01 as amended.



LUTHER N. BRAGG, CPA
Naval Audit Service

10 February 2000