

U.S. Department of Defense Financial Improvement and Audit Remediation (FIAR) Report



Office of the Under Secretary of Defense (Comptroller)
June 2020

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The Financial Improvement and Audit Remediation Report was prepared in accordance with section 240b of Title 10, United States Code.

Preparation of this report cost the Department of Defense approximately \$171,000.

Message from the Acting Under Secretary of Defense (Comptroller)/Chief Financial Officer

The annual financial statement audits and the changes we are making to correct the findings from these audits directly support or enable our ability to achieve the goals of the National Defense Strategy—to build a more lethal force, strengthen alliances and attract new partners, and reform the Department for greater performance and affordability. We have also placed a very strong priority on the health and well-being of our men and women in uniform, their families and the entire workforce of the Department of Defense who work so tirelessly to support them.

The COVID-19 pandemic has altered how we do business, but it has not altered our commitment or dedication to our mission. We expect to see some delays and cancelations in auditor site visits where physical access to assets, personally identifiable information, or a secure environment is required we will maintain our overall momentum on the audit. Corrective actions could also be effected. However, DoD auditors and financial managers are adapting and progress is being made on both conducting the fiscal year (FY) 2020 audits and in correcting findings from the FY 2019 audits. Testing and correcting information technology, Fund Balance with Treasury, and many other areas have been successfully performed virtually, and no currently held audit opinion is expected to regress. Increased communication with all stakeholders has been critical during this time, and we are grateful for the flexibility, patience, and resiliency demonstrated by the entire team.

In the FY 2019 audits, the Defense Commissary Agency progressed to an unmodified opinion for a total of seven organization receiving a clean opinion. One organization received a qualified opinion, and the remaining organizations under audit and the DoD consolidated audit resulted in disclaimers of opinions. The Independent Auditors Report is included as Appendix A, and I concur with these findings and the results of the DoD financial statement audits. As expected, the FY 2019 audit went deeper than the previous year. More than 1,400 auditors visited over 600 DoD locations, sent over 45,000 requests for documentation, and tested over 155,000 sample items for the audits of the DoD and its Components. This broader scope and increased testing resulted in more findings. The DoD Office of Inspector General cited 25 DoD-wide material weaknesses, a net increase of 5, and findings from all audits totaled 3,248, about a 36 percent increase over FY 2018. Auditors also performed follow-up testing on over 1,000 of the FY 2018 notices of findings and recommendations and closed about 26 percent. This is good progress, and although we do not know the full effect of the COVID-19 pandemic, we are maintaining momentum.

The audit continues to be a positive and forceful catalyst for change, and we are beginning to see the benefits and cultural change that ensures long-term sustainability and progress. The information we glean from these audits is accelerating our data analytic capabilities—giving us insight into systemic problems and automating Department-wide solutions. We are grateful for the support of Congress and other stakeholders in pursuit of our mission.



Elaine McCusker

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Message from the Chief Management Officer of the Department of Defense

The Department of Defense (DoD), under the joint leadership of the Chief Management Officer (CMO) and the Under Secretary of Defense (Comptroller) (USD(C)), is transforming its business practices for greater performance, efficiency, effectiveness, and affordability. Together, we work to ensure that identified transformation opportunities in all lines of business, at both the enterprise- and component-level, follow strict internal controls in order to improve readiness and promote greater lethality in support of the National Defense Strategy. The Defense-Wide review process has already realized important cost savings, and we continue to articulate opportunities for significant transformation across the Fourth Estate, which in turn helps identify savings and efficiencies to benefit the Military Departments.

Reform efforts and audit results are also leading to more reliable and actionable data. The COVID-19 pandemic forced us to reexamine how we conduct business within the Department. It tested our business systems in a way that we could not have done under normal circumstances. The CMO and Comptroller's partnership behind ADVANA illustrated the critical role that common sources of advanced data analytics across DoD have in accomplishing our mission.

Realizing the National Defense Strategy goals of reforming the Department for greater performance depends on evidence-based decision-making and policy formulation decision-making, but also on solid financial management and the strengthening of internal controls. The Financial Improvement and Audit Remediation (FIAR) strategy and the annual financial statement audit regimen are fundamental components of our strategic approach to reform.

The Comptroller is capturing Notices of Findings and Recommendations (NFR) from across the Department to facilitate the review and improvement of the Department's data sources. As a result, the Department has access to real-time information to support not only audit reviews, but also reliable information to support greater reform initiatives across business mission areas. For example, by leveraging the FIAR's NFRs, we are working with our partners to address identified areas of improvement in both reporting and recording of inventory. Additionally, the NFRs assist us in identifying systematic issues versus anomalies and inform reform at a root-cause level. These actions will enable the Department to better manage its inventory needs, while also validating the cost material in transit and in warehouses.

Actions taken to remediate audit findings result in increased discipline, stronger internal controls, standardized data, and more efficient business processes. When combined with transformation and reform efforts, they successfully embed transparency and accountability in our business operations and improve future audit results.

I am extremely proud of the Department's unwavering dedication to achieve these complementary goals of transformation and audit compliance. Through teamwork and innovation, we will meet the goals of the National Defense Strategy and achieve business excellence for the benefit of the warfighter and the American people.



HON Lisa W. Hershman

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Executive Summary

The Department of Defense (DoD) completed its second full financial statement audit in fiscal year (FY) 2019. The audit is foundational to the National Defense Strategy reform line of effort and to the Chief Financial Officer (CFO) of the Future vision, where financial data actively informs and drives decision-making. Each year, the Department expands its ability to respond, learn, and gain value from the audit. Amid the coronavirus crisis, the Secretary's primary focus became protecting the safety and well-being of the men and women serving in the Armed Services and throughout the DoD. However, even in this new environment, the Department maintains audit momentum and is pursuing its audit-related goals and priorities.

FY 2019 Audit Results

The DoD annual financial statement audit again comprised 24 standalone audits conducted by private sector independent public accounting firms (IPAs) and one consolidated audit conducted by the DoD Office of Inspector General (DoD OIG). Sensitive activities are included and audited within the classified environment. Seven organizations received unmodified opinions, the highest grade. This was the 12th consecutive unmodified opinion for the Army Corps of Engineers (Civil Works), the 20th consecutive unmodified opinion for the Defense Finance and Accounting Service (DFAS) Working Capital Fund, and the 25th consecutive unmodified opinion for the Military Retirement Fund. The Military Retirement Fund's nearly \$900 billion in total assets represents more than 30 percent of total DoD assets. The Defense Commissary Agency (DeCA), moved up to an unmodified opinion in FY 2019, an important indicator of progress. The Medicare-Eligible Retiree Health Care Fund (MERHCF) received a qualified opinion, which means the data is right with some exceptions. All other reporting entities received a disclaimer of



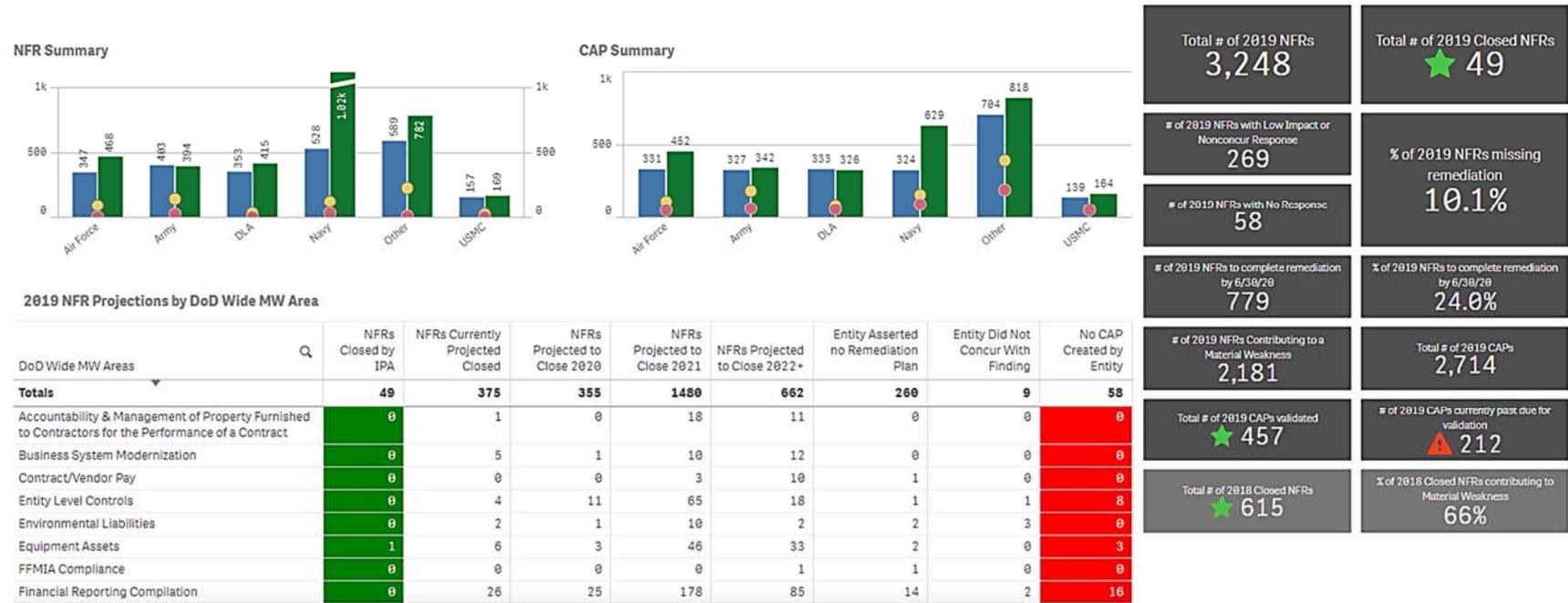
The Air Force and Navy flight demonstration squadrons, the Thunderbirds and the Blue Angels, fly over Washington, D.C., May 2, 2020, as part of "America Strong," a collaborative salute from the two services to recognize health care workers, first responders, service members and other essential personnel amid the COVID-19 pandemic. (DoD photo by Air Force Tech. Sgt. Ned T. Johnston)

opinion, which means the auditors did not have enough evidence to provide an opinion.

The audits went deeper this year and covered more ground. Auditors visited more than 600 DoD locations, sent 45,000 requests for documentation and tested more than 155,000 sample items. By comparison, auditors tested approximately 90,000 sample items in FY 2018. As a result of going deeper and expanding testing, findings from the FY 2019 audits also increased. The DoD OIG cited 25 DoD-wide material weaknesses, a net increase of 5; and auditors issued 3,248 Notices of Findings and Recommendations, or NFRs, 37 percent more than last year. However, more than half of FY 2019 NFRs were re-issued findings from FY 2018 and were not new issues. Roughly 45 percent of all FY 2019 NFRs related to financial management systems; 31 percent to financial reporting and Fund Balance with Treasury; and 17 percent to property-related issues.

Figure ES-1 shows the FY 2019 DoD-wide material weaknesses and associated NFRs.

Figure ES-1: FY 2019 DoD-Wide Material Weaknesses and Associated NFRs



Note: Information represented here is as of June 18, 2020. This information may vary from reports published on other dates. Blue bars indicate FY 2018 audit results. Yellow circle indicates FY 2018 NFRs closed and CAPs validated. Green bars indicate FY 2019 audit results. Red circle indicates FY 2019 NFRs closed and CAPs validated. Figure ES-1 and other figures throughout the report were created in the DCFO NFR Database, an enterprise repository that includes modern analytic and visual display capabilities.

Corrective Actions

In FY 2019, the Department developed more than 2,100 corrective action plans in response to the 2,377 findings issued during the FY 2018 audits. Corrective actions have resulted in the closure of 26 percent of FY 2018 NFRs. In FY 2020, the Department will continue to develop and complete corrective actions using material weaknesses to prioritize corrective actions.

Remediation work will focus on the FY 2019 Secretary of Defense priority areas (Inventory, Real Property, Information Technology (IT) Access Controls, and Government Furnished Property). For the current fiscal year, Secretary Esper endorsed four additional priorities:

- Fund Balance with Treasury
- Financial Reporting Internal Controls
- Joint Strike Fighter Program
- Audit Opinion Progression

Complexity of remediation activities is also expanding. For instance, Components that recently completed validating the existence and completeness of their property will move on to address asset valuation.

COVID-19 Effect and Maintaining Progress

The COVID-19 pandemic is altering the timing and scope of the FY 2020 financial statement audits underway as well as affecting the Components' ability to complete audit remediation activities. The Department remains mission-focused while balancing the health and safety of its workforce with existing audit and financial reporting requirements. It has extended telework resources and secure communication options. The Office of Management and Budget (OMB) is assessing how the pandemic is affecting the government-wide financial statements reporting timeline. Although the full effect may not be known at the time this report is published, the Department does not expect current audit opinions to slip as a result.

A survey of Components under audit suggests corrective actions could be delayed for multiple reasons, including personnel re-assigned to perform COVID-19 response activities, insufficient telework equipment and access to systems, and lack of physical access to assets and documentation needed to work on corrective actions. Some testing of IT systems and other areas has been completed virtually; however some testing requires physical access to assets and records. Other examples of the effect COVID-19 is having on current audits and corrective actions include:

- Delaying or canceling audit site visits due to travel restrictions
- Completing virtual walk-throughs, where possible, and issuing equipment to auditors to allow them to securely receive and test documents
- Foregoing the testing of assets and delaying corrective actions where physical access to assets and records is required
- Putting audit work and remediation work for sensitive and classified activities on hold due to the lack of secure, remote environments in which to conduct this work

The Department is assessing projected NFR closure rates and other areas affected by these delays as more information becomes available. Most high-level work to remediate material weaknesses appears to be on-track. A project by DFAS to resolve Statements of Differences—similar to reconciling hundreds of checking accounts each with billions of dollars in them and going back over the last 10 years—resulted in an 88 percent reduction in total differences from \$6.6 billion in December 2018 to \$821 million in March 2020, and reduced aged disbursements by 96 percent. Other, multi-year, enterprise solutions should continue with minimal negative effect assuming there is no worsening of the current situation. As testing progresses and travel restrictions are adjusted, DoD leaders will re-assess the overall effect COVID-19 has had on current audits and corrective action plans.

Audit Costs and Benefits

Audit, audit support, and audit remediation costs, including financial system fixes, totaled \$900 million for FY 2019. Approximately \$186 million was paid to the IPAs conducting the audits and examinations. Another \$242 million went to audit support, such as responding to auditor requests for information; and \$472 million went toward remediating audit findings. The Department expects these costs to remain relatively consistent for the next several years until more organizations begin to achieve unmodified opinions. Once the auditors are able to rely more heavily on internal controls, there will be less substantive testing and fewer site visits, which will lower the Department's audit costs.

Ultimately, these audits save resources by improving inventory management, identifying vulnerabilities in cybersecurity, and providing better data for decision-making. For example, at the Navy, Fleet Logistics Center Jacksonville conducted a 10-week exploratory assessment of material held within two active aviation squadrons and one building. They identified \$81 million worth of active material not tracked in the system that was available for immediate use, decreasing maintenance time and filling 174 requisitions, including 30 that were high-priority. They also eliminated unneeded equipment freeing up approximately 200,000 square feet (~4.6 acres). At Tooele Army Depot in Utah, auditors tested 3.5 million items of Operating Materials and Supplies for completeness and found no exceptions. The Air Force auditor tested 1511 military equipment assets with a net book value of \$19.3 billion at 27 sites for completeness with no exceptions noted. Department-wide, more than 60 sites achieved a 100 percent pass rate.

Streamlined business processes are providing cost avoidance and improved operational efficiencies. Improved visibility of assets and financial resources are enhancing DoD decision-making and support to the warfighter. As a result of improvements in financial reporting, budgeters have better insight into resources that can be used before

they expire or cancel. On the FY 2018 financial statements, the Department reported \$27.7 billion in expiring unobligated funds. On the FY 2019 financial statements, the Department reduced this amount to \$22.7 billion, indicating a more efficient use of resources. Most importantly, these audits are increasing transparency and public accountability.

At the end of last year, we completed our second department wide audit, which was no small feat for the nation's largest employer. Nearly 3 million military and civilian personnel work for the DoD operating on every continent, flying roughly 14,000 aircraft and maintaining over 570,000 facilities around the world. Ongoing annual reviews of this expensive enterprise are necessary to keep us on track."

*– Secretary of Defense Dr. Mark T. Esper
February 6, 2020
Remarks at the Johns Hopkins
School of Advanced International Studies*

Long-Term Audit Strategy

It often takes a large federal agency several years to move from a disclaimer of opinion to an unmodified or clean opinion. It is expected that reporting entities, over time, will move from a disclaimer of opinion to a qualified opinion, with the majority of DoD Components making progress on all or some portion of their financial statements within the next 4 to 6 years. This progression is a priority focus and an important way to measure progress.

Audit results and insights into DoD operations are reshaping how Department leaders establish priorities, apply solutions, and track and manage progress across the Department for greater business reform. Similarly, reform activities often shape audit solutions. The Under

Secretary of Defense (Comptroller) (USD(C))/CFO and the DoD Chief Management Officer (CMO) work in close partnership to strengthen both financial and operational internal controls and resolve long-standing enterprise challenges.

In FY 2019, the Department focused heavily on tracking corrective action plans and NFR closure progress. As the audits expand and evolve, so, too, does the Department's ability to prioritize findings, forecast timeframes and closure rates, and track dependencies. In FY 2020, the Department began using material weaknesses to prioritize corrective actions, improve operational value, and strategically move the Department closer to an unmodified opinion.

Progress is measured by the downgrading and elimination of material weaknesses, and by audit opinion progression. Projections for numbers of findings closed now take into account whether a finding contributes to a material weakness and therefore requires more extensive efforts. The Department is also improving how it tracks dependencies on service providers and external organizations.

The audits are driving the cultural changes needed to achieve the National Defense Strategy's business reform goals. By highlighting areas that need improvement, Department leaders are able to make targeted and effective decisions about streamlining processes and reducing the numbers of systems. The audits demand IT system improvements and data consolidation that is arming decision-makers with advanced data analytics capabilities that support efficiencies and sustain improvements. Ultimately, success is in the hands of the DoD workforce—and they are already realizing the benefits of these audits. By continuing to equip them with resources and tools they need to respond to auditor requests and correct audit findings, the Department

will achieve its audit goals while sustaining an improved level of business proficiency.

This Report

This report and its contents are required by section 240b of Title 10, United States Code. The report gives readers an overview of DoD's enterprise-wide status and is organized around priority areas of improvement that align to the DoD-wide material weaknesses. Anecdotal examples of benefits being derived from the audits are scattered throughout the report.

Section I, "Auditing the Department of Defense," focuses on FY 2019 audit results and the Department's plan for managing corrective actions and measuring progress. This includes examples of how corrective action plans are supporting the National Defense Strategy and how Department leaders are demonstrating commitment and holding people accountable for results. The section provides the audit timeline, resources, and benefits of audit.

Section II, "Status of FY 2019 Corrective Actions," reports DoD-wide status on the financial statement audit priorities and other areas of focus. Dashboards from the Deputy Chief Financial Officer (DCFO) NFR Database show remediation status as of June 17, 2019.

Appendix 1, "Independent Auditor's Report," includes the results of the DoD Inspector General's (IG) FY 2019 audit.

Appendix 2, "Acronyms and Abbreviations," defines acronyms and abbreviations used in this report.

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I. Auditing the Department of Defense

In a January 2, 2020, message to the Force, Secretary Esper quoted the National Defense Strategy: “We have a responsibility to gain full value from every taxpayer dollar spent on defense, thereby earning the trust of Congress and the American people.” He reinforced his commitment to pursuing aggressive reforms and targeting resources to the highest priorities while being willing to make tough choices.

The audits are the most efficient way to evaluate and reform the Department’s business practices, and it is the law. Similarly, reform activities often shape audit solutions. Audits test internal controls; verify the count, location, and condition of military equipment, property, materials, and supplies; test vulnerabilities in DoD IT systems; and validate the accuracy of records and actions. The USD(C)/CFO and the DoD CMO work in close partnership to strengthen both financial and operational internal controls and resolve long-standing enterprise challenges

COVID-19 Effect and Maintaining Progress

The COVID-19 pandemic is altering the timing and scope of the FY 2020 financial statement audits and the government-wide financial reporting timeline but not the Department’s commitment to the audits or its mission. Senior leaders in the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)), the DoD OIG, Military Departments, and other Components are working with auditors to find alternative ways to complete audit work, and OMB is assessing how the pandemic is affecting the government-wide financial statements reporting timeline. The full effect of the coronavirus crisis on the DoD audits and remediation activities is not currently known.

The Department’s first priority during the pandemic, the health and safety of its workforce, is being balanced against audit and financial reporting requirements as well as corrective actions. DoD financial

managers have worked hard to find creative solutions that keep corrective actions and the FY 2020 audits on track as much as possible. Until there is more information on adjustments to travel restrictions, telework, and personnel returning to work locations, the true effect of the COVID-19 cannot be known. A recent survey sought to better understand how DoD Component FY 2020 audits and plans to correct findings from prior years’ audits are being affected by the COVID-19 pandemic.

FY 2020 Audits

None of the Components is expecting its audit opinion to slip as result of audit limitations resulting from the COVID-19 pandemic, however, the scope of any audit may be narrowed. Audit testing of sensitive activities and areas that must be completed on site are being delayed. Inventory, Operating Materials and Supplies, and Property, Plant and Equipment—areas that require physical access to assets and documentation---are the most affected. Site visits have been postponed or canceled, and there are limited alternative procedures that auditors can use for testing these assets. Most Components are waiting to see if physical inventory counts and site visits can be rescheduled for later in the year. The Air Force, however, reports minimal delays and was able complete virtual military and civilian pay walkthroughs using redacted system screenshots.

Corrective Actions on FY 2019 Findings

Delays in corrective actions could also occur where physical access is needed to make corrections. Available personnel may also be limited due to re-assignment to COVID-19 response activities or a lack of sufficient telework equipment. Correcting findings that touch on classified or sensitive activities or other information that must be protected, such as personnel records, is on hold due to the lack of secure, remote environments in which to conduct this work. Corrective actions in areas most easily accessible during telework have continued with minimal interruption.

Lessons Learned

Maintaining and, in some cases, increasing communications with major stake holders is critical during this time of change. Open, frank, and transparent discussions from all parties regarding audit objectives, ongoing procedures, outstanding questions, and any roadblocks are essential to continued progress.

Most organizations have been able to use virtual tools to perform business process and IT system walkthroughs remotely. For some assets, auditors are planning alternative procedures, such as photos and video calls, when site visits cannot take place. While virtual audit sessions are helping to keep as much as possible on track, they often take longer to plan and conduct. An auditor’s and a DoD employee’s ability to work remotely vary with personal internet speeds and the reality of managing telework with COVID-19 family obligations. Improvements in remote technology capabilities, such as improved network capabilities, collaboration tools, and access to laptops, would increase effectiveness, and the Department’s IT support has been working hard to enable as many solutions as possible during this challenging time.

FY 2019 Audit Results

In FY 2019, private sector auditors again conducted 24 standalone audits of DoD reporting entities, and the DoD OIG performed the overarching consolidated audit. Sensitive activities are audited within the classified environment. Approximately 1,400 auditors reviewed billions of transactions from the more than 1,700 active accounts the Department manages. They made more than 600 site visits to military bases, depots, and warehouses, and requested over 200,000 items.

Auditors again found no evidence of fraud and no significant issues with amounts paid to civilian or military members. The Department

was able to account for the existence and completeness of major military equipment, such as armored vehicles, ships, and aircraft. And more than 60 site visits in the standalone audits had a 100 percent pass rate, that is, auditors noted no exceptions in the samples selected.

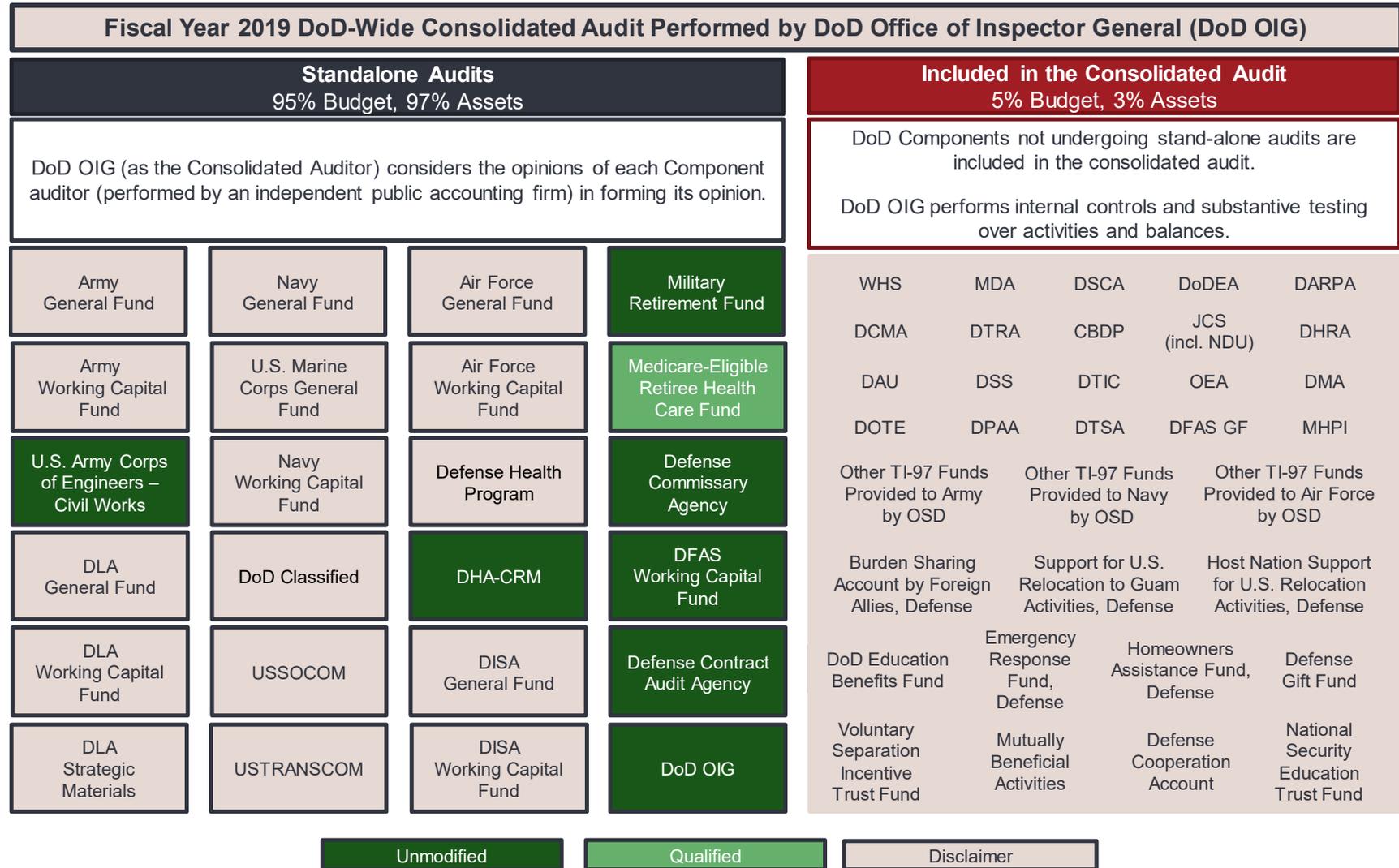
Figure I-1 shows seven reporting entities received unmodified opinions. The Defense Commissary Agency (DeCA) moved up to an unmodified opinion in FY 2019, an important indicator of progress and one measure of success. This was the 12th consecutive opinion for the Army Corps of Engineers (Civil Works), the 20th consecutive unmodified opinion for the DFAS Working Capital Fund, and the 25th consecutive unmodified opinion for the Military Retirement Fund. The Military Retirement Fund’s nearly \$900 billion in total assets represents more than 30 percent of total DoD assets.

Figure I-1: FY 2019 Audit Opinions

Unmodified Audit Opinions
U. S. Army Corps of Engineers – Civil Works
Defense Commissary Agency
Defense Contract Audit Agency
Defense Finance and Accounting Service – Working Capital Fund
Defense Health Agency – Contract Resource Management
Department of Defense Office of Inspector General
Military Retirement Fund
Qualified Audit Opinions
Medicare-Eligible Retiree Health Care Fund

Figure I-2 shows the resulting opinion or disclaimer of opinion for each reporting entity conducting a standalone audit or included in the consolidated audit in FY 2019.

Figure I-2: FY 2019 Audit Opinions and Disclaimers of Opinion



The Medicare-Eligible Retiree Health Care Fund (MERHCF) received a modified opinion, which means its financial statements are accurate with only minor exceptions. All other reporting entities received disclaimers of opinions, which means the auditors did not have enough evidence to provide an opinion on the reliability of the financial statements. The DoD classified activities, with the exception of one, also received disclaimers of opinion. No organization received an adverse opinion, and no fraud was found. The Department's leadership fully expected these results, and receiving a disclaimer of opinion is consistent with other federal agencies undergoing early financial statement audits.

The audits went deeper this year. Auditors visited more than 600 DoD locations, sent 45,000 requests for documentation, and tested more than 155,000 sample items. By comparison, auditors tested approximately 90,000 sample items in FY 2018. During the FY 2019 Army Working Capital Fund audit, Army and its Service Providers responded to more than 10,000 sample requests, approximately twice the number made during the FY 2018 audit. The Navy's auditor added 16 financially significant systems to its scope of testing for the FY 2019 audit. The Marine Corps' auditor tested more than 7,900 samples during the FY 2018 audit—that number increased to more than 9,200 samples for the FY 2019 audit. The Air Force responded to 7,946 provided by client requests and 2,454 sample requests, and supported 174 site visits across 63 locations.

As a result of going deeper and expanding testing, findings from the FY 2019 audits also increased. However, these findings, coupled with the cultural changes being driven by them, are the biggest benefit of the audits. They help the Department identify vulnerabilities in cybersecurity, improve inventory management, and provide better data for decision-making.

Material Weaknesses

The DoD OIG identified 25 Department-wide material weaknesses during FY 2019 audits, a net increase of five material weaknesses from the FY 2018 audits. A material weakness is a deficiency that presents a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected.

The DoD-wide material weaknesses are:

- Financial Management Systems and IT
- Universe of Transactions
- Fund Balance with Treasury
- Suspense Accounts*
- Inventory and Related Property
- Operating Materials and Supplies
- General Property, Plant, and Equipment
- Real Property*
- Government Property in the Possession of Contractors
- Joint Strike Fighter Program* (new)
- Military Housing Privatization Initiative* (new)
- Accounts Payable
- Environmental and Disposal Liabilities
- Legal Contingencies
- Beginning Balances
- Unsupported Accounting Adjustments (renamed)
- Intradepartmental Eliminations and Intragovernmental Transactions (renamed)
- Gross Costs*
- Earned Revenue*
- Reconciliation of Net Cost of Operations to Outlays (renamed)
- Budgetary Resources
- Service Providers* (new)
- Entity-Level Controls
- DoD-wide Oversight and Monitoring*
- Component-Level Oversight and Monitoring*

* New or broken out in FY 2019

Three of the new material weaknesses resulted from auditors increasing their testing and identifying new issues. The other new material weaknesses were subsets of FY 2018 material weaknesses that the auditors broke out to provide more detail. Financial Statement Compilation was consolidated into the DoD Management Oversight and Monitoring and Universe of Transactions material weaknesses in FY 2019.

Notices of Findings and Recommendations

The FY 2019 audits resulted in more than 3,200 Notices of Findings and Recommendations, or NFRs. This is a 37 percent increase over findings from the FY 2018 audit as auditors increased the extent of testing. Where remediation actions have been taken, findings from one audit year are tested by auditors in the next audit year. If the problem

has been remediated, that finding is validated as closed. Auditors validated 26 percent of FY 2018 NFRs as closed. If the problem persists, the auditor re-issues that finding in their new audit report. More than 50 percent of FY 2019 NFRs were re-issued findings from FY 2018 and were not new issues. Auditors evaluate those corrective actions completed by June 30 of each year to determine whether the issue has been effectively resolved. Re-issued findings can result when corrections were not completed in time for auditors to validate that the problem has been addressed. Some re-issued findings may be more complex, such as system issues, and require long-term remediation strategies.

Figure I-3 shows the number of FY 2018 NFRs closed by functional area in the FY 2019 audits. Figure I-4 shows the number of FY 2019 NFRs issued by functional area.

Figure I-3: FY 2018 NFRs Closed by Functional Area

Component	Financial Management Systems & IT	Financial Reporting & Fund Balance with Treasury	Property	Other	Total Number of FY 2018 NFRs Closed
Army	85	31	4	21	141
Navy	57	29	31	4	121
Marine Corps	12	3	0	0	15
Air Force	52	22	6	6	86
Other Reporting Entities and DoD Consolidated	165	65	14	6	250
Total DoD	371	150	55	37	613

Note: Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Figure I-4: FY 2019 NFRs by Functional Area

Component	Financial Management Systems & IT	Financial Reporting & Fund Balance with Treasury	Property	Other	Total Number of FY 2019 NFRs
Army	143	126	84	41	394
Navy	522	248	181	69	1,020
Marine Corps	86	46	24	13	169
Air Force	231	127	94	16	468
Other Reporting Entities and DoD Consolidated	481	466	182	68	1,197
Total DoD	1,463	1,013	565	207	3,248

Note: Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Findings from DoD Service Provider Examinations

Service providers that provide common services to multiple entities under audit obtain an IPA examination on their controls. IPA firms conduct these examinations in accordance with the Statement on Standards for Attestation Engagements (SSAE) No. 18, "Attestation Standards: Clarification and Recodification" and issue findings and render an opinion in a System and Organization Controls Report, or SOC 1 Report.

Results of these examinations can be used by other auditors as evidence the service provider's controls are designed and operating effectively. This reduces redundant testing of controls by auditors of other reporting entities, saving both time and money. The Department is also working to maximize the use of commercial and cloud service providers. As they can with DoD service providers, DoD auditors can

rely on SOC 1 Reports from outside providers with unmodified opinions, such as the Department of Treasury, Department of Labor, US Bancorp, Microsoft Azure, Amazon Web Services, and Oracle.

In FY 2019, DoD auditors completed 23 SSAE No. 18 examinations. Vendor Pay, which was previously one large, complex examination, was broken into four examinations and re-scoped around systems to improve usability. The 23 FY 2019 examinations resulted in 11 unmodified opinions. Those with unmodified opinions, including civilian pay, military pay, contract pay, and standard disbursing services, account for nearly 70 percent of disbursements made by DFAS. Ten examinations resulted in qualified opinions, and 2 resulted in adverse opinions. An adverse opinion in an SSAE No. 18 examination means there were pervasive misstatements in management's descriptions of the system, design of controls, and/or

failures in the operating effectiveness of controls that were both material and pervasive. Army Conventional Ammunition, which expanded the scope of its examination, is working to correct controls and regain their qualified opinion. The Defense Logistics Agency (DLA) is replacing the system used for Service-Owned Items in the Custody of DLA (SOIDC) with a modern solution that will enable it to achieve an unmodified opinion.

In FY 2020, auditors will complete three new SSAE No. 18 examinations for Defense Enterprise Accounting and Management System (DEAMS), Advana, and MilCloud; DLA did not perform an FY 2020 SOIDC examination, for a total of 25 DoD SOC 1 Reports for FY 2020.

Figure I-5 lists examinations conducted in FY 2019 for each DoD Service Provider. As the figure shows, one qualified opinion moved to unmodified, and five unmodified opinions were downgraded. The downgraded opinions largely resulted from the expanded scope of the examinations and some organizational staffing and business model changes within the service provider’s organization.

Figure I-5: DoD Service Provider Examination Results

SSAE No. 18	FY 2019			
	Opinion	# of NFRs Issued	# of FY 2018 NFRs Repeated	# of FY 2018 NFRs Closed
Army				
GFEBs	Qualified	27	7	3
Conv Ammunition	Adverse	69	21	22
Defense Contract Management Agency				
Contract Pay	Qualified	6	0	7
Defense Finance and Accounting Service				

SSAE No. 18	FY 2019			
	Opinion	# of NFRs Issued	# of FY 2018 NFRs Repeated	# of FY 2018 NFRs Closed
Civilian Pay	Unmodified	3	0	2
Military Pay	Unmodified	4	0	4
Vendor Pay				
CAPS-W	Qualified	10	1	N/A
DAI	Qualified	3	0	N/A
IAPS	Qualified	5	0	N/A
One Pay	Qualified	9	0	N/A
SDS	Unmodified	2	0	1
Contract Pay	Unmodified	1	0	2
Financial Reporting	Qualified	9	9	0
DCAS	Qualified	6	3	2
ELAN	Unmodified	1	0	3
Defense Information Systems Agency				
ECS	Qualified	27	4	14
ATAAPS	Unmodified	0	0	5
Defense Logistics Agency				
WAWF	Unmodified	1	0	1
DAAS	Qualified	8	0	N/A
SOIDC	Adverse	3	0	3
DAI	Unmodified	0	0	0
DPAS	Unmodified	0	0	0
Defense Manpower Data Center				
DCPDS	Unmodified	3	0	2
DTS	Unmodified	1	1	4
Total		198	46	86

Managing Corrective Actions

Audit results and insights into DoD operations are reshaping how Department leaders establish priorities, apply solutions, and track and manage progress across the Department for greater business reform. The FY 2019 priority areas (Inventory, Real Property, IT Access Controls, and Government Furnished Property) were expanded to include Fund Balance with Treasury; Financial Reporting Internal Controls; the Joint Strike Fighter Program; and advancing Components from a disclaimer of opinion, to a modified or unmodified opinion.

In FY 2019, the first real remediation year, the Department focused heavily on tracking corrective action plans and NFR closure progress. As the audits expand and evolve, so, too, does the Department's ability to prioritize findings, forecast timeframes and closure rates, and track dependencies. In FY 2020, the Department began using material weaknesses to prioritize corrective actions and strategically move the Department closer to an unmodified opinion.

Measuring Progress

Progress is measured by the downgrading and elimination of material weaknesses, and by audit opinion progression. Projections for numbers of findings closed now take into account whether a finding impacts a material weakness and therefore requires more extensive efforts. The Department is also improving how it tracks dependencies on service providers and external organizations.

The Department established metrics for each audit priority area to monitor the Department's progress toward downgrading or remediating that material weakness. These metrics are the Department's methodology to quantify progress throughout the year. For example, the first metric for Inventory helps the Department know how much has been inventoried and how significantly each Component is adjusting system records in their systems based on

physical counts. If minimal adjustments are needed, then the Department can have confidence that the Component is making progress on resolving issues with Inventory and remediating this weakness. Senior leaders can use these metrics to track incremental progress between audits.

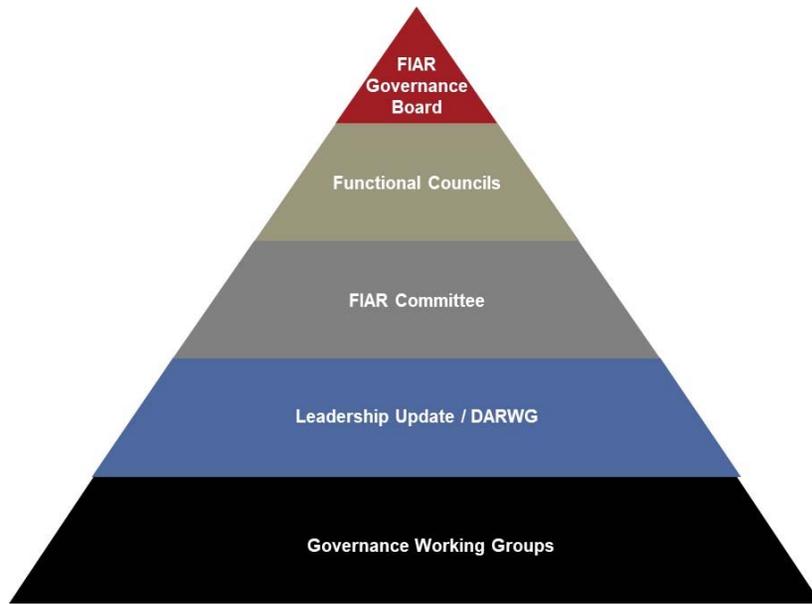
This initial iteration of metrics will likely change over time, as the Department completes process improvements and audit results evolve. The effect of COVID-19 on NFR closure rates is still being assessed, and current metrics may be re-evaluated for the FY 2021 audit.

FIAR Governance

The goal of the governance structure is to ensure leadership, at all levels, has the information and support they need to stay committed to audit success. The Department expanded the FIAR Governance structure to more actively and precisely provide guidance, direction, and timely decisions to the Military Departments and Components. To reinforce the unity between the Department's audit efforts and the Department's business reform efforts, the governance structure formalizes the role of the Office of the Chief Management Officer (OCMO) and the CMO as co-chair to the USD(C)/CFO of the FIAR Governance Board. This helps ensure issues identified by the audit can be actioned and, if necessary, developed into DoD-wide reforms.

Figure I-6 shows the elements of the FIAR governance structure. A more detailed explanation of each element of the governance structure follows.

The FIAR Governance Board provides vision, leadership, direction, oversight, and accountability in support of moving toward an unmodified audit opinion. It prioritizes Department-wide corrective actions that provide the greatest value to the warfighter. For example, recent Department-wide emphasis and board leadership efforts directly led to increased discovery, awareness, and accountability of inventory items critical to military operations.

Figure I-6: FIAR Governance Structure

Functional Councils address three high-profile and pivotal audit issues: Financial Reporting and Fund Balance with Treasury; Property; and IT. Councils meet quarterly to review remediation status and develop solutions that may involve changes to DoD policy and procedures.

The FIAR Committee advises the FIAR Governance Board on ways to optimize financial management improvement and audit remediation.

Leadership Update meetings provide updates on DoD-wide audit initiatives to Components not undergoing standalone audits.

DARWG (Defense Audit Remediation Working Group) interprets policy and accounting standards, and provides guidance on technical issues. It may, as needed, convene experts from the Department of Treasury, GAO, and the Federal Accounting Standards Advisory Board (FASAB) to help resolve issues.

Governance Working Groups are convened to develop specific content and recommendations to the appropriate governance body.

In addition to these Departmental-level governance elements, each Component maintains its own governance structure.

Data Analytics

There are numerous business and mission systems across the Department, all with different interfaces, formats, and schemas. Historically, these systems have proven so difficult to navigate that analysts have resorted to basic reporting within departmental silos. Advana, a mash-up of the words “Advancing Analytics,” is the DoD technology platform that houses a collection of enterprise data and arms leaders and decision-makers with analytics, visualizations, and data tools.

Advana is helping resolve some of the largest financial statement audit challenges with custom tools predicated on the idea that to achieve an unmodified opinion, each reporting entity must be able to identify and record its transactions accurately and completely, and demonstrate how those transactions flow to its financial statements. Tools that aggregate and reconcile audit populations are enabling reporting entities to drill from the financial statements down to general ledger details, better track and resolve auditor findings, improve funds management, and reduce cash reconciliation differences between DoD’s accounting systems and the Department of the Treasury.

The benefits of Advana extend beyond the Department’s financial management goals. Having detailed transactional data housed in a big

data platform ensures consistency across multiple needs and uses. For example, the same data used for audits is being used to report medical line of business costs. Additionally, standardized data elements create a structure across systems and eliminates the need to prepare data for reconciliation or other data analyses. This decreases the amount of time to complete an end-to-end reconciliation from three weeks to one day. Data captured once is managed centrally and available enterprise-wide.

Deputy Chief Financial Officer (DCFO) NFR Database

Each year's audit findings are uploaded into a centralized database managed by the DCFO. The DCFO NFR Database continues to be the single source for accurate, real-time, independent information on the progress of the DoD financial statement audits. It houses all findings from each standalone financial statement audit, the DoD Consolidated Audit, and service provider SSAE No. 18 examinations. Limited access rights protect the integrity of the findings and status of corrective actions.

For each NFR, the auditor details the conditions that led to that finding and assigns a deficiency category (material weakness, significant deficiency, control deficiency, or compliance). The Department uses this information to categorize and prioritize findings. The reporting entity receiving the NFR then develops and enters a corrective action plan into the database. A corrective action establishes milestones, assigns responsibility for completing the milestones, and projects a completion date.

The DCFO NFR Database provides a strategic view of pervasive issues and visibility into findings and progress. Senior leaders use customized dashboards to track NFRs, conditions, and corrective action plans. These dashboards show, in real-time, which reporting entity has the most validated and the most overdue plans. The database team is continually developing new dashboards for measuring progress and identifying Department-wide issues. "Reason for

Reissuance," was recently added to capture insight into NFRs re-issued from the previous year. Such enhancements help leadership identify Department-wide issues and trends and streamline remediation efforts. Managers use database reports to identify best practices and facilitate Department-wide solutions. The wide visibility of this tool helps reduce duplication of efforts and maintain accountability. A communication workflow has been added to track corrective action plan assessment in the DCFO NFR Database.

"Reforming the Department to free up time, money, and manpower is not optional—it is a strategic imperative if we are to modernize the Joint Force and improve its readiness and lethality."

– Secretary of Defense Dr. Mark T. Esper
January 6, 2020

Department of Defense Reform Focus in 2020 Memorandum

Supporting the National Defense Strategy

The annual financial statement audits are foundational to Secretary of Defense Dr. Mark T. Esper's broader reform agenda, the National Defense Strategy, and the drive to be more efficient, transparent, and accountable. The Honorable David Norquist, who now serves as Deputy Secretary of Defense, is still very focused on the audits. The Honorable Elaine McCusker, Acting Under Secretary of Defense (Comptroller)/CFO and other leaders within the Office of the Secretary of Defense (OSD) are maintaining aggressive levels of interest and engagement. The Government Accountability Office noted the Department met the leadership commitment in financial management criterion by completing its first audit and demonstrating commitment to making improvements.

Amid the coronavirus crisis, the Secretary's primary focus became protecting the safety and well-being of the men and women serving in

the Armed Services and throughout the DoD. However, even in this new environment, the Department's focus on achieving the National Defense Strategy remains unchanged.

The National Defense Strategy describes the need for the “seamless integration of multiple elements of national power—diplomacy, information, economics, finance, intelligence, law enforcement, and military. It establishes three distinct lines of effort:

1. Build a more lethal force
2. Strengthen alliances and attract new partners
3. Reform the Department for greater performance and affordability

Achieving a modern, effective, and efficient financial management environment through the annual financial statement audit and corrective actions process will help the Department accomplish all three lines:

- Improved accuracy of available and operational materials and inventory frees up resources for other uses and helps ensure the force has what it needs when and where it needs it.
- Effective controls and funds management demonstrates sound stewardship to our allies and partners.
- Modernizing the Department's business practices by identifying and addressing areas that need improvement advances readiness and accountability, and makes better use of taxpayer dollars.

Leadership commitment is key to achieving these goals. All Components under standalone audit have an internal process for monitoring progress on corrective actions. Many have issued executive directives to all staff underscoring the importance of audit and establishing priorities. All members of the DoD Senior Executive Service have an audit-related objective in their annual performance plan, and leaders throughout the Department are held accountable for

making remediating audit findings a priority. The following section describes how the Components are advancing the National Defense Strategy through audit improvements that demonstrate leadership commitment:

Military Departments

The Army is working to achieve an audit opinion on the Army Working Capital Fund in FY 2022 and the General Fund in FY 2023. The Army worked closely with DFAS to improve the control design around Fund Balance with Treasury reconciliation. This resulted in a material reduction in the differences between Army's accounting records and those of the Department of Treasury. In January 2019, this amount was reported as \$256 million. As of April 2020, this amount was reduced to \$36 million. The reduction of material differences and the improvement of the controls marks an important achievement and a huge step forward in Army business reform.

The Army also automated its FY 2015 – FY 2020 Account Balance Report and Reconciliations, which involves millions of records. This enables Army to tie any General Ledger from this time period to its systems and trial balances, an audit requirement.

Beginning balances for Real Property is essential to achieving an opinion. As part of its surge support to each continental U.S. garrison, the Army hired qualified veterans and military spouses to help conduct physical observations of the assets and validate critical data elements. In the first six months, the team reviewed over 5,000 asset records, a major success in making progress toward properly accounting for Real Property.

The Department of the Navy's (DON) audit remediation priorities address asset accountability, data quality and transparency, IT infrastructure security, government-furnished property in the hands of contractors, and accuracy of estimates for legal and environmental liabilities.

The DON is tackling long-standing business practices that inhibit budget execution traceability and transparency. This includes moving funds to where they are used and relieving burdensome documentation and reconciliation requirements. For example, DON realigned \$369 million in facility support funding, providing it directly to the Navy Facilities Engineering Command (NAVFAC), and consolidated NAVFAC financial operations with Commander, Naval Installations Command. These changes eliminated over 6,800 annual reimbursable documents and an associated 40,000 financial transactions. DON is also working to increase visibility and access to DON financial, budget, and execution data. Analytic dashboards with transaction-level drill-down capabilities are fostering improved financial management and improved readiness. Outcomes include an increased capability to collect, analyze, and report relevant data.

The DON is working aggressively to reduce disparate, stove-piped systems that are difficult to audit and unaffordable to sustain. The DON will continue to consolidate all accounting systems into the Standard Accounting, Budgeting, and Reporting System (SABRS) and Navy Enterprise Resource Planning system (ERP) by FY 2021 and consolidate more than 200 legacy logistics systems into an integrated network of a few modern systems.

The Marine Corps issued a detailed, prioritized FY 2020 audit plan to hold itself accountable for improving several critical lines of business and 12 focus areas. The Marine Corps received additional funding for surge resources in support of the FY 2020 full financial statement audit and is building on lessons learned from prior year audits and working toward a positive opinion in FY 2020.

The Air Force continues to remediate audit findings related to business process and system deficiencies—enabling business reform, enhanced performance, and mission readiness in alignment with the National Defense Strategy. Prioritized activities focus on reconciling Fund Balance with Treasury, mission-critical asset accountability and

readiness, IT modernization and cybersecurity, and advanced analytics and automation to streamline processes and enhance data-driven decision-making.

The Air Force is demonstrating effective stewardship of taxpayer dollars. At the end of FY 2019, the Air Force was able to reconcile 98 percent of its \$149.5 billion Fund Balance with Treasury transactions. To advance mission-critical asset accountability, the Air Force inspected its largest contractor inventory sites, identifying approximately 41,000 excess, obsolete, or unserviceable inventory items and potentially driving reductions in warehouse costs. Additionally the Air Force developed a valuation model to identify the full acquisition cost of delivered aircraft for two pilot programs (C-130J and MQ-9). The extrapolation of this methodology to all assets will provide more accurate cost data and help refine aircraft procurement budgeting.

The Air Force's IT portfolio modernization efforts targeted legacy systems replacement in key capability areas, such as the Air Force's Theatre Integrated Combat Munitions Systems, which directly improves readiness and was successfully deployed to all Air Force installations. In parallel, the Air Force developed Robotic Process Automations addressing financial and information technology deficiencies, increasing process accuracy to 99.9 percent. For example, the Air Force automated the monitoring and management of system user access, improving cybersecurity and resulting in an average monthly clean-up rate of 55 accounts in a user population of more than 66,000.

Other Reporting Entities Under Audit

The Defense Commissary Agency (DeCA) regained its unmodified opinion on its FY 2019 financial statements even while making changes to its business model and transforming inventory and resale financial management. The agency is continuing to transition to more commercial best practices and is incorporating procedures, internal

controls, and governance for inventory management as recommended by the auditors. These enhancements will improve DeCA's performance and accountability, ensure effective stewardship of taxpayer's resources, and automate processes for consistent product availability. DeCA is considered a mission-essential and critical operation to the health and welfare of the war fighters and their families. During COVID-19, the commissaries were declared part of the critical infrastructure.

The Defense Contract Audit Agency (DCAA) has sustained an unmodified opinion on its financial statements for 18 consecutive years and credits its leadership's dedication to accountability and excellence and a sustained commitment to training and development. These results demonstrate DCAA's continual efforts to evaluate internal controls and implement audit and procedural guidance. DCAA is also participating in a DoD-wide fraud detection and prevention pilot program to assist in developing fraud data analytics testing to strengthen DoD's overall internal control program.

The Defense Finance and Accounting Service has sustained an unmodified opinion on its financial statements for 20 consecutive years by creating a culture that supports continual review of internal controls and transactions, provides regular communication and guidance, and assesses audit consequences before executing any material financial decisions.

A number of DFAS initiatives advance the audit efforts of all DoD Components and the Department as a whole. Initiatives related to Fund Balance with Treasury, Journal Vouchers, and Universe of Transactions are detailed in Section II, "Status of FY 2019 Corrective Actions." Additionally, to improve documentation needed for audit, DFAS created voucher-level support for 90 percent of the Marine Corps' cross-disbursements that were previously only reported at the summary level. The updated process allows for better division of intransit balances between Navy and Marine Corps shared

appropriations and reduces concerns associated with shared lines of accounting. The reconciliation process recreated from FY 2014 through present established support for more than \$3.4 billion in cross-disbursement transactions for the Marine Corps appropriations alone.

The Defense Health Agency's (DHA) corrective actions align with the organization's goals to assist with the integration of operational readiness and healthcare delivery, including increased readiness, better health, better care, and lower cost. DHA aims to cultivate emerging technologies and a skilled military and civilian workforce to provide the necessary clinical care to forces across the military services. Its corrective action plans are prioritizing resources and addressing risks to holistically mitigate material weaknesses.

DHA is consolidating military medical treatment facilities and continuing the roll-out of the Military Health System electronic health record, MHS GENESIS. MHS GENESIS connects medical and dental information across the continuum of care, from the point of injury to the military medical treatment facility. Once fully deployed, it will provide a single health record for use by both medical professionals and financial managers for effective operational and financial stewardship. The Military Health System is also continuing its transition toward a single accounting system, the General Fund Enterprise Business System or GFEBS, and is currently assessing deploying GFEBS to the Air Force Medical Service. If achieved, roughly 85 percent of the Defense Health Program's Fund Balance with Treasury will be on GFEBS. Through Advana, DHA has also streamlined the automation of the Universe of Transaction reconciliation workbooks, which helps the DoD standardize data and achieve a common enterprise data repository.

The Defense Information Systems Agency (DISA) is working toward a positive opinion in FY 2020. DISA is on the leading edge of deploying, operating, and sustaining cyber tools, capabilities, and

expertise to maximize DoD Information Network operations. It ensures secure, available, and reliable services and capabilities and implements artificial intelligence and machine learning to support cyber defenders and improve and automate financial and contractual transactions. DISA contributes to the Department's IT reform work by supporting network and data center optimization, automating continuous endpoint monitoring, streamlining IT commodity purchases, providing enterprise collaboration suites, and consolidating cyber and IT responsibilities.

The Defense Intelligence Community is held to the same standards of audit, but audit work is performed in the classified environment by auditors with appropriate security clearances. The challenges faced by the intelligence agencies are often similar to those of other DoD Components and may relate to areas such as internal controls, Fund Balance with Treasury, Inventory, and Property. The National Reconnaissance Office has maintained 11 consecutive unmodified opinions and prioritizes financial stewardship and the Department's reform efforts. The Defense Intelligence Agency is addressing weaknesses in its financial reporting and business systems through a comprehensive internal controls program and support to DoD's Real Property reform work. The National Geospatial-Intelligence Agency is working to achieve an opinion on its FY 2023 financial statements by resolving its four material weaknesses. The National Security Agency has resolved more than half of its material weaknesses and is working to address the remaining five.

The Defense Logistics Agency's strategic plan establishes auditability as an imperative and sets priorities that align with DOD audit priorities. The agency is establishing clear and measurable performance standards on audit sustainment into its performance plans, and is expanding audit recruiting, training, and communications programs. DLA's corrective action plans, particularly those related to Inventory, Fund Balance with Treasury, IT General Controls, and Real

Property advance the Department's reform agenda. The agency is also implementing a Warehouse Management System to more efficiently and cost effectively support the warfighter.

The Military Retirement Trust Fund (MRF) has sustained an unmodified opinion on its financial statements for 24 consecutive years and credits a sustained commitment to training and its leadership's commitment to accountability and excellence. MRF partners at DFAS Cleveland, DFAS Indianapolis and Defense Manpower Data Center reinforce performance objectives to mitigate risk, monitor and respond to fraud, data mine and refine data matching techniques, and review performance and balances to ensure integrity throughout the system.

U.S. Special Operations Command's (USSOCOM) is working with the Defense Security Cooperation Agency to streamline the process for receiving, employing, and reporting funding provided under specific Congressional Authorities for support to U.S. allies and partners as well as supporting the Defense Strategy's other lines of effort. USSOCOM established metrics to track improvement and rank USSOCOM's Components and Theater Special Operation Commands, which holds them accountable and engages them in friendly competition to improve.

USSOCOM's corrective action plan strategy is to systematically improve internal controls. Modernization and standardization of asset management procedures are optimizing the redistribution of assets and realizing savings. IT improvements are narrowing security risks and supporting better management decision-making.

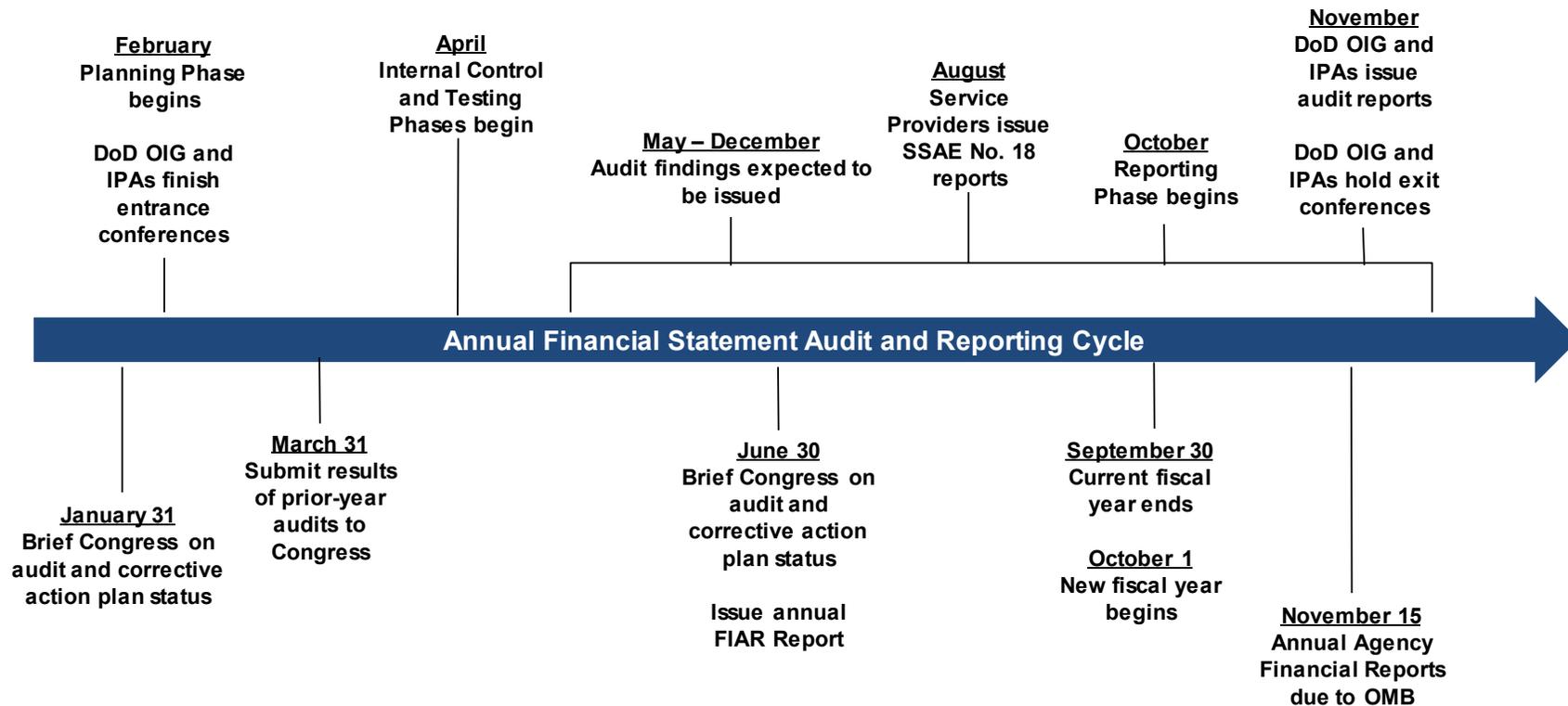
U.S. Transportation Command (USTRANSCOM) has aligned its audit remediation work to Department priorities and is focused on downgrading and eliminating material weaknesses and aligning corrective action plans to the National Defense Strategy.

Annual Audit Timeline

Each annual, standalone financial statement audit focuses on a single set of financial statements that represents the entire enterprise being audited. Unlike the Department’s many ad hoc compliance and program audits, these audits provide on-going visibility into DoD’s

overall status. Figure I-7 shows the audit timeline. Each year, the books are closed and financial reports produced as of September 30, the end of the fiscal year. By November 15 of each year, the final audit report is issued as part of the Agency Financial Report. This process is repeated each year.

Figure I-7: Annual Audit Timeline and Reporting Cycle



Audit Resources

Audit, audit support, and audit remediation costs, including financial system fixes, totaled \$900 million for FY 2019. These costs are relatively consistent with the FY 2018 audit, and arguably, much of this work would need to be completed regardless of whether the annual financial statement audits were required.

Approximately \$186 million was paid to the IPAs conducting the audits and SSAE No. 18 examinations. This is approximately 1/30th of one percent of DoD's budget and, as a percent of revenue, is equal to or less than what many of the top Fortune 100 companies pay their auditors. Another \$242 million went to audit support, such as responding to auditor requests for information; and \$472 million went toward remediating audit findings.

The Department expects audit-related costs to remain relatively consistent over the next several years until more organizations begin to achieve unmodified opinions. Once the auditors are able to rely more heavily on internal controls, there will be less substantive testing and fewer site visits, which should lower audit and audit support costs. And as reform efforts take hold, dividends from business reforms should continue to grow.

Figures I-8 through I-13 show FY 2018 costs for the Military Services and other reporting entities using the following definitions:

Audit Services and Support are the costs of the audits and SSAE No. 18 examinations performed by IPAs, plus government and contractor costs for supporting the audits and responding to auditor requests.

Audit Remediation includes government and contractor costs for correcting findings and the costs of achieving and sustaining an auditable systems environment. These costs do not include ERP deployment or maintenance costs.

Figure I-8: Total DoD Resources

Total DoD	FY 2019 (In Millions)
Audit Services and Support	\$428
Audit Remediation	\$472
Total Resources	\$900

Note: Numbers may not sum due to rounding.

Figure I-9: Army Resources

Army	FY 2019 (In Millions)
Audit Services and Support	\$79
Audit Remediation	\$57
Total Resources	\$136

Note: Numbers may not sum due to rounding.
Includes U.S. Army Corps of Engineers.

Figure I-10: Navy Resources

Navy	FY 2019 (In Millions)
Audit Services and Support	\$94
Audit Remediation	\$145
Total Resources	\$239

Note: Numbers may not sum due to rounding.

Navy resources are proportionally higher than the other Services, because Navy holds 50% of the Department’s Property, Plant, and Equipment, net; and 38% of the Department’s Inventory and Related Property, net; and requires additional resources to establish opening balances.

Figure I-11: Marine Corps Resources

Marine Corps	FY 2019 (In Millions)
Audit Services and Support	\$19
Audit Remediation	\$41
Total Resources	\$60

Note: Numbers may not sum due to rounding.

Figure I-12: Air Force Resources

Air Force	FY 2019 (In Millions)
Audit Services and Support	\$74
Audit Remediation	\$65
Total Resources	\$139

Note: Numbers may not sum due to rounding.

Figure I-13: Other Reporting Entities Resources

Other Reporting Entities	FY 2019 (In Millions)
Audit Services and Support	\$162
Audit Remediation	\$164
Total Resources	\$326

Note: Numbers may not sum due to rounding.

Includes costs incurred by Defense Agencies and other reporting entities not included in the Military Services; and the cost of the DoD consolidated audit.

Benefits of Audit

The audits result in valuable, independent insight into what is working and where the Department needs to improve. The return on investment will continue to increase as the audits mature. The Department is already realizing benefits in its culture, operations, and resources.

The DoD Payment Integrity Program, for example, which is complementary to the annual financial statement audits, requires Components to identify and report programs with more than \$100 million of improper payments and implement a cost-effective payment recapture program for overpayments that results in monetary losses to the Department. Since FY 2013, the Department has resolved 74 percent of DoD OIG audit recommendations related to the Payment Integrity Information Act and predecessor laws, steadily improved its overall compliance, and moved closer to meeting the President's Management Agenda, Cross-Agency Priority Goal 9, "Getting Payments Right."

As a result of improvements in financial reporting, budgeters have better insight into resources that can be used before they expire or cancel. On the FY 2018 financial statements, the Department reported \$27.7 billion in expiring unobligated funds. On the FY 2019 financial statements, the Department reduced this amount to \$22.7 billion, freeing up \$5 billion to support other priorities.

The audits are also laying the foundation for benefits that will be realized over time, such as:

Strengthened risk management and internal controls:

- Spotlight risks and help management respond before auditors identify issues
- Help prevent fraud, waste, and abuse
- Improve cybersecurity
- Enhance national security

Streamlined business processes:

- Lead to cost avoidance and increased buying power
- Increase operational efficiencies
- Reduce Component silos and audit complexity

Improved visibility of assets and financial resources:

- Optimizes the warfighter's posture and improves readiness, such as improving timeliness of getting supplies to our warfighters
- Enhances DoD decision-making by having more accurate data in DoD systems

Increased transparency and accountability:

- Provide an independent assessment of DoD's business processes
- Improve public confidence in DoD operations
- Send an implicit message to the public that the Department takes the use of taxpayer dollars seriously and hold itself accountable for their efficient use

II. Status of FY 2019 Corrective Actions

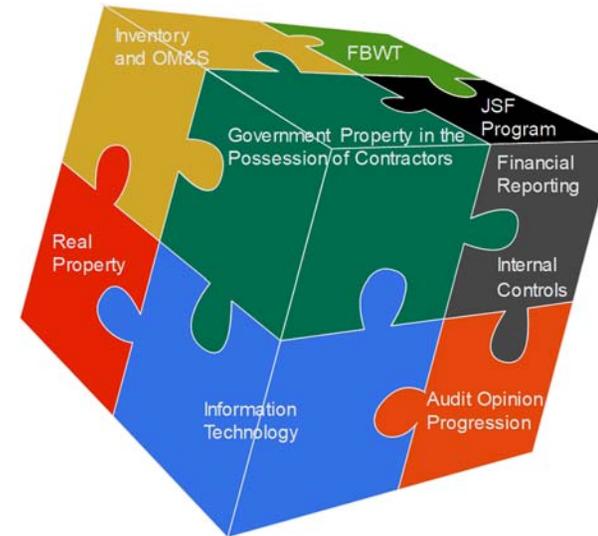
Auditors are doing exactly what the Department needs them to do—expanding testing and generating new findings and recommendations. These findings coupled with the cultural changes that they drive are the biggest benefit of the audits. Audit findings help us identify vulnerabilities in cyber security, better manage inventory, and improve data for decision-making.

Audit findings increased from 2,377 findings in FY 2018 to 3,248 in FY 2019. About 45 percent related to financial management systems and IT. Many of the IT-related findings resulted from the Department’s complex systems environment and numerous legacy systems. Beginning June 30, 2020, the Department will report on the status of achieving its IT target environment in the Defense Business Systems Audit Remediation Plan, due annually to Congress. Another 31 percent related to Financial Reporting and Fund Balance with Treasury, and findings related to property totaled 17 percent. The volume and global nature of property assets complicate the Department’s efforts to accurately value these assets and confirm existence and completeness of records.

Audit Priorities

The Department is developing and completing corrective actions using material weaknesses to prioritize remediation activities and strategically move closer to a clean opinion. To sustain and build on progress made last year, Secretary Esper called on the Department to remain focused on the FY 2019 priorities and endorsed the FY 2020 audit priorities, which included Fund Balance with Treasury, Financial Reporting Internal Controls, and remediating findings related to the reporting of assets for the Joint Strike Fighter Program. The Department also named Audit Opinion Progression, achieving new positive audit opinions each year going forward, a priority.

Figure II-1: DoD Audit Priorities



The 2018 National Defense Strategy requires relentless prioritization of effort to balance accomplishing near term and long terms goals. Reforming the way we do business with affordability and stewardship is a key driver for our high priority on annual financial audits.

*– Secretary of Defense Dr. Mark T. Esper
May 18, 2020*

Fiscal Year 2020 Financial Statement Audit Priorities Memorandum

Department-wide status for the FY 2020 and FY 2019 priority areas and other areas of focus follow.

Fund Balance with Treasury

Fund Balance with Treasury is an asset account that shows a reporting entity's available budget spending authority. Much like a personal checking account, the balance in the fund increases with receipts and collections and decreases with disbursements. Each reporting entity must be able to perform a detailed, monthly reconciliation between its records and the Department of Treasury's records. Performing these reconciliations and reducing differences is essential to supporting the budget authority and outlays reported on the Statement of Budgetary Resources. The auditors noted several deficiencies in the design and operation of internal controls for Fund Balance with Treasury resulting in a DoD-wide material weakness.

FY 2020 Corrective Actions: Implement end-to-end Fund Balance with Treasury processes and solutions to resolve reconciliation differences between the Defense Department and Treasury. Complete end-to-end process documentation. Resolve variances greater than 60 days in temporary-holding accounts, Defense-wide accounts, and disbursing officers' reports.

Status: The Department is executing its plan to downgrade the Fund Balance with Treasury material weakness by continuing to improve business processes, reducing differences to an immaterial amount, and automating account reconciliations. The Department is moving disbursing responsibilities to the federal shared service provider system under Treasury and becoming a Treasury Disbursing Office agency. This ensures traceability and timeliness of financial transaction processing, centralizes Fund Balance with Treasury systems and processes, and advances the retirement of related legacy systems. In the target environment, Components will be able to complete Fund Balance with Treasury cash reconciliations daily and directly between the ERPs and Treasury.

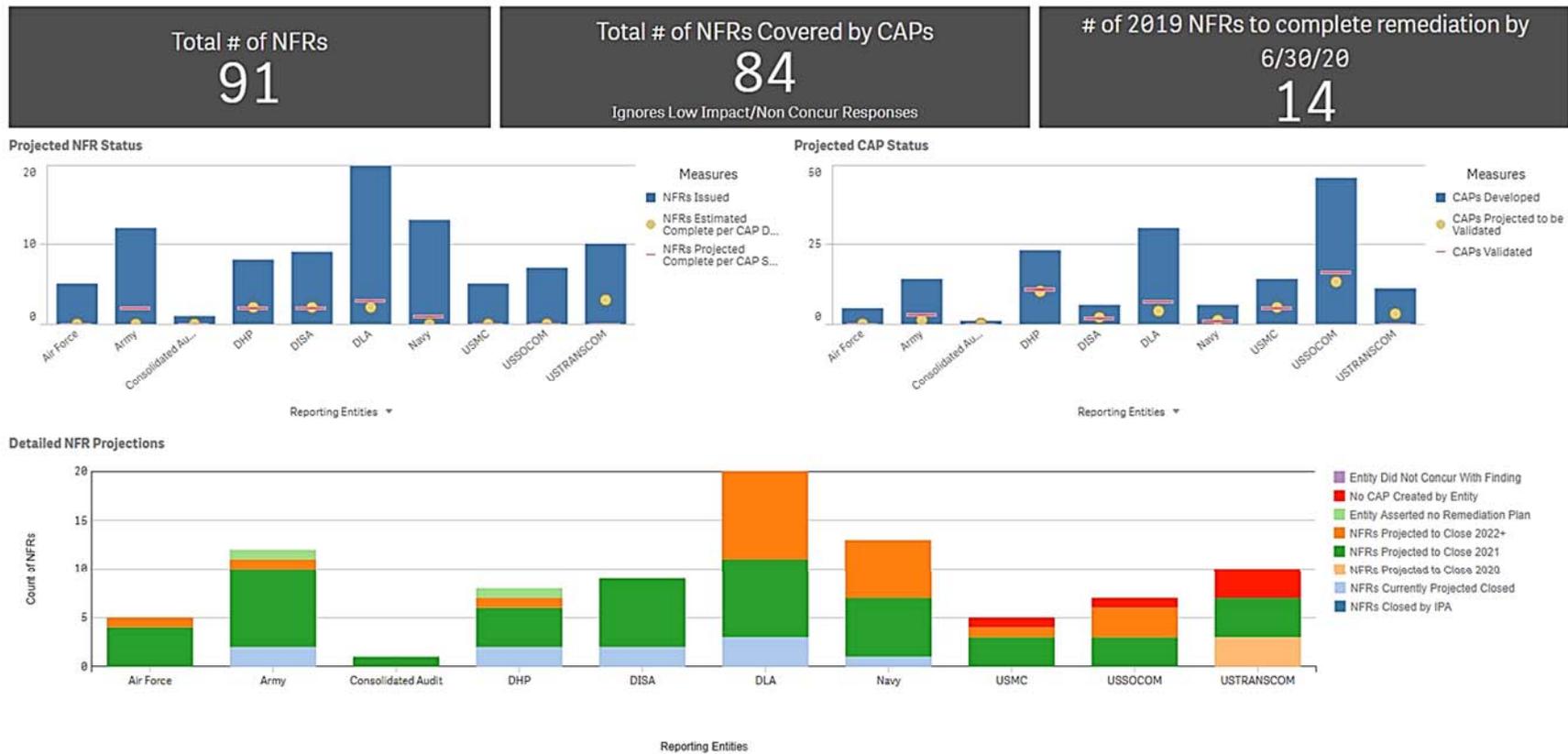
On April 1, 2020, the Department began a six-month transition and testing period between the Department 97 Reconciliation and

Reporting Tool (DRRT) and Advana Fund Balance with Treasury web application tools. Upon completion, DRRT will go offline, and Advana will become the reporting source for Treasury Index (TI)-97 Fund Balance with Treasury reconciliations in support of the FY 2021 audits. A similar project is being developed for Navy Fund Balance with Treasury. A USSOCOM transition from DRRT for Fund Balance with Treasury reconciliations to Advana led to an increased match rate of Army reconciliation files from 79 percent to 95 percent. Transitioning from legacy systems to Advana improves data standardization and internal control over Fund Balance with Treasury transactions and helps the Department identify trends to get at root causes.

Each month, Treasury compares DoD-reported disbursements and collections to their records of disbursement activities for DoD and issues a Statement of Differences. A project by DFAS to resolve Statements of Differences—similar to reconciling hundreds of checking accounts—resulted in an 88 percent reduction in total differences from \$6.6 billion in December 2018 to \$821 million in March 2020, and reduced aged differences by 96 percent. Total balance on the Statement of Differences now accounts for roughly only one-quarter of one percent of the Department's December 2019 Fund Balance with Treasury. Results of DFAS' data analysis have been shared throughout the DoD comptroller community to facilitate Component-ownership of resolving future differences. Quarterly transaction detail and management analysis reports for each DFAS disbursing station were deemed auditable in 2019 and are being sustained.

Figure II-2 shows the Department's overall status in addressing FY 2019 NFRs related to Fund Balance with Treasury.

Figure II-2: Status of FY 2019 NFRs for DoD-wide Fund Balance with Treasury



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.
As of June 17, 2020.
Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Financial Reporting Internal Controls

Auditors found that management lacked adequate oversight and monitoring for ensuring financial management controls were in place, identifying systemic issues, and implementing fixes timely. This resulted in a DoD-wide material weakness due to increased risk of material misstatement in the financial statements. This risk is compounded at the Department where financial transactions frequently cross multiple IT systems, and Components often rely on service providers for financial and business services.

FY 2020 Corrective Actions: Improve financial reporting internal controls with sufficient oversight and monitoring to ensure effectiveness. Implement and document financial reporting internal controls. Work with service providers to document and implement complementary user entity controls, or CUECs.

Status: The Department prioritized process improvements and established metrics for identifying risk; resolving abnormal balances recorded in quarterly financial statements; analyzing and reducing large variances in quarterly financial statement data; completing tie-point analysis to ensure all recorded transactions were supportable and prepared in compliance with generally accepted accounting principles; and implementing CUECs, to improve oversight of service providers. CUECs are the controls the customer organization must have in place when working with a service provider.

Each Component regularly assesses its financial reporting risks and estimates significance as part of their Risk Management and Internal Controls program (previously the Managers' Internal Controls Program or MICP). These assessments provide a basis for developing and implementing effective risk responses. The Department is developing in Advana the capability to examine large sets of financial transactions, assess inherent risk, and draw conclusions about the risk of material misstatement.

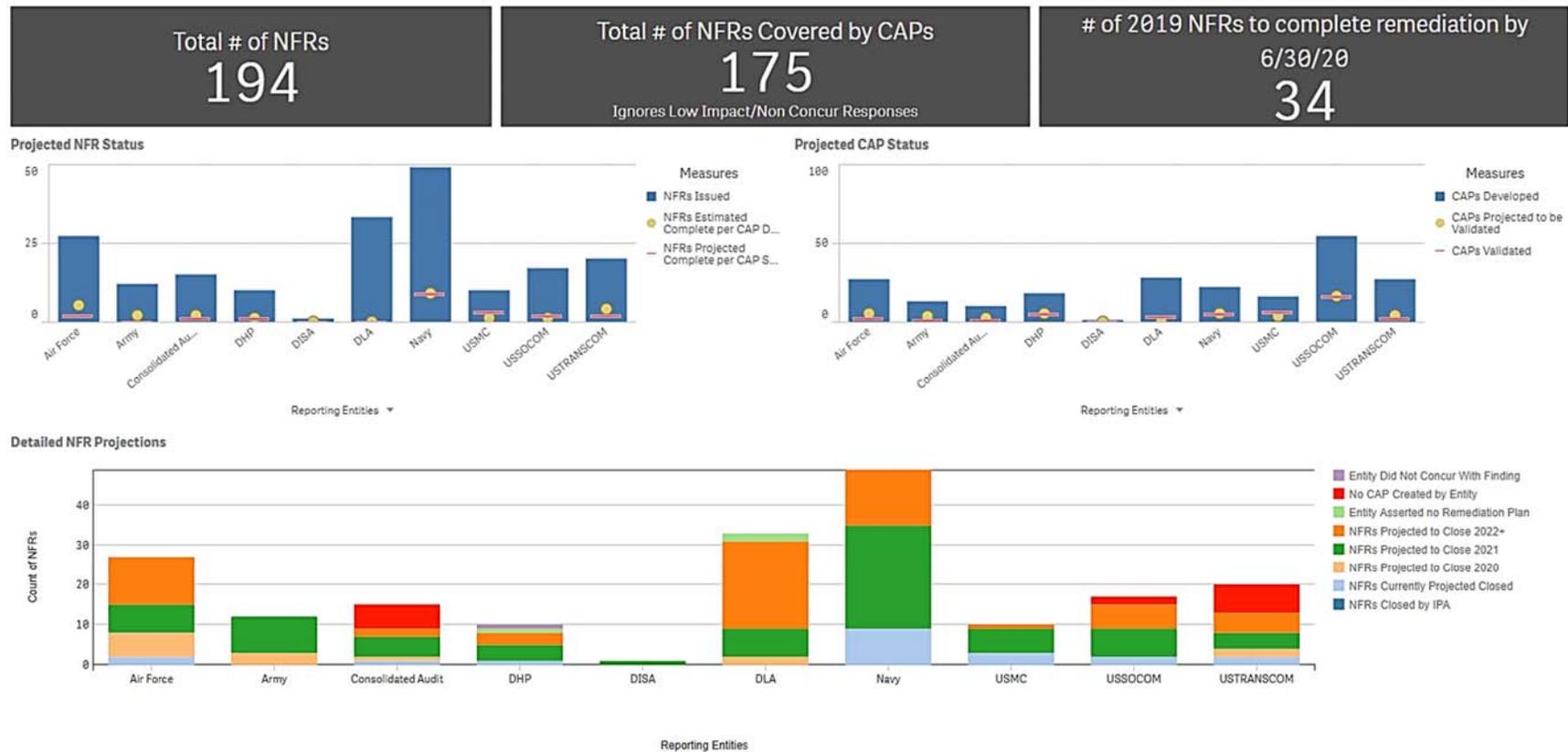
The Department is also using Advana's ability to process large amounts of data to automate reporting in other areas that contribute to this material weakness. For example, Advana will automate the abnormal balance review and reporting process, freeing up time for staff to focus on prioritizing and taking corrective actions. It will also automate variance analysis and identify lines in the financial statements that fluctuate past the established materiality threshold. Large variances between the four principle financial statements are not inherently invalid, but they must be explainable and documented.

Auditors also found that controls for overseeing and monitoring service providers were often not in place on the *customer side*. In FY 2019, DoD auditors issued 49 NFRs related to Third Party/Service Provider Monitoring and 233 NFRs for Lack of Controls to Address Service Providers. These findings contributed to the Oversight and Monitoring material weakness and led auditors to issue a new material weakness specific to the monitoring of service providers. The Department is addressing these findings and mitigating weaknesses.

The Marine Corps implemented the Managers' Internal Controls Remediation and Reporting application (MICRR) as part of the Department of the Navy's Governance Risk and Compliance program. The application fully automates and manages the Marine Corps' risk management and internal program and provides a complete audit trail for its A-123 Program. MICRR supports assessing risk and internal controls, managing NFRs and corrective action plans, documenting and validating entity-level controls, and reporting and aggregating the Statement of Assurance. In addition, MICRR can customize reports and critical data measurements for improved oversight, saving time and freeing up resources to focus on corrective actions.

Figure II-3 shows the Department's overall status in addressing FY 2019 NFRs related to Financial Reporting.

Figure II-3: Status of FY 2019 NFRs for DoD-wide Financial Reporting Internal Controls



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.

As of June 17, 2020.

Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Joint Strike Fighter Program

The Department did not properly account for or manage the Joint Strike Fighter (JSF) Program's government property, or record the property in a government accountability system. The JSF Program Office's property consists of items such as spare parts, consumables, special tooling, and other support equipment for F-35 aircraft and F135 turbofan engines. Problems arise when the F-35 supply chain cannot manage spare part shortages. This limits operational capabilities and risks deploying aircraft into combat operations with mismatched or incompatible parts. It is important to note that the Department maintains 100 percent visibility over all F-35 aircraft and F135 turbofan engines that have been delivered to the government.

FY 2020 Corrective Actions: The Office of the Secretary of Defense and the JSF Program Office will develop a plan to ensure all JSF Program activity and property is recorded in a government accountable property system of record and recorded in the DoD financial statements and supported by a trial balance.

Status: The Department is substantiating the existence, completeness, condition, and valuation of the Joint Strike Fighter Program's government property. The JSF Program Office is performing a physical inventory of its property and beginning to implement a

General Ledger accounting system and system of record for the JSF Program Office.

The Joint Program Office began its first ever physical inventory of government owned spare parts and support equipment, completing 18 sites to date with a 95 percent accuracy rate. The physical inventory lays the ground work for establishing accurate records in the government's accountable property system of record and for proper accounting in the government's general ledger system. The high accuracy rate builds confidence in the contractors' processes and controls in managing the property to support future operations and help the Department mitigate this risk.

The Department is tracking two NFRs for the Joint Strike Fighter program. One ties to government-furnished equipment and the other ties to Operating Materials and Supplies.

Real Property

The Department cannot validate that all existing real property assets are recorded in accountability systems or that the real property assets that are recorded accurately show ownership or occupancy. Real property includes such things as land, administrative buildings, runways, warehouses, water supply systems, aircraft hangars, and medical treatment facilities. Auditors must be able to test for accuracy and completeness of records and validate right of occupancy or ownership.

During FY 2019, the Department made some progress in this priority area. For example, auditors were able to expand existence and completeness testing over the Army's Real Property from 1,543 assets during FY 2018 to 3,712 during FY 2019 and observed accuracy rates greater than 97 percent. Additionally, the Department of Navy's efforts to account for its real property resulted in the downgrade of the prior year material weakness to a significant deficiency.

FY 2020 Corrective Actions: The Department will conduct a full existence and completeness baseline to ensure 100 percent reconciliation of its buildings and structures to the accountable property systems of record. In addition, the Department will complete the transfer of financial accounting responsibilities for all real property to the Military Services and the Washington Headquarters Services (WHS).

Status: The Military Departments and WHS are completing physical inventories and validating real property assets. Validating real property inventory data provides several benefits to the Department:

- Improves data used to manage and report the Department's real property
- Lays the groundwork for future valuation efforts

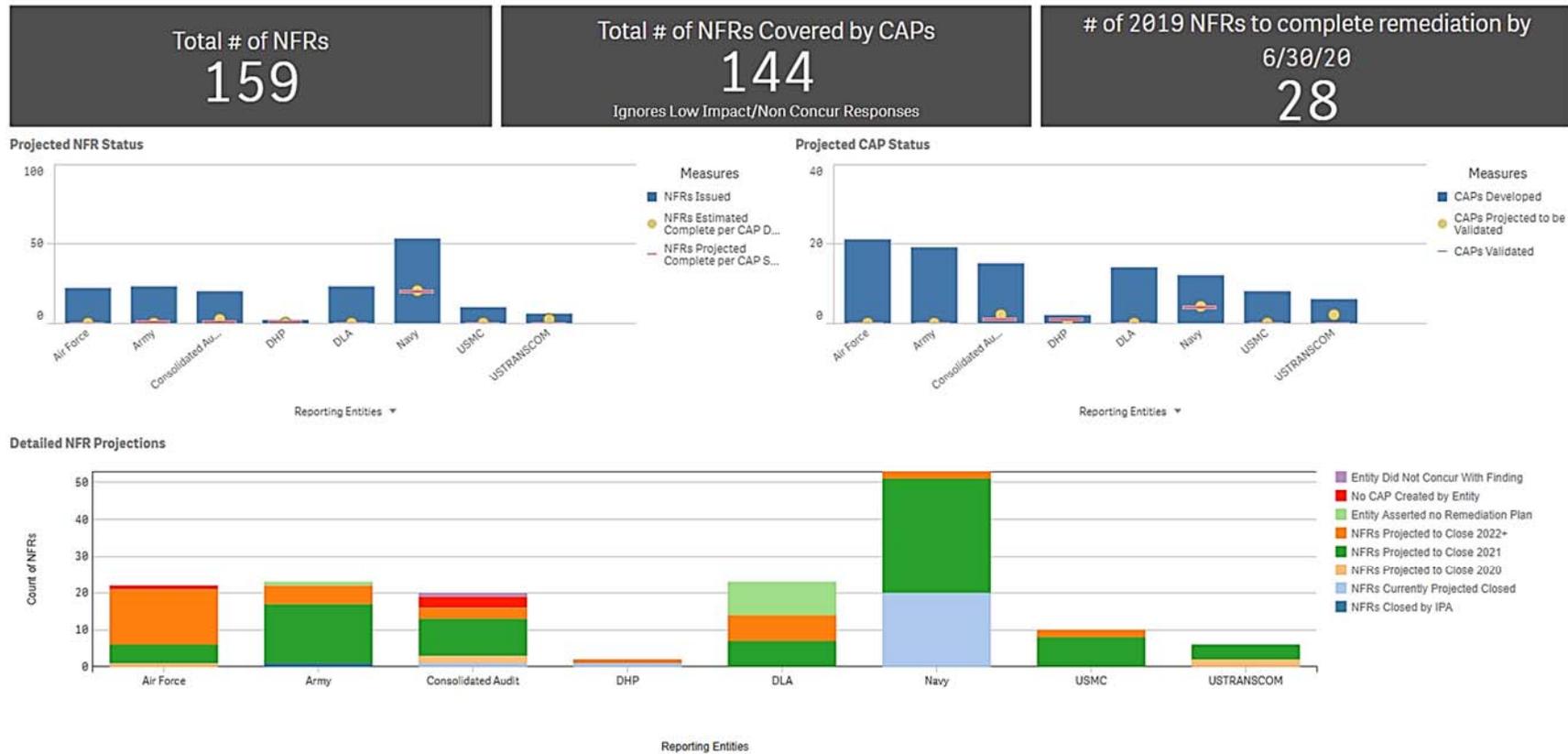
- Assists the Military Departments, WHS, and the Defense Agencies in implementing the recent changes to the DoD Financial Management Regulation with new financial reporting responsibilities for real property assets.

Recent policy changes are facilitating the transfer of all real property financial reporting responsibilities to the Military Departments and WHS. By simplifying financial reporting responsibilities and reducing duplicative reconciliation efforts, Defense Agencies can redirect resources to other critical efforts. This also improves the Military Departments' and WHS' ability to maintain positive control on financial reporting responsibilities for real property assets within their fence-lines.

The Navy addressed 100 percent of its FY 2018 audit existence and completeness of real property NFRs. This accountability over real property assets will support the Navy's infrastructure management program to benefit Sailors, Marines, civilian teammates, and families that are key to the Navy's success. The Navy revised its policies and guidance to improve compliance and conducted a 100 percent physical inventory of all 115,000+ above-ground, real property assets across 98 installations. Ultimately, this effort will allow the Navy to improve the accuracy of budget requirements in support of assets critical to the defense of the nation, such as mooring facilities for naval vessels and hangars for aircraft.

Figure II-4 shows the Department's overall status in addressing FY 2019 NFRs related to Real Property.

Figure II-4: Status of FY 2019 NFRs for DoD-wide Real Property



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.

As of June 17, 2020.

Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Inventory, and Operating Materials and Supplies

The Department cannot validate that all existing inventory and Operating Materials and Supplies (OM&S) assets are recorded in accountability systems or that the assets that are recorded in the systems do exist and can be evidenced. Inventory consists of items such as component parts for production or spare parts that are sold by the Department's service providers to repair combat vehicles or other equipment. OM&S consists of similar items that have been purchased and are consumed by the Department's operational entities. Problems arise for both inventory and OM&S when the Department incorrectly believes it is low on spare parts for a combat vehicle and orders additional parts. This wastes time, money, and storage space. Problems also arise when the Department inaccurately believes it has a sufficient quantity of spare parts for a combat vehicle, resulting in an inoperable vehicle waiting for parts.

FY 2020 Corrective Actions: The Department will conduct a floor-to-book and book-to-floor physical inventory of all Working Capital Fund inventory and all General Fund munitions/ordnance and uninstalled engines in its possession until the baseline is established and internal controls are in place and operating effectively.

Status: The Military Departments and DLA have completed physical inventories of uninstalled engines, munitions/ordnance, and working capital fund inventory in their possession. The Army has increased the number of sample items tested each year and continues to show year over year improvement with existence and completeness testing. The Navy completed counts of all priority inventory and OM&S assets and will continue to implement and test controls for receipt, issuance, and

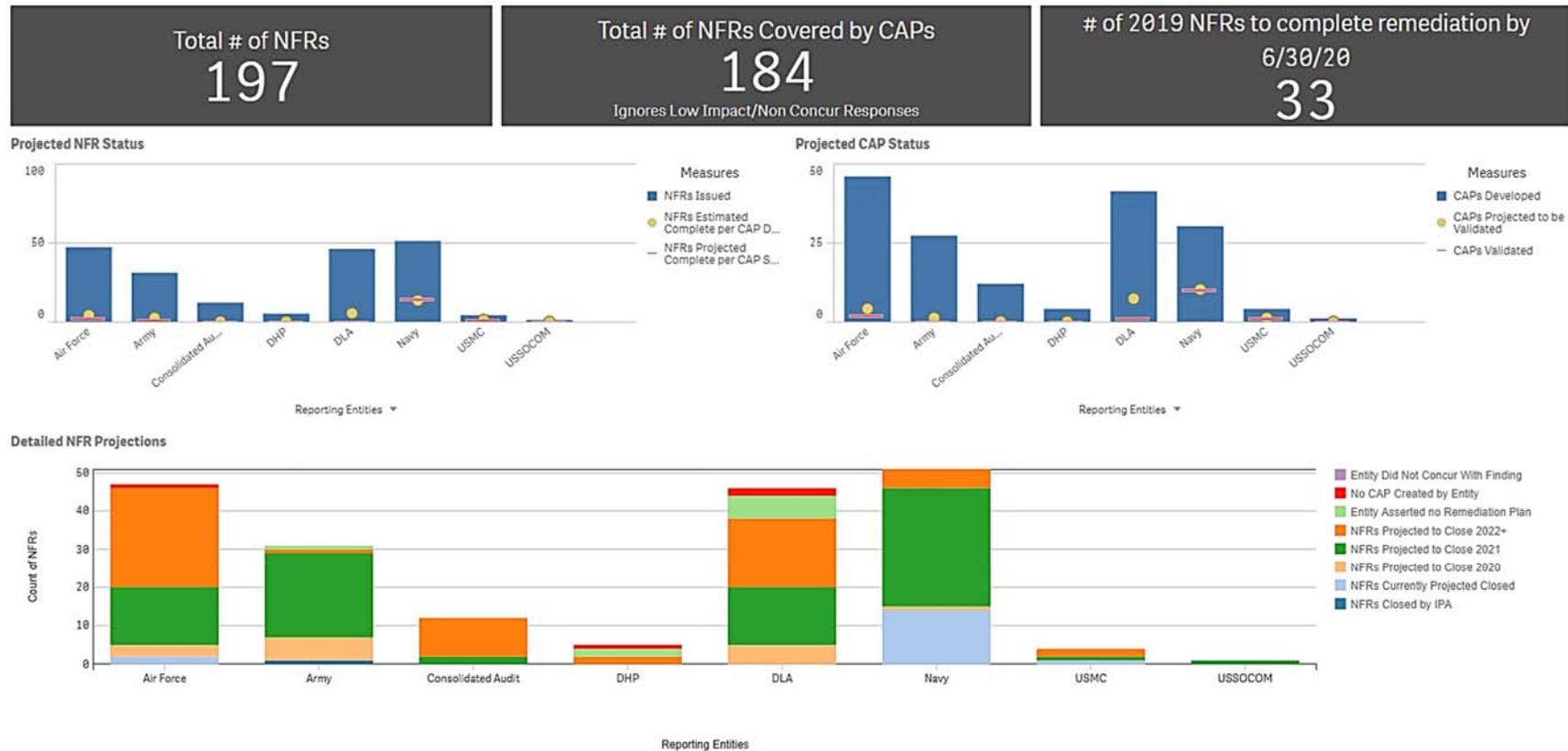
disposal of materials. Results of auditor testing for existence and completeness at Marine Corps' retail and depot locations holding ammunition were favorable. The Air Force completed counts of all its priority inventory, munitions, and uninstalled engines in FY 2019. The DLA executed a 100 percent physical count of inventory in DLA Distribution Centers.

The Navy is conducting a 100 percent physical inventory of all materiel to improve accountability and support readiness objectives. To date, the Navy has identified nearly \$3 billion worth of locally-managed inventory, OM&S, and General Equipment, of which \$2.4 billion has been added to the Navy supply chain and made available across the Navy. These items were subsequently used to fill over 12,000 requisitions totaling \$49.8 million in materiel and a further \$34.2 million has been disposed of. The Navy is currently screening the remaining \$455 million for future use or disposal.

DLA's inventory control program initiatives translated into more efficient processes and more reliable financial data, and DLA continues to mature its development of distribution and vendor-managed inventory reconciliation processes. These initiatives enabled DLA to reduce inventory variances by \$358 million and increased reliability for receipting, issuing, and completing physical inventories for DLA-owned material.

Figure II-5 shows the Department's overall status in addressing FY 2019 NFRs related to inventory and Operating Materials and Supplies.

Figure II-5: Status of FY 2019 NFRs for DoD-wide Inventory and Operating Materials and Supplies



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.
 As of June 17, 2020.
 Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Government Property in the Possession of Contractors

The Department lacks the policies, controls, oversight, and documentation to accurately record property in the possession of contractors. Contractors may hold government property that is directly acquired by them or furnished by the government to complete production or services on behalf of the Department. Types of this property include special tooling, test equipment, laptop computers, IT networking equipment, and inventory and OM&S used in the production or repair of weapons systems, for example. Without accurate records, the Department could direct one contractor to acquire property while directing another contractor to dispose of or donate the same type of property, wasting money and resources.

FY 2020 Corrective Actions: Each Component should, at a minimum, leverage existing inventory reporting requirements in sustainment contracts to reconcile contractor inventory data with property records and establish a complete baseline of assets for those contracts.

The Department will continue to review the policies, procedures, controls, and supporting documentation related to government property in the possession of contractors to ensure proper oversight and visibility. In addition, the Department will incorporate standard property management policies, procedures, and metrics into contract terms and conditions to enable proper accounting and accountability

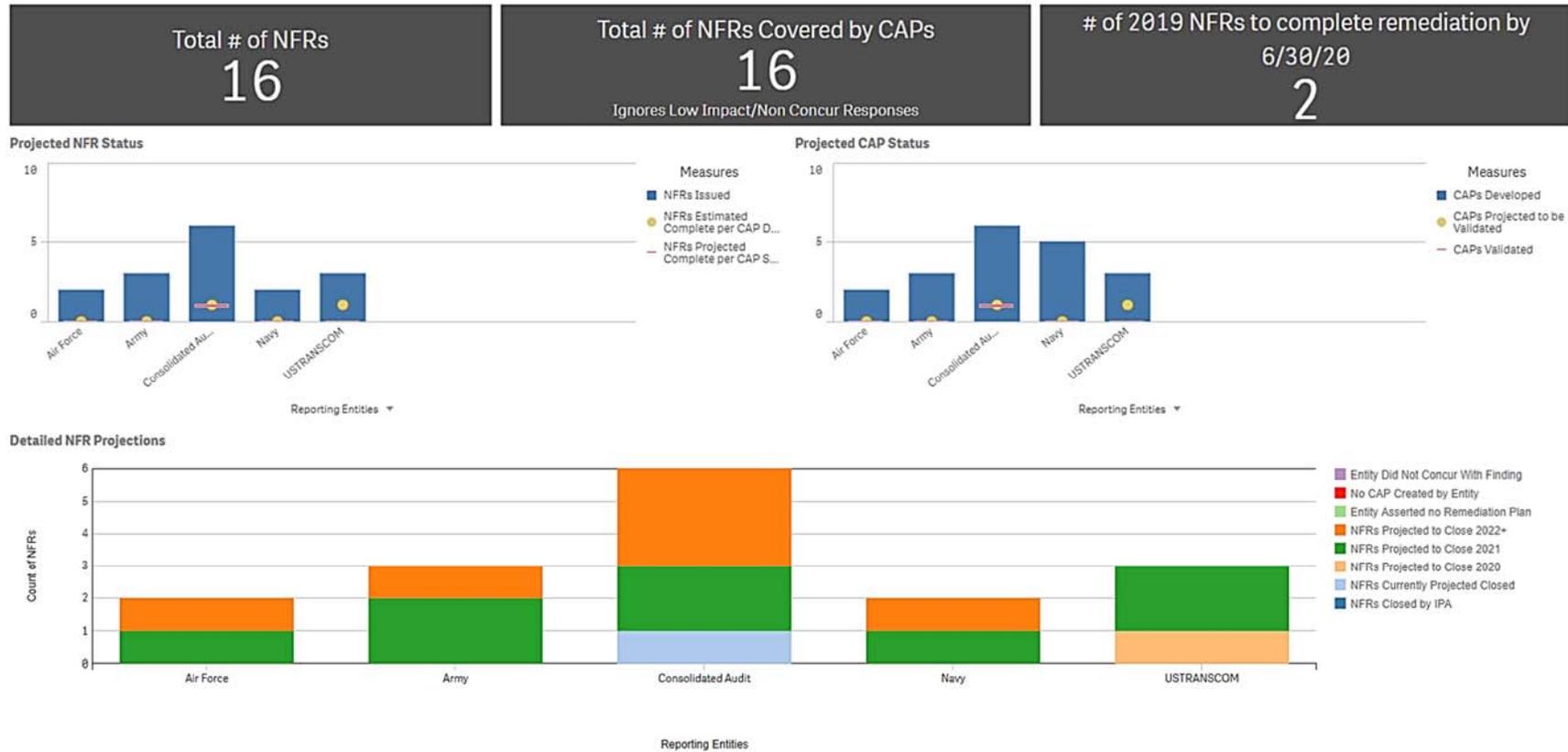
over government-furnished property and develop go-forward methodology to capture all government-furnished property.

Status: The Office of the Under Secretary of Defense (Acquisition and Sustainment) and the Defense Contract Management Agency (DCMA) are improving electronic data flows for reporting property in the possession of contractors. The Military Departments continue to review contracts to confirm that contract clauses, contract data requirement listings, policies, procedures, and systems support the accounting and accountability of property in the possession of contractors. In addition, the Department is working with commercial entities to ensure they can effectively support the Department's audit.

The Army is addressing systems deficiencies, policy, and training, and is developing tools to educate the field and Army auditors on government furnished property management processes and procedures. The Navy is developing and implementing standard contract requirements for property in the possession of contractors and aligning data reports with the timing of the audit. The Air Force is holding stakeholders accountable for critical activities and is upholding and improving contractor accountability and data reporting requirements for new and existing contracts.

Figure II-6 shows the Department's overall status in addressing FY 2019 NFRs related to Government Property in the Possession of Contractors.

Figure II-6: Status of FY 2019 NFRs for DoD-wide Government Property in the Possession of Contractors



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.
 As of June 17, 2020.
 Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Access Controls for IT Systems

Improving how the Department restricts user access and monitors user activity to safeguard sensitive data from unauthorized use are audit priorities. In FY 2019, auditors issued 1,694 IT-related NFRs findings from audits and SSAE No. 18 examinations for 158 of the 250 DoD-owned systems relevant to financial reporting. Consistent with prior year results, more than half of the IT NFRs related to user access. The Chief Information Officer (CIO), with support from the CMO and USD(C)/CFO, is leading the Department’s corrective action strategy.

FY 2020 Corrective Actions: Financial system owners and owners of business systems that contribute financial information must review and limit system access to only those who need it and only for the specific areas within the system they need to access.

Status: After the FY 2018 audits, the Department identified common conditions in IT-related NFRs that present the highest risk to the financial statement audits and operational security. The Components are prioritizing corrective actions for systems with those conditions. Figure II-7 shows the Components have closed 21 percent of the FY 2018 conditions.

Figure II-7: FY 2018 IT NFR High-Risk Conditions

High-Risk Conditions	Received	Closed
Shared administrative accounts	11	6
Privilege Users and High-Risk Transactions	64	16
Privileged Access Assigned Unnecessarily	52	13
User Assigned Conflicting Roles and Duties*	276	51
Developer Access to Production-Ready Code Files	29	5
Developer Access to Production Programs and Files	16	2
Total	448	93

* Includes effective controls and monitoring of users with approved conflicting access; and segregation of duties.

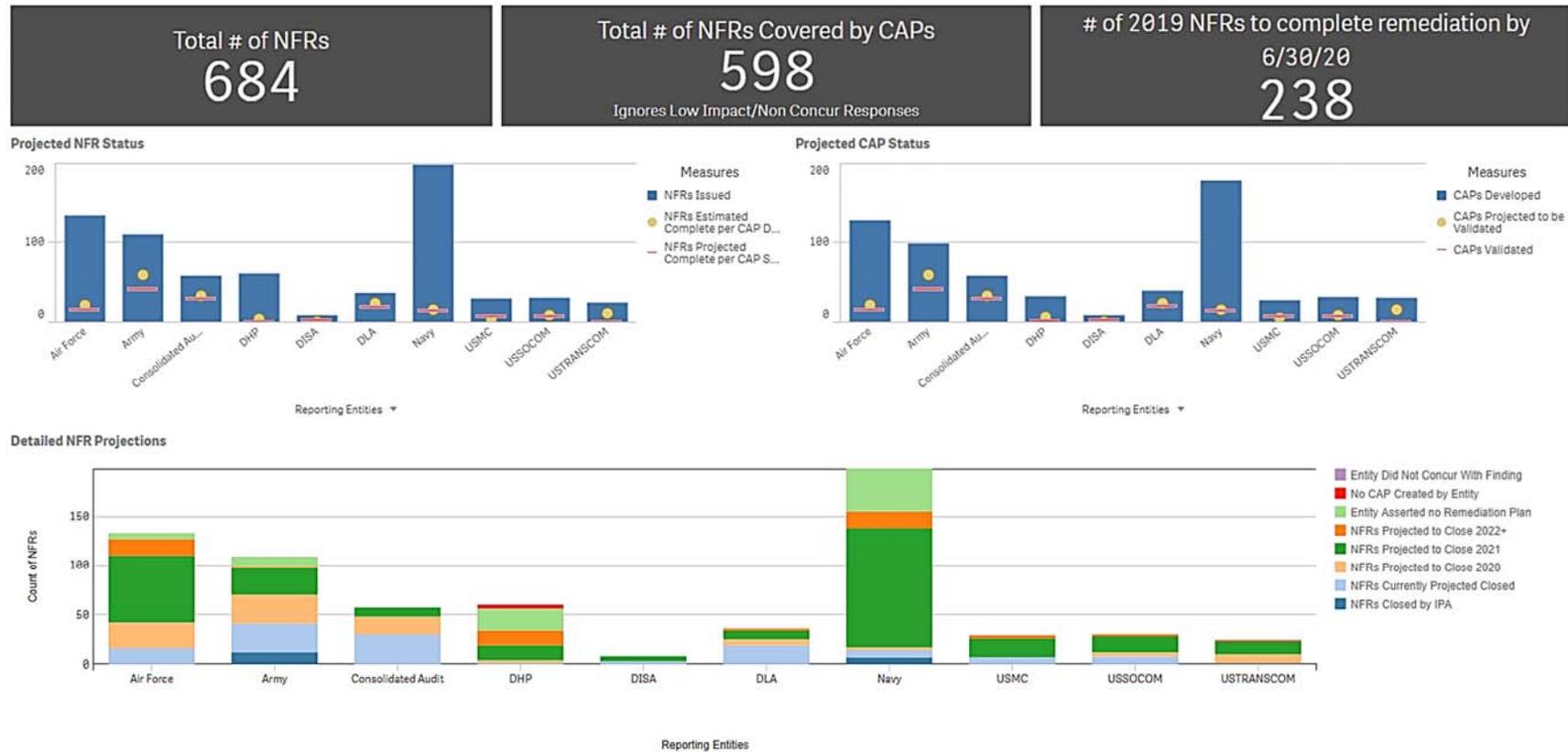
The DoD risk management framework is essential to the Department’s ability to self-identify issues and sustain improvements. The CIO is reviewing 49 IT systems with the largest number of IT findings. The reviews will determine whether differences exist between auditor-identified IT control deficiencies and deficiencies self-identified during system authorization and accreditation.

The Department is also implementing an automated solution to facilitate provisioning, review, modification, and removal of user access DoD-wide. The Identity, Credential, and Access Management (ICAM) solution combines information from DoD personnel systems with access-related information from DoD business systems to create a central repository that provides visibility into user access rights within and across systems. The Department has identified and prioritized applications to be migrated to the ICAM solution and the data elements needed from personnel systems, such as duty status changes. The development team obtained user master record file layouts for 84 percent of the target systems, and developed cross-application segregation of duties’ baselines for six end-to-end business cycles.

The Department is expanding its focus from primarily securing the perimeter of the network to actively securing and controlling use of the data itself. The DoD cloud strategy encourages the use of commercial cloud services and the modern security mechanisms built into these platforms that ensure the security of large amounts of data and safeguard the information. By moving infrastructure from DoD-managed, on-premises facilities to the cloud, the Department is also taking advantage of cloud providers’ ability to rapidly roll out updates to combat threats from both inside and outside the enterprise.

Figure II-8 shows the Department’s overall status in addressing FY 2019 NFRs related to Access Controls.

Figure II-8: Status of FY 2019 NFRs for Access Controls



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.
As of June 17, 2020.
Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Other Areas of Focus

Other auditor-identified issues are foundational to the Department's overall financial management health and long-term audit success. The Department self-identified many of these issues, and the OUSD(C) and leaders from the respective functional community are driving solutions.

Journal Vouchers

The Department continues to operate hundreds of financial and feeder systems. Many of the older systems cannot capture all of the transaction-level data attributes needed to satisfy various accountability and reporting requirements, such as preparing the financial statements. To bridge this gap, the Department makes manual adjustments using journal vouchers. A journal voucher is a routine adjustment made when preparing the financial statements. These adjustments often lack supporting documentation, and auditors are not able to verify the data. The number of journal vouchers lacking supporting documentation has increased the risk of material misstatement in the financial statements and resulted in the DoD-wide unsupported accounting adjustments material weakness.

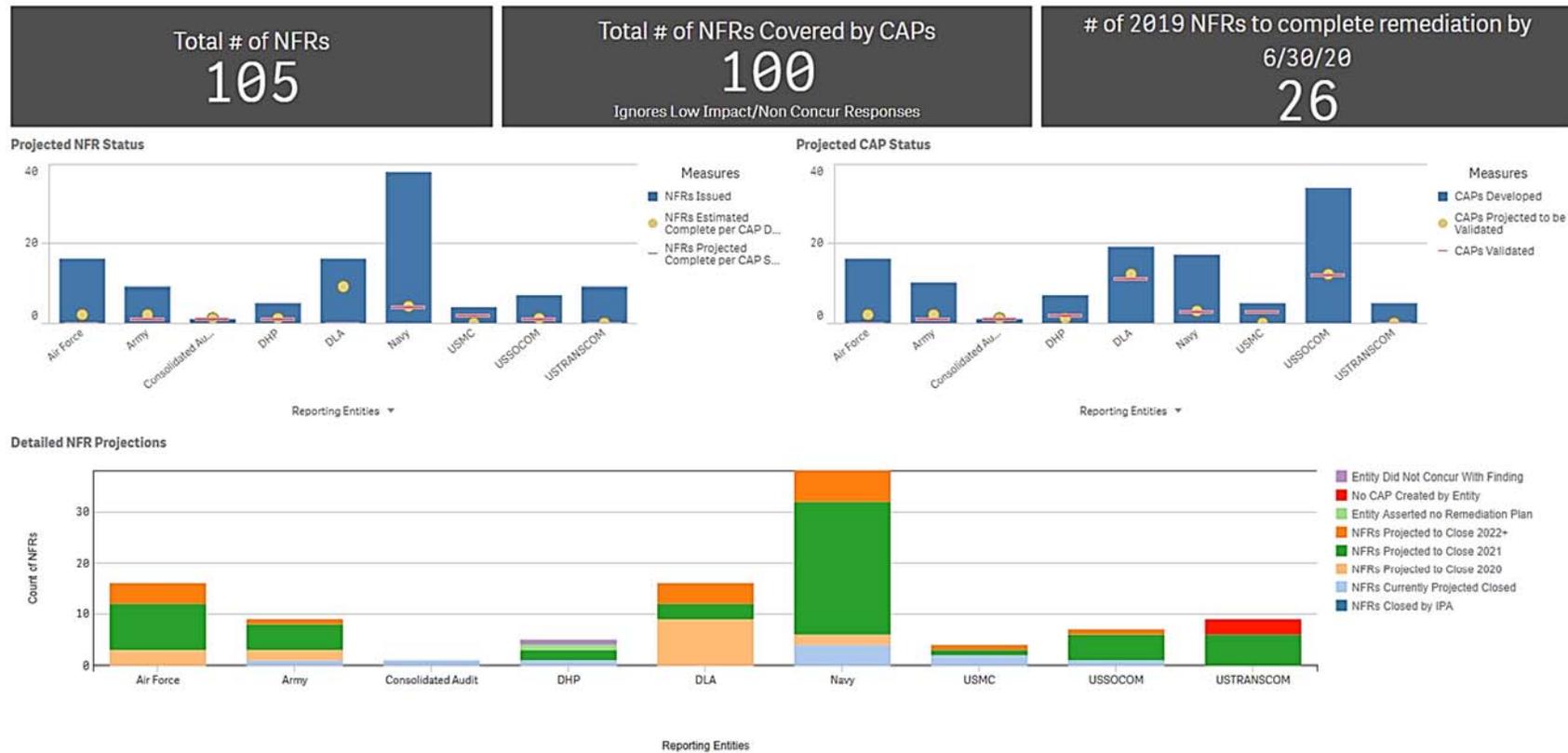
Status: The Department is continuing to retire and replace legacy systems while working to determine root causes of unsupported journal vouchers. Remediation work is focused on fixing accounting

systems, unsupported journal vouchers, and the trading partner eliminations process, with a goal of downgrading this material weakness to a significant deficiency. The Department improved internal controls and the reporting system's journal voucher descriptive capability. The Department also issued policy instructing reporting entities to reduce recording "on-top" adjustments in the financial reporting system and instead record adjustments in the source field-accounting system.

By implementing new internal controls and business processes, increasing supporting documentation, and improving customer collaboration, DFAS reduced the number of FY 2019 unsupported journal vouchers by 78 percent and the total dollar amount of adjustments by 63 percent. DFAS also worked closely with Navy Financial Management Office and Navy Commands to develop a process that better supports trading partner eliminations between Navy Working Capital Fund and Navy General Fund activities. For FY 2019, trading partner eliminations with proper support totaled \$2.65 billion, which contributed to the decrease in overall unsupported journal vouchers.

Figure II-9 shows the Department's overall status in addressing FY 2019 NFRs related to Journal Vouchers.

Figure II-9: Status of FY 2019 NFRs Journal Vouchers



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.
 As of June 17, 2020.
 Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Universe of Transactions

The FY 2019 financial statement audits resulted in 110 NFRs related to universe of transactions. The universe of transactions refers to the entirety of underlying, individual accounting transactions that support a financial statement line or balance. Each reporting entity must be able to validate that its universe of transactions is complete, providing a reliable basis for auditor sampling.

Status: The Department's platform for advanced analytics, Advana, is helping the Department build its universe of transactions. Advana continues to expand supporting audits and examinations related to TI-97 appropriated funds, and is expanding support to the Military Services.

Advana has more than 11,000 users and spans all Services. It has ingested approximately 40 billion transactions from more than 150 systems and is standardizing the data using a common data model. For Quarter 2 FY 2020, Advana reconciled 98 percent of the financial statement lines to the unadjusted trial balance and provided a capability to explain and help resolve variances.

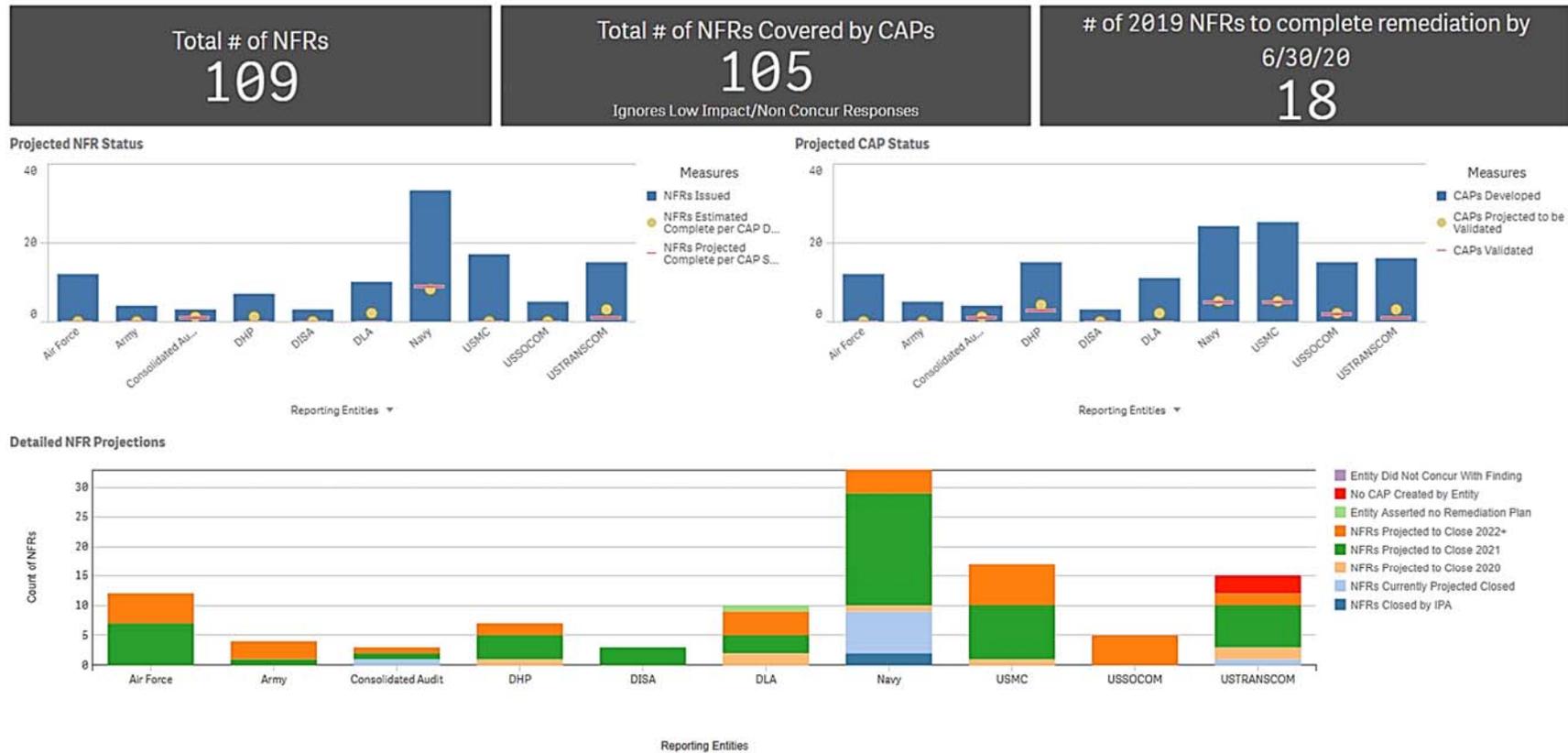
The benefits of Advana extend beyond the Department's financial management goals. For example, the same data used for audits is being used to report medical line of business costs. Data captured once is managed centrally and available enterprise-wide for multiple purposes.

The Military Departments' ERPs and the Defense Agencies Initiative (DAI), the primary accounting system used by 22 Defense Agencies and other Defense organizations, are also helping reporting entities produce a universe of transactions.

DFAS launched an effort to remove cleared and offsetting transactions and develop a sustainable and reliable universe of transactions for each Treasury Index. This resulted in a reduction of offsetting transaction totaling \$29.4 billion (absolute) from September 2018 to September 2019. Additionally, the OUSD(C) crafted policy guidance and paths to remove revenue associated transactions from suspense accounts by June 2020.

Figure II-10 shows the Department's overall status in addressing FY 2019 NFRs related to Universe of Transactions.

Figure II-10: Status of FY 2019 NFRs for DoD-wide Universe of Transactions



Note: COVID-19 is altering the Components' ability to complete corrective actions and other audit-related tasks. The effect on projected NFR closure rates is still being determined.
As of June 17, 2020.
Does not include NFRs from SSAE No. 18 examinations or audits of reporting entities with an unmodified opinion.

Conclusion

The June 2019 FIAR Report provided an overview and status of legacy systems migrations. Beginning June 30, 2020, the Department must submit the Defense Business Systems Audit Remediation Plan to describe how systems will be introduced, replaced, updated, modified, or retired in connection with the DoD full financial statement audits. Information on how the Department is improving its business systems environment is now reported annually by the Office of the Chief Management Officer through that report.

To download a copy of the FIAR Report, please visit the Office of the Deputy Chief Financial Officer website at: <https://comptroller.defense.gov/ODCFO/>.

Other updates on audit findings and the status of corrective actions are provided in semiannual briefings, Congressional hearings, and other reports, as required.

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Appendix 1. Independent Auditor's Report

The November 15, 2019, Independent Auditor's Report, issued by the DoD Inspector General and initially provided in the DoD FY 2019 Agency Financial Report, follows. The full FY 2019 Agency Financial Report, including the Department's FY 2019 financial statements, may be downloaded at:

<https://comptroller.defense.gov/odcfo/afr2019.aspx>

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 15, 2019

MEMORANDUM FOR SECRETARY OF DEFENSE
UNDER SECRETARY OF DEFENSE (COMPTROLLER)/
CHIEF FINANCIAL OFFICER, DOD

SUBJECT: Independent Auditor's Report on the Department of Defense FY 2019 and
FY 2018 Basic Financial Statements (Project No. D2019-D000FE-0067.000,
Report No. DODIG-2020-031)

We are providing the subject report to be published in the Department of Defense FY 2019 Agency Financial Report in conjunction with the Department of Defense FY 2019 and FY 2018 Basic Financial Statements provided to us in a "preliminary final" state on November 14, 2019. The Independent Auditor's report includes our disclaimer of opinion on the basic financial statements and our required Reports on Internal Control Over Financial Reporting and Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements. We are issuing our disclaimer of opinion to accompany the Department of Defense FY 2019 and FY 2018 Basic Financial Statements; therefore, this audit report should not be disseminated separately from those statements.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

A handwritten signature in cursive script that reads "Lorin T. Venable".

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 15, 2019

MEMORANDUM FOR SECRETARY OF DEFENSE
UNDER SECRETARY OF DEFENSE (COMPTROLLER)/
CHIEF FINANCIAL OFFICER, DOD

SUBJECT: Independent Auditor's Report on the Department of Defense FY 2019 and
FY 2018 Basic Financial Statements (Project No. D2019-D000FE-0067.000,
Report No. DODIG-2020-031)

Report on the Basic Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990," requires the DoD Inspector General to audit the accompanying DoD Agency-Wide consolidated balance sheet as of September 30, 2019, and September 30, 2018, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the basic financial statements which are referred to as financial statements or the Agency Financial Report in this report.

Management's Responsibility for the Annual Financial Statements

DoD management is responsible for the annual financial statements. Specifically, management is responsible for: (1) preparing financial statements that conform with accounting principles generally accepted in the United States of America (GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the controls met broad control objectives of Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982" (FMFIA); (3) ensuring that the DoD's financial management systems substantially comply with Public Law 104-208, "Federal Financial Management Improvement Act of 1996" (FFMIA) requirements; and (4) complying with applicable laws and regulations.

Auditor's Responsibility

We are responsible for expressing an opinion on the financial statements based on our audit. We conducted the audit in accordance with generally accepted government auditing standards (GAGAS) and the Office of Management and Budget (OMB) Bulletin No. 19-03.¹ However, because of the matters described in the "Basis for Disclaimer of Opinion" section below, we were unable to obtain sufficient, appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

OMB Bulletin No. 19-03 identifies DoD Components that are required to undergo financial statement audits. Auditors conducting the audits of these components issued disclaimers of opinion on the Components' financial statements:

- Department of the Army General Fund
- U.S. Navy General Fund
- Department of the Air Force General Fund
- U.S. Marine Corps General Fund
- Department of the Army Working Capital Fund
- Department of the Navy Working Capital Fund
- Department of the Air Force Working Capital Fund

In addition to the required reporting entities, the auditors also issued disclaimers of opinion on the component financial statements for the Defense Health Program, Defense Logistics Agency, U.S. Transportation Command, and U.S. Special Operations Command.

When combined, these reporting entities are material to the DoD Agency-Wide Basic financial statements. As a result, we were unable to obtain sufficient, appropriate audit evidence to provide a basis for an audit opinion.

We performed limited audit procedures at the agency-wide level and compiled the work from the audits of the DoD Components to identify material weaknesses in internal control over financial reporting that affected the DoD as a whole. We also compiled

¹ OMB Bulletin No. 19-03, "Audit Requirements for Federal Financial Statements," August 2019.

material weaknesses that DoD Components identified within their Statements of Assurance. These material weaknesses limit the DoD's ability to produce reliable financial statements. The underlying material weaknesses in internal control contributed to our disclaimer of opinion on the financial statements.

We considered the disclaimers of opinion on the DoD Component financial statements a scope limitation in forming our conclusions on the Agency-Wide Basic Financial Statements. Accordingly, we did not perform all the auditing procedures required by GAGAS and OMB Bulletin No. 19-03 to determine whether material amounts on the financial statements were presented fairly. Therefore, our work may not identify all issues that could affect the financial statements.

Disclaimer of Opinion

Because of the significance of matters described in the "Basis for Disclaimer of Opinion," we could not obtain sufficient, appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. Thus, the financial statements may contain undetected misstatements that are both material and pervasive.

Emphasis of Matter

In May 2019, the DoD Office of Inspector General (OIG) issued Report No. DoDIG-2019-085, "Audit of the Defense Security Cooperation Agency—Security Assistance Accounts," which recommended that the DoD report all the Security Assistance Account (SAA) balances that are administered by the DoD in the Agency Financial Report. The SAA balances include Foreign Military Sales, the Special Defense Acquisition Fund, Foreign Military Financing, and International Military Education and Training.

The DoD OIG position is that Statement of Federal Financial Accounting Standards No. 47² requires the DoD to present the SAA balances within the DoD Agency Financial Report. DoD management disagreed with this position, and stated that the Defense Security Cooperation Agency (DSCA)-SAA should be a stand-alone entity that is reported in the Government-wide financial statements. During the FY 2019 audit of the DoD Agency-Wide Basic financial statements, DoD OIG management and DoD management met with the Federal Accounting Standards Advisory Board (FASAB) to discuss whether the SAA balances should be consolidated within the DoD Agency Financial Report. Discussions between the FASAB, DoD OIG management, and DoD management are ongoing. As of November 15, 2019, the FASAB has not rendered a

² FASAB Handbook, Statement of Federal Financial Accounting Standards (SFFAS) No. 47, "Reporting Entity," December 2014.

decision on the presentation of the SAA balances. As a result, the DoD did not include the SAA balances in the consolidated DoD Agency Financial Report and these amounts were not considered when forming our opinion on the financial statements.

In addition, DoD management provided a “preliminary final” Agency Financial Report on November 14, 2019, which limited our ability to complete a thorough review of the published financial statements. However, during our review of the Agency Financial Report, we noted instances of non-compliances between the financial statements and applicable sections of OMB Circular No. A-136.³ Specifically, Note 7, Note 19, Note 24, Note 25, and Note 26, did not contain required disclosures to be presented in accordance with OMB Circular No. A-136.⁴

The DoD also restated the FY 2018 financial statements to correct errors in liabilities, Cumulative Results of Operations–Dedicated Collections, and Cumulative Results of Operations–Other Funds, net cost, Earned Revenue, and budgetary resources. These restatements are presented in Note 28 to the financial statements. We considered these restatements during our audit; however, we did not modify our FY 2019 or FY 2018 disclaimers of opinion on the financial statements with respect to this matter.

Finally, in the Agency Financial Report, DoD management referenced information on websites or other forms of interactive data outside the Agency Financial Report. Because this information is not required as part of the financial statements, it was not subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Other Information in the Annual Financial Statements

We performed our audit to form an opinion on the financial statements as a whole. DoD management presented the Management’s Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Information for additional analysis as part of the annual financial statements. These elements are not required parts of the financial statements. Therefore, we do not express an opinion or provide any assurance on the information. However, based on our limited review, we did not find any material inconsistencies between the information presented in these sections and applicable portions of OMB Circular No. A-136.

³ OMB Circular No. A-136, “Financial Reporting Requirements,” June 28, 2019.

⁴ Note 7, “Direct Loan and Loan Guarantees, Non-Federal Borrowers,” Note 19, “General Disclosures Related to the Statement of Net Cost,” Note 24, “Reconciliation of Net Cost to Net Outlays,” Note 25, “Public-Private Partnerships,” and Note 26, “Disclosure Entities and Related Parties”.

Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have a direct and material effect on the financial statements and compliance with OMB regulations and audit requirements for financial reporting. We compiled the results from the audits of the DoD Components to determine whether the DoD complied with provisions of applicable laws and regulations, contracts, and grant agreements.

However, it was not our objective to provide an opinion on compliance with certain provisions of laws and regulations, contracts, and grant agreements. Accordingly, we do not express such an opinion.

See the Attachment for additional details on internal control over financial reporting and compliance with legal and other regulatory requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to officials at the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. The officials provided technical comments that we have incorporated, as appropriate.

This report will be made publicly available under section 8M, paragraph (b)(1)(A), of the Inspector General Act of 1978. However, this report is intended solely for the information and use of Congress; the OMB; the Government Accountability Office; the Under Secretary of Defense (Comptroller)/Chief Financial Officer; DoD management; and the DoD Office of Inspector General. This report is neither intended for, nor should it be used by, any other audience.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

A handwritten signature in black ink that reads "Lorin T. Venable". The signature is written in a cursive style with a red checkmark above the "V" and a red checkmark below the "e".

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting

Attachment:

As stated

Report on Internal Control Over Financial Reporting

Internal Control Compliance

In planning our audit, we considered the DoD's internal control over financial reporting to determine appropriate auditing procedures for expressing an opinion on the financial statements, but not for expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on the DoD's internal control over financial reporting.

Management Responsibilities

DoD management is responsible for implementing and maintaining effective internal control, including providing reasonable assurance that DoD personnel recorded, processed, and summarized accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

Auditor's Responsibilities

The purpose of our audit was not to express an opinion on internal control over financial reporting, and we do not express such an opinion. However, we identified 25 material weaknesses and 1 significant deficiency by compiling the results from the audits of the DoD Components, performing limited audit procedures at the agency-wide level, and reviewing the DoD Components' Statements of Assurance. These material weaknesses and significant deficiency could adversely affect the DoD's financial operations.

Identified Material Weaknesses

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the DoD's financial statements in a timely manner.

Financial Management Systems and Information Technology. The FMFIA requires financial systems provide reasonable assurance that obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for to permit the preparation of reliable financial reports. The FFMIA requires Government agencies to incorporate accounting standards and reporting objectives established for the Federal Government

into their financial management systems. In addition, it requires that financial management systems have controls to support reliable financial management. However, the DoD had multiple financial management systems that did not comply with federal financial management system requirements. In addition, DoD Components did not implement effective controls over financial management systems to identify deficiencies that could impact the accuracy of the financial reporting. The DoD information systems environment had control weaknesses over security management, access, configuration management, segregation of duties, and business process applications. As a result, the DoD was unable to prepare reliable financial statements and disclosures.

Universe of Transactions. OMB Bulletin No. 19-03 states that internal control over financial reporting includes ensuring that transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements. However, the DoD Components were unable to provide transaction-level populations supporting material financial statement line items. Additionally, reconciliations of the information presented within trial balances to underlying transaction-level details did not exist for all DoD Components. Specifically, DoD Components performed reconciliations at a summary level, rather than the transaction level, and did not always perform these reconciliations in a timely manner. Furthermore, the Defense Finance and Accounting Service (DFAS) personnel stated that it was unable to trace amounts presented on the financial statements to transaction-level detail because a universe of transactions did not exist at the DoD-wide level. Without a complete universe of transactions, the DoD and its components could not verify the completeness and accuracy of data reported on the DoD Component and the DoD Agency-Wide Basic Financial Statements.

Fund Balance With Treasury. For FY 2019, the DoD reported a Fund Balance With Treasury balance of \$607.6 billion. The Statement of Federal Financial Accounting Standards (SFFAS) No. 1 defines Fund Balance With Treasury as the aggregate amount of funds in the DoD's accounts with Treasury for which the DoD is authorized to make expenditures and pay liabilities.⁵ SFFAS No. 1 and the Treasury Financial Manual (TFM) require the DoD to reconcile its Fund Balance With Treasury and explain any discrepancies between balances reported by the DoD and the U.S. Treasury to ensure the integrity and accuracy of the DoD and Government-Wide

⁵ FASAB, "Handbook of Federal Accounting Standards and Other Pronouncements" (FASAB Handbook), SFFAS No. 1, "Accounting for Selected Assets and Liabilities," March 30, 1993, as amended.

financial statements.⁶ However, the DoD had ineffective processes and controls for reconciling its Fund Balance With Treasury, and as a result, the DoD was unable to ensure the completeness and accuracy of its Fund Balance With Treasury account. For example, the Cash Management Report, a tool used by the DFAS and Other Defense Organizations to reconcile Fund Balance With Treasury, was not complete, accurate, or supported. Other Defense Organizations account for \$101.2 billion, or 17 percent, of the DoD Agency-Wide Fund Balance With Treasury. The lack of effective control over Fund Balance With Treasury increased the risk that the financial statements may be materially misstated.

Suspense Accounts. OMB Circular No. A-11 defines suspense accounts as accounts used to temporarily hold transactions that belong to the Government while waiting for information that will allow the transactions to be matched to a specific receipt or expenditure account.⁷ The DoD Financial Management Regulation states that suspense accounts may be used in accordance with Treasury guidance if transactions are reclassified to the correct line of accounting and properly reported in the accounting system within 60 days of the transaction entering suspense.⁸ However, DFAS and the DoD Components lacked the controls necessary to sufficiently monitor funds in suspense accounts and to research transactions to clear account variances in accordance with the 60-day requirement. The DoD lacked the proper controls to ensure that transactions were not being intentionally placed into suspense. Additionally, the DoD was unable to properly attribute suspense accounts transactions to the appropriate DoD Component because multiple components share the same suspense accounts. These control deficiencies within the DoD suspense accounts created a high risk that the financial statements were misstated.

Inventory and Related Property. For FY 2019, the DoD reported an Inventory and Related Property balance of \$291.5 billion. SFFAS No. 48, which amends SFFAS No. 3, requires the DoD to value inventory at historical cost or to use a method that reasonably approximates historical cost.⁹ However, multiple DoD Components did not account for Inventory and Related Property according to SFFAS No. 3, or the alternative valuation methods allowable by SFFAS No. 48. In addition, the DoD Components lacked the policies, procedures, controls, and supporting documentation necessary to

⁶ Treasury Financial Manual, volume 1, part 2, chapter 5100, "FBWT," May 2019.

⁷ OMB Circular No. A-11, "Preparation, Submission, and Execution of the Budget," June 2019.

⁸ DoD Financial Management Regulation, volume 12, chapter 1, "Funds," section 010403, "Temporary Account Requirement," March 2019.

⁹ FASAB Handbook, SFFAS No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials," January 2016.

substantiate the existence and completeness of Inventory and Related Property reported on their financial statements. Specifically, the DoD Components did not have internal control and procedures for inventory counts, movement of inventory, or in-transit inventory. In addition, the DoD Components could not produce documentation supporting the valuation of their inventory. As a result, the DoD was unable to support a material portion of its inventory, and there is high risk of material misstatement of Inventory and Related Property on the financial statements.

Operating Materials & Supplies. For FY 2019, the DoD reported an Operating Materials and Supplies (OM&S) balance of \$184.9 billion. SFFAS No. 3 requires the DoD to value its OM&S on the basis of historical cost or on a basis that reasonably approximates historical cost.¹⁰ SFFAS No. 48 amends SFFAS No. 3, and allows DoD to use a one-time alternative valuation method for establishing the opening balances of OM&S. However, the DoD must make an unreserved assertion that the balance is in accordance with GAAP, and the DoD must have a sustainable process for implementing SFFAS No. 3 following the initial valuation. Material DoD Components did not account for OM&S according to SFFAS No. 3, or the alternative valuation methods allowable by SFFAS No. 48. The DoD's inability to value OM&S in accordance with SFFAS No. 3, as amended by SFFAS No. 48, creates a high risk that balances presented on the financial statements are materially misstated.

SFFAS No. 3 also requires that OM&S be categorized as (1) OM&S held for use, (2) OM&S held in reserve for future use, or (3) excess, obsolete and unserviceable. We determined that DoD Components were not properly categorizing OM&S. For example, DoD Components categorized OM&S inventory as held for use, or held in reserve for future use, when the OM&S inventory was actually excess, obsolete, or unserviceable. This increases the risk that OM&S balances are overstated on the Component financial statements, resulting in an overstatement at the DoD Agency-Wide level.

General Property, Plant, and Equipment. For FY 2019, the DoD reported a General Property, Plant, and Equipment (PP&E) balance of \$768.6 billion. SFFAS No. 6 requires the DoD to report General PP&E at acquisition cost.¹¹ SFFAS No. 50 allows alternative methods for establishing opening balances to be applied for the reporting period in which the reporting entity makes an unreserved assertion that its

¹⁰ FASAB Handbook, SFFAS No. 3, "Accounting for Inventory and Related Property," October 1993.

¹¹ FASAB Handbook, SFFAS No. 6, "Accounting for Property, Plant, and Equipment," November 30, 1995, as amended.

financial statements are presented in accordance with GAAP.¹² However, as of September 30, 2019, the DoD had not completed its implementation of SFFAS No. 50 to establish opening balances of its General PP&E. In addition, the DoD did not have sufficient procedures to account for its General PP&E in accordance with SFFAS No. 6. Because the DoD cannot accurately value its General PP&E, the DoD is at risk of materially misstating its financial statements.

Real Property. In FY 2019, DoD management identified real property as a financial statement audit priority, and issued a new financial reporting policy that affects how the DoD Components will report real property in FY 2020. This policy requires DoD Components to transfer all real property to the Military Services or Washington Headquarters Services. However, the DoD was unable to provide a universe of transactions for its real property and the DoD Components did not have processes in place, or did not fully implement corrective actions to generate and reconcile populations of real property to those reported on their financial statements. Unsupported real property balances significantly increase the risk that the General PP&E line item may be materially misstated on the financial statements. Additionally, transfers of real property required by the new policy may be unsupported if not properly monitored by DoD management, resulting in additional risks of material misstatement for FY 2020.

Government Property in Possession of Contractors. SFFAS No. 6 requires that property and equipment in the possession of contractors, or acquired on behalf of the Government for use in accomplishing a contract, be considered Government property. The DoD must account for this property based on the nature of the item, regardless of who has possession. However, the DoD lacked policies, procedures, control, and supporting documentation for the acquisition, disposal, and inventory processes related to Government property in the possession of contractors. This prevented the DoD from substantiating the existence and completeness of Government property in the possession of contractors. Additionally, not all DoD contract terms and conditions incorporated standard inventory management policies, procedures, and metrics. As a result, the financial statements may be incomplete or inaccurate and could be materially misstated.

¹² FASAB Handbook, SFFAS No. 50, "Establishing Opening Balances for General PP&E: Amending SFFAS 6, 10, and 23, and Rescinding SFFAS 35," August 4, 2016.

Joint Strike Fighter Program. The Joint Strike Fighter is a multiservice, multinational acquisition to develop and field the next-generation strike fighter aircraft for the Navy, Air Force, Marine Corps, and international partners. However, the DoD did not account for and manage Joint Strike Fighter Program property, or record the property in an accountable property system of record. As a result, the DoD did not report the property on its financial statements. Additionally, the DoD is relying on contractor records to value the property associated with the Joint Strike Fighter Program. These contractor records indicate that the program contains over 3.45 million pieces of property valued at \$2.1 billion. The omission of the Joint Strike Fighter program property from the financial statements and inability to provide documentation supporting the value of the property indicate material failures in controls for recording joint programs within the DoD and presents a high risk that the financial statements contain material misstatements.

Military Housing Privatization Initiative (MHPI). Accounting Standards Codification 323 requires the DoD to report real property ownership transfers to MHPI private entities as increases to reported Other Investments and annual private entity profits and losses allocated to the DoD as changes to reported Other Investments.¹³ For FY 2019, the DoD reported an MHPI-related Other Investments balance of \$3.5 billion. However, the DoD did not report, as an increase to Other Investments, an estimated \$5.0 billion of real property transferred to the MHPI private entities in exchange for the DoD's ownership interest in the private entities. In addition, the DoD did not reduce Other Investments for an estimated \$1.1 billion in net cumulative annual losses allocated to the DoD based on its ownership interest. Furthermore, the DoD did not properly disclose information related to the MHPI as required by SFFAS No. 49¹⁴ and OMB Circular No. A-136.¹⁵ In the aggregate, deficiencies associated with the MHPI program present a high risk of material misstatement in the financial statements.

Accounts Payable. For FY 2019, the DoD reported a non-Federal Accounts Payable balance of \$39.7 billion. SFFAS No. 1 states that accounts payable are amounts owed to other Federal entities for receipt of goods and services, progress in contract performance, or rents. The DoD Components did not have sufficient policies, procedures, and control over their methodology for accruing payables. In addition, ineffective control over Accounts Payable increases the risk of unsupported transactions. As a result, the Accounts Payable balance on the financial statements

¹³ Accounting Standards Codification, Financial Accounting Standards Board, as updated through November 1, 2019, Code Section 323.

¹⁴ FASAB Handbook, "SFFAS No. 49, Public Private Partnerships: Disclosure Requirements," April 27, 2016.

¹⁵ OMB Circular No. A-136, "Financial Reporting Requirements," June 28, 2019.

may be materially misstated. Additional control failures associated with Federal Accounts Payable were included in the intradepartmental eliminations and intragovernmental transactions material weakness.

Environmental and Disposal Liabilities. For FY 2019, the DoD reported an Environmental and Disposal Liabilities balance of \$76.1 billion. Federal Financial Accounting and Auditing Technical Release 2 requires the DoD to recognize liabilities for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable.¹⁶ However, the DoD lacked formal policies, procedures, and supporting documentation to substantiate the completeness and accuracy of its Environmental and Disposal Liabilities. As a result, Environmental and Disposal Liabilities reported on the financial statements may be materially misstated.

Legal Contingencies. The TFM requires the DoD General Counsel to prepare a Legal Representation Letter that lists legal actions against the DoD. The Legal Representation Letter must be accompanied by a Management Schedule that summarizes the content of the Legal Representation Letter. This information supports financial statement disclosures. In FY 2019, there were control failures that affected the presentation and calculation of total legal contingencies at the DoD Agency-Wide level. Specifically, as a result of auditor-identified errors, DoD management made material changes to the Management Schedule. Additionally, the DoD Components did not record their legal contingencies using a consistent methodology and, as a result, the DoD Components posted adjustments to reconcile commitments and contingencies balances to the Management Schedule. Lack of controls over the process for preparing the Management Schedule, and the lack of consistent component reporting methodology, created a risk that the financial statements and related notes may be misstated.

¹⁶ FASAB Handbook, Federal Financial Accounting and Auditing Technical Release 2, "Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government," March 15, 1998.

Beginning Balances. SFFAS No. 48 defines beginning balances as account balances that exist at the beginning of that the reporting period and are based upon the closing balances of the prior period. These balances reflect the effects of transactions that occurred and accounting policies applied in prior periods. Material DoD Components did not have historical data to support beginning balances on their financial statements or the ability to reconcile beginning balances to closing balances at the end of the reporting period. Without support to confirm the completeness and accuracy of beginning balances, the financial statements may be materially misstated.

Unsupported Accounting Adjustments. The Federal Managers Financial Integrity Act (FMFIA) of 1982 requires the DoD to properly record and account for revenues and expenditures to permit the preparation of reliable financial reports and to maintain accountability over assets. Effective control is necessary to demonstrate compliance with the FMFIA. However, the DoD did not have effective control to provide reasonable assurance that accounting adjustments were valid, complete, and accurately recorded in its accounting and general ledger systems. Material DoD Components recorded manual and system-generated accounting adjustments that lacked supporting documentation and appropriate approvals. Without effective control, the DoD cannot provide reasonable assurance that material misstatements would be prevented, or detected and corrected, in the DoD Components and DoD Agency-Wide Basic Financial Statements in a timely manner. Additionally, the failure to establish and implement effective controls over accounting adjustments creates a high risk of material misstatement for all financial statement line items.

Intradepartmental Eliminations and Intragovernmental Transactions. The TFM defines trading partners as Federal entities that are party to transactions with other Federal entities.¹⁷ It further defines intradepartmental transactions as those occurring between two trading partners within the same entity. In order to properly present the balances on the financial statements, intradepartmental transactions must be eliminated during the financial statement preparation process. Additionally, the DoD must identify transactions that should be eliminated at the Government-wide level as a result of trading partner activity with other Federal entities. However, the DoD accounting systems were unable to capture intradepartmental and intragovernmental data at the transaction level to facilitate these required eliminations. Inability to reconcile and report intradepartmental and intragovernmental transactions creates a high risk of material misstatement for all financial statement line items.

¹⁷ TFM, volume 1, part 2, chapter 4700, "Federal Entity Reporting Requirements for the Financial Report of the United States Government," May 2019.

Gross Costs. For FY 2019, the DoD reported a Gross Costs balance of \$822.3 billion. Statement of Federal Financial Accounting Concepts (SFFAC) No. 2 requires the DoD to provide gross and net cost information related to the amounts of outputs and outcomes for programs or organizations on the Statement of Net Cost.¹⁸ The statement should present the amounts paid, the consumption of other assets, and the incurrence of liabilities as a result of rendering services, delivering or producing goods, or carrying out other operating activities. However, the DoD Components have material deficiencies related to the Gross Costs line item. These deficiencies included, but were not limited to, compliance with GAAP, inaccurate reporting of transactions, and inadequate procedures and controls for recording Gross Costs. Therefore, DoD management does not have reliable financial information to effectively manage and understand gross costs, and the DoD is at risk of materially misstating Gross Costs on its financial statements.

Earned Revenue. For FY 2019, the DoD reported an Earned Revenue balance of \$90.5 billion. SFFAC No. 2 requires the DoD to present the revenues earned by each program and organization on its statement of net costs. However, the DoD Components have material deficiencies related to the reliability of Earned Revenue on the Statement of Net Cost. These deficiencies included, but are not limited to, compliance with GAAP, inability to substantiate revenue-related transactions, and inadequate processes and controls for recording Earned Revenue. As a result, there is an increased risk that Earned Revenue may be materially misstated on the financial statements.

Reconciliation of Net Cost of Operations to Outlays. SFFAS No. 7 requires the DoD to perform a reconciliation of its proprietary and budgetary data.¹⁹ OMB Circular No. A-136 requires the DoD to include this reconciliation in the notes to the financial statements. However, the DoD was unable to adequately explain a \$10.3 billion reconciling difference between the budgetary and proprietary accounts in the DoD Agency Financial Report. This occurred because the DoD Components and DFAS have not designed and implemented controls to research and resolve variances between budgetary and proprietary data throughout the reporting period. The DoD's inability to provide details required to resolve this reconciling difference prevented auditors from determining the total impact to the financial statements and put the DoD at risk of materially misstating its financial statements.

¹⁸ FASAB Handbook, SFFAC No. 2, "Entity and Display," June 6, 1995, as amended.

¹⁹ FASAB Handbook, SFFAS No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," May 10, 1996, as amended.

Budgetary Resources. SFFAS No. 7 requires the DoD to present material budgetary information that comes wholly or in part from the budget in its Statement of Budgetary Resources. The material budgetary information includes total budgetary resources available to the DoD during the period, status of those resources, and outlays of those resources. The balances presented on the DoD Components' Statement of Budgetary Resources may not be complete, accurate, or supported. As a result, the DoD Components, and the DoD as a whole, may not have been able to accurately determine and monitor the total budgetary resources available during the reporting period, or the status of those resources. The inability to monitor the status of budgetary resources creates the potential for violations of the Antideficiency Act and increases the risk that the Statement of Budgetary Resources may be materially misstated.

Service Providers. A service provider is a third party that performs activities for many agencies. OMB Circular No. A-123 states that service providers are responsible for providing assurance to their customers and assisting those customers in understanding the relationship between the service provider's controls and the customer's user controls. Certain DoD Components function as service providers for other DoD Components and Federal agencies. The DoD service providers perform critical activities across the DoD, and for other Federal agencies such as managing inventory and preparing financial statements, and for other DoD Components and Federal agencies. However, many of the service providers have not designed or implemented reliable controls that provide the required assurance to the DoD Component customers. While DoD Component management retains responsibility for the performance of processes assigned to service providers, service provider control deficiencies decrease the reliability and accuracy of the DoD Component-level financial statements. As a result, there is an increased risk of material misstatement on the DoD Agency-Wide Basic Financial Statements.

Entity-Level Controls. The Government Accountability Office Green Book presents the internal control standards for Federal agencies for both program and financial management.²⁰ The Green Book states that entity-level controls are controls that have a pervasive effect on an entity's internal control system and may pertain to multiple components. Entity-level controls may include controls related to the entity's risk-assessment process, control environment, service organizations, and management's ability to override existing controls. However, multiple DoD Components did not design and implement effective entity-level controls for reliable financial reporting.

²⁰ The Government Accountability Office Green Book, "Standards for Internal Control in the Federal Government," September 2014.

Specifically, multiple DoD Components lacked controls or performed insufficient reviews while preparing their financial statements. As a result, the DoD Components were unable to detect and correct misstatements in the financial statements and related disclosures. Furthermore, most DoD Component financial statements were not prepared in accordance with GAAP. Ineffective entity-level controls create a risk of material misstatements on the DoD Component financial statements and, as a result, a corresponding risk of material misstatement on the DoD Agency-Wide Basic Financial Statements.

DoD-Wide Oversight and Monitoring. OMB Circular No. A-123 defines management's responsibility for internal control. Specifically, it requires that the DoD establish and integrate internal control into the entity's operations in a risk-based and cost-beneficial manner, which helps to provide reasonable assurance that the DoD's internal control over operations, reporting, and compliance is operating effectively. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer [OUSD(C)] and DFAS are responsible for consolidating component level information to produce documents such as the DoD Agency Financial Report. However, this component level information is incomplete, inaccurate, and not GAAP compliant. The OUSD(C) does not perform effective oversight and monitoring over this consolidation or have adequate time to perform verification of the component level information prior to publishing agency-wide information. Furthermore, the DoD Components did not always comply with the OUSD(C) issued guidance intended to provide consistency in reporting at the DoD Agency-Wide level. As a result, there is an increased risk that consolidated component level information is not complete or accurate when presented at the DoD Agency-Wide level.

Component-Level Oversight and Monitoring. OMB Circular No. A-123 requires DoD Component management to continuously monitor, assess, and improve the effectiveness of internal control associated with those objectives identified as part of their risk profile. In addition, it requires DoD Component management to evaluate and document internal control deficiencies and determine appropriate corrective actions for those deficiencies on a timely basis. However, DoD Components did not implement oversight and monitoring activities in a timely manner to identify and resolve deficiencies that could impact their financial statement balances and related disclosures. Therefore, the DoD Components could not provide reasonable assurance that internal control over financial reporting are effective and there is a risk that the DoD Agency-Wide Financial Statements may be misstated.

Identified Significant Deficiency

A significant deficiency in internal control is a deficiency, or a combination of deficiencies, that is less severe than a material weakness yet important enough to merit the attention of those charged with governance.

Accounts Receivable. For FY 2019, the DoD reported a non-Federal Accounts Receivable balance of \$5.9 billion. SFFAS No. 1 requires that the DoD recognize a receivable when it establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date, or goods or services provided. The DoD Components have not developed or implemented effective controls to prevent or detect misstatements of non-Federal accounts receivable balances. For example, one DoD Component did not reduce receivables when cash was collected in prior accounting periods in the accounting records. This error created an overstatement to the non-Federal Accounts Receivable line item. Lack of effective controls creates a significant risk that balances presented on the financial statements are misstated. Additional control failures associated with Federal accounts receivable are included in the intradepartmental eliminations and intragovernmental transactions material weakness.

Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

Generally accepted government auditing standards and OMB guidance require auditors to report on an entity's compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for compliance with existing laws, regulations, contracts, and grant agreements related to financial reporting. We compiled the results from the audits of the DoD Components and determined that the DoD was not compliant with all laws, regulations, contracts, and grant agreements that could have a direct and material effect on the financial statements. Specifically, the DoD did not comply with the Antideficiency Act (ADA), FFMA, FMFIA, the Federal Information Security Modernization Act, and the Debt Collection Improvement Act. However, our objective was not to express, and we do not express, an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Additionally, because of the significance of the matters described in the "Basis for Disclaimer of Opinion," we performed limited procedures that may not have detected all instances of noncompliance. The following instances of noncompliance impacted DoD Components.

Compliance With Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]), limits the DoD and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the DoD or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As required by 31 U.S.C. § 1517 (2004), the DoD and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the ADA, the head of the agency must immediately report to the President and Congress all relevant facts and a statement of actions taken. During FY 2019, the DoD reported multiple ADA violations within four completed cases.

DoD Regulation 7000.14-R, "Financial Management Regulation," volume 14, chapter 3, "Antideficiency Act Violation Process," establishes timeframes for identifying and reporting ADA violations. The regulation states that the formal investigation and reporting on ADA violations should take no more than 15 months. The DoD did not report any investigations of potential ADA violations that had been open for more than 15 months.

Compliance With Federal Financial Management Improvement Act

The FFMIA requires the DoD to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. For areas in which an agency is not in compliance, OMB Circular No. A-136 requires the agency to identify remediation activities planned or underway to bring the systems into substantial compliance with the FFMIA.

For FY 2019, the DoD did not substantially comply with the FFMIA. The OUSD(C) represented that the internal controls in place were not effective to provide reasonable assurance that financial reporting was reliable. The OUSD(C) represented that its financial management and feeder systems did not substantially comply with the Federal financial management systems requirements, Federal accounting standards, or the U.S. Standard General Ledger at the transaction level as of September 30, 2019. In addition, the auditors of the DoD Components identified that the DoD Components did not substantially comply with the FFMIA.

Compliance With Federal Managers' Financial Integrity Act

The FMFIA requires the DoD to perform ongoing evaluations and reports on the adequacy of its systems of internal accounting and administrative control. OMB Circular No. A-123, which implemented the FMFIA, requires DoD management to establish and maintain internal controls to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

For FY 2019, the DoD did not substantially comply with the FMFIA. The OUSD(C) represented that the DoD's internal control over financial reporting was not effective because of the material weaknesses reported in the FY 2019 Agency Financial Report. In addition, the auditors of the DoD Components identified that the DoD Components did not substantially comply with the FMFIA.

Compliance With Federal Information Security Modernization Act

The Federal Information Security Modernization Act of 2014 (FISMA) requires agencies to provide information security controls commensurate with the risk and potential harm of not having those controls in place. The National Institute of Standards and Technology publishes standards and guidelines for Federal entities to implement for non-national security systems. Deviations from these standards and guidelines represent departures from FISMA requirements. Two DoD Components did not comply with FISMA standards and guidelines. As a result, the DoD is not in compliance with FISMA.

Compliance With the Debt Collection Improvement Act

The Debt Collection Improvement Act of 1996, as amended by the Digital Accountability and Transparency Act of 2014, requires that any non-tax debts or claims owed to the U.S. Government that is over 120 days delinquent, are required to be reported to the Treasury for purposes of administrative offset. One DoD Component did not transfer all outstanding eligible debt in accordance with the Debt Collection Improvement Act requirements. As a result, the DoD is not in compliance with the Debt Collection Improvement Act.

Recommendations

This report does not include recommendations to correct the material weaknesses and instances of noncompliance with laws and regulations. The DoD OIG and component auditors provided Notices of Findings and Recommendations to DoD management and the DoD Components, respectively, to address reported material weaknesses and significant deficiencies, when appropriate.

Appendix 2. Acronyms and Abbreviations

A

ATAAPS Automated Time Attendance and Production System

C

C Comptroller

CAP Corrective Action Plan

CAPS-W **Computerized Accounts Payable System-Windows**

CBDP Chemical and Biological Defense Program

CFO Chief Financial Officer

CIO Chief Information Officer

CMO Chief Management Officer

COVID-19 Coronavirus Disease - 2019

CRM Contract Resource Management

CUEC Complementary User Entity Controls

D

DAAS Defense Automatic Addressing System

DAI Defense Agencies Initiative

DAU Defense Acquisition University

DARPA Defense Advanced Research Projects Agency

DARWG Defense Audit Remediation Working Group

DC District of Columbia

DCAA Defense Contract Audit Agency

DCAS Defense Cash Accountability System

DCFO Deputy Chief Financial Officer

DCMA Defense Contract Management Agency

DCPDS Defense Civilian Personnel Data System

DEAMS Defense Enterprise Accounting and Management System

DeCA Defense Commissary Agency

DFAS Defense Finance and Accounting Service

DFAS GF Defense Finance and Accounting Service General Fund

DHA Defense Health Agency

DHA-CRM Defense Health Agency – Contract Resource Management

DHP	Defense Health Program
DHRA	Defense Human Resources Activity
DISA	Defense Information Systems Agency
DLA	Defense Logistics Agency
DMA	Defense Media Activity
DoD	Department of Defense
DoDEA	Department of Defense Education Activity
DoD OIG	Department of Defense Office of Inspector General
DON	Department of the Navy
DOTTE	Director, Operational Test and Evaluation
DPAA	Defense POW/MIA Accounting Agency
DPAS	Defense Property Accountability System
DRRT	Department 97 Reconciliation and Reporting Tool
DSCA	Defense Security Cooperation Agency
DSS	Defense Security System
DTIC	Defense Technical Information Center
DTRA	Defense Threat Reduction Agency
DTS	Defense Travel System
DTSA	Defense Technology Security Administration

E

ECS	Enterprise Computing Services
ELAN	Enterprise Local Area Network
ERP	Enterprise Resource Planning System
ES	Executive Summary

F

FBWT	Fund Balance with Treasury
FFMIA	Federal Financial Management Improvement Act
FIAR	Financial Improvement and Audit Remediation
FM	Financial Management
FM&C	Financial Management and Comptroller
FY	Fiscal Year

G

GAO	Government Accountability Office
GF	General Fund
GFEB	General Fund Enterprise Business System

I

IAPS	Integrated Accounts Payable System
ICAM	Identify, Credential, and Access Management
IG	Inspector General
IPA	Independent Public Accountant or Independent Public Accounting firm
IT	Information Technology

J

JCS	Joint Chiefs of Staff
JSF	Joint Strike Fighter

M

MDA	Missile Defense Agency
MERHCF	Medicare-Eligible Retiree Health Care Fund
MHS	Medical Health System
MICP	Managers' Internal Controls Program
MICRR	Managers; Internal Controls Remediation and Reporting Application
MRF	Military Retirement Trust Fund

MW

Material Weakness

N

NAVFAC	Naval Facilities Engineering Command
NDAAs	National Defense Authorization Act
NDU	National Defense University
NFR	Notice of Findings and Recommendations

O

OCMO	Office of the Chief Management Officer
OIG	Office of Inspector General
ODCFO	Office of the Deputy Chief Financial Officer
OEA	Office of Economic Adjustment
OMB	Office of Management and Budget
OM&S	Operating Materials and Supplies
OSD	Office of the Secretary of Defense
OUS(D)	Office of the Under Secretary of Defense (Comptroller)

S

SABRS	Standard Accounting, Budgeting and Reporting System
SDS	Standard Disbursing Services
SECDEF	Secretary of Defense
SOC	System and Organization Controls
SOIDC	Service-Owned Items in the Custody of DLA
SSAE	Statement on Standards for Attestation Engagements

T

TI	Treasury Index
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U

US	United States
USD(C)	Under Secretary of Defense (Comptroller)
USMC	United States Marine Corps
USSOCOM	United States Special Operations Command
USTRANSCOM	United States Transportation Command

W

WAWF	Wide Area Work Flow
WHS	Washington Headquarters Services

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