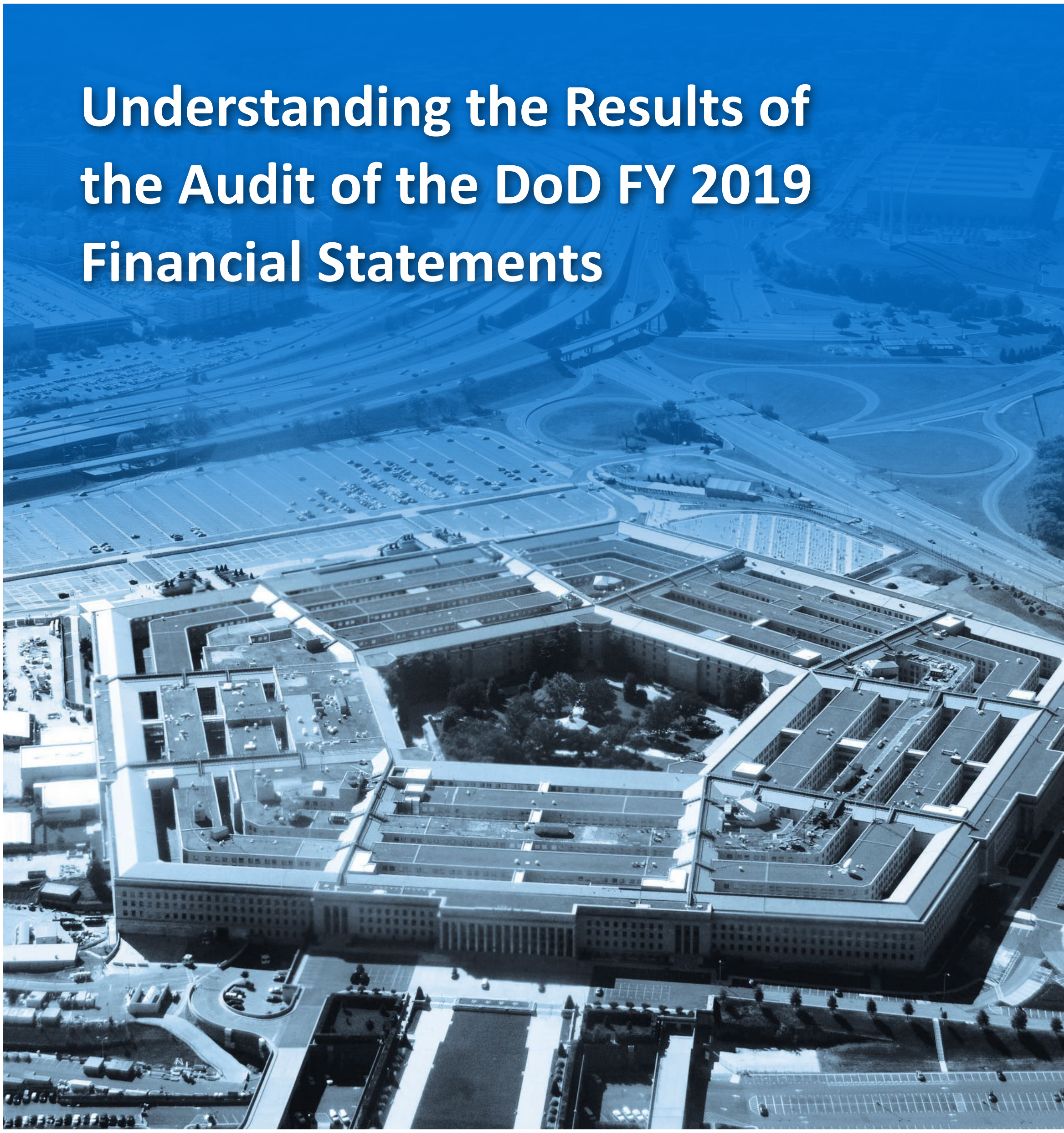
INSPECTOR GENERAL

U.S. Department of Defense

JANUARY 28, 2020

Understanding the Results of the Audit of the DoD FY 2019 Financial Statements



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DEPARTMENT OF DEFENSE

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During FY 2019, the Department of Defense (DoD) underwent a full financial statement audit for the second year. Like last year, this audit was performed by the DoD Office of Inspector General (DoD OIG).

Also similar to last year, the DoD received a disclaimer of opinion on the Agency-Wide Basic Financial Statements.

A typical financial statement audit would normally stop when the auditors determine that a disclaimer will be issued. However, like last year, the DoD OIG and the independent public accounting firms who conducted audits of 23 financial statements and the DoD's overall financial statements continued the audits to identify notices of findings and recommendations (NFRs) to help the DoD understand and address deficiencies.

The opinions issued by the auditors contain technical language and follow a format dictated by auditing standards. However, the DoD OIG believes that it is important for non-auditors to understand the results of the audits, as well as the value of the audits. That is the purpose of this report—to summarize in terms understandable to non-auditors the progress made by the DoD, the findings of the DoD's financial statement audits, and the additional actions the DoD should take to address the overall findings of the audit.

We believe that obtaining a clean audit opinion is important to the DoD and necessary for the Government-wide financial statements to receive a clean opinion. However, the financial statement audit has value beyond the audit opinion. The audit—and more accurate financial statements—enables Congress and the public to obtain a more accurate assessment of how the DoD spends its money; helps the DoD fix vulnerabilities in information technology systems; helps identify and prevent wasteful practices; and also assists the DoD in improving its operations. While the audit is expensive, it has valuable impacts.

This year, the DoD made progress in improving its financial management, but much more progress needs to be made. The first year the DoD underwent a full financial statement audit, in FY 2018, in addition to the disclaimer of opinion on the DoD Agency-Wide financial statements, auditors issued 2,595 NFRs to the DoD and its Components. Auditors also identified 20 agency-wide material weaknesses, which are weaknesses in internal controls that result in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statements in a timely manner.

This year, the DoD OIG again issued a disclaimer of opinion on the DoD's FY 2019 financial statements. As described in this report, the audits continued to identify material weaknesses and NFRs. The auditors identified 25 agency-wide material weaknesses, which included 8 new findings and 8 modified FY 2018 findings. The auditors reissued 1,897 FY 2018 NFRs and issued 1,575 new FY 2019 NFRs.

As discussed in the report, however, the auditors identified some areas of improvement since last year. First, the auditors closed 698 FY 2018 NFRs. In addition, the DoD, as a whole, has increased its ability to respond to audit requests. For example, the DoD and its Components demonstrated improvements in their understanding of their business processes and financial statements. In addition, auditors were able to expand testing in areas already tested, test in new areas, and draw conclusions on transactions selected for testing. This deeper level of testing is an improvement and also part of the reason that the DoD and its Components received more NFRs and material weaknesses.

However, much more work needs to be done, and the road to a clean opinion is not short. Continued progress requires sustained effort and attention throughout the DoD, from the top on down.

It is also critical that the DoD continues to implement corrective action plans and to monitor the implementation of those corrective actions. DoD leadership has stressed the importance of the financial statement audits and adequate corrective action plans, as well as the need to develop efficient and effective business processes that can lead to accurate financial information and improve DoD operations. The Secretary of Defense, Deputy Secretary of Defense, the Acting DoD Comptroller, and other DoD leaders have emphasized the importance of the audit, strong financial management, the need to cooperate with auditors, and the need to fix identified deficiencies. That emphasis needs to continue.

At the DoD OIG, we will continue to fully and fairly audit the financial statements, identify deficiencies, and provide clear information to the DoD on what is necessary to fix these deficiencies.

This is an important, long-term effort that we are committed to supporting. We hope this report helps explain the DoD audits, and helps support the DoD's efforts to improve financial processes and provide accurate financial statements.

Glenn A. Fine
Principal Deputy Inspector General
Performing the Duties of the Inspector General

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INTEGRITY EFFICIENCY

DEPARTMENT OF DEFENSE

Understanding the Results of the Audit of the DoD FY 2019 Financial Statements

The Department of Defense (DoD) prepares the annual Agency Financial Report (financial report) to describe and communicate the financial position and results of operations of the DoD. Prior to FY 2018, the DoD's financial report was not fully audited. The National Defense Authorization Act (NDAA) of 2002 required the DoD Office of the Inspector General (OIG) to perform only the procedures necessary to audit what the DoD represented as audit ready.

In 2014, the NDAA required the Secretary of Defense to ensure that a full-scope audit be performed over the DoD financial statements beginning in FY 2018. As a result, the DoD OIG ensured that the DoD's financial statements underwent a full audit beginning in FY 2018. The audits determined whether the financial statements were fairly presented in accordance with Generally Accepted Accounting Principles, and resulted in audit opinions.

In FY 2018, the DoD OIG and five independent public accounting firms overseen by the DoD OIG performed audits consisting of audit procedures on balances listed on the DoD's and 21 DoD Components' financial statements. The DoD and 15 of its reporting entities received disclaimers of opinion. Five reporting entities received clean audit opinions and one entity received a qualified audit opinion.

This year, in FY 2019, the DoD OIG and five independent public accounting firms overseen by the DoD OIG performed audits consisting of audit procedures on balances listed on the DoD's and 23 DoD Components' financial statements to determine if the financial statements were accurately presented.[1,2] Similar to FY 2018, in FY 2019, the DoD and 15 of its reporting entities received disclaimers of opinion. In addition, seven reporting entities received clean audit opinions and one entity received a qualified audit opinion.

In addition, the auditors provided a report to the audited entities that identified the material weaknesses, significant deficiencies, and instances of non-compliance with laws and regulations within the DoD and the DoD Components. Although the overall audit opinions for the DoD and the 23 Components whose audits were overseen by the DoD OIG did not change from FY 2018 to FY 2019, the auditors noted progress for the DoD and the DoD Components that received disclaimers of opinion regarding their understanding of their business processes, ability to provide universes of transactions for testing, and ability to provide supporting documentation for transactions selected for testing.

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[1] The DoD OIG contracted with six independent public accounting firms to support the overall audit of the DoD. Five independent public accounting firms performed full financial statement audits of one or more DoD reporting entities and one independent accounting firm performed limited internal control testing over entity controls for DoD Components.

[2] DoD management tracks and reports on the standalone audits that are performed on the DoD's and DoD Components' financial statements, which includes the Defense Finance and Accounting Service, the Defense Contract Audit Agency, the Defense Commissary Agency, the DoD OIG, and the Defense intelligence agencies, which are not overseen by the DoD OIG. DoD management does not track or report the standalone audits for the four sub-allotted financial statements overseen by the DoD OIG. Therefore, the reporting by DoD management and the DoD OIG may differ.

Although the DoD has made progress, there is still significant progress to be made. As discussed in this report, continued progress will require sustained effort and attention throughout the DoD. It is critical that the DoD and its Components fix the weaknesses and deficiencies identified in the audits through the development, implementation, and monitoring of corrective action plans. Developing sustainable business processes will also benefit the DoD through improved operations that will help the DoD and its Components use their limited resources more effectively. It will also ultimately help lead to a clean audit opinion.

Audit opinions, by their nature and by the requirements of generally accepted auditing standards, are technical, follow a prescribed format, and may not be easy to understand without a background in accounting. The objective of this report is to explain the financial report and the financial statement audits in a way that is understandable and meaningful to a non-auditor.

Specifically, this report describes the importance of financial statement audits and the roles and responsibilities of DoD management and the auditors that reviewed the financial statements. It also summarizes the FY 2019 DoD Component and agency-wide audit results, discusses significant material weaknesses, explains improvements that have been made since FY 2018, and provides the DoD OIG's perspective on what the DoD should do to continue its progress towards clean opinions and stronger financial management.

A. Agency Financial Report

The goal of an agency's financial report is to provide a comprehensive and accurate overview of the agency's finances, mission, and other general information. In addition to the financial statements and related notes, a financial report includes insights into the agency's operations, the agency's assessment of its own internal controls, the agency's compliance with laws and regulations, and material weaknesses in the processes the agency follows to complete its financial statement reporting.

Like in FY 2018, the DoD Agency Financial Report for FY 2019 contains eight major sections.

- Management's Discussion and Analysis
- Financial Statements
  - Consolidated Balance Sheet
  - Consolidated Statement of Net Cost
  - Consolidated Statement of Changes in Net Position
  - Combined Statement of Budgetary Resources
- Notes to the Financial Statements
- Required Supplementary Stewardship Information
- Required Supplementary Information

- DoD OIG Audit Report
- Other Information
- Summary of the DoD Inspector General, "Fiscal Year 2020 Top Management Challenges"

See Appendix A for a detailed discussion on the contents of each section of the Agency Financial Report.

1. Consolidated Financial Statements

The DoD Agency-Wide financial statements provide the financial status for the entire Department, which includes 67 separate entities. However, for the FY 2019 financial statement audits, the Office of Management and Budget (OMB) required the DoD to submit audited financial statements for the DoD and nine of the DoD Components.

The DoD OIG contracted with and oversaw independent public accounting firms' financial statement audits for the following nine DoD Components.

- Department of the Army General Fund
- Department of the Army Working Capital Fund
- U.S. Navy General Fund
- Department of the Navy Working Capital Fund
- Department of the Air Force General Fund
- Department of the Air Force Working Capital Fund
- U.S. Marine Corps General Fund
- Military Retirement Fund
- U.S. Army Corps of Engineers Civil Works

In addition to these 9 required audits of DoD Components, the DoD decided that 21 additional DoD Components would submit audited financial statements to the Office of the Under Secretary of Defense Comptroller/Chief Financial Officer (DoD Comptroller) because these Components' financial statements were significant to the Agency-Wide financial statements. These additional 21 Components included, among other Components, the:

- Defense Information Systems Agency General Fund and Working Capital Fund,
- U.S. Special Operations Command General Fund, and
- Defense Logistics Agency General Fund, Working Capital Fund, and National Defense Stockpile Trust Fund.

The DoD OIG oversaw the independent public accounting firms' financial statement audits for 14 of these 21 stand-alone financial statement audits. The other seven audits were completed by independent public accounting firms who were contracted with and monitored by the entity's Office of Inspector General or internal audit function.[3] As noted in Footnote 3, the audit of the DoD OIG financial statements is ongoing. This report focuses on the audit results of the DoD and the 23 DoD reporting entity audits performed and overseen by the DoD OIG.

In addition to the opinion reports on the DoD and Component financial statements, the DoD OIG and the independent public accounting firms also issued reports on the agencies' internal control over financial reporting, compliance with the requirements of Federal financial management systems, and compliance with applicable laws, regulations, contracts, and grant agreements.

As the overall auditor of the Agency-Wide Basic Financial Statements, the DoD OIG oversaw these audits and performed additional procedures as necessary to support the overall audit opinion of the Agency-Wide Basic Financial Statements. The DoD OIG also performed audit procedures on balances of the 37 DoD Components that did not produce stand-alone financial reports. The balances for these 37 Components were consolidated into the Agency-Wide Basic Financial Statements.

As previously noted, the Agency Financial Report includes more than financial statements and the related notes. The Management's Discussion and Analysis section of the report present management's perspective on the financial information and overall operations and significant conditions that may affect future operations. While the Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, Other Information, and Appendixes in the financial report were not required to be audited, they are still important aspects of the financial report and are helpful in gaining a better understanding of the information in the financial statements.

2. Requirements for Audited Financial Statements

The Chief Financial Officers Act of 1990 requires that Federal agencies prepare financial statements and have those financial statements audited by the agency's Inspector General or by an independent external auditor, as determined by the agency's Inspector General. The DoD submitted financial statements for the Department of the Army to the Government Accountability Office (GAO) to be audited beginning in FY 1991. The DoD began submitting the Agency-Wide financial statements to the DoD OIG for audit in FY 1996. The DoD OIG performed limited scope audits on the financial statements for FYs 1996 through 2001. Although those audits were limited in scope, the DoD OIG also performed steps above and beyond those required by auditing standards to render a disclaimer of opinion in order to provide the DoD feedback on its financial processes and controls.

[3] These seven audits were for the Defense Finance and Accounting Service, the Defense Contract Audit Agency, the Defense Commissary Agency, the DoD OIG, and the Defense intelligence agencies. The Defense Finance and Accounting Service, the Defense Contract Audit Agency, the Defense Commissary Agency all received unqualified audit opinions on their FY 2019 financial statements. The Defense intelligence agencies all received disclaimers of opinion on their FY 2019 financial statements. The audit of the DoD OIG financial statements is ongoing, and the DoD OIG expects to receive a clean opinion. In addition, in future years the DoD OIG will seek to issue its audited financial statements closer to or on the same cycle as the other DoD Component audits.

However, the FY 2002 NDAA limited the audit procedures that the DoD OIG was allowed to perform on the DoD's financial statements. The Act allowed the DoD OIG to perform the procedures required by generally accepted government auditing standards and limited the DoD OIG to auditing only the information that DoD management stated was ready for audit.

Prior to FY 2018, only a limited number of DoD Components asserted that their information was ready for audit, such as the Military Retirement Fund financial statements and the U.S. Army Corps of Engineers-Civil Works financial statements. However, the FY 2014 NDAA required the Secretary of Defense to ensure that an annual full-scope audit was performed over the DoD financial statements beginning in FY 2018.

The FY 2016 NDAA required the DoD OIG to obtain independent external auditors to audit the DoD Component financial statements. As the overall auditor of the Agency-Wide Basic Financial Statements, the DoD OIG oversees the audits performed by the independent public accounting firms and performs additional procedures necessary to support the overall audit opinion on the Agency-Wide Basic Financial Statements. To meet these requirements, the DoD OIG contracted with five independent public accounting firms to perform a total of 23 DoD Component financial statement audits in FY 2019.

See Appendix B for a fuller discussion on the requirements for audited financial statements and the requirements of prior year NDAAs.

3. Defining a Financial Statement Audit

The DoD OIG and independent public accounting firms conducted the audits of the FY 2019 DoD and DoD Component financial statements to:

- express an opinion on whether the consolidated financial statements were fairly presented in accordance with Generally Accepted Accounting Principles;
- report any material weaknesses or significant deficiencies in internal control over financial reporting; and
- report on compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements that were tested.

Most of the auditors' work in forming an opinion on financial statements and identifying internal control deficiencies and non-compliance with laws and regulations consists of obtaining and evaluating sufficient appropriate evidence concerning the assertions in the financial statements. The five broad categories of financial statement assertions are:

- **Existence or occurrence:** An entity's assets, such as inventories; liabilities, such as money owed to others; and changes in net position, which is the difference between assets and liabilities, exist on a given date. Auditors must confirm that transactions and events impacting the balances reported occurred during the period under audit, are recorded in the correct account, and belong to the entity.

- **Completeness:** Entities are responsible for recording all assets, liabilities, and changes in net position properly and in the correct period. Auditors perform procedures to confirm that all transactions and events were accounted for.
- **Rights and obligations:** Before an entity records a transaction, it must have authority over the transaction. For example, for the Army to record a purchase of inventory, it must have the rights to the inventory. Conversely, when establishing the accounts payable, money owed to the seller of the inventory, the Army must establish that it has an obligation to pay the vendor on a given date. Auditors perform procedures to confirm that the transactions or events actually belonged to the entity under audit.
- **Accuracy/valuation or allocation:** An entity must record transactions and events appropriately, including recording transactions in the accurate amounts; accurately determining the value of assets and liabilities; and disclosing other information, such as the breakout of investments in the notes to the financial statements, fairly and at the appropriate amounts. Auditors perform procedures to determine the accuracy of the recorded transactions and how the entity determined the value of its assets.
- **Presentation and disclosure:** When presenting financial and other information in the financial statements, an entity must present and describe the information in accordance with Generally Accepted Accounting Principles. In addition, an entity must make required disclosures and ensure those disclosures are clearly expressed. Auditors perform procedures to confirm all disclosures that should have been included in the financial statements were included and that the disclosed events, transactions, and other matters occurred and pertained to the entity under audit.

According to auditing standards and guidance from the GAO, for full-scope financial statement audits, auditors should perform appropriate control and substantive tests for each significant assertion for each significant line item and account. As discussed later in this report, after the auditors determine that they will be unable to obtain sufficient appropriate audit evidence on which to base an opinion, they could stop detailed testing and perform only those procedures required to issue a disclaimer of opinion. However, for the DoD Component audits performed and overseen by the DoD OIG for FY 2019, the auditors continued to perform testing in a limited capacity so that they could continue to identify deficiencies and make recommendations to improve controls, processes, and other areas material to the Component's financial statements.

B. The Importance of Audited Financial Statements

The full financial statement audits of the Agency-Wide and DoD Components' financial statements are important for several reasons, even beyond the ultimate opinion. First, the audits provide Congress and the public an accurate assessment of where the DoD spends its funds. The audits also provide transparency on where DoD resources are spent.

In addition, although financial statement audits are not designed to detect waste, fraud, and abuse, auditors remain alert throughout the process and take appropriate action, such as referring matters to investigative agencies, when they uncover or suspect waste, fraud, or abuse. Moreover, the audits can assist in deterring and detecting waste, fraud, and abuse by baselining, or determining a starting point for the costs and rate of spending. This will allow DoD management to perform analysis and comparison and to plan for the costs and rate of spending. Having a baseline allows management to detect anomalies that could help identify waste, fraud, and abuse.

Furthermore, a significant function of financial statement audits involves reviewing information technology and cyber security. Many of the systems crucial to financial management and reporting are also used for operational purposes. Therefore, testing during the financial statement audits of DoD information technology systems and interfaces between information technology systems can identify vulnerabilities in those systems and result in recommendations to improve the DoD's cyber security. Without effective internal controls and proper cyber security, the systems that the DoD relies on to conduct military operations could be compromised and potentially undermine DoD operations.

Financial statement audits can also help management improve DoD operations. The audits provide feedback regarding the effectiveness and efficiency of each reporting entity's business systems, processes, and controls. For example, the DoD audit identified multiple systems that do not talk to each other or have a significant number of errors in transferring data between systems, and the recommendations related to these findings can assist the DoD in developing systems and business processes that require data to be entered only one time. These recommendations could also result in significant efficiencies and labor savings by eliminating manual entries to correct data errors.

Another important impact of the financial statement audits relates to the DoD's development of business processes. The audit can help improve the DoD's business processes, such as its ability to more accurately forecast and determine the most efficient and effective uses of its funds. For example, if the DoD knows that the asset values and counts are correct, it can properly allocate funds and reduce excess purchases and costs. The DoD can also better predict how much funds it needs for certain purposes, and where unneeded funds can be reallocated and put to better use.

The audits can also improve operational decision-making throughout the DoD. The audits can provide DoD leadership a better understanding of the risks for waste, fraud, and abuse; enable improvements to operations through more efficient business systems, processes, and controls; and allow DoD Components to provide more accurate and consistent information. Ultimately, the DoD can improve its strategic decisions, such as allocating resources, deploying new systems, and implementing new policies, by having more accurate and complete information in the financial statements.

1. Size of the DoD and Relationship to the Government-Wide Financial Statement Audit

The DoD is the largest agency in the Federal Government. It employs 2.1 million Military Service members and over 770,000 civilian employees at approximately 4,500 DoD sites located in all 50 states, 7 U.S. territories, and over 40 countries. In FY 2019, the DoD reported that it received congressional appropriations of $874.4 billion. Approximately $186.6 billion of the appropriations is considered mandatory, and the remaining $687.8 billion is discretionary.[4] The DoD's discretionary spending is almost half of the total U.S. Government's discretionary funding. In addition, the DoD owns the majority of the U.S Government's financial assets—in FY 2019, it reported $2.9 trillion in assets, which is approximately 75 percent of total Government assets.

The GAO is responsible for conducting the annual audit of the Consolidated Financial Statements of the U.S. Government. The DoD's size and its disclaimer of opinion contributes to the Government receiving a disclaimer of opinion. While other factors also contribute to the disclaimer of opinion on the Government-wide financial statements, the Government will likely continue to receive a disclaimer of opinion until the DoD further improves its financial reporting.

2. Roles and Responsibilities Related to the Financial Statements

This section briefly describes the roles and responsibilities of DoD and DoD Component management and the auditors. See Appendix C for a fuller description of the roles and responsibilities of the various individuals and entities involved in the compilation and audit of the DoD's financial statements.

a. DoD and Component Management

The Secretary of Defense, in conjunction with the DoD Comptroller is responsible for compiling and presenting the DoD Agency-Wide Basic Financial Statements. The Secretary of Defense and the DoD Comptroller are also responsible for communicating the objectives and importance of DoD financial statement audits throughout the DoD.

The DoD Components audited in FY 2019 include the Offices of the Secretary of Defense, the Military Departments, the Joint Chiefs of Staff, the combatant commands, the Defense agencies, the DoD field activities, and all other organizational entities in the DoD. Each Component is responsible for ensuring that key processes, systems, internal controls, and supporting documentation affecting the Component's financial statements are complete and accurate. In addition, each Component is responsible for improving its accounting and financial functions.

[4] The total dollar amount of mandatory funding is set by formulas established by Congress, such as contributions for military retirement and health benefits. The dollar amount of discretionary funding, otherwise known as budget authority, is determined by Congress on an annual basis and is used to pay most DoD expenses such as payroll, inventory, and equipment.

During the audit, the Components are also responsible for responding to document requests from the auditors.

The Defense Finance and Accounting Service (DFAS), which reports to the DoD Comptroller, is responsible for standardizing, consolidating, and integrating accounting and financial functions throughout the DoD. DoD Components rely heavily on DFAS processes for maintaining, compiling, and reporting their financial transactions. Additionally, DFAS is responsible for preparing the draft and final versions of the DoD Agency-Wide Basic Financial Statements, which are included in the financial report.

b. DoD Office of Inspector General and the Independent Public Accounting Firms

The DoD OIG is responsible for managing and completing the audit of the DoD Agency-Wide Basic Financial Statements. Additionally, the DoD OIG contracts with independent public accounting firms to perform the financial statement audits of the DoD Components. The DoD OIG monitors and oversees the audit work of these independent accounting firms.

The independent public accounting firms must perform the audits of the Components' financial statements in accordance with both the generally accepted auditing standards that are issued by the Comptroller General of the United States and with the audit requirements for Federal financial statements that are issued by the OMB.

In their audits, the independent public accounting firms test the design and effectiveness of internal controls and the accuracy and completeness of transactions and balances. Independent public accounting firms are required to provide opinions as to whether the Components' presentation of the financial statements conforms with Generally Accepted Accounting Principles.

The DoD OIG monitors and oversees the work of the independent public accounting firms throughout the audit. This oversight includes attending meetings between the independent public accounting firms and the Components being audited, reviewing the independent public accounting firms' testing results, and verifying that the work performed by the independent public accounting firms complies with contract requirements and auditing standards.

The independent public accounting firms provide the DoD OIG the results of their testing for review and consolidation into the DoD Agency-Wide Basic Financial Statements. The DoD OIG consolidates data and results from the independent public accounting firms and uses the results to support the conclusions in the DoD OIG's audit of the DoD Agency-Wide Basic Financial Statements. The DoD OIG is required to report these audit results to the GAO, OMB, and the Department of the Treasury.

3. Secretary of Defense FY 2019 Financial Statement Audit Priorities

Prior to the FY 2018 full financial statement audit of the DoD required by the NDAA, the Secretary of Defense and DoD Comptroller stated that the DoD was ready for audit but also acknowledged that the DoD did not expect an unmodified audit opinion on its Agency-Wide Consolidated Financial Statements. They also stated that the DoD was not certifying that the DoD or Component financial statements were reliable. Rather, the Secretary and DoD Comptroller stated that the DoD was prepared to support the audit procedures and that they expected to receive findings and recommendations regarding the weaknesses and inefficiencies in the DoD's financial management processes.

In FY 2018, the DoD and 15 of its reporting entities received disclaimers of opinion. In addition, five reporting entities received clean audit opinions and one entity received a qualified audit opinion. The DoD OIG identified 20 material weaknesses in FY 2018, including material weaknesses related to General Property, Plant & Equipment, Inventory and Related Property, Government Property in Possession of Contractors, and Financial Management Systems and Information Technology.

After receiving the results from the FY 2018 audit, the then Acting Secretary of Defense announced the FY 2019 financial statement audit priorities for the DoD. Notwithstanding changes in DoD leadership since that time, the following goals remained.

- **Real Property.** Conduct a full existence and completeness count to ensure 100 percent of its building and structures were accounted for in the financial management systems.
- **Inventory.** Conduct a 100-percent count of all Working Capital Fund inventory and all General Fund munitions, ordnance, and uninstalled engines in its possession to establish a complete baseline of these assets.
- **Government Property in the Possession of Contractors.** Complete a reconciliation of contractor inventory data to DoD property records to establish a complete baseline of assets with the contractors.
- **Information Technology (IT).** Ensure that access to financial systems and business systems that fed financial information was limited to only those individuals who needed it and only for the specific areas within the system that they needed to access.

Some DoD Components made progress toward these goals, as discussed in the "DoD Progress Made Since FY 2018" section of this report. However, the DoD did not meet all of these goals. Each of these areas remained a material weakness in FY 2019, as discussed in the "Significant DoD Material Weaknesses" section of this report.

4. Financial Statement Audits and Potential Results

As discussed, the DoD OIG and independent public accounting firms conducted the audits of the FY 2019 DoD and DoD Component financial statements to express an opinion on the financial statements, report deficiencies in internal control over financial reporting, and report non-compliance with applicable laws and regulations.

a. Financial Statement Audit Opinions

When performing a financial statement audit, the auditor can express one of the following potential results on the financial statements:

1. unmodified opinion
2. modified opinions
    a. qualified opinion
    b. adverse opinion
    c. disclaimer of opinion

An unmodified opinion, sometimes referred to as a clean opinion, is expressed when the auditor concludes that management has presented the financial statements fairly and in accordance with Generally Accepted Accounting Principles.

A qualified opinion is expressed when the auditor concludes that there are misstatements in the financial statements which are material to the financial statements but are not significant to the overall presentation of the financial statements.[5]

An adverse opinion is expressed when the auditor concludes that misstatements in the financial statements are both material and significant to the financial statements. Neither the DoD nor any DoD Component has received an adverse opinion on the financial statements since the DoD OIG has been auditing or overseeing the audits of the DoD.

A disclaimer of opinion is expressed when the auditor is unable to obtain sufficient appropriate audit evidence on which to base an opinion.

In FY 2019, the DoD OIG issued a disclaimer of opinion on the Agency-Wide Basic Financial Statements because multiple DoD Components that account for the majority of the balances consolidated into the Agency-Wide Basic Financial Statements received disclaimers of opinion. DoD Components received disclaimers of opinion because they continued to have unresolved accounting issues and material weaknesses that prevented them from providing evidence to support the balances presented on the financial statements.

[5] For example, for FY 2019, the auditors issued a qualified opinion on the financial statements of the DoD's Medicare-Eligible Retiree Health Care Fund because the auditors could not obtain evidence to support the costs of care provided by DoD-managed Military Treatment Facilities. These costs were based on estimates and not in accordance with accounting standards. The auditors concluded that these estimated costs were material to the financial statements because they were 23 percent of the total liabilities and 11 percent of program costs on the financial statements. Except for these amounts, however, the financial statements were presented fairly in all material respects, which allowed the auditors to issue a qualified opinion.

As noted, although every financial statement audit starts as a full-scope audit, after the auditors determine they will be unable to obtain sufficient appropriate audit evidence on which to base an opinion, they could stop any detailed testing and perform only those procedures required to issue a disclaimer of opinion. However, for the DoD Component audits performed and overseen by the DoD OIG, the auditors continue to perform testing in a limited capacity so that they can make recommendations to improve controls, processes, and other areas material to the financial statements. This is referred to as the audit continuation plan.

As part of this process, auditors can test different areas for each Component each year using probe, statistical, or judgmental samples to provide feedback to the Components.[6] Testing depends on what the Component states is ready to be tested. For example, in FY 2019, auditors performed completeness and existence testing on a statistical sample of U.S. Marine Corps General Fund real property, but auditors for the Navy General Fund performed completeness and existence testing on a judgmental sample of real property because the Navy determined that it had not completed enough corrective actions to warrant full statistical samples.

Auditors also follow up on prior year findings and, if Components perform corrective actions and as time permits, auditors can test the controls to determine if the prior year findings should be closed. Because of differences in the level of testing, the audit results by Component over time cannot be simply compared to obtain an accurate depiction of progress or lack of progress in the financial statements. As testing continues to expand, progress or lack of progress can potentially be measured in additional ways, such as the percentage of balances that are tested or that remain untested.

b. Internal Control Weaknesses

Financial statement audits not only determine and provide an overall opinion on the accuracy of the financial statements, they also identify weaknesses and inefficiencies in the financial management processes and controls. Auditors classify weaknesses and inefficiencies in internal controls based on the severity of the weakness. The classifications include material weaknesses, significant deficiencies, and control deficiencies.

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 financial statements in a timely manner.

A significant deficiency is less severe than a material weakness, but important enough to bring to management’s attention. Control deficiencies are noted weaknesses or deficiencies that auditors bring to the attention of management that typically do not have an impact on the financial statements, but could improve the business processes of the agency.

[6] A probe sample, also called a discovery sample, is not designed to achieve specified levels of confidence and precision such as a statistical sample. Instead, a probe sample may be used to determine if a Component is ready for statistical sampling and to identify weaknesses in business processes and make recommendations to fix the areas for the following year.

The following are examples of material weaknesses that were identified in the Audit of the FY 2019 DoD Agency-Wide Basic Financial Statements.

- The DoD Components lacked policies, procedures, controls, and supporting documentation necessary to verify the existence and completeness of Inventory and Related Property that was reported on the financial statements.
- 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.
- 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.

In the "FY 2019 DoD Agency-Wide Audit Results" section of this report, we list all 25 agency-wide material weaknesses auditors identified in the DoD's FY 2019 financial statements and discuss some of the most important ones in more detail.

5. Costs of the Financial Statement Audit

For the FY 2019 audit, the Acting DoD Comptroller reported audit-related costs of nearly $1 billion for the Military Departments, other Defense organizations, and the Office of Inspector General. This included contract costs for the independent public accounting firms; the cost of remediating audit findings; supporting the audits and responding to auditors requests; and achieving an auditable systems environment. The majority of the nearly $1 billion dollar cost of the FY 2019 audit was spent on DoD personnel, who prepared for the audit and remediated deficiencies identified during the FY 2018 audit. In his November 2019 testimony to the Senate Armed Services Subcommittee on Readiness and Management Support, Deputy Secretary of Defense David Norquist stated "before we started the audit, the Department was spending $770 million to fix problems," indicating this would have been spent even without the audit.

In FY 2019, the DoD spent approximately $183.3 million on the contracts with independent public accounting firms to perform the financial statement audits. However, this percentage of the DoD budget for the audits is not inconsistent with costs for audits in the private sector. For example, the DoD contract costs of $183.3 million for independent public accounting firms equated to one-thirtieth of one percent of the DoD's budget. According to a 2017 study by ComplianceWeekly.com, publicly traded companies spent $548 per $1 million of revenue to have their financial statements audited, which equated to one-twentieth of one percent of their revenue. The 2017 study also concluded that audit costs were expected to rise.

In addition, the audits can result in significant savings to the DoD. For example after the FY 2018 audits discovered errors in the Navy's real property and inventory records, while performing corrective actions for those findings the Navy identified a warehouse that was not in its property records. Upon inspection of the warehouse, the Navy found approximately $126 million in aircraft parts for the F-14 Tomcat, P-8 Poseidon, and P-3 Orion. Within weeks of adding the inventory to the inventory system, the Navy was able to fill over $20 million in open orders for the parts. As a result, the Navy was able to repair aircraft without procuring additional spare parts.

C. The Results of the DoD OIG's Audit of the DoD's FY 2019 Financial Statements

As noted, the DoD OIG is required to audit the DoD Agency-Wide Consolidated Balance Sheet, consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the basic financial statements. Although the overall audit opinions for the DoD and its Components did not change from FY 2018 to FY 2019, the auditors identified progress for the DoD and the DoD Components that received disclaimers of opinion. This section discusses the progress made by the DoD and its Components, the overall audit results, and what we believe the DoD needs to do to continue progress towards better business processes, more accurate financial statements, and clean opinions.

1. DoD Progress Made Since FY 2018

The road to a clean financial statement opinion for the DoD is a long-term effort and could take years to achieve. Federal agencies smaller than the DoD have taken years to obtain clean audit opinions due to the size and complexities of the organizations. For example, the Department of Homeland Security took nearly 10 years, of which the last few years were waiting on one component, the Coast Guard, to achieve a clean audit opinion.

In his testimony to the Senate Armed Services Subcommittee on Readiness and Management Support on November 20, 2019, Deputy Secretary of Defense Norquist stated that he expected to see movement in getting to a clean audit opinion every year with another entity getting a clean opinion or entities moving to qualified audit opinions. He also stated that he anticipated that "within five or so years" the majority of DoD Components would have clean audit opinions.

During the FY 2019 financial statement audits, several DoD Components made progress in improving their financial management. Auditors noted that the DoD and its Components improved their understanding of the business processes and financial statements, and that they were able to provide more universes of transactions for testing and better supporting documentation for transactions selected for testing. As a result, the auditors were able to expand testing of previously tested areas, test in new areas, or draw conclusions on more transactions in previously tested areas.

For example, in FY 2019 the U.S. Transportation Command improved its understanding and ability to communicate its business processes. For instance, in FY 2018, the U.S. Transportation Command was unable to provide auditors supporting documentation that business processes occurred in the manner described to the auditors. Therefore, the auditors performed very limited testing. In FY 2019, the U.S. Transportation Command was able to communicate and provide supporting documentation to the auditors for its non-payroll and revenue transactions. As a result, the auditors were able to perform 113 non-payroll and 63 revenue business process reviews. The auditors believe this improvement will allow for additional testing in FY 2020.

In another example, for the first time ever, the Army was able to provide auditors a universe of transactions for Army Working Capital Fund inventory work in progress, which consists of raw materials that are used to make a finished product. The universe of transactions was valued at $952 million. Although the auditors could not test the transactions because the universe was not provided until October 2019, the auditors were able to reconcile the universe of transactions to the balances in the accounting system. This progress will allow auditors to perform testing of these transactions in early FY 2020.

In addition, in FY 2019 the U.S. Special Operations Command (USSOCOM) demonstrated a more detailed understanding of its business processes and how those processes contributed to the overall financial reporting process. As a result, the auditors for USSOCOM were able to expand their testing to include several new audit areas, including Revenue, Accounts Payable, and Operating Materials and Supplies. These new testing areas resulted in five new FY 2019 notices of findings and recommendations (NFRs). Additionally, the auditors expanded testing related to Fund Balance With Treasury, funding, and general equipment.

Additional examples of DoD improvements and progress are discussed in the "Significant DoD Material Weaknesses" section of this report.

Although the DoD and its Components made progress in different areas, the total number of NFRs increased. As noted, part of the reason for additional NFRs was that more testing took place in FY 2019 than in FY 2018 because the DoD was able to provide better information to the auditors, which demonstrates progress.

Overall, the number of NFRs, material weaknesses, and significant deficiencies alone does not fully measure progress in the audit. The key is whether the deficiencies are corrected. The DoD's progress must be measured by the maturity of the business processes it uses and the sustainability of the corrective actions it has taken. Progress potentially can be assessed over time as the percentage of balances that are tested increases or decreases based on the DoD and DoD Component corrective actions.

2. FY 2019 DoD Financial Statement Audit Results

As noted, during FY 2019, the DoD OIG oversaw the completion of 23 DoD Component financial statement audits and completed the audit of the FY 2019 DoD Agency-Wide Basic Financial Statements. The DoD OIG contracted with six independent public accounting firms to support the overall effort to audit the Agency-Wide and Component financial statements. The firms were Cotton & Company, LLP; Ernst & Young, LLP; Grant Thornton, LLP; Kearney & Company; KPMG, LLP; and RMA Associates.

Collectively, the DoD OIG and independent public accounting firms assigned over 1,400 auditors to perform audits of the DoD Components' financial statements and the Agency-Wide financial statements. As one of the largest financial statement audits in history, the scope of the audit was massive. In total, 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. In addition, auditors performed followup testing on over 1,000 of the 2,595 FY 2018 NFRs to determine if the findings could be closed.

As a result of the site visits, testing, and reviews of DoD documents, the auditors closed 698 FY 2018 NFRs, reissued 1,897 FY 2018 NFRs, and issued 1,575 new FY 2019 NFRs related to DoD financial statements and financial management systems. As auditors continue to expand testing, the DoD and its Components should anticipate new NFRs in future years.

a. FY 2019 DoD Component Audit Results

Of the 23 DoD reporting entities that undergo audits overseen by the DoD OIG, 7 received unmodified opinions, 1 received a qualified opinion, and 15 received disclaimers of opinion. As seen in Table 1, which provides a list of DoD reporting entities and the results of the audits overseen by the DoD OIG in FYs 2018 and 2019, there were no changes in opinions for DoD reporting entities that were audited in both years. Neither the Defense Health Agency Sub-Allotted nor USSOCOM Sub-Allotted reporting entities were audited in FY 2018.

Table 1. FY 2018 and 2019 Financial Statement Opinions for DoD Reporting Entities

Reporting Entity	FY 2018 Opinion	FY 2019 Opinion
U.S. Army Corps of Engineers–Civil Works	Unmodified	Unmodified
Defense Health Agency–Contract Resource Management	Unmodified	Unmodified
Military Retirement Fund	Unmodified	Unmodified
Army Sub-Allotted	Unmodified	Unmodified
Defense Health Agency Sub-Allotted	N/A	Unmodified
Defense Logistics Agency Sub-Allotted	Unmodified	Unmodified
U.S. Special Operations Command Sub-Allotted	N/A	Unmodified
Medicare-Eligible Retiree Health Care Fund	Qualified	Qualified
Department of the Army GF	Disclaimer	Disclaimer

Reporting Entity	FY 2018 Opinion	FY 2019 Opinion
Department of the Army WCF	Disclaimer	Disclaimer
U.S. Navy GF	Disclaimer	Disclaimer
Department of the Navy WCF	Disclaimer	Disclaimer
Department of the Air Force GF	Disclaimer	Disclaimer
Department of the Air Force WCF	Disclaimer	Disclaimer
U.S. Marine Corps GF	Disclaimer	Disclaimer
Defense Health Program GF	Disclaimer	Disclaimer
Defense Information Systems Agency GF	Disclaimer	Disclaimer
Defense Information Systems Agency WCF	Disclaimer	Disclaimer
Defense Logistics Agency GF	Disclaimer	Disclaimer
Defense Logistics Agency WCF	Disclaimer	Disclaimer
Defense Logistics Agency Transaction Fund	Disclaimer	Disclaimer
U.S. Special Operations Command GF	Disclaimer	Disclaimer
U.S. Transportation Command WCF	Disclaimer	Disclaimer

LEGEND:

GF – General Fund

WCF – Working Capital Fund

Source: The DoD OIG.

Table 2 presents the number of NFRs issued in FYs 2018 and 2019, the number of NFRs closed in FY 2019, and the total number of open NFRs by DoD Component. As shown in Table 2, auditors issued 1,575 new NFRs for deficiencies identified in FY 2019. As explained earlier, in general, new deficiencies were identified as a result of new and expanded testing that was conducted during the FY 2019 audits. In addition to the new NFRs, auditors reissued 1,897 NFRs in FY 2019 for deficiencies identified in FY 2018 that were not fully addressed. Finally, auditors closed 698 of the FY 2018 NFRs, which shows that the DoD and its Components took corrective actions to fix deficiencies identified by the auditors in FY 2018.

Table 2. Number of Notices of Findings and Recommendations by Component

Reporting Entity	Total FY 2018 NFRs	NFRs Closed in FY 2019[1]	Financial NFRs – New	Financial NFRs – reissued[2]	IT NFRs – New	IT NFRs – Reissued[3]	Total Issued FY 2019 NFRs[3]
Department of the Army[4]	408	149	107	172	77	87	443
Department of the Navy[4]	529	121	350	148	262	260	1,020
Department of the Air Force	347	86	88	144	119	117	468
U.S. Marine Corps[4]	156	17	4	79	26	60	169
U.S. Army Corps of Engineers	86	35	36	43	0	8	87
Defense Health Program	124	15	34	64	31	45	174
Defense Information Systems Agency[4]	45	25	20	11	3	9	43
Defense Logistics Agency	409	35	57	295	45	79	476
U.S. Special Operations Command	101	33	21	31	23	37	112
U.S. Transportation Command[4]	166	47	28	67	4	52	151
Defense Health Agency–Contract Resource Management	14	4	1	0	1	10	12
Medicare-Eligible Retiree Health Care Fund	16	4	1	2	2	10	15
Military Retirement Fund	10	2	3	2	4	6	15
Agency-Wide	184	125	71	19	157	40	287
Total	**2,595**	**698**	**821**	**1,077**	**754**	**820**	**3,472**

[1] Auditors closed NFRs for a variety of reasons, including when the Component took actions and the condition no longer existed, the condition no longer existed because the process or systems used were eliminated, or because the Component accepted the risk associated with the condition.

[2] NFRs are considered reissued if the weakness or inefficiency noted in the NFR was identified during a prior year audit but has not yet been corrected by the Component.

[3] Auditors will continue to issue NFRs in December 2019 and January 2020. Therefore, the table numbers do not reflect all NFRs issued as a result of the FY 2019 financial statement audits.

[4] These Components' NFR counts have changed due to auditor decisions to consolidate or remove crossover prior year NFRs in FY 2019.

Source: The DoD OIG.

Auditors classify the weaknesses and inefficiencies in internal controls, which are identified in the NFRs, based on the severity of the weakness. The classifications include material weaknesses, significant deficiencies, and control deficiencies as explained earlier. The classifications resulted in the identification of 152 material weaknesses across the Components, as shown in Table 3. This was an increase of 14 material weaknesses when compared to FY 2018.

As discussed earlier, audit results by Component and by year cannot be compared easily, and sometimes not at all. However, most DoD Components had similar material weaknesses from FY 2018 to FY 2019. A few DoD Components, such as the Navy General Fund and Department of the Navy Working Capital Fund, had significant increases in the number of material weaknesses.

Increases in the number of material weaknesses occurred for multiple reasons, but the two most common were (1) auditors expanded testing that resulted in new findings that led to material weaknesses, and (2) auditors presented material weaknesses at a more granular level. For example, in FY 2019 auditors expanded testing in the area of environmental and disposal liabilities for the Navy General Fund because the Navy was able to provide additional support and explanations regarding the liabilities. As a result, there was a new material weakness identified for the Navy in FY 2019 related to environmental and disposal liabilities.

Many Components had similar material weaknesses. For example, most Components had material weaknesses related to information technology (IT), such as inadequate access controls, system change controls, and security management controls of the IT systems.

In addition, DoD Components had 46 instances of non-compliance with laws and regulations in FY 2019. There was little change between FY 2018 and FY 2019 related to non-compliance with laws and regulations. As with material weaknesses, many instances of non-compliance with laws and regulations were similar between Components. For example, most Components did not fully comply with the Federal Financial Management Improvement Act. The act requires compliance with the U.S. Standard General Ledger at the transaction level. However, many DoD financial management systems were developed prior to the implementation of current requirements, and, as a result, are not capable of producing transaction-level detail.

Table 3 provides the number of material weaknesses and the number of non-compliances for each of the Component audits overseen by the DoD OIG.

Table 3. Component FY 2018 and FY 2019 Audit Results

Entity	FY 2018		FY 2019	
	Material Weaknesses	Non-Compliance	Material Weaknesses	Non-Compliance
Department of the Army GF	12	3	12	2
Department of the Army WCF	12	2	13	2
U.S. Navy GF	13	2	17	2
Department of the Navy WCF	9	2	13	2
Department of the Air Force GF	11	2	12	2
Department of the Air Force WCF	12	2	11	2
U.S. Marine Corps GF	9	4	9	4
U.S. Army Corps of Engineers–Civil Works	2	2	2	2
Defense Health Program GF	13	4	13	4
Defense Information Systems Agency GF	5	3	5	3
Defense Information Systems Agency WCF	4	3	4	3
Defense Logistics Agency GF	7	2	7	2
Defense Logistics Agency WCF	8	2	8	2
Defense Logistics Agency Transaction Fund	6	2	7	2
U.S. Special Operations Command GF	5	2	5	2
U.S. Transportation Command WCF	5	1	5	1
Defense Health Agency–Contract Resource Management	0	0	0	0
Medicare-Eligible Retiree Health Care Fund	1	1	1	1
Military Retirement Fund	0	0	0	0
Army Sub-Allotted	3	2	3	2
Defense Logistics Agency Sub-Allotted	1	2	1	2
Defense Health Agency Sub-Allotted	N/A	N/A	2	2
U.S. Special Operations Command Sub-Allotted	N/A	N/A	2	2
Total	**138**	**43**	**152**	**46**

LEGEND:

GF – General Fund

WCF – Working Capital Fund

Source: The DoD OIG.

b. FY 2019 DoD Agency-Wide Audit Results

On November 15, 2019, the DoD OIG issued a disclaimer of opinion on the FY 2019 Agency-Wide Basic Financial Statements, meaning that an overall opinion could not be expressed on the financial statements under audit. After compiling over 3,000 DoD Component NFRs and 152 DoD Component material weaknesses, the DoD OIG identified 25 agency-wide material weaknesses and 1 agency-wide significant deficiency.

Table 4 provides a list of the 25 agency-wide material weaknesses and a brief summary of each weakness. As seen in the table, of the 25 agency-wide material weaknesses that the DoD OIG identified:

- 9 material weaknesses were repeated from FY 2018;
- 8 material weaknesses were repeated from FY 2018 and modified to update them for conclusions drawn in FY 2019;
- 1 material weakness from FY 2018 was presented at a more granular level as 2 material weaknesses in FY 2019; and
- 6 material weaknesses were new in FY 2019.

In addition to these material weaknesses, the DoD OIG downgraded one FY 2018 material weakness—Accounts Receivable—to a significant deficiency. The DoD OIG concluded in both FY 2018 and FY 2019 that the DoD did not develop or implement effective controls to prevent or detect misstatements of non-Federal accounts receivable balances. However, due to the amount of non-Federal accounts receivable the DoD has, the DoD OIG determined that any misstatement resulting from this deficiency in FY 2019 would not be material to the financial statements. As a result, the DoD OIG reclassified this deficiency as a significant deficiency for FY 2019, which is less severe than a material weakness, but important enough to bring to management's attention.

After the table, we provide a more in-depth analysis of the material weaknesses that, in our judgment, stand out as the most significant material weaknesses within the DoD.

Table 4. Agency-Wide Material Weaknesses Identified During the FY 2019 Financial Statement Audit

Material Weakness	Description	Repeat or New
1. Financial Management Systems and Information Technology	The DoD had wide-ranging weaknesses in financial management systems that prevented the DoD from collecting and reporting financial and performance information that is accurate, reliable, and timely.	Repeat
2. Universe of Transactions	The DoD was unable to provide a complete universe of transactions that reconciled to its accounting records.	Repeat
3. Fund Balance With Treasury	The DoD had ineffective processes and controls for reconciling its Fund Balance With Treasury.	Repeat
4. Suspense Accounts	The DoD was unable to attribute suspense transactions to the appropriate DoD Component. In addition, the Defense Finance and Accounting Service and the DoD Components lacked the controls necessary to monitor, research, and clear the transactions in the suspense accounts.	New
5. Inventory and Related Property	The DoD lacked the systems and controls necessary to provide assurance over the existence, completeness, and valuation of inventory recorded in the financial statements.	Repeat
6. Operating Materials & Supplies	The DoD was unable to report Operating Materials and Supplies in accordance with Generally Accepted Accounting Principles (GAAP).	Repeat
7. General Property, Plant & Equipment	The DoD could not accurately value its General Property, Plant & Equipment in accordance with GAAP.	Repeat/ Modified

Table 4. Agency-Wide Material Weaknesses Identified During the FY 2019 Financial Statement Audit (cont'd)

Material Weakness	Description	Repeat or New
8. Real Property	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.	New
9. Government Property in Possession of Contractors	The DoD lacked policies, procedures, controls, and supporting documentation over the acquisition, disposal, and inventory processes of Government property in the possession of contractors.	Repeat
10. Joint Strike Fighter Program	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. The omission of the Joint Strike Fighter program property from the financial statements and the inability to provide documentation supporting the value of the property indicate material failures in controls for recording of joint programs within the DoD.	New
11. Military Housing Privatization Initiative	The DoD did not record or report Military Housing Privatization Initiative-related investments or profits and losses. In addition, the DoD did not disclose information in its financial statements related to the Military Housing Privatization Initiative as required by GAAP.	New
12. Accounts Payable	The DoD did not have sufficient policies, procedures, and internal controls over its methodology for accruing payables.	Repeat/ Modified
13. Environmental and Disposal Liabilities	The DoD lacked formal policies, procedures, and supporting documentation to substantiate the completeness and accuracy of its Environmental and Disposal Liabilities.	Repeat/ Modified
14. Legal Contingencies	The DoD Components did not record their legal contingencies using a consistent methodology and, as a result, adjustments were required to reconcile commitments and contingencies to the Management Schedule.	Repeat/ Modified

Table 4. Agency-Wide Material Weaknesses Identified During the FY 2019 Financial Statement Audit (cont'd)

Material Weakness	Description	Repeat or New
15. Beginning Balances	The DoD did not have the historical data to support beginning balances on its financial statements or the ability to reconcile beginning balances to closing balances at the end of the reporting period.	Repeat
16. Unsupported Accounting Adjustments	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.	Renamed/ Modified
17. Intradepartmental Eliminations and Intragovernmental Transactions	The DoD accounting systems were unable to capture intradepartmental and intragovernmental data at the transaction level to facilitate required eliminations to ensure accurate consolidation for both the DoD Agency-Wide Basic Financial Statements or the Consolidated Financial Statements of the U.S. Government.	Renamed/ Modified
18. Gross Costs	The DoD did not have reliable financial information to effectively manage and understand Gross Costs because the DoD Components did not record Gross Costs in compliance with GAAP, inaccurately reported Gross Costs transactions, or established insufficient procedures and controls for recording Gross Costs.	Previously included in Statement of Net Costs
19. Earned Revenue	The DoD did not have reliable financial information to effectively manage and understand Earned Revenue because the DoD Components did not record Earned Revenue in compliance with GAAP, could not substantiate revenue-related transactions, or established insufficient procedures and controls for recording Earned Revenue.	Previously included in Statement of Net Costs
20. Reconciliation of Net Cost to Outlays	The DoD did not design and implement controls to research and resolve variances between budgetary and proprietary data throughout the reporting period.	Repeat/ Renamed
21. Budgetary Resources	The DoD was unable to accurately determine its total budgetary resources available or the status of those resources.	Repeat

Table 4. Agency-Wide Material Weaknesses Identified During the FY 2019 Financial Statement Audit (cont'd)

Material Weakness	Description	Repeat or New
22. Service Providers	Many of the service providers did not design or implement reliable controls that provide the required assurance to the DoD Component customers.	New
23. Entity-Level Controls	Multiple DoD Components have did not design and implement effective entity-level controls for reliable financial reporting, or lacked controls or performed insufficient reviews while preparing their financial statements.	Repeat/ Modified
24. DoD-Wide Oversight and Monitoring	The Office of the DoD Comptroller did not perform effective oversight and monitoring of the consolidation of the Component-level information or have adequate time to perform verification of the Component-level information prior to publishing Agency-Wide information.	Repeat/ Modified
25. Component-Level Oversight and Monitoring	The 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.	New

Source: The DoD OIG.

Finally, the DoD OIG identified the same five instances of non-compliance with laws and regulations across the DoD in both FYs 2018 and 2019. Specifically, the DoD did not comply with the Federal Managers' Financial Integrity Act of 1982, the Federal Financial Management Improvement Act of 1996, the Antideficiency Act, the Federal Information Security Modernization Act of 2014, and the Debt Collection Improvement Act of 1996.[7] For example, the Debt Collection Improvement Act requires that a non-tax debt or claim owed to the U.S. Government that is overdue by 120 days or more be reported to the Department of the Treasury for collection. During FY 2019, the Defense Health Program did not transfer all outstanding eligible debt in accordance with the Debt Collection Improvement Act.

3. Significant DoD Material Weaknesses

As noted in Table 4, the DoD OIG identified 25 agency-wide material weaknesses during the FY 2019 audit. DoD management is responsible for prioritizing the findings and corrective action plans to address these material weaknesses. Most of these weaknesses affect many of the DoD Components that produce financial statements. Each weakness can hinder the DoD's efforts to improve its business processes and achieve auditable financial statements and is critically important to correct.

In FY 2018, the DoD OIG identified six material weaknesses that we believed to be the most significant. Two of the six material weaknesses, while still reported as material weaknesses and significant for the DoD, were removed from our most significant listing in this report for FY 2019. Those two were Universe of Transactions and Fund Balance With Treasury.

While the DoD and its Components continue to experience challenges in providing accurate universes of transactions for the balances being audited, the auditors identified progress regarding universes of transactions in FY 2019. For example, in both FY 2017 and FY 2018 the U.S. Marine Corps was unable to provide a universe of transactions for munitions. In FY 2019, the auditors received the universe of transactions that allowed for testing. As a result of the progress the DoD and its Components made during FY 2019 and the DoD's planned corrective actions, the DoD OIG removed this material weakness from its list of most significant material weaknesses.

[7] The Federal Managers' Financial Integrity Act requires the DoD to perform ongoing evaluations and report on the adequacy of its systems of internal accounting and administrative control.

The Federal Financial Management Improvement Act 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.

The Antideficiency Act prohibits the DoD from making or authorizing expenditures or obligations that exceeded the available appropriations or funds.

The Federal Information Security Modernization Act requires the DoD provide information security controls.

The Debt Collection Improvement Act requires the DoD transfer all outstanding eligible debt that is overdue by 120 days or more.

In addition to the progress shown on the Universe of Transaction material weakness, the DoD showed progress and continued improvement related to Fund Balance With Treasury. Fund Balance With Treasury was considered one of the most significant material weaknesses in FY 2018 because auditors found weaknesses in the DoD Components' reconciliation processes and over 12 DoD Components identified Fund Balance With Treasury as a material weakness. While there remain weaknesses in Fund Balance With Treasury in FY 2019, the DoD made a concerted effort to improve its reconciliation processes for the Fund Balance With Treasury. For example, in the FY 2019 audits of the Defense Information Systems Agency General and Working Capital Funds, DFAS provided a beginning balance universe of transactions for suspense accounts, statements of differences, and cash management reports, which are all used to reconcile Fund Balance With Treasury. DFAS's effort was a major step in eliminating the Fund Balance With Treasury material weakness. As a result and because of the continued focus by the DoD, the DoD OIG removed Fund Balance With Treasury from its list of most significant material weaknesses.

The Financial Statement Compilation material weakness was a stand-alone material weakness in FY 2018 due to the Office of the DoD Comptroller incorrectly compiling three significant DoD Component financial statements into the Agency-Wide Basic Financial Statements. The DoD took steps to correct that specific issue, but other issues remain regarding the financial statement compilation process related to the Office of the DoD Comptroller's oversight and monitoring role. As a result, the DoD OIG included the weaknesses related to the financial statement compilation process in the FY 2019 DoD-Wide Oversight and Monitoring material weakness.

The DoD OIG also added two material weaknesses to its list of the most significant material weaknesses for FY 2019: (1) Government Property in the Possession of Contractors, and (2) Environmental and Disposal Liabilities. Although these material weakness were not identified in the "Understanding the Results of the Audit of the DoD FY 2018 Financial Statements" report in the list of the six most significant material weaknesses, the expanded audit procedures in the FY 2019 audit identified significantly more findings in these areas. As a result, and as discussed in the respective sections of this report, we added these material weaknesses to our FY 2019 list of significant material weaknesses.

In our judgment, the following FY 2019 material weaknesses are the most significant.

- Financial Management Systems and Information Technology
- Inventory and Related Property
- General Property, Plant & Equipment (PP&E), including Real Property
- Government Property in the Possession of Contractors
- Environmental and Disposal Liabilities
- Oversight and Monitoring

a. Financial Management Systems and Information Technology

In FY 2018 the DoD received over 1,200 NFRs related to IT. Overall for FY 2019, auditors closed 398 of the FY 2018 IT NFRs, reissued 820 of the FY 2018 IT NFRs, and issued 754 new IT NFRs for a total of 1,574 open IT NFRs. Similar to FY 2018, the DoD and 13 of its Components had a material weakness related to financial management systems, as well as the IT environment.

Within the DoD, financial transactions are rarely completed using only one IT system from the point of initiation to the point that the transactions are reported on the financial statements. In addition, DoD Components do not own and operate all of the IT systems that they use to process their financial transactions. During FY 2019, the DoD identified 247 systems relevant to internal controls over financial reporting. For example, to process and record contract payments, the Military Services depend on over a dozen IT systems that are owned and operated by other DoD Components.

Ineffective IT system controls can result in significant risk to DoD operations and assets. For example, payments and collections could be lost, stolen, or duplicated as a result of weak IT controls. In addition, critical operations, such as those supporting national defense and emergency services, could be disrupted through weak IT controls. Across multiple DoD Components, the auditors found significant control deficiencies regarding IT systems. Specifically, the auditors found that:

- Security controls were not regularly monitored or tested for effectiveness.
- Access rights and responsibilities were not appropriately restricted according to segregation of duties policy.
- Configuration changes to IT systems were not monitored to ensure the changes were appropriate.
- Reconciliations were not being performed between systems to verify the completeness and accuracy of data transferred between systems.

For example, when verifying the existence and completeness of ammunition in the U.S. Marine Corps, the auditors found that the local inventory systems were generally correct. However, some of the local inventory systems did not match the total U.S. Marine Corps ammunition reported in the accounting records. As a result, the overall amount of inventory that the U.S. Marine Corps reported it owned on its financial statements was unsupported and did not reconcile to the local inventory system. Furthermore, the U.S. Marine Corps did not have an accurate assessment of its inventory at an organizational level. Instead, to understand the true amount of ammunition it had, the U.S. Marine Corps relied on multiple local systems, some of which are owned by other DoD Components. As a result, the U.S. Marine Corps could not efficiently determine the total amount of its ammunition at any given time, which could result in over-or under-buying.

As stated earlier, one of the DoD's goals in FY 2019 was to ensure that access to financial systems and business systems that feed financial information was limited to only those who need it and only for the specific areas within the system that they needed to access. While the DoD did not meet its goal, progress was made in this area. In FY 2019, the auditors closed approximately 400 IT NFRs related to the design and effectiveness of financial management systems and IT controls based on corrective actions that the DoD Components took.

For example, the Army implemented 65 percent of its IT corrective action plans related to findings from the FY 2018 audit. In one instance, the Army was able to close an NFR related to the Army property system's configuration management. Specifically, the NFR was issued in FY 2018 because management responsible for the property system configuration had not maintained evidence of technical testing, including the use of scripts, as part of the quarterly patching process. However, management established a process for logging and monitoring security events and tested this process in FY 2019. As a result, the auditors determined that the FY 2018 NFR should be closed because the Army fully remediated the NFR as of October 1, 2019.

Although the DoD and its Components showed progress in this area, the auditors found additional IT weaknesses and deficiencies, many of which were similar to findings from FY 2018. In FY 2019, auditors reviewed additional systems, such as the Defense Civilian Pay System, and found similar weaknesses as those closed from the prior year on other systems. For example, for the Defense Contract Management Agency and DoD Education Activity, the auditors reviewed the Defense Civilian Pay System. The auditors identified a lack of access controls for both agencies related to this system, an issue that was identified in FY 2018 for the Defense Agencies Initiative and Defense Cash Accountability Systems and closed in FY 2019.

It is critical that DoD and DoD Component leadership consider the audit findings and recommendations more broadly and incorporate the corrective action plans into other systems that may have similar issues, even if the auditors have not yet reviewed those systems. It is not enough to simply address a narrow finding in one area or one Component. Rather, DoD and Component leadership must ensure that the vulnerabilities identified in one system do not exist in other systems.

The DoD is pursuing several initiatives to address weaknesses related to IT systems. For example, according to the FY 2019 DoD Agency Financial Report, the DoD is developing a business plan that will lay out the number of systems that impact financial reporting that the DoD plans to retire, resulting in a reduced footprint of systems that impact financial reporting. This plan includes decreasing the number of legacy IT systems by 51 between FY 2019 to FY 2023—more than 25 more systems than the DoD planned to eliminate in FY 2018.

Improving internal controls for IT systems that process financial transactions can improve not only financial management but also the cybersecurity of the DoD's IT systems. The DoD must defend its own networks, systems, and information from cyber attacks. Improving internal controls over IT systems that process financial information can help the DoD both protect against and rapidly respond to cyber threats across different networks and systems.

For example, DoD and Component leadership should establish and consistently follow processes and controls to manage user account access and segregation of duties within their IT system environment. In addition, as IT vulnerabilities are identified, the DoD and its Components must conduct thorough reviews of each system to ensure that the vulnerabilities identified in one system do not exist in other systems.

b. Inventory and Related Property

Inventory and Related Property consists of inventory, such as spare parts, clothing, and textiles; Operating Materials and Supplies, such as ammunition, tactical missiles, and aircraft configuration pods; and stockpile material, such as aluminum and tin. The Military Services and DoD Components own inventory that they must report on their financial statements. The inventory can be in the custody of and managed by the Military Service or the DoD Component that owns the items or in the custody of and managed by another organization.

Inaccurate information in financial reporting of inventory can have significant consequences. For example, if a Military Service believes it has a low quantity of a spare part for an aircraft based on a service provider's inaccurate report or does not review the inventory held by others, the Service may decide to order additional parts that it does not need, which is a waste of funds. Conversely, if the Service inaccurately believes that it has a sufficient quantity of spare parts for an aircraft when it actually does not, it may not order additional spare parts, resulting in shortfalls of the parts and the inability of aircraft to be repaired rapidly, which can affect operational readiness.

Inventory and Related Property remained a material weakness in FY 2019. As of September 30, 2019, the DoD reported $291.5 billion in Inventory and Related Property. The DoD and 10 of its Components had a material weakness related to Inventory and Related Property. Auditors found that numerous DoD Components lacked policies, procedures, controls, oversight, and documentation related to providing assurance over the existence, completeness, and valuation of inventory. For example, auditors found that items selected for testing:

- had been moved or used but were still in the inventory records;
- were found in the warehouse but not listed in the inventory records;
- were recorded as in good condition but were actually unserviceable; and
- did not have supporting documentation to demonstrate ownership.

Several of the deficiencies found, if corrected, could improve not only the financial management of inventory but also the DoD's mission readiness. Auditors issued several NFRs regarding Inventory and Related Property that could have an operational impact. For example, auditors identified the following in their NFRs.

- Air Force supporting systems could not be reconciled with inventory records. This increased the risk that the Air Force did not have inventory reflected in its records or had inventory on hand not reflected in its records.
- During observation procedures, incorrect condition codes were noted on 42 Navy items. Navy records indicated that unusable items were usable, resulting in a direct impact to readiness. Seventy of 296 on-hand quantities of various types of ammunition confirmed through physical observation could not be reconciled to Marine Corps inventory records.
- Munition inventory held at contractor sites did not reconcile to Army inventory records because the Army did not have policies and procedures to record and monitor transactions for munitions that were produced and refurbished at contractor-owned and operated locations.

One of the DoD's goals in FY 2019 was to conduct a 100-percent count of all Working Capital Fund inventory and all General Fund munitions, ordnance, and uninstalled engines in its possession to establish a complete baseline of these assets. While the DoD did not meet this goal, it made progress in this area. For example, the Department of the Navy established a process for completing its 100-percent count of all Working Capital Fund inventory. In FY 2019 it completed counts at multiple locations and anticipates completing all counts no later than FY 2020. As a result, the auditors may be able to perform existence testing on a statistical sample of the Department of the Navy Working Capital Fund inventory.

The DoD also drafted policies to address issues with physical inventories, but as of September 30, 2019, had not finalized and issued these polices. These policies range from improving management oversight of Government Property in Possession of Contractors to directing Components to develop, test, and implement automated solutions to address reconciliation issues on a material-by-material basis. These draft policies are expected to be finalized and implemented in FY 2023. The DoD Components are also updating inventory processes to include internal controls to verify the existence, completeness, and valuation of inventory. For example, the Air Force is developing a process to routinely monitor and adjust inventory held by others based on what is actually on hand. In addition, the DoD is implementing a new accounting system across all Components to improve transaction recording, improve documentation, correct control gaps, and improve internal processes to ensure proper valuation and documentation. However, the DoD does not expect to implement this new system until FY 2024.

Moving into FY 2020, DoD leadership must finalize and implement more comprehensive policies to address issues with physical inventories. The DoD and its Components need to prioritize corrective actions that address existence and completeness of inventory and Operating Materials and Supplies. The DoD should also emphasize formalizing and implementing procedures and controls related to physical counts, reconciliation, and contractor held inventory. These actions will not only improve financial management but will also improve business processes and operational readiness.

c. General Property, Plant & Equipment, Including Real Property

The DoD reported $768.6 billion in General Property, Plant & Equipment (PP&E) on its FY 2019 balance sheet, which was an approximately $10 billion increase from FY 2018. The DoD generally considers PP&E for financial reporting purposes as capital assets that have a minimum acquisition cost of $250,000 and have a useful life of 2 or more years. Examples of PP&E within the DoD include heavy-duty trucks, buses, and cargo ships. In addition, the DoD reports its real property within the PP&E line item on its balance sheet. Real property includes buildings, structures, and facilities. PP&E is not intended to be sold and is developed or purchased only for use by the DoD entity. The DoD uses property systems to account for its capital assets.

The DoD and 11 of its Components had a material weakness related to PP&E, including real property. For example, the DoD was unable to provide an agency-wide universe of its real property, meaning DoD leadership did not have the ability to easily identify a population of its buildings and structures. In addition, not all DoD Components had processes in place or fully implemented corrective actions to generate and reconcile populations of real property to those reported on their financial statements.

Auditors also found that the DoD continued to lack controls over financial reporting of its PP&E. For example, USSOCOM did not have controls to prevent the inaccurate reporting for existence and completeness of its assets. For instance, a communications system was transferred from a USSOCOM location to another DoD Component in FY 2018; however, USSOCOM still reported the communications system on its financial statements until the auditors discovered the error during the FY 2019 audit.

The DoD and its Components did not develop adequate procedures to assess what general equipment they should report on their financial statements. For example, auditors found that the Air Force reported on its balance sheet six KC-135 wing stands, which are used for aircraft wing and engine maintenance, that were deemed unusable and condemned by the Occupational Safety and Health Administration. The Air Force should not have included the wing stands in its PP&E balance on the balance sheet because the stands were inoperable and provided no benefit to the Air Force.

One of the DoD's goals for FY 2019 was to conduct a full existence and completeness count to ensure that 100 percent of its building and structures were reported accurately on the financial statements. Although the DoD did not reach its goal, some Components made significant progress. For example, the Navy completed substantial remediation efforts, such as revising policies for providing evidence for all above-ground real property on its bases, which the auditors validated during the audit. In addition, the Navy achieved significant improvements related to the existence and completeness of its real property, including a 99-percent pass rate for a completeness judgmental sample performed by the auditors, meaning the auditors concluded that the list of real property tested was complete.

The DoD acknowledged its material weaknesses related to PP&E in FY 2018, including real property, and began developing corrective actions. Development and implementation of those corrective actions continued in FY 2019 and will continue into FY 2020. Specifically, the DoD Components continued to validate their PP&E listings in FY 2019. During FY 2019, the auditors noted that not all DoD Components completed the 100-percent count of their building and structures, though they plan to continue those efforts in FY 2020. In addition, DoD leadership is developing a consistent and streamlined methodology to value general equipment within the DoD, and expects to provide this methodology to the DoD Components no later than FY 2022. DoD leadership must continue to implement policies and procedures requiring regular validation of the existence and completeness of its assets and valuing its PP&E.

DoD leadership must also hold those responsible for implementing these policies and procedures accountable for completing the actions necessary to address the weaknesses in PP&E and real property. Part of the corrective actions need to include the use of property systems that capture the cost of equipment for accurate financial reporting.

d. Government Property in the Possession of Contractors

Federal Regulations allow contractors to hold Government property—specifically, Government-furnished property or contractor-acquired property—so that the contractors can complete contract work on behalf of the DoD. These assets are referred to as Government property in the possession of contractors.

Federal law requires the DoD to establish record-keeping controls for its property in accordance with Government standards. Federal Government standards permit the DoD to allow contractors to take on the task of record keeping for the Government property they hold; however, the DoD is still responsible for making sure the contractors keep accurate records. Auditors found that the DoD did not fully comply with either of these requirements in FY 2019.

Government property in the possession of contractors was identified as a material weakness during the FY 2018 audit and continued to be a material weakness for the DoD and three of its Components in FY 2019. During the FY 2019 financial statement audits, auditors reported that the DoD lacked the ability to accurately record property held by contractors. Specifically, auditors found that the DoD lacked policies, procedures, controls, oversight, and documentation related to property held by contractors.

For example, the Navy lacked oversight to validate the existence, completeness, accuracy and valuation of Trident Missile components. Specifically, auditors found that the Navy did not require its contractors to provide listings of Trident missile components, and when contractors did provide listings, the Navy lacked an understanding of the data provided. Furthermore, the Navy did not perform inspections at contractor facilities to verify the accuracy of the records it keeps for these assets.

In another example, the auditors found that neither the Navy nor the Air Force recorded the assets held by a contractor-managed a contractor-managed global spare parts pool for the Joint Strike Fighter program on their financial statements. Furthermore, personnel from the Office of the DoD Comptroller stated that the assets were not recorded elsewhere in the DoD's financial statements. As a result, the DoD OIG identified the Joint Strike Fighter program as an agency-wide material weakness in FY 2019. Omission of the Joint Strike Fighter program property from the financial statements, and the inability to provide documentation supporting the value of the property, indicated material failures in controls for recording joint programs within the DoD.

As a result of these weaknesses, there is increased risk that the DoD will not be able to prevent, detect, or correct errors in its financial records related to property held by contractors. Consequently, if the DoD understates its property held by contractors, it might unnecessarily buy more property than it needs in the future. Similarly, if the DoD overstates its property held by contractors, it might not buy enough property to meet its future needs, which could lead to reduced capabilities.

In FY 2019, one of the DoD's goals was for each DoD Component to complete a reconciliation of contractor inventory data to the Component's own property records and establish a complete baseline of assets in the possession of contractors by fiscal yearend. Not one DoD Service Component accomplished this goal in FY 2019. However, auditors were able to test Government property in the possession of contractors more extensively in FY 2019. This testing resulted in the issuance of additional NFRs, which benefit the DoD by identifying ways to improve financial management.

As mentioned, the expanded testing of Government property in the possession of contractors was a significant improvement in FY 2019. For example, the Air Force provided auditors with additional listings of transactions related to contractor inventory control point assets, which resulted in new findings. Beyond expanded testing, the Air Force pursued contract modifications that will require its contractors to report balances for property they hold. These modifications will help ensure that Air Force records better match contractor records and ultimately allow the audits to focus on other areas. Furthermore, contract modifications like these are an important step toward achieving the DoD's goal of establishing a complete baseline of assets in the possession of contractors and should be implemented across the DoD.

In the FY 2019 Agency Financial Report, the DoD reported ongoing corrective action initiatives designed to improve its ability to account for and manage its property held by contractors. Specifically, the DoD developed plans to improve policies and procedures and to hold working group meetings related to Government-furnished property. The DoD expects these initiatives to be complete by FY 2021.

The DoD must complete its efforts to create an accurate baseline of contractor-held assets and other related corrective actions. Additionally, the DoD must continue to develop and implement new corrective actions related to property held by contractors identified by the audit. Specifically, the Under Secretary of Defense for Acquisition and Sustainment must ensure proper contract clauses are incorporated in all contracts involving Government property in the possession of contractors. Proper contract clauses would greatly improve the DoD's ability to hold its Components and its contractors accountable for accurately tracking Government property in their possession.

e. Environmental and Disposal Liabilities

Environmental and Disposal Liabilities is the second largest liability on the DoD Agency-Wide Basic Financial Statements. The FY 2019 financial statements reported environmental liabilities of $76.1 billion, which was an increase of $5.7 billion from the previous year. Environmental and Disposal Liabilities are estimated costs for future remediation, cleanup, or disposal of items that have an impact on the environment resulting from DoD operations or the use of its assets. DoD Environmental and Disposal Liabilities can include items such as cleanup costs for active installations, weapon systems programs, and chemical weapons disposal programs.

In FY 2019, the DoD and four of its Components had a material weakness related to Environmental and Disposal Liabilities. Environmental and Disposal Liabilities was not identified in the "Understanding the Results of the Audit of the DoD FY 2018 Financial Statements" report as one of the six most significant material weaknesses. However, as a result of expanded audit procedures it was identified as one of the most significant material weaknesses in FY 2019. In addition, the importance of maintaining a complete and accurate list of locations and assets that have potential future environmental cleanup requirements is important for two reasons. First, a complete and accurate list of potential future environmental cleanup requirements is critical in accurately reporting liabilities on the balance sheet. Second, knowing what locations and assets have potential future environmental cleanup requirements can affect the health and welfare of the general public.

In developing estimates of future environmental costs and maintaining safety of the general public, the DoD must maintain a complete and accurate list of locations and assets that will require future remediation, cleanup, or disposal of hazardous materials. However, in FY 2019, DoD OIG auditors found that the DoD lacked formal policies, procedures, and supporting documentation to substantiate the completeness and accuracy of its Environmental and Disposal Liabilities. For example, the Army was unable to verify the completeness and accuracy of its locations and assets that had potential future environmental cleanup requirements. Furthermore, the Army could not show how it determined that its list of locations and assets that had potential future environmental cleanup requirements was complete when compared to a current fence-to-fence accountability of its property. Additionally, the Army did not implement controls and processes to estimate future environmental disposal costs for general and military equipment. The Army is currently working on its methodology and expects it to be completed in FY 2021.

To report Environmental and Disposal Liabilities on DoD and DoD Component balance sheets, the DoD Components must calculate the cost of future remediation, cleanup, or disposal of items based on available information. Information required for the estimates includes a complete and accurate list of locations and assets that will require future remediation, cleanup, or disposal of hazardous items. However, the DoD is unable to develop accurate estimates and account for Environmental and Disposal Liabilities because it does not have a full and accurate accounting of these locations and assets. In addition, the DoD does not have sufficient policy, procedures, and supporting documentation to develop cost estimates.

As stated, maintaining a complete and accurate list of locations and assets that will require future remediation, cleanup, or disposal of items is important not only for developing an estimate of future cost, but also for public health and welfare. For example, when locations are not identified and properly remediated and cleaned, it can have a devastating impact on the environment and put lives in danger. One example of a location with related environmental liabilities that were not being tracked for remediation and cleanup is in Washington D.C. This environmental liability was discovered by workers in 1993 when they were digging a utility trench in a Washington D.C. residential neighborhood called Spring Valley. While digging the trench they found bombs and lethal chemicals under homes. It was discovered that the location was the site of chemical weapons testing from 1917 to 1920. According to the Army Corps of Engineers, remediation of Spring Valley is still ongoing. The Army Corps of Engineers estimates the total cost to exceed $340 million.

To address this material weakness, the DoD must fully inventory all sites and assets that will require future remediation, cleanup, or disposal of hazardous items and establish a consistent and sustainable methodology to adequately gather data and develop estimates regarding current and future Environmental and Disposal Liabilities.

f. Oversight and Monitoring

In FY 2018, the DoD OIG reported financial statement compilation as a material weakness.[8] In FY 2019, the DoD OIG identified two material weaknesses related to oversight and monitoring affecting the DoD and nine of its Components: (1) Component-level Oversight and Monitoring and (2) DoD-Wide Oversight and Monitoring.

(1) 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.[9] This includes assessing risk, designing and testing the operating effectiveness of internal controls, identifying and reporting systemic material weaknesses and the status of corrective actions, and submitting an annual statement of assurance to the Office of the DoD Comptroller. In addition, DoD Component management is responsible for monitoring the Federal Accounting Standards Advisory Board activities, preparing policies and memorandums to guide financial statement preparation, and ensuring that the information reported by DoD Components is presented in accordance with Generally Accepted Accounting Principles and OMB Circular No. A-136.[10]

The auditors found that DoD Component management did not have adequate oversight and monitoring activities to ensure that the implementation of corrective actions resolved internal control weaknesses over financial reporting to prevent misstatements of the DoD Component financial statements. For example, in FY 2019, the Navy did not demonstrate adequate oversight and monitoring of its financial reporting process. As part of financial statement preparation, the Navy relied on its service provider, DFAS, to process financial data and prepare trial balance adjustments, which affect the financial statements. The auditors determined that Navy management did not implement sufficient controls to ensure that the adjustments were compliant, accurate, complete, and supported to prevent financial statement misstatement. For instance, DFAS prepared adjustments to the financial statements to reconcile business transactions between the Navy and other DoD Components. However, Navy management did not sufficiently review the adjustments to ensure all recorded transactions were supportable and prepared in compliance with U.S. Department of Treasury guidance and applicable accounting standards.

(2) DoD-Wide Oversight and Monitoring

The Office of the DoD Comptroller is responsible for developing accounting policy and guidance, executing enterprise-wide accounting solutions, and overseeing compliance and reporting efforts in the development of the DoD Agency Financial Report. The Office of the

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[8] The Financial Statement Compilation material weakness identified by the DoD OIG in the DoD Agency Financial Report for FY 2018 was consolidated into the DoD-Wide Oversight and Monitoring and Entity-Level Controls material weaknesses identified by the DoD OIG in FY 2019.

[9] OMB Circular No. 123, "Management's Responsibility for Enterprise Risk Management and Internal Control," July 15, 2016.

[10] OMB Circular No. A-136, "Financial Reporting Requirements," August 15, 2017.

DoD Comptroller and DFAS, as the DoD Component service provider, are responsible for consolidating DoD Component-level information to produce the DoD Agency Financial Report. Auditors determined that the DoD Component-level information was incomplete, inaccurate, and non-compliant with Generally Accepted Accounting Principles due to:

- **Ineffective oversight and monitoring of the consolidation process by Office of the DoD Comptroller.** For example, the Office of the DoD Comptroller did not ensure DFAS prepared the financial statements and footnotes completely, accurately, and consistently throughout the DoD where possible. For example, providing guidance and verifying that the DoD Components implement the new standard for consolidating reported contingent liabilities accurately and consistently will decrease the risk that the Agency-Wide financial statements and footnotes do not accurately reflect the financial position of the DoD. In FY 2019, the DoD OIG provided feedback to the Office of the DoD Comptroller on the consolidation of the DoD Component contingent legal liabilities which supported amounts presented in the Agency-Wide financial statements and footnotes. For example, the DoD OIG identified the inclusion of duplicate contingent legal liabilities, typographical errors, and omitted information during its review. As a result of corrections made in response to the DoD OIG comments, the contingent legal liabilities reported in the financial statements changed by more than $782 million.
- **Insufficient time for Office of the DoD Comptroller to verify DoD Component-level information prior to publishing the financial data at the DoD agency-wide level.** For example, in FY 2019, DoD Components provided their financial information on November 1 to Office of the DoD Comptroller, and the Office of the DoD Comptroller must issue the Agency Financial Report by November 15. Due to the short timeframe between receiving the information and issuing the Agency Financial Report, there is limited time for the Office of the DoD Comptroller to review the consolidated information. As a result, there is a high risk that errors in the consolidated financial statements will not be identified, and the consolidated financial statements may be misstated.
- **Non-compliance with Office of the DoD Comptroller-issued guidance that was designed to provide consistency in reporting at the DoD agency-wide level.** In many areas, the DoD has developed guidance on how to do things, such as appropriately record inventory, liabilities, and other business activities, in an effort to ensure each of the DoD Components uses the same process. However, auditors found that the DoD Components did not consistently follow the guidance. For example, the DoD and Military Departments were not consistent in their accounting and reporting of the Military Housing Privatization Initiative. Specifically, based on a September 16, 2019, Office of the DoD Comptroller policy, the FY 2019 DoD Agency-Wide Basic Financial Statement note disclosures report that the DoD would record annual profits and losses of the Military Housing Privatization Initiative in FY 2020. However, the Navy General Fund and Marine Corps General Fund Financial Statements state that the Navy and the Marine Corps do not recognize annual profits and losses, which is in direct conflict with the issued policy.

For FY 2019, DoD Component senior officials were required by the then Acting Secretary of Defense to provide corrective action plans for material weaknesses associated with the DoD's goal areas of real property, Inventory, and Operating Materials and Supplies, Government property in the possession of contractors, and information technology related to access controls. The DoD and its Component leadership used the DoD-Wide NFR database, discussed in the "FIAR Governance Board" section of this report, to oversee and monitor the development of corrective actions. In addition, the Deputy Secretary of Defense met with senior leadership within the DoD Components throughout the year to obtain updates on corrective actions and to determine if there was assistance his office could provide.

Although the DoD made progress toward the remediation of the oversight and monitoring material weakness, continued oversight and monitoring by the DoD and DoD Component senior leadership is critical to progress on developing sustained solutions that add value to the DoD and make sense. Specifically, DoD and DoD Component senior leadership must continue its high-level monitoring of corrective actions and hold personnel accountable for implementation of the corrective actions. In addition, the DoD and DoD Component senior leadership must identify and implement enterprise-wide corrective action that could benefit all of the DoD. Implementing effective oversight and monitoring will not only benefit the financial management community and potentially prevent material misstatements in the financial statements, but it will also develop more efficient business processes and allow for better use of the DoD's resources as enterprise solutions are developed.

D. The Way Forward Towards Improved Financial Management

As discussed, the DoD OIG identified 25 material weaknesses during the audit of the FY 2019 Agency-Wide Financial Statements, compared to 20 material weaknesses in FY 2018. However, the DoD and its Components developed and implemented hundreds of corrective actions to address the FY 2018 findings, and they continue to develop corrective actions to address both FY 2018 and now FY 2019 findings.

In this section, we discuss actions the DoD and its Components should take to further improve the DoD's financial management, including:

- continued focus on tone at the top,
- improved use of the FIAR Governance Board,
- development of sustainable business processes, and
- coordination of the DoD Components.

1. Tone at the Top

The "tone at the top" is a fundamental component of an effective internal control environment. Future changes to key leadership positions within the DoD and its Components could inhibit the DoD's ability to set a consistent tone. For example, since January 2017, in about 3 years' time, the DoD has had four Secretaries of Defense, three Secretaries of the Navy, three Secretaries of the Army, and four Secretaries of the Air Force.

In FY 2019, DoD leadership continued to stress the importance and the impact of the financial statement audits and the need to develop efficient and effective business processes that will lead to accurate financial information and improved DoD operations. For example, in a December 15, 2019, memorandum sent to all DoD employees, Secretary of Defense Mark Esper stated, "I want auditors to find our problem areas so we can permanently fix them with sustained solutions that add value and make sense." Similarly, during his November 2019 testimony to the Senate Armed Services Subcommittee on Readiness and Management Support, Deputy Secretary of Defense Norquist described the audit as a "foundational element of a broader landscape in the most complex of business reform in the National Defense Strategy."

Other DoD leaders have similarly expressed support for or initiated actions to promote the importance of improving the DoD financial management processes and systems. For example, Acting DoD Comptroller Elaine McCusker communicated the following in a June 2019 DoD Financial Improvement and Audit Remediation Report:

> [T]he audit has been a forceful catalyst for change within the Department. We welcome the transparency it brings. The audit will improve our financial clarity and decision-making as well as provide information that feeds modern data analytics to improve every element of how we do business. We are deeply committed to the long-term effort required and will continue to the use the auditors' independent feedback to measure progress from year to year.

DoD and Component leadership must continue to regularly emphasize and express the importance and priority of sound financial management, the financial statement audit, and the implementation of corrective action plans. For example, when Navy leadership attended an inventory site visit in July 2019 with the auditors, audit leadership and Navy leadership reinforced the importance of sound financial management practices and echoed the tone set by senior DoD leadership to the lower-level Navy personnel in attendance. This conversation led to a better understanding of the importance of improved Navy processes.

When all DoD leadership, including leadership from financial management, acquisition, logistics, policy, and other parts of the DoD, emphasizes the importance and impact of strong financial management, it has a positive effect on the attention placed on improving financial statements and, as a result, improves DoD operations. The consistent tone at the top is critical for continued improvements.

2. FIAR Governance Board

The DoD established the FIAR Governance Board in 2010 to enhance the financial management and audit-readiness efforts of the DoD and its Components. The FIAR Governance Board is co-chaired by the DoD Comptroller and the DoD Chief Management Officer. It includes the Chief Management Officers of the Military Departments, senior DoD financial management leaders, and senior representatives from the functional communities such as acquisition, logistics, and policy. The FIAR Governance Board meets every 2 months to review financial reporting and financial system material weaknesses. The Board also monitors the progress of NFR corrective action plans.

Under the FIAR Governance Board, the Office of the DoD Comptroller has made several accomplishments. For example, the Office of the DoD Comptroller has addressed 136 NFRs related to the material weakness of Universe of Transactions. Specifically, the Office of the DoD Comptroller developed Advanced Analytics (ADVANA), which is a repository of DoD Transactions that is designed to improve transparency of financial data and facilitate DoD-wide analysis and management of business operations. ADVANA has more than 4,000 users and spans all Military Services. It contains approximately 10 billion transactions from more than 60 systems and has established a standardized format for the transactions. The DoD has reported that it is already making use of the tool. For example, the DoD has used the tool to automate the quarterly review process of its obligations and identified $316 million that could be used or put to better use before the funding is canceled or expires.

In addition, the Office of the DoD Comptroller developed an NFR database, in which audit findings are uploaded. The database provides a single source of information for DoD management by reporting real-time information on the progress of the DoD financial statement audits. It houses all NFRs, corrective action plans, status of actions taken, and the status of the NFR from each stand-alone financial statement audit, the DoD Consolidated Audit, and service provider examinations. The DoD and FIAR Governance Board use this information to categorize and prioritize findings and corrective actions.

The Board should continue to review corrective action plans that address the causes of weaknesses and inefficiencies within the DoD's business processes. After testing the effectiveness of their corrective action plans, the DoD Components should share results and lessons learned with the Board. In addition, the Board should continue to use its meetings as a tool for collaboration across the DoD. This collaboration should include discussion of lessons learned from the audit, implementation of best practices throughout the DoD, coordination between service providers and their customers, identification of similar findings for the DoD Components, and development of enterprise-wide solutions. The Board should also track the progress of the corrective action plans throughout the DoD and its Components.

3. Development of Sustainable Business Processes

In FY 2019, the then Acting Secretary of Defense issued a memorandum stating the importance of the financial statement audit. The memorandum stated that the DoD Components must ensure that areas with positive results from the FY 2018 audit should have robust processes that allow the Components to sustain those results.

The DoD has been seeking to implement more consistent and sustainable processes rather than developing unique processes that were changed often for each Component, location, or office. In this regard, Deputy Secretary Norquist met with DoD Components frequently throughout FY 2019 to ensure corrective action plans were developed. Elaine McCusker, the Acting DoD Comptroller, also emphasized the importance of sustainability of business processes when she stated during a media appearance, "We made progress in our priority areas while focusing on the importance of sustainable solutions."

It is not likely the DoD will be able to resolve any of the DoD-wide material weaknesses quickly or easily. However, the DoD must seek to develop sustainable, lasting solutions in strategic priority areas, such as real property, Inventory, and Operating Materials and Supplies, Government property in the possession of contractors, and information technology. Developing sustainable business processes will also benefit the DoD through improved operations that will help the DoD and its Components use their limited resources more effectively. Sustainable business processes will also ultimately help lead to a clean audit opinion.

4. Coordination of Reporting Components

DoD Components regularly use shared services and rely on the business processes and information technology systems of other Components in their operations. For example, the Defense Logistics Agency often orders inventory for the Army, Navy, Air Force, and Marine Corps to gain cost savings through bulk purchases. Also, nearly all DoD Components rely on the Defense Information Systems Agency to provide telecommunication or internet services rather than contracting for those services individually.

Although DoD Components regularly use shared services, the Components have not implemented the controls necessary to ensure that the providers of those shared services submit reliable financial information to develop their financial statements. For example, the Air Force relies on its service provider, DFAS, to perform data analytics, reconciliations, and other key data functions related to analyzing its financial data without the necessary capability or capacity to fully monitor or review DFAS' work.

Shared services require coordination between the DoD Components to ensure that the Components understand the impact of those shared services on their business and financial management processes. However, the auditors found that many DoD Components could not explain their own role in the business processes of shared services or their own process for verifying the accuracy of information provided by others for both management and financial reporting purposes. For example, although the Military Services rely on the Defense Logistics Agency to purchase inventory, each Service is responsible for verifying that the Defense Logistics Agency is accounting for the inventory correctly, but not all the Services had a business process to verify that the inventory information obtained from the Defense Logistics Agency was accurate. As a result, the Services may have believed they had inventory they did not have or, conversely, did not have inventory they believed was available for use. This lack of coordination impacts the financial statements and can also impact readiness if inventory is not available when needed.

In FY 2019, the DoD and its Components began taking action to address identified process deficiencies with shared services. The service providers and customers used the FIAR Governance Board meetings to discuss the business process descriptions and their unique roles in the shared services. In addition, the service providers and customers developed cross-Component work groups to ensure the customers understand the services provided and the service providers understand the expectations of their customers.

The DoD and its Components must help the service providers and customers identify and resolve gaps in the business processes, controls, and expectations of the services being provided. Based on lessons learned in FY 2019 regarding purchase of inventory, many Services identified a gap in controls related to reconciliation of their inventory held and managed by the Defense Logistics Agency that should be addressed at an enterprise-wide level. In addition, the DoD should review all shared services within the DoD to ensure that all Components impacted by the shared services are aware of their roles in the internal control process, understand the business process of the service provider, and have clear and reasonable expectations of the service provider.

E. Conclusion

During FY 2019, the DoD underwent a full financial statement audit for the second year. Similar to last year, the DoD received a disclaimer of opinion on the Agency-Wide Basic Financial Statements. Of the 23 DoD reporting entities that receive audits overseen by the DoD OIG, no audit opinions changed from FY 2018 to FY 2019. Seven reporting entities received unmodified opinions, 1 received a qualified opinion, and 15 received disclaimers of opinion.

During FY 2019, auditors issued 1,575 new NFRs for deficiencies noted in FY 2019 as a result of new and expanded testing. In addition to the new NFRs, auditors reissued 1,897 NFRs and closed 698 NFRs in FY 2019. After compiling over 3,000 DoD Component NFRs and 152 DoD Component material weaknesses, the DoD OIG identified 25 agency-wide material weaknesses and 1 agency-wide significant deficiency compared to the 20 material weaknesses in FY 2018.

Although the audits of the DoD and its Components resulted in more NFRs and material weaknesses and the overall audit opinions did not change from FY 2018 to FY 2019, the auditors identified progress for the DoD and its Components. Specifically, the Components' understanding of business processes, ability to provide universes of transactions for testing, and ability to provide supporting documentation for transactions selected for testing improved. However, there is still significant progress that needs to be made. The DoD OIG identified 25 material weaknesses in FY 2019, including 6 new material weaknesses.

It is critical that the DoD and its Components fix the weaknesses and deficiencies identified in the audits through the development, implementation, and monitoring of corrective action plans. Developing sustainable business processes will also benefit the DoD through improved operations that will help the DoD and its Components use their limited resources more effectively. Improvements in financial processes and IT reform initiatives, and lessons learned from the audit must be applied across the DoD, not just in the Components where the deficiencies are identified. DoD and Component leadership must also continually emphasize and express the importance of sound financial management, the financial statement audits, and the implementation of corrective action plans.

The road to a clean financial statement opinion is a long-term effort. However, rather than focusing solely on the audit opinion, DoD leadership must ensure that strong sustainable, financial management and internal controls are developed, which will result in improved operations and also ultimately lead to a clean audit opinion.

The DoD OIG and its auditors are committed to supporting that effort by providing clear and actionable feedback through the financial statement audits, which can help improve the DoD's operations, save money, and ensure that Congress and the public understand how the DoD's resources are being spent.

Appendix A. Sections of the DoD Agency Financial Report

The DoD Agency Financial Report for FY 2019 contains eight major sections.

- Management's Discussion and Analysis. This section of the Financial Report provides a high-level overview of the DoD's operations and financial performance. This section also includes a summary of the DoD's mission, structure, and the current state of financial management systems. In addition, this section includes a discussion regarding the DoD's compliance with certain laws and regulations, such as the Antideficiency Act and the Digital Accountability and Transparency Act of 2014, and the DoD's Statement of Assurance, which summarizes its compliance with the Federal Managers' Financial Integrity Act of 1982 and the Federal Financial Management Improvement Act of 1996. The Statement of Assurance discusses improvements to the DoD's internal controls that resulted in cost savings and increases in efficiency and effectiveness.
- Financial Statements. This section of the Financial Report provides consolidated financial information, for all DoD entities, on the DoD's financial operations, condition, and position. The DoD Financial Statements include four principle statements.
  - Consolidated Balance Sheet. The balance sheet documents the value of assets and liabilities that the DoD has on a specific date. Assets are owned or managed by the DoD and include cash, investments, property, and inventory. Liabilities are amounts owed by the DoD to others, such as accounts payable and unpaid benefits to military and other Federal employees.
  - Consolidated Statement of Net Cost. This statement identifies how much it costs, by specific program, to operate the DoD. The DoD reports on seven programs: Military Retirement Benefits; Civil Works; Military Personnel; Operations, Readiness and Support; Procurement; Research, Development, Test and Evaluation; and Family Housing and Military Construction. The DoD's net cost is the difference between costs, revenue, and any gains or losses recognized from changes in investments. Each of the programs has different types of revenue, such as amounts received from local or state governments for research and development.
  - Consolidated Statement of Changes in Net Position. This statement provides information concerning the money the DoD receives through appropriations from Congress and, after deducting net cost, the DoD's "bottom line" net operating revenue or cost. In addition, it presents the appropriations provided to the DoD that remain unused at the end of the fiscal year. In addition, the statement focuses on how the DoD's operations are financed. The changes in net position equal the difference between assets and liabilities.

- Combined Statement of Budgetary Resources. This statement provides information about how the DoD received its budgetary resources. For example, the DoD could receive budgetary resources through appropriations made by Congress or the DoD could have unspent funds from the prior year. The statement also provides the status of the DoD's budgetary resources at the end of the fiscal year.

- Notes to the Financial Statements. This section provides important disclosures and details related to the information reported on the DoD's consolidated financial statements. For example, one of the required notes provides information regarding legal claims against the DoD. The note discusses the number of cases and total dollar value by the level of probability that the DoD will actually incur a liability.
- Required Supplementary Stewardship Information. This section highlights substantial DoD investments that have long-term benefits to the public, including programs related to non-Federal physical property, such as property owned by state and local governments, and research and development. The Defense Advanced Research Projects Agency Open Catalog is an example of research and development programs that may result in reusable technologies available to the general public to promote efficiency and effectiveness in developing national capabilities. The Defense Advanced Research Projects Agency programs include research for problem solving approaches in areas important to national security.
- Required Supplementary Information. This section provides information on other supplementary topics to enhance understanding of the DoD's financial operations, condition, and position. For example, this information provides a detailed presentation of maintenance and repairs that were not performed when needed or that were scheduled to be performed and were delayed, which provides information on the DoD's ability to keep real property assets in an acceptable condition.
- DoD OIG Audit Report. This report, written by the DoD OIG, presents the results of the DoD OIG's audit of the DoD Agency-Wide Basic Financial Statements and notes to the financial statements. The report includes the DoD OIG's overall audit opinion on the basic financial statements. In addition to the opinion, the report contains a report on the DoD's internal control over financial reporting, including a discussion of material weaknesses in the DoD's business processes that could result in a material misstatement in the financial statements, and a report on the DoD's compliance with applicable laws and regulations.

- Other Information. This section provides the DoD's summary of the financial statement audit, including a list of self-reported material weaknesses and planned corrective actions that the DoD has implemented or plans to implement to address its material weaknesses. Material weaknesses are deficiencies or a combination of deficiencies in internal control over financial reporting that result in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in its financial statements in a timely manner.
- Summary of the DoD Inspector General, "Fiscal Year 2020 Top Management Challenges." This section contains a statement of what the DoD Inspector General considers the most serious management and performance challenges facing the DoD. According to the Reports Consolidation Act of 2000, this annual statement is prepared by the Inspector General and must be included in the DoD financial report.

Appendix B. Requirements for Audited Financial Statements

The Chief Financial Officers Act of 1990 (CFO Act of 1990) requires that Federal agencies prepare financial statements and have those financial statements audited by the agency's Inspector General or by an independent external auditor, as determined by the agency's Inspector General. While FY 2018 is the first year that the DoD has undergone a full financial statement audit, it is not the first year that the DoD has produced financial statements or the first time Components of the DoD have been audited.

The DoD submitted financial statements for the Department of the Army to the DoD OIG to be audited beginning in FY 1991. The DoD began submitting the Agency-Wide financial statements to the DoD OIG for audit in FY 1996.

The DoD OIG only performed limited scope audits on the financial statements for FYs 1996 through 2001. Although those audits were limited in scope, the DoD OIG performed steps above and beyond those required to render a disclaimer of opinion according to generally accepted government auditing standards. The purpose of these audit steps was to provide the DoD feedback on its financial processes and controls. However, these audits were limited in scope because the DoD accounting systems produced unreliable data and financial statements; therefore, the DoD OIG was unable to obtain sufficient appropriate audit evidence on which to base an opinion, resulting in disclaimers of opinion.

Beginning in FY 2002 and continuing through FY 2018, Congress established requirements and due dates for the DoD audit-readiness efforts, including:

- establishing reporting requirements to assist in monitoring DoD financial improvement efforts,
- requiring specific financial statement audits, and
- establishing audit-readiness milestones.

For example, the FY 2002 NDAA limited the audit procedures that the DoD OIG was allowed to perform on the DoD's financial statements. The Act only allowed the DoD OIG to perform the procedures required by generally accepted government auditing standards and limited the DoD OIG to auditing only the information that DoD management stated was ready for audit. Prior to FY 2018, only a limited number of DoD Components asserted that their information was ready for audit, such as the Military Retirement Fund financial statements and the U.S. Army Corps of Engineers–Civil Works financial statements.

The FY 2010 NDAA required the DoD to develop and maintain a semiannual plan, known as the Financial Improvement and Audit Readiness (FIAR) Plan, which is prepared by the FIAR

Directorate.[11] The FIAR Directorate is located within the Office of the DoD Comptroller. Its purpose is to lead the DoD's improvement of its financial management processes. The FIAR Directorate also developed and tracked the progress of the FIAR Plan, which reported on the DoD's efforts to become audit-ready. The Plan was intended to assist the DoD in improving its internal controls over financial reporting and resolve material weaknesses in the financial reports. Additionally, the FIAR Plan set milestones for resolving problems that affect the accuracy, reliability, and timeliness of the DoD's financial information.

The FY 2012 NDAA further required the FIAR Plan to include interim objectives and a schedule of milestones to support the DoD's goal for the Statement of Budgetary Resources to be validated for audit by September 30, 2014. The DoD OIG began auditing DoD Components' Statements of Budgetary Activity in FY 2014.[12]

The FY 2014 NDAA required the Secretary of Defense to ensure that an annual full-scope audit be performed over the DoD financial statements beginning in FY 2018.

The FY 2016 NDAA required the DoD OIG to obtain independent external auditors to audit the DoD Component financial statements. As the overall auditor of the Agency-Wide Basic Financial Statements, the DoD OIG oversees these audits and performs additional procedures necessary to support the overall audit opinion on the Agency-Wide Basic Financial Statements. The DoD OIG contracted with five independent public accounting firms to perform a total of 21 financial statement audits in FY 2018.

The FY 2018 NDAA replaced the requirement for the FIAR Plan with the Financial Improvement and Audit Remediation Plan. The intent of the Remediation Plan is to describe the specific actions the DoD plans to take to address the NFRs that the auditors issue on the weaknesses in the DoD's business processes and financial statements that the audits identify. The Remediation Plan provides interim milestones for completing those actions and cost estimates for the remediation actions.

[11] Beginning in FY 2018, the Financial Improvement and Audit Readiness Directorate became the Financial Improvement and Audit Remediation Directorate.

[12] The Statement of Budgetary Activity is a limited schedule related to the Statement of Budgetary Resources. Similar to the Statement of Budgetary Resources, the Statement of Budgetary Activity includes information about how the DoD received its budgetary resources; however, unlike the Statement of Budgetary Resources, the information is not cumulative. Rather, the Statement of Budgetary Activity included only one or two years of information.

Appendix C. Roles and Responsibilities Related to the Financial Statements

This appendix briefly describe the roles and responsibilities of the various individuals and entities involved in the audit of the DoD's financial statements.

A. Secretary of Defense and Under Secretary of Defense (Comptroller)/Chief Financial Officer

The Secretary of Defense, in conjunction with the DoD Comptroller, is responsible for compiling and presenting the DoD Agency-Wide Basic Financial Statements.

This responsibility includes, but is not limited to, the following.

- Developing and overseeing implementation of DoD-wide accounting and finance policies.
- Overseeing and monitoring effective financial management processes, data, and systems.
- Assisting DoD Components working to remediate audit findings.
- Maintaining effective internal controls over financial reporting.
- Presenting the financial statements in accordance with Generally Accepted Accounting Principles.

The Secretary of Defense and the DoD Comptroller are also responsible for communicating the objectives and importance of DoD financial statement audits throughout the DoD.

In addition, the Secretary of Defense and the DoD Comptroller are responsible for preparing and signing the Management Representation Letter for the DoD Agency-Wide Basic Financial Statements. The Management Representation Letter contains a list of representations made by DoD management to the DoD OIG related to the preparation and presentation of financial statements and the effectiveness of internal controls on financial reporting. For example, in the FY 2018 Management Representation Letter, the Secretary of Defense and the DoD Comptroller stated that the FY 2018 and 2017 DoD Agency-Wide Basic Financial Statements were not presented in conformity with Generally Accepted Accounting Principles.

The Management Representation Letter also contains representations related to internal controls, fraud, and compliance with applicable laws and regulations, such as the Antideficiency Act and the Federal Financial Management Improvement Act.

B. DoD Component Management

The DoD Components audited in FY 2019 include the Offices of the Secretary of Defense, the Military Departments, the Joint Chiefs of Staff, the combatant commands, the Defense agencies, the DoD field activities, and all other organizational entities in the DoD.

Each Component is responsible for ensuring that key processes, systems, internal controls, and supporting documentation affecting the Component's financial statements are complete and accurate. In addition, each Component is responsible for improving its accounting and financial functions. During the audit, the Components are also responsible for responding to document requests from the auditors.

The Components must maintain their accounting records and submit these records to DFAS for financial statement compilation and reporting. Each Component, with support from DFAS, is responsible for reviewing its financial statements and associated notes to ensure that the financial information is complete and accurate. Additionally, the Components are responsible for implementing and sustaining corrective actions to address deficiencies identified by auditors.

C. Defense Finance and Accounting Service

DFAS, which reports to the DoD Comptroller, is responsible for standardizing, consolidating, and integrating accounting and financial functions throughout the DoD.

DoD Components rely heavily on DFAS processes for maintaining, compiling, and reporting their financial transactions. In addition, auditors must request and rely on data that is provided by DFAS to support the Components' financial statement audits because DFAS maintains the DoD's financial reporting systems that support financial statement balances. Additionally, DFAS is responsible for preparing the draft and final versions of the DoD Agency-Wide Basic Financial Statements, which are included in the financial report.

D. DoD Office of Inspector General

The DoD OIG is responsible for managing and completing the audits of the DoD Agency-Wide Basic Financial Statements. Additionally, the DoD OIG is responsible for monitoring and overseeing the independent public accounting firms that conduct financial statement audits of the DoD Components.

The DoD OIG consolidates data and results from the independent public accounting firms and uses the results to support the conclusions in the DoD OIG's audit of the DoD Agency-Wide Basic Financial Statements. The DoD OIG is required to report these audit results to the GAO, OMB, and the Department of the Treasury.

OMB issues guidance to the executive branch on how to prepare financial statements and conduct financial statement audits.

The Department of the Treasury consolidates all financial statements and prepares the Government-wide financial report and provides the statements to the GAO.

E. Independent Public Accounting Firms

The DoD OIG contracts with independent public accounting firms to perform DoD Components' financial statement audits. The independent public accounting firms submit contract proposal packages that are reviewed by a panel of DoD officials, composed of representatives from the DoD OIG, DoD contracting specialists, and the Component being audited. The independent public accounting firms' proposal packages include a price quote, their prior experience, their technical understanding of the subject area, and their proposed staff and resumes. Excluding price, the DoD OIG and Component personnel evaluate each proposal on its own merits and provide the contracting specialist a recommendation. The contracting specialist then takes the recommendation and factors in the price quote to determine which independent public accounting firm receives the contract based on the best value to the Government.

The independent public accounting firms must perform the audits of the Component's financial statements in accordance with both the generally accepted auditing standards that are issued by the Comptroller General of the United States and with the audit requirements for Federal financial statements that are issued by the OMB.

In their audits, the independent public accounting firms test the design and effectiveness of internal controls and the accuracy and completeness of transactions and balances. Independent public accounting firms are required to provide opinions as to whether the Components' presentation of the financial statements conform with Generally Accepted Accounting Principles.

The DoD OIG monitors and oversees the work of the independent public accounting firms throughout the audit. This oversight includes attending meetings between the independent public accounting firm and the Component being audited, reviewing the independent public accounting firms' testing results, and verifying that the work performed by the independent public accounting firms complies with contract requirements and auditing standards.

The independent public accounting firms provide the DoD OIG the results of their testing for review and consolidation into the DoD Agency-Wide Basic Financial Statements. The independent public accounting firms also provide financial improvement and audit remediation support to the DoD and its Components, such as monitoring material weaknesses and corrective action plans for the Components.

F. Government Accountability Office

The GAO is responsible for conducting the annual audit of the Consolidated Financial Statements of the U.S. Government. The Department of the Treasury prepares the Government-wide financial report, which represents the aggregation of the financial statements for all components of the U.S. Government. Just as the Consolidated Financial Statements aggregate the financial statements of the U.S. Government's components, the GAO's audit of the Consolidated Financial Statements aggregates the audit opinions of the Inspectors General and independent public accounting firms who audit the U.S. Government's components.

The GAO is also responsible for monitoring and evaluating the audit work of the Inspectors General and independent public accounting firms for the significant U.S. Government components. The results of the Government components' audits are incorporated into the GAO's audit of the Consolidated Financial Statements.

The GAO issued a disclaimer of opinion on the FY 2018 Consolidated Financial Statements, due in part to the results of the audit of the DoD's financial statements.

Acronyms and Abbreviations

DFAS	Defense Finance and Accounting Service
FIAR	Financial Improvement and Audit Readiness
GAO	Government Accountability Office
GAAP	Generally Accepted Accounting Principles
IT	Information Technology
NDAA	National Defense Authorization Act
NFR	Notice of Findings and Recommendations
OMB	Office of Management and Budget
PP&E	General Property, Plant & Equipment
USSOCOM	U.S. Special Operations Command

Whistleblower Protection

U.S. Department of Defense

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