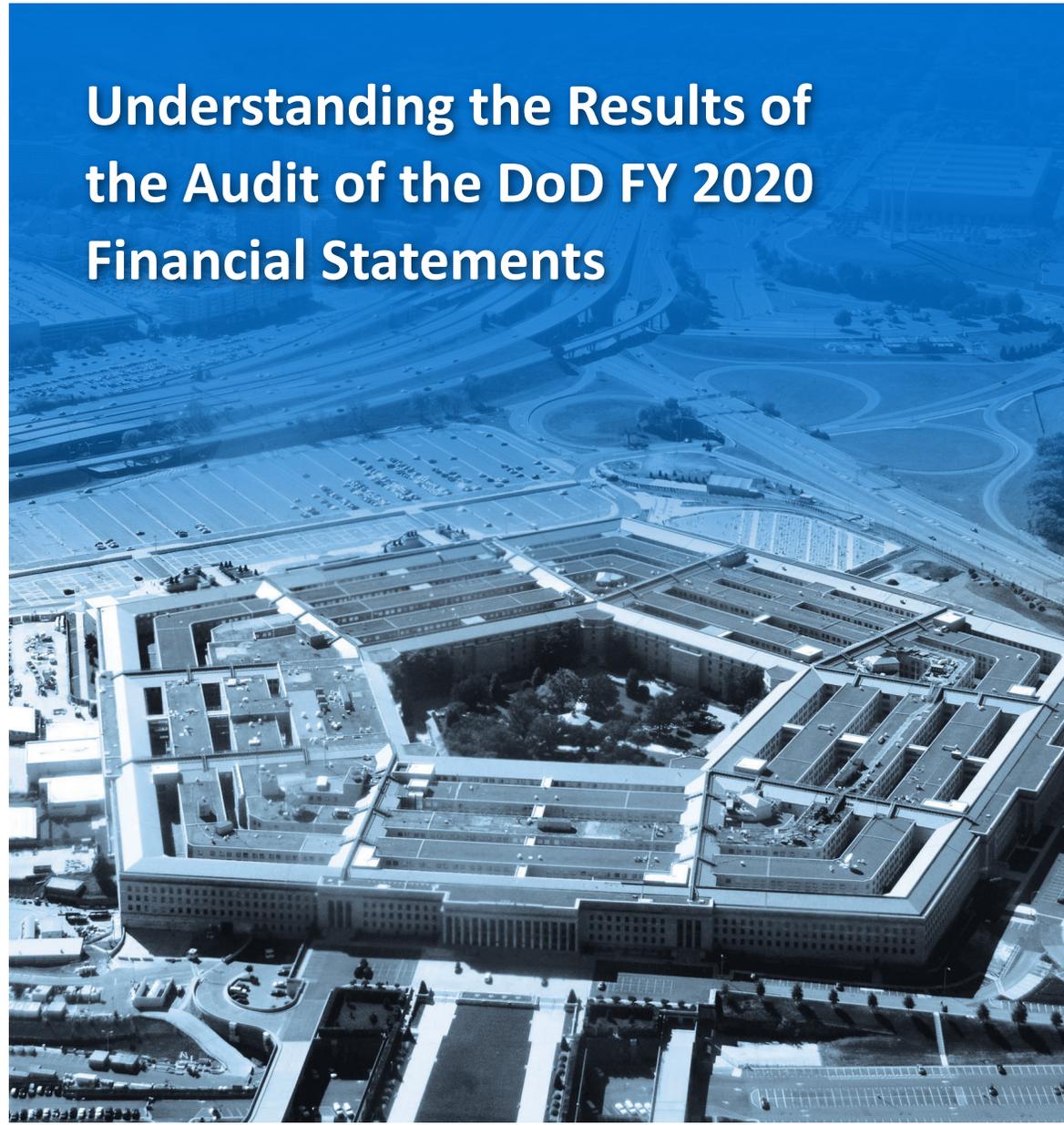




INSPECTOR GENERAL

U.S. Department of Defense

FEBRUARY 23, 2021



Understanding the Results of the Audit of the DoD FY 2020 Financial Statements

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE





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

February 23, 2021

During FY 2020, the DoD underwent a financial statement audit for the third year. As in prior years, the DoD Office of Inspector General (OIG) performed this audit, and issued a disclaimer of opinion on the Agency-Wide Basic Financial Statements – meaning the DoD was unable to provide sufficient evidence for the auditors to support an opinion.

A typical financial statement audit would normally stop when the auditors determine that a disclaimer will be issued. However, as in prior years, the DoD OIG and the independent public accounting firms, which conducted audits of 24 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, and their value. That is the purpose of this report—to summarize, in terms understandable to non-auditors, the findings of the DoD’s financial statement audits, the progress made by the DoD, and the additional actions the DoD should take to address the overall findings of the audit.

We believe that obtaining an unmodified (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 far beyond the audit opinion. The audit—and more accurate financial statements—enable Congress and the public to obtain a more accurate assessment of how the DoD spends its money; help the DoD fix vulnerabilities in information technology systems; help identify and prevent wasteful practices; and assist the DoD in improving its operations.

Each year, auditors experience new challenges as they work to perform audit procedures and expand the scope of the audits for those Components that receive disclaimers of opinion. FY 2020 was no different from the prior years. As a result of the COVID-19 pandemic, auditors had to adjust the timing and planned procedures for the DoD Agency-Wide and DoD Components’ FY 2020 financial statement audits. Despite these challenges, COVID-19 did not prevent the audits from continuing. Auditors were able to perform procedures or modify procedures to accommodate for COVID-19 restrictions and provide valuable feedback to the DoD.

While the DoD and its Components did not achieve any changes in audit opinions between FYs 2018 and 2019, in FY 2020, the Defense Information Systems Agency received a clean audit opinion on its working capital fund financial statements, a vast improvement from the disclaimers of opinion it received in FYs 2018 and 2019. In addition to this progress, the DoD and other Components made progress in improving financial management. Specifically, the DoD and its Components saw a reduction or downgrading of material weaknesses, improved their understanding and development of business processes, and improved supporting documentation for transactions selected for testing.

In FY 2020, auditors closed 857 FY 2019 NFRs, compared to 698 NFRs closed the prior year. In addition, the Navy Working Capital Fund, Air Force Working Capital Fund, Marine Corps General Fund, and the Defense Health Program General Fund had FY 2019 material weaknesses that were either downgraded to significant deficiencies or cleared completely.

Auditors also noted that the DoD and its Components better understood and developed their business processes and improved supporting documentation for transactions selected for testing. As a result, auditors were able to expand testing in areas previously 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 new NFRs in FY 2020.

While the auditors noted progress, much more progress is necessary. This year, the DoD OIG again issued a disclaimer of opinion on the DoD's FY 2020 financial statements. As described in this report, the audits continued to identify new NFRs and reissued a significant number of NFRs from the prior year. Specifically, in FY 2020, auditors reissued 2,641 FY 2019 NFRs and issued 918 new NFRs.

Auditors also identified 26 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. While the number of material weaknesses increased in FY 2020, the number of material weaknesses should not take away or detract from the progress made by the DoD.

As discussed in this report, the road to a clean opinion is not short. Continued progress requires sustained effort and attention throughout the DoD, at all levels. It is also critical that the DoD continues to implement and monitor corrective action plans. Prior Secretaries of Defense, Deputy Secretaries of Defense, DoD Comptrollers, and other DoD leaders have emphasized the importance of the audit and strong financial management; during this time of transition that emphasis must continue. DoD leadership should continue to stress 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.

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 and business processes and provide accurate financial statements.

A handwritten signature in black ink, reading "Sean W O'Donnell". The signature is written in a cursive style with a large, stylized 'S' and 'O'.

Sean W. O'Donnell
Acting Inspector General

Contents

- Understanding the Results of the FY 2020 Audit of the Department of Defense’s Financial Statements** 1
- A. Agency Financial Report 2
 - 1. Consolidated Financial Statements 3
 - 2. Requirements for Audited Financial Statements 5
 - 3. Defining a Financial Statement Audit 5
- B. The Importance of Audited Financial Statements 6
 - 1. Size of the DoD and Relationship to the Government-Wide Financial Statement Audit 7
 - 2. Roles and Responsibilities Related to the Financial Statements 8
 - 3. Secretary of Defense FY 2020 Financial Statement Audit Priorities 12
 - 4. Financial Statement Audits and Results 13
- C. Results of DoD and DoD Components’ FY 2020 Financial Statement Audits 16
 - 1. Impacts of COVID-19 on the FY 2020 Financial Statement Audits 16
 - 2. FY 2020 DoD Financial Statement Audit Results 17
 - 3. Significant DoD Material Weaknesses 29
- D. The Way Forward: Improved Financial Management 41
 - 1. Tone at the Top 41
 - 2. Development of Sustainable Business Processes 43
 - 3. Sustaining Financial Statement Audit Momentum 44
 - 4. Consideration of Financial Statement Extensions 45
- E. Conclusion 46

Appendixes

- Appendix A. Sections of the DoD Agency Financial Report 47
- Appendix B. Requirements for Audited Financial Statements 50

Acronyms and Abbreviations 53

Understanding the Results of the FY 2020 Audit of the Department of Defense's Financial Statements

The 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 had not been fully audited. The National Defense Authorization Act (NDAA) of 2002 required the DoD Office of Inspector General (DoD OIG) to perform only the procedures necessary to audit financial statements the DoD asserted 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 performed and contracted with independent public accounting firms to perform financial statement audits of the DoD and its Components every year since FY 2018. The audits determined whether the financial statements were fairly presented in accordance with Generally Accepted Accounting Principles (GAAP), and resulted in audit opinions.

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 discusses the roles and responsibilities of DoD management and the auditors. It also summarizes the FY 2020 DoD Component and agency-wide audit results, discusses several material weaknesses, explains improvements that have been made since FY 2019, and provides the DoD OIG's perspective on what the DoD should do to continue its progress toward stronger financial management and clean audit opinions.

For FYs 2018, 2019, and 2020, the DoD OIG and five independent public accounting firms overseen by the DoD OIG performed audits consisting of testing procedures on balances listed on the DoD's and its Components' financial statements.¹

In FY 2020, DISA received a clean audit opinion on its working capital fund financial statements.

The DoD and its Components did not achieve any changes in audit opinions between FY 2018 and FY 2019. However, in FY 2020 the Defense Information Systems Agency (DISA) received an unmodified, or clean, audit opinion on its working capital fund financial statements—meaning DISA management presented the financial statements fairly and in accordance with GAAP—a vast improvement from the disclaimers of opinion DISA received in FYs 2018 and 2019.

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 DoD reporting entities and one independent accounting firm performed limited internal control testing over entity controls for DoD Components.

In FY 2020, the DoD OIG and independent public accounting firms overseen by the DoD OIG performed audits of the DoD's and 24 DoD Components' financial statements to determine if the financial statements were accurately presented.² The DoD and 14 of its reporting entities received disclaimers of opinion—meaning the DoD and the Components were unable to provide sufficient evidence for the auditors to base an opinion. In addition, 9 reporting entities received clean audit opinions and 1 entity received a qualified audit opinion—meaning auditors concluded there were misstatements or potentially undetected misstatements that were or could have been material but were confined to individual accounts or items in the financial statements.

In addition, auditors provided a report to each audited entity that identified the material weaknesses, significant deficiencies, and instances of non-compliance with laws and regulations within the DoD and the DoD Components. The overall audit opinions for the DoD and most of the 24 Components whose audits were overseen by the DoD OIG did not change from FY 2019 to FY 2020. In spite of the lack of progress in the audit opinions, the auditors noted progress for the DoD and its Components, including the reduction or downgrading of material weaknesses, better understanding and development of business processes, and improved supporting documentation for transactions selected for testing.

Although the DoD made progress, it is important that the DoD and its Components sustain that progress while continuing to correct weaknesses and deficiencies identified by the auditors. Continued progress will require sustained effort and attention throughout the DoD. Developing sustainable business processes will benefit the DoD through improved operations that will help the DoD and its Components use their resources more effectively, and help lead to a clean audit opinion.

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.

² DoD management tracks and reports on standalone audits performed on the DoD's and DoD Components' financial statements, which include 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 five sub-allotted financial statements overseen by the DoD OIG. Therefore, the reporting by DoD management and the DoD OIG may differ.

Similar to prior years, the FY 2020 DoD Agency Financial Report 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 Information
- DoD OIG Audit Report
- Other Information
- Summary of the DoD Inspector General “Fiscal Year 2021 Top Management Challenges”
- Appendixes, including Security Assistance Accounts Financial Statements and Notes

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 69 separate entities. However, for the FY 2020 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 the independent public accounting firms’ financial statement audits for the following nine DoD reporting entities.

- 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, DoD management decided that 22 additional DoD Components would submit audited financial statements to the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer (DoD Comptroller), including, 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 Transaction Fund.

The DoD OIG oversaw the independent public accounting firms' financial statement audits for 15 of these 22 stand-alone financial statement audits. The other seven audits were completed by independent public accounting firms who were contracted for and monitored by the entity under audit or their respective Office of Inspector General.³ This report focuses on the audit results of the DoD and the 24 DoD reporting entities' 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 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 the balances of 38 DoD Components that did not produce stand-alone financial reports.

As previously noted, the agency financial report includes more than financial statements and the related notes. The Management Discussion and Analysis section of the financial report presents management's perspective on the financial information, overall operations, and significant conditions that may affect future operations. While the Management Discussion and Analysis, Required Supplementary Information, Other Information, and Appendix sections 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.

³ These seven audits were for the Defense Finance and Accounting Service Working Capital Fund, 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, and the Defense Commissary Agency all received unqualified audit opinions on their FY 2020 financial statements. The Defense intelligence agencies all received disclaimers of opinion on their FY 2020 financial statements. The audit of the DoD OIG financial statements is ongoing; however, in future years it will seek to issue its audited financial statements closer or on the same cycle as the other DoD Component audits.

2. Requirements for Audited Financial Statements

The Chief Financial Officers Act of 1990, as amended, 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 FY 2014 NDAA required the Secretary of Defense to ensure that an annual full-scope audit was performed on the DoD financial statements beginning in FY 2018.

The FY 2016 NDAA required the DoD OIG to obtain independent external auditors to audit the nine OMB required DoD reporting entities' financial statements. As the overall auditor of the Agency-Wide Basic Financial Statements, the DoD OIG oversees the audits performed by independent public accounting firms and performs additional procedures necessary to support the overall audit opinion on the Agency-Wide Basic Financial Statements. To meet the requirements of the FY 2014 and FY 2016 NDAs, the DoD OIG contracted with 5 independent public accounting firms to perform a total of 24 DoD reporting entities' financial statement audits in FY 2020.

See Appendix B for a full discussion on the requirements for audited financial statements and the requirements of prior-year NDAs.

3. Defining a Financial Statement Audit

The DoD OIG and independent public accounting firms conducted the audits of the FY 2020 DoD and DoD Component financial statements to:

- express an opinion on whether the consolidated financial statements were fairly presented in accordance with GAAP;
- 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. Financial statement assertions fall under the following five broad categories.

- **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 at a given date. Auditors must ensure 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 ensure that all transactions and events are 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 ensure 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 GAAP. In addition, the entity must make required disclosures and ensure those disclosures are clearly expressed. Auditors perform procedures to ensure all disclosures that should have been included in the financial statements are included and that the disclosed events, transactions, and other matters have occurred and pertain to the entity under audit.

According to auditing standards and guidance from the GAO, for full-scope financial statement audits, auditors should perform appropriate tests for each significant assertion for each significant line item and account. Significance is determined using the concept of materiality. Materiality is one of several factors the auditor uses to determine the nature, extent, and timing of procedures to be performed during the audit. Materiality is based on the concept that items of little importance, which would not affect the judgment of a reasonable user of the financial statements, do not require auditor review. Materiality has both quantitative and qualitative aspects.

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 beyond the audit opinion. First, the audits provide Congress and the public an assessment of the accuracy of where the DoD spends its funds. The audits also determine the reliability of the DoD financial statements, which 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 fraud. 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 within the reporting entity. 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 cybersecurity. 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 cybersecurity.

The financial statement audits can identify vulnerabilities in systems and result in recommendations to improve the DoD's cybersecurity.

Without effective internal controls and proper cybersecurity, 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 that financial systems and processes do not comply with current accounting standards. The recommendations related to these findings can assist the DoD in retiring outdated financial systems and to develop policies and procedures that align with the standards while improving the effectiveness and efficiency of reporting.

Another important impact of the financial statement audit 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 appropriate 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 U.S. Government (Government). It employs 2.1 million Military Service members and approximately 777,000 civilian employees at approximately 4,600 DoD sites located in all 50 states, 7 U.S. territories, and over 40 countries. In FY 2020, the DoD reported that it received congressional appropriations of \$914.2 billion. Approximately

\$191.1 billion of the appropriations is considered mandatory, and the remaining \$723.1 billion is discretionary.⁴ The DoD's discretionary spending is almost half of total Government

In FY 2020, the DoD reported nearly \$3.1 trillion in assets.

discretionary funding. In addition, the DoD owns the majority of Government assets, which are things owned that provide current or future value such as cash, equipment, and investments. In FY 2020, the DoD reported nearly \$3.1 trillion in assets, approximately 78 percent of total Government assets.

The GAO is responsible for conducting the annual audit of the Consolidated Financial Statements of the 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 as long as the DoD receives a disclaimer of opinion.

2. Roles and Responsibilities Related to the Financial Statements

This section briefly describes 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 actions.

- 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 GAAP.

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

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.

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 2020 Management Representation Letter, the Deputy Secretary of Defense and the Acting DoD Comptroller stated that the FY 2020 and 2019 DoD Agency–Wide Basic Financial Statements as presented did not fully comply with GAAP. 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 2020 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’s management 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 the Defense Finance and Accounting Service (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, 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 Deputy Chief Financial Officer, is responsible for standardizing, consolidating, and integrating accounting and financial functions throughout the DoD. DFAS provides financial management and accounting services, analyses, and consultation to its customers. The financial services include performing budgetary execution and financial statement preparation and analyses representing each customer’s financial condition.

DFAS has three locations that perform financial statement preparation for the DoD and most DoD Components: DFAS-Cleveland, DFAS-Columbus, and DFAS-Indianapolis.⁵ Table 1 shows which financial statements each DFAS location prepares. The DFAS, Financial Reporting Directorate, compiles the DoD Agency–Wide financial statements and notes.

⁵ DFAS does not prepare the financial statements of the U.S. Army Corps of Engineers Civil Works. The USACE finance center prepares the USACE-Civil Works financial statements.

Table 1. DFAS Locations Responsible for Compiling Their Respective DoD Reporting Entities' Financial Statements

DFAS – Indianapolis	DFAS – Columbus	DFAS – Cleveland
Army GF	Army WCF	Navy GF
Defense Health Agency–Contract Resource Management	Air Force GF	Department of the Navy WCF
Defense Health Program GF	Air Force WCF	Marine Corps GF
Military Retirement Trust Fund	Defense Logistics Agency GF	
Medicare-Eligible Retiree Health Care Fund	Defense Logistics Agency WCF	
United States Special Operations Command GF	Defense Logistics Agency Transaction Fund	
	Defense Information Systems Agency GF	
	Defense Information Systems Agency WCF	
	United States Transportation Command WCF	

Legend:

GF – General Fund

WCF – Working Capital Fund

Source: The DoD OIG.

Auditors 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.

In addition, DFAS ensures that the DoD's financial information is transmitted to the Department of Treasury for inclusion in the Consolidated Financial Statements of the U.S. Government.

d. DoD Office of Inspector General

The DoD OIG is responsible for managing and completing the audit of the DoD Agency-Wide Basic Financial Statements.

The DoD OIG is responsible for managing and completing the audit 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 material DoD Components.

To conclude on the DoD Agency-Wide Basic Financial Statements, the DoD OIG performs audit procedures at the agency-wide level, reviews notices of findings and recommendations (NFRs), and consolidates the results of the DoD Component audits. The DoD OIG is required to report the audit results to the GAO, OMB, and the Department of the Treasury.

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 which is composed of representatives from the DoD OIG, DoD contracting specialists, and sometimes, 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. Personnel on the panel evaluate the proposals absent the price quote and make a recommendation to the contracting specialist regarding which proposals are technically acceptable. 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 that is technically acceptable to the Government.

The independent public accounting firms must perform the audits of the Component's financial statements in accordance with auditing standards generally accepted in the U.S.; the standards for financial audits contained in Government Auditing Standards 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 GAAP. The scope of the audits are restricted to the DoD Component that each independent public accounting firm is contracted to audit based on the materiality threshold for that specific Component.

The DoD OIG monitors and oversees the work of the independent public accounting firms throughout the audit in our role as the contracting officer representative and as the auditor of the Agency-Wide financial statements. 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 issue financial statement audit opinions for the DoD Components. In addition, they provide the DoD OIG the results of their testing for review and consideration in developing an opinion on the DoD Agency-Wide Basic Financial Statements.

f. Other Federal Agencies

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 Government. Just as the Consolidated Financial Statements aggregate the financial

statements of the 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 Government components' financial statements.

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

The GAO issued a disclaimer of opinion on the FY 2019 Consolidated Financial Statements, due in part to the results of the audit of the DoD's financial statements.

3. Secretary of Defense FY 2020 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 asserted that the DoD was prepared to support the audit procedures and that they expected to receive findings and recommendations regarding weaknesses and inefficiencies in the DoD's financial management processes.

In FY 2019, the DoD and 15 of its reporting entities received disclaimers of opinion. In addition, 6 reporting entities received clean audit opinions and 1 entity received a qualified audit opinion. The DoD OIG identified 25 material weaknesses in FY 2019, 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 results from the FY 2019 audit, DoD leadership developed its FY 2020 financial statement audit priority areas and established goals for each area. Notwithstanding the changes in DoD leadership since that time, the following goals remained for FY 2020.

- **Information Technology (IT).** Ensure that access to financial systems and business systems that feed financial information is limited to only those individuals who need it and only for the specific areas within the system that they need to access (access controls), and ensure there are documented policies and procedures in place and operating effectively to assign and remove access in a timely manner going forward.
- **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 and updated records to ensure balances are accurate.

- **Real Property.** Conduct a full existence and completeness count to ensure 100 percent of its building and structures are accounted for in the financial management systems.
- **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 and incorporate standard inventory management policies, procedures, and metrics into contract terms and conditions.
- **Joint Strike Fighter Program.** Ensure all Joint Strike Fighter program property is recorded in a DoD accountable property system of record, recorded in the DoD financial statements, and supported by a trial balance.
- **Fund Balance with Treasury.** Complete timely and accurate Fund Balance With Treasury (FBWT) reconciliations including: (1) documenting and implementing the end-to-end reconciliation processes; and (2) researching and resolving all aged variances for the statements of differences, collections and disbursements, the cash management report, suspense account activity, and deposit fund activity.
- **Component-Level Oversight and Monitoring.** Implement and document entity level controls, such as OMB Circular No. A-123 controls, variance analysis, tie points, and abnormal balance analysis and collaborate with service providers to ensure all complementary user entity controls are identified, updated if needed, and implemented.
- **Audit Opinion Progression.** Sustain unmodified opinions received in FY 2019 and progress toward the Defense Information Systems Agency (DISA) and U.S. Marine Corps receiving something other than a disclaimer of opinion.

While some DoD Components made progress toward these goals, as discussed in the “FY 2020 DoD Financial Statement Audit Results” section of this report, the DoD did not ultimately achieve the goals. Each of these areas, except the audit opinion progression which is not a material weakness, remained a material weakness in FY 2020.

4. Financial Statement Audits and Results

As discussed, the DoD OIG and independent public accounting firms conducted the audits of the FY 2020 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 GAAP.

A qualified opinion is expressed when:

- a. the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive to the financial statements;⁶ or
- b. the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects of undetected misstatements on the financial statements, if any, could be material but not pervasive.

An adverse opinion is expressed on the financial statements taken as a whole when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. Neither the DoD nor any DoD Component have received an adverse opinion on the financial statements since the DoD OIG began 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, and the auditor concludes that the possible effects of undetected misstatements on the financial statements, if any, could be both material and pervasive.

In FY 2020, 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

⁶ For example, for FY 2020, the auditor 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 cost 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 24 percent of the total liabilities and 13 percent of the program costs on the financial statements. Except for these amounts, however, the financial statements were presented fairly in all material respects, which allowed the auditor to issue a qualified opinion.

support the balances presented on the financial statements, and the auditors concluded that the possible effects of undetected misstatements on the financial statements, if any, could be both material and pervasive.

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

When developing the audit continuation plan, the auditor determines the appropriate testing procedures for various areas, such as financial statement line items or asset categories. The auditor may test different areas each year using statistical and non-statistical samples to provide feedback to the Components. Testing depends on what the Component states is ready to be tested. For example, in FY 2020, auditors used a statistical sample to test FBWT transactions for the Army General Fund financial statements, but auditors for the Air Force General Fund financial statements used a nonstatistical sample to test FBWT transactions.

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 prior year findings should be closed. Because of differences in the level of testing, 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 tested, or that remain untested.

b. Deficiencies in Internal Control

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

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

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

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.

The following are examples of material weaknesses that were identified in the Audit of the FY 2020 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 FBWT, and as a result, the DoD was unable to ensure the completeness and accuracy of its FBWT account.
- The DoD had multiple legacy systems that did not comply with Federal financial management system requirements. In addition, DoD and Component management did not identify legacy systems consistently. The continued use of non-compliant systems inhibited the DoD’s ability to produce auditable basic financial statements.

Later in the report, in Table 5, we list all 26 agency–wide material weaknesses that auditors identified in the audit of the DoD’s FY 2020 financial statements and discuss those related to the DoD priority areas in more detail.

C. Results of DoD and DoD Components’ FY 2020 Financial Statement Audits

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. This section discusses the impacts the Coronavirus Disease–2019 (COVID-19) had on the audits, progress made by the DoD and its Components, the overall audit results, and what we believe the DoD needs to do to continue progress toward better business processes, more accurate financial statements, and clean audit opinions.

1. Impacts of COVID-19 on the FY 2020 Financial Statement Audits

COVID-19 is an infectious disease that can cause a wide spectrum of symptoms.

On March 11, 2020, the World Health Organization declared the COVID-19 outbreak a pandemic, and on March 13, 2020, the President declared the COVID-19 pandemic a national emergency. As a result of the social distancing and travel limitations that were instituted in response to the COVID-19 pandemic, auditors had to adjust the timing and planned procedures of the DoD Agency–Wide and DoD Components’ FY 2020 financial statement audits.

Throughout the audits, DoD OIG and other auditors collaborated with DoD and Component leadership to identify alternative procedures allowed by auditing standards to allow audit work to continue while prioritizing the health and well-being of audit and DoD personnel.

However, travel restrictions, mandatory quarantines, and the Government-wide policy to maximize the use of telework across the Federal workforce impacted various aspects of the audit. For example, auditors:

- delayed testing of sensitive activities and areas that must be completed on site;
- postponed or canceled site visits;
- used Service audit agencies to perform testing; and
- conducted site visits using video technology.

Despite these challenges and audit impacts, COVID-19 did not prevent the audits from continuing. Auditors were able to perform all necessary audit procedures for those audits that resulted in clean audit opinions and perform procedures and provide valuable feedback to the DoD and its Components on those audits that did not result in clean opinions.

2. FY 2020 DoD Financial Statement Audit Results

During the FY 2020 financial statement audits, the DoD OIG oversaw the completion of 24 DoD Component financial statement audits and completed the audit of the FY 2020 DoD Agency-Wide Basic Financial Statements. The DoD OIG contracted with five 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, P.C.; and KPMG, LLP.

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 100 DoD locations, performed over 500 virtual site visits, sent over 36,000 requests for documentation, and tested over 76,000 sample items for the audits of the DoD and its Components. In addition, auditors performed followup testing on over 1,000 of the 3,509 outstanding prior-year 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 857 prior-year NFRs, reissued 2,641 prior-year NFRs, and issued 918 new FY 2020 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.

The auditors closed 857 prior-year NFRs, reissued 2,641 prior-year NFRs, and issued 918 new FY 2020.

a. FY 2020 DoD Component Audit Results

One of DoD's priority areas was maintaining unmodified opinions from FY 2019 and progressing the audit opinions for the Defense Information System Agency and the U.S. Marine Corps. The DoD partially met its goal in FY 2020. While the U.S. Marine Corps received a disclaimer

of opinion in FY 2020, the Defense Information Systems Agency received a clean opinion on its working capital fund financial statements. In addition, those DoD Components that received unmodified opinions in FY 2019 maintained those opinions in FY 2020.

Overall, as presented in Table 2, of the 24 DoD reporting entities that had audits overseen by the DoD OIG in FY 2020, 9 received unmodified opinions, 1 received a qualified opinion, and 14 received disclaimers of opinion. The U.S. Air Force Sub-Allotted reporting entity did not receive an audit in FY 2019.

Table 2. FYs 2019 and 2020 Financial Statement Opinions for DoD Reporting Entities

Reporting Entity	FY 2019 Opinion	FY 2020 Opinion
U.S. Army Corps of Engineers-Civil Works	Unmodified	Unmodified
Defense Information Systems Agency WCF	Disclaimer	Unmodified
Defense Health Agency—Contract Resource Management	Unmodified	Unmodified
Military Retirement Fund	Unmodified	Unmodified
Army Sub-allotted	Unmodified	Unmodified
U.S. Air Force Sub-allotted	N/A	Unmodified
Defense Health Agency Sub-allotted	Unmodified	Unmodified
Defense Logistics Agency Sub-allotted	Unmodified	Unmodified
U.S. Special Operations Command Sub-allotted	Unmodified	Unmodified
Medicare-Eligible Retiree Health Care Fund	Qualified	Qualified
Department of the Army GF	Disclaimer	Disclaimer
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 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: DoD OIG.

Table 3 presents the number of NFRs issued in FYs 2019 and 2020; the number of NFRs closed in FY 2020; the number of new financial NFRs for FY 2020, the number of financial NFRs reissued for FY 2020; the number of new IT NFRs for FY 2020; and the number of IT NFRs reissued for FY 2020 by DoD Component. As shown in Table 3, auditors issued a total of 918 new NFRs for deficiencies identified in FY 2020. New deficiencies were generally identified as a result of new and expanded testing that was conducted during the FY 2020 audits. In addition to the new NFRs, auditors reissued a total of 2,641 NFRs in FY 2020 for deficiencies identified prior to FY 2020 that were not fully addressed by the end of FY 2020. Finally, auditors closed 857 of the FY 2019 NFRs, which shows that the DoD and its Components took corrective actions to fix many of the deficiencies identified by the auditors in FY 2019.

Table 3. Number of Notices of Findings and Recommendations by Component

Reporting Entity	Total FY 2019 NFRs	NFRs Closed in FY 2020 ¹	Financial NFRs–New	Financial NFRs–reissued ²	IT NFRs–New	IT NFRs–Reissued ³	Total Issued FY 2020 NFRs
Department of the Army ³	443	124	129	232	55	89	505
Department of the Navy	1,020	145	163	383	122	492	1,160
Department of the Air Force	468	118	61	184	110	166	521
U.S. Marine Corps ³	169	22	3	79	3	66	151
U.S. Army Corps of Engineers	83	47	19	32	2	4	57
Defense Health Program ³	190	42	13	71	8	63	155
Defense Information Systems Agency ³	43	22	45	16	2	6	69
Defense Logistics Agency ³	486	86	35	336	26	60	457
U.S. Special Operations Command	112	40	18	47	11	25	101
U.S. Transportation Command ³	151	12	13	96	3	49	161
Defense Health Agency - Contract Resource Management	20	9	1	0	1	11	13
Medicare-Eligible Retiree Health Care Fund	23	10	0	2	1	11	14
Military Retirement Fund	15	7	2	2	0	6	10
Agency–Wide	286	173	23	68	49	45	185
Total	3,509	857	525	1,548	393	1,093	3,559

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

² NFRs are considered reissued if the weakness or deficiency noted in the NFR was identified during a prior year audit, but which the DoD Component had not yet corrected.

³ These Components' NFR counts have changed due to IPA decisions to consolidate or remove crossover prior-year NFRs in FY 2020.

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. The classifications resulted in the identification of 144 material weaknesses across the Components for FY 2020, as shown in Table 4. This was a decrease of 8 material weaknesses when compared to FY 2019.

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 2019 to FY 2020. A few DoD Components, such as the Navy Working Capital Fund and the Air Force Working Capital Fund, saw decreases in the number of material weaknesses during FY 2020.

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 IT systems.

In addition, there was little change from FY 2019 to FY 2020 related to non-compliance with laws and regulations. DoD Components had 49 instances of non-compliance with laws and regulations in FY 2020 compared to 46 in FY 2019. 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.⁷ 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 4 provides the number of material weaknesses and the number of instances of non-compliance for each of the Component audits overseen by the DoD OIG.

⁷ The U.S. Standard General Ledger is a standard list of accounts to help standardize accounting across the Government.

Table 4. Component Audit Results, FY 2018 through FY 2020

Entity	FY 2018		FY 2019		FY 2020	
	Material Weaknesses	Non-Compliance	Material Weaknesses	Non-Compliance	Material Weaknesses	Non-Compliance
Department of the Army GF	12	3	12	2	12	2
Department of the Army WCF	12	2	13	2	13	2
U.S. Navy GF	13	2	17	2	17	2
Department of the Navy WCF	9	2	13	2	11	2
Department of the Air Force GF	11	2	12	2	12	2
Department of the Air Force WCF	12	2	11	2	10	2
U.S. Marine Corps GF	9	4	9	4	8	4
U.S. Army Corps of Engineers-Civil Works	2	2	2	2	2	2
Defense Health Program GF	13	4	13	4	11	4
Defense Information Systems Agency GF	5	3	5	3	5	3
Defense Information Systems Agency WCF	4	3	4	3	5	3
Defense Logistics Agency GF	7	2	7	2	7	2
Defense Logistics Agency WCF	8	2	8	2	7	2
Defense Logistics Agency Transaction Fund	6	2	7	2	6	2
U.S. Special Operations Command GF	5	2	5	2	5	2
U.S. Transportation Command WCF	5	1	5	1	5	2
Defense Health Agency-Contract Resource Management	0	0	0	0	0	0
Medicare-Eligible Retiree Health Care Fund	1	1	1	1	1	1
Military Retirement Fund	0	0	0	0	0	0
Army Sub-allotted	3	2	3	2	2	2

Table 4. Component Audit Results, FY 2018 through FY 2020 (cont'd)

Entity	FY 2018		FY 2019		FY 2020	
	Material Weaknesses	Non-Compliance	Material Weaknesses	Non-Compliance	Material Weaknesses	Non-Compliance
U.S. Air Force Sub-allotted	N/A	N/A	N/A	N/A	2	2
Defense Logistics Agency Sub-allotted	1	2	1	2	1	2
Defense Health Agency Sub-allotted	N/A	N/A	2	2	1	2
U.S. Special Operations Command Sub-allotted	N/A	N/A	2	2	1	2
Total	138	44	152	46	144	49

Legend:

GF – General Fund

WCF – Working Capital Fund

Source: The DoD OIG.

b. FY 2020 DoD Agency-Wide Audit Results

The DoD OIG identified 26 agency-wide material weaknesses and 4 agency-wide significant deficiencies.

On November 16, 2020, the DoD OIG issued a disclaimer of opinion on the FY 2020 Agency-Wide Basic Financial Statements. After compiling over 3,500 Agency-Wide and DoD Component NFRs and 144 DoD Component material weaknesses,

the DoD OIG identified 26 agency-wide material weaknesses and 4 agency-wide significant deficiencies. Of the material weaknesses and significant deficiencies identified:

- 22 material weaknesses were repeated from FY 2019;
- 1 material weakness from FY 2019 was presented at a more granular level as 4 new material weaknesses and 1 significant deficiency in FY 2020;
- 1 significant deficiency repeated from FY 2019; and
- 2 material weaknesses from FY 2019 were downgraded to significant deficiencies.

Table 5 provides a list of the 26 agency-wide material weaknesses and a brief summary of each weakness. After the table, we provide a more in-depth analysis of several repeat material weaknesses that the DoD determined to be priorities in FY 2020.

Table 5. Agency-Wide Material Weaknesses Identified During the FY 2020 Financial Statement Audit

Material Weakness	Description	Repeat or New
1. Legacy Systems	The DoD was unable to properly identify legacy systems and some legacy systems did not comply with the FFMIA.	New. Previously included in the Financial Management and Information Technology material weakness.
2. Configuration Management and Security Management	The DoD lacked effective configuration management and security management controls for key financial systems.	New. Previously included in the Financial Management and Information Technology material weakness.
3. Access Controls	The DoD lacked effective access controls for various key financial systems, and it did not identify all relevant risks or have documented procedures to ensure proper access controls.	New. Previously included in the Financial Management and Information Technology material weakness.
4. Segregation of Duties	The DoD was unable to properly identify conflicting roles or segregate key function roles.	New. Previously included in the Financial Management and Information Technology material weakness.
5. Universe of Transactions	The DoD was unable to provide a complete universe of transactions that reconciled to its accounting records.	Repeat.
6. Fund Balance with Treasury	The DoD had ineffective processes and controls for reconciling its FBWT.	Repeat.

Table 5. Agency-Wide Material Weaknesses Identified During the FY 2020 Financial Statement Audit (cont'd)

Material Weakness	Description	Repeat or New
7. Suspense Accounts	The DoD was unable to attribute suspense transactions to the appropriate DoD Component. In addition, DFAS and the DoD Components lacked the controls necessary to monitor, research, and clear the transactions in the suspense accounts.	Repeat.
8. 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.
9. Operating Material & Supplies	The DoD was unable to report Operating Material and Supplies in accordance with GAAP.	Repeat.
10. General Property, Plant & Equipment	The DoD could not accurately value its General Property, Plant, & Equipment in accordance with GAAP.	Repeat.
11. 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.	Repeat.
12. 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.

Table 5. Agency-Wide Material Weaknesses Identified During the FY 2020 Financial Statement Audit (cont'd)

Material Weakness	Description	Repeat or New
13. 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 Joint Strike Fighter program property from the financial statements and inability to provide documentation supporting the value of the property indicate material failures in controls for recording of joint programs within the DoD.	Repeat.
14. Military Housing Privatization Initiative (MHPI)	The DoD lacked GAAP-compliant policies and procedures to account for and report the MHPI program.	Repeat.
15. Accounts Payable	The DoD did not have sufficient policies, procedures, and internal controls over its methodology for accruing payables.	Repeat.
16. 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.
17. Beginning Balances	The DoD did not have the historical data to support beginning balances on their financial statements or the ability to reconcile beginning balances to closing balances at the end of the reporting period.	Repeat.
18. Unsupported Accounting Adjustments	The DoD did not have effective controls to provide reasonable assurance that accounting adjustments were valid, complete, and accurately recorded in its accounting and general ledger systems.	Repeat.

Table 5. Agency–Wide Material Weaknesses Identified During the FY 2020 Financial Statement Audit (cont’d)

Material Weakness	Description	Repeat or New
19. Intradepartmental Eliminations and Intragovernmental Transactions	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 and the Consolidated Financial Statements of the U.S. Government.	Repeat.
20. Gross Costs	The DoD did not have reliable financial information to effectively manage and understand Gross Costs because 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.	Repeat.
21. Earned Revenue	The DoD did not have reliable financial information to effectively manage and understand Earned Revenue because 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.	Repeat.
22. Budgetary Resources	The DoD was unable to accurately determine its total budgetary resources available or the status of those resources.	Repeat.
23. Service Providers	Many service providers did not design or implement reliable controls that provide required assurances to DoD Component customers.	Repeat.
24. Entity-Level Controls	Multiple DoD Components did not design and implement effective entity-level controls for reliable financial reporting, lacked controls, or performed insufficient reviews while preparing their financial statements.	Repeat.

Table 5. Agency-Wide Material Weaknesses Identified During the FY 2020 Financial Statement Audit (cont'd)

Material Weakness	Description	Repeat or New
25. DoD-Wide Oversight and Monitoring	The USD(C)/CFO did not perform effective oversight and monitoring of the consolidation of Component-level information or have adequate time to perform verification of Component level information prior to publishing Agency-Wide information.	Repeat.
26. Component-Level Oversight and Monitoring	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.	Repeat.

Legend:

USD(C)/CFO – Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD

FFMIA – Federal Financial Management Improvement Act

Source: The DoD OIG.

In addition to these material weaknesses, the DoD OIG identified a repeat significant deficiency for Accounts Receivable, identified a new significant deficiency for the DoD’s transition to its risk management framework, and downgraded two FY 19 material weaknesses for legal contingences and reconciliation of net cost of operations to outlays. Specifically, the DoD OIG concluded that:

- the DoD did not develop or implement effective controls to prevent or detect misstatements of non-Federal accounts receivable balances,
- multiple Components had not fully completed their transition from the DoD Information Assurance Certification and Accreditation Process to the risk management framework for various key financial systems,
- the DoD and its Components lacked controls over the process for preparing the Management Schedules and lacked a consistent methodology for reporting legal contingencies, and
- DoD Components were unable to support adjustments made to reconcile budgetary and proprietary data on their basic financial statements.

The DoD OIG determined that any misstatement resulting from these deficiencies in FY 2020 would not be material to the financial statements. As a result, the DoD OIG reported them as significant deficiencies, which are less severe than material weaknesses, but important enough to bring to management’s attention.

Finally, the DoD OIG identified seven instances of non-compliance with laws and regulations across the DoD in FY 2020. 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, the Debt Collection Improvement Act of 1996, the Prompt Payment Act, and the Coronavirus Aid, Relief, and Economic Security (CARES) Act. For example, the CARES Act requires the DoD to report certain obligations and expenditures to the OMB, Treasury, and Congress. During FY 2020, DoD management represented that they did not have the mechanisms within their financial reporting systems to track CARES Act related transactions and separately report the impact on the DoD's assets, liabilities, costs, revenues, and net position.

3. Significant DoD Material Weaknesses

The DoD OIG identified material weaknesses during the FY 2018 and FY 2019 financial statement audits. As noted in Table 5, the DoD OIG identified 26 Agency-Wide material weaknesses during the FY 2020 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 financial reporting, and to achieve auditable financial statements.

During FY 2020, the DoD identified eight priority areas, seven of which directly related to prior year material weaknesses.

1. Information Technology
2. Inventory
3. Real Property
4. Government Property in the Possession of Contracts
5. Joint Strike Fighter Program
6. Fund Balance with Treasury
7. Oversight and Monitoring

Because the DoD identified these seven areas as priorities, the DoD OIG is reporting on the progress, status, and what remains to be done for each material weakness that falls into these priority areas.

a. Information Technology

The DoD and its Components rely on IT systems and interfaces between IT systems for effective financial management and reporting, as well as for operational purposes. Ineffective IT system controls can result in significant risk to DoD operations and assets. For example, unauthorized access to financial systems could allow users the ability to directly access and modify files containing financial information, which could allow payments and collections to be lost, stolen, or duplicated.

During FY 2020, auditors reissued 1,093 prior-year IT NFRs and issued 393 new IT NFRs. As in prior years, the DoD and 12 of its Components had a material weakness related to financial management systems, as well as the IT environment. Auditors found that:

- DoD and Component management did not identify legacy systems consistently;
- multiple Components did not have formalized and comprehensive policies and procedures for configuration management and security management;
- multiple Components did not design and implement effective access controls for various key financial systems, identify relevant risks regarding access controls, or have documented procedures to ensure proper access controls;
- multiple Components did not develop a process to properly identify conflicting roles or segregate key function roles; and
- multiple Components did not complete their transition to the Risk Management Framework for various key financial systems.

The FY 2020 DoD goals focused on access controls, segregation of duties, and configuration management. In order to ensure Components made progress toward improving IT controls, the DoD required Components to certify whether they completed corrective actions related to the following five metrics.

- Eliminate the use of shared administrative user accounts.
- Identify, limit as necessary, and monitor all sensitive transactions, system resources, and privileged users.
- Remove all unnecessary privileged access to systems and implement proper segregation of duties.
- Perform a periodic comprehensive review of users authorized to develop, program, or make code changes, and remove these users so that they do not have access to the production environment.
- Update policies and procedures to limit access to production files to a small number of users.

Although the DoD began implementing corrective actions for these IT priority areas, the DoD did not make significant progress. As demonstrated in Table 6, the DoD is still nearly 50 percent away from reaching its goal in each IT priority area. Additionally, while there was a slight decrease in the number of open IT NFRs between FY 2019 and FY 2020, there are still over 1,400 outstanding IT NFRs. As of August 2020, the DoD had identified 250 IT systems relevant to the financial statement audits. The number of those systems certified as compliant for each metric are identified in Table 6.⁸

⁸ The total number of systems will not always be 250 because the goals may not be applicable to every system.

Table 6. Progress of Certified DoD Financial IT Systems, as of August 2020

Focus Area	Number of Certified Systems	Percentage of Certified System
Use of Shared Administrative User Accounts	137	54.8%
Sensitive/Privileged User/Transaction Identification	119	47.6%
Unnecessary Assignment of Privileged Access	122	48.8%
Developer Access to Production Program/Files	128	51.2%
Access to Production Ready Code Files	134	53.6%

Source: The DoD OIG.

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

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.

b. Inventory

Inventory and Related Property, hereafter referred to as inventory, 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.

As of September 30, 2020, the DoD reported \$310.2 billion in Inventory and Related Property. The DoD and 11 of its Components had a material weakness related to Inventory in FY 2020. Auditors found that multiple DoD Components lacked policies, procedures, controls, oversight, and documentation related to providing assurance over the existence and completeness of inventory and properly valuing inventory.

Inaccurate 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 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. This can result in parts shortfalls and the inability to rapidly repair aircraft, adversely affecting operational readiness.

The DoD's goal for Inventory in FY 2020 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. The DoD was not able to meet this goal, in part due to limitations imposed due to the COVID-19 pandemic such as the travel restrictions and mandatory quarantines.

While the DoD did not meet its overall goal related to Inventory, auditors did note progress by several DoD Components related to valuation of inventory.

While the DoD did not meet its overall goal related to Inventory, auditors did note progress by several DoD Components related to valuation of inventory. Specifically, those DoD Components continued to develop their one-time alternative valuation method for establishing the opening balances for Inventory.

As a result, auditors were able to expand testing related to the valuation methods the Components intended to use. For example, in FY 2019 auditors completed 19 nonstatistical samples for Army Working Capital Fund inventory valuation testing. In FY 2020, auditors expanded their inventory valuation testing to a statistical test of 1,218 sample items.

Although DoD Components are making progress toward establishing the opening balances of inventory, 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 after establishing the opening balances. For example, and similar to issues found in FY 2018 and FY 2019, 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 improve the DoD's mission readiness. Auditors issued several NFRs regarding Inventory and Related Property that could have an operational impact, and identified the following issues.

- Existence and completeness exceptions for 137 Navy items and 130 Marine Corps items. The exceptions indicate that the Navy and Marine Corps did not have the inventory that was reflected in their records or had on-hand inventory that was not recorded in their records.

- The Army valued all excess inventory at \$0 and the Air Force did not review inventory identified as excess in a timely manner. This increased the risk that the Army and the Air Force had inventory not reflected on the financial statements.
- Navy records contained incorrect condition codes on 148 Navy items. Specifically, the records indicated that items were in a usable condition when, in fact, the items were unusable, resulting in a direct impact to mission readiness.
- The Army did not have sufficient policies and procedures in place to identify asset ownership, increasing the risk that the Army reported inventory that it did not own. Additionally, the Marine Corps was unable to provide sufficient documentation to support 155 ammunition and 61 non-ammunition samples, hindering the Marine Corp's ability to support asset ownership.

The DoD is in the process of implementing corrective action plans to update policies and procedures related to Inventory. These policies range from improving the effectiveness of management oversight and controls to directing Components to address process and system deficiencies related to reconciliation and valuation methodologies. For example, in FY 2020, the Air Force effectively updated the procedural manual for a logistics system to include newly-implemented controls to restrict the ability to manually change inventory values. The DoD expects to finalize and implement the updated policies by FY 2026, a change to the previously planned completion date of FY 2023 due to delays in the implementation process.

Moving into FY 2021, DoD leadership must prioritize, finalize, and implement more comprehensive policies and procedures to address issues with physical inventories and develop a method for maintaining valuation of inventory after establishing an opening balance. The DoD should also emphasize formalizing and implementing procedures and controls related to physical counts and reconciliations. These actions will not only improve financial management but will also improve business processes and operational readiness.

c. Real Property

Real property includes land, land rights, facilities (including buildings, structures, and linear structures), construction in progress, assets under capital lease, and leasehold improvements. The DoD considers real property 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. The DoD records real property asset information and activity (such as acquisitions, transfers, and disposals) within the accountable property system of record. Property, Plant, and Equipment (PP&E), including real property, is not intended to be sold and is developed or purchased only for use by the DoD entity.

The DoD reports its real property within the General PP&E line item on its balance sheet. Of the \$790.5 billion that the DoD reported in General PP&E on its balance sheet for FY 2020, approximately \$308.6 billion represents real property.

The DoD goal for FY 2020 was to conduct a full existence and completeness count to ensure 100 percent of its buildings and structures were accounted for in the financial management systems. In addition, the DoD's goal was to fully implement the transfer of all real property to the Military Services and Washington Headquarters Services from all other DoD Components. For FY 2020, DoD management required that all real property be reported on the financial statements of the Component that owns or operates the installation where the real property is located, also known as the installation host.

The DoD and DoD Components were unable to meet this goal in FY 2020. For example, the Defense Logistics Agency (DLA) did not transfer out all real property to the installation hosts. In FY 2020, the DLA reported 274 real property assets, valued at \$13.4 million, on its working capital fund financial statements.

While the DoD did not reach its overall real property goal, some Components made progress. Although the DoD did not reach its real property goal, some Components made progress. For example, the Army General Fund detected and corrected a \$2.4 billion overstatement in which the Army and other Defense agencies double-reported real property in their FY 2019 financial statements.

When implementing the requirement to transfer real property to the installation host, Components made transfers without resolving outstanding auditor findings that directly related to unsupported and unsubstantiated balances, unsupported valuations, and incomplete listings of real property assets. This resulted in the errors being transferred to the host. For example, the U.S. Transportation Command and the DLA transferred real property to installation host in FY 2020; however, neither Component resolved deficiencies related to the existence, completeness, and valuation of their real property. These transfers ultimately transferred findings from the U.S. Transportation Command and the DLA to the installation hosts.

In addition, Components transferred real property to the installation hosts without supporting documentation and did not complete full reconciliations to ensure all real property was accounted for, and accounted for only once. For example, the Air Force transferred all Working Capital Fund real property to the Air Force General Fund; however, the Air Force could not support the transfers.

The DoD acknowledged its real property material weakness and provided its corrective action plan in its Agency Financial Report. The DoD plans to improve real property processes, controls, and supporting documentation by implementing a new accountable property system of record that provides a level of data and documentation to support its valuation of real property. Adequate documentation will allow the DoD to appropriately present and consistently report real property in the financial statements. The correction target date is FY 2025.

To achieve 100 percent accounting of Real Property, DoD leadership should design, implement, and monitor reconciliation controls between their accountable property systems of record and general ledger accounting systems. In addition, the DoD should complete regular validation of the existence and completeness of its real property assets. The DoD should also complete a full reconciliation of all real property transfers and identify the complete population of real property assets. When completing their corrective actions, DoD leadership must also hold those responsible for implementing these policies and procedures accountable for completing the actions necessary to address the weaknesses in real property.

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 recordkeeping controls for its property in accordance with Government standards. Government standards permit the DoD to allow contractors to take on the task of recordkeeping for the Government property they hold; however, the DoD is still responsible to ensure contractors keep accurate records. Auditors found that the DoD did not fully comply with this requirement in FY 2020. Specifically, auditors reported that the DoD did not accurately record the property held by contractors and lacked policies, procedures, controls, oversight, and documentation related to property held by contractors.

The DoD established goals to complete a reconciliation of contractor inventory data to DoD property records; establish a complete baseline of assets with the contractors; and incorporate standard inventory management policies, procedures, and metrics into contract terms and conditions. The DoD did not meet these goals in FY 2020.

The auditors found that the Department lacked policies, procedures, controls, and documentation necessary to accurately record and monitor Government property in the possession of contractors. Specifically, DoD Components:

- did not design and implement an effective monitoring and reconciliation process between contractor inventory management records and the DoD system of record;
- did not have policies and procedures to reconcile Operating Materials and Supplies held at contractor-owned and -operated facilities;
- did not have the required internal control procedures in place to ensure they provided effective oversight to those who managed the Component's inventory; and
- did not have a physical inventory plan to account for munitions assets at their contractor locations.

Auditors issued several NFRs regarding Government property in the possession of contractors, as shown in the following examples of deficiencies.

- The Air Force was unable to provide a complete listing of Government equipment in the possession of contractors and had not developed or implemented controls for the recording and monitoring of that equipment.
- The Army Working Capital Fund reported approximately \$2.5 billion of contractor-held inventory as of June 30, 2020. However, the Army did not detect and correct discrepancies between the contractors' records and the Army's records. Auditors found discrepancies in the records that included non-Army-owned items held at a contractor and inventory for closed contracts that no longer existed.
- The Navy lacked oversight of Trident missile system assets because contractor asset listings were not updated appropriately, and the assets were not recorded in a Government-owned system. Furthermore, the Navy relied on the Defense Contract Management Agency (DCMA) to perform oversight of the prime contractor's property management processes, including physical inventory. Auditors found that DCMA's current oversight was not a sufficient internal control for managing inventory held by contractors.

Correcting these deficiencies could improve the DoD's ability to manage its property and make decisions regarding acquisition, disposal, and reutilization.

⋮ *There is an 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.*

As a result of the internal control weaknesses over Government property in the possession of contractors, there is an 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.

The DoD acknowledged its Government property held by contractors as a weakness and provided its corrective action plan in the Agency Financial Report. The DoD plans to develop and implement automated solutions for reporting Government property held by contractors and to review metrics such as compliance with DoD policy. In addition, the DoD plans to continue its efforts to validate and reconcile Government property held by contractors. While the initial target completion date for addressing this material weakness was FY 2021, the DoD adjusted the target completion date to FY 2026 due to delays in the implementation and adoption of automated government-furnished property reporting solutions.

To achieve accurate records for its Government property held by contractors, the DoD must complete its efforts to create an accurate baseline of contractor-held assets and complete its other related corrective actions. Additionally, the DoD must continue to develop and implement new corrective actions related to properly recording government property held by contractors. For example, formalizing the DCMA's oversight into DoD Component processes with proper controls will provide the Components assurance on the accuracy of their contractors' records.

e. Joint Strike Fighter

The Joint Strike Fighter program consists of three variants of the F-35 aircraft across the Navy, Air Force, and Marine Corps. The Joint Strike Fighter program is intended to provide significant advances in military capability and is the DoD's main focus for obtaining an affordable next generation strike aircraft. The Joint Strike Fighter program focuses on reducing development cost, production cost, and cost of ownership for the various F-35 aircraft. In FY 2020, the defense authorization bill funded 90 F-35 aircraft for \$10.9 billion.

During the FY 2019 Financial Statement Audit, the Joint Strike Fighter program was identified as an agency-wide material weakness because it was not recorded on the DoD financial statements. In FY 2020, OUSD identified the Joint Strike Fighter program as one of its audit remediation priorities and its goal was to ensure that all Joint Strike Fighter program property was recorded in a DoD accountable property system of record and recorded on the FY 2020 DoD financial statements by September 30, 2020. The DoD did not achieve this goal.

The DoD did not account for and manage the Joint Strike Fighter property, or record the property in an accountable property system of record during FY 2020. As a result, it was omitted from the financial statements. Contractor records indicate the Joint Strike Fighter program has over 3.45 million pieces of property valued at \$2.1 billion.

The DoD did not account for and manage the Joint Strike Fighter property, or record the property in an accountable property system of record during FY 2020.

In August 2020, the DoD updated its goal and now plans to have the Joint Strike Fighter Program Office generate a trial balance as of March 30, 2021. In addition, all Joint Strike Fighter property is expected to be in an accountable property system of record by April 2021. Finally, the DoD plans to include the Joint Strike Fighter trial balance in the FY 2021 DoD financial statements.

f. Fund Balance with Treasury

The Fund Balance with Treasury (FBWT) is composed of hundreds of individual accounts maintained by the Department of the Treasury that reflect the funds available for the DoD to spend. In other words, FBWT is the DoD's cash balance reported by its bank—the Department of the Treasury. However, the DoD continues to struggle with its processes to reconcile its FBWT accounts.

Each reporting entity should be able to perform a detailed monthly reconciliation between its own records and the Department of the Treasury's records. It is essential to perform these reconciliations and reduce differences in order to support the budget authority and outlays reported on the Statement of Budgetary Resources. However, auditors continue to find weaknesses in the Components' reconciliation processes.

The DoD's overall goal for its FBWT was to perform timely, complete, and accurate FBWT reconciliations. While the DoD did not meet its goal, in FY 2020, the DoD and its Components continued building on their progress from FY 2019.

For example, Army and DFAS corrective actions in FYs 2019 and 2020 led to a \$250 million reduction of undistributed amounts, which are amounts that have been reported to Treasury but have not been posted to the appropriate Component account. This reduction in differences between the Army and the Department of Treasury in combination with improvements to the Army's FBWT internal controls marks an important achievement and a huge step forward in Army business reform.

The Defense Information System Agency (DISA) and Defense Finance and Accounting Service (DFAS) made progress supporting DISA's cash balance. In FY 2020, auditors determined that 98 percent and 100 percent of suspense and statements of differences, respectively, were fully supported for the DISA's Working Capital Fund.⁹ The FY 2020 results were a significant improvement from FY 2019, when suspense and statement of difference transactions failed for 44 percent and 8 percent of transactions sampled for the DISA's Working Capital Fund. DISA's improvement in its working capital fund cash balances was one of many improvements it made that allowed it to receive a clean audit opinion.

While the DoD and its Components continued implementing corrective actions for FBWT, there is room for improvement. The DoD must ensure corrective actions are allowable under laws and regulations. For example, in an attempt to clear aged FBWT transactions, DFAS determined it had exhausted all possible research efforts and could not support the transactions. To clear the unsupported transactions, DFAS transferred the transactions to accounts that had available funds, regardless of the purpose of those funds. Specifically, DFAS cleared \$1 billion of transactions using this process. In clearing the \$1 billion of transactions, DFAS transferred 18,824 transactions valued at \$404.20 million from Defense-Wide suspense accounts to an expired Defense-Wide operations and maintenance fund without knowing if the transactions were for operations and maintenance.

The DoD expects to remediate its FBWT material weakness by FY 2022.

In its FY 2020 Agency Financial Report, the DoD reported an accelerated timeline to remediate its FBWT material weakness and now expects to remediate the material weakness by FY 2022.

To remediate this material weakness, the DoD is developing a FBWT reconciliation process,

⁹ Suspense accounts are temporary holding accounts for transactions that need additional research to determine which Component the receipt or expenditure belongs to. A statement of difference reveals differences between monthly totals reported in the Components' accounting systems and the transactions reported to the Department of Treasury.

including implementation of internal controls that ensure reconciling differences are accurate, documented, and resolved in a timely manner. In addition, the DoD plans to expedite its transition to Treasury Direct Disbursing and daily reporting by retiring and replacing legacy systems and processes. These initiatives must be sustainable to enable the DoD to further progress toward more accurate FBWT reporting.

g. Oversight and Monitoring

In FYs 2019 and 2020, the DoD OIG identified two material weaknesses related to oversight and monitoring that affected the DoD and many of its Components: (1) Component-level Oversight and Monitoring and (2) DoD-Wide Oversight and monitoring.

(1) Component-Level Oversight and Monitoring

OMB Circular A-123 requires DoD Component management to continuously monitor, assess, and improve the effectiveness of internal controls.¹⁰ 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 GAAP and OMB Circular No. A-136.¹¹

In the 2020 Compendium of Open Office of Inspector General Recommendations to the Department of Defense, Chapter 5, “Recommendations Made in Financial Statement Audits,” we discussed the high concurrence rate of prior-year findings (at a rate of 75-100 percent), which indicated that management recognized when weaknesses existed and developed a plan to address them. However, in FY 2020, 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, auditors found that DLA management did not complete an assessment and plan for timely remediation of audit findings. In addition, various Navy and DLA plans for addressing material weaknesses were either not developed, or not completed. Auditors also found that Army management did not provide adequate guidance to ensure that oversight and monitoring activities were performed consistently across the Army.

In addition, some DoD Components did not show an awareness of, or commitment to ensuring that their financial statements and associated audit reports were issued in a timely manner. Before an audit report can be issued, management must provide written representations

¹⁰ OMB Circular No. 123, “Management’s Responsibility for Enterprise Risk Management and Internal Control,” July 15, 2016.

¹¹ OMB Circular No. A-136, “Financial Reporting Requirements,” August 27, 2020.

acknowledging their responsibility for various matters, including the preparation and fair presentation of financial statements, completeness of audit evidence and transactions, uncorrected misstatements, and related party transactions. Management provides these items in the form of Management Representation Letters, which must be signed and dated the same day the financial statement audit reports are contractually due. However, Army and Air Force management did not sign the Management Representation Letters on the contractual deadline of November 9, 2020, which caused these financial statements and audit reports to be issued late and compressed the DoD OIG's timeframe for analyzing and incorporating Component results into the Agency-Wide audit report.¹²

(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 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.

The Office of the DoD Comptroller did not perform effective oversight and monitoring over the financial reporting consolidation process.

In FY 2020 auditors determined that the Office of the DoD Comptroller did not perform effective oversight and monitoring over the financial reporting consolidation process or have adequate time to verify Component-level information prior to publishing the Agency Financial Report.

For example, the Office of the DoD Comptroller did not issue CARES Act guidance until October 2020, seven months after the President signed the Act into law. This delay resulted in Components improperly recording CARES Act appropriations in their accounting systems. In addition, the Office of the DoD Comptroller did not develop or implement various corrective action plans for addressing DoD material weaknesses, such as Unsupported Beginning Balances and Budgetary Resources.

The DoD's goal for FY 2020 was to continue to develop an awareness of controls-related activities and effectiveness of controls. To accomplish this goal and provide a DoD-wide snapshot into the financial reporting process, the DoD focused on developing a dashboard providing insight into 10 metrics, including abnormal balances and NFRs. The dashboard enabled the DoD Comptroller, DFAS, and Components to filter data to identify the most relevant stakeholder transactions.

The DoD also focused on implementing, documenting, and tracking user entity controls, which are controls the customer organization must have in place when working with a service provider. Several Defense agencies made significant progress in designing effective user entity controls, which resulted in a drastic decrease in associated NFRs and allowed auditors to continue testing the operating effectiveness of these controls.

¹² Army and Air Force signed the Management Representation Letters on November 10 and 12, respectively.

Although the DoD made progress toward remediating the oversight and monitoring material weaknesses, DoD and Component leadership must continue their high-level monitoring and hold personnel accountable for implementing corrective actions. In addition, the DoD and Component leadership must identify and implement enterprise-wide corrective actions. Implementing effective oversight and monitoring will not only benefit the financial management community and potentially prevent material misstatements in the financial statements, but 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: Improved Financial Management

The DoD and its Components developed and implemented hundreds of corrective actions to address the prior findings, and they continue to develop corrective actions to address prior-year and FY 2020 findings. As discussed in the previous section, the DoD OIG identified 26 material weaknesses during the audit of the FY 2020 Agency-Wide Financial Statements, compared to 25 material weaknesses in FY 2019 and 20 material weaknesses in FY 2018.

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

- developing and maintaining a balanced tone at the top,
- developing sustainable business processes,
- sustaining Financial Statement Audit momentum, and
- considering the impact of any financial statement extensions.

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 1, 2017, approximately 4 years' time, the DoD has had eight Secretaries of Defense, six DoD Comptrollers, seven Secretaries of the Navy, five Secretaries of the Army, and six Secretaries of the Air Force. Changes in leadership make it difficult to keep a consistent tone and message regarding good financial management and improved business processes. With the 2021 change in administration, the DoD should ensure it continues to emphasize the importance of sound financial management and business processes, and support the DoD financial statement audit.

In FY 2020, 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, former 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 DoD financial management processes and systems. For example, then Acting DoD Comptroller Elaine McCusker communicated the following in a June 2020 DoD Financial Improvement and Audit Remediation Report:

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

The DoD and its Components 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, the Army Materiel Command’s Executive Deputy to the Commanding General meets quarterly with Army Working Capital Fund auditors to receive updates on the audit’s progress, discuss current- and prior-year audit findings, and brief the auditors on corrective action plans and key milestones. As one of the operational heads of the Army’s supply chain, the Army Materiel Command’s interest in the Army Working Capital Fund financial statement audit is building engagement and awareness across its’ subordinate commands, which will go a long way to sustain momentum of financial and business process improvements and movement towards a clean audit opinion.

DoD and Component leadership must maintain and demonstrate high ethical standards to create an environment that leads to improved DoD operations and ultimately, improved financial statements. Although it is important for DoD and Component leadership to build reasonable goals and expectations for improved and sustainable financial management processes, excessive pressure can lead to:

- unrealistic milestones or expectations;
- adversarial relationships with the financial statement auditors, including refusal to accept auditor conclusions;
- requests to change accounting standards to “lower the bar” to allow for easier financial reporting requirements; and
- circumvention or misinterpretation of accounting standards.

It is important that DoD and Component leadership strike a clear balance of expectations to improve IT and financial management while providing sufficient time to implement corrective action plans.

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. While a consistent tone at the top is critical for continued improvement, it is important that DoD and Component leadership strike a clear balance of expectations to improve IT and financial management while providing sufficient time to implement corrective action plans.

2. Development of Sustainable Business Processes

In recent years, the DoD has sought to implement consistent and sustainable processes rather than developing unique processes that are frequently changed for each Component, location, or office. In this regard, the Financial Improvement and Audit Readiness (FIAR) Governance Board, which is chaired by the DoD Comptroller, brings together senior DoD financial management leaders, and senior representatives from the functional communities such as acquisition, logistics, and policy to enhance the financial management and audit readiness efforts of the DoD and its Components.

It is not likely that 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, Operating Materials and Supplies, Government property in the possession of contractors, and information technology. For example, to use the one-time allowed alternative valuation methodology for real property, general equipment, inventory, and Operating Materials and Supplies, the Department and its Components must have a sustainable process for tracking and valuing its assets to assert that it is ready for the alternative valuation to be audited and continue under prior accounting standards. The Army Working Capital Fund revalued much of its inventory in October 2018 using its alternative valuation method but did not assert that it was ready to move forward valuing future inventory using the appropriate accounting standards. Because the Army did not assert it was ready to move forward, auditors did not validate whether the valuation of the inventory was correct.

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. For example, having one sustainable business process for the DoD to track and value its inventory could reduce the resources spent to reconcile the differences between property systems and financial systems or differences between the Components and their service providers, it could also ensure more consistency in the valuation of like items across services and agencies.

To assist the DoD and its Components in developing sustainable business processes throughout the DoD, the FIAR Governance 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, DoD Components should share results and lessons learned with the FIAR Governance Board. In addition, the FIAR Governance 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 continue to track the progress of corrective action plans throughout the DoD and its Components to ensure sustainable business processes are developed and implemented appropriately. Sustainable business processes will ultimately help lead to clean audit opinions for the DoD and its Components.

3. Sustaining Financial Statement Audit Momentum

In April 2020, the Deputy Secretary of Defense requested that the DoD OIG provide suggestions for actions that the DoD should consider to help ensure progress on financial statement management and the financial statement audits is sustained through changes in leadership in the DoD and its Components. In his March 16, 2020 memorandum to the Deputy Secretary of Defense, the former Principal Deputy Inspector General Performing the Duties of the Inspector General highlighted that the DoD financial management community needs to work together to integrate the policies, business practices, and systems of its vastly divergent Components.

As stated in the memorandum, auditors continually hear about each DoD Component's way of doing things, but not about a "DoD way." Moreover, rather than focusing solely on the audit opinions of the DoD and its Components, DoD Components and leadership in key functional areas (such as financial management, acquisition, and cyber) need to work together to develop a "DoD way" that builds a foundation of sustainable practices that will support DoD operations. Specifically, the DoD OIG suggested that the DoD:

- develop a "DoD way" of doing business and enforcing it, rather than allowing each DoD Component to develop separate, non-integrated processes;
- develop one DoD-wide Enterprise Resource Planning (ERP) system for financial transactions;
- develop consistent DoD-level internal controls for business practices that are common across the DoD; and
- encourage DoD staff at all levels to become active participants and be invested in the DoD's efforts to improve financial management across the DoD.

Sustaining continuous progress toward a clean audit opinion will require the dedication and perseverance of DoD staff at all levels.

Sustaining continuous progress toward a clean audit opinion will require the dedication and perseverance of DoD staff at all levels. Continuous employee engagement and education regarding the financial statements and associated audits will help DoD staff to become more invested in the improvements and results associated with the audits.

4. Consideration of Financial Statement Extensions

As the DoD and its Components progress toward obtaining qualified and clean opinions and resolving material weaknesses and significant deficiencies, it is even more important that management have sustainable and efficient business processes in place. It is also likely that the DoD and Component leadership will continue to seek extensions to mandatory reporting deadlines to have more time to provide necessary data to auditors to complete their procedures.

In FY 2020, two Components, the Defense Information Systems Agency (DISA) and the Navy, obtained extensions to issue their financial statements in December 2020, 1 month after the DoD issued the Agency-Wide financial statements. The extensions for the DISA Working Capital Fund provided provided DFAS and the Component sufficient time to provide year-end transactions to auditors; allowed auditors to select samples, perform testing, and conclude on the financial statements; and enabled Component leadership to make any necessary adjustments to their financial statements. Ultimately, this led to a clean opinion for the DISA Working Capital Fund.

Additionally, the Navy requested an extension for both its General Fund and Working Capital Fund financial statements to provide Navy management more time to provide supporting documentation related to four FY 2019 material weaknesses. As a result of the extension and additional documentation, auditors were able to downgrade one prior year material weakness to a significant deficiency and to close one prior year material weakness for the Navy General Fund. The other two material weaknesses remained after further testing.

While extensions provide additional time and opportunities for the DoD and its Components to support their financial statements and potentially close NFRs, material weaknesses, and significant deficiencies, extensions also create unique challenges. When Components must make adjustments to the financial statements, those adjustments could have an impact on the DoD or other Component financial statements that were previously issued. For example, after the DoD issued the Agency-Wide financial statements on November 16, 2020, the Navy identified a \$9.3 billion error in its financial statements that required an adjustment. This was a material adjustment to the DoD financial statements, and, as a result, the DoD issued a revised Agency-Wide financial report in December to incorporate the Navy changes.

As the DoD and its Components move forward, the DoD should determine the risk and potential impact to the Agency-Wide and other Components' financial statements prior to requesting extensions.

E. Conclusion

During FY 2020, the DoD underwent a full financial statement audit for the third consecutive year. Similar to prior years, the DoD received a disclaimer of opinion on the Agency-Wide Basic Financial Statements. Of the 24 DoD reporting entities that received audits overseen by the DoD OIG, only the Defense Information System Agency improved its FY 2019 audit opinion and received a clean audit opinion on its working capital fund financial statements in FY 2020. Overall, 9 reporting entities received unmodified opinions, 1 received a qualified opinion, and 14 received disclaimers of opinion.

During FY 2020, auditors issued a total of 3,559 NFRs. Of those NFRs 918 were new NFRs for deficiencies noted in FY 2020 as a result of new and expanded testing. In addition to the new NFRs, auditors reissued 2,641 NFRs and closed 857 NFRs in FY 2020. After compiling over 3,500 DoD Component NFRs and 144 DoD Component material weaknesses, the DoD OIG identified 26 agency-wide material weaknesses and 4 agency-wide significant deficiencies. In comparison, the DoD OIG identified 25 material weaknesses and 1 significant deficiency in FY 2019.

Although the audits of the DoD and its Components resulted in more NFRs and material weaknesses and most disclaimer of opinions did not change from FY 2019 to FY 2020, the auditors saw progress by the DoD and its Components. Specifically, the auditors noted progress for the DoD and its Components that received disclaimers of opinion. This progress included the reduction or downgrading of material weaknesses, better understanding and development of business processes, and improved supporting documentation for transactions selected for testing.

To fix the weaknesses and deficiencies identified in the audits, the DoD and its Components must prioritize development and implementation of sustainable business processes. DoD leadership must continue to monitor corrective action plans to ensure progress is being made. In addition, DoD leadership should apply improvements in financial and business processes across the DoD, not just in the Components where the deficiencies are identified.

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, DoD-wide financial management and internal controls are developed. This will result in improved and more efficient operations, and also ultimately lead to a clean audit opinion.

Appendix A. Sections of the DoD Agency Financial Report

The DoD Agency Financial Report for FY 2020 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, 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. For FY 2020, the management’s discussion and analysis for the DoD and Component financial reports should have contained a section that summarized the financial impact, if significant, of COVID-19 on the entity, including any additional budgetary resources received. The COVID-19 section should summarize the purpose of the budgetary resources, obligations incurred, the portion of the budgetary resources that remain available for FY 2021 (including a reference to the existence and purpose of any indefinite budgetary resources), and the financial and performance impact of the additional budgetary resources. Discussion and analysis of the financial impact should include the impact on assets, liabilities, net costs, revenue, Funds from Dedicated Collections, net position, and other results, as appropriate.
- **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 from actuarial assumption changes for military retirement benefits. Each of the programs has different types of revenue, such as amounts received from investment earnings, contributions to support retirement and health benefit requirements, and earnings from reimbursed activities.

- 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 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.
- Appendixes. In FY 2020, the DoD added the Security Assistance Accounts (SAA) financial statements and notes as an Appendix to the financial report. The SAAs include balances from the security assistance programs for which the DoD has responsibility, including Foreign Military Sales, the Special Defense Acquisition Fund, Foreign Military Financing, and International Military Education and Training. The Defense Security Cooperation Agency is responsible for issuing the SAA basic financial statements, which are consolidated into the Government-wide financial statements. DoD management included the SAA basic financial statements in an appendix to the Agency Financial Report and included disclosures within the DoD Agency-Wide Basic Financial Statements to describe the relationship between the DoD and the SAAs. However, DoD management did not represent that the SAA information was complete and accurate. In addition, the SAA financial statements are not scheduled to undergo a full financial statement audit until FY 2022.

Appendix B. Requirements for Audited Financial Statements

The Chief Financial Officers Act of 1990, as amended, 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 was the first year that the DoD underwent a full financial statement audit, it was 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 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 National Defense Authorization Act (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.¹³ 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 2014.¹⁴

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, as well as cost estimates for the remediation actions.

The FY 2019 NDAA placed further requirements on the DoD to rank all Military Departments and Defense agencies in order of how advanced they are in achieving auditable financial statements, and to report this information to Congress. These Components must report detailed remediation plans for material weaknesses and provide milestones for closing NFRs.

¹³ Beginning in FY 2018, the Financial Improvement and Audit Readiness Directorate became the Financial Improvement and Audit Remediation Directorate.

¹⁴ 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 1 or 2 years' information.

The FY 2020 NDAA made the ranking report to Congress an annual requirement and added further reporting requirements to those Military Departments and Defense agencies that were in the bottom 25 percent, to include a description of its material weaknesses, the underlying causes of such weaknesses, and a plan for remediating such weaknesses.

Acronyms and Abbreviations

CARES ACT	Coronavirus Aid, Relief, and Economic Security Act
COVID-19	Coronavirus Disease 2019
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DLA	Defense Logistics Agency
FBWT	Fund Balance With Treasury
FIAR	Financial Improvement and Audit Readiness
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
IT	Information Technology
NDAA	National Defense Authorization Act
NFR	Notice of Finding and Recommendation
OMB	Office of Management and Budget
SAA	Security Assistance Accounts



Whistleblower Protection

U.S. DEPARTMENT OF DEFENSE

Whistleblower Protection safeguards DoD employees against retaliation for protected disclosures that expose possible waste, fraud, and abuse in government programs. For more information, please visit the Whistleblower webpage at <http://www.dodig.mil/Components/Administrative-Investigations/Whistleblower-Reprisal-Investigations/Whistleblower-Reprisal/> or contact the Whistleblower Protection Coordinator at Whistleblowerprotectioncoordinator@dodig.mil

For more information about DoD OIG reports or activities, please contact us:

Congressional Liaison

703.604.8324

Media Contact

public.affairs@dodig.mil; 703.604.8324

DoD OIG Mailing Lists

www.dodig.mil/Mailing-Lists/

Twitter

www.twitter.com/DoD_IG

DoD Hotline

www.dodig.mil/hotline



DEPARTMENT OF DEFENSE | OFFICE OF INSPECTOR GENERAL

4800 Mark Center Drive
Alexandria, Virginia 22350-1500
www.dodig.mil
DoD Hotline 1.800.424.9098

