INSPECTOR GENERAL

U.S. Department of Defense

MAY 18, 2022

Understanding the Results of the Audit of the FY 2021 DoD Financial Statements

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE

INSPECTOR GENERAL

INTEGRITY EFFICIENCY

DEPARTMENT OF DEFENSE

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

May 18, 2022

During Fiscal Year (FY) 2021, the Department of Defense (DoD) underwent a financial statement audit for the fourth year. As in prior years, the DoD Office of Inspector General (OIG) performed this audit, and issued a disclaimer of opinion on the DoD 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 they will issue a disclaimer. However, as in prior years, the DoD OIG and the independent public accounting firms continued the audits to identify deficiencies and help the DoD understand and address those deficiencies.

The auditors' opinions 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 audits.

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 assess how the DoD spends its money; identify vulnerabilities in information technology systems; help prevent wasteful practices; and assist the DoD in improving its operations.

The DoD Agency-Wide audit opinion did not change between FYs 2020 and 2021. While auditors closed 808 prior-year notices of findings and recommendations (NFRs), they also reissued 2,678 NFRs and issued 690 new NFRs in FY 2021. In addition, the DoD OIG identified 28 Agency-Wide material weaknesses, which are weaknesses in internal control that result in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statement in a timely manner. As discussed in this report, the DoD and its Components must collectively prioritize efforts to fix the weaknesses and deficiencies identified in the audits. To do so, DoD leadership must develop and implement reasonable, measurable goals to guide its Components in achieving clean audit opinions for the Components and the DoD.

The road to a clean audit opinion is long; the DoD has been working toward a clean opinion for more than 30 years and estimates that it will not obtain a clean opinion for at least another 7 years. To make measurable progress, all levels of the DoD must remain diligent in their efforts to obtain a clean opinion, remediate material weaknesses, and emphasize the need to focus on the overall DoD audit opinion. DoD leadership should continue to stress the importance of efficient and effective business processes that produce reliable financial information and improve DoD operations, while also continuing to develop and implement corrective action plans for identified findings and recommendations.

At the DoD OIG, we will continue to audit the financial statements, identify deficiencies, and provide clear recommendations to fix deficiencies. We hope this report helps explain the results of the DoD audits, and supports the DoD's efforts to improve business processes and produce accurate financial statements.

Sean W O'Donnell

Sean W. O'Donnell
Acting Inspector General

Contents

INSPECTOR GENERAL
INTEGRITY EFFICIENCY
DEPARTMENT OF DEFENSE

Understanding the Results of the Audit of the FY 2021 Department of Defense Financial Statements

The DoD prepares the annual DoD Agency Financial Report and the Component-level financial statements to provide an overview of the DoD's and its Components' financial information as well as summary-level information on DoD operations performance results. In FY 2021, the DoD Office of Inspector General (OIG) performed an audit of the DoD Agency-Wide financial statements and oversaw independent public accountants (IPAs) as they performed audits of the DoD Components' financial statements. The purpose of the audits was to determine whether the DoD and its Components presented their financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP), which establishes accounting concepts and principles, as well as industry-specific rules, that ensure an organization's financial statements are complete, consistent, and comparable.

The DoD's journey to achieving a clean audit opinion began more than 30 years ago, as shown in Figure 1. Based on the results for FY 2021, the DoD is still a long way from a clean opinion. The DoD estimates that it will not obtain a clean opinion for at least another 7 years.

Figure 1. Progression of the DoD Audited Financial Statements

1990	• The Chief Financial Officers Act required the DoD to prepare financial statements and the DoD OIG or an independent external auditor to perform the audit.
1991	• The DoD began submitting the Department of the Army financial statements to the DoD OIG for audit.
1996	• The DoD began submitting Agency-Wide financial statements to the DoD OIG for audit.
2002	• The National Defense Authorization Act limited the DoD OIG to perform procedures required by Generally Accepted Government Auditing Standards on information that DoD management asserted was ready for audit.
2014	• The National Defense Authorization Act required the Secretary of Defense to have a full-scope audit performed over DoD financial statements beginning in FY 2018.
2018	• The DoD OIG performed the first full-scope DoD Agency-Wide financial statement audit. • The DoD and 18 of 26 reporting entities received a disclaimer of opinion.
2019	• The DoD and 18 of 26 reporting entities received a disclaimer of opinion. • Auditors determined that the DoD and its Components made improvements to their financial management operations.
2020	• The DoD and 17 of 26 reporting entities received a disclaimer of opinion. • The Defense Information Systems Agency Working Capital Fund moved from a disclaimer of opinion to a clean opinion. • The DoD OIG downgraded two material weaknesses to significant deficiencies at the DoD-wide level.
2021	• The DoD and 17 of 26 reporting entities received a disclaimer of opinion. • The DoD OIG identified three new material weaknesses and downgraded one FY 2020 material weakness to a significant deficiency at the DoD-wide level.

Source: The DoD OIG.

The DoD financial statements and independent auditor's reports, which are included in the DoD Agency Financial Report, are technical, use complicated terminology, and are presented in a prescribed format that can be difficult to understand. Because of this, the DoD OIG produces this annual report to explain the results of the financial statement audits in a way that is understandable and meaningful to someone without a technical background in financial statement auditing and accounting. This report will explain or identify:

- the importance of the DoD financial statement audits;
- key roles and responsibilities of those involved in preparing or auditing the DoD financial statements;
- the process the DoD and its Components follow when preparing their financial statements;
- the process the DoD OIG and IPA firms follow when auditing the DoD and its Components' financial statements; and
- how to interpret the results of the FY 2021 financial statement audits.

We will also explain the FY 2021 audit results, as well as DoD management's priorities for achieving stronger financial management operations.

Importance of the DoD Financial Statement Audits

The DoD is the largest Department in the U.S. Government. It employs 2.1 million Military Service members and approximately 780,000 civilian employees at approximately 4,600 DoD sites located in all 50 states, 7 U.S. territories, and more than 40 foreign countries. In FY 2021, the DoD reported that it received congressional appropriations of $905.1 billion and reported nearly $3.2 trillion in assets, which is approximately 54 percent of the Government's total assets. Because of the DoD's size, the DoD has a major impact on the Government-wide financial statements. Size and level of funding aside, the DoD Agency-Wide and Component-level financial statement audits are important for several reasons.

First, the intent of the audits is to provide Congress and the public an assessment of where the DoD spends its resources and to provide transparency of the DoD's operations. In addition, although auditors do not design financial statement audits to detect waste, fraud, and abuse, auditors remain alert throughout the audit and take appropriate action, such as referring matters to investigative agencies, when they identify suspected waste, fraud, or abuse.

Second, financial statement audits assess the controls in information technology (IT) systems, such as access controls and segregation of duties. The DoD uses many systems that are crucial to the execution and financial management of its operations. Therefore, testing internal controls of DoD IT systems during the financial statement audits can identify vulnerabilities in those systems and result in recommendations to improve the DoD's IT infrastructure. Ineffective internal controls may negatively affect the DoD's ability to rely on information in the systems when making decisions.

Third, financial statement audits can improve DoD programs and operations. During the audits, auditors provide feedback to DoD management regarding the effectiveness of many of the Component's business systems, processes, and controls. For example, when auditing the completeness of inventory at a Component's facility, the auditors not only examine the systems used to process inventory, but also review the business processes used for ordering, receiving, and storing the inventory. In addition, the auditors review the internal controls to determine whether management designed controls to ensure that inventory information is accurate, including inventory quantity, location, condition, and value. Accurate inventories ensure that the DoD knows what it owns and where it is located, so it does not buy too much or too little.

Financial Statement and Audit Roles and Responsibilities

The effort to prepare and audit the DoD Agency-Wide and Component-level financial statements is immense and requires support from many individuals, Components, and processes throughout the DoD. Figure 2 identifies key roles and responsibilities of those involved in preparing and auditing the DoD financial statements.

Figure 2. Roles and Responsibilities Related to the Financial Statements

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

- Compile and present the DoD Financial Statements in accordance with GAAP.
- Develop and oversee implementation of DoD-wide accounting and finance policies.
- Maintain effective internal controls over financial reporting.

DoD Component Management

- Ensure that key processes, systems, and internal controls are effectively designed and implemented to support the Component's financial management operations.
- Review the respective Component's financial statements and associated footnotes to ensure that the financial information is complete and accurate.
- Implement and sustain corrective actions to address deficiencies identified by auditors.

Defense Finance and Accounting Service

- Standardize, consolidate, and integrate accounting and financial functions throughout the DoD.
- Provide financial management and accounting services, analyses, and consultation to the DoD and its Components.
- Perform budgetary execution and financial statement preparation for the DoD and its Components.

DoD OIG

- Plan and execute the audit of the DoD Agency-Wide financial statements.
- Monitor and oversee IPA firms that conduct financial statement audits of DoD Components.
- Report the DoD audit results to external stakeholders, such as the Government Accountability Office, the Office of Management and Budget, and the Department of the Treasury.

IPA Firms

- Perform DoD Component financial statement audits as required by contracts with the DoD OIG.

Other

- The Department of the Treasury prepares the Government-wide financial report, which aggregates the financial statements for all Components of the Government, including the DoD.
- The Government Accountability Office is responsible for conducting the annual audit of the Consolidated Financial Statements of the U.S. Government.

Source: The DoD OIG.

Preparing and Auditing the DoD Financial Statements

The DoD Agency-Wide financial statements include the financial activity from 60 DoD reporting entities, including the Military Departments, Defense agencies, and field activities, consolidated to create one set of financial statements.[1] These consolidated financial statements are referred to as the DoD Agency-Wide financial statements. In addition to the DoD Agency-Wide financial statements, many DoD Components prepare stand-alone financial statements specific to their funds, often referred to as reporting entities, to meet Federal or DoD reporting requirements. Figure 3 identifies and explains key sections of the FY 2021 DoD Agency Financial Report.

Figure 3. Significant Sections of the DoD Agency Financial Report

Management's Discussion and Analysis

- Provides a high-level overview of the DoD's operations and financial performance.

Financial Statements

- Consolidated Balance Sheet - documents the value of assets and liabilities that the DoD has as of September 30, 2021.
- Consolidated Statement of Net Cost - identifies costs, by specific program, to operate the DoD.
- Consolidated Statement of Changes in Net Position - 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.
- Combined Statement of Budgetary Resources - provides information about how the DoD received its budgetary resources, the status of budgetary resources at the end of the fiscal year, and the relationship between the budgetary resources and the outlays made against them.

Notes to the Financial Statements

- Provides important disclosures and details related to the information reported on the DoD's consolidated financial statements.

Required Supplementary Information

- Provides information on other supplementary topics to enhance understanding of the DoD's financial operations, condition, and position.

DoD OIG Audit Report

- Written by the DoD OIG, presents the results of the DoD OIG's audit of the DoD Agency–Wide financial statements and notes to the financial statements.

Other Sections

- Other Information - 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.
- Summary of the DoD Inspector General, "Fiscal Year 2022 Top Management Challenges" - contains a statement of what the DoD Inspector General considers the most serious management and performance challenges facing the DoD.
- Appendixes - contain a list of reporting entities, acronyms, and the Security Assistance Accounts financial statements and notes. The Security Assistance Accounts financial statements are not scheduled to undergo a full financial statement audit until FY 2022.

Source: The DoD OIG.

[1] DoD Component is a Military Department, Defense Agency or field activity such as the Defense Logistics Agency, a Combatant Command, or other organizational entity within the DoD. A reporting entity is the financial statement entity, such as the Defense Logistics Agency general fund.

The DoD reporting entities included in the DoD Agency-Wide financial statement audit either receive a stand-alone audit or are audited as part of the DoD-wide consolidated audit. For the FY 2021 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 reporting entities.

The DoD OIG contracted with and oversaw 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 reporting entities, DoD management decided that 17 additional DoD reporting entities would submit audited financial statements to the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD (DoD Comptroller), including, among other reporting entities:

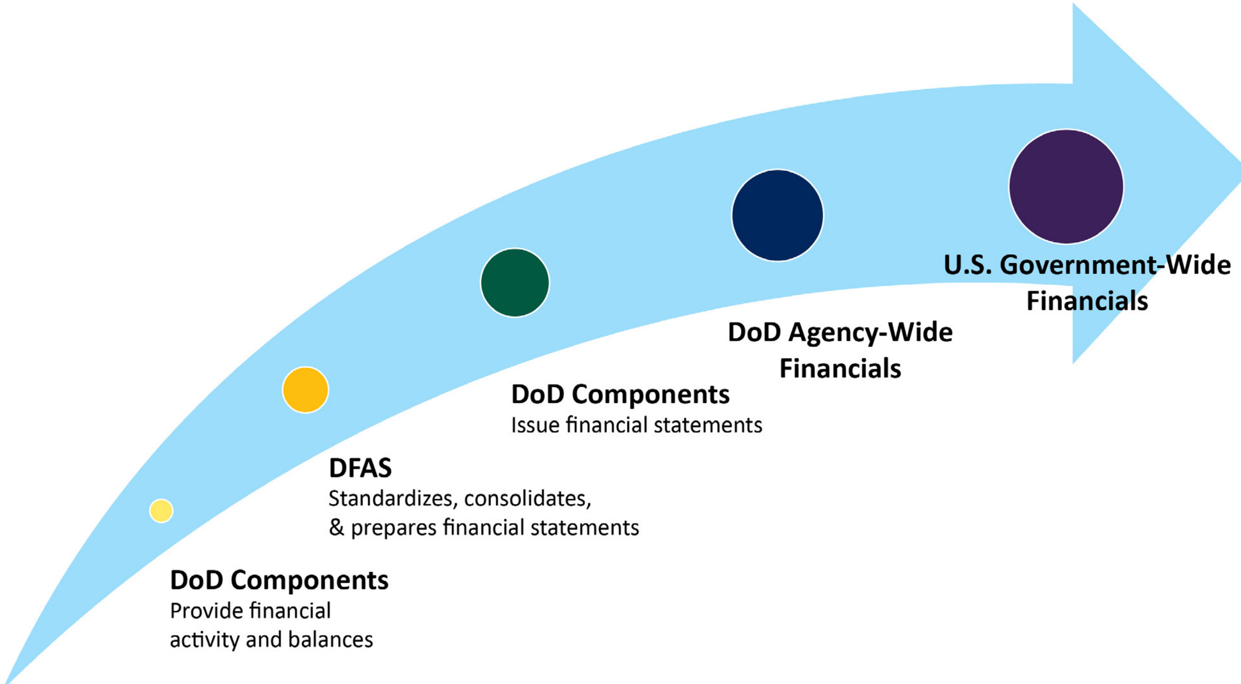
- Defense Information Systems Agency General Fund and Working Capital Fund,
- U.S. Special Operations Command General Fund, and
- Defense Logistics Agency General Fund, Working Capital Fund, and National Defense Stockpile Transaction Fund.

The reporting entities that do not receive stand-alone audits, such as Defense Advanced Research Projects Agency, Defense Acquisition University, and Military Housing Privatization Initiative, as shown in Figure 6, are included in the consolidated audit of the DoD Agency-Wide financial statements. Therefore, the DoD OIG performs select audit procedures over activities and balances of these Components as part of the DoD Agency-Wide financial statements audit.

To begin the process for preparing financial statements, reporting entities submit their financial statement-related data to the Defense Finance and Accounting Service (DFAS). Next, DFAS standardizes the data and prepares the consolidated DoD Agency-Wide financial statements. In addition, DFAS works with the stand-alone Components to prepare Component-level financial statements.[2] DFAS submits the DoD Agency-Wide financial statements and supporting financial information to the Department of the Treasury (the Treasury) for inclusion in the Consolidated Financial Statements of the U.S. Government. Figure 4 provides a high-level illustration of the process for preparing the financial statements.

[2] DFAS does not prepare the financial statements of the U.S. Army Corps of Engineers Civil Works. The U.S. Army Corps of Engineers finance center prepares the U.S. Army Corps of Engineers Civil Works financial statements.

Figure 4. Key Steps for Preparing the DoD Financial Statements



Source: The DoD OIG.

The DoD OIG and the IPAs audit the financial statements of the DoD and its Components in accordance with auditing standards and requirements issued by various Federal regulatory agencies, including the Government Accountability Office and the Office of Management and Budget (OMB).

The IPAs audit the DoD reporting entities they are contracted to audit. The DoD OIG oversees IPAs that perform select reporting entity audits by verifying the firm's compliance with applicable auditing standards and requirements, including the contract requirements. The DoD OIG's oversight procedures include attending meetings between the IPAs and the Component being audited and reviewing the IPAs' reports and audit documentation, including the results of their testing procedures. In addition, the DoD OIG uses the results of the Component-level audits in combination with results from its own audit procedures to determine whether the DoD Agency-Wide financial statements are presented fairly.

Understanding Financial Statement Audit Results

The DoD OIG and the IPAs conducted audits of the DoD Agency-Wide and DoD Component-level financial statements to:

- express an opinion on whether the Agency-Wide and associated Component-level 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.

Understanding the Types of Audit Opinions

When performing a financial statement audit, the auditors can express one of the following opinions on the financial statements.

1. **Unmodified opinion**. Auditors express an unmodified opinion, sometimes referred to as a clean opinion, when they conclude that management has presented the financial statements fairly and in accordance with GAAP.
2. **Modified opinions**.
    - **Qualified opinion**. Auditors give management qualified opinions when:
        - auditors obtain sufficient and appropriate evidence and conclude that material misstatements are not pervasive to the financial statements; or
        - auditors are unable to obtain sufficient appropriate evidence to support an opinion, but conclude that the possible effects of undetected material misstatements on the financial statements are not pervasive.
    - **Adverse opinion**. Auditors express an adverse opinion when they conclude that misstatements are both material and most likely widespread in the financial statements.
    - **Disclaimer of opinion**. Auditors express a disclaimer of opinion when they are unable to obtain sufficient appropriate evidence to support an opinion and conclude that the possible effects of undetected misstatements on the financial statements could be both material and pervasive.

In FY 2021, the DoD OIG issued a disclaimer of opinion on the FY 2021 DoD Agency-Wide Financial Statements.

In FY 2021, the DoD OIG issued a disclaimer of opinion on the FY 2021 DoD Agency-Wide Financial Statements. The DoD OIG issued this opinion because multiple DoD reporting entities that account for the majority of the DoD's balances continued to have unresolved accounting issues and material weaknesses that prevented them from providing sufficient and appropriate evidence to support the balances presented on their respective financial statements.

Understanding Deficiencies in Internal Controls and Material Weaknesses

In conducting an audit, an auditor typically considers whether internal controls are designed and operating effectively; however auditors do not provide an opinion on the overall effectiveness of internal controls. Rather, auditors issue notices of findings and recommendations (NFRs) to help the DoD understand and address internal control deficiencies. A deficiency in internal controls over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of operations, to prevent or detect misstatements in a timely manner. Auditors evaluate and classify identified deficiencies in internal controls based on the severity of the deficiency. Figure 5 lists the three classifications of deficiencies in internal controls from the least to the most severe.

Figure 5. Three Classifications of Deficiencies in Internal Control

Deficiency in Internal Control	A deficiency in the design or operation of a control exists when it 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.
Significant Deficiency	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.
Material Weakness	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.

Source: The DoD OIG.

While auditors do not provide an opinion on the overall effectiveness of internal controls, auditing standards require auditors to issue a report on internal control over financial reporting that identifies the significant deficiencies and material weaknesses identified during an audit. In the results section of this report, Table 2 lists all 28 material weaknesses and 4 significant deficiencies that the DoD OIG identified during the DoD's FY 2021 Agency-Wide financial statement audit.

It is important to note that auditors follow up on prior-year findings in each audit. From year to year, the level of audit testing can change; therefore, comparing a Component's results from one year to the next year does not always provide an accurate depiction of the progress from year to year. For example, as testing continues to expand, the DoD and its Components can potentially measure progress toward a clean audit opinion in additional ways, such as the percentage of balances tested, or that remain untested. The information included in the following results section of this report describes why the DoD OIG provided the DoD with a disclaimer of opinion in FY 2021.

Results of FY 2021 Audits

The DoD OIG oversaw the following IPA firms' financial statement audits of 24 DoD reporting entities in FY 2021.[3]

- Cotton & Company, LLP
- Ernst & Young, LLP
- Grant Thornton, LLP
- Kearney & Company, P.C.
- KPMG, LLP; and
- RMA Associates, LLC

In addition, the DoD OIG performed a comprehensive audit of the DoD Agency-Wide financial statements, which included financial information consolidated from every DoD reporting entity. This section of the report discusses the results of the FY 2021 DoD Component and DoD Agency-Wide Financial Statement Audits, any progression or regression from FY 2020, and suggestions for the DoD and its Components to help them achieve financial statement auditability and obtain clean opinions.

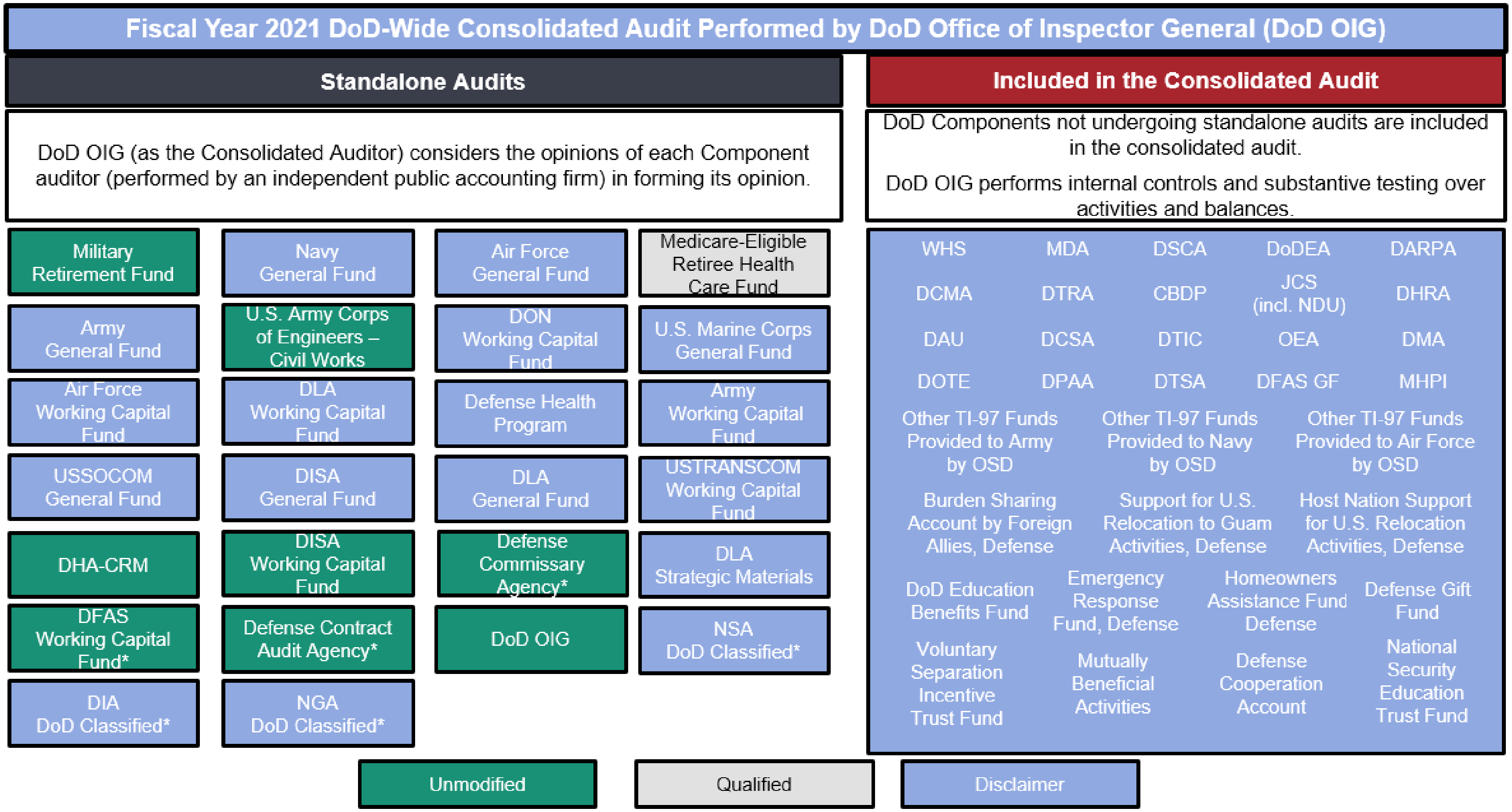
FY 2021 DoD Component Audit Results

In FY 2021, the DoD did not see any changes in audit opinions. As shown in Figure 6, DoD reporting entities received 8 clean opinions, 1 qualified opinion, and 17 disclaimers of opinion.

DoD reporting entities received 8 clean opinions, 1 qualified opinion, and 17 disclaimers of opinion.

[3] The 24 reporting entities consist of 20 DoD reporting entities and 4 sub-allotted fund financial statements.

Figure 6. FY 2021 DoD Agency-Wide Consolidated Financial Statement Audit Performed by the DoD OIG



* The DoD OIG does not oversee the financial statement audits of these DoD reporting entities.
Source: Office of the Under Secretary of Defense (Comptroller).

In FY 2021, the DoD had a stated goal to obtain an unmodified opinion for the Defense Information Systems Agency (DISA) General Fund. As shown in Figure 6, the DoD did not meet that goal and DISA General Fund received a disclaimer of opinion.

Collectively, in FY 2021, the DoD OIG and IPAs issued 3,368 NFRs to the DoD and its Components. The NFRs describe identified deficiencies and make recommendations to address them. In addition, the auditors identified 166 material weaknesses and 51 instances of non-compliance with laws and regulations, contracts, and grant agreements at the DoD and its Components.

During the FY 2021 audits, auditors closed 808 prior-year NFRs, reissued 2,678 prior-year NFRs, and issued 690 new NFRs. Table 1 provides the number of material weaknesses, the number of instances of non-compliance, and the number of NFRs for the DoD and each of the Component audits overseen by the DoD OIG in FYs 2020 and 2021.

Table 1. Total Deficiencies Identified in FYs 2020 and 2021

Component[1]	FY 2020			FY 2021		
	Material Weaknesses[3]	Non-Compliance[3]	NFRs	Material Weaknesses[3]	Non-Compliance[3]	NFRs
Department of the Army[1]	24	4	458	27	4	445
Department of the Navy[1]	28	4	1,160	27	4	1,121
Department of the Air Force[1]	22	4	521	19	4	476
U.S. Marine Corps	8	4	151	8	2	194
U.S. Army Corps of Engineers[2]	10	12	57	6	10	56
Defense Health Program	11	4	155	11	5	111
Defense Information Systems Agency[1]	10	6	69	8	4	67
Defense Logistics Agency[1]	20	6	457	20	6	445
U.S. Special Operations Command[1]	5	2	101	5	2	130
U.S. Transportation Command	5	2	161	6	2	138
Defense Health Agency-Contract Resource Management	0	0	13	0	0	11
Medicare-Eligible Retiree Health Care Fund	1	1	14	1	1	15
Military Retirement Fund	0	0	10	0	0	11
Agency-Wide	26	7	200	28	7	148
Total	**170**	**56**	**3,527**	**166**	**51**	**3,368**

[1] These DoD Components received separate opinions for each of their fund types, as indicated in Figure 6. We combined the deficiencies identified from all of the funds into a summary total for each DoD Component.

[2] The total material weaknesses, instances of non-compliance, and NFRs for the U.S. Army Corps of Engineers includes those from both Civil Works and Military Programs' sub-allotted fund accounts.

[3] The DoD Agency-Wide and multiple reporting entities can have the same material weakness and non-compliance issues reported. As a result, individual material weaknesses and noncompliance issues may be reported multiple times for some Components.

Note: The Army sub-allotted financial activity did not undergo a full financial statement audit in FY 2021.

Source: The DoD OIG.

FY 2021 DoD Agency-Wide Audit Results

The DoD OIG identified 28 material weaknesses and 4 significant deficiencies in FY 2021.

On November 15, 2021, the DoD OIG issued a disclaimer of opinion on the FY 2021 Agency-Wide Financial Statements, meaning the DoD was unable to provide sufficient evidence for the auditors to support an opinion. The DoD OIG identified 28 material weaknesses and 4 significant deficiencies in FY 2021. Of the material weaknesses and significant deficiencies identified:

- 25 material weaknesses and 2 significant deficiencies were repeated from FY 2020;
- 2 significant deficiencies from FY 2020 were upgraded to material weaknesses;
- 1 new material weakness and 1 new significant deficiency were reported; and
- 1 material weakness from FY 2020 was downgraded to a significant deficiency.

In FY 2020, the DoD OIG reported Legal Contingencies as a significant deficiency. During the FY 2021 audit, the DoD OIG identified additional control deficiencies and differences in the reporting of Contingent Legal Liabilities at the Component and Agency-Wide levels. As a result, the DoD OIG upgraded Legal Contingences to a material weakness and retitled the weakness Contingent Legal Liabilities.

In FY 2020, the DoD OIG reported Reconciliation of Net Cost of Operations to Outlays as a significant deficiency. The reconciliation of net cost (reported on the Statement of Cost) and net outlays (reported on the Statement of Budgetary Resources) clarifies the relationship between budgetary and financial accounting information. In FY 2020, we identified a $4.5 billion unexplained difference between the Statement of Net Cost and the Statement of Budgetary Resources. In FY 2021, this unexplained difference increased to $9.9 billion. As a result, the DoD OIG upgraded Reconciliation of Net Cost of Operations to Outlays to a material weakness in FY 2021.

The DoD OIG reported Financial Statement Compilation as a new material weakness in FY 2021. The DoD OIG reported that DoD and DFAS management lacked controls and documented processes over the compilation of Component-level financial information, and as a result, the DoD did not correctly compile Component financial information to produce the Agency-Wide financial statements.

The DoD OIG reported the Defense Agency Deposit Fund Accounts as a new significant deficiency in FY 2021. The DoD OIG reported that in FY 2020, DoD management issued a policy requiring all deposit fund activity to be reported at the consolidated level without considering the impact to Component financial statements. As a result, auditors for certain Components determined that the policy did not comply with GAAP for some business processes. Additionally, the DoD OIG reported that DFAS did not have controls to prevent or resolve abnormal balances before reporting balances and reconciling them with the Treasury. As a result, the DoD was unable to support the Defense agency deposit fund account balances.

In FY 2020, the DoD OIG reported the Military Housing Privatization Initiative as a material weakness because, as part of the initiative, the DoD did not report real property transferred to private entities on the Agency-Wide Balance Sheet. However, in FY 2021, the DoD processed a $7.9 billion adjustment to correct this issue. As a result, the DoD OIG downgraded the Military Housing Privatization Initiative material weakness to a significant deficiency in FY 2021. It remains a significant deficiency because the DoD did not properly report its share of profits and losses or report complete and accurate disclosures required by GAAP.

Table 2 lists the 28 material weaknesses and 4 significant deficiencies that the DoD OIG identified during the DoD's FY 2021 Agency-Wide financial statement audit, the classification or category of the deficiency, and the current condition. In the Significant Material Weaknesses section of this report, we provide a summary of several repeat material weaknesses that the DoD determined it must correct to obtain a clean audit opinion. The DoD OIG Audit Report, which includes material weaknesses and significant deficiencies, is published within the DoD Agency Financial Report, and is available at https://comptroller.defense.gov/odcfo/afr2021.aspx.

Table 2. Agency-Wide Deficiencies

Deficiency	Deficiency Category	FY 2021 Condition
Legacy Systems	Material Weakness	Repeat
Configuration Management and Security Management	Material Weakness	Repeat
Access Controls	Material Weakness	Repeat
Segregation of Duties	Material Weakness	Repeat
Universe of Transactions	Material Weakness	Repeat
Financial Statement Compilation	Material Weakness	New
Fund Balance With Treasury	Material Weakness	Repeat
Suspense Accounts	Material Weakness	Repeat
Inventory and Stockpile Materials	Material Weakness	Repeat Retitled from FY 2020
Operating Materials and Supplies	Material Weakness	Repeat
General Property, Plant, and Equipment	Material Weakness	Repeat
Real Property	Material Weakness	Repeat
Government Property in the Possession of Contractors	Material Weakness	Repeat
Joint Strike Fighter Program	Material Weakness	Repeat
Contingent Legal Liabilities	Material Weakness	Upgraded to Material Weakness Retitled from FY 2020
Accounts Payable	Material Weakness	Repeat
Environmental and Disposal Liabilities	Material Weakness	Repeat
Beginning Balances	Material Weakness	Repeat

Table 2. Agency-Wide Deficiencies (cont'd)

Deficiency	Deficiency Category	FY 2021 Condition
Unsupported Accounting Adjustments	Material Weakness	Repeat
Intragovernmental Transactions and Intradepartmental Eliminations	Material Weakness	Repeat Retitled from FY 2020
Gross Costs	Material Weakness	Repeat
Earned Revenue	Material Weakness	Repeat
Reconciliation of Net Cost of Operations to Outlays	Material Weakness	Upgraded to Material Weakness
Budgetary Resources	Material Weakness	Repeat
Service Organizations	Material Weakness	Repeat Retitled from FY 2020
Entity-Level Controls	Material Weakness	Repeat
DoD-Wide Oversight and Monitoring	Material Weakness	Repeat
Component-Level Oversight and Monitoring	Material Weakness	Repeat
Transition to Risk Management Framework	Significant Deficiency	Repeat
Defense Agency Deposit Fund Accounts	Significant Deficiency	New
Accounts Receivable	Significant Deficiency	Repeat
Military Housing Privatization Initiative	Significant Deficiency	Downgraded to Significant Deficiency

Source: The DoD OIG.

Finally, the DoD OIG identified seven instances of non-compliance with laws and regulations across the DoD in FY 2021. Specifically, the DoD did not comply with the:

- Federal Managers' Financial Integrity Act of 1982;
- Federal Financial Management Improvement Act of 1996;
- Antideficiency Act;
- Federal Information Security Modernization Act of 2014;
- Debt Collection Improvement Act of 1996;
- Prompt Payment Act; or
- Coronavirus Aid, Relief, and Economic Security Act.[4]

For example, the Coronavirus Aid, Relief, and Economic Security Act requires the DoD to report certain financial information to OMB, the Treasury, and Congress. During FY 2021, DoD management represented that it did not have the mechanisms within its financial reporting systems to track transactions related to the Act and separately report the impact on the DoD's financial statements.

[4] The DoD self-reported that it did not comply with the Federal Managers' Financial Integrity Act of 1982, the Federal Financial Management Improvement Act of 1996, and the Antideficiency Act.

Significant DoD Material Weaknesses

For FY 2021, DoD management developed and prioritized corrective actions to improve the DoD's financial management operations based on the 28 material weaknesses identified in FY 2020. Of the material weaknesses identified during the FY 2020 financial statement audit, the DoD prioritized and focused its remediation efforts on the following seven weaknesses during FY 2021.

- Information Technology (IT)
- Fund Balance With Treasury (FBWT)
- Inventory and Operating Materials and Supplies
- Real Property
- Government Property in the Possession of Contractors (GPIPC)
- Joint Strike Fighter (JSF) Program
- Oversight and Monitoring

The DoD has known many of these focus areas were roadblocks to its auditability since at least 2005.

While the full scope financial statement audits started in FY 2018, the DoD has known many of these focus areas were roadblocks to its auditability since at least 2005. In 2005, the OUSD(C)/CFO established the Financial Improvement and Audit Readiness (FIAR) Directorate to manage, integrate, and implement DoD-wide financial improvement efforts. Between 2005 and 2021, the FIAR Directorate published periodic reports that described financial statement deficiencies, corrective actions taken, and actions the DoD plans to take to remediate the deficiencies. In its first FIAR report, dated December 2005, the DoD acknowledged that IT, FBWT, Inventory and Operating Materials and Supplies, Real Property, and GPIPC were significant roadblocks to its auditability goals. These material weaknesses continue to exist 17 years later and are preventing the DoD from efficient and effective financial management and preventing progress toward receiving a clean audit opinion.

Because the DoD identified these as priority areas, we provide a summary and status of each material weakness and explaining what the DoD needs to do to remediate the weakness. Understanding and resolving these material weaknesses is key to the DoD obtaining a clean audit opinion in the future.

Information Technology

IT systems enable the DoD to effectively account for and report its financial transactions. The DoD assumes significant risk to its operations and assets when IT controls are ineffective. For example, users with unnecessary access to financial systems could modify files containing sensitive information, allowing payments and collections to be lost, stolen, or duplicated. Ineffective IT controls also prevent the DoD from defending its own networks, systems, and information from cyber attacks.

The DoD does not own or control all of the systems it uses to process financial transactions. In addition, the DoD rarely processes financial transactions using only one IT system. In FY 2021, the DoD reported that it used 299 separate IT systems to support the financial statements, 38 of which were owned by non-DoD entities. Because of the number of DoD systems, and the lack of management over non-DoD systems, it is critical that the DoD develops, implements, and maintains effective controls to ensure that data flows between systems correctly and is accurately reported on the DoD's financial statements.

Information Technology Material Weaknesses

For the last 3 years, the DoD has prioritized its efforts on remediating Configuration Management and Security Management, Access Controls, and Segregation of Duties material weaknesses. The DoD did not significantly improve its IT systems; therefore, the DoD OIG reissued four material weaknesses in FY 2021. While the DoD stated in the 2021 FIAR report that it was making progress, the number of the DoD's IT NFRs remained consistent between FYs 2020 and 2021. Figure 7 provides a description of each of the four material weaknesses and the DoD's efforts to remediate the weakness.

Figure 7. Information Technology Material Weaknesses

Configuration and Security Management	**Controls that prevent unauthorized changes to systems and aid in assessing risk, developing and implementing security procedures, and monitoring effectiveness.**

- **Deficiency:** The DoD Components lacked effective configuration and security management controls.
- **Remediation Efforts:** The DoD did not provide any evidence to indicate that it implemented remediation efforts. The DoD did not have an Agency-Wide corrective action plan to remediate this. material weakness.

Access Controls	**Controls that ensure roles for authorized users are reasonable and controls that prevent unauthorized users from accessing data, equipment, and facilities.**

- **Deficiency:** DoD Component personnel did not perform comprehensive periodic reviews of all users with access to key information systems to validate for appropriately assigned user access and roles.
- **Remediation Effort:** DoD management continues to work with DoD Components to monitor and resolve high-risk findings by combining information from various information systems to store and monitor user access rights across the DoD. The DoD plans to fully implement the solution by the beginning of FY 2027.

Segregation of Duties	**Controls that prevent system users from having conflicting key roles and functions.**

- **Deficiency:** Components did not develop processes to properly identify conflicting roles or segregate key function roles. Additionally, Components did not prioritize the proper and effective implementation of segregation of duties.
- **Remediation Effort:** The DoD plans to address this material weakness in concert with its efforts to remediate its access controls marerial weakness.

Legacy Systems	**Systems scheduled for retirement within 36 months or not originally designed for the development of auditable financial statements.**

- **Deficiency:** DoD management did not consider compliance with Federal system requirements when defining legacy systems; therefore, did not properly classify at least 140 systems as legacy systems. Additionally, DoD management extended retirement dates to September 2021 for 9 systems.
- **Remediation Effort:** The DoD did not provide any evidence to indicate that it implemented remediation efforts. DoD management is currently revising corrective plans and the associated milestones.

Source: The DoD OIG.

It is important that the DoD develop and complete corrective actions to remediate each of its material weaknesses, not only to obtain a clean opinion, but also to comply with federal financial management system requirements. To improve and simplify its IT infrastructure, the DoD should prioritize replacing its legacy systems. Replacing legacy IT systems with compliant systems will enable the DoD to consistently generate timely, accurate, and useful information.

To improve and simplify its IT infrastructure, the DoD should prioritize replacing its legacy systems.

Retiring Legacy Systems

Some of the DoD's legacy systems were designed and implemented in the 1960s, and are not able to capture all of the transaction-level details needed to satisfy various accounting and reporting requirements. As a result, the DoD relied on manual processes to record and report the transactions in its accounting systems and on its financial statements. However, the DoD did not always have the necessary documentation for auditors to verify that DoD personnel recorded and reported the transactions correctly.

DoD management's corrective action plan stated that the DoD planned to resolve its Legacy System material weakness by March 2022. The DoD has historically underestimated the time it would take to retire certain legacy systems, often extending retirement dates into the next fiscal year. For example, DoD management extended retirement dates for nine systems from September 2020 to September 2021. As of November 2021, the DoD had not retired any of those nine systems. In addition, as of September 30, 2021, the DoD had scheduled at least 13 legacy systems for retirement after 2026. The DoD also categorized certain systems as legacy systems without considering the system's compliance with Federal financial management system requirements. For example, there were at least 140 systems that did not comply with certain Federal requirements but the DoD did not consider these systems as legacy because the DoD did not plan to retire them until FY 2036.

DoD management recognizes the risk that legacy systems pose to operations and is in the process of identifying, retiring, and replacing legacy systems. For example, the Marine Corps is migrating from its legacy general ledger systems to the Defense Agencies Initiative System in FY 2022. While this is a positive step, the DoD must do more to replace its legacy systems. The DoD will not be able to remediate its legacy systems material weakness until its legacy systems comply with Federal financial management system requirements. The DoD must reconsider its criteria for the categorizing legacy systems, develop a plan to replace legacy systems with systems designed to comply with Federal requirements, and validate its current remediation milestones.

Auditors base material weaknesses on examples of control deficiencies identified during the audits; as a result, the material weaknesses are not an exclusive list of all deficiencies in a system. To remediate its Configuration Management and Security Management, Access Controls, and Segregation of Duties material weaknesses, the DoD and its Components must consider the audit findings and recommendations more broadly. For example, DoD Components should proactively incorporate corrective action plans into other systems that may not be under review by auditors. It is not enough to address a 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.

Fund Balance With Treasury

The DoD reported a Fund Balance With Treasury (FBWT) of $623.2 billion on its DoD Agency-Wide Balance Sheet, as of September 30, 2021. The FBWT is composed of hundreds of individual accounts maintained by the Treasury that reflect the funds available for the DoD to spend. The DoD's FBWT account balances increase with collections and decrease with payments, much like a personal checking account. The DoD is required to reconcile its FBWT accounting records to the records maintained by the Treasury.

The DoD has struggled with reconciling its FBWT accounts for more than 15 years. In its first report in 2005, the FIAR Directorate identified FBWT as a material weakness. In FY 2021, the DoD OIG issued a repeat FBWT material weakness for the fourth consecutive year because the DoD did not have effective processes and controls in place to reconcile its FBWT accounts. In addition, the DoD OIG issued a separate material weakness related to suspense account transactions because, among other reasons, the DoD lacked effective controls to attribute these temporary holding accounts to the appropriate DoD reporting entities and research and resolve the transactions in accordance with Treasury Financial Manual requirements. Figure 8 includes common FBWT deficiencies that auditors identified in FY 2021, many of which DoD management has known about since 2005.

Figure 8. Common FBWT Deficiencies Identified in FY 2021

Key Issues:	Suspense Accounts	Statement of Differences (SOD)	Cash Management Report (CMR)
Definition	Suspense accounts temporarily hold unidentified transactions until the proper account is identified.	The SOD shows the differences between the DoD's and the Treasury's accounting records.	Report designed by the DoD to help the defense agencies reconcile their FBWT accounting records to that of the Treasury's.
Examples	Army did not effectively design and implement controls to timely detect and correct suspense account transactions, or ensure their completeness and accuracy.	The DLA erroneously excluded $4 million of SOD in its FBWT reconciliation because it lacked effectively designed controls.	DISA did not implement effective controls to ensure transactions on the CMR were properly included or excluded from the DISA financial statements.

Source: The DoD OIG.

DoD Components must reconcile their FBWT accounts to the balances reported by the Treasury to verify the integrity, including completeness and accuracy, of their financial data. However, Components do not always have adequate processes in place to research and resolve differences between their records and the Treasury's records. For example, in FY 2021, auditors determined that DoD Components—such as the Navy, Marine Corps, U.S. Transportation Command, and DLA—did not design adequate procedures to reconcile their FBWT accounting records with the Treasury's records. As a result, these Components were unable to ensure that their FBWT accounts were complete and accurate. Without effective reconciliation procedures, the DoD's FBWT records will continue to contain discrepancies and compromise the integrity of the DoD's financial statements. In addition, without accurate FBWT records, the DoD's spending decisions could result in overuse or underuse of DoD funds.

Per the 2021 FIAR report, the DoD plans to remediate its FBWT material weakness by the end of FY 2022 by developing new and strengthening existing processes to reconcile its accounting records with the Treasury's records. This plan includes developing a complete population of all of the DoD's collections and disbursements made throughout the year. To develop the population, the DoD used the Advancing Analytics tool, commonly referred to as Advana, which collects and stores data such as collections and disbursements from the many DoD financial management systems. However, the DoD has not fully implemented Advana throughout the DoD, and Advana does not enable its users to perform effective FBWT reconciliations. For example, in FY 2021 the DoD OIG determined that DoD Component personnel could not reconcile the population of Defense agency transactions, which included FBWT transactions, in Advana to their respective financial statements. The DoD must continue to enhance the completeness and accuracy of the data in its various DoD financial management systems because the quality of Advana's output will only be as good as the source data it collects.

In addition to developing a complete and accurate FBWT population, DoD management must enforce its FBWT policies. For example, DoD management required all Components to start submitting FBWT disbursement and collections transactions to the Treasury on a daily basis by the end of FY 2020. This policy's intent is to help DoD Components develop a complete population of FBWT transactions and improve the Components' ability to reconcile their FBWT accounting records with the Treasury's records. Most DoD Components have not fully implemented this policy. For example, the Air Force and the Marine Corps are not scheduled to fully implement this policy until October 2028, and the Army and the Navy are not scheduled to fully implement it until December 2030.

Finally, the DoD and its Components need to design, document, implement, and sustain their FBWT process and internal controls. Until the DoD and its Components do this the DoD will not be able to consistently reconcile with the Treasury and will continue to report inaccurate information in their financial statements.

Inventory and Related Property

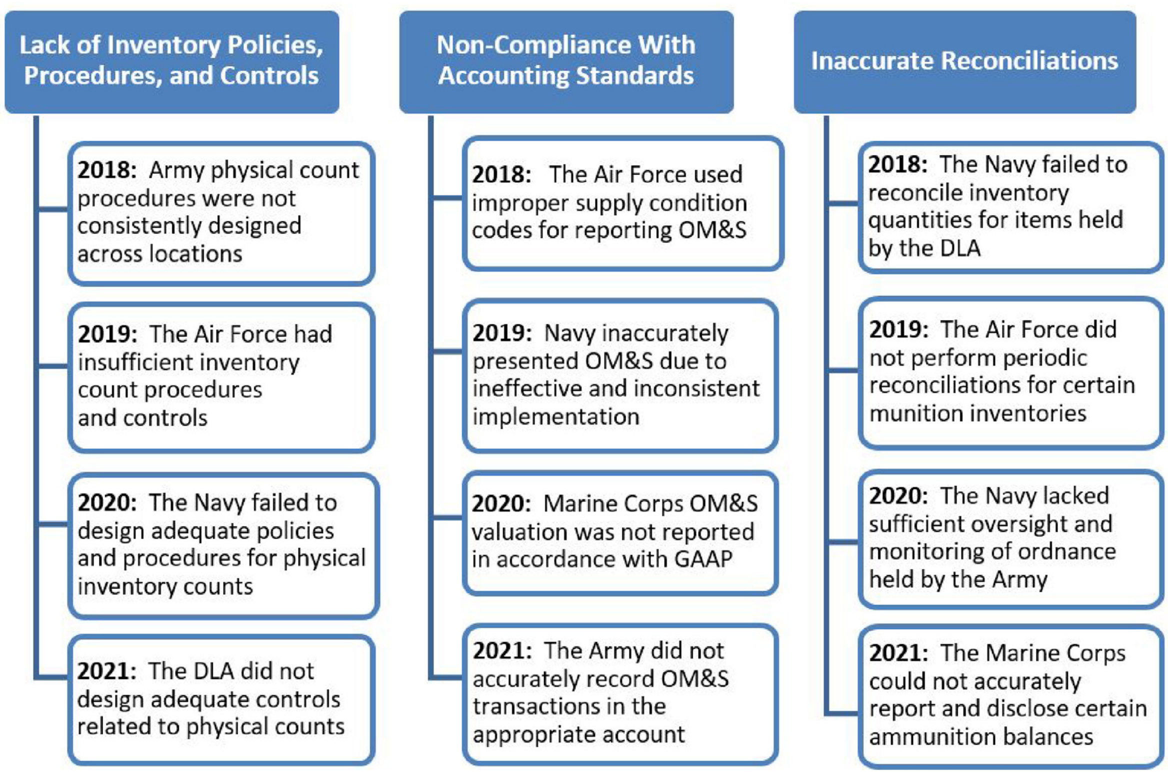
The DoD reported $326.9 billion in Inventory and Related Property on the DoD's FY 2021 Agency-Wide Balance Sheet. Inventory and Related Property consists of inventory, operating materials, supplies, and stockpile material. Inventory consists of items such as spare parts, clothing and textiles, and fuel. Operating materials and supplies include assets that the DoD uses for its operations, such as ammunition and missiles. Stockpile material consists of material that the DoD uses for its manufacturing operations, such as chemicals and metals.

In FY 2021, the DoD OIG issued a repeat Inventory material weakness for the fourth consecutive year because the DoD did not:

- provide adequate documentation to support the existence or completeness of its inventory records;
- properly account for or value its inventory; or
- implement policies and procedures to effectively reconcile its inventory.

The conditions that the DoD OIG identified in 2021 are consistent with the conditions that the DoD reported in 2005 and continue to be pervasive throughout DoD Components. Figure 9 demonstrates that the deficiencies identified by auditors year after year are consistent across the DoD Components.

Figure 9. DoD Component Inventory-Related Deficiencies From FY 2018 to FY 2021



Note: OM&S refers to Operating Materials and Supplies.
Source: The DoD OIG.

According to the June 2020 FIAR report, the DoD planned to complete a 100-percent physical count of all working capital fund inventories and general fund munitions, ordnance, and uninstalled engines. The DoD was unable to achieve this goal in FY 2020 due to limitations caused by the coronavirus disease–2019 pandemic. However, in its June 2021 FIAR report, the DoD reported it completed physical counts of 88 percent of working capital fund inventories, 99 percent of general fund munitions and ordnance, and 100 percent of spare engines. While the DoD made progress on its goal of completing this physical count and establishing an inventory reference point, the DoD has not fully realized the benefit of improving the existence and completeness of its inventory. For example, in FY 2021, KPMG identified inventory existence and completeness findings related to the Army's Inventory, such as ineffective inventory count reconciliations between systems and inconsistent documentation of specific inventory attributes.

Aside from affecting the DoD financial statements, inventory deficiencies can reduce the DoD's operational readiness. Without accurate quantities and locations of inventory, the DoD exposes itself to the risk that parts and supplies will not be available when Service members urgently need them. For example, in FY 2021, Ernst & Young determined that although the Navy's Inventory records showed eight guided missile fin assemblies at the contractor's site, a physical count revealed only two at the site.[5] In another example, the DLA did not accurately measure and record its inventory of strategic and critical stockpile materials, including ores, metals, and chemicals. By inaccurately measuring and recording the inventory of these items, the DLA could hinder the DoD's ability to respond to national emergencies by not having necessary supplies on hand. Finally, inaccurate quantities may cause the DoD to purchase inventory that it already owns, which is a waste of funds.

The DoD did not meet its FY 2020 goal of completing a 100-percent count of its Working Capital Fund Inventory and General Fund munitions, ordnance, and uninstalled engines. 96 percent of the DoD's Inventory was held by 10 Components that received an Inventory-related material weakness from their auditors in FY 2021. In some instances, auditors did not execute planned audit procedures in FY 2021 because the Components did not address conditions identified in prior years. For example, for certain inventory testing planned procedures in support of the FY 2021 DLA Working Capital Fund Audit, Ernst & Young did not select samples of in-transit inventory and verify the existence of inventory held by the third party due to unresolved findings in those areas.

The DoD adjusted its goal to resolve its Inventory material weakness from FY 2026 to FY 2028 because of its delay in implementing required policies.

The DoD adjusted its goal to resolve its Inventory material weakness from FY 2026 to FY 2028 because of its delay in implementing required policies. To address the weaknesses with its inventory processes, the DoD must identify which inventory policies and procedures need to be updated to be in compliance with GAAP and ensure that the applicable inventory guidance is consistently designed and implemented across the Components.

[5] A fin assembly enables a missile to adjust its course.

Real Property

The DoD reported $333.4 billion in Real Property assets as a portion of the General Property, Plant, and Equipment balance on the DoD's FY 2021 DoD Agency-Wide Balance Sheet. For financial reporting purposes, the DoD considers real property as assets it acquires at or in excess of $250,000, and that will provide a benefit to the DoD for 2 or more years. Real property assets generally include real estate assets, such as buildings, structures, and land.

In FY 2021, the DoD OIG issued a repeat Real Property material weakness for the fourth consecutive year because the DoD's real property was not:

- valued correctly;
- supported by sufficient documentation to verify that the DoD owned all of the assets;
- recorded promptly and accurately in the accounting system; or
- presented on the financial statements in accordance with financial reporting standards.

The DoD and its Components recognized many of these weaknesses in 2005; however, the DoD has not made significant progress in remediating its Real Property deficiencies. For example, in FY 2020, the DoD planned to conduct a full count of its Real Property assets to ensure that all of its assets were included in its property records. In addition, the DoD planned to implement a new system to account for its Real Property assets. However, in FY 2021, auditors determined that the DoD Components still could not completely and accurately record their Real Property within their accountable property systems of record because the Components had insufficient internal controls. In another example, in FY 2021 the DoD made a $5.1 billion adjustment to its net book value of Buildings, Structures, and Facilities, Construction-in-Progress, and General Equipment to correct previously recorded overstatements.

Without accurate Real Property records, the DoD does not know what property it has, the property's condition, and what property it needs to support its operations. For example, the Navy performed a 100-percent count of its real property that resulted in the correction of 16,000 real property records, enabling the Navy to re-purpose $29 million in FY 2020 for maintenance and replacement dollars. According to the FY 2021 DoD Agency-Wide Financial Report, the DoD plans to remediate its Real Property material weakness by FY 2025 through the development and implementation of DoD policies and procedures. Specifically, DoD management is developing DoD-wide manuals that help build a framework for managing and reporting real property data, as well as instructions to be implemented into operations to help Components account for and report Real Property assets in a complete and accurate manner. The DoD Components are working to correctly value their Real Property assets and reconcile the balances reported on their financial statements with the balances in their accounting systems.

While these actions are necessary, they are insufficient to remediate the deficiencies. DoD management must ensure that its policies and procedures are consistently implemented by
the Components. Component management must:

- design, document, and implement effective real property internal controls;
- perform effective reconciliations between balances reported on the financial statements and balances in the accounting systems;
- retain supporting documentation for real property transactions; and
- record real property transactions in their financial management system in a timely manner.

Government Property in the Possession of Contractors

The DoD's Inventory balance on the DoD Agency-Wide Balance Sheet includes both assets in the custody of the DoD and assets held by contractors on behalf of the DoD. Federal regulations allow for this contractor-held arrangement, which is referred to as Government Property in the Possession of Contractors (GPIPC). While GPIPC does not have its own amount on the balance sheet, the DoD OIG identified a separate material weakness apart from the Inventory material weaknesses because GPIPC deficiencies have the potential to cause misstatements in the financial statements.

In 2005, the DoD first acknowledged that it did not report GPIPC accurately because the DoD did not have effective processes to reconcile its inventory records with the records maintained by its contractors. In FY 2021, the DoD OIG issued a GPIPC material weakness for the fourth consecutive year because the DoD Components did not:

- reconcile the GPIPC balances reported on their financial statements to a financial management system; or
- support the existence and completeness of GPIPC balances reported on their financial statements with adequate documentation.

The DoD has not made significant progress in remediating its GPIPC material weakness because it relies too heavily on its contractors to maintain inventory records on its behalf. In addition, the DoD does not always verify that the inventory records belonging to its contractors are complete and accurate. For example, in FY 2021, Ernst & Young identified irreconcilable differences between the Air Force's inventory records and those of Air Force contractors, such as duplicate inventory records, incorrect inventory locations, and incorrect inventory quantities. In another example, in FY 2019, Ernst & Young reported that the Navy did not validate the existence, completeness, accuracy, and value of Trident Missile components in the custody of a contractor. In 2021, auditors reissued the same deficiency indicating that the Navy had not fully remediated the deficiency.

The GPIPC deficiencies identified during the financial statement audits have a direct operational impact on the DoD. For example, without accurate accounting records for GPIPC, the DoD could understate its property held by contractors and potentially buy more than it needs, or vice versa, and not be prepared to meet future needs.

According to the FY 2021 Agency-Wide Financial Report, the DoD plans to remediate this material weakness by FY 2026 by clarifying and enhancing the existing guidance on accounting for GPIPC and developing data standards and automated solutions for reporting GPIPC. While it is important for the DoD to continuously monitor and update its policies, the DoD and its Components must also:

- maintain supporting documentation for all inventory transactions;
- properly value their inventory;
- record accurate locations for their assets;
- ensure that contracts require contractors to maintain complete and accurate GPIPC records; and
- monitor and report all assets held by their contractors by performing accurate inventory counts and reconciliations.

The DoD must remediate the GPIPC material weakness; otherwise this material weakness could cause the DoD to miss inventory-related corrective action milestones as well.

Joint Strike Fighter Program

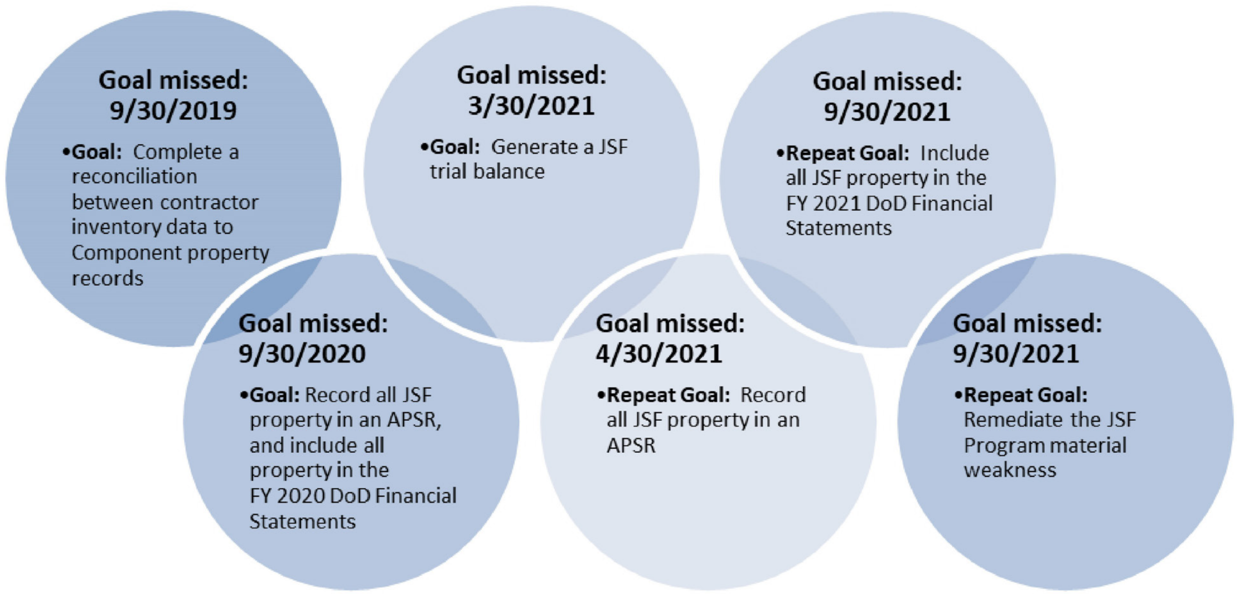
The Joint Strike Fighter (JSF) Program is a multiservice and multinational acquisition to develop and field the next-generation strike fighter aircraft, the F-35. The JSF Program Office, led by the Program Executive Officer, is responsible for total life cycle management of the JSF Program, including coordination of program objectives, requirements, schedules, and budgets.

As discussed in the Inventory and GPIPC sections of this report, the DoD has had long-standing deficiencies in accounting for inventories, including Inventory and GPIPC associated with the JSF Program. However, during the FY 2019 financial statement audit, the JSF Program was identified as an Agency-Wide material weakness because JSF property was not properly reflected in the DoD financial statements. The DoD's goal in FY 2020 was to record all JSF property within an accountable property system of record. However, in FY 2021, the JSF Program property was still not accounted for or recorded on the DoD's financial statements. The DoD missed its goal for the third consecutive year, as shown in Figure 10. Because of this, the DoD OIG issued a JSF Program material weakness in FY 2021 for the third consecutive year. Specifically, the DoD did not:

In FY 2021, the JSF Program property was still not accounted for or recorded on the DoD's financial statements.

- properly account for, manage, or record program assets in a financial management system; or
- report all of the JSF Program assets on its financial statements.

Figure 10. Joint Strike Fighter Program Missed Goals



Note: ASPR refers to an Accountable Property System of Record.
Source: The DoD OIG.

The DoD again adjusted its goal to remediate this material weakness from FY 2022 to FY 2023. In FY 2021, the DoD performed an inventory count to support the existence of JSF assets, but was unable to verify the completeness and value of the assets. While the DoD should continue its efforts, it must also:

- develop systems, policies, and processes to track JSF assets;
- obtain necessary information from the contractors to properly value each asset;
- record the program assets in a financial management system; and
- develop the program's accounting and financial reporting solutions that comply with GAAP.

To further complicate remediation efforts, the National Defense Authorization Act for FY 2022 requires the JSF Program Office to transfer all functions related to the management, planning, and execution of sustainment activities to the Secretary of the Air Force and the Secretary of the Navy by October 2027. It also requires the JSP Program Office to transfer all functions related to the program acquisition to the same transferees by October 2029. As a result, the DoD should consider how this transfer of responsibility will affect its corrective action plans and remediation efforts.

Oversight and Monitoring

For the third consecutive year, the DoD OIG identified material weaknesses related to Component and DoD–Wide oversight and monitoring. Because of the complexity and size of the DoD, DoD and Component management must continuously update their internal controls to adapt to new challenges, laws, and performance requirements.

Component-Level Oversight and Monitoring

Component management uses internal controls to ensure that day-to-day operations are effective, which includes reporting reliable financial information and complying with applicable regulations. Management must continuously monitor the design and implementation of its internal controls to ensure that they operate as intended.

Internal controls not only affect a Component's financial statements, but also have an operational impact. For example, effective internal controls over FBWT help management ensure it is accurately accounting for cash by reconciling their records to the Treasury's records. Without effective controls, the DoD is at risk of operating in an inefficient and ineffective manner.

In FY 2021, the DoD Components did not provide timely and sufficient oversight of their entity's internal control environments to identify potential risks and deficiencies that could negatively affect their financial statements. Because the DoD's internal controls did not comply with OMB Circular No. A-123, the DoD OIG issued a Component-level Oversight and Monitoring material weakness for the third consecutive year.[6] When the DoD first received this material weakness, the DoD intended to remediate the weakness by FY 2021, but moved the date to FY 2026 to give the Components more time to implement corrective actions.

DoD Component management developed audit roadmaps, which depict corrective action completion dates by fiscal year and audit focus area for their respective Components. However, the roadmaps are often vague, inconsistent, and lack details necessary to understand how the Components plan to remediate their individual material weaknesses. In addition, the Component roadmaps project remediation dates for certain material weaknesses that are too optimistic and likely unobtainable. These unrealistic dates directly affect management's ability to establish realistic timeframes for material weakness remediation at the DoD-wide level. The Components must improve their roadmaps to include detailed information, such as time-phased milestones, performance measures, and a discussion about risks and challenges of remediating the material weaknesses. This information will help DoD and Component management develop reasonable remediation dates and track progress.

DoD-Wide Oversight and Monitoring

DoD management must oversee and monitor the progress of DoD Components, to prevent inconsistencies between Components and erosion of previous progress. As an example of an inconsistency between Components, in FY 2018, the Navy began presenting single-year financial statements. The Air Force followed suit when it also changed course from presenting comparative statements to single-year statements in FY 2021. Single-year statements are not compliant with OMB Guidance. In addition, in FY 2021, the DoD OIG issued the DoD a material weakness on financial statement compilation because DoD management did not have controls

6 Office of Management and Budget Circular No. A-123, "Management's Responsibility for Enterprise Risk Management and Internal Control," July 15, 2016.

over compiling financial information at the Component level and did not have support for variances between Component financial statements and the Agency-Wide financial statements.

While the OUSD(C)/CFO used Component roadmaps to develop material weakness remediation strategies throughout the DoD, a DoD-wide roadmap did not exist for any of the DoD-level material weaknesses. In FY 2022, the OUSD(C)/CFO began to require their approval of all Component roadmap milestone changes, which will keep the OUSD(C)/CFO more informed of progress and material weakness remediation challenges; however, we believe that the DoD can and should do more. DoD management should set the direction for the Components and ensure that Components develop and implement internal controls, as well as execute DoD-wide policies and procedures. Because DoD-wide Oversight and Monitoring is directly linked to other material weaknesses, such as the FY 2021 Financial Reporting Compilation material weakness, the DoD must implement strong, sustainable corrective actions to remediate the DoD-wide Oversight and Monitoring material weakness. For example, DoD management should develop a DoD-wide roadmap, require Components to align their roadmaps, align Component corrective actions and goals, and develop stronger accountability for implementing corrective actions in order to meet its ultimate goal of achieving a positive audit opinion.

The Way Forward: Immediate Financial Management Improvement Needed

The DoD must make swift and aggressive changes to its accounting and financial management business processes to obtain and sustain auditability. After more than 15 years of the DoD and its Components performing audit readiness and remediation efforts, the DoD and most of its Components are still years away from clean audit opinions. In addition, the DoD and its Components have shown little progress toward financial management improvement, as indicated by the DoD's and its Components' progress in downgrading or closing material weaknesses and changes in audit opinions.

In this section, we discuss action the DoD and its Components should take to clearly demonstrate improvement in their financial management and progress toward financial statement accountability, including:

- developing reasonable, measurable, and consistent DoD-wide goals;
- holding DoD Components accountable using meaningful, consistent, and comparable criteria;
- developing, documenting, and sustaining internal controls in key business processes; and
- coordinating with appropriate regulatory agencies to overcome accounting challenges.

Developing Measurable Goals

As discussed earlier, the DoD has not developed or implemented reasonable, measurable goals that establish a clear path to strong financial management and ultimately a clean audit opinion. While the DoD and many of its Components have produced products that list "goals" and corrective actions, many of the goals only speak to the design of corrective actions rather than their implementation; for example, establishing goals to develop policies.

The DoD has known about many of its material weaknesses for 15 years or more, as evidenced in the 2005 FIAR report, and is still struggling to show measurable progress. For example, the OUSD(C)/CFO acknowledged a weakness associated with contract and vendor pay in its FYs 2018, 2019, 2020, and 2021 Agency Financial Reports. Each year, the DoD reported a corrective action, among other actions, to, "establish and publish a DoD Instruction setting policies, procedures, and data standards for purchase requests." While the DoD has reported its targeted correction date for the contract and vendor pay material weakness as FY 2025, the DoD has shown little progress toward completing its planned corrective actions.

The DoD must establish goals that can be measured and reported on annually until met and verified by auditors, and then develop new goals. For example, after receiving the results from the FY 2018 audit, the then Acting Secretary of Defense announced a measureable goal to conduct a 100-percent count of all Working Capital Fund inventory and all General Fund munitions, ordnance, and uninstalled engines in the DoD's and its contractors' possession, to establish a complete baseline of these assets. The DoD and its Components did not meet the goal in FY 2019 or FY 2020. In an FY 2021 FIAR Governance Board meeting, DoD personnel indicated that the DoD's new goal was to establish effective reconciliation procedures for its Working Capital Fund Inventory, which is not as specific and measurable as the prior goal established by the Acting Secretary of Defense.

Holding DoD Components Accountable

The National Defense Authorization Act for FY 2019 required the DoD to rank all Military Departments and Defense agencies in order of how advanced they were in achieving auditable financial statements and to report this information to Congress. The National Defense Authorization Act for FY 2020 made the ranking report to Congress an annual requirement and added reporting requirements to those Military Departments and Defense agencies that were ranked in the bottom 25 percent. Each Military Department and Defense agency in the bottom 25 percent of the ranking must report descriptions of their material weaknesses, the underlying causes of such weaknesses, and a plan for remediating such weaknesses.

The ranking report is one tool to measure DoD Components' progress toward auditable financial statements. However, the DoD must develop meaningful and consistent criteria for the ranking. For example, the OUSD(C)/CFO used different criteria each of the first 3 years it completed the ranking report. To illustrate, for the January 2020 ranking report, one of the factors the DoD used to rank Components was the number of material weaknesses each

Component received. This method was a disadvantage to Components whose auditors issued material weaknesses at a more granular level, resulting in a larger number of material weaknesses. However, for the January 2022 ranking report, the DoD used the number of material weaknesses eliminated or downgraded as one of the ranking factors. This method was a disadvantage to Components whose auditors issued material weaknesses at a less granular level. This inconsistency drives Components to focus on how auditors present material weaknesses rather than making meaningful progress toward auditability.

While the ranking report is a useful tool to promote transparency across the DoD, it does not establish the DoD's expectations for the Components or the consequences of not meeting those expectations. The DoD and its Components should look beyond how auditors can help to improve their ranking each year, and determine what the DoD's key expectations for the Components are and how to meet those expectations. In addition, DoD leadership should outline and communicate the consequences to Components if they fail to meet defined expectations.

While the ranking report is a useful tool to promote transparency across the DoD, it does not establish the DoD's expectations for the Components or the consequences of not meeting those expectations.

Developing 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 by each Component, location, or office. In this regard, the FIAR Governance Board, which is chaired by the USD(C)/CFO, brings together senior DoD financial management leaders, and senior representatives from the functional communities, such as acquisition, logistics, and policy, to enhance financial management and audit readiness efforts of the DoD and its Components.

The FIAR Governance Board is a great tool for the DoD to use to develop sustainable, lasting solutions in strategic priority areas, such as real property, inventory, GPIPC, and IT. These efforts must go beyond developing policies that each component can implement differently. For example, the DoD issued policy for managing IT access controls, but currently allows each Component to manage access controls according to its own risk assessments rather than making risk decisions supporting the needs of the DoD enterprise. However, the DoD plans to implement a DoD enterprise level solution by FY 2028.

In many instances, the DoD and its Components must develop sustainable solutions before resolving material weaknesses. For example, to use the one-time allowed alternative valuation methodology for real property, general equipment, inventory, and operating materials and supplies, the DoD and its Components must have a sustainable process for tracking and valuing their assets under the accounting standards prior to asserting that they are ready for the alternative valuation to be audited.

Developing sustainable business processes will also benefit the DoD by helping 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. In addition, it could also ensure consistency in the valuation of like items across Components.

To assist the DoD and its Components in developing sustainable business processes, the FIAR Governance Board has reviewed, and should continue to review, corrective action plans that address the root causes of weaknesses and inefficiencies within the DoD's business processes. The FIAR Governance Board should continue to use its meetings as a collaborative tool across the DoD. This collaboration should include discussions of lessons learned from the audits, 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.

Overcoming Accounting Challenges

As presented in Figure 2 of this report, the Secretary of Defense and the USD(C)/CFO are responsible for developing and overseeing the implementation of DoD–wide accounting and finance policies. As the DoD Agency-Wide and DoD Component financial statement audits continue, auditors will identify accounting challenges that must be addressed at a DoD-wide level and implemented consistently across the DoD Components. Such challenges may include accounting guidance and Congressional requirements.

The DoD and its Components must present their financial statements in accordance with GAAP, which is not always clear and can require interpretation. In addition, the DoD and its Components must follow laws, regulations, and guidance provided by Congress, the Treasury, and the OMB. When differences in the interpretation of accounting guidance or laws and regulations arise between the DoD and its Components, or the DoD and its auditors, the parties must coordinate with the appropriate authoritative organization to obtain guidance.

For example, DoD management determined that disclosing the Security Assistance Accounts financial statements in the DoD Agency Financial Report, rather than consolidating the information, was in accordance with GAAP and OMB guidance.[7] The DoD OIG believes that GAAP and OMB guidance require the DoD to consolidate the Security Assistance Account balances into the DoD financial statements. As of February 2022, DoD and DoD OIG management were working on a joint request to the OMB to obtain a clear interpretation of OMB guidance.

Some issues may require congressional action. For example, the November 15 deadline for financial statement reporting is reasonable for entities that have been receiving clean audit opinions for a few years. However, the DoD and many of its Components have never received

[7] The Security Assistance Accounts 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.

a clean audit opinion. Having only 45 days between the fiscal yearend and the issuance of financial statements has not allowed the DoD sufficient time to present balances and supporting transaction-level detail for audit. Because auditors must test yearend balances through at least the first few cycles of the DoD and its Components receiving clean audit opinions, the DoD and its Components may require more than 45 days to issue audited financial statements.

For example, DISA requested an extension to issue its Working Capital Fund financial statements for both FYs 2020 and 2021 because management could not provide FBWT universes of transactions and documentation in sufficient time for auditors to complete the audit procedures. In another example, the Marine Corps recently received legislative and OMB approval to undergo a 2-year audit cycle and not issue financial statements in FY 2022. This additional time will allow the Marine Corps to ensure that controls are in place and present the necessary information to the auditors in time for them to complete testing and an issue an opinion in FY 2023.

As the DoD and its Components identify accounting challenges, DoD management must prioritize the challenges from the most impactful to the least impactful. Additionally, the DoD and its Components should engage with each other, their auditors, and the appropriate authoritative entities to quickly resolve issues or seek clarifying guidance.

Conclusion

During FY 2021, the DoD underwent a full financial statement audit for the fourth consecutive year. As in prior years, the DoD received a disclaimer of opinion on the Agency-Wide financial statements. Overall, of the 26 DoD reporting entities that underwent stand-alone audits, 8 reporting entities received clean opinions, 1 reporting entity received a qualified opinion, and 17 reporting entities received disclaimers of opinion.

In FY 2021, auditors issued a total of 3,368 NFRs. Of those NFRs, 690 were new NFRs for deficiencies noted in FY 2021, and 2,678 were reissued prior-year NFRs that were not corrected during FY 2021. Additionally, the DoD OIG reported a total of 28 material weaknesses and 4 significant deficiencies. In comparison, during FY 2020, the DoD OIG identified 26 material weaknesses and 4 significant deficiencies.

As discussed throughout this report, the DoD and its Components must prioritize efforts to fix the weaknesses and deficiencies identified in the audits. To do so, DoD leadership must develop measurable goals to help the DoD and its Components reach financial statement auditability. DoD leadership must hold DoD Components accountable for developing, implementing, and improving sustainable business processes that support DoD operations and effective financial management.

Achieving a clean financial statement opinion is a long-term effort for the DoD. The DoD and its Components must work together to develop a "DoD way" of sustainable processes that will support DoD operations, and ultimately lead to a clean audit opinion.

Acronyms and Abbreviations

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 Remediation
GAAP	Generally Accepted Accounting Principles
GPIPC	Government Property in the Possession of Contractors
IPA	Independent Public Accountants
IT	Information Technology
JSF	Joint Strike Fighter
NFR	Notice of Finding and Recommendation
OIG	Office of Inspector General
OMB	Office of Management and Budget
OUSD(C)/CFO	Office of the Under Secretary of Defense(Comptroller)/Chief Financial Officer

INSPECTOR GENERAL

INTEGRITY EFFICIENCY

DEPARTMENT OF DEFENSE

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/Whisteblower-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