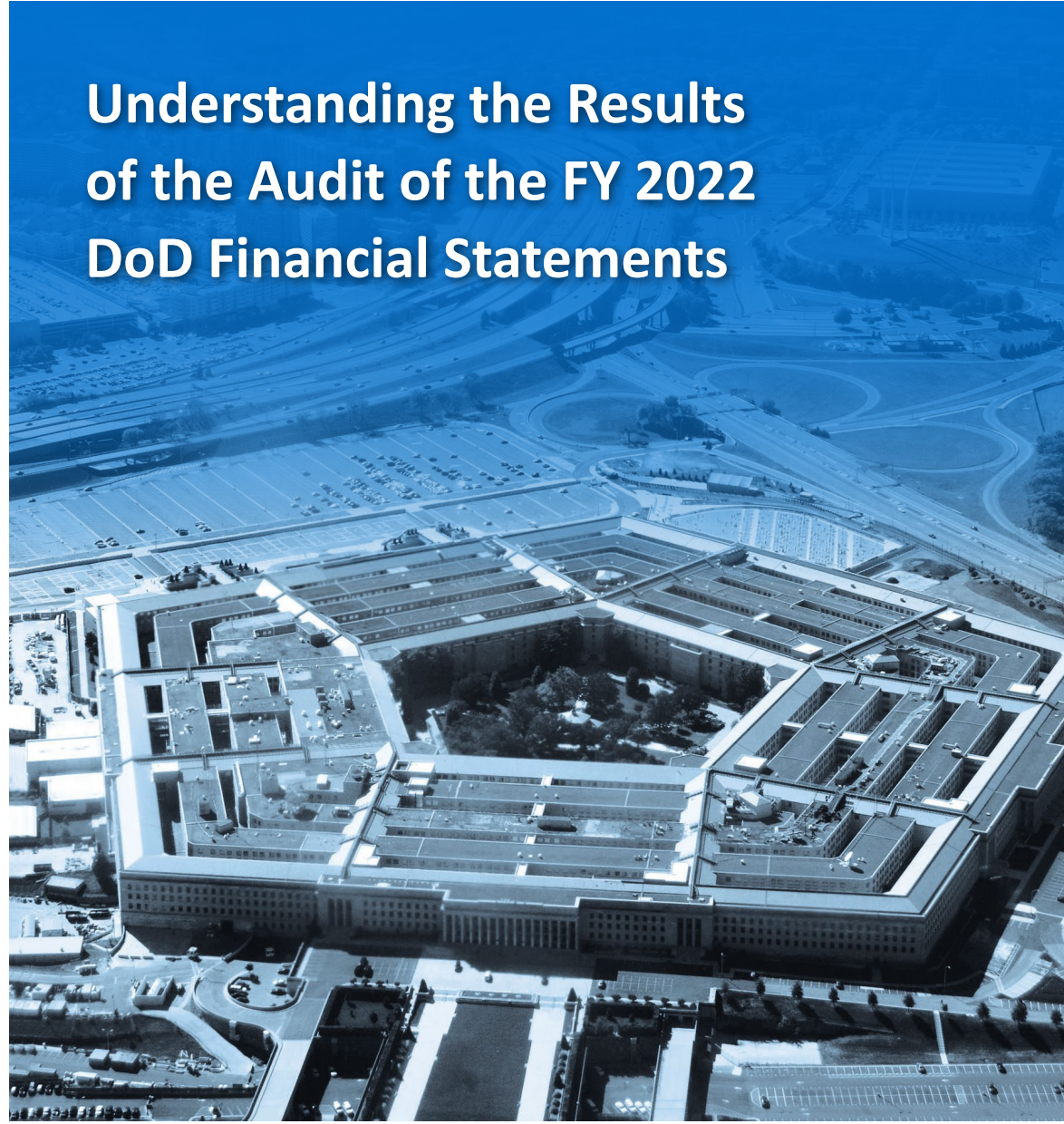




# INSPECTOR GENERAL

*U.S. Department of Defense*

MAY 16, 2023



## Understanding the Results of the Audit of the FY 2022 DoD Financial Statements

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE





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

May 16, 2023

During FY 2022, the DoD underwent its fifth financial statement audit. As in prior years, the DoD Office of Inspector General (OIG) issued a disclaimer of opinion on the DoD Agency-Wide Basic Financial Statements, meaning the DoD could not provide sufficient evidence for the auditors to conclude whether the DoD presented the financial statements fairly and in accordance with accounting guidance.

During the course of this year's audit, auditors closed 633 prior-year notices of findings and recommendations (NFRs) for a variety of reasons. For example, auditors closed NFRs because the DoD took action and the condition no longer existed, the auditors combined NFRs, or the process or system used was eliminated. Auditors also reissued 2,505 NFRs related to ongoing concerns and issued 479 new NFRs regarding issues identified during the current audit. In addition, the DoD OIG identified 28 Agency-Wide material weaknesses, which are weaknesses in internal controls that are so significant that they could prevent management from detecting and correcting a material misstatement in the financial statement in a timely manner. While the number of material weaknesses did not change between FYs 2021 and 2022, the DoD OIG combined three prior-year material weaknesses into repeat material weaknesses and identified three new material weaknesses in FY 2022.

Transparency is a core principle for OIGs, as we work to the greatest extent possible to highlight the issues that we identify regarding the operations of the departments and agencies we oversee. The DoD budget is large and of substantial public importance, comprising nearly half the non-discretionary spending of our Nation and almost three-fourths of its assets. In light of those considerations, this report is intended to summarize, in terms understandable to non-auditors, the findings of our audits of the DoD's financial statements, the progress made by the DoD, and the additional actions the DoD should take to address the overall audit findings. This report focuses on material weaknesses that are scope-limiting, meaning they prevent auditors from performing the necessary procedures to draw a conclusion on the financial statements. In addition, this report discusses how the DoD tracks progress toward its auditability goals and the DoD's decision to produce stand-alone financial statements for relatively small components whose finances are immaterial to the Department's overall financial picture.

We believe that obtaining an unmodified (clean) audit opinion is critically important for the DoD and that it is 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 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 help the DoD improve its operations.

The DoD OIG has initiated a number of performance audits, and it will continue to explore the potential for additional impactful oversight regarding issues identified through the financial statement audit. For example, during FY 2023, the DoD OIG will conduct performance audits related to the Joint Strike Fighter, the DoD's use of attestation engagements to review shared systems and processes, and the DoD's plans to address longstanding issues with outdated financial management systems. 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. We remain fully committed to this important, long-term effort to improve the financial health of this critically important Department.



Robert P. Storch  
Inspector General

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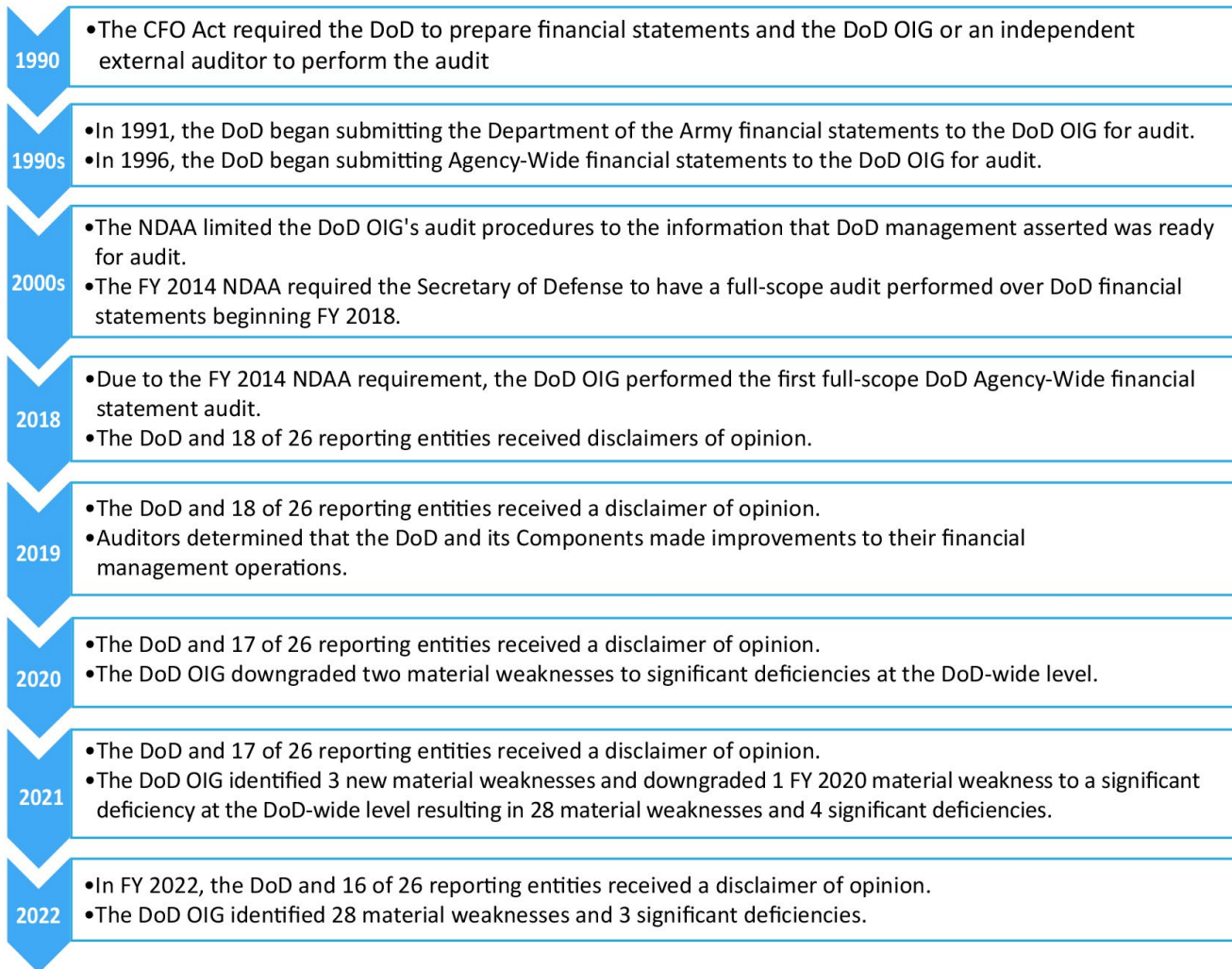


# Understanding the Results of the DoD FY 2022 Audited Financial Statements

The DoD prepares the annual DoD Agency Financial Report and the Component-level financial statements to provide an overview of the financial information of the DoD and its Components. These reports also provide summary-level information on performance results of DoD operations. On November 15, 2022, the DoD issued its FY 2022 DoD Agency Financial Report that included the FY 2022 DoD Agency-Wide financial statements. The DoD Office of Inspector General (OIG) performed an audit of the FY 2022 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 Generally Accepted Accounting Principles (GAAP) that establish accounting concepts and principles to ensure an organization's financial statements are complete, consistent, and comparable.

Shortly after the enactment of the Chief Financial Officers (CFO) Act in 1990, which requires Federal agencies to prepare financial statements for audit, the DoD submitted the first Component financial statements to the DoD OIG for audit. However, as shown in Figure 1, in FY 2002, Congress limited the audit procedures that the DoD OIG was allowed to perform on the DoD's financial statements and established requirements for the DoD audit readiness efforts. Twenty eight years after the enactment of the CFO Act, Congress required the DoD to undergo its first full-scope financial statement audit. Despite being the largest Department in the U.S. Government, the DoD has yet to obtain more than a disclaimer of opinion, and the DoD's corrective action plans show that it does not expect to obtain a clean opinion until at least 2028.

Figure 1. Progression of the DoD-Audited Financial Statements



**Legend**

CFO Chief Financial Officers  
 NDAA National Defense Authorization Act  
 Source: The DoD OIG.

The DoD Agency Financial Report, which includes the DoD financial statements and independent auditors’ reports, can be difficult to understand for readers unfamiliar with the technical language, industry-specific terminology, and prescribed formatting. To address these challenges, 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 those without a technical background in financial statement auditing and accounting. This report will explain:

- why the DoD financial statement audits are important;
- who is involved and the responsibilities they have in preparing or auditing the DoD financial statements;



- what processes the DoD and its reporting entities follow when preparing their financial statements;
- what processes the DoD OIG and IPA firms follow when auditing the DoD and its reporting entities' financial statements; and
- how to interpret the results of the FY 2022 financial statement audits.

In this report, we will also explain the FY 2022 audit results and discuss the DoD's challenges beyond the material weaknesses.

## **Importance of the DoD Financial Statement Audits**

The DoD is the largest Department in the U.S. Government. As reported in the FY 2022 DoD Agency Financial Report, the DoD employed approximately 2.1 million Military Service members and approximately 770,000 civilian employees and whose assets are located on more than 4,800 DoD sites located in all 50 states, the District of Columbia, 7 U.S. territories, and more than 40 foreign countries. In FY 2022, the DoD reported budgetary resources of more than \$776.6 billion and comprised nearly half the discretionary spending of the United States, and it reported nearly \$3.5 trillion in assets, which is approximately 70 percent of the Government's total assets.

Because of the DoD's size, it has a major impact on the Government-wide financial statements. The DoD Agency-Wide and Component-level financial statement audits are critically important for maintaining the public's trust, bolstering accountability, and improving DoD operations.

### ***Transparency***

One of the ways the DoD OIG seeks to maintain public trust is through transparency. The financial statement audits provide Congress and the public an assessment of how the DoD spends its resources. The audits are designed to validate and substantiate the financial information reported by the DoD. However, the financial information reported by the DoD can only be reliable if the DoD's financial management environment is sound. For example, if a DoD Component receives funding but does not have effective internal controls to manage those funds, there would be a lack of assurance that the funds were properly and consistently recorded; therefore, transparency in the accountability for and use of these funds suffers. The DoD Agency-Wide audit aids in improving operations, strengthening internal controls, and creating improved visibility of assets, thus increasing transparency.

### ***Accountability***

Financial accountability means to be able to justify actions or decisions made. The DoD is accountable to the President, Congress, and the American taxpayer for the proper use of the substantial volume of funds and resources that have been entrusted to it. The financial statement audits enhance the DoD's accountability because the auditors

examine the systems and processes used from the beginning of a transaction to the final numbers on the financial statements. For example, auditors examine the systems used to account for inventory and review the processes used for ordering, receiving, and storing the inventory. In addition, auditors determine whether management designed controls sufficiently to ensure that inventory information such as quantity, physical location, condition, and value is accurate. The accuracy of the DoD's inventory is enhanced by the auditors' examination of systems and processes, and their findings and recommendations related to the effectiveness of managements' controls.

Accountability in the DoD means that the DoD can demonstrate that the goods and services it purchased are supported by a bona fide need, correctly reported, and properly stored or disposed. The transparency that the audit delivers promotes sustainable, accountable business operations.

### ***Operations***

Financial statement audits provide valuable insight into the DoD's business processes, with assessments of which processes are working well and which are not. For example, financial statement audits assess the controls in information technology (IT) systems used by the DoD to execute and manage its operations. The auditors can identify vulnerabilities and make recommendations to improve the DoD's IT structure.

Increased effectiveness of internal controls will have a positive effect on the DoD's ability to rely on information systems when making operational decisions. When audits reveal weaknesses and deficiencies, and the DoD prioritizes efforts to correct these weaknesses, it can achieve sustainable business processes and effective financial management, and ultimately receive a clean audit opinion.

## **Financial Statement Preparation and Audit Roles and Responsibilities**

The effort to prepare and audit the DoD Agency-Wide and Component-level financial statements is immense. Many individuals and Components throughout the DoD work together to prepare and audit the statements. Figure 2 identifies those involved and their responsibilities in preparing and auditing the DoD financial statements.

Figure 2. Roles and Responsibilities Related to the Financial Statements and Audits

Financial Statement Preparation	
<b>Federal Accounting Standards Advisory Board</b>	<ul style="list-style-type: none"> <li>• Publish and interpret accounting principles for federal government entities, which are used in the preparation of financial statements.</li> </ul>
<b>Office of Management and Budget</b>	<ul style="list-style-type: none"> <li>• Establish federal financial statement reporting requirements.</li> <li>• Publish federal financial statement auditing requirements.</li> </ul>
<b>Secretary of Defense and the Under Secretary of Defense (Comptroller)/ CFO, DoD</b>	<ul style="list-style-type: none"> <li>• Compile and present the DoD Financial Statements in accordance with GAAP.</li> <li>• Develop and oversee implementation of DoD-Wide accounting and finance policies.</li> <li>• Maintain effective internal controls over financial reporting.</li> </ul>
<b>DoD Component Management</b>	<ul style="list-style-type: none"> <li>• Ensure that key processes, systems, and internal controls are effectively designed and implemented to support the DoD Component’s financial management operations.</li> <li>• Review the DoD Component’s financial statements and footnotes to ensure the financial information is complete and accurate.</li> <li>• Implement and sustain corrective actions to address deficiencies identified by auditors.</li> </ul>
<b>Defense Finance and Accounting Service</b>	<ul style="list-style-type: none"> <li>• Standardize, consolidate, and integrate accounting and financial functions throughout the DoD.</li> <li>• Provide financial management and accounting services, analyses, and consultation to the DoD and its Components.</li> </ul>
<b>Department of the Treasury</b>	<ul style="list-style-type: none"> <li>• Prepare the Government-wide financial report, which aggregates the financial statements for all Components of the Government, including the DoD.</li> </ul>
Financial Statement Audits	
<b>DoD OIG</b>	<ul style="list-style-type: none"> <li>• Plan and execute the audit of the DoD Agency-Wide financial statements.</li> <li>• Monitor and oversee IPA firms that perform financial statement audits of DoD Components.</li> <li>• 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.</li> </ul>
<b>IPA Firms</b>	<ul style="list-style-type: none"> <li>• Perform DoD Component financial statement audits as required by contracts with the DoD OIG.</li> <li>• Report DoD Component audit results to the DoD, the Component, and the DoD OIG.</li> </ul>
<b>Government Accountability Office</b>	<ul style="list-style-type: none"> <li>• Conduct the annual audit of the Consolidated Financial Statements of the U.S. Government.</li> </ul>

Source: The DoD OIG.

## Preparing and Auditing the DoD Financial Statements

The DoD Agency-Wide financial statements document the financial activity from more than 60 DoD entities, including the Military Departments, Defense agencies, and DoD field activities, consolidated to create one set of financial statements.<sup>1</sup> These consolidated financial statements are referred to as the DoD Agency-Wide financial statements. Figure 3 identifies and explains significant sections of the FY 2022 DoD Agency Financial Report.

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<sup>1</sup> For purposes of this report, a DoD Component is a Military Department, Defense agency, or field activity (such as the Defense Media Activity), combatant command, or other organizational entity within the DoD. A reporting entity is an organization that issues its own financial statements due to a statutory or administrative requirement or by choice, such as the Army General Fund and the Defense Logistics Agency General Fund. A consolidation entity is an organization that should be consolidated in the financial statements of a reporting entity such as the Missile Defense Agency.

Figure 3. Significant Sections of the DoD Agency Financial Report

<p><b>Management’s Discussion and Analysis</b></p>	<ul style="list-style-type: none"> <li>• Provided a high-level overview of the DoD’s operations and financial performance.</li> </ul>
<p><b>Financial Statements</b></p>	<ul style="list-style-type: none"> <li>• Consolidated Balance Sheets present the DoD’s financial position as of September 30, 2022.</li> <li>• Consolidated Statements of Net Cost presents the net cost of the DoD’s operations by major programs.<sup>1</sup></li> <li>• Consolidated Statements of Changes in Net Position presents the change in the DoD’s net position that resulted from the Net Cost of Operations, Budgetary Financing Sources, and Other Financing Sources.<sup>2</sup></li> <li>• Combined Statements of Budgetary Resources presents information on the DoD’s budgetary resources and their status at the end of the year.</li> </ul>
<p><b>Notes to the Financial Statements</b></p>	<ul style="list-style-type: none"> <li>• Provides important disclosures and details related to the information reported on the DoD’s consolidated financial statements.</li> </ul>
<p><b>Required Supplementary Information</b></p>	<ul style="list-style-type: none"> <li>• Provides additional information, such as the Deferred Maintenance and Repairs, to add context to the financial statements.</li> </ul>
<p><b>DoD OIG Audit Report</b></p>	<ul style="list-style-type: none"> <li>• Written by the DoD OIG, presents the results of the DoD OIG’s audit of the DoD Agency–Wide financial statements.</li> </ul>
<p><b>Top DoD Management Challenges</b></p>	<ul style="list-style-type: none"> <li>• Written by the DoD OIG, contains what the DoD Inspector General considers to be the most significant management and performance challenges facing the DoD.</li> </ul>
<p><b>Other Sections</b></p>	<ul style="list-style-type: none"> <li>• Other Information provides financial and non-financial information that is required to be included within the DoD Agency Financial Report.</li> <li>• Appendixes contain lists of reporting entities, acronyms, and definitions.</li> </ul>

<sup>1</sup> The Statement of Net Cost identified how much it costs, by specific program, to operate the DoD. The net cost is the difference between costs, revenue, and any gains or losses recognized from changes in investments.

<sup>2</sup> The 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. In addition, it presents the appropriations provided to the DoD that remain unused at the end of the fiscal year and focuses on how the DoD’s operations are financed. The change in net position equals the difference between assets and liabilities.

Source: The DoD OIG.

In addition to the DoD Agency-Wide financial statements, many DoD reporting entities prepare and issue stand-alone financial statements annually to meet Federal or DoD reporting requirements. For the FY 2022 financial statement audits, the Office of Management and Budget (OMB) required the DoD to submit audited financial statements for the DoD and eight of the DoD reporting entities.<sup>2</sup>

The DoD OIG contracted for and oversaw IPA firms' financial statement audits for the following eight required DoD reporting entities for FY 2022.

- 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
- Military Retirement Fund
- U.S. Army Corps of Engineers–Civil Works

In addition to these eight audits of DoD reporting entities, DoD management decided, for a variety of reasons, that 18 additional DoD reporting entities would submit audited financial statements to the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD (OUSD[C])/CFO, 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 Transaction Fund.

Several entities did not receive stand-alone audits in FY 2022, such as the Defense Advanced Research Projects Agency, Defense Acquisition University, and Military Housing Privatization Initiative, because they were not individually material to the DoD Agency-Wide financial statements. However, they were included in the consolidated audit of the DoD Agency-Wide financial statements and are material when taken as a whole. Therefore, the DoD OIG performs audit procedures over activities and balances of these entities as part of the DoD Agency-Wide financial statements audit.

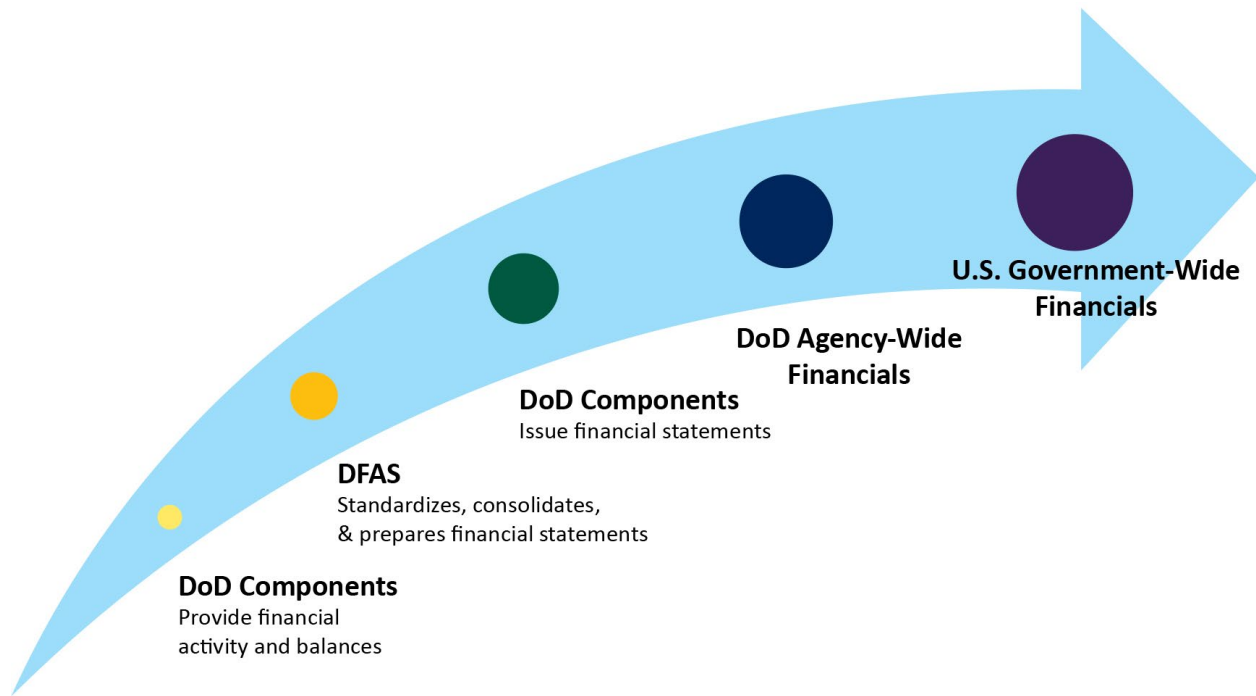
To begin the consolidation process, consolidation entities provide financial statement data to the Defense Finance and Accounting Service (DFAS), which standardizes and analyzes the data to prepare the consolidated DoD Agency-Wide financial statements. In addition, DFAS works

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<sup>2</sup> In FY 2022, the required reporting entities for the DoD changed from nine to eight. OMB Bulletin No. 22-01 lists the U.S. Marine Corps as a DoD Component that is required to prepare audited financial statements; however, for FY 2022, the OMB exempted the U.S. Marine Corps from preparing audited financial statements because it is undergoing a 2-year audit cycle, which will be completed in November 2023.

with the stand-alone reporting entities to prepare Component-level financial statements.<sup>3</sup> DFAS submits the DoD Agency-Wide financial statements and supporting financial information to the Department of 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.

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 OMB.

To oversee audits of significant reporting entities being conducted by IPAs, the DoD OIG verifies the IPA's compliance with applicable auditing standards and contract requirements. The DoD OIG's procedures for IPA oversight include attending meetings between the IPA and the Component being audited and reviewing results and other IPA-provided documentation, including testing procedure results. 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.

<sup>3</sup> 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.

## Interpreting Financial Statement Audit Results

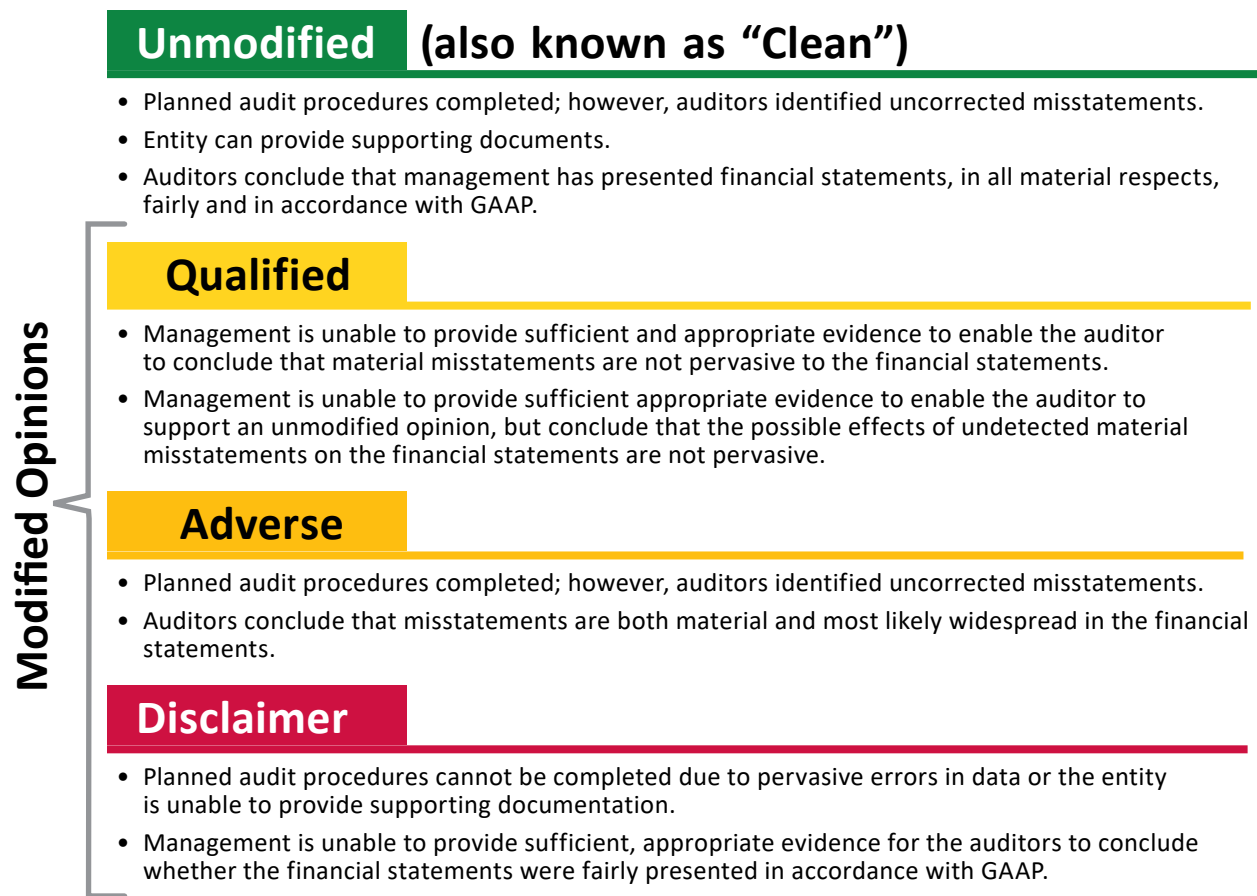
The DoD OIG and the IPAs conducted audits of the DoD Agency-Wide and DoD Component-level financial statements to:

- express an opinion on whether the Agency-Wide and associated Component-level financial statements were presented fairly and 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 auditors perform a financial statement audit, they are responsible for expressing their conclusion, called an opinion, on whether management fairly presented the financial statements and the related notes to the financial statements and in accordance with GAAP. Figure 5 demonstrates the types of opinions that auditors can issue.

Figure 5. Types of Audit Opinions



Source: The DoD OIG.



On November 15, 2022, the DoD OIG issued a disclaimer of opinion on the FY 2022 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 DoD management from providing sufficient and appropriate evidence to support the balances presented on their respective financial statements.

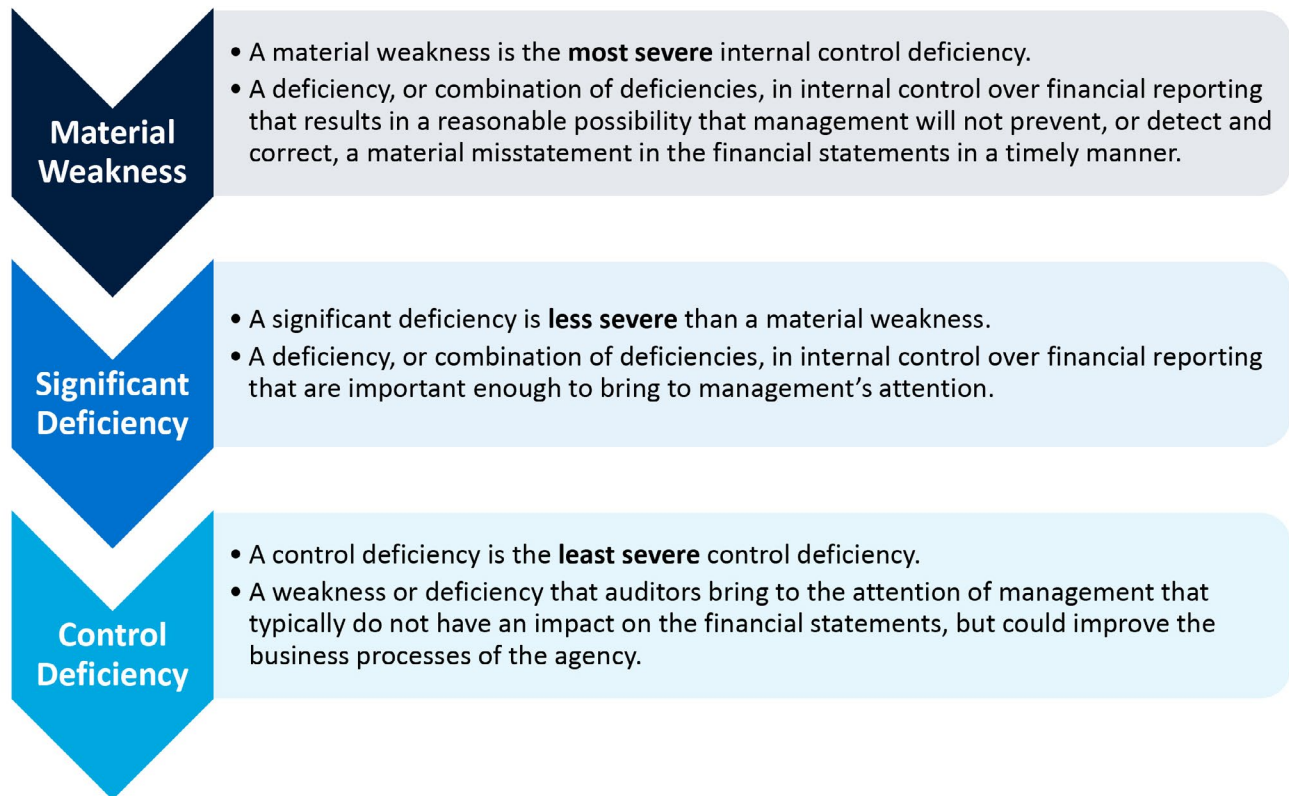
### ***Understanding Deficiencies in Internal Controls and Material Weaknesses***

When conducting an audit, auditors consider whether management has designed appropriate internal controls and whether those controls are operating effectively. However, auditors do not provide an opinion on the overall effectiveness of internal controls. Instead, auditors issue notices of findings and recommendations (NFRs) throughout the audit to communicate to management:

- any identified weaknesses and inefficiencies in the financial processes,
- the impact of these weaknesses and inefficiencies,
- the reason the weaknesses and inefficiencies exist, and
- recommendations on how to correct the weaknesses and inefficiencies.

A deficiency in internal controls, also called a control deficiency, 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 deficiencies in internal controls based on how severe the deficiency is. Figure 6 lists the three classifications of deficiencies in internal controls from the most severe to the least severe.

Figure 6. Three Classifications of Deficiencies in Internal Controls



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 controls over financial reporting that identifies the significant deficiencies and material weaknesses identified during an audit. The DoD OIG identified 28 material weaknesses and 3 significant deficiencies during the DoD’s FY 2022 Agency-Wide financial statement audit, which are further explained in Table 2 in the appendix of this report.

There is a tendency to compare material weakness from year to year to gauge progress toward clean financial statements. However, we believe that comparison is not a reliable measure because the level of audit testing can change every year. For example, the number of material weaknesses for the DoD has increased from 20 in FY 2018 to 28 in FY 2022. However, the DoD has made progress since FY 2018 in areas such as real property, Fund Balance with Treasury, and inventory. A more effective way of measuring progress could include measuring the percentage of balances that are scope-limiting, meaning the auditors’ ability to test the balances remain limited.

For example, prior to FY 2021, auditors of the Defense Information Systems Agency General Fund could not perform normal audit tests and procedures due to scope limitations over the Accounts Payable and Accounts Receivable line items, which directly contributed to two material weaknesses. Defense Information Systems Agency management implemented corrective actions in FY 2022 that significantly reduced the limitations and allowed for the auditor to conduct large-scale representative samples in their audit tests and procedures. Reducing or eliminating scope limitations significantly improved the auditability of the Defense Information Systems Agency and demonstrated progress; however, due to the results of the testing the Accounts Payable and Accounts Receivable material weaknesses remained.

## Results of FY 2022 Audits

The DoD OIG oversaw the following IPA firms' financial statement audits of 23 DoD reporting entities in FY 2022.<sup>4</sup>

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

The DoD OIG is required to audit the DoD Agency-Wide consolidated financial statements. To do this, the DoD OIG collectively assigned, between DoD OIG and IPA personnel, more than 1,600 auditors to perform the audit of the DoD Components' and Agency-Wide financial statements. This section of the report discusses the results of the FY 2022 DoD Component and DoD Agency-Wide Financial Statement Audits, any progress or regression from FY 2021, and the DoD OIG's suggestions for achieving and sustaining financial statement auditability.

### FY 2022 DoD Reporting Entity Audit Results

While FY 2022 observed minimal changes in audit opinions, the DoD continued to remediate FY 2021 audit findings. As shown in Figure 7, the DoD reporting entities received 9 unmodified (clean) opinions, 1 qualified opinion, and 16 disclaimers of opinions. Reporting entities, such as the Defense Health Agency–Contract Resource Management and U.S. Army Corps of Engineers–Civil Works, have consistently obtained unmodified opinions on their financial statements.

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<sup>4</sup> The 23 reporting entities consist of 19 DoD Components and 4 Sub-Allotted Fund Financial Statements.

Figure 7. FY 2022 DoD Reporting Entity Financial Statement Audit Results

Fiscal Year 2022 Audit Results			
Military Retirement Fund	U.S. Army Corps of Engineers – Civil Works	DHA-CRM	DISA Working Capital Fund
Defense Commissary Agency <sup>2</sup>	DFAS Working Capital Fund <sup>2</sup>	Defense Contract Audit Agency <sup>2</sup>	DoD OIG
NRO <sup>2</sup>			
Medicare-Eligible Retiree Health Care Fund			
Army General Fund	Army Working Capital Fund	Navy General Fund	DON Working Capital Fund
Air Force General Fund	Air Force Working Capital Fund	DLA Working Capital Fund	DLA General Fund
DLA Transaction Fund	Defense Health Program	DISA General Fund	USSOCOM
USTRANSCOM	NSA <sup>2</sup>	DIA <sup>2</sup>	NGA <sup>2</sup>
U.S. Marine Corps General Fund <sup>1</sup>			
Unmodified	Qualified	Adverse	Disclaimer

<sup>1</sup> OMB Bulletin No. 22-01 lists the U.S. Marine Corps as a DoD Component that is required to prepare audited financial statements; however, for FY 2022, the OMB exempted the U.S. Marine Corps from preparing audited financial statements, as they are under a 2-year audit cycle that will be completed November 2023. Therefore, we did not consider any results from the U.S. Marine Corps audit when issuing our disclaimer of opinion on the DoD Agency-Wide financial statements.

<sup>2</sup> The DoD OIG does not oversee the financial statement audits of these DoD reporting entities.

Source: The DoD OIG.

In FY 2022 for the audits the DoD OIG performed and oversaw, the DoD OIG and IPAs collectively reported 167 material weaknesses and 46 instances of non-compliance with applicable laws, regulations, contracts, and grant agreements, and it issued 2,984 NFRs to the DoD and its Components. During the FY 2022 audits, auditors closed 633 prior-year NFRs, reissued 2,505 prior-year NFRs, and issued 479 new NFRs. Table 1 displays the number of NFRs for the Agency-Wide DoD and each Component.

*Table 1. Total Deficiencies Identified in FY 2022*

Entity	FY 2022		
	Material Weaknesses <sup>5</sup>	Non-Compliance <sup>5</sup>	NFRs <sup>6</sup>
Department of the Army <sup>1</sup>	29	4	486
Department of the Navy <sup>1</sup>	26	4	956
Department of the Air Force <sup>1</sup>	18	4	452
U.S. Marine Corps <sup>2</sup>	0	0	0
U.S. Army Corps of Engineers <sup>3</sup>	6	10	42
Defense Health Program	10	3	105
Defense Information Systems Agency <sup>1</sup>	8	3	54
Defense Logistics Agency <sup>1</sup>	20	6	421
U.S. Special Operations Command <sup>1</sup>	5	2	131
U.S. Transportation Command <sup>1</sup>	16	2	145
Defense Health Agency-CRM	0	0	11
Medicare-Eligible Retiree Health Care Fund	1	1	16
Military Retirement Fund	0	0	12
Agency-Wide	28	7	153
<b>Total<sup>4</sup></b>	<b>167</b>	<b>46</b>	<b>2,984</b>

<sup>1</sup> These DoD Components received separate opinions for each of their fund types, as indicated in Figure 7. We combined the deficiencies identified from all of the funds into a summary total for each DoD Component.

<sup>2</sup> For FY 2022, the OMB exempted the U.S. Marine Corps from preparing audited financial statements because it is undergoing a 2-year audit cycle, which will be completed in November 2023. As a result, the auditors did not issue NFRs to the U.S. Marine Corps in FY 2022.

<sup>3</sup> 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. In addition, the Army sub-allotted financial activity did not undergo a full financial statement audit in FY 2022.

<sup>4</sup> Management material weakness, non-compliance, and NFR totals may differ due to management inclusion of audit and attestation engagements not included in the totals reported by the DoD OIG.

<sup>5</sup> 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 non-compliance issues may be reported multiple times for some Components.

<sup>6</sup> NFR totals for each Component can vary depending on the agreement of the NFR structure between the auditor and Component. For example, the Department of the Navy and its auditor have agreed to include only one condition per NFR, which results in a large NFR total. Conversely, the Department of the Army and the Department of the Air Force NFRs may contain multiple conditions per NFR, and therefore have a lower total NFR count. NFR totals should not be used to compare Component audit success.

Source: The DoD OIG.

## FY 2022 DoD Agency-Wide Audit Results

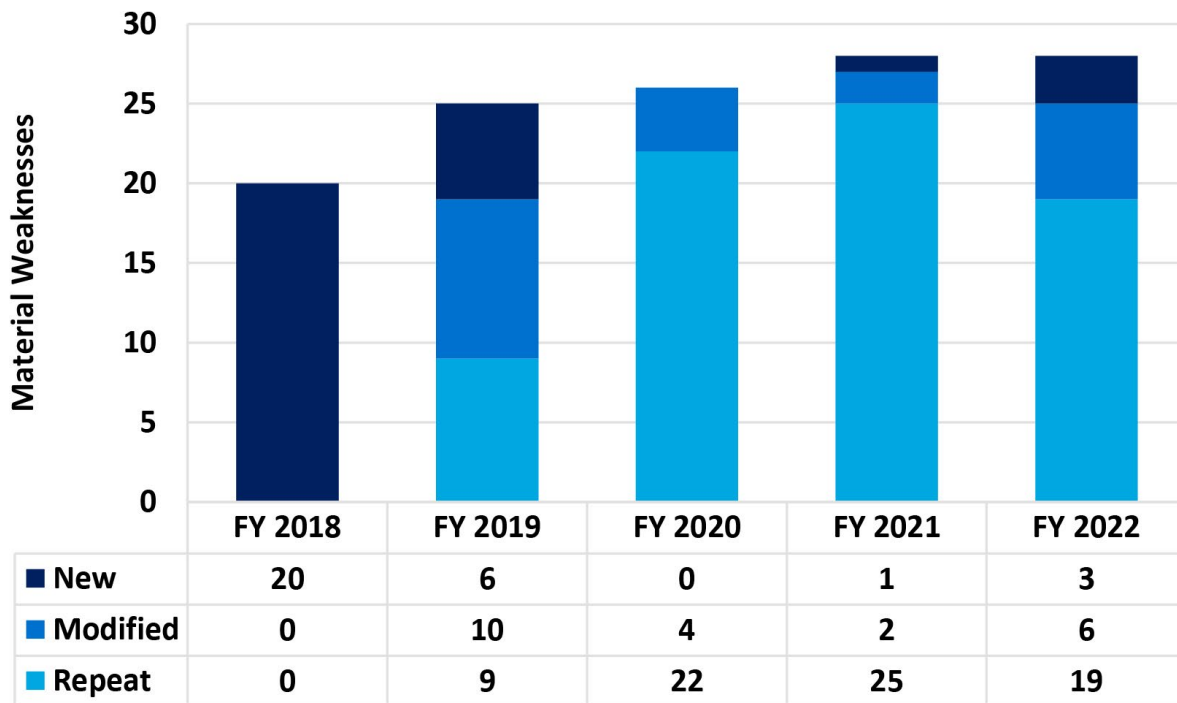
The DoD OIG’s disclaimer of opinion on the FY 2022 DoD Agency-Wide financial statements means that the DoD was unable to provide sufficient evidence for the auditors to conclude as to whether the financial statements were fairly presented in accordance with GAAP.

The DoD OIG identified at the DoD Agency-Wide level 28 material weaknesses and 3 significant deficiencies. Of the material weaknesses and significant deficiencies identified:

- 19 material weaknesses and 3 significant deficiencies were repeated from FY 2021;
- 6 prior-year material weaknesses were modified;
- 3 material weaknesses were new; and
- 1 significant deficiency was downgraded to a control deficiency.

As discussed above, comparing material weakness from year to year to gauge progress toward clean financial statements is not a reliable measure. For example, as shown in Figure 8, since 2018, the total number of material weaknesses has increased; however, the material weaknesses that comprise the total change from year to year. For example, while the total number of material weaknesses did not change between FYs 2021 and 2022, the DoD OIG combined three prior-year material weaknesses into repeat material weaknesses and identified three new material weaknesses in FY 2022.

Figure 8. Total Material Weaknesses Identified Annually Since FY 2018



Source: The DoD OIG.

## ***New Material Weaknesses***

In FY 2022, the DoD OIG identified three new material weaknesses.

- Reporting Entity
- DoD Component-level Accounts
- Interface Controls

DoD management is responsible for reporting for all organizations for which it is accountable, including all consolidation entities assigned to the DoD.<sup>5</sup> As further described in the Reporting Entity section of this report, DoD management did not correctly implement or apply the principles that assist the DoD in determining which entities it should consolidate and report in the Agency-Wide financial statements. DoD management did not report all consolidation entities, did not identify the responsible party for one material consolidation entity, and improperly identified all DoD consolidation entities as reporting entities. For all of these reasons, the DoD OIG identified Reporting Entity as a new material weakness in FY 2022. Because DoD management did not properly apply these standards meant to help the DoD define its entities, the DoD Agency-Wide financial statements were less reliable and possibly incomplete.

The DoD OIG also identified DoD Component-level Accounts as a new material weakness in FY 2022. The DoD Component-level Accounts is a consolidation entity that the DoD included in the DoD Agency-Wide financial statements. However, the DoD and DFAS lacked internal controls over the entity's balances and were unable to ensure the balances were complete and accurate.

Finally, the DoD OIG reported Interface Controls as a new IT-related material weakness in FY 2022. "Interfaces" are ways in which two or more IT systems share information. The DoD Components did not document complete descriptions of how information was shared between systems. The DoD Components also did not effectively design or put into place interface controls for multiple significant financial management systems. Ineffective interface controls directly impacted the reliability of the DoD's financial data.

## ***Scope-Limiting Material Weaknesses***

The DoD and its Components can receive clean audit opinions while still having material weaknesses. For example, the U.S. Army Corps of Engineers and the Defense Information Systems Agency Working Capital Fund both received unmodified opinions in FY 2022, even though their audits indicated they had material weaknesses, because the auditors were still able to perform sufficient audit procedures to conclude on the accuracy of the balances. However, some material weaknesses prevented auditors from performing the necessary

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<sup>5</sup> According to SFFAS No. 47, a reporting entity is an organization that issues its own financial statements due to a statutory or administrative requirement or by choice. Component reporting entity refers to a reporting entity within a larger reporting entity. A consolidation entity is an organization that should be consolidated in the financial statements of a reporting entity.



procedures to draw a conclusion on the financial statements. These material weaknesses are considered scope-limiting material weaknesses. Of the 28 material weaknesses identified at the DoD Agency-Wide level, the DoD OIG considers 16 weaknesses to be scope-limiting. We consolidated the 16 weaknesses into 10 categories and discuss them in detail in the sections that follow. The first three categories align with the Secretary of Defense's three FY 2023 financial statement audit priorities – Establish User Access Controls, Create a Universe of Transactions, and Improve Fund Balance with Treasury.<sup>6</sup>

1. Information Technology (IT)
2. Universe of Transactions
3. Fund Balance with Treasury (FBWT)
4. Inventory and Related Property
5. General Property, Plant, and Equipment, including Real Property
6. Reporting Entity
7. Government Property in the Possession of Contractors (GPIPC)
8. Joint Strike Fighter Program
9. DoD Oversight and Monitoring
10. Environmental and Disposal Liabilities

The DoD has known of some of these scope-limiting material weaknesses—which included IT, FBWT, Inventory and Operating Materials and Supplies, Real Property, and GPIPC—for more than 18 years. These longstanding material weaknesses are significant roadblocks to the DoD's auditability goals and are preventing the DoD from establishing an efficient and effective financial management environment.

### **Information Technology**

The internal controls over IT systems ensure safekeeping and accuracy of accounting transactions, which are critical to the financial statements. In FY 2022, the DoD and its Components reportedly used 334 systems and applications for financial management—an increase of 35 systems from FY 2021. However, the DoD does not own or control all of the systems and applications it uses to process financial transactions and it rarely processes financial transactions using only one IT system.

*The DoD and its Components lacked effective IT internal controls, which limited the auditors' ability to rely on information from the financial-related IT systems; therefore, auditors could not perform sufficient procedures to conclude on the financial statements balances.*

<sup>6</sup> Secretary of Defense Memorandum for the Senior Pentagon Leadership Defense Agency and DoD Field Activity Directors, "Fiscal Year 2023 Financial Statement Audit Priorities," November 22, 2022.

Longstanding IT challenges continue to impair the DoD’s ability to provide reliable, timely, and useful financial information needed for reporting and decision making. Figure 9 provides a description of each of the five IT material weaknesses.

Figure 9. Information Technology Material Weaknesses

<p><b>Financial Management Systems Modernization:</b> Systems that comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger.</p>	<ul style="list-style-type: none"> <li>• The DoD was unable to provide a complete listing of systems that do not comply with the Federal Financial Management Improvement Act of 1996.</li> <li>• While the DoD developed a multi-phased approach for reviewing its non-compliant systems, it did not provide a timeline for these reviews.</li> </ul>
<p><b>Configuration and Security Management:</b> Controls that prevent unauthorized changes to systems and aid in assessing risks, developing and implementing security procedures, and monitoring effectiveness.</p>	<ul style="list-style-type: none"> <li>• DoD Components lacked effective configuration and security management controls for significant financial management and feeder systems.</li> <li>• The lack of effective configuration management and security management controls increases the risk of unauthorized use of or inappropriate modifications to significant financial management and feeder systems.</li> </ul>
<p><b>Access Controls:</b> Controls that ensure roles for authorized users are reasonable and controls that prevent unauthorized users from accessing data, equipment, and facilities.</p>	<ul style="list-style-type: none"> <li>• DoD Components did not design and implement effective access controls for various significant financial management and feeder systems.</li> <li>• DoD management did not fully implement corrective actions to design and implement an enterprise process for managing the timely removal of terminated or transferred system user accounts.</li> </ul>
<p><b>Segregation of Duties:</b> Controls that prevent users from having conflicting roles and functions.</p>	<ul style="list-style-type: none"> <li>• DoD Components did not design and implement effective segregation of duties controls for significant financial management and feeder systems.</li> <li>• DoD Components did not prioritize the implementation of segregation of duties and did not collaborate with all stakeholders to ensure effective segregation of duties controls were implemented.</li> </ul>
<p><b>Interface Controls:</b> Controls that ensure data being processed between systems are accurate and completed in a timely manner.</p>	<ul style="list-style-type: none"> <li>• DoD Components did not perform or document sufficient reconciliations between systems, to validate completeness, and accuracy of financial data.</li> <li>• DoD Components did not have comprehensive or documented interface strategies and did not design or implement effective interface controls for multiple significant financial management systems.</li> </ul>

Source: The DoD OIG.

Without effective IT internal controls, the auditors cannot rely on the information obtained from the IT systems, which prevents the auditors from concluding on the financial statements. In addition, the DoD assumes significant risk to its operations and assets when IT controls are ineffective, which includes risking the DoD's ability to protect against and rapidly respond to cyber threats across its systems. To assess the DoD's plans to address issues with outdated financial management systems, the DoD OIG announced an audit that will determine the completeness and accuracy of the DoD list of systems that are relevant to internal controls over financial reporting.<sup>7</sup> Additionally, the DoD OIG will assess the DoD's plans to replace non-compliant financial management systems with systems that meet the requirements of the Federal Financial Management Improvement Act of 1996.

### *Universe of Transactions*

The DoD continues to experience significant challenges in providing an accurate universe of transactions (a list of every financial event or transaction that happened during a specific timeframe that impact a financial statement balance), due to its large volume of transactions coming from numerous accounting systems. A significant driver causing the DoD to experience these challenges is that a large number of transactions come from numerous accounting and feeder systems, which have various owners.

*The DoD and its Components could not provide complete and accurate universes of transactions to support the balances reported in the financial statements. As a result, auditors were unable to perform the necessary procedures to verify the accuracy of the balances presented.*

A complete and accurate universe of transactions is essential to a financial statement audit, as it allows auditors to test transactions, reconcile account balances back to their source, and support the final balances reported on the financial statements. In FY 2022, neither the DoD nor its Components were able to provide the auditors with an accurate universe of transactions.

Without a complete and accurate universe of transactions, the DoD and its Components could not support the completeness and accuracy of data reported on their financial statements. This deficiency increased the risk that the balances in the DoD Agency-Wide financial statements may be materially misstated.

<sup>7</sup> Project No. D2023-D000FV-0087.000, "Audit of the DoD Plans to Address Long-Standing Issues with Outdated Financial Management Systems," February 22, 2023.

## **Fund Balance with Treasury**

*The DoD and its Components could not balance their FBWT accounts with the amounts recorded at the Department of the Treasury, which causes the DoD to have to record unsupported journal vouchers in order to force the DoD's accounts to match the Treasury. These unsupported journal vouchers do not contain enough information that would allow auditors to verify that the DoD's balances are accurate.*

The DoD has struggled with reconciling its FBWT accounts since 2005, and the DoD OIG identified this in FY 2022 as a material weakness for the fifth consecutive year. The DoD reported a FBWT of \$692.9 billion on its DoD Agency-Wide Balance Sheet, as of September 30, 2022. 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.

Factors such as system limitations, co-mingling of funds, and cross-disbursing (disbursements made by one organization on behalf of another) contribute to these findings and hinder the DoD's ability to reconcile its FBWT. Figure 10 includes common FBWT deficiencies that auditors identified in FY 2022.

Figure 10. Common FBWT Deficiencies Identified in FY 2022

Key Issues:	Suspense Accounts	Treasury Variance	Cash Management Report
<p><b>Definition</b></p>	<p>Suspense accounts temporarily hold unidentified transactions until the proper account is identified</p>	<p>Statement of Differences show the differences between the DoD's and the Treasury's accounting records</p>	<p>Report designed by the DoD to help the Defense agencies reconcile their FBWT accounting records to that of the Treasury's</p>
<p><b>Examples</b></p>	<p>The DLA did not adequately document the process to determine the amounts recorded in suspense accounts</p>	<p>The Army did not analyze the risk of financial misstatements from variances and document the specific controls that address those risks</p>	<p>DISA's CMR process has internal control deficiencies that increase the risk that its FBWT balance is not complete or accurate</p>

**Legend**

- CMR Cash Management Report
  - DISA Defense Information Systems Agency
  - DLA Defense Logistics Agency
- Source: The DoD OIG.

In FY 2022, auditors identified progress for multiple Components in processes and controls to reconcile FBWT. For example, the Air Force made significant progress in improving the control environment around FBWT, including controls over its FBWT reconciliation and the monitoring and reduction of unmatched transactions. In addition, the Army implemented corrective actions that resulted in the closure of four suspense account NFRs, and the Navy implemented corrective actions that resulted in the closure of multiple internal control design findings. Effectively designed, documented, and implemented FBWT processes and internal controls aid the DoD and its Components in ensuring the integrity and accuracy of their financial data.

## ***Inventory and Related Property***

The DoD could not substantiate the existence and completeness of inventory reported on the financial statements and did not properly account for or value its inventory.<sup>8</sup>

The DoD reported \$337.1 billion in Inventory and Related Property on its FY 2022 Agency-Wide Balance Sheet. Inventory and Related Property, hereafter referred to as inventory, consists of inventory, operating materials, supplies, and stockpile material. Inventory includes a variety of items, such as spare parts, clothing, ammunition, missiles, and medicine.

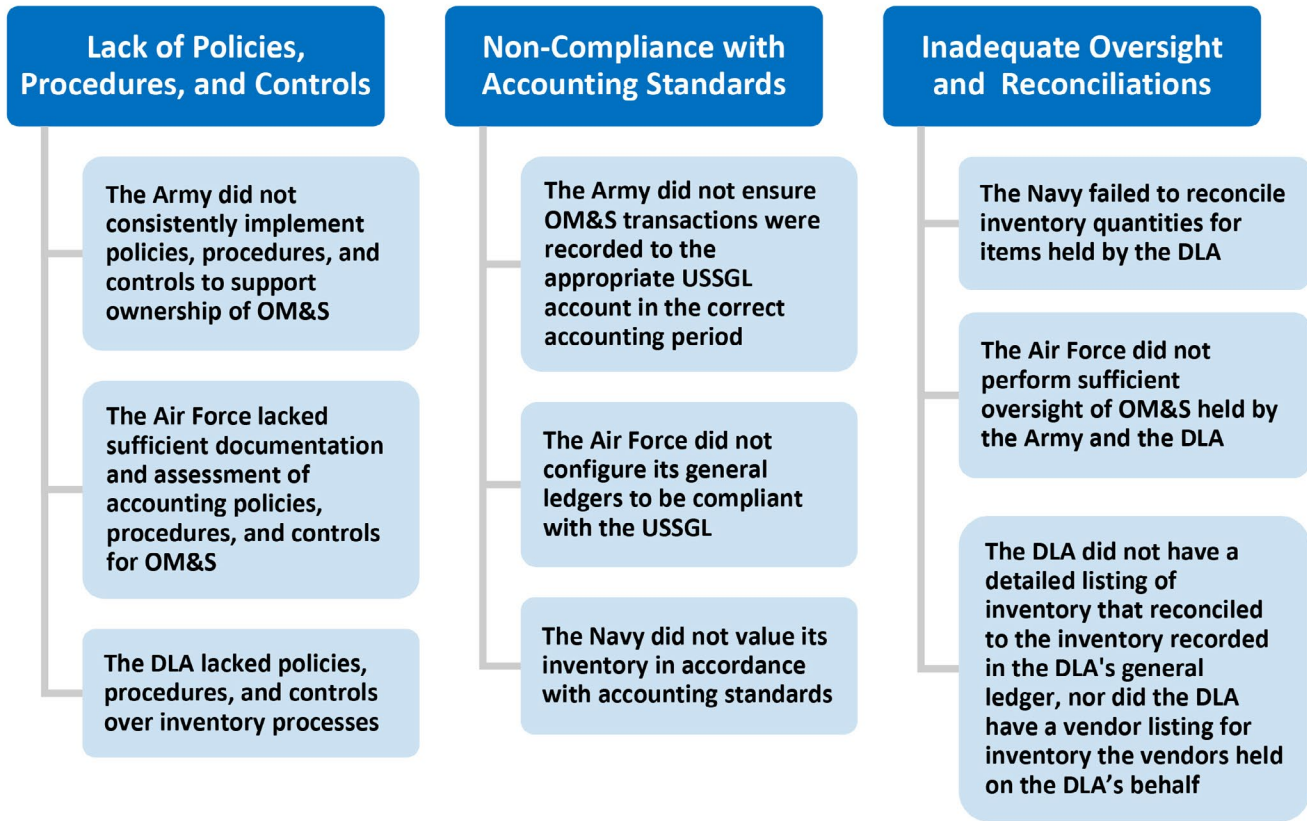
*The DoD was unable to substantiate the existence and completeness of inventory reported on the financial statements or did not properly account for or value its inventory. As a result, the auditors could not perform sufficient procedures to conclude on the inventory balance.*

Many DoD reporting entities did not have policies, procedures, or internal controls over their inventory processes. Most DoD reporting entities also did not calculate the dollar value of their inventory in accordance with accounting standards. Additionally, many DoD reporting entities did not have reconciliation processes for their own inventory or oversight of their inventory held by other DoD Components. Figure 11 provides examples from the FY 2022 DoD reporting entity audits.

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<sup>8</sup> The DoD was unable to provide documentation to support that the inventory reported on the balance sheet existed and that the balance included all inventory that should have been recorded.

Figure 11. Examples of DoD Reporting Entity Inventory Deficiencies Reported in FY 2022



**Legend**

DLA Defense Logistics Agency  
 OM&S Operating Materials and Supplies  
 USSGL U.S. Standard General Ledger  
 Source: The DoD OIG.

In FY 2022, auditors noted progress in some reporting entities policies, procedures, or internal controls over their inventory processes. For example, auditor testing of U.S. Marine Corps existence and completeness of inventory quantities was trending in a positive direction for testing completed during calendar year 2022. Specifically, the U.S. Marine Corps IPA tested 61,197,725 inventory samples across 16 sites and determined that only 131,869, or about 0.2 percent of samples had errors.

Aside from affecting the DoD financial statements, deficiencies in inventory 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 needed.

## General Property, Plant, and Equipment, Including Real Property

The DoD did not provide sufficient documentation to support the existence and completeness of its General Property, Plant, and Equipment (PP&E) and did not value its General PP&E in accordance with accounting standards. The DoD reported \$814.7 billion in General PP&E on the FY 2022 DoD Agency-Wide Balance Sheet, which included \$337.0 billion in real property. DoD General PP&E includes real property, such as buildings, structures, and land; general equipment, such as weapon systems; and software.

The DoD and its Components:

- did not have sufficient policies or procedures in place to accurately value and report General PP&E balances,
- were unable to substantiate the existence and completeness of the General PP&E reported in their financial statements, and
- did not have sufficient internal controls to ensure real property assets were recorded completely and accurately within their property systems of record.

*The DoD and its Components lacked sufficient policies or procedures to accurately value and report General PP&E balances. In addition, due to the lack of sufficient internal controls to ensure real property assets were recorded completely and accurately within accountable property systems of record, auditors could not perform sufficient procedures to determine whether the General PP&E balances on the financial statements were fairly presented, resulting in a scope limitation.*

For example, for FY 2022, the Army did not provide sufficient appropriate documentation to support the valuation for the more than \$62.6 billion of real property reported on the Army General Fund financial statements. In addition, for FY 2022, the Air Force needed to improve its controls and processes related to the value of the \$13.2 billion in military equipment construction in progress reported on the Air Force General Fund financial statements.

The DoD continues to work toward remediating its PP&E deficiencies. For example, in FY 2022, the Air Force made notable updates and enhancements to the design and implementation of key financial reporting controls, including implementing a process to reconcile its military equipment. In addition, the DoD corrected a \$5.7 billion understatement of the FY 2021 General PP&E balance across the Department. Furthermore, auditor testing of U.S. Marine Corps existence and completeness of PP&E was trending in a positive direction for testing completed during calendar year 2022. For example, the U.S. Marine Corps IPA tested 4,734 equipment samples at 11 sites and determined 139 (2.9 percent) of samples had errors. Additionally, the U.S. Marine Corps IPA



tested 7,330 real property assets at 19 sites and determined only 87, or about 1.2 percent had errors. Without complete and accurate data, decision makers will not have the information needed on status, cost, capacity, condition, use, and management of General PP&E.

### Reporting Entity

In FY 2022, the DoD did not report all material entities for which it has reporting responsibility within its financial statements. As noted above, Statement of Federal Financial Accounting Standard No. 47 (SFFAS 47) assists the DoD in determining which entities it should consolidate and report in the DoD Agency-Wide financial statements and what information it should present in those statements for the four types of reporting entities. SFFAS 47 defines the entities as shown in Figure 12.

*DoD management did not correctly apply SFFAS 47, which limited the auditors' ability to rely on the information published by DoD management. As a result, auditors could not conclude on the accuracy of the balances presented on the financial statements.*

Figure 12. Four Classifications of Entities

	Reporting Entity	Component Reporting Entity	Consolidation Entity	Disclosure Entity
Definition	An organization that issues its own financial statements due to a statutory or administrative requirement or by choice.	A reporting entity within a larger reporting entity.	An organization that should be consolidated in the financial statements of a reporting entity.	Similar to consolidation entities; however, they have a greater degree of autonomy.
Examples	The Army General Fund is considered a reporting entity because the OMB requires it to produce stand-alone financial statements.	The Army General Fund is also considered a component reporting entity because it is reported within the Agency-Wide Financial Statements.	The Missile Defense Agency is considered a consolidation entity because it is reported within the Agency-Wide Financial Statements.	Federally Funded Research and Development Centers are disclosure entities because they are sponsored by the DoD.

Source: The DoD OIG.

Improper implementation and application of SFFAS 47 affected the reliability of information published by DoD management and led DoD management to report materially incomplete balances in the DoD Agency-Wide financial statements. The DoD did not have a process to review the DoD Components' identified disclosure entities to determine whether they should be considered DoD Agency-Wide disclosure entities. For example, the Defense Health Program reported several disclosure entities that were not included in the DoD-Wide SFFAS 47 analysis. In addition, DoD management improperly identified all DoD consolidation entities as reporting entities in the DoD Agency Financial Report, but SFFAS 47 classifies these as two different types of entities. Therefore, the auditors concluded that the DoD improperly applied SFFAS 47.

The DoD's inability to properly identify whether all of its material entities have been consolidated or disclosed increases the likelihood that the DoD is failing to identify unique risks that may be affecting its organization and its financial statement opinion. In addition, users of the financial statements, including the public, may be misled by the DoD's failure to disclose all of the relevant and material entities that use taxpayer dollars.

### ***Government Property in the Possession of Contractors***

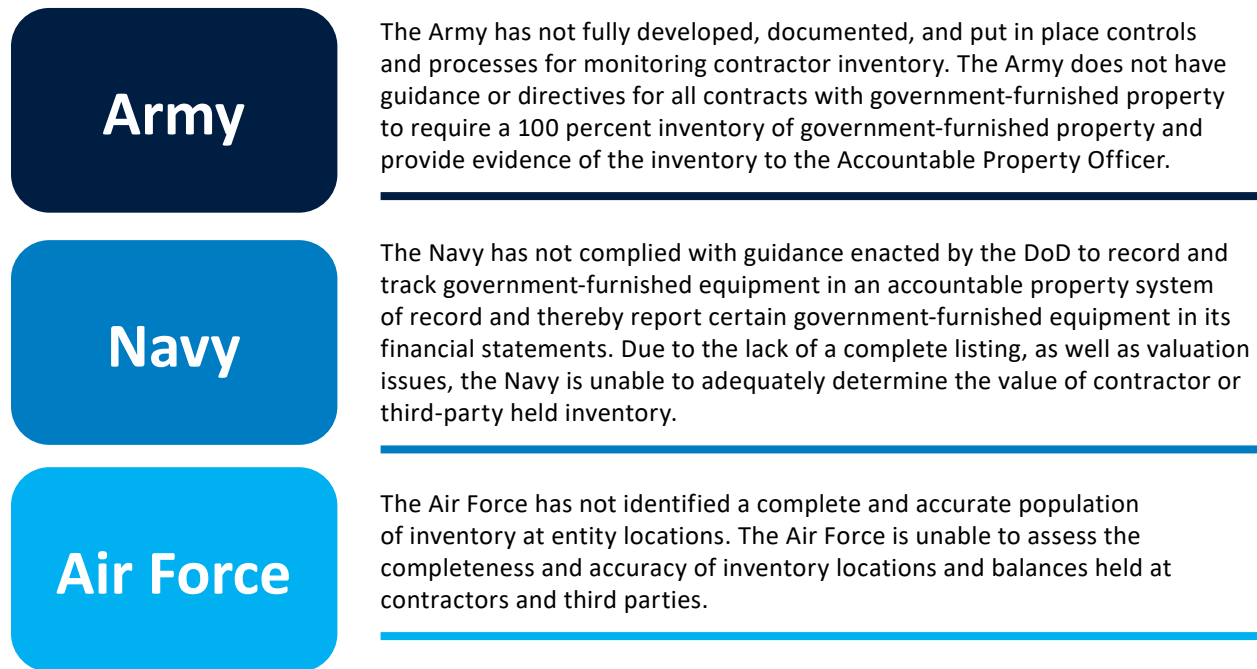
*The DoD and its Components did not have adequate internal controls to account for and reconcile their government property provided to contractors for performance of a contract or could not provide sufficient documentation to support the existence and completeness of their GPIPC. This created a scope limitation because the auditors could not perform sufficient procedures to conclude on the balances.*

In FY 2022, for the fifth consecutive year, the DoD Components could not reconcile the financial statements to the accountable property system of record and determine the existence and completeness of GPIPC. Federal regulations outline government property as all property owned or leased by the U.S. Government, including government property provided to contractors for performance of a contract (known as GPIPC).<sup>9</sup> The DoD typically includes GPIPC in Inventory for reporting on the financial statements; however, the DoD auditors will separately perform audit procedures on GPIPC to validate the existence and completeness of GPIPC

apart from Inventory. The DoD OIG identified GPIPC as a separate material weakness apart from the Inventory material weaknesses to reflect the importance of the potential risks to the financial statements. Figure 13 describes the GPIPC material weaknesses for the three Military Departments.

<sup>9</sup> Federal Acquisition Regulation (FAR) Part 45, "Government Property," Subpart 45.01, "General," Section 45.101, "Definitions."

Figure 13. DoD Military Departments' GPIPC Material Weaknesses



Source: The DoD OIG.

The DoD has not made significant progress in remediating its GPIPC material weakness although DoD leadership knows it will require action from across the operational functions of the DoD to remediate the problem. To attain accurate records for GPIPC, the DoD must design and implement corrective actions to validate and reconcile GPIPC to create an accurate starting point for proper record keeping.

The GPIPC deficiencies identified during the financial statement audits could cause the financial statements to be materially misstated and 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 or less than it needs, and, therefore, not be prepared to meet immediate or future needs.

### **Joint Strike Fighter Program**

*The Joint Strike Fighter Program Office was unable to verify the completeness and value of the Joint Strike Fighter Program assets, and the assets were not in an accountable property system of record. Not only were the auditors unable to perform the necessary procedures to conclude on the JSF property balances, but they also could not quantify the extent of the misstatement.*

In FY 2022, the DoD did not properly account for, manage, or record Joint Strike Fighter (JSF) Program assets in a financial management system or report the assets on its financial statements, causing the DoD OIG to identify this as a material weakness for the fourth consecutive year.

The JSF Program is a multi-Service and multinational acquisition to develop

and field the F-35—a fighter aircraft, pictured in Figure 14. The JSF Program is the largest acquisition program in the DoD, with an estimated lifecycle cost of \$1.7 trillion, with each F-35 costing more than \$70 million.



Figure 14. F-35 Joint Strike Fighter  
Source: The U.S. Air Force.

While this material weakness was reissued in FY 2022, the DoD has made improvements. The JSF Program Office performed an inventory count to support the existence of JSF assets; however, the DoD could not verify the completeness and value of those assets. Last year, the DoD reported that it would remediate this material weakness in FY 2023; however, in its FY 2022 Agency Financial Report, the DoD reported that it adjusted its anticipated remediation date by 4 more years to FY 2027. The DoD reported that it needed additional time to develop and implement policies, procedures, and systems to accurately record, track, and report certain JSF assets.

Because the JSF Program Office was unable to verify the completeness and value of the JSF Program assets, and because the assets were not in an accountable property system of record, the auditors were unable to perform the necessary procedures to conclude on the JSF property balances. However, the auditors were able to determine that the omission of the JSF property resulted in a material misstatement in the DoD's assets on the DoD Agency-Wide financial statements. Since the DoD updated its estimated remediation date to FY 2027 and because the JSF Program is the single largest defense program to date, it is imperative that JSF Program assets be accounted for to ensure the DoD and its partners have adequate JSF

inventory and support equipment. The DoD OIG is currently auditing the DoD's procedures for reporting JSF assets in the accountable property system of record and determining whether the DoD has made progress toward remediating this material weakness.

### **DoD-Wide Oversight and Monitoring**

In FY 2022, DoD management did not have sufficient controls over financial statement adjustments, financial statement preparation and related note disclosures, or funding execution and reporting, causing the DoD OIG to identify DoD-Wide oversight and monitoring as a material weakness for the fourth consecutive year. Oversight and monitoring encompasses the requirement that DoD management establish and incorporate internal controls into the DoD's operations at all levels.

*DoD management did not have sufficient controls over financial statement adjustments, the preparation of the financial statements and related note disclosures, or the execution and reporting of its funding, which increased the risks of misstatements and incomplete balances. As a result, auditors were unable to obtain reasonable assurance that information reported on the financial statements was presented in accordance with GAAP.*

On a quarterly and annual basis, DFAS uses its reporting system to produce the DoD Agency-Wide financial statements, which are a summary of all DoD Component financial statements. However, the DoD's business processes allowed DoD Components to make adjustments to their financial statements outside of the reporting system, and DoD management did not have sufficient internal controls over these adjustments. As a result, as demonstrated in Figure 15, there is a risk that the DoD Component financial statements are not complete and that the DoD Agency-Wide financial statements could be misstated.

*Figure 15. Impact of the DoD's Weakness in Oversight and Monitoring*



\*A Modified Opinion includes qualified opinions, adverse opinions, and disclaimers of opinion.  
Source: The DoD OIG.

Because of the DoD's size and complexity, DoD management must continuously update internal controls to adapt to new challenges, laws, and performance requirements. The development and implementation of sustainable corrective actions to remediate the DoD-Wide Oversight and Monitoring material weakness will assist the DoD in establishing an effective and efficient financial management environment.

### ***Environmental and Disposal Liabilities***

In FY 2022, for Environmental and Disposal Liabilities (E&DL), the DoD did not report all required costs, ensure DoD Components followed standards and policy to estimate them, or have sufficient formal procedures and internal controls to substantiate the completeness and accuracy of E&DL. For FY 2022, the DoD reported an E&DL balance of \$90.6 billion, which included estimated costs for the anticipated remediation, cleanup, and disposal of DoD assets associated with DoD operations. E&DL can include cleanup costs for active installations, weapon systems programs, and chemical weapons disposals.

Despite the challenges the DoD faces with E&DL, the DoD and its Components continue to work toward remediating deficiencies. For example, the Navy implemented procedures and strengthened controls for its E&DL estimation for aircraft, environmental restoration, base-realignment and closure, and other programs. The corrective actions strengthened the Navy's ability to produce, validate, and record E&DL estimates in accordance with accounting standards. The Navy's IPA confirmed the Navy's progress for reporting E&DL accurately and, accordingly, downgraded the prior-year E&DL material weakness to a significant deficiency in FY 2022.

*In FY 2022, the auditors identified E&DL as a material weakness and determined that the DoD did not have sufficient procedures or internal controls to substantiate the completeness and accuracy of its E&DL. Until the DoD provides a complete and accurate E&DL, auditors are unable to complete procedures to conclude on the E&DL balances.*

Nevertheless, the DoD reported an emerging issue due to an environmental incident at the Red Hill Storage Facility in Hawaii. In November 2021, a fuel line ruptured, resulting in the migration of 21,000 gallons of fuel into the drinking water supply at Joint Base Pearl Harbor Hickam. Approximately 93,000 people were affected by the contaminated drinking water, many of whom reported health symptoms as a result. In its FY 2022 financial statements, the DoD disclosed the Red Hill incident within the notes to the financial statements, but was unable to accurately estimate the environmental

liability associated with the incident.<sup>10</sup> While we determined that the DoD’s disclosure was appropriate under applicable accounting standards, Red Hill is only one example of an environmental incident that is still being assessed by the DoD.

Without a complete and accurate E&DL, auditors could not complete the procedures that were required to reach a conclusion on the accuracy of the E&DL balances. Additionally, such deficiencies also increased the risk that the E&DL reported in the DoD Agency-Wide financial statements may be materially misstated. The DoD must implement effective internal controls to ensure the balance of E&DL is complete, accurate, and reported in accordance with accounting standards.

## **The Financial Management Environment Needs Improvement**

As reflected throughout this report, in FY 2022, the DoD and its Components continued their efforts to remediate many of their material weaknesses. However, the material weaknesses were often caused by the lack of an effective and efficient financial management environment. 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. While it is important to continue to focus on remediating the material weaknesses, establishing an effective and efficient financial management environment is imperative for the DoD and its Components to move toward a clean audit opinion.

In this section, we discuss the three following key aspects of an effective and efficient financial management environment.

- Coordinating Financial Management Across the DoD
- Defining and Establishing Consistent Reporting Entities
- Recruiting and Retaining a Knowledgeable and Experienced Workforce

### ***Coordinating Financial Management Across the DoD***

Financial management, which includes budgeting, execution, monitoring, and reporting, consists of the policies and processes that govern the use of the funds entrusted to the DoD. There is often a misunderstanding that financial management is only the responsibility of the financial management workforce. However, financial management is everyone’s responsibility and must be a partnership across disciplines within the DoD. The DoD Financial Management Strategy, released in 2022, calls for the DoD financial management community and its partners to take action, stating, “We can only achieve successful financial management outcomes described in this strategy together – unified in vision and effort.”<sup>11</sup>

<sup>10</sup> The DoD OIG is evaluating whether Navy officials managed the operation, maintenance, safety, and oversight of the Red Hill Bulk Fuel Storage Facility, and protected the environment and drinking water systems, in compliance with Federal and state regulations and DoD policy.

<sup>11</sup> DoD Financial Management Transformation Community, OUSD(C)/CFO, “Department of Defense Financial Management Strategy, FY 22-26,” no date.

The financial management workforce and professionals from other disciplines across the DoD, such as those in acquisitions, policy, personnel, and readiness, must partner to support the development of an effective, efficient financial management environment. Additionally, the financial management workforce provides essential information to inform a wide range of decisions affecting the DoD mission. For example, policies, processes, and internal controls over the accountability of inventory not only ensure the inventory is reported correctly on the financial statements, but they also provide real-time accurate inventory data to enable Services and commands to reliably predict reorder timeframes and thereby minimize operational risk.

The OUSD(C)/CFO leads Financial Improvement and Audit Remediation (FIAR) efforts across the DoD. The FIAR efforts strive to bring together senior DoD financial management leaders and senior representatives from the functional communities, such as acquisition, logistics, and policy. Bringing these leaders together under the FIAR construct is intended to enable each to understand how their financial and operation roles intertwine, with the goal of forming partnerships that improve accuracy of information for decision makers in financial and operational disciplines.

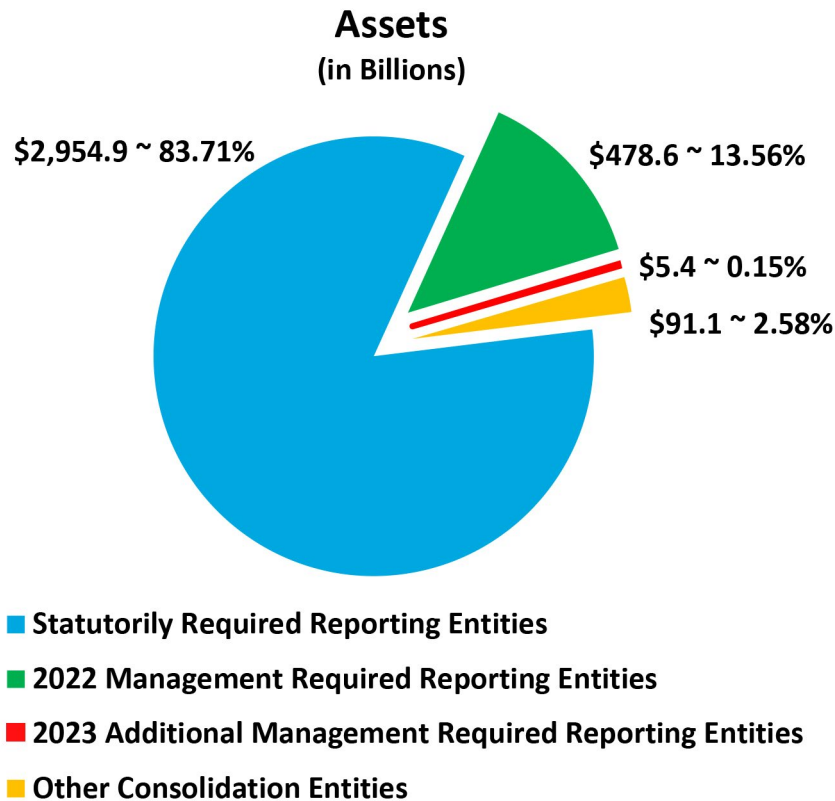
### ***Defining and Establishing Consistent Reporting Entities***

As discussed above, the DoD OIG identified Reporting Entity as a new material weakness because DoD management did not correctly apply SFFAS 47 and, as a result, did not report all entities for which it has reporting responsibility within its financial statements. In FY 2022, the DoD comprised more than 60 consolidation entities, of which 8 were statutorily required reporting entities and 18 were management directed reporting entities. Maintaining consistent reporting entities assists in proper planning for both the financial management workforce and the auditors.

The DoD has maintained consistent reporting entities since 2018, with the exception of the U.S. Marine Corps' 2-year audit cycle. However, beginning in FY 2023, the DoD added two additional reporting entities. As shown in Figure 16, the additional two reporting entities represented only 0.15 percent of the DoD Agency-Wide assets as of September 30, 2022, which has no impact on the DoD Agency-Wide financial statement audit opinion. To complete the audits of the two additional entities, the DoD committed resources across the DoD, including DFAS, which also supports the statutorily required audits, and contracted with IPAs, totaling almost \$20 million, to perform the new audits. The DoD should assess whether the benefits of performing the 20 management-directed audits warrants the resources needed to perform those audits.



Figure 16. Agency-Wide Financial Assets by Entity Category



Source: The DoD OIG.

In addition to having consistent reporting entities, the DoD should assess its overall consolidation structure. Ineffective application of SFFAS 47 created inefficient practices within the DoD. When defining the DoD consolidated entity and determining its reporting entities, the DoD should assess and determine how materiality, budget formation, operational structure, management, and systems controls are incorporated into its SFFAS 47 analysis.

Because the DoD is a large, complex, and diverse organization, the DoD must establish, document, and maintain a clear, consistent financial reporting structure. Establishing this structure will help the DoD develop a more effective and efficient financial management environment.

### ***Recruiting and Retaining a Knowledgeable and Experienced Workforce***

As reported in the FY 2022 DoD Agency Financial Report, the DoD is the largest employer in the United States, with 2.1 million Military Service members and approximately 770,000 civilian employees around the globe. As discussed in the DoD OIG's FY 2022

Top DoD Management Challenges, because of its size, the DoD is in a unique position to lead the U.S. Government in recruiting and retaining a highly skilled workforce capable of opposing the dynamic threat environment the DoD faces.<sup>12</sup>

One of the OUSD(C)/CFO's strategic goals, discussed in the DoD Financial Management Strategy, is attracting, recruiting, retaining, and training its workforce, which reflects the DoD's recognition that recruiting and retaining a skilled financial management workforce is a high priority. Yet, turnover in military and civilian leadership within the financial management community can result in changes of priorities and loss of historical knowledge.

The DoD also enhances its financial management workforce with contractors. However, DoD management is ultimately responsible for establishing and maintaining effective internal controls and financial policies. DoD OIG auditors have experienced times when the DoD contractors are more knowledgeable than DoD personnel about DoD processes, internal controls, and financial statement balances. Conversely, auditors have also experienced instances when DoD management relied solely on information provided by the contractors and reported incorrect information as a result.

The DoD must recruit and retain a knowledgeable and experienced workforce to improve its financial management environment. In addition, DoD financial managers should develop a knowledge transfer program to ensure continuity of historical knowledge during personnel turnover and enable fully informed decision-making. Overall, a more experienced and knowledgeable financial management workforce will create a more efficient and effective financial management environment.

## Conclusion

Auditors completed the DoD's and reporting entities' FY 2022 financial statement audits for the fifth consecutive year and noted minimal overall changes in the financial statement opinions. Of the 26 DoD reporting entities that underwent stand-alone audits, 9 reporting entities received clean opinions, 1 reporting entity received a qualified opinion, and 16 reporting entities received disclaimers of opinion.

In FY 2022, auditors issued 2,984 NFRs. Of those NFRs, 479 were new NFRs regarding issues identified during the current audit, and 2,505 were reissued prior-year NFRs that were not corrected during FY 2022. The DoD OIG reported a total of 28 material weaknesses and 3 significant deficiencies. While the number of material weaknesses did not change between FYs 2021 and 2022, the DoD OIG combined three prior-year material weaknesses into repeat material weaknesses and identified three new material weaknesses in FY 2022.

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<sup>12</sup> "Fiscal Year 2022 Top DoD Management Challenges" [https://media.defense.gov/2021/Nov/16/2002893873/-1/-1/1/management%20challenges\\_FY22.pdf](https://media.defense.gov/2021/Nov/16/2002893873/-1/-1/1/management%20challenges_FY22.pdf).

Achieving a clean financial statement opinion is a long-term effort for the DoD. As discussed throughout this report, the DoD and its Components must prioritize efforts to fix the weaknesses and deficiencies identified in the audits. Specifically, the DoD must focus on those material weaknesses that are scope-limiting and prevent the auditors from performing necessary procedures to draw a conclusion on the financial statements. To do so, DoD leadership must develop a sustainable, efficient, and effective financial management environment. The DoD and its Components must work together to develop unified, consistent, and sustainable processes that will support DoD operations, and ultimately lead to a clean audit opinion and the financial health that reflects for the Department and the American taxpayers.

## Appendix

The DoD OIG identified 28 material weaknesses in FY 2022. Table 2 lists the DoD OIG identified material weaknesses as depicted in the DoD Agency Financial Report.

*Table 2. Agency-Wide Material Weaknesses*

Deficiency	Description	FY 2022 Status
Financial Management Systems Modernization	The DoD maintained financial management systems that did not comply with applicable accounting standards. Therefore, the DoD could not produce a complete inventory population in accordance with the Federal Financial Management Improvement Act.	Modified Retitled from FY 2021
Configuration Management and Security Management	The DoD lacked necessary configuration and security management internal controls within financial management systems. This contributed to the risk of unauthorized use or modification to systems.	Repeat
Access Controls	The DoD insufficiently validated whether system users had appropriate access to financial management systems. Therefore, the confidentiality and integrity of financial data could be compromised.	Repeat
Segregation of Duties	The DoD had an absence of appropriate segregation of duties internal controls for financial systems. Therefore, the DoD could not identify whether stakeholders held inappropriate access and administration duties within feeder systems.	Repeat
Interface Controls	The DoD did not have reasonable assurance that data processed within financial systems were accurate and timely. Due to the DoD's lack of policies surrounding the completeness and reconciliations of financial systems, amounts within the financial statements may have been misstated.	New
Universe of Transactions	The DoD was not able to provide a complete transaction-level population to support line items. As a result, the DoD could not reconcile trial balances based on transaction-level detail. This may have led to misstated financial statement amounts.	Repeat
Reporting Entity	The DoD did not follow applicable standards that outline reporting entity principles. Therefore, the DoD could not provide a complete population of disclosure entities and inappropriately classified other entities.	New
DoD Component-level Accounts	The DoD did not maintain internal controls surrounding the efficiency of operations and reliability of data, specifically within the DoD Component-level Accounts entity. The DoD did not properly corroborate the completion and accuracy of these accounts.	New
Fund Balance with Treasury Incorporated FY 2021 material weakness— Suspense Account	The DoD did not have policies and procedures to reconcile or monitor its FBWT. This increased the chance of misstated financial statement amounts.	Modified

Table 2. Agency-Wide Material Weaknesses (cont'd)

Deficiency	Description	FY 2022 Status
Inventory and Stockpile Materials	The DoD did not follow applicable guidance in relation to the valuation of stockpile material. In addition, some DoD Components were not able to justify the existence or completeness assertions for inventory and stockpile material accounts.	Repeat
Operating Materials and Supplies	The DoD did not follow applicable guidance in relation to the valuation of Operating Materials and Supplies. In addition, some DoD Components were not able to justify the existence or completeness assertions for Operating Materials and Supplies accounts.	Repeat
General Property, Plant, and Equipment	The DoD did not follow applicable guidance in relation to the valuation of General PP&E. In addition, some DoD Components were not able to justify the existence or completeness assertions for General PP&E accounts.	Repeat
Real Property	The DoD was not able to support real property balances due to a lack of internal controls surrounding the completeness and accuracy of their accountable property system of record. As a result, real property assets may have been unsupported at the Component-level and the real property balance reported for General PP&E may have been materially misstated.	Repeat
Government Property in the Possession of Contractors	The DoD did not have policies and procedures regarding the reconciliation of GPIPC to the appropriate accountable property system of record. The DoD Components were unable to record the balances of GPIPC accurately, which led to the potential misstatement of GPIPC.	Repeat
Joint Strike Fighter Program	The DoD omitted JSF Program assets within its FY 2022 financial statements due to the DoD's inability to obtain accurate and reliable data surrounding JSF Program government property. The omission of this information, the financial statements were materially misstated and incomplete.	Modified
Accounts Payable	The DoD had insufficient policies and procedures to support the existence of its Accounts Payable accounts. In addition, the DoD did not have an appropriate methodology for accruing payables. This contributed to the potential misstatement of accounts payable reported in the financial statements.	Repeat
Environmental and Disposal Liabilities	The DoD did not follow applicable guidance available regarding the estimation of E&DL. This included not being able to substantiate the completeness and accuracy of E&DL data. Therefore, E&DL may have been materially misstated.	Repeat
Contingent Legal Liabilities	The DoD lacked appropriate documentation and internal controls within the calculation and consolidation of contingent legal liabilities. This created a risk that contingent legal liabilities may have been materially misstated.	Repeat
Beginning Balances	The DoD had financial management system limitations and did not maintain necessary historical data, which contributed to the lack of sufficient support for beginning balances of DoD financial statements. This ultimately led to the possibility that the financial statements may be materially misstated.	Repeat

Table 2. Agency-Wide Material Weaknesses (cont'd)

Deficiency	Description	FY 2022 Status
Unsupported Accounting Adjustments	The DoD lacked the internal controls necessary to validate complete and accurate accounting adjustments and approvals. Therefore, balances in the financial statements could have been potentially be misstated.	Repeat
Intragovernmental Transactions and Intradepartmental Eliminations	The DoD was not able to provide assurance that its financial management feeder systems eliminated intragovernmental and intradepartmental transactions. Therefore, balances in the financial statements could have been potentially misstated.	Repeat
Gross Costs	The DoD did not follow applicable guidance in relation to gross costs. As a result, the DoD Components' gross costs data were ineffectively managed and contributed to the possibility of misstated financial statement balances.	Repeat
Earned Revenue	The DoD did not follow applicable guidance in relation to earned revenue. As a result, the DoD Components' earned revenue data were ineffectively managed and contributed to the possibility of misstated financial statement balances.	Repeat
Reconciliation of Net Cost of Operations to Outlays	The DoD lacked the policies and procedures necessary to reconcile differences between budgetary and proprietary data throughout reporting periods. As a result, the DoD Agency-Wide financial statements did not accurately reflect the appropriate net position of the DoD and may have misstated financial statement balances.	Repeat
Budgetary Resources	The DoD did not have supported or complete balances within the Components' Statement of Budgetary Resources. Therefore, the DoD and its Components could not provide their available budgetary resources and the status of their resources.	Modified
Service Organizations	The DoD had numerous service organizations across the DoD reporting entities. These service organizations lacked enterprise-wide policies and were not able to provide the necessary assurance to user entities due to their inadequate controls. This contributed to the possibility of materially misstated financial statement balances.	Repeat
Component Entity-level Controls Incorporated FY 2021 material weakness—Component-Level Oversight and Monitoring	The DoD had many control deficiencies surrounding its ineffective control and design of the four components of internal control. In addition, the DoD Components had insufficient procedures for monitoring internal controls. This led to the risk of the financial statements being materially misstated.	Modified Retitled from FY 2021
DoD-Wide Oversight and Monitoring Incorporated FY 2021 material weakness—Financial Statement Compilation	The DoD lacked controls over the review of financial statements and related disclosures, as well as financial statement adjustments made at the Component-level. Therefore, this increased the risk that information presented in the financial statements could have been incomplete or inaccurate.	Modified

Source: The DoD OIG.

# Acronyms and Abbreviations

<b>DFAS</b>	Defense Finance and Accounting Service
<b>E&amp;DL</b>	Environmental and Disposal Liabilities
<b>FBWT</b>	Fund Balance with Treasury
<b>FIAR</b>	Financial Improvement and Audit Remediation
<b>GAAP</b>	Generally Accepted Accounting Principles
<b>GPIPC</b>	Government Property in the Possession of Contractors
<b>IPA</b>	Independent Public Accountants
<b>IT</b>	Information Technology
<b>JSF</b>	Joint Strike Fighter
<b>NFR</b>	Notice of Finding and Recommendation
<b>OIG</b>	Office of Inspector General
<b>OMB</b>	Office of Management and Budget
<b>OUS(D)/CFO</b>	Office of the Under Secretary of Defense(Comptroller)/Chief Financial Officer
<b>PP&amp;E</b>	Property, Plant, and Equipment
<b>SFFAS</b>	Statement of Federal Financial Accounting Standards





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