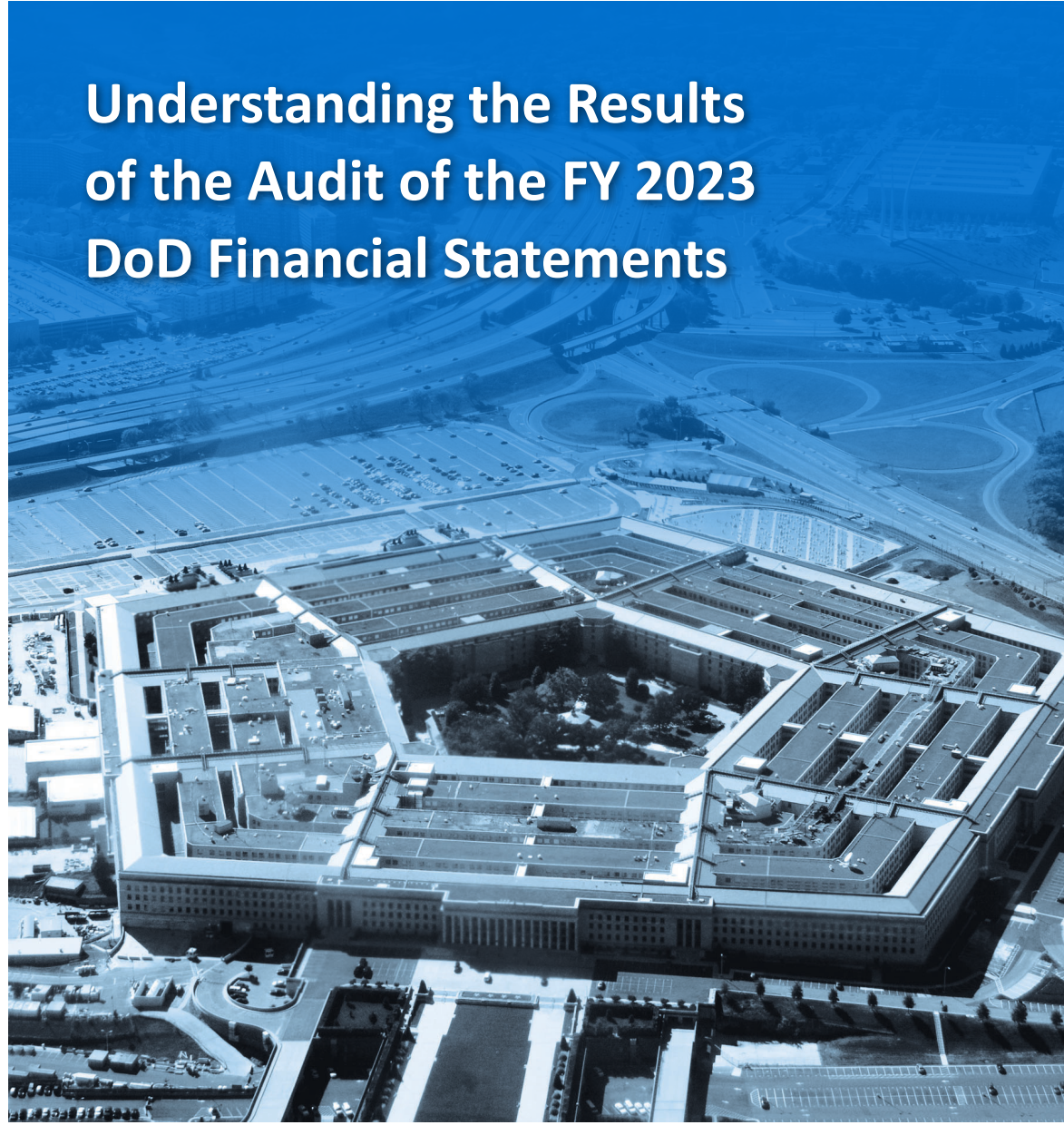




INSPECTOR GENERAL

U.S. Department of Defense

AUGUST 8, 2024



Understanding the Results of the Audit of the FY 2023 DoD Financial Statements

INDEPENDENCE ★ INTEGRITY ★ EXCELLENCE ★ TRANSPARENCY





**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
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August 8, 2024

During FY 2023, the DoD underwent its sixth financial statement audit. As in prior years, the DoD Office of Inspector General (OIG) issued a disclaimer of opinion on the FY 2023 DoD Agency-Wide Financial Statements, meaning the DoD could not provide sufficient evidence for the auditors to conclude whether the DoD fairly presented its financial statements in accordance with accounting guidance.

While the DoD OIG's disclaimer did not change from the prior year, the DoD did make progress toward remediating significant findings. Specifically, auditors were able to close 1,045 notices of findings and recommendations (NFRs) for various reasons, including that the DoD acted to correct the condition, the condition no longer existed, or the process or system used was eliminated. However, auditors also reissued 2,644 NFRs that identify issues from prior years that the DoD has not yet corrected and issued 569 new NFRs for issues identified during the FY 2023 audits.

Within the DoD OIG's audit report the DoD OIG identified 28 DoD 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. The number of material weaknesses in FY 2023 remained the same as the FY 2022 report; however, the DoD OIG combined two prior-year material weaknesses into one material weakness and separated one prior-year material weakness into two material weaknesses, which allowed the DoD to better align their remediation plans to those material weaknesses.

The public release of DoD OIG reports promotes accountability by the DoD and transparency with the public regarding the financial and operational challenges facing the DoD and its stewardship of taxpayer funds. Given the DoD's vital mission, and the significant resources required to execute its mission, the challenges the DoD faces are of substantial public importance. This report is intended to summarize, in a manner that is understandable to all, those challenges, which directly impact its ability to pass an audit of its financial statements. Specifically, this report explains and discusses the findings of our audits of the DoD 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, and the substantial collaborative effort needed from all DoD and non-DoD stakeholders to obtain an unmodified, or clean, audit opinion by FY 2028.

While the DoD has acknowledged the importance of financial statement audits and devoted substantial effort to making progress on them, the DoD must be mindful that accountability and transparency should be prerequisites when building new or modifying existing operational business processes. That is, financial management processes and controls must be built into the operational mission of the DoD. The Office of the Secretary of Defense civilian decision makers responsible for weapons acquisition, research, information technology, intelligence, personnel, and supply and logistics should collaborate with the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, to ensure the integration of robust financial management and accountability controls when building new or modifying existing operational systems. Through this collaboration and integration, the DoD would improve its operational effectiveness, enhance its decision-making capabilities, and be better positioned to achieve an unmodified (clean) financial statement audit opinion.

Obtaining a clean audit opinion is critically important for the DoD. The DoD's successful passing of an audit is also essential to the Government-wide financial statements receiving a clean audit opinion due to DoD's size and budget. However, the financial statement audits have value far beyond the audit opinion. The audits—and accurate financial statements—enable Congress and the public to assess how the DoD spends its money, help the DoD improve its operations, identify vulnerabilities in information technology and other systems, and can prevent wasteful practices before they occur and help to identify and remediate them when they do.

The DoD OIG has initiated several performance audits and will continue to explore the potential for additional impactful oversight based on issues identified through the financial statement audit. For example, during FY 2023, the DoD OIG performed audits related to outdated information systems, Ukraine assistance funding, the Joint Strike Fighter program, and the DoD's use of attestation engagements to review shared systems and processes. We will continue to fully and fairly audit the financial statements, identify deficiencies, and provide clear information and recommendations to the DoD on what is necessary to fix those deficiencies. We remain fully committed to this important long-term effort to improve the financial health of the DoD and, thereby, help to ensure its stewardship of taxpayer funds comprising approximately half the discretionary spending of the federal government, and 70 percent of its assets.

A handwritten signature in black ink, appearing to read 'Robert P. Storch', written in a cursive style.

Robert P. Storch
Inspector General

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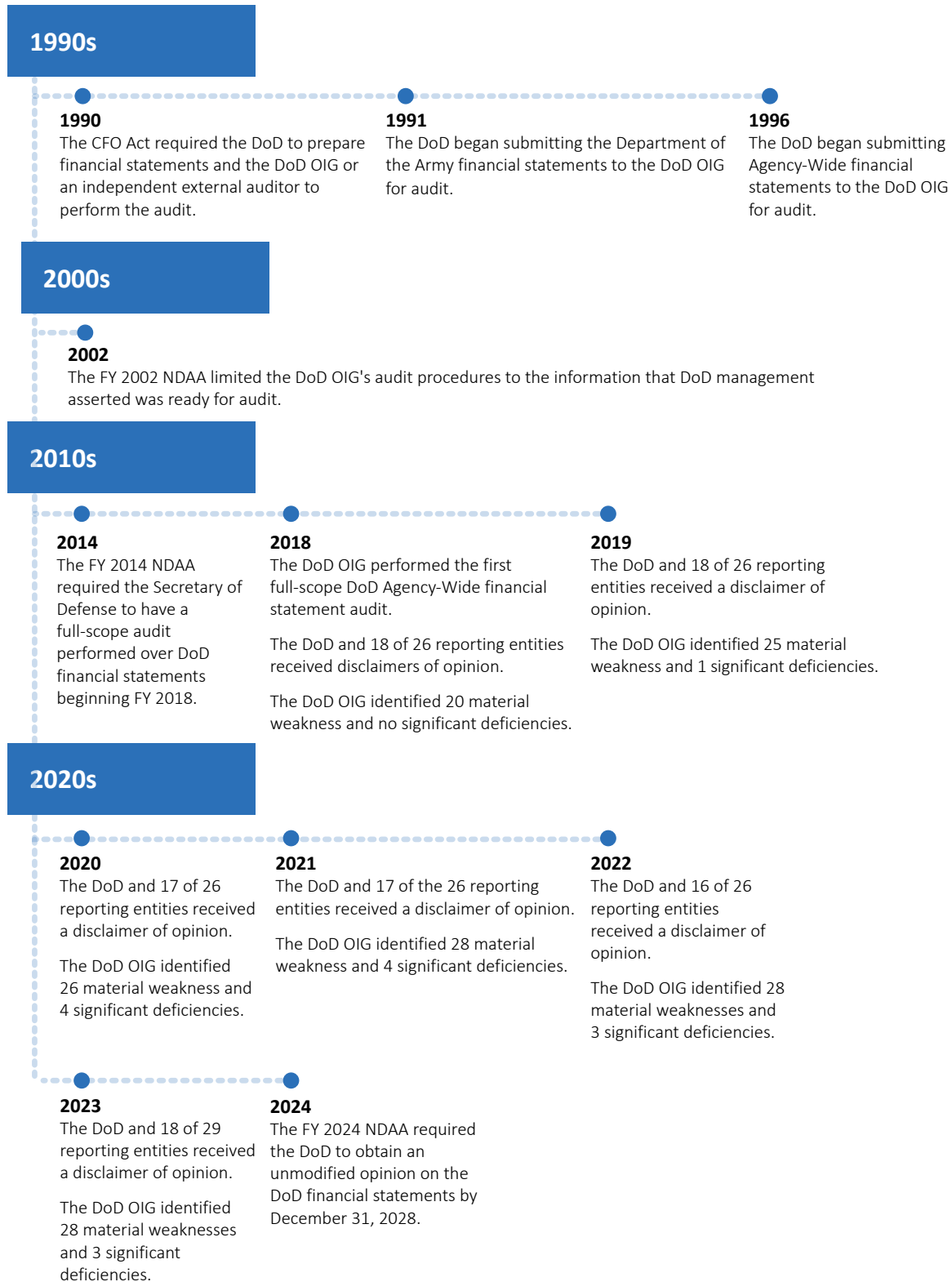
Understanding the Results of the DoD FY 2023 Audited Financial Statements

The DoD prepares the annual DoD Agency Financial Report and the Component-level financial statements to provide an overview of the financial and operational performance of the DoD and its Components. The DoD issued its FY 2023 DoD Agency Financial Report, which included the FY 2023 DoD Agency-Wide Financial Statements, on November 15, 2023. The DoD OIG performed an audit of the FY 2023 DoD Agency-Wide Financial Statements and oversaw independent public accountants (IPAs) as they performed audits of the DoD Components' financial statements. Collectively we performed the audits to determine whether the DoD and its Components presented their financial statements in accordance with Generally Accepted Accounting Principles (GAAP). GAAP establishes accounting concepts and principles to ensure that an organization's financial statements are clear, consistent, and comparable.

Shortly after the enactment of the Chief Financial Officers (CFO) Act of 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.¹ In FY 2002, as shown in Figure 1, Congress limited the audit procedures and directed the DoD OIG to perform audit procedures on only information that DoD management asserted was ready for audit. It was not until 28 years after the enactment of the CFO Act that Congress required the DoD to undergo its first full-scope financial statement audit. Over the last 6 years of full-scope audits, the DoD has shown incremental progress toward obtaining a favorable audit opinion. Despite that progress, the DoD still has substantial work to do, and its corrective action plans show that DoD management does not expect to obtain a favorable audit opinion until FY 2028.

¹ Public Law 101-576, "Chief Financial Officers Act of 1990," November 15, 1990, as amended (31 U.S.C. § 3515).

Figure 1. Progression of the DoD Agency-Wide Financial Statements



LEGEND

NDAAs 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 2023 financial statement audits.

In this report, we will also explain the FY 2023 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 2023 DoD Agency Financial Report, the DoD employed approximately 2.1 million Military Service members and approximately 778,000 civilian employees. The DoD has assets that are located on more than 4,600 DoD sites located in all 50 states, the District of Columbia, 7 U.S. territories, and more than 40 foreign countries. In FY 2023, the DoD reported discretionary appropriations of \$851.7 billion and comprised half the discretionary spending of the United States, and it reported nearly \$3.8 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.

Accountability

To be accountable 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 amounts 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.

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

Transparency

The DoD OIG's financial statement audits provide transparency to Congress and the public of how the DoD spends its resources. The audits are designed to validate and substantiate the financial information reported by the DoD. However, the reported financial information 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 processes and procedures in place to manage those funds, the public's confidence that the funds were used for the intended purpose could suffer. The DoD Agency-Wide audit supports transparency by identifying gaps in the DoD's operations, internal controls, processes, policies, and asset accountability. The DoD Agency-Wide auditors communicate those gaps through audit findings documented in the auditor's report. From those findings, the DoD then creates corrective action plans to close those gaps, with the goal of improving the overall health and transparency of the DoD's financial environment.

Operational Impact

Financial statement audits provide valuable insight into the DoD's business processes, by evaluating which processes are working well and which are not. For example, financial statement audits assess the controls in information technology (IT) systems the DoD uses to execute and manage its operations. The auditors can identify vulnerabilities and make recommendations to improve the DoD's IT structure. Securing those IT systems by improving controls provides auditors with more assurance that the financial information those systems produce is accurate and reliable.

As an added benefit, increased effectiveness of internal controls will have a positive effect on the DoD's ability to rely on information systems when making operational decisions. For example, an operational leader will be better suited to strategically place assets in support of a mission if they are using an IT system that accurately displays where those assets are located. The operational leader can rely on the information in the system, and therefore, can provide the needed assets for the mission with confidence. To achieve this, the DoD's operational and financial leaders should work together when designing or modifying existing systems and processes to ensure that proper controls have been implemented. In doing

so, the DoD can improve the reliability and sustainability of its decision-making systems and processes, while simultaneously strengthening financial statement accountability and transparency across the DoD.

DoD Financial Management Responsibilities

The DoD OIG articulated in its Understanding the Results of the Audit of the FY 2022 DoD Financial Statements report that coordination of the financial management environment across the DoD was critical to remediating the significant issues facing the financial statement audits.² Financial management activities include budgeting, executing, monitoring, and reporting, and consist of the policies and processes that govern the use of funds entrusted to the DoD. Financial management is a holistic responsibility and must be a partnership between the many disciplines across the DoD.

Since 1995, the Government Accountability Office (GAO) has identified DoD financial management on its “High-Risk List.”³ GAO officials stated in a May 2023 report that they “designated DoD financial management as high risk because of pervasive deficiencies in the DoD’s financial management systems, business processes, internal controls, and financial reporting.”⁴ The GAO’s “High-Risk List” report stated that “sound financial management practices and reliable, useful, timely financial and performance information would help improve the DoD’s accountability over its extensive resources and would support more efficient management of these resources.”

The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD (OUSD[C]/CFO) published the DoD Financial Management Strategy for FY 2022 to FY 2026 to simplify and standardize the DoD’s financial management environment to accelerate budget confidence, operational effectiveness, cybersecurity protection, auditability, transparency, and agility.⁵ In short, the DoD Financial Management Strategy is a call to action across the military, civilian, and contractor professionals, outlining the OUSD(C)/CFO’s five strategic goals that represent the highest priorities for the DoD-wide financial management community from FY 2022 to FY 2026.

1. Cultivate a skilled and inspired financial management workforce.
2. Optimize taxpayer dollars for the highest value outcomes.
3. Increase the integrity of financial results.
4. Simplify and optimize end-to-end business environment.
5. Empower data-driven, fiscally informed decision-making.

² Report No. DODIG-2023-070, “Understanding the Results of the Audit of the FY 2022 DoD Financial Statements,” May 16, 2023.

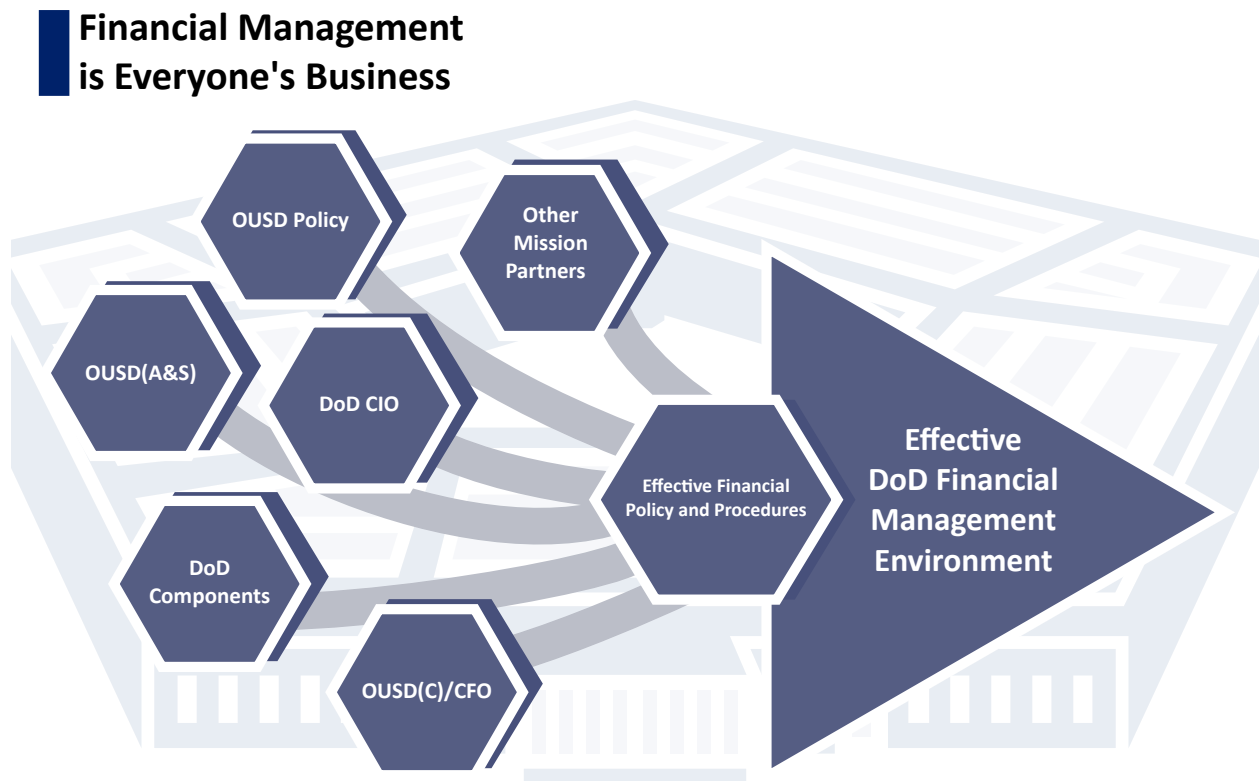
³ GAO Report No. GAO-23-106203, “High Risk Series: Efforts Made to Achieve Progress Need to Be Maintained and Expanded to Fully Address All Areas,” April 20, 2023. The GAO’s “High-Risk List” is a list of Federal programs and operations that are vulnerable to fraud, waste, abuse, and mismanagement, or need transformation.

⁴ GAO Report No. GAO-23-105784, “DoD Financial Management: Additional Actions Needed to Achieve a Clean Audit Opinion on DoD’s Financial Statements,” May 2023.

⁵ DoD Financial Management Transformation Community, OUSD(C)/CFO, “Department of Defense Financial Management Strategy, FY 22-26,” no date.

As shown in Figure 2, various parties within the Office of Secretary of the Defense and DoD Component management contribute to the effectiveness of the DoD’s financial management environment. We also identify roles and responsibilities of the various parties that are essential for a successful financial management environment in the sections following Figure 2.

Figure 2. Financial Management is Everyone’s Business



Source: The DoD OIG.

Office of the Secretary of Defense

The Office of Secretary of the Defense is responsible for policy development, planning, resource management, and program evaluation; and includes the offices of top civilian defense decision makers for personnel, weapons acquisition, research, intelligence, and fiscal policy. The following Office of Secretary of the Defense officials and organizations have important roles in coordinating financial management activities across the DoD.

- **Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD** – Responsible for budgetary and fiscal matters including financial management, accounting policy and systems, manager’s internal control systems, and other financial management activities for the DoD. The OUSD(C)/CFO develops, publishes, and interprets DoD-wide financial management improvements, audit readiness and execution methodologies, and guidance that supports statutory requirements for the DoD to audit its full set

of financial statements. The OUSD(C)/CFO also leads and oversees certain targeted efforts toward improved DoD financial integrity, including reporting Joint Strike Fighter parts and equipment.

- **DoD Chief Information Officer (CIO)** – Responsible for matters relating to IT and information resources management and ensuring that defense business systems comply with the DoD’s auditability requirements. For example, the Office of the DoD CIO develops DoD strategy and policy on the operation and protection of all DoD IT and information systems, including development of enterprise-wide architecture requirements and technical standards, and operation, and maintenance of systems. In addition, the Office of the DoD CIO coordinates with the OUSD(C)/CFO to develop a full and accurate accounting of DoD IT expenditures and related expenses.
- **Under Secretary of Defense for Acquisition and Sustainment (USD[A&S])** – Responsible for acquisition and sustainment related matters in the DoD, including production; logistics and distribution; procurement of goods and services; materiel readiness; maintenance; business management modernization; and nuclear, chemical, and biological defense programs. The Office of the USD(A&S) directs the Secretaries of the Military Departments and the DoD Components in executing such acquisition and sustainment functions. Furthermore, the Office of the USD(A&S) establishes policies and procedures for logistics to improve the visibility, accountability, and control of critical assets and support the auditability of the logistics enterprise.
- **Under Secretary of Defense for Policy** – Responsible for all matters of formulation of national security and defense policy, and the integration and oversight of DoD policy and plans to achieve national security objectives. This office impacts the financial management environment because it is responsible for the policy that governs the operations of the DoD.

DoD Components and Other Mission Partners

DoD Component management is responsible for ensuring that key processes, systems, and internal controls are effectively designed and implemented to support financial management operations.⁶

Furthermore, the Secretaries of the Military Departments are responsible for, among other common military functions, ensuring that their respective Departments efficiently and effectively implement policy, program, and budget decisions and instructions of the President or the Secretary of Defense; administer the funds made available for maintaining, equipping, and training forces; and establish and maintain reserves of manpower, equipment, and supplies.

⁶ For purposes of this report, a DoD Component is a Military Department, Defense agency, DoD field activity, combatant command, or other organizational entity within the DoD.

Defense agencies and DoD field activities provide consolidated support and service functions under the authority, direction, and control of the Secretary of Defense. Examples of Defense agencies include the Defense Finance and Accounting Service (DFAS), which provides financial management and accounting services, and the Defense Logistics Agency (DLA), which provides supplies to Military Services and supports the acquisition of weapons, fuel, repair parts, and other materials, as well as disposal of excess or unusable equipment. The Defense agencies and DoD field activities have government personnel in acquisitions, policy, personnel, readiness, and other non-financial roles. These non-financial managers have a significant part in establishing controls within the systems and processes they use. Those systems and processes either directly or indirectly feed into the DoD's financial management systems, highlighting the need for collaboration between operational and financial management personnel to establish a sound control environment.

In addition to the workforce within the DoD Components, the DoD partners with industry and commercial contractors to provide the goods and services it needs to support the DoD mission. These mission partners play a vital role in the DoD's operational and financial success. As a result, the DoD's goal of improving its financial management environment extends to the controls, practices, and policies employed by those outside the direct purview of the DoD. The DoD's financial management workforce and their mission partners must work together to support the development of an effective, efficient financial management environment by ensuring that operational and financial controls are built into the systems, policies, and practices that mission partners use when providing goods and services to the DoD. Through close collaboration, the DoD's mission partners can contribute to the strengthening of the DoD's financial management environment, improve operational decision making by providing accurate and reliable information, and increase the DoD's chances of audit success.

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. Figures 3 and 4 identify those involved and their responsibilities in preparing and auditing the DoD financial statements.

Figure 3. Responsibilities for Financial Statement Preparations and Audits



Source: The DoD OIG.

Figure 4. Responsibilities for Conducting Financial Statement Audits



Source: The DoD OIG.

Preparing and Auditing the DoD Financial Statements

The DoD Agency-Wide financial statements combine the financial activity of 62 DoD entities. The DoD publishes its financial statements annually as part of the DoD Agency Financial Report, which is DoD management’s representation of the DoD financial and operational performance. Included in the DoD Agency Financial Report is the DoD OIG’s independent auditor’s report on the fair and reasonable presentation of the DoD financial statements, and the DoD’s Top Management Challenges. Figure 5 identifies and explains significant sections of the FY 2023 DoD Agency Financial Report.

Figure 5. Significant Sections of the DoD Agency Financial Report



¹ 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.

² 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.

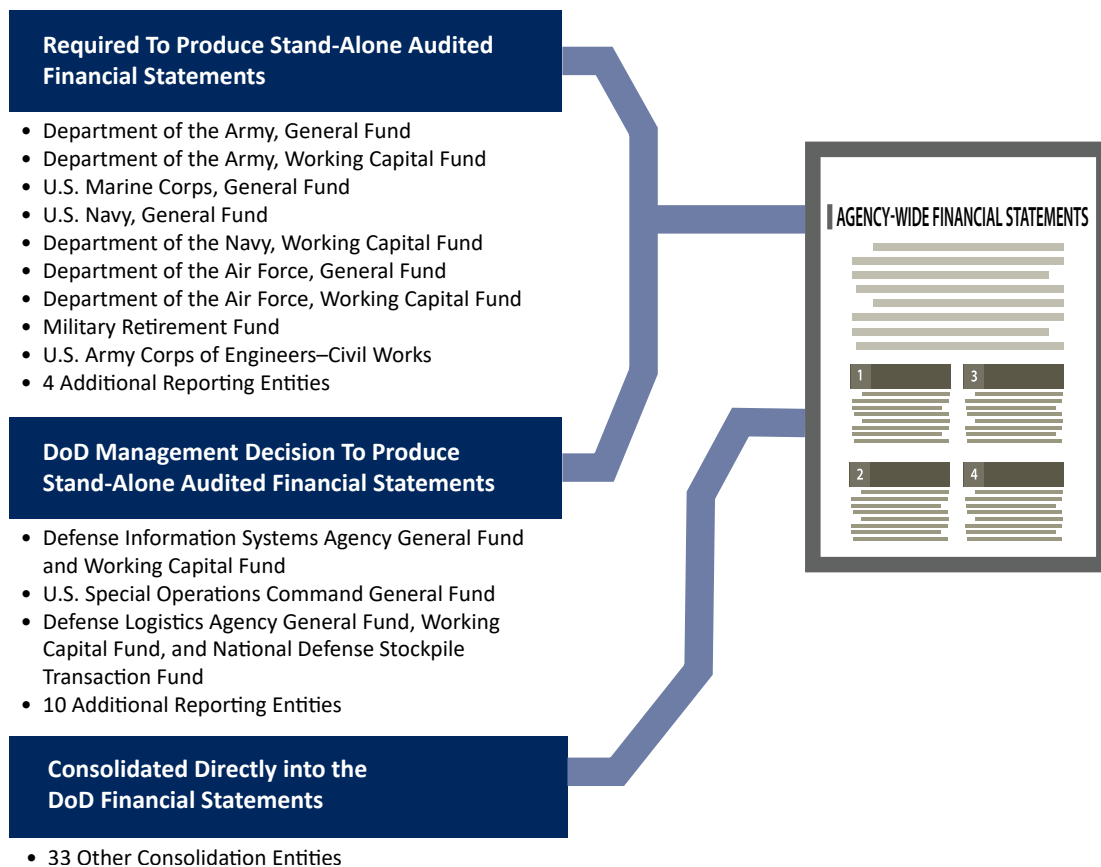
³ The DoD OIG's report on the Top DoD Management and Performance Challenges is statutorily required by the Reports Consolidation Act of 2000, 31 U.S.C. § 3516(d).

Source: The DoD OIG.

Requirements for DoD Entities to Produce Stand-Alone Financial Statements

As stated previously, the DoD Agency-Wide financial statements combine the financial activity of 62 DoD entities. Of the 62 entities, 29 prepare and issue their own stand-alone financial statements to meet certain reporting requirements.⁷ Specifically, the DoD prepares and issues stand-alone financial statements for 13 of the 29 entities as required by law and Office of Management and Budget (OMB) Bulletin No. 24-01.⁸ The remaining 16 are required by DoD management. The 33 entities that did not produce their own stand-alone financial statements are consolidated directly into the DoD Agency-Wide financial statements.⁹ Figure 6 provides a summary of the DoD’s financial statement preparation requirements for DoD entities.

Figure 6. The DoD’s Financial Statement Preparation Requirements



Note: While the U.S. Special Operations Command produced stand-alone financial statements in FY 2023, they will be consolidated directly into the DoD Agency-Wide financial statements for FY 2024.

Source: The DoD OIG.

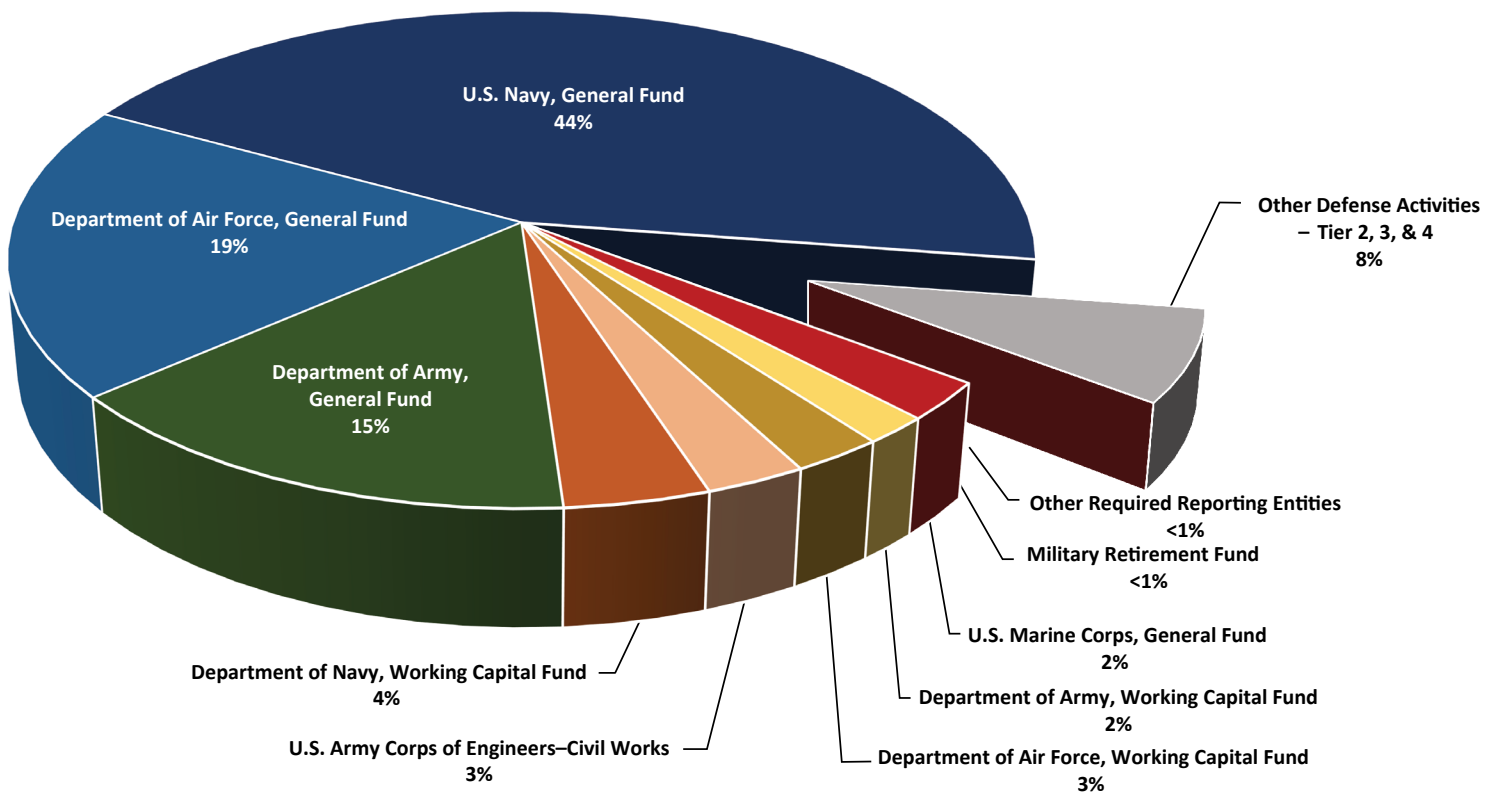
⁷ A reporting entity is an organization that issues its own financial statements due to a statutory or administrative requirement or by choice, such as the Army General Fund and the Defense Logistics Agency General Fund.

⁸ Of the 13, 9 are required by the Government Management Reform Act of 1994, as designated in OMB Bulletin 24-01 and implemented by DoD, while the other 4 are required by section 3108, title 50, United States Code.

⁹ A consolidation entity is an organization that should be consolidated in the financial statements of a reporting entity, such as the Missile Defense Agency.

The decision for OMB or DoD management to require an entity, that is not part of the CFO Act mandate, to have a stand-alone audit or be consolidated directly into the DoD Agency-Wide financial statement is generally driven by the materiality of that entity. Figure 7 shows the DoD’s total assets, other than intragovernmental assets, that are held by DoD entities. As depicted, most assets are held by entities that are required to produce stand-alone financial statements. Only 8 percent of the DoD’s assets are reported by entities that DoD management directed to produce stand-alone financial statements or that are directly consolidated into the DoD financial statements.

Figure 7. Total Other Than Intragovernmental Assets by DoD Entity



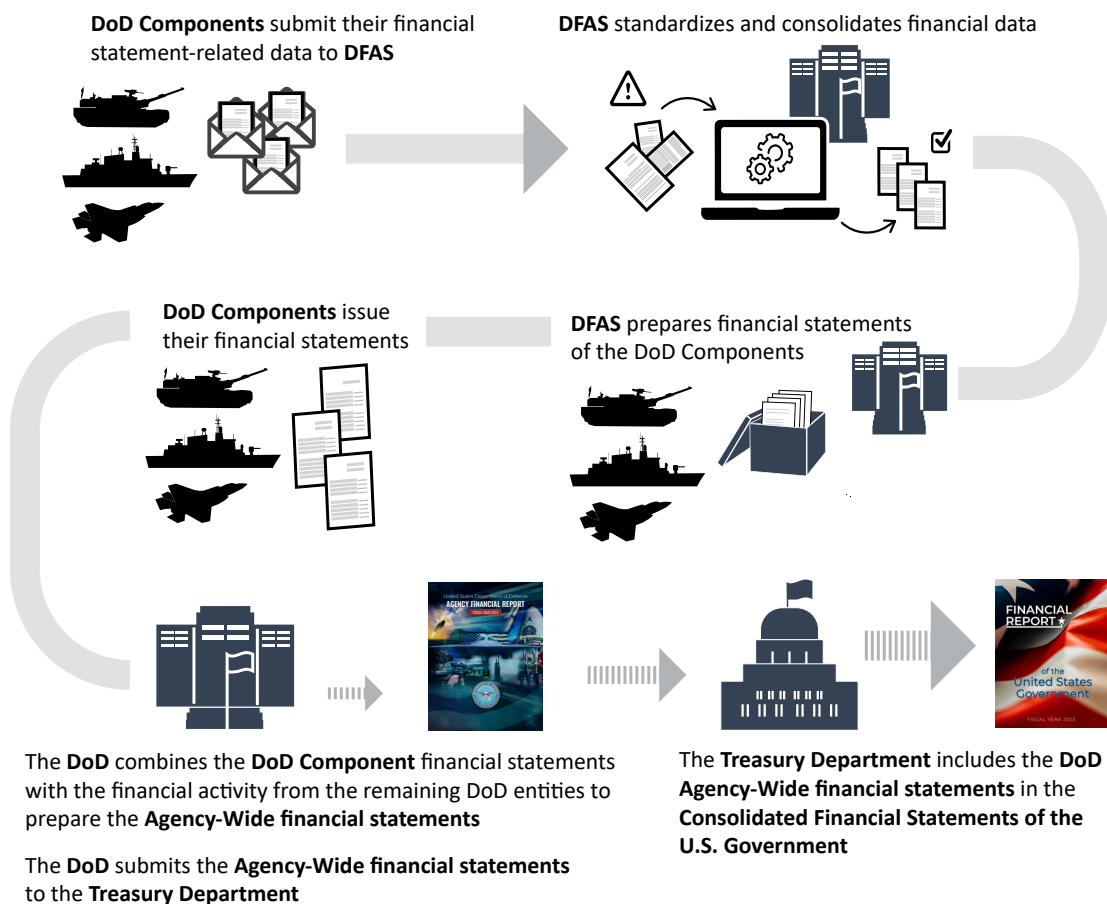
Note: This figure excludes intragovernmental assets because intragovernmental assets represent an asset to one Government entity while being a liability to another. Those assets net to zero and do not impact the Government-wide financial statements.

Source: The DoD OIG.

Preparing the DoD Agency-Wide Financial Statements

The process for preparing the consolidated DoD Agency-Wide financial statements begins with DoD reporting entities providing DFAS the financial information required to build the entity's financial statements. DFAS personnel then standardize the financial information and prepare that entity's stand-alone financial statements.¹⁰ Those stand-alone financial statements will ultimately be combined and consolidated with the financial information from entities that do not produce stand-alone financial statements to produce the DoD Agency-Wide financial statements. After consolidation, DFAS provides the DoD Agency-Wide financial statements and supplementary financial information to the Treasury Department for inclusion in the Consolidated Financial Statements of the U.S. Government. Figure 8 provides a high-level illustration of the process for preparing the financial statements.

Figure 8. Key Steps for Preparing the DoD Financial Statements



Source: The DoD OIG.

¹⁰ 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.

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 GAO and OMB. To oversee the IPAs' audits of significant reporting entities, the DoD OIG verifies the IPAs' compliance with applicable auditing standards and contract requirements. The DoD OIG's oversight procedures include reviewing the IPAs' plans, procedures, and testing 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.

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 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 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 9 demonstrates the types of opinions that auditors can issue.

Figure 9. Types of Audit Opinions

Types of Audit Opinions		
<p>Unmodified (also known as “Clean”)</p> <ul style="list-style-type: none"> Planned audit procedures completed and entity can provide supporting documents. Auditors conclude that management has presented financial statements, in all material respects, fairly and in accordance with GAAP. 		
Modified Opinions		
Qualified	Adverse	Disclaimer
<ul style="list-style-type: none"> Management provides sufficient appropriate evidence enabling the auditor to conclude that misstatements are material but not pervasive to the financial statements. Management is unable to provide sufficient appropriate evidence to enable the auditor to support an unmodified opinion, but the auditor concludes that the possible effects of undetected misstatements could be material but not pervasive. 	<ul style="list-style-type: none"> Management provides sufficient appropriate audit evidence to allow auditors to complete planned audit procedures; however, the auditor concludes that misstatements are both material and pervasive to the financial statements. 	<ul style="list-style-type: none"> Planned audit procedures cannot be completed because management is unable to provide sufficient appropriate evidence for the auditors to base an opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

Source: The DoD OIG.

On November 15, 2023, the DoD OIG issued a disclaimer of opinion on the FY 2023 DoD Agency-Wide Financial Statements. The DoD OIG issued this opinion because multiple DoD reporting entities continued to have unresolved accounting issues and material weaknesses. These unresolved issues and material weaknesses prevented DoD management from providing sufficient and appropriate evidence to support the balances presented on their respective financial statements. As a result, 18 DoD reporting entities, whose combined balances are material to the DoD Agency-Wide financial statements, received disclaimers of opinion on their financial statements for FY 2023.

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, DoD 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 over financial reporting, also called a control deficiency, 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 10 lists the three classifications of deficiencies in internal controls from the least severe to the most severe.

Figure 10. Three Classifications of Deficiencies in Internal Controls

Classifications of Deficiencies			
<p>A deficiency in internal controls over financial reporting exists when the design or operation of a control does not allow management or employees to prevent or detect misstatements in a timely manner.</p> <p>Severity of Deficiency</p> <p>Auditors evaluate and classify deficiencies in internal controls based on how severe the deficiency is.</p>	<p>Other Control Deficiency</p> <p>A weakness or deficiency that auditors bring to the attention of management that typically does not have a significant impact on the financial statements, but could improve the business processes of the agency.</p>	<p>Significant Deficiency</p> <p>A deficiency, or combination of deficiencies, in internal control over financial reporting that is important enough to bring to management's attention.</p>	<p>Material Weakness</p> <p>A deficiency, or 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.</p>
	Least Severe	Less Severe	Most Severe

Source: The DoD OIG.

While DoD auditors do not provide an opinion on the overall effectiveness of internal controls, auditing standards require auditors to report on internal controls over financial reporting that presents the significant deficiencies and material weaknesses identified during an audit.

There is a tendency to compare the number of material weaknesses 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 2023. However, the DoD has made progress since FY 2018 in areas such as real property, Fund Balance with Treasury (FBWT), and inventory. A more effective way of measuring progress could include measuring the percentage of balances that are ready to be tested or that remain unable to be tested.

Results of FY 2023 Audits

The DoD OIG is required to audit the DoD Agency-Wide consolidated financial statements. To do this, the DoD OIG conducts the agency-wide financial statement audit and oversees 6 IPA firms that audited 23 DoD reporting entities. Collectively, between DoD OIG and IPA personnel, more than 1,600 auditors participated in the audits of the DoD Components' and Agency-Wide financial statements. This section of the report discusses the results of the FY 2023 DoD Component and DoD Agency-Wide Financial Statement Audits, any progress or regression from FY 2022, and the DoD OIG's suggestions for achieving and sustaining financial statement auditability.

FY 2023 DoD Reporting Entity Audit Results

While FY 2023 saw minimal changes in audit opinions, the DoD continued to remediate FY 2022 audit findings. The most significant changes to the FY 2023 audit opinions included:

- the Marine Corps obtaining an unmodified opinion, based on substantial effort after completing an unconventional 2-year audit cycle;
- six DoD Components having at least 1 of their material weaknesses downgraded and five having at least 1 new material weakness identified;¹¹ and
- two DoD Components completing their first stand-alone audits in FY 2023, which resulted in disclaimers of opinion.

As shown in Figure 11, the DoD reporting entities received 10 unmodified (clean) opinions, 1 qualified opinion, and 18 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.

¹¹ DoD management reported that the DoD Components closed or downgraded 12 material weaknesses.

Figure 11. FY 2023 DoD Reporting Entity Financial Statement Audit Results

Fiscal Year 2023 Audit Results			
Military Retirement Fund	U.S. Army Corps of Engineers – Civil Works	Defense Health Agency-Contract Resource Management	Defense Information Systems Agency Working Capital Fund
Defense Commissary Agency ²	DFAS Working Capital Fund ²	Defense Contract Audit Agency ²	DoD OIG
National Reconnaissance Office ²	Marine Corps General Fund ¹		
Medicare-Eligible Retiree Health Care Fund			
Army General Fund	Army Working Capital Fund	Navy General Fund	Navy Working Capital Fund
Air Force General Fund	Air Force Working Capital Fund	DLA Working Capital Fund	DLA General Fund
DLA National Defense Stockpile Transaction Fund	Defense Health Program	Defense Information Systems Agency General Fund	U.S. Special Operations Command
U.S. Transportation Command	National Security Agency ²	Defense Intelligence Agency ²	National Geospatial-Intelligence Agency ²
Defense Advanced Research Projects Agency ²	Defense Threat Reduction Agency ²		
Unmodified	Qualified	Adverse	Disclaimer

¹ OMB Bulletin No. 22-01 listed the Marine Corps as a DoD Component required to prepare audited financial statements. However, the Marine Corps requested to be exempted from completing an audit in FY 2022, and instead requested to complete a 2-year audit cycle culminating in FY 2023. The OMB granted the request, and in FY 2023, the Marine Corps completed its 2-year audit cycle, where its IPA reported an unmodified opinion on February 22, 2024.

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

Source: The DoD OIG.

In the FY 2023 audits, the DoD OIG and IPAs collectively reported 169 material weaknesses and 42 instances of noncompliance with applicable laws, regulations, contracts, and grant agreements, and issued 3,213 NFRs to the DoD and its Components. During the FY 2023 audits, auditors closed 1,045 prior-year NFRs, reissued 2,644 prior-year NFRs, and issued 569 new NFRs. Table 1 displays the number of deficiencies for the DoD Agency-Wide and each Component.

Table 1. Total Deficiencies Identified in FY 2023

Component	FY 2023		
	Material Weaknesses ³	Non-Compliance ³	NFRs ⁴
Department of the Army ¹	31	4	679
Department of the Navy ¹	23	4	945
Department of the Air Force ¹	17	4	441
Marine Corps	7	2	84
U.S. Army Corps of Engineers ²	4	4	51
Defense Health Program	10	3	86
Defense Information Systems Agency ¹	6	3	49
Defense Logistics Agency ¹	21	6	432
U.S. Special Operations Command ¹	6	2	121
U.S. Transportation Command	15	2	140
Defense Health Agency-Contract Resource Management	0	0	10
Medicare-Eligible Retiree Health Care Fund	1	1	15
Military Retirement Fund	0	0	9
Agency-Wide	28	7	151
Total	169	42	3,213

¹ These DoD Components received separate opinions for each of their fund types, as indicated in Figure 11. 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 noncompliance, and NFRs for the U.S. Army Corps of Engineers includes those from 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 noncompliance issues reported. As a result, individual material weaknesses and noncompliance issues may be reported multiple times for some Components.

⁴ NFR totals may include the same NFR multiple times for a given Component. For example, one NFR could affect both the Army General Fund and Army Working Capital Fund, meaning the NFR would be counted twice under the Department of the Army. In addition, NFR totals are significantly affected by how the auditors decide to break out their NFRs. For example, one auditor may decide to combine multiple issues into one NFR, while another may choose to separate them.

Source: The DoD OIG.

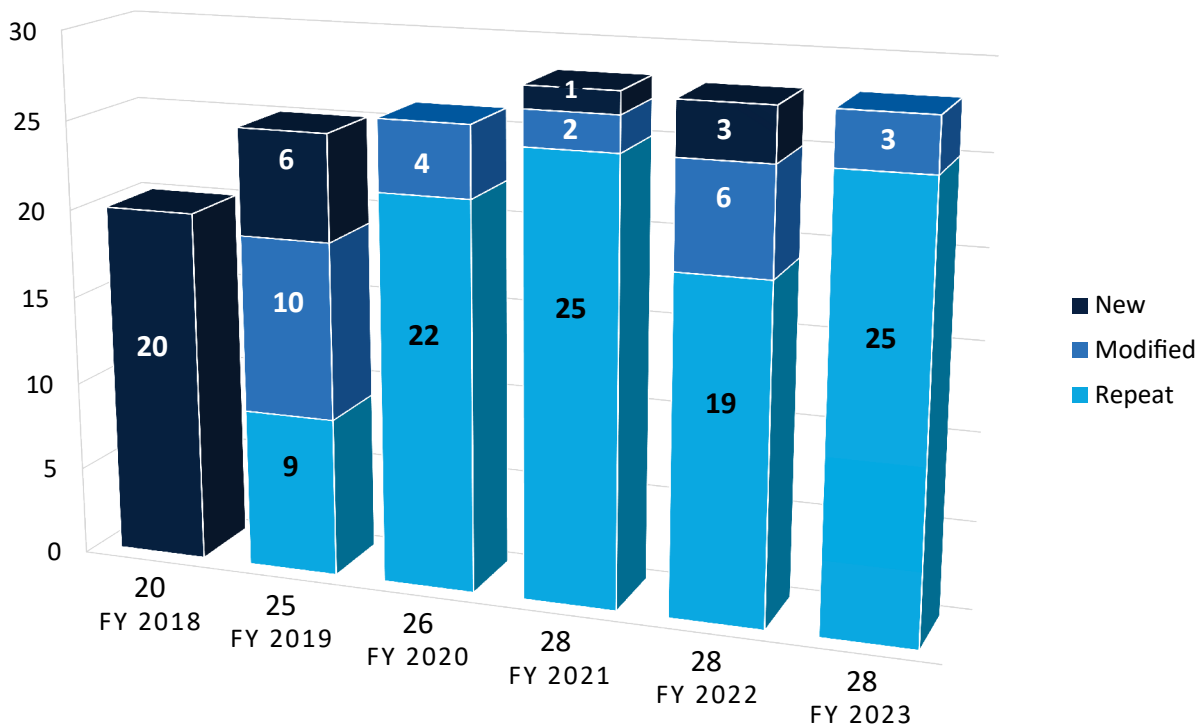
FY 2023 DoD Agency-Wide Audit Results

In FY 2023, the DoD OIG again issued a disclaimer of opinion on the FY 2023 DoD Agency-Wide Financial Statements. The disclaimer of opinion 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 28 material weaknesses and 3 significant deficiencies at the DoD Agency-Wide level, which are further explained in the appendix of this report. Of the material weaknesses and significant deficiencies identified:

- 25 material weaknesses and 3 significant deficiencies were repeated from FY 2022; and
- 3 prior-year material weaknesses were modified.

As discussed above, comparing material weakness from year to year to gauge progress toward clean financial statements is not a reliable measure. As shown in Figure 12, since 2018, the total number of material weaknesses has increased; however, the material weaknesses that make up the total change from year to year. For example, while the DoD OIG did not identify any new material weaknesses and the total number of material weaknesses did not change between FYs 2022 and 2023, the DoD OIG consolidated two prior-year material weaknesses into one material weakness and separated one prior-year material weakness into two material weaknesses in FY 2023. These adjustments were driven by the DoD OIG’s ongoing effort to ensure that the grouping of deficiencies into material weaknesses was optimized to enable the DoD to remediate those deficiencies in a timely manner.

Figure 12. Total Material Weaknesses Identified Annually Since FY 2018



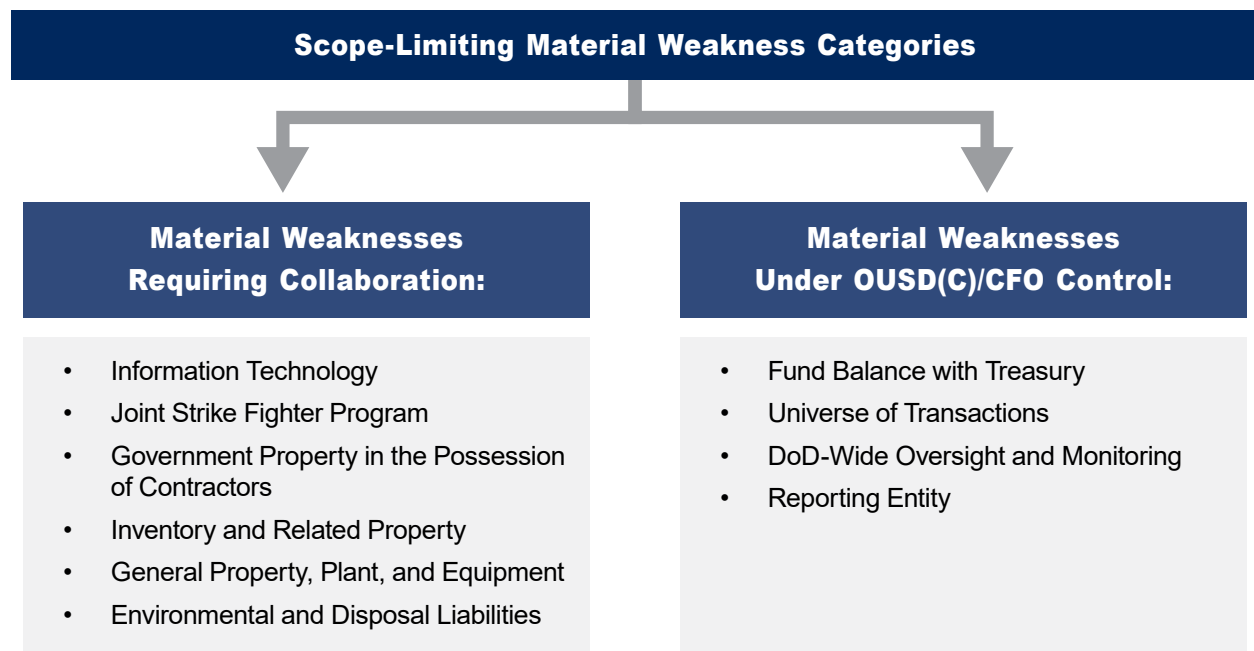
Source: The DoD OIG.

Scope-Limiting Material Weaknesses

As we introduced in our Understanding the Results of the Audit of the FY 2022 DoD Financial Statements report, scope-limiting material weaknesses continue to hinder audit progress for the DoD and its Components. While it is possible for an audited entity to receive a clean audit opinion while still having material weaknesses, those material weaknesses cannot be scope-limiting. For example, the Marine Corps, U.S. Army Corps of Engineers, and Defense Information Systems Agency Working Capital Fund all received unmodified opinions in FY 2023, even though their audits indicated they had material weaknesses. For those engagements, the auditors were still able to perform sufficient audit procedures to conclude on the accuracy of the financial statement balances. Material weaknesses identified with other audited entities prevented auditors from performing the necessary 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 17 of those weaknesses to be scope-limiting.

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 Government Property in the Possession of Contractors (GPIPC)—for more than 19 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. We consolidated the 17 weaknesses into 10 scope-limiting categories that we further divide into two groups. Figure 13 shows the material weakness categories that require coordination between the OUSD(C)/CFO and DoD operational partners, and those that are the primary responsibility of the OUSD(C)/CFO.

Figure 13. Scope-Limiting Material Weakness Categories



Source: The DoD OIG.

Scope-Limiting Categories Requiring Collaboration

In FY 2023, the DoD continued to demonstrate challenges in the following six areas.

- Information Technology
- Joint Strike Fighter Program
- Government Property in the Possession of Contractors
- Inventory and Related Property
- General Property, Plant, and Equipment
- Environmental and Disposal Liabilities

These scope-limiting categories require special attention, as their remediation requires collaboration between the Office of the Secretary of Defense, the DoD Components, and with industry partners contracted to assist the DoD in executing its mission.

Information Technology

The DoD OIG, again, identified IT material weaknesses in its FY 2023 audit report. The DoD's large and complex system environment led to significant findings across most of the financial statement and performance audits completed in FY 2023. The large, complex, and outdated financial management systems environment was the source of control deficiencies that resulted in 995 IT NFRs in FY 2023. By modernizing and reducing the number of outdated and noncompliant systems, the DoD could remediate many IT control deficiencies identified as part of the FY 2023 audit. In addition, the DoD OIG issued a report on the DoD's outdated financial management systems that highlighted that the DoD's overly complex systems environment:

By modernizing and reducing the number of outdated and noncompliant systems, the DoD could remediate many IT control deficiencies.

- consisted of at least 423 financial management systems and applications, many of which are outdated;
- included more than 2,000 interfaces between systems, further complicating accounting transactions and audit trails;
- was generally not compliant with the Federal Financial Management Improvement Act of 1996 (FFMIA);¹² and
- caused material weaknesses, significant deficiencies, and numerous audit findings for the DoD and its Components in FY 2023.¹³

¹² The Federal Financial Management Act of 1996 requires each Federal agency to implement and maintain financial management systems that comply with Federal requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

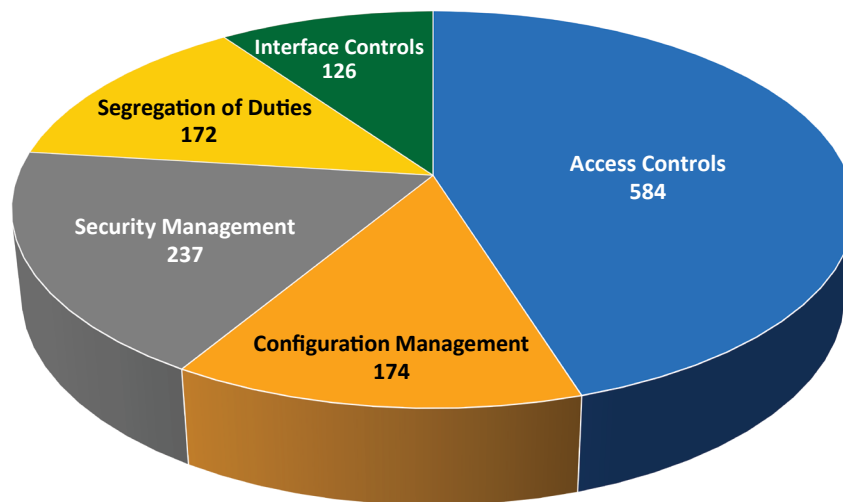
¹³ Report No. DODIG-2024-047, "Audit of the DoD's Plans to Address Longstanding Issues with Outdated Financial Management Systems," January 19, 2024.

The DoD has a significant need to update and modernize its outdated IT environment. This need provides a unique collaboration opportunity for the Office of the DoD CIO and OUSD(C)/CFO to build financial management controls into the DoD's operational IT systems. In doing so, these systems would have the necessary foundation to provide auditors with assurance that the data the DoD's systems produce are accurate and reliable.

INFORMATION TECHNOLOGY CONTROL DEFICIENCIES

The DoD and its Components lacked effective internal controls over their financial management systems, which limited the auditor's ability to rely on the information produced by those systems and used to support the DoD Agency-Wide financial statements. The DoD received 995 FY 2023 IT NFRs; however, one NFR can report multiple control deficiencies. As a result of the ineffective controls, the DoD had 1,554 control deficiencies identified within the 995 NFRs. Of the 1,554 total control deficiencies, 1,293 are related to one of the 5 material control deficiency categories highlighted in Figure 14.¹⁴ The remaining 261 deficiencies are related to various other IT issues.

Figure 14. DoD Agency-Wide Material IT Deficiencies by Control Category



Source: The DoD OIG.

¹⁴ The Federal Information System Controls Audit Manual defines control categories as groupings of related controls for similar types of risk, such as access controls.

The DoD OIG reported each of the five categories as material weaknesses in its FY 2023 audit report due to the pervasiveness and impact of the deficiencies within those five categories. Figure 15 defines the five control categories and the associated risks.

Figure 15. Definitions and Risks of the Five Control Categories Identified as Material Weaknesses in the DoD Agency-Wide Financial Statements

Control Categories	Risks
<p>Configuration Management</p> <p>Controls that prevent unauthorized or untested changes to critical information system resources and provide reasonable assurance that systems are securely configured and operated as intended.</p>	<p>Financial management systems not functioning as intended or reporting data that is incomplete or inaccurate in the Agency-Wide financial statements.</p>
<p>Security Management</p> <p>A framework and continuous cycle of activity for managing risk, development and implementation of effective security policies, assignment of responsibilities, and monitoring the adequacy of an entity’s information system controls.</p>	<p>Confidentiality, integrity, and availability of data will not be maintained throughout the DoD’s and its Component’s financial management systems.</p>
<p>Access Controls</p> <p>Controls that limit or detect inappropriate access to computer resources, protecting them from unauthorized modification, loss, and disclosure.</p>	<p>Users may gain or retain unauthorized, excessive, or otherwise inappropriate access to DoD financial management systems.</p>
<p>Segregation of Duties</p> <p>Controls that involve segregating work responsibilities so that one individual does not control all critical stages of a process.</p>	<p>Unauthorized access to data, negatively affecting the confidentiality and integrity of DoD financial management systems.</p>
<p>Interface Controls</p> <p>Controls that ensure the timely, accurate, and complete exchange of information between systems and applications on an ongoing basis, and complete and accurate migration of clean data during conversion.</p>	<p>Unable to validate the completeness and accuracy of data exchanged between two or more systems.</p>

Source: The DoD OIG.

INFORMATION SYSTEM MODERNIZATION

The DoD maintains a complex web of financial management systems and applications, which are connected by thousands of interfaces that the GAO and DoD OIG have issued audit findings on for over 27 years and the DoD OIG has identified as a material weakness in all 6 full financial statement audits. Many of these financial management systems are outdated and require various work-arounds due to limitations and shortcomings of the systems environments. For example, the DoD uses micro-applications as an inexpensive way to fill gaps in its system environment instead of establishing the capability within a modern Enterprise Resource Planning system.¹⁵ Furthermore, when the Marine Corps relied more heavily on modern Enterprise Resource Planning systems, the Marine Corps reduced the amount of unmatched disbursements by tens of millions of dollars and increased FBWT accuracy.¹⁶

The GAO and DoD OIG have identified issues related to DoD systems for over 27 years, and the DoD OIG has identified DoD systems as a material weakness in all 6 full financial statement audits performed.

The risks related to the control deficiencies listed in Figure 15 present unique challenges due to the complexity of the systems environment that must be assessed by the auditors during a financial statement audit. In addition, the issues identified while testing these high-risk areas have prevented the DoD from substantially complying with the FFMIA, which requires Federal financial management systems to produce reliable, timely, and useful financial information needed for reporting and decision making. In addition, the DoD OIG has identified the DoD's financial management systems as a material weakness since it performed the first full-scope financial statement audit in FY 2018.

Over the years, the DoD has developed and implemented plans, strategies, and other efforts to correct its financial management systems with goals of a simplified, integrated, modernized, and secure system environment. However, the DoD OIG has found that the DoD's plans to improve its system environment allowed for the DoD to maintain too many outdated and noncompliant systems for too long. For example, the DoD's current plans are to operate more than 100 financial management feeder systems beyond FY 2028, including 3 material, outdated accounting systems through FY 2031. Without a simplified, compliant, and modern systems environment:

- the DoD will remain at an increased risk of making ill-informed enterprise-wide business decisions, which could have a direct impact on the DoD's mission to ensure the security of our Nation;

¹⁵ An Enterprise Resource Planning system is capable of running all of the core business processes, such as finance, human resources, supply chain, contracting, and procurement, in one integrated system.

¹⁶ An unmatched disbursement is a disbursement transaction that has been received and accepted by an accounting office but has not been matched to the correct detail obligation.

- auditors cannot rely on the information obtained from the IT systems, which prevents the auditors from concluding on the financial statements; and
- the DoD may be unable to fully assess its financial management systems environment which could result in the development of duplicative systems and impede the DoD's progress toward its goal of a more simplified systems environment.

To correct its financial management system environment, the DoD must address the fundamental system challenges facing the DoD. The DoD CIO, in conjunction with the OUSD(C)/CFO and other DoD mission partners, must reduce the DoD's reliance on outdated, noncompliant systems, minimize the complex interface environment to only those required for operational and financial management, and strive to modernize DoD business processes and systems that will produce reliable, accurate, and timely financial data. Otherwise the DoD will likely continue to struggle with ensuring that its systems comply with the FFMIA, which could hinder the DoD's ability to reach its goal of achieving a clean financial statement audit opinion by FY 2028.

Joint Strike Fighter Program

In FY 2023, the DoD OIG identified that the DoD did not properly account for, manage, and report Joint Strike Fighter (JSF) Program inventory, including program and support equipment, spare parts, contractor-acquired property, and Government-furnished equipment

The JSF Program is the largest acquisition program the DoD has ever undertaken, with an estimated lifecycle cost of \$1.7 trillion and purchase price of \$70 million per aircraft.

and material. The JSF Program is a multi-Service and multinational effort to develop and field the F-35—a fighter aircraft, pictured in Figure 16.

This program is managed by the JSF Program Office, a joint office under the Naval Air Systems Command and the Air Force Materiel Command.

In addition, the Office of the USD(A&S) and the

OUSD(C)/CFO provide operational and financial oversight, respectively. The JSF Program is the largest acquisition program the DoD has ever undertaken, with an estimated lifecycle cost of \$1.7 trillion and purchase price of \$70 million per aircraft.

In FY 2023, the DoD again could not provide reliable data to verify the existence, completeness, and valuation of its JSF Program inventory. In addition, the DoD did not report JSF Program inventory on its FY 2023 financial statements, resulting in a material weakness for the fifth consecutive year and a material misstatement on the FY 2023 DoD Agency-Wide Financial Statements. Auditors could not quantify the extent of the misstatement because JSF Program officials could not identify or report a complete or valid population of JSF Program inventory in a timely manner due to the lack of processes or procedures to collect the information necessary to accurately report the number and value of JSF Program inventory.



Figure 16. F-35 Joint Strike Fighter
Source: The U.S. Air Force.

Because of the program’s size and the impact it has on the DoD financial statements, it is critical for the acquisition community, Military Departments, and OUSD(C)/CFO to work together in designing and implementing systems, processes, and controls at DoD and contractor facilities that will properly track, account for, and report inventory and their associated valuations for use in the DoD financial statements. In addition, the FY 2022 National Defense Authorization

Act required the JSF Program Office to transfer F-35 sustainment activities no later than October 1, 2027, and all acquisition functions by October 1, 2029, to the Secretaries of the Air Force and Navy. These requirements further signify the need for DoD operational leaders to work together to ensure that proper accountability controls are implemented to produce the reliable financial information.¹⁷

Government Property in the Possession of Contractors

GPIPC continues to be an obstacle to success in the audit of the DoD financial statements. Federal regulations define “government property” as all property owned or leased by the U.S. Government that is provided to contractors for performance of a contract (known as GPIPC).¹⁸ GPIPC includes government-furnished equipment, materials, and contractor-acquired property held by contractors on behalf of the DoD Components. A common trend shows that the DoD Components lack adequate policies, procedures, controls, and supporting documentation over the acquisition, disposal, tracking, and inventory processes for GPIPC. The Components also lack sufficient oversight of contractors for the accountability and reporting of assets and cannot identify the GPIPC in their property and financial systems. These deficiencies prevent auditors from validating the amounts reported by these DoD Components on their respective financial statements and related notes.

The DoD was unable to substantiate the existence, completeness, valuation, presentation, and disclosure of GPIPC reported on the DoD Agency-Wide balance sheet.

¹⁷ Public Law 117-81, “National Defense Authorization Act for Fiscal Year 2022”, Section 142, “Transfer of F-35 Program Responsibilities From the F-35 Joint Program Office to the Department of the Air Force and the Department of the Navy”, December 27, 2021.

¹⁸ Federal Acquisition Regulation (FAR) Part 45, “Government Property,” subpart 45.01, “General,” Section 45.101, “Definitions.”

DoD Components were unable to reconcile the GPIPC balances reported on their financial statements. Additionally, the DoD was unable to substantiate the existence, completeness, valuation, presentation, and disclosure of GPIPC reported on the DoD Agency-Wide balance sheet. For example, auditors found that the Navy lacked proper controls, documentation, and sufficient oversight of contractors in possession of government assets. Figure 17 describes the GPIPC material weaknesses for the three Military Departments.

Figure 17. DoD Military Departments' FY 2023 GPIPC Material Weaknesses

Government Property in Possession of Contractors: includes government-furnished equipment, materials, and contractor-acquired property held by contractors on behalf of the DoD Components.

NAVY

The Navy could not provide process documentation identifying the controls necessary for maintaining accountability for GPIPC and did not sufficiently oversee contractors with GPIPC to ensure the existence of GPIPC assets, and the accuracy of the information related to the reporting of those assets.



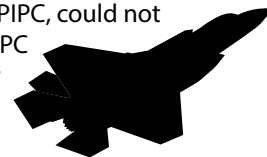
ARMY

The Army could not provide documentation describing the GPIPC process controls and financial reporting risks. In addition, the Army did not consistently apply controls over inventory counts and reconciliations of GPIPC at contractor sites.



AIR FORCE

The Air Force did not provide policies and procedures for maintaining accountability for GPIPC, could not provide a complete listing of GPIPC assets, and has not developed or implemented controls for monitoring those assets.



Source: The DoD OIG.

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. Having proper controls and policies to account for GPIPC is important in maintaining the integrity of the financial statements' Inventory, Operating Materials and Supplies, and Property, Plant, and Equipment (PP&E) balances, and significant errors in GPIPC could result in misrepresented amounts on the financial statements.

Control and accounting for GPIPC in the DoD presents another opportunity for DoD leaders to work in conjunction with the OUSD(C)/CFO in designing, modifying, developing, and implementing systems that will not only track and account for GPIPC in the various stages of acquisition, development, repair, or refurbishing, but accurately record the property in the respective financial accounting systems.

Inventory and Related Property

Inventory and Related Property, a significant line item totaling \$341.1 billion on the DoD Agency-Wide balance sheet, continued to be a challenge for the DoD in FY 2023.

The Inventory and Related Property line, hereafter referred to as inventory, consists of inventory, operating materials, supplies, and stockpile material. It can include a variety of items the DoD uses in executing its mission, such as spare parts, clothing, ammunition, and medicine.

The DoD and its Components did not have policies, procedures, or internal controls over their inventory processes sufficient to support the existence and completeness of inventory reported on their financial statements. DoD Components did not calculate the value of their inventory in accordance with accounting standards. Additionally, the DoD did not implement its control environment and business processes effectively to be able to reconcile, monitor, and accurately report the value of inventory balances. Figure 18 provides examples from the FY 2023 DoD Component audits.

Figure 18. Examples of DoD Component Inventory Deficiencies Reported in FY 2023

Inventory Deficiencies Reported in FY 2023		
<i>“The DoD was unable to substantiate the existence and completeness of inventory reported on the financial statements and did not properly account for or value its inventory and related property. As a result, the auditors could not perform sufficient procedures to conclude on the inventory and related property balance.”</i>		
Examples		
Lack of Policies, Procedures, and Internal Controls	Noncompliance with Accounting Standards	Inadequate Oversight and Reconciliations
<ul style="list-style-type: none"> • The Army did not implement policies, procedures, and design controls to support the ownership of inventory. • The Navy lacked policies, procedures, and internal controls to implement accounting standards over inventory. • The DLA lacked policies, procedures, and controls to effectively implement accounting standards over inventory. 	<ul style="list-style-type: none"> • The Army did not design and implement controls to accurately record transactions in the appropriate general ledger account or ensure the proper valuation of inventory in accordance with accounting standards. • The Air Force did not implement controls to properly value and report inventory, including excess, obsolete, and unserviceable operating materials and supplies. 	<ul style="list-style-type: none"> • The Navy did not fully implement reconciliations to ensure accurate reporting of inventory. • The Army did not design, implement, and perform reconciliations between financial systems and warehouse management systems. • The Air Force does not have sufficiently designed oversight procedures over inventory to prevent or detect and correct a material misstatement.

Source: The DoD OIG.

The DoD continues to identify and correct misstatements for inventory; however, the DoD does not expect to fully remediate the material weaknesses for inventory until FY 2028. The accuracy, completeness, and oversight of inventory within the DoD should be a priority of not only the OUSD(C)/CFO, but other DoD operational leaders as well, such as the USD(A&S). These operational leaders should collaborate with the OUSD(C)/CFO to implement policies, procedures, processes, and systems that strengthen the control environment over the DoD's inventory. The accuracy and the completeness of inventory data ensures that DoD operational leaders have the information they need to support and supply Service members, while also providing more accurate data to the financial systems used by the DoD's Components that produce financial statements. That is, a strong logistical and supply chain system control environment would lead to more accurate and reliable inventory counts, which would provide a better opportunity for the DoD to produce reliable valuations of inventory data.

General Property, Plant, and Equipment

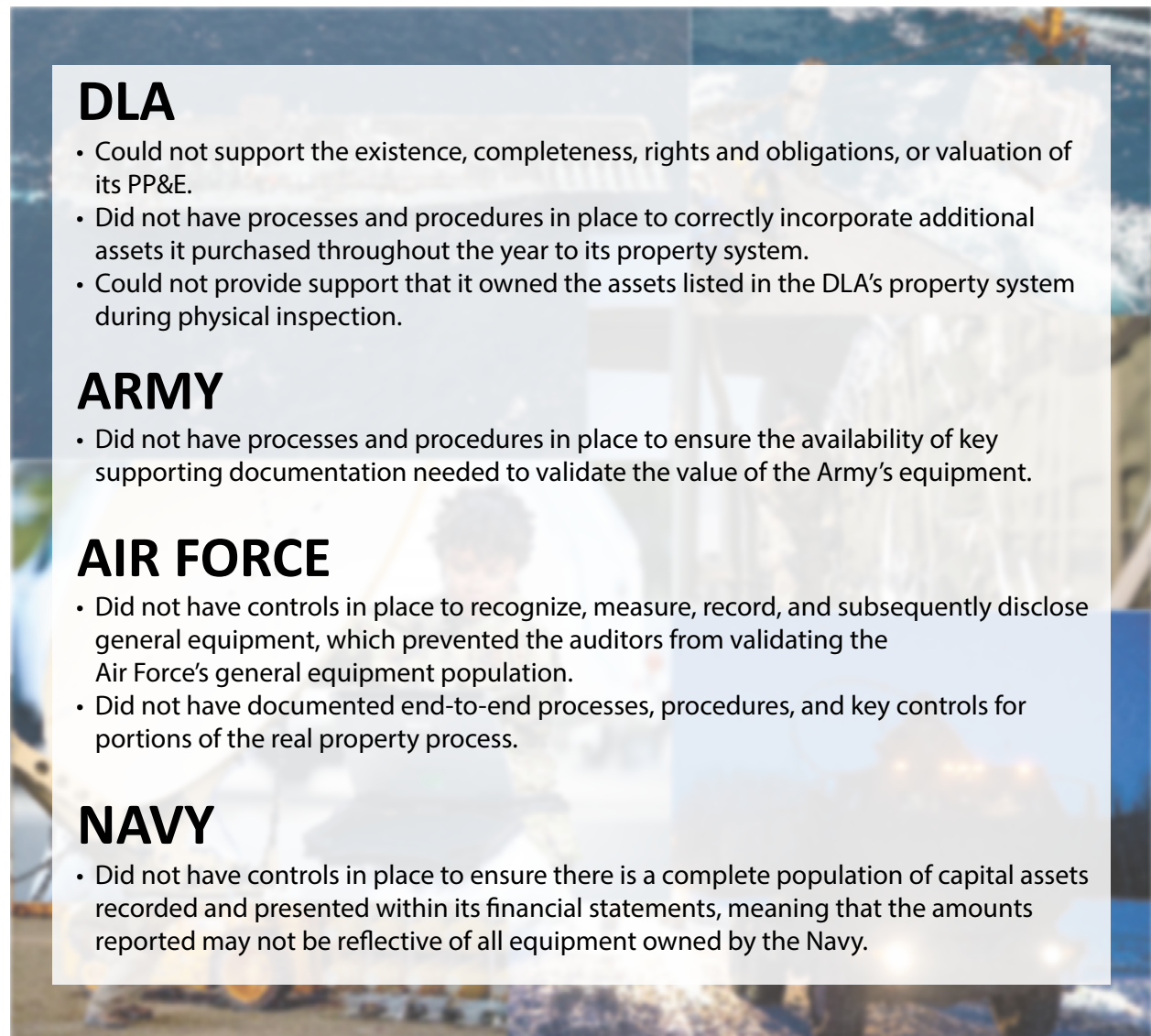
In FY 2023, the DoD continued to inaccurately account for and value the assets it owns and reports on the General PP&E line on its consolidated balance sheet. DoD General PP&E includes real property, such as buildings, structures, and land; general equipment, such as weapons systems and vehicles; and software. In FY 2023, the DoD reported \$832 billion in General PP&E, including \$367.6 billion in real property.

The DoD and its Components did not have the proper controls, policies, and procedures in place that would allow auditors to verify and substantiate the property and equipment that the DoD owns.

In FY 2023, the DoD and its Components did not have the proper controls, policies, and procedures in place that would allow auditors to verify and substantiate the property and equipment that the DoD owns. Figure 19 includes examples of deficiencies auditors identified in their FY 2023 audits regarding the policies, procedures,

and internal controls the DoD uses over the existence, completeness, and valuation of General PP&E.

Figure 19. Examples of DoD PP&E Deficiencies Reported in FY 2023



Source: The DoD OIG.

The lack of internal controls and complete populations for the DoD's General PP&E continues to be scope-limiting and hinders progress toward achieving an unmodified financial statement audit opinion. These challenges will continue for the DoD, as it does not expect to fully remediate these material weaknesses until FY 2027. The OUSD(C)/CFO and Component comptrollers should work together to establish the needed policies and controls to remediate these material weaknesses. For example, the Assistant Secretary of the Navy (Financial Management and Comptroller) should work with the Navy's various logistical, supply,

and infrastructure commands to ensure that proper controls exist across installations that enable complete asset accountability in the Navy's property systems of record. Completeness of these property systems will help enable auditors to validate the existence and completeness of the Navy's general and military equipment. Additionally, the DLA Finance Director should work with organization leadership within the DLA to establish policies and implement system controls that: (1) properly account for asset additions; (2) track and serialize DLA assets to ensure that they can be validated and substantiated; and (3) value DLA assets in accordance with accounting standards. Incorporating these measures and coordinating across functional offices of the DoD and its Components will assist in remediating the DoD PP&E issues. In addition to audit remediation, the DoD will have an improved foundation for executing its logistical, supply, and accounting decisions.

Environmental and Disposal Liabilities

In FY 2023, Environmental and Disposal Liabilities (E&DL) was identified again as a scope-limiting material weakness. For FY 2023, the DoD reported an E&DL balance of \$93.8 billion, a 3.5-percent increase from FY 2022. E&DL can include cleanup costs for active installations, weapon systems programs, and chemical weapons disposals. The auditors reported that the DoD did not include all cleanup, closure, or disposal costs associated with its E&DL in FY 2023. For example, the Army could not provide supporting documents that its listing of environmental hazard locations was complete, resulting in auditors reporting a material weakness in E&DL.

E&DL has been identified as a material weakness each year since 2018. A number of issues have combined to prevent E&DL from being downgraded to a significant deficiency.

For example, the Army General Fund auditors found that the Army's existing cost estimation software does not have proper processes or internal controls in place to determine whether E&DL cost information is meaningful and reliable. Specifically, Army management did not document or execute a review process that ensured its E&DL cost estimation software was

adequate and working as intended. Furthermore, Army management did not document or execute any review procedures that would have provided assurance that the estimation software's 2016 input data were reliable for estimating costs in FY 2023. As a result, auditors could not conclude whether the Army's use of the estimation software provided accurate and reliable estimates for presentation on the Army's financial statements.

The auditors reported that the DoD did not include all cleanup, closure, or disposal costs associated with its E&DL in FY 2023. As a result, auditors were unable to conclude on those balances.

Despite the challenges the DoD faces with E&DL, the DoD and its Components continue to work toward remediating deficiencies with a correction target of FY 2026. For example, a material weakness working group that includes representation from the OUSD(C)/CFO

and Office of the USD(A&S) continues to highlight policy gaps impacting the completeness, existence, and valuation of E&DL. In addition, the working group provided quarterly progress reports and shared information across Component members to leverage lessons learned. Furthermore, the DoD has developed policies to ensure that asset-driven E&DLs are being reported appropriately, as well as identifying methodologies to produce cost estimates consistently across Components.¹⁹

Weakness Categories Under OUSD(C)/CFO and DoD Component CFO Control

The remaining four scope-limiting material weakness categories of FBWT, Universe of Transactions (UoT), DoD-Wide Oversight and Monitoring, and Reporting Entity, continued to present accounting and financial reporting-related issues for the DoD in FY 2023 and require the primary support of the OUSD(C)/CFO and the DoD Component CFOs.

Fund Balance with Treasury

FBWT is composed of individual Treasury-maintained accounts that reflect the funds available for a federal agency to spend. These accounts operate like a personal checking account and are reconciled to the Treasury amounts. The DoD has hundreds of such accounts, the balances in which increase with collections and decrease with payments. The DoD is required to reconcile its FBWT accounting records to the records maintained by the Treasury, and as of September 30, 2023, the DoD reported a FBWT of \$768.1 billion on its DoD Agency-Wide Balance Sheet.

Since 2005, the DoD has not accurately reconciled its FBWT accounting records to those maintained by the Treasury. In FY 2023, the DoD OIG determined the DoD's inability to reconcile as a material weakness for the sixth consecutive year. The DoD's FBWT continued

Since 2005, the DoD has not accurately reconciled its FBWT accounting records to those maintained by the Treasury.

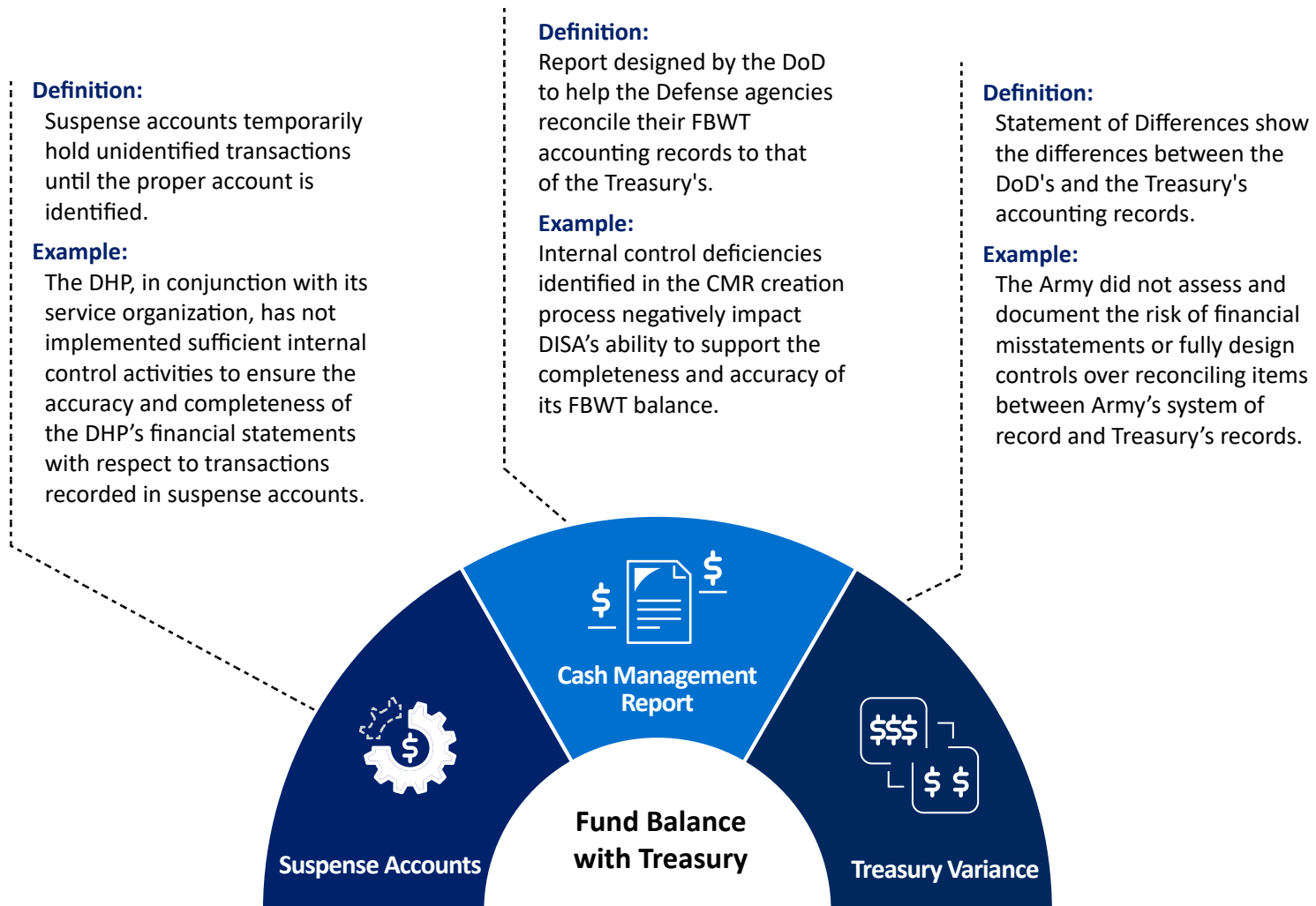
struggles are, at least in part, caused by the DoD's failure to fully use the U.S. Treasury's disbursing functionality for DoD funds. Currently, less than 50 percent of DoD funding is disbursed through the U.S. Treasury due to the DoD's unique business processes. As the DoD OIG's report on outdated systems identified, the Treasury disbursing functionality provides more accurate FBWT data, is provided at no cost to the DoD, is used by other Government agencies with clean audit opinions, and the Secretary of Defense requires its

¹⁹ Asset-Driven E&DLs are environmental and disposal costs associated with future DoD PP&E asset closure or disposal that involves non-routine removal of hazardous waste at the point of disposal or closure or environmental response explicitly required (by permit or other policy or law). Examples of an asset-driven liability include equipment environmental disposal liabilities, asbestos, and environmental closure requirements.

use. However, due to a variety of challenges, such as difficulties changing existing business processes and retiring outdated systems, the DoD Components have not fully implemented Treasury's direct disbursing functionality.

Another challenge is the complex nature of the DoD's business activity, in that DoD entities can execute transactions on the behalf of others (cross-disbursing), use the same funds or accounts (co-mingling), do business with each other (intragovernmental), and can combine contracts from vendors to take advantage of volume discounts. These activities pose risks when auditing individual Components and ensuring that a Component's financial statements contain all necessary data can be somewhat challenging. For example, the DoD and its Components were not able to balance their FBWT accounts with the Treasury, which causes the DoD to record unsupported adjustments to force the DoD's accounts to match. Figure 20 includes additional common FBWT deficiencies that auditors identified in FY 2023.

Figure 20. Common FBWT Deficiencies Identified in FY 2023



LEGEND

- CMR** Cash Management Report
- DISA** Defense Information Systems Agency
- DHP** Defense Health Program

Source: The DoD OIG.

In FY 2023, auditors identified progress for multiple Components in processes and controls to reconcile FBWT. For example, the Navy made significant progress in improving the control environment around FBWT, including the implementation of policies, procedures, and controls over the FBWT reconciliation process. The significant improvements made by the Navy resulted in the Navy General Fund downgrading its FBWT material weakness to a significant deficiency. The Army Working Capital Fund also downgraded its material weakness to a significant deficiency, while the Air Force General Fund was able to close its FBWT material weakness entirely. 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.

Universe of Transactions

The DoD OIG identified UoT as a material weakness in FY 2023 because the DoD and its Components continue to experience significant challenges in providing a complete and accurate UoT. A complete UoT is a record of every financial event, or transaction,

While the DoD has inherent challenges with accounting for the hundreds of billions of dollars it is appropriated annually, its challenges are compounded by the complexity of its IT systems environment.

that affects their financial statement balance for a given Fiscal Year. While the DoD has inherent challenges with accounting for the hundreds of billions of dollars it is appropriated annually, its challenges are compounded by the complexity of its IT systems environment. The transactions from hundreds of systems owned by various DoD and non-DoD entities are fed

through thousands of interfaces with multiple layers of systems as part of processes that the DoD and its Components have not fully documented to produce a UoT.

A complete and accurate UoT is essential to a financial statement audit as it supports management's representation of financial statement balances, which the auditors then test and reconcile back to their source to determine whether those balances are supported. Because the DoD and at least seven of its Components were unable to provide a complete and accurate UoT in FY 2023, there remains an increased risk that balances in the DoD Agency-Wide financial statements may be materially misstated.

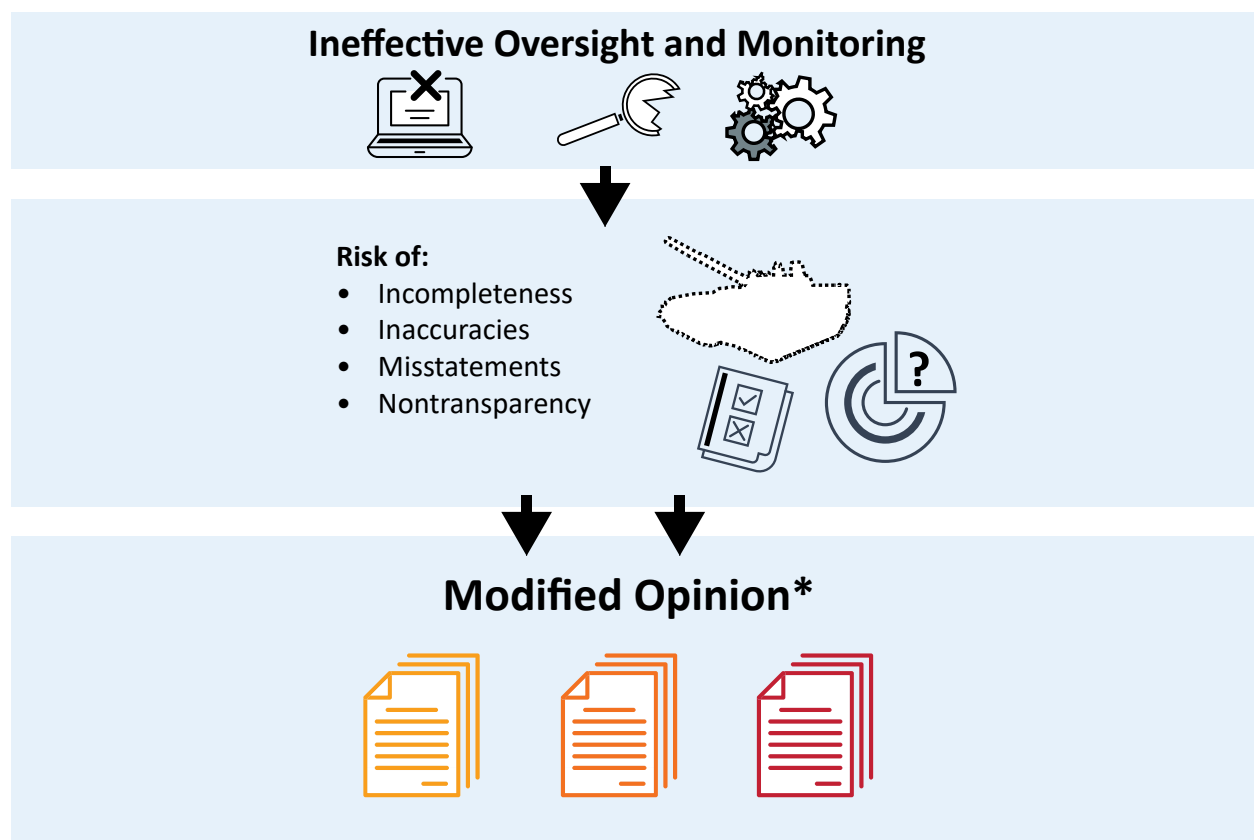
DoD-Wide Oversight and Monitoring

In FY 2023, we identified that DoD management did not have sufficient oversight and monitoring controls integrated into all levels of the DoD's operations to ensure that its financial statements were accurate and reliable. Specifically, the DoD lacked sufficient controls over financial statement adjustments, financial statement preparation and related note disclosures, and funding execution and reporting.

For example, the DoD OIG found that DoD management lacked sufficient controls over its Component Level Accounts, which is an entity consolidated into the DoD Agency-Wide financial statements with total assets of \$49.7 billion as of September 30, 2023. Without sufficient oversight and monitoring controls, the DoD remains at an increased risk of including inaccurate and unreliable information in its financial statements leading to a modified opinion, as demonstrated in Figure 21.

Without sufficient oversight and monitoring controls, the DoD remains at an increased risk of including inaccurate and unreliable information in its financial statements.

Figure 21. Impact of the DoD's Weakness in Oversight and Monitoring



*A Modified Opinion includes qualified opinions, adverse opinions, and disclaimers of opinion.

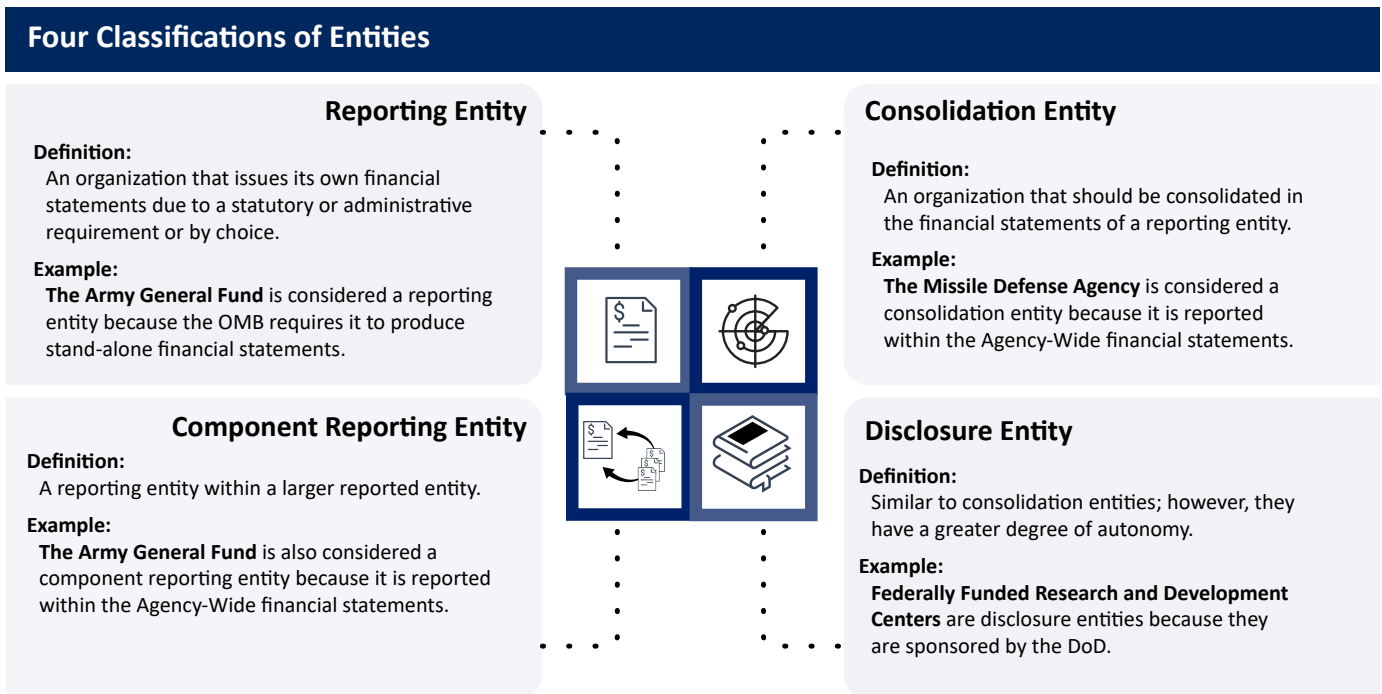
Source: The DoD OIG.

Until the DoD develops and implements sustainable oversight and monitoring controls over the entire DoD, DoD management may not have visibility over material amounts reported on the consolidated financial statements, and therefore may not be able to ensure its accuracy and validity. The DoD is a large and complex environment composed of people, equipment, systems, contracts, and financial information. Instituting sound oversight and monitoring capabilities in all aspects of the DoD will help ensure that DoD operational decision makers, DoD financial managers, and the public have the most current, accurate, and reliable information available.

Reporting Entity

Statement of Federal Financial Accounting Standards (SFFAS) No. 47 provides guidelines and standards to ensure clear and consistent financial reporting by government agencies. SFFAS 47 describes four types of entities: (1) reporting entity, (2) component reporting entity, (3) consolidation entity, and (4) disclosure entity. 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 22.

Figure 22. Four Classifications of Entities



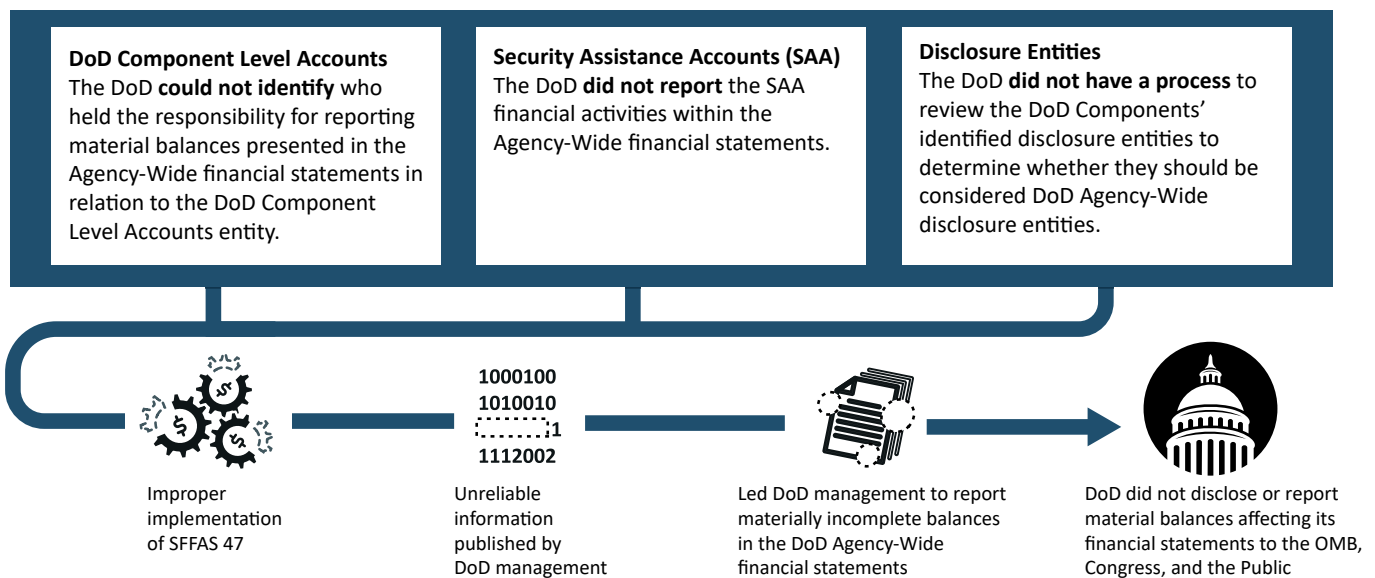
Source: The DoD OIG.

In FY 2023, the DoD did not report all material entities for which it has reporting responsibility within its financial statements. The DoD does not consolidate the Security Assistance Accounts financial statements in the DoD Agency-Wide financial statements, but instead the Security Assistance Accounts financial statements are directly consolidated into the Financial Report of the United States Government as a separate stand-alone significant reporting entity. If the DoD correctly implemented SFFAS 47, it would report the Security Assistance Accounts within its financial statements, which would roll-up into the Government-wide financial statements. Although the DoD does not consolidate the Security Assistance Accounts financial statements in the DoD Agency-Wide financial statements, the DoD included a footnote disclosing its relationship between the DoD and the Security Assistance Accounts, thus suggesting that the DoD should in fact, include the Security Assistance Account financial statements as a consolidation entity in the DoD Agency-Wide

financial statements. Furthermore, OMB Circular No. A-136 supports that the Security Assistance Accounts financial activity should be consolidated within the DoD Agency-Wide financial statements. The omission of the Security Assistance Accounts financial balances created a SFFAS 47 deficiency and materially misstated the DoD Agency-Wide Financial Statements.

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. As a result, auditors could not conclude on the accuracy of the balances presented on the financial statements. 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 risks that may be affecting its organization and its financial statement opinion. Figure 23 identifies the DoD’s deficiencies in how it defines the DoD reporting entity.

Figure 23. Identified SFFAS 47 Deficiencies



Source: The DoD OIG.

Collaboration is Needed to Achieve a Sustainable Financial Management Environment

As reflected throughout this report, in FY 2023, the DoD and its Components continued to work toward reaching a clean financial statement opinion. Yet, long-standing and scope-limiting material weaknesses continued to hinder their efforts, which were often undermined by their lack of an effective and efficient financial management environment. As a result, after more than 16 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. Many of the issues facing the DoD are shared among the different mission areas of the DoD and its Components. Within the DoD's Agency Financial Report, the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, explained that the remediation of these issues relies on coordination and collaboration among DoD operational and financial leadership, Congress, and industry partners. The DoD should establish clear lines of communication and awareness across its mission areas, conduct outreach concerning the importance of strong controls, and establish effective systems and business processes to support operational decision making, while also providing accurate and reliable financial information. To enhance these remediation efforts, the DoD should continue its efforts to reduce or replace its outdated information systems, retain knowledgeable staff, create sustainable audit approaches, and emphasize audit expectations across the DoD. All of this is imperative for the DoD and its Components to move toward a clean audit opinion.

Modernizing the DoD's Outdated Financial Management Systems

Creating and sustaining a strong financial management environment requires modernization of the DoD's financial management systems. For the last 27 years, the GAO has identified the DoD's business systems as being vulnerable to fraud, waste, abuse, and mismanagement, or needing transformation. Since these issues were first identified, the GAO and DoD OIG have reported that the DoD's efforts to improve its system environment, modernize its outdated systems, and become auditable have been insufficient.

Early in FY 2024, the DoD OIG issued its audit report on the DoD's plans to address its outdated financial management system environment. Within that report, the DoD identified at least 232 financial management systems that were subject to the FFMIA, which requires systems to provide accurate, reliable, and timely financial management information. The DoD reported in its FY 2023 Agency Financial Report that it planned to have DoD systems FFMIA compliant by FY 2028. However, DoD OIG auditors found that DoD's strategy for ensuring FFMIA compliancy was flawed. Specifically, the plans:

- were incomplete, as they did not identify which of the systems would become FFMIA compliant and the cost and timeline for getting them compliant;
- delayed the retirement of 23 accounting systems, which DoD management identified as outdated and not complying with FFMIA, until between FY 2027 and 2031;
- maintained beyond FY 2028 at least 109 systems that could be replaced by modern systems that integrate all business processes, such as finance, supply chain, and contracting, into one integrated system; and
- allowed for the DoD and its Components to maintain as many as 37 systems performing similar functions, such as entitlements.

The DoD must first understand the scope of its system issues and identify the future funding necessary to correct those issues to allow for them to become FFMIA compliant. Until the DoD has a comprehensive and aggressive plan to overhaul its systems environment, the DoD is unlikely to meet its goals of creating a modern, simplified, optimized, and auditable financial management systems environment.

Developing and implementing a comprehensive, aggressive plan for its outdated systems will require collaboration across the DoD. Specifically, the OUSD(C)/CFO, DoD CIO, and DoD Components must coordinate to:

- identify whether each DoD system will become compliant or be retired, estimate the cost of becoming compliant and identify the funding source, and develop milestones for when each system will become compliant or be retired;
- expedite the retirement of the outdated systems, which would allow the DoD to put at least \$727.9 million to better use;
- require the DoD Components to justify the use of each legacy DoD system and adopt modern, integrated systems to replace systems slated for retirement; and
- identify opportunities to use single systems DoD-wide to simplify the DoD's financial management system environment.

Without resolution of the issues identified above, the DoD will continue to spend large sums of money on noncompliant, outdated systems and fall short of achieving its goals. Without compliant and modern systems, the DoD is at risk of making poor enterprise-wide business decisions, which could directly impact the DoD's mission to ensure the security of our Nation.

Recruiting and Retaining a Knowledgeable and Experienced Financial Workforce

The OUSD(C)/CFO highlighted cultivating a skilled and inspired workforce as its number one strategic goal in the DoD Financial Management Strategy. In alignment with this goal, in FY 2023 the OUSD(C)/CFO maintained that skilled workforce and began to develop and implement several policies and practices that could lead to improvements in the DoD's financial management environment. For example, the OUSD(C)/CFO's Financial Management Policy and Reporting Directorate made significant progress obtaining, standardizing, reviewing, and compiling financial statement data from the DoD Components.²⁰ Although the Financial Management Policy and Reporting Directorate is still working to remediate findings related to financial reporting, the progress to date has significantly improved the controls around the Agency-Wide financial statement compilation process and improved the accuracy of the Agency-Wide financial statements.

²⁰ The OUSD(C)/CFO's Financial Management Policy and Reporting Directorate is responsible for developing, circulating, implementing, and interpreting DoD-wide accounting and financial policies. The Directorate is also responsible for providing oversight of, and performing liaison functions with, the DoD Components with respect to financial management operations, systems, responses to financial audit reports, policy clarifications, and other matters related to financial management.

While the OUSD(C)/CFO maintained key staff positions in FY 2023, an improvement from prior years, the DoD must continue to focus on retention of key positions responsible for financial management. These key positions are critical to implementing, strengthening, and maintaining financial management priorities and controls. However, frequent turnover in military and civilian leadership within the financial management community can disrupt financial goals and priorities, thus exacerbating DoD's challenge of building and maintaining a strong financial management environment. Due to the turnover, the DoD supplements its financial management workforce with contractors. However, DoD management is ultimately responsible for establishing and maintaining effective internal controls and financial policies. 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 contractor-provided information and reported incorrect information as a result.

The DoD must continue to 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 enabling collaboration across the DoD.

Creating Sustainable Audit Approaches

The FY 2023 audits concluded with one significant improvement over the prior year in that the Marine Corps, after undergoing an unconventional 2-year audit cycle, received an unmodified opinion on its FY 2023 financial statements. A traditional financial statement audit is required to be completed each year, with auditors providing opinions on the comparative financial statements of a particular entity.

The Marine Corps had received a disclaimer of opinion on its financial statements since their annual audits began in 2017. The Marine Corps believed that if granted additional time, it could obtain a clean audit opinion, as it would allow additional time for auditors to complete audit procedures and testing. In FY 2022, the OMB granted the Marine Corps' request to complete a 2-year audit cycle ending in FY 2023. The audit required an extraordinary effort by Marine Corps personnel, the IPA auditors, and the DoD OIG Oversight Team, as well as significant coordination across the DoD. The Marine Corps demonstrated a substantial commitment in providing support for the audit.

However, the approach to auditing the FY 2023 Marine Corps Financial Statements did not rely on a sound financial management control environment. Auditors conducted substantive testing over much of the Marine Corps financial statement balances. This substantive approach, as opposed to control testing, required auditors to test details of transactions at a much higher volume than what would be expected in a controls-based audit. As a result,

the Marine Corps audit took more than 2 years, was extraordinarily laborious, and cost over \$30 million. Consequently, the approach may not be sustainable for the Marine Corps, and likely is not repeatable for larger, more complex DoD Components considering the substantial resource commitment required for non-traditional audit cycles.

Instead, the DoD should focus on and develop sustainable audit cycles that align with the DoD's definition of its reporting entity, strive to complete annual audits according to OMB requirements, and leverage the Financial Improvement and Audit Remediation efforts and other working groups to determine the most appropriate audit approach for the DoD and its Components.

Expectations for Supporting Financial Statement Audits

On October 13, 2023, the Secretary of Defense issued a memorandum to the Secretaries of the Military Departments and Principal Staff Assistants that emphasized expectations for supporting the DoD financial statement audits.²¹ The Secretary of Defense stated that the Secretaries of the Military Departments must “ensure their Departments’ financial statement audit priorities, goals, and objectives, including meeting Secretary of Defense audit priorities, are supported by actionable plans.” Furthermore, the memorandum said, “Components will work to identify opportunities for DoD-wide solutions to simplify DoD’s financial management system environment,” noting that “compliant, auditable business systems are a key enabler to audit success and sustainment.” The Secretary of Defense called for the implementation of policies that support the financial statement audit by removing barriers to audit progress. For example, the Secretary of Defense directed:

- the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, to oversee and coordinate actions necessary to implement and report on recommendations provided by the GAO for achieving an unmodified audit opinion;
- the USD(A&S) to ensure contract and data standards compliance, validate Department-wide asset accountability, particularly property in the possession of contractors, and implement a plan for financial reporting of JSF program assets;
- the DoD CIO to implement strategies for segregation of duties to meet audit requirements and accelerate the retirement of noncompliant, outdated business systems; and
- the Director of Administration and Management to implement enterprise risk management and internal control guidance and policies over operations, and support DoD financial statement audit priorities, goals, and objectives for the Defense agencies and field activities.

²¹ Secretary of Defense Memorandum for Senior Pentagon Leadership, Commanders of the Combatant Commands, and Defense Agency and DoD Field Activity Directors, “Expectations for Supporting Department of Defense Financial Statement Audits,” October 13, 2023.

We agree with the Secretary of Defense’s memorandum, and as discussed throughout this report, that coordination and collaboration across the DoD is imperative to the success of the financial statement audits. The DoD’s mindset must be geared toward creating a robust control environment that incorporates operational and accountability controls into its systems and processes. 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 the DoD’s IT, acquisitions, policy, personnel, and readiness disciplines.

The DoD Financial Management Strategy, released in 2022, calls for the DoD financial management community and its partners to act, stating, “We can only achieve successful financial management outcomes described in this strategy together – unified in vision and effort.” The financial management workforce and professionals from other disciplines across the DoD, such as those in IT, acquisitions, policy, personnel, and readiness, must partner to support the development of an effective, efficient financial management environment.

Additionally, in the FY 2023 DoD Agency Financial Report, the OUSD(C)/CFO highlighted the need for assistance from Congress and industry partners to achieve a clean financial statement opinion. Specifically, the OUSD(C)/CFO referred to the DoD’s need from Congress to provide adequate and consistent resources for replacing outdated DoD systems. Additionally, the OUSD(C)/CFO called on industry partners to bring GPIPC into audit compliance; provide transparency into the location and condition of DoD assets; and provide compliant, innovative, and affordable enterprise solutions that will support audit progress.

The OUSD(C)/CFO leads Financial Improvement and Audit Remediation efforts across the DoD. The remediation efforts strive to bring together senior DoD financial management leaders and senior representatives from the operational and functional communities, such as acquisition, logistics, and policy. Bringing these leaders together under the Financial Improvement and Audit Remediation 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 both in financial and operational disciplines. We encourage the DoD to continue the Financial Improvement and Audit Remediation construct efforts and continue to challenge the functional and operational community leadership to incorporate controls that not only produce reliable financial data but assist in operational decision making as well.

Conclusion

Auditors completed the DoD's and reporting entities' FY 2023 financial statement audits for the sixth consecutive year, noting a major success with the Marine Corps reaching an unmodified opinion. Of the 29 DoD reporting entities that underwent stand-alone audits, 10 reporting entities received clean opinions, 1 reporting entity received a qualified opinion, and 18 reporting entities received disclaimers of opinion.

In FY 2023, auditors issued 3,213 NFRs. Of those NFRs, 569 were new NFRs regarding issues identified during the current audit, and 2,644 were reissued prior-year NFRs that were not corrected during FY 2023. The DoD OIG reported a total of 28 material weaknesses and 3 significant deficiencies in its reports on the Agency-Wide financial statements.

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. Remediating those material weaknesses is no easy task and will require sustained focus and significant coordination across the DoD. This must include modernizing the DoD's outdated financial management systems, strengthening the financial management workforce, creating sustainable audit approaches, and setting clear expectations for supporting financial statement audits. Through addressing scope-limiting material weaknesses and creating collaborative opportunities in financial management, the DoD and its Components can work together to develop unified, consistent, and sustainable processes to support DoD financial operations. Leading this effort will enable the DoD to achieve a clean audit opinion and create financial health for the Department, the government, and the American public.

Appendix

The DoD OIG identified 28 material weaknesses and 3 significant deficiencies in FY 2023. Table 2 lists the DoD OIG identified material weakness and significant deficiencies as depicted in the DoD Agency Financial Report.

Table 2. Agency-Wide Material Weaknesses and Significant Deficiencies

Deficiency	Description	FY 2023 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 and accurate list of financial management systems in accordance with the Federal Financial Management Improvement Act of 1996.	Repeat
Configuration Management	The DoD lacked necessary configuration management internal controls within financial management systems. This contributed to the risk of unauthorized or inappropriate changes to financial management systems.	Modified ¹
Security Management	The DoD lacked proper security management controls over financial management systems. This contributed to increased risk that the confidentiality, integrity, and availability of systems data will not be maintained.	Modified ¹
Access Controls	The DoD lacked sufficient access controls over financial management systems to ensure proper user access and timely access removal. This contributed to the risk of unauthorized, excessive, or inappropriate system access.	Repeat
Segregation of Duties	The DoD had an absence of proper segregation of duties internal controls over financial management systems. Therefore, this could result in unauthorized access to financial data and affect the confidentiality and integrity of financial management systems.	Repeat
Interface Controls	The DoD lacked sufficient interface controls to ensure the timely reconciliation of data and correction of errors. Therefore, the risk exists that financial system data is incomplete or inaccurate.	Repeat
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 verify the completeness and accuracy of financial statement data, increasing the risk of misstated financial statement amounts.	Repeat
Reporting Entity	The DoD did not follow applicable standards that outline reporting entity principles. Therefore, the DoD did not adequately identify and report all required financial activity in the financial statements.	Repeat

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

Deficiency	Description	FY 2023 Status
Fund Balance with Treasury	The DoD did not have sufficiently documented policies and procedures to reconcile or monitor its FBWT and could not produce a complete and accurate universe of transactions. This increased the risk of materially misstated financial statement amounts.	Repeat
Inventory and Stockpile Materials	The DoD did not account for or value inventory and stockpile materials in accordance with accounting standards. Therefore, the DoD was not able to substantiate the existence, completeness, and valuation of inventory and stockpile material accounts on the DoD's Consolidated Balance Sheet.	Repeat
Operating Materials and Supplies	The DoD did not follow applicable guidance in accounting for or valuing Operating Materials and Supplies. Therefore, the DoD could not substantiate the existence and completeness of Operating Materials and Supplies reported on the financial statements.	Repeat
General Property, Plant, and Equipment	The DoD did not accurately report and value General PP&E in accordance with applicable guidance. Therefore, the DoD could not substantiate the existence and completeness of General PP&E reported on the financial statements.	Repeat
Real Property	The DoD lacked the proper internal controls to substantiate the existence, completeness, and valuation of real property. As a result, real property assets were unsupported, and the real property balance reported within General PP&E may have been materially misstated.	Repeat
Government Property in the Possession of Contractors	The DoD was unable to reconcile GPIPC amounts to the appropriate accountable property system of record or substantiate the existence, completeness, and valuation of GPIPC reported, which led to the potential misstatement of GPIPC.	Repeat
Joint Strike Fighter Program	The DoD omitted JSF Program assets from its FY 2023 financial statements due to the DoD's inability to obtain accurate and reliable data surrounding JSF Program government property. Due to the omission of this information, the financial statements were materially misstated and incomplete.	Repeat
Accounts Payable	The DoD did not maintain supporting documentation for or ensure the accurate reporting of Accounts Payable liabilities in accordance with applicable accounting standards. This contributed to the potential misstatement of Accounts Payable reported in the financial statements.	Repeat

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

Deficiency	Description	FY 2023 Status
Environmental and Disposal Liabilities	The DoD did not follow applicable guidance available on the estimation of E&DL, including not reporting all costs within E&DL or sufficiently supporting assessments of environmental sites. Therefore, E&DL and related balances may have been incompletely or inaccurately reported on the financial statements.	Repeat
Contingent Legal Liabilities	The DoD lacked documented procedures for consolidating and reporting contingency legal liabilities. This created a risk that related documentation was inconsistent and incomplete, impacting the financial statements.	Repeat
Beginning Balances	The DoD had system limitations and did not maintain necessary historical data to sufficiently support beginning balances on their financial statements. This increased the risk that the financial statements were materially misstated.	Repeat
Unsupported Accounting Adjustments	The DoD lacked internal controls to ensure that accounting adjustments were valid, complete, and accurately recorded in its accounting systems or that they were properly reviewed, approved, and supported. Therefore, there is a risk that the financial statements were materially misstated.	Repeat
Intragovernmental Transactions and Intradepartmental Eliminations	The DoD did not have effective internal controls to capture all trading partner information necessary for reconciling transactions and elimination entries. Therefore, intragovernmental adjustments and eliminations were incomplete, inaccurate, and unsupported, risking materially misstated balances.	Repeat
Gross Costs	The DoD did not have adequate procedures or internal controls for recording gross costs, or financial systems that supported gross cost tracking in accordance with standards. As a result, the DoD did not have reliable financial information, increasing the risk of material misstatement.	Repeat
Earned Revenue	The DoD did not have adequate procedures or internal controls to accurately record earned revenue in accordance with standards. As a result, the DoD did not have reliable financial information to properly report earned revenue, possibly misstating the financial statements.	Repeat
Reconciliation of Net Cost of Operations to Outlays	The DoD lacked policies and procedures necessary to reconcile differences between budgetary and proprietary data. As a result, the DoD financial statements may not accurately reflect the DoD's financial position and may be materially misstated.	Repeat

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

Deficiency	Description	FY 2023 Status
Budgetary Resources	The DoD lacked effective controls to ensure Components prepared, accounted for, and reconciled their budgetary resources in accordance with standards. The DoD's inability to monitor the status of budgetary resources created a potential for Antideficiency Act violations.	Repeat
Service Organizations	The DoD did not adequately monitor the use of service organizations or implement and assess complimentary user entity controls. These control deficiencies increased the risk that the DoD financial statements were misstated.	Repeat
Component Entity-Level Controls	The DoD had material deficiencies related to two internal control components. In addition, the DoD lacked effectively designed and implemented internal controls to prevent or detect identified material misstatements, which increased the risk that the financial statements were misstated.	Repeat
DoD-Wide Oversight and Monitoring	The DoD lacked effective controls over the review of financial data reported within the DoD Component Level Accounts and did not oversee financial management activities. As a result, the DoD may be improperly classifying information related to its financial statements, therefore, increasing the risk that its financial statement data may be inconsistently reported or incomplete.	Modified ²
Risk Management Framework ³	The DoD did not fully implement the Risk Management Framework for DoD financial management systems. As a result, DoD Components may not have the information necessary to resolve deficiencies that impact internal control over financial reporting in a timely manner, increasing the risk of the financial statements being materially misstated.	Repeat
Accounts Receivable ³	The DoD did not have adequate documentation to support the completeness, existence, or validity of non-Federal Accounts Receivable balances, creating a significant risk that balances presented in the financial statements may be misstated.	Repeat
Military Housing Privatization Initiative ³	The DoD did not ensure that Military Housing Privatization Initiative information reported in its financial statement notes reconciled to the DoD Components financial statement-related notes. This increased the possibility of misstated financial balances.	Repeat

¹ FY 2022 material weakness "Configuration Management and Security Management" reported in FY 2023 as two separate material weaknesses "Configuration Management" and "Security Management."

² FY 2022 material weaknesses "DoD Component Level Accounts" and "DoD-Wide Oversight and Monitoring" combined in FY 2023 into one material weakness "DoD-Wide Oversight and Monitoring."

³ Significant deficiencies.

Source: The DoD OIG.

Acronyms and Abbreviations

DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
E&DL	Environmental and Disposal Liabilities
FBWT	Fund Balance with Treasury
FFMIA	Federal Financial Management Improvement Act of 1996
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
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
OMB	Office of Management and Budget
OUS(D)/CFO	Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD
PP&E	Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
UoT	Universe of Transactions
USD(A&S)	Under Secretary of Defense for Acquisition and Sustainment

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