



August 2016

DOD FINANCIAL MANAGEMENT

Improvements Needed in the Navy's Audit Readiness Efforts for Fund Balance with Treasury

Accessible Version

GAO Highlights

Highlights of [GAO-16-47](#), a report to congressional committees

Why GAO Did This Study

The National Defense Authorization Act for Fiscal Year 2014 mandates an audit of DOD's fiscal year 2018 department-wide financial statements. To help achieve this, the DOD Comptroller issued the FIAR Guidance to provide a standard methodology for DOD components to follow to improve financial management and achieve audit readiness, and designated the SBR as an audit priority. Full implementation of the Navy's General Fund FIP for FBWT is essential to achieving audit readiness for its General Fund SBR. The Navy asserted Statement of Budgetary Activity (SBA) audit readiness as of September 30, 2014, and in February 2016 received a disclaimer of opinion on the audit of its SBA for fiscal year 2015.

GAO is mandated to audit the U.S. government's consolidated financial statements, which cover activities and balances of executive branch agencies, including DOD. GAO's objective in this report was to determine the extent to which the Navy developed and implemented the Discovery phase of its General Fund FBWT FIP in accordance with the FIAR Guidance. GAO analyzed the Navy's FBWT FIP to determine whether it contained the tasks and activities required by the FIAR Guidance for the Discovery phase. GAO also reviewed the Navy's FBWT FIP key deliverables, such as process narratives and flowcharts, internal control assessments, and test results.

What GAO Recommends

GAO recommended that the Navy fully implement the FIAR Guidance for FBWT in the areas of process analysis, prioritization, internal control assessment and testing, and evaluation of supporting documentation to support audit readiness. The Navy concurred with all seven recommendations.

View [GAO-16-47](#). For more information, contact Asif A. Khan at (202) 512-9869 or khana@gao.gov.

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What GAO Found

The Navy has made progress in performing audit readiness activities, including developing a financial improvement plan (FIP) for its Fund Balance with Treasury (FBWT). These activities are critical to the Navy's General Fund Statement of Budgetary Resources (SBR) improvement efforts. The Navy's FBWT FIP is particularly important as it addresses improvement efforts across multiple business processes, including contract and vendor payments and military and civilian payroll that provide significant input to the SBR. However, the Navy did not fully implement certain tasks in its FBWT FIP in accordance with the Department of Defense's (DOD) Financial Improvement and Audit Readiness (FIAR) Guidance. These included activities in all four key tasks of the Discovery phase, the first of the five FIAR guidance phases. In the Discovery phase, the reporting entity documents processes, prioritizes audit readiness efforts, assesses and tests controls, and evaluates supporting documentation.

Document processes. The Navy did not fully document its FBWT process in system narratives and flowcharts. For example, the Navy's analysis did not explain the complex process that occurs within the Defense Departmental Reporting System - B, including merging data and deleting duplicative transactions. In the Navy's case, the process analysis is particularly important because the Navy's transactions do not follow the typical flow of data used to produce financial statements. Without a complete FBWT process analysis and system narratives, internal controls and risks for each of the systems in the process may not be readily identified and appropriately tested.

Prioritize audit readiness efforts. The Navy did not prioritize FBWT audit readiness efforts or fully implement its audit readiness prioritization and strategy for key information systems prior to its assertion of audit readiness. The Navy's lack of prioritization of key information technology limits management's ability to focus audit readiness efforts on the systems with the highest risk.

Assess and test internal controls. Within the FBWT assertion package, the Navy did not document information technology general computer controls for significant systems or the hardware and software interfaces, as required. Also, the Navy did not identify internal controls by assessable units (e.g., information systems supporting financial statement line items or other discrete portions of the program). Identifying controls by assessable unit is important for determining whether assessable units, sub-assessable units, and associated systems are producing reliable information and helps link systems and controls to the transaction flows.

Evaluate supporting documentation. Although the Navy performed substantive tests for supporting documents, such testing may not provide sufficient evidence of the Navy's ability to produce documentation in a substantive manner for future audits. An evaluation of key supporting documentation is important for determining whether the Navy would be able to support amounts presented in the financial statements or provide an external auditor with sufficient and appropriate evidence to perform the audit.

Addressing these shortfalls is critical to achieving audit readiness.

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Abbreviations

CARS	Central Accounting Reporting System
DCAS	Defense Cash Accounting System
DDRS-AFS	Defense Departmental Reporting System - Audited Financial Statements
DDRS-B	Defense Departmental Reporting System – Budgetary
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
DOD OIG	DOD’s Office of Inspector General
DSSN	Disbursing Station Symbol Number
Navy ERP	Navy Enterprise Resource Planning
FBWT	Fund Balance with Treasury
FIAR	Financial Improvement and Audit Readiness
FIP	financial improvement plan
FISCAM	<i>Federal Information System Controls Audit Manual</i>
IPA	independent public accountant
NDAA	National Defense Authorization Act
PBIS	Program Budget Information System
SBR	Statement of Budgetary Resources
STARS-FL	Standard Accounting and Reporting System – Field Level
STARS-HCM	Standard Accounting and Reporting System – Headquarter Claimant Module
Treasury	Department of the Treasury
USMC	U.S. Marine Corps

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August 19, 2016

The Honorable Ron Johnson
Chairman
The Honorable Thomas R. Carper
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Jason Chaffetz
Chairman
The Honorable Elijah Cummings
Ranking Member
Committee on Oversight and Government Reform
House of Representatives

The Navy is the second largest component of the Department of Defense (DOD), accounting for about \$160 billion, or 25 percent, of DOD's total reported expenditures in fiscal year 2014.¹ The Government Management Reform Act of 1994 requires DOD to annually prepare and submit audited financial statements to Congress and the Office of Management and Budget.² Over the years, we have reported on the Navy's and other DOD components' efforts to overcome long-standing financial management weaknesses that have prevented the issuance of auditable financial statements. Pervasive deficiencies in financial and related business management systems and internal controls have adversely affected DOD's and its components' ability to control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; prevent and detect fraud, waste, and abuse; address pressing management issues; and prepare auditable

¹The Navy and Marine Corps operate through 26 commands and direct reporting units, with component strength of over 513,000 active duty service members, about 99,000 reserve service members, over 200,000 civilian employees, and thousands of contract personnel. Amounts and figures include the U.S. Marine Corps.

²Pub. L. No. 103-356, § 40, 108 Stat. 3410, 3415 (Oct. 13, 1994), *codified as amended at* 31 U.S.C. § 3515.

financial statements. These issues have led GAO to designate DOD financial management as high risk since 1995.³

Our prior work has raised concerns about the ability of DOD components to effectively implement DOD's Financial Improvement and Audit Readiness (FIAR) Guidance.⁴ In this report, we focus on the Navy's General Fund Fund Balance with Treasury (FBWT) financial improvement plan (FIP).⁵ Although the U.S. Marine Corps (USMC) is included in the Navy's consolidated financial statements, it is excluded from the scope of this report since the USMC has separate financial statements and its own audit readiness FIPs.⁶

In the federal government, an agency's FBWT account is similar in concept to a corporate bank account. The difference is that instead of a cash balance, FBWT represents the remaining spending authority in

³GAO, *High-Risk Series: An Update*, [GAO-15-290](#) (Washington, D.C.: Feb. 11, 2015).

⁴GAO, *DOD Financial Management: Improvements Needed in Army's Efforts to Ensure the Reliability of Its Statement of Budgetary Resources*, [GAO-14-60](#) (Washington, D.C.: May 30, 2014); *DOD Financial Management: Actions Under Way Need to Be Successfully Completed to Address Long-standing Funds Control Weaknesses*, [GAO-14-94](#) (Washington, D.C.: Apr. 29, 2014); *DOD Financial Management: Ongoing Challenges with Reconciling Navy and Marine Corps Fund Balance with Treasury*, [GAO-12-132](#) (Washington, D.C.: Dec. 20, 2011); and *DOD Financial Management: Improvement Needed in DOD Components' Implementation of Audit Readiness Effort*, [GAO-11-851](#) (Washington, D.C.: Sept. 13, 2011).

⁵For purposes of determining whether the Navy implemented FIAR Guidance in its efforts to improve FBWT audit readiness, we used the November 2013 FIAR Guidance as this was the guidance in effect at the time the Navy asserted audit readiness on FBWT and expanded the scope of its FBWT audit readiness efforts to include all systems affecting the financial statement line items. According to the November 2013 FIAR Guidance, a FIP is a standard framework/template that organizes and prioritizes the financial improvement efforts of the reporting entities and aligns to the FIAR Methodology. It includes the following five phases: (1) Discovery - entities document their processes and identify, test, and assess their controls and evaluate and confirm the existence of documentation supporting relevant financial statement assertions; (2) Corrective Action - entities develop and execute plans to address identified deficiencies and verify implementation of corrective actions; (3) Assertion/Evaluation - entities assert their audit readiness; (4) Validation - entities have their assertion independently validated; and (5) Audit - entities employ an independent public accountant firm to perform a financial audit.

⁶According to DOD's *Financial Improvement and Audit Readiness Status Report* (issued in November 2014), "audit ready" means the department has strengthened internal controls and improved financial practices, processes, and systems so there is reasonable confidence the information can undergo an audit by an independent auditor.

appropriations.⁷ The Navy's FBWT FIP is particularly important as it addresses improvement efforts across multiple business processes that provide input for FBWT balances, including contract and vendor payments and military and civilian payroll that annually totals billions of dollars. These processes also provide input for budgetary resources and financial activity (e.g., appropriations, obligations, and outlays) that represent significant portions of the amounts reported on the Navy's Statement of Budgetary Resources (SBR).⁸ Consequently, efforts to develop and fully implement this FIP will significantly affect the Navy's ability to achieve SBR audit readiness as well as improve Navy management's ability to manage its funds.

This review was initiated under our mandate to audit the U.S. government's consolidated financial statements, which cover activities and balances of executive branch agencies, including DOD.⁹ Serious financial management problems at DOD represent one of the long-standing major impediments that continue to prevent GAO from expressing an audit opinion on the U.S. government's consolidated financial statements.¹⁰ We focused on the Navy's FBWT FIP because of its importance to the Navy's effort to achieve SBR auditability and, ultimately, audit readiness for DOD's department-wide SBR.

Our objective was to determine the extent to which the Navy developed and implemented the Discovery phase of its General Fund FBWT FIP in accordance with the FIAR Guidance.¹¹ To address our objective, we

⁷An appropriation provides an agency with legal authority to incur obligations and make payments from the Department of the Treasury for specified purposes.

⁸In DOD's November 2013 FIAR Guidance, the focus of audit readiness efforts was on the General Fund. The strategy for achieving audit readiness for the Working Capital Fund was included in DOD's updated 2015 FIAR Guidance, issued in April 2015. The Navy reported the Working Capital Fund as \$31.7 billion, or 13.1 percent of the Navy's total budgetary resources for fiscal year 2014. The Navy's audit readiness efforts for the Working Capital Fund were not included in the scope of this review.

⁹31 U.S.C. § 331(e).

¹⁰GAO, *Financial Audit: U.S. Government's Fiscal Years 2015 and 2014 Consolidated Financial Statements*, [GAO-16-357R](#) (Washington, D.C.: Feb. 25, 2016).

¹¹In the Discovery phase, reporting entities are to prepare process analysis and quantitative and qualitative supporting documentation for financial statement line items, prioritize their audit readiness efforts, document processes, assess and test internal controls, and evaluate supporting documentation.

analyzed the Navy's FBWT FIP to determine whether it contained the applicable elements and tasks to be performed for the Discovery phase of audit readiness efforts as required by the FIAR Guidance. We also identified and reviewed the Navy's FBWT FIP deliverables required by the FIAR Guidance, such as system narratives and flowcharts, key internal control assessments, and test results. In addition, we reviewed the results of DOD's Office of Inspector General (DOD OIG) audits as well as independent public accountant (IPA) examinations of audit readiness efforts related to the Navy's FBWT. We interviewed Navy, Defense Finance and Accounting Service (DFAS), and FIAR Directorate officials within DOD's Office of the Under Secretary of Defense (Comptroller) to obtain explanations and clarifications on documentation we reviewed.¹²

Additional information on our scope and methodology is provided in appendix I. We conducted this performance audit from April 2014 to August 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Background

The National Defense Authorization Act (NDAA) for Fiscal Year 2010 requires that DOD develop and maintain the FIAR Plan.¹³ The FIAR Plan must include specific actions to take and the costs associated with correcting the financial management deficiencies that impair DOD's ability to prepare reliable and timely financial management information and ensure that its financial statements are validated as ready for audit by September 30, 2017. Further, the NDAA for Fiscal Year 2014 mandates an audit of DOD's fiscal year 2018 department-wide financial statements and submission of those results to Congress by March 31, 2019.¹⁴ Since

¹²The FIAR Directorate provides management of the FIAR Plan to ensure integration of DOD-wide financial improvement efforts through various activities, including (1) developing and issuing the FIAR Guidance, (2) performing monthly detailed reviews of component FIPs and evaluating related deliverables, and (3) developing metrics for monitoring and progress reporting.

¹³Pub. L. No. 111-84, div. A, § 1003(a), (b), 123 Stat. 2190, 2439-40 (Oct. 28, 2009).

¹⁴Pub. L. No. 113-66, div. A, § 1003, 127 Stat. 672, 842 (Dec. 26, 2013).

DOD management relies heavily on budget information for day-to-day management decisions, the DOD Comptroller designated the SBR as an audit priority.¹⁵

In response to difficulties encountered in preparing for an SBR audit, DOD reduced the scope of initial SBR audits beginning in fiscal year 2015 to focus on current-year budget activity reported on a Schedule of Budgetary Activity. This is an interim step toward achieving an audit of multiple-year budget activity required for an audit of the SBR.

In the last quarter of fiscal year 2014, each military service, including the Navy, asserted audit readiness on its General Fund Schedule of Budgetary Activity. The fiscal year 2015 Schedule of Budgetary Activity reflects the balances and associated activity related only to budgetary authority on or after October 1, 2014.¹⁶ In December 2014, DOD contracted with an IPA, for the audit of the Navy's fiscal year 2015 Schedule of Budgetary Activity. In February 2016, the IPA issued a disclaimer of opinion on the Navy's Schedule of Budgetary Activity and identified pervasive control deficiencies in the Navy's decentralized financial management and information technology environment. Navy management concurred with the findings in the IPA's report and stated that it will develop and execute corrective actions to address the IPA's recommendations, including those related to FBWT.

FIAR Guidance

In May 2010, the DOD Comptroller issued the FIAR Guidance to provide a standard methodology for DOD components to follow in developing an audit strategy and implementing FIPs. The FIAR Guidance defines DOD's strategy, goals, roles and responsibilities, and procedures for the

¹⁵The SBR and related disclosures provide information about budgetary resources made available to an agency as well as the status of those resources at the end of the fiscal year.

¹⁶Unlike the SBR, which reflects multiple-year budget activity, the Schedule of Budgetary Activity reflects the balances and associated activity related only to funding from fiscal year 2015 forward. As a result, the Schedule of Budgetary Activity excludes unobligated and unexpended amounts carried over from funding prior to fiscal year 2015 as well as information on the status and use of such funding (e.g., obligations incurred and outlays) in fiscal year 2015 and thereafter.

components to become audit ready.¹⁷ Specifically, the guidance provides a standard methodology that DOD components are required to follow in developing and implementing FIPs. These plans, in turn, provide a framework for planning, performing, documenting, and monitoring efforts to achieve auditability. To manage their improvement efforts, components may develop multiple FIPs, including plans related to specific assessable units, which can be information systems supporting financial statement line items or other discrete portions of the program.¹⁸

The FIAR Guidance describes the five audit readiness phases and activities that DOD reporting entities (including the Navy) should include in their FIPs. The five audit readiness phases are Discovery, Corrective Action, Assertion/Evaluation, Validation, and Audit.¹⁹ Each phase includes multiple tasks and activities that reporting entities should complete and the corresponding required deliverables. (App. II identifies the detailed FIAR tasks and required deliverables for each of these phases.) Most of the audit readiness process occurs in the Discovery and Corrective Action phases. In the Discovery phase, entities document their processes and identify, test, and assess their controls and evaluate and confirm the existence of documentation supporting relevant financial statement

¹⁷Under the FIAR Guidance, DOD components include reporting entities (i.e., DOD entities or funds that prepare stand-alone financial statements included in the DOD department-wide financial statements) and service providers that provide a variety of accounting, personnel, logistics, systems, or other support services. Further, audit readiness assertions specify that (1) control activities are suitably designed, implemented, operating effectively, and sufficiently documented to provide reasonable assurance that applicable financial reporting objectives are achieved; (2) key supporting documents are readily available for review; and (3) account balances and transactions are accurately recorded.

¹⁸Assessable units can vary; they may be line items, processes, systems, or classes of assets. The Navy identified FBWT assessable units as collection and disbursement transactions. Assessable units can be further separated into assessable subunits at the reporting entity's discretion.

¹⁹In the April 2015 FIAR Guidance, the Assertion/Evaluation phase was renamed the Assertion/Examination phase.

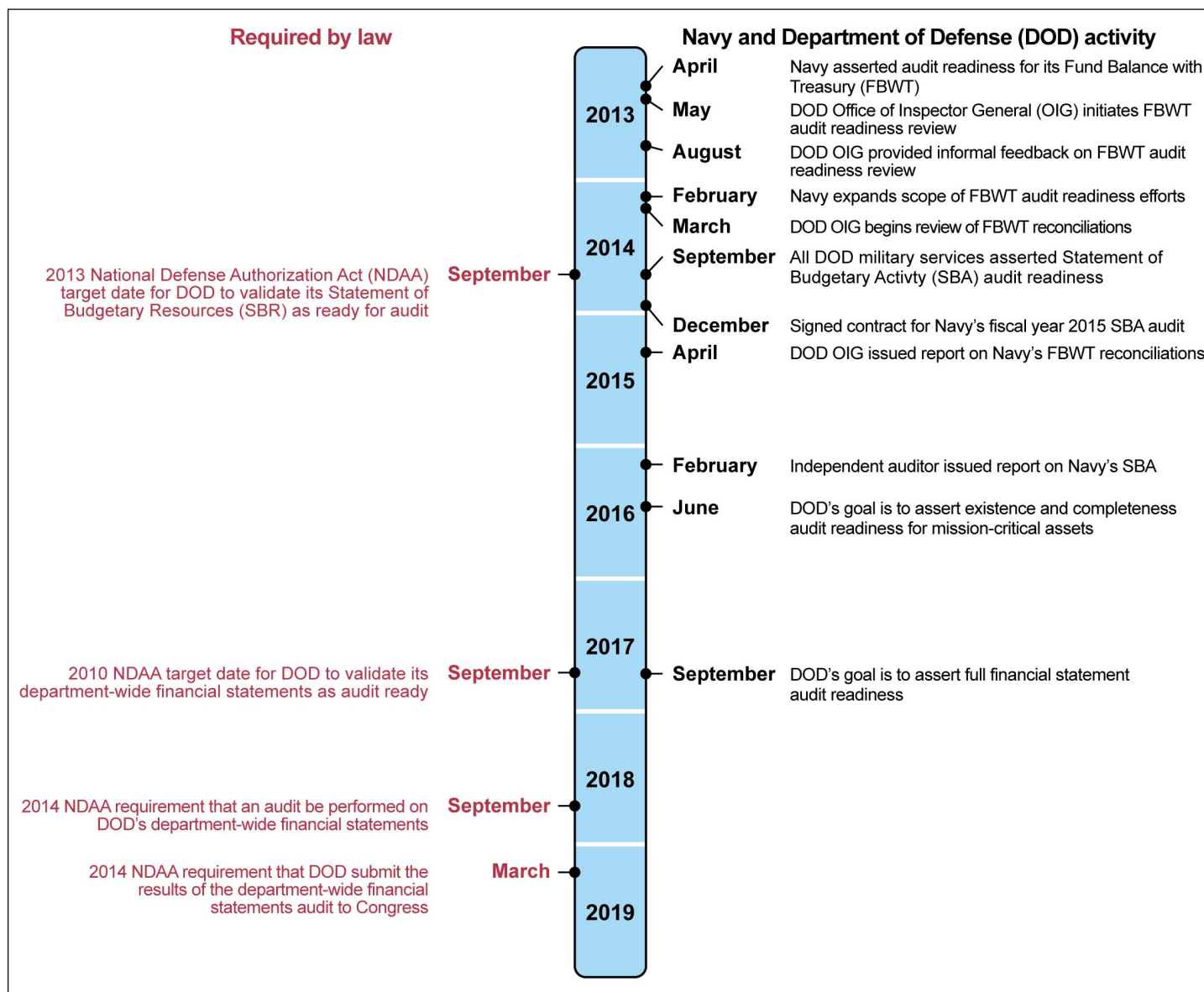
assertions.²⁰ In the Corrective Action phase, entities develop and execute plans to address identified deficiencies and verify implementation of corrective actions. In the last three phases, a reporting entity (1) asserts its audit readiness, (2) has its assertion independently validated, and (3) employs an IPA firm to perform a financial audit. The Navy asserted audit readiness but did not complete the Corrective Action phase or validate the assertion because of time constraints and moved directly into an audit of its Schedule of Budgetary Activity by an IPA firm.

**Navy FBWT Audit
Readiness Strategy,
Milestones, and Events**

The Navy's FBWT FIP provides a framework for planning, executing, and tracking essential steps with supporting documentation to achieve audit readiness for its FBWT. Figure 1 shows important milestones and events in Navy's FBWT FIP and overall audit readiness efforts.

²⁰Statement on Auditing Standards 122, AU-C § 315, .A113 - .A114 notes that in representing that financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation, and disclosure of the various elements of financial statements and related disclosures. Financial statement assertions fall within the following three categories: (1) classes of transactions and events for the period under audit (occurrence, completeness, accuracy, cutoff, and classification); (2) account balances at the period end (existence, rights and obligations, completeness, and valuation and allocation); and (3) presentation and disclosure (occurrence and rights and obligations, completeness, classification and understandability, and accuracy and valuation).

Figure 1: Navy Audit Readiness Milestones and Events



Source: GAO analysis of NDAA's, Navy's FBWT assertion, DOD OIG audit announcement and report, DOD FIAR Guidance, and DOD financial statements. | GAO-16-47

In April 2013, the Navy asserted that its FBWT process was audit ready.²¹ The scope of the Navy's audit readiness assertion began with the feeder systems that provide collection and disbursement transactions and extended through posting these transactions to DFAS's Defense Departmental Reporting System - Budgetary (DDRS-B).²² At the time of the Navy's assertion in April 2013, the Navy reported that 21 of 33 key controls that it had identified for FBWT were operating effectively. The Navy further reported that it had developed corrective action plans for the remaining 12 controls and the corrective actions were under way.

Subsequent to the Navy's assertion, in May 2013, the DOD OIG initiated a review of the Navy's FBWT assertion to determine audit readiness. Because of the significance of its findings, including that the Navy did not include in its assertion all significant systems affecting the FBWT line item, the DOD OIG did not complete its review. In August 2013, the DOD OIG provided the Navy with informal feedback, including areas for improving its FBWT audit readiness.²³ In February 2014, in response to the DOD OIG's feedback and to support the FBWT-related line items on its financial statements, the Navy expanded the scope of its FBWT audit readiness efforts to include all systems affecting the financial statement line items, including the Defense Departmental Reporting System -

²¹The Navy's FBWT audit readiness assertion summary defines the general fund FBWT process "as those funding, collection, and disbursement activities, procedures, transactions, and accounting events having a direct or important impact on the Statement of Budgetary Resources (SBR) financial statement, related to the Department of the Navy's balances recorded at the Department of the Treasury."

²²The Navy also included audit readiness efforts for parts of the FBWT process in another FIP: the Financial Statement Compilation and Reporting FIP. Audit readiness procedures for journal vouchers in the budget reporting system and combination and elimination entries in the financial reporting system were included in the Financial Statement Compilation and Reporting FIP. DDRS-B is the system the Navy uses for budgetary reporting.

²³The DOD OIG did not issue an audit report for its work on the Navy's FBWT assertion. Instead, it communicated its findings to the Office of the Secretary of Defense's FIAR Directorate in meetings and through correspondence. The DOD OIG communicated to a FIAR Directorate official that they found that the FBWT assertion package did not provide a level I quantitative drilldown; quantitatively or qualitatively rank assessable units; provide process and systems documentation; include documentation for the execution of tests of controls; and identify, evaluate, or classify deficiencies. The DOD OIG also noted that detailed transaction files were not part of the assertion package, and the Navy did not summarize test results or identify deficiencies.

Audited Financial Statements (DDRS-AFS) system.²⁴ Although the Navy expanded the scope of FBWT audit readiness efforts through financial statement compilation and reporting, it did not reassert FBWT audit readiness.

In March 2014, the DOD OIG began another engagement, which involved a review of the Navy's FBWT reconciliations. A DOD OIG official told us that this engagement did not include a review of the Navy's FBWT assertion, but rather was to determine whether the Navy's FBWT reconciliation was effective, supportable, and sustainable.

In September 2014, DOD officials announced that all military services and many defense agencies had asserted General Fund Schedule of Budgetary Activity audit readiness. In December 2014, a contract was signed with an IPA to audit the Navy's fiscal year 2015 General Fund Schedule of Budgetary Activity. For fiscal year 2015, the Navy's Schedule of Budgetary Activity and FBWT were based on funding from 19 General Fund appropriation accounts. The IPA was to determine whether the Schedule of Budgetary Activity and related notes were fairly presented, in all material respects, in accordance with U.S. generally accepted accounting principles.²⁵

In January 2015, after the Navy performed additional internal control testing, it reduced the total number of key internal controls for FBWT from 33 to 31. At that time, the Navy reported that 25 of the 31 controls were deemed to be operating effectively and that corrective actions were under way for the remaining 6 key controls.

In April 2015, the DOD OIG issued a report on the process the Navy uses to reconcile its FBWT accounts.²⁶ Reconciling FBWT activity records with the Department of the Treasury (Treasury) is similar to reconciling a

²⁴DDRS-AFS is the system the Navy uses to prepare financial statements. FBWT-related line items on the financial statements include FBWT on the balance sheet and collections and outlays on the SBR.

²⁵The contract excluded any financial information of the USMC from the audit of the Navy's Schedule of Budgetary Activity for fiscal year 2015, as the USMC was undergoing a separate audit.

²⁶Department of Defense, Office of Inspector General, *Additional Actions Needed to Effectively Reconcile Navy's Fund Balance With Treasury Account*, Report No.DODIG-2015-102 (Apr. 3, 2015).

checkbook to a bank statement. The *Treasury Financial Manual* requires agencies to reconcile their FBWT accounts to Treasury balances on a monthly basis.²⁷ In its report, the DOD OIG noted several findings, including that the Navy (1) did not use general ledger data as source data for FBWT reporting, (2) had difficulty identifying the universe of transactions supporting the FBWT balance, and (3) may have used unreliable computer-processed data from two FBWT-related systems with reported significant deficiencies in internal controls.²⁸

Further, in February 2016, the IPA issued a disclaimer of opinion on the Navy's Schedule of Budgetary Activity and identified material weaknesses in internal control. One of the material weaknesses included controls over FBWT reporting and reconciliations, including the Navy's related controls over its third-party service provider. As noted above, Navy management concurred with the findings in the IPA's report and stated that it will develop and execute corrective actions to address the IPA's recommendations.

Going forward, DOD's goals are to assert audit readiness for existence and completeness of its mission-critical assets by June 2016 and to assert full financial statement audit readiness by September 30, 2017. FBWT audit readiness is a step in achieving full financial statement audit readiness.

²⁷*Treasury Financial Manual*, vol. 1, pt. 2, ch. 5100, "Reconciling Fund Balance with Treasury Accounts," March 29, 2012.

²⁸The *Federal Information System Controls Audit Manual* (FISCAM) presents a methodology for performing information system control audits of federal and other governmental entities in accordance with professional standards. See GAO, *Federal Information System Controls Audit Manual (FISCAM)*, [GAO-09-232G](#) (Washington D.C.: February 2009). In FISCAM reviews by IPAs, two of the Navy FBWT-related systems, the Defense Cash Accountability System (DCAS) and the Program Budget Information System (PBIS) were found to have failed testing or controls were not tested. The Navy reported that DCAS had 56 percent of its FISCAM controls that failed testing or the controls were not tested, and 77 percent of PBIS system controls failed testing. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A significant deficiency is a deficiency or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Navy Did Not Fully Implement Certain FBWT FIP Tasks in Accordance with the FIAR Guidance

Although the Navy included all the required audit tasks for the Discovery phase in developing its FBWT FIP, it did not fully implement certain required activities within these tasks in accordance with the applicable FIAR Guidance.²⁹ These included activities in all four key tasks of the Discovery phase, which requires the Navy to (1) perform statement-to-process (process) analysis, (2) prioritize audit readiness efforts, (3) assess and test internal controls, and (4) evaluate supporting documentation. The purpose of these tasks is to improve financial information for Navy management and provide information to support the financial statement audit. Completion of these tasks remains important because FBWT collections and disbursements are integral to the Navy's Schedule of Budgetary Activity, which is currently undergoing a second year audit for fiscal year 2016. Further, the FBWT line item is included on the Navy's balance sheet, which is expected to be audited when the Navy undergoes the full financial statement audit planned for fiscal year 2018.

Process Analysis

The FIAR Guidance states that reporting entities are to perform a process analysis. We found that the Navy did not implement certain tasks for documenting the FBWT process, as required by the FIAR Guidance. The process analysis includes tracing from a summary amount, such as a line item on a financial statement, to underlying support, such as accounts in the general ledger, and support for those accounts, such as subledgers and transactions.

One of the purposes of the process analysis is to provide information on the flow of data through the various systems to the financial statements. To develop the process analysis, reporting entities are to identify assessable units, business processes, systems, and other characteristics associated with amounts reported in financial statement line items. A process analysis describes the process, such as military pay, and includes a system analysis depicting asset or transaction classes, underlying processes, assessable units and subunits, and associated systems. The Navy prepared two process analyses for the FBWT assertion package, one in April 2013 and the second in February 2014, when it expanded the scope of its FBWT audit readiness efforts to include

²⁹The guidance in effect at the time the Navy updated the scope of their FBWT audit readiness efforts was issued in November 2013. Therefore, for purposes of determining the extent to which the Navy developed and implemented its FBWT FIP in accordance with the FIAR Guidance, we used the November 2013 FIAR Guidance.

DDRS-AFS and the FBWT-related financial statement line items. The Navy's April 2013 process analysis identified collections and disbursements as assessable units for the FBWT process and the Navy's general ledgers as sub-assessable units. While both of these analyses identify the key systems involved in the FBWT process, neither fully documents the flow of data through the various systems to the financial statements.

Although the Navy provided narratives that describe the FBWT systems, the narratives did not include certain significant events in the flow of collection and disbursement transactions from feeder systems into the financial statements. Among the events not included was the reversal of general ledger amounts and other entries.³⁰ Navy officials told us that the narratives they provided in the FBWT assertion were based on the original April 2013 FBWT scope, that is, from feeder systems to DDRS-B.³¹ In February 2014, in response to DOD OIG concerns regarding the lack of agreement of FBWT financial statement amounts to the general ledger and supporting transactions, the Navy expanded the scope of the FBWT audit readiness efforts through the financial statement line item. Navy officials said that they did not apply FIAR methodology to any new items included in the expanded scope of the FBWT audit readiness efforts. Because of the limited time remaining until the audit of the fiscal year 2015 Schedule of Budgetary Activity, the Navy did not pursue an additional FBWT validation of assertion.

In the Navy's case, the process analysis is particularly important for understanding the FBWT financial reporting process because the Navy's transactions do not follow the typical flow of data used to produce financial statements. Generally, the flow is from subsidiary ledger to general ledger to trial balance to financial statements. Without a complete FBWT process analysis and system narratives, internal controls and risks

³⁰A reversing entry may be made at the beginning of an accounting period to cancel out, or reverse, an adjusting entry made at the end of the previous period. The entry is used to avoid the double counting of revenues or expenses and to allow for the timely recording of transactions.

³¹When the Navy expanded its FBWT scope, it did not update system narratives to reflect the expansion. The Navy did provide flowcharts reflecting the expanded scope, but these lacked critical information, including reversal of general ledger amounts and discussion of forced balance entries, which are posted in DDRS-B, to agree with Treasury's FBWT.

for each of the systems in the process may not be readily identified and appropriately tested.

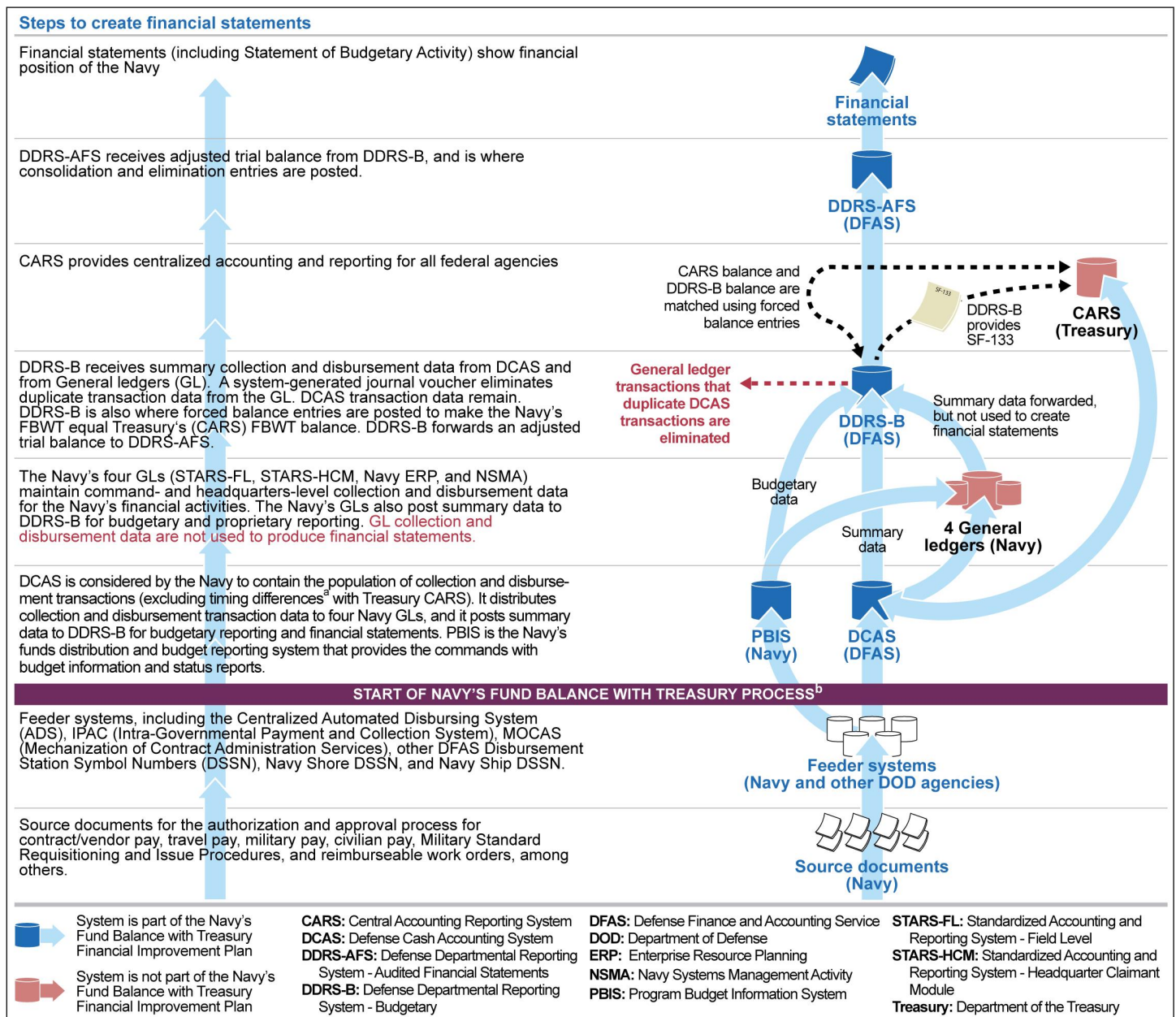
As shown in figure 2, the Navy's FBWT financial reporting process is complex, incorporates multiple information systems, and is based on systems originally created for budgetary reporting and support of other business functions. Figure 2 and the related narrative provide an overview of the Navy's FBWT data flow for financial reporting. A more detailed description of the Navy's FBWT data flow is included in appendix III.

The original systems include subsidiary ledgers (Program Budget Information System (PBIS) and Defense Cash Accountability System (DCAS)), a budgetary reporting system (DDRS-B), and its general ledger systems.³² These systems were modified over time to provide financial reports and data for financial statement compilation.³³

³²The Navy has four general ledger systems: Standard Accounting and Reporting System – Field Level, Standard Accounting and Reporting System – Headquarter Claimant Module, Navy Enterprise Resource Planning, and Navy Systems Management Activity. We did not include Navy Systems Management Activity in the scope of this review as its transactions are classified. PBIS is the Navy's funds distribution and budget reporting system that provides the commands with budget information and status reports. DCAS contains the universe of collection and disbursement transactions, a summary of which rolls up to the financial statements.

³³Summary data trial balances flow from the Navy's four general ledgers into DDRS-B.

Figure 2: Navy Fund Balance with Treasury Data Flow to Financial Statements



Source: GAO analysis of the Navy's system narratives, flowcharts, and from discussion with Navy officials. | GAO-16-47

^aTiming differences refers to collection and disbursement transactions and transaction adjustments, received by Treasury, that the Navy has not yet received.

^bThe Navy does not consider systems below this line part of the Fund Balance with Treasury end-to-end process.

Our analysis found that the Navy's FBWT process relies on subsidiary ledgers PBIS and DCAS to

- distribute (allocate) the Navy's funds to the general ledgers;
- distribute collection and disbursement transaction information to the general ledgers; and
- forward summary data to the DFAS budgetary reporting system (DDRS-B) for inclusion in the DFAS audited financial statements system (DDRS-AFS), which ultimately creates the Navy's consolidated financial statements.

Another important activity in the process analysis is the quantitative drilldown, which provides the sources to support a summarized amount, such as a financial statement line item. The FIAR Guidance requires the preparation of a level I and level II quantitative drilldown depicting dollar activity or balances for each assessable unit.

- A level I quantitative drilldown provides the first level of data sources, the assessable units, that make up the summarized amount on a financial statement.
- A level II quantitative drilldown provides the sub-assessable units that make up the amounts in the level I quantitative drilldown.

Navy officials told us that they did not prepare a level I quantitative drilldown for the Navy's FBWT assessable units, showing how FBWT amounts are summarized for financial reporting, as they did not think this requirement was applicable for FBWT. The FIAR Directorate, in its review of the Navy's FBWT assertion package, also determined that the quantitative drilldowns called for in the FIAR Guidance were not applicable.³⁴ A FIAR Directorate official noted that the quantitative drilldown is intended to prioritize and disaggregate assessable units at the early stages of FIAR execution. A comprehensive reconciliation of the

³⁴FIAR Guidance states that reporting entities must submit interim work products to the FIAR Directorate upon completion of the key tasks and activities in the Discovery and Corrective Action phases in accordance with their FIP milestone dates. The FIAR Directorate will review all work products as they are submitted by the reporting entities. This ongoing review will allow the FIAR Directorate to monitor the department's progress and provide the reporting entities with feedback prior to submission of their final audit-ready assertion documentation. Once management prepares the assertion, the FIAR Directorate must approve the scope, tasks, and deliverables for the examination of the assertion.

detailed transactions to the financial statements occurs later on. The FIAR Directorate official further noted that quantitative drilldowns by assessable unit were not necessary in this FIP because assessable units, such as military pay or contracts, are covered in other FIPs. Although the Navy and the FIAR Directorate said that a quantitative drilldown was not applicable, a level I quantitative drilldown for FBWT is critical for determining all the sources of transactions, including journal vouchers, comprising the population of transactions, as well as for prioritizing audit efforts. For example, system-generated entries and journal vouchers occur within DDRS-B. These journal vouchers are a source of activity affecting FBWT that according to FIAR Guidance, should be prioritized for testing. Without identification and an understanding of the entire population of transactions, including journal vouchers and other system-specific entries that a drilldown will help identify, Navy management and the auditor will not have information important for an understanding of the source of transactions, which is necessary to assess risk and determine the level of audit work necessary.

Other Audit Readiness Issues within the Navy's FBWT Process Analysis

Other audit readiness issues resulting from the Navy's FBWT process are its reconciliations and transactions posted to suspense accounts.³⁵ The Navy's FBWT reconciliation process is both complex and time-consuming. The Navy has 19 general funds (appropriations) and a FBWT account for each general fund, each of which the *Treasury Financial Manual* requires to be reconciled monthly to Treasury accounts. The diverse nature of the numerous feeder systems provides a large volume of transactions, and the Navy's complex FBWT process complicates the reconciliation process. The Navy's reconciliation process is further described in appendix IV. Suspense accounts have been a long-standing problem at DOD. For example, in fiscal year 2003, Congress authorized DOD to write off long-standing debit and credit transactions reported in suspense accounts.³⁶ DOD subsequently reported that it wrote off

³⁵Suspense accounts are accounts in the general ledger in which amounts are temporarily recorded. The suspense account is used because the proper account could not be determined at the time the transaction was recorded. When the proper account is determined, the amount will be moved from the suspense account to the proper account.

³⁶Bob Stump National Defense Authorization Act for Fiscal Year 2003, Pub. L. No. 107-314, § 1009, 116 Stat. 2458, 2635-36 (Dec. 2, 2002).

transactions with an absolute value of \$35 billion.³⁷ In April 2014, we reported that DOD had recorded billions of dollars of disbursement and collection transactions in suspense accounts over the years because the proper appropriation accounts could not be identified and charged, generally because of coding errors.³⁸ More recently, in March 2015, the DOD OIG withdrew its opinion on the USMC fiscal year 2012 Schedule of Budgetary Activity because of suspense accounts held at Treasury that contained USMC transactions that had not been posted to valid appropriations. Appendix V provides more information on the issues and extent to which DOD and the Navy use suspense accounts.

Prioritization of Audit Readiness Efforts

The Navy did not prioritize certain FBWT audit readiness efforts required by the FIAR Guidance to provide reasonable assurance that its audit readiness efforts were adequate. Because assessable units provide the focus for financial improvement efforts, FIAR Guidance requires the prioritization of audit readiness efforts, including ranking assessable units in order of quantitative materiality and developing qualitative factors affecting audit readiness. The FIAR Guidance also requires documenting the audit readiness strategy. However, the Navy did not prioritize its FBWT audit readiness efforts, quantitatively or qualitatively, or fully implement its audit readiness prioritization and strategy for key information systems prior to assertion. Without prioritization, the Navy cannot reasonably assure that it will first address the highest-risk areas within the FBWT process and information technology.

Prioritization of Audit Readiness Efforts for the FBWT Process

Navy officials told us that they did not produce a prioritization and audit strategy document because they considered FBWT systems complete, as they each contained 100 percent of the transactions.³⁹ DOD's FIAR Directorate reviewed the Navy's FBWT assertion documentation and agreed with Navy officials, indicating that the "comprehensive nature of

³⁷GAO, *DOD Problem Disbursements: Long-standing Accounting Weaknesses Result in Inaccurate Records and Substantial Write-offs*, [GAO-05-521](#) (Washington, D.C.: June 2, 2005).

³⁸[GAO-14-94](#).

³⁹Navy officials' statement that each of the FBWT systems contains 100 percent of the transactions pertains to transactions flowing through the various FBWT systems for financial reporting. All of the transactions flowing through DCAS also flow through DDBS-B and DDBS-AFS.

Prioritization of Audit Readiness Efforts for Information Technology Systems

the FBWT FIP assertion” (1) did not lend itself to prioritization within the SBR assessable unit or audit segment and (2) did not require any follow-up prior to examination.⁴⁰ However, certain activity is unique to each system, including system-generated entries, adjustments to reconcile to Treasury, and consolidation and elimination entries. As previously noted, a level I quantitative drilldown is critical for audit readiness and would show how each FBWT system is unique and the extent of system-specific activity, and would allow each FBWT system to be prioritized for audit purposes and assessed for risk. The FIAR Guidance states that agencies should rank each assessable unit in terms of risk and in order of quantitative materiality, with largest dollar activity being the highest priority. Further, in connection with performing a financial statement audit, government auditing standards state that the auditor gains an understanding of the operating environment and assesses key controls over information systems.⁴¹ While the same or similar transactions flow through each of the Navy’s FBWT systems, each system also includes unique activity. For example, DDRS-B includes system-generated entries that are not in the lower-level system of DCAS. In addition, qualitative factors, such as system ownership, can affect risk to varying degrees. By assigning the same priority to all of the FBWT systems, without regard to quantitative and qualitative factors and their effects on risk, the Navy cannot reasonably assure that it initiates audit readiness efforts and corrective actions for the higher-risk systems first.

For an audit readiness plan for key information technology systems, the Navy provided a schedule that identified 22 relevant systems, 16 of which the Navy deemed key FBWT systems. For these 16 systems, the Navy noted that to assess audit readiness, 11 systems would receive self-assessments, 4 systems would receive independent assessments, and for 1 system the assessment type had not yet been determined. However, the Navy indicated that only 6 of the self-assessments and all 4 of the independent assessments were completed. For the remaining 6 key FBWT systems, the Navy did not provide planned start dates or expected completion dates or indicate when it would obtain audit readiness assurance for these systems. Navy officials thought the systems

⁴⁰Assessable units can vary between line items, processes, systems, or classes of assets, depending on the reporting entity preferences.

⁴¹GAO, *Government Auditing Standards: 2011 Revision*, [GAO-12-331G](#) (Washington, D.C.: December 2011).

inventory schedule provided with the assertion package met the FIAR requirement for prioritization of systems. However, in our view, the Navy's schedule did not meet the FIAR Guidance requirement to prepare an assessable unit strategy document listing all assessable units prioritized by quantitative rank and adjusted for significant qualitative factors and scoping out legacy systems and processes that will not be part of the audit-ready environment. The Navy's lack of prioritization of key information technology systems used in the FBWT process limits management's ability to focus audit readiness efforts on the most important systems. Further, such a prioritization would also provide information to auditors on the effectiveness of controls for these systems.

Further, we noted that independent reports and reviews of key FBWT systems identified serious internal control deficiencies with reporting (DDRS-B), accounting (DCAS), and budgetary systems (PBIS).⁴² Statement on Standards for Attestation Engagement No 16 reports on controls for a service organization incorporating DDRS-B included an adverse opinion for the period March 1 to November 30, 2014, and a qualified opinion for the period December 1, 2014, to July 31, 2015, due primarily to ineffective controls.⁴³ The reviews of DCAS and PBIS identified significant deficiencies in internal controls. Without effective controls over key systems involved in the FBWT process, management may not have reasonable assurance that this financial statement line item is audit ready.

⁴²The reviews of DDRS-B were based on Statement on Standards for Attestation Engagement No 16. Statement on Standards for Attestation Engagement No 16 is the attestation standard used for reporting on controls at service organizations. The reviews of DCAS and PBIS were based on FISCAM.

⁴³American Institute of Certified Public Accountants, AU-C sec. 705 and secs. .08-.09 (from Statement on Auditing Standards Nos. 122 and 123), states that the auditor should express a qualified opinion, when (1) having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are material but not pervasive to the financial statements or (2) when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements could be material but not pervasive. The auditor should express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Internal Control Assessment and Testing

The Navy did not fully implement certain FBWT internal control and assessment activities required by the FIAR Guidance. Specifically, the Navy did not document information technology general computer controls for significant systems or the hardware and software interfaces as required by the FIAR Guidance.⁴⁴ In addition, as previously noted, the Navy did not sufficiently complete FIAR-required data flowcharts and system narratives. This includes an understanding of how data are processed and transferred in the various systems and how they interact with other data sources through the FBWT process to the financial statements.

An important activity required in the key FIAR task of assessing and testing controls is the preparation of systems documentation to include or describe

- system narratives and flowcharts;
- risk assessments and internal control worksheets documenting its financial statement assertion risks;
- financial reporting objectives;
- control activities and information technology general computer controls for significant systems, applications, or microapplications;
- system certifications or accreditations;
- system, end user, and systems documentation locations; and
- hardware, software, and interfaces.

While the Navy prepared system narratives, flowcharts, financial reporting objectives, and control activities and included them in the FBWT assertion package, it did not prepare documentation of general computer controls for significant systems; system certifications or accreditations; system, end user, and systems documentation locations; or a description of

⁴⁴For purposes of this FBWT FIP task, GAO considered significant systems as those identified in the Navy's FBWT Process Flowchart—including DCAS, DDRS-B, and DDRS-AFS but excluding the general ledgers and Treasury's Central Accounting Reporting System. According to FISCAM, information system controls consist of those internal controls that depend on information systems processing and include general controls (entity-wide, system, and business process application levels), business process application controls (input, processing, output, master file, interface, and data management system controls), and user controls (controls performed by people interacting with information systems).

hardware, software, and interfaces as required by the FIAR Guidance. Also, the system narratives and flowcharts the Navy provided did not sufficiently disclose the flow of data. This includes the Navy's collection and disbursement activity through the financial statement line items, including FBWT on the balance sheet and outlays on the SBR. For example, as previously noted, the narratives did not include discussion of the reversal of general ledger transactions or other entries within DDRS-B.

Navy officials told us that some of the missing systems documentation items might have been included in another audit segment or assertion package. However, the Navy did not provide evidence to support that claim, and no reference to another assertion package was made in the FBWT assertion package. According to the FIAR Guidance, documentation of performance of the required procedures for each FIP task must be completed and included in each applicable assertion package. Once the scope of the FBWT FIP was expanded to include all systems through the financial statement line item, FBWT audit readiness officials did not ensure that all required audit readiness procedures within the expanded scope were performed and the documentation supporting the procedures was available for auditors. Complete and accurate system narratives and flowcharts, and documentation of general computer controls, help to provide management and the auditor with information on the systems environment and data flow, which they use to prioritize audit efforts.

Further, in preparing its April 2013 internal control assessment, the Navy identified key internal controls in the FBWT process, but it did not identify those controls by assessable unit as required by FIAR Guidance.⁴⁵ The FIAR Guidance for this task requires (1) preparing an internal control assessment document for entity-level controls and for each assessable unit and (2) summarizing control activities that are appropriately designed

⁴⁵In January 2015, after the Navy performed additional internal control testing, it reduced the total number of key internal controls for FBWT from 33 to 31.

and in place.⁴⁶ Navy officials told us that several years ago they assembled a matrix of controls to be assessed. They organized the controls by the FBWT area that the controls supported or by control owner, and they thought that this met the FIAR Guidance requirement. Some of the internal controls the Navy identified and tested may be related to an assessable unit. However, the Navy did not identify controls for each assessable unit. Identifying controls by assessable unit is important for determining whether assessable units, sub-assessable units, and associated systems are producing reliable information and helps link systems and controls to the transaction flows. As a result, the Navy is missing an opportunity to identify and correct control deficiencies for the key systems that could affect its FBWT audit readiness. For example, DCAS is the primary subledger used to process the universe of collection and disbursement transactions for FBWT. Although the Navy did identify some controls involving DCAS, it did not identify internal controls by system or assessable unit. Therefore, the Navy does not have assurance that DCAS is operating as intended and that output from the system is reliable.

Evaluate Key Supporting Documentation

The Navy's substantive testing for key supporting documents may not provide sufficient evidence that its efforts to produce supporting documentation are sustainable for future audits. FIAR-required activities for this task include preparation of the transaction population, reviews of unusual or invalid transactions, and identification of key supporting documents.⁴⁷ The FIAR Guidance also requires developing a test plan,

⁴⁶Entity-level controls include five components: (1) control environment, the structure and culture management and employees create to sustain organizational support for effective internal control; (2) risk assessment, management's identification of internal and external risks that may prevent a department from meeting its objectives; (3) control activities, policies, procedures, and mechanisms in place to help ensure that the department's objectives are met; (4) information and communication, relevant, reliable, and timely information that is communicated to appropriate personnel at all levels within the department; and (5) monitoring, periodic reviews, reconciliations, or comparisons of data as part of the regular assigned duties of personnel.

⁴⁷FIAR Guidance provides for performance of substantive procedures as a supplement to testing internal controls. Substantive procedures test the dollar amounts and other data associated with recorded transactions and can include tests of supporting documentation, analytical analysis, or both. The Navy used randomly selected samples when performing substantive tests of high-volume transactions. The Navy used non-randomly selected samples for substantive tests of low-volume procedures, such as quarterly or monthly reconciliations.

selecting random samples from the population of transactions, and testing individual transactions and balances to confirm the existence and evaluate the quality of supporting documentation for relevant financial statement assertions. An evaluation of key supporting documentation is important for determining whether the Navy would be able to support amounts presented in the financial statements and provide an external auditor with sufficient and appropriate evidence to perform the audit.

In the first round of substantive testing, the Navy identified significant deficiencies that resulted in the test failing.⁴⁸ The Navy then performed another round of substantive testing, which, although it passed, may not provide sufficient evidence of the Navy's ability to produce needed documentation in a sustained manner for future audits. In the second round of testing, the Navy completed 13 procedures, 3 of which involved statistical sampling while the other 10 relied on analytic or non-random sampling procedures.⁴⁹ In both rounds of testing, documentation was limited to a 3-month period, which, even if successful, may not provide sufficient evidence of the consistent availability of supporting documentation for a 12-month period, or the ability to timely produce needed documentation over a sustained period.

Because the Navy performed two rounds of substantive tests, Navy officials considered this FIAR task implemented. Further, Navy officials told us that after they asserted audit readiness, they anticipated that they would be under audit by an IPA soon thereafter, so time constraints did not permit further testing. However, lack of supporting documentation has historically been an issue on DOD audits. This was also the case in the audit of the Navy's fiscal year 2015 Schedule of Budgetary Activity, in which the IPA disclaimed an opinion, in part, because the Navy could not

⁴⁸Navy officials noted that their policy for determining whether a control was effective for substantive tests to pass was 90 percent of transactions tested had to pass. For an individual transaction to pass, it had to meet all attributes tested.

⁴⁹The Navy implemented substantive procedures that considered (1) support for the direct funding reconciliation, (2) support for adjustments, (3) materiality (significance) of Disbursing Station Symbol Numbers, (4) general ledger overstatement of FBWT, (5) general ledger understatement of FBWT, (6) materiality and trend analysis of classes of transactions, (7) support for the Defense Departmental Reporting System feeder reconciliation, (8) support for the cross-disbursing reconciliation, (9) validation of Business Activity Monitoring Tool reconciliations, (10) DCAS undistributed transactions analytics, (11) adjustments analytics, (12) support for the interfund reconciliation, and (13) the materiality of certain invalid variances.

provide sufficient, appropriate audit evidence to support transactions. Without performing adequate substantive testing, the Navy does not have reasonable assurance of the availability of key documentation to support amounts presented in the financial statements.

Further, none of the procedures tested the supporting documentation for supplemental quarterly reconciliations. Supplemental quarterly reconciliations provide a secondary check on the accuracy of monthly reconciliations and on other monitoring procedures. Both monthly and quarterly reconciliations are key internal controls for FBWT and testing for these reconciliations provide reasonable assurance that supporting documentation is maintained and available for financial statement audits. In addition, the Navy did not perform reviews to identify unusual, invalid, or missing data as required by the FIAR Guidance. Specifically, the FIAR Guidance requires such reviews on the universe of transactions to identify and address (1) unusual or invalid transactions and (2) abnormal balances or missing data fields. Navy officials stated that these FIAR Guidance tasks were not performed because they thought these tasks would be performed in another FIP. However, we were not provided with evidence that such tasks were included in another FIP and no reference to another FIP was made in the FBWT assertion package. FIAR Guidance requires that documentation of performance of the required procedures for each FIP task be completed and included in each applicable assertion package. Without this testing, there is increased risk that errors may not be detected.

Conclusions

The Navy has made progress in performing its key audit readiness activities, including the development of its FBWT FIP to help guide implementation of its General Fund SBR improvement efforts. However, the Navy did not fully complete certain tasks in accordance with the FIAR Guidance prior to asserting audit readiness for FBWT, a significant account for the Navy's as well as DOD's department-wide SBR auditability. FIAR Guidance Discovery phase tasks that the Navy did not fully complete include the FBWT process analysis, system narratives, quantitative and qualitative drilldowns, prioritization of audit readiness efforts, and documentation of general computer controls. In addition, although the Navy performed substantive tests for supporting documentation, such testing may not provide sufficient evidence of the Navy's ability to produce needed documentation in a sustained manner for future audits.

For the most part, the Navy did not complete these tasks because Navy officials believed that their efforts had satisfied the FIAR Guidance requirement, that certain tasks did not apply to the FBWT effort, or that time constraints prevented completion of the tasks. However, it is critical that FBWT tasks are adequately evaluated and documented. Although required audit readiness procedures for FBWT were not fully completed, the Navy decided to go forward with an audit of its Schedule of Budgetary Activity. The IPA's fiscal year 2015 audit resulted in a disclaimer of opinion and the reporting of material weaknesses in internal control and related recommendations, including several recommendations pertaining to FBWT. Recommendations made in this report are in addition to the recommendations made in the IPA's audit report. Successful completion of the FIAR Discovery phase tasks for FBWT may identify additional deficiencies that affect the auditability of the Navy's financial statements. By not fully identifying and remediating its deficiencies specific to the FBWT effort, the Navy's ability to achieve audit readiness and remediate internal control weaknesses is hindered. Resolution of these deficiencies is crucial to the Navy's and DOD's efforts to meet the September 30, 2017, statutory target date for validating audit readiness of DOD's full financial statements.⁵⁰

Recommendations for Executive Action

To improve the Navy's implementation of the FIAR Guidance for its General Fund FBWT FIP and facilitate efforts to achieve SBR auditability, we recommend that the Secretary of the Navy direct the Assistant Secretary of the Navy, Financial Management and Comptroller, to take the following seven actions in the Discovery phase.

Process Analysis

- Update FBWT data flowcharts and narratives to fully describe the flow of data from the Navy's receipt of collection and disbursement transaction information through the financial statement line items, including the reversal of general ledger trial balance data generated by the automated system and other entries made within DDRS-B.
- Prepare a level I quantitative drilldown in accordance with the FIAR Guidance.

⁵⁰Pub. L. No. 113-66, div. A, § 1003, 127 Stat. 842 (Dec. 26, 2013).

Prioritization of Audit Readiness Efforts

- To prioritize audit readiness efforts for the key FBWT systems, prepare an audit strategy that identifies for each system (1) the Navy's plan for assessing the system to gain assurance that the system can be relied on; (2) the assessment types, including prioritizing the assessments based on qualitative and quantitative factors for each system; and (3) planned start and completion dates of these assessments for each system.

Internal Control Assessment and Testing

- Prepare, in accordance with FIAR Guidance, the documentation of control activities and information technology general computer controls for significant systems; system certifications or accreditations; system, end user, and systems documentation locations; and hardware, software, and interfaces.
- Prepare an internal control assessment document for each assessable unit, summarizing control activities that are appropriately designed and in place.

Supporting Documentation

- Perform sufficient testing for supporting documentation to reasonably determine whether such documentation, including that for key reconciliations, is available in a sustainable manner for future audit efforts.
- For each fiscal year expected to be under audit, identify and address unusual and invalid transactions, abnormal balances, and missing data fields in the universe of collection and disbursement transactions.

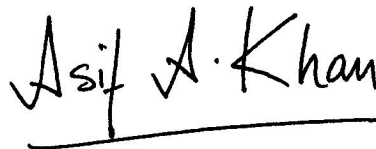
Agency Comments

We provided a draft of this report to the Navy for review and comment. In its written comments, reprinted in appendix VI, the Navy concurred with our seven recommendations. In response to our recommendations, the Navy stated that it has actions planned, taken, or under way to (1) develop procedures and documentation that describe the processes associated with the flow of data; (2) prepare a quantitative drilldown; (3) prioritize audit readiness efforts for key FBWT systems; (4) document control activities, information technology general computer controls for significant systems, systems documentation locations, and hardware, software, and interfaces; (5) prepare an internal control assessment document; (6) test effectiveness of FBWT controls, which includes assessing the availability of supporting documentation; and (7) obtain monthly data from DFAS on invalid FBWT transactions. The Navy also

provided technical comments, which we have incorporated as appropriate.

We are sending copies of this report to the Secretary of Defense; the Deputy Chief Management Officer; the Under Secretary of Defense (Comptroller/Chief Financial Officer); the Deputy Chief Financial Officer; the Director, Financial Improvement and Audit Readiness; the Secretary of the Navy; the Assistant Secretary of the Navy; the Chief Management Officer of the Navy; the Directors of the Defense Finance and Accounting Service and Defense Finance and Accounting Service, Cleveland; the Director of the Office of Management and Budget; and interested congressional committees. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9869 or khana@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff members who made key contributions to this report are listed in appendix VII.

A handwritten signature in black ink that reads "Asif A. Khan". The signature is written in a cursive style with a horizontal line underneath the name.

Asif A. Khan
Director
Financial Management and Assurance

Appendix I: Objective, Scope, and Methodology

The objective of our review was to determine the extent to which the Navy developed and implemented the Discovery phase for its General Funds' Fund Balance with Treasury (FBWT) financial improvement plan (FIP) in accordance with the Financial Improvement and Audit Readiness (FIAR) Guidance. This objective was applied to FBWT for three of the Navy's general ledgers—the Standard Accounting and Reporting System – Field Level, the Standard Accounting and Reporting System – Headquarter Claimant Module, and the Navy Enterprise Resource Planning. We excluded from our review the Navy's fourth general ledger, Navy Systems Management Activity, because of its classified activity. To address our objective, we analyzed the Navy's FBWT FIP to determine whether it contained the applicable elements and tasks to be performed for the Discovery phase of audit readiness as required by the FIAR Guidance. We identified and reviewed the Navy's FBWT FIP key deliverables required by the FIAR Guidance, such as system narratives and flowcharts, internal control assessments, and the Navy's test results. We performed a site visit to the Defense Finance and Accounting Service (DFAS), Cleveland, and walked through the FBWT process, reconciliations, and related systems. We interviewed Navy, DFAS, and FIAR Directorate officials within Department of Defense's (DOD) Office of the Under Secretary of Defense (Comptroller) to obtain explanations and clarifications on documentation we reviewed. In addition, we reviewed the results of DOD's Office of Inspector General audits as well as independent public accountant examinations of audit readiness efforts related to the Navy's FBWT.

We conducted this performance audit from April 2014 to August 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendix II: FIAR Guidance for Reporting Entities

Table 1 presents the reporting entity methodology in the Financial Improvement and Audit Readiness Guidance, which the Navy is required to follow in implementing its Fund Balance with Treasury financial improvement plan.

Table 1: Reporting Entity Methodology for Supporting Audit Readiness Included in DOD’s FIAR Guidance	
FIAR guidance phases and tasks	Required deliverables
Discovery phase tasks:	
<ol style="list-style-type: none"> The reporting entity performs process analysis (i.e., identifies assessable units, business processes, systems, and other characteristics associated with amounts reported in financial statement line items), including activities such as developing and documenting <ul style="list-style-type: none"> a process and system drilldown depicting asset/transaction classes, underlying processes, assessable units and subunits, and associated systems, including “as-is” and any planned “to-be” environments, and quantitative and qualitative drilldowns depicting the dollar activity (or balances) resulting from assessable units and subunits. The reporting entity prioritizes unit audit readiness efforts, including activities such as <ul style="list-style-type: none"> ranking each assessable unit in order of quantitative materiality and developing a list of qualitative risks or factors affecting audit readiness, documenting the audit readiness strategy, and developing a systems inventory list that includes all current and future systems. The reporting entity documents its processes and assesses and then tests controls, including activities such as the following: <ul style="list-style-type: none"> Preparing process and system documentation that includes narratives, flowcharts, risk assessments, and internal control worksheets documenting financial statement assertion risks, financial reporting objectives, control activities (manual and automated) and information technology general computer controls for significant systems, applications or microapplications, system certifications or accreditations, system and end user locations, and descriptions of hardware, software, and interfaces. Planning and executing internal control testing to obtain evidence of achieving control objectives and assessing the effectiveness of controls that would prevent or detect potential misstatements in financial statements, and summarizing and evaluating results and classifying identified control deficiencies. Submitting an annual Internal Control over Financial Reporting (ICOFR) Statement of Assurance (SOA) memorandum and material weakness corrective action plan (CAP) summary based on test results. The reporting entity evaluates supporting documentation, including activities to prepare the population; reviews for unusual items; identifies and documents supporting documentation; tests existence of documentation supporting transactions and balances; and summarizes and reports test results. 	<ul style="list-style-type: none"> Process analysis and drilldowns. Assessable unit and audit readiness strategy document; systems inventory. Process and system documentation narratives and flowcharts describing the end-to-end process for an assessable unit; internal control assessments. Test plans and results, updated control assessments and classification of identified control deficiencies. Annual ICOFR SOA memorandum and material weakness CAP summary. Populations and reconciliations, unusual item reviews, criteria matrices, aging analysis, test plans and test results, evaluation and reporting of test results.

Appendix II: FIAR Guidance for Reporting Entities

FIAR guidance phases and tasks	Required deliverables
Corrective Action phase tasks:	
1. The reporting entity designs an audit-ready environment, including requirements for remediating deficiencies in control activities and supporting documentation.	<ul style="list-style-type: none"> • “To-be” process flows and narratives with descriptions as to how documentation deficiencies will be resolved.
2. The reporting entity develops CAPs to resolve deficiencies identified during the Discovery phase, including efforts to update the corrective action section of the FIP to include the classification of the deficiencies (material weaknesses, significant deficiency, or control deficiency).	<ul style="list-style-type: none"> • CAP; updated FIP.
3. The reporting entity develops resource requirements, including estimates of funding and staffing required to execute CAPs.	<ul style="list-style-type: none"> • Budget estimates and justifications.
4. The reporting entity executes CAPs to reflect progress and accomplishments, including any scope and timeline changes, and verify that deficiencies have been successfully remediated.	<ul style="list-style-type: none"> • Updated FIP.
5. The reporting entity notifies the FIAR Directorate of its implementation and readiness for examination.	<ul style="list-style-type: none"> • Notification to the FIAR Directorate of CAP implementation.
Assertion/Evaluation phase tasks:	
1. The FIAR Directorate evaluates the reporting entity’s FIP documentation to assess whether the reporting entity is ready for an audit.	<ul style="list-style-type: none"> • Reporting entity FIP documentation.
2. The FIAR Directorate provides feedback to the reporting entity on its status of audit readiness.	<ul style="list-style-type: none"> • Results of the FIAR Directorate review.
3. If ready for audit, the reporting entity asserts readiness in a management assertion letter and the FIAR Directorate engages an independent public accountant (IPA) or the Department of Defense (DOD) Office of Inspector General (OIG) IPA or DOD OIG to perform an examination of reporting entity’s readiness assertion, and the auditor identifies any deficiencies.	<ul style="list-style-type: none"> • Reporting entity’s management assertion letter; IPA or DOD OIG examination report.
4. The reporting entity evaluates deficiencies identified by the IPA or DOD OIG and implements corrective actions to remediate them.	<ul style="list-style-type: none"> • Updated FIP.
5. The reporting entity verifies that corrective actions successfully remediated auditor-identified deficiencies.	<ul style="list-style-type: none"> • Updated FIP.
Validation phase tasks:	
1. The reporting entity submits additional documentation to the FIAR Directorate demonstrating that deficiencies identified by the auditors have been successfully remediated and that the reporting entity is audit ready.	<ul style="list-style-type: none"> • Documentation demonstrating remediation of deficiencies.
2. The FIAR Directorate reviews the examination report and additional documentation demonstrating remediation of deficiencies and makes a final determination of the reporting entity’s audit readiness state.	<ul style="list-style-type: none"> • FIAR Directorate’s final determination of audit readiness.
Audit phase tasks:	
1. The FIAR Directorate engages an IPA or DOD OIG to perform annual audits.	<ul style="list-style-type: none"> • Procurement contract.
2. The reporting entity supports the audit process.	<ul style="list-style-type: none"> • Engagement letter.
3. The auditor issues an audit opinion.	<ul style="list-style-type: none"> • Audit opinion

Legend: FIAR = Financial Improvement and Audit Readiness; FIP = financial improvement plan.

Source: DOD FIAR Guidance, November 2013. | GAO-16-47

Appendix III: Navy's FBWT Process and Data Flow System Descriptions

The Navy's Fund Balance with Treasury (FBWT) financial reporting process incorporates multiple information systems and is based on systems originally created for budgetary reporting and support of other business functions. The original systems include transaction-processing budget and reporting systems and its general ledger systems. These systems were modified over time to also provide financial reports and data for financial statement compilation. As a result, as shown in figure 2, the flow of the Navy's transactional data does not follow the typical flow of data from subsidiary ledger to general ledger to trial balance to financial statements.¹ The FBWT process relies on subsidiary ledgers to distribute and record the Navy's funds and to record collection and disbursement transaction information to the general ledgers. Data are forwarded from subsidiary ledgers to the budgetary reporting system for inclusion in the financial statement system, which ultimately creates the Navy's consolidated financial statements.

This process results in some transactions flowing to the financial statements that are not posted in any of the general ledgers. This bypass of the general ledgers for financial statement preparation represents a significant audit challenge because the general ledgers do not agree with the Navy's financial statements for FBWT. General ledgers are typically an entity's primary system of record, where all transactions are recorded and from which financial statements are prepared. In an audit, for supporting FBWT financial statement line item amounts, it is essential that the Navy reconcile any differences between the financial statements and the general ledgers, and between the general ledgers and underlying transactions, to assure that all transactions in the financial statements are recorded in the general ledgers. Specifically:

- According to the Navy, the Defense Cash Accountability System (DCAS) contains the universe of collection and disbursement transactions, except for timing difference transactions.² The Navy's FBWT process begins when collection and disbursement transaction information from the Navy's multiple disbursement feeder systems is

¹Summary data trial balances flow from the Navy's four general ledgers into Defense Departmental Reporting System - Budgetary. See fig. 2.

²Timing difference transactions are usually transactions received by the Department of the Treasury that have not yet been recorded in DCAS, such as Navy funds disbursed by other agencies.

posted to DCAS.³ When DCAS edit checks identify a transaction with missing or incorrect account coding information, the transaction is not distributed to the general ledgers and remains in DCAS as an “undistributed” transaction until it can be investigated and the necessary information obtained. DCAS distributes all other transactions to one of the Navy’s general ledgers. Each month, DCAS transmits summary collection and disbursement information, including undistributed transactions, to the Defense Departmental Reporting System - Budgetary (DDRS-B). DCAS is also used for the Navy’s fund balance reconciliation process with the Department of the Treasury’s (Treasury) Central Accounting Reporting System (CARS).

- DDRS-B has historically been used as a budgetary reporting tool for numerous Navy commands and Navy headquarters, but it has also been adapted for financial reporting. It receives budgetary information from the Program Budgetary Information System and proprietary information from DCAS.⁴ DDRS-B also receives summary information from the general ledgers. To avoid duplication of transactions, system-generated journal entries are made within DDRS-B that are intended to reverse the general ledger transactions, which were also posted by DCAS. The general ledger is typically the system of record for an entity’s financial reporting. However, since DCAS is considered to contain the universe of the Navy’s collection and disbursement transactions, DCAS transactions—not the summary transaction information from the general ledgers—flow through DDRS-B to the financial statements. Also, within DDRS-B, journal entries (forced-balance entries) are prepared and posted to temporarily make the balances in the Navy’s FBWT equal to the balances in Treasury’s CARS, until such differences can be reconciled as required by the

³Disbursement feeder systems include the Centralized Automated Disbursing System, Intra-Governmental Payment and Collections, Mechanization of Contract Administrative Services, other Defense Finance and Accounting Service Disbursing Station Symbol Numbers (DSSN), Navy Shore DSSNs, and Navy Ship DSSNs. The Navy refers to the action of feeder systems posting transactions to DCAS as registration of the transactions in DCAS.

⁴Proprietary information, in contrast to budgetary information, shows actual financial transactions of an entity, such as actual collections and disbursements, and includes balance sheet accounts.

Treasury Financial Manual.⁵ Navy officials said that forced-balance journal entries are eventually reconciled to transaction detail and are reversed in the following period; they are not posted to the Navy's general ledgers. As a result, the Navy's general ledger balances do not directly agree with the Navy's financial statements.⁶

- The Defense Departmental Reporting System - Audited Financial Statements (DDRS-AFS) receives an adjusted trial balance from DDRS-B. Consolidation and elimination entries are posted in DDRS-AFS to produce the Navy's financial statements. For the Navy, net expenditure amounts on the Schedule of Budgetary Activity and financial statements are supported by DDRS-AFS, then DDRS-B, then DCAS, and then numerous feeder systems, while the general ledgers are omitted from this drilldown process. Journal entries posted in DDRS-B and undistributed transactions in DCAS are not posted in the Navy's general ledgers, but are reflected in financial statement FBWT line item balances.

⁵*Treasury Financial Manual*, section 5100, requires agencies to reconcile their FBWT accounts on a regular and recurring basis (monthly). The Navy prepares forced balance journal entries and posts them to DDRS-B to balance each of the Navy's FBWT accounts to the balance at Treasury. Forced balance journal entries are reversed in the subsequent period. Differences between Treasury and Navy FBWT accounts are typically due to timing differences—collections and disbursements posted to Treasury that have not yet registered in the Navy's systems.

⁶Undistributed transactions, forced balance journal entries, and other adjustments posted in DDRS-B are components used to reconcile the general ledger to the financial statements.

Appendix IV: Navy's FBWT Reconciliations

The Navy's Fund Balance with Treasury (FBWT) reconciliation process requires investigating thousands of undistributed transactions. The Navy has 19 general funds (appropriations) and a FBWT account for each general fund, which the *Treasury Financial Manual* requires to be reconciled monthly to Department of the Treasury (Treasury) accounts. The diverse nature of the numerous feeder systems providing the transaction information also complicates the FBWT reconciliation process. The Navy receives transaction information from both centralized and decentralized disbursement feeder systems, including the Centralized Automated Disbursing System, Intra-Governmental Payment and Collections, Mechanization of Contract Administrative Services, and other component reporting through the Defense Finance and Accounting Service (DFAS) Disbursing Station Symbol Numbers (DSSN) by Navy Shore DSSNs and Navy Ship DSSNs.

The complexity of the overall financial reporting process leads to difficulties in the FBWT reconciliation process. With multiple systems used in the process and the Navy's unique process flow, additional reconciliations are required. Consequently, each month the Navy completes four reconciliations for each of its 19 general funds.¹ Each quarter, the Navy prepares reconciliations for each of the 19 general funds as well as consolidating schedules and reconciliations between financial systems. As of March 2015, it was taking the Navy from 2 to 3 months from the end of each fiscal quarter to complete its FBWT reconciliations.





In the first quarter of fiscal year 2015, DFAS processed, through the Defense Cash Accounting System (DCAS), an average of 1.6 million nonpayroll Navy transactions per month. Of those transactions processed, an average of about 22,000 per month required intervention by DFAS and Navy FBWT reconciliation staff for them to be posted appropriately to a general ledger account. A transaction registered in the Navy's DCAS and not distributed to one of the Navy's general ledgers is a

¹The four monthly reconciliations performed by Navy include (1) a reconciliation of summary values in Treasury's Central Accounting Reporting System (CARS) to the complete Defense Cash Accountability System (DCAS) transaction universe that identifies transactions in CARS that are not in DCAS, (2) a reconciliation of the DCAS transaction universe to DCAS-distributed transactions that identifies transactions not distributed to the general ledgers, (3) a summary-level reconciliation of Treasury's CARS to Navy general ledgers to identify variances, and (4) a transaction-level reconciliation of DCAS to the general ledger systems to identify transactions not distributed to the general ledgers.

variance that requires human investigation and adjustment so it can be distributed and posted in one of the Navy's general ledgers.

Two types of variances are a recurring part of the Navy's FBWT reconciliation process: (1) forced balance entries, which are necessary to agree the Navy's balances with Treasury's balances until timing difference transactions can be resolved, and (2) undistributed transactions, which come from feeder systems and contain insufficient or incorrect coding. Reconciling forced balance entries and investigating undistributed transactions contribute to the labor and time required to reconcile the Navy's FBWT. Figure 3 shows the reconciliation of Navy Treasury accounts to the Navy's general ledger for each of the quarters for fiscal year 2014 and the variance at the end of each quarter.

Figure 3: Reconciliation of Navy Net Expenditures by Quarter for Fiscal Year 2014

Dollars in millions	As of 12/31/2013	As of 3/31/2014	As of 6/30/2014	As of 9/30/2014
Net expenditures per Treasury's CARS system	\$14,587	\$31,623	\$51,689	\$75,248
Less forced balance entries	400	154	216	54
Net expenditures per DDRS-B	14,187	31,469	51,473	75,194
Less transactions undistributed to general ledger	190	418	429	723
Net expenditures per general ledger	\$13,997	\$31,051	\$51,044	\$74,471
Total variance between Treasury and general ledger	\$590	\$572	\$645	\$777
Total variance as a percentage of total net expenditures per Treasury	 4.0%	 1.8%	 1.2%	 1.0%

CARS: Central Accounting Reporting System **DDRS-B:** Defense Departmental Reporting System - Budgetary **Treasury:** Department of the Treasury

Source: GAO analysis of Navy FBWT reconciliations. | GAO-16-47

As noted in figure 3, at the end of fiscal year 2014, the total of net forced balance entries and net undistributed transactions was \$777 million, (1.0 percent of the Navy's total net expenditures for the year).²

²Net forced balance entries combine both debit and credit journal entries to FBWT. Net undistributed transactions combine both collection and disbursement transactions. The gross or absolute amount of forced balance entries and undistributed transactions would be larger. The Navy's use of forced balance entries when reconciling to Treasury and Navy's reconciliation efforts for transactions undistributed to the general ledgers were identified and discussed previously in GAO, *DOD Financial Management: Ongoing Challenges with Reconciling Navy and Marine Corps Fund Balance with Treasury*, [GAO-12-132](#) (Washington, D.C.: Dec. 20, 2011).

Appendix V: DOD and Navy Suspense Accounts

In fiscal year 2003, Congress authorized the Department of Defense (DOD) to write off long-standing debit and credit transactions that occurred before March 31, 2001, and could not be cleared from the department's books because DOD lacked the supporting documentation necessary to record the transactions to the correct appropriations.¹ DOD subsequently reported that it wrote off an absolute value of \$35 billion, or a net value of \$629 million, of suspense account amounts and check payment differences using this authority.²

Congress required GAO to review and report on DOD's use of this write-off authority.³ DOD reported that as of December 31, 2004, after the write-off of \$35 billion, it still had more than \$1.3 billion (absolute value) of suspense amounts that were not cleared for more than 60 days, and DOD acknowledged that its suspense reports were incomplete and inaccurate. Our June 2005 audit report concluded that without compliance with existing laws and enforcement of its own guidance for reconciling, reporting, and resolving amounts in suspense and check differences on a regular basis, the buildup of current balances would likely continue, the department's appropriation accounts would likely remain unreliable, and another costly write-off process could eventually be required.⁴

In April 2014, we reported that DOD had recorded billions of dollars of disbursement and collection transactions in suspense accounts because the proper appropriation accounts could not be identified and charged, generally because of coding errors.⁵ (Table 2 shows a comparison of the

¹Bob Stump National Defense Authorization Act for Fiscal Year 2003, Pub. L. No. 107-314, § 1009, 116 Stat. 2458, 2635-36 (Dec. 2, 2002).

²When absolute amounts are reported, collections and adjustments are added to disbursements. When net amounts are reported, collections and adjustments are offset against disbursements. Reporting net amounts can significantly understate the magnitude and impact of transaction errors.

³The conference report that accompanied the Bob Stump National Defense Authorization Act for Fiscal Year 2003 required GAO to review and report on DOD's use of this write-off authority. H.R. Conf. Rep. No. 107-772, at 686-87 (2002).

⁴GAO, *DOD Problem Disbursements: Long-standing Accounting Weaknesses Result in Inaccurate Records and Substantial Write-offs*, [GAO-05-521](#) (Washington, D.C.: June 2, 2005).

⁵GAO, *DOD Financial Management: Actions Under Way Need to Be Successfully Completed to Address Long-standing Funds Control Weaknesses*, [GAO-14-94](#) (Washington, D.C.: Apr. 29, 2014).

Navy's suspense account balances compared to total DOD suspense
account balances based on data in our April 2014 report.)

Table 2: DOD and Navy Suspense Account Balances (Net), Fiscal Years 2010-2013

Absolute value, dollars in billions

Fiscal year	Total DOD suspense balances (net) (dollars)	Total Navy suspense balances (net) (dollars)	Percentage of Navy to total DOD suspense balances
2013	2.19	0.73	33
2012	2.68	0.59	22
2011	2.35	0.65	28
2010	1.33	0.48	36

Legend: DOD = Department of Defense.





Source: GAO analysis of unaudited DOD data from [GAO-14-94](#). | GAO-16-47

In a letter dated March 23, 2015, the DOD Office of Inspector General (DOD OIG) withdrew its opinion on the U.S. Marine Corps' (USMC) fiscal year 2012 Schedule of Budgetary Activity because of suspense accounts held by the Department of the Treasury (Treasury) that contained USMC transactions that had not been posted to valid appropriations.⁶ Because these suspense accounts contained unrecorded transactions from all DOD components, the DOD OIG was unable to quantify the number and dollar amount of USMC transactions that resided in the accounts and whether those transactions were material to the fiscal year 2012 USMC Schedule of Budgetary Activity.⁷ In addition to the variances identified in the Navy's reconciliation process presented in figure 3, figure 4 identifies other transactions posted to Navy general ledger suspense accounts and other fund suspense account transactions not yet identified as belonging to Navy.

⁶Treasury has yet to determine the agency to which these transactions pertain. Until that determination is made, Treasury posts these transactions to suspense accounts.

⁷GAO, *DOD Financial Management: Actions Are Needed on Audit Issues Related to the Marine Corps' 2012 Schedule of Budgetary Activity*, [GAO-15-198](#) (Washington, D.C.: July 30, 2015).

Figure 4: Suspense Account Balances (Net) in Navy General Ledgers and Fund Suspense Account Balances (Net) by Quarter for Fiscal Year 2014

Dollars in millions	As of 12/31/2013	As of 3/31/2014	As of 6/30/2014	As of 9/30/2014
Net expenditures per Treasury's Central Accounting Reporting System	\$14,587	\$31,623	\$51,689	\$75,248
General ledger suspense accounts (net)^{a,b}	-91	-34	-12	94
Fund suspense and deposit accounts (net)^c	229	296	194	97
Total suspense account balances (net)	\$138	\$262	\$182	\$191
Total suspense account balances (net) as a percentage of total net expenditures per Treasury	 0.9%	 0.8%	 0.4%	 0.3%

Treasury: Department of the Treasury

Source: GAO analysis of unaudited Navy suspense account schedules. | GAO-16-47

^aExcludes other general ledger suspense accounts where the Navy is merely holding others' funds, such as deposit, receipt, and clearing accounts.

^bGeneral ledger suspense accounts include transactions with sufficient information to identify the Navy general ledger but lack sufficient information to match them with another data element, such as an obligation.

^cFund suspense accounts are for transactions at Treasury where there is insufficient information to identify the applicable fund.

In addition to the undistributed transactions and forced-balance amounts shown in figure 3, the Navy has two types of suspense accounts:⁸

- General ledger suspense accounts represent unmatched transactions for expenditures and collections. These transactions are distributed from the Defense Cash Accounting System and are recorded in a general ledger against valid fund accounts but lack sufficient

⁸Suspense accounts identified in fig. 4 represent collection and disbursement transactions that are missing sufficient information to attribute them to a DOD service or to adequately record them in a Navy general ledger. They differ from variances identified in fig. 3 (undistributed transactions and forced balance entries) in that they are not needed to reconcile the Navy's Fund Balance with Treasury to the balance per Treasury. However, suspense transactions need to be identified for proper posting to the general ledgers and the financial statements.

information to match them with another data element, such as an obligation.

- Fund suspense accounts represent temporary holding accounts used to record unidentifiable general, revolving, special, or trust fund expenditures or collections that are not included in the Navy's general ledgers. Fund suspense accounts can also include deposit accounts used to record money that the federal government owes to others, including state and local income taxes, security deposits, civilian pay allotments, foreign taxes, and estates of deceased service members.

Balances in Navy suspense accounts totaled \$191 million as of September 30, 2014, and represented only 0.3 percent of the Navy's total net expenditures. The balances reported are net, meaning increases and decreases are added together, and do not reflect the gross amount in suspense accounts or the age of individual transactions.

Appendix VI: Comments from the Department of the Navy



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

3 August 2016

MEMORANDUM FOR GOVERNMENT ACCOUNTABILITY OFFICE

SUBJECT: Response to Draft Report No. GAO-16-47 "DOD Financial Management: Improvements Needed in The Navy's Audit Readiness Efforts for Fund Balance with Treasury" dated July 5, 2016 (GAO Code 197133)

Reference: (a) Draft Report No. GAO-16-47 "DOD Financial Management: Improvements Needed In The Navy's Audit Readiness Efforts for Fund Balance with Treasury" dated July 5, 2016 (GAO Code 197133)

In response to reference (a), the Office of Financial Operations provides attached responses to Recommendations 1 through 7 of the subject report.

My point of contact for this matter is Mr. Freddie E. Williams, who may be reached at (202) 685-0785 or freddie.e.williams@navy.mil.

Karen L. Fenstermacher
Karen L. Fenstermacher
Deputy Assistant Secretary of the Navy
(Financial Operations)

GAO DRAFT REPORT DATED JULY 5, 2016
GAO-16-47 (GAO CODE 197133)

**“DOD FINANCIAL MANAGEMENT: IMPROVEMENTS NEEDED IN THE NAVY'S
AUDIT READINESS EFFORTS FOR FUND BALANCE WITH TREASURY”**

**DEPARTMENT OF THE NAVY COMMENTS
TO THE GAO RECOMMENDATIONS**

SUBJECT: PROCESS ANALYSIS

Recommendation 1: Update Fund Balance with Treasury (FBWT) data-flow charts and narratives to fully describe the flow of data from the Navy's receipt of collection and disbursement transaction information through the financial statement line items, including the reversal of general ledger trial balance data generated by the automated system and other entries made with Defense Departmental Reporting System-Budgetary (DDRS-B).

DON CONCUR: The Department of the Navy (DON) and Defense Finance and Accounting Service (DFAS) concur with the recommendation to update the Navy's process documentation, including its FBWT data-flow charts and narratives, to capture the flow of collection and disbursement data from the transaction level (general ledger) to its financial statements. DFAS, in coordination with the DON, has developed procedures and documentation that describe the processes associated with the flow of data and the creation of system-generated adjustments occurring in the DDRS-B. These documents and procedures are not currently part of the Navy's FBWT documentation, but will be incorporated as the Navy evaluates and updates the current process flows and narratives. Implementation of corrective actions is expected to be completed by December 31, 2016.

Recommendation 2: Prepare a level 1 quantitative drill down in accordance with the FIAR Guidance.

DON CONCUR: The DON concurs with the recommendation to prepare a level 1 quantitative drill down depicting the composition and balances of the FBWT assessable and sub-assessable units to the summarized amount reported on the balance sheet as of September 30, 2016. The drill down will identify sources of transactions which make up the reported balances. Implementation of corrective actions is expected to be completed by December 31, 2016.

SUBJECT: PRIORITATION OF AUDIT READINESS EFFORTS

Recommendation 3: To prioritize audit readiness efforts for the key FBWT systems, prepare an audit strategy that identifies for each system (1) the Navy's plan for assessing the system to gain assurance that the system can be relied on, (2) the assessment types, including prioritizing the assessments based on qualitative and quantitative factors for each system, and (3) planned start and completion dates for these assessments for each system.

DON CONCUR: The DON has begun to prioritize audit readiness efforts for the key FBWT systems. As part of those prioritization efforts, Navy is in the process of drafting an integrated

audit strategic plan that includes key FBwT systems. The audit strategic documentation is expected to be completed by December 31, 2016.

SUBJECT: INTERNAL CONTROLS ASSESSMENT AND TESTING

Recommendation 4: Internal Control Assessment and Testing - Prepare, in accordance with FIAR Guidance, the documentation of control activities and information technology general computer controls for significant systems; system certifications or accreditations; system, end user, and systems document locations; and hardware, software, and interfaces.

DON CONCUR: The DON is in the process of documenting control activities, information technology general computer controls for significant systems; systems documentation locations; and hardware, software, and interfaces. The documentation process is expected to be completed by December 31, 2016

Recommendation 5: Prepare an internal control assessment document for each assessable unit, summarizing control activities that are appropriately designed and in place.

DON CONCUR: The DON concurs with the recommendation to prepare an internal control assessment document for FBwT. With the support of the DFAS, the DON will receive quarterly documentation that summarizes the assessment of the effectiveness of the FBwT controls. The FBwT control assessment documentation will be produced by October 31, 2016 and then on a recurring quarterly basis.

SUBJECT: SUPPORTING DOCUMENTATION

Recommendation 6: Perform sufficient testing for supporting documentation to reasonably determine whether such documentation, including for key reconciliations, is available in a sustainable manner for future audit efforts.

DON CONCUR: The DON and DFAS generate key reconciliations supporting the Navy's FBwT process and documentation of those maintained by both organizations. As part of the FBwT sustainment testing program, controls are evaluated periodically throughout the fiscal year. With the support of DFAS, the DON will receive quarterly documentation that summarizes the assessment of the effectiveness of the FBwT controls as well as monthly status updates on the quantitative outputs of those controls (i.e. - counts and amounts of key FBwT measures such as suspense). Completion of the control evaluations and monthly metrics rely on the availability of supporting documentation. The FBwT control assessment documentation will be produced by October 31, 2016 and then on a recurring quarterly basis and the monthly metric data will be produced for June 2016 and forward.

Recommendation 7: For each fiscal year expected to be under audit, identify and address unusual and invalid transactions, abnormal balances, and missing data fields in the universe of collection and disbursement transactions.

DON CONCUR: With the support of DFAS, the DON will receive monthly documentation that summarizes the status of key FBwT quantitative metrics, which include data on invalid transactions such as counts and amounts reported in Treasury Suspense funds. The sharing of this data, as well as expanded collaboration between the DON and DFAS to address transactions

in Treasury Suspense, is expected to provide an improved capability to address invalid transactions going forward. The monthly metric data will be produced for June 2016 and forward. In addition, the DON is developing procedural documentation over the Treasury Suspense process, expected to be completed by December 31, 2016.

General Feedback

Navy FBwT asserted April 30, 2013, and did not reassert based on the expanded scope which included Financial Statement Compilation and Reporting (FSCR).

Appendix VII: GAO Contact and Staff Acknowledgments

GAO Contact

Asif A. Khan, (202) 512-9869 or khana@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made key contributions to this report: Francine DeVecchio, Doreen Eng, Maxine Hattery, Jason Kelly, Richard Kusman, Roger Stoltz (Assistant Director), and Chevalier Strong.

Appendix VIII: Accessible Data

Agency Comment Letter

Text of Appendix VI:
Comments from the
Department of the Navy

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DEPARTMENT OF THE NAVY

OFFICE OF THE ASSISTANT SECRETARY

(FINANCIAL MANAGEMENT AND COMPTROLLER)

1000 NAVY PENTAGON

WASHINGTON, DC 20350-1000

3 August 2016

MEMORANDUM FOR GOVERNMENT ACCOUNTABILITY OFFICE

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My point of contact for this matter is Mr. Freddie E. Williams, who may be reached at (202) 685-0785 or freddie.e.williams@navy.mil.

Karen L. Fenstermacher

Deputy Assistant Secretary of the Navy

(Financial Operations)

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GAO DRAFT REPORT DATED JULY 5, 2016 GA0-16-47 (GAO CODE 197133)

"DOD FINANCIAL MANAGEMENT: IMPROVEMENTS NEEDED IN THE NAVY'S AUDIT READINESS EFFORTS FOR FUND BALANCE WITH TREASURY"

DEPARTMENT OF THE NAVY COMMENTS TO THE GAO RECOMMENDATIONS

SUBJECT: PROCESS ANALYSIS

Recommendation 1: Update Fund Balance with Treasury (FBwT) data-flow charts and narratives to fully describe the flow of data from the Navy's receipt of collection and disbursement transaction information through the financial statement line items, including the reversal of general ledger trial balance data generated by the automated system and other entries made with Defense Departmental Reporting System-Budgetary (DDRS-B).

DON CONCUR: The Department of the Navy (DON) and Defense Finance and Accounting Service (DFAS) concur with the recommendation to update the Navy's process documentation, including its FBwT data-flow charts and narratives, to capture the flow of collection and disbursement data from the transaction level (general ledger) to its financial statements. DFAS, in coordination with the DON, has developed procedures and documentation that describe the processes associated with the flow of data and the creation of system-generated adjustments occurring in the DDRS-B. These documents and procedures are not currently part of the Navy's FBwT documentation, but will be incorporated as the Navy evaluates and updates the current process flows and narratives. Implementation of corrective actions is expected to be completed by December 31, 2016.

Recommendation 2: Prepare a level 1 quantitative drill down in accordance with the FIAR Guidance.

DON CONCUR: The DON concurs with the recommendation to prepare a level 1 quantitative drill down depicting the composition and balances of the FBwT assessable and sub-assessable units to the summarized amount reported on the balance sheet as of September 30, 2016. The

drill down will identify sources of transactions which make up the reported balances. Implementation of corrective actions is expected to be completed by December 31, 2016.

SUBJECT: PRIORITATION OF AUDIT READINESS EFFORTS

Recommendation 3: To prioritize audit readiness efforts for the key FBwT systems, prepare an audit strategy that identifies for each system (1) the Navy's plan for assessing the system to gain assurance that the system can be relied on, (2) the assessment types, including prioritizing the assessments based on qualitative and quantitative factors for each system, and (3) planned start and completion dates for these assessments for each system.

DON CONCUR: The DON has begun to prioritize audit readiness efforts for the key FBwT systems. As part of those prioritization efforts, Navy is in the process of drafting an integrated

Page 3

audit strategic plan that includes key FBwT systems. The audit strategic documentation is expected to be completed by December 31, 2016.

SUBJECT: INTERNAL CONTROLS ASSESSMENT AND TESTING

Recommendation 4: Internal Control Assessment and Testing - Prepare, in accordance with FIAR Guidance, the documentation of control activities and information technology general computer controls for significant systems; system certifications or accreditations; system, end user, and systems document locations; and hardware, software, and interfaces.

DON CONCUR: The DON is in the process of documenting control activities, information technology general computer controls for significant systems; systems documentation locations; and hardware, software, and interfaces. The documentation process is expected to be completed by December 31, 2016

Recommendation 5: Prepare an internal control assessment document for each assessable unit, summarizing control activities that are appropriately designed and in place.

DON CONCUR: The DON concurs with the recommendation to prepare an internal control assessment document for FBwT. With the support of the DFAS, the DON will receive quarterly documentation that summarizes the assessment of the effectiveness of the FBwT controls. The FBwT

control assessment documentation will be produced by October 31, 2016 and then on a recurring quarterly basis.

SUBJECT: SUPPORTING DOCUMENTATION

Recommendation 6: Perform sufficient testing for supporting documentation to reasonably determine whether such documentation, including for key reconciliations, is available in a sustainable manner for future audit efforts.

DON CONCUR: The DON and DFAS generate key reconciliations supporting the Navy's FBwT process and documentation of those maintained by both organizations. As part of the FBwT sustainment testing program, controls are evaluated periodically throughout the fiscal year. With the support of DFAS, the DON will receive quarterly documentation that summarizes the assessment of the effectiveness of the FBwT controls as well as monthly status updates on the quantitative outputs of those controls (i.e. - counts and amounts of key FBwT measures such as suspense). Completion of the control evaluations and monthly metrics rely on the availability of supporting documentation. The FBwT control assessment documentation will be produced by October 31, 2016 and then on a recurring quarterly basis and the monthly metric data will be produced for June 2016 and forward.

Recommendation 7: For each fiscal year expected to be under audit, identify and address unusual and invalid transactions, abnormal balances, and missing data fields in the universe of collection and disbursement transactions.

DON CONCUR: With the support of DFAS, the DON will receive monthly documentation that summarizes the status of key FBwT quantitative metrics, which include data on invalid transactions such as counts and amounts reported in Treasury Suspense funds. The sharing of this data, as well as expanded collaboration between the DON and DFAS to address transactions

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in Treasury Suspense, is expected to provide an improved capability to address invalid transactions going forward. The monthly metric data will be produced for June 2016 and forward. In addition, the DON is developing procedural documentation over the Treasury Suspense process, expected to be completed by December 31, 2016.

General Feedback

Navy FBwT asserted April 30, 2013, and did not reassert based on the expanded scope which included Financial Statement Compilation and Reporting (FSCR).

Data Tables

Data Table for Figure 3: Reconciliation of Navy Net Expenditures by Quarter for Fiscal Year 2014

Dollars in millions	As of 12/31/13	As of 3/31/14	As of 6/30/14	As of 9/30/14
Net expenditures per Treasury's CARS system	\$14,587	\$31,623	\$51,689	\$75,248
Less forced balance entries	\$400	\$154	\$216	\$54
Net expenditures per DDRS-B	\$14,187	\$31,469	\$51,473	\$75,194
Less transactions undistributed to general ledger	190	418	429	723
Net expenditures per general ledger	\$13,997	\$31,051	\$51,044	\$74,471
Total variance between Treasury and general ledger	\$590	\$572	\$645	\$777
Total variance as a percentage of total net expenditures per Treasury	4.0%	1.8%	1.2%	1.0%

Data Table for Figure 4: Suspense Account Balances (Net) in Navy General Ledgers and Fund Suspense Account Balances (Net) by Quarter for Fiscal Year 2014

Dollars in millions	As of 12/31/13	As of 3/31/14	As of 6/30/14	As of 9/30/14
Net expenditures per Treasury's Central Accounting Reporting System	\$14,587	\$31,623	\$51,689	\$75,248
General ledger suspense accounts (net)	\$-91	\$-34	\$-12	\$94
Fund suspense and deposit accounts (net)	\$229	\$296	\$194	\$97
Total suspense account balances (net)	\$138	\$262	\$182	\$191

Dollars in millions	As of 12/31/13	As of 3/31/14	As of 6/30/14	As of 9/30/14
Total suspense account balances (net) as a percentage of total net expenditures per Treasury	0.9%	0.8%	0.4%	0.3%

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