



May 2018

DOD FINANCIAL MANAGEMENT

The Navy Needs to Improve Internal Control over Its Buildings

Accessible Version

GAO Highlights

Highlights of [GAO-18-289](#), a report to congressional committees

Why GAO Did This Study

This engagement was initiated in connection with the statutory requirement for GAO to audit the U.S. government's consolidated financial statements. The 2018 National Defense Authorization Act requires that the Secretary of Defense ensure that a full audit is performed on the financial statements of DOD for each fiscal year and that the results be submitted to Congress no later than March 31 of the following fiscal year. The Navy was the first military department to assert real property audit readiness related to DOD's Financial Improvement and Audit Readiness effort.

For this report, GAO's objectives were to (1) determine the extent to which the Navy had internal control deficiencies, if any, that may impair its ability to assert that its buildings, as reported in its financial statements, exist and that the information about these buildings is complete and adequately supported by property records and (2) identify the challenges, if any, that Navy faces in valuing its buildings in accordance with federal accounting standards. GAO reviewed the Navy's policies and procedures for control activities over its buildings, performed data analyses, and tested a nongeneralizable sample of buildings. GAO also discussed with Navy officials the challenges in complying with federal accounting standards for valuing its buildings.

What GAO Recommends

GAO is making four recommendations to the Navy to improve internal controls for its buildings by implementing needed written procedures and control activities. The Navy concurred with these recommendations.

View [GAO-18-289](#). For more information, contact William J. Cordrey at (404) 679-1873 or cordreyw@gao.gov.

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The Navy Needs to Improve Internal Control over Its Buildings

What GAO Found

Although the United States Navy (Navy) has taken actions to become audit ready for its real property, GAO identified internal control deficiencies that impaired the Navy's ability to assert that (1) buildings recorded in the internet Navy Facility Assets Data Store (iNFADS), the Navy's real property system, and reported as assets in its financial statements existed and (2) all of the Navy's buildings were recorded in iNFADS and correctly reported as assets in the Navy's financial statements. As shown in the figure below, the effects of these internal control deficiencies contributed to the Navy (1) continuing to maintain records in iNFADS for buildings that had been demolished, sometimes many years ago, and include these buildings as assets in its financial statements; (2) excluding some of the buildings it owns from being recorded in iNFADS and reported as assets in its financial statements; (3) erroneously reporting nonfunctional buildings as assets in its financial statements; and (4) excluding certain buildings from being reported as assets in its financial statements that met or exceeded the Department of Defense's (DOD) capitalization threshold.

Effects of Internal Control Deficiencies Impairing the United States Navy's (Navy) Ability to Accurately Report Information on Its Buildings as Assets



Source: GAO analysis of Navy's building records and financial reporting. | GAO-18-289

The Navy has various efforts under way to address challenges in valuing its buildings for financial reporting in accordance with federal accounting standards. Navy officials have acknowledged that significant delays can sometimes occur in the Navy being able to complete supporting documentation of the final costs to properly report buildings in its financial statements. Additionally, implementation of the Navy's new methodology to properly account for capital improvements will be critical for capturing accurate costs for buildings. Furthermore, the Navy has not consistently completed a physical inventory (asset evaluation) for each building every 5 years as required by DOD policy. These asset evaluations are an important control to help ensure that the information recorded for buildings in iNFADS is accurate. Finally, the Navy also faces a challenge in determining the placed in service dates for those buildings found through inventory procedures. The Navy's use of the date the building was found rather than the estimated date the building was placed in service can substantially affect the accuracy of the information in the Navy's systems and financial statements. Navy officials are aware of these challenges and have various efforts under way to address them. Effective implementation of these efforts is crucial to help address these challenges.

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Abbreviations

BMS	Business Management System
DOD	Department of Defense
DON	Department of the Navy
FIAR	Financial Improvement and Audit Readiness

GAAP	generally accepted accounting principles
G-PP&E	general property, plant, and equipment
GIS	Geospatial Information System
iNFADS	internet Navy Facilities Assets Data Store
NAVFAC	Naval Facilities Engineering Command
Navy	United States Navy
NDAA	National Defense Authorization Act
Non-MILCON	non-military construction
PRV	Plant Replacement Value
RPAO	real property accountable officer
SFFAS	Statement of Federal Financial Accounting Standards

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May 10, 2018

The Honorable Ron Johnson
Chairman
The Honorable Claire McCaskill
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Trey Gowdy
Chairman
The Honorable Elijah E. Cummings
Ranking Member
Committee on Oversight and Government Reform
House of Representatives

The Department of Defense's (DOD) financial management has been on our High-Risk List since 1995 because of, among other things, long-standing, uncorrected deficiencies with its financial management systems, business processes, and material internal control and financial reporting weaknesses.¹ These deficiencies prevent DOD from having auditable financial statements, which is one of the three major impediments preventing us from expressing an opinion on the accrual-based consolidated financial statements of the U.S. government.²

The effects of DOD's financial management problems extend beyond financial reporting and negatively affect DOD's ability to manage the department and make sound decisions on mission and operations. For example, we found that DOD cannot fully determine the number, size, and costs of its leases for its leased facilities because the inventory

¹GAO, *High-Risk Series: Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others*, [GAO-17-317](#) (Washington, D.C.: Feb. 15, 2017).

²The other two impediments preventing us from rendering an opinion on the U.S. government's accrual-based consolidated financial statements are (1) the U.S. government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities and (2) the U.S. government's ineffective process for preparing the consolidated financial statements. See GAO, *Financial Audit: Fiscal Years 2017 and 2016 Consolidated Financial Statements of the U.S. Government*, [GAO-18-316R](#) (Washington, D.C.: Feb. 15, 2018).

system that DOD uses to report on its leased assets contains some inaccurate and incomplete data.³

DOD's reported property, plant, and equipment represent more than 70 percent of the U.S. government's reported property, plant, and equipment. DOD manages a global real property portfolio that it reported consists of approximately 562,000 facilities—including barracks, commissaries, data centers, office buildings, laboratories, and maintenance depots—located on about 4,800 sites worldwide and covering more than 24.9 million acres.⁴ With a DOD-estimated replacement value of about \$880 billion, this infrastructure is critical to maintaining military readiness, and the estimated cost to build and maintain it represents a significant financial commitment. However, DOD remains one of the few federal entities that cannot demonstrate its ability to accurately account for and reliably report its costs or assets.

DOD has undertaken several financial management improvement initiatives over the years to address deficiencies in business systems, processes, and controls through its Financial Improvement and Audit Readiness (FIAR) Plan.⁵ In addition to the FIAR Plan, the 2010 National Defense Authorization Act (NDAA) required, until December 2017, that DOD provide semiannual reports to the congressional defense committees on the status of the implementation of the FIAR Plan. The 2018 NDAA repealed the requirement for the FIAR Plan and semiannual status reports and codified a requirement for DOD to submit a Financial Improvement and Audit Remediation Plan to Congress by June 30, 2019,

³GAO, *Defense Infrastructure: More Accurate Data Would Allow DOD to Improve the Tracking, Management, and Security of Its Leased Facilities*, [GAO-16-101](#) (Washington, D.C.: Mar. 15, 2016).

⁴Department of Defense, *Base Structure Report – Fiscal Year 2015 Baseline* (Sept. 30, 2014). The *Base Structure Report* is a consolidated summary of the military departments' real property inventory data. The 2014 report was the most recently issued *Base Structure Report* as of the date of this report.

⁵Pub. L. No. 111-84, § 1003(a), 123 Stat. 2190, 2439, (Oct. 28, 2009), as amended. Until the enactment of the 2018 National Defense Authorization Act in December 2017, DOD was required to develop and maintain a FIAR Plan that among other things, listed the costs and actions associated with (1) correcting the financial management deficiencies that impaired DOD's ability to prepare timely, reliable, and complete financial management information; (2) ensuring that DOD's financial statements were validated as ready for audit no later than September 30, 2017, and the statement of budgetary resources was validated as ready for audit by September 30, 2014; and (3) ensuring that the audit of DOD's fiscal year 2018 financial statements occurred no later than March 31, 2019.

and annually thereafter.⁶ DOD is further required to prepare a consolidated corrective action plan management summary on the status of key corrective action plans and to brief the congressional defense committees semiannually on the status of the corrective action plans.⁷

The results of prior audits, including ours, have raised concerns about the data reliability of certain key categories of the military services' general property, plant, and equipment.⁸ In addition, the Department of the Navy's (DON) inability to accurately account for real property assets, specifically its buildings, continues to be a primary impediment to it receiving an auditor's opinion on its financial statements. One of the previously identified material weaknesses⁹ reported by the independent auditors for fiscal year 2017 related to real property.¹⁰ Specifically, the independent auditors reported that the DON had insufficient internal controls and supporting documentation for real property and construction-in-progress. The DON consists of two services—the United States Navy (Navy) and the United States Marine Corps.¹¹ The DON was the first military department to initially assert real property audit readiness for existence

⁶Further, the 2018 NDAA requires that the Secretary of Defense ensure that a full audit is performed on the financial statements of DOD for each fiscal year as required by 31 U.S.C. § 3521(e) and that the results be submitted to Congress no later than March 31 of the following fiscal year. Pub L. No. 115-91, §§ 1002(a)(2), (b)(1), (c), 131 Stat. 1283, 1540, *codified* at 10 U.S.C. §§ 251, 252.

⁷Pub. L. No. 115-91, § 1002(c), (d), *codified* at 10 U.S.C. §§ 252, 253.

⁸GAO, *DOD Financial Management: Greater Visibility Needed to Better Assess Audit Readiness for Property, Plant, and Equipment*, [GAO-16-383](#) (Washington, D.C.: May 26, 2016), and Department of Defense, Office of Inspector General, *Independent Auditor's Report on the Attestation of the Existence, Completeness, and Rights of the Army's Real Property*, DODIG-2015-166 (Alexandria, Va.: Sept. 2, 2015).

⁹A material weakness is a deficiency, or 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. 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.

¹⁰Department of Defense, Office of Inspector General, *Independent Auditor's Report on the Department of the Navy General Fund FY 2017 and FY 2016 Basic Financial Statements*, DODIG-2018-009 (Alexandria, Va.: Nov. 7, 2017).

¹¹In this report, we use "Navy" to refer to the United States Navy, except when DON is used. The Marine Corps financial statements for fiscal year 2017 were being audited by independent auditors, and therefore the Marine Corps was excluded from our audit.

and completeness.¹² According to the Navy's accountable real property system, the internet Navy Facility Assets Data Store (iNFADS), the Navy owned 35,308 and 35,600 buildings as of September 30, 2017, and September 30, 2016, respectively.¹³

This engagement was initiated in connection with the statutory requirement for GAO to audit the U.S. government's consolidated financial statements.¹⁴ Our objectives were to (1) determine the extent to which the Navy had internal control deficiencies, if any, that may impair its ability to assert that its buildings, as reported in its financial statements, exist and that the information about the buildings is complete and adequately supported by property records and (2) identify the challenges, if any, that the Navy faces in valuing its buildings in accordance with federal accounting standards.

To address our objectives, we interviewed DOD and Navy officials and reviewed regulations, instructions, policies, and procedures, including the Naval Facilities Engineering Command's (NAVFAC)¹⁵ desk-top procedures, to identify control activities over buildings.¹⁶ We reviewed the results from prior testing conducted by a contractor that the Navy engaged to help it achieve audit readiness for its real property. We also performed data analyses of building data elements contained in iNFADS as of September 30, 2016. To assess the reliability of data we used, we reviewed relevant Navy documentation, interviewed knowledgeable officials, reviewed policies and procedures regarding collecting and

¹²The Navy has two classes of real property: Class 1 (Land) and Class 2 (Buildings, Structures, and Utilities).

¹³The Navy's iNFADS is the source of real property information that DOD's Defense Finance and Accounting Service uses to compile the Navy's financial statements. Because iNFADS is not a financial reporting system, information from iNFADS to be reported in Navy's financial statements must be separately accumulated.

¹⁴The Secretary of the Treasury, in coordination with the Director of Office of Management and Budget, is required to annually submit audited financial statements for the U.S. government to the President and Congress. GAO is required to audit these statements. 31 U.S.C. § 331(e).

¹⁵NAVFAC is a global facilities engineering and acquisition command that manages the planning, design, construction, and sustainment of shore facilities for the Navy, Marine Corps, and other federal agencies.

¹⁶NAVFAC refers to these desk-top procedures as Business Management System (BMS) process documents. NAVFAC's Asset Management business line began issuing BMS process documents to further DOD's FIAR effort in 2012 and related training began in 2013.

maintaining the data, and performed data analyses to look for logical inconsistencies. We concluded that the data elements we used from iNFADS were sufficiently reliable for the purposes of selecting a nongeneralizable sample of buildings to test during our site visits. We selected the Norfolk and San Diego geographic areas for site visits because of the numerous bases in each area and the proximity of the 5 installations to one another in both areas. Finally, we conducted site visits in Norfolk and San Diego to understand the processes followed and documents used to record real property transactions, test the buildings selected in our nongeneralizable samples, and review the available supporting documentation for the selected buildings.

For the site visits, we selected a nongeneralizable sample of a total of 40 buildings from the iNFADS real property system, 20 from 5 Norfolk-area installations and 20 from 5 San Diego-area Navy installations that we visited, to test through observation whether these buildings existed (book-to-floor).¹⁷ We met with the real property accountable officers (RPAO) at the 10 installations we visited.¹⁸ In addition to testing for existence, we compared the descriptions of the buildings in iNFADS with the buildings that we observed. For example, if the date the building was placed in service was recent, we would observe whether it was a newer building. We also selected a nongeneralizable sample of an additional 39 buildings while at the installations to perform floor-to-book tests to test the completeness of Navy's recorded buildings in iNFADS.¹⁹

To identify the challenges the Navy faces in valuing its buildings in accordance with federal accounting standards, we reviewed federal accounting standards and the Navy's documents for recording assets into iNFADS and interviewed agency officials responsible for financial reporting and real property management, including the RPAOs at the installations we visited. While our audit objectives focused on certain control activities related to (1) the existence and completeness of the

¹⁷Our book-to-floor tests, used to verify existence and reported characteristics of the buildings in iNFADS, consisted of comparisons between buildings selected from those recorded in iNFADS to the physical buildings on an installation.

¹⁸The responsibilities of an RPAO are outlined in DOD Instruction 4165.14, *Real Property Inventory (RPI) and Forecasting* (Jan. 17, 2014). DOD Instruction 4165.14 requires that each installation have an RPAO appointed in writing.

¹⁹Our floor-to-book tests, used to verify the completeness of recorded buildings in iNFADS, consisted of comparisons between physical buildings identified on an installation to the buildings' information recorded in iNFADS.

Navy's buildings as reported in its financial statements and the completeness and adequacy of supporting property records for those buildings and (2) the valuation of the Navy's buildings in accordance with federal accounting standards, we did not evaluate all control activities and other components of internal control.²⁰ If we had done so, additional deficiencies may or may not have been identified that could affect the control activities evaluated as part of this audit. See appendix I for additional details on our audit scope and methodology.

We conducted this performance audit from September 2016 to May 2018 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 objectives.

Background

Navy's Real Property Audit Assertions

DOD has defined audit readiness as having the capabilities in place that allow an auditor to plan and perform a full financial statement audit that results in actionable feedback to DOD.²¹ In DOD's May 2016 FIAR Plan Status Report, the DON initially asserted that it would be audit ready with regard to real property (including construction-in-progress) for the existence and completeness assertions by June 2016 and with regard to the valuation assertion by March 2017.²² Subsequently, in DOD's

²⁰The four other components of internal control are (1) control environment, (2) risk assessment, (3) information and communication, and (4) monitoring. See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

²¹Department of Defense, Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *Financial Improvement and Audit Readiness (FIAR) Plan Status Report* (Washington, D.C.: May 2017).

²²According to the GAO/President's Council on Integrity & Efficiency's *Financial Audit Manual*, the existence assertion is that an entity's assets exist at a given date. The completeness assertion is defined as all assets that should have been recorded having been recorded in the proper period and properly included in the financial statements. The valuation assertion is defined as assets being included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments being properly recorded.

November 2016 FIAR Plan Status Report, the DON asserted that it would be audit ready for the existence, completeness, and valuation assertions by March 2017. In DOD's May 2017 FIAR Plan Status Report, the DON reported that it had validated that the existence and completeness assertions for real property. Ultimately, the DON reported in DOD's November 2017 FIAR Plan Status Report that it had achieved audit readiness for the existence and completeness assertions and was in the process of determining audit readiness for the valuation assertion.

Real Property Valuation Methods

In August 2016, the Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards (SFFAS) No. 50,²³ which allows reporting entities to apply alternative valuation methods in establishing opening balances²⁴ of general property, plant, and equipment (G-PP&E). Such alternative valuation methods may be applied in reporting periods beginning after September 30, 2016. SFFAS No. 50 permits each reporting entity to use alternative methods when presenting financial statements, or one or more line items, (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing financial statements in accordance with generally accepted accounting principles (GAAP) without using alternative methods. SFFAS No. 50 permits reporting entities to apply an alternative method only once per line item after the period during which the existing systems could not provide the information for producing financial statements in accordance with GAAP. As of March 2018, the Navy has not made an unreserved assertion attesting that its opening balances of G-PP&E are reported in accordance with SFFAS No. 50. After opening balances are established using an alternative valuation method, federal accounting standards require historical cost to be used in valuing G-PP&E acquired or constructed.

²³Statement of Federal Financial Accounting Standards No. 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS No. 6, SFFAS No. 10, SFFAS No. 23, and Rescinding SFFAS No. 35*, effective for periods beginning after September 30, 2016, with earlier implementation encouraged.

²⁴Opening balances, as defined in SFFAS No. 50, are those account balances existing at the beginning of the reporting period. The opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods.

Plant Replacement Value Being Used to Develop Opening Balances for the Navy's Buildings

DOD already uses plant replacement value (PRV) for decision making and management purposes and has reported that it will use PRV to develop opening balances for the Navy's buildings. Navy is also currently using PRV (an allowable alternative valuation method under SFFAS No. 50) for financial statement reporting of its buildings and plans to do so until the DON makes an unreserved assertion that its financial statements or its G-PP&E line item or reported assets classes are presented fairly in accordance with GAAP. PRV represents an estimate of the replacement cost in current year dollars to design and construct a facility to replace an existing facility at the same location.²⁵ As such, the replacement (or construction) cost factor, generally applied to buildings as a dollar amount multiplied by square footage, is also indexed to increase or decrease the amount to account for other variations in costs for different geographic areas or complexity of the facility. Once the calculation prescribed by the formula has resulted in PRV, accumulated depreciation is computed based on the placed in service date. Figure 1 shows an example of the PRV formula being applied to an enlisted housing facility.²⁶ The valuation adjustment factors, as shown below, vary by location and use of the building. Acquisitions and capital improvements made to existing buildings during subsequent financial periods are to be recorded at the actual cost of obtaining the asset or improvement and placing it into service.²⁷

²⁵SFFAS No. 50 defines replacement cost as the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life.

²⁶This example, using DOD's prescribed PRV methodology, was prepared by the Navy to demonstrate the PRV calculation. Naval Facilities Engineering Command, Financial Improvement Audit Readiness Program, *Justification of Navy General Fund Real Property Alternative Valuation Methodology*, WP# RP-01 (Washington, D.C.: June 30, 2017).

²⁷Federal Financial Accounting Technical Release 17, *Conforming Amendments to Technical Releases for SFFAS No. 50, Establishing Opening Balances for General Property, Plant, and Equipment*, issued on April 10, 2017, clarifies that all standards-level implementation guidance for G-PP&E is now in SFFAS No. 6, as amended.

Figure 1: Plant Replacement Value Formula

Plant replacement value	=	Asset measurement	X	Replacement cost factor	X	Area cost factor	X	Historical records adjustment	X	Planning and design factor	X	Supervision inspection and overhead factor	X	Contingency factor
\$8,989,405		33,302 square feet		\$209.91		1.06		1.0		1.09		1.06		1.05
		Amount of square footage		Estimated construction costs per square foot		Geographic location adjustment for costs of labor, material, and equipment		Increased costs, if any, for replacement of historical facilities or for construction in a historic district		Factor for planning and design of a nonmedical facility		Factor for supervision, inspection, and overhead activities for construction in the continental United States		Factor for construction contingencies

Source: GAO analysis of Navy’s methodology for establishing opening balances for general property, plant, and equipment. | GAO-18-289

Internal Control Activities

Internal control activities, as defined in *Standards for Internal Control in the Federal Government*, are the policies, procedures, and techniques that enforce management’s directives to achieve the entity’s objectives and address related risks.²⁸ A deficiency in internal control exists when the design, implementation, or operation of a control does not allow management or personnel, in the normal course of performing their assigned functions, to achieve control objectives and address related risks.

²⁸GAO-14-704G.

Internal Control Deficiencies Impaired the Navy's Ability to Properly Record and Report Certain of Its Buildings

We identified internal control deficiencies that impaired the Navy's ability to assert that as of September 30, 2016, (1) buildings recorded in iNFADS and reported as assets in Navy's financial statements existed and (2) all of the Navy's buildings were recorded in iNFADS and correctly reported as assets in Navy's financial statements. As shown in figure 2, the effects of these internal control deficiencies contributed to the Navy (1) continuing to maintain records in iNFADS for buildings that had been demolished, sometimes many years ago, and including these buildings as assets in its financial statements; (2) excluding some of the buildings that it owns from being recorded in iNFADS and reported as assets in its financial statements; (3) erroneously reporting nonfunctional buildings as assets in its financial statements;²⁹ and (4) excluding certain buildings from being reported as assets in its financial statements that met or exceeded DOD's capitalization threshold.³⁰

²⁹Nonfunctional buildings, as defined by the Navy, are buildings that cannot be used or occupied for any reason until functional capacity is restored to a usable or habitable condition or until the building is demolished. While nonfunctional buildings should continue to be recorded in iNFADS to help the Navy maintain accountability of its assets, the nonfunctional buildings should be excluded from financial statement reporting as part of G-PP&E.

³⁰In general accounting concepts, the capitalization threshold is the dollar amount that determines whether the cost of an asset is expensed to the operations or recorded as an asset of a reporting entity in its financial statements. Asset acquisition costs that are below the threshold are to be expensed. Asset acquisition costs that are greater than the threshold are to be capitalized and depreciated over the asset's useful life.

Figure 2: Effects of Internal Control Deficiencies Impairing the United States Navy’s (Navy) Ability to Properly Record and Report Its Buildings as Assets



Source: GAO analysis of Navy's building records and financial reporting. | GAO-18-289

The Navy Did Not Have Properly Designed Procedures and Related Control Activities to Reasonably Assure Proper Accounting for Its Demolished Buildings

While the Navy had written procedures for the multistep process for disposal of real property by demolition, these procedures and related control activities were not properly designed to reasonably assure that demolished buildings were recorded as disposed and removed from the accounting records. Specifically, the procedures and related control activities did not reasonably assure that RPAOs were provided with a signed demolition approval document and the related disposal form. Without these documents, an RPAO may not be aware that a building has been demolished and therefore may not take the appropriate actions to record the asset as disposed in iNFADS so that the asset record is subsequently removed from iNFADS at the end of the fiscal year and the asset is thereby not included in Navy's financial statements.

When a building is designated for disposal, multiple parties are involved in the demolition process. This business process can involve the installation's Public Works Department; the Regional Commander; the Facilities Engineering Command realty specialist; the Commander, Navy Installations Command; the demolition project manager; the demolition contractor; and the General Services Administration.³¹ The multiple functional offices involved in the disposal by demolition business process and the lack of communication between the offices can result in buildings being demolished without the RPAO's knowledge. The Navy's procedures

³¹The General Services Administration is involved for disposals of property valued above \$50,000.

for the disposal of real property by demolition state that the RPAO is to receive a signed demolition approval document from the installation's Public Works Department. After the demolition has been completed, the project manager is to work with the demolition contractor (if applicable), the planner, and the RPAO to complete the disposal form. The RPAO, within 10 days of the completion of the demolition, is to upload supporting documentation about the disposed asset into iNFADS and create the iNFADS disposal record.³² The Navy's procedures did not include a control activity, such as a step to verify the RPAO's receipt of a signed demolition approval document and disposal form, to reasonably assure that the RPAOs are notified of all building demolitions. These notifications are critical so that each RPAO can properly account for a building by creating an iNFADS disposal record, which ultimately results in records for demolished buildings being deleted from iNFADS and therefore not included as assets in the financial statements.

During our testing of a nongeneralizable sample of buildings in iNFADS, we identified buildings that had been demolished prior to September 30, 2016, but were still recorded in iNFADS as of September 30, 2016, and therefore were reported as assets in Navy's financial statements as of September 30, 2016.³³ According to SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, assets, including real property, shall be removed from the asset accounts along with the associated accumulated depreciation if the asset no longer provides service to the operations of the entity.³⁴ The inclusion of demolished buildings in iNFADS results in inaccurate Navy real property records and can lead to an overstatement of reported balances for real property in Navy's financial statements. Of the 40 buildings for which we performed book-to-floor tests for existence, we found that 4 had been destroyed and no longer physically existed but were still recorded in iNFADS and reported as assets in Navy's financial statements. Because we used a nongeneralizable sample of buildings, results from the sample cannot be used to make inferences about all of the Navy's buildings. The four demolished buildings are described below.

³²NAVAFAC has a pending Corrective Action Request that would change the BMS process document to revise the 10 days to 30 days. As of January 19, 2018, this Corrective Action Request had not yet been processed.

³³According to Navy officials, the property records for buildings identified in iNFADS as disposed are to be removed from iNFADS at the end of the fiscal year in which the property was disposed.

³⁴Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment*, effective for periods beginning after September 30, 1997.

- A six-car garage building had been demolished several years ago according to the Navy, but its operational status was shown as active in iNFADS as of September 30, 2016. Navy officials stated that while the actual demolition date for this building is not known, based on the demolition drawing for another building nearby, it appears to the Navy that the garage was demolished prior to 2001.
- A marina shop building was demolished as of June 30, 2016, so that a new building could be constructed at the same location. As of September 30, 2016, the operational status of this marina shop was shown as active in iNFADS. The disposal of the marina shop building was not recorded in iNFADS until May 2017.
- A storage building was demolished in February 2016 but was still recorded in iNFADS as of September 30, 2016. The RPAO was not notified that the building had been demolished until April 2016. After searching for the relevant paperwork, which could not be located, the RPAO prepared the disposal form that was dated December 20, 2016.
- An aviation warehouse, which had previously been demolished, was still recorded in iNFADS as of September 30, 2016. According to Navy officials, the demolition package was initiated in 2013, but the warehouse needed to remain in iNFADS until the site restoration work was completed. Based on available information, the warehouse was demolished around May 2014. The site restoration work was completed in 2016, but the RPAO was never notified. According to supporting documentation, a search for the relevant paperwork was completed, after which the building was recorded in iNFADS as disposed in March 2017.

Consistent with our findings, the Navy Office of Financial Operations, in preparing a white paper on real property accumulated depreciation, also found that there were buildings recorded as existing in iNFADS that did not exist.³⁵ For this white paper, the Navy selected a generalizable sample of 650 real property assets, including buildings, to test. Noted in the white paper as of May 31, 2017, only 584 of the 650 sampled real property assets were able to be tested. Specifically, 51 could not be validated, and an additional 15 real property assets, or 2.5 percent of the sample, were found to not exist, but were still recorded in iNFADS as existing. Based on Navy's testing, we estimated that 2.5 percent of real

³⁵Department of the Navy, Office of Financial Operations, *Real Property Accumulated Depreciation, Navy General Fund Real Property Facility Built Date (FBD) Validation and Analysis* (Washington, D.C.: June 30, 2017).

property in the Navy's iNFADS database as of May 2016 no longer existed but had not been recorded in iNFADS as disposed.³⁶

The Navy Lacks Procedures and Related Control Activities to Reasonably Assure Proper Accounting for Certain Buildings

During some of our site visits, the RPAOs stated that some buildings acquired or constructed with non-military construction funds (Non-MILCON) and that cost under \$750,000 were not recorded in iNFADS.³⁷ A Navy official confirmed that there were issues with recording Non-MILCON construction costing \$250,000 and above, but under \$750,000, for financial reporting purposes.³⁸ Specifically, buildings or capital improvements are sometimes built using other Non-MILCON funding, and in some cases, an entity other than NAVFAC spends the funds. The RPAOs therefore may not know of buildings constructed as Non-MILCON projects if NAVFAC was not involved in the construction project. For example, at one location, we observed a sentry house that had been constructed for the Navy using Non-MILCON funding around 2006. However, the sentry house was not recorded into iNFADS until 2014 when the building was identified as existing through the Navy's physical inventory procedures.

NAVFAC did not have final procedures and related control activities to reasonably assure that buildings funded with Non-MILCON funding below \$750,000 were consistently recorded in iNFADS and, if the cost exceeded the capitalization threshold, were reported as assets in the Navy's financial statements. In 2015, the Navy began to develop both the process and system changes required to track construction-in-progress costs for the Navy's Non-MILCON projects with costs greater than \$750,000, so that the cost of the buildings associated with these projects

³⁶Based on the Navy's testing procedures, we are 95 percent confident that the actual percent was between 2.4 and 2.6 percent.

³⁷The term military construction (MILCON) is sometimes used to refer to any type of military construction regardless of funding source or the statutory authority under which the construction is conducted. For the purposes of this report, we use MILCON to represent military construction appropriations or related funds. MILCON appropriations are typically provided in an appropriations act separate from the rest of DOD appropriations.

³⁸DOD's capitalization threshold for real property, which the Navy implemented, increased to \$250,000 for buildings accepted and placed in service on or after October 1, 2013.

would be properly recorded in iNFADS. In March 2017, NAVFAC updated its BMS process document with the steps for Non-MILCON buildings with costs greater than \$750,000 and adopted the new guidance in May 2017.

According to NAVFAC officials, the Navy has already determined that an equivalent detailed process is needed for Navy Non-MILCON buildings costing less than \$750,000 to reasonably assure that the RPAOs are aware of these projects. The RPAOs are not involved in project authorization or project funding and otherwise would be unaware of these Non-MILCON projects. As a result, the RPAOs may not know of Non-MILCON buildings acquired or constructed with operations and maintenance or other Non-MILCON funding under \$750,000 and accordingly do not have documentation to record the buildings' acquisitions in iNFADS. A BMS process document that addresses Non-MILCON projects costing under \$750,000 is being developed. However, according to a Navy official, a completion date has not been set for finalizing this document. Until effective procedures are implemented, Navy buildings constructed with Non-MILCON funding costing less than \$750,000 may not be timely recorded in iNFADS, which would cause iNFADS to have incomplete information. If the buildings are not recorded in iNFADS, the buildings will not be reported as assets in the financial statements, as required, when the cost of the building meets or exceeds the Navy's capitalization threshold of \$250,000.

The Navy Lacks Written Procedures and Related Control Activities to Reasonably Assure Proper Financial Reporting for Buildings Coded as Nonfunctional

NAVFAC did not have written procedures requiring buildings coded as nonfunctional in iNFADS to be excluded when accumulating data from iNFADS for financial reporting purposes, nor did it have related control activities to provide reasonable assurance that such buildings were excluded. As a result, the Navy incorrectly included the amounts associated with buildings coded as nonfunctional when accumulating iNFADS information for financial reporting purposes. Specifically, based on our aggregation of iNFADS data, the Navy erroneously reported 189 buildings coded as nonfunctional, amounting to \$411 million in gross value, \$403 million in accumulated depreciation, and \$8 million in net book value, as assets in the financial statements as of September 30, 2016. For example, one building coded as nonfunctional that we observed during our site visits was constructed in 1909, with a PRV of over \$5 million in iNFADS. The building has been vacant and unusable

since September 11, 2002, but was included as an asset in the financial statements for fiscal year 2016.

According to federal accounting standards, fully impaired assets, such as nonfunctional buildings, should not be included in an entity's financial statements and related notes. Specifically, SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, states that G-PP&E, which includes real property, shall be removed from the accounts along with the associated accumulated depreciation if the asset no longer provides service to the operations of the entity. Moreover, SFFAS No. 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, reiterates the requirement of SFFAS No. 6 by stating that fully impaired assets should be removed from the G-PP&E accounts along with the associated accumulated depreciation if, prior to disposal, the asset no longer provides service in the operations of the entity.³⁹

Navy officials confirmed that they do not have written procedures or related control activities requiring buildings coded as nonfunctional in iNFADS to be excluded when accumulating iNFADS data for financial statement reporting purposes. As a result, for fiscal year 2016, the Navy erroneously included buildings coded as nonfunctional as assets on its financial statements. Navy officials agreed that nonfunctional buildings meet the impairment definition of SFFAS No. 6 and No. 44, as these buildings no longer provide service to Navy operations, and therefore should be removed from the G-PP&E accounts. For fiscal year 2017, Navy officials stated that nonfunctional buildings were reclassified from the asset class that includes buildings to the "Other" asset class. However, both asset classes were reported as G-PP&E on the balance sheet, and as a result, the nonfunctional buildings were again reported as assets in the G-PP&E line item in the Navy's financial statements.

³⁹Statement of Federal Financial Accounting Standards No. 44, *Accounting for the Impairment of General Property, Plant, and Equipment Remaining in Use*, effective for periods for fiscal periods beginning after September 30, 2014, with early implementation encouraged.

The Navy Lacks Written Procedures and Related Control Activities to Reasonably Assure Proper Financial Reporting for Buildings That Meet or Exceed DOD's Capitalization Threshold

NAVFAC officials confirmed that they did not have written procedures and related control activities to reasonably assure that buildings recorded in iNFADS that met or exceeded DOD's established capitalization threshold are properly included as assets in Navy's financial statements. For financial reporting, the Navy's policy is to capitalize buildings based on the established capitalization threshold in effect when each building was placed in service.⁴⁰

According to Navy officials, buildings placed in service from October 1, 2007, through September 30, 2013, should have been included as assets in the financial statements if the buildings were valued at or above \$20,000, the capitalization threshold that was in place during that period. However, for buildings placed in service during this period, the Navy continued to use the previous capitalization threshold of \$100,000 rather than the \$20,000 threshold.⁴¹ An Office of the Secretary of Defense memorandum dated September 20, 2013, directed the services to increase the capitalization threshold to \$250,000 for assets acquired and placed in service on or after October 1, 2013, and the Navy implemented this change. Further, the Navy incorrectly reported in the notes to its fiscal year 2016 and 2017 financial statements that the \$20,000 capitalization threshold was used for real property.

Navy officials stated that when DOD's capitalization threshold was changed to \$20,000, the Navy did not adopt the reduced threshold pending an evaluation of changes needed to iNFADS and the development of procedures to implement the lower threshold. Because the Navy did not adopt DOD's \$20,000 capitalization threshold and instead continued to use the \$100,000 threshold, buildings placed in

⁴⁰The placed in service date is defined as the date on which the facility or improvement to a facility (such as a renovation or capital improvement) is available for the Navy's use. The real property asset or capital improvement placed in service date initiates the capitalization and depreciation of an asset.

⁴¹DOD policy required real property to be capitalized and accumulated for financial statement reporting if valued in excess of \$20,000 and acquired during the period October 1, 2007, through September 30, 2013.

service in fiscal years 2008 through 2013 with a value at or above \$20,000 but less than \$100,000 were not reported as assets in the Navy's financial statements as of September 30, 2016, and in prior years.⁴² Navy officials could not quantify the effect on its financial statements that occurred based on the Navy's use of the \$100,000 capitalization threshold instead of the \$20,000 threshold for fiscal years 2008 through 2013. Additionally, the Navy by not adopting DOD's \$20,000 capitalization threshold resulted in inconsistent reporting in DOD's consolidated financial statements.

Challenges the Navy Faces in Complying with Federal Accounting Standards for Valuing Its Buildings

The Navy faces several challenges in valuing its buildings in accordance with federal accounting standards, including (1) finalizing documentation of actual cost information for buildings that are acquired and placed in service after the Navy's opening balances have been established based on alternative valuation methods permitted by SFFAS No. 50; (2) capturing and recording costs of improvements that should be reported; (3) consistently completing asset evaluations for each building every 5 years as required by DOD Instruction 4165.14 to help ensure that each building's information in iNFADS is correct;⁴³ and (4) determining placed in service dates for previously unrecorded buildings that are subsequently discovered/identified through physical inventories/asset evaluations. Navy officials are aware of these challenges and have various efforts under way to address them. Effective implementation of these efforts is crucial to help address these challenges.

⁴²The Navy's real property, including buildings, is reported in the G-PP&E line item on its General Fund consolidated balance sheet. The notes to the financial statements show the asset classes that compose G-PP&E. Buildings are included in the Buildings, Structures, and Facilities asset class.

⁴³Asset evaluations are similar to conducting physical inventories of buildings and include facility walk-throughs. One of the tasks done during an asset evaluation is to help ensure that all data elements, such as a building's measurement, facility type, and usage, are correct.

Finalizing the DD-1354 for Buildings Being Valued at Cost

As we have previously reported, each completed military construction project includes the DD-1354, Transfer and Acceptance of DOD Real Property, to formally transfer ownership from the constructing entity to the acquiring entity.⁴⁴ The final version of the DD-1354 documents the final total cost of the project in iNFADS, the source of real property information for financial reporting. Navy officials acknowledge that significant delays may occur in getting to the final version of the DD-1354, which occurs after all costs are determined. If there are issues such as cost overruns or contract disputes, the delays in completing the final version of the form can be substantial. The Navy considers these substantial delays in getting to the final version of the DD-1354 to be an obstacle to timely documenting the final costs of buildings that are acquired and placed in service after the Navy's opening balances have been established, based on alternative valuation methods permitted by SFFAS No. 50. During our site visits when we tested 79 buildings, we identified 13 buildings, either constructed or with capital improvements made from 2012 through 2016, for which a final DD-1354 had not yet been completed.

According to several RPAOs we interviewed, getting to the final version of the DD-1354 is a complicated process, requiring coordination among multiple responsible parties and units, and determines all costs associated with the construction. For example, a complex project that involves the construction and demolition of multiple buildings makes the allocation of the construction costs among the buildings of the project considerably challenging.

Recording Capital Improvements

According to SFFAS No. 6, costs associated with capital improvements—those that extend the useful life of a building or improve its capacity—are to be recorded in the accountable real property system if the actual cost exceeds the capitalization threshold. Navy officials reported that one obstacle to capitalizing the costs of improvements is determining the actual costs associated with the projects for capital improvements that are made after the opening balances are established using alternative

⁴⁴GAO, *Defense Infrastructure: Energy Conservation Investment Program Needs Improved Reporting, Measurement, and Guidance*, [GAO-16-162](#) (Washington, D.C.: Jan. 29, 2016).

valuation methods. The Navy has developed and is testing its methodology to properly account for capital improvements to buildings. This methodology uses an automated link from the Facilities Information System (which has the construction-in-progress account) to iNFADS. The success of this methodology will be critical for capturing capital improvements for buildings.

The inability to account for the total costs associated with capital improvements to buildings after the opening balances have been established using alternative valuation methods would result in the undervaluing of the total actual cost and annual depreciation expense associated with the buildings. Once PRV is used to establish the opening balance for buildings, the Navy must accurately record capital improvements in iNFADS in order to appropriately value the buildings and record the correct depreciation expense.

Performing Timely Asset Evaluations

We observed that the Navy has taken steps to improve the quality of its asset evaluations by completing and maintaining supporting documentation. However, we found that the Navy has not consistently completed asset evaluations for each building every 5 years as required by DOD policy. An asset evaluation is a key Navy control to help ensure that the information recorded in iNFADS is accurate. While the Navy issued a revised BMS process document formalizing asset evaluations procedures, these evaluations have not been performed every 5 years as required. Specifically, in a June 30, 2017, Navy analysis, the Navy determined that while an asset evaluation is required to be performed every 5 years, the asset evaluations had not been done for more than 5 years for 17.4 percent of real property, including buildings.⁴⁵ When asset evaluations are not done every 5 years for each building, there is an increased risk that information in iNFADS may not be accurate. In addition, as a part of asset evaluations, Navy personnel verify key information, including the square footage of buildings that is used for the PRV calculation. The Navy has efforts under way to perform asset evaluations for those buildings for which these evaluations had not been completed in a 5-year period, including using contractors to help complete the asset evaluations.

⁴⁵Naval Facilities Engineering Command, Financial Improvement Audit Readiness Program, *Justification of Navy General Fund Real Property Alternative Valuation Methodology*, WP# RP-01 (Washington, D.C.: June 30, 2017).

Determining Placed in Service Dates for Buildings Found by Inventory

As stated in DOD's Financial Management Regulation, real property assets and capital improvements to these assets are to be capitalized as of the date each asset was placed in service.⁴⁶ Navy officials occasionally identify existing buildings that have not been recorded in iNFADS and are referred to as buildings found by inventory. These buildings are often identified through NAVFAC's asset evaluations and periodic virtual inventories.⁴⁷ For these buildings, the placed in service dates may not be known. While DOD and the Navy have subsequently developed procedures for determining the placed in service dates for buildings found by inventory, for some Navy buildings, the placed in service date recorded in iNFADS was the date the building was found, rather than the actual placed in service date.

According to previous guidance, if a placed in service date could not be identified through the due diligence process, then the building was recorded as placed in service as of the date it was found.⁴⁸ The Navy's BMS process document for real property found by inventory, dated October 25, 2016, stated each building found by inventory is to be recorded with an estimated placed in service date determined using the criteria provided in DOD's February 2015 guidance.⁴⁹ We were told that until December 2016, any building found by inventory was recorded with a placed in service date of the day the building was found.

The Navy's use of the date the building was found by inventory as the placed in service date can substantially affect the information in iNFADS. For example, one of the buildings in our nongeneralizable sample was an old, abandoned maintenance shed. However, based on the iNFADS property record, the building appeared to be a relatively new building based on the recorded placed in service date of August 16, 2016, the

⁴⁶Department of Defense, Financial Management Regulation, DOD 7000.14-R, vol. 4, ch. 6, section 060105, *Property, Plant, and Equipment* (June 2009).

⁴⁷Periodic virtual inventories include reconciliations of the buildings recorded in iNFADS and the Geospatial Information System (GIS) to verify that all of the buildings in iNFADS exist and that all buildings shown in GIS are recorded in iNFADS. According to Navy officials, these periodic virtual inventories are to be done quarterly.

⁴⁸Department of Defense, Financial Management Regulation, vol. 4, ch. 6 (June 2009).

⁴⁹Department of Defense, *Placed in Service Date* (Washington, D.C.: Feb. 19, 2015).

date it was found by inventory (see fig. 3). As a result, the building is recorded in iNFADS on August 16, 2016, the placed in service date and therefore the accumulated depreciation would be less than a building with an older placed in service date. The complete, timely, and accurate recording of the placed in service date information enables ensures reliable and accurate reporting of real property information in DOD's financial statements.

Navy officials are aware of the challenges discussed above and have various efforts under way to address them. Effective implementation of these efforts is crucial to help address these challenges.

Figure 3: Abandoned Shed Found by Inventory and Recorded in the internet Navy Facility Assets Data Store as Placed in Service August 16, 2016



Source: Naval Facilities Engineering Command. | GAO-18-289

Conclusions

The Navy's inability to accurately account for real property assets, specifically its buildings, continues to be a material weakness reported by independent auditors. Inadequate procedures and internal control deficiencies prevent the Navy from accurately recording and reporting its

buildings and knowing how many buildings it actually owns. Some buildings recorded in the Navy's accountable real property system, iNFADS, do not exist. Similarly, the Navy does not have adequate procedures and related controls to reasonably assure that all Non-MILCON buildings and capital improvements costing less than \$750,000 are recorded in iNFADS. Additionally, the Navy erroneously reported nonfunctional buildings as assets in its financial statements and excluded certain buildings that met or exceeded DOD's capitalization threshold as assets in its financial statements. As a result of these deficiencies, the Navy does not have adequate information to support reliable reporting of real property in its annual financial statements, and DOD, Congress, and others do not have reliable, useful, and timely information for decision making.

Recommendations for Executive Action

We are making the following four recommendations to the Navy.

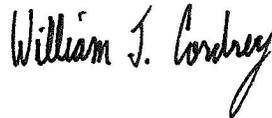
- The Commander of NAVFAC should develop and implement procedures and related control activities for real property disposed of by demolition to provide reasonable assurance that the RPAOs timely receive a signed demolition approval document and disposal form, so that demolished buildings are recorded as disposals in iNFADS and removed at the end of the fiscal year. (Recommendation 1)
- The Commander of NAVFAC should finalize and implement written procedures and related control activities to reasonably assure that all buildings costing less than \$750,000 and funded with Non-MILCON funding are recorded in the Navy's iNFADS and therefore included as assets in the financial statements if they meet or exceed the Navy's capitalization threshold. (Recommendation 2)
- The Commander of NAVFAC should develop and implement written procedures and related control activities to reasonably assure that buildings coded as nonfunctional in iNFADS are excluded for financial statement reporting purposes. (Recommendation 3)
- The Commander of NAVFAC should develop and implement written procedures and related control activities related to DOD's capitalization thresholds and outline the specific information to be accumulated from iNFADS to reasonably assure that real property assets are properly reported for financial statement reporting purposes. (Recommendation 4)

Agency Comments

We provided a draft of this report to the Navy for comment. In its comments, reproduced in appendix II, the Navy concurred with our four recommendations.

We are sending copies of this report to the Secretary of Defense, the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Deputy Chief Financial Officer, the Office of the Assistant Secretary of Defense (Energy, Installations, and Environment), the Assistant Secretary of the Navy (Energy, Installations and Environment), the Assistant Secretary of the Navy (Financial Management & Comptroller), the Director of the Office of Management and Budget, and appropriate 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 (404) 679-1873 or cordreyw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix III.



William J. Cordrey
Director
Financial Management and Assurance

Appendix I: Objectives, Scope, and Methodology

This engagement was initiated in connection with the statutory requirement for GAO to audit the U.S. government’s consolidated financial statements.¹ The focus of this engagement was the United States Navy’s (Navy) real property, specifically buildings,² because the Department of the Navy was the first military department to initially assert real property audit readiness for existence and completeness.³ Our objectives were to (1) determine the extent to which the Navy had internal control deficiencies, if any, that may impair its ability to assert that its buildings, as reported in its financial statements, exist and that the information about the buildings is complete and adequately supported by property records and (2) identify the challenges, if any, that the Navy faces in valuing its buildings in accordance with federal accounting standards.

To address our first objective, we interviewed Department of Defense (DOD) and Navy officials and reviewed relevant documentation, including the Naval Facilities Engineering Command’s (NAVFAC)⁴ Business Management System (BMS) process documents, which are similar to desktop procedures, to identify control activities over buildings.⁵ We reviewed the results from prior real property audit readiness testing conducted by a contractor that the Navy engaged to help it achieve audit

¹31 U.S.C. § 331(e)(2).

²The Navy’s buildings are a subset of the major asset class Buildings, Structures, and Facilities.

³The Department of the Navy consists of two services—the United States Navy and the United States Marine Corps. We excluded the United States Marine Corps from the scope of our audit because the Marine Corps was under a full financial statement audit for fiscal year 2017. In this report, we use “Navy” to refer to the United States Navy, except when Department of the Navy is used.

⁴NAVFAC is a global facilities engineering and acquisition command that manages the planning, design, construction, and sustainment of shore facilities for the Navy, Marine Corps, and other federal agencies.

⁵NAVFAC’s Asset Management business line began issuing BMS process documents in 2012 to further DOD’s FIAR effort.

readiness for its real property.⁶ We performed data analyses of buildings in the Navy's accountable real property system, the internet Navy Facility Assets Data Store (iNFADS) as of September 30, 2016. To assess the reliability of data we used, we reviewed relevant Navy documentation, interviewed knowledgeable officials, reviewed policies and procedures regarding collecting and maintaining the data, performed data analyses to look for logical inconsistencies, and traced a nongeneralizable sample of buildings to supporting documents. We concluded that the data elements we used from iNFADS were sufficiently reliable for the purposes of selecting a nongeneralizable sample of buildings to test.

We selected the Norfolk and San Diego geographic areas for site visits because of the numerous bases in each area and the proximity of 5 installations to one another in each of the areas. We analyzed data from the iNFADS database as of September 30, 2016, to select buildings that fit our selection criteria for our nongeneralizable sample of buildings for book-to-floor testing from these two geographic areas.⁷ These selection criteria included

- age of the buildings (both older and newer buildings);
- square footage of the buildings, including small buildings (such as sentry houses) and large buildings (such as training facilities and barracks);
- cost per square foot of the buildings, including lower cost (such as warehouses) and higher cost (sentry houses with sophisticated electronics);
- use of the buildings, to include a variety of uses (such as electrical substations, training facilities, and offices); and

⁶The Navy has two classes of real property: Class 1 (Land) and Class 2 (Buildings, Structures, and Utilities).

⁷Our book-to-floor tests, used to verify existence and reported characteristics of the buildings in iNFADS, consisted of comparisons between building selected from those recorded in iNFADS and physical buildings on an installation.

- operational status code of the buildings, including active and nonfunctional.⁸

We conducted site visits in Norfolk and San Diego to interview real property accountable officers (RPAO), observe buildings, and review the available supporting documents for the sample buildings. We tested 40 buildings book to floor by visiting these buildings at 10 Navy installations across two geographic areas. During our site visits, we also selected a nongeneralizable sample of a total of 39 buildings on Navy installations to be tested floor to book—19 from 5 Norfolk and 20 from 5 San Diego areas.⁹ We met with the RPAOs at each of the 10 installations and tested by observation whether the 40 buildings selected for book-to-floor testing existed. In addition to testing for existence, we compared the descriptions of the buildings in iNFADS with the buildings that we observed. For example, if the placed in service date in iNFADS was recent, we would observe whether it was a newer building. We selected a nongeneralizable sample of buildings for floor-to-book testing based on proximity to the buildings we had selected for book-to-floor testing. For the 39 buildings that we tested floor to book, we reviewed available supporting documents.

We also reviewed a Navy Office of Financial Operations white paper on the risk and potential amount of material misstatement of accumulated depreciation on the Navy's general fund consolidated balance sheet.¹⁰ This white paper presented the results of a statistical sample for which 15 selected real property assets were excluded from testing because the assets no longer existed. Two social science specialists with expertise in research design and statistics reviewed the methodology and sampling used in this study and found them to be sufficient for the purposes of estimating the proportion of Navy real property assets reported as

⁸Nonfunctional buildings, as defined by the Navy, are buildings that cannot be used or occupied for any reason until functional capacity is restored to a usable or habitable condition or until the building is demolished. While nonfunctional buildings should continue to be recorded in iNFADS to help the Navy maintain accountability of its assets, the nonfunctional buildings should be excluded from financial statement reporting as part of general property, plant, and equipment.

⁹Our floor-to-book tests, used to verify the completeness of recorded buildings in iNFADS, consisted of comparisons between physical buildings identified on an installation with the buildings' information recorded in iNFADS.

¹⁰Department of the Navy, Office of Financial Operations, *Real Property Accumulated Depreciation, Navy General Fund Real Property Facility Built Date (FBD) Validation and Analysis* (Washington, D.C.: June 30, 2017).

existing in iNFADS that did not exist as of May 31, 2017. We used the sampling information in the study to create a confidence interval around the estimate of the proportion of buildings at the 95 percent confidence level.

To address our second objective, we reviewed federal accounting standards, including Statement of Federal Financial Accounting Standard (SFFAS) No. 50, and the Navy's documents for recording assets into iNFADS.¹¹ We also interviewed agency officials responsible for financial reporting and real property management, including the RPAOs at the installations we visited, to identify the challenges the Navy faces in recording buildings at actual cost once the opening balances have been established according to SFFAS No. 50.

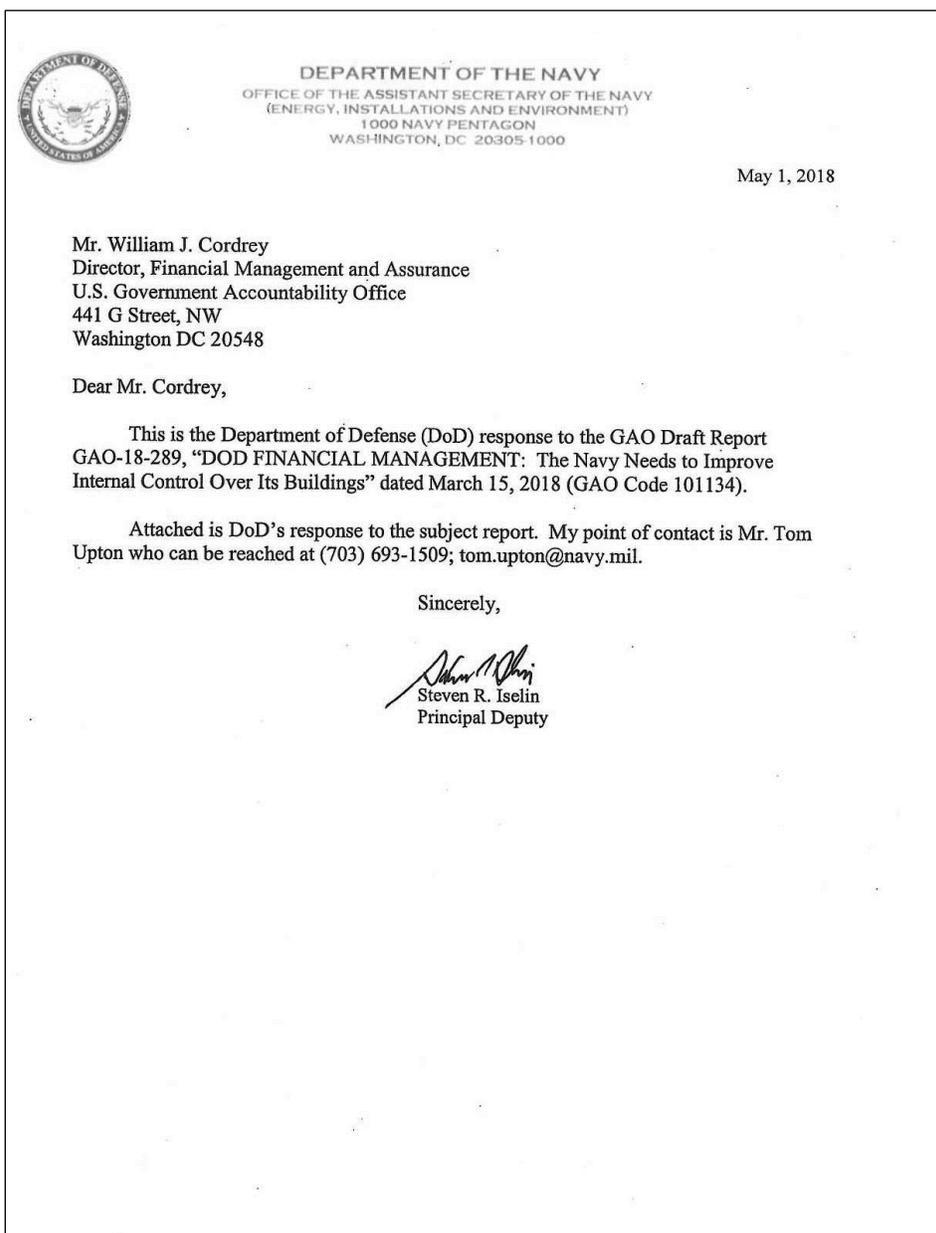
While our audit objectives focused on certain control activities related to (1) the existence and completeness of the Navy's buildings as reported in its financial statements and the completeness and adequacy of supporting property records for those buildings and (2) the valuation of the Navy's buildings in accordance with federal accounting standards, we did not evaluate all control activities and other components of internal control.¹² If we had done so, additional deficiencies may or may not have been identified that could impair the effectiveness of the control activities evaluated as part of this audit.

We conducted this performance audit from September 2016 to May 2018 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 objectives.

¹¹SFFAS No. 50 allows an entity to apply alternative valuation methods in establishing opening balances of G-PP&E in the first period in which the agency makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with generally accepted accounting principles.

¹²The four other components of internal control are (1) control environment, (2) risk assessment, (3) information and communication, and (4) monitoring. See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

Appendix II: Comments from the Department of the Navy



NAVFAC response to:
US Government Accountability Office (GAO) Draft Report GAO-18-289 of 15 Mar 2018 -
DOD FINANCIAL MANAGEMENT
THE NAVY NEEDS TO IMPROVE INTERNAL CONTROL OVER ITS BUILDING

The Naval Facilities Engineering Command's (NAVFAC) responses to the findings and recommendations of the GAO subject Draft Report are provided below.

The GAO recommends the Commander, NAVFAC:

Recommendation 1. The Commander of NAVFAC should develop and implement procedures and related control activities for real property disposed by demolition to provide reasonable assurance that the RPAOs timely receive a signed demolition approval documents and disposal form, so that demolished buildings are recorded as disposals in iNFADS and removed at the end of the fiscal year.

NAVFAC Response:

Concur. In FY 2013, NAVFAC updated and re-issued training process specific to NAVFAC executed demolition projects: Business Management System B-25.1.3.3 Real Property Disposal – Demolition. NAVFAC will review and update as required the internal controls and process governing NAVFAC executed demolition to ensure RPAOs are provided complete and timely disposal information.

Recommendation 2. The Commander of NAVFAC should finalize and implement written procedures and related control activities to reasonably assure that all building costing less than \$750,000 and funded with Non-MILCOM funding are recorded in the Navy's iNFADS and therefore included as assets in the financial statements if it meets or exceeds the Navy's capitalization threshold.

NAVFAC Response:

Concur.

Recommendation 3. The Commander of NAVFAC should develop and implement written procedures and related control activities to reasonably assure that buildings coded as nonfunctional in iNFADS are excluded for financial statement reporting purposes.

NAVFAC Response:

Concur.

Recommendation 4. The Commander of NAVFAC should develop and implement written procedures and related control activities related to DoD's capitalization thresholds and outlining the specific information to be accumulated from iNFADS to reasonably assure that real property assets are properly reported for financial statement reporting purposes.

NAVFAC Response:

Concur.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

William J. Cordrey, (404) 679-1873 or cordreyw@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made key contributions to this report: Paul Kinney (Assistant Director), Marcia Carlsen, Dennis Clarke, Francine DeVecchio, Maxine Hattery, Jason Kelly, Jared Minsk, Lisa Motley, Robert Sharpe, Sandra Silzer, and Shana Wallace.

Appendix IV: Accessible Data

Agency Comment Letter

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

Page 1

Dear Mr. Cordrey,

This is the Department of Defense (DoD) response to the GAO Draft Report

GAO-18-289, "DOD FINANCIAL MANAGEMENT: The Navy Needs to Improve Internal Control Over Its Buildings" dated March 15, 2018 (GAO Code 101134).

Attached is DoD's response to the subject report. My point of contact is Mr. Tom Upton who can be reached at (703) 693-1509; tom.upton@navy.mil.

Sincerely,

Steven R. Iselin
Principal Deputy

Page 2

NAVFAC response to:

**US Government Accountability Office (GAO) Draft Report GAO-18-289 of 15 Mar 2018 - DOD FINANCIAL MANAGEMENT
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The Commander of NAVFAC should develop and implement procedures and related control activities for real property disposed by demolition to provide reasonable assurance that the RPAOs timely receive a signed demolition approval documents and disposal form, so that demolished buildings are recorded as disposals in iNFADS and removed at the end of the fiscal year.

NAVFAC Response:

Concur. In FY 2013, NAVFAC updated and re-issued training process specific to NAVFAC executed demolition projects: Business Management System B-25.1.3.3 Real Property Disposal – Demolition. NAVFAC will review and update as required the internal controls and process governing NAVFAC executed demolition to ensure RPAOs are provided complete and timely disposal information.

Recommendation 2:

The Commander of NAVFAC should finalize and implement written procedures and related control activities to reasonably assure that all building costing less than

\$750,000 and funded with Non-MILCOM funding are recorded in the Navy's iNFADS and therefore included as assets in the financial statements if it meets or exceeds the Navy's capitalization threshold.

NAVFAC Response:

Concur.

Recommendation 3:

The Commander of NAVFAC should develop and implement written procedures and related control activities to reasonably assure that buildings coded as nonfunctional in iNFADS are excluded for financial statement reporting purposes.

NAVFAC Response:

Concur.

Recommendation 4:

The Commander of NAVFAC should develop and implement written procedures and related control activities related to DoD's capitalization thresholds and outlining the specific information to be accumulated from iNFADS to reasonably assure that real property assets are properly reported for financial statement reporting purposes.

NAVFAC Response:

Concur.

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