

# TI-97 Audit Challenges and Remediation Strategy



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# Agenda



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## Discussion Topics

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NDAAs Audit Readiness Requirement

Overview of Consolidated Audit Strategy

Critical Capabilities Required for Audit

Critical Capabilities and DoD-wide Material Weaknesses

Remediation Plan

Questions and Answers

# NDAA Audit Readiness Requirement



- **By September 30, 2017, in accordance with the National Defense Authorization Act for Fiscal Year 2002, the Department must certify that its financial statements for a fiscal year are reliable to commence full financial statement audits (audit ready).**
- **Audit readiness is defined as:**
  - *Having the capabilities in place to allow an auditor to scope and perform a full financial statement audit that results in actionable feedback. Assertion of audit readiness is based on overall progress against the critical capabilities defined by OUSD(C).*

# Overview of Consolidated Audit Strategy



## DoD-Wide Consolidated Audit Performed by DoD OIG

### Use the Work of Component Auditors

Group Auditor to assume responsibility for or make reference to audit opinions of each Component Auditor

#### Tier 1 (72% Budget, 82% Assets)

Army  
GF & WCF

Navy\*  
GF & WCF

Air Force  
GF & WCF

Other Tier 1  
Entities

23% Budget  
15% Assets

OMB  
Designated  
Audits

OMB  
Designated  
Audits

OMB  
Designated  
Audits

OMB  
Designated  
Audits

DoD  
Designated  
Audits

### Perform Independent Testing

Group Auditor to perform internal controls and substantive testing over activities & balances

#### Tiers 3 and 4

#### Eliminations

Tier 3  
4% Budget  
2% Assets

Tier 4  
1% Budget  
1% Assets

(e.g. WHS,  
DARPA, DTRA)

(e.g. DHRA, DSS,  
DFAS GF)

Mid-Sized  
Defense Agencies

Remaining  
Defense Agencies  
and Funds

Intra-Tier 1/Inter-Tier

Intra-Tier 2

Intra-Tier 3/4

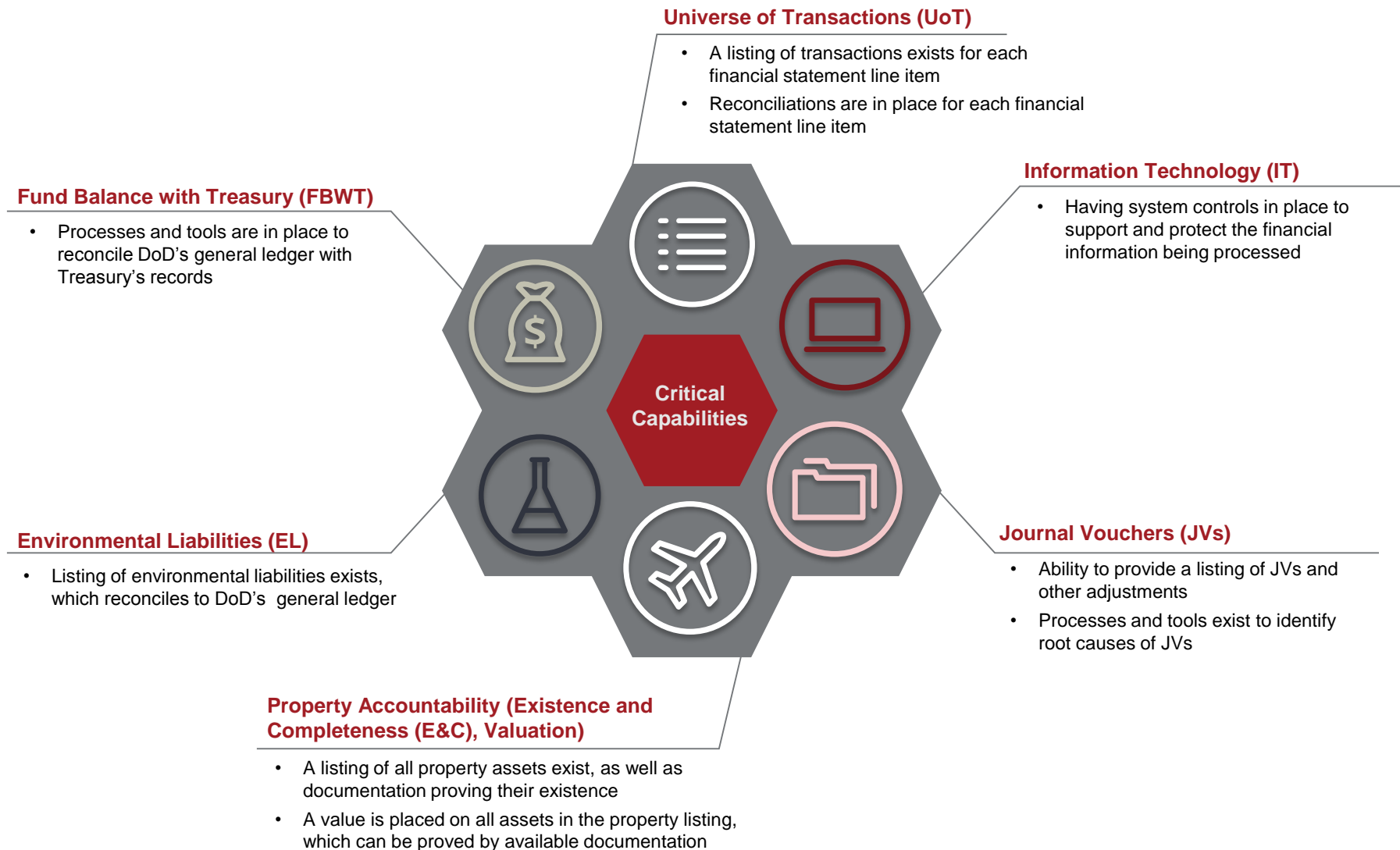
Consolidated  
Financial  
Statements

Tiers	Description	Consolidated Audit Coverage
<b>Tier 1: OMB Designated Audits</b>	<ul style="list-style-type: none"> <li>Mandated by OMB Bulletin No. 15-02 to prepare and issue audited financial statements annually</li> <li>Includes Military Departments (GF and WCF), USACE, and Military Retirement Trust Fund</li> </ul>	<b>Use the Work of Component Auditors</b> <ul style="list-style-type: none"> <li>Group Auditor may assume responsibility for the work of the Reporting Entity's Component Auditor, or make reference to the audit of the Component Auditor.</li> <li>Group Auditor may determine additional procedures need to be performed if the work of the Component Auditor is insufficient.</li> <li>Group Auditor will determine whether Reporting Entities have been completely and accurately consolidated into DoD agency-wide financial statements.</li> </ul>
<b>Tier 2: DoD Designated Audits</b>	<ul style="list-style-type: none"> <li>Directed by DoD to prepare and issue audited financial statements annually on a stand-alone basis</li> <li>Includes DLA (GF, WCF, and Strategic Materials), USSOCOM, DISA (GF and WCF), DHP, USTRANSCOM, IC Agencies, MERHCF (including Payments to MERHCF), MRF Payments, DeCA (GF and WCF), DFAS (WCF), DCAA, and DoD OIG</li> </ul>	
<b>Tier 3: Mid-Sized Defense Agencies</b>	<ul style="list-style-type: none"> <li>May be directed by DoD to undergo annual audit readiness examinations</li> <li>Includes WHS, MDA, DSCA, DoDEA, DARPA, CBDP, DTRA, DCMA, and JCS</li> </ul>	<b>Perform Independent Testing</b> <ul style="list-style-type: none"> <li>Group Auditor will perform analytical procedures at the group level.</li> <li>Group Auditor will perform sufficient audit procedures to conclude that the DoD agency-wide financial statements are fairly stated.</li> </ul>
<b>Tier 4: Remaining Defense Agencies and Funds</b>	<ul style="list-style-type: none"> <li>Identified as not material to DoD agency-wide financial statements either individually or collectively</li> <li>Includes all remaining Reporting Entities in the Fourth Estate not identified in the other Tiers</li> </ul>	

# Critical Capabilities Required for Audit



- OUSD(C) has identified the critical capabilities necessary to assert audit readiness:

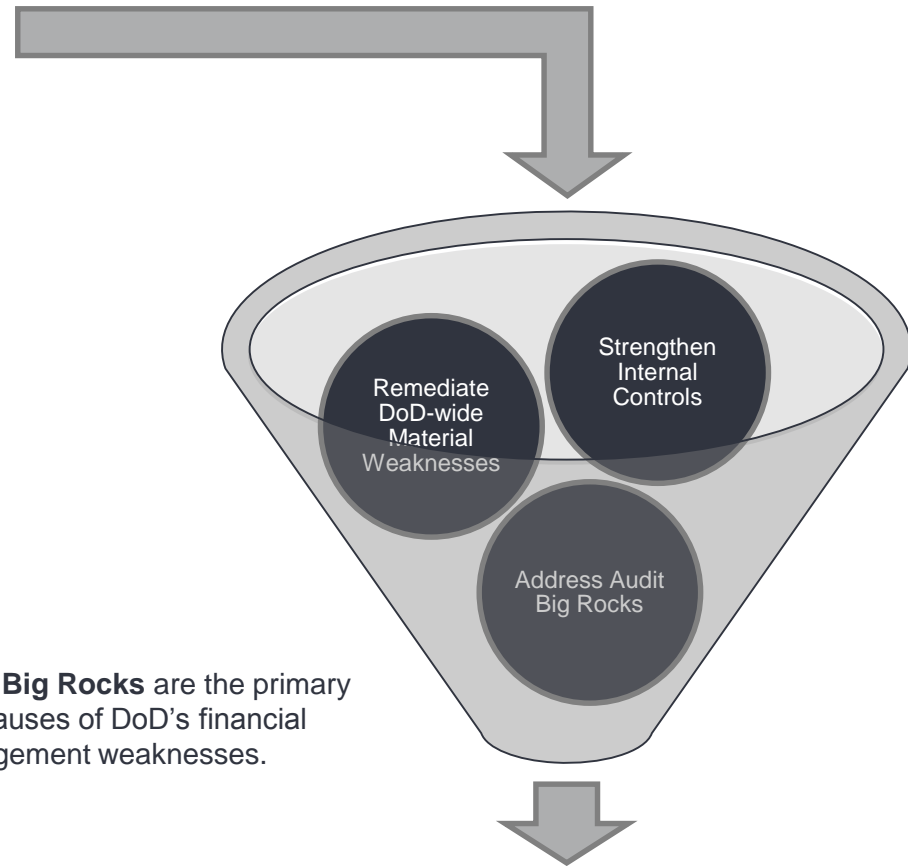


# Critical Capabilities and DoD-wide Material Weaknesses



FY 2016 Material Weaknesses	Critical Capabilities						
	UoT	FBWT	JVs	E&C	Valuation	EL	IT
Financial Management Systems							★
Fund Balance with Treasury	★	★					
Accounts Receivable							
Inventory	★			★	★		
Operating Materials and Supplies	★			★	★		
General Property, Plant, and Equipment	★			★	★		
Contractor Help Property, Plant, and Equipment				★	★		
Accounts Payable							
Environmental Liabilities						★	
Statement of Net Cost							
Intragovernmental Eliminations	★		★				
Accounting Entries	★		★				
Reconciliation of Net Cost to Budget			★				

# Remediation Plan



**Critical capabilities** are the minimum elements that must be in place to allow an auditor to scope and perform a full financial statement audit that results in actionable feedback.

**Audit Big Rocks** are the primary root causes of DoD's financial management weaknesses.

Solutions/Outcomes

USD(C) is utilizing a variety of solutions to remediate TI-97 audit challenges



# Challenges – Universe of Transactions



**Requirement:** Produce a universe of transactions/balances that supports beginning balances at a detailed level.

## Challenges:

- **Ineffective processes and controls** to prepare accurate financial statements supported by general ledger balances
- **Inadequate financial management systems** and related processes and procedures
- **Inconsistent documented processes** and procedures for performing reconciliations and resolving differences
- **Lack of developed approach** for performing and retaining reconciled data for sensitive activities

**Legacy systems and some feeder systems not designed with audit readiness in mind, resulting in lack of capabilities**

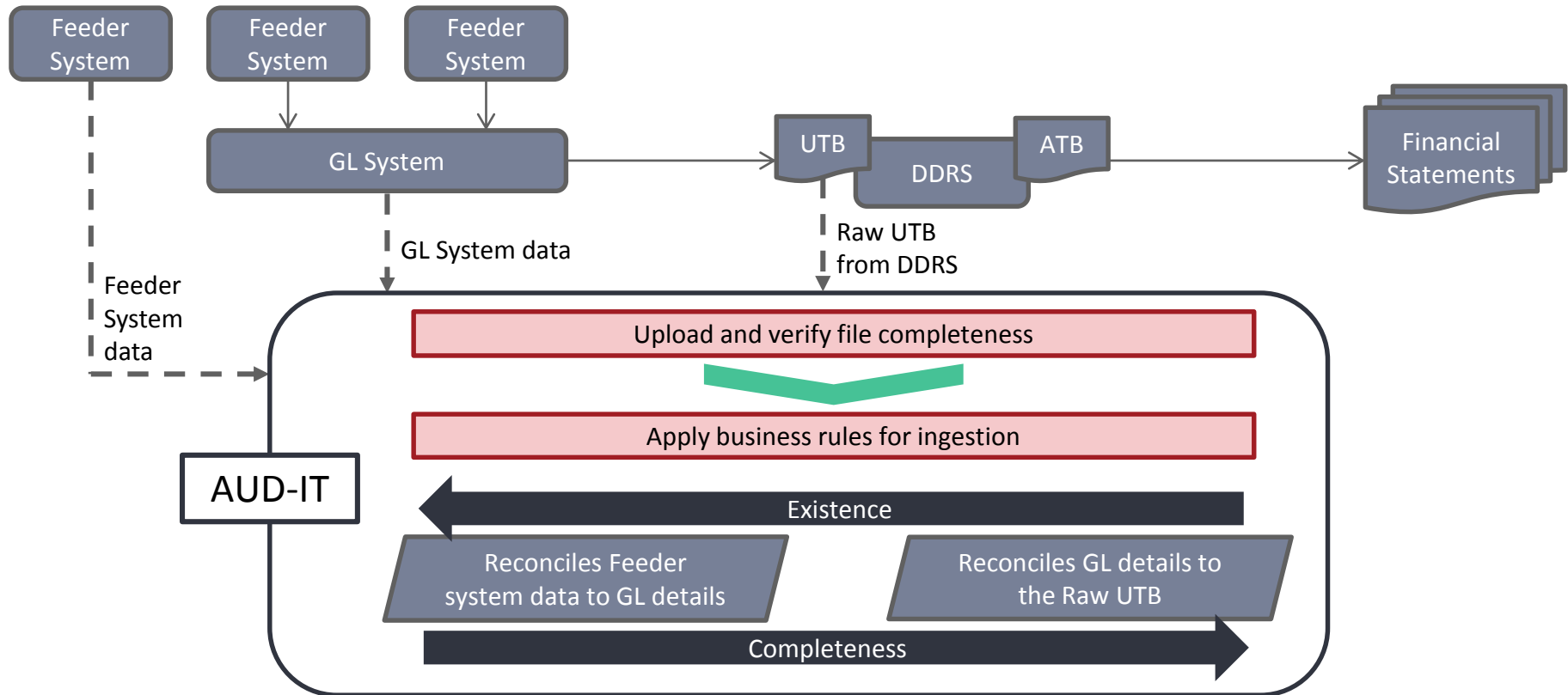




# Solutions and Outcomes – Universe of Transactions



**Solution:** OUSD(C) is developing a UoT solution for TI-97 reporting entities. The Auditable Universe of Data – Intelligence Tool (AUD-IT) will be capable of providing a complete UoT for all TI-97 general fund entities.



## Outcome:

- Reporting Entities will be able to provide a complete universe of transactions which can be reconciled to each general ledger account



# Challenges – Fund Balance With Treasury



**Requirement:** Ensure financial events recorded in Fund Balance with Treasury (FBWT) general ledger accounts are reconciled to the U.S. Treasury records.

## Challenges:

- **Lack of standardization**
- **Lack of fully-integrated reconciliation toolset** that efficiently enables timely resolution of variances
- **Complex processes** contribute to data integrity issues and manually-intensive reconciliation processes
- **Aged unmatched transactions** exist requiring research and resolution
- **Budget clearing accounts** are being used for multiple purposes and aged balances exist causing completeness concerns

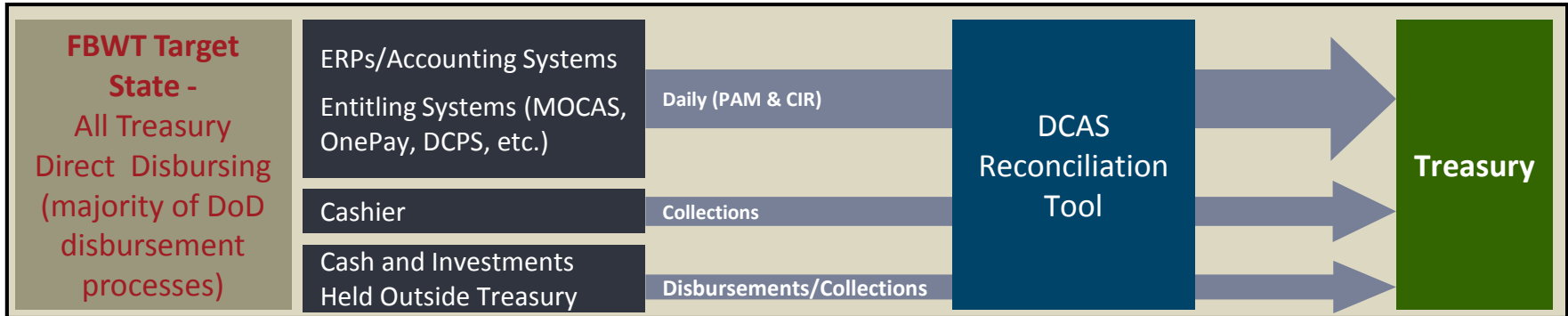


# Solutions and Outcomes – Fund Balance With Treasury



## Solutions:

- Implement FBWT Reconciliations to Get Ready and Support Audit- Strengthen controls and drive process and system changes that support required accounting reconciliations and reduce variances to insignificant levels
- Complete Treasury reconciliations to accounting source systems through implementation of Department 97 Reporting and Reconciliation Tool (DRRT) enhancements
- Resolve existing variances between accounting systems and Treasury to insignificant levels (less than 1%) including Cash Management Report variances, Treasury Statement of Differences, Budget clearing accounts (suspense accounts), etc.
- Implement FBWT improvements to Improve Financial Management and Sustain Audit – Modernize business processes and systems that improve data quality, streamline reporting, and eliminate redundant systems C



## Outcomes:

- Reduction of manually-intensive reconciliations
- Improved funds status data for decision-making
- Greater reliability and data traceability, which dramatically enhances audit readiness



# Challenges – Journal Vouchers



**Requirement:** Journal vouchers and other adjustments must be adequately supported.

## Challenges:

- **Large unsupported top-end adjustments** are made to record accounting events not recorded in source systems and to balance reports
- **Inability to reconcile** detail-level transactions with the general ledgers
- **Insufficient documentation** to support all adjustments
- **Initial coordination** and approval of Journal Vouchers



# Solutions and Outcomes – Journal Vouchers



## Solutions:

- **Eliminate Journal Vouchers** to the maximum support possible:
  - Implement Systemic initiatives and changes that eliminate Journal Vouchers
  - Continued partnership with Components and Agencies to record adjustments in source systems
- **Support unsupported adjustments:**
  - Complete Journal Voucher catalog and checklist ✓
  - Develop MOUs with Stakeholders ✓
  - Implement ongoing Training/Peer reviews ✓
  - Identify and implement standard enterprise reconciliations that provide support for buyer/seller balances and timing differences
  - Include sufficient detailed documentation to fully support Journal Vouchers

## Outcomes:

- **Improved controls and reliability** of financial reports
- **Reduction of resources** currently required to support top-end adjustments



# Challenges – Existence and Completeness of Property



**Requirement:** Ensure that all accountable assets recorded in their Accountable Property System of Record (APSR) or equivalent exist (Existence); are recorded in their APSRs, general ledgers, and financial statements (Completeness); and reporting entities have the rights to report these assets (Rights).

## Challenges:

- **Ineffective processes and controls** to account for the quantity of military and general equipment
- **Business process updates** are required to account for Government Furnished Property
- **Data validation for assets being loaded into DPAS** could affect the ability to complete the existence and completeness assertion activities
- **Supporting documentation and controls** may not be put into place in time to support all audit readiness activities



# Solutions and Outcomes – Existence and Completeness of Property



## Solutions

- **Validate accountable property records and supporting documentation** through existence and completeness testing
- **Establish and implement procedures** and training on property management policies
- **Establish accountable records** that will identify property, to include Government Furnished Property
- **Transition the balance of the inventories** to the moving average cost method through the use of new inventory systems

## Outcomes

- **Existence:** All the assets the reporting entity lists in its APSR or equivalent exist
- **Completeness:** The reporting entity reports all of its assets



# Challenges – Property Valuation



**Requirement:** Ensure the amounts reported for assets in each reporting entities' financial statements are accurate and supportable.

## Challenges:

- **Inability to distinguish cost accumulation** among all asset classes, and between capital and expense portions
- **Ineffective processes and controls** to account for the value of military and general equipment
- **Insufficient policies and procedures** to support inventory transactions and valuation
- **Lack of clear audit trails** to trace transactions from source documentation to the reported total dollar values on the financial statements
- **Historical cost data is not maintained** as required by Generally Accepted Accounting Principles (GAAP)





# Solutions – Property Valuation



## Solutions

- **Implement an alternate valuation methodology** using Plant Replacement Value in the APSR (iNFADS)
- **Implement methodology** to value inventory in the absence of historical costs (for baseline of asset inventory)
- **Modify systems** to account for material in transit at the detailed level
- **Modify systems/processes** to account for Government Furnished Material (GFM)

## Outcome

- Assets, liabilities, and net position are included in the financial statements at appropriate amounts, and any resulting **valuation or allocation adjustments are properly recorded**



# Challenges – Environmental Liabilities



**Requirement:** Provide a listing of Environmental Liabilities (EL) reconciled to the financial statements, and begin implementing a plan to establish auditable processes to support clean-up costs for EL.

## Challenges:

- **Lack of existing implementation guidance** for general equipment environmental liabilities
- **Inability to provide assurance** that clean-up costs for all of its ongoing, closed, and disposal operations are identified, consistently estimated, and appropriately reported
- **Unable to consistently report EL disclosures** and supporting documentation is not properly maintained
- **Unable to fully capture the cost** of environmental liabilities associated with equipment



# Solutions and Outcomes – Environmental Liabilities



## Solutions

- **Implement systems, processes, and controls** to ensure the accuracy of environmental liabilities identification, valuation, documentation and reporting
- **Develop new DoD strategy** for achieving EL Audit Readiness, providing guidance on capturing the environmental liability universe, estimation and modeling practices for developing the cost estimates
- **Develop new DoD policies** for accounting treatment and recording of environmental liabilities
- **Implement business processes** and controls to ensure transactions are recorded timely and accurately, and supporting documentation is retained and available

## Outcome

- Reporting Entities will be able to provide a listing of EL reconciled to the financial statements, establish an auditable process for estimating and recording EL, and **demonstrate the completeness of reported EL**



# Challenges – Information Technology



**Requirement:** Implement critical information technology general and application controls for material, financially relevant systems.

## Challenges:

- **Tremendous financial management system complexity** – 382 FM systems currently
- **Lack of accountability** for systems implementation, review, and oversight
- **Lack of system security safe guards** integrated into the design, lack of user training, and policies are not consistently validated and updated
- **Lack of Records Management procedures** included during the systems development process

## Monthly Testing Themes:

- Reporting Entities could not provide system access request forms
- Finding related to: access controls, interface controls, and configuration management



# Solutions and Outcomes – Information Technology



## Solutions

- **Consolidate audit relevant applications** into fewer data centers
- **Increase standardization** of business processes
- **Reduce the number** of redundant legacy systems
- **Leverage the capabilities** of ERP solutions

## Outcomes

- Increased reliance on IT systems and controls, will **reduce the substantive testing** required during an audit
  - **Reduces** workload
  - **Saves** time and resources

# Conclusion



- **DoD is required by law to assert audit readiness by September 30, 2017**
- **OUSD(C) developed the critical capabilities as the minimum requirements to begin an audit**
- **In addition to audit readiness assertion, achieving and sustaining critical capabilities will contribute to the remediation of DoD-wide material weaknesses**
- **Achieving and maintaining TI-97 audit readiness is a responsibility shared by OUSD(C), DFAS, and the Defense Agencies**

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## **Questions and Answers**