TI-97 Audit Challenges and Remediation Strategy

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Agenda

Discussion Topics

NDAA 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
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: OMB Designated Audits
- (72% Budget, 82% Assets)
- Army GF & WCF
- Navy * GF & WCF (*includes USMC)
- Air Force GF & WCF
- Other Tier 1 Entities (e.g. USACE, Military Ret. Trust Fund)

### Tier 2: DoD Designated Audits
- 23% Budget
- 15% Assets
- (e.g. DLA, SOCOM, DISA)

### Tier 3: Mid-Sized Defense Agencies
- Tier 3
  - 4% Budget
  - 2% Assets
  - (e.g. WHS, DARPA, DTRA)

### Tier 4: Remaining Defense Agencies and Funds
- Tier 4
  - 1% Budget
  - 1% Assets
  - (e.g. DHRA, DSS, DFAS GF)

### Elaborations
- **Consolidated Financial Statements**

## Tier 1: OMB Designated Audits
- Mandated by OMB Bulletin No. 15-02 to prepare and issue audited financial statements annually
- Includes Military Departments (GF and WCF), USACE, and Military Retirement Trust Fund

## Tier 2: DoD Designated Audits
- Directed by DoD to prepare and issue audited financial statements annually on a stand-alone basis
- Includes DLA (GF, WCF, and Strategic Materials), USASOCOM, 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

## Tier 3: Mid-Sized Defense Agencies
- May be directed by DoD to undergo annual audit readiness examinations
- Includes WHS, MDA, DSCA, DoDEA, DARPA, CBDP, DTRA, DCMA, and JCS

## Tier 4: Remaining Defense Agencies and Funds
- Identified as not material to DoD agency-wide financial statements either individually or collectively
- Includes all remaining Reporting Entities in the Fourth Estate not identified in the other Tiers

## Use the Work of Component Auditors
- 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.
- Group Auditor may determine additional procedures needed to be performed if the work of the Component Auditor is insufficient.
- Group Auditor will determine whether Reporting Entities have been completely and accurately consolidated into DoD agency-wide financial statements.

## Perform Independent Testing
- Group Auditor will perform analytical procedures at the group level.
- Group Auditor will perform sufficient audit procedures to conclude that the DoD agency-wide financial statements are fairly stated.
Critical Capabilities Required for Audit

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

  **Universe of Transactions (UoT)**
  - A listing of transactions exists for each financial statement line item
  - Reconciliations are in place for each financial statement line item

  **Fund Balance with Treasury (FBWT)**
  - Processes and tools are in place to reconcile DoD’s general ledger with Treasury’s records

  **Environmental Liabilities (EL)**
  - Listing of environmental liabilities exists, which reconciles to DoD’s general ledger

  **Property Accountability (Existence and Completeness (E&C), Valuation)**
  - A listing of all property assets exist, as well as documentation proving their existence
  - A value is placed on all assets in the property listing, which can be proved by available documentation

  **Information Technology (IT)**
  - Having system controls in place to support and protect the financial information being processed

  **Journal Vouchers (JVs)**
  - Ability to provide a listing of JVs and other adjustments
  - Processes and tools exist to identify root causes of JVs
## Critical Capabilities and DoD-wide Material Weaknesses

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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.

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

- **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