



Department of Navy Audit Update

**Northern Virginia Chapter
Association of Government Accountants
April 28, 2017**

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Agenda

What We've Done

- Journey to Date: Key Milestones
- Financial Operating Environment

SBA Audit Results and Remediation

- SBA FY2015 and 2016 Results
- Remediation Efforts

Full Financial Statement Approach

- Audit Roadmap
- Annual Audit Objectives and Beginning Balance Strategy
- Key Challenges

Sustainment

- True North
- Maturation of Control Environment
- Key Takeaways



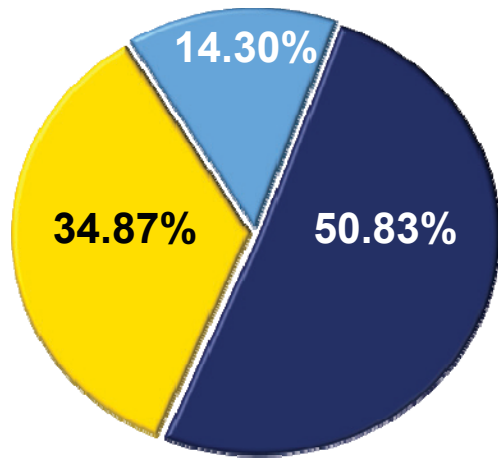
What We've Done

Journey To Date: Key Milestones

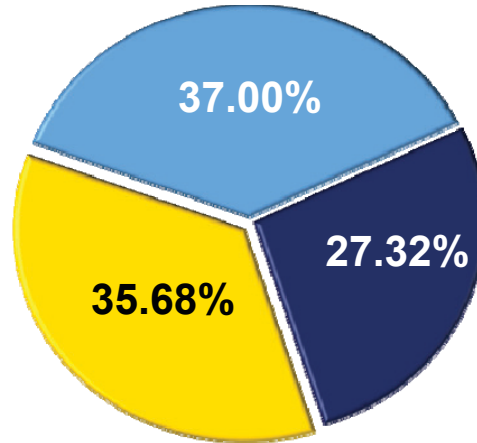
- 2008: USMC Asserted Audit Readiness on SBR
- 2009: DoD FIAR Guidance Issued
- 2010-2012: Positive Examinations of Selected Navy Business Segments
- 2012: Focus on SBA; Established Audit Response Center
- 2013: Prioritized IT Systems and Data Management
- 2014: USMC Received Disclaimer of Opinion
- 2015: Conducted First Navy SBA Audit
- 2015: Established Enterprise Remediation Capability to Address NFR Root Causes
- 2016: Established Internal Controls Governance Structure
- 2017: Initiated first USMC Full Financial Statement Audit



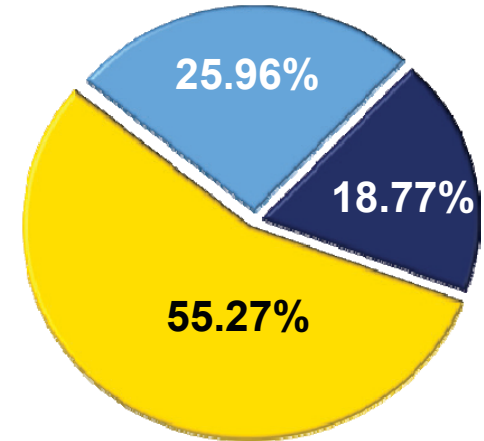
FY2016 Financial Statistics



Discretionary Budget



General Property, Plant, and Equipment, Net



Inventory and Related Property


Navy


Non-DoD


Rest of DoD



Financial Operating Environment

- Decentralized environment creates complexity within its financial and functional business processes
- Financial transactions generated around the globe and at the deck-plate level
- Multitude of legacy IT systems that do not meet audit standards

Complexity of Navy Financial Reporting Environment
19 Budget Submitting Offices
Over 500,000 Civilian and Military Personnel
72 Treasury Accounts
10 Shared with USMC
8 General Ledgers (GL) Systems
~100 Direct GL Feeder Systems

A financial statement audit has never been conducted on an organization as large and complex as Navy



SBA Audit Results and Remediation

SBA FY 2015 and 2016 Results

External Audit Results – Disclaimer of Opinion

- The IPA identified 3 material weaknesses related to controls over **IT, Business Processes** and **Financial Reporting**.
- The IPA also noted noncompliance with the Federal Financial Management Improvement Act (FFMIA)

Audit Findings (NFRs)

IT NFR Type	# of NFRs	Financial NFR Type	# of NFRs
Audit Logging / Monitoring	36	Financial Compilation and Reporting	13
Access Control / Access Management	40	Funds Balance with Treasury	5
Risk Management	28	Procurement (CVP, RWO, MILSTRIP)	10
Segregation of Duty	30	Document Retention	9
Change Management	16	Management Oversight	10
Other Control Failures (e.g., Interfaces, Configuration Management, Sensitive Transactions, Contingency Planning)	52	Other Control Failures (e.g., Budget Control, Tri-Annual Review, Authorization)	8
Total	202	Total	55

Statement of Assurance Results – Qualified

In FY 2016, DON reported a “qualified” Statement of Assurance and reported the following material weaknesses:

7 ICONO	23 ICOFR	9 ICOFS
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Navy Efforts to Remediate Finding and Reduce Audit Risk

Evaluation, Prioritization, and Remediation (EPR) Program

- Assess and prioritize deficiencies (NFRs) noted by the Auditor
- Coordinate designation of SES/Flag Level Offices of Primary Responsibility (OPRs) to resolve NFRs
- Support OPRs with CAP development and validate CAP implementation and operating effectiveness

Business Process Improvement (BPI)

- Transforming the Navy's underlying business processes provides data integrity and supports fact-based decision making surrounding resource management
- Established modernized, standard business processes across the Navy

System Rationalization and IT Controls

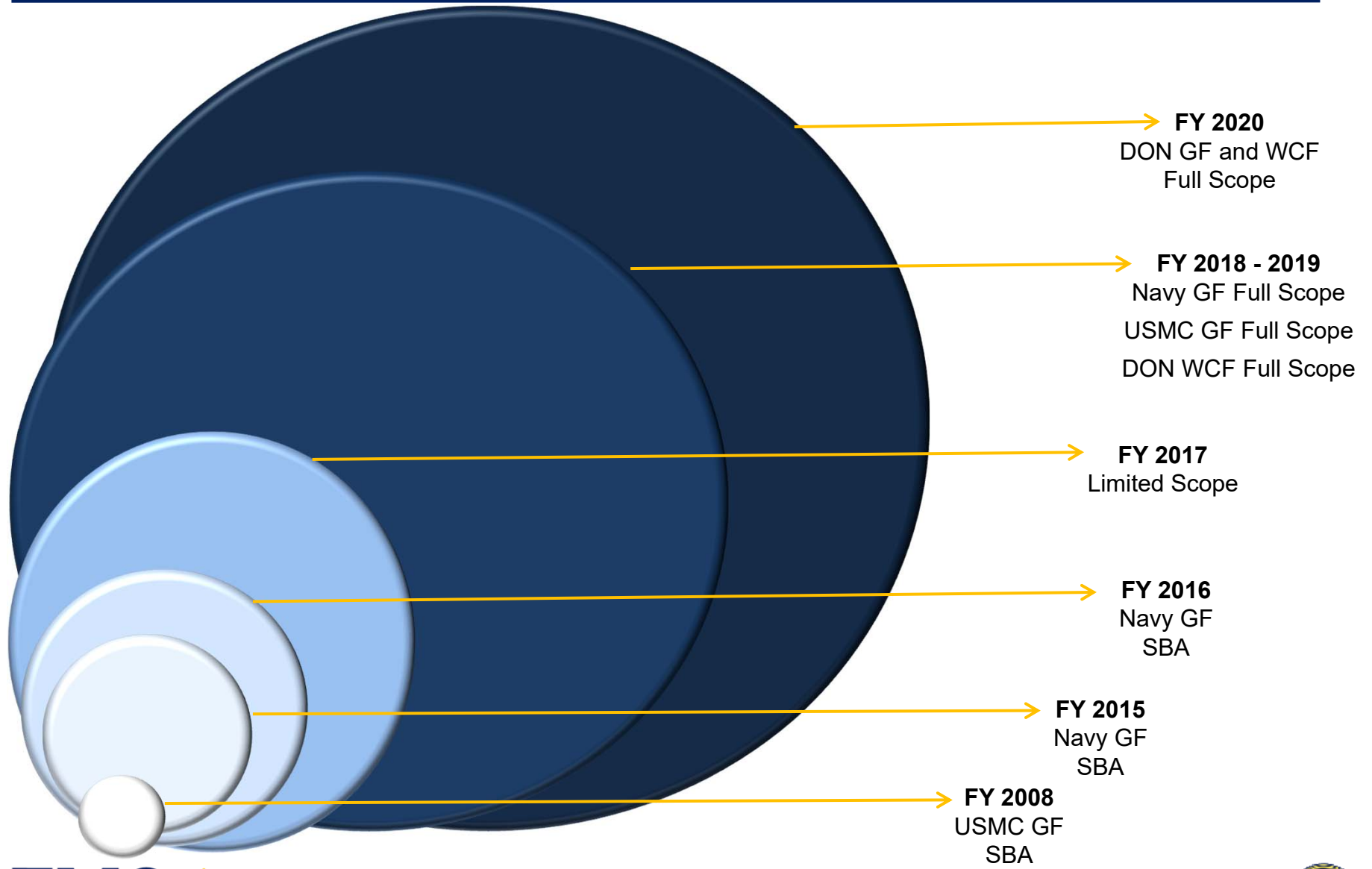
- Created Audit-Ready Systems Compliance Profile to bring the Navy into compliance with financial audit and cyber standards
 - Financial Management Overlay – Leverages DoD's Risk Management Framework (RMF) for information security, enabling system owners to achieve audit readiness and cyber security objectives at the same time
- Enterprise wide effort to rationalize key financial systems and transition towards a target IT environment

Outcomes
BPI – Streamlined Over ~2,000 Unique Business Processes to Establish 39 Standard Processes
EPR – OPRs remediated 77 NFRs across IT systems and business processes from FY2015 SBA Audit
IT Controls – Reduced The Number Of IT Systems By 39%



Full Financial Statement Approach

Audit Roadmap



Annual Audit Objectives and Beginning Balance Strategy

To achieve the Audit Roadmap milestones, the Navy has adopted a two part strategy

1. Implementing a Balance Sheet and SBA/SBR “build” approach:

Conducted in-depth line item substantive Impartial Verification and Validation (IV&V) (i.e. Mock Audits) to identify and correct gaps in beginning balances



— Accumulating evidential matter necessary to support beginning balances



Collaborating closely with BSOs and other stakeholders to validate Navy’s significant financial accounting policies and modify as necessary in order to comply with Generally Accepted Accounting Principals (GAAP), for both historic and prospective reporting



2. Continuing with the Navy’s strategy to support future audits beyond the Balance Sheet and SBA/SBR by focusing on:

- FIAR activities (focused on improving processes, controls, and systems)
- Reliable / repeatable processes to accumulate and report balances
- IT systems reconciliations (link with Transaction Universe)
- Effective internal controls to support efficient audits



Financial Statements - Balance Sheet and SBR Beginning Balances

Impartial Verification and Validation (IV&V) activities to assess Navy's ability to:

- Produce (build) an auditable Balance Sheet as of September 30, 2017;
- Respond to expected auditor requests to perform substantive audit procedures; and
- Provide accurate and complete evidential matter timely

Receive feedback from experienced auditors to help identify and prioritize critical gaps in Navy's readiness

Leverage audit expertise to design most effective corrective actions to complete readiness with time-frame (6 – 12 months)

Ensure that all major readiness activities are:

- Comprehensive, coordinated, and cross-supportive (e.g., TU, IT system reconciliations, JV analysis, look-back analysis, BSO support)
- Focused on priorities necessary to support balance sheet audit



Key Challenges

- Universe of Transactions – Reconciling financial transactions that comprise the financial statements
 - GL Detail to the Financial Statements
 - Feeder Systems to the GL
- Journal Vouchers – Reduction and improving supportability
 - Automated “On Top” entries in Defense Departmental Reporting System
 - Root cause analysis to reduce field-level JVs and require approval thresholds for BSO Commanders
- FBWT Reconciliation – Timely aggregation of disparate financial data
 - Significant number of IT systems
 - Many different types of APPNs
 - DoD business practices / Transactions for Others
- Asset Accountability and Valuation – Developing GAAP compliant valuation strategies and ensuring accountability for all major operational assets on the Balance Sheet
- Undelivered Orders/Unfilled Customer Orders – Historical clean up and proactive management going forward

Short-term manual efforts may mitigate the related audit risks, but IT system changes are required to transform business processes in order to enable sustainment



Sustainment

True North

Ongoing audits of Consolidated Full Financial Statement for Department of Navy

- Congressional auditability mandates are fast approaching and achieving full financial statement auditability by the end of FY2017 is a top priority for the Department.

Financial system modernization to produce accurate and transparent data

- Making continuous process/system improvement an essential priority at every level

Command audit capabilities that cover both the uniform and civilian

- "Tone from the top" messaging from Navy leaders is essential and must be forceful and consistent. Strategy, tasks, and timelines need to be communicated and understood at all levels, at all major commands.
- Emphasizing that an improved business culture includes participation from every functional level.

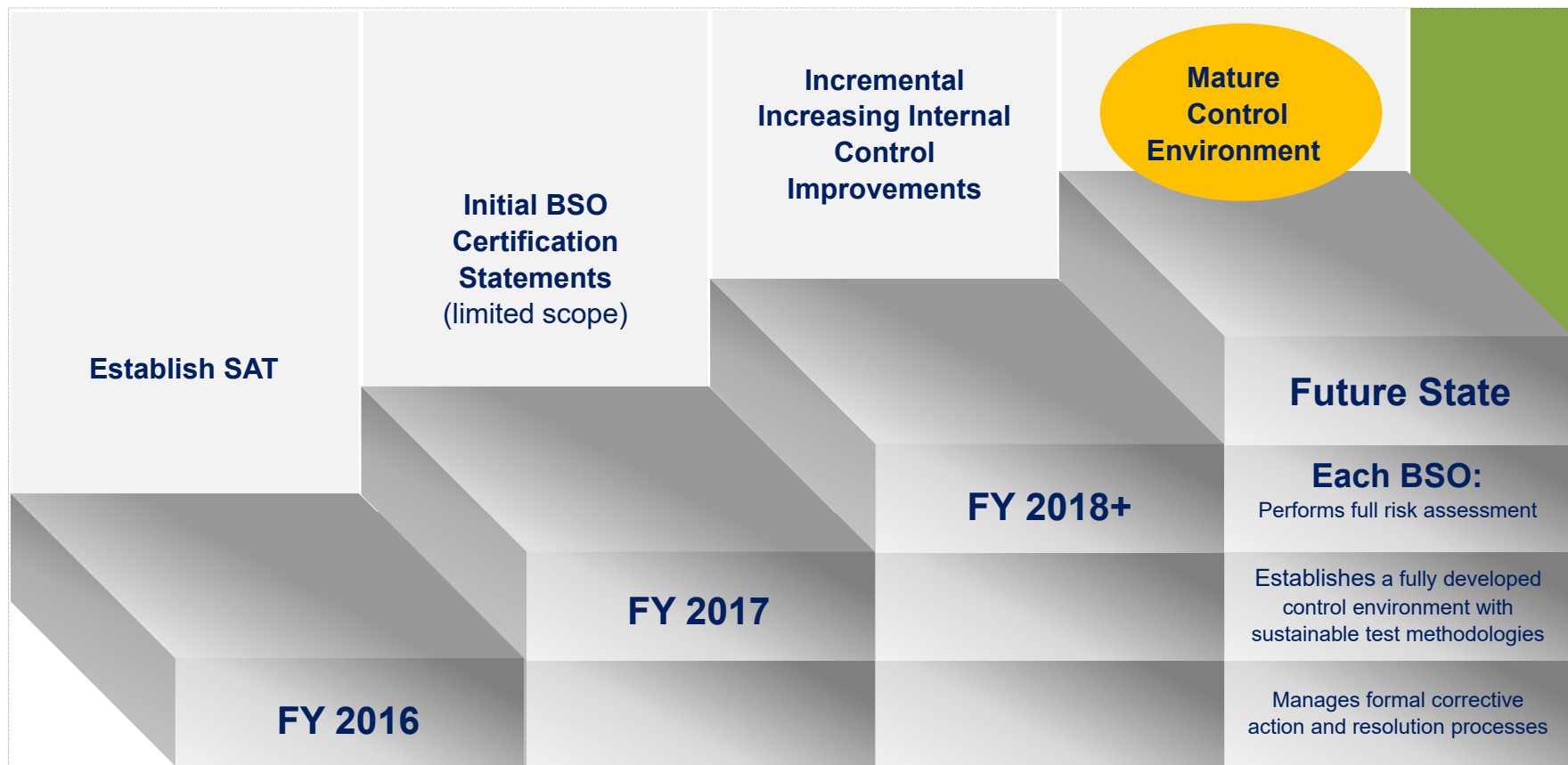
Mature MICP for effective and sustained internal control environment

- Command testing programs are a valuable tool for Commanders to understand the state of their internal control environment
- As the Navy matures its MICP across the enterprise, it will not only reduce financial, operational, and system risk, but will become the sustainment engine to maintain a state of audibility into the future.



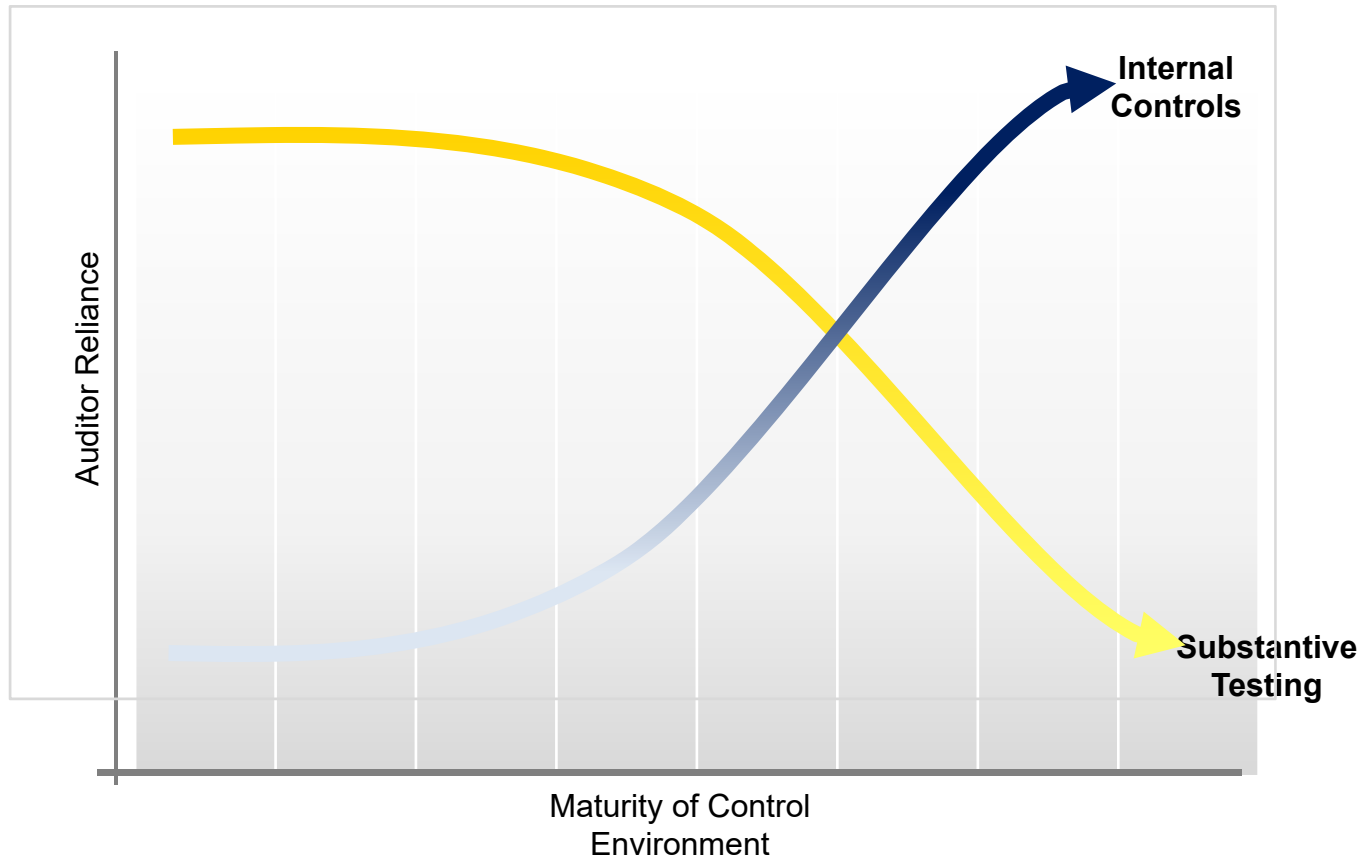
Maturation of Control Environment

- Goal: achieve a mature control environment through various audit readiness initiatives
- The path is built upon the work of multiple stakeholders each fiscal year



Shifting Focus

A robust internal control program is the key to sustainability and success in an audit environment



The Navy responded to over 8,000 PBC requests during the FY15 and FY16 SB audits and produced nearly 100% of the requested supporting documentation. This LOE cannot be sustained as audit scope increases.



Manager Internal Controls Program Governance

Manager Internal Controls Program (MICP)

- Centralized Internal Control Governance at the enterprise level, by the establishing the Senior Assessment Team (SAT) and Senior Management Council (SMC)
- Assign Senior Accountable Officials (SAO) at the Flag or SES level to drive remediation efforts
- Provide oversight to commands on conducting risk assessments, identifying key controls, and developing test plans to assess the effectiveness of correcting activities

Command Internal Control Testing Program

- Commanders to understand the state of their Internal Control Environment
- Testing results to identify effectively operating controls or improved risk mitigation needed
- Decisive action to address gaps before they become widespread, redirect and/or rebalance resources
- Share lessons learned across the Commands

Mature and Sustain Internal Control Environment

- Reduced financial, operational and system risk
- Become the sustainment engine to maintain a state of audibility into the future
- Commands assumption of greater responsibility for risk assessment, internal control testing, and self-reporting results in order to address any control gaps



Key Takeaways

Enterprise Level:

- Transforming and standardizing business processes, internal controls, & documentation.

Organizational Level:

- Adopting/enforcing/testing standardized business processes and effective internal controls
- Driving accountability: Personnel at all levels must understand responsibilities & be held accountable routinely for transaction excellence, internal controls and documentation.

Cultural Change:

- Tone at the top: Organizational commitment and understanding of the benefits of audit
- Driving accountability: Linking audit compliance to performance goals... Military and Civilian across all functional areas
- SAO/OPR at the Flag or SES Level to own and drive remediation of key audit issues
- BSO Comptrollers: Feedback on key audit metrics provided to Commanders; aligned with performance cycle

