

**Office of the Under Secretary of Defense (Comptroller)
Minimizing Resources Used to Prepare and Audit Unreliable Financial Statements**

	FY 2007		FY 2008		FY 2009	
	<u>FTE</u>	<u>(\$000)</u>	<u>FTE</u>	<u>(\$000)</u>	<u>FTE</u>	<u>(\$000)</u>
Preparation:						
Costs						
Redirected Amounts						
Audit - DoD Components:						
Costs						
Redirected Amounts						
Audit – DoD Inspector General:						
Costs						
Redirected Amounts						
Total Costs						
Total Redirected Amounts						

Introduction. Sections 1008 (b) and (d) of the National Defense Authorization Act for Fiscal Year (FY) 2002 direct the Under Secretary of Defense (Comptroller) to submit an estimate of the resources that the Department of Defense is saving or expects to save as a result of actions taken and to be taken to minimize, consistent with the benefits to be derived, the resources that are used to develop, compile, and report on the financial statements. On each financial statement that is assessed as unreliable, the Inspector General of the Department of Defense is to perform only the minimum audit procedures required by generally accepted government auditing standards consistent with any representation made by management. Section 1008 further requires the Under Secretary of Defense (Comptroller) and the Inspector General of the Department of Defense to (1) redirect resources saved as a result of implementing the provisions of Section 1008 to the oversight and improvement of financial management policies, procedures, and internal controls, as well as underlying systems, within the Department of Defense, and (2) submit to Congress an estimate of those funds which have been redirected from audit efforts and a discussion of how the resources were redirected.

Preparation of Financial Statements. The Department of Defense submits financial statements for 10 separate reporting entities to the Office of Management and Budget (OMB). They are General Funds and Working Capital Funds for Army, Navy, and Air Force; United States Army Corps of Engineers Civil Works; Military Retirement Fund; Medicare-Eligible Retiree Health Care Fund; and Department of Defense Agency-wide. In addition, as required by the Department of Defense, 14 defense agencies prepare stand-alone financial statements and submit those statements to the Under Secretary of Defense (Comptroller).

To prepare the Department of Defense Agency-wide financial statements, all financial information needed for preparation of the individual Component statements must be compiled. As a result, the Department cannot further reduce the costs associated with preparation of the financial statements until automated systems and data collection procedures are implemented.

Audit of Financial Statements. The DoD Office of the Inspector General auditors performed limited audit procedures on FY 2006 financial statements to issue disclaimers of opinions for 7 of the 10 DoD entities that submit financial statements to OMB. For the 3 remaining entities (Military Retirement Fund, Medicare-Eligible Retiree Health Care Fund and U.S. Army Corps of Engineers, Civil Works Program), the Department contracts with certified public accounting firms to conduct the audits; 2 entities received favorable opinions on their FY 2006 financial statements while the U.S. Army Corps of Engineers FY 2006 financial statements are still under audit. The Department also established an internal reporting requirement that requires an additional 14 entities to produce stand-alone financial statements. Of these 14 defense entities, 5 entities are audited by certified public accounting firms and have received unqualified audit opinions on their FY 2006 financial statements. In addition, although not required by the Department, a certified public accounting firm audited and issued an unqualified opinion on the DoD Office of Inspector General FY 2006 financial statements.

Redirected Amounts. Both the Under Secretary of Defense (Comptroller) and the Inspector General have embraced the concept of minimizing the expenditure of resources to perform audits of financial statements determined to be unreliable. Therefore, in its pursuit of improved financial management and an unqualified audit opinion of the Department-wide financial statements, the Under Secretary of Defense (Comptroller), in concert with the Inspector General, have adopted an incremental approach.

In support of Section 1008, Department of Defense Components have prepared financial improvement plans. As a result of this requirement, these activities are not only redirecting contracted audit costs, but they are also enlisting the efforts of service audit agencies and internal review offices to perform internal validations. As fund holders resolve identified deficiencies and assert that specific accounts are reliable, the Inspector General's office will assess the assertion and schedule an audit of the accounts.

The DoD Component redirected costs are a result of modified contracts with external CPA firms to identify and validate solutions in financial reporting. As this process evolves, financial data should become more reliable and auditable.

Amounts Redirected by DoD Components. The provisions of Section 1008 do not apply to the Military Retirement Fund and the Defense Agencies which have received unqualified audit opinions on their financial statements. For the other statements in FY 2006, the DoD Components redirected \$1.3 million of projected audit resources toward identifying and rectifying systems, processes, and internal control deficiencies. They estimate redirecting \$1 million in FY 2007.

Amounts Redirected by the Inspector General, Department of Defense The Inspector General, DoD, redirected \$14.6 million (154 workyears) in FY 2006 from financial statement audits to systems audits and audits of internal controls, and other audits requested by OSD (Acquisition, Technology and Logistics), and Congress (i.e. Military Interdepartmental Purchase Requests, and Hurricane Katrina related audits) until financial statements are ready to audit. In FY 2007, the DoD Office of Inspector General anticipates redirecting \$14.9 million (154 workyears) to perform internal control and other audits until financial statements are ready to audit.