UNITED STATES DEPARTMENT OF DEFENSE

# Financial Improvement and Audit Readiness (FIAR) Guidance

December 2011

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER) / CFO

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***Note: The blue bolded text throughout this document indicates key requirements.***

## SIGNIFICANT CHANGES

The FIAR Guidance has been restructured so that the FIAR Priorities, Strategy and Methodology are discussed in the core document. Material reporting entities, key departmental stakeholders/boards/committees, wave-specific risks/key control objectives (KCOs)/key supporting documents (KSDs), and details on control and supporting documentation testing have been moved to appendices. The red text[1] in the Methodology graphic and wave-specific risks/KCOs/KSD tables highlight changes and updates from the May 2010 FIAR Guidance[2]. In addition, the following significant changes that have been made to this version of the FIAR Guidance from the May 2010 version are:

| SIGNIFICANT CHANGE | REFERENCE |
|---|---|
| 1. This Guidance fully merges the FIAR Methodology internal controls over financial reporting (ICOFR) methodology. | Section 2.F and throughout |
| 2. A section on the FIAR Business Case analysis, including the Impact of the analysis on the FIAR audit readiness strategy and related guidance has been added. | Section 2.E. |
| 3. Wave 5 was eliminated based on the FIAR Business Case, which concluded that it was not cost effective to value existing assets. | Section 2.E and throughout |
| 4. Tools and templates have been removed from the core Guidance, and will be published separately on the FIAR website. Links to the website are included within the Guidance. | Throughout |
| 5. Language that management must use to assert audit readiness for an assessable unit has been added to the guide. | Section 2.D |
| 6. For ease of reference, The FIAR Methodology phases have been numbered. | Throughout |
| 7. The "Sustainment Phase" has been removed from the FIAR Methodology and instead shown as gray boxes on the Methodology (**Figure 2 and 12**). The reason was that certain tasks within the Methodology must be repeated on a continuous basis to fully integrate ICOFR and FIAR. | Section 1.B, **Figure 2**<br>Section 3.A, **Figure 12** |
| 8. The "Discovery & Evaluation Phase" has been re-titled to "Discovery Phase" to distinguish it from the "Evaluation" phase. | Section 3.A.1 and throughout |

[1] Note that red text may not be legible when printing in black and white.

[2] Refer to FIAR Guidance website for a listing of all ***changes to the wave-specific risks/KCOs/KSD tables*** including deletions from the May 2010 version of the guide.

| SIGNIFICANT CHANGE | REFERENCE |
|---|---|
| 9. Key Task 1.3.7 and 3.1.1(f) titled "Submit Annual ICOFR SOA and Material Weakness CAP Summary" have been added to the FIAR Methodology. | Section 3.A.5 |
| 10. Key Task 1.5.1 "Define Audit Ready Environment" has been eliminated. The requirements for this task were merged with Key Task 2.1.1 "Design Audit Ready Environment" because the scopes of the tasks were very similar. | Section 3.A.1 and 3.A.5 |
| 11. Key capabilities and capability measures have been updated, along with some additions, for each wave. | Wave 1: 2.C.1.1<br>Wave 2: 2.C.2.1<br>Wave 3: 2.C.3.1<br>Wave 4: 2.C.4.1 |
| 12. A list of audit "dealbreakers" that have prevented reporting entities from achieving audit readiness is included in the Guidance. | Section 3.A.6, **Figure 27** |
| 13. Additional service provider tasks and activities have been added. In addition, the section was enhanced to include a list of the most common DoD service providers within DoD, guidance related to types of service organization control (SOC) reports, and guidance related to responsibilities when subservice organizations are used. | Section 3.B.<br>**Figures 32 – 38** |
| 14. Material reporting entities analysis for wave 4 has been developed based on FY10 financial statements. | **Appendix A, Figure 7 – 12** |
| 15. For the most common Wave 2 assessable units throughout DoD, baseline financial reporting risks and related outcomes have been included in the Guidance. | **Appendix C**, Section C.2.2 |
| 16. KSDs specific to Military Equipment have been developed. A reference to the MilPay FIAR guidance supplement which includes the additional KSDs has been added to the Guidance. | **Appendix C**, Section C.2.2, Wave 2 KSD table |
| 17. Appendix D – FIAR Methodology details for reporting entities and service providers has been added | **Appendix D** |
| 18. Appendix E – OMB Circular A-123, Appendix A Crosswalk to FIAR Guide has been added | **Appendix E** |

# EXECUTIVE SUMMARY

The Department of Defense (DoD or the Department) is the largest and most complex organization in the world. Each of the Military Departments is larger than most American companies. The Department's annual budget is 56 percent of the Federal Government's discretionary budget and it holds 86 percent of the Federal government's assets, as reported on the Federal Government's Consolidated Financial Statements.

With over $1 trillion in combined budgetary resources, producing auditable financial statements requires a strategic, long-term plan that addresses issues in an organized, prioritized, and incremental manner.

## PURPOSE OF THIS GUIDANCE:

This guidance provides instructions for implementing a consistent, Department-wide plan[3] for achieving the Department's financial improvement and audit readiness objectives. In accordance with the National Defense Authorization Act for Fiscal Year 2010, Section 1003, the Financial Improvement and Audit Readiness (FIAR) Directorate developed this guidance for reporting entities and service providers working toward the goal of audit readiness[4].

It defines the Department's goals, priorities, strategy, and methodology to becoming audit ready. Furthermore, this guidance details the roles and responsibilities of reporting entities and service providers, as well as the processes they should use to achieve audit readiness.

[3] This guidance does not have to be used by the following intelligence agencies: National Reconnaissance Office, Defense Intelligence Agency, National Geospatial-Intelligence Agency and National Security Agency. These agencies are following the Office of the Director of National Intelligence (ODNI) guidance.

[4] Among the provisions of the legislation is the requirement that the Department "…develop standardized guidance for financial improvement plans by components of the Department."

# 1. INTRODUCTION

This FIAR Guidance is a handbook that serves as a standard reference guide for existing and new users involved in all audit readiness initiatives. It will be updated periodically to ensure it remains current with the Department's priorities and aligns with all applicable Federal and Departmental financial management requirements. This update fully incorporates the requirements of the CFO Act and OMB A-123, Appendix A, driving efficiency in the integration of the Department's resources and to meet the Department's objective in achieving audit readiness by September 30, 2014 (for the SBR audit) and September 30, 2017 (for the full financial statement audit). This updated guidance supersedes the Department's ICOFR guidance previously issued under the title Fiscal Year 2011 Guidance for Implementing Office of Management and Budget (OMB) Circular A-123, Appendix A: ICOFR, dated October 5, 2010. Any future updates to ICOFR requirements will be included as part of updates to the FIAR Guidance.

## 1.A FIAR Priorities and Strategy:

**The Under Secretary of Defense (Comptroller) (USD(C)) priorities require reporting entities and service providers to focus on improving controls and processes supporting information that is most often used to manage the Department, while continuing to work toward financial, information technology, and supporting documentation improvements that facilitate the achievement of unqualified audit opinions on their financial statements.** In support of these objectives, the USD(C) designated two priorities:

- budgetary information, and
- mission critical asset information.

As shown in **Figure 1**, the FIAR Strategy provides a critical path for the Department. The strategy balances the need for short-term accomplishments (Wave 1) against the long-term goal of achieving an unqualified opinion on the Department's financial statements (Wave 4). The FIAR Strategy is consistent with and focuses improvement work on the USD(C) priorities. The first three waves should be performed concurrently because they focus on both of the USD(C)'s priorities, that is, budgetary information and mission critical asset information. Once reporting entities achieve audit readiness for Waves 1, 2, and 3, they should commence Wave 4 audit readiness activities.


**Figure 1. FIAR Strategy includes Four Prioritized Waves to Achieve Full Financial Statement Audits**

## 1.B FIAR METHODOLOGY

The FIAR Methodology (Methodology) maximizes the potential for successful financial statement audits by considering auditing standards. In accordance with professional standards, auditors collect evidence supporting the fair presentation of financial statement amounts by focusing on two primary areas: internal controls and supporting documentation. To achieve audit readiness, **reporting entities must:**

- **Identify and evaluate the risk of material misstatement and then design and implement control activities to meet key control objectives (KCO) that limit the risk of material misstatements, and**
- **Support account balances with sufficient and appropriate audit evidence, defined as key supporting documents (KSD), supplemented with the reporting entities' own documentation requirements.**

Reporting entities should focus their audit readiness efforts on improving their processes, controls, and related documentation based on the results of the application of the Methodology. Adherence to the Methodology will also attain compliance with the most relevant laws and regulations that have a direct and material impact on the Department's consolidated financial statements. Any standalone efforts to comply with direct and material laws and regulations affecting the Component's financial statements should be completed after achieving audit readiness. The phases and key tasks of the Methodology can be seen in **Figure 2**.

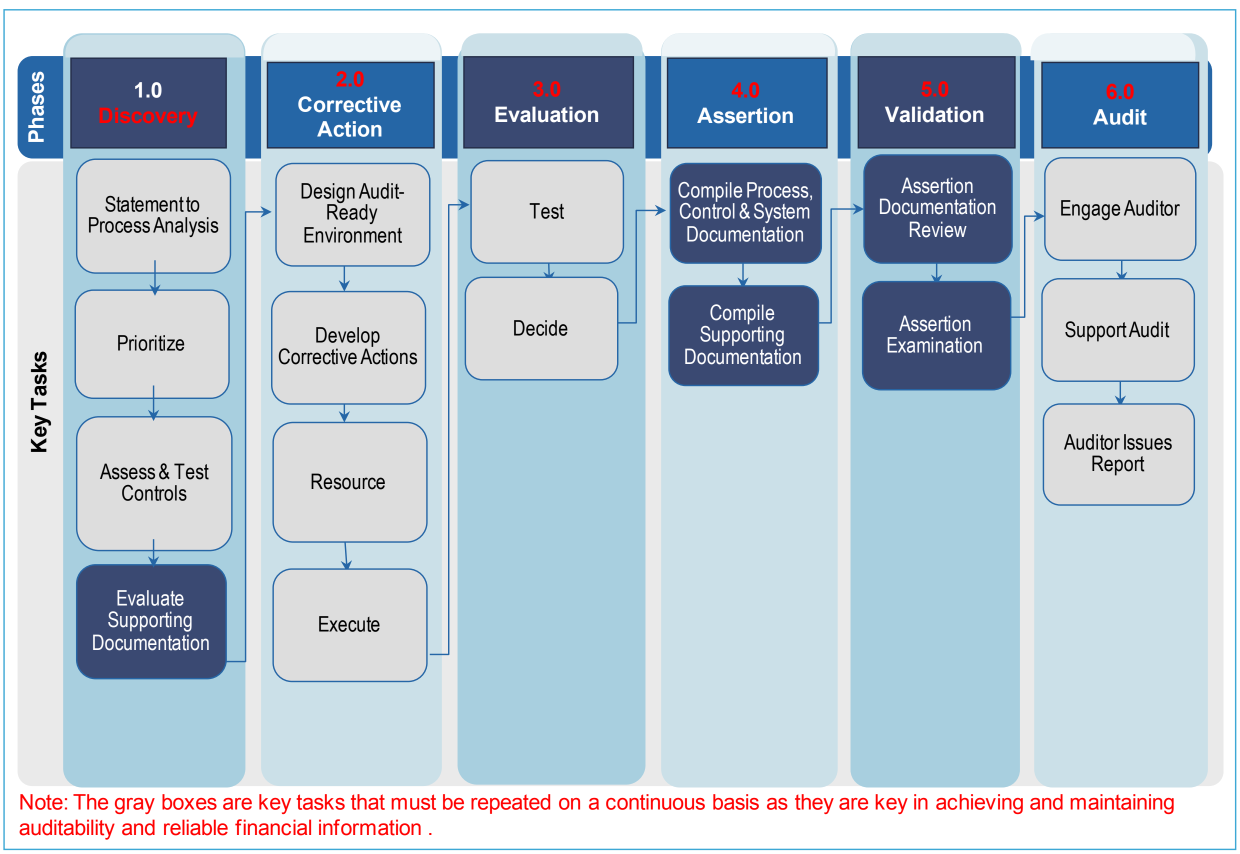



**Figure 2. FIAR Methodology Phases and Key Tasks to Achieve Auditability and Reliable Financial Information**

# 2. FIAR GOAL, PRIORITIES, AND STRATEGY

## 2.A FIAR GOAL

The FIAR Goal is to improve the Department's financial management operations, helping provide America's Service men and women with the resources they need to carry out their mission and improving our stewardship of the resources entrusted to us by the taxpayers. Success will be demonstrated through a financial statement audit performed by independent auditors resulting in an unqualified audit opinion on the Department's financial statements.

## 2.B PRIORITIES

The USD(C) established the current FIAR priorities on August 11, 2009. Before establishing the Department's priorities, the USD(C) coordinated them with the Deputy Secretary of Defense, reporting entities, Department of Defense Office of the Inspector General (DoD OIG), OMB, Government Accountability Office (GAO), and Congress, who approved, endorsed or acknowledged these priorities.

The USD(C) priorities are designed to achieve the FIAR objectives. These priorities are:

- budgetary information, and
- mission critical asset information.

The USD(C) also directed the reporting entities to modify and regularly update their Financial Improvement Plans (FIPs) to achieve these objectives and priorities.

### 2.B.1 Budgetary Information

The Department's major financial decisions are based on budgetary data (e.g., status of funds received, obligated, and expended). As a result, the first USD(C) priority focuses on process improvements, controls, and systems that produce budgetary information. The starting point for achieving auditable financial statements is the Statement of Budgetary Resources (SBR), specifically the Appropriations Received line item. The benefits of focusing improvement efforts on budgetary information and the SBR are:

- Improve the visibility of budgetary transactions resulting in more effective use of resources;
- Provide for operational efficiencies through more readily available financial information;
- Improve fiscal stewardship (ensures that funds appropriated, expended and recorded are reported accurately, reliably and timely); and
- Improve budget processes and controls (precludes Antideficiency Act violations).

### 2.B.2 Mission Critical Asset Information

The second priority focuses improvement and audit readiness efforts on information that is essential to the effective management of the Department's mission critical assets. For purposes of this priority, mission critical assets are:

- Military Equipment (ME) (e.g., ships, aircraft, combat vehicles),
- Real Property (RP) (e.g., land, buildings, structures, construction in progress, facilities),
- Inventory (INV) (e.g., rations, supplies, spare parts, fuel),
- Operating Materials and Supplies (OM&S) (e.g., ammunition, munitions, missiles), and
- General Equipment (GE) (e.g., material handling equipment, training equipment, special tooling, and special test equipment).

Financial management information necessary for the management of the Department's mission critical assets is also required to support future financial statement audits. This financial management information includes:

- Individual Item Identifier (e.g., unique item identifier, aircraft tail number, ship number, and real property unique identifier),
- Category/Asset Type (e.g., aircraft – airlift fixed-wing),
- Location (e.g., military installation/organization),
- Operational Status (e.g., active, closed, disposed),
- Item Description (e.g., building headquarters, base library), and
- Controlling/Financial Reporting Organization (e.g., Air Force, Defense Logistics Agency).

This information, as well as other management and financial information, is recorded in official systems of record, which are referred to as "Accountable Property Systems of Record" (APSRs). Ensuring that asset accountability and important management information relevant to mission critical assets is accurately recorded in each reporting entity's APSRs is the objective of this priority. Please see FIAR Guidance website for the ***Existence and Completeness Financial Management Data Fields Definitions and Supporting Documentation requirements*** document.

Accomplishing this priority will improve important management information about mission critical assets and move the Department closer to achieving financial statement auditability and reliable financial information. The existence and completeness (E&C) of assets are two of the four financial statement assertions that financial statement auditors will test in Wave 3. **Reporting entities must ensure that all assets recorded in their APSR exist (Existence), all of the reporting entities' assets are recorded in their APSRs (Completeness), reporting entities have the right to report all assets (Rights) and assets are consistently categorized, summarized and reported period to period (Presentation and Disclosure).** The fifth financial statement assertion, Valuation, will not be addressed until Wave 4.

## 2.C Strategy

Since 2005, when the first FIAR Plan was published, the Department's strategy for achieving improved financial information and auditability has evolved to be more focused, effective, and consistent across the reporting entities. The FIAR Strategy (Strategy) incorporates refinements and remains:

- Incremental and prioritized;
- Guided by a Methodology (Business Rules);
- Integrated with the requirements of OMB Circular A-123, Appendix A;
- Integrated with the implementation of the CFO Act and Federal Financial Management Improvement Act (FFMIA) (DoD FMR Vol.1 Chap 3);
- Integrated with the modernization of business and financial systems;
- Based on decentralized, reporting entity-level execution; and
- Comprehensive by focusing improvements on policies, processes and controls, systems and data, audit evidence, and human capital.

A clear, comprehensive strategy for achieving audit readiness is critical to ensuring that limited resources are assigned effectively to facilitate sustained and measurable progress. The Strategy provides a critical path for the Department, while balancing short-term accomplishments with the long-term goal of an unqualified opinion on the Department's financial statements.

Each of the Department's material financial statement line items is affected by unique and complex accounting and auditing challenges that must be overcome to achieve auditability and reliable financial information. **The Strategy groups and prioritizes the material business processes (that result in activity reported on various financial statement line items) within four waves, and then summarizes the steps each reporting entity must take to address each wave.** The waves and steps are prioritized based on the USD(C) priorities, known challenges, and the related dependencies of financial statements, line items and business processes on one another. The Strategy "waves" representing significant levels of effort and accomplishments are noted on **Figure 3.**


**Figure 3. FIAR Strategy includes 4 Prioritized Waves to Achieve Full Financial Statement Audits**

The Department's Strategy draws from the strengths of several alternative approaches and groups individual end-to-end processes into one or more waves. It provides coverage of all financial statements, while prioritizing and improving information most often used by DoD management and the war fighter. Furthermore, as depicted in **Figure 3**, the four waves will lead to interim audit-ready milestones and ultimately to a full-scope financial statement audit. **The reporting entities must ensure appropriate controls are in place and operating effectively**

**for relevant financial reporting processes before asserting that each wave is audit ready (e.g., controls over the presentation and disclosure over the SBR must be asserted as ready at the end of Wave 2). The first three waves should be performed concurrently because they focus on both of the USD(C)'s priorities, budgetary information and mission critical asset information.** Once reporting entities achieve audit readiness for Waves 1, 2, and 3, they should commence Wave 4 audit readiness activities.

Previously, the Strategy included a fifth wave that required a full audit (including the valuation of existing assets). However, based on a business case analysis performed by the Department, all assets will not be subject to the valuation assertion. Refer to section 2.E for discussion of the business case analysis.

The following sections discuss critical aspects of each wave, including the key capabilities that must be reached to demonstrate audit readiness and related success criteria and challenges.

### 2.C.1 Wave 1 – Appropriations Received Audit

Accurate and timely recording of appropriations and other budget activity is critical because it provides the budget authority needed to commit, obligate, and expend funds. Absent accurate and timely budget authority information, the Department's ability to fund its mission and operational requirements could be jeopardized and could affect the Department's ability to defend the Nation and its allies. Inaccurate budget authority information could also result in over obligation and expenditures resulting in Antideficiency Act violations.

Recognizing the importance of budgetary information, on August 11, 2009, the USD(C) established the Department's financial improvement priorities. The goal of one of the priorities is accurate and reliable budgetary information, as validated by an SBR audit.

A key element of the SBR is the appropriations receipt and distribution process, which reflects the current fiscal year's appropriated funds. It also includes apportionment and re-apportionment activity by OMB as well as allotment and some sub-allotment activity. **Recognizing the importance of the Department's ability to record properly such funding activity in budget and accounting systems, the USD(C) directed that appropriations received and funds distribution be prepared for audit.**

Wave 1 processes and related controls include activities performed to control and record transactions related to: (1) the receipt of the budget ("Appropriations Received"), and (2) the distribution of the budget to the major command level. Once Wave 1 related processes and controls have achieved audit readiness, it will demonstrate to Congress and the public that the Department's annual funding has been accurately recorded, controlled, and allocated, and that the funds have been accurately recorded in its financial statements. Successful achievement of Wave 1 will also instill more congressional confidence in the Department's budget processes and budget requests. The processes in this wave include Budget-to-Report, including Fund Balance with Treasury (FBWT).

Although this assertion covers controls that are in place to prevent over-issuance of budget authority, it does not include controls required to prevent over-obligation of budget authority. Controls to prevent over-obligation of appropriated funds are addressed in Wave 2, SBR Audit, which covers all processes, internal controls, systems and supporting documentation that must be audit ready before the entire SBR can be audited.

The goal of audit readiness is for the reporting entity to design and implement control activities that limit the risk of material misstatements by achieving the KCOs and support account balances with sufficient and appropriate audit evidence, defined as KSDs and found in **Appendix C**, supplemented with the reporting entity's own documentation requirements.

#### 2.C.1.1 Key Capabilities, Capability Measures, and Success Criteria

#### *Key Capabilities and Capability Measures*

**Reporting entities must achieve key capabilities while working to complete Wave 1. Reaching these key capabilities demonstrates a reporting entity's Appropriations Received audit readiness.** The key capabilities are aligned with the capability measures, as shown in **Figure 4.**

These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress towards achieving these capabilities.

| Key Capabilities | Definitions/Capability Measures |
|---|---|
| 1. Effective controls over recording Appropriations | **Reporting entities must design and implement control activities to achieve KCOs for recording Appropriations.** See Wave 1 KCOs in **Appendix C**, for a complete listing of relevant KCOs.<br>• % of appropriation control activities assessed<br>• % of appropriation control activities determined effective |
| 2. Retain and make available supporting documentation to meet audit standards | **Reporting entities must ensure that adequate documentation is readily available for an Appropriations Received audit.** See Wave 1 KSDs, in Appendix C, for minimum documentation requirements.<br>• % of supporting documentation assessed<br>• % of supporting documentation determined sufficient |

**Figure 4. Appropriations Received Key Capabilities**

### *Success Criteria*

**To achieve audit readiness for Appropriation Received, a reporting entity must:**

- **Design and implement control activities that limit the risk of material misstatements by meeting all relevant KCOs defined in Appendix C, and**
- **Support account transactions and balances with sufficient audit evidence defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.**

**Reporting entities must test their control activities and supporting documentation to ensure audit readiness. In most cases, auditors will need to test both controls and supporting documentation to support their audit opinion. The more reliance the auditor can place on the reporting entity's internal controls, based on their test of controls, the less testing of supporting documentation will be needed. A high reliance on internal controls yields a more effective and efficient audit, lowering the cost of the audit and the impact on the reporting entity personnel and operations.**

### 2.C.1.2 Common Challenges

**Each wave contains accounting and auditing challenges that must be resolved for reporting entities to become audit ready. For example, during Wave 1 reporting entities must ensure that:**

- **They are capable of supporting the completeness of funds distributed to the major commands or equivalent. Reporting entities must demonstrate completeness of funds distribution by reconciling the current year budget authority apportioned and allotted to USSGL accounts 4510 and 4610 of the general ledger to the fund distribution system. The reconciliation must identify current year budget authority as an element of the entire**

**balance, which includes beginning balances, reductions for executed funds, and upward/downward adjustments, recorded in these accounts.**

- **Internal controls and supporting documentation are appropriately evaluated and maintained for all material funds sub-allotted to other DoD organizations (e.g., U.S. Army Corps of Engineers (USACE), Naval Facilities Engineering Command (NAVFAC)).**

### 2.C.2 Wave 2 – SBR Audit

The SBR presents all budgetary resources that a reporting entity has available, the status of those resources at period end, a reconciliation of changes in obligated balances from the beginning to the end of the period, and cash collections and disbursements for the period reported. A Wave 2 SBR audit includes all processes, internal controls, systems and supporting documentation that must be audit ready before the SBR can be audited. Significant processes in this wave include Procure-to-Pay, Hire-to-Retire, Order-to-Cash, and Budget-to-Report, including Fund Balance with Treasury (FBWT).

#### 2.C.2.1 Key Capabilities, Capability Measures, and Success Criteria

***Key Capabilities and Capability Measures***

**The FIAR Directorate has defined key capabilities that reporting entities must achieve to complete Wave 2. These are major capabilities that reporting entities must achieve and sustain to demonstrate SBR audit readiness.** The key capabilities are aligned with the capability measures, as shown in **Figure 5**. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress in achieving these capabilities.

| Key Capabilities | Definitions/Capability Measures |
|---|---|
| 1. Effective FBWT transaction-level reconciliations and reporting to Treasury | **Reporting entities must design and implement control activities to meet KCOs for FBWT.** See Wave 2 FBWT KCOs Table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of FBWT control objectives assessed<br>• % of FBWT control activities determined effective |
| 2. Effective controls over recording and maintaining obligations | **Reporting entities must design and implement control activities to meet KCOs for recording obligations.** See Wave 2 KCO table in **Appendix C** for a complete listing of KCOs relevant to the obligations incurred.<br>• % of obligation control objectives assessed<br>• % of obligation control activities determined effective |
| 3. Effective controls over recording receipt of goods or services | **Reporting entities must design and implement control activities to meet KCOs for recording receipt of goods or services.** See Wave 2 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of receipt control objectives assessed<br>• % of receipt control activities determined effective |
| 4. Effective controls over recording disbursements | **Reporting entities must design and implement control activities to meet KCOs for recording disbursements.** See Wave 2 KCO table in **Appendix C** for a complete listing of KCOs relevant to disbursements/outlays.<br>• % of disbursement control objectives assessed<br>• % of disbursement control activities determined effective |

| Key Capabilities | Definitions/Capability Measures |
|---|---|
| 5. Retain and make available supporting documentation to meet audit standards | Reporting entities are responsible for ensuring adequate documentation is readily available for all material line items. See Wave 2 KSD table, in Appendix C, for minimum documentation requirements.<br>• % of supporting documents assessed<br>• % of supporting documents determined sufficient (adequately retained and readily available) |

**Figure 5. SBR Key Capabilities**

### *Success Criteria*

**To achieve SBR audit readiness, a reporting entity, in coordination with its service provider(s) must:**

- **Have designed and implemented control activities that limit the risk of material misstatements by meeting all relevant KCOs defined in Appendix C, and**
- **Be able to support account transactions and balances with sufficient audit evidence defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.**

**Reporting entities must test their control activities and supporting documentation to ensure audit readiness. In most cases, auditors will need to test both controls and supporting documentation to support their audit opinion.** The more reliance the auditor can place on the reporting entity's internal controls based on their test of controls, the lesser the amount of testing of supporting documentation they will need to complete. A high reliance on internal controls yields a more effective and efficient audit, lowering the cost of the audit and the impact on the reporting entity personnel and operations.

### 2.C.2.2 Common Challenges

**Each wave contains accounting and auditing issues that must be resolved for reporting entities to progress towards audit readiness. For example, during Wave 2 reporting entities must address:**

- **Beginning balances for FBWT. Given the long life of Federal appropriations, reporting entities must keep a minimum of six to 10 years of documentation to support all funding, collections, disbursements, adjustments, and reconciliation activity (note: audit requirements are different from National Archives and Records Administration (NARA) requirements).**
- **Complexities surrounding shared Treasury accounts. Reporting entities sharing Treasury accounts must work with their service provider to ensure that internal controls and supporting documentation are in place to support an SBR audit, especially to ensure suspense account items are assigned to the correct entity.**
- **Reconciliation and traceability of interagency agreements, including Military Interdepartmental Purchase Requests (MIPR). Due to the limited capabilities of existing**

**accounting systems, reporting entities are not always able to capture sufficient trading partner information needed to reconcile intragovernmental transactions and balances. Additionally, some reporting entities have difficulty in tracing recorded interagency agreements back to originating source documentation (e.g., interagency agreement, invoices, receiving reports).**

- **Accounts Payable Accruals. Because goods/services are partially or fully delivered in advance of invoices, reporting entities should design effective accrual processes to ensure that goods or services received are recorded in the SBR in the proper period.**

- **Dependencies on service provider(s) processes and controls for efficient and effective execution of its end-to-end business processes.**

As reporting entities continue to work on Wave 2, additional accounting and auditing issues may be identified. Reporting entities should report issues in their FIPs, allowing them to track progress for resolution and assign resources and dependencies based on related key tasks.

### 2.C.3 Wave 3 – Mission Critical Asset E&C Audit

Mission Critical Asset E&C audit focuses primarily on the E&C financial statement assertions, but also includes the Rights assertion and portions of the Presentation and Disclosure assertion. That is, **reporting entities must ensure that all assets recorded in their APSR exist (Existence), all of the reporting entities' assets are recorded in their system (Completeness), reporting entities have the right to report all assets (Rights),** and assets are consistently categorized, summarized, and reported period to period (Presentation and Disclosure). **The asset categories included in this wave include ME, RP, INV, OM&S, and GE.** This will allow the Department and its reporting entities to demonstrate the E&C of its assets before focusing on the reported value of the assets.

#### 2.C.3.1 Key Capabilities, Capability Measures, and Success Criteria

##### *Key Capabilities and Capability Measures*

**The FIAR Directorate has defined key capabilities that reporting entities must achieve to successfully complete Wave 3. These are key capabilities the reporting entities must achieve and sustain to demonstrate E&C audit readiness.** The key capabilities are aligned with the capability measures, as shown in **Figure 6**. These measures, based on audit requirements to evaluate internal controls and supporting documentation, are designed to measure reporting entity progress towards achieving these capabilities.

| Key Capabilities | Definitions/Capability Measures |
|---|---|
| 1. Effective physical inventories that meet audit standards | **Reporting entities must design and implement physical inventory count procedures and documentation that will withstand audit scrutiny.** See DoDI 4140.1 R, 4000.25-M, 4000.25-2M, 5100.76-M, 4165.14, 5000.64 for the Department's instructions for physical inventory counts.<br><br>% of assets subject to physical inventory within the required time span |
| 2. Effective controls over recording asset acquisitions, disposals and transfers | **Reporting entities must design and implement control activities to meet KCOs for recording asset acquisitions, disposals, and transfers.** Adjustments to physical inventory counts are an indication of the effectiveness of controls over recording acquisitions, disposals, and transfers of assets.<br><br>% of physical inventory adjustments |
| 3. Retain and make available supporting documentation to meet audit standards | **Reporting entities must ensure adequate documentation is readily available for an E&C audit.** See Wave 3 KSD table, in Appendix C, for minimum documentation requirements.<br>• % of supporting documents assessed<br>• % of supporting documents determined sufficient (adequately retained and readily available) |
| 4. Effective controls over financial and management data in the Accountable Property Systems of Record | **Reporting entities must ensure the accuracy of Financial and Management data in preparation for an E&C audit.** See Wave 3 Financial Management Data Table in Appendix C for minimum data fields validation requirements.<br><br># of data fields blank out of total data fields |

| Key Capabilities | Definitions/Capability Measures |
|---|---|
| 5. Effective processes, controls and system improvements | **Reporting entities must design and implement corrective actions to remediate weaknesses in processes, internal controls, and supporting financial related systems.**<br>• % of corrective actions complete (per FIPs)<br>• % of assessable units validated |

**Figure 6. Wave 3 Key Capabilities**

### *Success Criteria*

**To achieve E&C audit readiness, a reporting entity, in coordination with its service provider(s) must:**

- **Have designed and implemented control activities that limit the risk of material misstatements by meeting all relevant KCOs defined in Appendix C, and**
- **Be able to support account transactions and balances with sufficient audit evidence defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.**

**Reporting entities and service providers must test their control activities and supporting documentation to ensure audit readiness. In most cases, auditors will need to test both controls and supporting documentation to support their audit opinion.** The more reliance the auditor can place on internal controls based on their test of controls, the lesser the amount of testing of supporting documentation they will need to complete. A high reliance on internal controls yields a more effective and efficient audit, lowering the cost of the audit and the impact on the reporting entity personnel and operations.

## 2.C.3.2 Common Challenges

**Each wave is subject to accounting and auditing issues that must be resolved to progress towards audit readiness. For example, during Wave 3 reporting entities must address:**

- **Units of Measure – Implementing standard definitions for units of inventory and assets to ensure that item counts are accurate (e.g., will airframes be separately counted from engines or the two items together comprise one asset record within the APSR?).**
- **Rights to Assets – Work with leading OSD offices to implement business rules around co-located facilities (joint basing) and assets purchased by others (e.g., USMC aircraft).**
- **Reworked Assets – Implement a standard and consistent method for tracking and reporting assets that are removed from a larger asset, reworked or otherwise modified and then integrated into a different asset (e.g., aircraft engines).**
- **Physically Isolated Assets – Implement techniques and methods for demonstrating the existence of assets that are not easily inspected (e.g., assets located in space or underwater).**
- **Dependencies on service provider(s) processes and controls for efficient and effective execution of its end-to-end business processes.**

## 2.C.4 Wave 4 – Full Audit Except for Existing Asset Valuation

Assertions for this wave include the proprietary side of budgetary transactions covered in Wave 2, as well as accounts receivable, earned revenue, accounts payable, gross costs and other liabilities. In addition, this wave adds the valuation assertion for assets (i.e., ME, RP, GE, INV, and OM&S). However, based on the business case analysis performed by the Department, existing assets will not be subject to the valuation assertion. Refer to 2.E for additional details regarding the business case.

### 2.C.4.1 Key Capabilities, Capability Measures, and Success Criteria

#### *Key Capabilities and Capability Measures*

**Reporting entities must track and achieve the following key capabilities while working to complete Wave 4. These major capabilities demonstrate a reporting entity's full-scope audit readiness, with the exception of existing asset valuation**. The key capabilities are aligned with the capability measures, as shown in **Figure 7**. These measures will be based on audit requirements to evaluate internal controls and supporting documentation and will be designed to measure reporting entity progress towards achieving these capabilities.

| Key Capabilities | Definitions/Capability Measures |
|---|---|
| 1. All capabilities from Waves 1 through 3 have been met. | **Reporting entities must design and implement control activities to meet KCOs for Wave 1 through 3.** See KCO tables in **Appendix C** for a complete listing of KCOs relevant to Wave 1, 2 and 3. |
| 2. To manage, account for, and report Investments | **Reporting entities must design and implement control activities to meet KCOs related to investments.** See Wave 4 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of obligation control objectives assessed<br>• % of obligation control activities determined effective |
| 3. To correctly value, maintain accountability, and report all categories/asset classes of non-existing Inventory and Related Property, and General Property, Plant and Equipment (PP&E) | **Reporting entities must design and implement control activities to meet KCOs for valuation of non-existing inventory and general PP&E assets.** See Wave 4 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of obligation control objectives assessed<br>• % of obligation control activities determined effective |
| 4. To effectively manage, estimate, classify, and report Military Retirement and other Federal Employee Benefits | **Reporting entities must design and implement control activities to meet KCOs related to military health benefits actuarial accruals.** See Wave 4 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of receipt control objectives assessed<br>• % of receipt control activities determined effective |

| Key Capabilities | Definitions/Capability Measures |
|---|---|
| 5. To accurately estimate, disburse and report Environmental Liabilities | **Reporting entities must design and implement control activities to meet KCOs related to environmental liabilities.** See Wave 4 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of disbursement control objectives assessed<br>• % of disbursement control activities determined effective |
| 6. To correctly estimate, record, and report- Other Liabilities- Intragovernmental: Custodial Liabilities, Disbursing Officer Cash, Advances from Others, and/or FECA Disbursement to Department of Labor | **Reporting entities must design and implement control activities to meet KCOs related to Custodial Liabilities, Disbursing Officer Cash, Advances from Others and/or FECA Disbursement to the Department of Labor.** See Wave 4 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of disbursement control objectives assessed<br>• % of disbursement control activities determined effective |
| 7. To correctly estimate, record, and report- Other Liabilities- Non-Federal: Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities | **Reporting entities must design and implement control activities to meet KCOs related to Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities.** See Wave 4 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of disbursement control objectives assessed<br>• % of disbursement control activities determined effective |
| 8. To correctly calculate, record, and report Depreciation Expense | **Reporting entities must design and implement control activities to meet KCOs related to Depreciation Expense.** See Wave 4 KCO table in **Appendix C** for a complete listing of relevant KCOs.<br>• % of disbursement control objectives assessed<br>• % of disbursement control activities determined effective |
| 9. To retain and make readily available supporting documentation to meet audit standards | Reporting entities are responsible for ensuring adequate documentation is readily available for all material line items. See Wave 4, KSD table in Appendix C, for minimum documentation requirements.<br>• % of supporting documents assessed<br>• % of supporting documents determined sufficient (adequately retained and readily available) |

**Figure 7. Key Capabilities for Wave 4**

## *Success Criteria*

**To achieve audit readiness for Wave 4, a reporting entity must:**

- **Have designed and implemented control activities that limit the risk of material misstatements by meeting all relevant KCOs defined in Appendix C, and**
- **Be able to support account transactions and balances with sufficient audit evidence defined as KSDs in Appendix C, supplemented with the reporting entity's own documentation requirements.**

**Reporting entities must test their control activities and supporting documentation to ensure audit readiness. In most cases, auditors will need to test both controls and supporting documentation to support their audit opinion.** The more reliance the auditor can place on the reporting entity's internal controls based on their test of controls, the lesser the amount of testing of supporting documentation they will need to complete. A high reliance on internal controls yields a more effective and efficient audit, lowering the cost of the audit and the impact on the reporting entity personnel and operations.

### 2.C.4.2 Common Challenges

**Historical acquisition costs for existing assets will not be audited in Wave 4; however, reporting entities must have the capability to properly value and report new asset acquisitions.** This capability is one of the more difficult challenges in Wave 4, since it requires the implementation of new acquisition processes, and controls impacting contract structure for cost accumulation. This work has been ongoing for years and began with the change to the Federal accounting standard affecting the reporting of ME (e.g., ships, aircraft, and combat vehicles). Prior to this standard change in 2003, the standards permitted the expensing of ME assets.

**Other challenges that must be addressed in coordination with leading OSD offices are:**

- **Valuing reworked PP&E**
- **Establishing an infrastructure to support a full-scope financial statement audit. This will be important to ensure that resources are available to support auditor requests for information and support and resolve audit issues that arise during the course of the audit.**

To ensure consistency, OSD will provide guidance when these types of issues are identified.

Details about the scope, risks, KCOs, KSDs, and audit execution of each wave are included in **Appendix C**.

## 2.D Management Assertion

Once a reporting entity completes its audit readiness efforts for an assessable unit, the reporting entity will prepare an assertion declaring that the subject matter (assessable unit) is audit ready. See section 3.A.3 for the definition of assessable unit. Management's assertion is a written declaration that the subject matter (assessable unit) is audit ready in conformity with the internal control and supporting documentation criteria (included in the following "Management Assertion Template"), which are based upon the Methodology. **If Management is asserting audit readiness of something other than a financial statement line item, Management must define the subject matter of the assertion (assessable unit) by clearly identifying the beginning/initiation and end of the process or the items that are specifically included and excluded in the scope of their assertion.** Note that the criteria is suitable for examinations of management assertions of audit readiness, but not for audits of financial statements (or financial statement line item balances), in accordance with auditing standards.

Management will be required to support its assertion with adequate documentation to demonstrate that it has performed the appropriate mix of internal control and supporting documentation testing to achieve audit readiness. See **Figure 40**. The assertion criteria also require the independent practitioner to perform independent testing for internal controls and supporting documentation to support their examination opinion. Management's audit readiness testing and the practitioner's examination testing to assess audit readiness are both less rigorous than testing that will be required under a financial statement audit. Therefore, management must accept the implications of sampling risk and understand that its test results will be assessed in light of more rigorous audit testing when the subject matter (assessable unit) is subject to a financial statement audit. Refer to **Appendix D** for guidance on control and supporting documentation testing to support audit readiness.

**Management must prepare its assertion related to the subject matter (assessable unit) and provide the following assertion template to the practitioner, who will perform an examination on this assertion and report its opinion in the *Validation Phase*.**

### *Management Assertion Template*

**Assertion: Management asserts that [insert subject matter[5]] is audit ready as defined by the following criteria for the [include "time period" for the assertion].**

Internal Control Criteria: Management has designed and implemented effective control activities that meet all key control objectives relevant to **[insert subject matter]** in accordance with the FIAR Guidance, **Appendix C [insert appropriate FIAR Guidance KCOs from the appropriate Appendix C Section based on wave, include applicable KCO numbers]** for the **[include the "time period" for the assertion]**. For each internal control activity related to the KCO's, management can provide documentation demonstrating the effective operation of the controls. The documentation is readily available for review, for a randomly-selected sample in accordance with FIAR Guidance **Appendix D**, Section D.2.3. Internal Control Criteria are further defined by the following:

a. Relevant key control objectives needed to limit the risks of applicable financial statement material misstatement have been identified.

b. Control activities satisfying all relevant key control objectives have been documented and placed in operation.

c. Control activities are effectively designed considering the following: (1) directness (extent internal control activity relates to the control objective), (2) selectivity (magnitude of the amount of dollar activity not subject to the control), (3) manner of application (frequency of application and the experience/skills of personnel performing the internal control activity), and (4) follow-up (procedures performed when the control identifies an exception).

d. "Readily available for review" is measured by the capability to provide requested documentation to the practitioners with sufficient time for the practitioners to test the

[5] If the subject matter is not generally understood or otherwise defined in accounting standards it may need further definition in an attachment. (e.g. A Major Defense Acquisition Program (MDAP) assertion would be defined by attaching a custom 1002 report, an assertion of audit readiness for an entity where an Enterprise Resource Plan (ERP) is implemented would define the scope of processes asserted using diagrams)

documentation, prepare and review work papers, and write and issue their report by the examination deadlines.

e. Control activities are operating effectively in accordance with sample sizes and audit readiness acceptable deviations, as defined in the FIAR Guidance, **Appendix D**, Section 2.3.

Supporting Documentation Criteria: Management has sufficient, adequate supporting documentation that includes all key supporting documents relevant to **[insert subject matter]** in accordance with the FIAR Guidance, **Appendix C [insert appropriate Appendix C, KSD section based on related Wave] and Appendix D, Section D.3** for the **[include "time period " for the assertion]**. For a randomly-selected sample, management's key supporting documents are readily available for review to demonstrate transactions/items were accurately recorded in applicable systems **[insert list of applicable systems]**, and to demonstrate that transactions/items exist for assets the entity has the right/obligation to report in accordance with the FIAR Guidance, **Appendix D**, Section D.4. Supporting Documentation Criteria is further defined by the following:

a. All key supporting documents necessary to address the financial statement assertions relevant to the asserted transactions/items have been identified.

b. Tests of supporting documentation that result in exceptions will be evaluated in accordance with the FIAR Guidance, **Appendix D**, Section D.3, for the sampling technique chosen by Management (non-statistical or statistical), to conclude whether sufficient, adequate supporting documentation is available.

c. "Readily available for review" is measured by the capability to provide requested documentation to the practitioners with sufficient time for the practitioners to test the documentation, prepare and review work papers, and write and issue their report by the examination deadlines.

d. Accurately recorded transactions/items is defined as:

   - Waves 1, 2, and 4 – Correct transaction dollar amount, accounting period, appropriation, appropriation purpose, and general ledger account (if applicable) recorded in **[insert applicable general ledger system]**.
   - Wave 3 – Correct asset classification and quantities are recorded in **[insert applicable APSR]**.

## 2.E Business Case Analysis

Developed in 2011, the *Business Case Analysis of Alternatives for Valuing Mission Critical Assets* (BCA) was required by the FY 2011 National Defense Authorization Act (NDAA), which states:

> "…the Under Secretary of Defense (Comptroller) shall…examine the costs and benefits of alternatives for valuing Department of Defense assets and select an approach to such valuation that is consistent with principles of sound financial management and the conservation of taxpayer resources."

Since the Department is focused on reducing its annual operating budget, as directed by the Secretary of Defense, the NDAA requirement to conduct the BCA provided DoD the opportunity to select an approach to not just resolve this long-standing valuation obstacle to achieving auditability and reliable financial information, but to do so in such a way that is cost effective to conserve DoD and taxpayer resources.

The BCA considered and incorporated the following assumptions:

- The DoD will maintain its current strategy to achieve auditability in waves starting with the priorities of the Statement of Budgetary Resources (SBR) and validating the existence and completeness of mission critical assets, and only after achieving those priorities, will the Department begin to value assets for Balance Sheet reporting. Given this assumption, this BCA only looks at the incremental cost to record and audit asset values in an improved reporting environment that results from changes to business and financial processes, controls and systems needed to achieve the objectives of the SBR and mission critical asset existence and completeness priorities.
- The ERP systems will provide the capability to accurately and timely record business events and financial transactions and post them to DoD accounting ledgers.
- DoD produces audited financial statements for users outside the Department, and the primary purpose of government financial statements is to demonstrate effective stewardship and management of public funds to citizens.

### *Impact of the Business Case Analysis on the FIAR Audit Readiness Strategy*

The Business Case concluded that it was not cost effective to value existing assets; therefore, Wave 5 has been eliminated. **However, each entity asserting audit readiness must establish a date for each class of PP&E, Inventory, and Operating Materials & Supplies for which it can provide sufficient evidence to support recorded transactions.** For example, one entity may have reengineered its real property business processes and established effective controls for recording transactions in fiscal year 2006. Another entity may not have established effective business process and controls for real property until fiscal year 2010. The first entity could assert that its real property transactions are supportable beginning in fiscal years 2006, the second in fiscal year 2010. Therefore, assertions about the date at which transactions become auditable will vary by component and asset class.

From the standpoint of an audit opinion, the further back an entity can assert the quicker the existing assets become immaterial to the reported balances. A basic assumption associated with not valuing existing assets is that over time the net book value of such assets becomes immaterial to the reported balances. A second assumption is that the cost of valuing assets acquired before effective processes (existing assets) and controls were implemented is not justified by the value of such information.

## 2.F Integration of FIAR Methodology and OMB Circular A-123, Appendix A Requirements

The USD(C) Memorandum, signed by the Honorable Mr. Robert Hale, titled "Changes to the Annual Internal Control Over Financial Reporting (ICOFR) Statement of Assurance (SOA) Reporting Requirements" dated April 22, 2011 states that the ICOFR guidance will be fully integrated with the next FIAR Guidance update. Therefore, this FIAR Guidance update **fully merges OMB Circular A-123, Appendix A requirements into the FIAR Methodology, resulting in compliance with both the CFO Act and OMB A-123, Appendix A. This integration drives efficiency in the utilization of the Department's resources to meet the objective of achieving an audit ready state.**

**The reporting entities should submit interim work products (e.g., process flowcharts and narratives, risk assessments, test plans, etc.) to FIAR in accordance with their FIP milestone dates.** This will allow FIAR to monitor the Department's progress and provide the reporting entities' with feedback prior to submission of their audit readiness assertion documentation.

### 2.F.1 Additional Reporting Requirements

**All reporting entities must follow the FIAR Methodology, to include completing key tasks, activities, and work products. In addition, each DoD reporting entity must submit the following:**

1. **ICOFR and Internal Control over Financial Systems SOA memorandum signed by the Component Senior Assessment Team (SAT) Chairman to OUSD(C).** (Refer to FIAR Guidance website for ***additional reporting instructions***, the latest ***Statement of Assurance Memorandum*** template and example ***Statement of Assurance Memorandum***). Refer to DoD FMR Vol.1 Chap 3 for guidance related to Internal Control over Financial Systems.
2. **Summary Corrective Action Plans (CAPs) for each identified material weakness (if applicable) to the OSD Senior Accountable Official and OUSD(C) FIAR Directorate with the detailed CAPs updated in the respective FIPs.** (Refer to FIAR Guidance website for the ***Corrective Action Plan (CAP) Development Instructions*** document, latest ***Corrective Action Plan Template*** and example ***Corrective Action Plan***).

**Items (1) and (2) above must be submitted no later than 10 business days after June 30th.** The OSD Senior Accountable Officials in charge of the reported financial material weakness will meet with the reporting entities that have reported financial material weaknesses to monitor progress throughout the year for the Department.

**Reporting entities must assess internal controls over financial reporting related to areas of high risk that have been previously reported as auditor-identified or self-identified resulting in a material weakness. Note that internal control testing must be performed on an annual basis. Therefore, reporting entities must continue to perform the related procedures each year even after reporting entities have attained an audit ready state.**

## 2.G FIAR Strategy Link To the DoD Strategic Management Plan

The Department's Strategic Management Plan (SMP), a requirement of the NDAA for FY 2008, establishes seven specific business goals to further articulate needed changes in the Department's "business domain" and to structure unity of effort across the enterprise. Business Goal 2, "Strengthen DoD Financial Management", as seen in **Figure 8**, identifies the Department's plans and their relationships to ensure Department leaders have access to timely, relevant and reliable financial and cost information to make informed decisions. One focus area of Business Goal 2 is to "sustain public confidence through auditable financial statements." Due to its size and complexity, the Department utilizes a "family of plans" approach to cascade enterprise business priorities into functional and organizational plans. These include the Enterprise Transition Plan (ETP) and the FIAR Plan supported by the Business Enterprise Architecture (BEA).

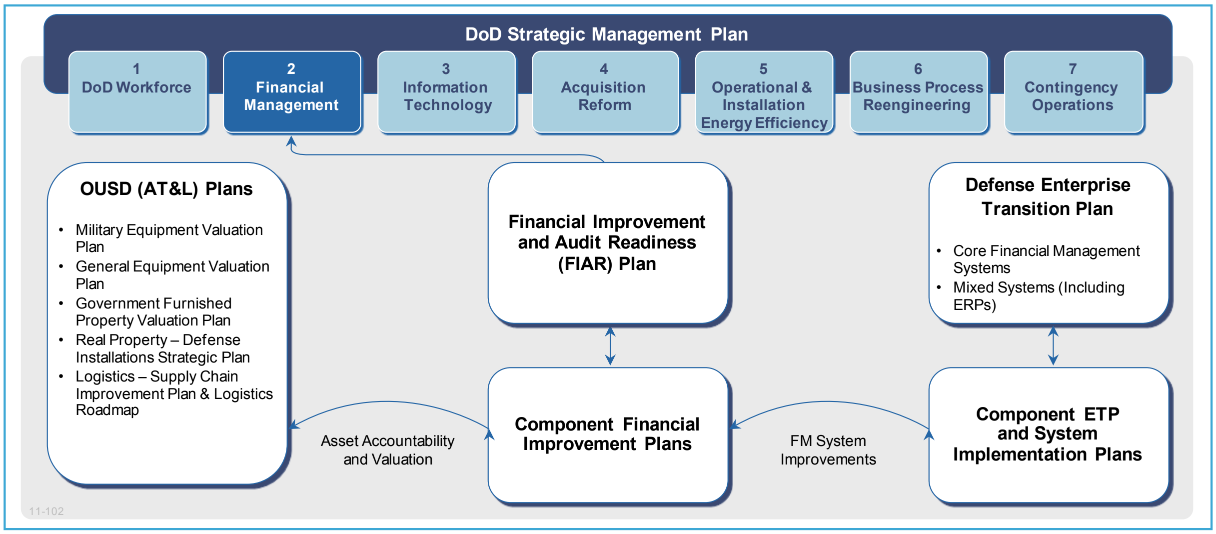



**Figure 8. DoD Strategic Management Plan Relationship to Financial Management**

Progress relative to established goals is reported and monitored by a formal and regularly scheduled FIAR governance process that involves the Deputy Secretary of Defense, Under Secretary of Defense Comptroller (USD(C/CFO), DoD Deputy Chief Management Officer, Military Department Chief Management Officers and Financial Management/Comptrollers, along with senior leaders from the functional communities. The FIAR Guidance provides the strategy and methodology to integrate the Department and Component financial, acquisition, and enterprise transition plans.

The Business Goal 2 key initiative that drives auditability is "Execute the Financial Improvement and Audit Readiness (FIAR) strategy and plans to achieve audit readiness by Fiscal Year (FY) 2017."

## 2.H System Transformation Initiatives

The Strategy integrates key elements of the Enterprise Transition Plan (ETP), which organizes and prioritizes efforts to modernize DoD business and financial processes and systems. The ETP is the roadmap that implements the BEA and defines specific implementation goals, milestones and measures for each fiscal year to reach the "to-be", or future, envisioned state. It is a cohesive plan that implements and modernizes business systems within and across each functional area of the Department, and in effect provides consistency across all reporting entities.

For most of the Department, success in financial management improvement depends on system modernization and business transformation initiatives. Additionally, FIAR and ETP efforts must also be aligned to comply with Federal Managers Financial Integrity Act (FMFIA) requirements to maximize the effectiveness of limited resources and promote efficiency. The "to-be" dates in the ETP and the phasing out of existing systems must be considered in the development of reporting entity FIPs as reporting entities begin the Corrective Action Phase "Design Audit-Ready Environment" key task.

**Reporting entities must assess the target dates of their "to-be" environments against their audit ready assertion dates in order to determine whether the existing systems or "to-be" systems (or both) should be included in their current audit readiness efforts. For reporting entity business processes currently using existing systems that will be modernized or replaced with ERPs by their audit ready assertion date, the "to-be" must be included in their audit readiness efforts and reflected in the FIPs. In these situations, reporting entities need to (1) assess existing processes, (2) identify those processes that will change with the new implementation, and (3) map modernized system/ERP requirements to known weaknesses. In situations where a system implementation will replace a process, the reporting entity should build the system implementation date into its FIPs as a dependency for remediating the associated controls and processes. The reporting entity FIPs must demonstrate that system requirements and transformation initiatives map to KCOs and control activities that will ensure that system controls will be properly designed and will operate effectively to remediate known weaknesses.**

**Figure 9** is an example of an audit ready environment for the Procure-to-Pay business process where the current "as-is," transitional, and target systems environments have been identified.

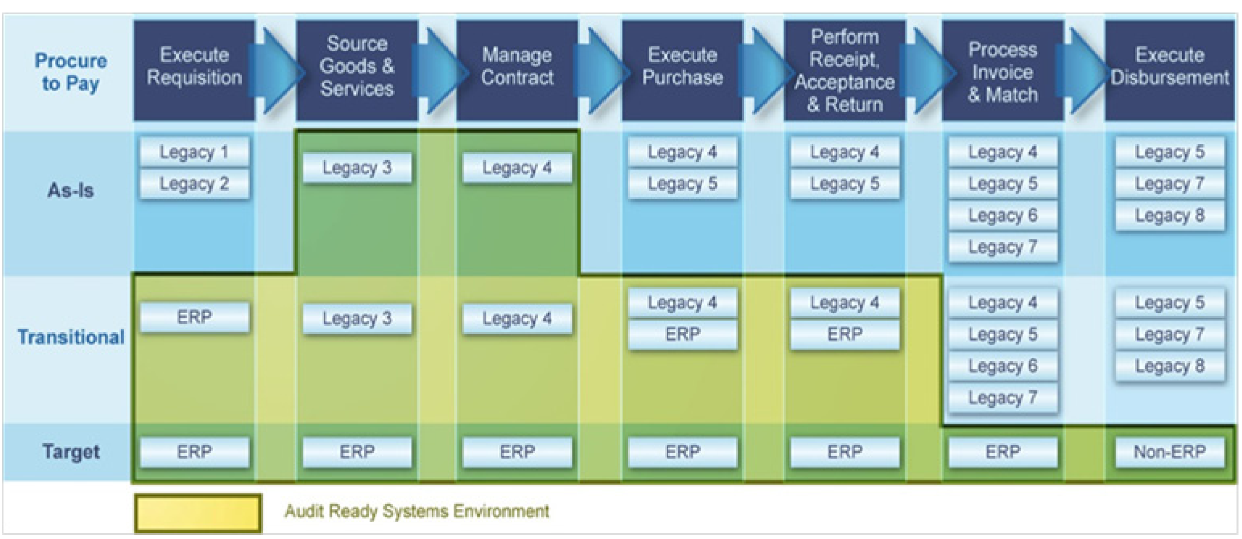



**Figure 9. SBR Example –Corrective Action Phase – Design Audit Readiness Environment**

It is important to note that auditability may be achieved before full system/ERP implementation; therefore not all existing systems can be scoped out of audit readiness efforts.

While reporting entities can evaluate the design of “to-be” system solutions, tests of operating effectiveness cannot be performed until the solution is implemented. Evaluating the design of these “to-be” solutions will help ensure that business processes and controls will be effective when the system solution is implemented and will help ensure that new processes and/or controls will meet FIAR objectives. Prior to the implementation of system solutions, reporting entities can implement compensating controls that mitigate identified risks and allow them to assert audit readiness.

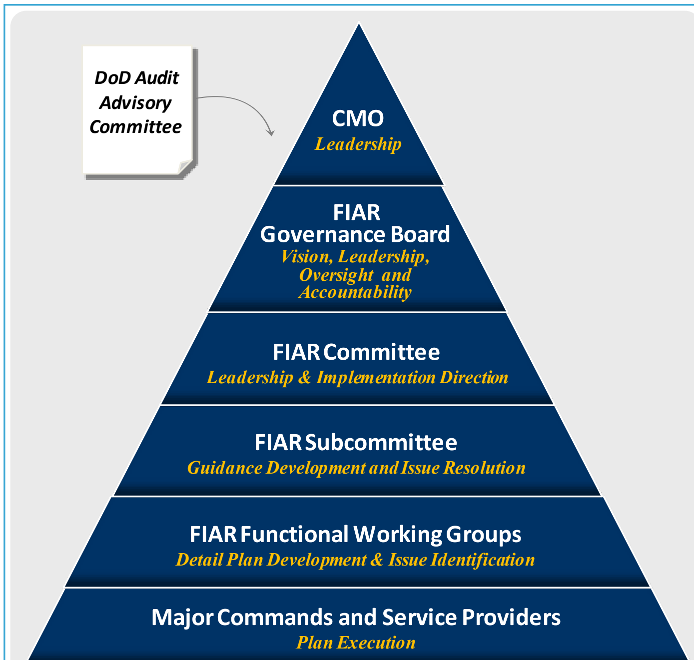
## 2.I Roles and Responsibilities

### 2.I.1 Governance

The Department has implemented a governance structure that engages all of its key stakeholders. **Figure 10** provides a graphical representation of the structure, the participants, and their roles. The USD(C) and FIAR Governance Board provide the vision, goals, and priorities of the FIAR Strategy, which are coordinated with key stakeholders within the Department, e.g., Military Departments, as well as outside the Department (OMB and Congress). The Deputy Secretary of Defense/CMO approves the vision, goals, and priorities.

### 2.I.2 FIAR Governance Board

The USD(C) and DCMO co-chair the FIAR Governance Board, which includes the Military Department DCMOs. The FIAR Governance Board engages the Department’s most senior leaders from the financial management community along with the DCMOs and senior representatives from the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) (OUSD(AT&L)). The DCMOs have cross-community (business and financial) responsibilities and authority to transform budget, finance, and accounting operations, and to eliminate or replace financial




| | |
|---|---|
| **Leadership** | • CMO |
| **Vision, Leadership, Oversight & Accountability** | • USD(C)/CFO, DoD DCMO, MILDEP DCMOs, MILDEP FM/C Asst Secretaries, DCFO, DFAS Director, DLA Compt |
| **Leadership & Implementation Direction** | • DCFO, FIAR Director, AT&L Directors, MILDEP FM/C Deputy Asst Secretaries, Senior Assessment Team (SAT), DFAS DepDir, DLA Compt, DoD IG (Advisory Member) |
| **Guidance Development & Issue Resolution** | • FIAR Director, Senior Staff of AT&L, Component FM and Functional Offices, DoDIG (Advisory Member) |
| **Detail Plan Development & Issue Identification** | • FIAR Staff, Staff of AT&L, Component FM and Functional Offices |
| **Plan Execution** | • Major Commands, Service Providers |

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**Figure 10 - FIAR Governance spans from the CMO through Major Commands and Service Providers**

management systems that are inconsistent or not aligned to transformation efforts.

The FIAR Governance Board meets quarterly and monitors Component progress. Accountability for progress begins at the top and is a key role of the Board. The Board's governance role also provides the Department with a visible leadership commitment that is critical to achieving the FIAR goals and objectives

### 2.I.3 DoD Reporting Entities (including their Major Commands) and Service Providers

#### *Reporting Entities*

The CFO Act, as amended by the Government Management Reform Act (GMRA), requires major agencies of the Federal Government to prepare and submit audited financial statements. Additionally, OMB requires the Department and several of its reporting entities, to prepare quarterly and annual stand alone financial statements in accordance with OMB Circular A-136, "Financial Reporting Requirements." The DoD Agency-wide financial statements provide the financial status of the entire Department. In this guidance, the DoD reporting entities refer to entities within the Department that prepare stand-alone financial statements, as well as Other Defense Organizations (ODOs) entities and funds that are material to the DOD Agency-wide financial statements and perform audit readiness activities.

The reporting entities' major commands, such as the NAVFAC, execute the FIPs, perform the *Discovery Phase* tasks, test and strengthen internal controls, and correct deficiencies. It is within the major commands where business events occur that trigger financial transactions, and where the functional community engages with the financial community to achieve the vision, goals, and priorities of the USD(C). **Figure 11** illustrates the interconnection between reporting entities and service providers[6], entities that provide services to and are responsible for executing one or more significant business processes on behalf of the reporting entities, across the five Financial Improvement Elements (FIE).

Details for Service Providers is located in Section 3.B FIAR Methodology Service Provider.


**Figure 11. Service providers are responsible for portions of the financial improvement elements of customer reporting entities**

[6] In AICPA literature, a service provider is normally referred to as a "service organization".

# 3. FIAR METHODOLOGY

## 3.A Methodology – Reporting Entity

**The Methodology is a mandatory set of standardized phases and tasks that reporting entities must follow to achieve audit readiness.** The Methodology, shown in **Figure 12**, is discussed in the pages that follow.

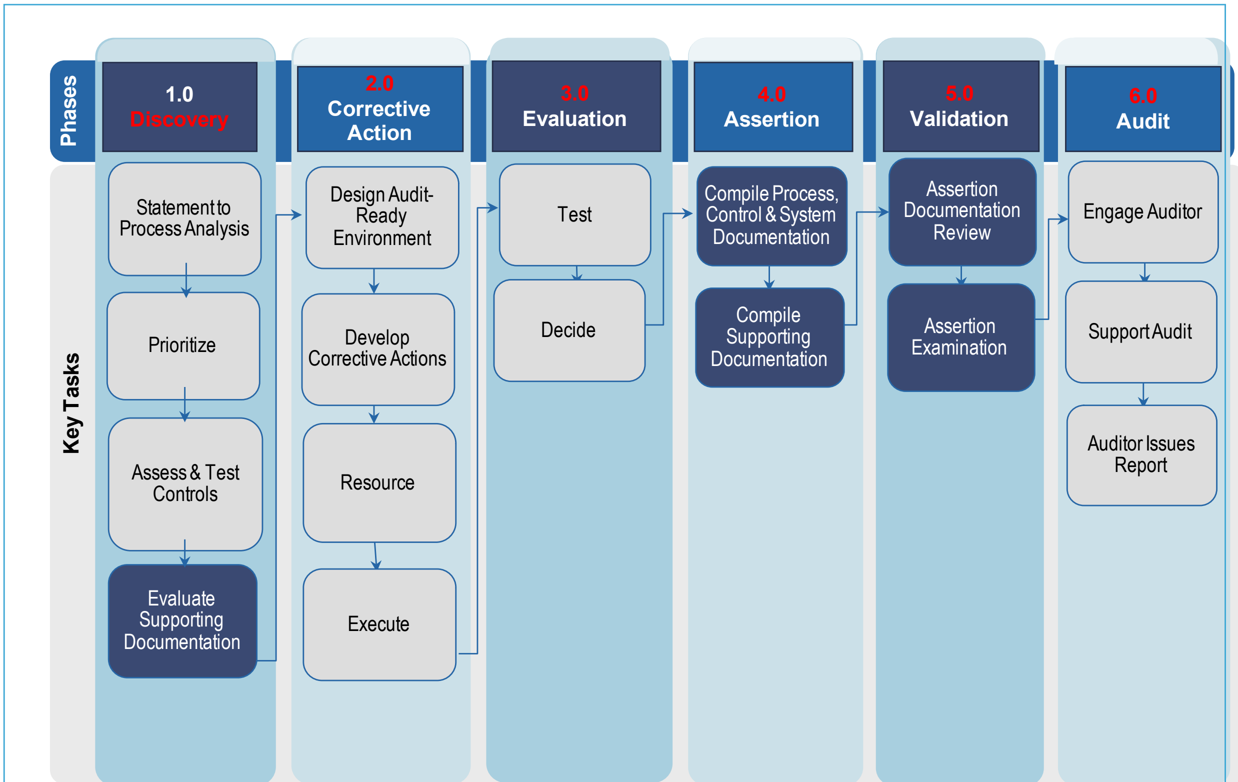


**Figure 12. Phases and Key Tasks to Achieve Auditability and Reliable Financial Information**

### 3.A.1 Phases and Key Tasks

The Methodology provides phases and key tasks for improving financial information and achieving audit readiness. **Figure 12** graphically depicts the phases and the key tasks within each phase.

The phases and key tasks, which can be applied uniformly regardless of the size, materiality, or scope of an assessable unit, are as follows:

1. Discovery:

   a. document business and financial environment,

   b. define and prioritize its processes into assessable units,

   c. assess risks, define key control objectives and control activities, and tests controls,

   d. evaluate supporting documentation, and
   e. identify weaknesses and deficiencies.
2. <u>Corrective Action</u>:
   a. define and design audit readiness environment, to include implementation of the audit ready environment,
   b. document solutions to resolve each deficiency identified,
   c. identify resources required and committed, and
   d. define and develop validation procedures that will be performed to confirm the corrective action plan successfully remediated the deficiency.
3. <u>Evaluation</u>:
   a. evaluate corrective action effectiveness through testing and
   b. determine whether management is ready to assert audit readiness.
4. <u>Assertion</u>:
   a. prepare documentation and assert audit readiness to the OUSD(C) and DoD OIG and
   b. submit a management assertion about the reporting entity's design and effectiveness of its internal controls based on the results of the three preceding phases.
5. <u>Validation</u>:
   a. review and provide feedback on management's assertion and
   b. engage auditors to perform an examination on audit readiness assertion.
6. <u>Audit</u>:
   a. engage an auditor and
   b. support the audit of assessable unit or financial statements, depending on the assessable unit.

**Reporting entities are responsible for the *Discovery Phase*, *Corrective Action Phase*, *Evaluation Phase*, and *Assertion Phase* for their assessable units or financial statements. The reporting entity then engages an independent auditor to perform an examination on management's audit readiness assertion in the *Validation Phase* and once the examination validates the reporting entity is audit ready, the reporting entity engages an independent auditor to perform the audit of the assessable unit or financial statement(s) in the *Audit Phase*.**

**Reporting entities are also required to annually prepare and submit a SOA over internal controls over financial reporting and internal control over financial systems. This is not a separate phase, rather an annual requirement that must be performed regardless of the audit readiness status of the reporting entity. Requirements related to the submission of the annual statement of assurance including the summary corrective action plan are described in**

**Section 2.F. Please refer to the FIAR Guidance website to obtain the latest *Statement of Assurance Memorandum* Template and the *Corrective Action Plan* Template.**

The terms "audit," "examination", and "specified elements audit," used throughout this document are defined as:

- Financial statement audit (Audit) – The primary purpose of a financial statement audit is to provide reasonable assurance through an opinion (or disclaimer of an opinion) about whether an entity's financial statements are presented fairly in all material respects in conformity with United States (U.S.) generally accepted accounting principles (GAAP). These audits are performed in accordance with Generally Accepted Government Auditing Standards (GAGAS).
- Examination – Consists of obtaining sufficient, appropriate evidence to express an opinion, in accordance with GAGAS, on whether the subject matter is based on (or in conformity with) criteria[7] that are suitable (i.e., objective, measurable, complete and relevant) and available to users, in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria. See Section 2.D for example management assertion template to be used when engaging an auditor for a *Validation Phase* audit readiness examination.
- Specified elements audit – Consists of an independent auditor conducting an audit in accordance with GAGAS and AU623, *Special Reports,* to obtain sufficient, appropriate evidence to express an opinion in connection with specified elements, accounts or items of a financial statement.

### 3.A.2. Consideration of Service Providers

Embedded within the Methodology's phases are the reporting entity's considerations of its service providers and how their activities affect its financial processes and related audit readiness.

**Reporting entities' management is responsible for the internal control over their financial information and, therefore, must ensure that they understand what financially significant activities are outsourced to service providers and the effectiveness of the service providers' related internal controls. In turn, service providers are responsible for providing a description of their controls that may affect their customer reporting entities' control environment, risk assessment, control activities, and information and communication systems.** The description of controls should be detailed enough to provide the reporting entity auditors with sufficient information to assess the risks of material misstatement. For a detailed discussion of service providers' role in the Methodology, see Section 3.B.

[7] "Criteria" are the standards or benchmarks used to measure or present the subject matter and against which the practitioner evaluates the subject matter. Management may establish criteria for an examination; however, practitioners will evaluate management's criteria to ensure that it is suitable, that is, relevant, measurable, complete and objective. (http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AT-00101.pdf)

### 3.A.3 Assessable Units

**Reporting entities must follow the Methodology for each assessable unit.** Assessable units can vary between line items, processes, systems, or classes of assets, depending on the wave and reporting entity preferences. These assessable units can be further separated into assessable sub-units at the entity's discretion. **Reporting entities must establish assessable units for all processes, systems, or classes of assets that result in material transactions and balances in their financial statements.** Additionally, established assessable units should not be duplicative or overlap. To ensure completeness of assessable units, reporting entities should prepare quantitative drill downs depicting the dollar volume of activity flowing through each assessable unit consistent with the tasks in the *Discovery Phase* step 1.1.2. Wave-specific considerations when identifying assessable units are included in the following paragraphs.

#### *Waves 1 & 2*

**The USD(C) has pre-defined one assessable unit for the SBR, Appropriations Received, which represents Wave 1. Due to its limited scope, the USD(C) has pre-defined this assessable unit for all reporting entities and directed them to prioritize this assessable unit to allow the Department to demonstrate immediate progress.** Refer to **Appendix C** for a more detailed discussion of the scope of this wave.

Beyond Wave 1, reporting entities have the flexibility to determine their appropriate assessable units for the remainder of the SBR (Wave 2). Assessable units for the SBR may be subaccounts that make up the obligations line item, classes of financial transactions or processing systems. For example, the "Obligations Incurred" line item on the SBR is comprised of many types of financial transactions that are processed through many systems. Assessable units within the "Obligations Incurred" line item may be comprised of classes of financial transactions, such as contractor payments, military pay, and civilian pay. For example, an assessable unit may be a class of transactions or it may also be all financial transactions that are processed through a particular system. Determining assessable units is a key task of preparing for auditability because the assessable units provide the focus for financial improvement efforts.

#### *Waves 3 & 4*

For Waves 3 & 4, assessable units include classes, categories, or groupings of all accountable assets. Asset-related assessable units may also be groups of data within an APSR, such as the Reliability and Maintainability Information System (REMIS), which is used by the Air Force for aircraft accountability, and the Defense Property Accountability System (DPAS), which is used by the Marine Corps (and other reporting entities) for GE. When the data in an APSR defines the assessable unit, the scope will include all mission critical assets within the system. Examples of assessable units for these waves include:

- Aircraft,
- Satellites and satellite launchers,
- Intercontinental ballistic missiles,
- Unmanned aerospace vehicles, and

- Externally carried pods.

### 3.A.4 Financial Systems Considerations

Reporting entities are responsible for internal controls relevant to financial information systems through which their transactions are processed. **Reporting entities must ensure that the requirements set forth in GAO's Federal Information System Controls Audit Manual (FISCAM) are met for the systems that are necessary to achieve financial improvement and audit readiness.** The GAO's FISCAM is comprised of three sections for internal controls relevant to financial information systems:

- Entity Level Information Technology General Controls (ITGCs),
- Application Level ITGCs, and
- Automated Application Controls.

Entity Level ITGCs consist of: Security Management, Access Controls, Configuration Management, Segregation of Duties, and Contingency Planning. Entity Level ITGCs are pervasive across platforms and affect the entire organization. Application Level ITGCs cover the same basic controls as Entity Level ITGCs, but focus solely on the business and/or financial system and any feeder systems.

Automated Application Controls use a different set of control categories (Application Security, Business Process Controls, Interface and Conversion Controls and Data Management System Controls) and focus on a specific application (e.g., STANFINS, Defense Civilian Pay System, etc.). In those instances where reporting entities have identified, documented the design, and tested the operating effectiveness of internal controls during DIACAP (or other) certification and accreditation efforts, this work may be leveraged to complete the FISCAM steps relevant for financial reporting, but is not a substitute. The extent to which the results can be leveraged will be determined by the degree to which it meets FIAR controls documentation and testing requirements. FIAR has identified the FISCAM control activities and techniques needed to address the key internal controls over financial reporting risk areas most likely to be present based on the Department's experience. A summary analysis of those ***FISCAM control activities and techniques*** that have the highest relevance to addressing key risk areas for financial reporting and other FISCAM control activities and techniques that should be considered by reporting entities in their audit readiness efforts can be found on the FIAR Guidance website.

**Per DoD Instruction 5010.40, reporting entities are required to report, as part of their SOA, whether their financial systems comply with the requirements of FFMIA, also known as internal controls over financial management systems.**

As illustrated in the system view diagram included as **Figure 13**, in some cases, reporting entity financial systems may be owned and/or operated by executive agents and the transactions that flow through those systems may be processed by a service provider. In such situations, the reporting entity still has the ultimate responsibility for information technology controls over those systems through which its financial transactions flow, and will need to communicate and coordinate audit readiness efforts with the executive agent and service provider. Section 3.B provides a discussion of reporting entity and service provider roles and responsibilities in the execution of the Methodology and FIP reporting.

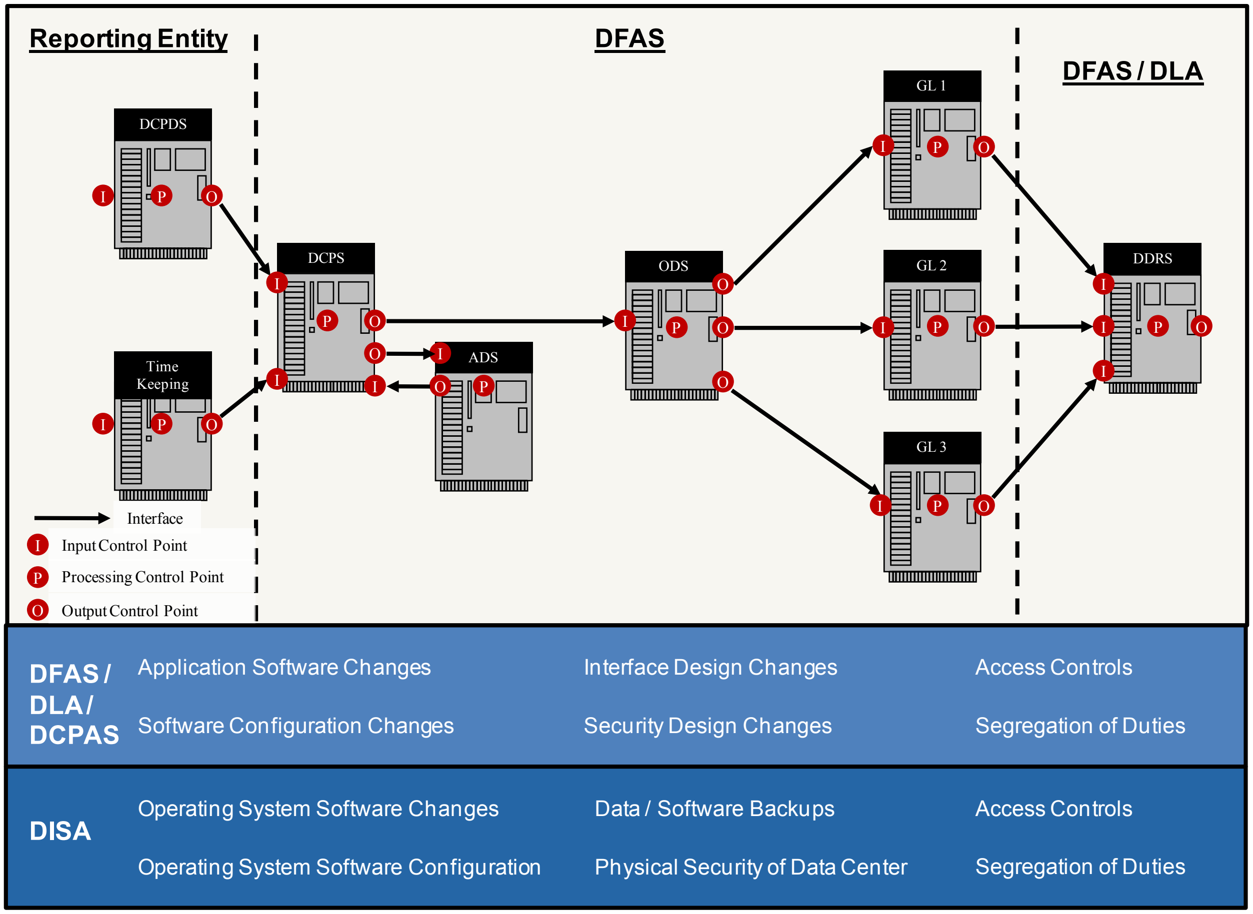


**Figure 13. System View Diagram: Reporting entities must consider information technology input, process, output and general computer controls for all relevant reporting entity and service provider systems**

Financial system controls are important to reporting entity audit readiness because system outputs (e.g., system reports) and electronic evidence (e.g., electronic invoices) may serve as KSDs for both the operating effectiveness of controls and transactions/balances. There are varieties of systems that must be considered in reporting entity audit readiness efforts, such as: general ledger systems, source/feeder systems, system interfaces, disbursing systems, reporting systems, and property management systems. **Therefore, reporting entities must ensure adequate entity-level and application-level ITGCs and automated application controls are in place or appropriate corrective actions are planned and implemented. The reporting entity must identify all key systems and feeder systems that affect the assessable unit being asserted as audit ready. These key systems have been evaluated and IT controls have been identified and tested if the reporting entity's**

- **Controls within the system are identified as key controls in the controls assessment**
- **Systems are used to generate or store original key supporting documentation, or**
- **Reports from a system are utilized in the execution of key controls.**

In addition, if reporting entities are implementing an ERP or system modernization and the system is a solution for resolving audit impediments, the reporting entity should map known process and control weaknesses to the new system's requirements to ensure that the new system will adequately address the impediment. For example, reporting entities with Environmental Liability material weaknesses should reference the DUSD(I&E) Environmental Liability business process reengineering requirements for mapping to their ERP and control objectives provided as KCOs.

## 3.A.5 Detailed Activities

Key tasks are essential to accomplish each of the six phases. The Methodology provides guidance to the reporting entities on the detailed activities that should be performed within key tasks that result in outcomes and work products that are essential to achieve audit readiness. As the reporting entities prepare and execute their FIPs to accomplish the USD(C) priorities for budgetary and mission critical asset information, these detailed activities should be reflected in their FIPs as key tasks within the appropriate phase. See FIAR Guidance Website for ***Wave 2*** and ***Wave 3*** example work products (described in **Figures 14 – 26 below)** required to be prepared as part of achieving auditability and reliable financial information for the Department.

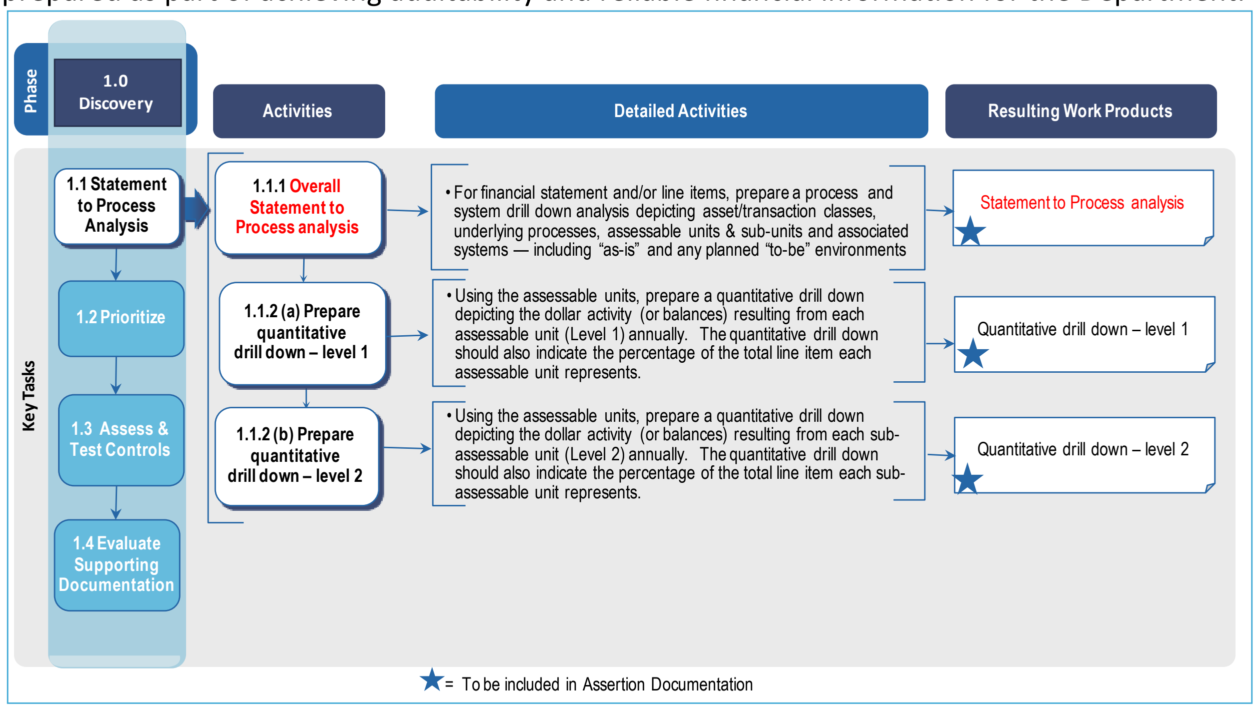


**Figure 14. Discovery Phase – Statement to Process Analysis**

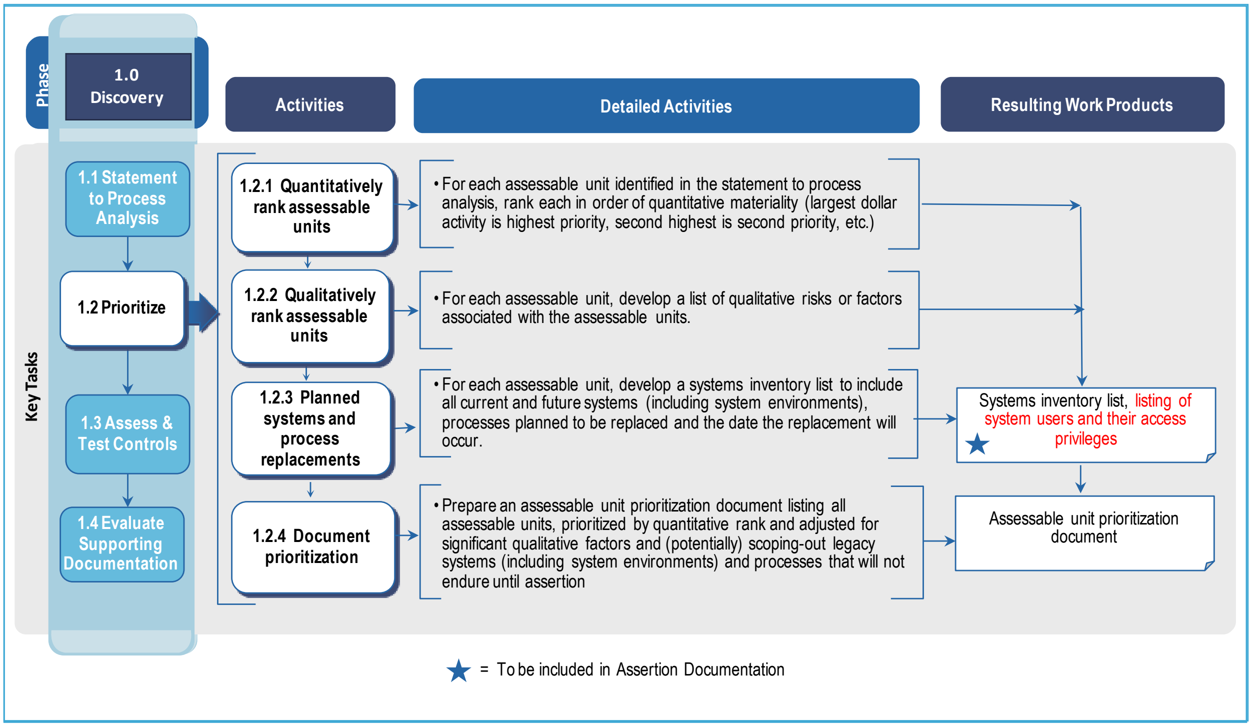


**Figure 15. Discovery Phase – Prioritization**

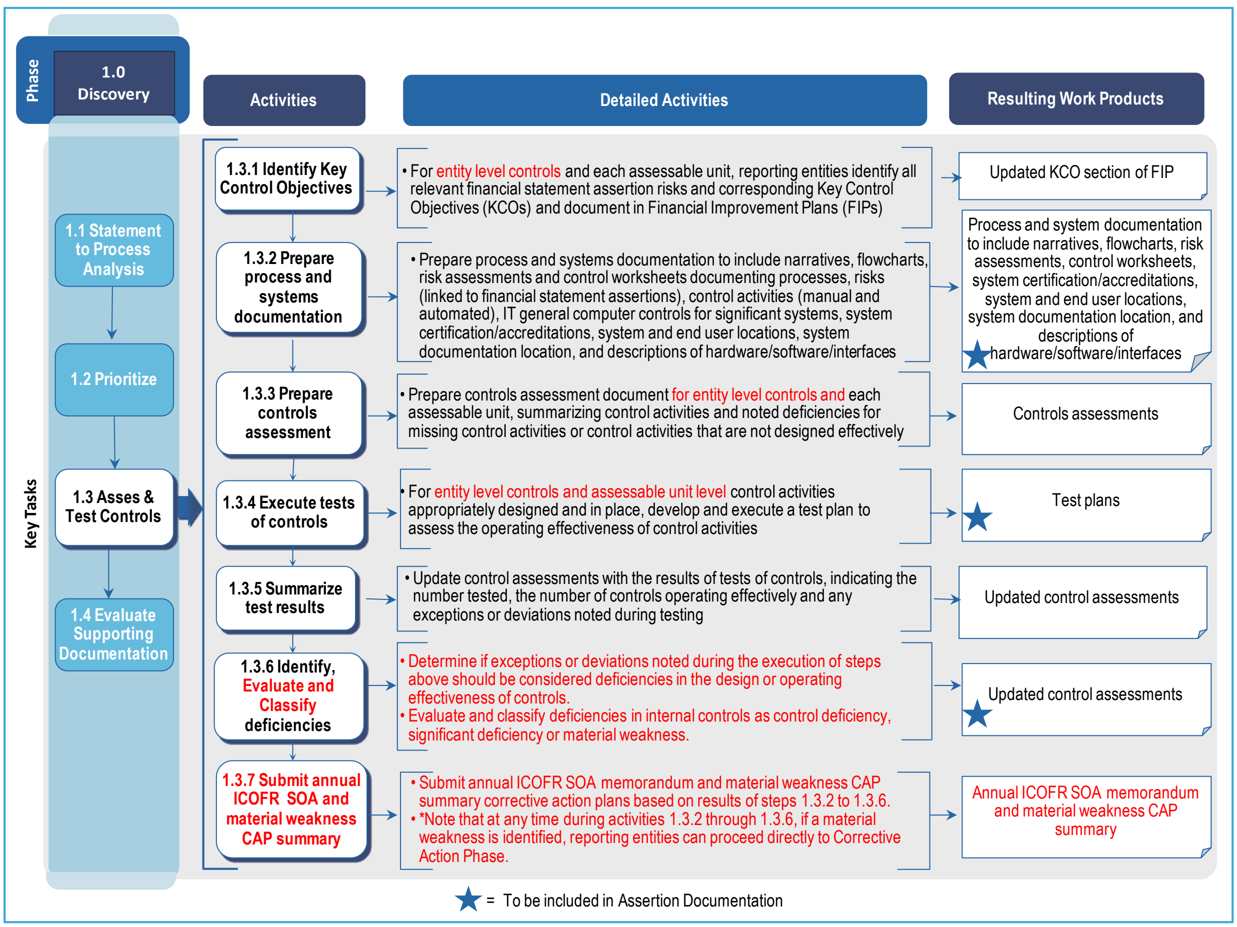


**Figure 16. Discovery – Test Controls and Develop ICOFR Statement of Assurance**

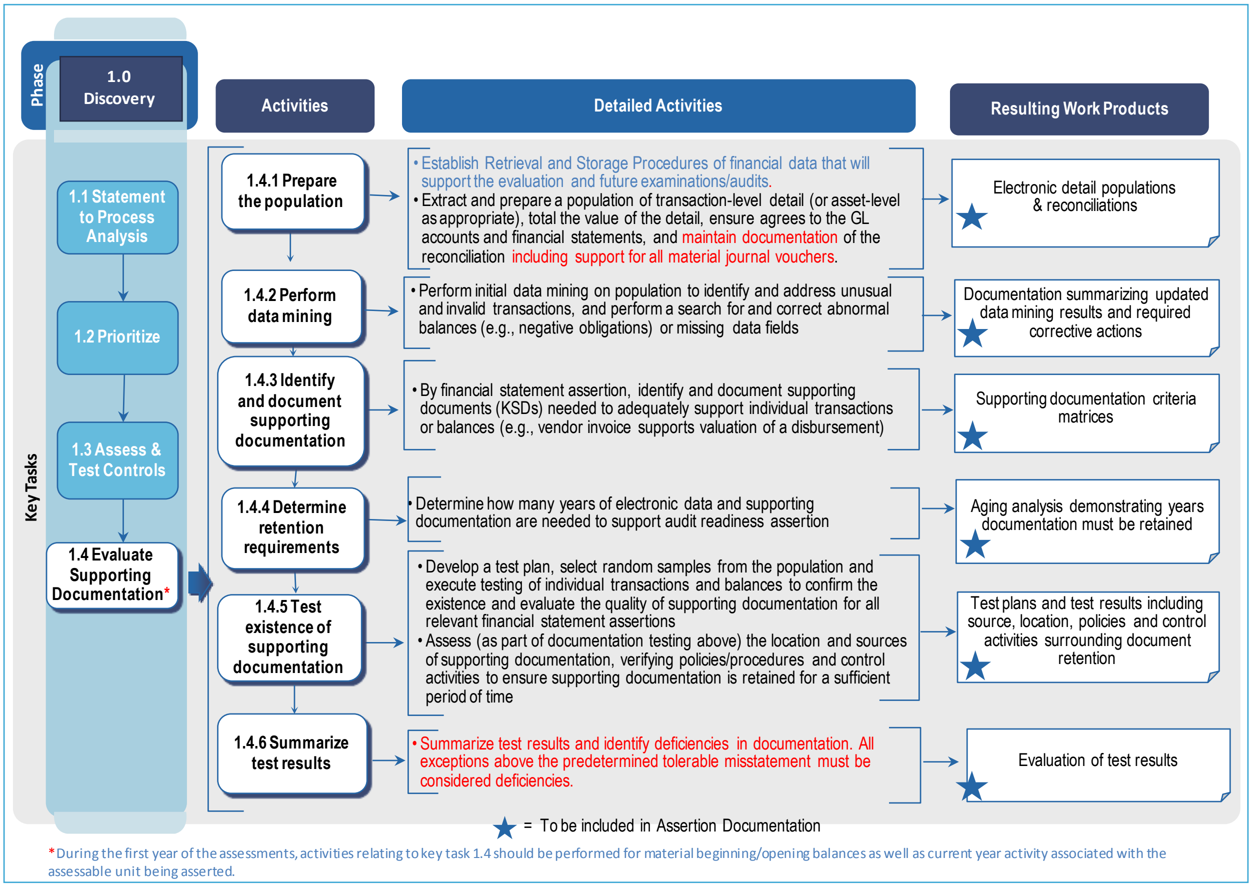


**Figure 17. Discovery Phase – Evaluate Supporting Documentation**

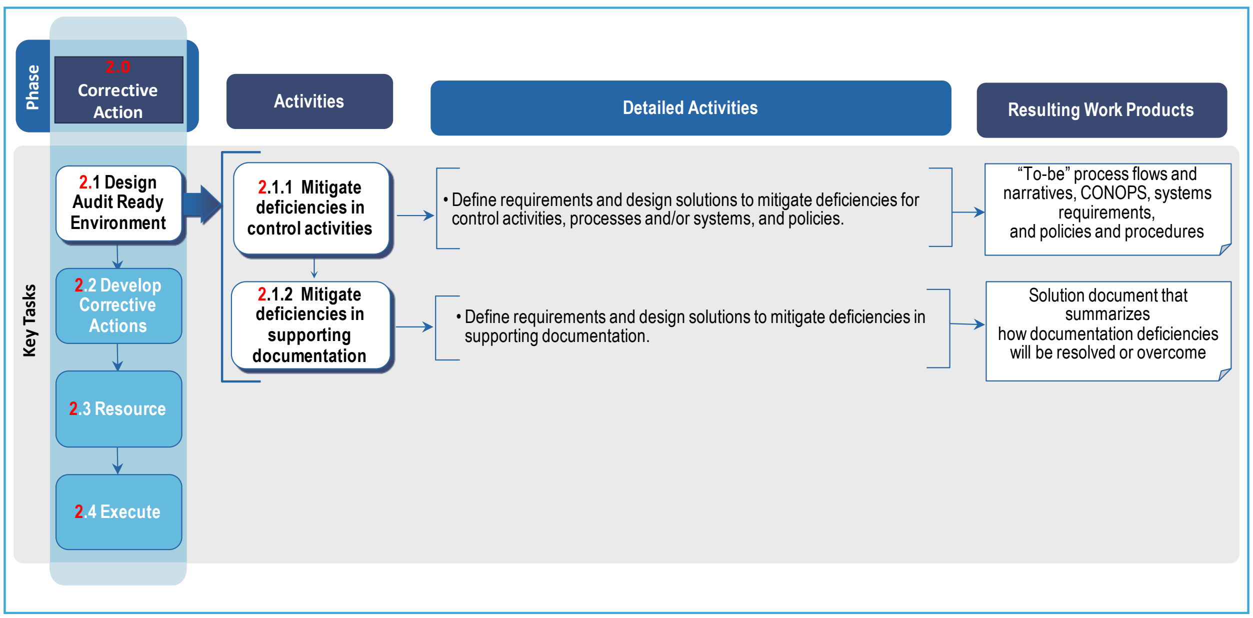


**Figure 18. Corrective Action Phase – Design Audit Ready Environment**

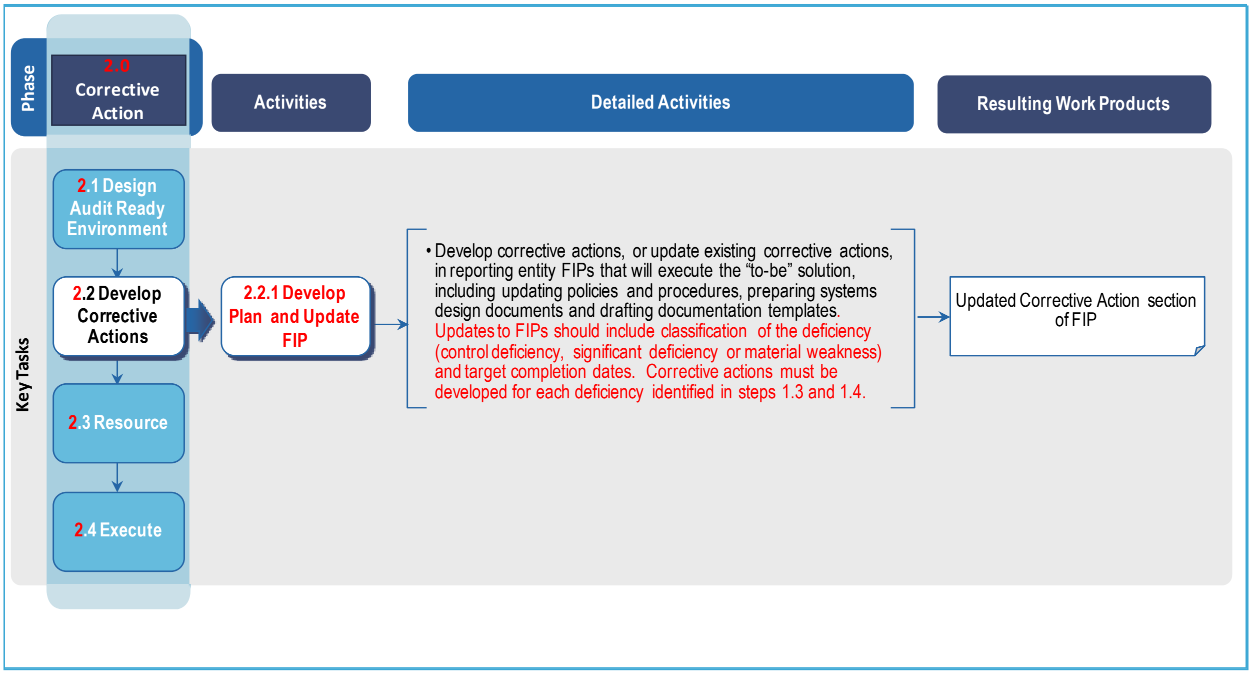


**Figure 19. Corrective Action Phase – Develop Corrective Actions**

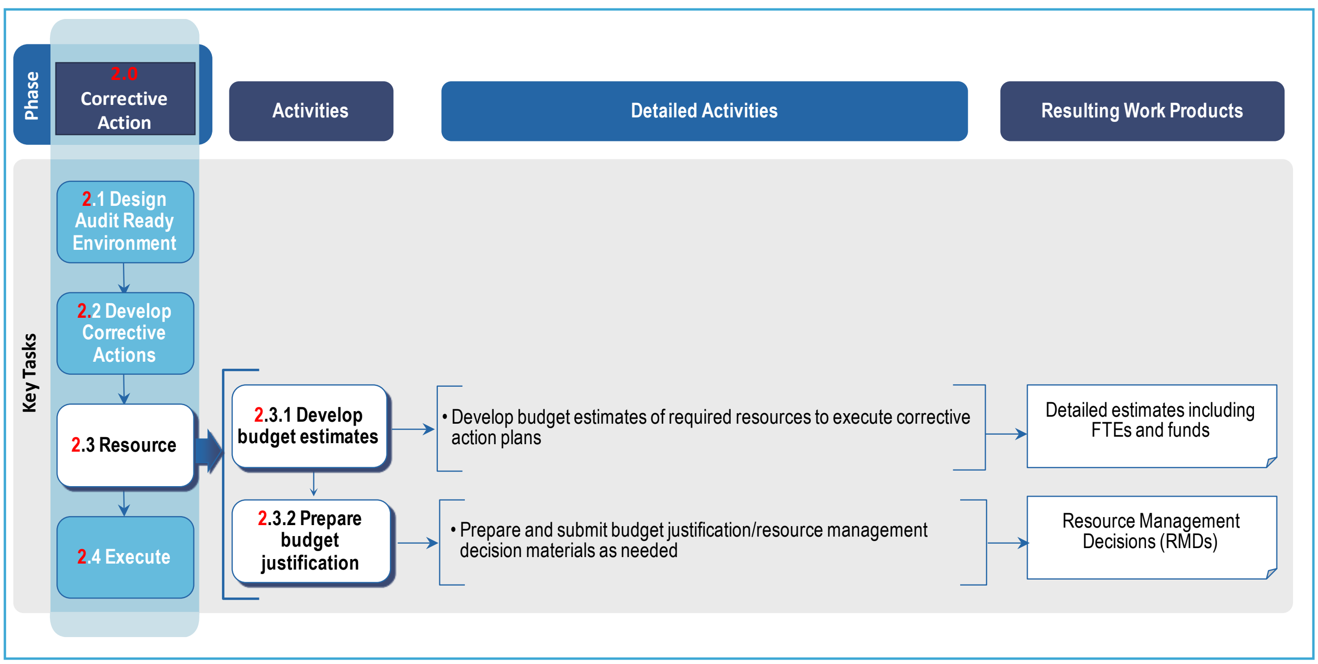


**Figure 20. Corrective Action Phase – Resource**

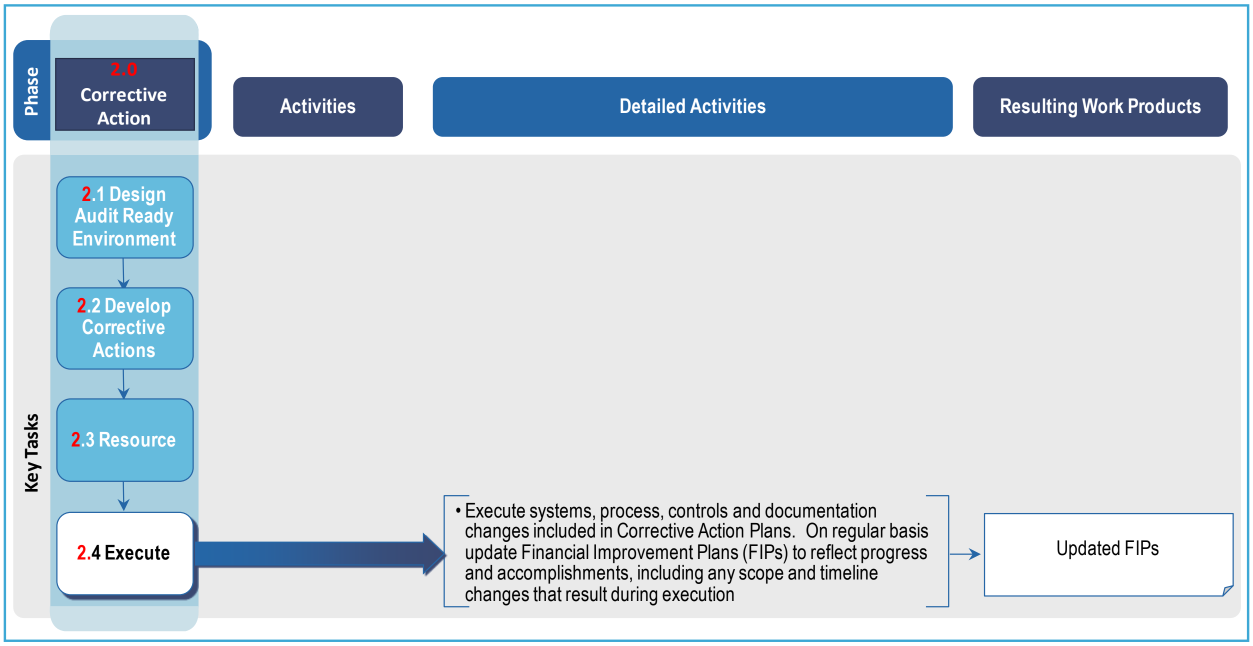


**Figure 21. Corrective Action Phase – Execute**

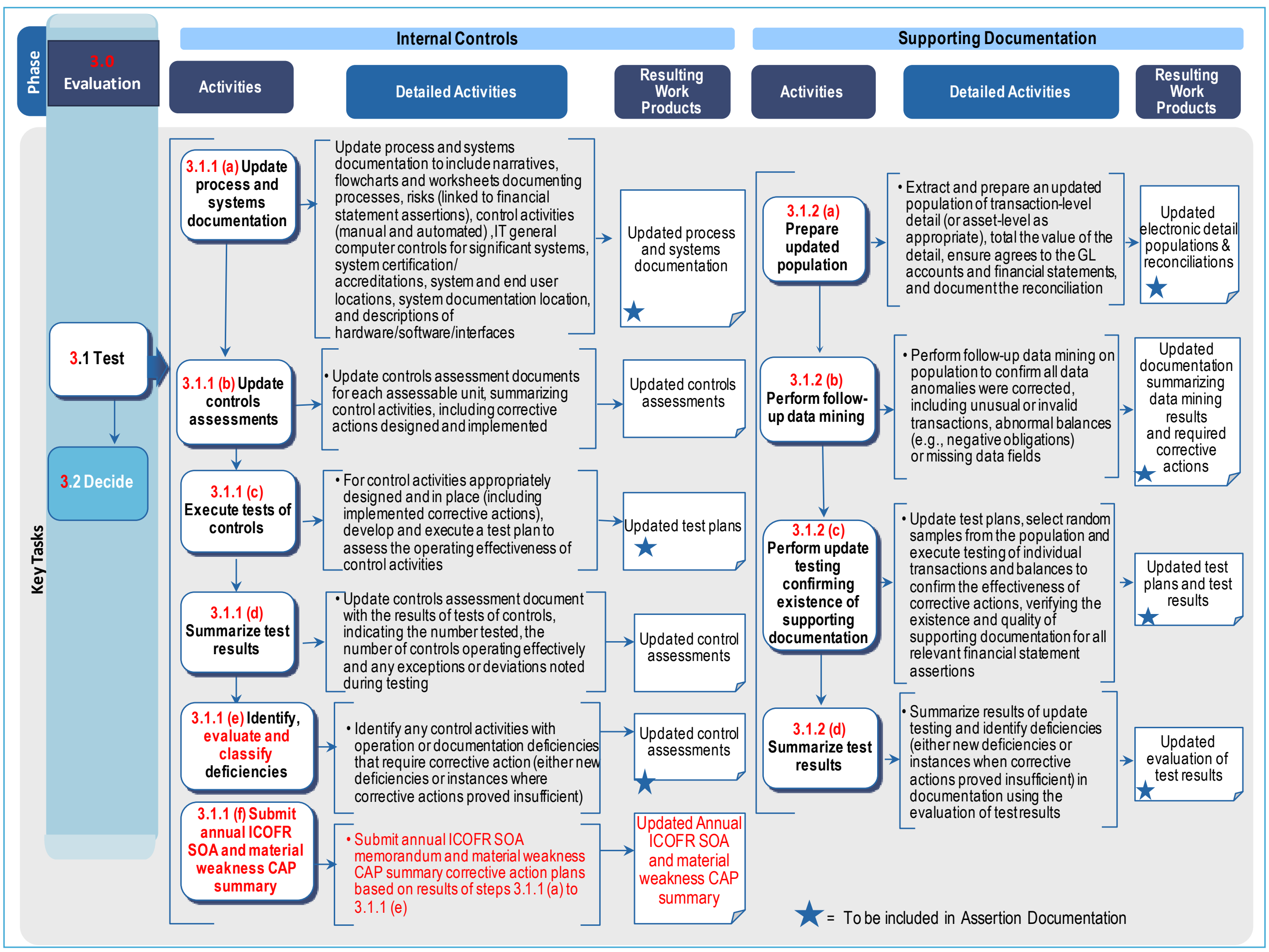


**Figure 22. Evaluation Phase – Testing**

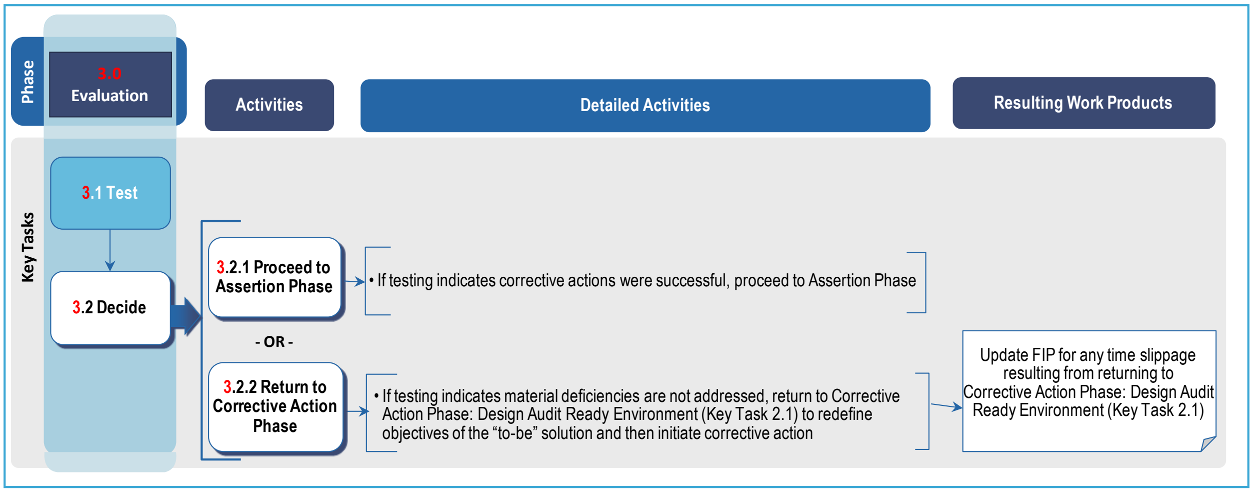


**Figure 23. Evaluation Phase – Decision**

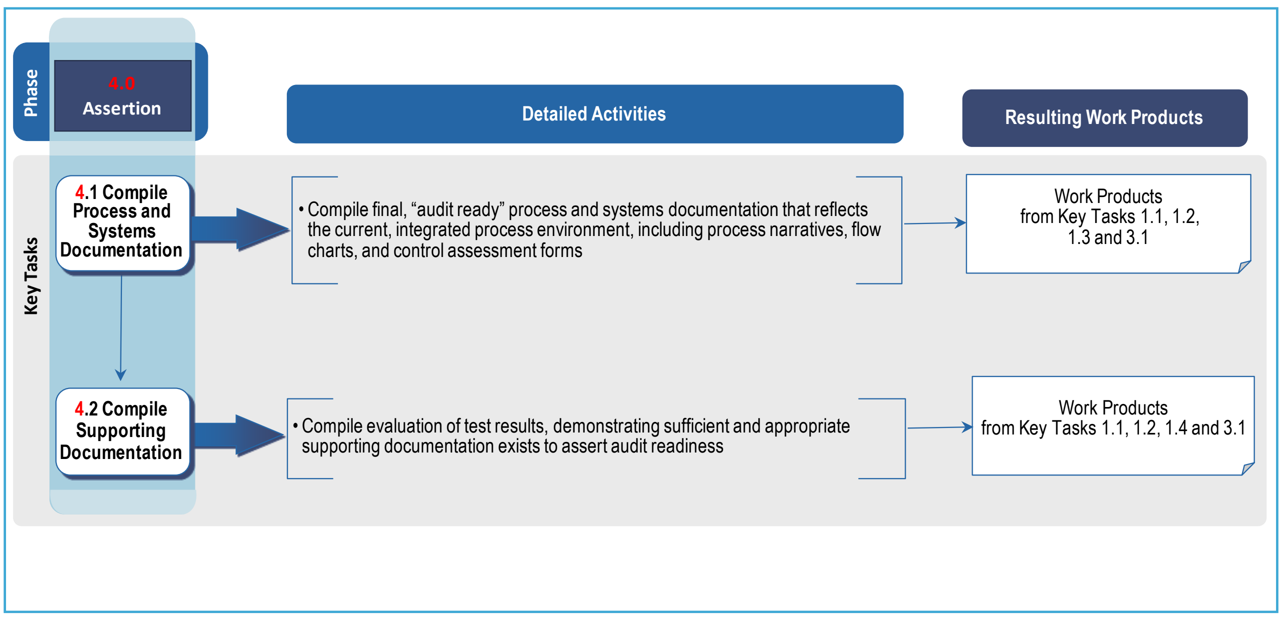


**Figure 24. Assertion Phase**

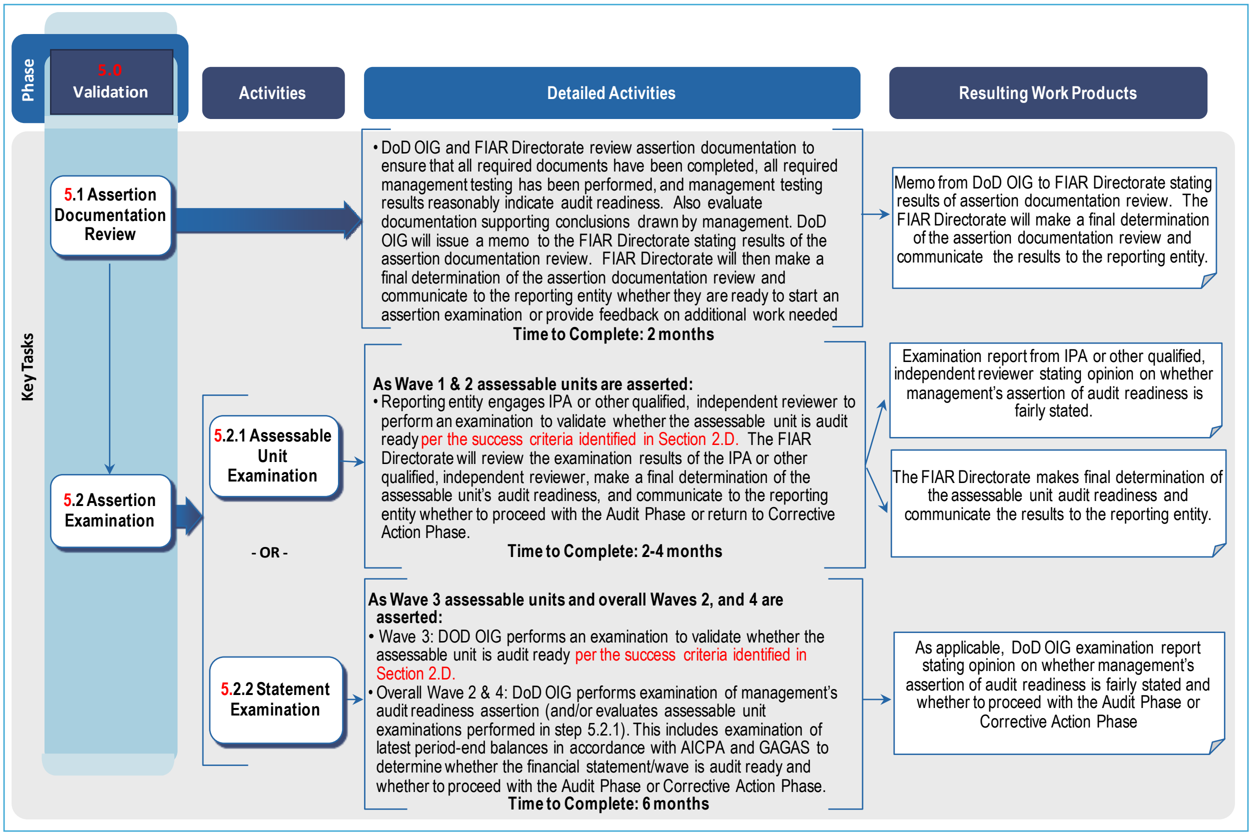


**Figure 25. Validation Phase**

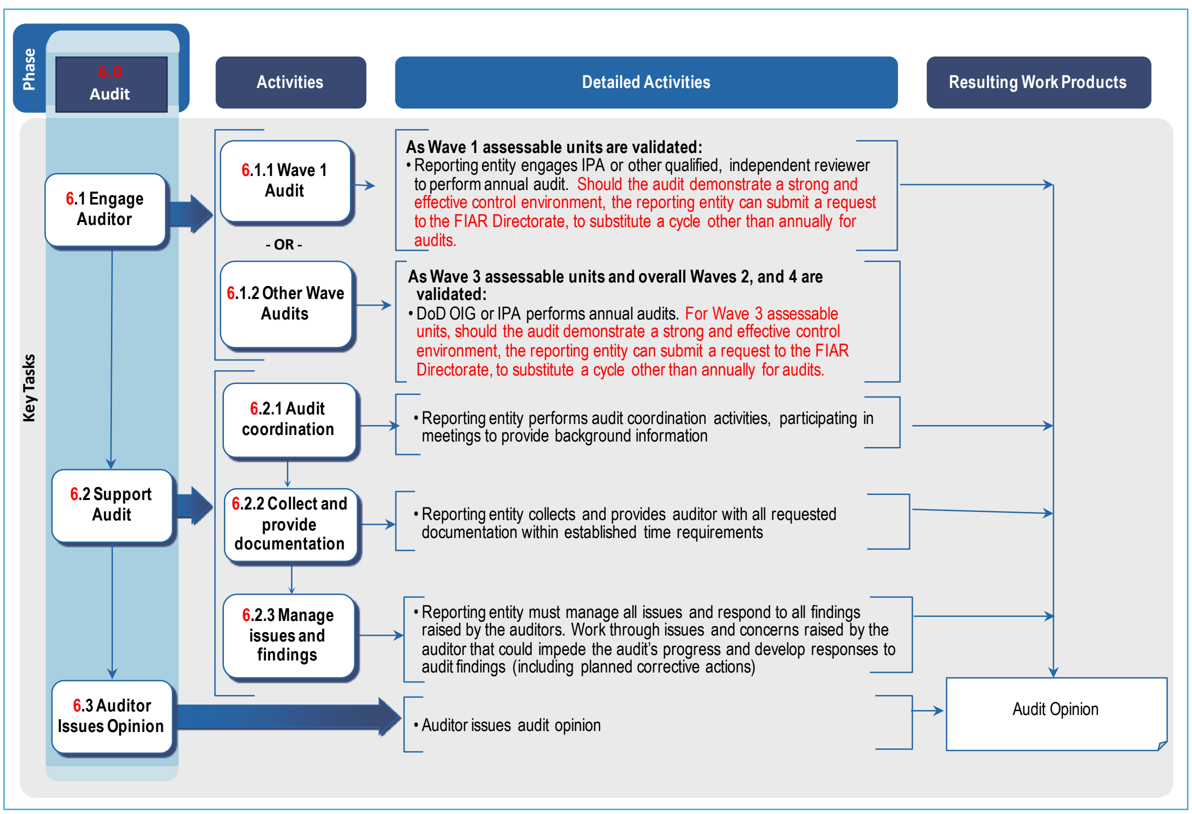


**Figure 26. Audit Phase**

### 3.A.6 Capabilities (Key Control Objectives and Key Supporting Documents)

**GAGAS require auditors to collect evidence supporting the fair presentation of financial statement amounts by focusing on two primary areas: internal controls and supporting documentation. Therefore, to achieve audit readiness reporting entities must:**

- **Limit the risk of material misstatements by designing and implementing control activities that will achieve KCOs, and**
- **Support account balances with sufficient and appropriate audit evidence defined as KSDs, supplemented with the reporting entity's own documentation requirements.**

To maximize the efficiency and effectiveness of audit readiness efforts, the Department has identified relevant financial statement assertion risks, KCOs (as defined in the ***Government Accountability Office/President's Council on Integrity and Efficiency Federal Audit Manual*** (GAO/PCIE's FAM), and supporting documentation required to substantiate financial transactions and balances by each of the four prioritized waves. For a full discussion of these requirements, see **Appendix C**.

#### *Key Control Objectives*

**KCOs must be included on all reporting entity and service provider FIPs, as they are the outcomes needed to achieve proper financial reporting and serve as a point of reference to evaluate the effectiveness of internal controls.** Effective internal controls mitigate risks and provide assurance that financial information is properly and accurately recorded and reported. They are critical to successful financial statement audits. KCOs do the following:

- Ensure that key risks are mitigated, and
- Ensure internal controls are aligned with the financial statement assertions.

During the *Discovery Phase*, identifying and assessing the design and operational effectiveness of internal controls is necessary to understand and evaluate operational business processes. The *Discovery Phase* includes assessments to identify inherent risks[8] and testing controls to identify weaknesses. Corrective action plans are developed and implemented to remediate noted weaknesses and then update testing is performed to ensure that the corrective actions were successfully implemented to achieve the control objectives.

To identify relevant KCOs to address key risks for the SBR and each E&C priority assessable unit, the Department reviewed the GAO/PCIE Financial Audit Manual and other relevant GAO guidance and selected KCOs that reporting entities must incorporate in their FIPs. **Reporting entities must indicate whether they have assessed control activities that meet KCOs, and whether the control activities are effective.** If they are not effective, then specific corrective action and re-testing tasks must be included in the entity's FIP and linked to the appropriate

[8] The GAO/PCIE *Financial Audit Manual*, Section 260: Identify Risk Factors, Paragraph .02, defines inherent risk as "the susceptibility of a relevant assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls."

KCO. By embedding the KCOs in the FIPs and linking corrective actions to them, the Department is better assured that financial reporting deficiencies will be identified and resolved. Additionally, progress toward achieving reliable financial information and auditability can be better monitored, managed, and measured.

### *Supporting Documentation*

**Reporting entities' FIPs must include specific tasks to ensure adequate KSDs are retained to demonstrate that control activities are properly designed and operating effectively to satisfy KCOs, as well support individual financial transactions and accounting events. Assessing supporting documentation is an essential FIP task and is a critical audit requirement for SBR and E&C assertions. In fact, the GAO/PCIE FAM states that organizations must retain documentation to support:**

1. **Balances reported in the financial statements,**
2. **Systems of internal control,**
3. **Substantial compliance of the financial management systems with FFMIA requirements,**
4. **Substantial compliance of internal controls with FMFIA requirements,**
5. **Compliance with laws and regulations, and**
6. **Required supplementary information (RSI) including any stewardship information (RSSI).**

The GAO/PCIE FAM also states that auditors performing financial statement audits must obtain sufficient evidential matter to form an opinion on an organization's financial statements.[9]

Auditors must adhere to professional standards, which have been codified as Auditing Standards (AUs). AU 326, paragraph .04 notes, "Management is responsible for the preparation of the financial statements based upon the accounting records of the entity."

**Reporting entities must identify the documents that qualify as adequate supporting documentation and determine the retention period for the documents.** These determinations must be made before a successful SBR and E&C audit can be achieved. **Appendix C** provides the KCO and KSD requirements for each prioritized wave of the Strategy.

#### *AUDIT READINESS "DEALBREAKERS"*

Drawing on lessons learned from past audit readiness efforts, the FIAR Directorate has compiled a list of dealbreakers that have prevented reporting entities from achieving audit readiness. **Figure 27** lists the most common dealbreakers and links each back to where the item will be addressed by following this Guidance.

[9] Government Auditing Standards (Yellow Book) are the requirements for those performing Federal financial statement audits. The GAO/PCIE *FAM* is subordinate to Yellow Book requirements in the event conflicts arise.

| Dealbreakers | FIAR Guidance Reference |
|---|---|
| 1. Reconcile the general ledger to transaction detail, including support for all material journal vouchers related to the assessable unit. | **Figure 17,** Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.1 Prepare the population. |
| 2. Testing of transaction samples back to source documents that: | **Figure 17**, Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.5 Test existence of supporting documentation. |
| a. Does not cover all material transaction types, sub-processes, and locations | **Appendix D,** Section D.3, Supporting Documentation Testing |
| b. Is not extensive enough to draw conclusions consistent with the effectiveness of controls. Specifically, if controls are ineffective, sufficient substantive testing (i.e., test of details performed through statistical or valid non-statistical sampling, or substantive analytical procedures) must be performed that would reduce the risk of material misstatements to an acceptable level, resulting in evidence that the balances are fairly stated. | Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation |
| 3. All financial statement assertions and relevant risks are not addressed either through control or substantive testing. | **Figure 16,** Discovery Phase, Task 1.3 Assess & Test Controls, Activity 1.3.1 Identify Key Control Objectives<br>**Figure 17,** Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.5 Test existence of supporting documentation. |
| 4. Reconciliations, transaction populations, and supporting documentation cannot be provided in a timely manner. | Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation |
| 5. Cannot demonstrate effective controls for high transaction volume areas (e.g., supply, contracts, FBWT, Inventory, OM&S, GE, etc.). | Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation |
| 6. IT general and application controls are not deemed effective and tested for management to rely on automated application controls or system generated reports (i.e., KSDs) from IT systems and/or microapplications. | Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation |
| 7. Supporting Documentation Testing (i.e., substantive testing) cannot overcome ineffective or missing ITGC and application controls when transaction evidence is electronic and only maintained within a system, or the key supporting evidence are system generated reports. | Section 3.C. Preparing for an Audit, Sub-section 3.C.1 Assertion Documentation |
| 8. Service provider processes, risks, and controls are not integrated within scope of testing if those processes are material to the assessable unit. | Section 3.A. FIAR Methodology-Reporting Entity, Sub-section 3.A.1 Phases and Key Tasks, and 3.A.2 Consideration of Service Providers. |
| 9. Management has not established retrieval and storage procedures of financial data that will support | **Figure 17,** Discovery Phase, Task 1.4 Evaluate Supporting Documentation, Activity 1.4.1. |

| Dealbreakers | FIAR Guidance Reference |
|---|---|
| management evaluation and future examinations/audits. | Prepare the Population. |
| 10. Material Beginning Balances/Opening Balances are not evaluated through appropriate testing. | **Figure 17,** Discovery Phase, Task 1.4 Evaluate Supporting Documentation. |

**Figure 27. Most Common Audit Readiness Dealbreakers**

### 3.A.7 Standard FIP Framework

Recognizing the benefits from a standard Financial Improvement Plan (FIP) framework and content, the FIAR Directorate, working collaboratively with reporting entities, developed a standard framework and template for the FIPs. The framework incorporates the Methodology Phases and KCOs, and is compatible with the Department's FIAR Planning Tool (FIAR-PT), which is a web-based software tool that provides DoD-wide access and visibility to the plans in a controlled environment.

Reporting entities and Service Providers (as necessary) are required by the standard FIP framework to include information that will improve their ability to manage their FIPs and the Department's ability to monitor progress indicators, examples include:

- Task start, finish, and baseline dates,
- Percent complete,
- Primary and secondary financial statement assertions,
- FIAR milestone designations[10],
- Responsible person,
- End-to-end process indicators,
- Lead and support organization designations, and
- Resource requirements to include level of effort to complete and level of effort committed.

**Reporting entities and service providers must use the standard FIP framework, regardless of their audit ready status, (i.e., under audit or preparing for audit).** The FIPs are living documents and must be maintained and updated as reporting entities progress through the phases/tasks/activities of the Methodology. Although the sequence of the information included in the standard FIP template may be altered, all required information must be included. FIP dates will be used to update the FIAR Plan Status Report, which serves as the Department's annual Financial Management Improvement Plan, required by Section 1008(a) of the NDAA for FY 2002, to address the issues preventing the reliability of Department financial statements. See FIAR Guidance website for the ***standard FIP template*** and ***FIP Preparation and Submission Instructions*** document.

[10] It should be noted that Components will also be meeting OMB Circular A-123, Appendix A milestones as part of their efforts for meeting the FIAR methodology milestone dates.

## 3.B FIAR Methodology – Service Provider

Reporting entities are responsible for all audit readiness efforts, including services performed by service providers. However, as shown in **Figure 29**, service providers working with reporting entities are also responsible for audit readiness efforts surrounding service provider systems and data, processes and controls, and supporting documentation that have a direct affect on reporting entities' auditability.


**Figure 29. Service providers are responsible for the systems and data, processes and controls, and supporting documentation that affect a reporting entity's audit readiness efforts**

Normally it is inefficient for both the entity under audit and the service provider to have the financial statement auditors also audit the service provider's controls. The general practice is for the service provider to have an examination in accordance with the Statement on Standards for Attestation Engagements (SSAE) No. 16[11] on the service provider's controls. An SSAE No. 16 report includes the following four sections:

1. Section 1 – Service Auditor's Report
2. Section 2 – Management's Assertion
3. Section 3 – Management's Description of its system(s), including control objectives and related controls
4. Section 4 – Service Auditor's Description of tests of controls and results

The reporting entity's auditors can rely on the opinion, which reduces the nature and extent of internal control and substantive testing required for the financial statements audit. From the perspective of the service provider, the primary benefit is not having extensive interaction with multiple reporting entity auditors, each evaluating and testing the service provider's controls.

The process for eliminating audit impediments and known service provider exceptions **is to follow the Service Provider Methodology whereby the service provider entity evaluates the effectiveness of control design and operation, and corrects material deficiencies before an SSAE No. 16 examination begins.** The Service Provider Methodology incorporates the inter-relationships between the reporting entity's end-to-end processes and the service provider's processes, systems, controls, transactions and documentation. For example, **Figure 30** is a notional illustration of the Civilian Pay process. The illustration includes processes, systems, controls, and documentation within both the reporting entity and the service provider. Note that controls may be manual or automated and documentation may reside in either entity. In addition, transactions may occur within the reporting entity portion of the process or service provider portion of the process. **Therefore, both organizations must be able to provide**

[11] SSAE No. 16 superseded Statement on Auditing Standard (SAS) No. 70, effective for reports with an issue date of June 15, 2011 or later.

**supporting documentation to demonstrate that controls are properly designed and operating effectively and transactions are properly posted to the accounting records.**

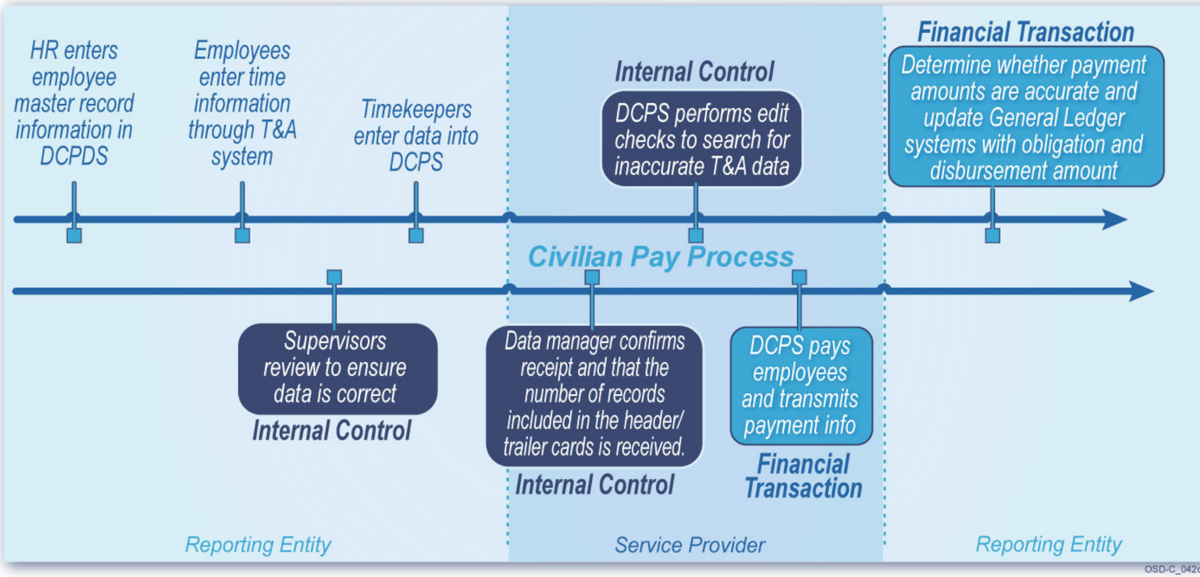


**Figure 30. Reporting entities and service providers are responsible for different segments of end-to-end processes in the Department**

### 3.B.1 Definitions

The following SSAE No. 16 definitions facilitate the discussion of the Service Provider Strategy and Methodology that follow:

- Reporting Entity – The entity that has outsourced business tasks or functions to other entities (service providers) and is working to become audit ready or its financial statements are being audited.
- Service Provider – The entity (or segment of an entity) that performs outsourced business tasks or functions for the reporting entity that are part of the reporting entity's manual and/or automated processes for financial reporting.
- User Auditor – The financial statement auditor who issues an opinion report on the financial statements of the reporting entity.
- Service Provider Auditor (Service Auditor) – The auditor who is retained by the service provider to issue an opinion on the service provider controls that are relevant to a reporting entity's internal control as it relates to an audit of the reporting entity's financial statements (e.g., SSAE No. 16 attestation report).

In addition to the SSAE No. 16 service provider definitions, the Department has designated executive agents as service providers. DoD Instruction (DoDI) 5101.1 "DoD Executive Agent" section 3.1, defines an executive agent as "the head of a DoD Component to whom the Secretary of Defense or the Deputy Secretary of Defense has assigned specific responsibilities, functions, and authorities to provide defined levels of support for operational missions, or administrative or other designated activities that involve two or more of the DoD Components." An example of an executive agent is an entity (or segment of an entity) that owns an information system and runs that system on behalf of a reporting entity (e.g. the DCPAS maintains the Department's Civilian Personnel System (DCPDS) software, which is used to initiate, approve, and process personnel actions for reporting entity civilian employees). Because Departmental executive agents are service providers, they must follow the Service Provider Methodology.

### 3.B.2 Relationship to Waves

The DoD Components include both reporting entities and service providers. The Department utilizes many service providers to improve efficiency and standardize business operations. This section of the Report describes the Department's methodology for service providers to be able to support their customers' work to achieve audit readiness, as well as Departmental efforts to develop a common strategy by bringing together service providers and reporting entities to identify risks, develop common control objectives, and ensure controls are designed to meet those risks and are operating effectively.

Examples of service providers within the Department include the Defense Finance and Accounting Service (DFAS), Defense Information Systems Agency (DISA), Defense Logistics Agency (DLA), Defense Contracts Management Agency (DCMA), and Defense Civilian Personnel Advisory Service (DCPAS). These service providers perform a variety of accounting, personnel, logistics, or system development or operations/hosting support.

The following table illustrates the most common service providers for each wave. It is not a complete list.

| **WAVES 2 & 3 SERVICE PROVIDERS** | |
|---|---|
| **Service Providers** | **Description of Services Provided** |
| **Wave 2 – Statement of Budgetary Resources** | |
| *CIVILIAN PAYROLL* | |
| DCPAS | DCPAS maintains DCPDS, or the Department's civilian Personnel system software, which is used to initiate, approve, and process personnel actions for reporting entity civilian employees. Additionally, for reporting entities other than the Military Services, DCPAS hosts the personnel system at a DCPAS managed data center. Accordingly, reporting entities rely on the system (including relevant system controls) to ensure the completeness, accuracy, validity, and restricted access to civilian personnel actions. |

| WAVES 2 & 3 SERVICE PROVIDERS | |
|---|---|
| **Service Providers** | **Description of Services Provided** |
| DFAS | DFAS calculates bi weekly civilian pay using personnel data obtained from the personnel system, combined with time and attendance information passed from reporting entity systems. In addition to calculating the bi-weekly payroll, DFAS also disburses the bi-weekly pay for reporting entities through direct deposit or check. The DFAS also records the bi weekly pay accounting transactions in the general ledger for some reporting entities.<br>The services performed by DFAS represent a large portion of the civilian pay activity; therefore, reporting entities are relying on DFAS processes, systems, and controls for a large portion of their civilian payroll process. |
| DISA | DISA hosts applications for the Department's service providers and reporting entities. Specific to civilian pay, DISA hosts DFAS pay processing and disbursing applications, as well as some of the reporting entity time and attendance and general ledger applications. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. For service providers and reporting entities to rely on the automated controls and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively. |
| *MILITARY PAYROLL* | |
| DFAS | DFAS processes the bi-monthly military pay using personnel data obtained from the Military Service's personnel systems. In addition to calculating the bi-monthly pay, DFAS also disburses the pay for military personnel through direct deposit or check. DFAS also records the bimonthly accounting transactions in the Military Departments' general ledger.<br>DFAS performed services represents a large portion of the military pay activity; therefore, the Military Services are relying on<br>DFAS processes, systems, and controls for a large portion of their military pay process. |
| DISA | DISA hosts applications for the Department's service providers and the Military Services. Specific to military pay, DISA hosts DFAS pay processing and disbursing applications, as well as some of the Military Services' general ledgers applications. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. For the service providers and Military Services to rely on the automated controls and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively. |

| WAVES 2 & 3 SERVICE PROVIDERS | |
|---|---|
| **Service Providers** | **Description of Services Provided** |
| *CONTRACT & VENDOR PAY* | |
| DLA | DLA maintains the Department's contract writing and invoice or receipt processing systems used to initiate, approve, and process contracts and invoices. Accordingly, reporting entities rely on these systems, including their relevant system controls, to help ensure the completeness, accuracy, validity, and restricted access for contracts and invoicing and receipt activity. |
| DCMA | DCMA maintains the Department's contract management system in coordination with DFAS that is used to manage the Department's largest contracts from inception to closeout. Accordingly, reporting entities rely on this system, including relevant system controls, to help ensure the completeness, accuracy, validity, and restricted access for contracts management activity. In addition to maintaining Department systems, DCMA monitors contractor performance and management systems to ensure that cost, product performance, and delivery schedules comply with the terms and conditions of the contracts |
| DFAS | DFAS performs the entitlement and disbursement functions of contract and vendor pay for the reporting entities. In addition, DFAS also records the contract and vendor pay accounting transactions in the general ledgers for some reporting entities. Accordingly, reporting entities rely on DFAS entitlement and disbursement processes and systems, including the relevant system controls, to help ensure the completeness, accuracy, validity, and restricted access for contract disbursements and accounting. |
| DISA | DISA hosts applications for the Department's service providers and reporting entities. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. In order for the service providers and reporting entities to rely on the automated controls and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively. |
| **Wave 3 – Existence & Completeness of Assets** | |
| DLA | DLA provides almost all consumable items needed by the Military Services to operate, from food, fuel, and energy to uniforms, medical supplies, and construction and barrier equipment. DLA also supplies the majority of the Military Services spare parts and manages the reutilization of military equipment. Accordingly, the Military Services rely on DLA processes and systems, including relevant system controls, to help ensure the completeness, accuracy, validity, and restricted access for certain military equipment, inventory, and operating materials and supplies. |

| Waves 2 & 3 Service Providers | |
|---|---|
| **Service Providers** | **Description of Services Provided** |
| DISA | DISA hosts applications for the Department's service providers and reporting entities. As a result, DISA is responsible for most of the Information Technology General Controls (ITGCs) over the environment in which these key applications reside. For service providers and reporting entities to rely on the automated controls and documentation within these applications, it is essential for the ITGCs to be appropriately designed and operating effectively. |

### 3.B.3 Strategy

**Figure 31 presents the steps a service provider must use to determine how it should approach service provider audit readiness at an assessable unit** (see **Section 3.A.3** for more detailed information on assessable units) **level.**

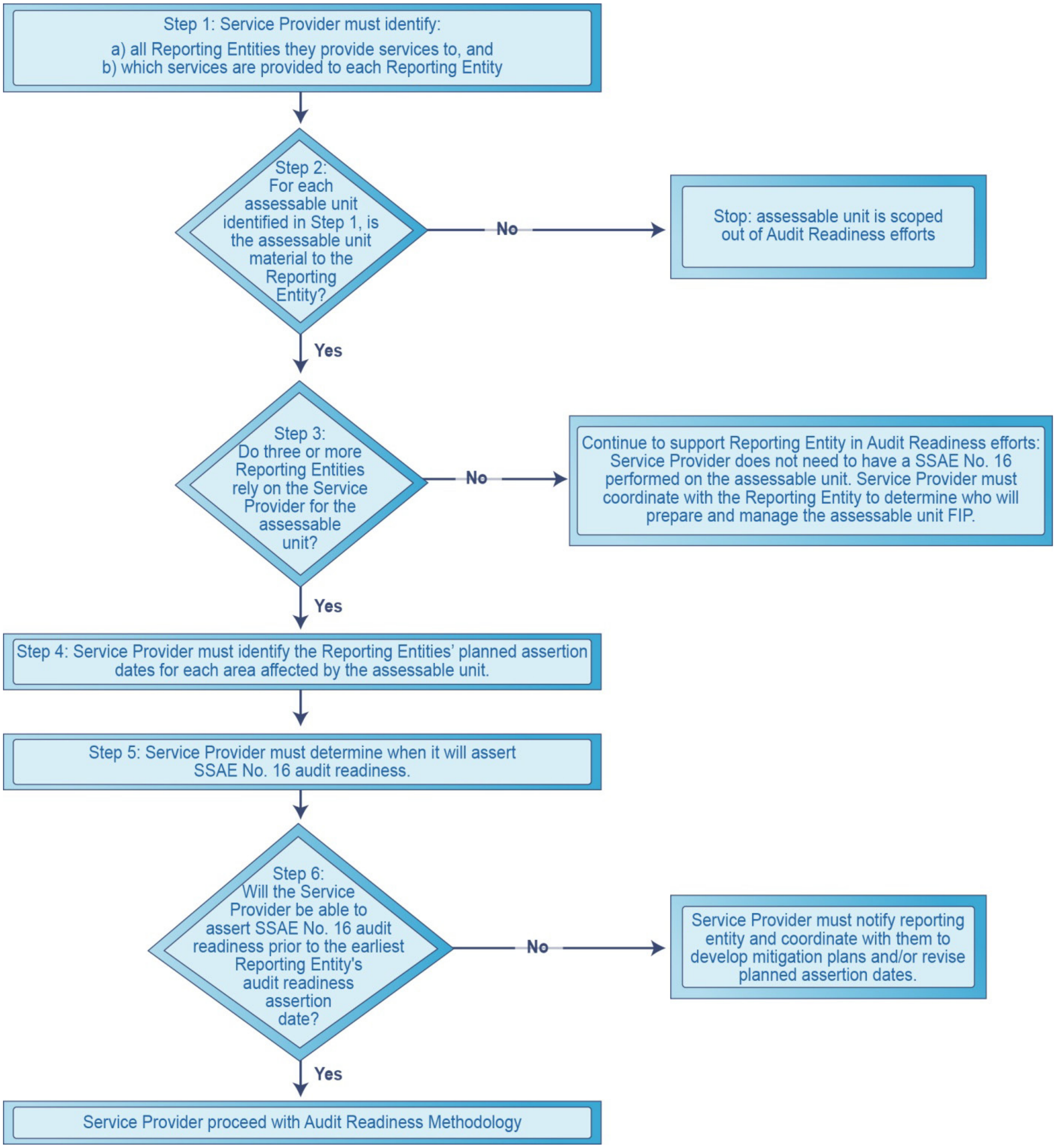


**Figure 31. Service Provider Methodology**

**As service providers work to become audit ready, they must focus on the following key factors:**

- **The reporting entity is responsible for the processes, systems, controls, transactions, and documentation to support its financial reporting assertions and audit readiness efforts.**
- **The reporting entity must communicate with its service provider to understand the scope of the service provider's processes, systems, controls, and documentation that are material to the reporting entities audit readiness success, and therefore, may require a SSAE No. 16 examination.**

**The service provider and the reporting entity must work together to:**

1. **Maintain open communications and coordinate with each other and their supporting contractors;**
2. **Provide additional system and financial information within agreed upon timeframes; and**
3. **Provide access to subject matter experts or contractors supporting those organizations in agreed upon timeframes.**

   **The reporting entity and service provider must agree on rules for the creation, completion, and retention of supporting documentation for transactions affected by the service provider and will document this within a MOU.** This agreement includes deciding what supporting documentation should be retained for each business process and transaction type, which organization will retain the specific documents, and for how long the documents should be retained.

   **The service provider must provide a description of its controls that may affect the reporting entity's control environment, risk assessment, control activities, information and communication, or monitoring of the reporting entity's internal control.** The description of controls should be at a level of detail that provides user auditors with sufficient information to assess the risks of material misstatement. The descriptions need not address every aspect of the service provider's processing or the services provided to the reporting entity. Refer to **Appendix D** on entity level controls for additional details.

- **Per the AICPA Implementation Guidance, the SSAE No. 16 specifically states that SSAE No.16 is not applicable when the service auditor is reporting on controls at a service provider other than those controls that are relevant to reporting entities' internal controls over financial reporting (such as controls related to regulatory compliance or privacy). For audit readiness purposes, the service provider is not required to provide the reporting entity with an opinion on controls other than those that are relevant to ICOFR. As described below in "Types of Service Organization Control (SOC) reports", the service provider has three options when deciding on the SOC report to prepare. The SOC 1 report is the most common and is required for financial statement audit readiness.** If the reporting entity requests information on compliance or regulatory controls not related to ICOFR and the service provider has not completed a SOC 2 or SOC 3 report, the service provider may provide the reporting entity with results from their internal review, such as the Department of Defense Information Assurance Certification and Accreditation Process

(DIACAP), Federal Information Security Management Act (FISMA), or Federal Financial Management Improvement Act (FFMIA).

- **Service providers must prepare, evaluate, and remediate their processes, systems, controls and supporting documentation to support the reporting entity audit. This requires the service provider to understand the reporting entity's audit readiness timeline.** It is required that the service provider follow the assertion process, prior to engaging an IPA to perform an SSAE No. 16 attestation. The service provider may also occasionally need support from the reporting entity, so that service provider audit readiness activities are coordinated with those of the reporting entity. Coordination and communication between the service provider and reporting entity is essential throughout the audit readiness process.
- **The service provider must execute the Methodology.**
- **Service providers with three or more customers must initiate an SSAE No. 16 attestation that covers at least six months of the customer's audit period. Service providers with two or fewer customers must continue to support their reporting entity customer audit readiness efforts but are not required to undergo an SSAE No. 16 engagement on the assessable unit. The service provider must coordinate with their customers to ensure all required audit readiness activities are fully and accurately captured in the reporting entity FIPs. In this circumstance, the service provider must also be ready to support the testing that will be performed by the customer's external auditors during the actual financial statement audit.**
- **The service provider has lead responsibility to coordinate SSAE No. 16 attestation engagements of its processes by completing the steps in Figure 31.**
- **Because of the complexities inherent in DoD reporting entity and service provider relationships and associated audit readiness interdependencies, it is essential that a common, detailed understanding of the method for obtaining assurance (SSAE No. 16 or as part of customer audit readiness efforts), scope, roles, responsibilities, required FIAR deliverables, and timeline be established. Accordingly, the service provider and reporting entity shared understanding and agreement on these essential elements must be documented in a Service Level Agreement (SLA) or Memorandum of Understanding (MOU). In addition to addressing the essential audit readiness elements for obtaining assurance, scope, roles, responsibilities, required FIAR deliverables, and timeline, the SLA or MOU will also specify whether the service provider and/or executive agent will prepare its own FIP or whether its audit readiness activities will be included in the reporting entity FIP.**
- **The service provider and reporting entity must work together to discover and correct audit impediments.**

## *Types of Service Organization Control (SOC) Reports*

In response to the evolving assurance needs of service organization customers, the AICPA has responded by designing multiple Service Organization Control (SOC) reports. The reports are based on AICPA Statement on Standards for Attestation Engagements (SSAE) No. 16 and Trust Services (AT 101).

Each type of SOC report has been purposefully developed to address a specific assurance need, for example, controls that affect user entities' financial reporting or controls that affect the security, availability, and processing integrity of the systems or the confidentiality or privacy of the information processed for user entities' customers. The applicable SOC report will vary depending on the subject matter.

The SOC 1 Report is the report that should be used for the purpose of FIAR requirements for Audit Readiness, as it is the report that provides the control information necessary for financial reporting.

### 1. SOC 1 Report – Report on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting

These reports, prepared in accordance with SSAE No. 16 are specifically intended to meet the needs of the reporting entities that use service providers and the reporting entity's auditors. The SOC 1 report is used in evaluating the effect of the controls of the service provider on the reporting entity's financial statements. SOC 1 is a report on controls at a service provider which are relevant to the reporting entities' internal controls over financial reporting and is what would have previously been considered the standard SAS 70 (complete with Type 1 and Type 2 reports). SOC 1 reports do not address non-financial reporting-related controls.

Similar to the SAS 70, the SSAE No. 16 Guidance allows for either a Type 1 Report or a Type 2 Report.

#### a. SOC 1 – Type 1 Report – Report on Management's Description of a Service Organization's System and the Suitability of Design of Controls

These reports encompass:

- the service auditor's report in which the service auditor
  - expresses an opinion on the fairness of the presentation of management's description of the service provider's system, and
  - the suitability of the design of the controls to achieve the related control objectives included in the description as of a specified date.
  - objectives included in the description as of a specified date.
- management's description of the service organization's system,
- management's written assertion

### b. SOC 1 – Type 2 Report – Report on Management's Description of a Service Organization's System and the Suitability of the Design and Operating Effectiveness of Controls

These reports encompass:

- the service auditor's report in which the service auditor
  - expresses an opinion on the fairness of the presentation of management's description of the service provider's system, and
  - the suitability of the design and the operating effectiveness of the controls to achieve the related control objectives included in the description throughout a specified period.
- management's description of the service provider's system,
- management's written assertion, and

A Type 2 report is more commonly used and provides an opinion on both the design and operating effectiveness of controls. FIAR requires service providers to obtain Type 2 reports as these reports demonstrate both the design and operating effectiveness of controls. Since the Type 2 is the recommended and more commonly used of the reports, when a SOC 1 report is discussed in the remainder of the guidance it is referring to the Type 2 report.

### 2. SOC 2 Report – Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality or Privacy

These reports are intended to meet the needs of a broad range of users that need information and assurance about the controls at a service organization that affect security, availability, and processing integrity of the systems the service provider uses to process the reporting entity's data and the confidentiality and privacy of the information processed by these systems. The SOC 2 reports are performed in accordance with, and are based upon Attestation Standard (AT) 101, "Attest Engagements". AT 101 is governed by the AICPA and establishes the framework for controls and non-financial attest work. These reports are for compliance purposes and are not required for audit readiness.

### 3. SOC 3 Report – Trust Services Report for Service Organizations

These reports are designed to meet the needs of users who need assurance about the controls at a service provider that affect the security, availability, and processing integrity of the systems used by the service provider to process the reporting entity's information and the confidentiality, or privacy of that information but do not have the need for or the knowledge necessary to make effective use of a SOC 2 Report. The SOC 3 report, just like the SOC 2, is based upon the Trust Service Principles and performed under AT 101, the difference being that a SOC 3 report can be general use distribution and only reports on whether the entity has achieved the Trust Services criteria or not. These reports are for compliance purposes and are not required for audit readiness purposes.

## *Carve-Out Method Requirements*

Per the SSAE No. 16 Guidance published by the AICPA, a service provider may use the carve-out method to present information about the services provided by the subservice organization in its description of the subservice organization's system. The carve-out is a method used by the service provider's management to identify the nature of the services provided by a subservice organization, but excludes the subservice organization's relevant control objectives and related controls from the description and scope of the service provider's SSAE No. 16 report. DISA is an example of a subservice provider, providing application hosting services for the DCPS Civilian Pay application.

**If the service provider plans to use the carve-out method additional actions must be performed by the service organization to ensure that all required controls are covered by either the service provider or the subservice provider organization (as required by OMB Bulletin No. 07-04, Section 6).** When using the carve-out method, management of the service provider would carve-out those control objectives for which related controls operate only or mostly at a subservice organization. However, management of the service organization is responsible for communicating with the subservice organization to ensure that the control objectives and related controls that they plan to carve-out are being evaluated by the subservice organization and are operating effectively[12]. Management must also be aware that per the SSAE No. 16 the service provider is expected to provide a description of controls they have in place to monitor certain key activities and controls performed by the subservice organization.

When the carve-out method is used, the description should include the nature of the services performed by the subservice organization, but it would not describe the detailed processing or controls at the subservice organization. The description of the service provider's system carves out those control objectives for which related controls operate only or primarily at the subservice organization. However, the description would contain sufficient information concerning the carved-out services to enable the user auditor to understand what additional information the service auditor needs to obtain from the subservice organization to assess the risk of material misstatement of the service provider's financial statements. The service provider will include all available subservice organization SSAE No. 16 reports in their assertion documentation.

When using the carve-out method, instances may exist in which achieving one or more control objectives depends on one or more controls performed by a subservice organization. In such instances, management's description of its system would identify the controls performed at the service provider and indicate that the related controls objectives would be achieved only if the subservice organization's controls were suitability designed and operating effectively throughout the period. The service provider may include a table in its description that identifies those instances in which control objectives are met solely by the service provider and those in which controls at the service provider and at the subservice organization are needed to meet the control objective. Communication between the service provider and the subservice organization,

[12] Adopted from OMB Bulletin 07-04, paragraph 6.17.

as well as a documented SLA or MOA is essential to ensure that all controls needed are covered.

If a service provider cannot successfully prepare and undergo a SSAE No. 16 within the required timeframe, it should notify its customers (reporting entities) immediately so that customers and the service provider can work on mitigation plans and/or revise planned FIP milestone dates for this key audit readiness dependency, and then notify FIAR of these changes.

## 3.B.4 Methodology

There is a direct relationship between the service providers' processes and controls and their customers' audit readiness. Service provider audit readiness addresses the affect that a service provider could have on a reporting entity's internal control and the availability of audit evidence.

The following charts (**Figures 32 – 39**) provide a methodology for service providers, service provider auditors, reporting entities, and user auditors to follow during the Discovery, Assertion, and Validation Phases, and SSAE No. 16 Evaluation Phase of the service provider Methodology. (Note: all other key tasks and phases of the Service Provider Methodology are the same as the Reporting Entity Methodology discussed in Section 3.A). The key tasks are numbered to coincide with the standard FIP template. For example, the Discovery Phase of the FIP template includes key tasks beginning with section 1.1, while the Audit Phase begins with section 8.1 of the template.

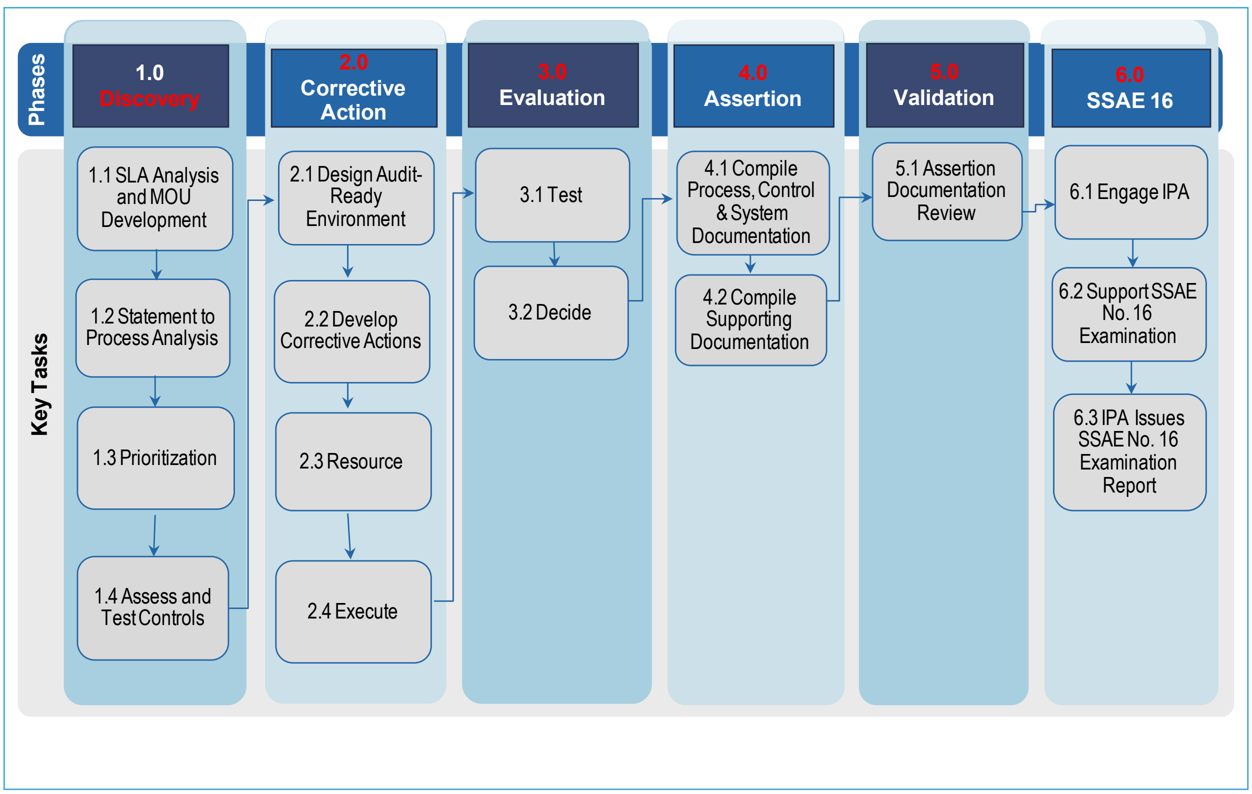


**Figure 32. Service Provider Phases and Key Tasks to Achieve Auditability and Reliable Financial Information**

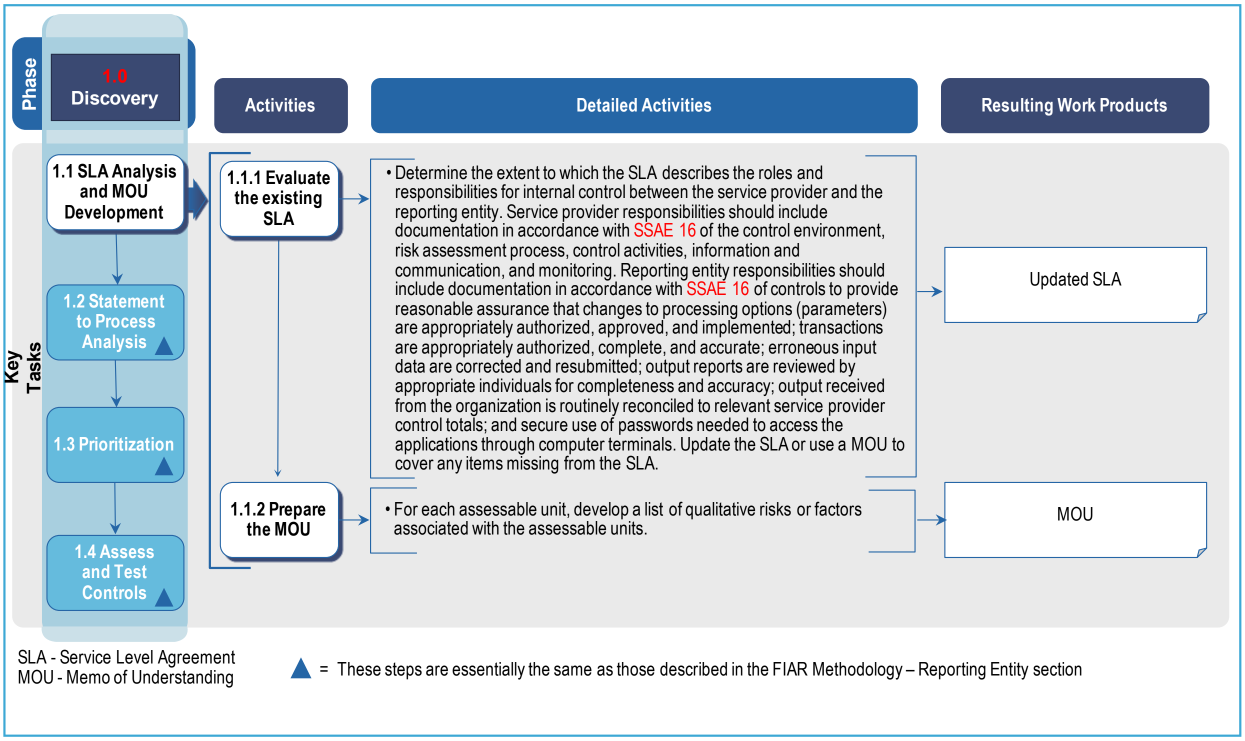


**Figure 33. Discovery Phase – SLA Analysis and MOU Development**

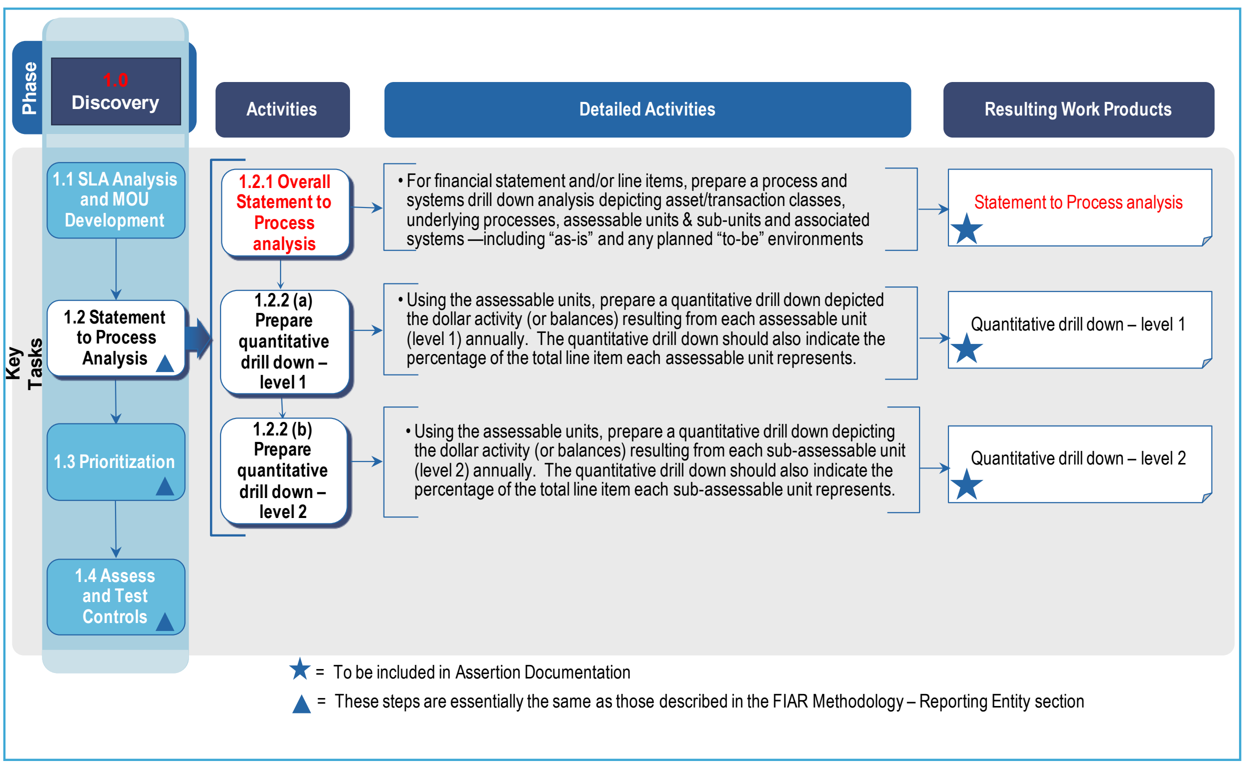


**Figure 34. Discovery Phase – Statement to Process Analysis**

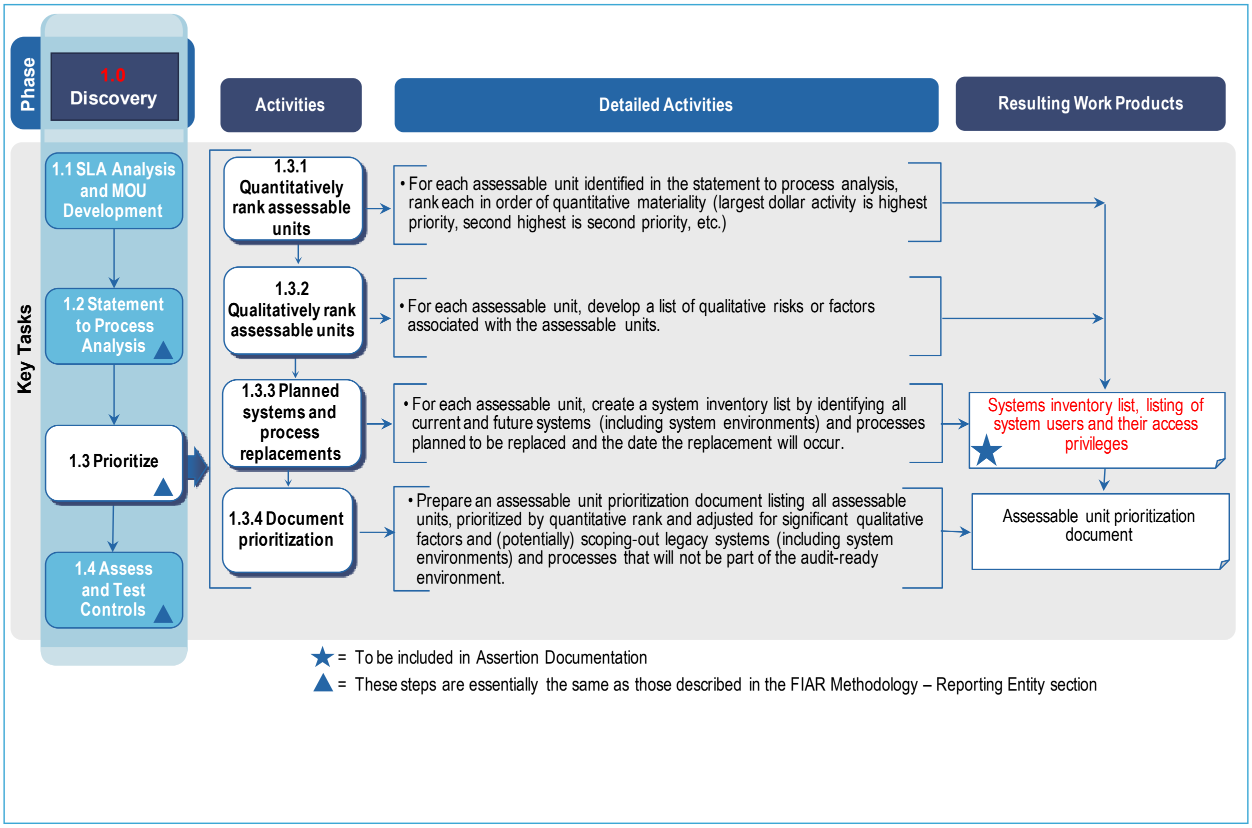


**Figure 35. Discovery Phase – Prioritization**

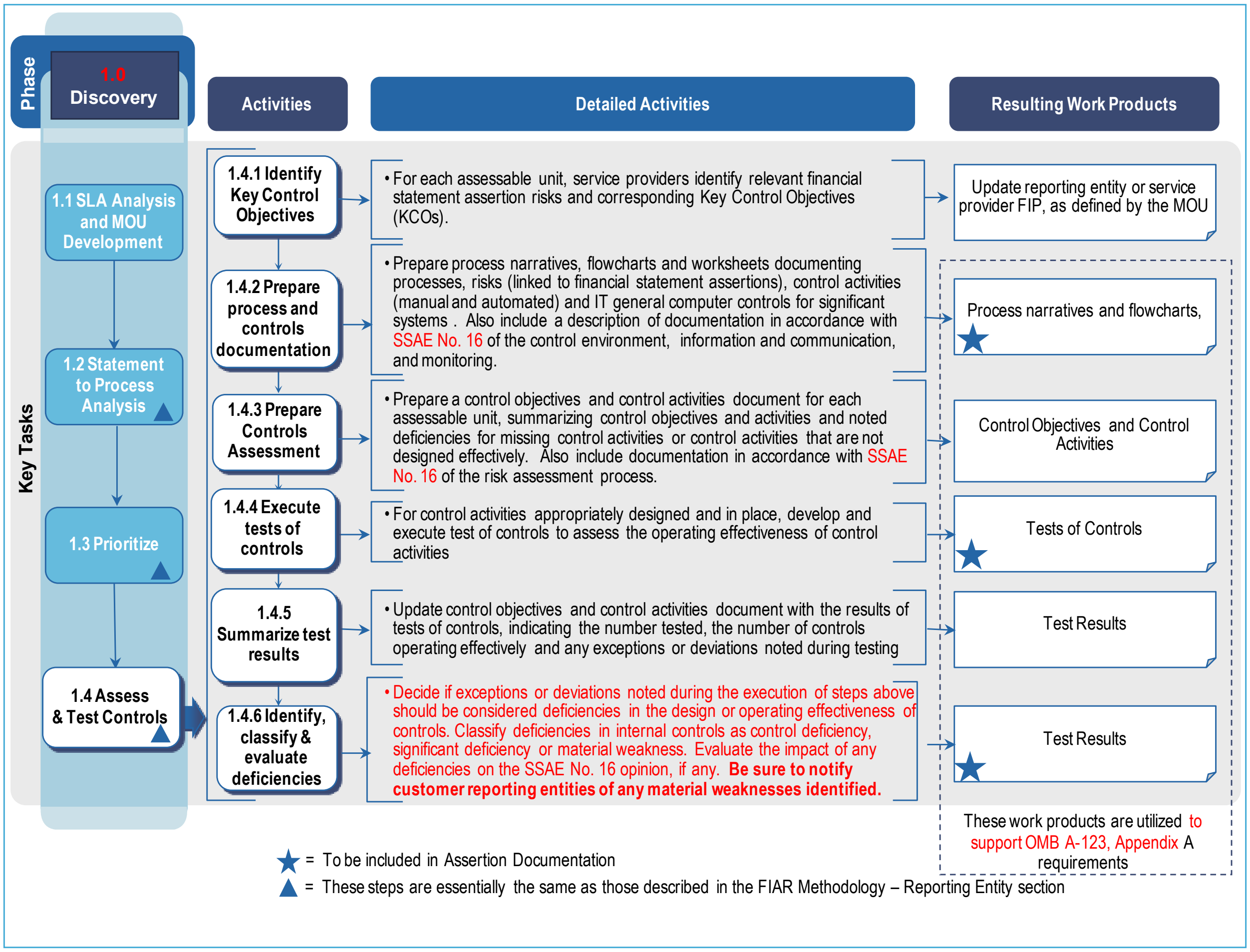


**Figure 36. Discovery Phase – Assess & Test Controls**

When defining the control objectives for the SSAE No. 16 the service provider should use existing guidance and best practices. For business process controls, the AICPA SSAE No. 16 Implementation Guidance outlines high level control objectives and includes illustrative examples of control objectives to be used for various service provider responsibilities, for example, payroll processing. For the IT General and Application Controls, use the FISCAM to define control objectives. Refer to the FIAR Guidance website for a summary analysis of those ***FISCAM control activities and techniques*** that have the highest relevance to addressing key risk areas for financial reporting and other FISCAM control activities and techniques that should be considered by reporting entities and their service providers in their audit readiness efforts.

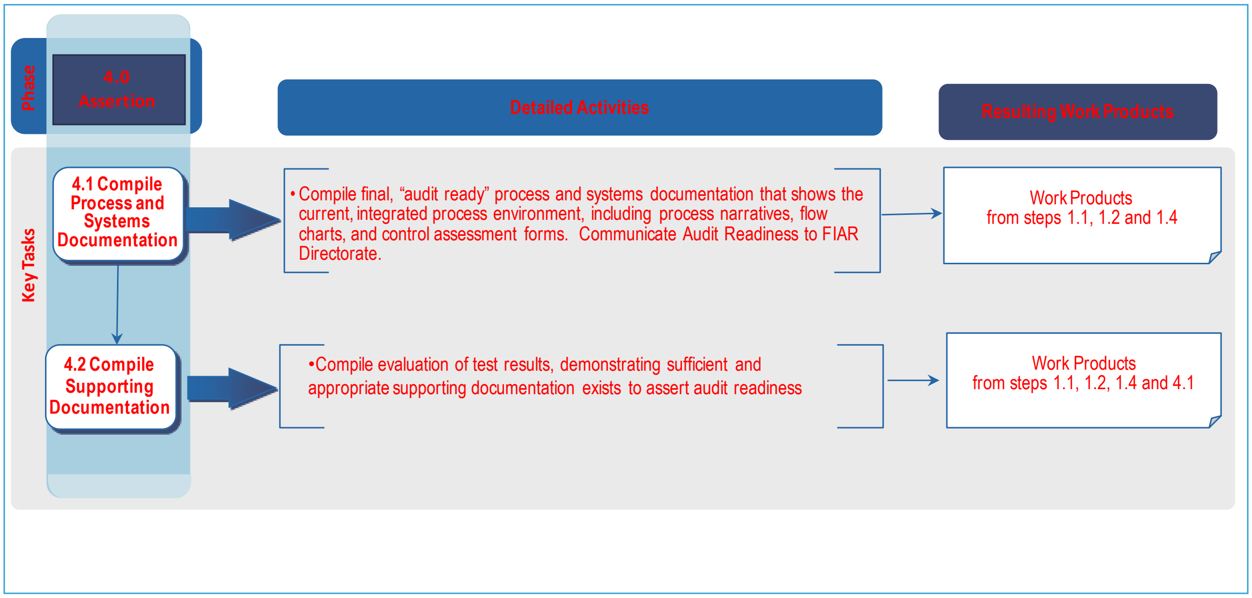


**Figure 37. Assertion Phase**

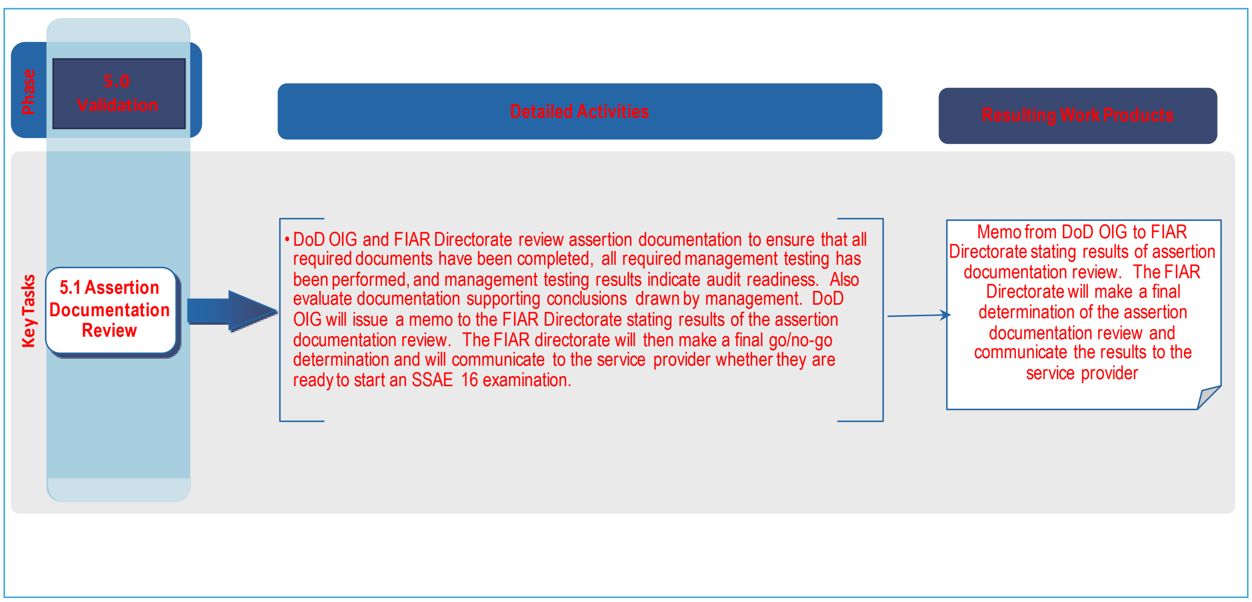


**Figure 38. Validation Phase**

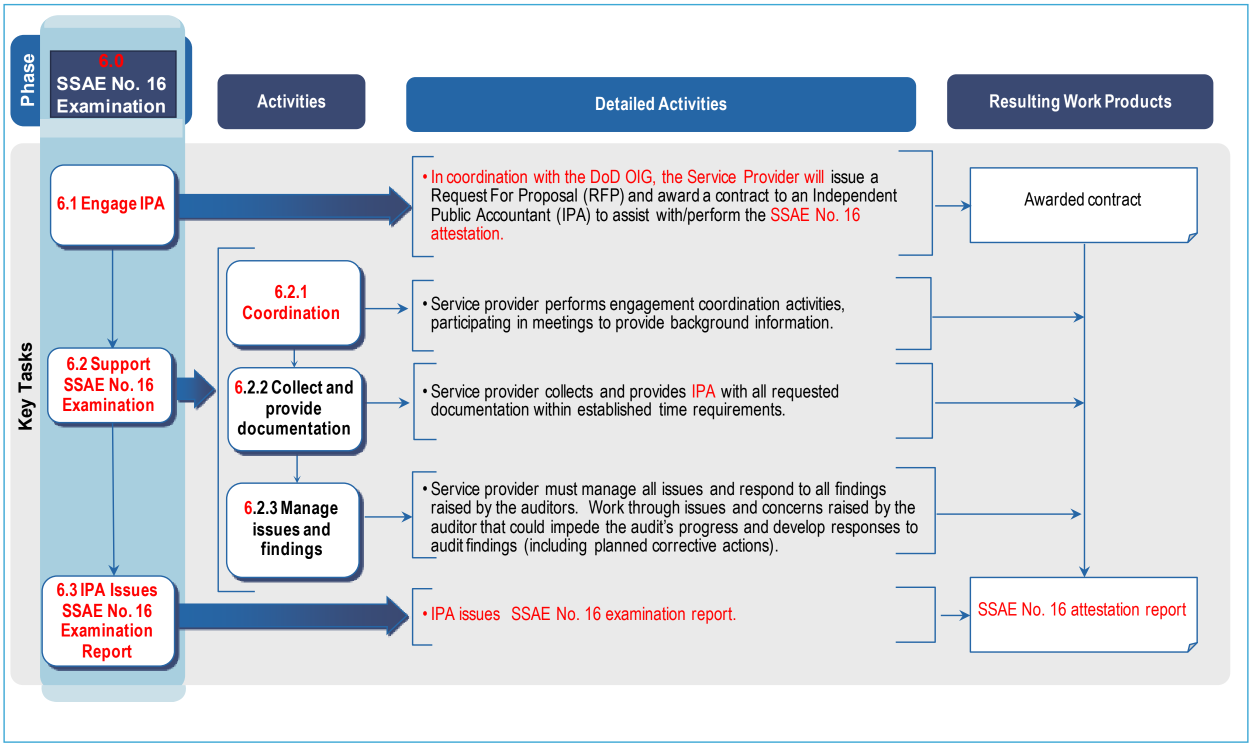


**Figure 39. SSAE No. 16 Examination – Finalize the Report**

## 3.B.5 Assertion Documentation

**Service provider assertion documentation must follow the format of an SSAE No. 16 report and include the information that will be included in Section III and Section IV of the Service Auditor's Report.** Section I of an SSAE No. 16 report is the Service Auditor's Report that identifies the scope of the SSAE 16 examination and the auditor's opinion. It is not required for the service provider's assertion documentation. Section II of an SSAE No. 16 includes management's assertion, and Section III of an SSAE No. 16 includes a description of the service organization's "system", including control objectives and related controls. Section IV of an SSAE No. 16 includes a description of the service auditor's test plans and the test results. See the FIAR Guidance website to see an example of a completed ***Section IV of the SSAE 16*** report and to download the updated ***SSAE 16 Section IV template***.

During the service provider's discovery phase, a materiality assessment defining the scope of the service auditor's report may be performed in place of the statement to process analysis and quantitative drill downs. **The reporting entity must provide the overall statement to process analysis, quantitative drill down level 1 and quantitative drill down level 2 it prepares to the service provider.** The service provider will use the documents provided by the reporting entity to determine the material processes, sub processes, and systems that the service provider is responsible for that should be included in the SSAE No. 16.

The graphic below illustrates the service provider assertion documents outlined in accordance with the SSAE No. 16 report for Section II and Section III, as well as the depicting how these service provider assertion documents align to supporting customer related reporting entity assertion documentation. The service provider's assertion documentation will be incorporated into customer reporting entity assertion documentation.

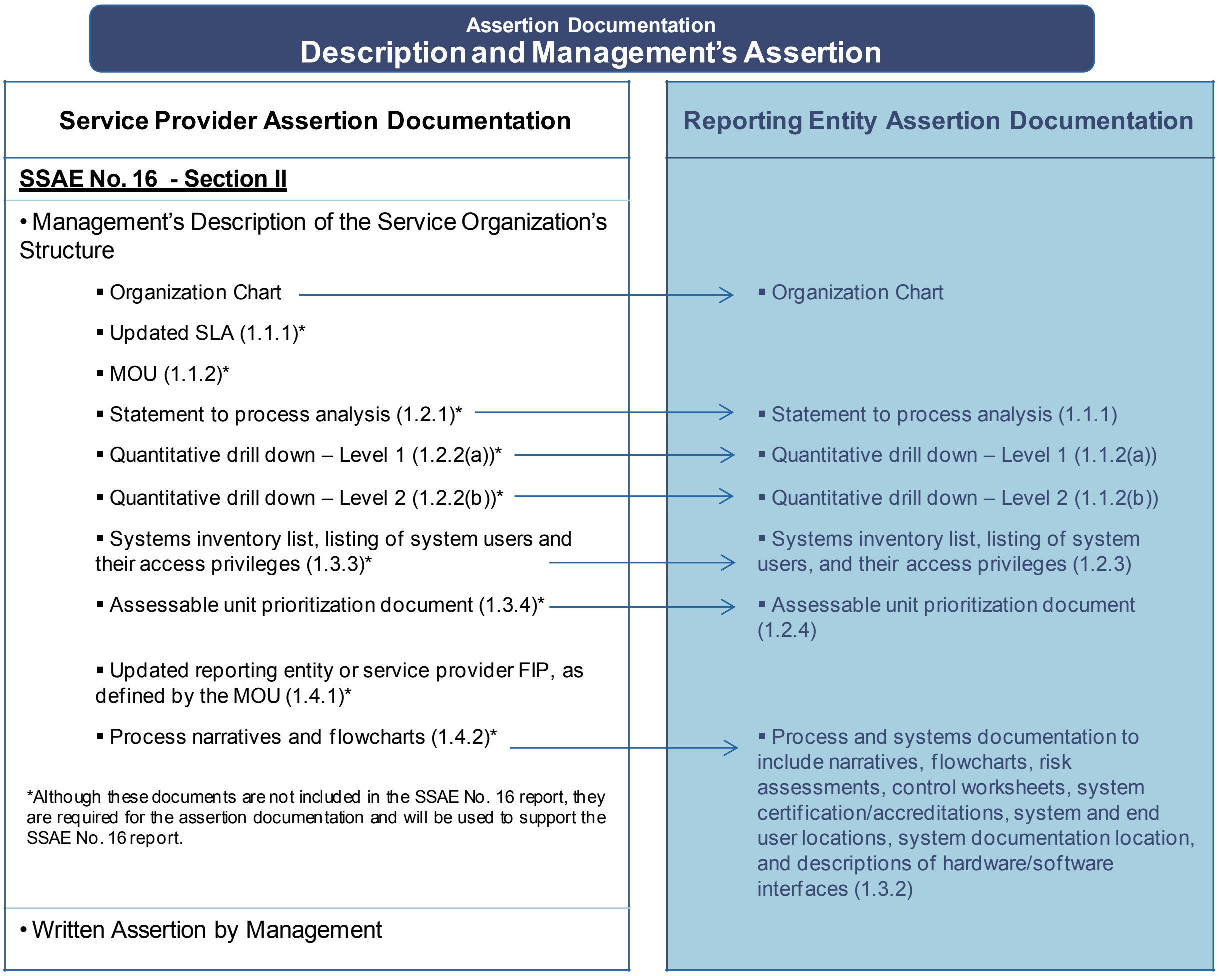


**Figure 40. Service Provider and Reporting Entity Assertion Documentation – SSAE No. 16 Section III**

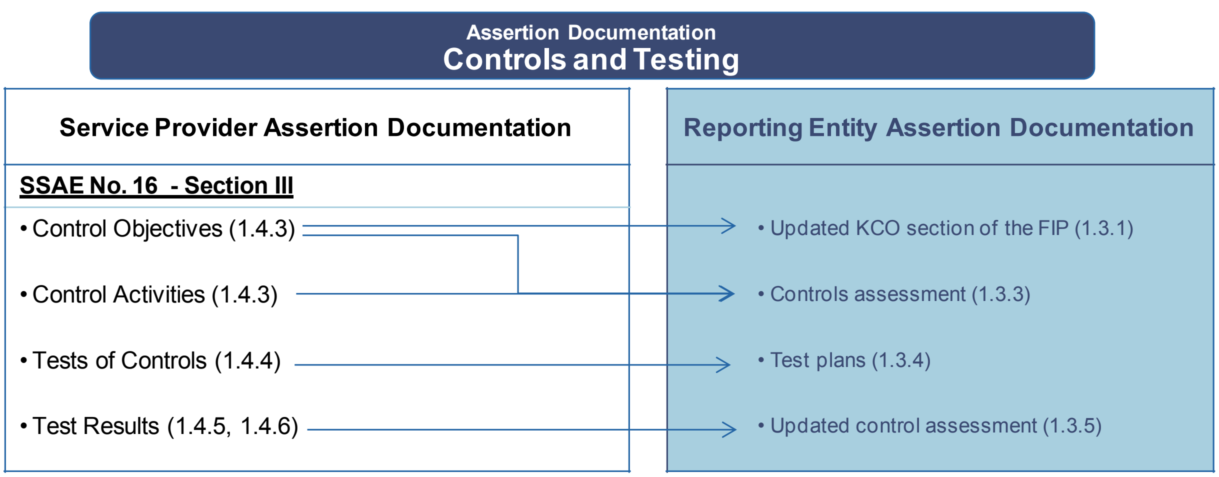


**Figure 41. Service Provider and Reporting Entity Assertion Documentation – SSAE No.16 Section IV**

If the service provider is not ready to assert their SSAE No. 16 readiness, they are still required to provide their customers with required KSDs for the reporting entity's assertion documentation. **If a SSAE No. 16 report is not available from the service provider, the service provider must be able to provide all of the KSDs listed in the preceding graphic to the reporting entity.**

### 3.B.6 Scoping the SSAE No. 16

To rely on an SSAE No. 16 examination report the user auditor will consider many factors, including the period of time covered by the report, control objectives and control activities addressed in the report, and the results of the tests of controls and the conclusions of the service auditor. User auditor needs of the SSAE No. 16 report should be taken into consideration, whenever possible. For this reason, when information technology general or application controls are included in the scope of the SSAE No. 16, the service provider should align its control objectives with GAO's Federal Information Systems Controls Audit Manual (FISCAM). A recommended list of control objectives, aligned to the FISCAM, is presented in the following tables.

| IT General Control Objectives |
|---|
| **Security Management** |
| Controls provide reasonable assurance that security management is effective, including effective:<br>• security management program,<br>• periodic assessments and validation of risk,<br>• security control policies and procedures,<br>• security awareness training and other security-related personnel issues,<br>• periodic testing and evaluation of the effectiveness of information security policies, procedures, and practices,<br>• remediation of information security weaknesses, and<br>• security over activities performed by external third parties. |
| **Access Controls** |
| Controls provide reasonable assurance that access to computer resources (data, equipment, and facilities) is reasonable and restricted to authorized individuals, including effective:<br>• protection of information system boundaries,<br>• identification and authentication mechanisms,<br>• authorization controls,<br>• protection of sensitive system resources,<br>• audit and monitoring capability, including incident handling, and<br>• physical security controls. |
| **Configuration Management** |
| Controls provide reasonable assurance that changes to information system resources are authorized and systems are configured and operated securely and as intended, including effective:<br>• configuration management policies, plans, and procedures,<br>• current configuration identification information,<br>• proper authorization, testing, approval, and tracking of all configuration changes,<br>• routine monitoring of the configuration, |

| |
|---|
| • updating software on a timely basis to protect against known vulnerabilities, and<br>• documentation and approval of emergency changes to the configuration. |
| **Segregation of Duties** |
| Controls provide reasonable assurance that incompatible duties are effectively segregated, including effective:<br>• segregation of incompatible duties and responsibilities and related policies, and<br>• control of personnel activities through formal operating procedures, supervision, and review. |
| **Contingency Planning** |
| Controls provide reasonable assurance that contingency planning (1) protects information resources and minimizes the risk of unplanned interruptions and (2) provides for recovery of critical operations should interruptions occur, including effective:<br>• assessment of the criticality and sensitivity of computerized operations and identification of supporting resources,<br>• steps taken to prevent and minimize potential damage and interruption,<br>• comprehensive contingency plan, and<br>• periodic testing of the contingency plan, with appropriate adjustments to the plan based on the testing. |
| **IT Application Control Objectives** |
| **Completeness** |
| Controls provide reasonable assurance that all transactions that occurred are input into the system, accepted for processing, processed once and only once by the system, and properly included in output. |
| **Accuracy** |
| Controls provide reasonable assurance that transactions are properly recorded, with correct amount/data, and on a timely basis (in the proper period); key data elements input for transactions are accurate; data elements are processed accurately by applications that produce reliable results; and output is accurate. |
| **Validity** |
| Controls provide reasonable assurance that (1) all recorded transactions and actually occurred (are real), relate to the organization, are authentic, and were properly approved in accordance with management's authorization; and (2) output contains only valid data. |
| **Confidentiality** |
| Controls provide reasonable assurance that application data and reports and other output are protected against unauthorized access. |
| **Availability** |
| Controls provide reasonable assurance that application data and reports and other relevant business information are readily available to users when needed. |

### *Service Providers without a SSAE No. 16 Opinion*

When the reporting entity is subject to a financial statement audit and the service provider does not receive an SSAE No. 16 attestation report (e.g., they are in the service provider audit readiness stage), the service provider's processes and controls that affect reporting entity financial transactions are audited as part of the reporting entity. As a result, the service provider will need to support the following, as required by OMB Bulletin No. 07-04:

- The user auditor's evaluation of the service provider's control design and operating effectiveness. When performing these tests, the user auditor is required to either physically observe the control while it is performed or request supporting documentation to evaluate evidence that the control is in operation. Therefore, the service provider (in addition to the reporting entity) will need to make personnel who perform the control activities, as well as related supporting documentation, available for the user auditors.
- In addition to performing tests of internal controls, user auditors are required to obtain evidence over financial transactions and balances by reviewing supporting documentation that substantiates amounts reported by the reporting entity. To obtain the necessary evidence, the user auditor will typically use a combination of substantive analytical procedures (e.g., trend analysis of a balance over time) or tests of details (e.g., selecting samples of individual financial transactions and reviewing relevant supporting documentation). **To support this testing, both the reporting entity and the service provider must provide transaction-level downloads of reporting entity transactions accompanied by reconciliations to the general ledger, supporting documentation for requested sample items, and personnel/responses to questions asked about trends, variances and specific financial transactions. To satisfy the user auditor requests, the reporting entity and the service provider will need to ensure that they each have an infrastructure of processes and resources available to quickly and effectively respond to these requests.**

### *Reporting Entity*

Typical controls that the reporting entity is responsible for implementing to complement the controls of the service provider include:

- Controls that provide reasonable assurance that any changes to processing options (parameters) requested by the reporting entity are appropriately authorized and approved.
- Controls that provide reasonable assurance that output received from the service provider is routinely reconciled to relevant reporting entity control totals.
- Controls that provide reasonable assurance over passwords needed to access the systems resident at the service provider through computer terminals.

## 3.C Preparing for an Audit

### 3.C.1 Assertion Documentation

The Methodology provides guidance for each key task, activity, and resulting work product essential to accomplishing each of the seven phases. The compilation of work products from the *Discovery* , *Corrective Action* and E*valuation Phases* not only satisfy most OMB Circular A-123, Appendix A requirements, but will also provide the evidence that the reporting entity is ready for audit.

The goal of the Methodology, and therefore, the assertion documentation is to provide evidence proving that the reporting entity has:

- Designed and implemented control activities that limit the risk of material misstatements by meeting the KCOs contained in **Appendix C**, and
- Supported account balances with sufficient and appropriate audit evidence, defined as KSDs also contained in **Appendix C**, supplemented with the reporting entity's own documentation requirements.

**Assertion documentation is not separate documentation that is prepared for the *Assertion* phase but rather a compilation of the documentation developed in the earlier phases. Assertion documentation must be completed for each assessable unit to indicate that the reporting entity asserts that the assessable unit is ready for validation.** However, within Wave 3 – Mission Critical Asset E&C Audit, reporting entities may prepare assertion documentation by assessable unit or sub-unit indicating that the particular assessable unit or sub-unit is ready for validation.

**Reporting entity management must decide how it will demonstrate audit readiness. The reporting entity must rely on effective internal controls, but has flexibility with regard to how much to rely on internal control,** as shown in **Figure 39**. In general, areas with large transaction volumes or numerous individual assets (e.g., supply, contracts, FBWT, Inventory, OM&S, GE, etc.) require management and the auditor to rely on effective internal controls to provide assurance that balances are properly stated at any given date. Management's determination that effective controls are <u>not</u> in place to mitigate risk does not necessarily preclude an assertion of audit readiness. For example, management may decide that it is more efficient to rely on supporting documentation and limit

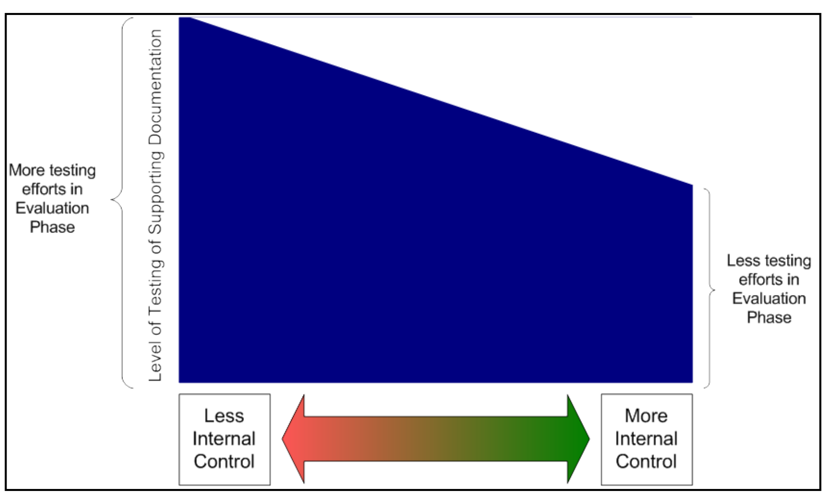


**Figure 39. Reliance on internal controls affects the level of testing of supporting documentation**

internal controls reliance for the existence and completeness assertion of low volume items, such as satellites. However, for populations with a large number of items or with a high volume of transaction activity, such as OM&S, it is more effective and efficient to place more reliance on internal controls, which requires detailed control documentation, including risk assessments, KCOs, and control assessments. **In cases where management reduces controls reliance, the reporting entity must provide extensive supporting evidence in the assertion documentation to offset the low reliance on controls. ITGCs and application controls must be designed effectively and tested for operating effectiveness in order for management to rely on the automated controls and system generated reports (i.e., KSDs).** Supporting documentation testing (i.e., substantive testing) cannot overcome ineffective or missing ITGCs and application controls when transaction evidence is electronic and only maintained within a system, or the key supporting evidence is system generated reports.

**Figure 40 is a graphical depiction of the work products that must be included in the assertion documentation. These work products must be provided in either hard copy and/or electronic format, such as the DFAS ePortal or CD-ROM, depending on the volume of documentation, so that they are readily accessible for FIAR/DoD OIG/other auditor requests.** To facilitate the *Validation Phase*, reporting entities should accumulate and place assertion documentation work products in "Tabs" separated by the work products depicted in each "Task" as shown in **Figure 40**. The work product "Test Results" found in Tasks 1.4 and 4.1 should include test plans and supporting documentation for the sample items tested. The assertion documentation requirements illustrated in **Figure 40** replaces the "18-Tab" requirements defined in the DCFO's "Financial Improvement Initiative Assertion Package Criteria and Organization" memorandum, dated November 15, 2004.

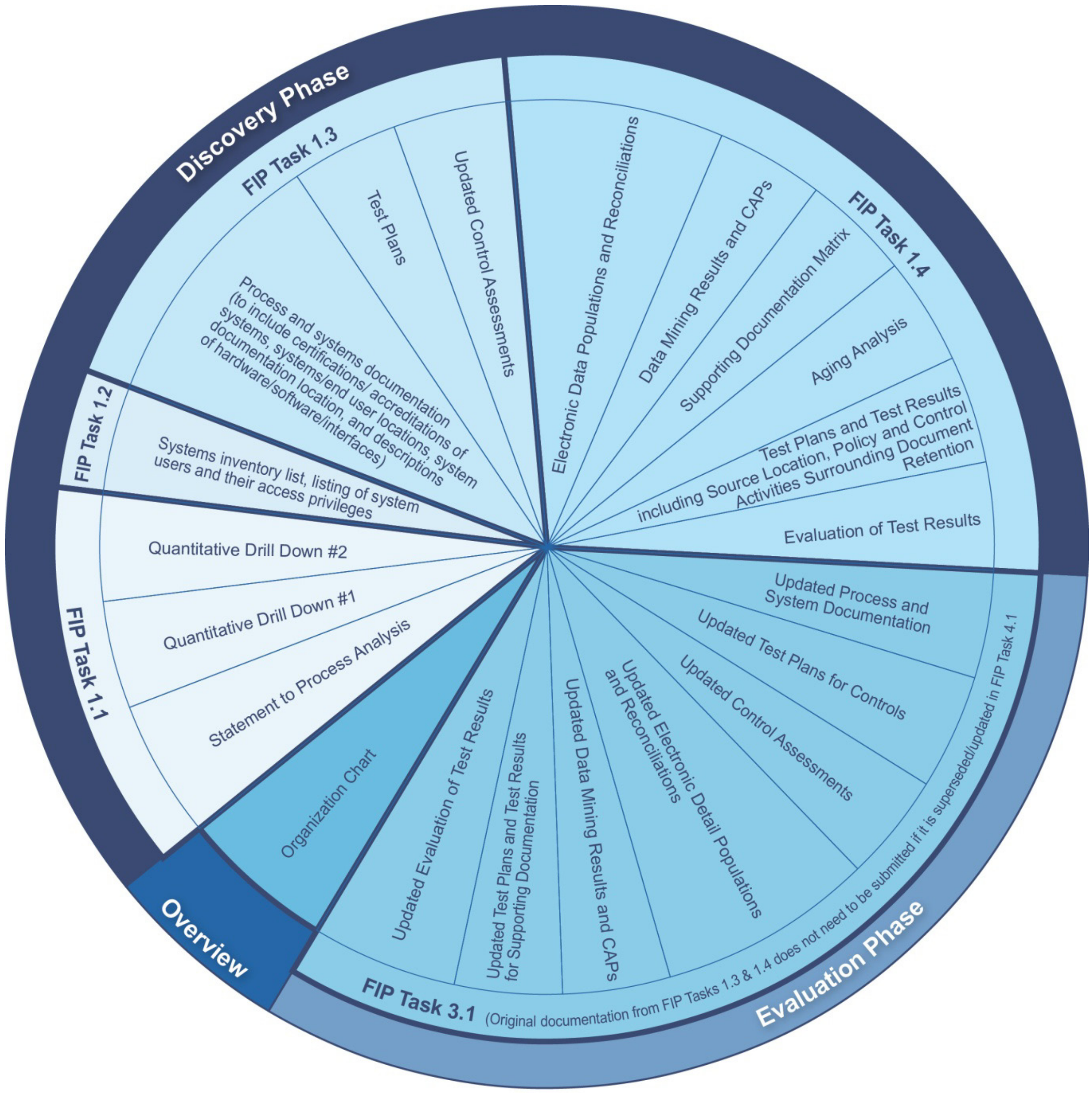


**Figure 40. Assertion Documentation Work Products Requirements**

### 3.C.2 Assertion Process

**Several tasks must be completed to assert that an assessable unit is ready for validation. Specifically, the following are three key steps a reporting entity must follow:**

- Submit a management assertion addressed to the DCFO and DoD OIG declaring that the subject matter (assessable unit) is audit ready. Refer to Section 2.D. for guidance on management assertions. **The assertion must be signed by the person, individual, or representative of the organization responsible for the subject matter (assessable unit).**
- Submit "audit ready" assertion documentation in accordance with the prescribed requirements to both the DoD OIG and FIAR Directorate. Assertion documentation must be provided in either hard copy and/or electronic format, such as the DFAS ePortal or CD-ROM, depending on the volume of documentation, so that they are readily accessible for FIAR/DoD OIG/other auditor requests.
- Schedule and conduct a "kick-off" meeting between the reporting entity, FIAR Directorate, DoD OIG, and Service Providers (if appropriate) to walk through the contents of the assertion documentation.

**Please note, the review of the assertion documentation by FIAR Directorate and DoD OIG (e.g., *Validation Phase*) will not begin until all three tasks have been completed. The DoD OIG and the FIAR Directorate review of assertion documentation includes verifying that all required documents have been completed, all required management testing has been performed, and management testing results reasonably indicate audit readiness. This step is accomplished by evaluating the assertion documentation to determine whether management's conclusions are adequately supported and whether the reporting entity is ready to enter the second key task of the Validation Phase: assertion examination. An Assertion Documentation Review Work-plan has been developed to guide the DoD OIG and FIAR Directorate in performing their reviews of the assertion documentation.**

### 3.C.3 Human Capital

**The reporting entity must ensure that the personnel assigned to perform financial improvement and audit readiness activities have the necessary competence.** This includes the basic knowledge of accounting and auditing concepts, including:

- familiarity with financial statements and their content,
- understanding of financial statement assertions,
- knowledge of accounting requirements, including DoD policies,
- understanding of internal controls, and
- familiarity with the reporting entity's systems.

After determining the assessable units, the reporting entity should identify the competencies required (e.g., accounting, information technology, fiscal law) to achieve auditability and reliable financial information and determine whether the personnel assigned to audit readiness tasks have the required competencies or whether those competencies need to be developed.

The Office of the Under Secretary of Defense (Comptroller) has developed ***FM myLearn***, a multi-purpose website for DoD financial management workforce, to serve as an online catalog of professional training opportunities for financial management personnel and support career-long learning objectives. The people assigned to financial improvement and audit readiness activities should participate in financial management training, ensuring that they have sufficient knowledge of accounting and auditing requirements to complete the tasks accurately.

In addition to competence, the people who perform the work must have the necessary objectivity. Persons performing the evaluating the design of internal controls, performing tests of operating effectiveness, validating the sufficiency of corrective actions and testing for the adequacy of supporting documentation should not be the personnel responsible for performing the control or report directly to the person performing the control. Preferably, personnel performing discovery audit readiness efforts are outside of the organization unit that is responsible for carrying out the day-to-day operational activities.

### 3.C.4 Necessary Infrastructure

Reporting entities undergoing a first-year audit frequently underestimate the workload and level of effort needed to support their auditors. With a need to substantiate beginning balances, first-year audits require substantially larger sample sizes and place greater demands on both the auditor and auditee. To manage this surge in effort, reporting entities should have the infrastructure in place before to beginning a first-year audit. The entity should establish a project management office (PMO) to create and sustain this infrastructure during the first-year audit. The PMO should focus on the following major tasks:

#### *Audit Coordination*

During a first-year audit, auditors typically spend a significant amount of time gaining an understanding of the auditee. This is accomplished through reviews of documentation and interviews with key personnel. The coordination and satisfaction of these auditor requests for documentation and interviews is essential to providing auditors with the information they need, within their time constraints, to help support a successful and timely audit.

#### *Document Management*

All first-year audits include requests for substantial supporting documentation to verify management's beginning balances. In a first-year audit, sample sizes can be three times the size of those for a recurring audit; therefore, management should establish an infrastructure to manage these requests, as well future audits. This infrastructure includes receiving requests from the auditors, coordinating with field personnel to collect and submit the documentation to the auditors, and responding to auditor questions about the documentation. In a first-year audit, it is common for management to receive a large number of auditor questions about supporting documentation because the auditors are building an understanding of the entity and its operations.

### *Issue/Finding Management*

As the audit progresses, the following two kinds of issues typically arise, especially during first-year audits:

- Audit Impediments – Typical impediments include unorganized documentation and issues surrounding the format and content of system downloads. As such, conflicts will occur due to competing demands on limited resources. These impediments must be identified, discussed, and solutions implemented quickly to resolve the impediments. Otherwise, the likelihood of delays in schedule (and potential scope restrictions) increases due to the cumulative effect of these issues.
- Audit Findings – As the audit progresses, the auditors will identify findings and recommendations. **The reporting entity must develop Plans of Action and Milestones (POAMs) and assign resources to lead remediation for findings the reporting entity agrees are valid.** Without periodic PMO monitoring, there is a risk that remediation efforts will not be sustained. Significant control deficiencies contribute directly to additional time and auditor fees because alternative procedures must be performed to overcome control deficiencies. Therefore, timely and effective remediation of audit findings results in direct savings of Departmental resources.

## 3.D Audit Execution

The Department's reporting entities vary significantly from a financial statement perspective (e.g., the Military Departments are few in number but material to the Department, versus a large number of less material Defense Agencies). Therefore, it is not effective or efficient to perform financial statement audits on all stand-alone financial statements.

To increase the efficiency of the annual financial statement audits, reporting entities have been grouped into three categories, and must follow this guidance:

- Category 1 (shown in Figure 41) – includes the Military Departments, Military Retirement Fund, and U.S. Army Corps of Engineers Civil Works Program (in accordance with the requirements of OMB Bulletin No. 07-04, as amended). These reporting entities will perform all audit readiness efforts following the Methodology and will undergo annual financial statement audits on their stand-alone financial statements.
- Category 2 (shown in Figure 41) – other material reporting entities not included in Category 1, will perform all audit readiness efforts following the Methodology, but are not required to undergo annual standalone financial statement audits. Instead, these reporting entities will be audited as part of the Department's consolidated financial statement audit. Figure 41 presents all financially material reporting entities, and identifies specific areas of the reporting entity that are material to the Department's consolidated financial statements.
- Category 3 (not shown on Figure 41) – all immaterial reporting entities not presented in Figure 41 represent the remainder of the Department. While these immaterial reporting entities need to become audit ready and will be part of the Department's consolidated financial statement audit, they do not need to report their progress to the FIAR Directorate and are not required to undergo standalone financial statement audits.

OUSD(C) will regularly update this analysis to confirm that all reporting entities material to the Department are appropriately focused on audit readiness. OUSD(C) will communicate the updated analyses separate from this guidance.

| Reporting Entities | Audit Readiness Category | Waves 1 & 2 | Waves 3 & 4 | | | | |
|---|---|---|---|---|---|---|---|
| | | SBR | ME | RP | INV | OM&S | GE |
| **Under Audit** | | | | | | | |
| Military Retirement Trust Fund | Category 1 | √ | | | | | |
| U.S. Army Corps of Engineers – Civil Works | Category 1 | √ | | √ | √ | √ | √ |
| United States Marine Corps, GF | Category 1 (part of Navy GF) | √ | • | • | • | • | • |
| Tricare Management Activity - CRM | Category 2 | √ | | | | | |
| Medicare-Eligible Retiree Healthcare Fund | Category 2 | √ | | | | | |
| Defense Commissary Agency | Category 2 | √ | | √ | √ | | √ |
| Defense Finance and Accounting Service | Category 2 | √ | | √ | | | √ |
| Defense Contract Audit Agency | Category 2 | √ | | | | | √ |
| Office of the Inspector General, DoD | Category 2 | √ | | | | | |
| **Preparing for Audit** | | | | | | | |
| Army, GF | Category 1 | √ | √ | √ | | √ | √ |
| Air Force, GF | Category 1 | √ | √ | √ | | √ | √ |
| Navy, GF | Category 1 | √ | √ | √ | | √ | √ |
| Miltary Retirement Fund Payment* | Category 2 | √ | | | | | |
| Defense Logistics Agency, WCF | Category 2 | √ | | √ | √ | | √ |
| Navy, WCF | Category 1 | √ | | √ | √ | √ | √ |
| DoD Component Level Accounts | Category 2 | √ | | | | | |
| Service Medical Activity | Category 2 | √ | | √ | | | |
| Army, WCF | Category 1 | √ | | √ | √ | | √ |
| Office of the Secretary of Defense (WHS) | Category 2 | √ | | √ | | | |
| Pentagon Reservation Maintenance Revolving Fund | Category 2 | | | √ | | | |
| UNAL/DIS – DoD Component Level Accounts (USD(C)) | Category 2 | √ | | √ | | | √ |
| Washington Headquarters Services | Category 2 | | | | | | √ |
| Air Force, WCF | Category 1 | √ | | √ | √ | √ | √ |
| U.S. Special Operations Command | Category 2 | √ | | √ | | | √ |
| Missile Defense Agency | Category 2 | √ | | √ | | | |
| US Transportation Command Air Force – Air Mobility Command | Category 2 | √ | | | | | |
| Other 97 Funds Provided to the Army by OSD | Category 2 | √ | | | | | |
| Defense Information Systems Agency, WCF | Category 2 | √ | | | | | |
| Defense Advanced Research Projects Agency | Category 2 | √ | | | | | |
| DoD Education Activity | Category 2 | √ | | | | | |
| TMA - (FOD) | Category 2 | √ | | | | | √ |
| Defense Information Systems Agency, GF | Category 2 | √ | | | | | √ |
| US Transportation Command Army: Military Surface Deployment & Distribution | Category 2 | √ | | | | | |
| Chemical Biological Defense Program | Category 2 | √ | | | | | |
| Defense Security Cooperation Agency | Category 2 | √ | | | | | |
| Defense Threat Reduction Agency | Category 2 | √ | | | | | |
| Defense Contract Management Agency | Category 2 | √ | | | | | |
| Defense Logistics Agency, GF | Category 2 | √ | | | | | |
| Defense Technical Information Center | Category 2 | √ | | | | | |
| United States Marine Corps, GF | Category 1 (part of Navy GF) | | √ | √ | | √ | √ |
| United States Marine Corps, WCF | Category 1 (part of Navy WCF) | √ | | √ | √ | √ | √ |

**√ = Material to DoD Consolidated financial statements**

**• = USMC Currently undergoing SBR audit only**

• Reporting entities planned for standalone audit will perform all audit readiness phases (i.e. Evaluation & Discovery, Corrective Action, Evaluation, Assertion, Sustainment, Validation, and Audit). However, reporting entities planned for DoD consolidated audit will stop after performing the Validation Phase.

• Reporting entities planned for DoD consolidated audit are allowed to procure audits if they desire to do so.

* Military Retirement Fund Payment is not a traditional reporting entity. This entity represents a Treasury account that is only used to receive and disburse appropriations to the Military Retirement Trust Fund.

**Figure 41. Material reporting entities to DoD Consolidated Financial Statements**

Once a reporting entity is audit ready, and the appropriate management assertions have been made, the assertions will be validated by an independent auditor. In the *Validation Phase*, a reporting entity will undergo an examination of an assessable unit after management asserts that an assessable unit is audit ready.

Should the examination indicate that an assessable unit is not audit ready, the reporting entity should return to the *Corrective Action Phase* to perform necessary remediation activities. Upon receiving an unqualified opinion from the audit readiness examination, reporting entities (Category 1) will progress to the *Audit Phase* and commence annual financial statement audits. The specific scope of the audits will vary depending on which wave the readiness assertion relates. For example, note from **Figure 42** that reporting entities asserting audit readiness for Wave 3 will undergo an audit and receive a specified elements audit opinion, which is issued in connection with audits of specified elements, accounts or items of a financial statement. A reporting entity asserting audit readiness at the completion of Waves 1, 2, and 4 will undergo a financial statement audit of the SBR statement or full financial statements. Once an assertion is validated, audits will be performed annually. Further details on individual waves are discussed in the specific wave section.

| | Validation Phase | Audit Phase |
|---|---|---|
| **WAVE 1** | | |
| • Appropriations Received Assessable Unit | Assertion Examination by IPA or other qualified, independent reviewer engaged by the Reporting Entity. | Not applicable until full SBR is audit ready |
| **WAVE 2** | | |
| • SBR Assessable Units | Assertion Examination by IPA or other qualified, independent reviewer engaged by the Reporting Entity | Not applicable until full SBR is audit ready |
| • Full SBR | Assertion Examination by DoD OIG | Audit by DoD OIG |
| **WAVE 3** | | |
| • Mission Critical Asset Assessable Units | Assertion Examination by DoD OIG | Specified Elements Audit by DoD OIG |
| **WAVE 4** | | |
| • All Financial Statements | Assertion Examination by DoD OIG | Audit by DoD OIG |

**Figure 42. Validation and Audit Phases for each Wave**

## APPENDIX A – MATERIAL REPORTING ENTITIES

The Department, with its many reporting entities preparing stand-alone financial statements, has a complex reporting structure. Its reporting entities vary significantly from a financial statement perspective (e.g., the Military Departments are few in number but material to the Department, versus a large number of less material Defense Agencies). Therefore, it is not effective or efficient to perform financial statement audits on all stand-alone financial statements. To increase the efficiency of the annual financial statement audits, reporting entities have been grouped into three categories, and must follow this guidance:

- **Category 1** – includes the Military Departments, Military Retirement Fund, and U.S. Army Corps of Engineers Civil Works Program (in accordance with the requirements of OMB Bulletin No. 07 – 04, as amended). These reporting entities will perform all audit readiness efforts following the Methodology and will undergo annual financial statement audits on their stand-alone financial statements.
- **Category 2** – other material reporting entities not included in Category 1, will perform all audit readiness efforts following the Methodology, but are not required to undergo annual standalone financial statement audits. Instead, these reporting entities will be audited as part of the Department's consolidated financial statement audit. **Figure 41** in Section 3 of the FIAR Guidance presents all financially material reporting entities, and identifies specific areas of the reporting entity that are material to the Department's consolidated financial statements.
- **Category 3** – all immaterial reporting entities not presented in **Figure 41** in Section 3 of the FIAR Guidance represent the remainder of the Department. While these immaterial reporting entities need to become audit ready and will be part of the Department's consolidated financial statement audit, they do not need to report their progress to the FIAR Directorate and are not required to undergo standalone financial statement audits. OUSD(C) will regularly update this analysis to confirm that all reporting entities material to the Department are appropriately focused on audit readiness. OUSD(C) will communicate the updated analyses separate from this guidance.

This appendix provides the Department's evaluation of materiality in determining what reporting entities are considered reporting entities for each wave of the FIAR strategy.

**Note**: The material reporting entities analysis for Waves 1 – 3 included below is based on FY 2009 financial statement reported amounts. The results of utilizing FY 2009 vs. FY 2010 amounts did not result in a significant enough change in the list of reporting entities to support the change (i.e., inclusion/exclusion of previously identified reporting entities).

### WAVES 1 AND 2

**All reporting entities needed to achieve coverage of at least 99 percent of the Department's total Budgetary Resources are designated as material reporting entities that must complete Waves 1 and 2. The Department has concluded that all amounts greater than one percent are considered material, therefore, the Department must ensure that at least 99 percent of the**

**amounts reported are audit ready prior to asserting Department-wide audit readiness.** This materiality threshold ensures the Department is focusing its limited resources on its significant reporting entities.

The following table summarizes the analysis performed to ensure that all material reporting entities were appropriately included in Waves 1 and 2 audit readiness efforts. This analysis further identifies reporting entities that are currently undergoing audits or are preparing for an audit.

The Department depends on many reporting entities to reach coverage totaling nearly 100 percent of Budgetary Resources and achieve an auditable Department-wide SBR. By combining the 14 percent coverage already achieved with the 85 percent coverage from the Military Departments and other reporting entities, the Department will have coverage on over 99 percent of its total Budgetary Resources. The remaining entities summarized in the following table as "Immaterial Reporting Entities" are deemed immaterial to the Department based on current reported account balances. While these immaterial reporting entities should follow this guidance to become audit ready, they do not need to report their progress to the FIAR Directorate. OUSD(C) will regularly update this analysis to confirm that all reporting entities material to the Department are focused on audit readiness efforts. OUSD(C) will communicate the updated analyses outside this guidance.

| Organization | SBR Line 7, Total Budgetary Resources Balance (FY2009) | | Percent of Balance | Planned Audit Type |
|---|---|---|---|---|
| **Under Audit** | | | | |
| Military Retirement Fund | $ | 50,303,962,635 | 4.27% | Category 1 |
| U.S. Army Corps of Engineers- Civil Works | $ | 40,394,543,982 | 3.43% | Category 1 |
| United States Marine Corps, GF | $ | 38,391,004,750 | 3.26% | Category 1 |
| Tricare Management Activity (CRM) | $ | 14,268,323,055 | 1.21% | Category 2 |
| Medicare-Eligible Retiree Healthcare Fund | $ | 8,290,649,170 | 0.70% | Category 2 |
| Defense Commissary Agency | $ | 7,655,363,185 | 0.65% | Category 2 |
| Defense Finance and Accounting Service | $ | 1,600,708,030 | 0.14% | Category 2 |
| Defense Contract Audit Agency | $ | 501,701,746 | 0.04% | Category 2 |
| Office of the Inspector General, DoD | $ | 318,440,862 | 0.03% | Category 2 |
| **Subtotal Under Audit** | **$** | **161,724,697,415** | **13.73%** | |
| | | | | |
| **Preparing for Audit** | | | | |
| Army, GF | $ | 320,490,685,931 | 27.20% | Category 1 |
| Air Force, GF | $ | 201,591,287,902 | 17.11% | Category 1 |
| Navy, GF | $ | 185,530,753,342 | 15.75% | Category 1 |
| Military Retirement Fund Payment* | $ | 65,530,000,000 | 5.56% | Category 2 |
| Defense Logistics Agency, WCF | $ | 38,007,067,441 | 3.23% | Category 2 |
| Navy | $ | 29,024,958,565 | 2.46% | Category 1 |
| DoD Component Level Accounts | $ | 27,630,141,514 | 2.35% | Category 2 |
| Service Medical Activity | $ | 21,085,592,983 | 1.79% | Category 2 |
| Army, WCF | $ | 18,718,420,062 | 1.59% | Category 1 |
| Office of the Secretary of Defense (WHS) | $ | 17,898,445,770 | 1.52% | Category 2 |
| Air Force, WCF | $ | 11,611,967,179 | 0.99% | Category 1 |
| U.S. Special Operations Command | $ | 11,515,699,390 | 0.98% | Category 2 |
| Missile Defense Agency | $ | 9,684,128,234 | 0.82% | Category 2 |
| U.S. Transportation Command Air Force- Air Mobility Command | $ | 9,384,961,552 | 0.80% | Category 2 |
| Other 97 Funds Provided to the Army by OSD | $ | 5,718,523,836 | 0.49% | Category 2 |
| Defense Information Systems Agency, WCF | $ | 5,556,128,764 | 0.47% | Category 2 |
| Defense Advanced Research Projects Agency | $ | 4,630,405,349 | 0.39% | Category 2 |
| DoD Education Activity | $ | 3,398,056,969 | 0.29% | Category 2 |
| Tricare Management Activity- Financial Operations Division (FOD) | $ | 2,618,643,987 | 0.22% | Category 2 |
| Defense Information Systems Agency, GF | $ | 2,600,758,230 | 0.22% | Category 2 |
| U.S. Transportation Command Army- Military Surface Deployment & Distribution | $ | 2,590,281,123 | 0.22% | Category 2 |
| Chemical Biological Defense Program | $ | 2,317,164,642 | 0.20% | Category 2 |
| Defense Security Cooperation Agency | $ | 1,705,910,466 | 0.14% | Category 2 |
| Defense Threat Reduction Agency | $ | 1,542,102,738 | 0.13% | Category 2 |
| Defense Contract Management Agency | $ | 1,284,093,209 | 0.11% | Category 2 |
| Defense Logistics Agency, GF | $ | 1,124,337,523 | 0.10% | Category 2 |
| Defense Technical Information Center | $ | 1,044,309,843 | 0.09% | Category 2 |
| United States Marine Corps, WCF | $ | 994,114,351 | 0.08% | Category 1 |
| **Subtotal Preparing for Audit** | **$** | **1,004,828,940,895** | **85.29%** | |
| | | | | |
| Immaterial Reporting Entities | **$** | **11,541,410,258** | **0.98%** | Category 3 |
| | | | | |
| **Total** | **$** | **1,178,095,048,568** | **100.00%** | |

* Military Fund Retirement Payment is not a traditional reporting entity. This entity represents a Treasury account that is only used to receive and disburse appropriations to the Military Retirement Trust Fund.
* Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation and Audit. However, reporting entities in Category 2 will stop after performing the Validation phase.
* Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 1. FY 2009 Material Reporting Entities for SBR**

## WAVE 3

**All reporting entities needed to achieve coverage of at least 99 percent of material Department asset categories are designated as material reporting entities that must complete Wave 3. The Department has concluded that all amounts greater than 1 percent are considered material, therefore, the Department must ensure that at least 99 percent of the amounts reported are audit ready prior to asserting Department-wide audit readiness.** This materiality threshold ensures the Department is focusing its limited resources on its significant reporting entities.

The following tables summarize the analysis performed to ensure all material reporting entities were appropriately included in Wave 3 readiness efforts for the five major asset categories. This analysis further identifies reporting entities that are currently undergoing audits, or are preparing for audit.

### Military Equipment

| Reporting Entities | Military Equipment – Acquisition Value (FY 2009) Dollars in Thousands | Percent of Balance | Planned Audit Type |
|---|---|---|---|
| **Preparing for Audit** | | | |
| Navy, GF | $ 337,303,591,871 | 42.33% | Category 1 |
| Air Force, GF | $ 300,284,137,963 | 37.68% | Category 1 |
| Army, GF | $ 141,160,619,600 | 17.71% | Category 1 |
| United States Marine Corps, GF | $ 11,202,272,000 | 1.41% | Category 1 |
| **Subtotal Preparing for Audit** | **$ 789,950,621,434** | **99.14%** | |
| | | | |
| Immaterial Reporting Entities | $ 6,891,979,363 | 0.86% | Category 3 |
| | | | |
| **Total** | **$ 796,842,600,797** | **100.00%** | |
| • Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase. • Reporting entities in Category 2 are allowed to procure audits if they desire to do so. | | | |

**Figure 2. FY 2009 Material Reporting Entities for Military Equipment**

## Real Property

| Organization | Real Property – Acquisition Value (FY 2009) Dollars in Thousands | Percent of Balance | Planned Audit Type |
|---|---|---|---|
| **Under Audit** | | | |
| US Army Corps of Engineers - Civil Works | $ 40,658,819,493 | 17.45% | Category 1 |
| Defense Commissary Agency | $ 2,029,566,000 | 0.87% | Category 2 |
| Defense Finance and Accounting Service | $ 123,563,000 | 0.05% | Category 2 |
| **Subtotal Under Audit** | **$ 42,811,948,493** | **18.38%** | |
| | | | |
| **Preparing for Audit** | | | |
| Army, GF | $ 62,710,234,121 | 26.92% | Category 1 |
| Air Force, GF | $ 58,992,240,227 | 25.32% | Category 1 |
| Navy, GF | $ 30,142,398,720 | 12.94% | Category 1 |
| United States Marine Corps, GF and WCF | $ 8,864,932,000 | 3.81% | Category 1 |
| Navy, WCF | $ 6,979,369,034 | 3.00% | Category 1 |
| Office of the Secretary of Defense (WHS) | $ 6,076,406,386 | 2.61% | Category 2 |
| Pentagon Reservation Maintenance Revolving Fund (WHS) | $ 3,713,833,098 | 1.59% | Category 2 |
| UNAL/DIS - DoD Component Level Accounts (USD(C)) | $ 3,329,421,249 | 1.43% | Category 2 |
| Defense Logistics Agency, WCF | $ 2,216,339,000 | 0.95% | Category 2 |
| Army, WCF | $ 1,716,082,172 | 0.74% | Category 1 |
| U.S. Special Operations Command | $ 1,159,054,000 | 0.50% | Category 2 |
| Air Force, WCF | $ 1,032,181,097 | 0.44% | Category 1 |
| Missile Defense Agency | $ 833,762,000 | 0.36% | Category 2 |
| Service Medical Activity | $ 665,634,000 | 0.29% | Category 2 |
| **Subtotal Preparing for Audit** | **$ 188,431,887,104** | **80.89%** | |
| | | | |
| Immaterial Reporting Entities | $ 1,710,864,403 | 0.73% | Category 3 |
| | | | |
| **Total** | **$ 232,954,700,000** | **100.00%** | |

- Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase.
- Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 3. FY 2009 Material Reporting Entities for Real Property**

## General Equipment

| Organization | General Equipment – Acquisition Value (FY 2009) Dollars in Thousands | | Percent of Balance | Planned Audit Type |
|---|---|---|---|---|
| **Under Audit** | | | | |
| US Army Corps of Engineers - Civil Works | $ | 1,524,212,842 | 1.89% | Category 1 |
| Defense Finance and Accounting Service | $ | 313,036,000 | 0.39% | Category 2 |
| Defense Commissary Agency, GF & WCF | $ | 151,636,000 | 0.19% | Category 2 |
| Defense Contract Audit Agency, GF | $ | 124,000 | 0.00% | Category 2 |
| **Subtotal Under Audit** | **$** | **1,989,008,842** | **2.46%** | |
| | | | | |
| **Preparing for Audit** | | | | |
| Air Force, GF | $ | 41,527,663,603 | 51.47% | Category 1 |
| Navy, GF | $ | 11,171,172,875 | 13.84% | Category 1 |
| U.S. Special Operations Command | $ | 7,361,202,000 | 9.12% | Category 1 |
| Army, GF | $ | 3,984,679,227 | 4.94% | Category 1 |
| UNAL/DIS - DoD Component Level Accounts (USD(C)) | $ | 3,187,970,418 | 3.95% | Category 2 |
| Navy, WCF | $ | 2,552,894,521 | 3.16% | Category 1 |
| Defense Information Systems Agency, GF & WCF | $ | 2,483,411,000 | 3.08% | Category 2 |
| Air Force, WCF | $ | 2,351,361,179 | 2.91% | Category 1 |
| Army, WCF | $ | 1,595,058,051 | 1.98% | Category 1 |
| Defense Logistics Agency, WCF | $ | 657,425,000 | 0.81% | Category 2 |
| United States Marine Corps, GF & WCF | $ | 465,519,000 | 0.58% | Category 1 |
| Tricare Management Activity | $ | 438,041,000 | 0.54% | Category 2 |
| Washington Headquarter Services | $ | 196,903,282 | 0.24% | Category 2 |
| **Subtotal Preparing for Audit** | **$** | **77,973,301,157** | **96.63%** | |
| | | | | |
| Immaterial Reporting Entities | $ | 728,390,001 | **0.90%** | Category 3 |
| | | | | |
| **Total** | **$** | **80,690,700,000** | **100.00%** | |

· Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase.

· Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 4. FY 2009 Material Reporting Entities for General Equipment**

## Inventory and Related Property

| Organization | | Inventory (FY 2009) Dollars in Thousands | Percent of Balance | Planned Audit Type |
|---|---|---|---|---|
| **Under Audit** | | | | |
| Defense Commissary Agency, WCF | $ | 400,397,000 | 0.48% | Category 2 |
| US Army Corps of Engineers - Civil Works | $ | 36,860,000 | 0.04% | Category 1 |
| **Subtotal Under Audit** | **$** | **437,257,000** | **0.53%** | |
| | | | | |
| **Preparing for Audit** | | | | |
| Air Force, WCF | $ | 29,915,921,000 | 36.12% | Category 1 |
| Army, WCF | $ | 23,164,252,000 | 27.97% | Category 1 |
| Defense Logistics Agency, WCF | $ | 17,340,386,000 | 20.94% | Category 2 |
| Navy, WCF | $ | 11,793,983,000 | 14.24% | Category 1 |
| United States Marine Corps, WCF | $ | 157,599,000 | 0.19% | Category 1 |
| **Subtotal Preparing for Audit** | **$** | **82,372,141,000** | **99.47%** | |
| | | | | |
| Immaterial Reporting Entities | $ | 5,202,000 | 0.01% | Category 3 |
| | | | | |
| **Total** | **$** | **82,814,600,000** | **100.00%** | |

* Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation and Audit. However, reporting entities in Category 2 will stop after performing the Validation phase.

* Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 5. FY 2009 Material Reporting Entities for Inventory and Related Property**

## Operating Material & Supplies

| Organization | OM&S (FY 2009) Dollars in Thousands | | Percent of Balance | Planned Audit Type |
|---|---|---|---|---|
| **Under Audit** | | | | |
| US Army Corps of Engineers - Civil Works | $ | 95,570,000 | 0.07% | Category 1 |
| **Subtotal Under Audit** | **$** | **95,570,000** | **0.07%** | |
| | | | | |
| **Preparing for Audit** | | | | |
| Navy, GF | $ | 56,614,797,000 | 38.98% | Category 1 |
| Air Force, GF | $ | 47,588,283,000 | 32.76% | Category 1 |
| Army, GF | $ | 34,497,598,000 | 23.75% | Category 1 |
| United States Marine Corps, GF & WCF | $ | 5,905,146,000 | 4.07% | Category 1 |
| Air Force, WCF | $ | 143,417,000 | 0.10% | Category 1 |
| Navy, WCF | $ | 128,846,000 | 0.09% | Category 1 |
| **Subtotal Preparing for Audit** | **$** | **144,878,087,000** | **99.74%** | |
| | | | | |
| Immaterial Reporting Entities | $ | 284,743,000 | 0.20% | Category 3 |
| | | | | |
| **Total** | **$** | **145,258,400,000** | **100.00%** | |

* Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation and Audit. However, reporting entities in Category 2 will stop after performing the Validation phase.

* Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 6. FY 2009 Material Reporting Entities for Operating Material & Supplies**

The Department is dependent on many reporting entities reaching coverage totaling nearly 100 percent of assets to achieve auditable Department-wide PP&E, Inventory and OM&S balances. All reporting entities that are material by asset category have been specifically identified in the preceding tables. The remaining balance of entities, summarized on the “Immaterial Reporting Entities” line in each table, is deemed immaterial to the Department based upon current reported account balances. While these immaterial reporting entities should follow this guidance to become audit ready, they do not need to report their progress to the FIAR Directorate. The OUSD(C) will regularly update this analysis to confirm that all reporting entities material to the Department are appropriately focused on audit readiness efforts. The OUSD(C) will communicate the updated analyses outside of this guidance.

## WAVE 4

**All reporting entity financial statement line items needed to achieve coverage of at least 99 percent of the Department's material financial statement line items, are designated as material reporting entity line items that must be addressed in Wave 4. The Department has concluded that all amounts greater than one percent are considered material, therefore, the Department must ensure that at least 99 percent of the amounts reported are audit ready prior to asserting Department-wide audit readiness.** This materiality threshold ensures the Department is focusing its limited resources on its significant reporting entities.

A three-step analysis was completed to identify all material reporting entity line items that must be addressed in wave 4. This three-step analysis was comprised of: (1) Identification of material financial statement line items on the Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position (Statement of Budgetary Resources was fully addressed in Wave 2); (2) Identification of reporting entities that are material to the Department financial statement line items identified in Step 1; and (3) exclusion of reporting entity line items (or activities) that were addressed in an earlier wave. The following tables summarize the results of the analysis performed, and further identify reporting entities that are currently undergoing audits or are preparing for an audit.

## Military Retirement & Other Federal Employee Benefits

| Reporting Entities | Military Retirement & Other Fed. Empl. Ben. (FY 2010) | | Percent of Balance | Planned Audit Type |
|---|---|---|---|---|
| **Under Audit** | | | | |
| Military Retirement Trust Fund | $ | 1,262,672,927,029 | 58.01% | Category 1 |
| Medicare-Eligible Retiree Health Care Fund | $ | 573,671,310,000 | 26.36% | Category 2 |
| Tricare Management Activity – CRM | $ | 256,490,931,721 | 11.78% | Category 2 |
| U.S. Army Corps of Engineers – Civil Works | $ | 243,459,734 | 0.01% | Category 1 |
| Defense Commissary Agency | $ | 167,221,475 | 0.01% | Category 2 |
| Defense Finance and Accounting Service | $ | 39,804,072 | 0.00% | Category 2 |
| Defense Contract Audit Agency | $ | 16,127,453 | 0.00% | Category 2 |
| | | | | |
| **Subtotal Under Audit** | **$** | **2,093,301,781,484** | **96.17%** | |
| | | | | |
| **Preparing for Audit** | | | | |
| Service Medical Activity | $ | 74,760,305,753 | 3.43% | Category 2 |
| United States Marine Corps, GF | $ | 196,374,009 | 0.01% | Category 1 |
| | | | | |
| **Subtotal Preparing for Audit** | **$** | **74,956,679,762** | **3.44%** | |
| | | | | |
| Immaterial Reporting Entities | $ | 8,440,280,879 | 0.39% | Category 3 |
| | | | | |
| **TOTAL** | **$** | **2,176,698,742,126** | **100.00%** | |

- Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase.
- Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 7. FY 2010 Material Reporting Entities for Military Retirement & Other Federal Employee Benefits**

## Environmental & Disposal Liability

| Reporting Entities | Environmental & Disposal Liability (FY 2010) | Percent of Balance | Planned Audit Type |
|---|---|---|---|
| **Under Audit** | | | |
| U.S. Army Corps of Engineers – Civil Works | $ 1,038,121,750 | 1.65% | Category 1 |
| Defense Commissary Agency | $ 31,017,837 | 0.05% | Category 2 |
| | | | |
| **Subtotal Under Audit** | **$ 1,069,139,587** | **1.70%** | |
| | | | |
| **Preparing for Audit** | | | |
| Army, GF | $ 33,352,730,535 | 53.02% | Category 1 |
| Navy, GF | $ 19,072,451,611 | 30.32% | Category 1 |
| Air Force, GF | $ 8,839,352,000 | 14.05% | Category 1 |
| United States Marine Corps, GF | $ 261,443,270 | 0.42% | Category 1 |
| | | | |
| **Subtotal Preparing for Audit** | **$ 61,525,977,416** | **97.81%** | |
| | | | |
| Immaterial Reporting Entities | $ 307,074,347 | 0.49% | Category 3 |
| | | | |
| **TOTAL** | **$ 62,902,191,350** | **100.00%** | |

· Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase.

· Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 8. FY 2010 Material Reporting Entities for Environmental & Disposal Liability**

## Other Liabilities – Intragovernmental

| Reporting Entities | Other Liabilities – Intragovermental (FY 2010) | Percent of Balance | Planned Audit Type |
|---|---|---|---|
| **Under Audit** | | | |
| U.S. Army Corps of Engineers – Civil Works | $ 3,511,004,929 | 25.48% | Category 1 |
| **Subtotal Under Audit** | **$ 3,511,004,929** | **25.48%** | |
| | | | |
| **Preparing for Audit** | | | |
| Navy, GF | $ 4,621,000,819 | 33.53% | Category 1 |
| Army, GF | $ 2,923,569,447 | 21.21% | Category 1 |
| Air Force, GF | $ 1,505,285,035 | 10.92% | Category 1 |
| Navy, WCF | $ 423,621,223 | 3.07% | Category 1 |
| United States Marine Corps, GF | $ 372,427,968 | 2.70% | Category 1 |
| Under Secretary of Defense (Personnel and Readiness) | $ 120,038,774 | 0.87% | Category 2 |
| Under Secretary of Defense (Acquisition, Technology and Logistics) | $ 74,586,620 | 0.54% | Category 2 |
| Army, WCF | $ 63,418,442 | 0.46% | Category 1 |
| **Subtotal Preparing for Audit** | **$ 10,103,948,327** | **73.32%** | |
| | | | |
| Immaterial Reporting Entities | $ 166,511,746 | 0.86% | Category 3 |
| | | | |
| **TOTAL** | **$ 13,781,465,003** | **100%** | |

· Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase.

· Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 9. FY 2010 Material Reporting Entities for Other Liabilities – Intragovernmental**

## Other Liabilities – Nonfederal

| Reporting Entities | Other Liabilities – Nonfederal (FY 2010) | | Percent of Balance | Planned Audit Type |
|---|---|---|---|---|
| **Under Audit** | | | | |
| U.S. Army Corps of Engineers – Civil Works | $ | 2,173,317,729 | 6.11% | Category 1 |
| Defense Finance and Accounting Service | $ | 111,701,727 | 0.31% | Category 2 |
| Defense Commissary Agency | $ | 100,757,131 | 0.28% | Category 2 |
| Defense Contract Audit Agency | $ | 54,401,261 | 0.15% | Category 2 |
| Defense Information Systems Agency, WCF | $ | 42,431,011 | 0.12% | Category 2 |
| | | | | |
| **Subtotal Under Audit** | **$** | **2,482,608,858** | **6.98%** | |
| | | | | |
| **Preparing for Audit** | | | | |
| Army, GF | $ | 13,532,369,598 | 38.05% | Category 1 |
| Air Force, GF | $ | 6,402,702,144 | 18.00% | Category 1 |
| Navy, GF | $ | 5,412,207,197 | 15.22% | Category 1 |
| Navy, WCF | $ | 1,752,327,879 | 4.93% | Category 1 |
| DoD Component Level Accounts | $ | 1,603,698,613 | 4.51% | Category 2 |
| United States Marine Corps, GF | $ | 1,461,335,095 | 4.11% | Category 1 |
| Air Force, WCF | $ | 429,768,556 | 1.21% | Category 1 |
| Office of the Secretary of Defense | $ | 394,691,563 | 1.11% | Category 2 |
| Other 97 Funds Provided to the Army by OSD | $ | 387,975,489 | 1.09% | Category 2 |
| Army, WCF | $ | 377,082,216 | 1.06% | Category 1 |
| Service Medical Activity | $ | 296,806,261 | 0.83% | Category 2 |
| Defense Logistics Agency, WCF | $ | 278,809,604 | 0.78% | Category 2 |
| Defense Contract Management Agency | $ | 144,699,005 | 0.41% | Category 2 |
| U.S. Special Operations Command | $ | 94,565,357 | 0.27% | Category 2 |
| DoD Education Activity | $ | 63,002,902 | 0.18% | Category 2 |
| Defense Information Systems Agency, GF | $ | 61,385,598 | 0.17% | Category 2 |
| Missile Defense Agency | $ | 44,738,563 | 0.13% | Category 2 |
| | | | | |
| **Subtotal Preparing for Audit** | **$** | **32,738,165,642** | **92.06%** | |
| | | | | |
| Immaterial Reporting Entities | $ | 342,752,244 | 0.96% | Category 3 |
| | | | | |
| **TOTAL** | **$** | **35,563,526,744** | **100.00%** | |

• Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase.

• Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 10. FY 2010 Material Reporting Entities for Other Liabilities – Nonfederal**

## Losses/(Gains) from Actuarial Assumption Changes

| Reporting Entities | Lossess/(Gains) from Actuarial Assumption Changes (FY 2010) | Percent of Balance | Planned Audit Type |
|---|---|---|---|
| **Under Audit** | | | |
| Military Retirement Fund | $ 85,006,894,000 | 51.81% | Category 2 |
| Medicare-Eligible Retiree Health Care Fund | $ 63,528,740,000 | 38.72% | Category 2 |
| Tricare Management Activity - CRM | $ 10,804,407,000 | 6.58% | Category 2 |
| **Subtotal Under Audit** | **$ 159,340,041,000** | **97.11%** | |
| | | | |
| **Preparing for Audit** | | | |
| Service Medical Activity | $ 4,728,559,000 | 2.88% | Category 2 |
| **Subtotal Preparing for Audit** | **$ 4,728,559,000** | **2.88%** | |
| | | | |
| Immaterial Reporting Entities | $ 20,469,000 | 0.01% | Category 3 |
| | | | |
| **TOTAL** | **$ 164,089,069,000** | **100.00%** | |

- Reporting entities in Category 1 will perform all audit readiness phases (i.e., Discovery, Corrective Action, Evaluation, Assertion, Validation, and Audit). However, reporting entities in Category 2 will stop after performing the Validation phase.
- Reporting entities in Category 2 are allowed to procure audits if they desire to do so.

**Figure 11. FY 2010 Material Reporting Entities for Losses/(Gains) from Actuarial Assumption Changes**

## Depreciation Expense

Reporting Entities that are material to the General Property & Equipment balances per Wave 3 must address related depreciation expense for the same asset classes during Wave 4. See **Figures 2, 3, and 4** of this Appendix for the listing of Reporting Entities that must address Depreciation Expense during Wave 4.

# APPENDIX B – ROLES AND RESPONSIBILITIES

As noted in Section 2.I, the FIAR Governance Board plays a significant role in the Department's audit readiness effort. This appendix includes a description of additional key stakeholders and governing bodies for financial improvement and audit readiness.

## B.1 Key Departmental Stakeholders

### B.1.1 Office of the Deputy Chief Management Officer (ODCMO)

The DCMO leads and integrates Enterprise-wide performance improvement and business operations to enable and support the war fighter. The creation of the DCMO and Military Department CMOs is assisting with driving and measuring financial management results. These offices are actively coordinating and marshaling resources from across the Department in support of USD(C) financial improvement efforts and emphasizing the need to think of our business from an end-to-end process perspective.

One of the key financial improvement roles the DCMO and Military Department CMOs play is ensuring that functional communities (e.g., Logistics and Human Resources) recognize their vital role in achieving audit readiness, since most financial transactions originate as the result of business events in the functional community's operations. The Department has worked for years to fully engage functional communities in addressing auditability with varying success, but with the assistance of the DCMO and the Military Department CMOs, this is expected to improve. They also are providing the unifying support and oversight needed to ensure that business system modernization efforts are fully synchronized with reporting entity financial improvement activities depicted in their FIPs. To date, linking these two initiatives has been difficult because of the compartmentalized nature of the two efforts.

As Principal Staff Assistant (PSA) to the Secretary of Defense, the DCMO also provided oversight of the Business Transformation Agency (BTA), a Defense Agency which helped facilitate transformation of the Department's financial processes and systems. However, as a result of the Secretary of Defense's efficiency Initiative this past year, the decision was made to disestablish the BTA and incorporate its core functions into the ODCMO and its direct program management responsibilities for specific enterprise defense business systems into the Defense Logistics Agency (DLA). The expanded ODCMO will continue to support FIAR efforts.

### B.1.2 Under Secretary of Defense (Comptroller)/Chief Financial Officer

The Comptroller/Chief Financial Officer (CFO) is charged with the responsibility of developing and implementing DoD-wide financial management systems and overseeing financial management activities relating to CFO programs and operations of the DoD.

The CFO's oversight responsibilities include: (1) establishing financial management policies for the DoD, including its reporting entity parts; (2) ensuring compliance throughout the DoD with applicable accounting policies, standards and principles, as well as financial information and systems functional standards; (3) establishing, reviewing, and enforcing internal control policies, standards, and compliance guidelines involving financial management; (4) providing oversight of financial management activities and operations, including (a) preparation and revision of the FIAR Plan and the FIAR Plan Status Report and (b) oversee and execute the development of financial management budgets; (5) oversee adequate financial controls over real property, equipment and inventories; and (6) ensuring that complete, reliable, consistent, timely and accurate information on all transactions is available in financial management systems. **[See *DoD Directive 5118.03, Under Secretary of Defense Comptroller) (USD(C))/Chief Financial Officer (CFO), Department of Defense*.]**

### B.1.3 Office of Under Secretary of Defense (Comptroller)/Deputy Chief Financial Officer (DCFO)

The DCFO is responsible for overseeing and implementing accounting policy, improvements in financial management, as well as other financial management functions for the DoD on a day-to-day basis. To discharge his or her responsibilities, the DCFO has three Directorates: Financial Improvement and Audit Readiness (FIAR), Accounting and Finance Policy, and the Business Integration Office.

#### *FIAR Directorate*

The FIAR Directorate, created by the USD(C), provides day-to-day management of the FIAR Plan to ensure that DoD-wide financial improvement efforts are integrated with functional community improvement activities. The FIAR Directorate:

- Recommends strategic direction to the DCFO and USD(C),
- Assists the DoD Components by evaluating FIAR plans, products and deliverables, as well as providing subject matter experts to assist in Component FIAR activities,
- Develops and issues detailed financial improvement and audit preparation methodologies and guidance,
- Organizes and convenes cross-Component financial and functional working groups to address issues and develop solutions,
- Utilizing experienced financial, accounting and auditing personnel, embeds teams to develop, improve, and execute Financial Improvement Plans (FIPs) and provide training to the Components,
- Biannually, publishes the FIAR Plan Status Report,
- Maintains the FIAR Planning Tool, which is used by the Components to manage their FIPs,
- Monthly, performs detailed reviews of the Component FIPs supported by the OUSD(AT&L) and provides feedback to the Components, as needed, and
- Develops metrics for monitoring and reporting progress.

#### *Accounting and Finance Policy Directorate*

The Accounting & Finance Policy (A&FP) Directorate is primarily responsible for accounting and finance policy within the DoD. The Directorate manages the content and publication of the DoD Financial Management Regulation (FMR), writes accounting and finance policies, and publishes policies written by others. The Directorate works closely with the FIAR Directorate to address critical accounting and financial management policy challenges throughout the Department.

### *Business Integration Office*

The Business Integration Office (BIO) ensures that the Department's business and financial systems and process transformation plans are aligned with USD(C) goals and objectives and consistent with Federal requirements. BIO provides functional oversight during business system implementations to ensure appropriate controls are in place and that systems conform to applicable legislation such as the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA); and that functional priorities and requirements are consistent with DoD enterprise standards (e.g., Business Enterprise Architecture, Standard Financial Information Structure (SFIS)). BIO mission areas include: Enterprise System Support (e.g., Defense Agencies Initiative (DAI), Business Enterprise Information Services (BEIS)), Systems Oversight/Compliance/Institutional Review Board (IRB) Support, Business systems modernization and process transformation, and Metrics.

## B.1.4 Office of the Under Secretary of Defense (Acquisitions, Technology & Logistics)

### *Assistant Secretary of Defense (Logistics and Materiel Readiness)*

The Assistant Secretary of Defense (Logistics and Materiel Readiness) (ASD(L&MR)) serves as the principal staff assistant and advisor to the USD(AT&L), Deputy Secretary of Defense, and Secretary of Defense on logistics and materiel readiness in the Department and is the principal logistics official within the senior management of the DoD. In this capacity, the ASD(L&MR):

- Prescribes policies and procedures for the conduct of logistics, maintenance, materiel readiness, strategic mobility, and sustainment support in the DoD, to include, supply, maintenance, and transportation.
- Advises and assists the USD(AT&L), Secretary of Defense, and Deputy Secretary of Defense in providing guidance to the Secretaries of the Military Departments with respect to logistics, maintenance, materiel readiness, strategic mobility, and sustainment support in the DoD.
- Monitors and reviews all logistics, maintenance, materiel readiness, strategic mobility, and sustainment support programs.
- Participates in the DoD Planning, Programming, and Budgeting System.

### *Deputy Under Secretary of Defense (Installations and Environment)*

The mission of the Office of the Deputy Under Secretary of Defense (Installations and Environment (DUSD(I&E)) is to provide installation assets and services necessary to support our military forces in a cost effective, safe, sustainable, and environmentally sound manner. DUSD(I&E) provides oversight for DoD Environmental, Safety and Occupational Health (ESOH) programs, and issues ESOH asset management policy for use by the DoD Components in planning, programming, and budgeting. DUSD(I&E) focuses on modernizing business processes and supporting information technology to enable integrated and sustainable real property asset management. Among other things, DUSD(I&E) establishes policies for standardized processes and data elements for collecting and managing real property inventory information, developing and using unique identifiers for all real property sites and assets, and standardized practices for the accounting for environmental liabilities.

***Property & Equipment Policy Office***

The mission of the Property & Equipment Policy Office (PEP) is to establish policies and support business process development that enables reporting entities (military services and defense agencies) to provide more accurate and reliable information to senior leaders to support management decisions at an enterprise-level. The Property & Equipment Policy Office focuses on improving the Department's property, plant and equipment (PP&E) business practices, policies, procedures and systems through constant interaction with reporting entities, as well as the DoD OIG and OUSD(C), including assisting with feedback on Existence and Completeness (E&C) plans. P&EP is the lead OUSD(AT&L) office for supporting the E&C effort regarding general and military equipment. P&EP assists the Components in evaluating whether their inventories for Quick Win assets meet the requirements for E&C assertion. P&EP is also the DoD lead for Military Equipment Valuation (MEV), which is a DoD-wide effort to implement Federal accounting standards requiring military equipment, including modifications and upgrades, to be treated as capitalized assets on the DoD financial statements.

### B.1.5 Defense Finance and Accounting Service

DFAS operates most finance and accounting systems and functions for all appropriated, nonappropriated, working capital, revolving, and trust fund activities, including security assistance. DFAS establishes and enforces requirements, procedures, and practices necessary to comply with finance and accounting statutory and regulatory requirements applicable to DoD. DFAS also provides professional finance and accounting services for DoD reporting entities and other Federal agencies. DFAS also directs the consolidation, standardization, and integration of finance and accounting requirements, functions, procedures, operations, and systems and ensures their proper relationship with other DoD functional areas (e.g., budget, personnel, logistics, acquisition, civil engineering, etc.). DFAS executes statutory and regulatory financial reporting requirements and prepares financial statements. [See ***DoD Directive 5118.5, Defense Finance and Accounting Service.***]

### B.1.6 Major Commands and Service Providers

It is Components' major commands and service providers, such as the Army Materiel Command (AMC) and DFAS, where the FIPs are executed. The major commands and service providers perform the discovery work, test and strengthen internal controls, and correct deficiencies. It is within the major commands where business events occur that trigger financial transactions, and where the functional community engages with the financial community to achieve the vision, goals, and priorities of the FIAR Plan.

### B.1.7 Department of Defense Office of Inspector General (OIG)

The OIG performs audits of the finance and accounting systems, functions, and activities established to carry out DoD fiscal responsibilities. The OIG is involved in the FIAR Methodology during the Validation and Audit phases. The OIG and FIAR Directorate review assertion documentation against common criteria and make recommendations on the reporting entity's audit readiness. If a reporting entity is asserting readiness to Wave 2 or 3, the DoD OIG will perform an examination of the audit readiness assertion or will review the work of other auditors performing examinations of individual assessable units within these waves. At the completion of Waves 2, 3, and 4 during the *Audit Phase*, the DoD OIG either performs the audit or engages an independent public accountant (IPA) to assist with the audit. When an IPA is utilized, the DoD OIG provides oversight of audit work and either signs the opinion or transmits the IPA's opinion on the financial statements. [See ***DoD Directive 5106.01, Inspector General of the Department of Defense***]

### B.1.8 Reporting Entities's Senior Assessment Teams

Each reporting entity is required to have a Senior Assessment Team (SAT) that oversees the execution of the Strategy and Methodology. The primary responsibilities of the reporting entity's SAT include:

- Ensuring the FIAR Goal and Strategy are clearly communicated throughout the reporting entity;
- Ensuring that the Methodology is carried out in a thorough, effective, and timely manner (effective project management);
- Reporting the results of the execution of the FIAR Strategy and Methodology to senior management;
- Ensuring that personnel executing the FIAR Methodology are adequately trained;
- Monitoring the timely implementation of corrective actions; and
- Complying with ICOFR SOA annual reporting requirements (discussed in Section 2.D).

## B.2 Key Boards and Committees

### B.2.1 DoD Audit Advisory Committee

The DoD Audit Advisory Committee, established under the provisions of the Federal Advisory Committee Act of 1972, provides the Secretary of Defense, through the USD(C), independent advice and recommendations on DoD financial management, to include financial reporting processes, internal controls, audit processes, and processes for monitoring compliance with relevant laws and regulations. The Committee is comprised of five members, who are distinguished members of the audit, accounting, and financial communities. The members are not DoD employees. The Committee meets at the call of the USD(C) or approximately four times a year. As needed, the Committee can establish subcommittees or workgroups to study, analyze, or address audit readiness issues and make recommendations to the Committee.

### B.2.2 FIAR Committee

The FIAR Committee meets monthly to oversee the management of the FIAR Plan. The Committee leads the implementation of the FIAR Plan priorities. Chaired by the Deputy Chief Financial Officer (DCFO), the Committee is comprised of executive-level representatives of the OUSD(AT&L), Military Departments, Defense Logistics Agency (DLA) and Defense Finance and Accounting Service (DFAS). The Deputy Inspector General for Auditing acts as an adviser to the FIAR Committee.

### B.2.3 FIAR Subcommittee

An active FIAR Subcommittee of senior accountants, financial managers, management analysts, and auditors support the FIAR Committee. The FIAR Director chairs the subcommittee that supports the FIAR Committee in its efforts to improve financial management within the Department. It also supports the integration of financial management requirements within the financial community and functional communities (Logistics, Acquisition, Personnel, etc.).

The Sub-Committee provides advice and recommendations to the FIAR Committee on opportunities to prioritize, integrate and manage efforts to improve financial management and achieve audit readiness. Management of these improvement efforts employs a federated approach that identifies enterprise requirements and recognizes unique reporting entity-level execution and implementation plans. Improvements focus on human capital requirements, policies, processes, controls, systems, and organizational structures.

# APPENDIX C – FIAR STRATEGY DETAILS

This appendix provides FIAR Strategy details for reporting entities and service providers working to become audit ready. Organized by wave, this appendix includes specific key risks of material misstatements (ROMMs), control objectives (KCOs) and key supporting documents (KSDs) for each wave.

## C. 1 WAVE 1 – APPROPRIATIONS RECEIVED AUDIT

The DoD FMR 7000.14, Volume 6B, Chapter 7 defines appropriations (SBR line 3A, Appropriations) as "... the amount of appropriations specified in the appropriations act or in substantive laws that become available for obligation on or after October 1 of the fiscal year (actual and anticipated)." Therefore, Wave 1 represents all budgetary funding appropriated from Congress and the related first level of funding distribution for the reporting entity's use.

### C.1.1 Readiness Scope

To successfully prepare for an Appropriations Received audit, **Wave 1 reporting entity readiness efforts must include all processes that result in financial transactions material to recording and distributing budget authority.** This typically includes:

- Funding appropriated by Congress for the current fiscal year,
- Apportionment/re-apportionment activity approved by the OMB,
- Department-level allotment and reprogramming activity,
- Reporting entity-level allotment and reprogramming activity, and
- Treasury warrants documenting the availability of Fund Balance with Treasury (FBWT).

These processes include the receipt of congressional appropriations, the accurate apportionment of the funds, the proper dissemination of the funding apportionments downward, the recording in general ledgers, and finally, the reporting on the reporting entity financial statements. Specifically, this would include actions the OUSD(C) or reporting entity headquarters takes to make the funding allocations flow from headquarters to the responsible manager at the installation level, as well as actions taken by DFAS to prepare the financial statements.

Wave 1 processes and related controls include activities performed to control and record transactions related to: (1) the receipt of the budget ("Appropriations Received"), and (2) the distribution of the budget to the major command level.

Current year appropriations distribution includes the capability to support the completeness of funds distributed to the major command or equivalent. Reporting entities should demonstrate completeness of funds distribution by reconciling the current year budget authority apportioned and allotted to USSGL accounts 4510, "Apportionments", and 4610, "Allotments-Realized Resources", of the general ledger to the fund distribution system. The reconciliation should identify current year budget authority as an element of the entire balance, which includes beginning balances, reductions for executed funds and upward or downward adjustments, recorded in these accounts.

The first event is the receipt of the budget funding. This involves SBR Line 3A, Appropriations Received, and preparing that line item for audit. Financial events resulting from appropriations include an increase to the Appropriations line item on the SBR and a corresponding increase to FBWT on the proprietary side. Note that during the apportionment process (SF 132), not only are the actual and anticipated resources apportioned (such as appropriations supporting Line 3A), but also the actual and anticipated additions and reductions to resources (such as rescissions and general provision reductions, rescissions, and transfers) that eventually populate SBR Lines 4, 5, and 6, included in Wave 2. Refer to Section C.1.2 for the KCO and KSD listings related to SBR Lines 4, 5, and 6.

The second area of importance is the distribution of the budget. While SBR Line 3A reports appropriated resources received, the distribution of these resources, reported as changes to status within SBR lines 9 and 10, plays a critical role in each organization's funding and execution controls. The evaluation of distribution controls for activity recorded to these status lines become a critical component of a comprehensive audit of the Status of Budgetary Resources. Success depends on effective controls that mitigate the risk of potential misstatement within all material lines and account balances. In particular, effective controls for receipt and distribution of funds aid in the prevention of Anti-Deficiency Act violations. These controls also provide mid-year monitoring of spending to identify the need for reprogramming, transfers and/or journal vouchers as applicable. Refer to Section C.1.2 for a listing of KSDs used to demonstrate the accuracy of the transactions recorded and the controls are in place.

## C.1.2 Risks, Key Control Objectives and Key Supporting Documents

### *Risks*

The following table presents the key ROMM related to the Wave 1, Appropriations Received, by each of the five financial statement assertions. A reference to the source of each risk is included in parentheses. **Reporting entities must mitigate these risks by designing and implementing control activities.** Refer to the KCOs in the table following this risk table for further details.

| Wave 1 – Appropriations Received<br>Key Risks of Material Misstatement | |
|---|---|
| **Financial Statement Assertions** | **Key Risks of Material Misstatement** |
| Existence | 1. Recorded budget authority does not exist (e.g., not authorized by Public Law) (FAM 395B: 4) |
| Completeness | 2. All new budget authority made available for obligation was not recorded (GAO-02-126G; p. 26) |
| Valuation | 3. New budget authority was recorded at incorrect amounts (GAO-02-126G; p. 25)<br>4. Apportionment amounts do not agree to the total appropriated amount (FAM 395F: 01b)<br>5. Allotted amounts do not agree to appropriated/apportioned amounts (FAM 395F: 01c) |
| Presentation and Disclosure | 6. Accumulated accounts or transactions are not properly classified and described in the SBR and SF-133 (FAM 395B: 15)<br>7. The current period SBR is based on accounting principles different from those used in prior |

| Wave 1 – Appropriations Received<br>Key Risks of Material Misstatement | |
|---|---|
| **Financial Statement Assertions** | **Key Risks of Material Misstatement** |
| | periods presented (FAM 395B: 16)<br>8. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements (including OMB and FASAB guidance) (FAM 395B: 17) |
| Rights and Obligations | 9. Agencies do not have rights to budgetary resources reported on the SBR (FAM 395F: 01a) |

## *Key Control Objectives*

**The following table presents the KCOs that must be achieved in Wave 1 by the design and implementation of effective control activities. It is the reporting entity's responsibility to design and implement internal controls that will achieve the KCOs.** Each KCO has been linked to its relevant financial statement assertions (as indicated with an "X" in the relevant columns), including if the KCO relates to compliance with laws and regulations. At the end of each KCO is a source reference. This is not a complete listing of control objectives, but rather those KCOs needed to address key risk areas most likely to be present based on the Department's experience. **Reporting entities must apply judgment to determine if additional KCOs should be included given their specific business processes and financial statements.** Reporting entities may also refer to the GAO/PCIE FAM Section 395B and 395F for a list of general control objectives based on financial statement assertions.

| Wave 1 – Appropriations Received Key Control Objectives | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Line Items** | **Key Control Objectives** | **Financial Statement Assertions** | | | | | **Compliance** |
| | | **Existence** | **Completeness** | **Valuation** | **Presentation & Disclosure** | **Rights & Obligations** | |
| Budgetary Authority: Appropriations<br><br>**Note: While not a part of Wave 1, these same KCOs should be used for Borrowing Authority and Contract Authority, if applicable.** | 1. Appropriation transactions (or other forms of budget authority): Recorded appropriation (or other forms of budget authority) is the same as the appropriation or other legislation, that was made available for obligation (including restrictions on amount, purpose & timing) and pertains to the entity (FAM 395F: 01a) | X | | X | | X | X |
| | 2. Appropriation transactions (or other forms of budget authority): All new budget authority that was made available for obligation was recorded in the proper accounts and properly summarized (GAO-02-126G; p. 26) | X | X | | X | | |

| Wave 1 – Appropriations Received Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| | 3. Apportionment transactions: Recorded apportionments agree with the OMB apportionments (as indicated on the apportionment schedules), and the total amount apportioned does not exceed the total amount appropriated (FAM 395F: 01b) | x | | x | | x | x |
| | 4. Allotment and sub-allotment transactions: The total amount allotted does not exceed the total amount apportioned (FAM 395F: 01c) | | | | | | x |

### *Key Supporting Documents*

**The following table lists the minimum internal control documentation and supporting documentation required to assert as audit ready for Wave 1, Appropriations Received.** The table links each listed document to the potential financial statement assertions that it supports. Internal control documentation is marked as meeting all financial statement assertions, because the specific control activities described in the internal control documentation will determine which specific financial statement assertions are satisfied. Specific to Wave 1 supporting documentation:

- Reporting entities must retain all internal control documentation that demonstrates the design and operation of processes and activities.
- Reporting entities must retain supporting documentation that constitutes financial transaction evidence substantiating the accuracy of all relevant financial statement assertions. For example, reporting entities must retain appropriation documentation for the life of the appropriation.

| Wave 1 – Appropriations Received Key Supporting Documents | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Line Items** | **Documentation Type** | **Key Supporting Documents** | **Financial Statement Assertions** | | | | |
| | | | **Existence** | **Completeness** | **Valuation** | **Presentation & Disclosure** | **Rights & Obligations** |
| All Financial Statement Line Items | Internal Control Documentation | 1. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations | x | x | x | x | x |
| | | 2. Applicable policies and procedures | x | x | x | x | x |
| | | 3. Process narratives and flowcharts | x | x | x | x | x |
| | | 4. Control worksheets, identifying risks, KCOs and corresponding control activities | x | x | x | x | x |
| | | 5. Test plans documenting planned procedures used to test the operating effectiveness of control activities | x | x | x | x | x |
| | | 6. Control assessments with test results | x | x | x | x | x |
| | | 7. Evaluation of test results | x | x | x | x | x |
| | | 8. Documentation evidencing the operation of internal control activities for the period under audit. For example:<br>• Approval signature documentation (electronic or manual) demonstrating accuracy reviews of appropriation transactions recorded in the general ledger (compared to supporting documentation such as Appropriation Act / Public Law) | x | x | x | x | x |
| | | 9. System inventory list, listing of system users and their access privileges. | x | x | x | x | x |
| Budgetary Authority: Appropriations | Transaction Documentation | 10. Appropriation Act (Public Law) | x | x | x | x | x |
| | | 11. Treasury Warrants (FMS 6200) | x | x | x | x | x |
| | | 12. Apportionment and Reapportionment Schedule (SF 132) | x | x | x | x | x |
| | | 13. Funding Authorization Documents (FADs) supporting Departmental Allotments | | | | | x |
| | | 14. Reporting entity-level sub-allotment documentation (if applicable) | | | | | x |
| | | 15. Report on Budget Execution and Budgetary Resources (SF 133) | | | | x | |
| | | 16. Trial balance by fund code (Treasury account) corresponding to each appropriation | | | | x | |
| | | 17. Year-End Closing Statement (FMS 2108) | | | | x | x |

### C.1.3 Example Work Products

Refer to SBR Section C.2.3 for examples of SBR work products and related guidance.

### C.1.4 Wave-Specific Audit Execution

**Wave 1 reporting entity readiness efforts must include all processes that result in financial transactions material to their receipt and distribution (first level of distribution within the reporting entity) of budget authority. Reporting entities must perform Discovery, Corrective Action and Evaluation phases prior to asserting audit readiness for this wave. Once a reporting entity asserts audit readiness for Appropriations Received, and the FIAR Directorate approves the assertion after performing validation, the entity must engage an IPA or other qualified, independent reviewer to perform a Validation phase examination to form an opinion on the reporting entity's audit readiness assertion. If the examination results in an unqualified opinion on the reporting entity's audit readiness assertion, the reporting entity should engage an IPA or other qualified, independent reviewer to commence annual audits on this line item until Wave 2 is complete and the reporting entity undergoes a full SBR audit.** Should these audits demonstrate a strong and effective control environment, the reporting entity can submit a request to the FIAR directorate to substitute a cycle other than annually for audits.

## C.2 WAVE 2 – SBR AUDIT

The SBR presents all budgetary resources that a reporting entity has available, the status of those resources at period end, a reconciliation of changes in obligated balances from the beginning to the end of the period, and cash collections and disbursements for the period reported. Wave 2 – SBR Audit includes all processes, internal controls, systems and supporting documentation that must be audit ready before asserting audit readiness for the SBR. Significant business cycles in this wave include Procure-to-Pay, Hire-to-Retire, Order-to-Cash, and Budget-to-Report (including FBWT).

### C.2.1 Readiness Scope

To prepare for an SBR audit, a reporting entity's audit readiness efforts must include all processes that result in financial transactions material to their SBR. The financial transactions that are summarized and reported on the SBR also affect other financial statements. The most important relationships are those between the SBR and the Balance Sheet. Specifically, because of the strong relationship between the FBWT line item on the Balance Sheet and SBR line items, examples shown in **Figure 1**, the Department's strategy for the SBRs depends on an auditable FBWT balance. This includes not only cash collection and disbursement transactions that affect multiple SBR line items and the FBWT line item on the Balance Sheet, but also the Treasury reporting and reconciliation activities reporting entities perform to ensure their records remain in balance with the Treasury.

| Example Financial Event | SBR Impact | Balance Sheet – FBWT Impact |
|---|---|---|
| Appropriation Received | Increase to Appropriation | Increase to FBWT |
| Rescissions | Increase to Permanently not Available | Decrease to FBWT |
| Unfilled Order Received with Advance | Increase to Unfilled Customer Orders | Increase to FBWT |
| Collection | Increase to Earned Spending Authority | Increase to FBWT |
| Disbursement | Increase to Gross Outlays | Decrease to FBWT |

**Figure 1. Relationship between SBR and FBWT**

Wave 2 includes the SBR's main sections and the underlying financial transactions reported in each section and FBWT:

- *Budgetary Resources* – including recoveries of prior year unpaid obligations [SBR line 2], appropriations (addressed in Wave 1) [SBR line 3A], contract authority [SBR line 3C], reimbursable activity [SBR line 3D], non-expenditure transfers [SBR line 4] and rescissions [SBR line 6], status of budgetary resources – including direct [SBR line 8A] and reimbursable [SBR line 8B] obligations incurred under various procure-to-pay and hire-to-retire processes (vendor purchases, civilian and military payroll, travel, Military Interagency Purchase Requests (MIPRs), etc.), and ending unobligated balances [SBR lines 9 – 10],

- *Change in Obligated Balance* – including delivery of orders and the status of period-end balances for undelivered/delivered orders and unfilled customer orders/receivables from Federal sources [SBR lines 12 through 18C],
- *Net Outlays* – including cash disbursement and collection activity, along with distributed offsetting receipts [SBR lines 19A – 19D], and
- *FBWT* – including aspects of FBWT such as appropriations (addressed in Wave 1), cash disbursements and collection (same as preceding bullet), monthly reconciliations of all open appropriation accounts at the transaction level, and reporting.

The preceding is not a complete list, but rather a listing of major transaction types contained within a typical SBR. Reporting entities should follow the FIAR Methodology to identify all processes that result in transactions and balances material to their SBR.

## C.2.2 Risks, Key Control Objectives, Assessable Unit Risks and Outcomes, and Key Supporting Documents

### *Risks*

The following table presents the key ROMM related to the Wave 2, SBR Audit, by each of the five financial statement assertions. The second table contains the same information for FBWT. A reference to the source of each risk is included in parentheses. **Reporting entities must mitigate these risks by designing and implementing control activities.** Refer to the KCOs in separate tables following these risk tables for further details.

| Financial Statement Assertions | Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Risks of Material Misstatement |
|---|---|
| Existence | 1. Recorded unobligated balances brought forward are not available for obligation in the current period because balances have been rescinded or are otherwise restricted (GAO-02-126G: p. 26)<br>2. Recoveries of prior year obligations are incorrect or are no longer available (GAO-02-126G; p.28)<br>3. Recorded budget authority does not exist (e.g., not authorized by Public Law) (FAM 395B: 4)<br>4. Spending authority from offsetting collections do not exist, are not supported by an authorized agreement or are not yet earned (FAM 395B: 4)<br>5. Recorded transfers are not properly authorized (FAM 395B: 1)<br>6. Budgetary resources not available for obligation are not properly reported (GAO-02-126G; p. 29)<br>7. Recorded obligations do not represent valid orders, contracts, or other events that will require future payment (GAO-02-126G; p. 31)<br>8. Obligations are recorded in bulk amounts not supported by binding agreements (FAM 395F: 01e)<br>9. Obligations are not properly liquidated when transactions are completed (GAO-02-126G; p. 34)<br>10. Recorded outlays are for invalid or unauthorized transactions and/or are not supported by disbursement evidence (GAO-02-126G: p. 35). Recorded Collection or Receipt transactions are not valid or available for obligation during the year (GAO-02-126G: p. 27, 36)<br>11. Transactions are recorded in the current period, but the related economic events occurred in a different period (FAM 395 B: 2)*<br>12. Transactions are summarized improperly, resulting in an overstated total (FAM 395B: 3)* |
| Completeness | 13. All unobligated available balances brought forward are not recorded (GAO-02-126G: p. 26)<br>14. All recoveries of prior year obligations that are available for obligation are not recorded as recoveries in |

| Financial Statement Assertions | Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Risks of Material Misstatement |
|---|---|
| | the SBR (GAO-02-126G: p. 28)<br>15. All new budget authority made available for obligation was not recorded (GAO-02-126G: p. 26)<br>16. All available and authorized spending authority is not recorded (GAO-02-126G: p. 27)<br>17. Transfers are not recorded in the correct period (FAM 395B: 6)<br>18. All canceled, restricted, or limited budgetary resources are not included as reductions on the SBR (GAO-02-126G: p. 27)<br>19. All obligations incurred are not properly recorded (GAO-02-126G: p. 31)<br>20. An agency may have placed an order for goods/services and not recorded the Undelivered Order (UDO) amount (GAO-02-126G: p. 34)<br>21. Goods or services may have been received, but the Delivered Orders /Accounts Payable (AP) has not been recorded and Undelivered Order amount reduced (GAO-02-126G: p. 34)<br>22. All appropriate outlays and adjustments are not recorded (FAM 395F: 01g)<br>23. All valid and authorized collection or receipt transactions are not recorded (GAO-02-126G: p. 27, 36)<br>24. Economic events occurred in the current period, but the related transactions are recorded in a different period (FAM 395B: 6)*<br>25. Transactions are summarized improperly, resulting in an understated total (FAM 395B: 7)* |
| Valuation | 26. Unobligated balances brought forward are recorded at incorrect amounts (GAO-02-126G: p. 26)<br>27. Recoveries of prior year obligations are incorrectly calculated (GAO-02-126G: p. 28)<br>28. New budget authority was recorded at incorrect amounts (GAO-02-126G: p. 25)<br>29. Apportionment amounts do not agree to the total appropriated amount (FAM 395F: 01b)<br>30. Allotted amounts do not agree to appropriated/apportioned amounts (FAM 395F: 01c)<br>31. Spending authority from offsetting collections is not recorded at the correct amount (GAO-02-126G: p. 27)<br>32. Transfers are not recorded at the correct amount (FAM 395B: 9)<br>33. Budgetary resources temporarily or permanently not available for obligation are recorded at incorrect amounts (FAM 395B: 9)<br>34. Obligations not are recorded at the proper amounts (GAO-02-126G: p. 31)<br>35. Inaccurate Uncollected Customer Payments/Accounts Receivable (AR) and Unfilled Customer Order (UFCO) amounts are included in the obligated balance, net end of period (FAM 395F: 01e)<br>36. Outlays and adjustments are reported at incorrect amounts (FAM 395F: 01g)<br>37. Collections or Receipts are misstated (GAO-02-126G: p. 27, 35) |
| Presentation and Disclosure | 38. Accumulated accounts or transactions are not properly classified and described in the SBR and SF-133 (FAM 395B: 15)<br>39. The current period SBR is based on accounting principles different from those used in prior periods presented (FAM 395B: 16)<br>40. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements (including OMB and FASAB guidance) (FAM 395B: 17) |
| Rights and Obligations | 41. Agencies do not have rights to budgetary resources reported on the SBR, including collection and/or receipt activity (FAM 395F: 01a)<br>42. Unobligated balances are misstated and expired balances or errors are carried forward into next year's balances (GAO-02-126G: p. 32)<br>43. UFCOs related to expired agreements are included in the uncollected customer payments balance (FAM 395B: 13)<br>44. Agency is not contractually or legally bound to the obligation and therefore, related outlays should not be made, recorded or reported (FAM 395F: 01j) |
| * Risk Applies to all SBR line items. | |

| Financial Statement Assertions | Fund Balance with Treasury<br>Wave 2 – SBR Audit<br>Key Risks of Material Misstatement |
|---|---|
| Existence | 1. FBWT amounts recorded in the general ledger do not exist (FAM 921C: 1)<br>2. FBWT reconciliations to Treasury reports are not performed in a timely manner (FAM 395B: 3)<br>3. Unreconciled differences, including those that are temporarily recorded in budget clearing accounts are not researched and resolved in a timely manner (FAM 395B: 3) |
| Completeness | 4. Increases/decreases to FBWT are not appropriately and completely recorded (FAM 395B: 5)<br>5. FBWT balance exists but is omitted from the financial statements (FAM 921C: 2) |
| Valuation | 6. FBWT transactions are recorded at incorrect amounts (FAM 921C: 3) |
| Presentation and Disclosure | 7. FBWT is not properly classified and described in the financial statements (FAM 921C: 6)<br>8. The current period FBWT is based on accounting principles different from those used in prior periods presented (FAM 921C: 7)<br>9. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements (including OMB and FASAB guidance) (FAM 921C: 8) |
| Rights and Obligations | 10. The entity does not have rights to the recorded FBWT amounts (FAM 921C: 5)<br>11. Recorded FBWT is owned by others (FAM 921C: 4) |

### *Key Control Objectives*

**The following table presents the KCOs (by SBR line item) that must be achieved in Wave 2 by designing and implementing effective control activities. It is the reporting entity's responsibility to design and implement internal controls that will achieve the KCOs.** Note that some SBR line items are listed more than once because different groups of KCOs link to different combinations of line items. Therefore, it is important to review the entire table to ensure a complete list of KCOs relevant to a particular assessable unit/line item. Each KCO has been linked to its relevant financial statement assertions (as indicated with an "X" in the relevant columns), including if the KCO relates to compliance with laws and regulations. At the end of each KCO is a source reference. This is not a complete listing of control objectives, but rather those KCOs needed to address key risk areas most likely to be present based on the Department's experience. **Reporting entities must apply judgment to determine if additional KCOs should be included given their specific business processes and financial statements.** Reporting entities may also refer to the GAO/PCIE FAM Section 395B and 395F for a list of general control objectives based on financial statement assertions.

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Key Control Objectives | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | Compliance |
| All Financial Statement Line Items | 1. Accounts and all the transactions they accumulate are properly classified and described in the SBR and SF-133 (FAM 395B: 15)* | | | | x | | |
| | 2. The current period SBR is based on accounting principles that are consistently applied from period to period (FAM 395B: 16)* | | | | x | | |
| | 3. SBR and related footnotes contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 17)* | | | | x | | |
| | 4. Recorded transactions underlying events, and related processing procedures are authorized by federal laws, regulations, and management policy (FAM 395B: 1a) | x | | | | | |
| | 5. Transactions recorded in the current period represent economic events that occurred during the current period (FAM 395B: 2) | x | | | | | |
| | 6. The summarization of recorded transactions is not overstated (FAM 395B: 3) | x | | | | | |
| | 7. All economic events that occurred in the current period are recorded as transactions in the current period (FAM 395B: 6) | | x | | | | |
| | 8. The summarization of recorded transactions is not understated (FAM 395B: 7) | | x | | | | |
| Unobligated Balance, Brought Forward October 1 | 9. Recorded unobligated balances from prior periods remain available for obligation and pertains to the entity (GAO-02-126G: p. 26) | x | | | | x | |
| | 10. All unobligated balances from prior periods are recorded and agree with prior year balances (GAO-02-126G: p. 27) | | x | x | | | |
| Recoveries of Prior Year Unpaid Obligations | 11. Recorded recoveries represent cancellations or downward adjustments of prior obligations, remain available, are recorded in the proper accounts and pertains to the entity (GAO-02-126G: p. 28) | x | | | x | x | |
| | 12. All recoveries of prior years that are available for obligation were included in the SBR (GAO-02-126G: p. 28) | | x | | | | |

**Statement of Budgetary Resources**
**Wave 2 – SBR Audit**
**Key Control Objectives**

| Line Items | Key Control Objectives | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | Compliance |
|---|---|---|---|---|---|---|---|
| Spending Authority from Offsetting Collections (including Earned: Collected, Earned: Change in receivables from Federal Sources, Change in Unfilled Customer Orders: Advance Received, Change in Unfilled Customer Orders: Without Advance from Federal Sources) | 13. Spending authority from offsetting collections (anticipated and accepted orders) is available for obligation during the year, was recorded in the proper accounts and pertains to the entity and is supported by proper documentation (GAO-02-126G: p. 27) | x | | | x | x | |
| | 14. All offsetting collections are available for obligation by reference to authorizing legislation (GAO-02-126G: p. 27) | | | | | x | x |
| | 15. All revenue and collections are recorded in the proper accounts (GAO-02-126G: p. 27) | | x | | x | | |
| | 16. Spending authority from offsetting collections was reconciled to reported revenue from third parties (GAO-02-126G: p. 27) | x | x | x | | x | |
| | 17. All available and authorized spending authority is recorded and at correct amounts (GAO-02-126G: p. 27) | | x | x | | | |
| Nonexpenditure Transfers, net, Anticipated and Actual | 18. Recorded non-expenditure transfers represent valid transfers authorized by OMB and pertain to the entity (FAM 395B: 1a) | x | | | | x | |
| | 19. All transfers authorized by OMB are recorded in the proper period and at correct amounts (FAM 395B: 6, 9) | | x | x | | | |
| Temporarily not Available Pursuant to Public Law<br><br>Permanently not Available | 20. Reported amounts not available (temporarily or permanently) represent valid restrictions on the availability of budget authority or cancellations, pertain to the entity and are supported by available documentation (GAO-02-126G: p. 26) | x | | | | x | |
| | 21. All amounts that are canceled, restricted, or limited are included as reductions of resources in the SBR (GAO-02-126G: p. 27) | | x | | | | |
| Recoveries of prior year unpaid obligations (for those KCOs referencing | 22. Obligations represent valid orders that will require future payment (FAM 395F: 01e) | x | | | | x | |
| | 23. Obligations are for the same purpose for which the appropriation was made (FAM 395F: 01e) | | | | | | x |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Line Items** | **Key Control Objectives** | **Financial Statement Assertions** | | | | | **Compliance** |
| | | **Existence** | **Completeness** | **Valuation** | **Presentation & Disclosure** | **Rights & Obligations** | |
| “adjustments” to obligations) | 24. Obligations are incurred within the time that the appropriation was available for new obligations (FAM 395F: 01e) | | | | | x | x |
| Obligations Incurred: Direct | 25. Obligations do not exceed the amount allotted or appropriated by statue, nor were the obligations incurred before the appropriation became law (unless otherwise provided by law) (FAM 395F: 01e) | | | | | x | x |
| Obligations Incurred: Reimbursable | 26. Obligations comply with all other legally binding restrictions such as obligation ceilings or earmarks (FAM 395F: 01e) | | | | | x | |
| Unpaid Obligations, Brought Forward October 1 | 27. Obligations are not subsequently cancelled nor have the goods or services been received (FAM 395F: 01e) | x | | | | x | |
| Unpaid Obligations, End of Period | 28. Adjustments represent a "contract change" as defined in OMB Circular A-11 (FAM 395F: 01e) and satisfy reporting and approval requirements in that circular | | | | | | x |
| | 29. Adjustments do not cause the entity to exceed the amount allotted or appropriated by statute (FAM 395F: 01e) | | | | | | x |
| | 30. Adjustments are recorded during the period when the account is available for adjustments (5 years) and was made for a valid obligation incurred before the authority expired (FAM 395F: 01e) | x | | | | x | |
| | 31. New obligations are not recorded in expired accounts (FAM 395F: 01e) | | | | | x | |
| | 32. All new and valid obligations incurred during the period are recorded in the proper accounts (FAM 395F: 01e) | | x | | x | | |
| | 33. Obligations are recorded in the proper period (FAM 395F: 01e) | x | x | | | | |
| | 34. Obligations are recorded at the best available estimate of actual cost (FAM 395F: 01e) | | | x | | | |
| | 35. Obligations are recorded in the proper appropriation or fund accounts (also by program and by object, if applicable), including the proper appropriation year if the account is multiyear (FAM 395F: 01e) | | | | x | | |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| | 36. Commitment transactions: If commitment controls are relied upon to achieve objectives related to obligations and expenditures, commitment objectives are the same as obligations and expenditures (FAM 395F: 01d) | | | | | | x |
| | 37. Expended authority transactions recorded have occurred, as evidenced by appropriate supporting documentation (FAM 395F: 01f) | x | | | | | |
| | 38. For expended authority transactions in expired accounts, transactions do not cause the entity to exceed the amount appropriated by statute (FAM 395F: 01f) | | | | | | x |
| | 39. For expended authority transactions in expired accounts, transactions are recorded during the period when the account is available for adjustment (5 years) (FAM 395F: 01f) | | | | | x | x |
| | 40. For expended authority transactions in expired accounts, transactions are not made out of closed accounts (FAM 395F: 01f) | | | | | x | x |
| | 41. All expended authority transactions and adjustments are recorded (FAM 395F: 01f) | | x | | | | |
| | 42. Expended authority transactions and adjustments are recorded at the correct amount(FAM 395F: 01f) | | | x | | | |
| | 43. Expended authority transactions and adjustments are recorded in the proper period (FAM 395F: 01f) | x | x | | | | |
| | 44. Expended authority transactions and adjustments are recorded in the proper appropriation or fund accounts (also by program and by object, if applicable), including the proper appropriation year if account is multiyear (FAM 395F: 01f) | | | | x | | |
| Unobligated Balance: Apportioned | 45. Unobligated balances exist and represent available or not available (expired) funds and pertain to the entity (FAM 395B: 04a, 13) | x | | | | x | |
| | 46. Unobligated balances do not include any expired, canceled, or rescinded amounts (GAO-02-126G: p. 32) | x | | | | | |
| Unobligated Balance: Exempt | 47. All unobligated funds are recorded (FAM 395B: 05) | | x | | | | |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Key Control Objectives | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | Compliance |
| from Apportionment<br><br>Unobligated Balances Not Available | 48. Recorded balances as of a given date are supported by appropriate detailed records that are accurately summarized and reconciled to the appropriation or fund account balance, by year, for each account (FAM 395B: 4b) | x | x | x | x | | |
| | 49. Total undelivered orders plus total expended authority transactions do not exceed the amount of the appropriation or other statutory limitations (FAM 395F: 01h) | | | | | | x |
| | 50. Fixed appropriation accounts are closed on September 30 of the 5th fiscal year after the end of the period that they are available for obligation, any remaining balance (whether obligated or unobligated) is canceled and no longer available for obligation or expenditure for any purpose (FAM 395F: 01h) | | | | | x | x |
| | 51. Indefinite appropriation accounts are closed if (1) the entity head or President determines the purpose of the appropriation has been carried out, and (2) no disbursements have been made for two consecutive fiscal years (FAM 395F: 01h) | | | | | x | x |
| Unpaid Obligations, Brought Forward October 1<br>Unpaid Obligations, End of Period<br>Uncollected customer payments from Federal Sources, Brought Forward October 1<br>Uncollected Customer Payments from Federal Sources, End of Period | 52. Total payments of outstanding unliquidated obligations that relate to closed accounts do not exceed the limits described in OMB Circular No. A-11 (FAM 395F: 01h) | | | | | | x |
| | 53. Unpaid obligations and uncollected customer payments represent amounts for orders placed/received, contracts awarded, and similar obligating/ordering transactions for which goods and services have not been paid or agreements expired and pertain to the entity (FAM 395B: 01a, 14) | x | | | | x | |
| | 54. All unpaid obligations and uncollected customer payments are recorded in the proper accounts, the correct fiscal year, the correct amount and are properly classified and presented in the financial statement (FAM 395B: 9, 15) | | | x | x | | |
| Gross Outlays | 55. Outlays represent valid, authorized transactions and pertain to the entity (FAM 395F: 01j) | x | | | | x | |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| | 56. Outlays are recorded against obligations made during the period of availability of the appropriation (as applicable) (FAM 395F: 01f) | | | | | x | x |
| | 57. All outlays are recorded (FAM 395F: 01g) | | x | | | | |
| | 58. Outlays are recorded at the correct amounts (FAM 395F: 01g) | | | x | | | |
| | 59. Outlays are recorded in the proper accounts (by both program and by object, if applicable), including the proper appropriation year if the account is multiyear-evidenced by matching outlay to the underlying obligation (if applicable) (FAM 395F: 01g) | | | | x | | |
| | 60. Outlays are recorded in the proper period (FAM 395F: 01g) | x | x | | | | |
| | 61. Recorded balances of outlay for the fiscal year are supported by appropriate detail records that are accurately summarized for each account (FAM 395F: 01j) | x | | | x | | |
| Gross Outlays | 62. Outlays are for the purposes for which the appropriation was provided and in an amount not exceeding the obligation, as adjusted, authorizing the outlay (FAM 395F: 01g) | | | | | | x |
| | 63. Outlays do not use "first-in, first out" or other arbitrary means to liquidate obligations, unless supporting evidence demonstrates it reasonably represents the manner in which costs are incurred (FAM 395F: 01g) | | | | | | x |
| Offsetting Collections<br><br>Distributed Offsetting Receipts | 64. Collections and receipts authorized or required to be credited to an appropriation account but not received before the account is closed are deposited in the Treasury as a miscellaneous receipt (FAM 395F: 01k) | | | | | | x |
| | 65. Recorded offsetting collections are available for obligation during the year and were recorded in the proper accounts (GAO-02-126G, p. 27) | x | | | | | |
| | 66. Recorded receipts are valid and were recorded in the proper accounts ( GAO-02-126G, p. 36) | x | | | | | |
| | 67. All current year offsetting receipts are recorded (GAO-02-126G, p. 36) | | x | | | | |
| | 68. All current year offsetting collections are recorded (FAM 395B:5) | | x | | | | |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Control Objectives | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Line Items | Key Control Objectives | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | Compliance |
| | 69. All current year offsetting collections and/or receipts are recorded at the correct amounts (FAM 395B: 9) | | | x | | | |
| | 70. The entity has the rights to the recorded offsetting collections and/or receipts (FAM 395B: 13) | | | | | x | |
| | 71. Offsetting collections and/or receipts are appropriately summarized, classified and presented on the financial statement (FAM 395B: 15) | | | | x | | |
| *Components should review applicable sections of the GAO/PCIE FAM section 2010 Federal Accounting Checklist and 2020 Federal Reporting and Disclosure Checklists to ensure proper presentation and disclosures. | | | | | | | |
| FBWT<br><br>Indirectly: Obligated and Unobligated Balances, Brought Forward, October 1, and End of Period | 72. Recorded FBWT amounts exist as of a given date. (FAM 921C: 1a) | x | | | | | |
| | 73. Financial events recorded in the general ledger FBWT accounts at a given date are supported by appropriate source documents and detailed records that are accurately summarized and reconciled to the account balance and are recorded in the proper period (FAM 921C: 1a and 1b) | x | x | x | x | | |
| | 74. FBWT reports submitted to Treasury for all funds and Disbursing Locations are supported by the entity's general ledger and are submitted to Treasury in a timely manner (FAM 921: 10)** | x | x | x | x | | |
| | 75. Reconciling items identified during the FBwT reconciliation process are researched and resolved in a timely manner (FAM 921:18)** | x | x | x | | x | |
| | 76. Transactions recorded in budget clearing and/or suspense accounts are researched and resolved/cleared in a timely manner (FAM 921: 18)** | x | x | x | | x | |
| | 77. Access to FBWT, critical forms, records, and processing and storage areas is in accordance with laws, regulations, and management policy – Persons do not have uncontrolled access to both assets and records; they are not assigned duties to put them in a position that would allow them to both commit and conceal errors or fraud (i.e., segregation of duties) (FAM 921C: 1c) | | X | | | | |
| | 78. All FBWT balance amounts are included in the financial statements – and reconciles to activity/balances in monthly Treasury reports for the reporting period (FAM 921C: 2a)** | | X | | | | |
| | 79. FBWT transactions are accurately recorded (FAM 921C: 3a) | | | x | x | | |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| | 80. FBWT is properly classified and described in the financial statements (FAM 921C: 6a) | | | | x | | |
| | 81. FBWT is based on accounting principles that are applied consistently from period to period (FAM 921C: 7a) | | | | X | | |
| | 82. The entity owns recorded FBWT – FBWT amounts represent legislative spending limits granted to the agency available for use during the current period (FAM 921C: 4a) | | | | | x | X |
| | 83. The entity has the rights to recorded FBWT at a given date – FBWT balance is reflective of entities' budget authority at a given date (FAM 921C: 5a) | | | | | X | |
| | 84. All required disclosures are made and are accurately reported (FAM 921C: 8a) | | | | x | | |
| Note: Other Defense Organizations must take into account the additional complexities of shared appropriations.<br>** KCO related to the FBWT Reconciliation Process | | | | | | | |

## *Assessable Unit Risks and Outcomes*

For the most common Wave 2 assessable units throughout DoD, FIAR has defined baseline financial reporting risks and related outcomes. Specifically, FIAR has identified the key risks for these assessable units that may cause a financial statement balance to be inaccurate or invalid. Once the risks are mitigated the related assessable unit outcome is achieved. **Figure 2** depicts how the tailored risks and outcomes relate to the Wave 2 risks of material misstatement and key control objectives identified.

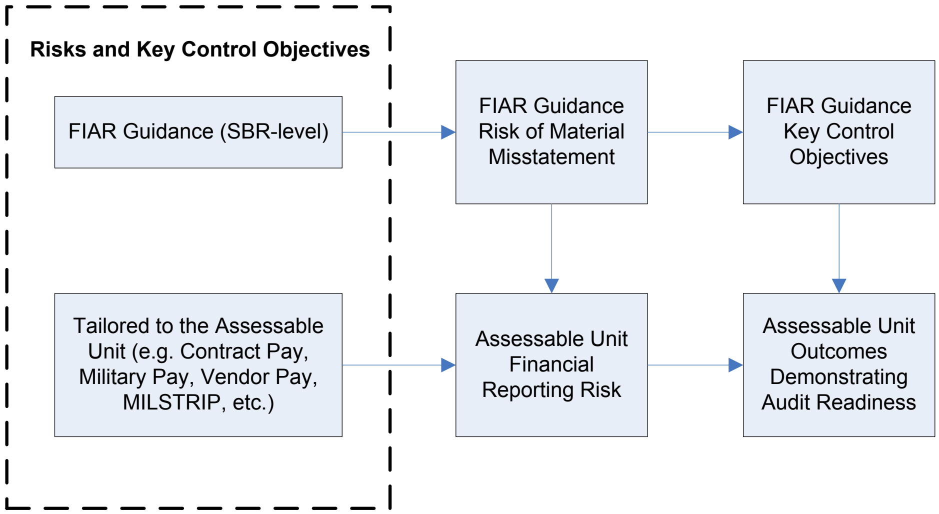


**Figure 2. Relationship of Wave 2 Risks and Key Control Objectives to Assessable Unit Financial Reporting Risks and related Outcomes**

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| **Contract Pay** | | | | |
| 1 | All obligations may not be recorded timely | SBR Wave 2, ROMM #20 | All obligations are recorded in the correct period and within 10 days of award | SBR Wave 2, KCO #33 |
| 2 | Obligations may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44 | Obligations are recorded accurately (correct amount, Treasury account, vendor, line of accounting (agrees to requisition), reporting entity) and contracts are valid (authorized/approved transactions supported by contract) | SBR Wave 2, KCO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54 |
| 3 | All accruals and/or payables may not be recorded timely | SBR Wave 2, ROMM #21 | All accruals and/or payables (for goods/services received not yet invoiced) are recorded in the correct period and within 10 days of receipt | SBR Wave 2, KCO # 41, 43 |
| 4 | Accruals and/or payables may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #34 | All accruals and/or payables are recorded accurately (correct amount, Treasury account, contract/obligation/line of accounting, reporting entity) and invoices are valid (authorized/approved transactions supported by evidence goods/services were received or otherwise due) | SBR Wave 2, KCO #37, 39, 40, 42, 43, 44, 53, 54 |
| 5 | All disbursements may not be recorded timely | SBR Wave 2, ROMM #22 | All disbursements are recorded in the correct period and within 10 days of payment | SBR Wave 2, KCO #57, 60 |
| 6 | Disbursements may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #10, 36 | Disbursements are recorded accurately (correct amount, Treasury account, contract/obligation/line of accounting, reporting entity) and disbursements are valid (authorized/approved transactions supported by invoice and receiving report) | SBR Wave 2, KCO #55, 56, 58, 59, 61 |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| 7 | Stale or invalid obligations and accruals may not be removed | SBR Wave 2, ROMM #2, 9, 14, 27 | All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year | SBR Wave 2, KCO #11, 12, 22, 27, 43 |
| 8 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **MILSTRIP** | | | | |
| 1 | All obligations may not be recorded timely | SBR Wave 2, ROMM #20 | All obligations are recorded in the correct period and within 10 days | SBR Wave 2, KCO #33 |
| 2 | Obligations may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44 | Obligations are recorded accurately (correct amount, Treasury account, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by requisition documentation) | SBR Wave 2, KCO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54 |
| 3 | All receipt/payables may not be recorded timely | SBR Wave 2, ROMM #21 | All receipts/payables (for goods received not yet invoiced) are recorded in the correct period and within 10 days of receipt | SBR Wave 2, KCO # 41, 43 |
| 4 | Receipt/Payables may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #34 | All receipts/payables are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by evidence goods were actually received) | SBR Wave 2, KCO #37, 39, 40, 42, 43, 44, 53, 54 |
| 5 | All disbursements may not be recorded timely | SBR Wave 2, ROMM #22 | All disbursements are recorded in the correct period and within 10 days of payment | SBR Wave 2, KCO #57, 60 |
| 6 | Disbursements may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #10, 36 | Disbursements are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and disbursements are valid (authorized/approved transactions supported by invoice and receiving report) | SBR Wave 2, KCO #55, 56, 58, 59, 61 |
| 7 | Stale or invalid obligations and accruals may not be removed | SBR Wave 2, ROMM #2, 9, 14, 27 | All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year. | SBR Wave 2, KCO #11, 12, 22, 27, 43 |
| 8 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **Vendor Pay** | | | | |
| 1 | All obligations may not be recorded timely | SBR Wave 2, ROMM #20 | All obligations are recorded in the correct period and within 10 days | SBR Wave 2, KCO #33 |
| 2 | Obligations may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44 | Obligations are recorded accurately (correct amount, Treasury account, vendor, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by obligation documentation) | SBR Wave 2, KCO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54 |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| 3 | All accruals and/or payables may not be recorded timely | SBR Wave 2, ROMM #21 | All accruals and/or payables (for goods/services received not yet invoiced) are recorded in the correct period and within 10 days of receipt | SBR Wave 2, KCO # 41, 43 |
| 4 | Accruals and/or payables may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #34 | All accruals and/or payables are recorded accurately (correct amount, Treasury account, obligation/line of accounting, reporting entity) and invoices are valid (authorized/approved transactions supported by evidence goods/services were received or otherwise due) | SBR Wave 2, KCO #37, 39, 40, 42, 43, 44, 53, 54 |
| 5 | All Disbursements may not be recorded timely | SBR Wave 2, ROMM #22 | All disbursements are recorded in the correct period and within 10 days of payment | SBR Wave 2, KCO #57, 60 |
| 6 | Disbursements may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #10, 36 | Disbursements are recorded accurately (correct amount, Treasury account, obligation/line of accounting, reporting entity) and disbursements are valid (authorized/approved transactions supported by invoice and receiving report) | SBR Wave 2, KCO #55, 56, 58, 59, 61 |
| 7 | Stale or invalid obligations and accruals may not be removed | SBR Wave 2, ROMM #2, 9, 14, 27 | All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year | SBR Wave 2, KCO #11, 12, 22, 27, 43 |
| 8 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **Reimbursable Work Order – Grantor** | | | | |
| 1 | All obligations may not be recorded timely | SBR Wave 2, ROMM #20 | All obligations are recorded in the correct period and within 10 days | SBR Wave 2, KCO #33 |
| 2 | Obligations may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #7, 8, 11, 12, 19, 34, 44 | Obligations are recorded accurately (correct amount, Treasury account, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by authorized documentation) | SBR Wave 2, KCO #24, 25, 26, 30, 31, 32, 34, 35, 53, 54 |
| 3 | All accruals/payables may not be recorded timely | SBR Wave 2, ROMM #21 | All receipts/payables (for goods/services received not yet invoiced) are recorded in the correct period and within 10 days of receipt | SBR Wave 2, KCO # 41, 43 |
| 4 | Accruals/payables may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #34 | All receipts/payables are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by evidence goods/services were actually received) | SBR Wave 2, KCO #37, 39, 40, 42, 43, 44, 53, 54 |
| 5 | All IPAC disbursements/advances may not be recorded timely | SBR Wave 2, ROMM #22 | All IPAC disbursements/Advances are recorded in the correct period and within 10 days of payment | SBR Wave 2, KCO #57, 60 |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| 6 | IPAC Disbursements/advances may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #10, 36 | IPAC Disbursements/Advances are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by invoices/orders/receiving report) | SBR Wave 2, KCO #55, 56, 58, 59, 61 |
| 7 | Stale or invalid obligations and accruals may not be removed | SBR Wave 2, ROMM #2, 9, 14, 27 | All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year | SBR Wave 2, KCO #11, 12, 22, 27, 43 |
| 8 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **Fund Balance with Treasury** | | | | |
| 1 | All disbursements and collections may not be reported timely | FBWT Wave 2, ROMM #4, 5 | All disbursements and collections are reported to Treasury in the correct period and within Treasury deadline | SBR Wave 2, KCO # 73, 74, 77, 78 |
| 2 | Disbursements and collections may not be reported accurately or be valid | FBWT Wave 2, ROMM # 1, 6, 8, 13, 26, 42 | Disbursements and collections are accurately (correct amount, Treasury account, budget fiscal year) reported to Treasury and are valid (authorized/approved transactions supported by documentation, e.g. invoice and receiving report) | SBR Wave 2, KCO # 9, 10, 73, 74, 78, 79, 81 |
| 3 | All Treasury accounts may not be reconciled timely | FBWT Wave 2, ROMM #2 | All Treasury accounts related to the Component are reconciled monthly within required timeline | SBR Wave 2, KCO # 48, 77, 78 |
| 4 | Reconciliations, including general ledger and disbursing system data, may not be accurate | FBWT Wave 2, ROMM #1, 6, 8, 10, 11 | All Treasury reconciliations, including general ledger and disbursing system data, are accurate (using correct Treasury accounts, dollar amounts/ accounting periods from GWA, General Ledger, and Disbursing) | SBR Wave 2, KCO # 48, 72, 79, 81, 82, 83 |
| 5 | All reconciling items may not be identified timely | FBWT Wave 2, ROMM #3, 4, 5 | All reconciling differences and budget clearing account items are identified at the transaction level (specific disbursement or collection causing the difference) | SBR Wave 2, KCO # 75, 76 |
| 6 | Reconciling items may not resolved accurately or be valid | FBWT Wave 2, ROMM # 1, 6 | Reconciling and budget clearing account items are appropriately resolved (adjustment recorded in General Ledger or reported to Treasury (SF 1219/1220), at the correct amount (Treasury account and budget fiscal year) and valid (authorized/approved transactions supported by documentation that demonstrates how the individual transaction should have been recorded/reported) | SBR Wave 2, KCO # 75, 76 |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| 7 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **Appropriations Received** | | | | |
| 1 | Apportionment amounts do not agree to the total appropriated amount | Appropriations Received Wave 1, ROMM #4, 9; SBR Wave 2, ROMM #29 | Apportionments agree to total amount appropriated (dollar amount, Treasury account, type of funds, years of availability) | Appropriations Received Wave 1 , KCO #1, 2, 3; SBR Wave 2 #45 |
| 2 | Allotted amounts do not agree to appropriated/ apportioned amounts | Appropriations Received Wave 1, ROMM #5; SBR Wave 2, ROMM #30 | Allotted amounts agree to total amount apportioned/appropriated (dollar amount, Treasury account, type of funds, years of availability) | Appropriations Received Wave 1, KCO #4 |
| 3 | Current year funds distributed may not be recorded timely in the Distribution System | Appropriations Received Wave 1, ROMM #2, 3; SBR Wave 2, ROMM #15, 28 | All current year funds are recorded in Distribution System the correct period | Appropriations Received Wave 1, KCO #2 |
| 4 | Current year funds distributed may be recorded inaccurately in the Distribution System or may be invalid | Appropriations Received Wave 1, ROMM #3; SBR Wave 2, ROMM #28 | Current year funds are recorded accurately (correct amount, treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by Funding Authorization Documents (FAD)) | Appropriations Received Wave 1, KCO #1, 2, 3 |
| 5 | Current year sub-allotments may not be recorded timely | Appropriations Received Wave 1, ROMM #2, 3; SBR Wave 2, ROMM #15, 28 | Current year sub-allotments are recorded in the correct period | Appropriations Received Wave 1, KCO #2 |
| 6 | Current year sub-allotments may be recorded inaccurately or may be invalid | Appropriations Received Wave 1, ROMM #3; SBR Wave 2, ROMM #28 | Current year sub-allotments are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by FAD) | Appropriations Received Wave 1, KCO #1, 2, 3 |
| 7 | Current year funds distributed may not be recorded timely in the General Ledger | Appropriations Received Wave 1, ROMM #2, 3; SBR Wave 2, ROMM #15, 28 | Current year funds are recorded in the general ledger in the correct period. | Appropriations Received Wave 1, KCO #2 |
| 8 | Current year funds distributed may be recorded inaccurately in the General Ledger or may be invalid | Appropriations Received Wave 1, ROMM #3; SBR Wave 2, ROMM #28 | Current year funds are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by Funding Authorization Documents (FAD)) | Appropriations Received Wave 1, KCO #1, 2, 3 |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| 9 | Other activity (e.g. undistributed amounts) may be recorded inaccurately in the General Ledger that may affect the balance of current year fund distributed within the organization. | Appropriations Received Wave 1 #3; SBR Wave 2, ROMM #28 | Other activity (e.g. undistributed amounts) that affect the balance of the current year funds distributed within the organization are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity). | Appropriations Received Wave 1, KCO #2 |
| 10 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **Military Pay** | | | | |
| 1 | Personnel information may not be recorded timely | SBR Wave 2, ROMM #19, 20, 21, 22 | All personnel information (promotions, changes in dependents, entering/exiting theater, etc.) are recorded timely | SBR Wave 2, KCO #32, 33, 41, 43 |
| 2 | Personnel information may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #7, 9, 22, 34, 36, 38, 39 | Personnel information is recorded accurately (correct amount, correct action, correct individual) and are valid (authorized/approved transactions supported by request for personnel action) | SBR Wave 2, KCO #27, 34, 35, 37, 41, 42, 43, 44 |
| 3 | Payroll may be calculated or processed inaccurately | SBR Wave 2, ROMM #7, 9, 22, 34, 36, 38, 39 | Payroll is calculated and processed accurately | SBR Wave 2, KCO #27, 34, 35, 37, 41, 42, 43, 44 |
| 4 | All payroll obligations, expenses, accruals, and disbursements may not be recorded timely | SBR Wave 2, ROMM #19, 20, 21, 22 | All payroll obligations, expenses, accruals, and disbursements are recorded timely | SBR Wave 2, KCO #32, 33, 41, 43 |
| 5 | Payroll obligations, expenses, accruals, and disbursements may not be recorded accurately or may be invalid | SBR Wave 2, ROMM #7, 9, 22, 34, 36, 38, 39 | All payroll obligations, expenses, accruals, and disbursements are recorded at correct amounts in the General Ledger(s) and are valid entries (authorized/approved transactions supported by pay file, disbursing voucher, etc.) | SBR Wave 2, KCO #27, 34, 35, 37, 41, 42, 43, 44 |
| 6 | Stale or invalid obligations and accruals may not be removed | SBR Wave 2, ROMM #2, 9, 14, 27 | All obligations and accruals are reviewed, and adjusted as necessary, at least three times per year | SBR Wave 2, KCO #11, 12, 22, 27, 43 |
| 7 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| **Civilian Pay** | | | | |
| 1 | Incorrect personnel information may be recorded | SBR Wave 2, ROMM #7, 34, 36 | Civilian personnel actions are valid (authorized/approved transactions supported by requests for personnel action) and recorded accurately | SBR Wave 2, KCO #34, 37, 42 |
| 2 | Personnel information is missing or incomplete | SBR Wave 2, ROMM #19, 20, 34 | All civilian personnel actions are recorded timely | SBR Wave 2, KCO #32, 33, 34, 41,42, 43 |
| 3 | Incorrect time and attendance information may be recorded | SBR Wave 2, ROMM #34, 36 | T&A information is valid (authorized/approved transactions supported by timesheet) and is recorded correctly | SBR Wave 2, KCO #34, 42 |
| 4 | Time and attendance information is missing or incomplete | SBR Wave 2, ROMM #19 | All T&A information is recorded timely | SBR Wave 2, KCO #32, 33, 41, 43 |
| 5 | Payroll may be calculated or processed incorrectly | SBR Wave 2, ROMM #34, 36 | Bi-weekly payroll is calculated and processed correctly | SBR Wave 2, KCO #42 |
| 6 | Payroll obligations, expenses, accruals and disbursements may be recorded incorrectly | SBR Wave 2, ROMM #10, 34, 38, 39, 40 | Payroll obligations, expenses, accruals, and disbursements are valid (authorized/approved transactions supported by pay file, disbursing voucher, etc.) and are correctly recorded in the General Ledger(s) | SBR Wave 2, KCO #35, 37, 42, 44 |
| 7 | All Payroll obligations, expenses, accruals and disbursements may not be recorded | SBR Wave 2, ROMM #22 | All payroll obligations, expenses, accruals and disbursements are recorded in the General Ledger(s) timely | SBR Wave 2, KCO #41, 43 |
| 8 | Stale obligations and accruals may not be removed | SBR Wave 2, ROMM #2, 9, 14, 27 | All stale obligations and accruals are removed from the General Ledger(s) timely | SBR Wave 2, KCO #11, 12, 22, 27, 43 |
| 9 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **Reimbursable Work Orders - Acceptor** | | | | |
| 1 | All unfilled customer orders may not be recorded timely | SBR Wave 2, ROMM #16 | All unfilled customer orders are recorded in the correct period and within 10 days | SBR Wave 2, KCO # 16, 17 |
| 2 | Unfilled customer orders may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #4, 31, 34, 43 | Unfilled customer orders are recorded accurately (correct amount, Treasury account, line of accounting, reporting entity) and are valid (authorized/approved transactions supported by MIPR) | SBR Wave 2, KCO # 13, 14, 16 |
| 3 | All revenue, advances, IPAcollections may not be recorded timely | SBR Wave 2, ROMM #23 | All revenue/IPAC collections are recorded in the correct period and within 10 days of payment | SBR Wave 2, KCO # 15, 67, 68 |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| 4 | Revenue/advances/IPAC collections may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #10, 37, 41 | Revenue/IPAC collections are recorded accurately (correct amount, line of accounting, obligation, Treasury account, reporting entity) and are valid (authorized/approved transactions supported by invoices/orders/receiving report) | SBR Wave 2, KCO #65, 66, 69, 70, 71 |
| 5 | Stale or invalid unfilled customer orders and uncollected customer payments/accounts receivable may not be removed | SBR Wave 2, ROMM #37 | All unfilled customer orders and uncollected customer payments/accounts receivable are reviewed, and adjusted as necessary, at least three times per year | SBR Wave 2, KCO #66 |
| 6 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |
| **Other Budgetary Activity** | | | | |
| 1 | All other budgetary activity (rescissions, non-expenditure transfers) may not be recorded timely | SBR Wave 2, ROMM #17, 18 | All other budgetary activity is reported in the correct period. | SBR Wave 2, KCO #19, 21, 46 |
| 2 | Other budgetary activity (rescissions, non-expenditure transfers) may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #5, 6, 32, 33, 38, 41 | Other budgetary activity is recorded accurately (dollar amount, Treasury account, type of funds, years of availability) and valid (authorized/approved transaction supported by Public Law, Treasury Warrant, SF-1151s, FADs) | SBR Wave 2, KCO #18, 19, 20, 47, 50, 51 |
| 3 | All current year other budgetary activity sub-allotments may not be recorded timely | SBR Wave 2, ROMM #17, 18 | All current year other budgetary activity for sub-allotments is recorded in the correct period. | SBR Wave 2, KCO #19, 21, 46 |
| 4 | Current year other budgetary activity sub-allotments may be recorded inaccurately or may be invalid | SBR Wave 2, ROMM #5, 32, 33, 38, 41 | Current year other budgetary activity for sub-allotments are recorded accurately (correct amount, Treasury account, type of funds, years of availability, reporting entity) and are valid (authorized/approved transactions supported by FAD) | SBR Wave 2, KCO #18, 19, 20, 47, 50, 51 |
| 5 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |

| | Financial Reporting Risks | FIAR Guidance Risk of Material Misstatement (ROMM) Reference | Outcomes Demonstrating Audit Readiness | FIAR Guide Key Control Objective (KCO) Reference |
|---|---|---|---|---|
| **Financial Reporting** | | | | |
| 1 | All trial balances (or equivalents) are not produced timely | SBR Wave 2, ROMM #25, 40 | Trial balances (or equivalents) are produced timely | SBR Wave 2, KCO #3, 8 |
| 2 | Trial balances (or equivalents) are not accurate or valid | SBR Wave 2, ROMM #11, 12, 24, 38, 39 | Trial balances (or equivalents) are accurate and valid | SBR Wave 2, KCO #1, 2, 4, 5, 6, 7 |
| 3 | All trial balances (or equivalents) are not loaded into DDRS-B timely | SBR Wave 2, ROMM #25, 40 | Trial balances (or equivalents) are loaded into DDRS-B timely | SBR Wave 2, KCO #3, 8 |
| 4 | Trial balances (or equivalents) are not completely or accurately loaded into DDRS-B | SBR Wave 2, ROMM #11, 12, 24, 38, 39 | Trial balances (or equivalents) are complete and accurately loaded into DDRS-B | SBR Wave 2, KCO #1, 2, 4, 5, 6, 7 |
| 5 | All trial balance data in DDRS-B is not loaded into DDRS-AFS | SBR Wave 2, ROMM #25, 40 | Trial balance data in DDRS-B is loaded into DDRS-AFS timely | SBR Wave 2, KCO #3, 8 |
| 6 | Trial balance data is not accurately loaded from DDRS-B into DDRS-AFS | SBR Wave 2, ROMM #11, 12, 24, 38, 39 | Trial balances data is accurately loaded from DDRS-B into DDRS-AFS | SBR Wave 2, KCO #1, 2, 4, 5, 6, 7 |
| 7 | All adjustments recorded in DDRS-B and DDRS-AFS are recorded timely | SBR Wave 2, ROMM #25, 40 | All adjustments are recorded timely in DDRS-B and DDRS-AFS | SBR Wave 2, KCO #3, 8 |
| 8 | Adjustments recorded in DDRS-B and DDRS-AFS are not accurate or valid | SBR Wave 2, ROMM #11, 12, 24, 38, 39 | All adjustments recorded in DDRS-B and DDRS-AFS are accurate (correct amount, Treasury account, line of accounting, reporting entity) and valid (authorized/approved transactions supported by appropriate documentation) | SBR Wave 2, KCO #1, 2, 4, 5, 6, 7 |
| 9 | The Statement of Budgetary Resources, related footnotes and accompanying information is not completed timely | SBR Wave 2, ROMM #25, 40 | The Statement of Budgetary Resources, related footnotes and accompanying information is completed timely. | SBR Wave 2, KCO #3, 8 |
| 10 | The Statement of Budgetary Resources, related footnotes and accompanying information is not accurate or valid | Appropriations Received Wave 1, ROMM #8;<br>SBR Wave 2, ROMM #38, 39, 40;<br>FBWT Wave 2, ROMM #7, 9 | The Statement of Budgetary Resources, related footnotes and accompanying information is accurate (complies with accounting and reporting standards) and valid (supported by data in DDRS-AFS) | SBR Wave 2 #1, 2, 3, 80, 84 |
| 11 | IT General Controls may not be appropriately designed or operating effectively | FIAR Guidance FISCAM Risks | All material systems achieve the relevant FISCAM IT general and application-level general control objectives | FIAR Guidance FISCAM Objectives |

### *Key Supporting Documents*

**The following table lists the minimum internal control documentation and supporting documentation necessary to support activity and balances asserted as audit-ready for an SBR Audit.** The table links each listed document to the potential financial statement assertions that it supports. Internal control documentation is marked as meeting all financial statement assertions, because the specific control activities described in the internal control documentation will determine which specific financial statement assertions are satisfied.

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Supporting Documents | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Documentation Type | Key Supporting Documents | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
| All Financial Statement Line Items | Internal Control | 1. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations | X | X | X | X | X |
| | | 2. Applicable policies and procedures | X | X | X | X | X |
| | | 3. Process narratives and flowcharts | X | X | X | X | X |
| | | 4. Control worksheets, identifying risks, KCOs and corresponding control activities | X | X | X | X | X |
| | | 5. Test plans documenting planned procedures used to test the operating effectiveness of control activities | X | X | X | X | X |
| | | 6. Control assessments with test results | X | X | X | X | X |
| | | 7. Evaluation of test results | X | X | X | X | X |
| | | 8. Documentation demonstrating the operation of internal control activities for the period under audit. Examples include:<br>• Approval signature documentation (electronic or manual) demonstrating accuracy reviews of appropriation transactions recorded in the general ledger (compared to supporting documentation such as Appropriation Act / Public Law)<br>• Reconciliations of non-expenditure transfers recorded in the general ledger to OMB-approved Non-Expenditure Transfer Authorizations (SF-1151s) | X | X | X | X | X |
| | | 9. System inventory list, listing of system users and their access privileges. | X | X | X | X | X |
| All Financial Statement Line Items (especially Unobligated Balances: Apportioned, and Unobligated Balances Not Available) | Transaction Documentation | 10. Apportionment and Reapportionment Schedule (SF 132) | X | X | X | X | X |
| | | 11. Report on Budget Execution and Budgetary Resources (SF 133) | X | X | X | X | X |
| | | 12. Year-End Closing Statement (FMS 2108) | X | X | X | X | X |
| | | 13. Trial balance by fund code (Treasury account) corresponding to each appropriation | X | X | X | X | X |
| | | 14. Reconciliation of populations to general ledger and to the financial statements. Including the reconciliation of unadjusted trial balances to adjusted trial balances and support for journal vouchers posted to the adjusted trial balance. | | X | | X | |
| Unobligated Balance, | | 15. FIRST-TIME AUDITS ONLY – Analysis of unobligated balance brought forward that demonstrates the "age" of material appropriations | X | X | X | X | X |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Supporting Documents | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Documentation Type | Key Supporting Documents | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
| Brought Forward, October 1 | | 16. FIRST-TIME AUDITS ONLY – Supporting documentation evidencing the beginning balances of Fund Balance with Treasury, Accounts Receivable, Unfilled Customer Orders, and Delivered Orders – Unpaid | | x | x | x | |
| Recoveries of Prior Year Unpaid Obligations | | 17. Original obligating documents (such as contracts, reimbursable agreements, MIPRs, purchase orders, travel orders, grant agreements, etc.) along with contract modification documents supporting the recovery | x | x | x | | x |
| | | 18. Invoice/receiving report noting changes in payment amount (e.g., De-obligation of funds can result from receipt of goods or services with an invoice payment less than the obligation balance and no further activity is anticipated). | x | x | x | | x |
| Spending Authority from Offsetting Collections | | 19. Documentation demonstrating spending authority and collections from other Federal agencies such as Reimbursable Agreements, MIPRs, Intra-governmental Payment and Collection (IPACs), billing documents and related supporting documentation | x | x | x | | x |
| | | 20. Documentation supporting amounts earned (invoices to customer agency, obligating document/receiving reports/invoices from vendor performing services, payroll (timesheets, official personnel files, etc) for internal payroll charges, travel orders/vouchers, etc.) | | x | x | | x |
| | | 21. Cash collection documentation (for amounts earned and advances received) such as deposit tickets, IPACs, etc. | x | x | X | | |
| Nonexpendi-ture Transfers, net | | 22. Non-expenditure Transfer Authorization (SF 1151) | x | x | x | | x |
| | | 23. Appropriation Act (Public Law) enacting temporary restrictions on budgetary resources or permanent rescission | x | x | x | | x |
| | | 24. Negative Treasury Warrants (Rescission) | x | x | x | | x |
| Obligations Incurred: Direct and Reimbursable | | 25. Obligating document and related modifications such as contract purchase order, MIPR, etc. Note: for payroll transactions SF-52s (Request for Personnel Action), SF-50s (Notifications of Personnel Action), timesheets used to support disbursement transactions also support payroll obligations incurred. | x | x | x | | x |
| Unpaid Obligations, Brought Forward, October 1 | | 26. Unpaid Obligations (Undelivered Orders) brought forward and at end of period are supported by valid obligating documents such as contracts, reimbursable agreements, MIPRs, purchase orders, etc. (first-year audits only). For any portions of the order delivered, see supporting documentation requirements for Delivered Orders | x | x | x | | x |

| Statement of Budgetary Resources<br>Wave 2 – SBR Audit<br>Key Supporting Documents | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Documentation Type | Key Supporting Documents | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
| Unpaid Obligations, End of Period | | Unpaid Obligations (Delivered Orders/Accounts Payable) brought forward and at end of period are supported by:<br>27. Receiving Report, and<br>28. Billing document such as vendor invoice (or equivalent), or<br>29. Accrual estimate support (if invoice has not been received or support for payroll accrual calculations) | X | X | X | | X |
| Unfilled Customer Payments, Brought Forward, October 1<br>Unpaid Customer Payments, End of Period | | 30. Uncollected Customer Payments (Unfilled Customer Orders) brought forward and at end of period are supported by valid orders from other Federal agencies such as Reimbursable Agreements, MIPRs, or Cooperative Agreements. For any portions of the order delivered, see supporting documentation requirements for Accounts Receivable | X | X | X | | X |
| | | 31. Uncollected Customer Payments (Accounts Receivable) brought forward and at end of period are supported by subsequent IPAC collection documents, billing documents, and related obligation and expenditure documentation supporting the expense amounts charged to the customer. | X | X | X | | X |
| Gross Outlays<br><br>Offsetting Collections | | 32. Cash disbursement document (invoice, receiving report, , IPAC, travel voucher, credit card statements, etc). Note: for payroll transactions SF-52s (Request for Personnel Action), SF-50s (Notifications of Personnel Action), timesheets used to support obligations incurred transactions also support payroll disbursements. | X | X | X | | X |
| | | 33. Cash collection document (deposit ticket, IPAC, billing document, etc) | X | X | X | | X |
| | | 34. Statement of Accountability (SF 1218/1219) | X | X | X | | X |
| | | 35. Statement of Transactions (SF 1220/1221) | X | X | X | | X |
| | | 36. Statement of Interfund Transactions (DD 1400) | X | X | X | | X |
| | | 37. Statement of Transactions (DD 1329) | X | X | X | | X |
| | | 38. Government-wide Accounting (GWA) Account Statement | X | X | X | | X |
| Distributed Offsetting Receipts | | 39. Treasury Annual Report Appendix Part 7, Other Information B Receipts by Department | X | X | | | X |
| | | 40. Cash collection document (deposit ticket, IPAC, billing document, etc, to support basis for receipt) | X | X | X | | X |
| **Refer to *MilPay FIAR guidance supplement* located within the FIAR Guidance website for KSDs related to Military Pay.** | | | | | | | |

| Fund Balance with Treasury<br>Wave 2 – SBR Audit<br>Key Supporting Documents | | | | | | | |
|---|---|---|---|---|---|---|---|
| Line Items | Documentation Types | Key Supporting Documents | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
| FBWT | Internal Control Documentation | 41. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations | X | X | X | X | X |
| | | 42. Applicable policies and procedures | X | X | X | X | X |
| | | 43. Process narratives and flowcharts | X | X | X | X | X |
| | | 44. Control worksheets, identifying risks, KCOs and corresponding control activities | X | X | X | X | X |
| | | 45. Test plans documenting planned procedures used to test the operating effectiveness of control activities | X | X | X | X | X |
| | | 46. Control assessments with test results | X | X | X | X | X |
| | | 47. Evaluation of test results | X | X | X | X | X |
| | | 48. Documentation evidencing the operation of internal control activities for the period under audit. Examples include:<br>• A supervisory review is performed monthly to verify monthly Treasury reconciliations were performed timely and signed/dated by the completer, supervisor evidences review by signing and dating reconciliation.<br>• All reconciling items are aged monthly to ensure all differences are resolved within 60 days. Supervisor randomly selects items cleared from the aging and reviews supporting documentation (and entry recorded in system) to verify reconciling item was appropriately resolved. | X | X | X | X | X |
| | Transaction Documentation | 49. Monthly FBWT reconciliations | X | X | X | X | X |
| | | 50. General ledger and subsidiary ledgers identifying individual FBWT transactions within each Treasury account | X | | | X | |
| | | 51. Supporting documentation for individual transaction differences and adjustments between the agency and Treasury's records, including supporting documentation for cash disbursements, cash collections and adjustments as described in the preceding sections. | X | X | X | | X |
| | | 52. Check Issue Discrepancy (FMS 5206) | X | X | X | | |

### C.2.3 Example Work Products

Refer to FIAR Guidance website for ***[Wave 2 specific work product examples](#)*** and related guidance.

### C.2.4 Wave-Specific Audit Execution

Wave 2 includes multiple end-to-end business processes and related financial statement line items that reporting entities can divide into assessable units. Reporting entities will assert audit readiness on individual assessable units once they determine controls are properly designed and operating effectively, and all necessary supporting documentation is readily available. **As entities assert audit readiness for their assessable units, the FIAR Directorate reviews the assertion documentation. During the review the FIAR Directorate will normally make inquiries about the assertion and the content of the documentation. Based on the content of the package and the responses to inquiries the FIAR Directorate will reach a decision on whether the entity has demonstrated audit readiness and is therefore ready to proceed. Approval to go forward to the next stage of engaging an IPA or other qualified, independent reviewer to perform a *Validation phase* audit readiness examination is determined at the end of the assertion review. If an examination is performed and results in an unqualified opinion on the reporting entity's audit readiness assertion, the reporting entity must sustain their audit-ready state until they are ready for a full SBR audit. As depicted in Figure 3, reporting entities can only assert full SBR audit readiness after all assessable units are validated as audit ready. Once all Wave 2 assessable units are validated as audit ready, the DoD OIG will conduct an SBR financial statement audit readiness examination and opine on the reporting entity's SBR audit readiness assertion. If the examination results in an unqualified opinion, the DoD OIG performs annual financial statement audits on the reporting entity's SBR.**

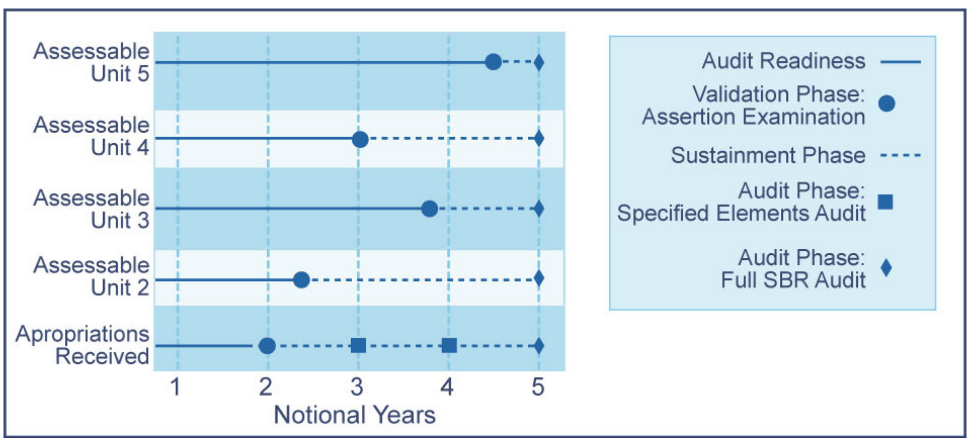


**Figure 3. Wave 2 Audit Strategy**

## C.3 Wave 3 – Mission Critical Asset E&C Audit

**Mission Critical Asset Existence and Completeness (E&C) Audits** focus on the E&C financial statement assertions, but also include the Rights assertion and portions of the Presentation and Disclosure assertion. That is, **reporting entities must ensure that all assets recorded in their Accountable Property System of Record (APSR) exist (Existence), all of the reporting entities' assets are recorded in their APSR (Completeness), reporting entities have the right to report all assets (Rights), and assets are consistently categorized, summarized and reported period to period (Presentation and Disclosure). The asset categories include Military Equipment (ME), Real Property (RP), Inventory, Operating Materials and Supplies (OM&S), and General Equipment (GE).** This wave will allow the Department and its reporting entities to demonstrate the existence and completeness of its assets prior to focusing on the reported value of the assets.

### C.3.1 Readiness Scope

Successful execution of the Department's military missions depends on a properly equipped and supplied Force. Achieving accurate and reliable accountable systems of record through E&C audits is the objective of Wave 3 and is a critical step for achieving successful financial statement audits.

Mission critical assets consist of accountable property. In other words, mission critical assets are not simply assets that exceed the capitalization threshold (Refer to DoD FMR Volume 4, Chapter 6, Section 060103.A.1.d for capitalization threshold) but are all assets greater than the property accountability threshold (Refer to DoDI 4165.14 para 5.1 for real property accountability threshold, DoDI 5000.64, para 6.2.1 for GE accountability threshold, and DoD 4140.1 for inventory and OM&S accountability thresholds). Mission critical assets are defined broadly as: ME, Real Property (Land, Buildings, Structures and Facilities, and Construction in Progress), GE, Inventory, and OM&S.

As of September 30, 2010, these five asset categories comprise over 99 percent of the Department's total reported acquisition costs or amounts for PP&E and Inventory/OM&S. The OUSD(C) will periodically re-evaluate this coverage and will separately communicate with reporting entities if changes in scope are required.

The Department will demonstrate progress towards audit readiness when independent auditors render unqualified opinions on the existence and completeness of mission critical assets. To ensure success, it is important for both the reporting entity and auditor to understand the audit scope. These audits are to, determine whether (1) all the assets the reporting entity lists in its APSR exist and (2) the reporting entity reports all of its assets. However, to ensure compliance with auditing standards, auditors are also required to consider the impact of additional, interrelated areas, as **Figure 4** demonstrates.

Auditors performing government financial statement audits in the United States must adhere to professional standards promulgated by GAO and the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board. The GAO has codified its standards for financial statement and performance audits in the Government Auditing Standards (Yellow Book). The

AICPA has codified its professional standards as AUs, which are incorporated by reference into the Government Auditing Standards. These professional standards require that the auditor be satisfied that elements, accounts, or items that are interrelated with those on which he or she has been engaged to express an opinion have been considered in expressing an opinion.

The GAO/PCIE FAM Section 235.02, "Identify Significant Line Items, Accounts, Assertions, and RSSI," defines the Existence or Occurrence assertions as "Recorded transactions and accounting events have occurred during the given period, are properly classified, and **pertain to the entity**. An entity's assets, liabilities, and net position exist at a given date." The bolded text (which is the essence of the definition of the Rights assertion) demonstrates the interrelationship of the Rights and Existence assertions.

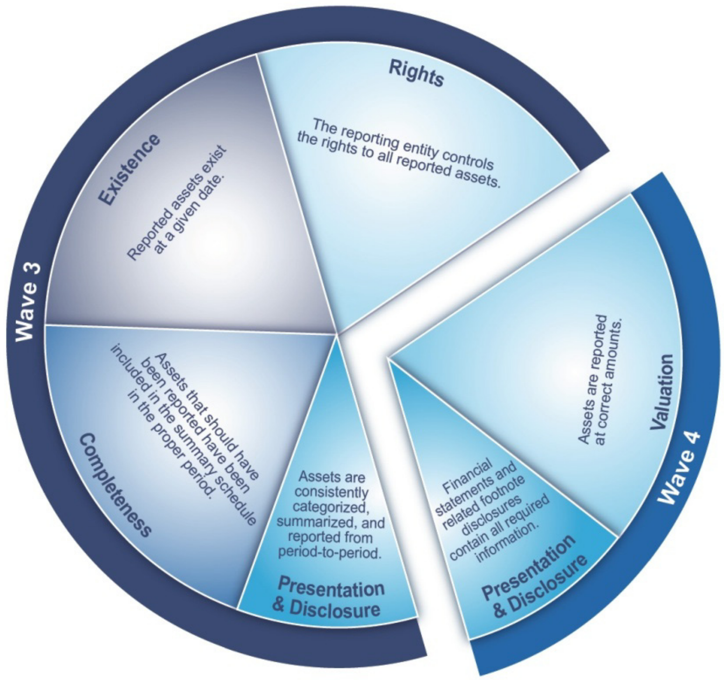


**Figure 4. Audit scope of Wave 3, Existence and Completeness of Mission Critical Assets**

Presentation and Disclosure is the other assertion that is interrelated with E&C audits. Specifically, the summarization and classification elements of Presentation and Disclosure are directly related to E&C audits, because these are the assertions that ensure accurate quantities of assets are presented and correctly classified (e.g., assets reported as ME versus GE) on summary schedules covered by E&C audits.

Because of the interrelationship among the E&C and Rights assertions, along with elements of the Presentation and Disclosure assertion, it is necessary to include these assertions in the scope of E&C audit readiness preparation and resulting E&C audits, as shown in **Figure 3**.

### *Mission Critical Financial Management Data*

The Department will have the auditors test financial management data maintained in the reporting entity's APSR. This testing is in addition to the auditors determining whether assets recorded in the APSR physically exist and determining if the population of assets in the APSR is complete, i.e., includes all assets to which the reporting entity has rights that meet the property accountability threshold.

For a full listing of the financial management data that must be included in the scope of an E&C audit, see Section C.3.2, Subsection Financial Management Data. Ensuring that this information is accurate and reliable is important not only for managing mission critical assets, but also for proper financial reporting and future financial statement audits. For example, "Placed-in-Service Date" is important to ensure the completeness of asset records at the end of a reporting period.

### *Note Regarding Internal Controls:*

When determining the scope of audit readiness efforts for Wave 3, reporting entities must consider whether it is more efficient to mostly use a substantive, supporting documentation approach (given the nature/size of the population). There will be instances when an entity and OUSD(C) conclude it is more efficient and effective to use a substantive approach to supporting an E&C audit-readiness assertion for specific assessable units (combined with a periodic physical inventory count control activity). For example, a reporting entity has a space satellites assessable unit with eight asset items and can substantively demonstrate the existence/completeness/rights to all eight assets even though the entity has not completed the process and internal control documentation (or without controls fully functioning). In this example, audit readiness may be asserted without completing extensive process and internal control documentation, in addition to the periodic physical inventory count.

However, it may not be practical for the auditor to rely on substantive testing, and instead the auditor needs to evaluate, test and place reliance on a reporting entity's relevant internal control activities. For example, if a reporting entity has large quantities of OM&S that are geographically dispersed with a high volume of acquisition and/or disposal activity, it may not be practical for an auditor to substantively test sufficient OM&S to render an opinion (since the OM&S balance is constantly changing). However, if the auditors determine they can rely on the design and operating effectiveness of the reporting entity's control activities over the OM&S balance, the auditor can significantly reduce testing and rely on the control activities. The result is a significant reduction in the quantity of testing and duration of the E&C audit and result in direct cost and effort savings by both the reporting entity and its auditor.

Therefore, flexibility is needed with respect to process and controls documentation for E&C audits. When practical, a primarily substantive evidence approach can be used, but depending on the nature and quantities of assets and the potential need to remediate processes and control activities for new acquisitions, reporting entities may need to plan for complete process and internal control evaluations and documentation. The distinction will largely depend on the complexity of the business area and the quantity of assets and financial events. The following table identifies the major processes that are likely to affect the E&C of assets and potential segments of those processes that the entity should be consider.

| Major Processes | Segments |
| --- | --- |
| Acquisitions (purchases, in-house construction, takings, transfers-in) | Key processes and internal controls that ensure the existence, completeness, and rights of assets should be included in an E&C assertion. These include: (a) controls to ensure all asset acquisitions (capital and accountable) are appropriately flagged or fed into asset/accountability/inventory systems; (b) controls to ensure assets are recorded when control of the asset passes to the reporting entity or when placed into service (for constructed assets); and (c) controls to ensure only assets to which the reporting entity has financial reporting responsibility (the reporting entity has the ability to control the benefits of the asset) are recorded. |
| Disposals (sales, destructions, donations, excesses, transfers-out) | Key processes and internal controls that ensure all disposals are correctly recorded in the APSR and disposals are only recorded when the reporting entity has transferred or otherwise ended its ability to control the asset. |
| Periodic physical inventory counts | Entire process is "in scope" and the principle control to ensure E&C. |
| APSR maintenance (IT general and application level controls surrounding the APSR) | Entire process is "in scope" and relevant to ensure information in the system of record is not incorrectly adjusted (especially subsequent to physical inventory counts) and that unauthorized personnel cannot make adjustments. For situations where supporting documentation is generated and/or retained electronically (e.g., transaction history within a system), then it is likely that system must also be scoped into audit readiness efforts. |

## C.3.2 Risks, Key Control Objectives and Key Supporting Documents

### *Risks*

The following table presents the key ROMM related to the Wave 3, Mission Critical Assets E&C Audit. A reference to the source of each risk is included in parentheses. **Reporting entities must mitigate these risks by designing and implementing control activities.** Refer to the KCOs in the table following this risk table for further details.

| Wave 3 – Mission Critical Asset E&C Audit<br>Key Risks of Material Misstatement | |
| --- | --- |
| **Financial Statement Assertions** | **Key Risks of Material Misstatement** |
| Existence | 1. Recorded transactions do not represent economic events that actually occurred. (FAM 395B: 1)<br>2. Assets are not properly classified. (FAM 395B: 1c and 5)<br>3. Recorded assets do not exist at a given date (FAM 395B: 4)<br>4. Recorded assets may not be properly supported with adequate supporting documentation (FAM 395B: 4)<br>5. Transactions are recorded in the current period, but the related economic events occurred in a different period (FAM 395B: 2)<br>6. Transactions are summarized improperly, resulting in an overstated total (FAM 395B: 3) |
| Completeness | 7. Assets of the reporting entity exist but are omitted from the APSR and/or summary schedules (financial statement equivalent) (FAM 395B: 8)<br>8. Economic events occurred in the current period, but the related transactions are recorded in a different period (FAM 395B: 6)<br>9. Transactions are summarized improperly, resulting in an understated total (FAM 395B: 7) |
| Presentation and Disclosure | 10. Accumulated accounts or assets are not properly classified and described in the summary schedules (FAM 395B: 15)<br>11. The current period summary schedules (various classes of assets) are based on accounting |

| Wave 3 – Mission Critical Asset E&C Audit<br>Key Risks of Material Misstatement | |
|---|---|
| **Financial Statement Assertions** | **Key Risks of Material Misstatement** |
| | principles different from those used in prior periods presented (FAM 395B: 16)<br>12. The entity is exposed to loss of assets and various potential misstatements, including certain of those above, as a result of inadequate segregation of duties (FAM 395B: 18) |
| Rights and Obligations | 13. Recorded assets are owned* by others because of sale, consignment, or other contractual arrangements (FAM 395B: 12)<br>14. The reporting entity does not have certain rights to recorded assets because of liens, pledges, or other restrictions (FAM 395B: 13)<br>* Note: OUSD(C) A&FP is currently updating the DoD FMR to clarify rights and reporting responsibilities for mission critical assets. |

## *Key Control Objectives*

**The following table presents the KCOs that must be achieved in Wave 3 by designing and implementing effective control activities. It is the reporting entity's responsibility to design and implement internal controls that will achieve the KCO.** Each KCO has been linked to its relevant financial statement assertions (as indicated with an "X" in the relevant columns), including if the KCO relates to compliance with laws and regulations. At the end of each KCO is a source reference. This is not a complete listing of control objectives, but rather those KCOs needed to address key risk areas most likely to be present based on the Department's experience. **Reporting entities must apply judgment to determine if additional KCOs should be included given their specific business processes and financial statements.** Reporting entities may also refer to the GAO/PCIE FAM Section 395B for a list of general control objectives based on financial statement assertions.

| Wave 3 – Mission Critical Asset E&C Audit<br>Key Control Objectives | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Asset Categories** | **Key Control Objectives** | **Financial Statement Assertions** | | | | | **Compliance** |
| | | **Existence** | **Completeness** | **Valuation** | **Presentation & Disclosure** | **Rights & Obligations** | |
| Military Equipment | 1. Accounts and all the transactions (or assets) they accumulate are properly classified and Accounting principles are consistently applied from period to period (FAM 395B: 15, 16). | | x | | x | | |
| Real Property | 2. Ensure recorded transactions represent economic events that actually occurred and are properly classified (FAM 395B: 1c, 2). | x | | | | | |

| Wave 3 – Mission Critical Asset E&C Audit Key Control Objectives | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Asset Categories | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| Inventory | 3. Ensure recorded assets exist at a given date (FAM 395B: 4a). | x | | | | | |
| Operating Materials and Supplies<br><br>General Property | 4. Ensure recorded assets at a given date, are supported by appropriate detailed records that are accurately summarized and reconciled to the account balance (FAM 395B: 4b). | x | | | | | |
| | 5. Ensure recorded assets are owned by the entity. The entity has rights to the recorded asset at a given date (FAM 395B: 12, 13). | | | | | x | |
| | 6. Ensure all existing assets, as of the reporting date, including property in the custody of third parties, are included in the general ledger (FAM 395B: 8). | | x | | | | |
| | 7. Asset transactions recorded in the current period represent economic events that occurred during the current period (FAM 395B: 2) | x | | | | | |
| | 8. The summarization of recorded assets is not overstated (FAM 395B: 3) | x | | | | | |
| | 9. All asset related events that occurred in the current period are recorded as transactions in the current period (FAM 395B: 6) | | x | | | | |
| | 10. The summarization of recorded assets is not understated (FAM 395B: 7) | | x | | | | |

## *Key Supporting Documents*

Two types of documentation are needed to prepare for E&C audits. The first type of documentation, direct supporting documentation, includes internal control documentation and substantive, supporting documentation used by a reporting entity to directly demonstrate financial statement assertions (e.g., a land deed directly supports the Rights assertion). The second type of documentation, financial management data, represents supported data fields in the APSRs that substantiate financial reporting assertions and management/budget information (e.g., a tract map supports location information, which indirectly supports the Existence assertion). **Both types of documentation are required to demonstrate to management and decision makers the accuracy and reliability of E&C information.** Because supporting management with better information is the goal of the E&C audits, both categories of information are included in the scope of E&C audit readiness and therefore will be validated by auditors.

**The following table presents a detailed listing by relevant financial statement assertion of minimum internal control and direct supporting documentation that a reporting entity must make readily available for auditors.** For some financial statement assertions different levels or Tiers of documentation exist, which reporting entities may use to demonstrate financial statement assertions. In accordance with auditing standards, the most robust documentation, presented as Tier 1, should be used whenever possible. When Tier 1 documentation is unavailable, reporting entities should move down to Tier 2. **Please note that this list is not all-inclusive.** Additional documentation, including reporting entity-specific documentation, may exist that is equivalent to or supplements the items detailed in the table.

| Line Items | Documentation Type | Wave 3 – Mission Critical Asset E&C Audit Key Supporting Documents | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
|---|---|---|---|---|---|---|---|
| All Financial Statement Line Items | Internal Control Documentation | 1. Statement-to-process analyses demonstrating the dollar amount and quantity of activity flowing through various processes and/or locations | X | X | | X | X |
| | | 2. Applicable policies and procedures | X | X | | X | X |
| | | 3. Process narratives and flowcharts | X | X | | X | X |
| | | 4. Control worksheets, identifying risks, KCOs and corresponding control activities | X | X | | X | X |
| | | 5. Test plans documenting planned procedures used to test the operating effectiveness of control activities | X | X | | X | X |
| | | 6. Control assessments with test results | X | X | | X | X |
| | | 7. Evaluation of test results | X | X | | X | X |
| | | 8. Documentation demonstrating the operation of internal control activities for the period under audit. Examples include:<br>• Approval signature documentation (electronic or manual) demonstrating accuracy reviews of appropriation transactions recorded in the general ledger (compared to supporting documentation such as Appropriation Act/Public Law)<br>• Reconciliations of non-expenditure transfers recorded in the general ledger to OMB-approved Non-Expenditure Transfer Authorizations (SF-1151s) | X | X | | X | X |
| | | 9. System inventory list, listing of system users and their access privileges. | | | | X | X |
| Tier 1 | Asset Documentation | 10. Physical inventory count documentation (inventory instructions, completed inventory count sheets (indicating items selected from the “book” and physically inspected on the “floor”), preparer/reviewer signatures and supporting documentation evidencing resolution of differences). Physical inventory counts must include sufficient statistical coverage of the population and comply with applicable requirements (e.g., DoDI 5000.64, Enclosure 3, Section 11) | X | | | | |
| | | 11. Physical inventory count documentation (inventory instructions, completed inventory count sheets (indicating items selected from the “floor” and traced back to the “book”), preparer/reviewer signatures and supporting documentation evidencing resolution of differences). Physical inventory counts must include sufficient statistical coverage of the population and comply with applicable OUSD(AT&L) requirements. | | X | | | |
| | | 12. Detailed listing of all assets from APSRs | | | | X | |
| | | 13. Summary schedule reporting the amounts/quantities by class of assets | | | | X | |
| | | 14. Reconciliation of the summary schedule of assets to the general ledger. | | | | X | |

| Line Items | Documentation Type | Wave 3 – Mission Critical Asset E&C Audit Key Supporting Documents | Financial Statement Assertions: Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
|---|---|---|---|---|---|---|---|
| | | 15. Policies and procedures relevant to the assets, demonstrating the consistency of accounting treatment across all years presented | | | | x | |
| | Asset Documentation | 16. Written definitions of asset classes and assessable units | | | | x | |
| | | 17. Documentation demonstrating efforts made to obtain supporting documentation in cases where Tier 1 documentation is not used. Examples include data call requests, email traffic, meeting documentation, site visit inspection notes, etc. | | | | x | |
| | | 18. Contract documentation, including (for base assets and asset modifications):<br>• Statement of Work<br>• Contract clauses that define who owns assets and when Reporting Entity takes possession<br>• Purchase Orders<br>• Receiving report or other acceptance document (e.g., DD250 (Materiel Inspection and Receiving Report) or DD1354 (Transfer and Acceptance of DoD Real Property)<br>• Deeds/titles (for Land only)<br>• Lease, Occupancy Agreement, Reversion Legal Document, Judgment Legal Document (for condemnation), Letter of Withdrawal (for withdrawal from Public Domain) | | | | | x |
| Tier 2 | | 19. Asset logs (e.g., maintenance logs or usage logs) that are reconciled to the APSR, demonstrating the completeness of the APSR population | x | | | | |
| | | 20. Mission-management/logistics data (if different from the APSRs) used by leadership to track, deploy or distribute assets, reconciled to the APSR demonstrating the completeness of the APSR population | | x | | | |
| | | 21. Tract maps, land plats, space management systems, utilities maps, or facility diagrams that are reconciled to the APSR, demonstrating the completeness of the APSR population | | | | | x |
| | | 22. Other estimation techniques that can be used to estimate the size of the population with tolerable precision and then compared to the APSR population to demonstrate completeness | | | | | x |
| | | 23. Physical indicators of ownership rights, including:<br>• Assets located on Reporting Entity facility<br>• Assets tagged with identification numbers (e.g., barcodes or tail numbers) that indicate Reporting Entity ownership<br>• Assets are marked with the Reporting Entity's name (or other coding or naming conventions) that demonstrate the Reporting Entities control over the asset<br>• Other evidence of exclusive rights to use assets | | | | | x |

### *Financial Management Data*

**During physical inventory counts, entities must support and verify key data fields in the APSR to ensure that all information required for financial statement and management reporting is recorded and accurate.** As part of the physical inventory counts, data should be recorded and testing performed for all selected items to confirm that the information in these data fields is accurate. The specific data fields that will be reviewed during an existence and completeness specified elements audit are summarized in the following table (refer to FIAR Guidance website for the ***Existence & Completeness Financial Management Data Fields definitions and supporting documentation***). The table separates data fields according to those that relate to financial statements, referred to as Financial Statement Data, and those that are primarily used as important management information referred to as Management and Budget Data.

**Both categories of data are mandatory and must be validated in the APSR, because their reliability and accuracy are important for decision making. Prior to an assertion of audit readiness, management must ensure that the data is accurate in the APSR.** The scope of an E&C audit will include a review of the data fields in the Financial Statement Data category (No. 1 through No. 16), in the following table. Auditors will then apply separate agreed-upon procedures on the Management and Budget data fields to validate the accuracy of the management information. Note that some data fields may not apply to all asset types within the categories.

| No. | General Title & Purpose | (PEP) ME & GE | (I&E) RP | (LM&R) Inv/OM&S |
|---|---|---|---|---|
| **Financial Statement Data** | | | | |
| 1 | Individual Item Identifier – Used by the auditor to link the APSR asset record to the physical asset | Vehicle Identification Number, Serial Number, Tail Number, Unique Item Identifier | Real Property Site Unique Identifier, Real Property Unique Identifier (RPUID), Facility Number | Unique Item Identifier (for serially managed assets only) |
| 2 | Category/Asset Type – Used by the auditor to link the APSR asset record to the physical asset | National Stock Number (NSN), or if no NSN is available: Noun Name, Part Number, Manufacturer and Item Description | Real Property Asset Type Code; Real Property Asset Predominant Current Use CATCODE Code | NSN, Local Stock Number (LSN) when NSN is not available, |
| 3 | Location – Used by the auditor to link the APSR asset record to the location of the physical asset | Location information contained in data fields 7 and 8 | Address Street Direction Code, Address Street Name, Address Street Number, Address Street Type Code, Country Code, County Code, City Code, Location Directions, State or Country Primary Subdivision Code, Postal Code | DoDAAC |
| 4 | Unit of Measure/Unit of Issue – Used by the auditor to count the quantity of items during physical inspection | N/A | Real Property Total Unit of Measure Code | Unit of Issue |
| 5 | Quantity – Used by the auditor to confirm the quantity of physical items during physical inspection | N/A | Real Property Total Unit of Measure Quantity | Quantity in APSR, Physical Quantity |
| 6 | Item Description – Used by the auditor to link the APSR asset record to the physical asset | Item Description | RPA Description Text | Item Description if NSN is not on item |
| 7 | Controlling/Financial Reporting Organization – Used by the auditor to confirm the reporting entity has rights to the asset | Accountable Organization | Real Property Asset Command Claimant Code; Real Property Asset Financial Reporting Org Code | Owning Organization |
| 8 | Custodial/User Organization – Used by the auditor to confirm the reporting entity has rights to versus use of the asset | Custodial Organization | Asset Allocation User Organization Code | Accountable Organization, Custodial Organization |
| 9 | Interest Code – Used by the auditor to confirm the reporting entity has rights to the asset | N/A | Real Property Asset Interest Type Code | N/A |
| 10 | Operational Status – Used by the auditor to confirm whether the asset is useable and correctly classified in the APSR | Status | Real Property Asset Operational Status Code | Current Condition Code |
| 11 | Placed-In-Service, Title Transfer, or Acquisition Date – Used by auditors to confirm the reporting entity's rights to the asset at a specific date | ME/GE Placed in Service and Acquisition Date | Real Property Asset Placed In Service Date | Title Transfer Date, Receipt Date for FOB Destination |
| 12 | Real Property Asset Historic Status Code – Used by auditors to confirm the asset is correctly classified as a heritage asset | N/A | Real Property Asset Historic Status Code | N/A |

| No. | General Title & Purpose | (PEP)<br>ME & GE | (I&E)<br>RP | (LM&R)<br>Inv/OM&S |
|---|---|---|---|---|
| 13 | Real Property Asset Historical Status Date – Used by auditors to confirm the asset was correctly classified as a heritage asset at a specific date | N/A | Real Property Asset Historical Status Date | N/A |
| 14 | APSR – Used by the auditor to confirm the asset record is included in the reporting entity's APSR | APSR | APSR | APSR |
| 15 | Asset Review Date – Used by the auditor to confirm the most recent date the asset was physically inspected by management as part of its physical inventory control | Inventory Date | Asset Review Date | Inventory Date |
| 16 | Asset Review Type – Used by the auditor to confirm the type of review management performed over the asset as part of its physical inventory control | N/A | Asset Review Type Code | N/A |
| **Management and Budget Data** | | | | |
| 17 | Condition – Used by auditors to verify the asset's current condition | Current Condition Code | Facility Physical Quality Rate | |
| 18 | Acquisition Cost – Used by auditors to confirm the recorded asset acquisition cost is adequately supported | Original Acquisition Cost | | |
| 19 | Usage – Used by the auditor to confirm the operational status of the asset | Usage Data | | |
| 20 | Secondary Unique Identifier - Used by the auditor to link the APSR asset record to the physical asset | UII or DoD recognized IUID | | Controlled Inventory Item Code (CIIC), if applicable |
| 21 | Replacement Value – Used by auditors to confirm the recorded replacement value is supported | | Facility Plant Replacement Value Amount | |
| 22 | Utilization Rate – Used by the auditor to verify the accuracy of utilization data used in capital planning | | Real Property Asset Utilization Rate | |
| 23 | Allocation Quantity – Used by the auditor to confirm the quantity of physical items during physical inspection | | Asset Allocation Size Quantity | |
| 24 | Allocation Unit of Measure– Used by the auditor to count the quantity of items during physical inspection | | Asset Allocation Size Unit of Measure Code | |
| 25 | Grantee – Used by the auditor to confirm the reporting entity has rights to the asset | | Grantee Organization Code | |
| 26 | Grantor – Used by the auditor to confirm the reporting entity has rights to the asset | | Grantor Organization Code | |
| 27 | Grant Start Date - Used by auditors to confirm the reporting entity's rights to the asset at a specific date | | Grant Start Date | |

| No. | General Title & Purpose | (PEP) ME & GE | (I&E) RP | (LM&R) Inv/OM&S |
|---|---|---|---|---|
| 28 | Grant End Date - Used by auditors to confirm the reporting entity's rights to the asset at a specific date | | Grant End Date | |

### C.3.3 Example Work Products

Refer to FIAR Guidance website for ***Wave 3 specific work products*** and related guidance.

### C.3.4 Wave-Specific Audit Execution

Wave 3 focuses primarily on the E&C financial statement assertions for select asset accounts (ME, RP, GE, Inventory, and OM&S). Reporting entities should break these general asset categories into subsidiary assessable units that they deem appropriate and logical given their asset composition.

**As individual assessable units are asserted as audit ready, and if the FIAR Directorate approves the assertion package after performing validation, the DoD OIG will perform a *Validation Phase* audit readiness examination to form an opinion on the reporting entity's audit readiness assertion, as shown in Figure 5. If the examination results in an unqualified opinion on the reporting entity's audit readiness assertion, the DoD OIG will perform annual specific elements audits on the assessable unit. As the reporting entity asserts additional assessable units as audit ready, and the DoD OIG's examinations result in unqualified opinions on these additional assessable units, the DoD OIG will expand the scope of its annual specified elements audits to include these additional units. The level of effort associated with E&C audits is expected to decrease in subsequent years as the controls associated with the receipt of goods and services included in the Procure-to-Pay and Acquire-to-Retire processes provide evidence of E&C sustainability.** Should these audits demonstrate a strong and effective control environment, the reporting entity can submit a request to the FIAR directorate to substitute a cycle other than annually for audits.

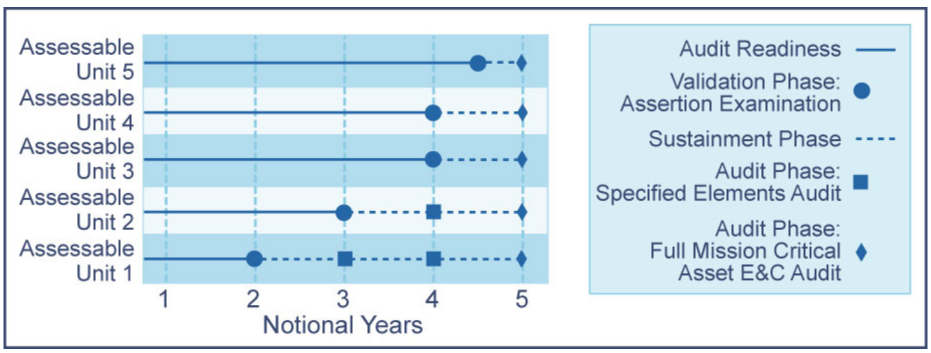


**Figure 5. E&C Audit Strategy**

## C.4 Wave 4 – Full Audit Except for Existing Asset Valuation

Wave 4 assertions include the proprietary side of budgetary transactions covered in Wave 2, as well as Accounts Receivable, Earned Revenue, Accounts Payable, Gross Cost and Other Liabilities. In addition, this wave adds the valuation assertion for assets (i.e., real property, general equipment, inventory, and operating materials and supplies). However, based on the results of a business case analysis performed by the Department not all of the assets of these types will be subject to the valuation assertion.

The business case analysis concluded that the value of historical cost information for existing military equipment, real property, general equipment, inventory, and operating materials and supplies did not merit spending additional resources to establish auditable historical costs for existing assets. Refer to Section 2.E for additional details.

### C.4.1Readiness Scope

**Reporting entity audit readiness efforts must include all remaining processes, controls, and supporting documentation that result in financial transactions and balances that are material to their financial statements, except for those related to existing asset valuation. To effectively remediate new PP&E acquisition processes, reporting entities must identify the date they will be able to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions.** This is consistent with another conclusion from the business case, the Department will not spend resources to support the capitalized cost of existing general equipment, real property, inventory, and operating materials and supplies until it has the capability to capture transaction costs and retain documentation to support the recorded amounts.

**Because reporting entities are at different stages in implementing new information technology systems and in improving business processes they must individually establish dates by type of asset – effectively acquisition dates – after which they expect to have supportable acquisition cost information.** Depending on the type of asset and the reporting entity, those dates may be in the past or in the future after a reporting entity implements a new system or systems. For example, a reporting entity may have had effective processes and controls for real property since FY 2004. In that instance, the reporting entity could assert that the historical cost amounts for real property acquired during or after FY 2004 are auditable. Another reporting entity might not be able to assert that the historical cost information for its inventory is auditable until it completes implementation of an ERP. The selected dates must be disclosed in the financial statements and when asserting audit readiness.

### C.4.2 Risks, Key Control Objectives and Key Supporting Documents

#### *Risks*

The following table presents the key ROMM related to Wave 4, including those specific to the valuation of new asset acquisitions. A reference to the source of each risk is included in parentheses. **These risks must be mitigated by designing and implementing control activities.** Refer to the KCOs in the table following this table for further details.

| Wave 4 – Full Audit Except for Existing Asset Valuation<br>Key Risks of Material Misstatement | |
|---|---|
| **Financial Statement Assertion** | **Key Risks of Material Misstatement** |
| Existence | 1. Recorded pension amounts are not representative of pensions earned by employees. (FAM 395B: 1)<br>2. Recorded Environmental Liabilities are not representative of legal environmental costs incurred by the entity. (FAM 395B: 1)<br>3. Recorded Environmental Liabilities do not pertain to the entity. (FAM 395B: 1)<br>4. Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities do not pertain to the entity. (FAM 395B: 1)<br>5. Recorded Non-Exchange Revenue does not represent economic events that actually occurred or do not pertain to the entity. (FAM 395B: 1)<br>6. Imputed Financing costs do not represent economic events that actually occurred or do not pertain to the entity. (FAM 395B: 1)<br>7. Recorded Depreciation Expense does not represent depreciation cost incurred by the related asset. (FAM 395B: 1)<br>8. Transactions are recorded in the current period but the related economic events occurred in a different period. (FAM 395B: 2)*<br>9. Transactions are summarized improperly, resulting in an overstated total. (FAM 395B: 3)*<br>10. Recorded assets and liabilities do not exist at a given date. (FAM 395B: 4)**<br>11. Adjusting entries are not representative of events that actually occurred, were not properly classified or supported by valid supporting documentation. (FAM 395B: 1c)* |
| Completeness | 12. Valid pension liabilities were not recorded or are improperly summarized. (FAM 395B: 5)<br>13. Valid Environmental liabilities were not recorded or are improperly summarized. (FAM 395B: 5)<br>14. Advances from Others, Accrued Unfunded Annual Leave and/or Contingent Liabilities were not recorded or were improperly summarized. (FAM 395B: 5)<br>15. Valid Exchange Revenue transactions were not recorded or were improperly summarized. (FAM 395B: 5)<br>16. Valid Imputed Financing transactions were not recorded or were improperly summarized. (FAM 395B: 5)<br>17. Depreciation Expense was not recorded or was improperly summarized. (FAM 395B: 5)<br>18. Economic Events occurred in the current period, but the related transactions are recorded in a different period. (FAM 395B: 6)*<br>19. Transactions were summarized improperly, resulting in an overstated total. (FAM 396B: 7)*<br>20. Assets and liabilities of the entity exist but are omitted from the financial statements. (FAM 395B: 8)** |
| Valuation | 21. Transactions were recorded at incorrect amounts. (FAM 395B: 9)<br>22. Assets and liabilities included in the financial statements are valued at incorrect amounts. (FAM 395B: 10)<br>23. Assets and related book values included in the financial statements are valued on an appropriate basis.(FAM 395B: 10)<br>24. Revenues and expenses included in the financial statements are measured improperly. (FAM 395B: 11) |
| Presentation and Disclosure | 25. Accounts or the transactions they accumulate are not properly classified and described in the financial statements. (FAM 395B: 15)*<br>26. The current period financial statement components are based on accounting principles different than those used in the prior periods presented. (FAM 395B: 16)*<br>27. Information needed for fair presentation in accordance with U.S. GAAP is not disclosed in the financial statements or in the related footnotes. (FAM 395B: 17)* |
| Rights and Obligations | 28. The entity does not have an obligation for recorded liabilities at a given date. (FAM395B: 14) |
| * Risks applies to all line items<br>** Risks apply to balance sheet line items. | |

*Note: This table only includes a sample of information and will be expanded in a future version of the FIAR Guidance.*

## *Key Control Objectives*

**The table below presents the KCOs that must be achieved in Wave 4 by the reporting entity designing and implementing effective control activities.** Each KCO has been linked to its relevant financial statement assertions (as indicated with an "X" in the relevant columns), including if the KCO relates to compliance with laws and regulations. At the end of each KCO is a source reference. This is not a complete listing of control objectives, but rather those KCOs needed to address key risk areas most likely to be present based on the Department's experience. **Reporting entities must apply judgment to determine if additional KCOs should be included given their specific business processes and financial statements.** Reporting entities may also refer to the GAO/PCIE FAM Section 395B for a list of general control objectives based on financial statement assertions.

**Wave 4 – Full Audit Except for Existing Asset Valuation Key Control Objectives**

| Asset Categories | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
|---|---|---|---|---|---|---|---|
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| Military Equipment<br><br>Real Property<br><br>General Equipment[1] | 1. Ensure balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, and 17).** | | | | x | | |
| | 2. Ensure all assets are recorded at full cost in the general ledger at correct amounts (FAM 395B: 9, 10). | | | x | | | |
| | 3. Ensure the net book value of assets is accurate and related depreciation, depletion and amortization is accumulated, based on the capitalized cost, useful life, date of service, and salvage value, if applicable (FAM 395B: 10). | | | x | | | |
| | 4. Ensure transferred, sold, excess, unusable, or idle GE assets are timely and properly recorded at correct amounts (FAM 395B: 9, 10). | | | x | | | |
| Inventory<br><br>Operating Material and Supplies | 5. Ensure balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, 17).** | | | | x | | |
| | 6. Ensure all assets are recorded at full cost in the general ledger at correct amounts (FAM 395B: 9, 10). | | | x | | | |
| | 7. Ensure transferred, sold/consumed, excess, unusable, or idle assets are timely and properly recorded (FAM 395B: 10). | | | x | | | |

[1] The PP&E Category for Wave 4 only addresses key control objectives as they relate to the Accuracy &Valuation and Presentation & Disclosure Assertions. The control objectives addressing Existence and Completeness are discussed in Wave 3, "Mission Critical Asset E&C Audit".

| Wave 4 – Full Audit Except for Existing Asset Valuation Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Asset Categories | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| Military Retirement Health Benefits | 8. Ensure actuarial calculations related to military retirement benefits are supported by complete and accurate data, and valid assumptions that comply with specified laws and regulations. | x | x | x | | x | |
| | 9. Ensure military retirement benefits accruals are properly allocated across appropriate reporting periods (FAM 395B: 2, 6). | x | x | | | | |
| | 10. Ensure actuarial calculations related to military retirement benefits are summarized and recorded in the financial statements accurately (FAM 395B: 3, 7, 9). | x | x | x | | | |
| | 11. Ensure Military Retirement Health Benefit accrual balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, 17).** | | | | x | | |
| Environmental Liabilities | 12. Ensure Environmental Liabilities balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, and 17).** | | | | x | | |
| | 13. Ensure all potential Environmental Liabilities are recorded at full cost in the general ledger (FAM 395B: 9, 10). | | | x | | | |
| | 14. Ensure consistent use of appropriate methodologies for valuing Environmental Liabilities (FAM 395B: 16). | | | x | | | |
| | 15. Ensure Environmental Liabilities are properly allocated across appropriate reporting periods (FAM 395B: 2, 6). | x | x | | | | |
| | 16. Ensure calculations related to Environmental Liabilities are summarized and recorded in the financial statements accurately (FAM 395B: 3, 7, 9). | x | x | x | | | |
| Other Liabilities Intragovern-mental: Disbursing Officer Cash | 17. Ensure all disbursing officer cash is recorded completely and accurately reflects amounts owed to Treasury. | | x | x | | x | |
| Other Liabilities Intragovern-mental: FECA Reimburse-ment to DOL | 18. Ensure all FECA reimbursements to DOL are recorded completely and accurately reflects amounts owed to DOL. | | x | x | | x | |

| Wave 4 – Full Audit Except for Existing Asset Valuation Key Control Objectives | | | | | | | |
|---|---|---|---|---|---|---|---|
| Asset Categories | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| Other Liabilities Intragovern-mental: Custodial Liabilities | 19. Ensure all Custodial Liabilities are recorded completely and accurately reflects amounts owed. | | x | x | | x | |
| Other Liabilities Nonfederal:<br><br>Advances from Others<br><br>Accrued Unfunded Annual Leave Contingent Liabilities | 20. Ensure advances from others and accrued unfunded annual leave represent events that actually occurred, are properly classified, and pertain to the entity (FAM 395B: 1c). | x | | | | | |
| | 21. Ensure that appropriate individuals approve recorded contingent liabilities in accordance with management's general or specified criteria (FAM 395B: 1b). | x | | | | | |
| | 22. Ensure advances from others, accrued unfunded annual leave, and contingent liabilities are properly allocated across appropriate reporting periods (FAM 395B: 2, 6). | x | x | | | | |
| | 23. Ensure all valid transactions related to advances from others, accrued unfunded annual leave, and contingent liabilities are summarized and recorded in the financial statements accurately (FAM 395B: 3, 5, 7, 9). | x | x | x | | | |
| | 24. Ensure recorded advances from others, accrued unfunded annual leave, and contingent liabilities are the entity's obligation at a given date (FAM 395B:14). | | | | | x | |
| | 25. Ensure advances from others, accrued unfunded annual leave, and contingent liabilities balances and related footnote disclosures contain all information needed for fair presentation in accordance with U.S. GAAP (FAM 395B: 15, 16, 17).** | | | | x | | |
| All Line Items | 26. Adjusting entries are representative of events that actually occur, are properly classified and supported by valid supporting documentation (FAM 395B:1c). | x | | | x | | |
| | 27. Recorded assets and related processing procedures are authorized by federal laws, regulations, and management policy (FAM 395B: 1a) | | | | | x | x |
| | 28. Access to assets, critical forms, records, and processing and storage areas is permitted only in accordance with laws, regulations, and management policy (FAM 395B: 4c) | | | | | x | x |
| | 29. Persons do not have uncontrolled access to both assets and records; they are not assigned duties to put them in a position that would allow them to both commit and conceal errors or fraud (FAM 395B: 18) | | | | x | | |

| Wave 4 – Full Audit Except for Existing Asset Valuation<br>Key Control Objectives | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Asset Categories | Key Control Objectives | Financial Statement Assertions | | | | | Compliance |
| | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations | |
| **Components should review applicable sections of the GAO/PCIE FAM section 2010 Federal Accounting Checklist and 2020 Federal Reporting and Disclosure Checklists to ensure proper presentation and disclosures. | | | | | | | |

*Note: This table only includes a sample of information and will be expanded in a future version of the FIAR Guidance.*

### *Key Supporting Documents*

**The following table lists the minimum internal controls documentation and supporting documentation required to support activity and balances asserted as audit-ready for Wave 4.** Each document indicates which financial statement assertions are potentially met by that specific document. Internal control documentation is marked as satisfying all financial statement assertions, because the specific control activities described in the internal control documentation will determine which financial statement assertions are met.

| Wave 4 – Full Audit Except for Existing Asset Valuation<br>Key Supporting Documents | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Key Supporting Documents | | | Financial Statement Assertions | | | | | |
| | | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
| All Financial Statement Line Items | Internal Control Documentation | 1. Statement-to-process analyses quantifying the dollar amount and volume of activity flowing through various processes and/or locations | | | X | | |
| | | 2. Applicable policies and procedures | | | X | | |
| | | 3. Process narratives and flowcharts | | | X | | |
| | | 4. Control worksheets, identifying risks, KCOs and corresponding control activities | | | X | | |
| | | 5. Test plans documenting detailed procedures used to test the operating effectiveness of control activities | | | X | | |
| | | 6. Control assessments with test results | | | X | | |
| | | 7. Evaluation of test results | | | X | | |
| | | 8. Documentation evidencing the operation of internal control activities for the period under audit. Examples include:<br>• Approval signature documentation (electronic or manual) demonstrating authorization for an acquisition<br>• System edit checks alerting users that new obligations are for proper purpose and amount<br>• APSRs balances that reconcile to general ledger balances | | | X | | |
| | | 9. System inventory list, listing of system users and their access privileges. | | | | | |
| Asset Documentation | Transaction Documentation | 10. Obligating documents such as contracts, reimbursable agreements, MIPRs, purchase orders, travel orders, payroll documents, etc. | | | X | | |
| | | 11. Physical inventory count documentation (inventory instructions, completed inventory count sheets (indicating items selected from the "book" and physically inspected on the "floor"), preparer/reviewer signatures and supporting documentation evidencing resolution of differences). Physical inventory counts must include sufficient statistical coverage of the population and comply with applicable OUSD (AT&L) requirements. | | | X | | |
| | | 12. Detailed listing of all assets from APSRs | | | X | | |
| Military Retirement Health Benefits | | 13. Summary schedule reporting the amounts/quantities by class of assets | | | X | | |
| | | 14. Reconciliation demonstrating how totals in the detail listing agree to the amounts/quantities reported in the summary schedule | | | X | | |
| | | 15. Detail listing of factors, data, assumption, and formulas used to prepare the actuarial calculations for each sub-process involved in the projection. | | X | X | | |

| Wave 4 – Full Audit Except for Existing Asset Valuation<br>Key Supporting Documents | | | | | | | |
|---|---|---|---|---|---|---|---|
| Key Supporting Documents | | | Financial Statement Assertions | | | | |
| | | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
| Environmental Liabilities | | 16. Reconciliation of the detail listing of all assets in the APSR to the amounts reported by the Treasury Department/FMS Judgment Fund, including appropriate explanations for reconciling items. | x | x | x | | x |
| | | 17. Record of Decision (ROD) | x | | x | | x |
| | | 18. Contract, invoices, receiving reports/status reports | x | | x | | |
| | | 19. Other clean-up cost estimates, if applicable | | | x | | |
| | | 20. Data call results of site inspections, comparisons to EPA listings, other publicly available RCRA/CERCLA supporting documentation, etc. used to identify the complete population of environmental liabilities | | x | | | |
| Other Liabilities Intragovern-mental: Disbursing Officer Cash | | 21. DD Form 2657 Daily Statement of Accountability, DD Form 2665 Daily Agent Accountability Summary, DD Form 1081 Statement of Agent Officer's Account-Advance of Funds/Return of Funds-Vouchers, and/or SF 1219 Statement of Accountability. GWA Treasury Statement. | x | x | x | | x |
| Other Liabilities Intragovern-mental: FECA Reimburse-ment to DOL | | 22. DOL FECA billings and IPAC subsequent payment documents | x | x | x | | x |
| Other Liabilities Intragovern-mental: Custodial Liabilities | | 23. Refer to Wave 2 SBR KSDs 32 and 33 | x | x | x | | x |
| Advances from Others (Other Liabilities Intra-governmental and Nonfederal) | | 24. Ordering Document: MIPR, Reimbursable Agreement, Customer Order, etc. | x | | | | x |
| | | 25. IPAC/Goals report evidencing amounts advanced | | | x | | |
| | | 26. Invoices, IPAC billings (using GOALS reports) supporting any reductions of advances for amounts earned | | | x | | |
| Other Liabilities Nonfederal: Accrued Unfunded Annual Leave | | 27. Individual employee-level listing of hours, hourly rates, and total dollar amount of unfunded leave liability that reconciles to amount recorded in the financial statements | | x | x | | |
| | | 28. Timesheets & leave earning reports that support the amount of leave taken and earned, respectively, by pay period for individual employees | | | x | | x |
| | | 29. SF-50s & SF-52s that support the hourly rate for leave liability calculation (supporting the grade/step/locality) for individual employees | x | | x | | |

| Wave 4 – Full Audit Except for Existing Asset Valuation<br>Key Supporting Documents | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Key Supporting Documents | | | Financial Statement Assertions | | | | |
| | | | Existence | Completeness | Valuation | Presentation & Disclosure | Rights & Obligations |
| Other Liabilities Nonfederal: Contingent Liabilities | | 30. Legal representation letter prepared by the Office of General Counsel (in accordance OMB Bulletin No. 07-04, Section 9) | x | x | x | | x |
| | | 31. Management's schedule of legal liabilities (in accordance OMB Bulletin No. 07-04, Section 9) | x | x | x | | x |
| Depreciation Expense | | 32. DD-250, Receiving Report or DD-1354 to support placed in service date for asset | | | x | | |
| | | 33. Mathematical calculations supporting recorded depreciation expense (demonstrating that the system is correctly calculating depreciation expense for a sample of assets, appropriately considering additions/betterments, etc. that may affect useful lives and acquisition costs over the life of assets) | | | x | | |

*Note: This table only includes a sample of information and will be updated in a future version of the FIAR Guidance.*

### C.4.3 Example Work Products

See Sections C.2.3 and C.3.3 for Wave 2 and Wave 3 specific work product examples.

### C.4.4 Wave-Specific Audit Execution

Entities completing Wave 4 should be ready for a full-scope financial statement audit except for existing asset valuation. To prepare for full-audit, a reporting entity must clearly define and disclose what they classify as existing assets, in writing, to provide its auditors with clear boundaries of what is outside the scope of its audit readiness effort. Using this information, the auditor will be able to determine the impact of not having auditable costs for existing assets in relationship to the financial statements taken as a whole, the impact of which could result in a qualified or disclaimer of opinion.

# APPENDIX D – FIAR METHODOLOGY DETAILS

This appendix provides FIAR Methodology (Methodology) details for reporting entities and service providers working to become audit ready related to tests of controls, tests of supporting documentation, and document retention requirements.

## TESTS OF CONTROLS

The following sections provide additional guidance related to Methodology Activities 1.3.2 to 1.3.6 included in **Figure 1** below as it relates to assessing entity-level controls and assessable unit control activities.

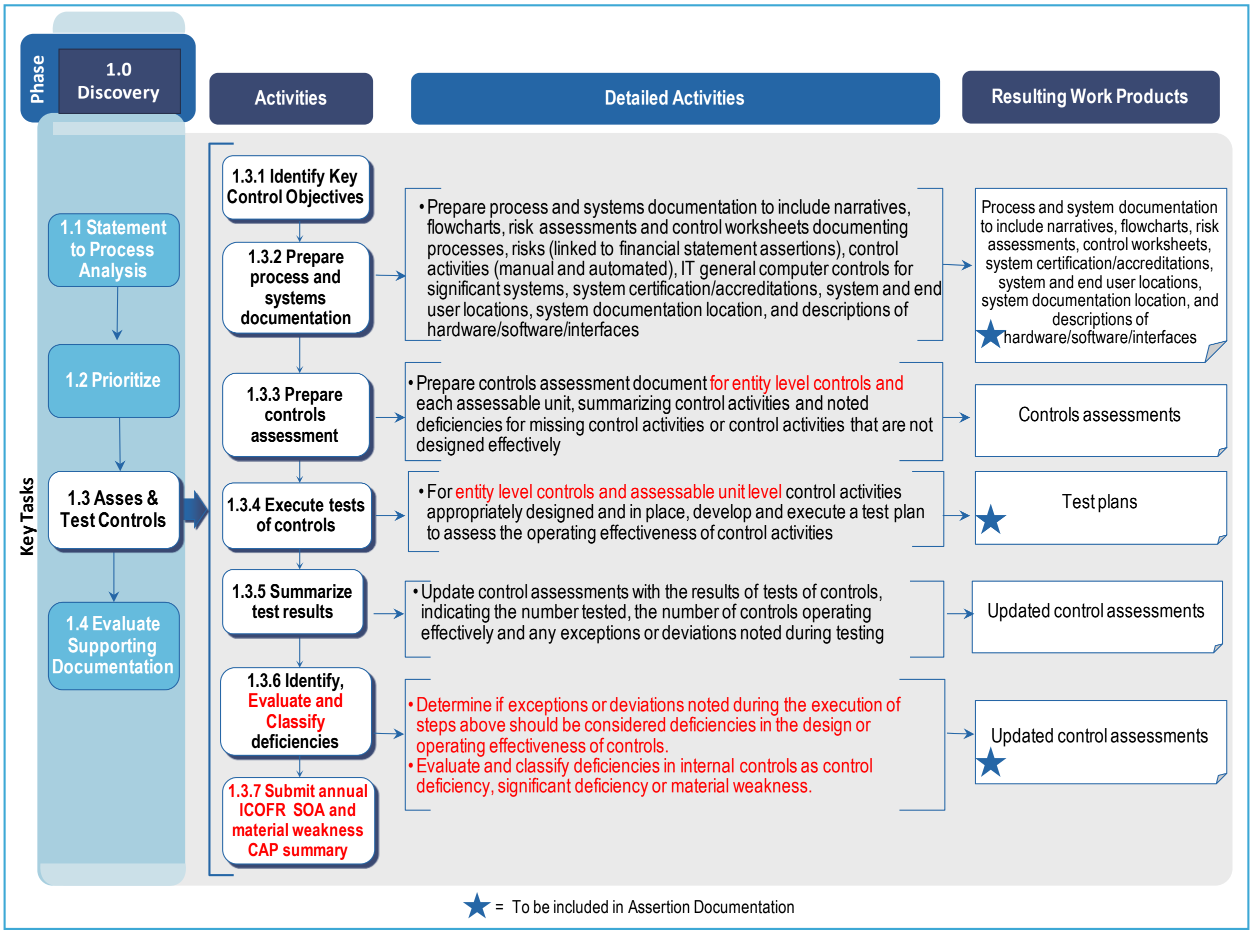


**Figure 1. Discovery – Assess & Test Controls**

## D.1 Assessment of Entity-Level Controls

The U.S. Government Accountability Office (GAO) issues internal control standards for Federal entities in the "Standards for Internal Control in the Federal Government," also referred to as the "Green Book." GAO also issued the "Internal Control Management and Evaluation Tool", based upon guidance provided by GAO's Green Book, to assist agencies in maintaining or implementing effective internal control, and improve or maintain effective operations. The Office of Management and Budget (OMB) has issued guidance, OMB Circular A-123, "Management's Responsibility for Internal Control, to assist Federal managers with improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. The standards promulgated by GAO's Green Book, and internal control guidance provided by GAO's Management and Evaluation Tool and OMB Circular A-123 collectively define the minimum level of quality acceptable for internal control in government and provide the basis against which internal control is to be evaluated. However, they are not intended to limit or interfere with duly granted authority related to developing legislation, rule making, or other discretionary policy-making in an agency. In implementing these standards, management is responsible for developing the detailed policies, procedures, and practices to fit their agency's operations and to ensure that they are built into and are an integral part of operations. The five components of the standard, as noted on **Figure 2**, represent the entity-level controls of an organization. Weaknesses or deficiencies within these foundation controls weaken other internal controls, such as controls at the assessable unit level. **Therefore, reporting entities should begin their control assessments with an evaluation of entity-level controls, which will then serve as a basis for the reporting entities' financial improvement and audit readiness plans.**

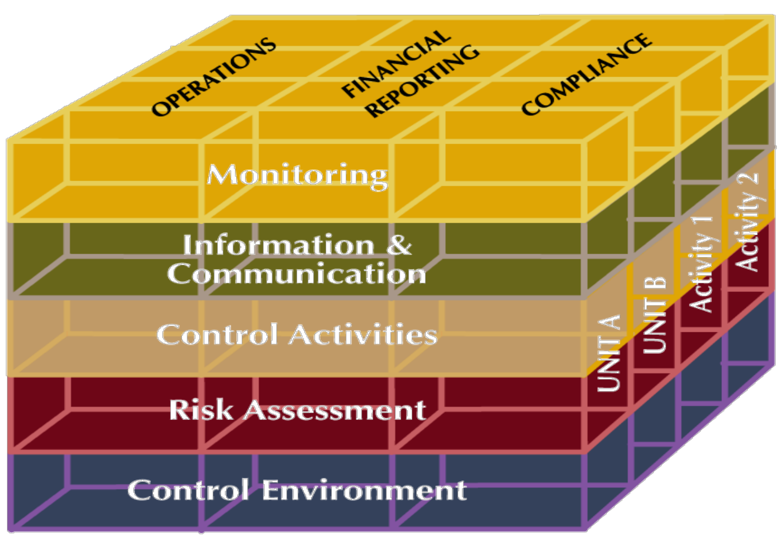


**Figure 2. Standards for Internal Control in the Federal Government – Entity-Level Controls**

The five components of entity-level controls are defined as:

- Control Environment – Structure and culture created by DoD management and employees to sustain organizational support for effective internal control. The control environment is often called "tone at the top" and is critical to the success of all the other pieces of the internal control framework.

- Risk Assessment – Management's identification of internal and external risks that may prevent the Department from meeting its objectives. The risk assessment is the basis for all other control activities. The identification should include risks related to new or revamped information systems implemented by the reporting entity or its service provider. For example, the service provider may implement a client-server version of its software that was previously run on a mainframe. Although the new software may perform similar functions, it may operate so differently that it affects the reporting entity operations.
- Control Activities – Policies, procedures, and mechanisms in place to help ensure that the Department's objectives are met. Control activities, both manual and automated, are the day-to-day actions that are at the core of internal controls. These controls include information technology general controls (ITGCs) over all financially significant computer applications, automated application controls over financial transaction balances within computer applications, and manual application controls performed outside of computer applications.
- Information and Communication – Relevant, reliable, and timely information is communicated to appropriate personnel at all levels within the Department. Information and communication ensures that internal controls are flexible enough to respond to changes in the control environment.
- Monitoring – Periodic reviews, reconciliations, or comparisons of data should be part of the regular assigned duties of personnel. Monitoring is the process that ensures the control structure is operating as planned and fills all gaps that may exist in the internal control structure. Monitoring the effectiveness of internal controls is part of the normal course of business.

Addressing entity-level controls requires a well-planned approach. Additional guidance specific to the evaluation of entity-level controls within the *Discovery* phase, task named "Assess & Test Controls" of the Methodology is included below.

### *D.1.1 Prepare Process and System Documentation (Activity 1.3.2)*

**The first step is to identify and document key entity-level controls. Entity-level controls should be considered at the reporting entity and/or service provider-wide level and at their individually important locations. Documentation should include the following four components of entity-level controls:**

- **Control Environment, including code of conduct, Human Capital (HC) policies, tone-at-the-top, senior management effectiveness, and anti-fraud programs;**
- **Risk Assessment, including management's fraud and financial reporting risk assessment processes;**

- **Information and Communication, including management's process for identifying changes in accounting standards and communicating new policies and procedures within the organization; and**
- **Monitoring, including internal reviews and self-assessment activities.**

Control activities are incorporated in the business processes and sub-processes, and are documented and tested separately from the entity-level control components.

### *D.1.2 Prepare Control Assessment (Activity 1.3.3), Execute Tests of Controls (Activity 1.3.4), and Summarize Test Results (Activity 1.3.5)*

**Once entity-level controls have been identified and documented, a reporting entity should develop a process for testing entity-level controls and summarizing results (Activities 1.3.3 – 1.3.5). Entities must assess entity-level controls annually.** A reporting entity should consider using GAO's Internal Control Management and Evaluation Tool (found at http://www.gao.gov/new.items/d011008g.pdf), which is based on the GAO Green Book, to assist in the assessment process. The tool was developed by the GAO to assist agencies in assessing entity-level controls, and help determine what, where, and how improvements can be implemented. The tool provides a systematic, organized, and structured approach for assessing the internal control structure of an organization.

**Because entity-level controls are the foundation for all other control activities implemented within DoD, these control activities must be assessed as early in the FIAR process as possible.** Inadequate entity-level controls may be an indication that the control environment is ineffective. Weaknesses or deficiencies identified within these foundation control activities must be remediated as soon as possible to prevent the weakening of other internal controls.

### *D.1.3 Identify Evaluate and Classify Deficiencies (Activity 1.3.6)*

The identification, evaluation, and classification of deficiencies should be conducted in the same manner for entity-level controls and assessable units. However, the evaluation of the results of entity-level assessments requires significant judgment. When deficiencies are identified, it is important to begin *Corrective Action* phase activities quickly, given the importance and pervasive nature of entity-level controls. For example, for systemic issues with respect to the assignment of authority, the development and communication of policies and procedures, or management's anti-fraud programs are not quick fixes and may take several weeks to months to address.

## D.2. Assessable Unit Internal Control Testing & Evaluation of Deficiencies

Reporting entities and service providers must obtain a high level of assurance that internal controls over financial reporting are working effectively when performing test of controls to support the audit readiness assertion of an assessable unit. **The entity must obtain sufficient, competent evidence about the design and operating effectiveness of control activities over all relevant assertions related to the assessable unit key control objectives (KCOs).** More guidance related to the testing of assessable unit controls within the *Discovery Phase*, task named "Assess &Test Controls" of the Methodology is included below.

### *D.2.1 Prepare Process and Systems Documentation (Activity 1.3.2)*

**The entity must prepare process and systems documentation to include narratives, flowcharts, risk assessments and control worksheets documenting processes, risks (linked to financial statement assertions), control activities (manual and automated), IT general computer controls for significant systems, system certification and accreditations, system and end user locations, system documentation location, and descriptions of hardware, software, and interfaces.**

#### DOCUMENTATION MUST DIFFERENTIATE BETWEEN BUSINESS PROCESSES AND RELATED CONTROLS ACTIVITIES

Business processes consist of a sequence of activities that are performed in order to accomplish work and achieve the business's objectives. These activities may range from a simple procedure, such as paying an invoice, to a key element of the business operations, such as processing civilian pay or purchasing missiles. They may also include functional processes, such as maintaining an organization's financial records, to cross-functional processes, such as an application of human resources.

Control activities are the policies, procedures, techniques, and mechanisms that help make certain that management directives are carried out. Control activities include: business performance reviews, controls over information processing (e.g., application controls and IT general controls (ITGCs), physical controls, and segregation of duties).

Business process should not be confused with control activities, which are the procedures established by management to ensure that business processes are carried out as directed, while providing the organization with reasonable assurance that misstatements of the financial statements will be prevented or detected. **Figure 3** provides examples of these concepts.

| Business Process | Business Sub-Process | Sub-Process Risk | Control Objectives | Control Activity |
|---|---|---|---|---|
| Civilian Payroll | Payroll Computation | Payroll may be calculated incorrectly | Salary and benefits are calculated, paid, and recorded based on applying appropriate data from accurate formulas, calculations, and/or data processing. | Payroll technicians review the report which identifies payments less than $1 and greater than $5,000/$10,000 for civilians on their respective databases and review their payroll system records to determine whether they were valid payments. If the net amount for each employee/item is greater than $5,000/10,000 or less than $1, the report is annotated and updates are made in the payroll system for any invalid payments. |
| Civilian Payroll | Payroll Computation | Invalid payroll payments may be made to employees | Only valid payroll disbursements and collections are included in the outlays section of the Statement of Budgetary Resources. | Payroll technicians review the Master Pay History and Master Employee Record, in both databases, for each employee on the duplicate Social Security number listing to determine if an overpayment exists and if the employee should be separated. |

**Figure 3. Examples of Civilian Payroll Control Activities**

#### Ensure Completeness of IT Documentation

**The description of information technology (IT) systems must include all automated systems and technology tools used during the execution of the processes related to the assessable unit, including financial systems, mixed-systems, non-financial systems, and micro-applications (i.e., spreadsheets, databases, and/or other automated tools used to perform reconciliations, calculations, or other business functions).** The purpose of each IT system or tool must be documented. A system view diagram should be completed as part of Activity 1.3.2 to include all systems and automated tools used during the execution of the processes related to the assessable unit. Refer to Section 3.A.4, **Figure 13**, for an example of a system view diagram. **Tests of controls related to automated controls and/or tests of the integrity of automated tools must be performed.** Refer to Section D.2.3 for additional guidance related to execution of tests of controls.

### *D.2.2 Prepare Control Assessment (Activity 1.3.3)*

The reporting entity or service provider must first identify the controls to be tested. **They must evaluate control activities to determine if they have been designed effectively (i.e., designed to meet control objectives).** The design effectiveness of controls is based on the following criteria: (1) Directness (extent control activity relates to control objective), (2) selectivity (magnitude of amount of dollar activity not subject to the control), (3) manner of execution (frequency of control execution and skills/experience of personnel performing the control activity), and (4) follow-up (procedures performed when the control identifies an exception).

The entity will only test effectively designed control activities (i.e., meet the applicable KCOs) for operational effectiveness.

## *Avoid Duplication of Efforts with Other Similar Activities*

**The entity should identify other assessments where controls have been identified for testing and coordinate the efforts to avoid duplication of efforts with other similar entities.** For example, agencies are required to perform reviews of financial systems under FFMIA, through the DoD Manager's Internal Control Program, or information security under FISMA. Reviews performed by entities or at the entity's discretion may be used to help accomplish this assessment. This is not to suggest that the entity can avoid sampling and testing control activities. Rather, an entity can use alternative sources of evidence (if available) in combination with detailed sample testing to achieve a high level of assurance.

Possible sources of testing may come from[1]:

- Management knowledge gained from the daily operation of agency programs and systems.
- Management reviews conducted (1) expressly for the purpose of assessing internal control, or (2) for other purposes with an assessment of internal control as a by-product of the review.
- Inspector General and GAO reports, including audits, inspections, reviews, investigations, outcome of hotline complaints, or other products.
- Program evaluations.
- Audits of financial statements conducted pursuant to the CFO Act, as amended, including: information revealed in preparing the financial statements; the auditor's reports on the financial statements, internal control, and compliance with laws and regulations; and any other materials prepared relating to the statements.
- Reviews of financial systems which consider whether the requirements of FFMIA and OMB Circular No. A-127, Financial Management Systems are being met.
- Annual evaluations and reports pursuant to FISMA and OMB Circular No. A-130, Management of Federal Information Resources.
- Annual performance plans and reports pursuant to the Government Performance and Results Act of 1993.
- The American Recovery and Reinvestment Act of 2009 (ARRA) reporting requirements[2.]
- Annual reviews and reports pursuant to the Improper Payments Information Act of 2002, amended by the Improper Payments Elimination and Recovery Act of 2010.
- Single Audit reports for grant-making agencies.

[1] OMB Circular A-123, Appendix A, p. 13.

[2] OMB Circular A-123, Appendix A, p. 13, references the PART. The PART has subsequently been replaced by the reporting requirements under ARRA.

- Reports and other information provided by the congressional committees of jurisdiction.
- Other reviews or reports relating to agency operations, including service-level audit reports.
- Type 2 SSAE 16 report when service providers are involved.

An entity has primary responsibility for assessing and monitoring controls, and should use other sources as a supplement – not a replacement for its judgment.

#### Identify Who Will Perform the Testing

**Once the entity has determined what control activities are assessed by another process, in full or in part, management must determine who will perform the remaining tests of control activities.**

The entity may evaluate the operating effectiveness based on procedures such as:

- testing of control activities by quality control or internal control organizational units,
- testing of control activities by contractors under the direction of management,
- using service organization reports,
- inspecting evidence of the application of control activities, or
- testing by means of a self-assessment process that might occur as part of management's ongoing monitoring process.

In every case, entities must take responsibility for the work including determining whether the:

1. Personnel who perform the work have the necessary competence and objectivity, (i.e., personnel performing the test should not be the person responsible for performing the control or report directly to the person performing the control), and
2. Procedures provide evidence sufficient to support the assertion package and annual Internal Controls over Financial Reporting (ICOFR) Statement of Assurance (SOA) memorandum[3].

### *D.2.3 Execute Tests of Controls (Activity 1.3.4)*

**Reporting entities and service providers should develop formal test plans to facilitate review and approval of test procedures and results by interested parties.** Refer to the FIAR Guidance website for an example of a completed ***test plan***. **The execution of the test plans should include the consideration of the nature, extent (including sampling technique), and timing of the execution of the controls tests.**

#### Nature of Tests

Tests can be classified into four categories: inquiry, observation, inspection, and re-performance. These categories are described below:

[3] Derived from PCAOB AS 5.

- Inquiry tests are conducted by making either oral or written inquiries of entity personnel involved in the execution of specific control activities to determine what they do or how they perform a specific control activity. The inquiries are typically open-ended. Evidence obtained through inquiry is the least reliable evidence and should be corroborated through other types of control tests (observation or inspection). Inquiry regarding a control's effectiveness does not, by itself, provide sufficient evidence about whether a control is operating effectively. The reliability of evidence obtained from inquiry depends on factors such as:
  - The competence, experience, knowledge, independence, and integrity of the person of whom the inquiry was made – evidential reliability is enhanced when the person possesses these attributes,
  - Whether the evidence was general or specific – specific evidence is usually more reliable than general,
  - The extent of corroborative evidence obtained – evidence obtained from several entity personnel is usually more reliable than evidence obtained from only one, and
  - Whether the evidence was provided orally or in writing – evidence provided in writing is generally more reliable than evidence provided orally[4].
- Observation tests are conducted by observing entity personnel performing control activities in the normal course of their duties. Observation generally provides highly reliable evidence that a control activity is properly applied during the period of observation; however, it provides no evidence the control was in operation at any other time. Consequently, observation tests should be supplemented by corroborative evidence obtained from other tests (such as inquiry and inspection) about the operation of control activities at other times. However, observation of the control provides a higher degree of assurance than inquiries, and may be an acceptable technique for assessing automated controls[5].
- Examination of evidence is often used to determine whether manual control activities are being performed. Inspections are conducted by examining documents and records for evidence (such as the existence of initials or signatures) that a control activity was applied to those documents and records. When using examination to perform tests of controls, reporting entities should note the following:
  - System documentation, such as operations manuals, flow charts, and job descriptions, may provide evidence of control design but do not provide evidence that control activities are operating or applied consistently. To use system documentation as evidence of effective control activities, the entity should obtain additional evidence on how the control activities were applied.
  - Because documentary evidence generally does not provide evidence concerning how effectively the control was applied, the entity should supplement inspection tests with

[4] Definition adapted from the FAM, Section 350.
[5] Ibid.

observation or inquiry of persons applying the control. For example, the entity generally should supplement inspection of initials on documents with observation or inquiry of the individuals who initialed the documents to understand the procedures they followed before initialing[6].

- Re-performance of the control activity is necessary for the entity to obtain sufficient evidence of its operating effectiveness. For example, a signature on a voucher package to indicate approval does not necessarily mean the person carefully reviewed the package before signing. The package may have been signed based on only a cursory review (or without any review). As a result, the quality of the evidence regarding the effective operation of the control might not be sufficiently persuasive. If that is the case, the entity should re-perform the control (such as checking prices, extensions, and additions) as part of the test of the control. In addition, entity personnel might inquire of the person responsible for approving voucher packages what he or she looks for when approving packages, and how many errors have been found within voucher packages. Entity personnel also might inquire of supervisors whether they have any knowledge of errors that the person responsible for approving the voucher packages failed to detect. Because entity personnel are re-performing a control, it is not necessary to select high value items for testing or to select different types of transactions.

Combining two or more of these test techniques provides greater assurance than using only one testing technique. The more significant the account, disclosure, or process and the greater the risk, the more important it is to ensure the evidence extends beyond one testing technique. The nature of the control also influences the nature of the tests of controls. Most manual control activities are through a combination of inquiry, observation, examination, or re-performance. This is illustrated in **Figure 4**.

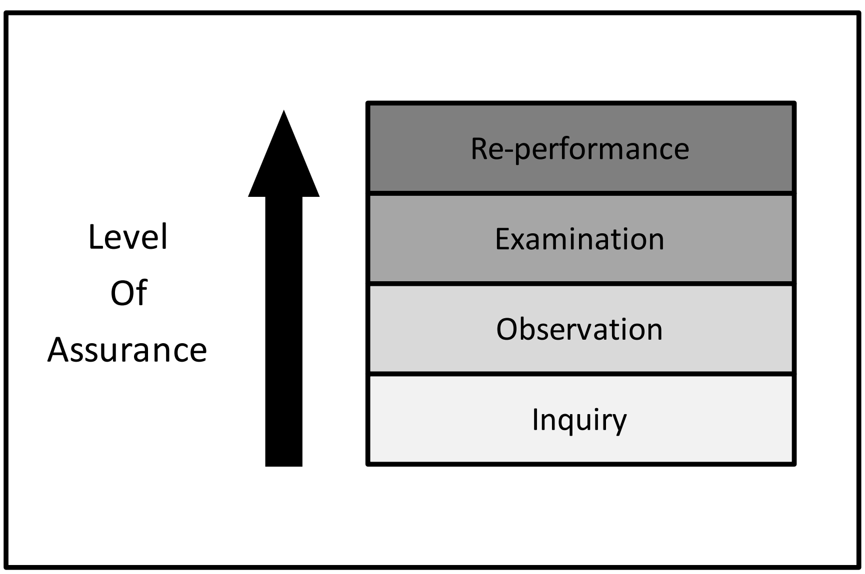


**Figure 4. Relative Level of Assurance by Nature of Test**

[6] Ibid.

### EXTENT OF TESTING

The extent of testing of a control will vary depending on a variety of factors, including whether a control is automated or manual.

#### *Testing of Automated Controls*

For an automated control, the number of items tested can be minimal (one to a few items), assuming ITGCs have been tested and found to be effective. A common example of an automated control is an edit check activated during data entry. If a request is entered to pay an individual, the timekeeping and/or payroll system(s) would check to see if an SSN exists for the employee before processing the transaction. If the SSN is not in the system, an error message will be displayed and the pay request will not be processed. Each attribute of the automated control must be tested for design effectiveness and if determined to be designed effectively, the control will then need to be tested for operating effectiveness. In this example, a baseline understanding should be obtained that will determine whether the edit check controls are designed effectively to work under all circumstances. If the control is effectively designed, then the operating effectiveness should be tested by entering a few different invalid entries. In some cases, management override procedures may allow an automated control to be circumvented. The override capability should be evaluated to assess potential internal control deficiencies.

When testing automated controls, the reporting entity or service provider: (1) ensures ITGCs are effective and (2) performs a detailed review of the control activities within the computer applications (e.g., a pre-implementation or a post-implementation review). It is management's responsibility to ensure that the automated controls are working as designed and there are alternative methods that may be used to accomplish this objective, such as reviewing program code, walkthroughs of transactions, observing and confirming all relevant transaction types and error conditions are covered, etc. For third-party software solutions (e.g., enterprise resource planning systems), the entity should validate that the solution has been configured to include expected automated controls and there is a control process over future changes to configurable parameters. For custom-developed or in-house applications, more extensive procedures may be required to validate the design of the control. However, if independent verification and validation testing of changes have been performed for custom- or in-house developed programs, management should evaluate the level of reliance, if any, that can be placed on these procedures.

#### *Testing of Manual Controls*

Tests of manual controls (control activities performed manually, not by computer) should include a mix of inquiry, observation, examination, or re-performance. Inquiry alone does not provide sufficient evidence to support the control's operating effectiveness. Effective testing generally requires examining a control at a particular location many times (referred to as "sampling"). Inherent to sampling is the risk that the control is not operating effectively at all times, although the entity may find nothing amiss in the samples (resulting in a conclusion that a control is operating effectively). Sampling risk should be minimized by selecting a sufficient number of items to test (e.g., using either statistical or judgmental sampling). Sampling risk increases with the frequency of the control's execution.

The CFO Council, Implementation Guide for OMB Circular A-123, Appendix A provides guidance for determining sample sizes, based on the frequency of a control activity, that will support a conclusion that a manual control is operating effectively. The CFO Council's guidance has been included in **Figure 5** along with an acceptable number of deviations that reporting entities can use only for audit readiness purposes (last column). The Department has determined that for certain sample sizes, a larger number of deviations from that accepted by the CFO Council's guidance will be acceptable for audit readiness purposes. However, Management must accept the implications of sampling risk and understand that testing under a financial statement audit will be more rigorous and allow fewer deviations. Entities must document the justification of the sample size used for testing if it differs from the guidance provided below.

| Frequency | Population Size | Total Sample Size | Acceptable Number of Deviations/Tolerable Misstatement (CFO Council)* | Acceptable Number of Deviations/Tolerable Misstatement (Audit Readiness Guidance) |
|---|---|---|---|---|
| Annual | 1 | 1 | 0 | 0 |
| Quarterly | 4 | 2 | 0 | 0 |
| Monthly | 12 | 3 | 0 | 0 |
| Weekly | 52 | 10 | 0 | 1 |
| Daily | 250 | 30 | 0 | 3 |
| Multiple Times per day | Over 250 | 45 | 0 | 5 |

*Represent number of deviations to most likely be used by an auditor when performing an audit.

**Figure 5. Frequency of Control Activity Determines Sample Size.**

For control activities that occur many times each day, the sample size noted on **Figure 5** is consistent with the sampling guidance included in *GAO/PCIE FAM, Section 450, Sampling Control Tests, Figure 450.1, Table 1* for populations over 2,000 items. Using this sample size will derive a 90 percent confidence level when zero deviations are identified.

For controls applied many times a day or ad hoc controls that are not over 2,000 items, consistent with guidance included within FAM section 450[7], the entity may consult a statistician (or personnel qualified to perform sample selections and interpret results) to calculate a reduced sample size and to evaluate the results. The effect is generally small unless the sample size per the table is more that 10 percent of the population.

### *Sampling Technique*

**Once the sample size has been determined, the entity should identify a sampling technique to select the items to be tested.** When applying the FIAR Methodology, the following 2 techniques are recommended:

[7] Refer to FAM, Section 450, footnote 2.

- Random: Provides a method to ensure that all items in the population have an equal chance of being selected.
- Haphazard[8]: Provides a method for selecting a representative sample without relying on a truly random process. Sample items should be selected without any conscious bias.

**An entity should make every effort to use random sampling.** To select randomly, the entity can use random number tables, random numbers generated in software such as Microsoft Excel, or random selection offered by sampling software. When using haphazard selection, be careful to avoid distorting the group of transactions picked for testing by purposely selecting certain types of transactions, such as unusual or large transactions.

#### *Consideration of Locations*

When selecting a sample, consideration should be given to the location of the control (where the control is in place), and how the control is implemented. The Statement to Process Analysis (Activity 1.1) performed during the *Discovery Phase* should assist the entity in determining which location should be included within the sample based on quantitative and qualitative considerations (i.e., individually important locations).

Where controls are implemented across many locations in a standardized manner and are routine in nature, the entity should consider selecting one sample across all of the individually important locations. However, if the entity determines that controls in place to meet an assessable unit's KCO differ or the method of implementation differ at each important location, separate samples should be selected for each location.

### TIMING OF PROCEDURES

The time period over which the entity tests its internal control must be sufficient to determine operating effectiveness as of the date of the assertions, (i.e., audit readiness assertion when applicable and/or ICOFR SOA). Perform testing in increments throughout the period being asserted. **The period tested must be sufficient to enable the entity to obtain adequate evidence about the control activities' operating effectiveness.** At a minimum to make an assertion, the entity must have performed enough tests of controls to meet the minimum sample sizes included in **Figure 5**, (e.g., for a monthly control at least 3 months must have been tested for the entity to assert to the effectiveness of controls).

Various techniques are available to spread testing across a period. If attempting to obtain evidence of the effectiveness of controls over a fiscal year, one method is to assess the sample over several quarters. For example, to reach a desired sample quantity of 45, the entity could test 15 instances in each of the first three quarters of the year.

#### *Consideration of Timing for Entities in the Sustainment Phase*

For entities that have achieved audit readiness and are in the sustainment phase over either one, multiple, or all assessable units, (i.e., full scale audit), the expected timing of the

[8] A haphazard sample is a sample consisting of sampling units selected without conscious bias, that is, without any special reason for including or excluding items from the sample. It does not consist of sampling units selected in an arbitrary manner; rather it is selected in a way the auditor expects to be representative of the population.

assessment should be at least the nine-month period covering October 1 to June 30. An entity may choose to design its assessment to cover the full fiscal year to evaluate if corrective actions implemented earlier during the fiscal year had the desired effect, and therefore, conclude that the deficiency has been remediated and controls are working effectively. However, entities should be mindful of the ICOFR SOA annual reporting requirements. Refer to FIAR Guidance Section 2.F for details of reporting requirements.

*Testing Remediated Controls*

**If remediated or new controls have been implemented during the year or there have been significant changes in internal controls during the year (e.g., internal control enhancements or changes addressing deficiencies detected during interim or prior year testing), the entity must assess the control's design and test operating effectiveness of the remediated or new control between the time the new controls were implemented and the end of the assertion period.** This period must be sufficient to enable entity management to obtain adequate evidence that the control is operating effectively. For example, if an entity is asserting controls over a fiscal year and a new monthly manual control is implemented in the middle of the fiscal year's last month, entity management will not have sufficient opportunity to assess its operating effectiveness.

### *D.2.4 Summarize Test Results (Activity 1.3.5)*

**Once the tests of control activities are complete, the results must be documented.** The documentation provides support for the entity's assertions (i.e., audit readiness assertion when applicable and/or ICOFR SOA); therefore, it might be reviewed by the independent auditor and possibly by the GAO or Office of Management and Budget. Thus, the testing should be sufficiently documented to allow an independent person to understand and re-perform the test. The documentation should identify the items tested (e.g., the title and date of the report, invoice numbers, check numbers), who performed the testing, and the test results. Please refer to the FIAR Guidance website for an example of a ***test plan*** with documented test results.

### *D.2.5 Identify, Evaluate and Classify Deficiencies (Activity 1.3.6)*

**If an exception occurs during testing, the entity must evaluate the exception to determine why it occurred.** After investigation of the exception, the entity may determine that the control is not operating effectively. When an exception occurs in a quarterly, monthly, or weekly control, there is a strong indication that a deficiency exists due to the small populations involved (e.g., four quarters, 12 months, or 52 weeks). Additionally, the existence of compensating controls does not affect whether an internal control deficiency exists. The factors considered when evaluating control deficiencies are *likelihood* and *magnitude*. These are defined as:

- ***Likelihood*** – Refers to the probability that a control, or combination of controls, could have failed to prevent or detect a misstatement in the financial statements being audited. If it is at least reasonably possible that a misstatement could have occurred because of a missing control, or because of the failure of a control or combination of controls, then the likelihood is more than remote. The existence of a design weakness, in and of itself, is sufficient to conclude that there is more than a remote likelihood that the control would not have been effective. Remote and reasonably possible are defined as follows:

- *Remote*: The chance of the future event or events occurring is slight.
- *Reasonably Possible*: The chance of the future event or events occurring is more than remote but less than likely to occur. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.

When attempting to determine the likelihood of a misstatement consider the following:

- The nature of the financial statement accounts, disclosures, and assertions involved;
- The susceptibility of the related assets or liability to loss or fraud, (i.e., greater susceptibility increases risk);
- The subjectivity, complexity, or extent of judgment required to determine the amount involved (i.e., greater subjectivity, complexity, or judgment – like that related to an accounting estimate – increases risk);
- The cause and frequency of known or detected exceptions for the control's operating effectiveness;
- The interaction or relationship of the control with the other control activities, (e.g., the interdependence or redundancy of the control);
- The interaction of the deficiencies; and
- The possible consequences of the deficiency.

- ***Magnitude*** – Refers to the extent of the misstatement that could have occurred, or that actually occurred, since misstatements include both potential and actual misstatements. The magnitude of a misstatement may be inconsequential, more than inconsequential but less than material, or material, as follows:
  - A misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements. If a reasonable person would not reach such a conclusion regarding a particular misstatement, that misstatement is more than inconsequential.
  - The difference between a significant deficiency and a material weakness is the magnitude of the misstatement that could occur because of the failure of the control to prevent or detect a misstatement. If the magnitude of the actual or potential misstatement is less than material but more than inconsequential, the control deficiency is a significant deficiency. If the misstatement was material to the financial statements, the control deficiency is a material weakness. In this evaluation, it does not matter if a misstatement did not actually occur; what is relevant is the potential for misstatement.

In attempting to determine the magnitude of a misstatement the following should be considered:

- The financial statement amounts or total of transactions exposed to the deficiency; and
- The volume of activity in the account balance or class of transactions exposed to the deficiency that has occurred in the current period or is expected to occur in future periods.

Deficiencies range from a control deficiency to significant deficiency to material weaknesses in internal control as defined below[9]:

- Control Deficiency – 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 misstatements on a timely basis. Control deficiencies are internal to DoD and not reported externally.
- Significant Deficiency – A control deficiency or combination of control deficiencies adversely affecting the ability of DoD to initiate, authorize, record, process, or report external financial data reliably in accordance with Generally Accepted Accounting Principles (GAAP) such that there is a more-than-remote[10] likelihood of not preventing or detecting a more-than-inconsequential misstatement of the entity's financial statements (or other significant financial reports). Such deficiencies are internal and not reported externally.
- Material Weakness – A significant deficiency, or combination of reportable conditions, resulting in a more-than-remote[11] likelihood that a material misstatement of the financial statements (or other significant financial reports) will not be prevented or detected. Material weaknesses and a summary of the corrective action plans (CAPs) are reported in the Agency Financial Report (AFR).

**Figure 6** can be used to assess the classification of internal control deficiencies, individually or in the aggregate, after considering compensating controls.

[9] OMB Circular A-123, pp. 18 – 19.
[10] The term "remote" is defined in Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, as the chance of the future event, or events, occurring is slight.
[11] Ibid.

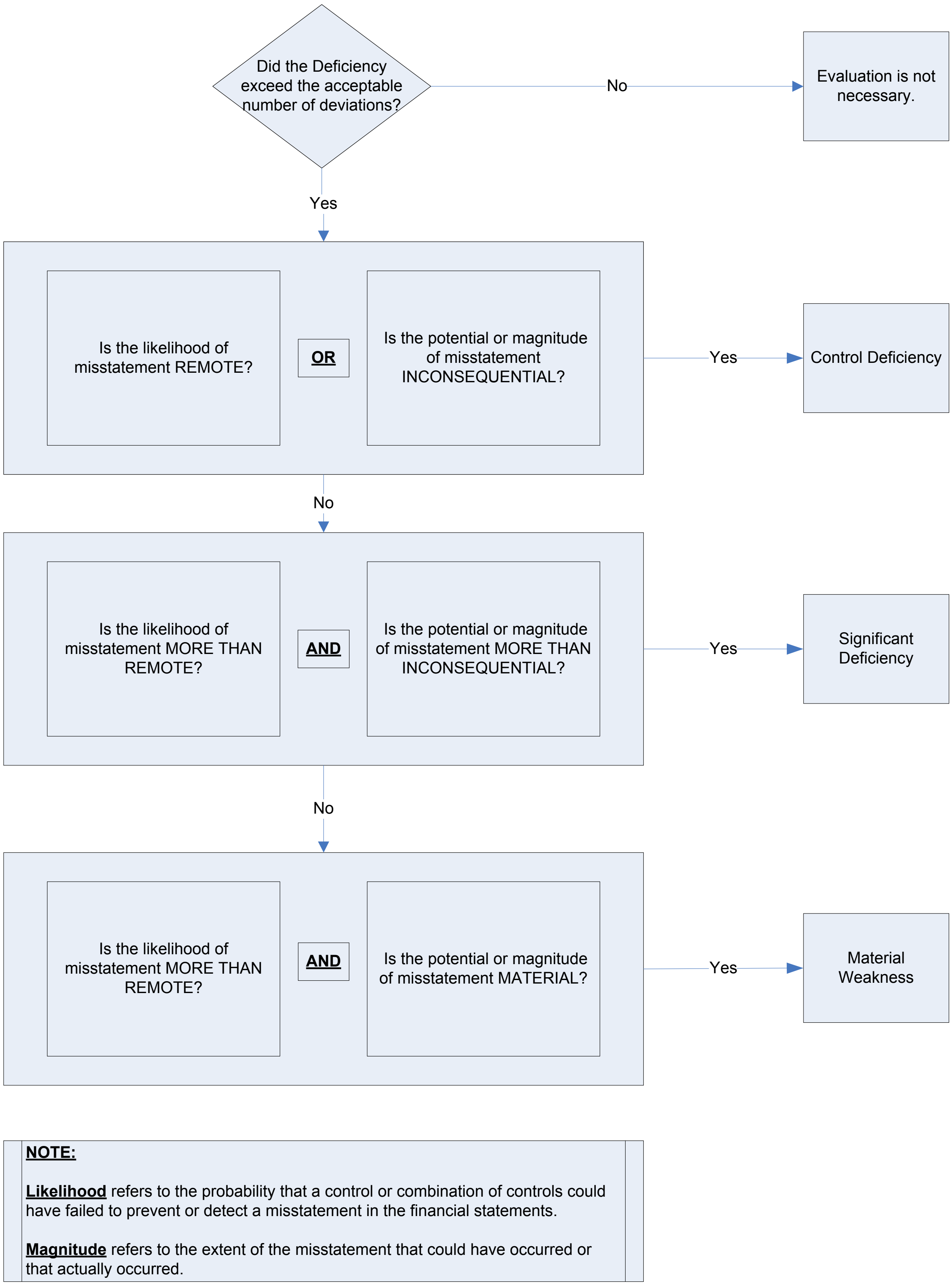


**Figure 6. Classification of an Internal Control Deficiency**

### *Aggregation of deficiencies and Consideration of Compensating Controls*

**Reporting entities or service providers should first evaluate control deficiencies individually or in combination and then decide whether they are significant deficiencies or material weaknesses, after considering the effects of compensating controls.** A compensating control is a control that limits the severity of a control deficiency and prevents it from rising to the level of a significant deficiency or, in some cases, a material weakness. Compensating controls can be preventive or detective. Its main objective is to prevent or detect errors that may not be prevented or detected by other controls. For example, comparison of a receiving report to an approved purchase order allows the reporting entity to prevent the acceptance of an unapproved purchase. This control compensates for weaknesses in controls over purchases.

Compensating controls should be tested, documented, and taken into account when assessing the likelihood of a misstatement occurring and not being detected. However, the existence of a compensating control does not affect whether a control deficiency exists. If the reporting entity or service provider believes there are compensating controls in place that could address the financial statement assertion or risk resulting from the deficiency, it should consider and validate whether:

- the compensating control is effective; and
- the compensating control would identify an error and address the assertion.

Since a significant deficiency can be a combination of internal control deficiencies, and a material weakness can be a combination of significant deficiencies, the reporting entity must accumulate all internal control deficiencies for evaluation in the aggregate, considering whether there is a concentration of deficiencies over a particular assessable unit, or financial statement assertion. For example, assume a reporting entity or service provider has three internal control deficiencies in relation to the processing of civilian payroll. Although none of these deficiencies may individually be a significant deficiency, they could potentially rise to the level of a significant deficiency when aggregated together. The assessment of the interaction of deficiencies with each other is essentially a search for patterns (e.g., could the deficiencies affect the same financial statement accounts and assertions). The reporting entity or service provider should utilize the Summary of Aggregated Deficiency (SAD) Template to assess the likelihood and potential magnitude. Refer to the FIAR Guidance website to obtain the latest version of the ***SAD Template***.

### *Classification of Internal Control Material Weakness*

Internal control material weaknesses previously identified by the reporting entities were classified in the Department's AFR by the financial statement line item or type of activity affected by the material weakness. Beginning in FY 2011, material weaknesses must be classified by the end-to-end business processes affected by the control weakness reported in the AFR. **Therefore, reporting entities must reclassify previously reported material weaknesses based on the end-to-end business processes affected by the material weakness.** Reclassifying the prior year material weaknesses provides a roll-forward in the AFR from the prior year material weakness to the material weaknesses in FY 2011. **Figure 7** provides a summary of the end-to-end business processes and must be used to ensure the classification is consistent among reporting entities.

| End-to-End Business Process | Process Description |
|---|---|
| Budget-to-Report | Budget-to-Report encompasses the business functions necessary to plan, formulate, create, execute, and report on the budget and business activities of the entity. It includes updates to the general ledger. It also includes all activities associated with generating and managing the internal and external financial reporting requirements of the entity, including pre- and post-closing entries related to adjustments, reconciliations, consolidations/eliminations, etc. |
| Hire-to-Retire | Hire-to-Retire encompasses the business functions necessary to plan for, hire, develop, assign, sustain, and separate personnel in the Department. |
| Order-to-Cash | Order-to-Cash encompasses the business functions necessary to accept and process customer orders for services and/or inventory. This includes such functions as managing customers, accepting orders, prioritizing and fulfilling orders, performing distribution, managing receivables, and managing cash collections. |
| Procure-to-Pay | Procure-to-Pay encompasses the business functions necessary to obtain goods and services. This includes such functions as requirements identification, sourcing, contract management, purchasing, payment management, and receipt and debt management. |
| Acquire-to-Retire | Acquire-to-Retire encompasses the business functions necessary to obtain, manage, and dispose of accountable and reportable property (capitalized and non-capitalized assets) through their entire life-cycle. It includes such functions such as requirements identification, sourcing, contract management, purchasing, payment management, general property, plant & equipment management, and retirement. |
| Plan-to-Stock | Plan-to-Stock encompasses the business functions necessary to plan, procure, produce, inventory, and stock materials used both in operations and maintenance (O&M) as well as for sale. |

**Figure 7. DoD End-to-End Business Processes**

Please refer to FIAR Guidance website for more guidance related to the ***classification of previously reported material weaknesses and identification of OSD Senior Accountability Officials***.

## D.3 Supporting Documentation Testing (Activity 1.4.5)

**In addition to performing tests of internal controls, reporting entities must perform tests to assess whether appropriate supporting documentation exists and is readily available to support transactions and balances.** When possible and effective, reporting entities are encouraged to select dual-purpose samples, whereby documentation demonstrating the effectiveness of internal controls and supporting transactions and balances can be addressed with one sample. For example, a sample of invoices is selected and reviewed to determine whether the invoices:

- contain evidence of review/approval control, and
- support a transaction selected from the population.

Reporting entities may utilize a variety of sampling techniques to efficiently and effectively form conclusions about the entire population. Sampling techniques may be non-statistical or statistical. Non-statistical sampling is the Department's preferred sampling technique method. Non-statistical techniques for selecting samples of transactions for supporting documentation testing include:

1. Selecting a random sample from the entire population, and
2. Stratifying the population and then selecting random samples from each strata (useful to ensure higher-risk transactions are isolated, tested and concluded upon separate from the general population).

The Department's non-statistical sampling size guidance has been included in **Figure 8** along with an acceptable number of deviations that reporting entities can use only for audit readiness purposes (last column). The Department has determined that for certain sample sizes, a larger number of deviations from that accepted by the CFO Council's guidance will be acceptable for audit readiness purposes. However, Management must accept the implications of sampling risk and understand that testing under a financial statement audit will be more rigorous and allow fewer deviations. Entities must document the justification of the sample size used for testing if it differs from the guidance provided below.

| Population Size | Total Sample Size | Acceptable Number of Deviations/Tolerable Misstatement* | Acceptable Number of Deviation/Tolerable Misstatement (Audit Readiness) |
|---|---|---|---|
| 200 or More | 55 | 0 | 5 |
| 100 – 199 | 44 | 0 | 4 |
| 50 – 99 | 22 | 0 | 2 |
| 20 – 49 | 11 | 0 | 1 |
| Less than 20 | 5 | 0 | 0 |

*Represents number of deviations to most likely be used by an auditor when performing an audit.

**Figure 8. Population Size Determines Sample Size**

If the errors exceeds the acceptable number of deviations, the reporting entities must design and implement corrective actions to remediate the documentation deficiency and then re-perform additional testing.

While non-statistical sampling is the preferred approach for testing transactions and/or populations attributes, Statistical sampling can be used when deemed more effective. Statistical sampling helps management (a) to design an efficient sample, (b) to measure the sufficiency of the audit evidence obtained, and (c) to evaluate the sample results and extrapolate the results to the population. By using statistical theory, management can quantify sampling risk to assist in limiting it to a level considered acceptable.

If considering the use of a statistical sample within its evaluation, the reporting entity must engage a statistician or personnel qualified to perform the sample selection and interpret the results.

**When using statistical sampling for audit readiness purposes, entities must design samples to provide a minimum level of assurance of 86 percent, which is the minimum associated with a moderate risk of misstatement per FAM Table 470.1.** However, management must be aware that of the implications of sampling risks associated with deriving sample sizes using a moderate risk of misstatement and understand that testing under a financial statement audit will be more rigorous as external auditors will strive to obtain a higher level of assurance (typically 95 percent).

When the testing of statistical samples is complete, reporting entities should extrapolate the results to the entire population. Compare the estimated error to the materiality threshold. If the error is less than the materiality threshold, the entities should consider the transactions or balances to be adequately supported. If the error is greater than the materiality threshold, the reporting entities must design and implement corrective actions to remediate the documentation deficiency and then re-perform additional testing.

**Regardless of the sampling technique utilized, reporting entities must ensure that:**

1. **The sampling technique, sample sizes, and tolerable errors are defined before executing the sample,**
2. **All items in the population have an equal chance of being selected (through the use of random sampling), and**
3. **Samples are representative of the population; therefore, no material transactions or groups of transactions are excluded from the population.**

**When this testing is completed, as part of FIAR Methodology steps 1.4.5 and 3.1.1(c), reporting entities must retain testing documentation to allow for review during the *Validation Phase.***

## D.4 Document Retention Requirements

Document retention requirements applicable to Federal entities are included in the U.S. Code Title 44 and the National Archives and Records Administration (NARA) General Record Schedules. The Department has also developed supplementary guidance in DoDI 5015.2 and in the DoD FMR Volume 1, Chapter 9 – Financial Records Retention. However, these requirements do not emphasize the retention requirements of documents necessary to assert and support audit readiness.

As previously discussed, auditors performing government financial statement audits in the United States must adhere to professional standards, which have been codified as Auditing Standards (AUs). These AUs do not directly contain document retention requirements. Instead, they define evidential matter (i.e., supporting documentation) that auditors must obtain and test to form an opinion on the entity's financial statements.

Specifically, AU326 Audit Evidence paragraph .04 notes "… management is responsible for the preparation of the financial statements based on the accounting records of the entity. The auditor should obtain audit evidence by testing the accounting records, for example, through analysis and review, re-performing procedures followed in the financial reporting process and reconciling related types and applications of the same information." In paragraph .02, AU326 defines the term audit evidence as "… all information used by the auditor in arriving at the conclusions on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information." Accounting records, per AU326 paragraph .03, generally include "… the records of initial entries and supporting records, such as checks and records of electronic fund transfers, invoices, contracts, the general and subsidiary ledgers, journal entries, and other adjustments to the financial statements that are not reflected in formal journal entries, and records such as worksheets and spreadsheet supporting cost allocations, computations, reconciliations, and disclosures."

Accordingly, the document retention requirements to achieve auditability and reliable financial information are sometimes different and more stringent (longer duration) than the requirements set forth by the NARA General Records, the DoD Directives, and reporting entity-specific requirements. The retention requirements for auditability may be less stringent in some cases; therefore, reporting entities must apply to the most stringent record retention requirement.

## APPENDIX E – OMB CIRCULAR A-123, APPENDIX A CROSSWALK TO FIAR GUIDANCE

The following crosswalk demonstrates how the FIAR Guidance aligns with the requirements of OMB Circular A-123, Appendix A.

| OMB Circular A-123, Appendix A | FIAR Guidance |
|---|---|
| **I. SCOPE** | |
| A. Objectives of Internal Control over Financial Reporting | Section 1.B FIAR Methodology |
| B. Definition of Financial Reporting | Section 1.A FIAR Priorities and Strategy |
| C. Planning Materiality | **Appendix A**, Material Reporting Entities |
| D. Definition of Deficiencies | **Appendix D**, Section D.2.5 Identify, Evaluate and Classify Deficiencies |
| **II. ASSESSING INTERNAL CONTROL OVER FINANCIAL REPORTING** | |
| A. Establish a Senior Assessment Team | **Appendix B**, Section B.1.8 Reporting Entities' Senior Assessment Teams |
| B. Evaluate Internal Control at the Entity Level | **Appendix D**, Section D.1 Assessment of Entity Level Controls |
| 1. Control Environment | **Appendix D**, Section D.1 Assessment of Entity Level Controls |
| 2. Risk Assessment | **Appendix D**, Section D.1 Assessment of Entity Level Controls |
| 3. Control Activities | **Appendix D**, Section D.1 Assessment of Entity Level Controls |
| 4. Information and Communication | **Appendix D**, Section D.1 Assessment of Entity Level Controls |
| 5. Monitoring | **Appendix D**, Section D.1 Assessment of Entity Level Controls |
| C. Evaluate Internal Control at the Process, Transaction, or Application Level | Section 3.A.1 Discovery Phase, and **Appendix D**, Section D.2 Assessable Unit Internal Control Testing and Evaluation of Deficiencies |
| 1. Determine Significant Accounts or Groups of Accounts | Section 3.A.5, Discovery – Statement to Process Analysis and Prioritization, Tasks 1.1 and 1.2 |
| 2. Identify and Evaluate the Major Classes of Transactions | Section 3.A.5, Discovery – Prioritization, Tasks 1.2. |
| 3. Understand the Financial Reporting Process | Section 3.A.5, Discovery – Assess & Test Controls, Tasks 1.3.1 Identify Key Control Objectives |
| 4. Gain an Understanding of Control Design to Achieve Management's Assertions | Section 3.A.5, Discovery – Assess & Test Controls, Tasks 1.3.1 Identify Key Control Objectives and Task 1.3.2. Prepare Process and Systems Documentation |

| OMB Circular A-123, Appendix A | FIAR Guidance |
|---|---|
| 5. Controls Not Adequately Designed | Section 3.A.5, Discovery – Assess & Test Controls, Tasks 1.3.3. Prepare Control Assessment |
| 6. Test Controls and Assess Compliance to Support Management's Assertions | Section 3.A.5, Discovery – Assess & Test Controls, Tasks 1.3.4. Execute Tests of Controls, and **Appendix D**, Section D.2 Assessable Unit Internal Control Testing & Evaluation of Deficiencies |
| D. Overall Assessment of the Design and Operation of Internal Control over Financial Reporting | Section 2.F.1 Additional Reporting Requirements and **Appendix D**, Section D.2 Assessable Unit Internal Control Testing & Evaluation of Deficiencies |
| E. Reliance on Other Work to Accomplish Assessment | **Appendix D**, Section D.2.2 Prepare Control Assessment, Avoid Duplication of Efforts with Other Similar Activities |
| **III. DOCUMENTATION** | |
| A. Documenting Internal Control over Financial Reporting | Section 3.A.5, Discovery – Assess & Test Controls, Task 1.3.2. Prepare Process and Systems Documentation |
| B. Documenting the Assessment of Effectiveness | |
| **IV. MANAGEMENT'S ASSURANCE STATEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING** | |
| IV. Management's Assurance Statement on Internal Control over Financial Reporting | Section 2.F.1 Additional Reporting Requirements |
| A. Agencies Obtaining Audit Opinions on Internal Control | N/A |
| **V. CORRECTING MATERIAL WEAKNESSESS IN INTERNAL CONTROL OVER FINANCIAL REPORTING** | |
| V. Correcting Material Weaknesses in Internal Control over Financial Reporting | Section 3.A.1 Phases and Key Tasks, Corrective Action |
| **Exhibit 2: Sample Annual Assurance Statement on Internal Control over Financial Reporting** | |
| Sample Annual Assurance Statement | Section 2.F.1 Additional Reporting Requirements. |

## APPENDIX F – ACRONYM LIST

| Acronym | Definition |
|---|---|
| A&FP | Accounting and Finance Policy |
| AFR | Annual Financial Report |
| AICPA | American Institute of Certified Public Accountants |
| AMC | Army Materiel Command |
| AP | Accounts Payable |
| APSR | Accountable Property System of Record |
| AR | Accounts Receivable |
| ARRA | American Recovery and Reinvestment Act of 2009 |
| ASD | Assistant Secretary of Defense |
| AT&L | Acquisition, Technology and Logistics |
| AU | Auditing Standards |
| BEA | Business Enterprise Architecture |
| BIO | Business Integration Office |
| BTA | Business Transformation Agency |
| CAGE | Commercial and Government Entity Code |
| CAP | Corrective Action Plan |
| CFO | Chief Financial Officer |
| CIIC | Controlled Inventory Item Code |
| CMO | Chief Management Officer |
| DCFO | Deputy Chief Financial Officer |
| DCPS | Defense Civilian Pay System |
| DFAS | Defense Finance and Accounting Service |
| DIACAP | DoD Information Assurance Certification and Accreditation Process |
| DLA | Defense Logistics Agency |
| DoD | Department of Defense |
| DoD OIG | Department of Defense Office of Inspector General |
| DoDAAC | Department of Defense Activity Address Code |
| DoDI | Department of Defense Instruction |
| DPAS | Defense Property Accountability System |
| DUSD | Deputy Under Secretary of Defense |
| E&C | Existence and Completeness |
| ERP | Enterprise Resource Planning |
| ESOH | Environmental, Safety and Occupational Health |
| ETP | Enterprise Transition Plan |
| FAD | Funding Authorization Documents |
| FAM | Financial Audit Manual |
| FASAB | Federal Accounting Standards Advisory Board |
| FBWT | Fund Balance with Treasury |
| FFMIA | Federal Financial Managers' Improvement Act |
| FIAR | Financial Improvement and Audit Readiness |
| FIAR-PT | Financial Improvement and Audit Readiness- Planning Tool |

| Acronym | Definition |
|---|---|
| FIE | Financial Improvement Element |
| FIP | Financial Improvement Plan |
| FISCAM | Federal Information System Controls Audit Manual |
| FMFIA | Federal Management Financial Integrity Act |
| FMR | Financial Management Regulation |
| FMS | Financial Management Service |
| FY | Fiscal Year |
| GAGAS | Generally Accepted Government Auditing Standards |
| GAO | Government Accountability Office |
| GE | General Equipment |
| GF | General Fund |
| GMRA | Government Management Reform Act |
| GWA | Government-wide Accounting |
| HC | Human Capital |
| I&E | Installations and Environment |
| ICOFR | Internal Control over Financial Reporting |
| INV | Inventory |
| IPA | Independent Public Accountant |
| IPAC | Intra-governmental Payment and Collection |
| IRB | Institutional Review Board |
| ITCG | Information Technology General Controls |
| KCO | Key Control Objectives |
| KSD | Key Supporting Document |
| LM&R | Logistics & Materiel Readiness |
| LSN | Local Stock Number |
| MDAP | Major Defense Acquisition Program |
| ME | Military Equipment |
| MIPR | Military Interdepartmental Purchase Request |
| MOU | Memorandum of Understanding |
| NARA | National Archives and Records Administration |
| NAVFAC | Naval Facilities Engineering Command |
| NDAA | National Defense Authorization Act |
| NSN | National Stock Number |
| ODCMO | Office of the Deputy Chief Management Officer |
| ODO | Other Defense Organizations |
| OM&S | Operating Material & Supplies |
| OMB | Office of Management and Budget |
| OUSD(C) | Office of the Under Secretary of Defense (Comptroller) |
| PCIE | President's Council on Integrity and Efficiency |
| PEP | Property & Equipment Policy Office |
| PMO | Project Management Office |
| POAM | Plan of Actions and Milestones |
| PP&E | Property, Plant & Equipment |

| Acronym | Definition |
| --- | --- |
| REMIS | Reliability and Maintainability Information System |
| RFP | Request For Proposal |
| RIC | Routing Identifier Code |
| RMD | Resource Management Decision |
| RP | Real Property |
| RPUID | Real Property Unique Identifier |
| RSI | Required Supplementary Information |
| RSSI | Required Supplementary Stewardship Information |
| SAS | Statement on Auditing Standards |
| SAT | Senior Assessment Team |
| SBR | Statement of Budgetary Resources |
| SFFAS | Statement of Federal Financial Accounting Standards |
| SLA | Service Level Agreement |
| SMP | Strategic Management Plan |
| SOA | Statement of Assurance |
| SSAE | Statements on Standards for Attestation Engagements |
| SSN | Social Security Number |
| STANFINS | Standard Financial System |
| U.S. | United States |
| UDO | Undelivered Order |
| UFCO | Unfilled Customer Order |
| USACE | U.S. Army Corps of Engineers |
| USD(C) | Under Secretary of Defense (Comptroller) |
| USMC | United States Marine Corps |
| WCF | Working Capital Fund |

# APPENDIX G – GLOSSARY

**Auditability** – Management's ability to assert that its financial statements, a financial statement line item, or a process/sub-process has sufficient control activities and adequate documentation to undergo an examination or a financial statement audit by an independent auditor and obtain an opinion from the independent auditor, stating that the aforementioned items are free of material misstatement.

**Financial Statement Assertions** – Management representations that are embodied in transactions. The financial statement assertions can be either explicit or implicit and can be classified into the following broad categories:

*Existence and Occurrence*: Recorded transactions and events occurred during the given period, are properly classified, and pertain to the entity. An entity's assets, liabilities, and net position exist at a given date.

*Completeness:* All transactions and events that should have been recorded are recorded in the proper period. All assets, liabilities, and net position that should have been recorded have been recorded in the proper period and properly included in the financial statements.

*Rights and obligations*: The entity holds or controls the rights to assets, and liabilities are the obligations of the entity at a given date.

*Accuracy/valuation or allocation*: Amounts and other data relating to recorded transactions and events have been recorded appropriately. Assets, liabilities, and net position are included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments are properly recorded. Financial and other information is disclosed fairly and at appropriate amounts.

*Presentation and Disclosure*: The financial and other information in the financial statements is appropriately presented and described and disclosures are clearly expressed. All disclosures that should have been included in the financial statements have been included. Disclosed events and transactions have occurred and pertain to the entity.

**Assertion Documentation** – Documentation that demonstrates the reporting entity has designed and implemented control activities to limit the risk of material misstatements by meeting the Key Control Objectives, and supported account balances with sufficient and appropriate evidence defined as Key Supporting Documents. The documentation is compiled and formally submitted when a reporting entity determines that an assessable unit and/or financial statement is audit-ready.

**CAGE Code** – The CAGE Code is a five position code that identifies contractors doing business with the Federal Government, NATO member nations, and other foreign governments. The CAGE Code is used to support a variety of mechanized systems throughout the government and provides for a standardized method of identifying a given facility at a specific location. CAGE code system is administered by the Defense Logistics Information Service (DLIS).

**Corrective Action Plan** – A written document that spells out the specific steps a reporting entity will take to resolve a deficiency in its internal control, including targeted milestones and completion dates. Also referred to as a remediation plan, this plan is a result of following the requirements of OMBA Circular A-123, Appendix A. Integrate your corrective action plans into your entity Financial Improvement Plan (FIP).

**Deficiency** – A deficiency that 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 misstatements in a timely manner.

**Department of Defense Activity Address Code** – A six position code that uniquely identifies a unit, activity, or organization that has the authority to requisition and/or receive material. The first position designates the particular Service/Agency element of ownership. These codes are particularly important for Defense Department financial, contracting and auditing records.

**Enterprise Transition Plan** – A plan that organizes and prioritizes efforts to modernize DoD business, financial processes, systems, and tracks the transformation strategy to achieve the business architecture of the BTA.

**Examination** – An attestation engagement performed by auditors that consists of obtaining sufficient, appropriate evidence to express an opinion, in accordance with Generally Accepted Government Auditing Standards (GAGAS), on whether the subject matter is based on (or in conformity with) the criteria in all material respects, or the assertion is presented (or fairly stated), in all material respects, based on the criteria.

**Executive Agents** – The head of a DoD reporting entity to whom the Secretary of Defense or the Deputy Secretary of Defense has assigned specific responsibilities, functions, and authorities to provide defined levels of support for operations missions, or administrative or other designated activities that involve two or more of the DoD reporting entities.

**FIAR Governance Structure** – A top-down view of financial improvement and audit readiness, which includes roles and stakeholders, and provides the vision and oversight necessary to align financial improvement and audit readiness efforts across the department.

**FIAR Guidance** – A document that defines the Department's goals, strategy and methodology for becoming audit ready, including roles and responsibilities, and processes for reporting entities, service providers and executive agents.

**FIAR Methodology** – The Business Rules (presently referred to as the FIAR Methodology) including key tasks, underlying detailed activities and resulting work products that all reporting entities should follow to become audit ready.

**FIAR Plan** – The strategy for improving financial management, prioritizing needs, and identifying dependencies impeding auditability. The FIAR Plan has three goals: 1) provide timely, reliable, accurate, and relevant financial information to decision makers; 2) sustain improvements through an effective internal control program; and 3) produce auditable financial statements. The primary source of the FIAR Plan is the individual FIPs from material reporting entities.

**FIAR Plan Status Report** – A document published bi-annually that summarizes the current status, at a point in time, of the Department and its reporting entities in executing the FIAR Plan.

**FIAR Strategy** – The critical path for the Department's audit readiness and financial improvement efforts. The Strategy balances the need to achieve short-term accomplishments with the long-term goal of an unqualified opinion on the Department's financial statements.

**Financial Improvement Plans (FIPs)** – A standard framework/template that organizes and prioritizes the financial improvement efforts of the reporting entities and aligns to the FIAR Methodology. It provides a consistent, structured approach for measuring auditability progress, allows transparency into the challenges facing DoD, and highlights progress.

**Financial Management Information** – Information needed to manage the Department's mission critical assets.

**Financial Statement Audits** – Financial statement audits provide reasonable assurance through an opinion (or disclaim an opinion) about whether an entity's financial statements are presented fairly in all material respects in conformity with U.S. GAAP, or with a comprehensive basis of accounting other than U.S. Generally Accepted Accounting Principles.

**Generally Accepted Accounting Principles (GAAP)** – Standards, conventions and rules accountants follow in recording and summarizing transactions as well as the preparation of financial statements.

**Generally Accepted Auditing Standards (GAAS)** – Sets of standards against which the quality of audits is performed and may be judged.

**Key Capabilities** – Key indicators that that demonstrate a reporting entity's audit readiness.

**Key Control Objectives** – Objectives that capture the outcomes needed to achieve proper financial reporting and serve as a point against which the effectiveness of financial controls can be evaluated.

**Key Supporting Documents** – Documentation retained to demonstrate control activities are properly designed and operate to satisfy KCOs, as well support individual financial transactions and accounting events.

**Legacy Assets** – In order to effectively remediate new PP&E acquisition processes, reporting entities must begin by identifying the date by which they will be able to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions that will capture and sustain transaction based data that meet the historical cost valuation requirements of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. Assets acquired before that date are considered legacy assets.

**Material Reporting Entities** – All DoD reporting entities needed to achieve coverage of at least 99 percent of the Department's total Budgetary Resources or assets.

**Material Weakness** – A deficiency, or combination of deficiencies, in internal control, 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 (per AU Section 325.06).

**Mission Critical Assets** – Assets deemed necessary to perform the primary missions of the Department. For purposes of this definition, mission critical assets include: Military Equipment (e.g., ships, aircraft, and combat vehicles), Real Property (e.g., land, buildings, structures, and utilities), Inventory (e.g., rations, supplies, spare parts, and fuel), OM&S (e.g., ammunition, munitions, and missiles), and GE (e.g., training equipment, special tooling, and special test equipment).

**Mock SSAE 16 Attestation** – An alternative approach to undergoing an SSAE 16 attestation, in which similar procedures are applied to the service provider processes to determine whether there are any impediments to obtaining a "clean" SSAE 16 report. A mock SSAE No. 16 will include a description of the service organization's "system" and a written assertion from management of the service organization that fairly presents the service organization's system as designed and implemented throughout the specified period, and that the controls related to the control objectives stated in the description of the "system" for the service organization were suitably designed to achieve the control objectives as of the specified period. However, a mock SSAE No. report will not include an assurance report with an auditor's opinion on management's assertions.

**Reporting Entity** – An entity or fund within the Department of Defense that prepares stand-alone financial statements included in the DoD Agency-wide financial statements. All reporting entities are working to become audit ready or their financial statements are currently being audited.

**Routing Identifier Code (RIC)** – Codes assigned by services/agencies for processing inter-service/agency and intra-service/agency logistics transactions. The codes serve multiple purposes in that they are source of supply codes, intersystem routing codes, intra-system routing codes and consignor (shipper) codes.

**SSAE 16 attestation** – An attestation in accordance with Statement on Standards for Attestation Engagements (SSAE) No. 16, Reporting on Controls at a Service Organization. A SSAE No. 16 report includes the following three sections:

1. A description of the service organization's "system."
2. A written assertion from management of the service organization that fairly presents the service organization's system as designed and implemented throughout the specified period, and that the controls related to the control objectives stated in the description of the "system" for the service organization were suitably designed to achieve the control objectives as of the specified period.
3. A service auditor's assurance report.

SSAE No. 16 was finalized by the Auditing Standards Board of the AICPA in January 2010 and replaces SAS 70 as the authoritative guidance for reporting on service organizations for reports with an issue date of June 15, 2011 or later.

**Service Provider Auditor** – The auditor who is retained by the service provider to issue an opinion report on controls of the service provider that may be relevant to a reporting entity's internal control as it relates to an audit of financial statements (e.g., SSAE 16 attestation report).

**Service Provider** – The entity (or segment of an entity) that provides services to a reporting entity that are part of the reporting entity's manual and/or automated processes for financial reporting.

**Significant Deficiency** – A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance (per AU Section 325.07).

**Strategic Management Plan** – An executive overview of the Department's overall strategic planning and management framework. The National Defense Authorization Act for Fiscal Year 2008 called for a SMP to be issued by the Department of Defense in July 2008. The second SMP, published and delivered to Congress in July 2009, described the integrated activities representing the Department's performance management system. This integration has enabled the Department's leadership to increase productivity by focusing resources on the key levers that drive success. It establishes five high-level priorities for business operations.

**User Auditor** – The financial statement auditor who issues an opinion report on the financial statements of the reporting entity.