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## Defense Primer: FY2023 Department of Defense Audit Results

The Chief Financial Officers Act of 1990 (CFO Act, P.L. 101-576) requires annual audits of financial statements for federal agencies. Under the CFO Act, audits of federal agencies are the responsibility of the agency's inspector general (IG), but the IG may contract with one or more external auditors to perform the audit.

The Department of Defense (DOD) released the results of its sixth annual audit, FY2023, on November 15, 2023. DOD received a disclaimer of opinion, meaning auditors could not express an opinion on the financial statements because the financial information was not sufficiently reliable. The DOD's IG coordinated the agency-wide financial audit of DOD, covering \$3.8 trillion in assets and \$4.0 trillion in liabilities. The agency-wide audit was conducted by Independent Public Accounting (IPA) firms contracted by DOD IG. The IPAs conducted 29 separate audits within DOD.

Generally, the process and standards used to audit DOD are the same as those used to audit other federal agencies. Understanding why and how the DOD audit was conducted can help Congress evaluate the audit results and usefulness of the audit.

### Why an Audit?

Government entities, including the United States government as a unitary entity, issue annual reports that present their current financial position and condition, and discuss key financial topics and trends. An audit of the government's financial information provides accountability over government agencies' use of public resources to Congress, oversight bodies, and the public.

Financial audits aim to provide reasonable assurance that the audited entity's financial statements are free of material misstatements whether caused by error or fraud. DOD audits can provide critical insight into (1) the reliability of its financial data; (2) the efficiency and effectiveness of internal operations; and (3) its compliance with statutes and financial regulations. With such information, DOD and Congress could take steps to improve DOD's performance in these areas.

DOD's financial management has been on the Government Accountability Office's (GAO's) *High-Risk list* (HRL) since 1995. The HRL identifies areas that might be subject to fraud, waste, abuse, and mismanagement. In addition to the financial management, other aspects of DOD's operations that could affect the financial management are on the GAO's April 2023 HRL.

### How Are Audits Done?

For each line item on a financial statement and notes to the financial statement, an auditor examines a sample of underlying economic events to determine the accuracy of the information reported. The auditor is expected to give an unbiased opinion on whether the financial statements and related disclosures are fairly stated in all material respects for a given period of time in accordance with Generally Accepted Accounting Principles (GAAP). While the Federal Accounting Standards Advisory Board (FASAB) sets the financial reporting and accounting standards for the federal government, GAO is responsible for establishing auditing standards for federal agencies, including for federal grant recipients in state and local governments.

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Material misstatement in financial reporting can be defined as information on a financial statement that could potentially affect the reader's decision or the conclusions drawn by a reader about the financial status of an agency

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### Auditing Standards

GAO issues the Generally Accepted Government Auditing Standards (GAGAS), also commonly known as the "Yellow Book," which provides a framework for conducting federal government audits. Similar to the requirements in the private sector, GAGAS requires federal financial reporting to disclose compliance with laws, regulations, contracts, and grant agreements that have a material effect on the entities' financial statements. The GAGAS requires auditors to consider the visibility and sensitivity of government programs in determining the materiality threshold.

Some organizations within the federal government use a hybrid of external and internal auditors. Whether external or internal auditors perform the function, they are required to adhere to the standards established under GAGAS.

In addition to examining financial information, an audit evaluates management's assertion of internal control over financial reporting. Audit of internal control includes audit of computer systems at the entity-wide, system, and application levels. GAGAS recommends using specific frameworks for internal control policies and procedures, including certain evaluation tools created specifically for federal government entities.

### Types of Audit Opinions

Auditors form opinions by examining the types of risks an organization might face and the types of controls that exist to mitigate those risks. Once the risks and controls to mitigate those risks have been determined, the auditors will

examine supporting evidence to determine if management is presenting the financial statements fairly in all material respects. Although many entities in the federal government usually receive unmodified opinions, auditors may express other types of opinions based on the circumstances. There are four types of audit opinions:

**Unmodified Opinion.** An unmodified opinion (clean opinion) states that the financial statements present fairly, in all material respects, the consolidated balance sheets, related consolidated statements of net cost and changes in net position, combined statements of budgetary resources, and related notes to the consolidated financial statements in accordance with GAAP. This opinion is expressed in a standard report. In certain circumstances, explanatory language might be added to the auditor’s standard report, which does not affect the unmodified opinion.

**Modified Opinion.** A modified opinion states that, except for the effects of the matter(s) identified in the opinion, the financial statements present fairly in all material respects in conformity with GAAP.

**Adverse Opinion.** An adverse opinion states that the financial statement(s) do not present fairly in accordance with GAAP.

**Disclaimer of Opinion.** A disclaimer of opinion states that the auditor does not express an opinion on the financial statements. The auditor’s report should give all of the substantive reasons for the disclaimer. Some of the reasons for a disclaimer of opinion include financial statements not conforming to GAAP and financial management systems that are unable to provide sufficient evidence for the auditor to express an opinion.

Of the 29 standalone audits included in the FY2023 DOD audit, 18 received disclaimers of opinion; seven received unmodified opinions; one received a modified opinion; and three opinions were still pending as of November 2023, when the FY2023 audit was released.

## Limitation of Audits

Independent audit opinions provide reasonable assurance, but for the following reasons do not fully guarantee, that financial statements present fairly in all material respects:

- Auditors use statistical methods for random sampling and look at only a fraction of economic events or documents during an audit. It is cost and time prohibitive to recreate or sample them all.
- Audit procedures cannot eliminate potential fraud, though it is possible that an auditor may find fraud during the audit process.

## Considerations for Congress

**Assessing Root Causes.** DOD’s November 2023 audit oversight report identified five *root causes* that DOD considers focus areas for corrective action and process improvements: workforce modernization; business operations; quality decision-making; reliable networks; and enhanced public confidence. Congress may consider reviewing the results of the FY2023 DOD audit and using the findings to enhance oversight of DOD’s remediation of issues in these or other focus areas.

**DOD Financial Management Systems and Business Systems Modernization.** DOD’s FY2023 audit assessed compliance across 160 distinct financial management (FM) systems. GAO has assessed DOD FM systems as posing a high risk of fraud, waste, abuse, and mismanagement, alongside high-risk areas of business systems modernization, contract management and weapons system acquisition. GAO’s April 2023 *High Risk Series* report downgraded DOD’s Business Systems Modernization efforts due to stalled progress on agency action plans since 2021. DOD reports it is “revisiting its approach to business enterprise architecture.” Congress might consider clarifying the underlying causes of DOD’s stalled progress and the desired timeline and expected costs and benefits of achieving unmodified audit opinions.

**Logistics Information Systems.** DOD personnel providing information to auditors needed to consult over 400 distinct logistics information technology (IT) systems for the FY2023 audit. These systems contain essential information for building audit trails of DOD property, plant, and equipment assets, including cargo shipments. Congress might assess ongoing DOD efforts to consolidate logistics IT systems, standardize data structures, and automate the extraction of management information so assets are visible to DOD personnel and financial transactions affecting these assets are transparent and accessible to auditors in a timely manner.

**Assessing the Audit Workforce.** Congress might consider assessing institutional learning among IPAs and DOD IGs performing DOD audits. Comprehensive audits are labor and knowledge intensive, with approximately 1,600 auditors requiring DOD-specific knowledge in addition to security clearances and extensive international travel. It is not clear from publicly available documents how IPAs and IG leadership are mitigating common risks, such as workforce turnover, that might limit institutional learning specific to the conduct of DOD audits.

### CRS Resources

CRS Report R44894, *Accounting and Auditing Regulatory Structure: U.S. and International*, by Raj Gnanarajah  
 CRS In Focus IF10701, *Introduction to Financial Services: Accounting and Auditing Regulatory Structure, U.S. and International*, by Raj Gnanarajah

### Other Resources

Office of the Under Secretary of Defense (Comptroller)/ Chief Financial Officer, *Department of Defense Agency Financial Report FY 2023*, November 2023  
 Office of the Under Secretary of Defense (Comptroller)/ Chief Financial Officer, *Defense Budget Overview, Fiscal Year 2024 Budget Request*, March 2023  
 U.S. Government Accountability Office, *High-Risk Series, GAO-23-106203*, April 2023

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