NPS-CM-24-227

ACQUISITION RESEARCH PROGRAM
SPONSORED REPORT SERIES

Navy Agency Financial Reports: An Internal Control Analysis

June 2024

ENS Hannah S. McGivern, USN

Thesis Advisors: Dr. Juanita M. Rendon, Lecturer
Dr Rene G. Rendon, Associate Professor

Department of Defense Management

Naval Postgraduate School

Prepared for the Naval Postgraduate School, Monterey, CA 93943.

ACQUISITION RESEARCH PROGRAM
DEPARTMENT OF DEFENSE MANAGEMENT
NAVAL POSTGRADUATE SCHOOL

The research presented in this report was supported by the Acquisition Research Program of the Department of Defense Management at the Naval Postgraduate School.

To request defense acquisition research, to become a research sponsor, or to print additional copies of reports, please contact the Acquisition Research Program (ARP) via email, arp@nps.edu or at 831-656-3793.

Acquisition Research Program
Department of Defense Management
Naval Postgraduate School

ABSTRACT

This capstone research study aims to provide an in-depth analysis of the Navy Agency Financial Reports (AFRs), with a specific focus on internal control material weaknesses identified by external auditors. This study also specifically analyzes the auditor recommendations for contract management, seeking to identify the extent to which the Navy contractors contribute to internal control deficiencies. Furthermore, this research aligns the identified material weaknesses with the COSO internal control framework components. This seeks to identify the specific internal control components that contribute to these material weaknesses. The contract management material weakness was briefly discussed by identifying internal control deficiencies that contributed to the material weaknesses and the recommendations made by the external auditors. Through both qualitative and quantitative methodologies, this study aims to identify insights related to the Navy's financial controls and contract management. This research study's goal is to present recommendations to enhance the Navy's internal control program. This study contributes to the existing literature by addressing critical gaps in understanding the connection between internal control material weaknesses, contractor management, and their alignment with established control frameworks. This study may serve as a valuable resource for policymakers and practitioners in the realm of government financial management and contracting.

THIS PAGE INTENTIONALLY LEFT BLANK

ACKNOWLEDGMENTS

I would like to thank my thesis advisors, Professor Juanita Rendon and Professor Rene Rendon, as they took me on unexpectedly. Professor Juanita Rendon, thank you for taking the time to respond to all my miscellaneous emails along the way. I am very happy that I got to work with you throughout this process. You were such a big help regarding questions, information, and overall moral support. Thank you to my wife for being patient with me throughout this process and continuously pushing me to not procrastinate.

THIS PAGE INTENTIONALLY LEFT BLANK

NPS-CM-24-227

ACQUISITION RESEARCH PROGRAM
SPONSORED REPORT SERIES

Navy Agency Financial Reports: An Internal Control Analysis

June 2024

ENS Hannah S. McGivern, USN

Thesis Advisors: Dr. Juanita M. Rendon, Lecturer
Dr Rene G. Rendon, Associate Professor

Department of Defense Management

Naval Postgraduate School

Prepared for the Naval Postgraduate School, Monterey, CA 93943.

ACQUISITION RESEARCH PROGRAM
DEPARTMENT OF DEFENSE MANAGEMENT
NAVAL POSTGRADUATE SCHOOL

THIS PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF FIGURES

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF TABLES

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF ACRONYMS AND ABBREVIATIONS

AFR	Agency Financial Report
AGC(F)	Assistant General Counsel Fiscal
AP	Accounts Payable
ASN(FM&C)	Assistant Secretary of the Navy for Financial Management and Comptroller
BSO	Budget Submitting Offices
CFO	Chief Financial Officers
CFOA	Chief Financial Officers Act
CFS	Consolidated Financial Statements
COSO	Committee on Sponsoring Organizations of the Treadway Commission
DFAS	Defense Financial and Accounting Service
DOD	Department of Defense
DODIG	Department of Defense Inspector General
DON	Department of the Navy
EDL	Environmental and Disposal Liabilities
ERM	Enterprise Risk Management
EY	Ernst and Young
FASAB	Federal Accounting Standards Advisory Board
FBwT	Fund Balance with Treasury
FFMIA	Federal Financial Management Improvement Act
FIAR	Financial Improvement and Audit Readiness
FMA	Financial Management Administration
FMB	Office of Budget
FMFIA	Federal Managers' Financial Integrity Act
FMO	Office of Financial Operations
FMS	Financial Management Service
FRUSG	Financial Report of the United States Government
FY	Fiscal Year
GAGAS	Generally Accepted Government Auditing Standards

GAO	Government Accountability Office
GMRA	Government Management Reform Act
IPA	Independent Public Accountants
IRB	Institutional Review Board
IRM	Integrated Risk Management
MICP	Managers' Internal Control Program
NAS	Naval Audit Service
NCMA	National Contract Management Association
NDAA	National Defense Authorization Act
ODCFO	Office of the Deputy Chief Financial Officer
OMB	Office of Management and Budget
PII	Personal Identifiable Information
PP&E-GE	Property, Plant & Equipment – General Equipment
SCRD	Secretariat Comptroller and Resources Department
SEC	Securities Exchange Commissions
SFFAC	Statement of Federal Financial Concepts
USSGL	United States Standard General Ledger

I. INTRODUCTION

A. BACKGROUND

The foundation for agency financial reporting in the Department of the Navy (DON) was established due to numerous different acts including the Chief Financial Officers (CFO) Act of 1990, the Government Management Reform Act (GMRA) of 1994, and subsequent amendments (Colgren, 2019). These laws mandated all federal agencies to produce annual agency financial reports (AFRs) to enhance transparency, accountability, and oversight in financial management. The main organizer for AFRs is the Assistant Secretary of the Navy for Financial Management and Comptroller (ASN[FM&C]; U.S. Department of Defense, n.d.). The ASN(FM&C) oversees financial management activities, including preparing financial statements and reports, and leading over 9,200 financial managers (Financial Management and Comptroller, n.d.-b). These reports include detailed descriptions of financial performance, budget execution, information on internal controls, audit findings, and remediation efforts.

In the fiscal year (FY) 2010 National Defense Authorization Act, provisions were enacted which authorized funding and outlined policies for the Department of Defense (DOD). These provisions highlighted the importance of the DOD in attaining audit readiness. This Act also set a goal for achieving this readiness by the conclusion of FY 2017, which was not met (GAO, 2023, p. 11). Concurrently, the DOD Comptroller issued the *Financial Improvement and Audit Readiness (FIAR) Guidance* (Government Accountability Office, 2011). This guidance outlined and milestones for guiding the DOD toward auditability, including multiple initiatives to enhance financial management practices and internal controls (Office of the Under Secretary of Defense [Comptroller]/Chief Financial Officer, 2017). The synchronized implementation of legislative directives and strategic guidance marked a collective effort to instill greater transparency, accountability, and fiscal stewardship within the DOD's financial management framework.

As of FY 2017, the DON has undergone extensive external audits that have revealed a concerning prevalence of material weaknesses. As stated by UC [University of California] Santa Barbara Business & Financial Services (n.d.), "a material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected" (p. 1). These material weaknesses highlight the notable deficiencies within the industry's Committee of the Sponsoring Organizations of Treadway Commission (COSO) internal control integrated framework (hereafter referred to as the COSO framework) adopted by the DON in 2004 and was updated in 2014 (GAO, 2004). The COSO framework is an internal control model for evaluating and improving internal control systems with "five key components of internal controls: control environment, risk assessment, control activities, information/communication, and monitoring activities" (COSO, 2023).

Material weaknesses significantly affect the DON's ability to fulfill its mission and effectively manage its resources. They also have severe repercussions in the public eye as taxpayers lose their trust in the DOD's ability to effectively manage their money. Research that helps analyze these internal control material weaknesses can help the DON enhance its operational efficiency, increase its accountability and transparency, and mitigate its fraud risks. Applying the COSO Framework to the DON AFRs and conducting a comparative analysis of material weaknesses and the internal control deficiencies related to the material weakness may help the DON understand the problems within the DON's AFRs.

The DON's AFRs offer in-depth examinations of material weaknesses that cover numerous topical areas, including financial reporting, inventory management, information systems, and contract management. This research focuses on comparing and analyzing the DON's material weaknesses from FY 2018 to FY 2022. Within the material weaknesses, there are significant deficiencies related to internal controls that are also compared and analyzed. This research briefly focuses on contract management-related material weaknesses and recommendations. According to the *Contract Management Body of Knowledge* (CMBOK; National Contract Management Association [NCMA], 2019), the

contract life cycle includes the pre-award, award, and post-award phases, which are distinct activities that both buyers and sellers undertake. The pre-award activities include planning and formulation of proposals. The award phase entails analyzing those proposals, contractor negotiations, and the final selection. Finally, the post-award activities center around the administration work of contractors, the compliance with federal regulations, and the eventual contract closeout (NCMA, 2019).

Despite progressing through these contract management phases, the DON still confronts persistent challenges related to fraud and material weaknesses in its contract management practices. Historical instances, such as the Fat Leonard scandal, highlight the DON's vulnerability to misconduct in its handling of contract affairs. Analyzing the material weaknesses outlined in the AFRs is imperative to recognize potential links to contract management deficiencies and to solidify the DON's overall financial integrity (NCMA, 2019).

B. PURPOSE OF RESEARCH

The purpose of this research is to conduct a comparative analysis of the DON AFRs. Specifically, the research analyzes the internal control material weaknesses identified by external auditors. Additionally, the material weaknesses are aligned with the COSO framework to determine which internal control components contributed to those material weaknesses. The material weaknesses and the auditor's recommendations for these weaknesses are then further analyzed to determine to what extent the DON's contract management contributes to the material weaknesses. Recommendations for improving the DON's internal control program and contract management are presented.

C. RESEARCH QUESTIONS

This research study will answer the following questions:

1. What internal control material weaknesses were identified in the DON AFRs?
2. Based on the analysis of material weaknesses for all FYs, how do they align with the COSO Framework internal control components?

3. Based on the analysis of material weaknesses, what recommendations are identified for the DON's improvement of internal controls and contract management?

D. METHODOLOGY

The dataset analyzed in this research encompasses DON AFRs from FY 2018 to FY 2022, highlighting material weaknesses identified by external auditors. Each material weakness was broken down into its associated significant deficiencies, highlighting systemic issues in the DON's financial management, such as insufficient oversight and inadequate internal controls. These material weaknesses compromise the accuracy of financial statements and impede operational efficiency and accountability in managing financial and physical assets. Initially, each control deficiency was linked to an internal control component: "control environment, risk assessment, control activities, information and communication, and monitoring activities" —allowing for an analysis of the DON's internal control mechanisms (COSO, 2013).

To facilitate an understanding of trends and patterns, quantitative data on the control deficiencies were aggregated and visually represented using multi-series bar graphs and pie charts in Microsoft Excel. These graphs show the distribution and frequency of internal control issues across the FYs. This approach provided a clear depiction of areas requiring concentrated improvement efforts. Additionally, a cumulative analysis spanning all FYs combined the data to display trends in material weaknesses and control deficiencies, offering government officials a straightforward way to evaluate the implementation of corrective measures over time. This comprehensive analysis using charts and graphs aids in showing persistent challenges and guides future enhancements in the DON's internal control systems. This research provides a brief analysis of the material weakness and recommendations from auditors related to contract management. Within this research, no personal identifiable information (PII) collected, and Institutional Review Board (IRB) determined that this research does not involve human subjects.

E. LIMITATIONS OF THE RESEARCH

One significant limitation of this research is its reliance on the DON AFRs from FY 2018 to FY 2022 as the primary data source. While these reports provide a reliable overview of identified material weaknesses and significant deficiencies, they may not capture all aspects of internal control issues due to the inherent limitations of audit processes and reporting standards. External audits, although thorough, can sometimes miss issues that internal audits or other oversight mechanisms might identify.

Additionally, the research focuses predominantly on contract management-related recommendations to material weaknesses, which might overlook other critical areas of financial management that could influence internal controls overall. This analysis also means that recent developments or improvements in internal controls post-FY 2022 are not considered, potentially skewing the findings. Furthermore, the interpretation of qualitative data and alignment with the COSO framework could introduce subjectivity, despite efforts to maintain objectivity through systematic categorization and analysis. These limitations suggest that while the findings provide valuable insights, they should be considered.

F. IMPORTANCE OF THE RESEARCH

This research analyzed multiple internal control material weaknesses were identified in DON AFRs by focusing on areas of control failure vulnerabilities. It addresses critical questions that directly impact the DON's financial management material weaknesses and the specific deficiencies within those material weaknesses. This research also analyzes the recommendations only related to contract management. The importance of this research study is that it may identify problems within internal control material weaknesses which can lead to recommendations to improve financial vulnerabilities, accountability, and operational effectiveness and readiness. This research is directly related to financial management as well as contract management.

G. ORGANIZATION OF STUDY

The organization of this research includes five chapters: Chapter I: Introduction, Chapter II: Literature Review, Chapter III: Methodology and Data, Chapter IV: Findings,

Analysis and Recommendations, and Chapter V: Conclusion and Areas for Further Research. Chapter I provides a background on the necessity of financial reporting and internal controls within the DON. It outlines the legislative and strategic framework governing financial operations, emphasizing goals for achieving transparency and accountability in financial management. Chapter II reviews existing scholarly work and relevant government documents related to financial reporting, auditability, audit practices, and internal controls. Chapter III describes the methods used to analyze the DON's AFRs. It details the approaches for identifying and categorizing internal control material weaknesses, the data collection process, and the techniques used to evaluate the data. Chapter IV presents the findings from the analysis of internal control material weaknesses identified in the AFRs and their alignment to the COSO Framework internal control components. It discusses the prevalence and trends of material weaknesses over the years, highlighting the most significant weaknesses. It also provides implications of the findings and recommendations based on the findings. Chapter V includes a summary, the conclusions drawn from the research, and the outlines of potential areas for further research.

H. SUMMARY

This chapter provided an overview of the legislative foundation for financial reporting in DON. The chapter discussed research purpose and research qualities. This research focused on the deficiencies in internal controls and the alignment of the material weaknesses with the COSO internal control framework components. The methodology was also provided which involved quantitative data analysis and visual representation to identify trends and deficiencies. The chapter also acknowledged research limitations such as reliance on AFRs and potential subjectivity in data interpretation, emphasizing the importance of the research for improving financial and contract management practices in the DON. This chapter also discussed the organization of this research paper.

II. LITERATURE REVIEW

A. INTRODUCTION

This chapter includes an examination of the auditability theory to contextualize industry best practices. The chapter then transitions to auditing and financial management within the DON, beginning with the creation of financial reporting practices within the DON and the significance of DOD and DON financial reports. It also discusses government financial reports and provides an exploration of the roles of those making these reports and an evaluation of the data they provide, which informs strategic decisions and highlights material weaknesses in financial practices. Additionally, the chapter provides the DOD's efforts towards a clean opinion from external auditors. This chapter then addresses internal controls, emphasizing management responsibilities, Office of Management and Budget (OMB) Circular A-123, and auditing standards such as Generally Accepted Government Auditing Standards (GAGAS). Finally, the chapter transitions into contract management, detailing each phase from pre-award to post-award and emphasizing the procedural frameworks that ensure effective and accountable contract execution within the DON. The following section addresses the auditability theory as the theoretical foundation of this research study.

B. AUDITABILITY THEORY

The auditability theory examines how well a system, organization, business, or corporation allows for deviations from established mechanisms (Grigoryan, 2023). This theory assesses the transparency and detectability of actions within a system to ensure integrity and accountability. For instance, in allocation mechanisms, auditability helps determine how easily participants or third-party auditors can identify deviations from planned processes. The theory provides a framework to compare and enhance the auditability of various mechanisms in different applications. The auditability theory looks at whether an organization is auditable. This framework for the auditability theory includes the auditability triangle which has three main components: "competent personnel, capable processes, and effective internal controls" (Rendon & Rendon, 2015a).

1. Auditability Triangle

Rendon & Rendon (2015a) describe the auditability triangle as "a conceptual framework that includes competent personnel, capable processes, and effective internal controls" (p. 1). These components and their relationships are shown in Figure 3.

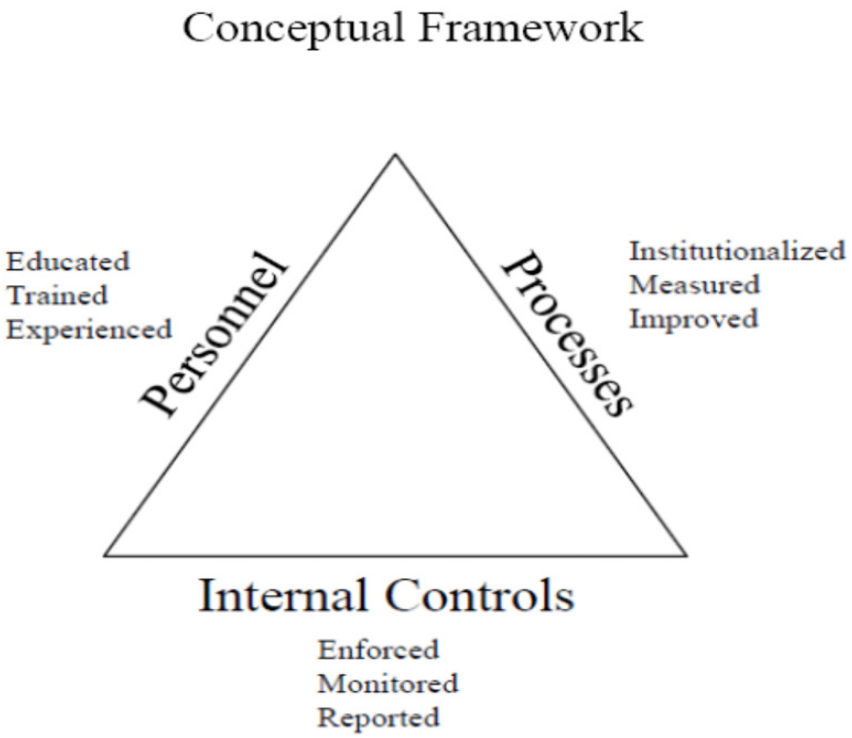

Figure 1. Conceptual Framework for the Auditability Triangle. Source: Rendon and Rendon (2015).

One component of the auditability triangle is competent personnel. Rendon & Rendon (2015-a) describe competent personnel as "those with necessary education, training, and experience requirements for each functional area" (p. 716). This helps to uphold the financial reporting process's efficiency and integrity. A high-level of expertise helps ensure more accurate financial statements that comply with standards and reflect the organization's financial health. Competent personnel can help build stakeholder confidence and secure the organizations long-term sustainability.

Another component of the triangle is capable processes, which must be firmly established, continuously monitored, and progressively enhanced to support accurate and reliable financial reporting (Rendon & Rendon, 2015-a). According to the Sarbanes-Oxley Act, robust financial processes are essential for preventing errors and fraud in financial statements (Sarbanes Oaxley Act, 2002). Capable processes help ensure transparency, minimize errors, and foster a culture of accountability within organizations. Thus, by continuously improving these processes, organizations can comply with legal requirements more accurately while also providing more trust and transparency with their stakeholders.

The third component represents effective internal controls, which are essential for enforcing policies, monitoring activities, and reporting internal control deficiencies (Rendon & Rendon, 2015-a). These internal controls are critical in providing a systematic method to evaluate and improve the efficiency of an organization. A strong internal control system not only detects and prevents inaccuracies and fraud, but also enhances the reliability of financial reporting (RiskOptics, 2022). Effective internal controls are important for achieving financial and operational objectives and ensuring accurate financial statements. The focus of this research is on the internal control component of the auditability triangle.

Overall, the auditability triangle is vital for organizations aiming for audit readiness. It shows the importance of a strong internal controls as advocated by the COSO framework (Rendon & Rendon, 2015-a). The auditability triangle is very important as it can be applied to any organization, corporation, business, or agency. The next section in this chapter will discuss auditing within the government, specifically related to the DON.

C. AUDITING

For the DOD and the DON, having strong internal controls is critical for achieving audit readiness. These controls are vital for ensuring that personnel within the DON can effectively manage and mitigate risks that lead to material weaknesses. Effective internal controls lead to the securing of essential financial data, ensuring the presence of adequate supporting documents, providing reliable data, and enhancing communications with auditors. These measures are fundamental in enabling the DON and the DOD to address

and navigate audit readiness, ultimately influencing the DONs capability to meet audit requirements effectively.

1. DON Audit Reports and Integrated Audits

The DON conducts integrated audits to examine both its financial statements and the effectiveness of its internal controls (Blackline, n.d.). These audits are carried out by both internal auditors, who are DON employees, and external auditors, who are employees of independent organizations. The use of internal and external auditors helps ensure that the financial records accurately reflect the DONs fiscal state and that internal controls are implemented effectively. Integrated audits help to identify areas where financial processes can be improved and where compliance with regulations may be lacking, providing a clear path for corrective actions.

Audit reports generated from these integrated audits offer an overview of the DON's financial health and operational integrity. Auditors provide an opinion based on their evaluation of the DON's financial statements and the effectiveness of its internal controls. Typically, this opinion can have two different outcomes: unmodified or modified. An unmodified opinion indicates that the financial statements abide by accounting standards and are presented accurately. On the other hand, a modified opinion indicates that there are significant issues, whether it is related to financial reporting, financial statements, or operations. These audit reports are crucial for senior DON officials and policy-makers, providing them with a foundation that is reliable for making informed decisions and ensuring that the DON adheres to high standards of financial accountability and transparency.

2. Generally Accepted Government Auditing Standards (GAGAS)

GAGAS, commonly known as the Yellow Book (2024), include guidelines for auditors to follow when conducting government audits. Seattle Inspector General Lisa Judge states that GAGAS "sets the foundation for conducting audits with integrity, objectivity, and independence in the government" (Office of Inspector General, n.d.). Established by the GAO in 1972, GAGAS are designed to be applied across governmental

audits to ensure accountability and transparency within federal, state, and local governments. The establishment of GAGAS was driven by the necessity to adopt a set of auditing standards that would direct government auditors in managing public funds with efficiency and integrity. These standards have been updated periodically to incorporate changes in the auditing environment, technological advancements, and best practices in the field of government auditing. The GAGAS encompasses various types of audit processes such as performance evaluations and attestations, which highlight the dynamic development of governmental accountability frameworks (Office of Inspector General, n.d.). The GAGAS has adopted the Generally Accepted Auditing Standards (GAAS) used in industry.

3. Internal Auditors in the DON

The Naval Audit Service (NAS), established in 1966, is an independent auditing entity that seeks to ensure the accuracy and integrity of the DON AFRs. The NAS conducts audits to assess the financial management practices and internal control systems across various naval commands and activities (NAS, 2024). These audits are conducted to uncover potential risks, assess the effectiveness of internal control implementation, and ensure that DON leadership can trust the financial data shown in AFRs. The NAS (2024) has the following mission statement: "To improve program and operational efficiency and effectiveness while mitigating risk in support of our Sailors, Marines, Civilians, and their Families" (p. 1).

The Auditor General of the Navy, a position currently held by Donjette L. Gilmore, is the DONs senior audit official aad responsible for the implementation of internal auditing functions (NAS, 2024). The Auditor General reports directly to the Under Secretary of the Navy. The Auditor General is a highly experienced and qualified professional with extensive expertise in financial management, auditing, and government accountability. The Auditor General's office sets audit priorities, confirms compliance with auditing standards, and provides independent and objective assessments of the DONs financial operations. The Auditor General's and the NAS's (2024) main goal is to "uphold the highest standards of integrity and accountability in the management of naval resources" (NAS, 2024).

4. External Auditors in the DON

Ernst and Young (EY) is the current external auditor for the DON, having been awarded a 5-year contract by the Defense Finance and Accounting Service (DFAS; n.d.), with a total value of $263.4 million. This contract is part of the effort by the DON to reach full audit readiness, outlined by a 2014 DOD report, which was to have been achieved by the end of FY 2017 (Hoffman, 2017). Prior to FY 2016, the audit contract for FY 2015 was held by Cotton & Company. The shift from Cotton & Company to EY was driven by the necessity to expand the audit's scope to fulfill the DOD's goal of audit readiness. As an independent public accounting firm, EY's audit services are conducted under the influence of the DOD Office of Inspector General (OIG; Hoffman, 2017). This allows for the assurance of integrity and oversight in the auditing process. In FY 2021, Defense officials released a new date to achieve audit readiness: FY 2028. According to the Federal News Network (2021), FY 2028 "coincides with the current schedule for DOD officials to finish implementing corrective action plans to address the material weaknesses the first few audits have identified."

5. The Preparation Process of DOD Financial Statements for Auditing

The DOD engages in a financial statement preparation and auditing process to aid in the accuracy and accountability in its financial reporting. The DOD OIG manages this process and coordinates the process with DFAS. DFAS compiles the financial data submitted by various DOD components and is tasked with standardizing this data (DOD, 2023). After analyzing the data, DFAS produces consolidated financial statements that include the elimination of intradepartmental transactions. These financial statements are then reviewed by the Office of the Deputy Chief Financial Officer and are included in the AFR. Figure 4 shows the basic process of how DOD financial statements are prepared using the guidance of the GAO. It shows the importance of DFAS within the audit readiness process (GAO, 2023, p. 11).

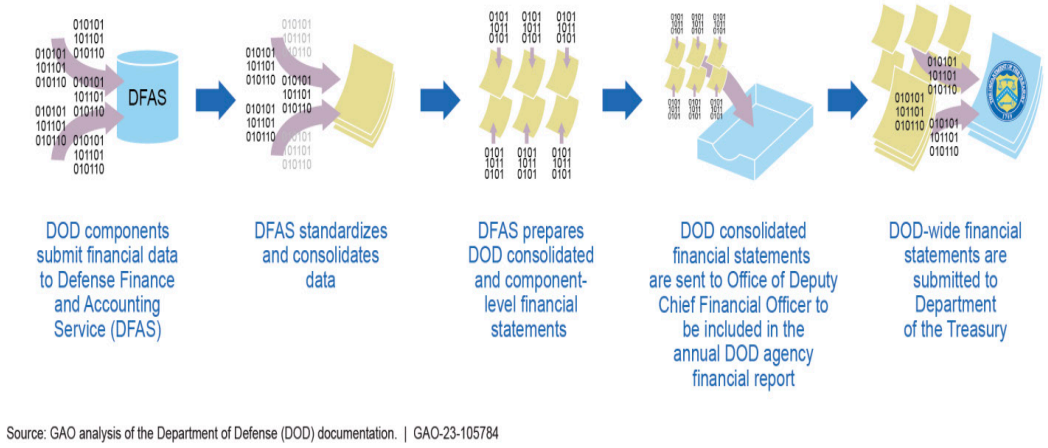

Figure 2. Example of DOD Financial Statement Preparation Process. Source: GAO (2023, p. 11).

To further validate and audit these financial statements, the DOD OIG contracts independent public accountants (IPAs) for component audits of different DOD entities (DOD, 2023). These IPAs conduct audits following established standards. The DOD OIG oversees the accountants' efforts to guarantee adherence to contract requirements and auditing guidelines. By consolidating the audit findings, the DOD OIG reinforces the overall audit conclusions presented in the DOD's financial statements.

Annually, by November 15, DFAS ensures that the DOD's consolidated financial statements are forwarded to the Treasury (Comptroller, 2022). These statements are then integrated into the one financial statement that represents the entire U.S. government. After all of the financial documents are merged, the Treasury and the OMB are responsible for presenting the fully audited U.S. government financial statements to the President and Congress 6 months after the FY ends on September 30 (GAO, 2023, p. 11). However, the GAO (2023) has been unable to effectively audit and approve the financial reports of the U.S. government due to recurring financial management problems within the DOD.

6. DOD's Roadmap for Financial Auditability

The DOD has encountered significant challenges in achieving an unmodified opinion, also referred to as clean audit opinion, largely due to the limitations of its financial

management systems. These systems, some dating back to the 1960s, were not originally designed to meet modern financial management needs or current accounting and reporting requirements (DFAS, n.d.). This has led to a situation where the DOD struggles to compile and report financial data that is both accurate and within contemporary standards. The DOD's outdated systems also fall short of the FFMIA of 1996, which dictates the necessary financial management and reporting capabilities (DFAS, n.d.).

The DOD has been working on achieving financial auditability in all its agencies and departments since FY 2017. This effort is reflected in its ongoing efforts and regular reports like the FIAR report. This initiative is a response to the complexity of the DOD's financial environment and the challenge of achieving a clean audit opinion. The DOD involves complex issues that need enhancement to achieve audit readiness. It currently struggles with the reconciliation of financial processes, controls, and systems across the board. The goal of the DOD is to improve financial management and accountability within the DOD (U.S. Department of Defense, 2023).

Efforts to modernize financial systems have been halted by insufficiently detailed plans for the transition to newer, compliant systems. Even with recognition of the risks posed by legacy systems and moves to address them, the DOD still reported material weaknesses as of FY 2022. The persistence of these outdated systems stands as a considerable obstacle in the path toward clean financial audits, emphasizing the need for modernization initiatives and comprehensive, detailed migration strategies (GAO, 2023, p. 29). While this is the main obstacle noted in the DOD AFR for FY 2023, there are 77 material weaknesses across 24 assessable units. These material weaknesses include entity level controls, equipment assets, real property assets, inventory, internal use software, IT, contract administration as well as numerous others (U.S. Department of Defense, 2023). The most recent developments and plans regarding the DOD's roadmap to financial auditability are detailed in Figure 3 (GAO, 2023, p. 30).

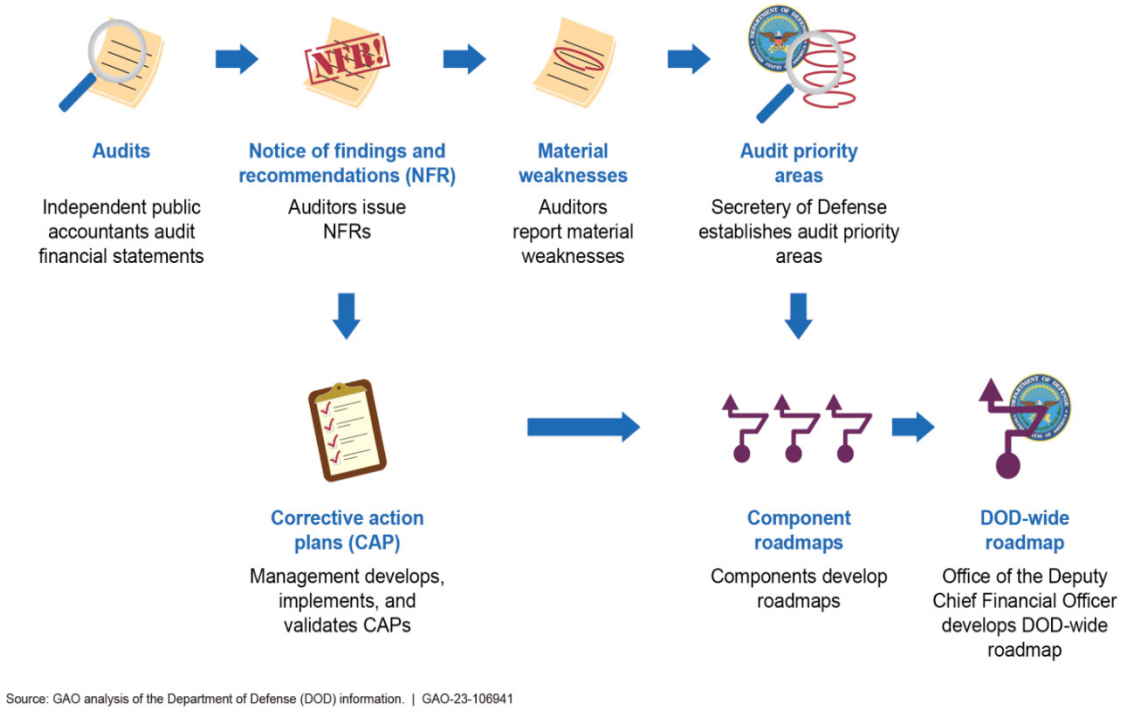

Figure 3. DOD-Wide Roadmap. Source: GAO (2023, p. 30).

7. DOD's Financial Improvement and Audit Readiness (FIAR) Program

The DOD FIAR program was created to mitigate the DOD's financial management issues and help guide it towards audit readiness (Office of the Under Secretary of Defense, 2017). It is designed to ensure that the DOD's financial statements are dependable, precise, and capable of withstanding an audit. The program sets guidelines and procedures to enhance the departments financial practices, including modernizing systems, improving processes, and reinforcing accountability (D'Anjou, 2017). Through the FIAR program, the DOD aims to provide more accurate financial information to aid in decision-making and demonstrate accountable use of taxpayer funds. The program is an ongoing effort that requires collaboration across various DOD agencies and components. The next section discusses the background and content included in government financial reports.

D. GOVERNMENT FINANCIAL REPORTS

The *Financial Report of the United States Government* (FRUSG) is a document that consolidates the AFRs of various component entities within the federal government. These component entities include numerous organizations, ranging from core departments like the DON to independent agencies such as the Securities and Exchange Commission (SEC). The consolidation of all financial statements from government agencies into one singular, government-wide report allows for transparency to the taxpayers. It also enables an assessment of the overall financial health and sustainability of the government (Bureau of the Fiscal Service, n.d.-b).

The FRUSG upholds standards of accuracy and reliability, reinforcing its credibility, through audits conducted by the Government Accountability Office (GAO) (GAO, 2011). Through collaboration and coordination of all government agencies, there is a strong commitment to achieving a comprehensive understanding of the nation's fiscal landscape. The FRUSG has evolved into an important publication (GAO, 2018). Over its nearly 30 years of publication, the FRUSG has undergone numerous refinements and improvements (Bureau of the Fiscal Service, n.d.-b). It has responded to the evolving complexities of government finance and has incorporated best practices in financial reporting. The FRUSG has become an important document for policy-makers, financial analysts, and the public (Bureau of the Fiscal Service, n.d.-b). It allows insight for decision-making, fiscal oversight, and the use of public resources.

1. History of Agency Financial Reports

As mentioned by the Federal Accounting Standards Advisory Board (FASAB; n.d.), "The Budget and Accounting Act of 1950 had provided for the GAO to set accounting standards for federal agencies. GAO subsequently published such standards as 'title 2' of its Policies and Procedures Manual for the Guidance of Federal Agencies." (p. 2). Most of the government agencies implemented the standards put forth by FASAB, but the OMB did not mandate the adoption. It was not until 1990 that the federal government officially adopted the FASAB (n.d.).

The Consolidated Financial Statements, now formally referred to as the Prototype Financial Report, date to FYs 1973 and 1974 (U.S. Department of the Treasury, 1975). It was during this time that the audit firm Arthur Andersen started reviewing and auditing the government's financial documents. Later, the Secretary of the Treasury became responsible for the Prototype Financial Report in FY 1975, transitioning all guidance to the Department of the Treasury (hereafter referred to as the Treasury). Within the Treasury, the Financial Management Service (FMS) performed the routine accounting procedures required for the production and consolidation of the Prototype Financial Report (U.S. Department of the Treasury, 2024). In 2012, the FMS merged with the Bureau of Public Debt which became the Bureau of Fiscal Service (Congressional Research Service, 2023, p. 16). This marked a foundational moment in the evolution of federal financial reporting.

Under the Secretary of the Treasury at the time, William Simon, development of the Prototype Financial Report gained strategic direction and emphasized the need for an informative financial document (U.S. Department of the Treasury, 1975). To ensure its efficacy, the Treasury formed a distinguished blue-ribbon panel comprising of experts in financial reporting (U.S. Department of the Treasury, 2024). The advice on structure and substance provided by this panel contributed to establishing a foundation for the future development of the Prototype Financial Report (McDonough & Warren, 2022). Throughout the remainder of the 1970s and the entirety of the 1980s, the report maintained an annual publication frequency. In FY 1982, the Federal Managers' Financial Integrity Act (FMFIA) was passed. This established the requirement for ongoing evaluations and documentation concerning the efficiency of internal financial and managerial oversight mechanisms (Federal Managers' Financial Integrity Act [FMFIA], 1982).

During this period of financial reporting, the regulatory structure for federal government financial reports was still in development. Despite this, the Treasury contracted out to independent accounting organizations such as Arthur Andersen and Price Waterhouse (Bureau of Government Financial Operations, 1976). These external entities were tasked with reviewing procedures related to the collection of source data and documentation, reflecting a commitment to upholding standards in the absence of a formalized regulatory architecture (Bureau of Government Financial Operations, 1976).

The commitment to seeking external expertise, the influence of key leaders like Secretary Simon, and the establishment of foundational practices during this period all helped shape the evolution of the Prototype Financial Report.

In the early 1990s, AFRs underwent significant developments that solidified both structural framework and the required content. These enhancements ensured that financial documents outlined the financial activities and positions of each government agency. These documents detail budgetary performance, financial management, and adherence to accounting standards. This shift was started due to new requirements outlined in the CFO Act of 1990 and the GMRA of 1994 (Office of Inspector General, 2023). At the same time, additional changes were driven by the requirement to conform to the accounting norms created by the FASAB, also referred to as the Board. According to the National Archives and Records Administration (2009), "the establishment of FASAB in 1990 occurred due to the efforts of the Secretary of the Treasury, the director of the OMB, and the Comptroller General of the United States, who leads the General Accountability Office" (GAO). This initiative aimed to establish accounting standards for the government, which provides the structural basis for creating the financial reports required by the CFO Act of 1990. The CFO Act of 1990 highlighted the necessity for advanced financial management strategies across federal institutions.

The enactment of the CFO Act in 1990 resulted in the creation of 14 Chief Financial Officers (CFOs) in departments at the cabinet level and an additional 10 CFOs in federal agencies (Chief Information Officers Council, 2024, p. 4). At the end of FY 1993, the FASAB created the Statement of Federal Financial Accounting Concepts (SFFAC). According to Federal Accounting Standards Advisory Board (1993), there are "four primary objectives of financial reporting which included budget integrity, evaluating operating performance, stewardship, and systems and control" (p. 2). This document has been refined over time through three updates, enhancing the structure of federal financial accounting practices (U.S. Department of Commerce, 2021). In FY 1994, the GMRA brought further revisions to the CFO Act of 1990, broadening its scope to include all principal agencies and mandating them to produce fully audited financial statements that reflect their complete range of activities. CFOs were tasked with the responsibility of

annually submitting audited consolidated statements to the OMB, ensuring the provision of "complete, consistent, reliable, and timely information" to the public and holding government agencies accountable (Chief Information Officers Council, 2024, p. 4). CFOs were tasked with the responsibility of annually submitting audited consolidated statements to the OMB, "ensuring that accurate and timely financial statements and reports are prepared and distributed to stakeholders" (Artsyl, n.d.).

In 1996, Congress passed the Federal Financial Management Improvement Act (FFMIA; U.S. Department of Commerce, 2021). This act required government agencies to complete the necessary financial statements to conduct audits, assessing their financial systems' "compliance with federal requirements, accounting standards, and the Government General Ledger" (DOD, 2023). In FY 1997, the U.S. government made its first official attempt to create a cohesive account of financial statements (U.S. Department of the Treasury, 2004). During this time, the GMRA directed the GAO to commence the first audit of the FRUSG, marking the end of its prototype status.

Until FY 2000, agencies compiled reports separately, creating challenges in achieving cohesive financial statements. Recognizing this issue, Congress enacted the Reports Consolidation Act of 2000, which provided agencies the authority to consolidate financial statements and reports into a unified annual report. This legislation aimed to ease the reporting process, facilitating the creation of singular reports for each agency. Consequently, these individual reports were combined into a single government financial report. This offered a consolidated overview of the financial activities across various government entities. The Reports Consolidation Act of 2000 significantly enhanced the efficiency and clarity of financial reporting within the government.

Years later, in the FY 2010 NDAA, provisions were enacted to authorize funding and outline policies for the DOD. These provisions highlighted how important it was for the DOD to attain external audit readiness (Municipal Technical Advisory Service, 2022). This set a strategic goal for achieving this readiness by the conclusion of FY 2017. Concurrently, the DOD Comptroller played a crucial role by issuing the FIAR guidance. This guidance outlined a series of steps and milestones essential for guiding the DOD toward auditability, including initiatives to enhance financial management practices and

internal controls. The synchronized implementation of legislative directives and strategic guidance helped instill greater transparency, accountability, and fiscal stewardship within the DOD's financial management framework (Defense Acquisition University, 2024).

2. The Personnel Involved in the Creation of DON AFRs

The Assistant Secretary of the Navy (Financial Management and Comptroller; ASN[FM&C]) oversees all financial matters within the DON. In recent years, the ASN(FM&C) has helped with efforts to achieve audit readiness, execute effective budgets, consolidate financial systems, ensure stewardship of taxpayer dollars, and comply with financial regulations (Financial Management and Comptroller, n.d.-a). This mission sets annual strategic goals aimed at enhancing auditability and financial fluidity. According to the Financial and Management and Comptroller (2023), "the ASN(FM&C) collaborates with six other entities, including Major Command Comptrollers, the Office of Budget (FMB), the Office of Financial Operations (FMO), Financial Management Systems (FMS), the Assistant General Counsel (Fiscal; AGC[F]), Secretariat Comptroller and Resources Department (SCRD), and Financial Management Administration (FMA) to create the DON financial reports." Figure. 4 shows the hierarchy below the ASN(FM&C), including the six entities previously mentioned.

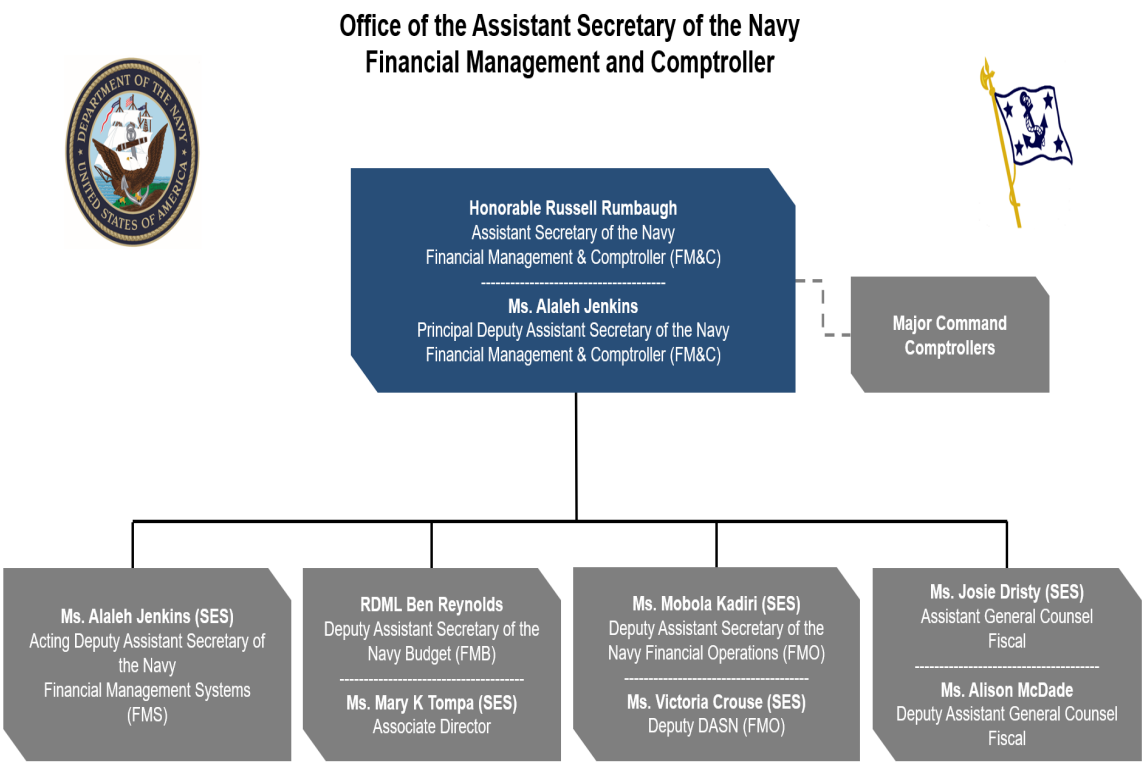

Figure 4. Government Financial Management Structure under the ASN(FM&C). Source: Financial Management and Comptroller (n.d.-a).

Major Command Comptrollers directly collaborate with the ASN(FM&C) to review and present accounting, budgeting, and other financial-related support for their respective commands. The information from Comptrollers helps provide key perceptions of the cash flows, net position, resource management, contracts, and other finances. They also work with the Integrated Risk Management (IRM) coordinators to oversee developing and implementing internal controls within their commands (SECNAV M-5200.35, 2008). Their oversight ensures the overall integrity and auditability of command finances, thus contributing accurate data for the creation of AFRs for the DON (Naval Sea Systems Command, 2015).

The FMB also assists in contributing to the creation of the DON's AFRs. The FMBs direction, formulation, and execution of the DON budget ensure that financial resources are allocated strategically and are in alignment with organizational objectives and priorities. The FMB develops budgetary plans that support mission readiness and

operational requirements by working closely with various departments and commands (Financial Management and Comptroller, n.d.-d). Through analysis and collaboration, FMB provides critical financial understanding to decision-makers, which helps contribute to the accuracy and reliability of DON AFRs. Additionally, the FMBs supervision of budget justifications and effective allocation of resources ensures that financial data presented in AFRs accurately reflect the DONs financial status (Financial Management and Comptroller, n-d.-c).

The FMO focuses on enhancing and sustaining financial operations. The FMOs leadership assists with preparing financial statements that can be audited and in establishing internal controls that verify the dependability of the financial information included in the AFRs. The FMO establishes financial statement compilations and analysis infrastructures, processes, and capabilities to assure that AFRs follow the OMB Circular A-136 (Officer of Financial Services, 2020). Additionally, the FMO guides DON audit remediation efforts and institutionalizes a DON-wide financial audit response process. With control over the general ledger, the FMO oversees the financial data presented in AFRs that reflects the DONs financial status (Officer of Financial Services, 2020).

The FMS team provides support for financial management processes within the DON. The FMS delivers enterprise solutions that support warfighter outcomes, making sure financial systems are optimized to meet DON objectives. With their management, oversight, and governance of operational financial systems, the FMS is responsible for the coordination between all branches for successful system migration or capability implementation. The FMS is also responsible for potential policy processes and technology developments that impact financial systems to help the DON improve mission and audit readiness (Financial Management and Comptroller, n.d.-e). Standard enterprise data has been made accessible, understandable, and usable for the DON through the FMS, which manages critical systems like the Navy Standard Accounting, Budgeting, and Reporting System (Talbert, 1970). These are integral to the creation of AFRs.

The AGC(F) offers legal guidance to support the DON in achieving its audit readiness and meeting its goals. The AGC(F) advises on various legal matters related to financial management, including budgetary considerations, contractual agreements, and

regulatory compliance (Financial Management and Comptroller, n.d.-a). They offer expert legal support and help mitigate legal risks. Their fundamental goal is to guarantee that financial operations are carried out with integrity and comply with recognized norms. The AGC(F) helps provide information that allows the DON AFRs to be legal and in compliance with regulations, policies, and standards (U.S. Department of Treasury, 2024).

The SCRD assists the FM&C in synchronizing financial management practices. The SCRD is responsible for making sure that budgeting, conducting financial operations, and overseeing resources occur in unison. They are responsible for managing the Budget Submitting Officer (BSO)-12 FIAR program, which emphasizes internal controls and property administration to meet auditing norms. Through these efforts, the division is responsible for the precision, clarity, and operational effectiveness of DON fiscal operations, resource management, contracts, and strategic communications related to AFRs. The division's commitment to following regulatory standards and optimizing financial governance and reporting underlines its role in delivering dependable AFRs for the DON (SCRD, 2024).

The FMA is comprised of 350 civilian personnel dedicated to supporting the creation of AFRs (FM&C, n.d.-c). The FMA aids in management oversight responsibilities over the Budget Submitting Offices (BSOs). Financial administrators within FMA manage, allocate, and monitor financial resources. Their expertise extends to risk assessment, fraud detection, and waste and abuse detection. The FMA staff and accountants comb through financial records, contributing to the accuracy of AFRs (U.S. Department of Commerce, 2016, p. 4).

Overall, these entities, in collaboration with the ASN(FM&C) are integral in managing and directing all financial matters, including the creation of AFRs. These offices, with the inclusion of the FMA, ensure transparency, accountability, and efficiency in financial management processes within the DON.

3. The Information AFRs Provide to the DON

The DON's AFRs are documents that show the organization's financial position and performance for each FY. The AFRs are formatted following the guidelines of OMB Circular A-136, which specifies the financial reporting obligations for federal agencies. The DOD (2005) lists the four principal financial statements that are included within the DON's AFRs: balance sheet, statement of net cost, statement of net position, and statement of budgetary resources. DON AFRs also includes a mandatory section for required supplementary information (RSI) that can vary in size and content.

The balance sheet is the first key financial statement, including the DON's financial status that details assets, liabilities, and net position at FY close. The second financial document is the statement of net cost, which shows the expenses that the DON incurs in its provisions of goods and services. This statement is used as a tool to gauge the DON's operational efficiency and impact. The third financial statement is the statement of net position, which includes records of change in net position throughout the FY. This illustrates the effects of revenues, expenses, gains, losses, and other transactions regarding net position throughout the FY. The fourth financial statement is the statement of budgetary resources. The budgetary resources statement outlines the management and allocation of funds, comparing budgetary allocations against commitments and expenditures, and providing evidence to adhere to fiscal limitations (DOD, 2005).

Also included in the AFR, is the external auditor section that lists the identified material weaknesses based on an audit or review of internal controls over financial reporting. The material weaknesses in the DONs financial reports indicate significant deficiencies in its internal control systems that could potentially lead to misstatements in its financial statements. These weaknesses expose gaps in processes, oversight, and compliance, which identify areas where improvements are necessary to ensure accuracy, efficiency, and accountability in financial management practices (Kahn, 2023). Identifying material weaknesses within the DON's AFR help guide corrective actions to enhance financial accuracy and compliance.

4. Material Weaknesses in the Department of the Navy

Material weaknesses identified in AFRs indicate notable lapses in the internal regulation of financial reporting, which may lead to considerable errors or discrepancies in the financial statements. Material weaknesses are critical issues that require immediate action and corrective measures. This helps with the overall the accuracy, dependability, and integrity of the financial data presented by the DON (Kahn, 2023). The specific weaknesses can differ annually and are influenced by various factors, but recurring instances noted in AFRs may encompass insufficient segregation of duties, inadequate supervisory mechanisms, subpar documentation practices, or suboptimal information technology safeguards. Material weaknesses may indicate potential for a higher likelihood of errors or fraud occurring within the financial reporting process.

5. Addressing Material Weaknesses

Addressing material weaknesses in DON systems requires an approach involving thorough assessments, remediation plans, and ongoing monitoring and testing of internal controls. This process involves collaboration among various stakeholders, including financial managers, internal auditors, and IT specialists, to identify root causes of material weaknesses and implement effective solutions. Remediation efforts may involve strengthening control procedures, enhancing staff training, upgrading IT systems, or restructuring organizational processes to mitigate risks and improve the overall environment (Kahn, 2023). Additionally, continuous monitoring and regular evaluations help verify the effectiveness of the internal control implementation. By addressing material weaknesses, the DON can enhance the reliability and transparency of its financial reporting.

6. The Importance of Agency Financial Reports

Within the government FRs are AFRs, which are official financial documents that outline financial activities and positions of government agencies. They detail budgetary performance and financial management while adhering to accounting standards. The most important function of AFRs is to help promote transparency, accountability, and public

trust in the allocation of taxpayer funds. These reports provide key insight into the financial transactions and expenditures within the federal government and offer insights into how taxpayer money is utilized throughout the FY. Understanding where funds are allocated allows taxpayers to make informed assessments of the government's fiscal responsibility and the efficiency of resource utilization.

Transparency and accountability are key elements facilitated by these reports, as they provide a detailed account of financial transactions, budgetary allocations, and expenditures. This openness not only raises public consciousness but also cultivates an atmosphere of transparency and responsibility in government operations. The AFRs contribute to the accountability of the government by establishing a clear framework for financial management. With detailed financial information available to the public, government officials are held accountable for their fiscal decisions and actions. This accountability is vital in ensuring that taxpayer dollars are used responsibly and effectively (Russo, 2022). The following section addresses internal controls in the federal government.

E. INTERNAL CONTORLS

Internal controls within the DON are a crucial aspect of ensuring financial accountability and accurate reporting of its fiscal health. The DON is responsible for its system of internal controls into daily activities, executed by staff across various tiers of the DON. The *Standards for Internal Control in the Federal Government* (hereafter referred to as the Green Book), the directives of OMB Circular A-123, which outline the *Management's Responsibility for Internal Control*, and the IRM strategy, also known as Secretary of the Navy Instruction (SECNAVINST) 5200.35E, aim to offer reliable confidence that the DON's goals will be achieved efficiently and effectively.

The GAO provides recommendations to the DOD and the DON for an enhancement of internal controls (United States House of Representatives, 2024). This includes creating new procedures, developing new systems, and verifying financial records. These measures and advancements are critical to the progress of the FIAR Program, which guides the DON towards achieving an audit with no modifications. In addition to these measures, the DON

uses industry-wide knowledge, like the COSO Framework. This enhances their efforts to create financial statements to be ready for audits.

1. The Standards for Internal Control in the Federal Government (Green Book)

The Green Book, published by the GAO, provides the federal government with a framework for establishing strong internal control systems. This guidance helps government bodies to manage initiatives that meet efficiency and efficacy standards while adhering to relevant laws and regulations (Comptroller General of the United States, 2013). According to GAO (2014), the Green Book "covers components of internal control such as the control environment, risk assessment, control activities, information and communication, and monitoring activities." These five internal control components were adopted from the COSO framework (Office of the Commandant, 2022). These components are discussed in detail later. By using these standards, the DOD can implement policies that could impact the goal of achieving a clean audit.

2. OMB Circular A-123

OMB Circular A-123, known as *Management's Responsibility for Internal Control*, provides federal agencies with the primary instructions to implement their internal controls. It was released in FY 1982 after the enactment of the FMFIA of 1982 (GAO, 2004). The FMFIA of 1982 required the federal government to create and implement internal control within each government agency. This structure is integral to verifying the operations effectiveness and efficiency, ensuring the trustworthiness of financial reports, and guaranteeing adherence to all relevant legislations and regulations.

OMB Circular A-123 was revised to include Appendix D, ensuring adherence to the mandates of the FFMIA from 1996. It has more stringent criteria than the GMRA does, which only obligated a production of yearly audited financial statements. The FFMIA of 1996 facilitated a standardization and uniformity of financial reporting across the federal financial management systems. Such consistency aids in simplifying the monitoring of federal finances for the President, Congress, and the general public (OMB, 2000). Figure

5 (Taylor, 2005) shows the five-step process that is used to determine how effective internal controls are in the federal government. This figure implements the GAO's (2004) five key steps to take when assessing how effective internal controls are over financial reporting as shown in Table 1.

Table 1. Five Steps to Take When Assessing Effective Internal Controls. Source: Springer (2004).

Step 1	Strategizing to Ensure that the Agency's Methods and Execution are in Accordance with Audit Standards
Step 2	Assessing the Internal Control within the Organizational Structure
Step 3	Assessment of Internal Control at the Procedural Stage
Step 4	Examining the Efficacy of Control Structures and Their Operational Functionality in Transactional Processes
Step 5	Finalizing, Documenting, and Amending in the Audit Process

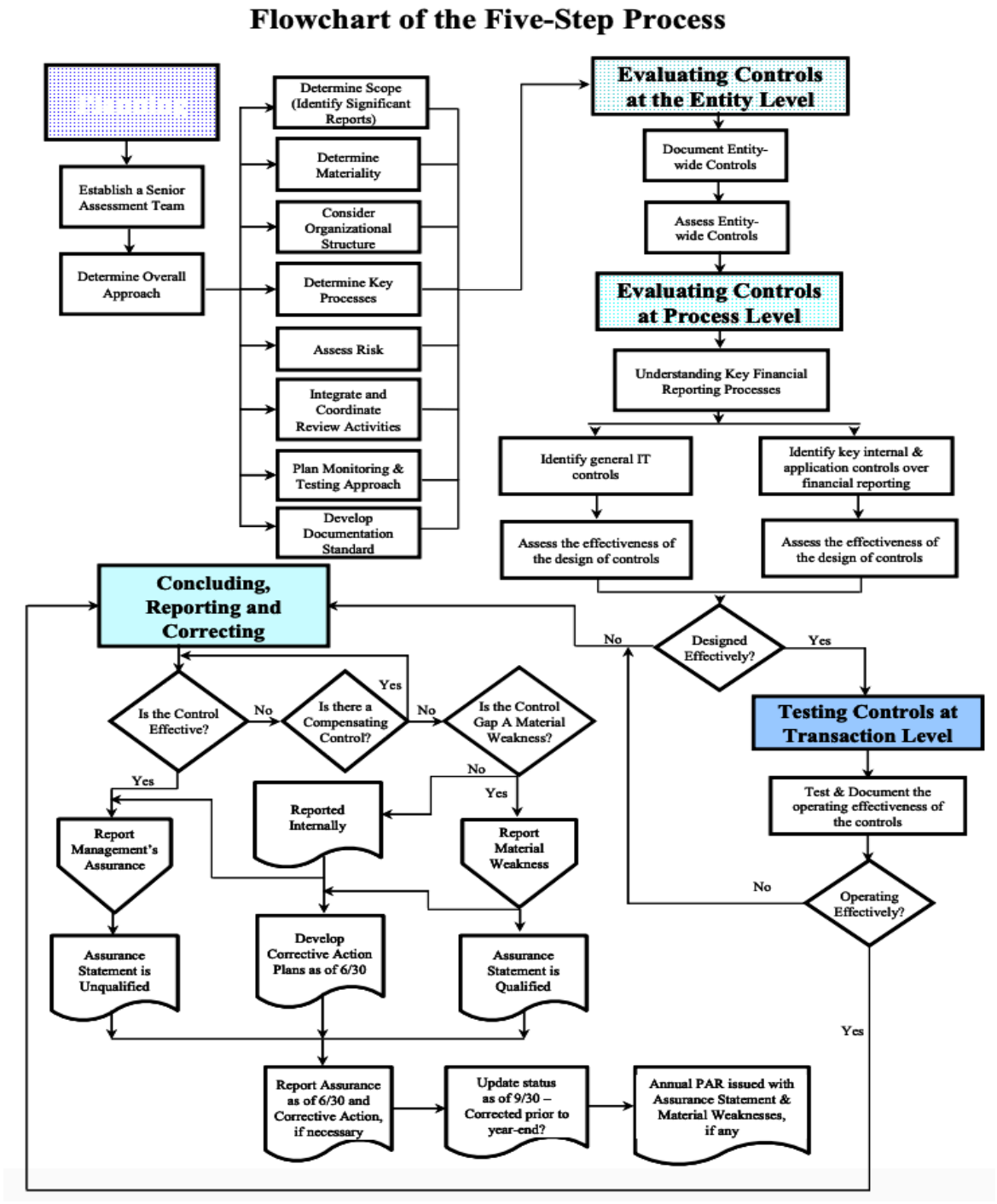

Figure 5. Flowchart of the Federal Governments Five Main Steps for Determining Internal Control Effectiveness Source: Taylor (2005).

The directives outlined in OMB Circular A-123 defines the obligations of managers pertaining to the internal control systems within federal institutions (Deloitte, 2018). OMB Circular A-123 provides the updated policies and procedures for agencies to follow to improve accountability and efficacy in financial procedures. This is achieved through the incorporation of enterprise risk management (ERM) alongside internal control mechanisms within federal agencies (GAO, 2016). The purpose of the circular is to ensure a credible level of confidence concerning the attainment of operations that are both effective and efficient, the dependability of financial reporting, and adherence to the relevant legal and regulatory frameworks. OMB A-123 is relevant to all executive agencies and their leadership, mandating an orderly method for the assessment and enhancement of processes related to internal control and risk management (Taylor, 2005).

3. DON Integrated Risk Management (IRM) Strategy

The DON IRM strategy is an approach that aligns risk management practices across the entire organization. It aims to integrate risk management into all aspects of Navy operations and decision-making processes. The IRM strategy enhances traditional risk management practices by ensuring risk evaluations throughout every level and function (Naval Sea Systems Command, 2023). It provides DOD components with the necessary guidelines, methodologies, and reporting protocols to appraise and oversee the efficiency of their internal control mechanisms. Aligning with the FMFIA's goals, the strategy incorporates internal control assessments into the DODs core operational tasks and mandates that DOD leadership consistently review and report on their internal control framework. This includes the exposure of any material weaknesses detected. The IRM strategy sponsor for specific departments, programs, commands, and ships is most often a collateral duty, meaning ample time may not be spent on the IRM strategy at hand (GAO, 2016).

The switch from the Managers Internal Control Program (MICP) to the IRM approach represented a major shift from reactive to proactive. The instruction for the IRM strategy states that the shift stemmed from a less compliance-focused framework to a more strategic and integrated process (U.S. Department of Defense, 2016). The MICP

traditionally focused on evaluating and improving internal controls within specific areas of an organization, ensuring compliance with policies and procedures. Conversely, IRM adopts a broad approach for pinpointing and handling potential threats that may impede the DONs pursuit of its strategic goals, which spans operational, financial, and reputational risk areas (Naval Sea Systems Command, 2023).

4. Internal Auditors' Role in Internal Control

Internal auditors supervise and improve the internal frameworks of organizations. They are actual employees of the organization, agency, or corporation that are seeking audit readiness. Mainly, they are tasked with assessing how well internal controls function in the areas of financial reporting, operational activities, and adherence to legal and regulatory standards. Internal auditors conduct assessments of control activities, risk management practices, and governance structures to identify potential weaknesses and areas for improvement (Liberto, 2022). Information is compiled and a detailed preparation is provided for external auditors, who are independent of the organization, agency, or corporation, to perform their audit.

5. External Auditors' Role in Internal Control

In the process of auditing financial statements, external auditors, also known as independent auditors, scrutinize an organization's internal controls. The external auditors provide an opinion, also known as an auditor's report, on the audit based on their analysis. Governmental audits are conducted in adherence with the GAO's GAGAS, also known as the Yellow Book. The guidelines provided in the GAGAS serve as a detailed framework to set the specific methods and practices to be followed for conducting audits in governmental organizations (GAO, 2021). The federal government audit reports typically focus on three core aspects: the accuracy of financial data, adherence to laws and regulations, and effective internal controls (Comptroller General of the United States, 2011).

To conduct audits, auditors typically use a universal five-stage approach. In the first stage, they strategize on the most effective approach in financial reporting audits by

evaluating financial statements and internal controls. In the second stage, auditors decide which controls to test by employing a top-down approach, focusing first on the areas of greatest risk. In the third stage, they assess the design of these controls to determine if they are structured effectively. The fourth stage involves a thorough examination of the controls in action, verifying that they operate effectively. Finally, in the fifth stage, auditors formulate and present an opinion based on all the information collected in the last four stages, concluding the audit process (Whittington & Pany, 2015, p. 278).

External auditors are tasked with identifying and reporting any significant deficiencies in internal controls, including material weaknesses. Effective internal controls are essential, as they can help minimize the necessity for extensive and expensive auditing procedures. Internal control systems are deemed effective when they exhibit certain qualities that adhere to standards set forth by the DON in OMB Circular A-123, IRM, and the Green Book. These qualities include the proficiency and clarity of personnel roles, establishment of and adherence to proper procedures, adequate policies to protect assets, and ensuring compliance with documentation practices (Porter et al., 2014). Additionally, there should be regular independent checks to confirm internal control implementation is effective.

In the DON's financial audits, the dialogue between external auditors and stakeholders at various organizational levels is crucial. Auditors often sample transactions and may require documentation from parties involved in those transactions to assess the internal controls design, operational efficacy, and regulatory compliance (Office of Inspector General, 2023). Their review is comprehensive, spanning the entirety of operations. To equip all involved parties for financial audits, the DON emphasizes the significance and consequences of such evaluations. Training initiatives guide commands in validating financial reporting procedures, reinforcing internal control mechanisms, and employing audit trail checklists (GAO, 2021). These checklists help to spotlight crucial elements within supporting documents, ensuring thorough preparedness for the audit process.

6. Industry Internal Control Framework

COSO was established in the United States in 1985 (Cornell, n.d). Their main goal is to address corporate financial reporting issues and prevent fraudulent financial reporting practices (COSO, 2023). It was created due to several high-profile business and accounting scandals across the United States. According to COSO (2023), "the initiative was a joint effort of five major professional associations: the American Accounting Association, the American Institute of Certified Public Accountants, the Financial Executives International, the Institute of Internal Auditors, and the Institute of Management Accountants" (p. 10). The collective formation of the COSO framework by these entities was driven by the fundamental goal to design a comprehensive framework that would facilitate the evaluation and enhancement of internal control mechanisms.

The COSO framework made a significant impact on internal controls with the introduction in 1992 of the *Internal Control—Integrated Framework*, which has become the definitive guide for the development, implementation, and evaluation of internal control systems (COSO, 2013). In response to evolving business and operational landscapes, the framework underwent an update in 2013 to refine the criteria for establishing effective internal controls (American Institute of Certified Public Accountants, n.d.). COSO expanded its focus with additional frameworks addressing enterprise risk management, known as the *Enterprise Risk Management—Integrated Framework*, which was published in 2004 and updated in 2017 (Berman, 2024). COSOs frameworks have become instrumental for organizations worldwide, helping them to manage risks effectively and ensure the accuracy of their finances.

7. Five COSO Components

The COSO (2013) details "five key components: control environment, risk assessment, control activities, information and communication, and monitoring activities" (p. 5). These components are the basis of a robust internal control system that are effectively developed and implemented. Within this framework, there are 17 principles that are critical for developing an internal control system tailored to meet specific

organizational needs. These principles ensure that the objectives of the internal control system are clearly connected to the requirements of each component (Comptroller General of the United States, 2011).

The control environment is a component within the COSO framework that establishes the organizational ethics and provides a base for the remaining elements of internal control. It reflects the organization's commitment to maintaining integrity, observing ethical principles, and enhancing the skills of its employees (UCLA Business & Finance Solutions, 2023). As such, it is essential in underpinning the structure of internal controls throughout the organization. This influences how other aspects of internal controls are developed and implemented, guiding effective management of control tasks. Essentially, the control environment shapes the governance and ethical climate within which company operations are conducted. The culture sets the foundational tone of an organization, emphasizing ethical behavior, and integrity.

In 2013, COSO detailed the five principles related to the control environment:

- The organization demonstrates a commitment to integrity and ethical values.
- The board of directors demonstrates independence from management and oversees the development and performance of internal control.
- Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
- The organization demonstrates a commitment to attracting, developing, and retaining competent individuals in alignment with objectives.
- The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives. (p. 31)

Risk assessment is a detailed and critical process used to identify and analyze potential hazards that might impede an organization's goals (RiskOptics, 2022). This process is essential for understanding the range of risks facing an organization and deciding on the strategies to mitigate these risks efficiently. By conducting thorough risk assessments, organizations can establish a foundation for determining the necessary management actions and acceptable risk levels (COSO, 2013, p. 59). Entities encounter

numerous risks from both external and internal sources, which require careful evaluation. Establishing clear objectives, which are aligned at various levels and consistent internally, is a fundamental step before undertaking risk assessment.

In 2013, COSO detailed the four principles related to risk assessment:

- The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
- The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
- The organization considers the potential for fraud in assessing risk to the achievement of objectives.
- The organization identifies and assesses changes that could significantly impact the system of internal control. (p. 59)

Control activities consist of measures implemented to mitigate risks and fulfill an organization's goals (University of San Francisco, 2024). By implementing these actions, organizations ensure that managerial directives are effectively executed. These actions typically include necessary tasks such as securing approvals, authorizing transactions, performing verifications and reconciliations, conducting performance reviews, securing assets, and maintaining clear separations of duties (COSO, 2013, p. 87). These activities are specific policies and procedures that provide a framework for operational efficiency and risk mitigation, ensuring that all parts of the organization operate in alignment with set goals and compliance requirements.

In 2013, COSO detailed the three principles related to control activities:

- The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- The organization selects and develops general control activities over technology to support the achievement of objectives.
- The organization deploys control activities through policies that establish what is expected and procedures that put policies into action. (p. 87)

The information and communication component of the internal control integrated framework is critical, as it reinforces the significance of managing both the inward and

outward flow of information and ensuring its effective dissemination throughout the organization. This component ensures that essential information is quickly recognized, protected, and distributed in a way that supports the effective fulfillment of duties by members of the organization (RiskOptics, 2022). It is essential for communication to extend vertically and horizontally across various levels of the organization to support informed decision-making and operational efficiency. Communication mechanisms are foundational for the effective functioning of all other internal control components, ensuring that each part of the organization is aligned and informed to meet its objectives effectively. Accounting systems are also part of the information and communication component of internal controls, ensuring that financial data is accurately recorded and effectively communicated.

In 2013, COSO detailed the three principles related to information and communication:

- The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
- The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
- The organization communicates with external parties regarding matters affecting the function of internal control. (p. 105)

Monitoring activities refer to the "processes that assess the quality and effectiveness of an organization's internal control over time" (COSO, 2013, p. 123). This component ensures that internal controls continue to operate effectively and that any deviations are detected and addressed promptly. Monitoring is conducted through observing ongoing activities and separate evaluations. This allows organizations to react to changes and maintain internal control effectiveness.

In 2013, COSO detailed the three principles related to monitoring activities:

- The organization selects, develops, and performs ongoing and/ or separate evaluations to ascertain whether the components of internal control are present and functioning.
- The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for

taking corrective action, including senior management and the board of directors, as appropriate.

- The organization uses relevant information from internal and external sources to support the functioning of other components of internal control. (p. 123)

Figure 6 shows the five components that are detailed in the COSO framework, with the principles that are included with each component. 5 principles are associated with control environment, 4 principles are associated with risk assessment, 3 principles are associated with control activities, 3 are associated with information & communication, and 2 are associated with monitoring activities. This table serves as a visual to the information provided in the entire *Five COSO Components* section. The next section in this chapter will discuss the key topics related to the contract management phases.

Components	Principles	Number of Points of Focus
Control Environment	1. Commitment to integrity and ethical values	4
	2. Independent board of directors' oversight	4
	3. Structures, reporting lines, authorities, responsibilities	3
	4. Attract, develop and retain competent people	4
	5. People held accountable for internal control	5
Risk Assessment	6. Clear objectives specified	15
	7. Risks identified to achievement of objectives	5
	8. Potential for fraud considered	4
	9. Significant changes identified and assessed	3
Control Activities	10. Control activities selected and developed	6
	11. General IT controls selected and developed	4
	12. Controls deployed through policies and procedures	6
Information & Communication	13. Quality information obtained, generated and used	5
	14. Internal control information internally communicated	4
	15. Internal control information externally communicated	5
Monitoring Activities	16. Ongoing and/or separate evaluations conducted	7
	17. Internal control deficiencies evaluated and communicated	3

Figure 6. Principles for Each Component of the Internal Control Framework. Source: COSO (2023, p. 12).

F. CONTRACT MANAGEMENT

DON contract management guides contracts from inception to completion. It verifies that each contract with third-party entities follows established legal standards, financial principles, and organizational policies. According to Rendon and Snider (2008), the process is structured into pre-award, award, and post-award phases. This disciplined framework is critical to the DONs ability to manage contracts effectively, control costs, and deliver on its commitments (Rendon & Snider, 2008). Figure 7 displays the contract life-cycle phases and the domains associated with those phases (NCMA, 2019).

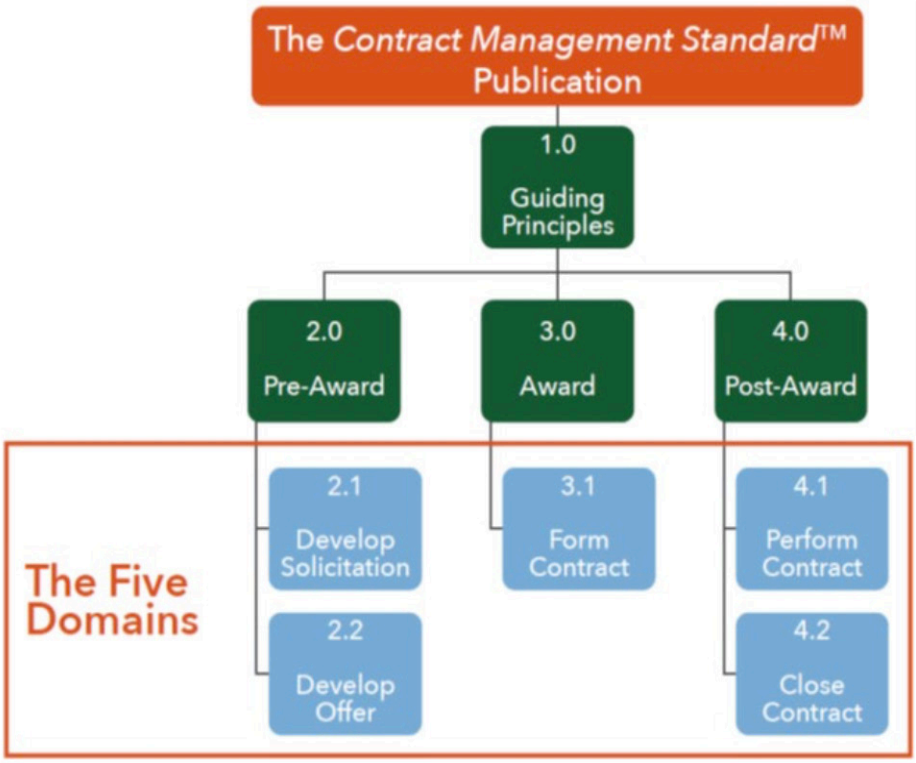

Figure 7. Five Domains of Contract Life-Cycle Phases. Source: NCMA (2019).

1. Pre-Award Phase

In the pre-award phase of DON contract management, the process is divided into two primary domains: developing the solicitation and developing the offer (NCMA, 2019). During the development of the solicitation, contracting professionals work with the requisitioning team to conduct market research and formulate a comprehensive strategy that outlines the contract's scope and requirements. This strategy results in a solicitation document, designed to accurately reflect the customer's needs and to facilitate the creation of a viable, executable contract (Rendon & Rendon, 2016).

On the other side, sellers are responsible for developing their offers, which involves carefully planning sales strategies and formulating competitive offers in response to the solicitation. This entails an analysis of the market and competition to ensure alignment with the customer's immediate and long-term objectives. Companies then prepare their offers, leveraging their strengths to present a compelling proposition that aims to secure the contract, thereby enhancing their position in the marketplace (Diligent Corporation, 2019). Both domains are critical in setting the stage for successful contract awards and subsequent performance.

2. Award Phase

In the award phase of contract management, as outlined by the Contract Management Standard (2019), the contract formation process includes four subdomains designed to optimize the selection and negotiation aspects of procurement. Initially, a price or cost analysis is conducted to assess the reasonableness and realism of prices or costs proposed by offerors. This aids in preparing for effective negotiations and reduces financial risks associated with contract performance. Secondly, negotiations occur to formulate strategies and to discuss offeror responses, clarify requirements, and consider alternative proposals, ensuring both parties clearly understand the contract terms. Thirdly, the source selection process involves evaluating all offers against set criteria to choose the most suitable source. This enhances the likelihood of successful contract performance and minimizes the risk of protests. Finally, managing disagreements is crucial for addressing

and resolving any conflicts that arise between buyers and contractors (NCMA, 2019). By utilizing both formal and informal resolution methods, relations can be maintained, and contract continuity can be ensured. This approach not only secures the best possible contractual terms but also fosters a stable procurement environment.

3. Post-Award Phase

In the post-award phase of contract management, the process is categorized into "two main domains: perform contract and close contract" (NCMA, 2019). The perform contract domain encompasses the execution of the contract, management of contractor relationships, and handling of any contract modifications. This domain ensures adherence to contract specifications and assesses contract performance, structured into "four subdomains: administer contract, ensure quality, manage subcontracts, and manage changes" (NCMA, 2019). Each of these subdomains is geared toward managing different aspects of the contract to optimize performance and compliance.

The close contract domain, on the other hand, deals with the finalization of the contract process. This includes confirming that all contractual obligations are obliged, addressing outstanding issues, and making the final payments. The process concludes with a comprehensive reconciliation of the contract, ensuring that everything is settled as per the agreed-upon terms. This single subdomain, close out contract, focuses on final contractor evaluations, confirming the completion of contract requirements, and the overall acceptance of the contract's deliverables, solidifying the closure of the contractual agreement (NCMA, 2019).

4. Material Weaknesses Related to Contract Management

Since FY 2018, there has only been one material weakness related to contract management: government property with contractors. This issue involves deficiencies in tracking and managing government-owned property that has been provided to contractors. The challenge lies in maintaining accurate and up-to-date records, ensuring that property is used appropriately for contractual purposes, and verifying that it is returned or accounted for at the end of the contract term. The failure to effectively manage this property not only

poses risks to the asset's security and value but also affects the DON's overall financial accountability. Addressing this material weakness is crucial for improving the DON's financial integrity and operational efficiency, as it directly impacts the DON's ability to control and utilize its resources effectively.

While the DON only has one material weaknesses related to contract management, Rendon and Rendon (2016) reviewed numerous fraud schemes across the DOD. The study stated, "the procurement fraud schemes identified in the fraud incidents that were used included collusion, bid rigging, bribery, conflicts of interest and billing/cost/pricing schemes." This shows that there are still areas lacking competent personnel, capable processes, and effective internal controls potentially being susceptible to fraud, waste, and abuse (Rendon and Rendon, 2015a). In this research study, the material weakness related to contract management is discussed as an example of how to address the material weakness and its recommendations in DON AFRs. The following section provides a summary of the chapter.

G. SUMMARY

This chapter used numerous peer-reviewed scholarly works and official records to research the background of the DON's financial dynamics. It started with the summarization of frameworks and practices that ensure the DON's financial and operational integrity through auditing, including the auditability triangle, external auditors, and internal auditors. The chapter then discussed an in-depth look at the historical evolution of financial reporting. It looked at the significance of DOD financial reports and the critical role of the personnel who compile them. The narrative then shifted to internal control systems, looking at the Green Book and aligned it with directives from OMB Circular A-123 and GAGAS. This chapter then emphasized the DON's IRM strategy and the internal control guidance for the federal government. It then included a discussion about the work of internal and external auditors. It finished up with internal controls, as it outlined the industry internal control framework and its alignment with the five COSO components. Lastly, the chapter transitioned into the phases of contract management within the DOD, detailing each step from pre-award to post-award.

THIS PAGE INTENTIONALLY LEFT BLANK

III. METHODOLOGY

A. INTRODUCTION

This section outlines the methodological approach used in analyzing the DON AFRs from FY 2018 to FY 2022, focusing on identifying and examining material weaknesses and the internal control deficiencies. The dataset uses AFRs information to highlight material weaknesses found by external auditors. The study characterizes material weaknesses and their associated internal control deficiencies according to the COSO's five key internal control components. Quantitative data is represented using bar graphs and pie charts to patterns and trends. This methodology facilitates a comprehensive understanding of the recurring issues within the DON's internal control systems, providing a foundation to enhance operational efficiency and financial accountability.

B. DATA SOURCES

The dataset for this research includes DON AFRs spanning from FY 2018 to FY 2022, focusing on the material weaknesses identified by external auditors. The DON AFRs were found via the DON Financial Management website that is available to the general public. Within this dataset, every material weakness related to financial reporting, financial statements, and operations had subsections including a list of significant internal control deficiencies. These material weaknesses reflect systemic issues in the DON's financial management practices, which include examples like the lack of sufficient oversight, inadequate internal control frameworks, and poor documentation and reporting processes. Such deficiencies not only impact the DON's ability to provide reliable financial statements but also affect its operational efficiency and accountability in the management of significant financial and physical assets. There was no PII collected for this research. IRB determined this research does not involve human subjects.

C. DATABASE CREATED

The database for this research, created by the researcher, was developed by identifying material weakness within the DON AFRs and categorizing those material

weaknesses along with the specific number of internal control deficiencies it contained, ranging from 1 to 7 per material weakness in Excel. It encompassed all the material weaknesses corresponding to each FY. There were 13 material weaknesses in FY 2018, 17 material weaknesses in FY 2019, 17 material weaknesses in FY 2020, 16 material weaknesses FY 2018, and 15 material weaknesses FY 2022. This detailed tracking allowed for an analysis of internal control components across different operational segments. The material weaknesses were then further analyzed by placing each internal control deficiency next to the associated material weakness. Subsequently, these deficiencies were categorized according to the five standard components of internal control as specified by the COSO framework: "control environment, risk assessment, control activities, information and communication, and monitoring activities" (COSO, 2013). Each deficiency was associated with one of these COSO framework internal control components based on its nature and impact on the DON's operations. For the one recommendations graph for the contract management material weakness, there was a completely different database. This database only included the FY's and the number of recommendations associated with the material weaknesses and its internal control deficiencies in Excel.

D. HOW THE ANALYSIS WAS CONDUCTED

Quantitative data on the deficiencies were then aggregated and analyzed to determine patterns and trends. Starting with the collection of material weaknesses with the detailed deficiencies that were classified according to the COSO Framework for each FY. This data was then visually represented in multi-series bar graphs to illustrate the distribution and frequency of internal control deficiencies across different areas of the DON's financial management system, aiding in the identification of areas requiring focused improvement efforts. Percentages were then calculated to represent the proportion of deficiencies related to each COSO component, providing a clear breakdown of areas with significant control challenges in pie charts. This methodology not only highlighted the prevalent areas of concern within each material weakness, but also facilitated a comparative analysis over each individual FY. This allows the DON to prioritize improvements in its internal control systems based on recurring issues.

Switching over to an analysis of all FYs in one graph, data from each FY was combined to create a dataset that shows the number of deficiencies per material weakness from FY 2018 to FY 2022. The trend analysis was represented in bar graphs, showing the progression or reduction of deficiencies for each reoccurring material weakness over the years. This allows stakeholders to easily visualize trends and assess the effectiveness of corrective actions taken. These analyses were visualized using pie charts and bar graphs in Microsoft Excel to illustrate the distribution and severity of control deficiencies across the various categories, making it easier to communicate the findings and guide targeted remedial actions. For purpose of this research, only the contract management material weakness and recommendations for all FYs was used as provided.

E. SUMMARY

This chapter discussed the methodological approach used to analyze the DON AFRs from FY 2018 to FY 2022, focusing on identifying and examining material weaknesses and internal control deficiencies. The dataset, obtained from publicly available DON AFRs, highlights material weaknesses identified by external auditors. These weaknesses were categorized according to the COSO framework's five key internal control components. A database was created to track these weaknesses and their associated deficiencies, facilitating a detailed analysis across different operational segments. Quantitative data was aggregated and visually represented using bar graphs and pie charts to identify patterns and trends in internal control issues. The analysis aimed to highlight prevalent areas of concern and provide a clear depiction of the distribution and frequency of deficiencies. Additionally, a cumulative analysis combined data from all FYs to assess the effectiveness of corrective actions over time. This approach aided in identifying reoccurring issues and guiding improvements in the DON's internal control systems. The research methodology ensured no PII was collected, and the IRB determined that the research does not involve human subjects.

THIS PAGE INTENTIONALLY LEFT BLANK

IV. FINDINGS, ANALYSIS, AND RECOMMENDATIONS

A. INTRODUCTION

This chapter discusses the DON's AFRs from FY 2018 to FY 2022, focusing on the identification, evaluation, and progression of material weaknesses and internal control deficiencies. By reviewing the findings across these FYs, this analysis highlights persistent challenges and areas where the DON has struggled to maintain financial and operational integrity. Special attention is given to material weaknesses that have recurred for more than three years, showing the issues that have continually affected the DON's ability to manage and report financial data accurately. Through this detailed examination, stakeholders can gain insights into the areas of financial management that require urgent reform and the steps necessary to enhance accountability and efficiency within the DON's financial operations. This chapter also provides recommendations based on the findings and analysis. The next section discusses the findings of this research study.

B. FINDINGS

In the evaluation of the DON's AFRs spanning from FY 2018 to FY 2022, a detailed analysis of material weaknesses and internal control deficiencies revealed persistent challenges in financial management and operational practices. This research created a database of the material weaknesses in the DON AFRs. It encompassed all the material weaknesses corresponding to each FY. There were 13 material weaknesses in FY 2018, 17 material weaknesses in FY 2019, 17 material weaknesses in FY 2020, 16 material weaknesses FY 2018, and 15 material weaknesses FY 2022. Within those material weaknesses, the study compiled and categorized the internal control deficiencies. The deficiencies totaled 49 deficiencies in FY 2018, 51 deficiencies in FY 2019, 57 deficiencies in FY 2020, 55 deficiencies in FY 2021, and 51 deficiencies in FY 2022. With this categorization, it found that control activities were the most prevalent control activity. Figure 8 shows the percentage makeup of the five COSO internal control components that were related to internal control deficiencies.

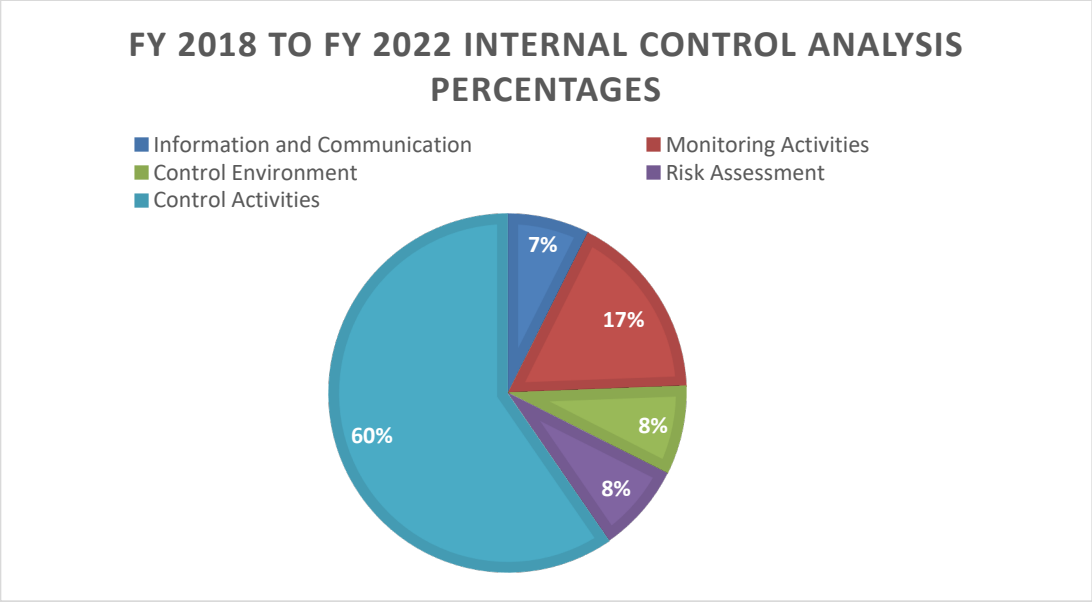

Figure 8. FY 2018 to FY 2022 Total Internal Control Analysis Percentages. Source: Department of the Navy (2018–2022).

1. FY 2018 DON AFR

In the FY 2018 DON AFR, 13 material weaknesses that encompass the DONs financial and operational aspects were identified. This is the second year being externally audited, but there was no real count of material weaknesses prior to FY 2018. Due to procedural changes between FY 2017 and FY 2018, FY 2018 was the first year with a quantifiable number of material weaknesses. These weaknesses highlight significant deficiencies in internal controls, policies, procedures, and documentation across various segments of the DONs operations. Each of these areas exhibits critical gaps that may hinder the DON's ability to accurately substantiate financial balances reported in their financial statements. Table 2 presents the 13 material weaknesses found in the DON AFR in FY 2018 (Department of the Navy, 2018).

Table 2. FY 2018 Material Weaknesses. Adapted from Department of the Navy (2018).

FY 2018 Material Weaknesses	
1	Financial Reporting
2	Fund Balance with Treasury
3	Accounts Payable
4	Government Property with Contractors
5	Property, Plant & Equipment General Equipment Reminder
6	Property, Plant & Equipment E General Equipment Valuation
7	Property, Plant & Equipment Real Property
8	Inventory and Related – OS&SR
9	Inventory and Related – OS&SO
10	Oversight and Monitoring
11	Financial Information Systems – Access Controls/Segregation of Duties
12	Financial Information Systems – Configuration Management
13	Financial Information Systems – Interface Processing

These material weaknesses had numerous internal control deficiencies ranging from 1 to 7 deficiencies per material weakness. There was a total of 49 internal control deficiencies within the 13 total material weaknesses for FY 2018. Using the descriptions in the FY 2018 DON AFR for the control deficiencies within each material weakness, each deficiency was aligned to the COSO framework internal control components. Figure 9 shows the alignment of the internal control components with material weaknesses.

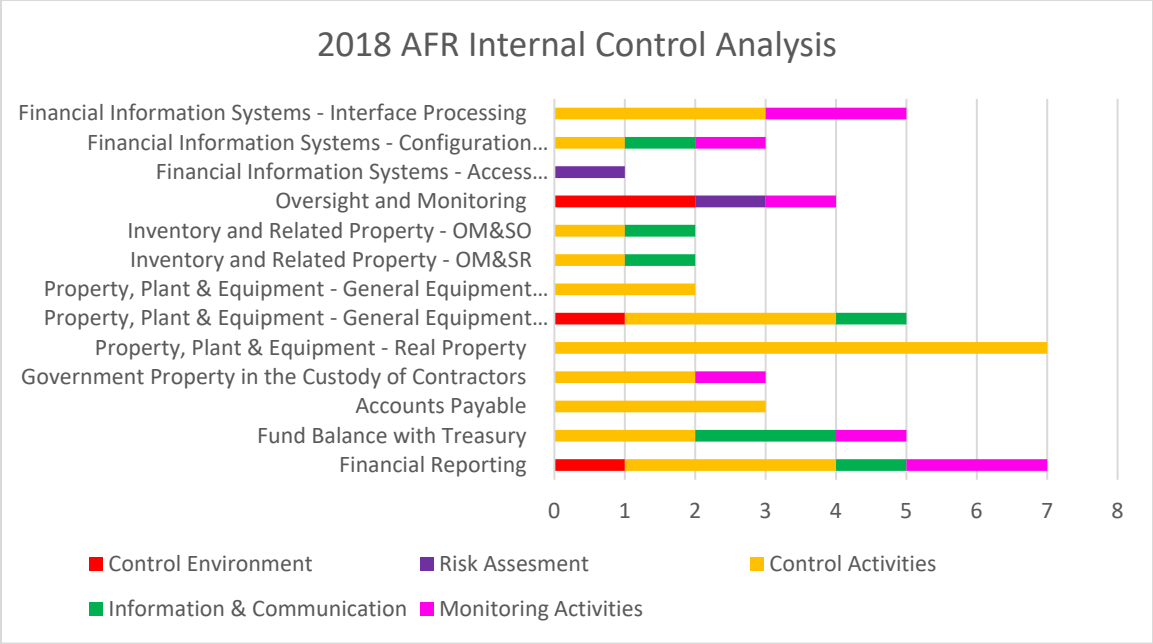

Figure 9. Material Weakness Deficiencies Tied to Internal Control Components

After evaluating the 45 internal control deficiencies within the 13 total material weaknesses, 8% were related to control environment, 4% were related to risk assessment, 57% were related to control activities, 14% were related to information & communication, and 17% were related to monitoring activities. This analysis indicates that control activities had the highest number of internal control deficiencies which may be of significant concern. Out of the 13 material weaknesses, only 1 material weakness was related to contracting and contract management, which was related to a total of 2 internal control deficiencies. Contract management made up 4.4% of the total deficiencies and 8% of the total material weaknesses. Figure 10 shows the percentage of the material weakness control deficiency related to each internal control component within FY 2018.

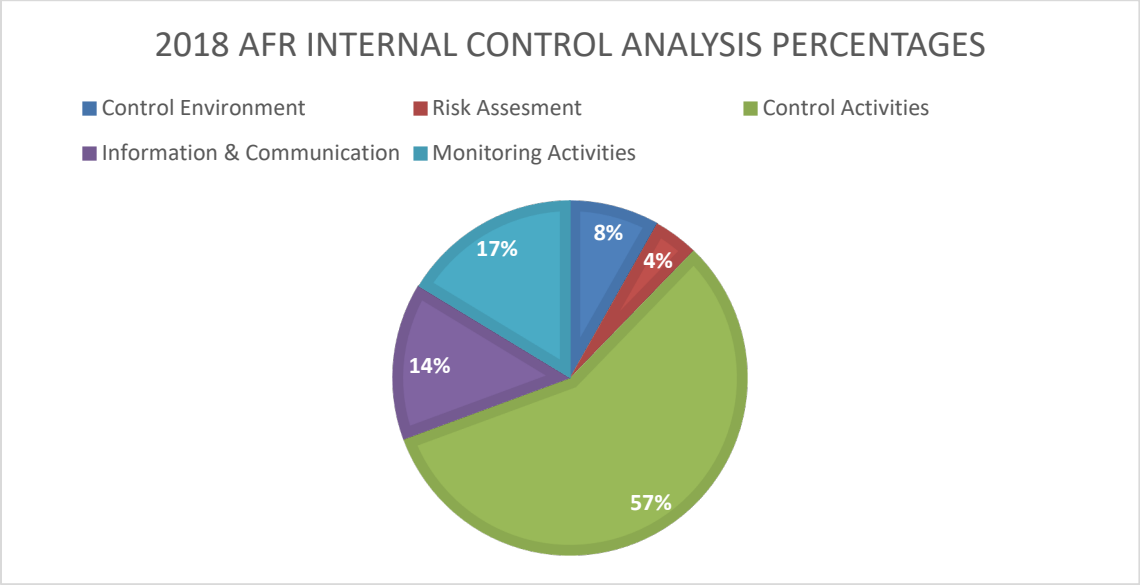

Figure 10. 2018 AFR Internal Control Makeup Percentage

2. FY 2019 DON AFR

In the 2019 DON AFR, 17 material weaknesses that encompass the DONs financial and operational aspects were identified, having 5 more material weakness than the prior FY. The 5 new material weaknesses include "property, plant & equipment – utilities, budget execution and undelivered orders, revenue and unfilled customer orders, contingent legal liabilities, and environmental and disposal liabilities" (Department of the Navy, 2019). These material weaknesses highlight significant deficiencies in internal controls, policies, procedures, and documentation across various segments of the DONs operations. Each of these areas exhibits critical gaps that may hinder the DON's ability to accurately substantiate financial balances reported in their financial statements. Table 3 presents the 17 material weaknesses found in the DON AFR in FY 2019 (Department of the Navy, 2019).

Table 3. FY 2019 Material Weaknesses. Adapted from Department of the Navy (2019).

FY 2019 Material Weaknesses	
1	Financial Reporting
2	Fund Balance with Treasury
3	Government Property with Contractors
4	Inventory and Related Property – OM&SR
5	Inventory and Related Property – OM&SO
6	Property, Plant, & Equipment – Utilities
7	Property, Plant, & Equipment – General Equipment
8	Property, Plant, & Equipment – Construction in Progress
9	Environmental and Disposal Liabilities
10	Contingent Legal Liabilities
11	Expenses and A/P
12	Revenue and Unfulfilled Customer Orders
13	Budget Execution and Undelivered Orders
14	Entity Level Controls – Oversight and Monitoring
15	Financial Information Systems – Access Controls/Segregation of Duties
16	Financial Information Systems – Configuration Management
17	Financial Information Systems – Interface Processing

These material weaknesses had numerous internal control deficiencies ranging from 1 to 5 deficiencies per material weakness. There was a total of 51 internal control deficiencies within the 17 total material weaknesses for FY 2019. Using the descriptions in the FY 2019 DON AFR for the control deficiencies within each material weakness, each

deficiency was aligned to the COSO framework internal control components. Figure 11 shows the alignment of the internal control components with material weaknesses.

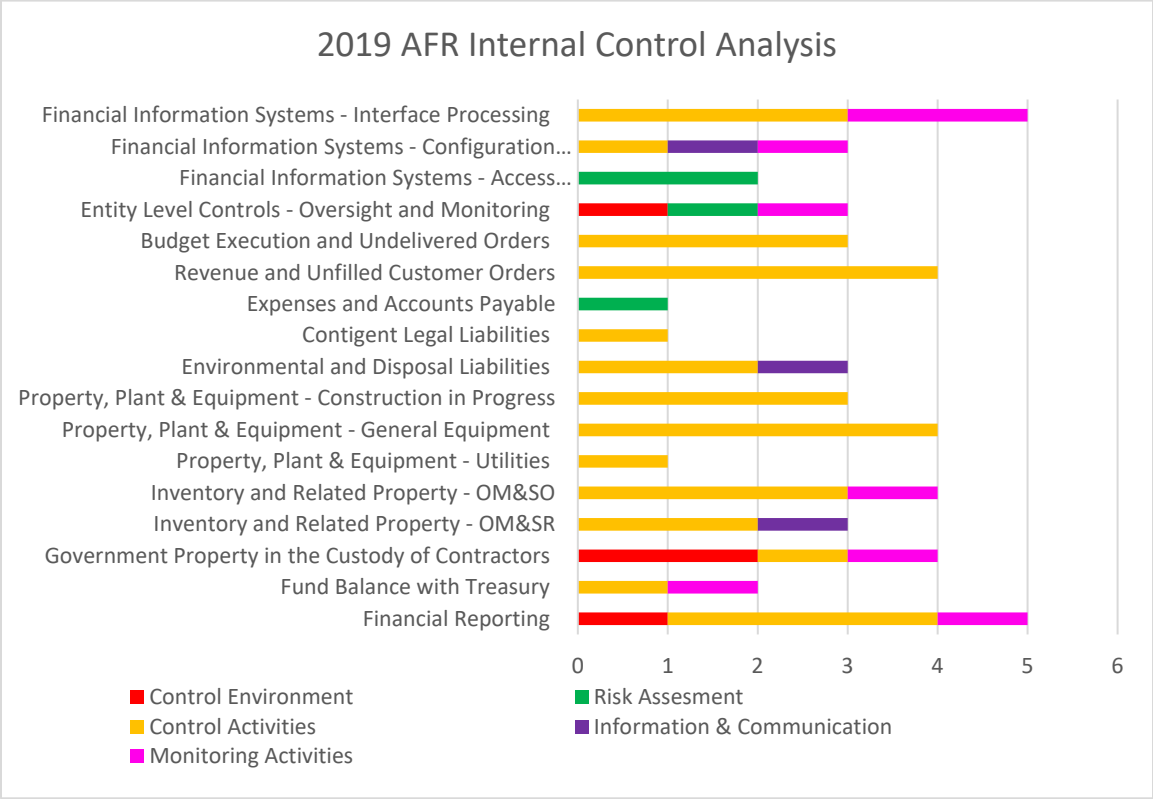

Figure 11. Material Weakness Deficiencies Tied to Internal Control Components

After evaluating the 51 internal control deficiencies, 15% were related to control environment, 8% were related to risk assessment, 63% were related to control activities, 6% were related to information & communication, and 15% were related to monitoring activities. This analysis indicates that control activities had the highest number of internal control deficiencies which may be of significant concern. Out of the 17 material weaknesses, only 1 material weakness was related to contracting and contract management, which was related to a total of 4 internal control deficiencies. Contract management made up 7.8% of the total deficiencies and 5.9% of the total material weaknesses. Figure 12

shows the percentage of the material weakness control deficiencies related to each internal control component within FY 2019.

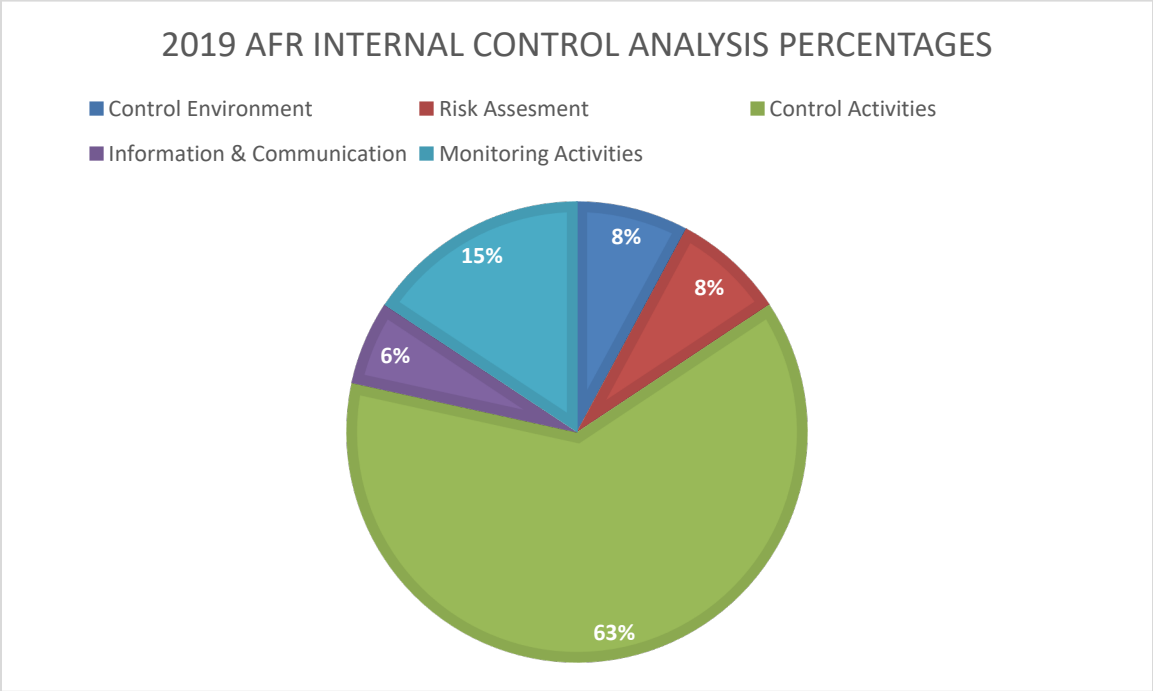

Figure 12. 2019 AFR Internal Control Makeup Percentages

3. FY 2020 DON AFR

In the 2020 DON AFR, 17 material weaknesses that encompass the DONs financial and operational aspects were identified, having the same number of material weakness as the prior FY. There was one new type of material weakness which was the inventory and related property – OM&SV and one resolved material weakness which was contingent legal liabilities. These material weaknesses highlight significant deficiencies in internal controls, policies, procedures, and documentation across various segments of the DONs operations. Each of these areas exhibits critical gaps that may hinder the DON's ability to accurately substantiate financial balances reported in their financial statements. Table 4 presents

the 17 material weaknesses found in the DON AFR in FY 2020 (Department of the Navy, 2020).

Table 4. FY 2020 Material Weaknesses. Adapted from Department of the Navy (2020).

FY 2020 Material Weaknesses	
1	Financial Reporting
2	Fund Balance with Treasury
3	Government Property with Contractors
4	Inventory and Related Property – OM&SR
5	Inventory and Related Property – OM&SO
6	Inventory and Related Property – OM&SV
7	Property, Plant, & Equipment – Utilities
8	Property, Plant, & Equipment – General Equipment
9	Property, Plant, & Equipment – Construction in Progress
10	Environmental and Disposal Liabilities
11	Expenses and A/P
12	Revenue and Unfulfilled Customer Orders
13	Budget Execution and Undelivered Orders
14	Entity Level Controls – Oversight and Monitoring
15	Financial Information Systems
16	Financial Information Systems – Configuration Management
17	Financial Information Systems – Interface Processing

These material weaknesses had numerous internal control deficiencies ranging from 1 to 5 deficiencies per material weakness. There was a total of 57 internal control deficiencies within the 17 total material weaknesses for FY 2020. Using the descriptions in the FY 2020 DON AFR for the control deficiencies within each material weakness, each deficiency was aligned to the COSO framework internal control components. Figure 13 shows the alignment of the internal control components with material weaknesses.

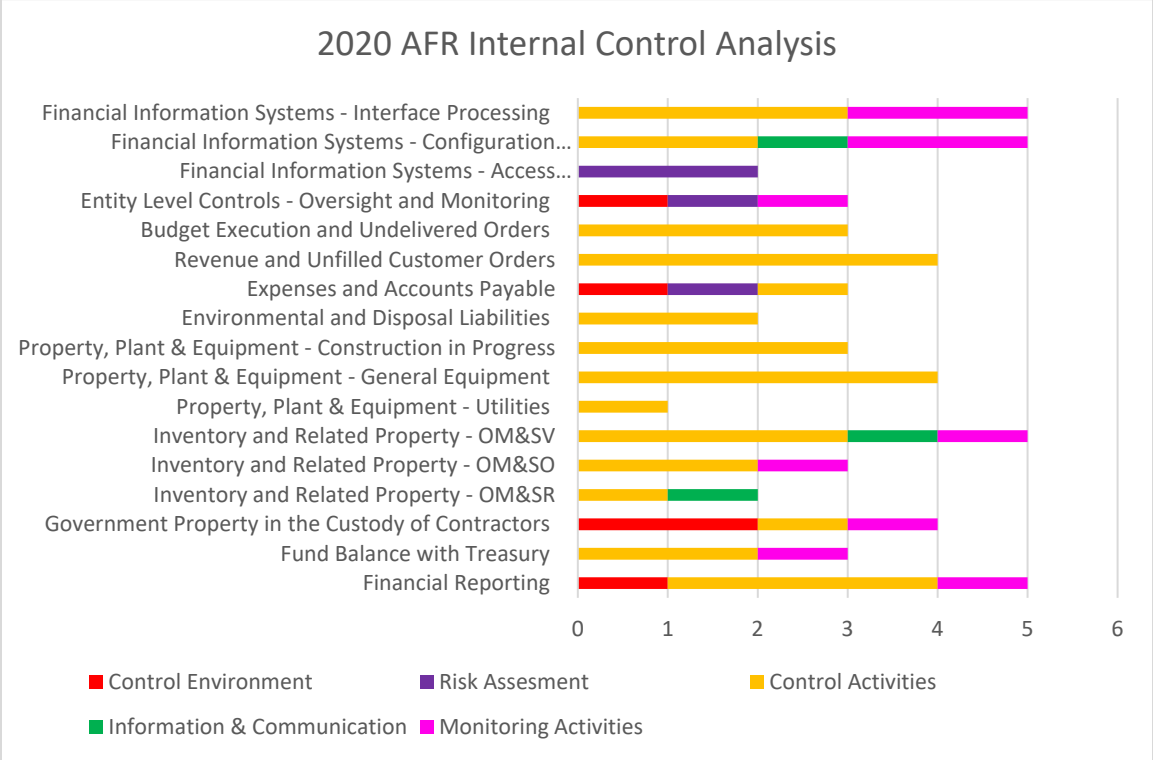

Figure 13. Material Weakness Deficiencies Tied to Internal Control Components

After evaluating the 57 internal control deficiencies, 9% were related to control environment, 7% were related to risk assessment, 61% were related to control activities, 5% were related to information & communication, and 18% were related to monitoring activities. This analysis indicates that control activities had the highest number of internal control deficiencies which may be of significant concern. Out of the 17 material weaknesses, only one material weakness was related to contracting and contract

management, which was related to a total of 4 internal control deficiencies. Contract management made up 7% of the total deficiencies and 5.9% of the total material weaknesses. Figure 14 shows the percentage of the material weakness control deficiencies related to each internal control component within FY 2020.

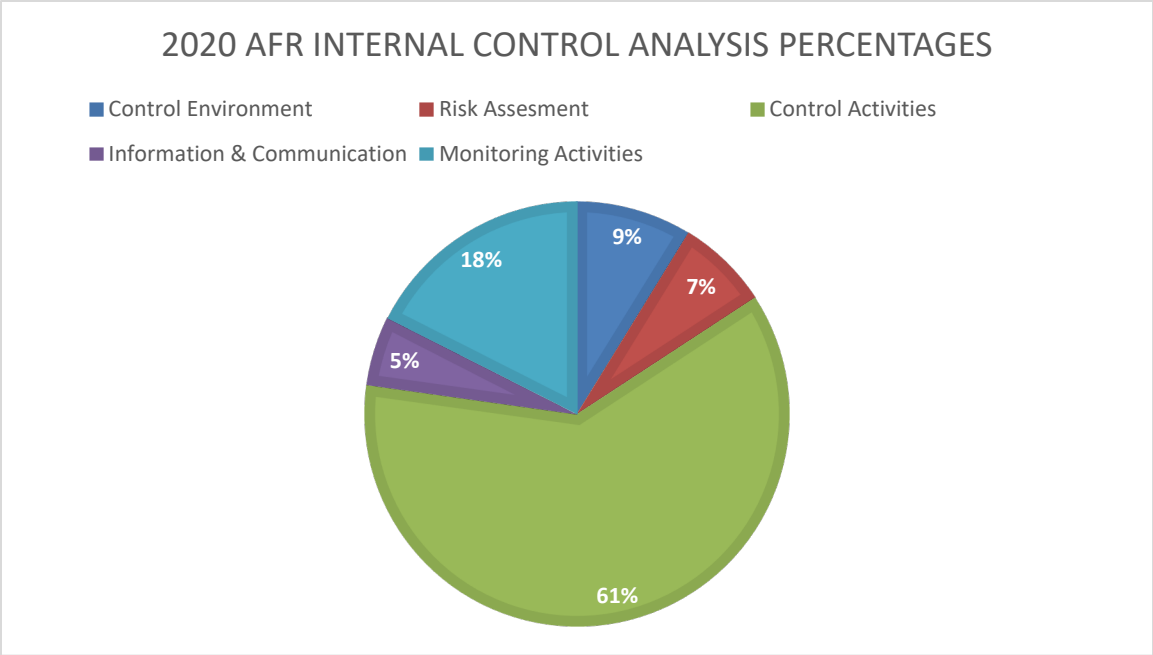

Figure 14. 2020 AFR Internal Control Makeup Percentage

4. FY 2021 DON AFR

In the 2021 DON AFR, 16 material weaknesses that encompass the DONs financial and operational aspects were identified, having 1 less material weakness as the prior FY. The property, plant, & equipment – utilities was resolved. These material weaknesses highlight significant deficiencies in internal controls, policies, procedures, and documentation across various segments of the DONs operations. Each of these areas exhibits critical gaps that may hinder the DON's ability to accurately substantiate financial balances reported in their financial statements. Table 5 presents the 16 material weaknesses found in the DON AFR in FY 2021 (Department of the Navy, 2021).

Table 5. FY 2021 Material Weaknesses. Adapted from Department of the Navy (2021).

FY 2021 Material Weaknesses	
1	Financial Reporting
2	Fund Balance with Treasury
3	Government Property with Contractors
4	Inventory and Related Property – OM&SR
5	Inventory and Related Property – OM&SO
6	Inventory and Related Property – OM&SV
7	Property, Plant, & Equipment – General Equipment
8	Property, Plant, & Equipment – Construction in Progress
9	Environmental and Disposal Liabilities
10	Expenses and A/P
11	Revenue and Unfulfilled Customer Orders
12	Budget Execution and Undelivered Orders
13	Entity Level Controls – Oversight and Monitoring
14	Financial Information Systems
15	Financial Information Systems – Configuration Management
16	Financial Information Systems – Interface Processing

These material weaknesses had numerous internal control deficiencies ranging from 1 to 6 deficiencies per material weakness. There was a total of 55 internal control deficiencies within the 16 total material weaknesses for FY 2021. Using the descriptions

in the FY 2021 DON AFR for the control deficiencies within each material weakness, each deficiency was aligned to the COSO framework internal control components. Figure 15 shows the alignment of the internal control components with material weaknesses.

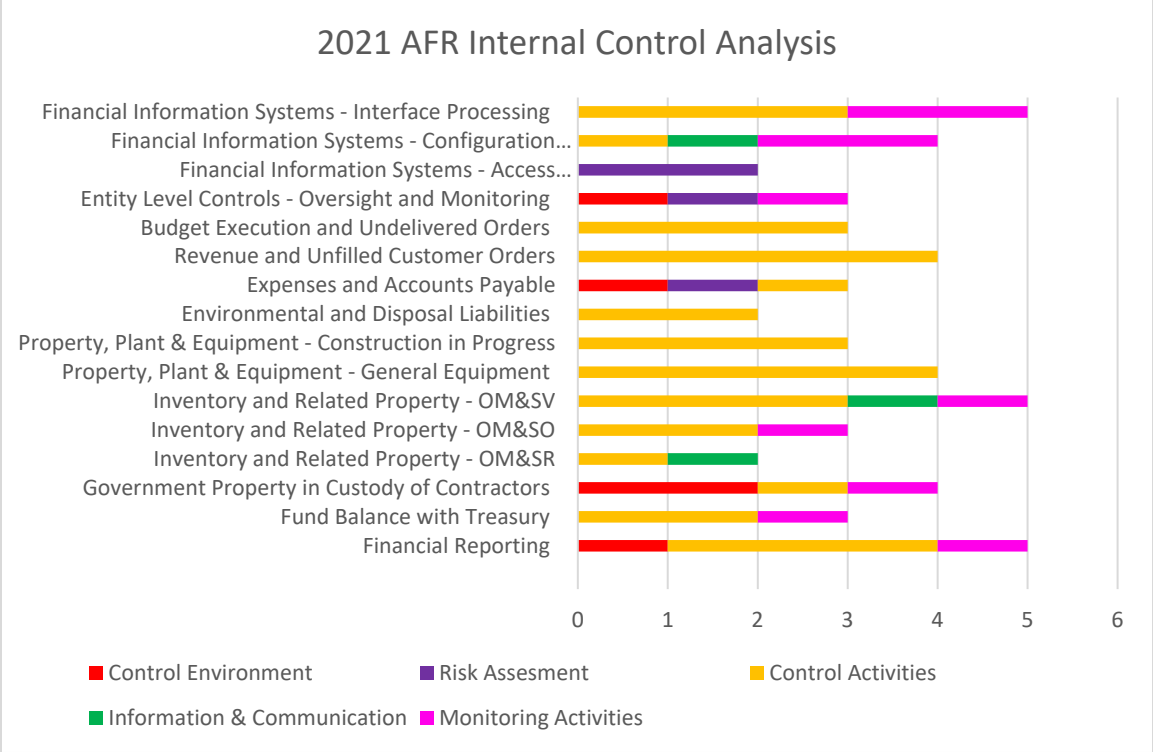

Figure 15. Material Weakness Deficiencies Tied to Internal Control Components

After evaluating the 55 internal control deficiencies, 9% were related to control environment, 7% were related to risk assessment, 60% were related to control activities, 6% were related to information & communication, and 18% were related to monitoring activities. This analysis indicates that control activities had the highest number of internal control deficiencies which may be of significant concern. Out of the 16 material weaknesses, only one material weakness was related to contracting and contract management, which was tied to a total of 4 internal control deficiencies. Contract management made up 7.3% of the total deficiencies and 6.3% of the total material

weaknesses. Figure 16 shows the percentage of the material weakness control deficiencies related to each internal control component within FY 2021.

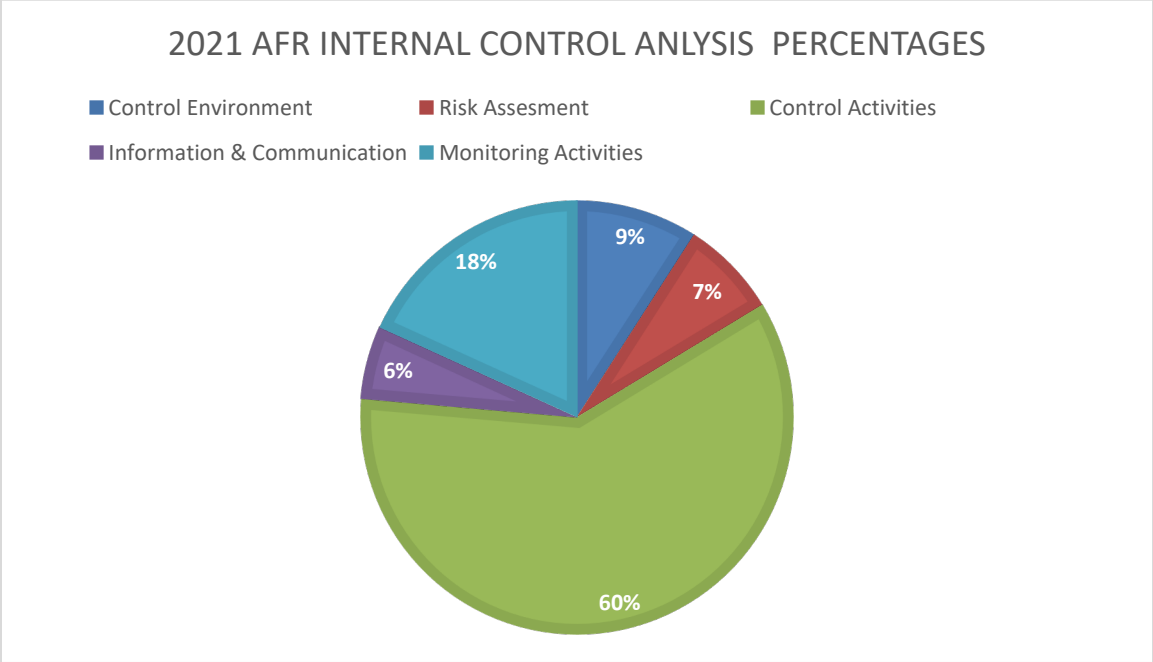

Figure 16. 2021 AFR Internal Control Makeup Percentage

5. FY 2022 DON AFR

In the 2022 DON AFR, 15 material weaknesses that encompass the DONs financial and operational aspects were identified, having 1 less material weakness as the prior FY. The environmental and disposal liabilities was resolved. These material weaknesses highlight significant deficiencies in internal controls, policies, procedures, and documentation across various segments of the DONs operations. Each of these areas exhibits critical gaps that may hinder the DON's ability to accurately substantiate financial balances reported in their financial statements. Table 6 presents the 15 material weaknesses found in the DON AFR in FY 2022 (Department of the Navy, 2022).

Table 6. FY 2021 Material Weaknesses. Adapted from Department of the Navy (2021).

FY 2021 Material Weaknesses	
1	Financial Reporting
2	Fund Balance with Treasury
3	Government Property with Contractors
4	Inventory and Related Property – OM&SR
5	Inventory and Related Property – OM&SO
6	Inventory and Related Property – OM&SV
7	Property, Plant, & Equipment – General Equipment
8	Property, Plant, & Equipment – Construction in Progress
9	Expenses and A/P
10	Revenue and Unfulfilled Customer Orders
11	Budget Execution and Undelivered Orders
12	Entity Level Controls – Oversight and Monitoring
13	Financial Information Systems
14	Financial Information Systems – Configuration Management
15	Financial Information Systems – Interface Processing

These material weaknesses had numerous internal control deficiencies ranging from 1 to 6 deficiencies per material weakness. There was a total of 51 internal control deficiencies within the 15 total material weaknesses for FY 2022. Using the descriptions in the FY 2022 DON AFR for the control deficiencies within each material weakness, each deficiency was aligned to the COSO framework internal control components. Figure 17 shows the alignment of the internal control components with material weaknesses.

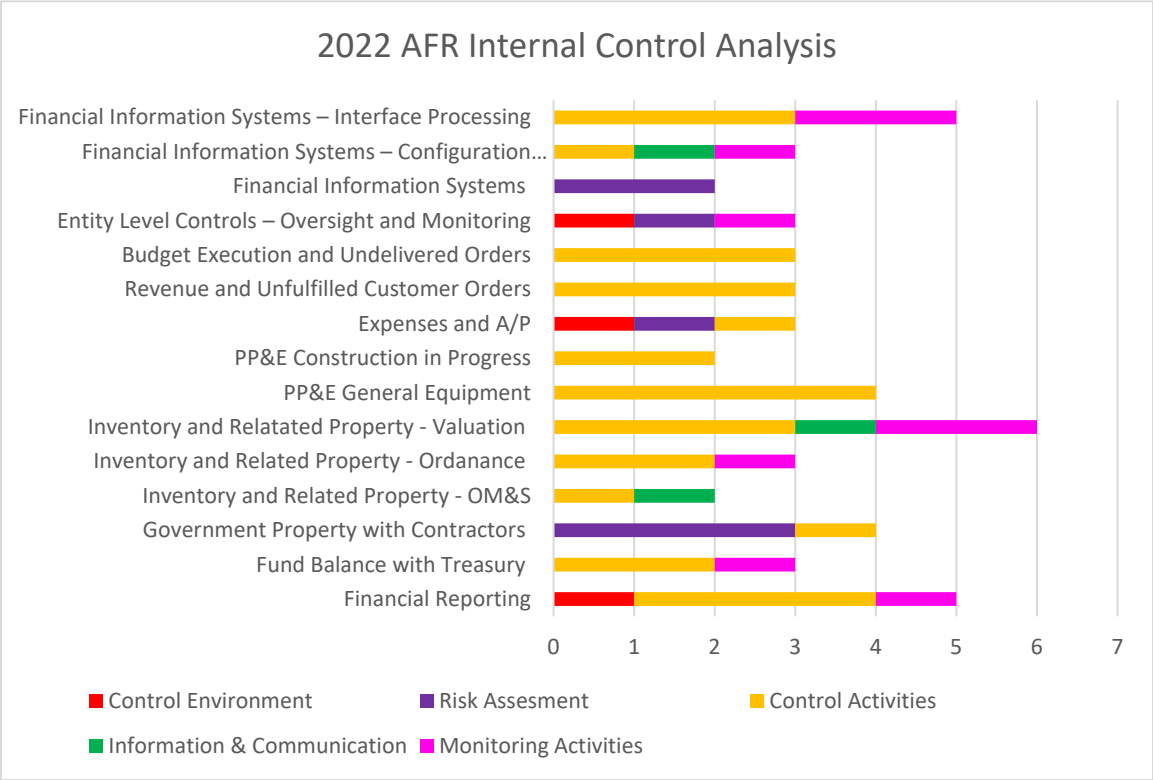

Figure 17. Material Weakness Deficiencies Tied to Internal Control Components

After evaluating the 51 internal control deficiencies, 6% were related to control environment, 14% were related to risk assessment, 57% were related to control activities, 6% were related to information & communication, and 17% were related to monitoring activities. This analysis indicates that control activities had the highest number of internal control deficiencies which may be of significant concern. Out of the 15 material weaknesses, only 1material weakness was related to contracting and contract management, which was related to a total of 4 internal control deficiencies. Contract management made up 7.8% of the total deficiencies and 6.7% of the total material weaknesses. Figure 18 shows the percentage of the material weakness control deficiencies related to each internal control component within FY 2022.

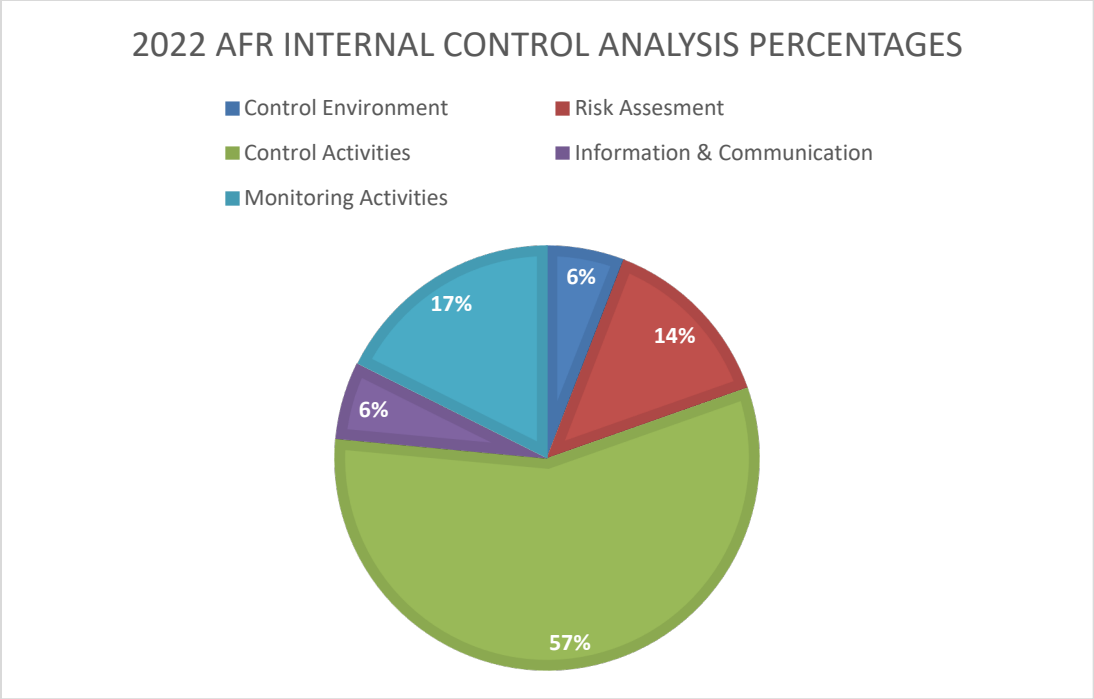

Figure 18. Material Weakness Deficiencies Tied to Internal Control Components

C. ANALYSIS

This section analyzes reoccurring material weaknesses from FY 2018 to FY 2022 and their associated internal control deficiencies. This trend analysis shows the patterns and changes in an organization's internal control deficiencies over time, highlighting persistent issues and areas identified for improvement. It allows stakeholders to assess the effectiveness of corrective actions implemented and to identify sectors that may require more rigorous control measures and oversight. There is a total of 16 material weaknesses being analyzed. There are 11 reoccurring material weaknesses from FY 2018 to FY 2022. There are 3 reoccurring weaknesses from FY 2019 to FY 2022. There is 1 reoccurring material weakness from FY 2019 to FY 2021. Finally, there is 1 reoccurring material weakness from FY 2020 to FY 2022. There were 2 material weaknesses resolved in FY 2019, 1 material weakness resolved in FY 2020, and 1 material weakness resolved in FY 2021. These 4 resolved material weaknesses were not evaluated due to the inability to create a trend analysis for them. For the purpose of this study, only material weaknesses

that reoccurred for 3 FYs or more were evaluated, and those 4 material weaknesses appeared in 2 FYs or less.

1. Trend Analysis of Each Reoccurring Material Weakness with Associated Internal Control Deficiencies

The first material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was financial reporting. In FY 2018, the DON had 7 internal control deficiencies (Department of the Navy, 2018). From FY 2019 to FY 2022, the DON had 5 out of those 7 deficiencies each FY, eliminating 2 internal control deficiencies (Department of the Navy, 2019–2022).

In 2018, the Department of the Navy detailed 7 internal control deficiencies:

- Internal control flaws in financial reporting
- Inadequate documentation on policies and procedures
- Lack of sufficient oversight and monitoring
- Lack of oversight of service provider
- Lack of controls over compliance
- Known errors in balance data
- Records trading partner eliminations that are non-compliant. (Department of the Navy, 2018, p. 51-53)

From 2019 to 2022, the Department of the Navy detailed 5 internal control deficiencies:

- Internal control flaws in financial reporting
- Lack of or inadequate documentation of financial reporting policies and procedures, including controls
- Lack of sufficient oversight and monitoring of financial reporting process
- Lack of oversight of service provider
- Lack of controls over compliance. (Department of the Navy, 2018–2022)

The average internal control deficiencies in the financial reporting material weakness is 5.4, as it had 27 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 19 shows the disbursement of internal control components across all the FYs for the financial reporting material weakness.

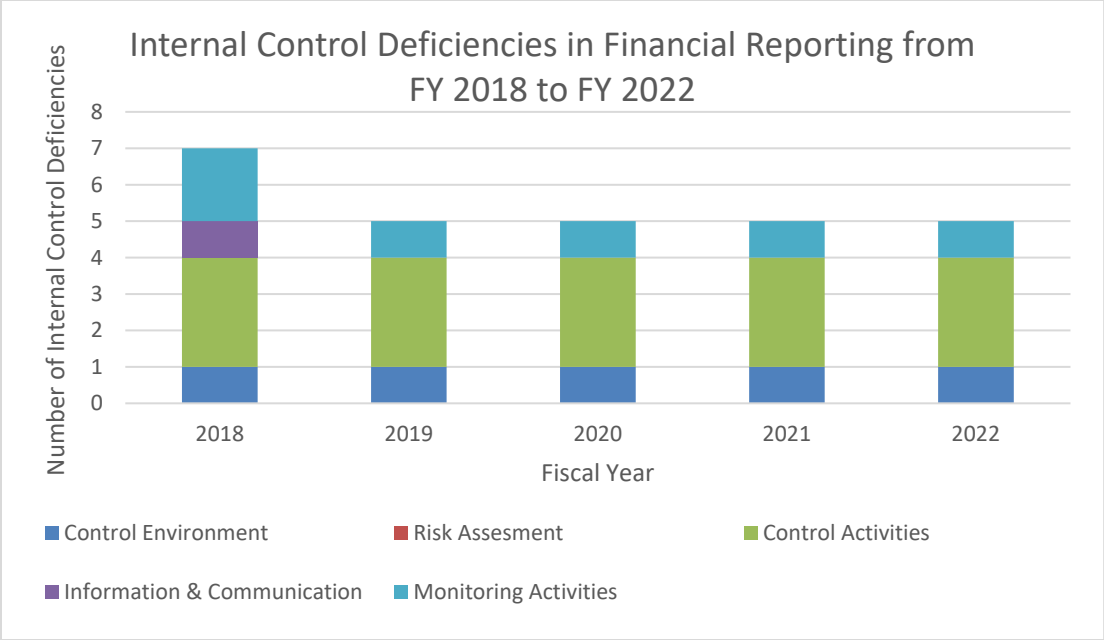

Figure 19. Internal Control Deficiencies in the Financial Reporting Material Weakness from FY 2018 to FY 2022

The second material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was fund balance with treasury (FBwT). In FY 2018, the DON had 5 internal control deficiencies (Department of the Navy, 2018). In FY 2019, the DON had 2 internal control deficiencies (Department of the Navy, 2019). From FY 2020 to FY 2022, the DON had the same 2 internal control deficiencies carry over from FY 2019 with 1 new internal control deficiency each FY (Department of the Navy, 2020–2022).

In 2018, the Department of the Navy detailed 5 internal control deficiencies:

- Recording resulting in an overstatement of collection
- Not compliant with OMB
- Does not have documentation for the FBwT process
- Unable to reconcile FBwT from the United States Standard General Ledger (USSGL) to the U.S. Treasury as the Navy's FBwT reconciliation is not adequately designed
- Navy Fund Balance not designed to identify the undistributed amount between DON and the U.S. Treasury. (Department of the Navy, 2018, p. 53)

In 2019, the Department of the Navy detailed 2 internal control deficiencies:

- Lack of or inadequate documentation of FBwT accounting policies and procedures, including controls, roles, responsibilities, processes, and transactions executed at each of its disbursing stations.
- Inability to reconcile FBwT from the USSGL to the U.S. Treasury as the Navy's FBwT reconciliation is not adequately designed. (Department of the Navy, 2019, p. 101–102)

From 2020 to 2022, the Department of the Navy detailed 3 internal control deficiencies:

- Lack of effectively designed or implemented controls in the FBwT process
- Lack of or inadequate documentation of FBwT accounting policies and procedures, including controls, roles, responsibilities, processes, and transactions executed at each of its disbursing stations
- Inability to reconcile FBwT from the USSGL to the U.S. Treasury as the Navy's FBwT reconciliation is not adequately designed. (Department of the Navy, 2020–2022)

The average internal control deficiencies in the FBwT material weakness is 3.2, as it had 16 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 20 shows the disbursement of internal control components across all the FYs for the FBwT material weakness.

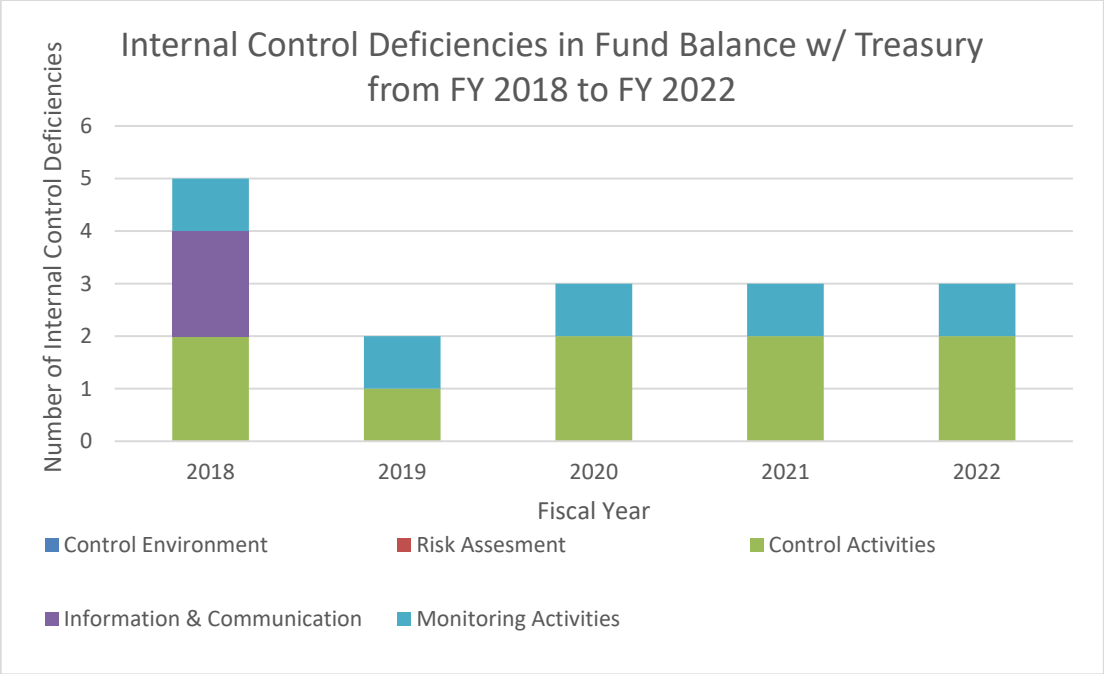

Figure 20. Internal Control Deficiencies in the Fund Balance with Treasury Material Weakness from FY 2018 to FY 2022

The third material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was expenses and accounts payable (AP). In FY 2018, the DON had 3 internal control deficiencies (Department of the Navy, 2018). In FY 2019, the DON had 1 internal control deficiency (Department of the Navy, 2019). From FY 2020 to FY 2022, the DON had 3 internal control deficiencies (Department of the Navy, 2020–2022).

In 2018, the Department of the Navy detailed 3 internal control deficiencies:

- Failed to record AP reported to management by its vendors at the transaction level
- Lacks sufficient documentation to support the procedures to accrue the AP estimate
- AP accrual methodology lacks appropriate rigor and precision excluding transactions without testing or documenting the validity of their exclusion. (Department of the Navy, 2018, p. 55)

In 2019, the Department of the Navy detailed 1 internal control deficiency:

- Current procedures over its end-to-end expense processes do not address financial reporting risks, leading to inaccuracies in amounts reported within the financial statements. Specifically, expenses and AP were not posted in a timely manner for the CVP, MILSTRIP, TOP, TOT, MILSTRIP. (Department of the Navy, 2019, p. 117)

From 2020 to 2022, the Department of the Navy detailed 3 new internal control deficiencies:

- Lack of effectively designed controls in the expense and AP process in posting of expenses and AP and receipt and acceptance
- Lack of sufficient AP control environment. There is a lack of sufficient controls surrounding the AP accrual process.
- Lack of effectively designed system migration process. (Department of the Navy, 2020–2022)

The average internal control deficiencies in the expenses and A/P material weakness is 2.6, as it had 13 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 21 shows the disbursement of internal control components across all the FYs for the expenses and A/P material weakness.

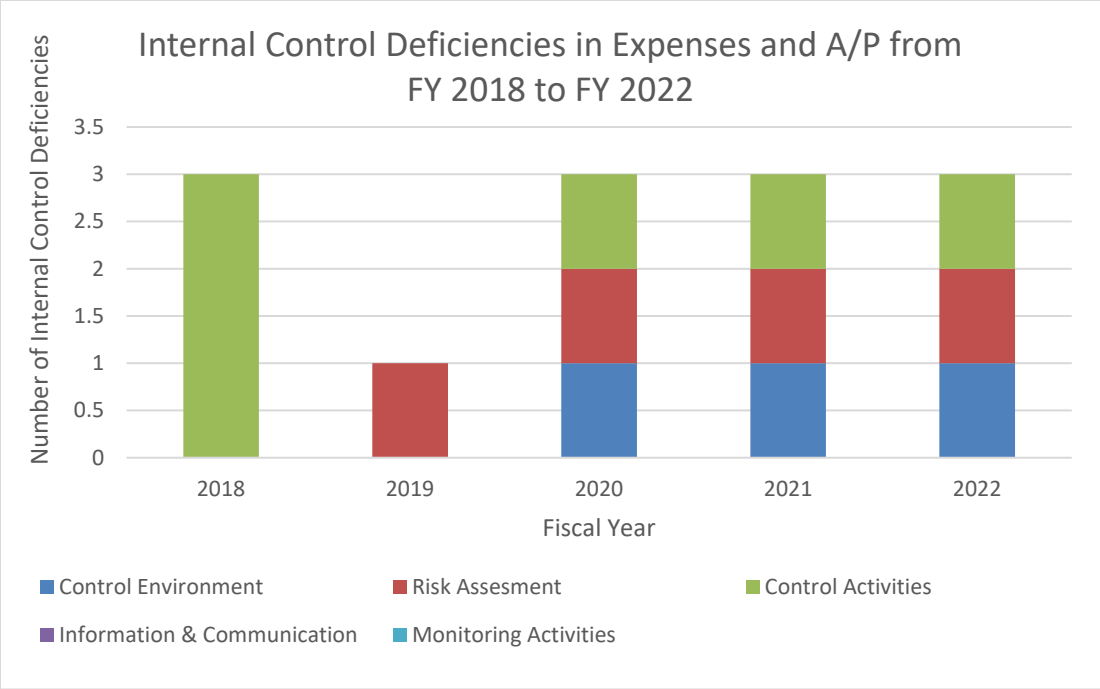

Figure 21. Internal Control Deficiencies in the Expenses and Accounts Payable Material Weakness from FY 2018 to FY 2022

The fourth material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was government property in custody with contractors. In FY 2018, the DON had 2 internal control deficiencies (Department of the Navy, 2018). From FY 2019 to FY 2022, the DON had 2 of the same internal control deficiencies carry over from FY 2018 with 2 new internal control deficiencies each FY (Department of the Navy, 2019–2022).

In 2018, the Department of the Navy detailed 2 internal control deficiencies:

- Lack of sufficient oversight of contractors for trident assets and does not promptly record dispositions or losses of property
- Lack of policies and procedures, that adequately describe the end-to-end process to maintain accountability for, or to financially report, property in the custody of contractors. (Department of the Navy, 2018, p. 56-57)

From 2019 to 2022, the Department of the Navy detailed 4 internal control deficiencies:

- Lack of sufficient oversight of contractors for GE-R Inadequate documentation on policies and procedures
- Lack of sufficient oversight of contractors for ordnance
- Lack of sufficient oversight of contractors for trident assets and inappropriate reliance on third parties for tridents
- Lack of or inadequate policies and procedures, including controls and related documentation. (Department of the Navy, 2019–2022)

The average internal control deficiencies in the government property in custody of contractor's material weakness is 3.6, as it had 18 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 22 shows the disbursement of internal control components across all the FYs for the government property in custody of contractor's material weakness.

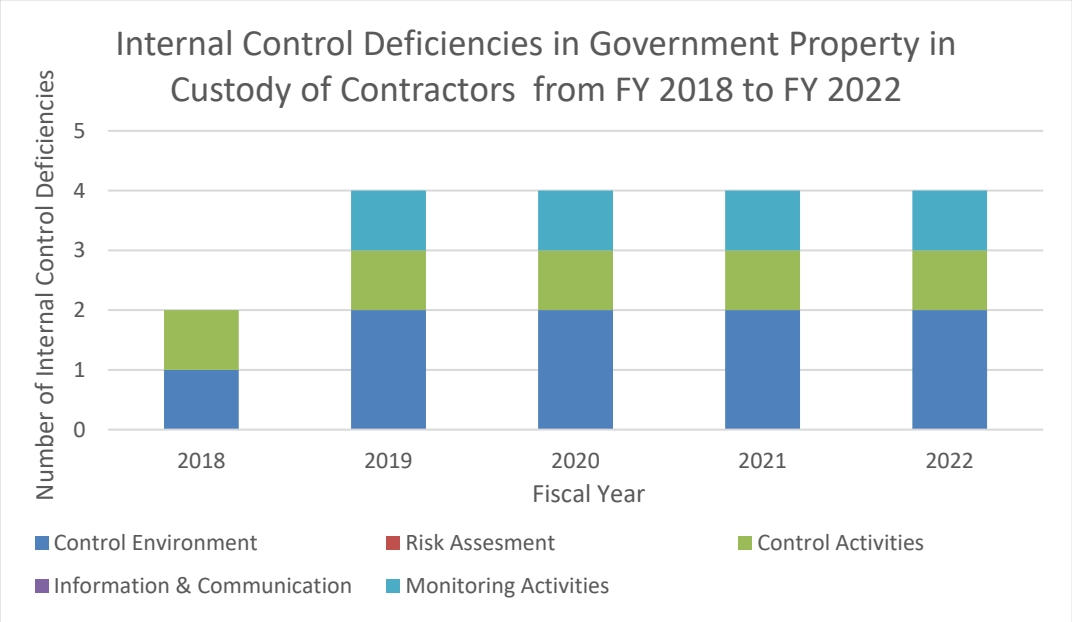

Figure 22. Internal Control Deficiencies in the Government Property in Custody of Contractors Material Weakness from FY 2018 to FY 2022.

The fifth material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was property, plant, & equipment – general equipment (PP&E-GE). In FY 2018, the DON had 5 internal control deficiencies (Department of the Navy, 2018). From FY 2019 to FY 2022, the DON had 4 internal control deficiencies carry over

from FY 2019 with 1 less deficiency each FY compared to FY 2018 (Department of the Navy, 2019–2022).

In 2018, the Department of the Navy detailed 5 internal control deficiencies:

- Has not implemented the USSGL account for PP&E
- Unable to identify a complete population of its general equipment assets
- Has not documented its processes for GE-R
- Process for performing a physical inventory is not operating effectively
- The issuance of a policy in direct conflict with DOD policy (Department of the Navy, 2018, p. 64-65)

From 2019 to 2022, the Department of the Navy detailed 4 internal control deficiencies:

- Has not implemented the USSGL account for PP&E
- Unable to identify a complete population of its general equipment assets
- Has not documented its processes for GE-R
- Process for performing a physical inventory is not operating effectively or in correct accordance with policy. (Department of the Navy, 2019–2022)

The average internal control deficiencies in the PP&E – GE material weakness is 4.2, as it had 21 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 23 shows the disbursement of internal control components across all the FYs for the PP&E-GE material weakness.

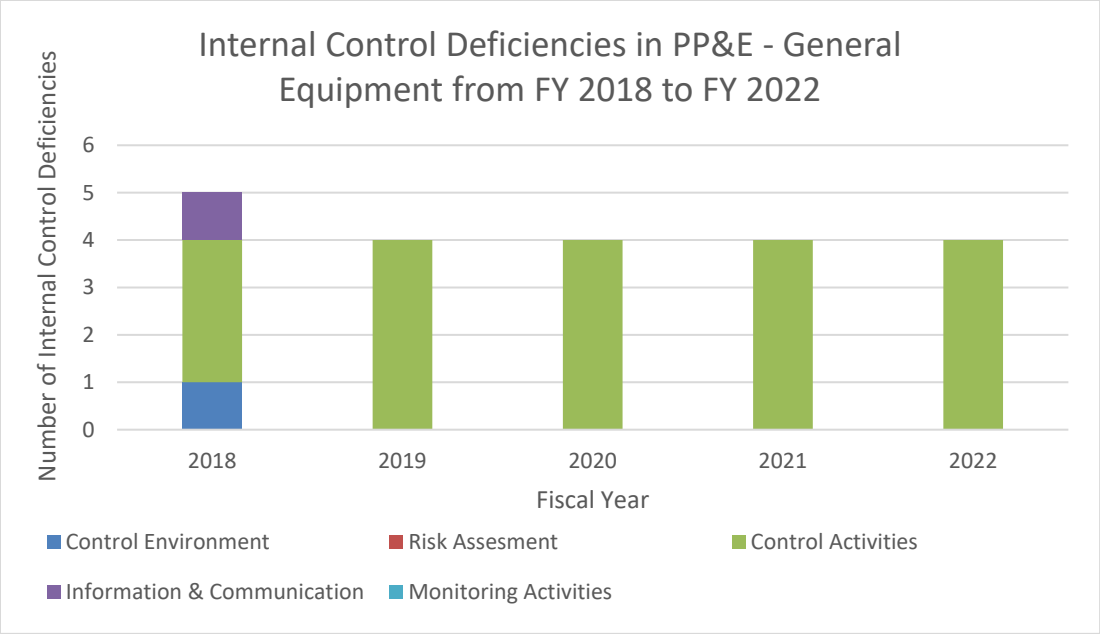

Figure 23. Internal Control Deficiencies in the Property, Plant & Equipment – General Equipment Material Weakness from FY 2018 to FY 2022

The sixth material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was inventory and related property – OM&SR. In FY 2018, the DON had 2 internal control deficiencies (Department of the Navy, 2018). FY 2019 had 3 internal control deficiencies with 2 of them carrying over from the previous FY, with 1 new internal control deficiency each FY (Department of the Navy, 2019). From FY 2020 to FY 2022, the DON had the same 2 internal control deficiencies carry over from FY 2019 with 1 less internal control deficiency each FY (Department of the Navy, 2020–2022).

In 2018, the Department of the Navy detailed 2 internal control deficiencies:

- Inability to identify a complete population of OM&S-R assets and is unable to provide a complete and accurate financial record, and does not report balances appropriately
- Lack of policies and procedures, including internal controls over OM&S-R valuation and accounting methodology. (Department of the Navy, 2018, p. 66)

In 2019, the Department of the Navy detailed 2 internal control deficiencies:

- Lack of or inadequate documentation of OM&S-R policies and procedures, including controls
- Inability to identify a complete population of OM&S-R assets and is unable to provide a complete and accurate financial record and does not report balances appropriately
- Lack of policies and procedures, including internal controls over OM&S-R valuation and accounting methodology. (Department of the Navy, 2019, p. 105)

From 2020 to 2022, the Department of the Navy detailed 3 internal control deficiencies:

- Lack of or inadequate documentation of OM&S-R policies and procedures, including internal controls
- Inability to identify a complete population of OM&S-R assets and is unable to provide a complete and accurate financial record and does not report balances appropriately. (Department of the Navy, 2020–2022)

The average internal control deficiencies in the inventory and related property – OS&SR material weakness is 2.2, as it had 11 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 24 shows the disbursement of internal control components across all the FYs for the inventory and related property – OS&SR material weakness.

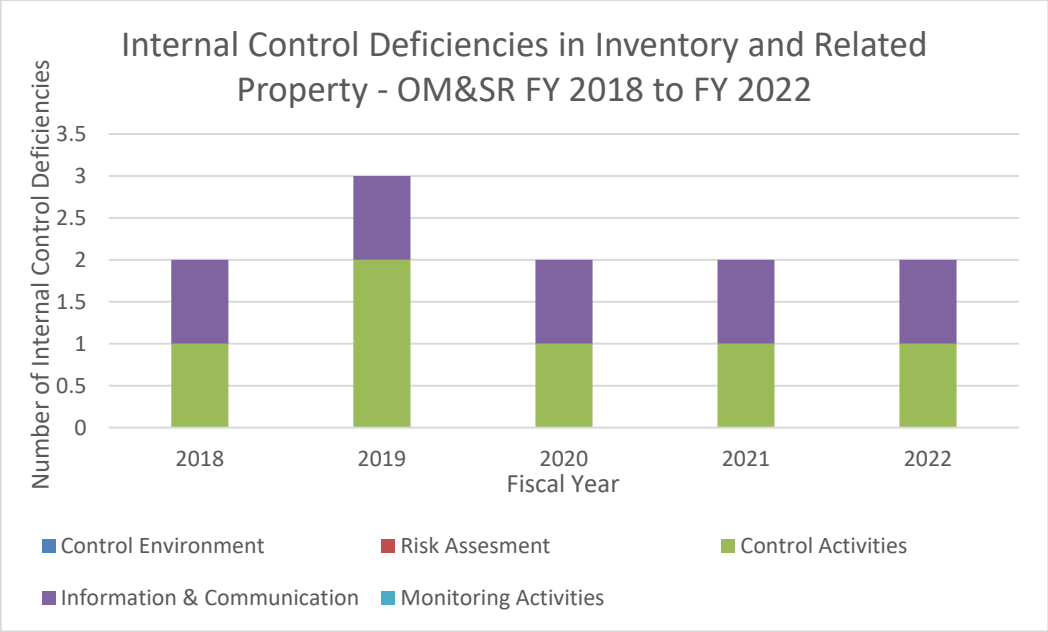

Figure 24. Internal Control Deficiencies in the Inventory and Related Property – OM&SR Material Weakness from FY 2018 to FY 2022

The seventh material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was inventory and related property – OM&SO. In FY 2018, the DON had 2 internal control deficiencies (Department of the Navy, 2018). In FY 2019 had 4 internal control deficiencies with 1 of the internal control deficiencies carrying over from the previous FY with 3 new internal control deficiencies each FY (Department of the Navy, 2019). From FY 2020 to FY 2022, the DON had the same 3 internal control deficiencies carry over from FY 2019 with 1 less internal control deficiency each FY (Department of the Navy, 2020–2022).

In 2018, the Department of the Navy detailed 2 internal control deficiencies:

- Lack of policies and procedures, including internal controls to effectively implement accounting standards, there are many instances where contractors failed to account for and report OM&S-O and the related transactions
- Unable to identify a complete and accurate population of its OM&S-O assets. (Department of the Navy, 2018, p. 67)

In 2019, the Department of the Navy detailed 4 internal control deficiencies:

- Lack of sufficient oversight and monitoring of ordnance held by third parties
- Inadequate or lack of controls over financial reporting of ordnance
- Lack of or inadequate documentation of ordnance accounting policies and procedures
- Lack of policies and procedures, including internal controls to effectively implement accounting standards. (Department of the Navy, 2019, p. 107)

From 2020 to 2022, the Department of the Navy detailed 3 internal control deficiencies:

- Lack of sufficient oversight and monitoring of ordnance held by third parties
- Inadequate or lack of controls over financial reporting of ordnance
- Lack of or inadequate documentation of ordnance accounting policies and procedures. (Department of the Navy, 2020–2022)

The average internal control deficiencies in the inventory and related property – OM&SO material weakness is 2.2, as it had 11 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 25 shows the disbursement of internal control components across all the FYs for the inventory and related property – OS&SO material weakness.

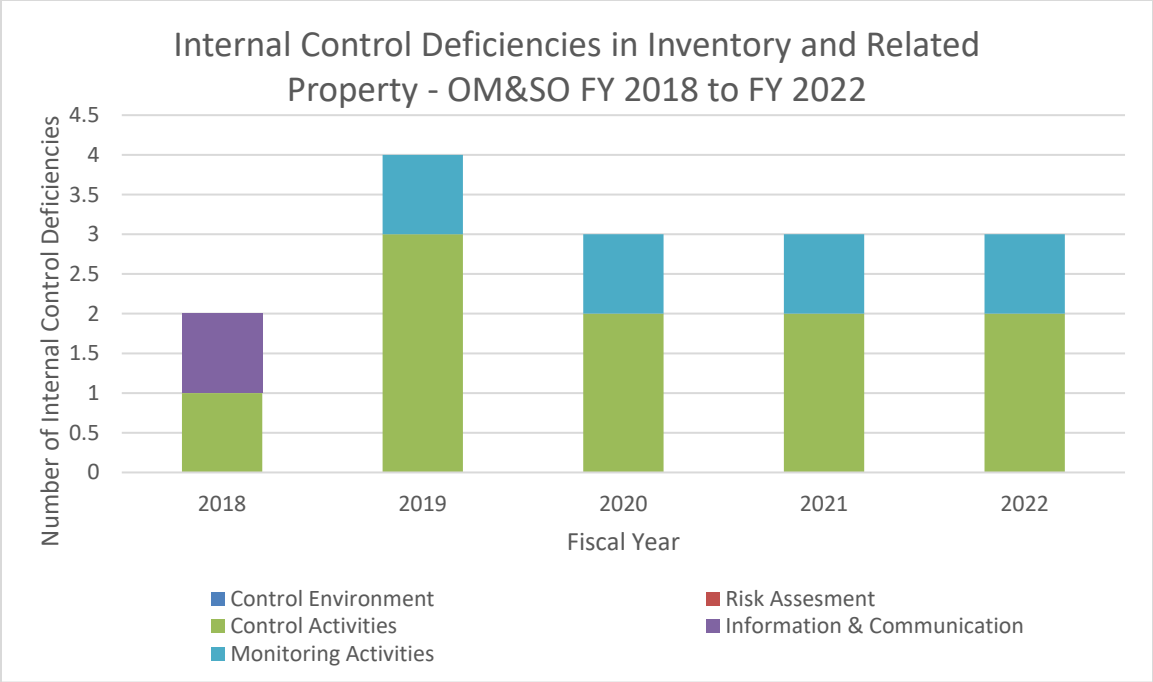

Figure 25. Internal Control Deficiencies in the Inventory and Related Property – OM&SO Material Weakness from FY 2018 to FY 2022

The eighth material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was oversight and monitoring. In FY 2018, the DON had 4 internal control deficiencies (Department of the Navy, 2018). From FY 2019 to FY 2022, the DON had the same 3 internal control deficiencies carry over from FY 2018 with 1 less internal control deficiency each FY (Department of the Navy, 2019–2022). In 2018, the Department of the Navy detailed 4 internal control deficiencies:

- Inadequate control environment related to management review controls
- Lack of risk assessment by failing to implement a policy for developing Enterprise Risk Management and internal control, including appropriate documentation
- Inadequate monitoring controls
- Navy has not designed and/or documented entity level controls to ensure compliance with the "Green Book" (GAO-14-704G), *Standards for Internal Control in the Federal Government.* (Department of the Navy, 2018, p. 69)

From 2019 to 2022, the Department of the Navy detailed 3 internal control deficiencies:

- Inadequate control environment related to management review controls
- Lack of risk assessment by failing to implement a policy for developing Enterprise Risk Management and internal control, including appropriate documentation
- Inadequate monitoring controls. (Department of the Navy, 2019–2022)

The average internal control deficiencies in the oversight and monitoring material weakness is 3.2, as it had 16 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 26 shows the disbursement of internal control components across all the FYs for oversight and monitoring material weakness.

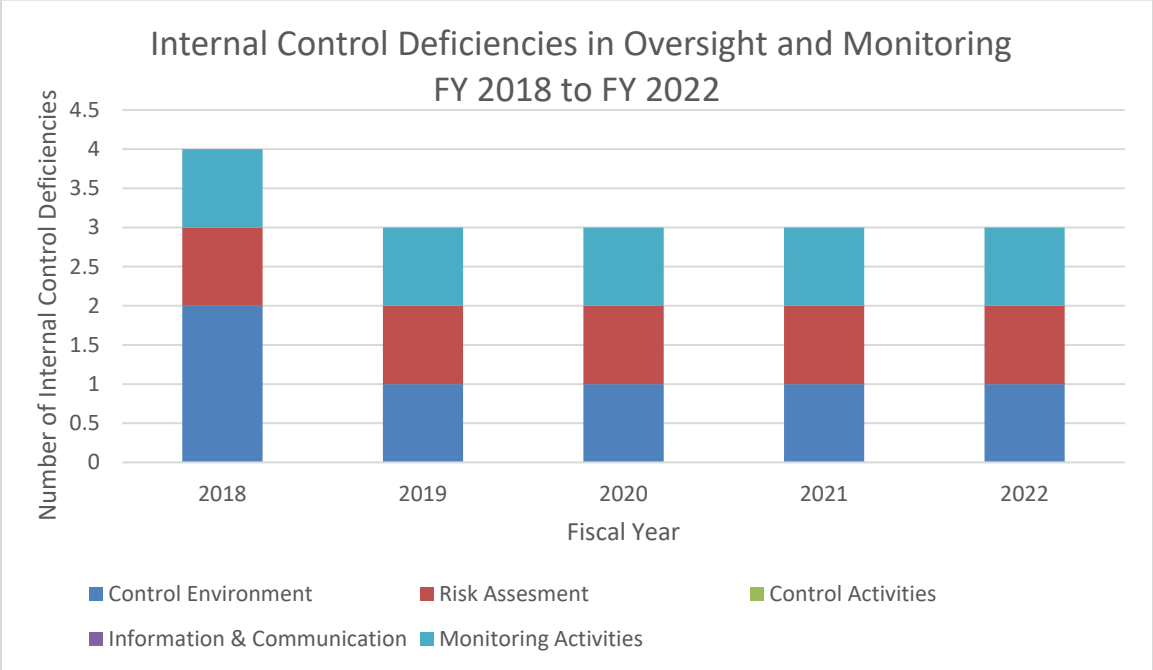

Figure 26. Internal Control Deficiencies in the Oversight and Monitoring Material Weakness from FY 2018 to FY 2022

The ninth material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was financial information systems – segregation of

duties. In FY 2018, the DON had 1 internal control deficiency (Department of the Navy, 2018). From FY 2019 to FY 2022, the DON had the 1 internal control deficiency carry over from FY 2018 with 1 new internal control deficiency each FY (Department of the Navy, 2019–2022).

In 2018, the Department of the Navy detailed 1 internal control deficiency:

> - Risk to the DON financial management information systems environment due to completeness and accuracy of user populations, inconsistent user access provisioning and termination processes, inconsistent periodic review and recertification of user access, and security administrator access to business and functional roles. (Department of the Navy, 2018, p. 46)

From 2020 to 2022, the Department of the Navy detailed 2 internal control deficiencies:

> - Risk to the DON financial management information systems environment due to completeness and accuracy of user populations, inconsistent user access provisioning and termination processes, inconsistent periodic review and recertification of user access, and security administrator access to business and functional roles
> - Significant risk to the DON financial management information systems. (Department of the Navy, 2020–2022)

The average internal control deficiencies in the financial information systems – segregation of duties material weakness is 1.8, as it had 9 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 27 shows the disbursement of internal control components across all the FYs for financial information system – segregation of duties material weakness.

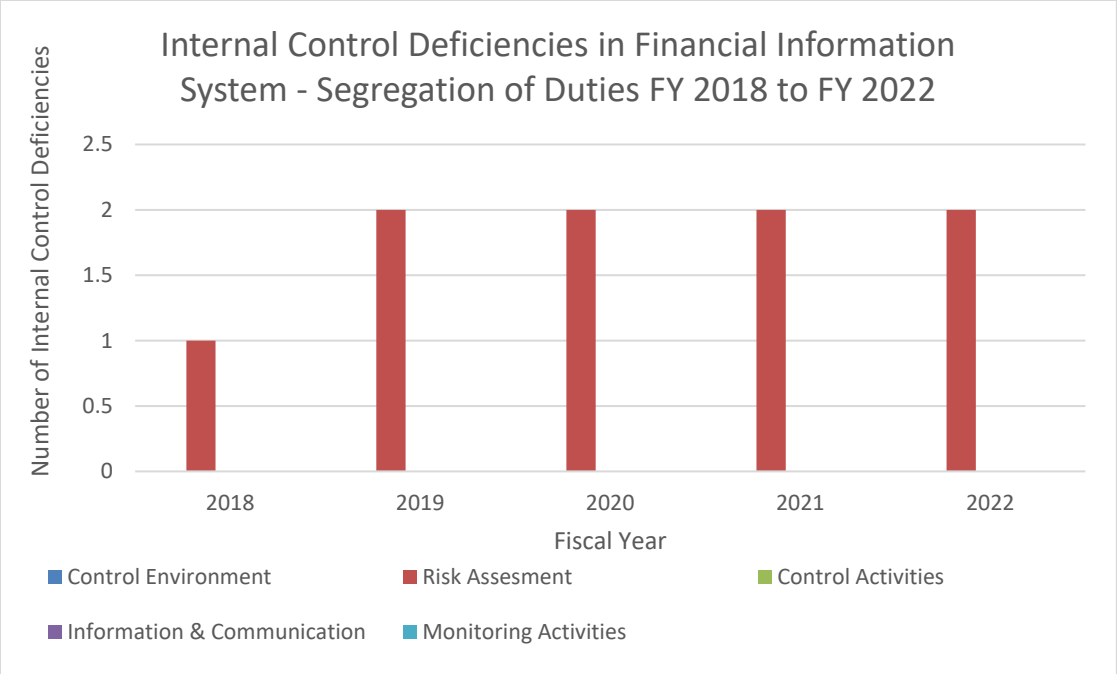

Figure 27. Internal Control Deficiencies in the Financial Information System – Segregation of Duties Material Weakness from FY 2018 to FY 2022

The tenth material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2018 to FY 2022 was financial information systems – configuration management. In FY 2018, the DON had 3 internal control deficiencies (Department of the Navy, 2018). From FY 2019 to FY 2021 had 5 internal control deficiencies each FY with 3 of them carrying over from FY 2018, and 2 new internal control deficiencies (Department of the Navy, 2019–2021). In FY 2022, it had 3 internal control deficiencies with 3 of them carrying over from FY 2021, resolving 2 internal control deficiencies (Department of the Navy, 2022).

In 2018, the Department of the Navy detailed 3 internal control deficiencies:

- Incomplete and inaccurate system generated population and inconsistent authorization, testing and approval of changes
- No segregation of duties within critical configuration management processes or access (i.e., developers with migrator access)
- Logging and monitoring controls were not implemented. (Department of the Navy, 2018, p. 47)

From 2019 to 2021, the DON detailed 5 internal control deficiencies:

- Lack of management review or monitoring of third-party service providers
- Inadequate governance and requirements during system conversion
- No segregation of duties within critical configuration management processes or access (i.e., developers with migrator access)
- Incomplete and inaccurate system generated population and inconsistent authorization, testing and approval of changes
- Logging and monitoring controls were not implemented. (Department of the Navy, 2019–2021)

In 2022, the Department of the Navy detailed 3 internal control deficiencies:

- Incomplete and inaccurate system generated population and inconsistent authorization, testing and approval of changes
- Logging and monitoring controls were not implemented
- No segregation of duties within critical configuration management processes or access (i.e., developers with migrator access). (Department of the Navy, 2022, p. 41)

The average internal control deficiencies in the financial information systems – configuration management material weakness is 4.2, as it had 21 total internal control deficiencies spanning from FY 2018 to FY 2022. Figure 28 shows the disbursement of internal control components across all the FYs for financial information system – configuration management material weakness.

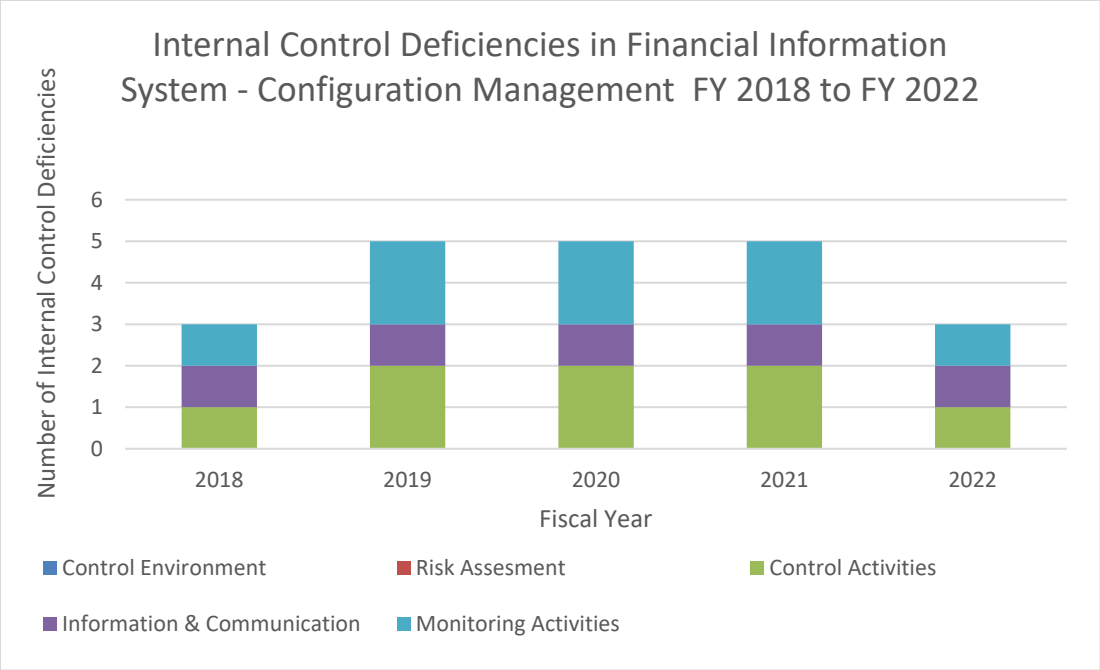

Figure 28. Internal Control Deficiencies in the Financial Information System – Configuration Management Material Weakness from FY 2018 to FY 2022

The eleventh material weakness analyzed out of the 11 reoccurring material weaknesses from FY 2019 to FY 2022 was financial information systems – interface processing. In FY 2018, the DON had 4 internal control deficiencies (Department of the Navy, 2018). From FY 2019 to FY 2022 the DON 5 internal control deficiencies each FY with 4 of them carrying over from FY 2018, and 1 new internal control deficiency (Department of the Navy, 2019–2022).

In 2018, the Department of the Navy detailed 4 internal control deficiencies:

- Inability to identify and verify that financially relevant edit checks
- Automated interface reconciliations were not performed between target systems
- Interface files were not consistently protected from unauthorized access
- Remediation of identified errors in interface processing were not completed. (Department of the Navy, 2018, p. 47)

From 2019 to 2022, the Department of the Navy detailed 5 internal control deficiencies:

- Logs of interface processing activities were not retained to support subsequent auditing
- Inability to identify and verify that financially relevant edit checks
- Automated interface reconciliations were not performed between target systems
- Interface files were not consistently protected from unauthorized access
- Remediation of identified errors in interface processing were not. (Department of the Navy, 2019–2022)

The average internal control deficiencies in the financial information systems – interface processing material weakness is 4.8, as it had 24 total internal control deficiencies spanning from FY 2018 to FY 2022. These are the 11 material weaknesses that reoccur from FY 2018 to FY 2022. Figure 29 shows the disbursement of internal control components across all the FYs for financial information system – interface processing material weakness.

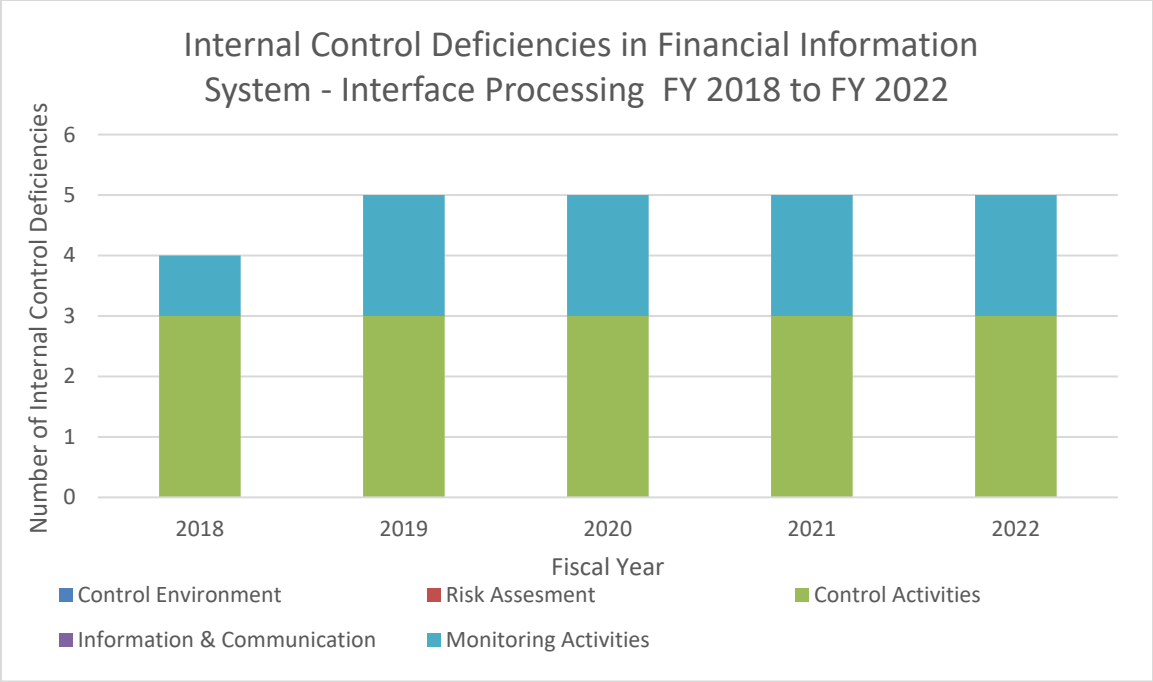

Figure 29. Internal Control Deficiencies in the Financial Information System – Interface Processing Material Weakness from FY 2018 to FY 2022

The next 3 material weaknesses analyzed are from FY 2019 to FY 2022. The first material weakness analyzed out of the 3 reoccurring material weaknesses from FY 2019 to FY 2022 was PP&E – construction in progress. From FY 2019 to FY 2021, the DON detailed the 2 internal control deficiencies (Department of the Navy, 2019–2021). FY 2022 had 3 internal control deficiencies with 2 of them carrying over from FY 2021, and 1 new internal control deficiency (Department of the Navy, 2022).

From 2019 to 2021, the Department of the Navy detailed 2 internal control deficiencies:

- Lack of policies, procedures, and controls over real property within construction in progress as controls are not in place for an adequate amount of time to ensure that all CIP is properly released
- Lack of sufficient policies, procedures, and controls over vessels with construction in progress. (Department of the Navy, 2019–2022)

In 2022, the Department of the Navy detailed 3 internal control deficiencies:

- Lack of sufficient policies, procedures, and controls over aircraft with construction in progress
- Lack of policies, procedures, and controls over real property construction in progress as controls are not in place for an adequate amount of time to ensure that all CIP is properly released
- Lack of sufficient policies, procedures, and controls over vessels with construction in progress. (Department of the Navy, 2022, p. 82)

The average internal control deficiencies in the PP&E – construction in progress material weakness is 1.8, as it had 9 total internal control deficiencies spanning from FY 2019 to FY 2022. Figure 30 shows the disbursement of internal control components across all the FYs for the PP&E – construction in progress material weakness.

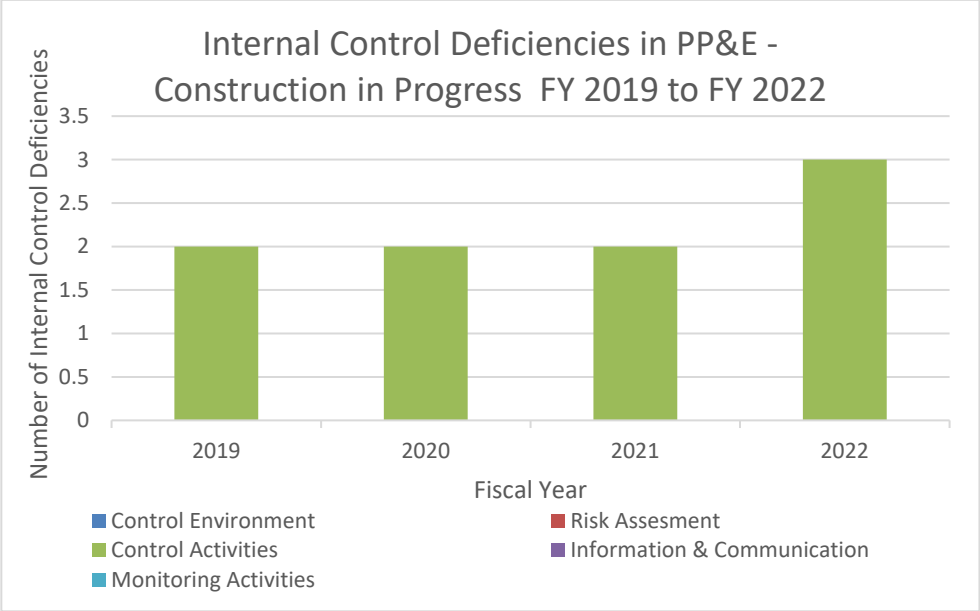

Figure 30. Internal Control Deficiencies in the PP&E – Construction in Progress Material Weakness from FY 2019 to FY 2022

The second material weakness analyzed out of the 3 reoccurring material weaknesses from FY 2019 to FY 2022 was budget execution and undelivered orders. From FY 2019 to FY 2022, the DON had 3 internal control deficiencies (Department of the Navy, 2019–2022).

From 2019 to 2022, the Department of the Navy detailed 3 internal control deficiencies:

- Lack of or inadequate documentation of budget execution policies and procedures, including internal controls
- Lack of or inadequate budget execution principles
- Lack of effectively designed controls in the budget execution process. (Department of the Navy, 2019–2022)

The average internal control deficiencies in the PP&E – construction in progress material weakness is 3, as it had 12 total internal control deficiencies spanning from FY 2019 to FY 2022. Figure 31 shows the disbursement of internal control components across all the FYs for the budget execution and undelivered orders material weakness.

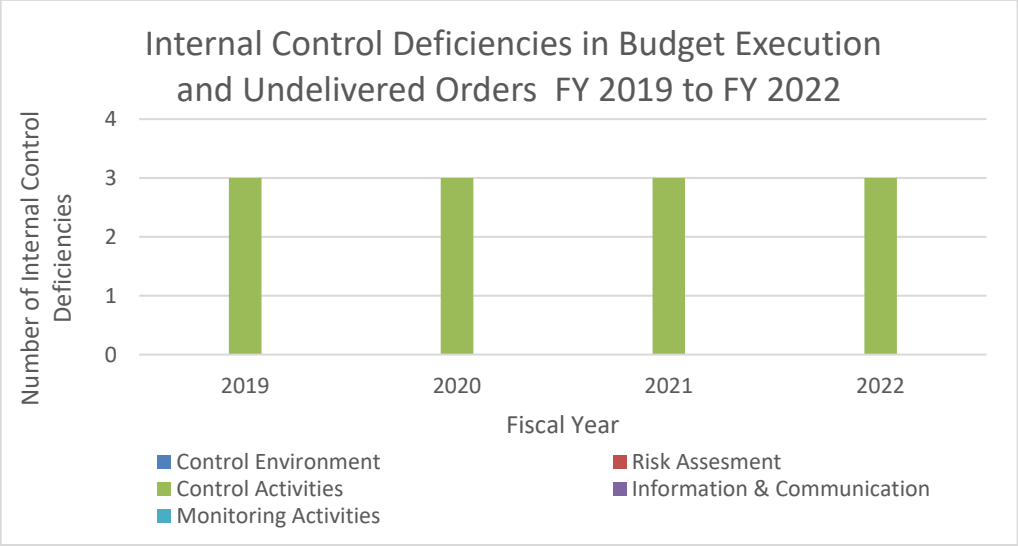

Figure 31. Internal Control Deficiencies in the Budget Execution and Undelivered Orders Material Weakness from FY 2019 to FY 2022

The third material weakness analyzed out of the 3 reoccurring material weaknesses from FY 2019 to FY 2022 was revenue and unfulfilled customer orders. It had the same 4 reoccurring internal control deficiencies from FY 2019 to FY 2022 (Department of the Navy, 2019–2022).

From 2019 to 2022, the Department of the Navy detailed the 4 internal control deficiencies:

- Lack of or inadequate documentation of RWO-P policies and procedures, including controls
- Ineffective or inadequate RWO-P procedures and processes
- Lack of effectively designed controls in the RWO-P process
- Inadequate controls over financial reporting of revenue. (Department of the Navy, 2019–2022)

The average internal control deficiencies in the revenue and unfulfilled customer orders material weakness is 4, as it had 16 total internal control deficiencies spanning from FY 2019 to FY 2022. Figure 32 shows the disbursement of internal control components across all the FYs for the budget execution and undelivered orders material weakness.

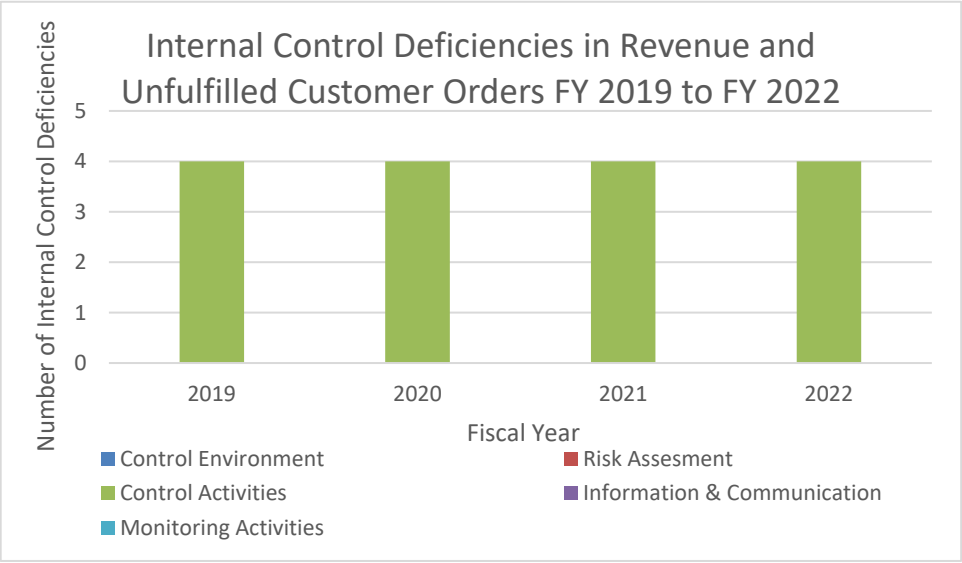

Figure 32. Internal Control Deficiencies in the Revenue and Unfulfilled Customer Orders Material Weakness from FY 2019 to FY 2022

The first and only reoccurring material weakness from FY 2019 to FY 2021 was environmental and disposal liabilities (EDL). In FY 2019, the DON had 4 internal control deficiencies (Department of the Navy, 2019). In FY 2020 and FY 2021, the DON had 2 internal control deficiencies with 2 of them carrying over from FY 2019, and 1 resolved deficiency from the previous FY (Department of the Navy, 2020–2021).

In 2019, the Department of the Navy detailed 3 internal control deficiencies:

- Lack of or inadequate documentation of EDL accounting policies and procedures, including controls. Policies and procedures are not sufficient to ensure proper documentation, including key assumptions or judgements
- Lack of complete and accurate data used in EDL process
- Lack of effectively designed controls in the EDL process. (Department of the Navy, 2019, p. 115)

In 2020 and 2021, the Department of the Navy detailed 2 internal control deficiencies:

- Lack of or inadequate documentation of EDL accounting policies and procedures, including controls. Policies and procedures are not sufficient to ensure proper documentation, including key assumptions or judgements.
- Lack of effectively designed controls in the EDL process. (Department of the Navy, 2021)

The average internal control deficiencies in the EDL material weakness is 2.3, as it had 7 total internal control deficiencies spanning from FY 2019 to FY 2022. Figure 33 shows the disbursement of internal control components across all the FYs for the EDL material weaknesses.

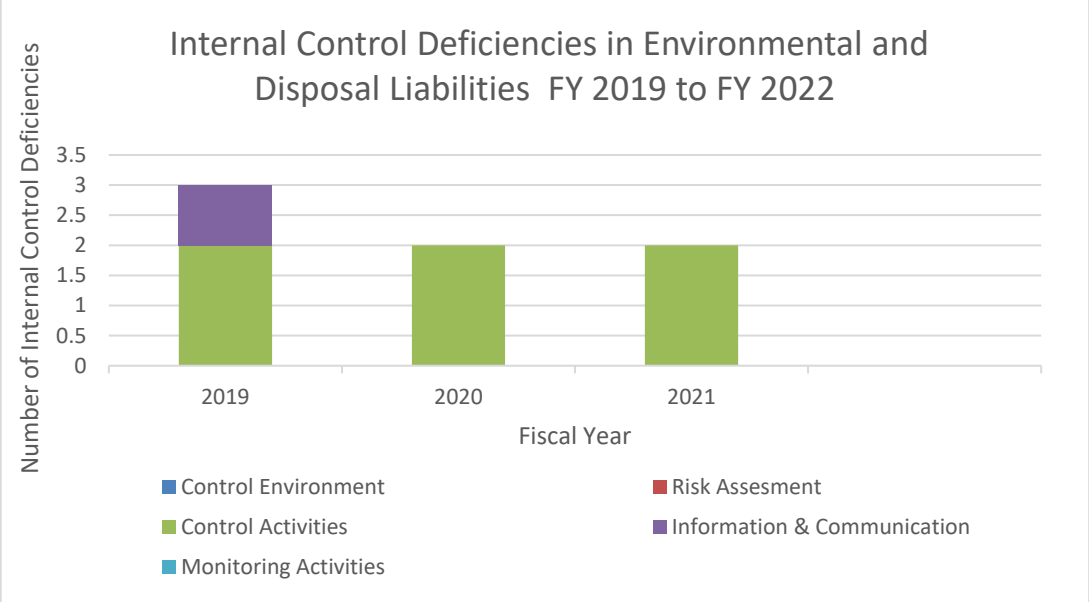

Figure 33. Internal Control Deficiencies in the Environmental and Disposal Material Weakness from FY 2019 to FY 2021

The first and only reoccurring material weakness from FY 2020 to FY 2022 was inventory and related property – OM&SV. From FY 2020 to FY 2022, the DON detailed 5 internal control deficiencies (Department of the Navy, 2020–2022).

From 2020 to 2022, the Department of the Navy detailed 5 internal control deficiencies:

- Has to revalue Trident and UAE assets
- Has not revalued ordnance assets
- Does not have procedures in place to evaluate the proper use
- Unable to provide support for current recording
- Does not have an adequate methodology to support the allowance. (Department of the Navy, 2020–2022)

The average internal control deficiencies in the inventory and related property – OM&SV material weakness is 5, as it had 15 total internal control deficiencies spanning from FY 2020 to FY 2022. Figure 34 shows the disbursement of internal control components across all the FYs for the inventory and related property – OM&SV material weaknesses.

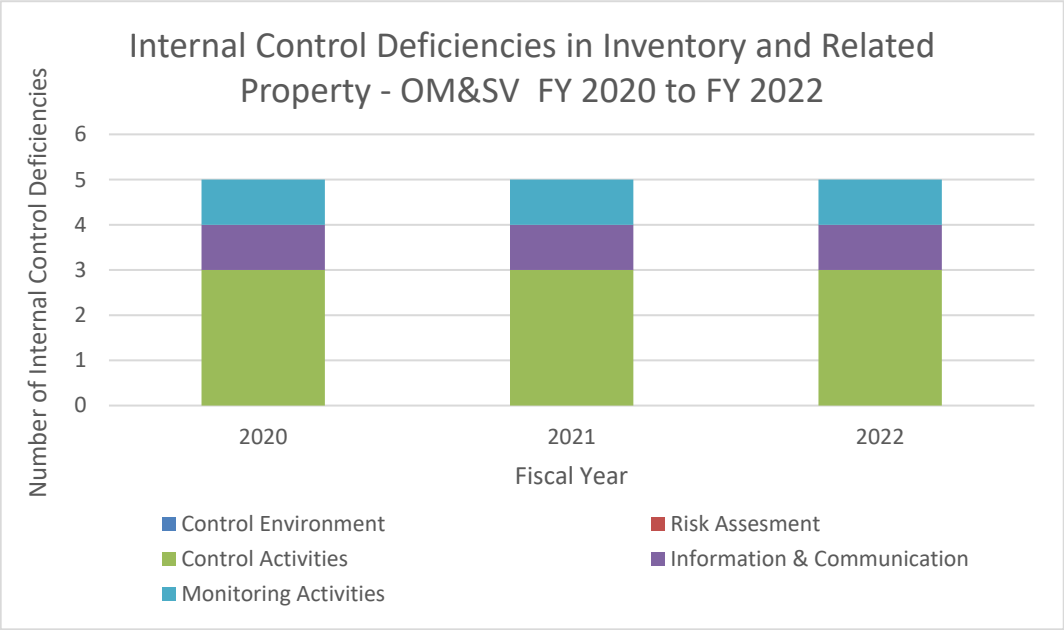

Figure 34. Internal Control Deficiencies in the Environmental and Disposal Material Weakness from FY 2019 to FY 2022

There were 4 material weaknesses that were resolved across all fiscal years: 2 in FY 2019, 1 in FY 2020, and 1 in FY 2021. The 2 resolved in FY 2019 were "property, plant & equipment – real property and property, plant & equipment – general equipment valuation" (Department of the Navy, 2019). The 1 resolved in FY 2020 was contingent legal liabilities (Department of the Navy, 2020). The 1 resolved in FY 2021 was property, plant & equipment – utilities (Department of the Navy, 2021). While they had notable internal control deficiencies, these 4 were not studied because there was no trend analysis to be developed from only 2 FYs of existence. The next two subsections discuss the material weakness related to contract management and external auditor's recommendations. This involves evaluating and categorizing the recommendations.

2. Contract Management Material Weakness

The only contract management-related material weakness was the government property in custody with contractors. It had 2 internal control deficiencies in FY 2018, and it had 4 internal control deficiencies from FY 2019 to FY 2022. The average internal control deficiencies in the government property in custody of contractor's material weakness is 3.6, as it had 18 total internal control deficiencies spanning from FY 2018 to FY 2022.

3. An Example of How to Quantitatively Evaluate the External Auditor's Recommendations – Contract Management

There were 3 internal control deficiencies in FY 2018 with 37 recommendations for those internal control deficiencies related to contract management. There were 4 internal control deficiencies for each FY from FY 2019 to FY 2022. There were 11 recommendations in FY 2019, 19 recommendations in FY 2020, 19 recommendations in FY 2021, and 18 recommendations in FY 2022. Figure 34 shows the numerous recommendations made by external auditors for each FY. This is for one material weakness, showing the alarming number of changes needed for one material weakness. It helps shows the progress made to reduce internal control issues and can help identify what

areas are still needing improvement. The next section discusses the implications of the findings and analysis.

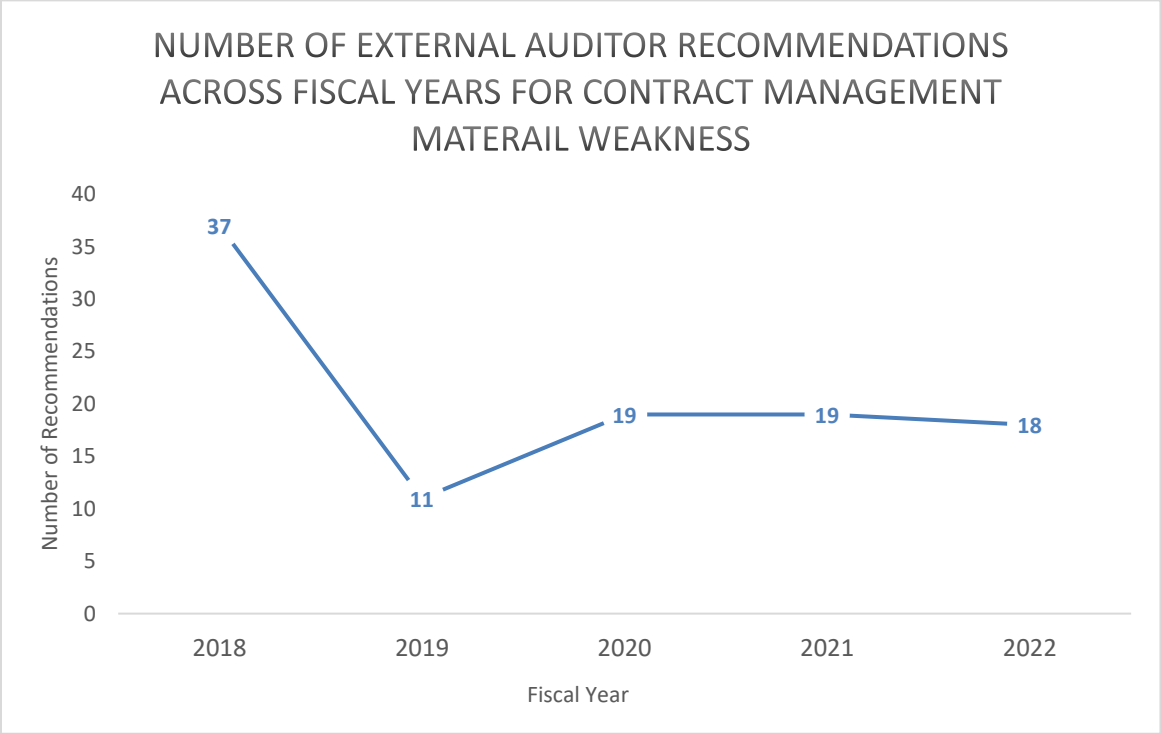

Figure 35. Number of External Auditor Recommendations from FY 2018 to FY 2022 For Contract Management

D. IMPLICATIONS OF FINDINGS

The extensive analysis of recurring material weaknesses in the DON financial reporting from FY 2018 to FY 2022, particularly in control activities, reveals implications for its internal controls. Control activities, as indicated by the data, consistently accounted for the highest proportion of control deficiencies across the FYs analyzed with monitoring activities being second. This pattern shows a critical vulnerability in the DON's ability to enforce necessary checks and balances within its financial operations. It suggests a systemic issue where the processes meant to ensure the accuracy and reliability of financial data are not robust enough, leading to risks of financial misstatement and non-compliance with applicable standards.

This analysis reveals persistent challenges in financial management and operational practices. This assessment emphasizes critical areas where the DON's ability to provide accurate and reliable financial statements is compromised, reflecting systemic issues such as inadequate oversight, insufficient internal controls, and flawed documentation processes. The examination of these reports identifies recurring material weaknesses across several FYs, highlighting the urgency for targeted reforms. The primary areas of concern include financial reporting accuracy, fund management, asset control, and the execution of operational budgets. Despite some variations, a consistent thread of deficiencies in control activities is prevalent, pointing to the need for stronger regulatory compliance and oversight mechanisms.

The recommendations section will provide a strategic blueprint aimed at addressing these deficiencies, with specific emphasis on the one material weakness related to contract management. By implementing internal controls, enhancing the training and capabilities of financial personnel, and improving information systems and procedures, the DON can better secure its financial integrity and operational effectiveness. These recommendations will focus on both immediate corrective actions and long-term reforms to foster transparency, accountability, and efficiency in the DON's financial management practices.

The repeated deficiencies not only impact the trustworthiness of financial reporting, but also reflect on the overall effectiveness of risk management practices within the DON. These findings suggest that while policies may be in place, their execution is often flawed or insufficiently monitored. This is a significant concern as it directly affects the DON's ability to manage and safeguard its resources effectively. Without strong control activities, the likelihood of undetected errors or even fraudulent activities increases, potentially leading to financial losses or reputational damage. This situation calls for an urgent review and enhancement of the existing control mechanisms to better align with best practices and regulatory requirements. The contract management material weakness can lead to poorly managed contracts and inadequate oversight of government property with contractors. This can lead to significant financial losses, inefficiencies, and increased risks of fraud and misuse of resources. These issues undermine the effectiveness and accountability of

government operations, compromising public trust and potentially compromising mission-critical objectives.

In response to these findings, it is important for the DON to take actions to strengthen its overall environment. This includes investing in training and development to enhance the competencies of personnel involved in control activities, upgrading financial information systems to support more robust controls, and implementing more monitoring procedures to ensure that control measures are effectively applied. Addressing these deficiencies is not only crucial for achieving compliance with financial regulations but also for enhancing the overall operational efficiency and accountability of the DON. Such measures will help in building a more resilient financial management system that can withstand the complexities of modern financial environments. The next section discusses the recommendations based on the findings.

E. RECOMMENDATIONS BASED ON FINDINGS

There are three recommendations, based on the findings, that could help the DON with enhancing internal controls and risk management frameworks: modernizing financial information systems create a better training program for personnel and focus on the auditability triangle. These recommendations come forth due to the biggest deficiencies stemming from control activities and monitoring activities. For the financial systems, there needs to be an involvement of integrating advanced technology solutions that provide real-time monitoring and analysis capabilities, thus enabling quicker detection and resolution of discrepancies. Additionally, these systems should be equipped with automated checks and enhanced security features to reduce the potential for human error and prevent unauthorized access. For the training program, the program should focus on the latest financial management practices and compliance requirements, emphasizing the importance financial reporting. The training should also include regular updates and refresher courses to keep all personnel up to date with changes in regulations and internal policies. The DON can enhance accountability and ensure a high standard of financial governance by implementing these two recommendations.

In addition to the two recommendations discussed previously, a third recommendation would be to focus on the "auditability triangle: capable processes, competent personnel, and effective internal controls" (Rendon and Rendon, 2015a). These components are interdependent; the effectiveness of one impacts the others. Implementing capable processes ensures operational and financial efficiency through continuous measurement and improvement. Competent personnel reduce financial errors and fraud risks due to proper training and reliability. Effective internal controls enable adherence to IRM, OMB, and FIAR guidance more strictly, facilitated by enforced and monitored controls. This approach enhances overall operational integrity and accountability.

F. SUMMARY

The analysis of the DON financial reporting from FY 2018 to FY 2022 reveals persistent material weaknesses with numerous internal control deficiencies. This shows significant vulnerabilities in its internal control systems. The trend analysis analyzing each individual material weakness shows a recurring issue with control activities, which consistently exhibited the highest proportion of deficiencies. This pattern highlights systemic weaknesses in the DON's financial operations. This impacts the accuracy and reliability of financial data and raises concerns about non-compliance with applicable standards.

The implications of these findings are substantial, affecting the trustworthiness of the DON's financial reporting and its overall effectiveness. The analysis indicates that despite having policies in place, their implementation is often flawed or inadequately monitored. This flawed system could lead to undetected errors, potential fraud, financial losses, or reputational damage. These issues present the need for an urgent reassessment and strengthening of the existing control mechanisms to align better with best practices and regulatory requirements.

The recommendations based on findings include investing in the modernization of financial information systems and to develop and implement a robust training program for personnel involved in financial operations. This is primarily due to control activities making up the highest percentage of internal control deficiencies. Additionally, the

narrowed focus of the auditability triangle is essential for building a resilient financial management system capable of mitigating issues with control activities. These recommendations could help navigate the complexities of modern financial environments and maintain high standards of accountability and transparency within the DON.

V. SUMMARY, CONCLUSIONS, RESEARCH QUESTIONS, AND AREAS FOR FURTHER RESEARCH

A. INTRODUCTION

This chapter provides a summary of this research study's findings on the DON AFRs internal control deficiencies. It then provides a conclusive overview that shows the challenges with internal control deficiencies, particularly highlighting financial reporting accuracy, fund management, asset control, and operational budget execution. The research questions explored in this study address the identification of internal control material weaknesses and their alignment with the components of the COSO framework. This chapter suggests areas for further research, such as the impact of technological advancements on internal controls, the effectiveness of auditor recommendations over time, and a comparative analysis of internal control frameworks across different military branches. It offers different pathways to enhance the DON's financial governance and oversight mechanisms.

B. SUMMARY

This research on DON AFRs presents an analysis of material weaknesses in internal controls from FY 2018 to FY 2022. The study highlights persistent challenges in financial management and identifies critical areas requiring improvement. It particularly focuses on challenges in financial reporting accuracy, fund management, asset control, and operational budget execution. The analysis highlights that control activities, among the five components of the COSO framework, is the most frequently identified deficiency, indicating significant issues with regulatory compliance and oversight within the Navy's financial operations.

Throughout the analysis, recurring material weaknesses across several FYs were identified, emphasizing the need for focused reforms to address these systemic issues. For instance, the study showed a consistent pattern of deficiencies in control activities, which affected the DON's ability to provide reliable financial statements and comply with established financial management standards. The persistent nature of these issues suggests

that despite previous efforts, more effective measures are required to rectify these control weaknesses. The contract management material weakness was briefly analyzed showing how to evaluate the recommendations given by external auditors for material weaknesses.

C. CONLUSIONS

The DON has a complex financial management environment that challenges the effectiveness of its internal controls. The diverse systems and processes, some of which are outdated, complicates the task of establishing an internal control framework. This situation grows due to the varying levels of financial management practices across different units within the DON. There is a need for enhanced oversight and integration of financial management practices across the DON. The DON AFRs have shown constant material weaknesses. The recurring issues among financial reporting, financial statements, and operations expose the vulnerabilities in the DON's financial controls. These material weaknesses are indicating substantial deficiencies in the DON's internal control systems, which suggests that existing measures are insufficient in mitigating risks to financial accuracy and reliability. Overall, there needs to be an enhancement in all aspects of "the auditability triangle: competent personnel, capable processes, and effective internal controls" (Rendon and Rendon, 2015a).

D. RESEARCH QUESTIONS

Table 7 answers the three research questions that are stated in the beginning of this research study. The three questions include what internal controls material weaknesses were identified in the DON AFRs, based on the analysis of material weaknesses for all FY's, how do they align with the COSO Framework, and based on the analysis of material weaknesses, what recommendations are identified for the Navy's improvement of internal controls and contract management?

Table 7. Research Questions

Research Questions	Summary of Findings
1. What internal controls material weaknesses were identified in the DON AFRs?	• FY 2018 had 13 material weaknesses, FY 2019 had 17 material weaknesses, FY 2020 had 17 material weaknesses, FY 2021 had 16 material weaknesses, and FY 2022 had 15 material weaknesses. • All the material weaknesses from FY 2018–2022 include "financial reporting, FBwT, government property with contractors, PP&E – GE, PP&E – real property, PP&E – GE valuation, inventory and related property – OM&SR, inventory and related property – OM&SO, oversight and monitoring, financial information systems – segregation of duties, financial information systems – configuration management, financial information systems – interface processing, PP&E – utilities, PP&E – construction in progress, EDL, legal liabilities, revenue and unfilled customer orders, budget execution and undelivered orders, and inventory and related property – OM&SV" (Department of the Navy, 2018–2022).
2. Based on the analysis of material weaknesses for all FY's, how do they align with the COSO Framework?	• Each FY, there was an average of 52.6 internal control related deficiencies within the material weaknesses with most of them belonging to ineffective control activities. • Control environment made up 9% of the internal control deficiencies. Risk assessment made up 8% of the internal control deficiencies. Control activities made up 59% of the internal control deficiencies. Information and communication made up 7% of the internal control deficiencies. Monitoring activities made up 17% of the internal control deficiencies.
3. Based on the analysis of material weaknesses, what recommendations are identified for the Navy's improvement of internal controls and contract management?	• Overall, it is recommended, specifically for the contract management material weakness to validate inventory lists, continuously update these lists and property records, and implement inventory tracking systems, whether technological or written. • The DON also needs to continuously train its personnel for proper inventory etiquette and implement a policy that strictly enforces more direct oversight and monitoring.

E. AREAS FOR FURTHER RESEARCH

Based on the research on DON AFRs and the identification of internal control deficiencies, there are several areas for further research. These areas for further research include the impact of technological advancements on internal controls, a comparative analysis over fiscal years on external auditor recommendations to material weaknesses, and comparative analysis of internal controls with other branches included.

1. **Technological Advancements on Internal Controls**: Future research could explore how advancements in technology, especially in financial software and data analytics, can enhance or challenge the DON's internal control mechanisms. This would investigate the role of automated systems in reducing human error and increasing efficiency in financial reporting.

2. **Comparative Analysis on External Auditor Recommendations:** A comparative analysis across all FYs on external auditors' recommendations on material weaknesses allow researchers to review the recommendations. This review allows researchers to identify trends and impacts on compliance and financial integrity over time. This could involve examining the implementation of these recommendations and measuring their effectiveness in mitigating identified weaknesses. By comparing data across different fiscal years, it would be possible to assess the progress in addressing audit concerns and the role of technological integration in enhancing the audit response.

3. **Comparative Study with Other Branches of the Military**: This research could be expanded to include a comparative analysis of internal control frameworks across different branches of the U.S. military. The study would highlight best practices and areas needing improvement. This would provide a broader perspective on financial management

effectiveness within the DOD. The study could help all branches mitigate risks and implement more effective internal controls.

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF REFERENCES

American Institute of Certified Public Accountants. (2013, November). *COSO internal control- integrated framework*. Retrieved March 2024, from https://us.aicpa.org/interestareas/businessindustryandgovernment/resources/riskmanagmentandinternalcontrol/coso-integrated-framework-project

Artsyl. (n.d.). *Financial Statements and Reports: What CFOs Need to Know.* Retrieved March 2024, from https://www.artsyltech.com/blog/Financial-Statements-And-Reports-For-CFO#:~:text=Role%20of%20CFOs%20in%20Managing%20Financial %20Statements%20and%20Reports&text=Overseeing%20the%20preparation%20and%20distribution,prepared%20and%20distributed%20to%20stakeholders.

Berman, M. (2024, January 24). ERM 101: *What's COSO, and why should I care?* Retrieved March 2024, from https://www.ncontracts.com/nsight-blog/erm-101-whats-coso-and-why-should-i-care

BlackLine. (n.d.). *Integrated audit.* Retrieved May 2024, from https://www.blackline.com/resources/glossaries/integrated-audit/

Bureau of the Fiscal Service. (n.d.-a). *About us.* U.S. Department of the Treasury. https://fiscal.treasury.gov/about.html

Bureau of the Fiscal Service. (n.d.-b). *Financial report of the United States government*. U.S. Department of the Treasury. Retrieved Month Day, Year, from https://www.fiscal.treasury.gov/reports-statements/financial-report/

Bureau of Government Financial Operations. (1976). *United States government consolidated financial statements.* Department of the Treasury. https://www.fiscal.treasury.gov/files/reports-statements/financial-report/cfs-1975.pdf

Chief Information Officers Council. (2024). *2.4 Chief Financial Officers Act (1990): Information technology laws*. Retrieved March 2024, from https://www.cio.gov/handbook/it-laws/cfo-act/

Colgren, David. (2019, February 01). *Modernizing government financial reporting.* Retrieved May 2024, from https://www.sfmagazine.com/articles/2019/february/modernizing-government-financial-reporting

Committee of Sponsoring Organizations of the Treadway Commission. (2013). *Internal Control – Integrated framework, executive summary*. Retrieved April 2024, from https://www.coso.org/_files/ugd/3059fc_1df7d5dd38074006bce8fdf621a942cf.pdf

Committee of Sponsoring Organizations of the Treadway Commission. (2023). *Home page*. Retrieved April 2024, from https://www.coso.org/

Comptroller General of the United States. (2011, December). *Government auditing standards: 2011 revision* (GAO-12-331G). Government Accountability Office. https://www.gao.gov/assets/files.gao.gov/assets/gao-12-331g.pdf

Comptroller General of the United States. (2014, September 10). *Standards for internal control in the federal government* (GAO-14-704G). Government Accountability Office. https://www.gao.gov/products/gao-14-704g

Congressional Research Service. (2023, December 06). *Hidden Cost: The True Price of Federal Debt to American Taxpayers.* https://gop-waysandmeans.house.gov/wp-content/uploads/2023/12/Driessen-Testimony.pdf

Cornell University. (n.d.) *About the COSO Framework.* Division of Financial Services – University Controller. Retrieved May 2024, from https://finance.cornell.edu/controller/internalcontrols/cosoframework

Diligent Corporation. (2019, April 8). *The three phases of contract management*. https://www.diligent.com/resources/blog/three-phases-contract-management%2F

D'Anjou, S. (2017, September 22). *Financial improvement and audit readiness (FIAR) overview* [Video]. Defense Acquisition University. https://media.dau.edu/media/Financial+Improvement+and+Audit+Readiness+(FIAR)+Overview/1_u37dz70y

Defense Acquisition University. (n.d.). *Financial improvement and audit remediation (FIAR) for product support*. Retrieved April 2024, from https://www.dau.edu/acquipedia-article/financial-improvement-and-audit-remediation-fiar-product-support

Defense Finance and Accounting Service. (n.d.). *Mission*. Retrieved April 2024, from https://www.dfas.mil/dfasffmia/

Deloitte. (2018). *Navigating the revised OMB circular A-123: What are the new requirements for internal control?* https://www2.deloitte.com/us/en/pages/public-sector/articles/navigating-the-revised-omb-circular-a-one-two-three.html

Department of the Navy. (2008, June). *Managers' internal control manual.* (SECNAV M-5200.35). Retrieved April 2024, from https://comptroller.defense.gov/Portals/45/documents/micp_docs/Reference_Documents/Department_of_Navy_MICM.pdf

Department of the Navy. (2018). *Department of the Navy fiscal year 2018 agency financial report*. https://www.secnav.navy.mil/fmc/fmo/Documents/18NavyWCF_AFRdraft11-14v2.pdf

Department of the Navy. (2019). *Department of the Navy fiscal year 2019 agency financial report.* https://www.secnav.navy.mil/fmc/fmo/Documents/Navy-General-Fund-and-DON-Working-Capital-Fund-FY19-AFR-Final-13112019.pdf

Department of the Navy. (2020). *Department of the Navy fiscal year 2020 agency financial report.* https://www.secnav.navy.mil/fmc/fmo/Documents/2020%20Annual%20Financial%20Report.pdf

Department of the Navy. (2021). *Department of the Navy fiscal year 2021 agency financial report.* https://www.secnav.navy.mil/fmc/fmo/Documents/FY%202021%20Navy%20Agency%20Financial%20Report_11.15.2021.pdf

Department of the Navy. (2022). *Department of the Navy fiscal year 2021 agency financial report.* https://www.secnav.navy.mil/fmc/fmo/Documents/FY%202022%20Department%20of%20Navy%20Agency%20Financial%20Report%20(AFR)_FINAL_FOR%20PUBLISHING.pdf

Department of the Navy. (2023). *Department of the Navy: Financial management strategy*. https://www.secnav.navy.mil/fmc/Documents/Department%20of%20Navy%20Financial%20Management%20Strategy.pdf

Federal Accounting Standards Advisory Board. (n.d.). *History of FASAB*. Retrieved April 2024, from https://fasab.gov/about-fasab/fasab-history/the-history-of-fasab/

Federal Accounting Standards Advisory Board. (1993, September 02). *Statement of federal financial accounting concepts*. https://files.fasab.gov/pdffiles/handbook_sffac_1.pdf

Federal Managers Financial Integrity Act, 31 U.S.C. § 66a (1982).

Federal News Network. (2021, May 03). *DOD targets 2028 for first clean financial statement audit*. https://federalnewsnetwork.com/defense-main/2021/05/dod-targets-2028-for-first- clean-financial-statement-audit/

Financial Management and Comptroller. (n.d.-a). *AGC(F) mission*. Secretary of the Navy. Retrieved April 2024, from https://www.secnav.navy.mil/fmc/Pages/agcf.aspx

Financial Management and Comptroller. (n.d.-b). *ASN (FM&C) – Honorable Russell Rumbaugh*. Secretary of the Navy. Retrieved April 2024, from https://www.secnav.navy.mil/fmc /Pages/Leadership.aspx

Financial Management and Comptroller. (n.d.-c). *FMA background*. Secretary of the Navy. Retrieved April 2024, from https://www.secnav.navy.mil/fmc/Pages/fma.aspx

Financial Management and Comptroller. (n.d.-e). *FMS vision*. Secretary of the Navy. Retrieved April 2024, from https://www.secnav.navy.mil/fmc/Pages/FMS.aspx

Financial Management and Comptroller. (n.d.-d). *FMB vision*. Secretary of the Navy. Retrieved April 2024, from https://www.secnav.navy.mil/fmc/Pages/FMB.aspx

Government Accountability Office. (1977, February 1). *The United States General Accounting Office: Its role as an independent audit and evaluation agency*. https://www.gao.gov/products/100454

Government Accountability Office. (2004, December 21). *OMB circular A-123 – management's responsibility for Internal Control*. National Archives and Records Administration. https://obamawhitehouse.archives.gov/omb/circulars_a123_rev

Government Accountability Office. (2011, September 13). *DOD financial management: improvement needed in DOD components' implementation of audit readiness effort.* (GAO-11-851). https://www.gao.gov/products/gao-11-851#:~:text=In%20May%202010%2C%20DOD%20issued,FIPs)%20for%20achieving%20audit%20readiness.

Government Accountability Office. (2016, December 1). *Enterprise risk management: Selected agencies' experiences illustrate good practices in managing risk* (GAO-17-63). https://www.gao.gov/products/gao-17-63

Government Accountability Office. (2018, February). *Understanding the financial report of the United States government* (GAO-18-239SP).

Government Accountability Office. (2021, April 14). *Government auditing standards: 2018 revision technical update April 2021 (Supersedes GAO-18-568G)* (GAO-21-368G). https://www.gao.gov/products/gao-21-368g

Government Accountability Office. (2023, May). *Additional actions needed to achieve a clean audit opinion on DOD's financial statements* (GAO-23-105784). https://www.gao.gov/assets/gao-23-105784.pdf

Government Accountability Office. (2023, August). *U.S. consolidated financial statements: Improvements needed in internal controls over treasury and OMB Preparation Processes* (GAO-23-106707). https://www.gao.gov/products/gao-23-106707

Government Accountability Office. (2024, February 15). *Financial Audit: FY 2023 and FY 2022 consolidated financial statements of the U.S. Government*. (GAO-24-106660). https://www.gao.gov/products/gao-24-106660

Grigoryan, Aram. (2023, May 16). *A Theory of auditability for allocation mechanisms*. arXiv. https://arxiv.org/abs/2305.09314

Hoffman, M.-L. (2017, July 12). *EY wins $149M contract to audit navy financial statements*. GovCon Wire. Retrieved April 2024, from https://www.govconwire.com/2017/07/ey-wins-149m-contract-to-audit-navy-financial-statements/

Judge, L. (2022). *About generally accepted government auditing standards*. Seattle.gov. Retrieved May 2024, from https://www.seattle.gov/oig/audits/about-gagas#:~:text=In%20short%2C%20GAGAS%20are%20the,by%20governments%20around%20the%20country.

Kahn, A. A. (2023, July 13). *DOD financial management: Efforts to address auditability and systems challenges need to continue* (GAO-23-106941). Government Accountability Office.

Liberto, D. (2022, March 29). *Internal auditor (IA): Definition, process, and example*. Investopedia. from https://www.investopedia.com/terms/i/internalauditor.asp#:~:text=An%20internal%20auditor%20(IA)%20is%20a%20trained%20professional%20tasked%20with,proper%20procedures%20and%20function%20efficiently

McDonough, R., & Warren, J. D., Jr. (2022). Accounting and the U.S. Constitution: The evolution of federal financial accounting and reporting practices. *Journal of Governmental & Nonprofit Accounting, 11*(1), 87–118. https://doi.org/10.2308/JOGNA-2021-008

Municipal Technical Advisory Service. (2022, October 27). *National Defense Authorization Act of 2010*. University of Tennessee Institute for Public Service. https://www.mtas.tennessee.edu/reference/national-defense-authorization-act-2010

National Archives and Records Administration. (2009). *Federal Register – The daily journal of the United States government*. Federal Register. Retrieved April 2024, from https://www.federalregister.gov/agencies/federal-accounting-standards-advisory board#:~:text=The%20mission%20of%20the%20FASAB,users%20of%20federal%20financial%20information

National Contract Management Association. (2017). *Contract management body of knowledge (CMBOK)* (5th ed.).

National Contract Management Association. (2023). *The contract management standard* (3rd ed.). https://www.ncmahq.org/common/Uploaded%20files/Standards%20Practices/ANSI-NCMA%20ASD%201-2019 %20(R2022).pdf

Naval Audit Service. (n.d.). *Naval audit service.* Department of the Navy. Retrieved May, 2024 from https://www.secnav.navy.mil/navaudsvc

Naval Sea Systems Command. (2015, May 19). *Comptroller department*. https://www.navsea.navy.mil/Home/Warfare-Centers/NSWC-Corona/What-We-Do/Comptroller-Department/

Naval Sea Systems Command. (2023, December 1). *SUPSHIP operations manual (SOM)* (NAVSEA S0300-B2-MAN-010). Department of the Navy. https://www.navsea.navy.mil/Home/SUPSHIP/SUPSHIP-Operations-Manual/

Office of Budget. (2024, January 10). *FMB Vision*. DON Financial Management Strategy. https://www.secnav.navy.mil/fmc/Pages/FMB.aspx

Office of the Commandant. (2022, November). *Management's responsibility for internal controls and reporting requirements* (COMDTINST 5200.10A). U.S. Coast Guard. https://media.defense.gov/2022/Nov/03/2003107756/-1/-1/0/CI_5200_10A.PDF

Officer of Financial Services. (n.d.) *Leadership.* Department of the Navy. Retrieved May 2024, from *https://www.secnav.navy.mil/fmc/fmo/Pages/Leadership.aspx*

Office of Inspector General. (n.d.). *About generally accepted government auditing standards*. City of Seattle. Retrieved May 2024, from https://www.seattle.gov/oig/audits/about-gagas#:~:text=In%20short%2C%20GAGAS%20are%20the,by%20governments%20around%20the%20country

Office of Inspector General. (n.d.). *Authorities under which the OIG carries out its work*. U.S. Department of Labor. Retrieved May 2024, from https://www.oig.dol.gov/statutory.htm

Office of Inspector General. (2023, June 23). *Summary external peer review of the Naval Audit Service* (DODIG-2023-091). Department of Defense. Retrieved April 2024, from https://media.defense.gov/2023/Jun/29/2003251178/-1/-1/1/DODIG-2023-091.PDF

Office of Inspector General. (2023, January). *Authorities under which the OIG carries out its work*. Office of Inspector General – U.S. Department of Labor. Retrieved April 2024, from https://www.oig.dol.gov/statutory.htm

Office of Management and Budget. (2000, March 31). *Testimony of Joshua Gotbaum*. The White House, President Barack Obama. Retrieved April 2024, from https://obamawhitehouse.archives.gov/omb/legislative_testimony_20000331/

Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. (2017, April). *Financial improvement and audit readiness (FIAR) guidance*. Department of Defense.

Porter, B., Simon, J., & Hatherly, D. (2014). *Principles of external auditing* (4th ed.). John Wiley & Sons.

Rendon, R. G., & Snider, K. F. (Eds.). (2008). *Management of defense acquisition projects.* Reston, VA: American Institute of Aeronautics and Astronautics.

Rendon, R. G., & Rendon, J. M. (2015a). Auditability in public procurement: An analysis of internal controls and fraud vulnerability. *International Journal of Procurement Management*, *8*(6), 710–730.

Rendon, J. M., & Rendon, R. G. (2015b, March 22). *Defense procurement: An analysis of contract management internal controls* (NPS-CM-15-003). Naval Postgraduate School.

Rendon, J. M., & Rendon, R. G. (2016). Procurement fraud in the U.S. Department of Defense: Implications for contracting procedures and internal controls. *Managerial Audit Journal, 31*(6/7), 741–767.

Russo, K. (2022, June 1). *What is financial reporting and why is it important*? Oracle NetSuite. https://www.netsuite.com/portal/resource/articles/accounting/financial-reporting.shtml

Sarbanes Oaxley Act, 15 U.S.C. § 7201 (2002).

Secretariat Comptroller and Resources Department. (2024). *SCRD mission.* Retrieved April 2024, from https://www.secnav.navy.mil/fmc/Pages/scrd.aspx

Reports Consolidation Act, S. Rep. No. 106–337 (2000). https://www.govinfo.gov/content/pkg/CRPT-106srpt337/html/CRPT-106srpt337.htm

Talbert, J. T. (2019, September 5). *Navy financial management of resources.* USNI. https://www.usni.org/magazines/proceedings/1970/february/navy-financial-management-resources

Taylor, James. L. (2005) Implementation guide for OMB circular A-123, management's responsibility for internal control Appendix A, internal control over financial reporting [Memorandum]. https://www.whitehouse.gov/wp-content/uploads/legacy_drupal_files /omb/circulars/A123/a123_appx_a_implementation_guide.pdf

UC Santa Barbara Business & Financial Services. (n.d.). *Category of control deficiencies*. Retrieved May 2024, from https://bfs.ucsb.edu/controller/categories-control-deficiencies#:~:text=A%20material%20weakness%20is%20a,not%20be%20prevented%20or%20detected

U.S. Coast Guard. (2022, November). *Managements responsibility for internal controls and reporting requirements* (COMDTINST 5200.10A). https://media.defense.gov/2022/Nov/03/ 2003107756/-1/-1/0/CI_5200_10A.PDF

U.S. Department of Commerce. (2016). *Accounting principles and standards handbook* (1st ed.).

U.S. Department of Defense. (2005). *Department of Defense footnotes to the principal statements*. https://comptroller.defense.gov/Portals/45/documents/cfs/fy1999/06_Part_F_Sec_3.pdf

U.S. Department of Defense. (2022). *United States Department of Defense agency financial report fiscal year 2022*. https://comptroller.defense.gov/Portals/45/Documents/afr/fy2022/DOD_FY22_Agency_Financial_Report.pdf

U.S. Department of Defense. (2023). *United States Department of Defense agency financial report Fiscal Year 2023*. https://comptroller.defense.gov/Portals/45/Documents/afr/fy2023/DOD_FY23_Agency_Financial_Report.pdf

U.S. Department of Defense. (n.d.). *Honorable Russell Rumbaugh assistant secretary of the Navy (financial management & comptroller).* Retrieved May 2024, from https://www.defense.gov/About/Biographies/Biography/Article/3402524/honorable-russell-rumbaugh/

U.S. Department of the Treasury. (1975). *United States government consolidated financial statements 1–15*. U.S. Federal Government.

U.S. Department of the Treasury. (2004). *2004 Financial report of the United States government*. Retrieved April 2024, from https://www.gao.gov/assets/2021-03/04frusg.pdf

U.S. Department of the Treasury. (n.d.). *Assistant general counsel*. Retrieved May 2024, from https://home.treasury.gov/about/offices/general-counsel/assistant-general-counsel

U.S. Government. (1976). *United States Government consolidated financial statements.* Retrieved April 2024, from https://www.fiscal.treasury.gov/files/reports-statements/financial-report/cfs-1975.pdf

U.S. Government Publishing Office. (2000, July 11). *Reports Consolidation Act of 2000 – Report of the Committee on Governmental Affairs United States Senate*. https://www.govinfo.gov/content/pkg/CRPT-106srpt337/html/CRPT-106srpt337.htm

U.S. House of Representatives. (n.d.). *Government Accountability Office*. Retrieved May 2024, from https://www.house.gov/the-house-explained/legislative-branch-partners/government-accountability-office#:~:text=The%20Government%2ccountabi0Ality%20Office%20(GAO,benefit%20of%20the%20American%20people

U.S. Department of Treasury. (2024, March 27). *Fiscal Service overview.* Bureau of the Fiscal Service – About Us. Retrieved April 2024, from https://fiscal.treasury.gov/about.html

Whittington, O. R., & Pany, K. (2015). *Principles of auditing and other assurance services* (20th ed.). McGraw Hill.

Acquisition Research Program
Naval Postgraduate School
555 Dyer Road, Ingersoll Hall
Monterey, CA 93943

www.acquisitionresearch.net