THE UNDER SECRETARY OF THE NAVY
WASHINGTON DC 20350-1000

April 26, 2012

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Strengthening Internal Controls and Developing a Commander's Checklist

Over the past several months, the Naval Audit Service has visited almost three dozen Echelon 3-and-below organizations. The auditors performed a cursory assessment of activities' current readiness to support a financial audit. The Audit Service reviewed a limited number of financial transactions (commitments, obligations, and accounts payable) to determine if they were properly documented and if the internal controls associated with those transactions were functioning. The results were not discouraging, but there is still much work to be done by us all – commanders, senior managers, and functional specialists – if the Department is to achieve its Fiscal Year 2013 goal of financial audit readiness for the Statement of Budgetary Resources.

In its limited testing, the Naval Audit Service found that about 94 percent of financial transactions were adequately documented, which was a positive result; this indicates that documentation to substantiate transactions was available in almost all instances. However, the Audit Service also discovered that some key internal controls governing the business events tested were in place and functioning for only about 65 percent of the transactions. Because internal controls were either absent or not effective 35 percent of the time, commands must act to meet this challenge and help strengthen controls over the Department's business environment.

Strong and effective internal controls mitigate the potential for fraud, waste, and abuse when procuring goods and services and paying our people. As I have stated previously, when we fail to implement and sustain adequate internal controls, we are at high risk of improperly accounting for funds entrusted to us by taxpayers and the Congress. Effective controls will also help ensure that Navy-Marine Corps financial statements are accurate and ready for audit.

Examples of internal controls that the Naval Audit Service found to be deficient included: absent or out-of-date authorization letters; receiving reports for goods and services which were not signed; transaction amounts recorded in business systems which did not match records documenting the transaction value; and files not readily available (within 5 days). Most of these deficiencies could be corrected by consistently following existing guidance, without changes to business systems or policies; in short, executing business processes correctly the first time will improve most of these control deficiencies.

SUBJECT: Strengthening Internal Controls and Developing a Commander's Checklist

The Naval Audit Service will continue its assessments of internal controls and documentation related to Departmental financial transactions. The initial effort encompassed General Fund business events executed in legacy accounting and business systems. Future rounds will focus on the Statement of Budgetary Resources, Working Capital Fund transactions, and transactions resident in the Navy Enterprise Resource Planning (ERP) system. Regardless of your own business line, processes, and systems, I urge all commanders, senior managers, and functional specialists to review your transactional internal controls to ensure they are in place and working as intended. Improving discipline in this area will result in audit readiness and accurate financial reporting. More importantly, implementing and documenting controls will enhance our collective stewardship of public funds.

I encourage each organization head to use the attached Commander's Checklist to assist you in assessing the effectiveness of internal controls over business processes in your activity. The checklist attached covers the common business processes conducted at most Department of the Navy organizations. This list can help you measure your Command's progress on the audit readiness continuum. You and your managers should conduct an initial assessment of your organization's audit readiness, correct any deficiencies identified, and thereafter conduct quarterly reviews to assess sustainment.

The Department cannot achieve audit readiness and improved financial performance without your support and active involvement. Every major command has a Financial Improvement and Audit Readiness (FIAR) team working to implement and sustain adequate internal controls. This team will work with you to ensure the Department attains financial statement audit readiness. For more information regarding the Department's FIAR effort, please visit the Audit Readiness Information Center at www.fmo.navy.mil.

Robert O. Work

Attachment:
As stated

Distribution:
See next page

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Commander's Quick Reference Guide to Audit Readiness

The Commander's Role in Achieving Audit Readiness

The Department of Defense (DoD) is under increasing pressure to deliver the same capability with fewer resources. To achieve this, leaders across DoD must have increasing precise business information, revealing true costs, and enabling them to drive their organizations toward efficiencies. To ensure greater fidelity in cost data and to foster efficiencies, Secretary of Defense Panetta directed DoD to produce financial statements which are audit ready, by 2017. This auditability goal cannot be achieved without support and action from each Commander/Commanding Officer/Director/Officer-in-Charge. Secretary Panetta has declared that audit readiness is a Department-wide priority and an all-hands responsibility: fiscal stewardship is a prime responsibility of every Commander, just as environmental preservation, and information and physical security are.

When the Department of the Navy (DON) declares that new ships, planes, and other weapons systems are ready for action, or when a deploying unit is ready to begin a mission, it's only after documented testing proves operational readiness. Similarly, discipline and rigor in executing our business processes will lead to financial audit readiness...which must be demonstrated through tests and documentation.

Our military culture embraces risk mitigation during operations, as we execute our primary missions. In parallel, we must all work to reduce the various risks of erring in our business operations, so that we: minimize fraud, waste and abuse; make more efficient use of our human and fiscal resources; and comply with audit standards, just as large commercial organizations must do. Minimizing business risk may require your team to strengthen its controls over your business functions. Financial audit readiness, including Secretary Panetta's goal of a "clean" opinion on financial statements, will be the eventual outcome of these changes.

Asking the Hard Questions to Get the Right Answers

This document includes a checklist with basic questions an organization head should regularly ask as he or she assesses business process effectiveness. You should use the checklist repeatedly as part of your assessment of how well your organization is executing its mission. As with inspections of ships and tests of weapons systems, assessing audit readiness helps you determine if there is rigor and discipline around your business processes – if they are "ready for deployment" – so that, if a financial auditor comes in tomorrow, would your command's business execution pass inspection?

Having Confidence in the Navy's Core Business Processes

All business managers should be aware of basic tests of accountability and financial audit readiness, which span all business functions:

- Are qualified people authorized to perform specific roles throughout your business processes? Is there record of this authorization?
- Is there a segregation of responsibilities to mitigate fraud, waste and abuse? Is the person who requested goods or services different from the person who approved the purchase? Another example: Is your travel system administrator also able to approve travel vouchers?
- How do your managers regularly verify that your organization is not spending more funds than have been authorized?

- Do your managers regularly validate obligations on your books (cancelling those for items no longer needed and recouping funds for another use)?
- Is your organization executing its business processes using consistent procedures? Are your managers documenting the steps in executing processes – and are they retaining the documentation?
- Are you testing business process controls, documenting the tests, and correcting your processes when necessary?

And, while there are a multitude of operational missions throughout DON, every organization performs three key business functions on a daily basis. We pay people. We buy goods and services. We account for our assets. The checklist contains basic questions which leaders of organizations can use to assess how well their business functions are being executed. By driving your organization toward these standards of sound business process execution, your will boost audit readiness within DON. Some primary checks from the comprehensive list in the Appendix:

Paying People:

- Military Pay:
  - Are all military personnel and pay-related actions generated within your command processed timely and accurately?
  - Is documentation supporting personnel-and-pay-related transactions on file and retained?
  - Is Personally Identifiable Information (PII) restricted to authorized personnel only?
- Civilian Pay:
  - Are personnel complying with time and attendance (T&A) policy?
  - Is T&A reviewed by the employee's supervisor?
  - Are there records of the review?

Buying Goods and Services:

- Contracts:
  - Are contracts properly executed and available for inspection?
  - For contracts your organization administers, has a Contracting officer representative been assigned for each contract?
  - Are invoices properly certified and promptly submitted for payment?
- Reimbursable Work Orders:
  - Is there a properly approved work request?
  - For work that we grant, is there documentation that your command has received the goods and services which have been billed?
  - Is there a periodic check that your command has not exceeded total reimbursable authority?
  - For work that we perform, have all work requests been properly accepted?
  - Does your billing accurately reflect the value of goods and services provided? Is billing timely as work is performed?
- Requisitioning using MILSTRIP Process:
  - When we requisition, are the proper fund codes always cited to ensure the correct appropriation is used?
  - Are the requisitions approved by a supervisor?
  - Are all outstanding requisitions regularly validated by the end user?

- Travel/Purchase Card
  - Have all cardholders and approving officials received training?
  - Purchase Card: Does your command observe: (1) segregation of duties; (2) segregation of function; and (3) appropriate span of control over card users?
  - Travel Card: Are users trained to use DTS? Are travelers and approving officials trained in federal travel regulations?

Asset Management:

- Is documentation recording receipt, transfer, and disposal of assets properly executed and retained?
- Are required inventories conducted periodically?
- Are inventories on file and retained?

A Department-wide Goal

The DON's goal is to improve business processes so financial audit readiness can be achieved. This is not solely, nor primarily, a Comptroller action. It will involve everyone who plays a role in paying our people, buying goods and services, or managing assets. Discuss your Commander's Checklist with all of your business and program managers. The checklist should be used regularly as part of your assessment of your organization's effectiveness. Please note that the checklist is not intended as an all-inclusive document; there are more checks that can and should be made. However, this list is a good baseline for discussions with business managers.

Additional Information Is Available

The Department cannot achieve audit readiness and improve its business and financial information without your support and active involvement. Every major command has a Financial Improvement and Audit Readiness (FIAR) team working to implement and sustain adequate internal controls. This team will work with you to ensure the Department attains financial statement audit readiness. For more information regarding the Department's FIAR effort, please visit the Audit Readiness Information Center at www.fmo.navy.mil. The website aims to enhance your awareness of audit readiness and to offer the necessary tools for you in your role as stewards of public funds.

APPENDIX- Commander's Checklist for Audit Readiness

This checklist of activities provides you with more detailed standards to assess the health of your business operations. You should regularly review these activities with your managers and retain a record of each review.

Date When Check Conducted	Execution of General Business Processes
	• Are forms (e.g., DD-577) or letters authorizing persons by name to perform specific roles on file and retained?
	• Are roles separated in some business processes, as prescribed – e.g., is the person who requested goods or services different from the person who approved it? • Is this separation periodically verified?
	• Are appropriate persons granted access to business systems, and in prescribed roles? • Is this authorization (usually a System Authorization Access Request (SAAR) form) retained? • Are access roles periodically reviewed for validity?
	• Are reviews of obligated funds conducted and documented rigorously, three times yearly, as required (also known as the tri-annual review)? • Are adjustments made in all cases, as needed?
	• Are commitments and obligations reviewed, approved, and recorded in a timely manner in your command's accounting system? • Are disbursements (payments) matched to obligations in the accounting system?
	• Do your financial managers regularly verify that the sum of all funding amounts they recorded in the accounting system do not exceed your command's authorized amounts? • Is a record of that verification retained?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is all documentation to support the historical execution of business processes (and to provide an audit trail) retained?

Date When Check Conducted	Purchase of Goods and Services (Contracting)
	• Are contracts executed by and/or funded by your organization properly executed? • Retained for inspection?
	• Are appropriate authorizations (SF-1402, DD-577, SAAR, e.g.) for contracting activity executed and retained?
	• Has a Contracting Officer Representative (COR) been assigned to each contract/task order? • Do all CORs have an account in WAWF (Wide Area Work Flow)? • Did the contractor provide the COR with copies of all invoices and necessary documentation? • Were invoices reviewed by the COR for reasonableness?
	• Are commitments and obligations: (1) properly authorized and valid? (2) not in excess of authorized amounts? (3) recorded in the accounting system in the proper amount, with the proper line of accounting, in the proper period?
	• Do disbursements (payments on contracts) match obligations, and are they recorded in the correct periods? • Are accounting adjustments initiated when necessary to ensure accurate matching? • Is a record of adjustment activity retained?

	• Are invoices properly certified by commands for prompt payment, as required?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting the execution of contracting actions retained?

Date When Check Conducted	Purchase of Goods and Services (Reimbursable Work Orders (Grantor))
	• Is there a properly approved funding document ?
	• Was the obligation covering the funding document recorded properly (for amount, period, and appropriation) in the accounting system?
	• Is there proper assurance and documentation that your command has received the goods and services which have been billed? • If not, what action has been taken?
	• Is there proper assurance and documentation that your command has not exceeded its total reimbursable authority?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting the execution of reimbursable work orders (Grantor) activities retained?

Date When Check Conducted	Purchase of Goods and Services (Reimbursable Work Orders (Performer))
	• For work we perform, have all funding documents been properly accepted?
	• Is billing done promptly upon providing goods and services?
	• Does the value of goods billed reflect the value delivered? • Is documentation corroborating the amount billed retained?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting the execution of reimbursable work orders (Performer) retained?

Date When Check Conducted	Purchase of Goods and Services (Requisitioning using MILSTRIP Process)
	• Are requisitions approved by a supervisor?
	• To ensure that correct appropriations are used, does your command always cite the correct fund code when requisitioning?
	• When requisitioned items are received, is the receipt documentation retained?
	• Are outstanding requisitions regularly monitored and is appropriate command action taken in response to the status? Have items with shipping status been received?
	• Are all outstanding requisitions regularly validated by the end user?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting this process (orders, periodic order validation, receipt, material distribution) retained?

Date When Check Conducted	Purchase of Goods and Services (Transportation of People using Defense Travel System (DTS))
	• Are users trained to use DTS? Are travelers and approving officials trained in federal travel regulations?
	• Are appropriate personnel designated in writing (DD-577) to approve vouchers? Are the designations retained in a central file?
	• Does your command observe the permission levels/segregation of duties as outlined in the NAVADMIN 393/11? For example, is your local DTS administrator excluded from approving travel vouchers?
	• Are travel vouchers filed within 5 working days upon completion of travel?
	• Is the accounting system monitored to ensure the timely posting of obligations and expenditures?
	• Are DTS management reports regularly reviewed to identify discrepancies?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting this process retained?

Date When Check Conducted	Purchase of Goods and Services (Charge Cards including Government Purchase Card and Travel Card)
	• Have all cardholders and approving officials received training?
	• Do your managers use the management tools required or recommended at www.navsup.navy.mil/ccpmd? (These tools will assist in identifying actual, potential misuse of the card.)
	• Purchase Card: Does your command observe: (1) segregation of duties; (2) segregation of function; and (3) appropriate span of control?
	• Purchase Card: Are letters of delegation completed, filed, and retained for purchase approvers and cardholders?
	• Purchase Card: Are charge card invoices certified promptly by cardholders?
	• Travel Card: Is the card being used for travel-related purposes only?
	• Travel Card: Are travel vouchers submitted within 5 working days following completed travel?
	• Are funds obligated for travel de-obligated when travel is cancelled? • Are travel orders authorized and approved outside of DTS? • Are travel receipts reviewed by approving officials prior to approval?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting this process retained?

Date When Check Conducted	Payment of People (Military Pay)
	• Are all military personnel and pay-related actions generated by your command processed timely and accurately?
	• Is documentation supporting personnel-and-pay-related transactions on file and retained?
	• Do managers who make personnel-and-pay-related changes have written authority, on file and retained?

	• Is access to Personally Identifiable Information (PII) restricted to authorized personnel only?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting this process retained?

Date When Check Conducted	Payment of People (Civilian Pay)
	• Are all requests for personnel action (usually SF-52) generated by your command processed timely and accurately? Is documentation supporting personnel actions on file and retained?
	• Is time and attendance (T&A) for each employee entered promptly into the prescribed T&A system?
	• Is T&A reviewed by the employee's supervisor? Is the record of that review retained?
	• Are departures from a regular time sheet, such as overtime and leave, requested and approved appropriately? Is a record of the approval retained?
	• Do supervisors who approve personnel changes and certify time have written authorizations (usually DD-577 form) in a central retained file?
	• Are transactions regularly sampled and tested to answer these questions? Are the testing results acted upon if needed, and are the results retained?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting this process retained?

Date When Check Conducted	Asset Management
	• Is documentation recording receipt, transfer, and disposal of assets (e.g. DD-250, DD-1348, DD-1149, Surveys) properly executed, on file, and retained? • Are receipts and transfers recorded accurately and timely in the Accountable Property System of Record (APSR)?
	• Are required inventories conducted periodically? • Are inventories on file and retained?
	• Do designated officials at the command approve adjustments to assets as a result of an inventory review prior to inputting the adjustment into the APSR? • Are approved adjustments reflected in the general ledger (applicable for Navy Working Capital Fund activities)?
	• Are transactions regularly sampled and tested to answer these questions? • Are the testing results acted upon if needed, and are the results retained?
	• Is documentation supporting the asset management process retained?