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Defense Primer: FY2025 Department of Defense Audit Results

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

The Department of Defense (DOD)—which is “using a secondary Department of War designation” under Executive Order 14347 dated September 5, 2025—released the results of its eighth annual audit, for FY2025, on December 18, 2025. DOD received a disclaimer of opinion for the eighth time, meaning auditors could not express overall opinions on the financial statements because the financial information was not sufficiently reliable.

DOD’s IG coordinated the agency-wide financial audit, covering \$4.65 trillion in reported assets and \$4.73 trillion in reported liabilities. The agency-wide audit was conducted by independent public accounting (IPA) firms contracted by DOD IG. The IPAs conducted 26 separate entity-level audits within the DOD. The entities receiving disclaimers of opinion combined accounted for 43% of DOD’s total assets and at least 64% of DOD’s total budgetary resources.

Additional statutory requirements related to DOD’s audited financial statements are contained in Title 10 of the *U.S. Code*, Chapter 9A.

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

Why an Audit?

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

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

DOD’s financial management has been on the Government Accountability Office’s (GAO’s) High-Risk List (HRL) since 1995. The HRL identifies areas that might be subject to fraud, waste, abuse, and mismanagement. In addition to financial management, GAO’s February 2025 HRL includes other aspects of DOD’s operations that could affect financial management.

How Are Audits Done?

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

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

Auditing Standards

GAO issues the *generally accepted government auditing standards* (GAGAS), also commonly known as the “Yellow Book,” which provides a framework for conducting federal government audits. Similar to the requirements in the private sector, GAGAS requires federal financial reports to disclose compliance with laws, regulations, contracts, and grant agreements that have a material effect on the entities’ financial statements. GAGAS requires auditors to consider the visibility and sensitivity of government programs in determining the materiality threshold.

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

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

Types of Audit Opinions

Auditors form opinions by examining the types of risks an organization might face and the types of controls that exist to mitigate those risks. Once the risks and controls to mitigate those risks have been determined, the auditors will examine supporting evidence to determine if management is presenting the financial statements fairly in all material respects. Although many entities in the federal government usually receive unmodified opinions, auditors may express other types of opinions based on the circumstances. There are four types of audit opinions:

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

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

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

Disclaimer of opinion. A disclaimer of opinion states that the auditor does not express an opinion on the financial statements. The auditor’s report may be expected to give all of the substantive reasons for the disclaimer. Reasons for a disclaimer of opinion include financial statements not conforming to GAAP and financial management systems being unable to provide sufficient evidence for the auditor to express an opinion.

Financial and Operation Benefits

GAO reports over the last two years highlight a number of financial and operational benefits obtained through DOD financial audits.

Financial benefits. The Navy identified 14 legacy systems that it plans to retire, with an estimated \$103 million cost avoidance. “[T]he Air Force reported using machine learning to identify \$653 million in obligations that may be applied in ways that preserve future buying power.”

Operational benefits. Navy audits identified \$4.3 billion in previously untracked equipment and supplies, making these working capital fund items available for requisition and operational use. Army process automations continue to save labor hours required for audit reporting; in FY2023 alone, the Army reportedly saved 5,600 labor hours through 79 process automations by reconciling fund balances with Treasury.

According to GAO, DOD needs to continue addressing its material weaknesses. DOD IG reported that if these material weaknesses are not resolved, they could continue to impede DOD and its components from achieving a clean audit opinion.

Limitation of Audits

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

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

Considerations for Congress

Clean audit by 2028. Section 1005 of the National Defense Authorization Act for Fiscal Year 2024 (P.L. 118-31) required DOD to obtain an unmodified audit opinion by December 31, 2028. Section 1004 required that each DOD component be subject to an independent audit or face cancellation of 1.5% certain unobligated funding. Section 920 required DOD to develop and implement metrics to operationalize audit readiness by April 2025.

Use of artificial intelligence (AI) in DOD audits. Section 1007 of the Servicemember Quality of Life Improvement and National Defense Authorization Act for Fiscal Year 2025 (P.L. 118-159) required senior DOD officials to “encourage, to the greatest extent practicable,” the use of AI and machine learning (ML) to facilitate DOD financial statement audits. Congress may assess the role of AI and ML in DOD audits and consider legislative approaches to address benefits and challenges.

Funding for corrective action plans. Paths to an unmodified audit opinion require allocating resources toward corrective action plans that respond to auditors’ notifications of findings and recommendations. Section 1002 of the National Defense Authorization Act for Fiscal Year 2026 (P.L. 119-60) amended Title 10 of the *U.S. Code*, Section 240b, to require DOD annually to provide “a detailed estimate of the funding required for the next fiscal year to procure, obtain, or otherwise implement each process, system, and technology identified to address the corrective action plan or plans of each department, agency, component, or element of [DOD].” Congress may assess the completeness and adequacy of these detailed estimates, comparing identified funding requirements with DOD’s budget request for FY2027 and future years.

CRS Resources

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

Other Resources

Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *Department of Defense Agency Financial Report Fiscal Year 2025*, December 2025

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