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B. DATE Report Downloaded From the Internet: 10/22/99

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D. Currently Applicable Classification Level: Unclassified

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Audit



Report

OFFICE OF THE INSPECTOR GENERAL

THE FUND BALANCE WITH TREASURY ACCOUNT
FOR THE RESEARCH, DEVELOPMENT, TEST AND
EVALUATION APPROPRIATION, DEPARTMENT 97

Report No. 97-151

June 4, 1997

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Acronyms

DFAS
RDT&E

Defense Finance and Accounting Service
Research, Development, Test, and Evaluation



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



June 4, 1997

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Audit Report on the Fund Balance With Treasury Account for the
Research, Development, Test, and Evaluation Appropriation,
Department 97 (Report No. 97-151)**

We are providing this audit report for your information and use. The audit was performed in response to the Chief Financial Officers Act of 1990 and the Federal Financial Management Act of 1994. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson, Audit Program Director, at (703) 604-9582 (DSN 664-9582) or Mr. Hoa H. Pham, Acting Audit Project Manager, at (703) 604-9588 (DSN 664-9588). See Appendix E for the report distribution. Audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-151
(Project No. 6RA-2014.02)

June 4, 1997

The Fund Balance With Treasury Account for the Research, Development, Test and Evaluation Appropriation, Department 97

Executive Summary

Introduction. This report is one in a series of reports on the Department 97* Fund Balance With Treasury account in response to the Chief Financial Officers Act of 1990 (Public Law 101-576) and the Federal Financial Management Act of 1994 (Public Law 103-356). Public Law 103-356 requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The Defense Finance and Accounting Service Indianapolis Center has responsibility for preparing consolidated DoD trial balances from the trial balances submitted by 23 Defense accounting offices. In FY 1995, Defense organizations received \$37.0 billion of Department 97 general funds for the performance of their missions. A total of \$8.6 billion was allocated to 16 Defense organizations for research, development, test and evaluation.

Audit Objectives. The audit objective was to evaluate the Defense Finance and Accounting Service Indianapolis Center's administration of the FY 1995 Fund Balance With Treasury Account for the Research, Development, Test, and Evaluation Appropriation, Department 97. Specifically, we reviewed the process the Defense Finance and Accounting Service Indianapolis Center used to reconcile and adjust the individual and consolidated adjusted trial balances for the Defense organizations' Fund Balance With Treasury Account for the Research, Development, Test, and Evaluation Appropriation, Department 97. We also evaluated the management control program related to the process the Defense Finance and Accounting Service Indianapolis Center used to reconcile and adjust the individual and consolidated adjusted trial balances. Our next audit of the Department 97 Fund Balance With Treasury Accounts will address all appropriations.

Audit Results. The Defense Finance and Accounting Service Indianapolis Center did not make two material disclosures in the Notes report to the Department of the Treasury regarding the Research, Development, Test, and Evaluation Appropriation, Department 97 Fund Balance With Treasury account:

- o a \$1.0 billion reduction, and
- o the amount reported as the Department 97 Fund Balance With Treasury was the amount shown in the Department of the Treasury's accounting system not the amounts generated from the Defense organizations' accounting systems.

*Department 97 funds are general fund appropriations allocated to Defense organizations and Military Departments.

Additionally, the Defense Finance and Accounting Service Indianapolis Center did not notify the affected Defense organizations of the adjustments it made to their adjusted trial balances. If the Defense Finance and Accounting Service Indianapolis Center used the same practices to prepare the Notes report for FY 1996, the Notes report would have contained unreliable information. As a result of the audit, the Defense Finance Accounting Service Indianapolis Center took corrective action to disclose the adjustments in the FY 1996 Notes report.

The management control program could be improved by correcting material weaknesses related to full disclosure of adjustments to the Fund Balance With Treasury account. (Appendix A)

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, coordinate the research to determine the causes of the differences between certified budget execution reports and general ledger adjusted trial balances and fully disclose the basis for adjustments made to the Department of the Treasury fund balance.

Management Comments. The Defense Finance and Accounting Service concurred with the recommendations. See Part I for a complete discussion of management comments and Part III for the complete text of the comments.

Audit Response. The Defense Finance and Accounting Service actions and comments are fully responsive. No additional comments are required.

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Part I - Audit Results

Audit Background

We performed the audit in response to the Chief Financial Officers Act of 1990 (Public Law 101-576), which established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, "The Federal Financial Management Act of 1994," requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The consolidated DoD financial statements for FY 1996 will include the financial information for a reporting entity entitled "Other Defense Organizations." The "Other Defense Organizations" includes the financial information for the various Defense organizations, that were either appropriated or suballocated Department 97 funds.

In FY 1995, 30 Defense organizations received \$37.0 billion of Department 97 funds for the performance of their missions and functions. Of the 30 Defense organizations, 16 received a total of \$8.6 billion for research, development, test, and evaluation (RDT&E). See Appendix C for a list of Defense organizations receiving FY 1995 Department 97, RDT&E funding.

Fund Balance With Treasury. The Office of Management and Budget Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," March 30, 1993, defines a Federal entity's Fund Balance With Treasury as the aggregate amount of funds in the entity's accounts with the Department of the Treasury for which the entity is authorized to make expenditures and pay liabilities. Fund Balance With Treasury is an intra-Governmental item. From the reporting entity's perspective, the Fund Balance With Treasury is an asset, because it represents the entity's claim to the Federal Government's resources.

Roles and Responsibilities in Financial Reporting. The Defense Finance and Accounting Service (DFAS) Indianapolis Center took on the difficult task of consolidating the first adjusted trial balances prepared for the Defense organizations. The consolidation task is prescribed by DoD 7000.14-R, "DoD Financial Management Regulation," volume 6, chapter 2, February 1996, which states:

The preparation and issuance of DoD Component financial reports, for which accounting support is provided by the DFAS, is a responsibility of the DFAS. Both the DFAS and DoD Component customers of the DFAS are responsible for reviewing financial reports to assess the accuracy of the reported financial information and take corrective actions, when needed, to improve the timeliness and quality of those financial reports. Ultimately, however, the DoD Component customer is responsible for the financial information in reports which present the financial effects of the Component's operations.

*Department 97 funds are general fund appropriations allocated to Defense organizations and Military Departments.

Because each DoD Component is responsible for its own financial statement, it is important that DFAS keep the Component customers fully informed of all adjustments made to the financial statements.

DFAS Indianapolis Center Requirement for Adjusted Trial Balance Submissions. In April 1995, the DFAS Indianapolis Center assumed responsibility for preparing the accounting reports for the Department 97 appropriations to include satisfying the full disclosure requirements of the Department of the Treasury's Federal Agencies' Centralized Trial-balance System for FY 1995. On June 25, 1995, the Deputy Director for Accounting Operations, DFAS Indianapolis Center, requested that the accounting offices submit an abbreviated trial balance using the general ledger accounts for the period ending September 30, 1995.

Audit Objectives

The audit objective was to evaluate the DFAS Indianapolis Center's administration of the FY 1995 Defense Organizations' Fund Balance With Treasury account for the RDT&E appropriation, Department 97. Specifically, we reviewed the procedures the DFAS Indianapolis Center used to reconcile and adjust the individual and consolidated adjusted trial balances for the Defense organizations' Fund Balance With Treasury account for the RDT&E appropriation. We also evaluated the management control program related to the process the DFAS Indianapolis Center used to reconcile and adjust the individual and consolidated adjusted trial balances. Appendix A discusses the audit scope and methodology and the review of the management control program. Appendix B provides details on related prior audits and other reviews.

Disclosure and Notification of Adjustments to the Defense Organizations' Adjusted Trial Balances

The DFAS Indianapolis Center did not make two material disclosures in the Notes report to the Department of the Treasury regarding the Fund Balance With Treasury account for the FY 1995 RDT&E appropriation, Department 97:

- o a \$1.0 billion reduction, and
- o the amount reported as the Department 97 Fund Balance With Treasury was the amount shown in the Department of the Treasury's accounting system not the amounts generated from the Defense organizations' accounting systems.

Additionally, the DFAS Indianapolis Center did not notify the affected Defense organizations of the adjustments it made to their adjusted trial balances. These conditions occurred because the DFAS Indianapolis Center did not follow the Federal and DoD requirements to disclose, coordinate, research, and reconcile the discrepancies between the Defense organizations' accounting records and the Department of the Treasury's records when preparing the FY 1995 Department 97 consolidated adjusted trial balance and Notes report. Moreover, the DFAS Indianapolis Center relied on the Department of the Treasury's Government On-line Accounting Link System because more than half of the accounting offices supporting the Defense organizations did not have complete general ledger accounting systems to produce FY 1995 individual adjusted trial balances. Also, the DFAS Indianapolis Center had not established the management controls necessary to ensure that general ledger account discrepancies are reported to the Department of the Treasury and that the Defense organizations are notified of the adjustments. If the DFAS Indianapolis Center used the same practices to prepare the Notes report for FY 1996, the Notes report would have contained unreliable information. As a result of our audit, the DFAS Indianapolis Center took corrective action to disclose the adjustments in the FY 1996 Notes report.

Financial Accounting and Reporting Requirements

Office of Management and Budget Policy. The Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," March 30, 1993, requires Federal entities to disclose any discrepancies between their general ledger Fund Balance With Treasury amount and the Fund Balance With Treasury amount in the Department of the Treasury's Government On-line Accounting Link System and to explain the

Disclosure and Notification of Adjustments to the Defense Organizations' Adjusted Trial Balances

reasons for discrepancies in the footnotes to the financial statements. Discrepancies due to time lag should be reconciled, and discrepancies due to error should be corrected when financial reports are prepared.

Department of the Treasury Policy. The Treasury Financial Manual, volume 1, part 2, chapter 4000, "Federal Agencies' Centralized Trial-balance System," April 1996, requires Federal agencies to electronically transmit to the Department of the Treasury an adjusted trial balance, at the Treasury appropriation level, using the U.S. Government standard general ledger accounts. The standard general ledger data on the adjusted trial balances must be the same data that are used to prepare the audited financial statements due to the Office of Management and Budget.

The Treasury Financial Manual also requires Federal agencies to electronically transmit a Notes report to the Department of the Treasury. The Notes report contains additional information and balances for the associated adjusted trial balances. The Notes report contains 13 notes. Notes 1 and 2 are required of all agencies; notes 3 through 13 are required only when applicable. Note 2, "Reconciliation of Fund Balance With Treasury to Fund Balance per Agency," gives the agency a chance to explain the difference(s) between the agency's Fund Balance With Treasury as shown in the adjusted trial balance and the Department of the Treasury's Fund Balance With Treasury amount. Together, the adjusted trial balances and Notes report present a complete financial picture of a logical reporting unit. The adjusted trial balances and Notes report must be transmitted annually to the Department of the Treasury by March 1st of each year, so that the Secretary of the Department of the Treasury can prepare comprehensive reports on all the financial activities of the U.S. Government.

DoD Policy. DoD policy on preparing departmental-level financial reports for DoD Component customers is in the DoD 7000.14-R, "DoD Financial Management Regulation," volume 6, chapter 2, February 1996. The Regulation requires DFAS to identify the requirement for adjustments to financial data and to adequately support and justify in writing, any adjustment made to the official accounting records. Specifically, DFAS must:

- o establish procedures to ensure that all general ledger balances and other associated financial balances are reconciled, at least on a quarterly basis;

- o investigate, document, and process unreconciled differences in accordance with applicable provisions of DoD 7000.14 to balance the general ledger amount with the amount of the subsidiary records; and

- o identify unreconcilable differences between the general ledger records that exceed \$1.0 million. The reconciliation shall be performed on a monthly basis in order to determine the cause of the differences and to take appropriate corrective actions to ensure the accuracy and integrity of the accounting system and monthly reports. Further, certain adjustments proposed by the DFAS must be reviewed and approved by the customer before the adjustment is recorded.

DoD 7000.14-R, "DoD Financial Management Regulation," volume 4, chapter 2, May 1996, prescribes the accounting policy and related management

Disclosure and Notification of Adjustments to the Defense Organizations' Adjusted Trial Balances

requirements necessary to establish financial control over fund balances with the Department of the Treasury. A Federal entity should explain any discrepancies between its general ledger Fund Balance With Treasury amount and the Department of the Treasury's Fund Balance amount and provide the reasons for the discrepancies. Discrepancies due to time lag should be reconciled, and discrepancies due to error should be corrected. Further, full financial disclosure, accountability, adequate financial information, and reports must be provided for external reporting to the Office of Management and Budget and the Department of the Treasury.

Disclosing Adjustments to the Department of the Treasury

The DFAS Indianapolis Center did not disclose and explain the reasons for making the reduction to the FY 1995 Fund Balance With Treasury amount for the RDT&E appropriation, Department 97.

Disclosing Adjustments in the Required Notes Report to the Department of the Treasury. The Statement of Federal Financial Accounting Standards, the Treasury Financial Manual, and the DoD Financial Management Regulation require that Federal entities disclose and explain any discrepancies between their general ledger Fund Balance With Treasury amount and the Fund Balance With Treasury amount in the Department of the Treasury records. The DFAS Indianapolis Center did not disclose in the Notes report to the Department of the Treasury for FY 1995 a \$1.0 billion adjustment for the RDT&E appropriation, Department 97. The DFAS Indianapolis Center reduced the Defense organizations' general ledger Fund Balance With Treasury from \$9.1 billion to \$8.1 billion. The \$8.1 billion is the same balance the Department of the Treasury's Government On-line Accounting Link System showed for the Department 97 RDT&E fund balance. According to Department of the Treasury instructions for preparing the required Notes report, the agency is required to list and provide a brief description for each adjustment, for example, adjustments for errors, unreconciled differences, and timing differences. However, the DFAS Indianapolis Center did not include the \$1.0 billion adjustment and explanations for the adjustment when preparing the FY 1995 Department 97 Notes report. The DFAS Indianapolis Center officials responsible for preparing the FY 1995 consolidated adjusted trial balance and Notes report to the Department of the Treasury stated that they failed to disclose the \$1.0 billion adjustment because of the confusion in preparing the consolidated report for the first time. As a result of our audit, the DFAS Indianapolis Center agreed to disclose the required adjustments in the FY 1996 Notes report, and we verified that the disclosure was made on March 3, 1997.

Relying on the Department of the Treasury Government On-line Accounting Link System

For the FY 1995 Notes report, the DFAS Indianapolis Center reported the Fund Balance With Treasury amount in the Treasury Government On-line Accounting Link System, rather than the Fund Balance With Treasury amounts submitted in the Defense organizations' individual adjusted trial balances and the certified budget execution reports, generated through the budgetary accounting system. Inspector General, DoD, Audit Report No. 97-017, "Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations" October 31, 1996, reported that the DFAS Indianapolis Center could not rely on the Defense organizations' individual adjusted trial balances because prior audits showed that the Defense organizations' accounting records are not reliable and that more than 50 percent of the accounting offices supporting the Defense organizations did not have a complete general ledger accounting control system to produce their FY 1995 adjusted trial balances.

Reconciling and Notifying Defense Organizations of Adjustments

The DFAS Indianapolis Center did not coordinate with the affected Defense organizations to determine the cause of the \$1.0 billion discrepancy between their records and Department of the Treasury records and to take appropriate corrective action. Additionally, the DFAS Indianapolis Center did not notify the affected Defense organizations of the adjustments made to the individual general ledger Fund Balance With Treasury amount to make it agree with the certified budget execution report. The DFAS Indianapolis Center operating personnel previously adjusted certified budget execution report information to match the Department of the Treasury's Fund Balance amount.

Reconciling Differences Between the Defense Organizations' Adjusted Trial Balances and the Certified Budget Execution Reports. As of September 1996, the DFAS Indianapolis Center had not formulated plans for informing accounting offices of the need to investigate and resolve the discrepancies between the amounts in the Defense organizations' FY 1995 Department 97 individual adjusted trial balances and certified budget execution reports and the amounts in the Treasury Government On-line Accounting Link System. The DFAS Indianapolis Center accounting officials stated that they did not have sufficient personnel to perform reconciliations of discrepancies in general ledger-produced Fund Balance With Treasury accounts, but would investigate ways to provide feedback to the accounting offices through the use of an advanced automated database application that is shared with all of DoD.

Notifying the Affected Defense Organizations of Adjustments Made to the General Ledger. The DFAS Indianapolis Center adjusted official accounting records without notifying the affected Defense organizations, which is in

Disclosure and Notification of Adjustments to the Defense Organizations' Adjusted Trial Balances

contradiction to DoD 7000.14-R, "DoD Financial Management Regulation," volume 6, chapter 2, February 1996, which states that the DFAS is to identify the requirement for adjustments to the financial data. The Regulation also specifies six exceptions that allows the DFAS to make adjustments without the prior approval of the Defense organization. None of these exceptions were pertinent to the \$1 billion adjustment.

The DFAS Indianapolis Center made the adjustment to ensure that the Defense organizations' general ledger Fund Balance With Treasury amount agreed with the Department of the Treasury's Fund Balance amount. Therefore, the DFAS Indianapolis Center should notify the affected Defense organizations of the adjustment.

Management Controls for Ensuring Compliance with Guidance on Disclosure and Notification

The DFAS Indianapolis Center had not established the necessary management controls to ensure that the financial information provided to the Department of the Treasury adequately reflected the Defense organizations' financial position.

Management Control Requirements. DoD 7000.14-R, "DoD Financial Management Regulation," volume 6, chapter 2, February 1996, requires the DFAS to establish management controls to ensure that the financial reports it prepares are supportable, reliable, and accurate. Also, the DFAS Indianapolis Center must establish procedures to ensure that the process for preparing financial reports is consistent, timely, and auditable.

Management Controls at the DFAS Indianapolis Center. The DFAS Indianapolis did not have the management controls in place to ensure that the discrepancies between the Defense organizations' general ledgers and the Department of the Treasury's records were promptly researched, resolved, and documented. The DFAS Indianapolis Center reduced the Defense organizations' FY 1995 Fund Balance With Treasury amount for the RDT&E appropriation, Department 97 to equal the Department of the Treasury's Fund Balance With Treasury amount. However, the Department of the Treasury had no knowledge of the adjustment because the DFAS Indianapolis Center did not disclose and explain the adjustment in the required Notes report to the Department of the Treasury. Also, the DFAS Indianapolis Center did not notify the affected Defense organizations before adjustments were made to their individual adjusted trial balances. We discussed the lack of disclosure with operating officials at the DFAS Indianapolis Center, and we agreed with their proposed response to the recommendation in Inspector General, DoD, Audit Report No. 97-079 "Documentation of the Federal Financial System Process at the Defense Finance and Accounting Service Indianapolis Center," January 24, 1997. The proposed corrective action is to document the processes for receiving, adjusting, and consolidating the general ledger trial balances received from fiscal stations, which would result in improved management controls. The DFAS Indianapolis Center officials stated that as they gained more experience

Disclosure and Notification of Adjustments to the Defense Organizations' Adjusted Trial Balances

with consolidating the "Other Defense Organizations" financial information, discrepancies between Department of the Treasury records and the Defense organizations' financial information would be researched and resolved in a more timely manner.

Effects of Not Disclosing and Notifying the Department of the Treasury and the Defense Organizations of Adjustments

Because the DFAS Indianapolis Center did not notify the Defense organizations of adjustments made to make the general ledger Fund Balance With Treasury amount to agree with the Department of the Treasury's Fund Balance amount, the Defense organizations maintain a \$9.1 billion Fund Balance With Treasury amount rather than the \$8.1 billion Fund Balance With Treasury amount the DFAS Indianapolis Center reported to the Department of the Treasury. Accordingly, the Defense organizations will use the \$9.1 billion Fund Balance With Treasury amount as the beginning balance for the FY 1996 individual adjusted trial balance submissions, rather than the \$8.1 billion Fund Balance With Treasury amount the DFAS Indianapolis Center reported to the Department of the Treasury. For example, the DFAS Indianapolis Center reduced the Defense Advanced Research Projects Agency Fund Balance With Treasury amount by more than \$100 million, from \$3.0 billion to \$2.9 billion, without the knowledge of the Defense Advanced Research Projects Agency. Therefore, the Defense Advanced Research Projects Agency adjusted trial balance will continue to show the \$3.0 billion Fund Balance With Treasury amount as its FY 1996 beginning balance. As a result, the Fund Balance With Treasury amount presented in the FY 1995 financial statements cannot be relied on by reviewers of the financial statements. Furthermore, ending balances on the FY 1995 individual adjusted trial balances do not provide reliable beginning balances for the FY 1996 financial statements. Appendix D, Table D-1, provides an explanation of how the DFAS Indianapolis Center accounted for the \$1.0 billion adjustment. Appendix D, Table D-2, includes a list of Defense organizations whose adjusted trial balances were affected by the DFAS Indianapolis Center adjustments and shows the discrepancies that existed.

Recommendations and Management Comments

We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center:

- 1. Coordinate adjustments with the affected Defense organizations to determine the causes of the differences between certified budget execution reports and general ledger adjusted trial balances.**

Disclosure and Notification of Adjustments to the Defense Organizations' Adjusted Trial Balances

DFAS Comments. DFAS partially concurred with the recommendation and stated that it plans to coordinate and make the FY 1997 adjustments when they are identifiable to specific accounting activities.

2. Fully disclose that adjustments made to DoD accounting records to match the Department of the Treasury fund balance were not based on complete reconciliations of the differences between DoD accounting records for the "Other Defense Organizations" and Department of the Treasury accounting records.

DFAS Comments. DFAS concurred with the recommendation and stated that it plans to make the disclosure in FY 1997 and beyond as required.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology. We reviewed the Fund Balance With Treasury account for the 16 Defense organizations that received funding from the RDT&E appropriation, Department 97. As of September 30, 1995, the financial records of those 16 Defense organizations reported a \$9.1 billion Fund Balance With Treasury account balance. We also reviewed the FY 1995 adjusted trial balances the Defense organizations submitted to the DFAS Indianapolis Center. Further, we reviewed the process the DFAS Indianapolis Center used to reconcile and adjust the individual Defense organizations' FY 1995 RDT&E appropriation and the consolidated adjusted trial balances Fund Balance With Treasury amount to:

- o the certified budget execution reports, and
- o the Department of the Treasury's Fund Balance amount.

Specifically, we tracked and compared the adjustments the DFAS Indianapolis Center made to the FY 1995 Department 97 individual and consolidated adjusted trial balances before and after the DFAS Indianapolis Center transmitted the consolidated adjusted trial balance and required Notes report to the Department of the Treasury. Also, we evaluated the rationale the DFAS Indianapolis Center used to reduce the Defense organizations' FY 1995 RDT&E appropriation Fund Balance With Treasury amount by \$1.0 billion to equal the Department of the Treasury's Fund Balance amount for the RDT&E appropriation.

Use of Computer-Processed Data. We used computer-processed data without confirming the reliability of the data because the reliability of the data did not materially affect the audit results. In addition, we did not determine the reliability of the data because our review was to determine whether the process and rationale the DFAS Indianapolis Center used to reduce the Defense organizations' FY 1995 RDT&E appropriation Fund Balance With Treasury amount was reasonably supported.

Audit Contacts. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Audit Period, Standards, and Locations. We conducted this financial-related audit from August 1996 through February 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of the DFAS Indianapolis Center management controls over reconciling and adjusting the FY 1995 RDT&E appropriation, Department 97, individual and consolidated adjusted trial balance Fund Balance With Treasury amounts. Specifically, we examined management controls over the process the DFAS Indianapolis Center used to reconcile and adjust the RDT&E appropriation, Department 97, in the Defense organizations' adjusted trial balances to the Department of the Treasury's records. We assessed the DFAS Indianapolis Center's self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Directive 5010.38, at the DFAS Indianapolis Center. The DFAS Indianapolis Center management controls for departmental financial reporting were not adequate to ensure that all adjustments to the Defense organizations' FY 1995 Department 97 adjusted trial balances were sufficiently researched, supported, and documented. Also, management controls did not ensure that adjustments were properly disclosed and explained to the Department of the Treasury and the affected Defense organizations, as required. The recommendations, if implemented, will correct the deficiencies. A copy of this report will be provided to the senior DFAS official responsible for management controls.

Adequacy of Management's Self-Evaluation. Management's self-evaluation did not detect and report the management control weaknesses identified in this report because the DFAS Indianapolis Center did not assess the reconciling and adjusting of the Defense organizations' adjusted trial balances as part of the DFAS Indianapolis Center management control program.

Appendix B. Summary of Prior Audits and Other Reviews

The Office of the Inspector General, DoD, issued a total of five audit reports in 1996 and 1997 that relate to accounting controls applicable to the preparation of financial statements as required by the Chief Financial Officers Act of 1990.

Inspector General, DoD, Report No. 97-079, "Documentation of the Federal Financial System Process at the Defense Finance and Accounting Service Indianapolis Center," January 24, 1997, states that the DFAS Indianapolis Center process of receiving, adjusting, and consolidating the general ledger trial balances from fiscal stations is not documented as required by the DoD Financial Management Regulation. As a result, general ledger account balances cannot be readily and may not be effectively tested to ensure reliability of the general ledger trial balances reported for Department 97 appropriations. The report recommends that the DFAS Indianapolis Center document the process for receiving, adjusting, and consolidating the general ledger trial balances received from fiscal stations. The Director, Defense Finance and Accounting Service Indianapolis Center, did not concur with the recommendation because the Federal Financial System is used to receive, adjust, and consolidate the trial balance for Army managed funds and will not be used to compile the trial balances for all Defense agencies. Also, modifying the Federal Financial System to accommodate trial balance submissions for all Defense agencies was not cost-effective. As a result of management comments, the recommendation was revised to recognize the change in systems at the DFAS Indianapolis Center.

Inspector General, DoD, Report No. 97-017, "Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations," October 31, 1996, states that the accounting organizations supporting 19 Defense organizations used data from sources other than a general ledger accounting control system to prepare their FY 1995 adjusted trial balances. Also, the DFAS Indianapolis Center did not have complete information on all FY 1995 Department 97 funds received by the Defense organizations. In addition, the DFAS Indianapolis Center had not established the management controls necessary to ensure that all Department 97 fund recipients provided complete financial information for the preparation of the consolidated Defense organization financial reports. As a result, \$19.0 billion of FY 1995 Department 97 funding was not controlled through a general ledger accounting control system and about \$820.0 million of the FY 1995 funding was omitted from the Defense organizations' FY 1995 adjusted trial balance submissions to the DFAS Indianapolis Center. Until those issues are corrected, the Department 97 financial data included in consolidated DoD financial statements will not be complete, comprehensive, or readily auditable. Further, more than 50 percent of the FY 1996 Department 97 appropriation will not be controlled by a general ledger accounting control system. The report recommended that the Director, DFAS Indianapolis Center, establish procedures and management controls for ensuring that all Department 97 fund recipients provide financial reports in compliance with the Federal Agencies' Centralized Trial-balance

Appendix B. Summary of Prior Audits and Other Reviews

System and the Federal Financial Management Act requirements. The Director, DFAS Indianapolis Center, agreed with the recommendations and established procedures for obtaining financial reports on the Department 97 general funds.

Inspector General, DoD, Report No. 96-213, "Financial Accounting for the National Security Agency," August 20, 1996, states that the financial accounting system used by the National Security Agency was capable, if modified, of producing information necessary for financial statements required by the Chief Financial Officers Act. However, the National Security Agency must correct deficiencies in the accounting system and establish effective management controls for producing accurate financial statements for inclusion in the DoD consolidated statements. The report states that the National Security Agency had not programmed the accounting system to produce necessary information for developing accurate financial statements and that recorded balances of equipment, real property, and inventory were incorrect, misstated, or not supported. As a result, the general ledger and supporting information could not be relied on for information necessary to produce accurate financial statements required by the Chief Financial Officers Act. The report recommends that the National Security Agency reprogram its accounting system to produce required information for financial statements. The National Security Agency fully concurred with the recommendations.

Inspector General, DoD, Report No. 96-161, "Compilation of FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service Indianapolis Center," June 13, 1996, states that the DFAS Indianapolis Center consistently and accurately compiled financial data from field entities and other sources into the FY 1995 consolidated financial statements for the Army General Fund. The efficiency of and management control environment for the compilation processes significantly improved since FY 1993 (the last time the Inspector General reported on the compilation process). However, improvements in the compilation process were still needed. The DFAS Indianapolis Center could have better explained that variances of up to \$6 billion in financial statement line items from year to year occurred because FY 1995 financial data were not comparable to FY 1994 financial data. Further, the DFAS Indianapolis Center did not prepare a required footnote for the financial statement. Also, controls over making 15 auditor-recommended adjustments totaling about \$19.5 billion and over preparing 165 accounting adjustment vouchers needed improvement. The audit also reviewed the progress of the DFAS Indianapolis Center in assuming the new task of maintaining accounting records and preparing financial reports for all Defense organizations. As of June 13, 1996, preparations were not yet completed for the compilation of FY 1996 Chief Financial Officers Act financial statements for Defense organizations other than the Army. Basic planning and analysis have been completed, and Defense agency data have been integrated into some parts of the process used to compile the financial statements. The report recommends that the Director, DFAS Indianapolis Center, improve management controls over the processes used to compile the Chief Financial Officers Act financial statements. The Director, DFAS Indianapolis Center, concurred with all the audit recommendations. He agreed that year-to-year financial statement line item variances should be explained. The Director also agreed that all required footnotes should be prepared, and the DFAS Indianapolis Center has already

Appendix B. Summary of Prior Audits and Other Reviews

implemented procedures that allow for tracking the recording of auditor-recommended adjustments by field accounting entities. Finally, the Director agreed to subject the Defense agencies adjustment journal voucher process to the same control procedures used for the Army General Fund adjustment journal voucher process.

Inspector General, DoD, Report No. 96-080, "Annual Reviews of User Accounting Controls for the Washington Headquarters Services Allotment Accounting System," February 29, 1996, discusses annual accounting system reviews to determine whether DoD accounting systems are in compliance with accounting principles, standards, and related accounting requirements established by the General Accounting Office, the Office of Management and Budget, the Department of the Treasury, and DoD. The report concludes that annual reviews for FYs 1994 and 1995 were not fully coordinated with Washington Headquarters Services Allotment Accounting System users. As a result, annual reviews of the Washington Headquarters Services Allotment Accounting System were incomplete and cannot be relied on to verify the adequacy of principal user accounting system controls. DFAS management did not concur with the recommendations to fully coordinate annual reviews. Instead, in 1995, DFAS developed an automated system-specific annual review process.

Appendix C. Defense Organizations Receiving FYs 1995 and 1996 RDT&E Appropriation, Department 97 Funds

<u>Defense Organizations</u>	RDT&E Funding (thousands)	
	FY 1995	FY 1996
Ballistic Missile Defense Organization (and Chemical Biological Defense Program)	\$2,470,653	\$3,298,680
Defense Advanced Research Projects Agency	2,371,941	2,279,192
Office of the Secretary of Defense	1,867,084	1,689,856
Other*	1,213,397	1,275,935
Defense Special Weapons Agency	242,204	259,628
Special Operations Command	199,718	147,002
Defense Logistics Agency (includes Defense Technical Information Center and Defense Support Activities)	76,452	74,479
Defense Information Systems Agency	82,533	60,630
Defense Special Projects Office	46,664	54,769
Joint Staff	4,154	5,526
Defense Investigative Service	472	402
Total	\$8,575,272	\$9,146,099

*Includes the National Security Agency, the National Imagery and Mapping Agency, and the Defense Intelligence Agency.

Appendix D. Accounting for the \$1.0 Billion Adjustment

After transmitting the Notes report to the consolidated adjusted trial balance to the Department of Treasury, the DFAS Indianapolis Center reversed the \$1.0 billion adjustment made to match the Department of Treasury fund balance amount. As displayed in Table D-1, the adjustment consisted of \$743.0 million for undistributed disbursements (payments recorded by the Department of the Treasury, but not recorded in the Defense organizations' general ledger records), \$189.0 million because the appropriations were canceled, \$63.0 million for adjustments to 11 Defense organizations, and \$5.0 million that was unaccounted for.

Table D-1. Accounting for the \$1.0 Billion Adjustment
(rounded to the nearest millions)

Undistributed Disbursements	\$ 743.0
Canceled Year Appropriations	189.0
Adjustments to Match Budget Execution Reports	63.0
Amount Unaccounted for	<u>5.0</u>
Total	\$1,000.0

The DFAS Indianapolis Center adjusted the individual fund balances of 11 Defense organizations by total of \$63.0 million to agree with certified budget execution reports. (The certified budget execution reports' Fund Balance With Treasury amounts are already adjusted to match the Department of the Treasury's Government On-line Accounting Link System Fund Balance With Treasury amount.) Table D-2 shows the adjustments made to the Defense organizations' FY 1995 Fund Balance With Treasury Account.

Appendix D. Accounting for the \$1.0 Billion Adjustment

**Table D-2. Adjustments Made to the Defense Organizations'
FY 1995 Fund Balance With Treasury Amount**

Defense Organizations	Individual Adjusted Trial Balances	Certified Budget Execution Reports (thousands)	Adjustments by the DFAS Indianapolis Center
Defense Advanced Research Projects Agency	\$2,994,378	\$2,877,441	\$(116,937)
Ballistic Missile Defense Organization	1,910,989	1,889,007	(21,982)
Defense Logistics Agency	93,820	80,576	(13,244)
Defense Information Systems Agency	112,660	106,136	(6,524)
Defense Special Weapons Agency	202,460	197,588	(4,872)
Uniformed Services University of Health Sciences	770	740	(30)
Joint Staff	45,263	57,863	12,600
Other*	957,116 ¹	984,799	27,683
Office of the Secretary of Defense	2,358,658	2,418,796	<u>60,138</u>
Net Adjustments			\$(63,168)

*Includes the National Security Agency, the National Imagery and Mapping Agency, and the Defense Intelligence Agency.

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Joint Staff
Director, Washington Headquarters Services
Director for Budget and Finance

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Unified Command

Commander in Chief, U.S. Special Operations Command

Defense Organizations

Director, Ballistic Missile Defense Organization
Director, Defense Advanced Research Projects Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Information Systems Agency
Director, Defense Intelligence Agency
Inspector General, Defense Intelligence Agency
Director, Defense Investigative Service
Director, Defense Logistics Agency

Director, Defense Special Projects Office
Director, Defense Special Weapons Agency
Director, National Imagery and Mapping Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

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Part III - Management Comments

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

MAY 28 1997

DFAS-HQ/AFB

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT
OF DEFENSE

SUBJECT: Audit Report on the Fund Balance With Treasury
Account for the Department 97, Research,
Development, Test, and Evaluation Appropriation
(Project No. 6RA-2014.02)

The attached comments are provided in response to the
subject audit.

Please direct any questions concerning this matter to
Ms. Martha Cooper on (703) 607-5102.

Richard Buschman
for Edward A. Harris
Deputy Director for
Accounting

Attachment:
As stated

SUBJECT: DoD IG Draft Audit Report on the Fund Balance With Treasury Account for the Department 97, Research, Development, Test, and Evaluation Appropriation (Project 6RA-2014.02)

RECOMMENDATION 1. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center coordinate adjustments with the affected Defense organizations to determine the causes of the differences between certified budget execution reports and general ledger adjusted trial balances.

DFAS RESPONSE. Partially concur. The DFAS plans to coordinate and make the Fiscal Year (FY) 1997 adjustments when the adjustments are identifiable to specific accounting activities. In addition, sufficient time must be allowed to coordinate any required adjustments of the trial balances prior to the release of financial statements to auditors. Many of the accounting offices that support "Other Defense Agencies" do not have accounting systems that can produce the necessary general ledger trial balances. Therefore, these trial balances must be manually created from a combination of budgetary data that are produced by the accounting systems and other financial data, such as property and inventory, that are produced by the Components' information systems. In FY 1996, manually produced trial balances were received and in most cases, were too late for the CFO process to coordinate departmental level adjustments. Those adjustments were necessary to align the trial balances with the respective certified budgetary reports.

Many activities are involved in the accounting and reporting of Treasury Index 97 funds. The DFAS adheres to the current CFO reporting requirements, and as a result, the DFAS has very little time to coordinate adjustments with the "Other Defense Agencies" and their supporting accounting offices prior to forwarding the CFO reports to the auditors. The DFAS is dependent upon the Defense organizations' capability to provide timely and accurate financial data to the accounting systems.

Fiscal year 1996 was the first year the Defense Agencies were under the umbrella of CFO reporting. The DFAS believes the number of required adjustments will decline as the agencies become more familiar with the reporting process and the requirements.

Estimated completion date. September 30, 1997.

RECOMMENDATION 2. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center fully disclose that adjustments made to DoD accounting records to match the Department of the Treasury fund balance were not based on complete reconciliations of the differences between DoD accounting records for the "Other Defense Organizations" and Department of the Treasury Accounting records.

DFAS RESPONSE. Concur. The DFAS plans to make the disclosure in FY 1997 and beyond as required.

Estimated completion date. September 30, 1997.

Audit Team Members

This report was prepared by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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