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FY 1998 DEPARTMENT OF DEFENSE AGENCY-WIDE
STATEMENT OF BUDGETARY RESOURCES

Report No. D-2000-069

December 29, 1999

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Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
GPRA	Government Performance and Results Act
MOCAS	Mechanization of Contract Administration Services
OMB	Office of Management and Budget
SBR	Statement of Budgetary Resources
USD(C)	Under Secretary of Defense (Comptroller)
WCF	Working Capital Fund



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

December 29, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on the FY 1998 Department of Defense Agency-Wide
Statement of Budgetary Resources (Report No. D-2000-069)

We are providing this report for review and comments. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. As a result of management comments, we revised Recommendation B.2. to clarify our intention, revised Finding C, and deleted Recommendation C.2. We request that the Director, Defense Finance and Accounting Service, provide additional comments on Recommendations B.1.c. and B.2. in response to the final report by February 29, 2000.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Brian M. Flynn at (703) 604-9145 (DSN 664-9145) (bflynn@dodig.osd.mil) or Mr. W. Andy Cooley at (303) 676-7393 (DSN 926-7393) (wcooley@dodig.osd.mil). See Appendix C 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. D-2000-069
(Project No. 8FI-2024.03)

December 29, 1999

FY 1998 Department of Defense Agency-Wide Statement of Budgetary Resources

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires the Inspector General, DoD, to audit the DoD financial statements. Beginning in FY 1998, the Office of Management and Budget required budgetary resource reporting as part of the financial statements of DoD and its reporting entities. The Defense Finance and Accounting Service (DFAS) Indianapolis Center, Indianapolis, Indiana, maintained accounting records and prepared the FY 1998 DoD Agency-Wide Statement of Budgetary Resources. At the end of FY 1998, more than \$600 billion in total budgetary resources was reported on this statement.

Objectives. The objective was to determine whether the FY 1998 DoD Agency-wide financial statements were prepared in accordance with Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," November 20, 1998. This audit was limited to determining the reliability of the FY 1998 budgetary data reported on the DoD Agency-Wide Statement of Budgetary Resources.

Results. The FY 1998 budgetary data reported on the DoD Agency-Wide Statement of Budgetary Resources was not reliable for financial reporting purposes.

- The Statement of Budgetary Resources for FY 1998 for DoD and its reporting entities was not auditable because of material control weaknesses in financial accounting systems, unsupported obligations and budgetary adjustments, unmatched disbursements, and inadequate accounting practices and funding controls. As a result, the Statement of Budgetary Resources was included in the disclaimer of opinion issued by the DoD audit community on all except one of the DoD reporting entities' FY 1998 financial statements (Finding A).
- Internal controls over the Mechanization of Contact Administration Services system did not ensure that transactions processed by the system during the test period were adequately supported and accurately recorded. Additionally, transactions were not always accurately recorded in other DoD accounting systems. As a result of these control problems, transaction data from the Mechanization of Contact Administration Services system included in the DoD Agency-wide and reporting entities' Statements of Budgetary Resources could not be relied on and may not be complete (Finding B).
- The combined Statement of Budgetary Resources for the FY 1998 DoD Agency-wide financial statements and other DoD reporting entities was not

prepared in accordance with the Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board. As a result, senior DoD managers, Congress, and other users of DoD financial statements did not have the audited financial information that could be used for making decisions on the status and disposition of more than \$600 billion in DoD budgetary resources in FY 1998 (Finding C).

See the finding section for a complete discussion of the audit results, and Appendix A for details of the review of the management control program.

Summary of Recommendations. We recommend that the Director, DFAS Columbus Center, establish and implement internal control procedures to ensure that transactions are adequately documented and accurately recorded and reported. In addition, we recommend that accounting classification data be included on the voucher before disbursement vouchers are certified for payment. Further, transactions that are allowed to bypass application edit checks should be properly identified and approved. The DFAS Columbus Center should also ensure that all transactions are reported to the appropriate accountable stations. Additionally, we recommend that the Director, DFAS, ensure that all transactions are recorded at the accountable stations in time to support the financial statements. We also recommend that the Under Secretary of Defense (Comptroller) revise DoD Regulation 7000.4-R, the "DoD Financial Management Regulation," to require reporting entities to prepare a principal combining Statement of Budgetary Resources for FY 1999.

Management Comments. The Director, DFAS, concurred with all but one recommendation. The DFAS Columbus Center will provide supplemental guidance or reiterate existing guidance for document retention and maintenance, and for adequate supporting documentation; for recording and reporting transactions in the Mechanization of Contact Administration Services system; for complying with procedures for processing force-through transactions; and for supervisory approval for force-through transactions. The Director, DFAS, also stated that all transactions in the Mechanization of Contact Administration Services system are reported to the appropriate accountable stations. Finally, the Director, DFAS, stated that the requirement for posting the accounting classification on SF 1034 does not apply to the Mechanization of Contact Administration Services system. The Under Secretary of Defense (Comptroller) stated that a combining Statement of Budgetary Resources is now required in the revised DoD Regulation 7000.14-R. A discussion of management comments is in the Findings section of the report, and the complete text is in the Management Comments section.

Audit Response. The comments from the Director, DFAS, are partially responsive, and the comments from the Under Secretary of Defense (Comptroller) are responsive. The requirement for posting accounting classifications on SF 1034 applies to transactions in the Mechanization of Contact Administration Services system. Although the transactions are eventually reported to the accountable stations, they are not always reported in time to support the financial statements. Therefore, we changed the recommendation to define the timely reporting of these transactions to the accountable stations. We request that the Director, DFAS, provide comments on the final report by February 29, 2000.

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Background

Financial Statement Requirements. Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, requires Federal organizations to submit audited financial statements to the Director, Office of Management and Budget (OMB), and requires the Inspector General, DoD, or an appointee to audit the financial statements. Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD and other Government agencies to prepare consolidated financial statements.

Statement of Budgetary Resources. The DoD Agency-Wide Statement of Budgetary Resources (SBR) reports the status and disposition of budgetary resources for the entire DoD. In FY 1998, the DoD Agency-Wide SBR reported on more than \$600 billion in total budgetary resources. The SBR gave details by major categories and individual budget accounts. OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," as amended November 20, 1998, identified the SBR as one of the principal statements required for financial reporting for the fiscal year ending September 30, 1998. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," governs financial management in the DoD and provides form and content guidance for the preparation of the DoD Agency-wide and DoD entity financial statements. The OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," as amended January 25, 1999, established the audit requirements for the SBR and other financial statements. The budget is the primary tool of the Federal Government for financial planning and control. For this reason, and because of its importance to users of Federal financial information, material budgetary information is presented in the SBR. The SBR and the related disclosures provide information about how budgetary resources were made available, as well as the status of the budgetary resources at the end of the reporting period. The SBR is prepared by reporting entities whose financing is wholly or partially from budgetary resources. The SBR illustrates the information that OMB Circular No. A-34, "Instructions on Budget Execution," revised November 7, 1997, requires on SF 133, "Report on Budget Execution."

Objectives

The objective was to determine whether the FY 1998 DoD Agency-wide financial statements were prepared in accordance with OMB Bulletin No. 97-01. This audit was limited to determining the reliability of the FY 1998 budgetary data reported on the DoD Agency-Wide SBR. Specifically, we determined:

- the material weaknesses reported by the DoD audit community that prevented the production of an accurate and complete SBR for DoD and its reporting entities.

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- the reliability of internal controls designed to ensure that disbursement, collection, and adjustment transactions reported by the Mechanization of Contract Administration Services system (MOCAS) were adequately supported and accurately recorded.
 - the reliability of internal controls designed to ensure that disbursement, collection, and external adjustment transactions reported by MOCAS for preparing the FY 1998 DoD Agency-Wide SBR were accurately recorded in the various DoD financial accounting systems.
 - whether the combined SBR for the FY 1998 DoD Agency-wide financial statements and other DoD reporting entities were prepared in accordance with Federal accounting standards.

We also reviewed the adequacy of the management control program at the Defense Finance and Accounting Service (DFAS) Columbus Center, Columbus, Ohio, over the recording and processing of disbursement, collection, and adjustment transactions. Appendix A discusses the audit scope and gives information on prior audits related to the audit objectives. Appendix B gives details of the statistical sampling methodology used.

A. Issues Affecting the Statement of Budgetary Resources

The FY 1998 Statements of Budgetary Resources for DoD and its reporting entities were not auditable.

- The financial accounting systems contained material internal control weaknesses.
- Obligations were not always supported or support was not always readily available. Additionally, obligations were not always valid.
- Unsupported adjustments were made to financial budgetary data.
- Disbursements were not always correctly matched to related obligations in the accounting records.
- Inadequate accounting practices caused obligations to be overstated and understated.
- Adequate funding controls were not always in place to prevent the over-obligation of available funds.

As a result, the FY 1998 SBRs for DoD and its reporting entities were not reliable for financial reporting purposes, for planning or control of programs, or decisionmaking.

Statements of Budgetary Resources

The DoD Agency-Wide SBR is compiled from the SBRs of the DoD reporting entities: the Army, Navy, and Air Force General Funds; the Army, Navy, Air Force, Defense Logistics Agency, and DFAS Working Capital Funds (WCFs); the Military Retirement Trust Fund; the U.S. Army Corps of Engineers, Civil Works Program (the Army Corps of Engineers); and financial data for the Other Defense Organizations General Funds and WCF. DFAS compiles the DoD Agency-wide and reporting entities' SBRs.

Accounting Issues with Statement of Budgetary Resources

The SBRs prepared by DoD reporting entities were not auditable for many reasons.

Financial Accounting Systems. The financial accounting systems that compiled the statements had deficiencies in their general ledgers. The general ledgers were neither integrated nor transaction-driven, and the financial accounting systems had

inadequate audit trails. In September 1998, DoD published the first DoD Biennial Financial Management Improvement Plan, which identified many impediments to achieving auditable financial statements, including deficiencies in financial accounting systems.

Documentation and Validity of Obligations. Obligations were not always supported or support was not always readily available. Additionally, obligations were not always valid.

- Although printed lists were retained, the DFAS Denver Center, Denver, Colorado, and the Air Force WCF Supply Management Activity Group routinely destroyed electronic listings that supported year-end budgetary amounts valued at \$6 billion. Recomputing the account balance from the printed reports was not practical or cost-effective for 493 individual accounts located world-wide. The DFAS Denver Center is modifying the Standard Materiel Accounting System to meet transaction data requirements for the Supply Management Activity Group. The estimated implementation date is FY 2000.
- The DFAS Denver Center and its operating locations could not provide Depot Maintenance and Airlift Services year-end transactions for more than \$2.5 billion of unliquidated obligations from the General Accounting and Finance System and the Central Procurement Accounting System. The transactions were not available because the files processed at year's end were not retained, and therefore could not be retrieved for the audit.
- Unliquidated obligations, valued at \$244.6 million and recorded in the Air Force WCF SBR, were not supported, invalid, or no longer needed, thus overstating unliquidated obligations and understating budgetary resources available. This occurred because DFAS and Air Force personnel did not adequately implement internal controls to review and deobligate recorded unliquidated obligations. Invalid, unliquidated obligations on the Navy General Fund SBR, valued at \$101.2 million, were not detected by management because complete and timely reviews were not performed.
- Unliquidated obligations of \$70 million reported on the Navy General Fund SBR were invalid because supporting documentation was missing, funds were not properly deobligated when work was canceled or completed, and billings were not posted to the accounting records.
- The SBR for DFAS contained \$2.4 million in unverifiable unliquidated obligations because the disbursements and collections used to compute the obligation balance could not be reconciled to accounting records or traced to supporting transactions.
- The DFAS Denver Center operating locations could not always support the value of the Air Force General Fund unliquidated obligations in the accounting systems at year's end.

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- Obligations reported on the SBR for the Air Force General Fund may not be materially correct because DFAS Denver Center procedures for triannual reviews of commitments and unliquidated obligations were not followed.

Adjustments. Unsupported adjustments were made to financial budgetary data.

- The DFAS Cleveland Center, Cleveland, Ohio, moved \$880 billion by journal voucher adjustments between the Navy General Fund budgetary and proprietary general ledgers to force the debits to equal credits in the Navy budgetary general ledger.
- The DFAS Indianapolis Center, Indianapolis, Indiana, made \$17.7 billion in unsupported adjustments to the Other Defense Organizations Report on Budget Execution. The adjustments were made to match accounting office records with disbursements reported to the U.S. Treasury, and to subtract accounts receivable from accounts payable for canceling appropriations.
- Undocumented adjustments totaling \$388.8 million, made to the beginning balances of the Army Corps of Engineers, Civil Works Program, Report on Budget Execution, affected the FY 1998 SBR. The adjustments made the FY 1998 beginning balances agree with the FY 1997 ending balances without providing the required footnote disclosure of the difference.

Unmatched Disbursements. Disbursements were not always correctly matched to related obligations in the accounting records.

- Navy General Fund disbursements valued at about \$7.4 billion were not correctly matched to obligations. The unmatched disbursements occurred because funds were not always obligated promptly and unmatched disbursements were not always resolved promptly. DFAS and the Navy are making changes to automated accounting systems to meet the requirement for prevalidation of disbursements by matching proposed payments to obligations before payments are made. Additionally, the Navy plans to reduce manual data entry and make the payment process more automated.
- Unmatched disbursements valued at more than \$2 billion and negative unliquidated obligations valued at \$490 million distorted the availability of funds for the Army General Fund. This material weakness was caused by a lack of integration between the entitlement and accounting systems, by errors, and by delays in posting disbursements to accounting records.
- DFAS internal controls were not adequate to ensure that disbursements were matched with related obligations. This resulted in \$388 million of negative unliquidated obligations in the Air Force General Fund accounting systems.

Recording and Accounting for Obligations. Inadequate accounting practices caused obligations to be overstated and understated.

- An Air Force WCF overstatement of accrued expenses resulted in overstatements of obligations by at least \$22.2 million, and ineffective

work-around procedures to capture outstanding undelivered orders resulted in understatements of obligations by \$568 million. These errors occurred because DFAS and the Air Force WCF did not have adequate accounting procedures for supporting, recording, and reporting Accrued Expenses-Organic and Undelivered Orders Outstanding Contract Maintenance.

- Accounting deficiencies caused unliquidated obligations to be overstated by \$510 million on the SBR for the Air Force WCF because DFAS and WCF accounting personnel did not update their estimates for contract and overhead expenses with actual expenses. The contract accounting system used by the Air Force Depot Maintenance Activity Group is being modified to correct the accruals for contract performance.
- Accounting practices and data systems allowed the aviation fuels accounts payable account to be overstated by \$324 million, and allowed the budgetary resources available for the Air Force Supply Management Activity Group to be understated by the same amount. The DFAS Denver Center initiated a system change request for the Standard Base Supply System and the Defense Logistics Agency systems to update aviation fuel receipts from the same file.
- Air Force General Fund contracts and contract modifications made in FY 1998 were not always promptly recorded in the accountable records. As a result, FY 1998 obligations could be misstated.

Funding Controls. Adequate funding controls were not always in place to prevent the overobligation of available funds.

- Air Force WCF personnel at major commands obligated \$732.2 million more than budget authority as of September 30, 1998. The Assistant Secretary of the Air Force (Financial Management and Comptroller) advised that command-level over obligations were offset by command-level under obligations. This occurred because Air Force and DFAS personnel did not have funding controls to prevent command-level overobligation of available budgetary resources.
- Internal control weaknesses in military pay appropriations affected the Army SBR. Systemic weaknesses existed in expenditures paid from the National Guard Personnel open allotment pay accounts. Systemic weaknesses in the Defense Joint Military Pay System affected the ability of the Army Reserve to ensure that obligations were properly established. Payroll and personnel data for Reserve Component soldiers could not always be matched. Annual Statements of Assurance prepared by the Army identified these uncorrected material internal control weaknesses. The Army and DFAS are taking several actions to alleviate the problems in military pay.

Issues Affecting Future Statements of Budgetary Resources

Two issues were identified that will affect future SBRs, if uncorrected.

Eliminating Entries. The DFAS Indianapolis Center has not considered how to eliminate transactions between WCF business activities for the SBR. OMB did not require transactions between activities to be eliminated for the FY 1998 SBR; however, transactions must be eliminated beginning with the FY 2000 financial statements.

Compilation Procedures. Automated compilation procedures used by the Army Corps of Engineers incorrectly reported \$2.3 billion of Revolving Fund spending authority on line 1 of the SBR, Budget Authority, rather than on line 4, Spending Authority from Offsetting Collections. Although this error was manually corrected during the preparation of the financial statements, a similar, uncorrected error on future SBRs will materially affect the statements. Changes were recommended in the general ledger crosswalks to correct this problem.

Summary

The intent of the SBR is for DoD managers, Congress, and other users of DoD financial statements to be able to use the SBR for planning and control of DoD budgetary resources. However, significant problems reduced the reliability of the budgetary data, impairing the use of the SBR for making decisions. As a result, the SBR was included in the disclaimer of opinion issued by the DoD audit community on all of the DoD reporting entities' FY 1998 consolidated financial statements, except for the Military Retirement Trust Fund. Although all amounts for each deficiency noted in this finding were material to the respective SBRs, the amounts were not always material to the DoD Agency-Wide SBR. The amounts were included in this report to show the challenges that the DoD management must overcome in order to produce an auditable DoD Agency-Wide SBR.

Ongoing Corrective Actions

Corrective action has been initiated on some of the deficiencies that supported the disclaimer of opinion on the DoD Agency-wide and the DoD reporting entities' SBRs. Additionally, where corrective action has not been initiated, the DoD audit community has recommended appropriate actions. Therefore, no additional recommendations are made in this finding.

B. Internal Controls Over Transactions in Mechanization of Contract Administration Services System

Tests of Mechanization of Contract Administration Services (MOCAS) transactions over a 5-day period showed that internal controls over disbursements, collections, and adjustments need strengthening. Similar tests of financial accounting records used to prepare the FY 1998 DoD Agency-Wide SBR showed that the records did not include all MOCAS transactions or included the transactions in the wrong accounting period.

- Internal controls at the DFAS Columbus Center did not ensure that transactions reported by MOCAS were adequately supported, accurately recorded, and properly approved.
- Internal controls at the DFAS Columbus Center and the accountable stations did not ensure that all reported MOCAS transactions were recorded in the various financial accounting systems and in the correct accounting period.

Based on our statistical samples, we were 90-percent confident that the error rate of disbursements, collections, and adjustments tested in MOCAS exceeded the tolerable error rate for reliability of internal controls. As a result, transaction data passed from MOCAS to DoD, foreign military sales, and non-DoD agency financial accounting systems could not be relied on. Further, the DoD Agency-Wide SBR may not include all MOCAS transactions reported. Because of the limited test period, the control weaknesses identified by the audit may not represent the entire year. However, the audit identified two systemic material control weaknesses over MOCAS transactions.

Transaction Testing

MOCAS disbursed more than \$70 billion of the total \$310 billion outlays reported on the FY 1998 DoD Agency-Wide SBR. MOCAS is an integrated system used by contract pay and administration offices, funding stations, procurement managers, and other personnel who make contract disbursements, collections, and adjustments on Government contracts. As of October 1998, MOCAS performed contract administration for approximately 384,000 contracts valued at \$845 billion. MOCAS provides contract pay support for the Army, Navy, Air Force, Marine Corps, Defense Logistics Agency, other Defense agencies, and more than 22,400 Government contractors. MOCAS disbursements averaged \$6 billion monthly.

As discussed in Appendix B, we conducted a DoD Agency-wide sample and performed specific tests on a sample of MOCAS disbursement, collection, and adjustment transactions. The tests were designed to satisfy two objectives.

- The first objective was to determine whether disbursement, collection, and adjustment transactions were supported and accurately recorded in MOCAS.

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- The second objective was to determine whether the disbursement, collection, and adjustment transactions reported by MOCAS were accurately recorded in the DoD financial accounting records used to prepare the FY 1998 DoD Agency-Wide SBR.

To rely on the internal controls tested, we had to be 90-percent confident that the actual error rate in the MOCAS populations tested for the 5-day period was no more than 5-percent. Based on this criterion, the internal controls would be considered unreliable if the tests identified more than 2 errors in a sample of 105 transactions or any error in a sample of 45. The tests and sampling results are summarized below and detailed in Appendix B.

MOCAS Internal Controls

Tests performed on disbursements, collections, external adjustments¹, and internal adjustments² showed that internal controls over MOCAS transactions were not functioning.

- The DFAS Columbus Center did not provide documentation to adequately support transactions.
- Transactions were not accurately recorded and reported.
- Sensitive force-through transactions were not properly documented or approved. To expedite processing, force-through transactions bypassed edit checks and other controls in MOCAS.

As a result, transaction data reported by MOCAS to DoD, foreign military sales, and other non-DoD financial accounting systems could not be relied on.

Adequate Documentation. The DFAS Columbus Center could not provide adequate documentation to support its disbursements and collections, external adjustments, and internal adjustments. Based on the sample, we were 90-percent confident that more than 5 percent of all MOCAS transactions in the period tested were inadequately documented.

Disbursements and Collections. The DFAS Columbus Center did not have adequate support for 29 of 105 disbursement and collection transactions tested.

- Accounting classifications for 21 transactions were not identified on the SF 1034, "Public Voucher for Purchases and Services Other Than

¹External adjustments flow from MOCAS to the financial accounting systems. Such adjustments include, for example, transactions to correct expenditures and payments made against incorrect Accounting Classification Reference Numbers.

²Internal adjustments are internal to MOCAS processing, and therefore should not flow to the financial accounting systems. For example, such adjustments are made to reverse other unsupported internal adjustments on financial history files and to process credits for previously voided checks.

Personal," as required by DoD Regulation 7000.14-R, volume 10, chapter 8, "Preparation and Distribution of Payment Vouchers," February 1996.

- Five transactions were not properly authorized.
- An adequate documentation trail did not exist to show why three transactions were processed.

External Adjustments. Adequate documentation was not available for 31 of 105 external adjustments tested. Specifically, DFAS Columbus Center personnel could not provide original contracts or contract modifications for 9 of the 31 transactions. Supporting documentation did not adequately explain the reason for 22 other adjustments.

Internal Adjustments. Adequate support was not available for 15 of 45 internal adjustments tested. The DFAS Columbus Center could not provide the required Optional Form 1017-G, "Journal Voucher," for nine transactions. Based on the documentation provided, six additional transactions could not be logically followed through the adjustment process to determine the reliability of the documents or verify the validity of the adjustment.

Accurate Recording and Reporting. The DFAS Columbus Center did not ensure that MOCAS transactions were accurately recorded and reported. We were 90-percent confident that more than 5-percent of all MOCAS disbursement and collection transactions and external adjustments made during the test period had not been accurately recorded and reported. Our sampling results are described below.

Disbursements and Collections. The DFAS Columbus Center did not accurately record and report 30 of 105 disbursement and collection³ transactions tested.

- On five transactions, costs were charged to improper accounts because accounting information provided on the SF 1034s was not used.
- One foreign military sales appropriation was erroneously charged \$183,334 for a DoD disbursement. This type of error can result in an understatement on the DoD Agency-wide financial statements.
- The remaining four transactions were erroneously charged to incorrect Military Department accounting classifications. These four errors did not cause a misstatement of the DoD Agency-wide financial statements, but could result in misstatements of the Military Department financial statements.
- Twenty-one transactions were assigned to various accounts by MOCAS because accounting information was not provided on the SF 1034s. The

³Twenty-five of these transactions were included in the 29 transactions previously identified as not supported by adequate documentation.

DFAS Columbus Center procedures authorized the payment of the SF 1034s, although accounting information required by DoD Regulation 7000.14-R was not always provided.

- For two transactions, the payee's data did not agree with data on the invoice.
- Documentation was not provided for one force-through transaction and one refund transaction.

External Adjustments. Of 105 external transactions tested, 30 were not accurately recorded.

- For 14 transactions, adjustments could not be traced back to the original disbursement or collection entries.
- For 13 transactions, appropriation data in MOCAS did not match the appropriation data in the source documents.
- For three additional transactions, the SF 1081, "Voucher and Schedule of Withdrawals and Credits," did not state the reason for the adjustment as required.

Force-Through Processing Controls. The DFAS Columbus Center did not ensure that transactions identified for force-through processing were adequately documented and approved. The force-through transactions were sensitive because they bypassed the automated system edit checks and other controls applied to other MOCAS transactions. Based on our sampling results described below, we were 90-percent confident that more than 5 percent of all MOCAS external and internal adjustments identified for force-through processing during the test period were not adequately documented and approved.

External Adjustments. Of 105 external adjustments tested, 88 were identified for sensitive force-through processing. Twenty-eight of those 88 adjustments, however, were not adequately documented and approved.

- The DFAS Columbus Center could not provide the required "Force Thru Approval Listing" for eight transactions.
- Three transactions were identified by MOCAS history as force-through transactions; however, because of a problem in the contract reconciliation system, these transactions were not properly identified as force-throughs. Consequently, normal supervisory controls over the three sensitive transactions were bypassed.
- "Force Thru Approval Listings" provided by the DFAS Columbus Center for 17 transactions were not approved by supervisors.

Internal Adjustments. Out of 45 internal adjustments tested, 36 were identified for sensitive force-through processing. The DFAS Columbus Center could not provide the required "Force Thru Approval Listings" for 17 of those 36 adjustments.

- MOCAS history identified 11 transactions as force-through transactions; however, because of problems in the contract reconciliation system, they were not properly identified as force-throughs in that system. Consequently, normal supervisory controls over the sensitive transactions were bypassed. Because this condition would affect all force-through transactions, we considered it a systemic material weakness in internal controls.
- "Force Thru Approval Listings" could not be located for six internal transactions.

Accounting Controls Over MOCAS Transactions

Internal controls designed to ensure that MOCAS transactions are properly recorded should not be relied on if more than 5 percent of the transactions were not recorded in the DoD accounting records in the correct accounting period. Based on our sampling results, we were 90-percent confident that more than 5 percent of all MOCAS transactions during the test period were not recorded in the DoD accounting records at the accountable stations or were recorded in an incorrect accounting period.

- Of 105 MOCAS disbursements and collections tested, 5 transactions reported to DFAS accountable stations were not recorded or were recorded as much as 4 months after the transactions were processed by MOCAS.
- Of 105 MOCAS external adjustments tested, 9 were not recorded or were recorded as much as 3 months after the transactions were processed by MOCAS.

Because of the inadequate internal controls over recording these transactions, an increased risk existed that the DoD Agency-Wide SBR did not include all MOCAS transactions reported to the accountable stations. Internal control procedures at the DFAS Columbus Center and the accountable stations did not ensure that transactions were accurately recorded in the accountable records.

Summary

To ensure the reliability of MOCAS transactions reported to DoD, foreign military sales, and non-DoD financial accounting systems, the DFAS Columbus Center must strengthen internal controls over MOCAS transaction processing. Additionally, to ensure the accurate reporting of MOCAS transactions in the DoD Agency-wide and DoD reporting entities' SBRs, internal controls must be improved over recording transactions at the DoD accountable stations.

Recommendations, Management Comments, and Audit Response

We revised Recommendation B.2. to specify that MOCAS transactions must be reported to and included in the accountable records in time to support the affected Statement of Budgetary Resources.

B.1. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, establish and implement internal control procedures that:

a. Provide adequate documentation to support all processing of disbursements, collections, and adjustments.

Management Comments. DFAS concurred, stating that the DFAS Columbus Center will distribute supplemental policy reiterating the importance of proper retention and maintenance of supporting documents. The guidance will also specify what constitutes adequate supporting documentation for MOCAS transactions.

b. Require that each transaction be accurately recorded and reported in the Mechanization of Contract Administration Services system.

Management Comments. DFAS concurred, stating that the DFAS Columbus Center will issue supplemental guidance that specifies the proper procedures for accurately recording and reporting MOCAS transactions.

c. Require the accounting classification data on SF 1034, "Public Voucher for Purchases and Services Other Than Personal," to be completed before vouchers are certified for payment."

Management Comments. DFAS nonconcurred, stating that the requirement for posting the accounting classification on the SF 1034 does not apply to the MOCAS area because the funding structure and the payment method are established in the terms of the contract. When a discrepancy exists between the Federal Acquisition Regulation and DoD Regulation 7000.14-R, the policy of DFAS is to follow the Federal Acquisition Regulation.

Audit Response. Management comments were not responsive. The guidance in DoD Regulation 7000.14-R applies to the MOCAS area because the SF 1034 is normally used for processing payments on cost reimbursement contracts. The audit found numerous transactions processed by MOCAS that used the SF 1034. Management acknowledged that DoD Regulation 7000.14-R requires all SF 1034s to include accounting classifications. This accounting information is vital to the accurate recording of payments to accounting records, especially when funds from different DoD and non-DoD entities are included on the same line of a contract. Not only does this affect the initial posting of disbursements to the accounting records, but it affects the auditors' evaluation of the accuracy of the financial statements at year's end. The validity of disbursements cannot be determined without the accounting classification. We request that DFAS reconsider its position on Recommendation B.1.c. and provide additional comments in response to the final report.

d. Identify as force-through transactions each disbursement, collection, and adjustment that bypasses critical system edit checks in the Mechanization of Contract Administration Services system.

Management Comments. DFAS concurred, stating that the field identifying force-through transactions was lost during a conversion of the Contract Reconciliation System, allowing numerous transactions to not be identified as force-throughs. The problem has been solved. Additionally, the DFAS Columbus Center will issue supplemental guidance that reiterates the importance of complying with force-through procedures.

e. Require supervisory approval on "Force Thru Approval Listings" for all force-through transactions in the Mechanization of Contract Administration Services system.

Management Comments. DFAS concurred, stating that the DFAS Columbus Center will emphasize in supplemental guidance the importance of supervisory approval for all force-through transactions.

f. Verify that all transactions in the Mechanization of Contract Administration Services system are reported to the appropriate accountable station.

Management Comments. DFAS concurred, stating that policies and procedures exist to ensure that proper documents and reports are transmitted, and that a matrix exists to ensure that all documents required by the accountable stations are identified.

B.2. We recommend that the Director, Defense Finance and Accounting Service, initiate action to require compliance with existing procedures to ensure the accurate and timely recording of all Mechanization of Contract Administration Services system transactions in the accountable station records in time to support the financial statements.

Management Comments. DFAS concurred, stating that DFAS has procedures in place to ensure that transactions are recorded in an accountable station's records.

Audit Response. Management comments are not responsive. Disbursements, collections, and adjustments must be recorded in the respective accountable records in time to support the budgetary data reported on the SBR each year. The recording of these transactions after the financial statements are prepared does not provide adequate support for amounts reported in the SBR, which may affect the auditor's opinion on the SBR. We revised Recommendation B.2. accordingly. We request that DFAS reconsider its position on Recommendation B.2. and provide additional comments in response to the final report.

C. Statement of Budgetary Resources

The combined SBR for the FY 1998 DoD Agency-wide financial statements and other DoD reporting entities were not prepared in accordance with Federal accounting standards. This presentation is a material departure from Federal accounting standards, which require a principal combining SBR. Because DoD did not properly implement the Federal accounting standards, DoD managers, Congress, and other users of DoD financial statements did not have the audited information they needed for decisionmaking on the status and disposition of more than \$600 billion in DoD budgetary resources in FY 1998.

Federal Accounting Standards

Definition. Federal accounting standards are defined in OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, as those standards included in the hierarchy of Federal accounting standards described in paragraph 5 of the bulletin. Included in that hierarchy are the "requirements contained in the OMB Form and Content Bulletin [OMB Bulletin No. 97-01, "Formats and Instructions for the Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998] in effect for the period covered by the financial statements."

OMB Form and Content Bulletin. OMB Bulletin No. 97-01, which applies to financial statements for FY 1998 and subsequent years, was revised on November 20, 1998. Among other changes, the revised OMB Bulletin No. 97-01:

- replaced the consolidated SBR with a combining SBR,⁴ which does not require the elimination of intra-agency transactions; and
- changed the SBR instructions to provide for a combining statement to replace a consolidated statement.

Before the November 20, 1998, revision, OMB Bulletin No. 97-01 required a consolidated SBR as one of the principal statements.

Principal Combining SBR. The revised OMB Bulletin No. 97-01 provides guidance on the format for the principal combining SBR, including an example of the combining SBR. The example of a combining SBR provides details on each line item by major budgetary accounts, which add up to the combined total shown on the combining SBR. OMB Bulletin No. 97-01 also requires a combining SBR, not a combined SBR.

⁴Auditing standards make a distinction between a "combined statement" and a "combining statement." A combined statement presents a single column of dollar amounts, and a combining statement presents multiple columns of amounts that are added to make a combined total. This same distinction is made between consolidating and consolidated statements, which also require the elimination of intra-agency transactions. See the American Institute of Certified Public Accountants, "Codification of Statements on Auditing Standards," AU Section 551.16 through 19.

... A consolidating statement of budgetary resources is preferred but not required for fiscal years 1998 and 1999. Instead, reporting entities may prepare a combining statement. Reporting entities that prepare a *combining* statement must disclose in a note that the statement is *combining* and, as such, intra-entity transactions have not been eliminated. Also, the statement must be properly titled "consolidating" or "*combining*," as appropriate. [Emphasis added.]

As discussed below, DoD Regulation 7000.14-R was not consistent with these Federal accounting standards.

DoD Form and Content Guidance

DoD form and content guidance is found in DoD Regulation 7000.14-R, the "DoD Financial Management Regulation" (the Regulation). The Regulation was revised to implement the November 1998 changes to OMB Bulletin No. 97-01 for the DoD reporting entities' use in preparing financial statements in FY 1998 and subsequent years. The current Regulation was issued in December 1998.

However, the revisions made to DoD Regulation 7000.14-R, volume 6B, chapter 7, "Statement of Budgetary Resources," do not properly implement OMB Bulletin No 97-01. Instead, the Regulation requires a combined SBR, not a combining SBR.

DoD Regulation 7000.14-R, volume 6B, chapter 7, figure 7-1, illustrates the combined SBR. Chapter 7 of the Regulation gives instructions for preparing the combined SBR.

A. . . . The Statement of Budgetary Resources should be aggregated to reflect all the activity of the reporting entity for the year covered by the financial statement. Prior year information should be presented to allow the reader to make appropriate comparisons with prior periods. However, for FY 1998 no prior year column is required. . . . The Office of Management and Budget (OMB) does not require consolidated and consolidating statements of budgetary resources. *Therefore, the Department of Defense (DoD) has elected to prepare for FY 1998 a combined Principal Statement of Budgetary Resources and a combining Disaggregated Statement of Budgetary Resources.* The statements will be appropriately titled combined or combining. [Emphasis added.]

Contrary to the Regulation, OMB Bulletin No. 97-01 requires a combining SBR. In preparing the principal statements, OMB Bulletin No. 97-01 gave DoD and other reporting entities a choice between a consolidating SBR (preferred) and a combining SBR, not between a combining or combined SBR. Thus, the DoD Regulation 7000.14-R erred by stating that DoD could present the principal SBR on a combined basis instead of a combining basis.

Summary

Because of this material departure from Federal accounting standards, senior DoD managers, Congress, and other decisionmakers did not receive adequate information on the status and disposition of more than \$600 billion in current and multiyear budgetary resources available to DoD in FY 1998. DoD can resolve this departure from Federal

accounting standards by reporting the budgetary information already available. After the required DoD financial statements have been prepared, the annual audits of those statements can provide decisionmakers with opinions on the reliability of the information presented.

Recommendation and Management Comments

Based on management comments, we deleted Recommendation C.2. made in our draft report concerning the required supplementary information on the SBR, and renumbered Recommendation C.1. as Recommendation C. Management provided additional OMB correspondence, not previously disclosed, that gave additional guidance to management on the required supplementary information for the SBR. Based on that OMB guidance and the corrective actions taken in response to Recommendation C., the required supplementary information for the SBR required by DoD regulation meets OMB requirements. Therefore, we deleted the discussion in our draft report's finding and the related recommendation on the required supplementary information on the SBR.

C. We recommend that the Under Secretary of Defense (Comptroller) make DoD Regulation 7000.14-R, volume 6B, consistent with Office of Management and Budget Bulletin No. 97-01 by revising chapter 7, "Statement of Budgetary Resources," to require that DoD reporting entities prepare a principal combining Statement of Budgetary Resources for FY 1999.

Management Comments. The Under Secretary of Defense (Comptroller) stated that DoD Regulation 7000.14-R currently requires the preparation of a combining Statement of Budgetary Resources.

Audit Response. In response to the recommendation made in our draft report, Chapter 7 of DoD Regulation 7000.14-R was revised in October 1999 to require a combining Statement of Budgetary Resources from DoD reporting entities. Therefore, the comments from the Under Secretary of Defense (Comptroller) are responsive.

Appendix A. Audit Process

Scope

Work Performed. We reviewed draft and final audit reports related to the reporting of budgetary data for FY 1998 issued by the DoD audit community. Additionally, in support of the SBR, we reviewed disbursement, collection, and adjustment transactions reported by MOCAS for the 5-day period of June 22 through 26, 1998. We did not evaluate the general and application controls over MOCAS. Further, with audit support from each Military Department audit organization, we attempted to trace the MOCAS transactions to the accountable records of the DoD financial accounting systems (see Appendix B). MOCAS supports contract administration for approximately 384,000 contracts valued at \$844.7 billion. Monthly MOCAS disbursements total \$6 billion. Finally, we reviewed the FY 1998 DoD Agency-wide and the DoD reporting entities' SBRs for compliance with Federal accounting standards. We did not evaluate the completeness of the MOCAS database.

DoD-Wide Corporate-Level Government Performance and Results Act (GPRA)

Goals. In response to the GPRA, the Department of Defense has established 2 DoD-wide goals and 7 subordinate performance goals. This report pertains to achievement of the following goals (and subordinate performance goals):

Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **Performance Goal 2.3:** Streamline the DoD infrastructure by redesigning the Department's support structure and pursuing business practice reforms.

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management Functional Area. Objective: Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. (FM-5.3)

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Audit Type, Dates, and Standards. This financial-related audit was performed from August 1998 through June 1999. The audit was made in accordance with auditing

standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly included such tests of management controls as were considered necessary.

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

Management Control Program

DoD Directive 5010.38, "Management Control 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 made a limited review of the adequacy of the management controls over the recording and processing of disbursements, collections, and adjustments at the DFAS Columbus Center.

Adequacy of Management Controls. We identified two material internal control weaknesses at the DFAS Columbus Center, as defined by DoD Directive 5010.38. As discussed in finding B, these two systemic material weaknesses in internal controls affected MOCAS transaction processing. Specifically, DFAS Columbus Center management controls over payments on public vouchers did not ensure that payments were not made when the required accounting information was omitted from the contractor's public voucher. In addition, because of a systemic problem in the contract reconciliation system, not all sensitive force-through internal adjustment transactions were identified. Consequently, normal supervisory controls over these sensitive transactions were bypassed. We also identified the DoD implementation of Federal accounting standards as a material departure from the standards. Implementing Recommendations B.1.c., B.1.d., and C. will improve management controls in the processing of MOCAS transactions and the application of Federal accounting standards within DoD. A copy of the report will be provided to the senior official responsible for management controls for DFAS and the Office of the USD(C).

Adequacy of Management's Self-Evaluation. DFAS Columbus Center officials determined that MOCAS did not meet all the necessary requirements of DoD Regulation 7000.14-R and cannot be certified as being in substantial compliance with the Regulation. Management performed a self-evaluation and reported material control weaknesses in the DFAS FY 1998 Annual Statement of Assurance; however, management did not identify and implement corrective actions for the material weaknesses identified in this report. We did not evaluate the self-evaluation performed by the USD(C).

Summary of Prior Coverage

During the last 5 years, the General Accounting Office and the Inspector General, DoD, have conducted multiple reviews on financial statement issues. General Accounting Office audit reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, audit reports can be accessed on the Internet at <http://www.dodig.osd.mil>.

Appendix B. Statistical Sampling Methodology

Use of Computer-Processed Data. We relied on computer-processed data extracted from the MOCAS "Contract Support Obligations and Disbursement Inquiry" database. Although this database had known weaknesses, it was the only source that provided data at the individual transaction level. We used automated and manual techniques to analyze system data. Based on those tests and assessments, we concluded that the data were sufficiently reliable to be used in meeting the audit objectives. All system testing and use was accomplished in a controlled environment with management's approval. Statistical Application Software was used to identify the MOCAS transactions included in the audit universe. We attempted to validate transactions selected with supporting documentation at the DFAS Columbus Center. We also attempted to trace the selected transactions to the accountable records within the respective DoD accounting systems.

Use of Technical Assistance. Operations research analysts in the Quantitative Methods Division of the Office of the Assistant Inspector General for Auditing assisted in designing and evaluating of the sampling plan.

Audit Universe. Statistical sampling methodology was used to determine the reliability of internal controls over MOCAS transaction processing (Objective 1), and the reporting and recording of the MOCAS transactions in the accountable records (Objective 2). For Objective 1, we identified a universe of 44,529 MOCAS disbursement, collection, and adjustment transactions reported during the 5-day period of June 22 through 26, 1998, in the Contract Support Obligations and Disbursement Inquiry database within MOCAS. We further stratified the universe, with a net value of \$1.8 billion,¹ into three types of transactions.

- Stratum 1 represented contract disbursements and collections, valued at \$1,808 million, reported by MOCAS.
- Stratum 2 represented external adjustments, valued at a negative \$6.4 million, made by DFAS Columbus Center personnel to correct transaction discrepancies in MOCAS.
- Stratum 3 represented internal adjustments, valued at a negative \$49 million, made by DFAS Columbus Center personnel.

Some MOCAS transactions included in our first universe were not reported on the FY 1998 DoD Agency-Wide SBR. Therefore, for Objective 2, a second universe of DoD SBR-related transactions was established by eliminating transactions (from the first universe of MOCAS) that were not reported on the FY 1998 DoD Agency-Wide SBR. That is, our second universe was derived from the first universe by eliminating:

¹Where Finding B is discussed, references to the dollar values of the audit universe, individual stratum, or sampling units are for information only. Using acceptance sampling techniques, no projections are made of dollar values.

- blank disbursements (canceled accounts), direct foreign military sales and administrative expenses, and other non-DoD (Coast Guard) transactions from both Stratum 1 and 2; and
- all internal adjustments from Stratum 3.

The resulting universe consisted of 37,305 MOCAS transactions with a net value of \$1,555 million.

Table B-1 illustrates the number of transactions included in each stratum of the two universes tested.

Table B-1. Stratified Universe of MOCAS Transactions for Each Audit Objective				
Stratum Number and Description	All MOCAS Transactions	Audit Objective	DoD SBR-Related MOCAS Transactions	Audit Objective
1. Disbursements and collections	34,562	1	31,892	2
2. External adjustments	6,049	1	5,413	2
3. Internal adjustments	3,918	1	0	
Total Transactions	44,529		37,305	

Sampling Plan. To accomplish the two MOCAS objectives, we designed acceptance samples for each stratum tested. In acceptance sampling,² we tested the sample results against pre-established criteria:

- a tolerable error rate (5 percent), and
- a maximum level of risk (10 percent) of accepting all the transactions in a stratum as meeting the tolerable error rate criteria, when the true error rate exceeded those criteria.

Based on those criteria, the audit tests used a sample size of 105 and a critical value of no more than two errors each for Stratum 1 and 2 transactions, and a sample of 45 and a critical value of 0 (zero) errors for Stratum 3 transactions. To stay within our 10-percent maximum level of risk, all samples and tests used a confidence level of 90-percent. The 90-percent confidence level meant that, for many like-sized samples, we would accept a group of transactions whose actual error rate exceeded 5 percent only 1 time in 10 (10 percent). When the number of errors in a sample exceeded the critical value, the sample failed that test; based on the sampling results, we were 90-percent confident that the actual error rate exceeded the tolerable error rate of

²Acceptance sampling has several elements: a population size, a sample size, a tolerable rate, a risk level (probability) used for the test, and a test or critical value. Using the disbursements and collections line in Table B-2 as an example, we started with a population size (34,562 transactions), established a tolerable error rate (5 percent) and desired level of risk (confidence in the results of the test) – in our case, 90-percent confidence. These criteria led us to combinations of sample size and critical numbers of errors (2 of 105, and 0 of 45). We were testing to determine whether, 90-percent of the time, we could expect to find no more than 2 errors in a sample of 105 transactions when the transaction population had an error rate of 5 percent or less.

5 percent. Table B-2 summarizes the different types of transactions, the two populations, and the number of sample transactions drawn from each group.

Table B-2. Populations, Samples, and Critical Values, by Stratum, of MOCAS Transactions for Audit Objectives 1 and 2						
Stratum Number and Description	Total MOCAS Transactions (Objective 1)			DoD SBR-Related MOCAS Transactions (Objective 2)		
	<u>Population</u>	<u>Sample</u>	<u>Critical Value</u>	<u>Population</u>	<u>Sample</u>	<u>Critical Value</u>
1. Disbursements and collections	34,562	105	2	31,892	105	2
2. External adjustments	6,049	105	2	5,413	105	2
3. Internal adjustments	3,918	45	0	0	0	
Total Population	44,529			37,305		

Each Military Department audit organization provided support by performing the test criteria for our second objective.

Tests of MOCAS Internal Controls (Objective 1). The following test methodology was used in evaluating the MOCAS disbursement, collection, and adjustment transactions identified in Stratum 1, 2, and 3.

Disbursements and Collections (Stratum 1). Each of the 105 disbursement and collection transactions included in the sample was evaluated against the following test criteria.

Test 1: Adequate Documentation. Supporting documentation was requested for each transaction and evaluated to determine whether each transaction was adequately supported. For example, we requested invoices, vouchers, receiving reports, and other supporting documentation from the entitlement and disbursement offices at the DFAS Columbus Center. We reviewed the documentation to ensure that it was properly prepared and authorized in accordance with DoD Regulation 7000.14-R, volume 10, chapter 8, "Preparation and Distribution of Payment Vouchers." We also reviewed the documentation to determine whether the transaction could be traced back to the supporting documentation. If the documentation did not adequately support the transaction or meet the requirements of the regulation, the transaction failed the test, and a critical error was recorded. However, transactions that failed this test were still subject to the additional test described below.

Test 2: Accurate Recording and Reporting. Supporting documentation was reviewed to ensure that the sampled transactions were accurately and completely recorded in MOCAS. Specifically, the sample transaction recorded in MOCAS was compared to supporting documentation to determine whether the amount and accounting classification data were accurately recorded in MOCAS. Likewise, vendor information was verified by comparing the transaction invoice to the disbursement voucher. A critical error was recorded for the transaction if the supporting documents and the transaction data were in conflict in any of the areas reviewed.

External Adjustments (Stratum 2). Each of the 105 external adjustments included in the sample was evaluated against the following test criteria.

Test 1: Adequate Documentation. Several factors were considered to determine whether or not each external transaction was adequately documented. The SF 1081, the primary source document supporting each adjustment, was requested and reviewed. Additional supporting documentation, such as contracts and contract modifications, was also requested if supplementary information was essential to further verifying the accuracy of the adjustment. All supporting documentation was reviewed for completeness and supervisory approval. Source documents were also compared to the corresponding MOCAS disbursement history, and discrepancies were noted. If the requirements of these tests were not met, the transaction failed the test and a critical error was recorded.

Test 2: Accurate Recording and Reporting. To verify that each external adjustment was accurately recorded and reported, the classification and amount of the adjustment recorded in MOCAS was compared to the information provided on the SF 1081. Prior payment information on the SF 1081 was also verified with the historical information in MOCAS to ensure that the adjustment actually reversed the original MOCAS disbursement. If the information in MOCAS and on the SF 1081 did not agree, the transaction failed the test, and a critical error was recorded.

Test 3: Force-Through Processing Controls. This test was applied only to the 88 external adjustments identified by MOCAS as force-through transactions.³ The "Force Thru Approval Listings" required by the DFAS Columbus Center were requested for each adjustment and evaluated for supervisory approval. A critical error was recorded if the listings were not available or properly approved.

Internal Adjustments (Stratum 3). Each of the 45 internal adjustments included in the sample was evaluated against the following test criteria.

Test 1: Adequate Documentation. The required Optional Form 1017-G, "Journal Voucher," was requested for each transaction and reviewed to determine whether the internal adjustment was adequately documented and supported. When provided, the Optional Form 1017-G, along with all other available documentation, was used to evaluate the reasonableness of the transaction and determine whether the transaction was properly classified as an internal adjustment. If the DFAS Columbus Center did not provide documentation to fully support each transaction, a critical error was recorded.

³Normally, in addition to the 88 force-through transactions examined, another 17 would be selected to meet the minimum sample size of 105. However, the test had already failed, based on the 88 transactions examined. Therefore, the test results would not have changed if replacements had been made.

Test 2: Force-Through Processing Controls. This test was applied on the 36 internal adjustments identified by MOCAS as force-through transactions.⁴ The test was made to determine whether such adjustments were adequately documented and approved. The "Force Thru Approval Listings" required by the DFAS Columbus Center for such transactions were requested. When provided, these lists were evaluated for the required supervisory approval. Lists provided with the required signatures passed this test, even if undated. If the "Force Thru Approval Listing" was not provided, the transaction failed the test and a critical error was recorded.

Tests of Financial Accounting Controls Over MOCAS Transactions (Objective 2). With support from each Military Department audit organization, we determined whether the MOCAS transactions were recorded in the accountable records of the DoD financial accounting systems. We identified the accountable station for each disbursement transaction, collection transaction, and external adjustment transaction in our sample. We queried the financial accounting system at the accountable stations to determine whether each sampled transaction was recorded in the accountable records. We also coordinated our audit with accountable station personnel to locate MOCAS transactions that were not recorded in the accountable records. The results of this review were summarized and the total errors were compared to the critical value to determine whether the recording of MOCAS transactions in the DoD financial accounting systems passed our tests.

Sample Results of MOCAS Transaction Tests. As discussed in Finding B and summarized in Tables B-3 and B-4, the sample results failed to meet the audit tests applied. That is, none reported errors at or below their critical value. Therefore, a greater than 10-percent risk exists that the actual error rate is more than 5 percent for each stratum.

Because the sample results exceeded the critical number of errors (2 for a sample of 105; 0 for 45), we concluded that the probability of the actual error rate being lower than 5 percent was less than our desired 90-percent confidence level. The sample results indicated risk levels higher than 1 in 10.

⁴The 9 internal adjustments not identified as force-through transactions were not replaced, as would normally be required to meet the minimum sample size of 45. However, the test had already failed, based on the 36 transactions examined. Therefore, the test results would not have changed if replacements had been made.

Table B-3. Sample Results for All MOCAS Transactions (Objective 1)					
Stratum Number and Description; Test Number and Description	Population	Sample	Audit Errors	Critical Value	Test Results ¹
1. Disbursements and collections	34,562	105			
Test 1: Adequate documentation			29	2	Fail
Test 2: Accurate recording and reporting			30	2	Fail
2. External adjustments	6,049	105			
Test 1: Adequate documentation			31	2	Fail
Test 2: Accurate recording			30	2	Fail
Test 3: Force-through processing controls ²			28	2	Fail
3. Internal adjustments	3,918	45			
Test 1: Adequate documentation			15	0	Fail
Test 2: Force-through processing controls ²			17	0	Fail
Total Population	44,529				

Table B-4. Sample Results for SBR-Related MOCAS Transactions for DoD (Objective 2)					
Stratum Number and Description; Test Number and Description	Population	Sample	Audit Errors	Critical Value	Test Results
1. Disbursements and collections	31,892	105			
Test: Recorded in financial systems			5	2	Fail
2. External adjustments	5,413	105			
Test: Recorded in financial systems			9	2	Fail
Total Population	37,305				

¹By stating that our sample results showed that the sample failed, we mean that because the number of errors observed exceeded the critical value, we were no longer at least 90-percent confident that the population had an error rate of 5 percent or less. The larger the number of audit errors found, the less confidence we had that there were 5 percent or fewer errors in the population. If we sampled and tested 105 transactions and found 21 with errors, there would be a possibility that 20 percent of the sample had errors by chance out of a population with only 5 percent, but it would not be likely.

²Only 88 of 105 external adjustments and 36 of 45 internal adjustments were identified as force-through transactions. Thus, this test was not applicable to the other remaining adjustments in those samples. However, replacing those transactions with force-through transactions would have made no difference in the reported test results in Table B-3. That is, the test had already failed because the critical error rate was exceeded on the sampling units tested.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Director, Accounting Policy
Deputy Comptroller (Program/Budget)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics 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
General Accounting Office
National Security and International Affairs Division
Technical Information Center

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

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 Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International
Relations, Committee on Government Reform

Under Secretary of Defense (Comptroller) Comments



COMPTROLLER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

NOV -5 1999



MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL

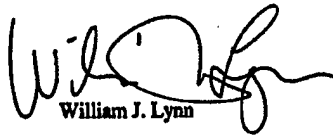
SUBJECT: Draft Audit Report on the FY 1998 Department of Defense Agency-wide Statement
of Budgetary Resources (Project No. 8FI-2024.03)

This is the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) response
to the subject draft audit report.

The draft audit report recommends that the OUSD(C) revise the "Department of Defense
Financial Management Regulation" ("DoDFMR") to require reporting entities to prepare a
principal combining Statement of Budgetary Resources for fiscal year (FY) 1999. The
"DoDFMR" guidance currently does require reporting entities to prepare a combining Statement
of Budgetary Resources for FY 1999.

The draft audit report also recommends that the OUSD(C) revise the "DoDFMR" to
provide disaggregated information on the Statement of Budgetary Resources for the
appropriation accounts identified in the Regulation. The "DoDFMR" currently includes a
requirement for a disaggregated Statement of Budgetary Resources by account groupings
approved by the Office of Management and Budget (OMB). It should be noted that the FY 1998
Department of Defense Agency-wide Financial Statements included a Disaggregated Statement
of Budgetary Resources by account groupings as approved by the OMB. Attachment A provides
the OUSD(C) comments on recommendations C.1. and C.2. Attachment B provides a copy of
the OMB memorandum clarifying this issue.

The point of contact for this matter is Ms. Eileen Parlow. She may be reached by e-mail:
parlowe@osd.pentagon.mil or by telephone at (703) 697-7297 or DSN 227-7297.


William J. Lynn

Attachments

**DRAFT AUDIT REPORT ON THE FY 1998 DEPARTMENT OF DEFENSE
AGENCY-WIDE STATEMENT OF BUDGETARY RESOURCES
(PROJECT NO. 8FI-2024.03)**

COMMENTS ON RECOMMENDATIONS

DRAFT RECOMMENDATION C.1: The Inspector General, Department of Defense (DoD) recommends that the Under Secretary of Defense (Comptroller) make the DoD Regulation 7000.14-R, the "DoD Financial Management Regulation", volume 6B, consistent with OMB Bulletin 97-01 by revising:

Renumbered
as Recom-
mendation
C.

1. Chapter 7, "Statement of Budgetary Resources," to require that DoD reporting entities prepare a principal combining Statement of Budgetary Resources for FY 1999.

OUSD(C) Response: The "DoD Financial Management Regulation" currently requires that the DoD reporting entities prepare a combining Statement of Budgetary Resources for FY 1999 in Volume 6B, Chapter 7, paragraph 0702, and in Volume 6B, Chapter 1, "Introduction and Summary," paragraph 0107. In addition, the DoD reporting entities are required to prepare a principal combined Statement of Budgetary Resources.

DRAFT RECOMMENDATION C.2: The Inspector General, Department of Defense (DoD) recommends that the Under Secretary of Defense (Comptroller) make the DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," Volume 6B, consistent with OMB Bulletin 97-01 by revising:

Deleted

2. Chapter 12, "Required Supplementary Information," to require that DoD reporting entities provide disaggregated information on the Statement of Budgetary Resources for each of the appropriation accounts included in the major budgetary accounts identified in Table 12-1, "Appropriation Grouping for the Disaggregated Statement of Budgetary Resources."

OUSD(C) Response: Current DoD guidance complies with OMB reporting requirements. In a memorandum from the Deputy Controller, OMB to the Deputy Chief Financial Officer, DoD, (copy at Attachment B), the OMB stated that, "The Bulletin provides DoD the flexibility to decide which accounts to disaggregate. Based on a snapshot of DoD's audited financial statements, we believe major budgetary accounts may include (in a separate schedule or separate column in a combining schedule) Military Construction; Operations and Maintenance; Procurement; Family Housing; Military Personnel; and Research, Development, Test and Evaluation." The FY 1998 DoD Disaggregated Statement of Budgetary Resources included all of the above, except for Family Housing and, in addition, included Military Retirement Trust Fund, Corps of Engineers Civil Works, Other Defense Organizations General Funds, and Other Defense Organizations Working Capital Funds.

Attachment A



OFFICE OF FEDERAL
FINANCIAL MANAGEMENT

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D. C. 20503

December 1, 1997

MEMORANDUM FOR NELSON TOYE, DOD DEPUTY CFO

FROM: Norwood J. Jackson, Jr. *NJ Jackson*
Deputy Controller

SUBJECT: Statement of Budgetary Resources

This memorandum responds to your letter requesting a waiver for the Department of Defense (DoD) from preparing supplemental information in support of the "Statement of Budgetary Resources."

Your memorandum states DoD's support for a Consolidated Statement of Budgetary Resources covering all of its budget activity for the year. However, there appears to be a misinterpretation of Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements," since your memorandum suggests that a separate statement for each of DoD's more than 800 budgetary accounts is required to support the consolidated statement. This misinterpretation prompted the waiver request. Instead of granting a waiver, we will clarify herein the OMB guidance.

OMB Bulletin No. 97-01 provides guidance for meeting the requirements in the Statements of Federal Financial Accounting Standards recommended by the Federal Accounting Standards Advisory Board and approved by the Director of OMB, Comptroller General and Secretary of the Treasury. The formats and instructions in the Bulletin provide a framework within which individual agencies have the flexibility to provide information that is useful to the Congress, agency managers, and the public. OMB Bulletin No. 97-01 provides for a Statement of Budgetary Resources which aggregates all the budgetary activity of the reporting entity for the year. In addition, the Bulletin provides for disaggregated budgetary information for major budgetary accounts (i.e., small accounts may be aggregated). The Bulletin provides DoD the flexibility to decide which accounts to disaggregate.

Based on a snapshot of DoD's audited financial statements, we believe major budgetary accounts may include (in a separate schedule or separate column in a combining schedule) Military Construction; Operations and Maintenance; Procurement; Family Housing; Military Personnel; and Research, Development, Test and Evaluation. However, we request the opportunity to work with you, DoD IG, and DoD reporting entities to identify those budgetary accounts which may be candidates for disaggregate reporting. We will contact you later this week to schedule a meeting. Our point of contact is James Short at (202) 395-3124 or E-mail: short_j@a1.eop.gov.

Attachment B

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

NOV 8 1999

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING
DIRECTORATE, OFFICE OF THE INSPECTOR
GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the FY 1998 Department of Defense Agency-wide
Statement of Budgetary Resources (Project No. 8FI-2024.03)

Our response to the subject audit is attached. The primary point of contact (POC)
is Mr. Wayne Ebaugh, (703) 607-2857 or DSN 327-2857, and the secondary POC is
Mr. Mike Bryant, (703) 607-1562 or DSN 327-1562.


Bruce M. Carnes
Deputy Director

Attachment:
As stated

cc:
DFAS-HQ/PO
DFAS-CO/AD

**DFAS Comments on Audit Report on the FY 1998 Department of Defense Agency-wide
Statement of Budgetary Resources (Project No. 8FI-2024.03)**

Responses to Recommendations

Recommendation B.1.: We recommend that the Director, Defense Finance and Accounting Service Columbus Center, establish and implement internal control procedures that:

Recommendation B.1.a: Provide adequate documentation to support all transaction processing for disbursements, collections, and adjustments.

DFAS Management Comments: Concur. The Defense Finance and Accounting Service Columbus Center (DFAS-CO) agrees that the retention of documents that support disbursements, collections and adjustments made by the Contract Entitlement Directorate is vital to the integrity of transactions processed within the Mechanization of Contract Administration Services (MOCAS). While procedural controls exist, the DFAS-CO will distribute a supplemental policy memorandum to all DFAS-CO associates, reiterating the importance of proper retention and maintenance of supporting documents. In addition, the memorandum will contain additional guidance as to what constitutes adequate supporting documentation for the various types of transactions processed through MOCAS.

Estimated Completion Date: November 30, 1999.

Recommendation B.1.b: Require the accurate recording and reporting of each transaction to the Mechanization of Contract Administration Services system.

DFAS Management Comments: Concur. Numerous policy memorandums and standard operating procedures are in place within MOCAS to ensure all transactions are recorded and reported properly. The DFAS-CO will reiterate the proper procedures for accurately recording and reporting transactions in MOCAS in a supplemental policy memorandum to be issued to all DFAS-CO associates.

Estimated Completion Date: November 30, 1999.

Recommendation B.1.c: Require the accounting classification data on Standard Form 1034, "Public Voucher for Purchases and Services Other Than Personal," to be completed before vouchers are certified for payment.

DFAS Management Comments: Nonconcur. The requirement in the Financial Management Regulation (FMR), Volume 10, Chapter 8, Preparation and Distribution of Payment Vouchers, that cites the accounting classification on the Standard Form (SF) 1034 is intended for the vendor payment area. The policy guidance is not applicable to the MOCAS area because the funding structure and the method in which payments are made are set entirely in the terms of the contract. The FMR, Volume 10, Chapter 8, paragraph 080106, states that each accounting classification that will be charged must be listed on the SF 1034. However, the Federal

Acquisition Regulation (FAR), Chapter 52.247.28, does not require the accounting classification to be listed on the SF 1034. The policy of DFAS is to follow guidance provided in the FAR when a discrepancy exists between the FAR and the FMR.

Recommendation B.1.d: Identify as force-through transactions each disbursement, collection, and adjustment that bypasses critical system edit checks in the Mechanization of Contract Administration Services system.

DFAS Management Comments: Concur. Policies and procedures are in place within MOCAS to ensure that all force-through transactions can be identified. Daily reports are available through the Entitlement Automation System that provide a listing of all force-through transactions occurring that day.

During FY 1998, a conversion of the Contract Reconciliation System (CRS) from version 2 to version 3 was performed. The field identifying force-through transactions was lost during the conversion; therefore, numerous transactions could not be identified as force-through transactions. The identification problem has been resolved and all force-through transactions processed after this conversion can be identified in the CRS and the Coding Automation.

The DFAS-CO will reiterate the importance of complying with the procedures for processing force-through transactions in a supplemental policy memorandum to be issued to all DFAS-CO associates.

Estimated Completion Date: November 30, 1999.

Recommendation B.1.e: Require supervisory approval on Force Thru (sic) Approval Listing forms for all force-through transactions in the Mechanization of Contract Administration Services system.

DFAS Management Comments: Concur. Procedural guidance provides detailed instructions for approving force-through transactions within MOCAS. Each disbursement, obligation, and adjustment that requires a force-through transaction in MOCAS must have first line supervisory approval. In addition, numerous documents are generated daily to ensure a proper audit trail exists. Per existing procedures, manual and or systemic logs are maintained within each payment directorate, detailing each force-through transaction generated in that directorate. All adjustments processed through Coding Automation must be approved within the CRS by the supervisor. The DFAS-CO will emphasize the importance of supervisory approval for all force-through transactions in a supplemental policy memorandum to be issued to all DFAS-CO associates.

Estimated Completion Date: November 30, 1999.

Recommendation B.1.f: Verify that all transactions in the Mechanization of Contract Administration Services system are reported to the appropriate accountable station.

DFAS Management Comments: Concur. The MOCAS Financial Reporting Branch reports all transactions processed by MOCAS to the appropriate accountable stations daily and monthly. Policies and procedures exist to ensure proper documents and reports are transmitted, and a matrix also exists to ensure all documents required by the accountable stations are identified.

Completion Date: October 22, 1999.

Recommendation B.2: We recommend that the Director, Defense Finance and Accounting Service, initiate action to require compliance with existing procedures to ensure the accurate and timely recording of all Mechanization of Contract Administration Services system transactions in the accountable station records.

DFAS Management Comments: Concur. The DFAS has procedures in place to ensure transactions are recorded in an accountable station's records. Some timing differences occur due to the locations of the accounting offices; however, all MOCAS transactions that are forwarded to the accounting offices are recorded and tracked until they are posted in an accountable station's records.

Completion Date: October 22, 1999.

Appendix A, Page 21, Management Control Program: Adequacy of Management Controls.

Management Comments: As stated in management comments to Recommendations B.1. and B.2., policies, procedures, and internal controls have been established within MOCAS to ensure obligations, entitlements, disbursements, and adjustments are processed as intended. The DFAS-CO constantly strives to ensure actions performed within MOCAS are correct and timely.

With regard to the DFAS controls over public vouchers, the DFAS-CO operates in accordance with FAR guidelines when processing public vouchers. The DFAS also relies on our process partners for a great deal of system information that is provided to MOCAS. If a public voucher is prepared and submitted in accordance with FAR guidelines, is approved for payment by the Defense Contract Audit Agency, and matches all system edits in place within MOCAS, the voucher is considered to be proper and is approved for payment. MOCAS validates each invoice against the Procurement Instrument Identification Number, the Supplemental Procurement Instrument Identification Number, the invoice, and shipment data prior to entitlement and has the capability to deny entitlement if the payment will create an unliquidated obligation on any accounting line. While the DFAS-CO constantly strives to improve payment practices, we feel that internal controls are adequate to ensure payments made by MOCAS are proper.

Systematic problems that existed in the CRS during FY 1998 did result in the loss of force-through data for numerous payments. However, these problems have been resolved, and as a result, all force-through transactions processed through CRS can be easily identified.

Revised

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

F. Jay Lane
Brian M. Flynn
W. Andy Cooley
Samuel R. Mensch
Frances E. Cain
John W. Barklage
Thomas G. Hare
Debra L. Sherwood
Henry D. Barton
Susanne B. Allen

INTERNET DOCUMENT INFORMATION FORM

A. Report Title: FY 1998 Department of Defense Agency-Wide Statement of Budgetary Resources

B. DATE Report Downloaded From the Internet: 02/03/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ Preparation Date 02/03/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.