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COMPILATION OF THE FY 1999 ARMY WORKING
CAPITAL FUND FINANCIAL STATEMENTS

Report No. D-2000-173

August 15, 2000

Office of the Inspector General
Department of Defense

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Acronyms

AAA	Army Audit Agency
AR	Accounting Report
CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
WCF	Working Capital Fund



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

August 15, 2000

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Compilation of the FY 1999 Army Working Capital Fund
Financial Statements (Report No. D-2000-173)

We are providing this report for your information and use. We performed the audit as part of our audit of the FY 1999 DoD Agency-Wide consolidated financial statements, 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.

The Defense Finance and Accounting Service comments conformed to the requirement of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Richard B. Bird at (703) 604-9159 (DSN 664-9159) (rbird@dodig.osd.mil) or Mr. Carmelo G. Ventimiglia at (317) 510-3852 (DSN 699-3852) (cventimiglia@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink that reads "Robert J. Lieberman".

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-173

(Project No. D2000FI-0065.001)
(formerly Project No. OFI-2117.01)

August 15, 2000

Compilation of the FY 1999 Army Working Capital Fund Financial Statements

Executive Summary

Introduction. This report is the second in a series of audit reports relating to the audit of the FY 1999 Army Working Capital Fund financial statements. The first report was on our oversight of the Army Audit Agency audit of the FY 1999 Army Working Capital Fund financial statements. We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires that DoD provide audited financial statements to the Office of Management and Budget. The Chief Financial Officers Act requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards. The Inspector General, DoD, delegated the audit of the FY 1999 Army Working Capital Fund financial statements to the Army Audit Agency. The Inspector General, DoD, and the Army Audit Agency jointly performed audit work at the Defense Finance and Accounting Service (DFAS) Indianapolis Center. The Army Audit Agency disclaimed an opinion on the FY 1999 Army Working Capital Fund financial statements, and we endorsed the disclaimer. The FY 1999 Army Working Capital Fund financial statements reported assets of \$13.9 billion and liabilities of \$678 million. Net program costs for the Army Working Capital Fund were \$376 million.

Objectives. The overall audit objective was to determine whether DFAS Indianapolis Center consistently and accurately compiled financial data received from field organizations and other sources for the financial statements of the Army Working Capital Fund. We reviewed management controls as they related to the audit objective.

Results. DFAS Indianapolis Center did not adequately support \$127.8 billion of its \$181.8 billion in adjusting accounting entries for the FY 1999 Army Working Capital Fund financial statements.

- The DFAS Indianapolis Center's Working Capital Fund Team made \$85.4 billion in adjusting accounting entries to the year-end Accounting Report 1307 database without adequate support or audit trails. The year-end Accounting Report 1307 database was used as the beginning general ledger database file for the financial statements. In January 2000, after DFAS Indianapolis Center provided additional documentation for the

unsupported adjusting accounting entries, the Army Audit Agency was later able to reconstruct an audit trail for \$82.8 billion of the \$85.4 billion adjusting accounting entries.

- The DFAS Indianapolis Center's Chief Financial Officers Reporting Team did not adequately support \$42.4 billion in adjusting accounting entries made to the general ledger database file and made \$41.4 billion of the entries without proper approval.

Further, the Working Capital Fund Team made \$10.4 billion in adjusting accounting entries to budgetary data contained in the Working Capital Fund Report on Budget Execution (SF 133) database used to prepare the Statement of Budgetary Resources without preparing adjusting accounting entries or providing supporting documentation. As a result, the FY 1999 Army Working Capital Fund financial statements were subject to a high risk of material misstatement. For details of the audit results, see the Finding section of the report.

See Appendix A for details of the management control program as it relates to the controls over the automated and manual processes used to compile the FY 1999 Army Working Capital Fund financial statements.

Summary of Recommendations. We recommend that the Director, DFAS Center for Sustaining Forces - Indianapolis, establish controls in accordance with DoD guidance on preparing adjusting accounting entries made during the compilation of the Army Working Capital Fund financial statements and ensure review and approval of all adjusting accounting entries for version 3 of the FY 1999 Army Working Capital Fund financial statements valued at more than \$100 million. We also recommend establishing a team to independently perform a quality assurance review of the adjusting accounting entries made during the compilation process.

Management Comments. The Director for Accounting, DFAS, concurred with all recommendations except establishing a team to perform independent quality assurance reviews of accounting entries. Instead, the Director for Accounting stated that the revised guidance would require specific approval of supporting documentation as part of the accounting entry approval process. See the Finding section for a complete discussion of the management comments and the Management Comments section for the complete text of the comments.

Audit Response. We consider the comments and proposed actions from the Director for Accounting, DFAS, responsive to the audit recommendations. We continue to believe that independent quality assurance reviews of accounting entries are necessary to ensure proper preparation of accounting entries. However, we will defer further discussion of the issue pending our review of accounting entries during the audit of the FY 2000 Army Working Capital Fund financial statements.

Table of Contents

Executive Summary	i
Introduction	
Background	1
Objectives	3
Finding	
Accounting Entries to Financial Statements	4
Appendixes	
A. Audit Process	
Scope	13
Methodology	14
Management Control Program	15
B. Prior Coverage	16
C. Report Distribution	17
Management Comments	
Defense Finance and Accounting Service	19

Background

This report is the second in a series of audit reports on the FY 1999 Army Working Capital Fund (WCF) financial statements. The first report was on our oversight of the Army Audit Agency (AAA) audit of the FY 1999 Army WCF financial statements. This report summarizes the compilation process at the Defense Finance and Accounting Service (DFAS) Indianapolis Center and reflects the audit work jointly performed by the Inspector General, DoD, and AAA.

Chief Financial Officers Act. The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD and other Government agencies to prepare financial statements covering substantial commercial functions, revolving funds, and trust funds. The CFO Act also requires the Inspector General or an appointed external auditor to audit financial statements in accordance with generally accepted Government auditing standards and other criteria that the Office of Management and Budget established.

Roles and Responsibilities. The Under Secretary of Defense (Comptroller), as the Chief Financial Officer, DoD, is responsible for overseeing the preparation of agency-wide financial statements. The Under Secretary of Defense (Comptroller) is also responsible for providing accounting policy and procedures to DoD. The DoD Financial Management Regulation 7000.14-R, volume 1, chapter 3, addendum, "Key Accounting Requirements," May 1993, states the following:

A fundamental requirement for any compliant accounting system is that the financial transactions for which the system must account be adequately supported with pertinent documents and source records. All transactions, including those which are computer-generated and computer-processed, must be traceable to individual sources records. Audit trails enable the tracing or replicating of a transaction from its source to the resulting record or report, and from the resulting record or report to the source.

The DoD Financial Management Regulation 7000.14-R, volume 6, chapter 2, "Departmental Financial Reports Roles and Responsibilities," February 12, 1996, states, "DFAS shall establish procedures to ensure that the process for preparing financial reports is consistent, timely, auditable, and controls are in place to provide for the accuracy of the reports." The regulation also states, "the DFAS shall support adequately, and justify in writing, any adjustment to the official accounting records."

Role of the DFAS Indianapolis Center. Each month, field accounting entities that DFAS Indianapolis Center supports submit a general ledger trial balance directly to the Federal Financial System, a general ledger module of the Headquarters Accounting and Reporting System. They also submit monthly financial data on the status of appropriations to DFAS Indianapolis Center. Two teams within the Departmental Accounting Directorate at DFAS Indianapolis Center are instrumental in the preparation of accounting data that go into making up the Army WCF financial statements. The WCF Team prepares the monthly and year-end Defense WCF Accounting Report (AR) 1307 for the

consolidated business areas as well as the Army entity levels. The CFO Reporting Team maintains departmental accounting records and prepares the Army WCF financial statements.

Data on the Status of Appropriations. During the fiscal year, DFAS Indianapolis Center records the data on the status of the Army WCF appropriation. Responsible officials are required to fax, mail, or electronically submit copies of their monthly status reports to DFAS Indianapolis Center for the reconciliation process. If necessary, accounting entries are made so that status-of-appropriations data agree with the beginning balances certified from the prior year and ending balances submitted for the current reporting period. The certified status-of-appropriations data are then reconciled to the net expenditures recorded by the Department of the Treasury. Status data are used to compile the Status of Reimbursements (SF 112) report, the Status of Approved Resources (SF 218) report, and the Report on Budget Execution (SF 133). The status-of-appropriations data are also reconciled with the AR 1307. If the two reports differ, the AR 1307 is adjusted to agree with the status-of-appropriations data, which have been certified and are considered to be the most correct.

Preparation of Accounting Reports. The WCF Team prepares the monthly AR 1307 for each field accounting entity. Most accounting entities' general ledgers are transaction-driven; however, some financial data submitted to DFAS Indianapolis Center are not generated by an integrated transaction-driven general ledger system. The general ledger data in the AR 1307 database are supplemented with information from other sources, such as Army Stock Fund Monthly Management Report/Statement 7, the Cost Accounting Budget general ledger, Reports on Budget Execution, and the Army WCF cash management report. The WCF Team adjusts the general ledger data in the AR 1307 database to agree with certified data on the status of appropriations, to record field accounting adjusting entries, to revalue inventory, to record undistributed collections and disbursements, to reconcile with the Department of the Treasury's records, and to record assets. After the general ledger is supplemented with other information, the general ledger data are used to prepare the monthly AR 1307. Each field accounting entity reviews its AR 1307 for accuracy and completeness and certifies it. At the end of the fiscal year, the WCF Team produces the year-end AR 1307.

Preparation of the Financial Statements. The Headquarters Accounting and Reporting System data are downloaded to another microcomputer system that prepares the Army WCF financial statements. The year-end AR 1307 database becomes the beginning general ledger database file for the Army WCF financial statements. The DFAS Indianapolis Center then makes additional adjusting accounting entries that are accumulated in a database called the Journal Voucher database file in the Headquarters Accounting and Reporting System. Adjusting accounting entries are made for many reasons, including recording auditors' adjustments, making intra-agency eliminations, and meeting special reporting requirements. The DFAS Indianapolis Center adds footnotes and supplementary schedules, and the Assistant Secretary of the Army (Financial Management and Comptroller) adds an overview section to the financial statements to create the Army WCF CFO annual financial statements. Because DFAS found it

increasingly hard to get compatible financial statements from the DFAS centers, in September 1999, DFAS implemented the Chief Financial Officers Financial System to ensure compatibility of financial statements.

Army WCF Financial Statements. The FY 1999 Army WCF financial statements consist of the consolidated and consolidating balance sheets, consolidated and consolidating Statements of Net Cost, consolidated and consolidating Statements of Changes in Net Position, combined and combining Statements of Budgetary Resources, combined and combining Statements of Financing, supporting footnotes, and the management overview on the Army WCF financial statements. The FY 1999 Army WCF Consolidated Balance Sheet reported total assets of \$13.9 billion and total liabilities of \$678 million, and the consolidated Statement of Net Cost reported net program costs of \$376 million.

Objectives

The overall audit objective was to determine whether DFAS Indianapolis Center consistently and accurately compiled financial data received from field organizations and other sources for the financial statements of the Army WCF. Specifically, we worked with AAA to evaluate whether the compilation of financial information for the FY 1999 financial statements was complete and materially correct. We reviewed management controls as they related to the audit objective. See Appendix A for a discussion of the audit process and the DFAS Indianapolis Center management control program. See Appendix B for prior audit coverage related to the audit objective.

Accounting Entries to Financial Statements

DFAS Indianapolis Center did not adequately support \$127.8 billion of its \$181.8 billion in adjusting accounting entries for the FY 1999 Army WCF financial statements.

- The DFAS Indianapolis Center's WCF Team made \$85.4 billion in adjusting accounting entries to the AR 1307 database without adequate support or audit trails. The year-end AR 1307 database was used as the beginning general ledger database file for the financial statements. In January 2000, after DFAS Indianapolis Center provided additional documentation for the unsupported adjusting accounting entries, the Army Audit Agency was later able to reconstruct an audit trail for \$82.8 billion of the \$85.4 billion adjusting accounting entries.
- The DFAS Indianapolis Center's CFO Reporting Team did not adequately support \$42.4 billion in adjusting accounting entries made to the general ledger database file and made \$41.4 billion of the entries without proper approval.

Further, the WCF Team made \$10.4 billion in adjusting accounting entries to budgetary data contained in the WCF Report on Budget Execution (SF 133) database used to prepare the Statement of Budgetary Resources without preparing adjusting accounting entries or providing supporting documentation. Adjusting accounting entries were not adequately supported because DFAS Indianapolis Center personnel did not follow established guidance for the preparation of adjusting accounting entries. As a result, the FY 1999 Army WCF financial statements were subject to a high risk of material misstatement.

Guidance for Compilation

Preparation of Adjusting Accounting Entries. The DFAS Headquarters issued guidance, DFAS Memorandum, "Journal Voucher Guidance," October 28, 1999, to each of the DFAS centers for use in compiling the FY 1999 financial statements. The guidance identifies several operational controls. DFAS centers were to do the following to adjusting accounting entries:

- sequentially number them to maintain integrity;
- review them for proper recording in posting accounts;
- adequately document them to support the validity and amount;
- make sure that the relevant authority authorized and approved them;

-
- segregate them when processing them for preparation, documentation, submission, approval, and entry; and
 - annotate them with the name, title, and office symbol of both the preparer and the approver.

The guidance also identifies the required documentation for each adjusting accounting entry, and it identifies the approval thresholds of adjusting accounting entries. The guidance identifies the following managerial controls for the proper preparation of adjusting accounting entries.

- Before submission of each version of the CFO Act statements, the DFAS center's Director for Accounting was to review all adjusting accounting entries to determine whether approval thresholds were met, and if not, to obtain approvals.
- After fiscal year-end reporting was complete, the DFAS center's Director for Accounting was to review all adjusting accounting entries to determine whether supporting documentation was present and adequate.
- The DFAS center's Director for Accounting was to review all reversing adjusting accounting entries to ascertain that they are correctly prepared, documented, reviewed, processed, and approved.
- The internal review office at the DFAS center was to include adjusting accounting entry processing in the annual management control review process, consistent with requirements in the Federal Managers' Financial Integrity Act, which were incorporated in section 3512, title 31, United States Code.

Accounting and Budgetary Data Entries

The WCF Team prepared 68 adjusting accounting entries, valued at about \$115.3 billion, for the general ledger data in the AR 1307 database. Of the 68 adjusting accounting entries, 21 entries, valued at about \$85.4 billion, did not have adequate support to verify the accounting data or an adequate audit trail back to supporting adjusting accounting entries. The WCF Team also made 8,878 accounting entries for WCF budgetary data, valued at about \$10.4 billion, to the SF 133 database used to prepare the Statement of Budgetary Resources without preparing adjusting accounting entries or providing supporting documentation.

AR 1307 Accounting Entries. The WCF Team improved the management control procedures used to prepare adjusting accounting entries to the AR 1307 database. For example, as a result of the recommendations from Inspector General, DoD, Report No. 99-258, "Compilation of the FY 1998 Army

Working Capital Fund Financial Statements," September 23, 1999, the WCF Team established procedures to ensure that adjusting accounting entries did the following:

- were posted to the adjusting accounting entry control log,
- had the proper approvals,
- were valid,
- had an adequate audit trail, and
- were maintained by an independent party.

Although the WCF Team established procedures to ensure that adjusting accounting entries were properly supported, 21 adjusting accounting entries, valued at \$85.4 billion, did not have sufficient documentation attached to them for an adequate audit trail. In late November 1999, AAA requested additional supporting documentation for the 21 adjusting accounting entries. In January 2000, after DFAS Indianapolis Center provided the additional documentation for the unsupported adjusting accounting entries, AAA concluded, and we concurred, that 12 of 21 adjusting accounting entries, or about \$82.8 billion of the \$85.4 billion, were valid adjusting accounting entries. By then, version 2 of the financial statements had been issued for audit. The WCF Team should have attached sufficient documentation to the adjusting accounting entries shortly after the entries were made and before they were initially submitted to the auditors for review. Attaching the documentation should be part of the controls that DFAS should establish.

Preparation of SF 133s. The AAA reported that the WCF Team made 8,878 entries, valued at about \$10.4 billion in WCF budgetary data, to the SF 133 database used to prepare the Statement of Budgetary Resources. AAA reviewed the financial data entries and determined that they were not supported by adjusting accounting entries, and consequently, they had no documented supervisory reviews to ensure that the adjusting accounting entries were valid and proper. The entries were not under adjusting accounting entry control and were made manually to supplement information that Army organizations submitted. Because the data entries have an impact on the Statement of Budgetary Resources, AAA will make a recommendation that they be placed under adjusting accounting entry control to ensure an audit trail and supervisory review. Therefore, this report makes no recommendation concerning the entries.

CFO Reporting Team Accounting Entries

In the last 3 years, the CFO Reporting Team did not follow the established guidance for the preparation of adjusting accounting entries in compiling the general ledger database file for the compilation of the Army WCF financial statements.

Prior Year Reports. In FYs 1997 and 1998, the Inspector General, DoD, reported that material accounting changes made to the general ledger database file were not adequately supported or were in error. Inspector General, DoD, Report No. 98-216, "Compilation of the FY 1997 Army Working Capital Fund Financial Statements," September 29, 1998, recommended that DFAS Indianapolis Center reconcile transactions that were incorrectly made to the general ledger database file. The report also recommended that DFAS Indianapolis Center provide sufficient documentation for the adjusting accounting entries as DoD Financial Management Regulation 7000.14-R requires, and the Director, DFAS Indianapolis Center, concurred with the recommendation. The Inspector General, DoD, Report No. 99-258, "Compilation of the FY 1998 Army Working Capital Fund Financial Statements," September 23, 1999, reports that the management control weaknesses identified during the preparation of the FY 1997 financial statements had not been corrected.

FY 1999 Adjusting Accounting Entries. In FY 1999, DFAS Indianapolis Center prepared 127 adjusting accounting entries, valued at \$66.5 billion, to the general ledger database file. However, 84 adjusting accounting entries, valued at \$42.4 billion, did not have sufficient documentation to determine whether the adjusting accounting entries were adequately supported or proper. We classified the 84 adjusting accounting entries into five different classifications. Table 1 shows the classifications.

Table 1. Adjusting Accounting Entry Classifications

<u>Description of Deficiency</u>	<u>Number of Vouchers</u>	<u>Value of Vouchers (millions)</u>
The buyer's accounting data were adjusted to the seller's accounting data without reconciliation.	27	\$35,949
The accounting data were moved from one general ledger account to another general ledger account without proper support.	28	2,225
The adjusting accounting entries were used to force one set of accounting data or statement to agree with another set of accounting data or statement without sufficient documentation or reconciliation.	14	3,547
Documentation was missing, was incomplete, lacked audit trails, was illogical, or contained erroneous data.	12	693
Transfer of assets to another entity did not have sufficient support.	<u>3</u>	<u>4</u>
Total	84	\$42,418

Because many of the adjusting accounting entries were prepared from November 1999 through January 2000, we were neither in a position to request additional documentation for the adjusting accounting entries nor able to later reevaluate the adjusting accounting entries for adequate support and validity.

Operational Controls. DFAS Indianapolis Center personnel did not ensure that adjusting accounting entries were adequately documented to support the validity and amount of the journal entry. The chief of the CFO Reporting Team reviewed each adjusting accounting entry prepared for the financial statements. Part of his review should include a review of the documentation to support the adjusting accounting entry. However, 84 of the 127 adjusting accounting entries received for audit did not contain sufficient documentation to validate the amounts or the reason for the adjusting accounting entry. Examples follow:

- Adjusting accounting entry 1293115BBA, valued at \$192 million, was to correct adjusting accounting entries processed in FY 1998 and to bring the FY 1999 beginning cumulative results of operations into agreement with the FY 1999 AR 1307. Attached to the adjusting accounting entry was a sheet of paper listing the adjusting accounting

entries from FY 1998, the amounts that made up the FY 1999 cumulative results of operations for the beginning balance on the AR 1307, and the beginning balance for the cumulative results of operations on the FY 1999 CFO financial statements. Because of a difference between the two statements, the CFO Reporting Team processed an adjusting accounting entry for the difference. We could not verify the amounts of the FY 1998 adjusting accounting entries, nor could we verify the amounts on the AR 1307 and CFO financial statements because the information was not attached to the adjusting accounting entry.

- Of the 30 adjusting accounting entries made to the general ledger database file between the version 2 of the financial statements and the final version of the financial statements, 26 vouchers did not have sufficient documentation or any documentation attached to the vouchers. Although the adjusting accounting entries were processed, the adjusting accounting entries should have been returned to the preparer with an explanation of why the adjusting accounting entries should not be processed and with a request for additional documentation to support the adjusting accounting entries.

Approval of Adjusting Accounting Entries. Appropriate DFAS Indianapolis Center personnel did not always authorize and approve the adjusting accounting entries before issuing version 2 and version 3 of the Army WCF financial statements. Of the 127 adjusting accounting entries processed to support the FY 1999 Army WCF general ledger, none of the 41 adjusting accounting entries valued at more than \$100 million were approved before issuing each version of the financial statements. Further, 26 of the 41 unapproved adjusting accounting entries were also unsupported, and represent \$41.4 billion of the \$42.4 billion unsupported adjusting accounting entries made to the general ledger database file. Table 2 shows the approval authority levels, the number of adjusting accounting entries prepared for each version of the financial statements, and whether or not the adjusting accounting entries were approved before issuing each version of the financial statements.

Level of Approval Authority	Number of Adjusting Journal Vouchers		Adjusting Journal Vouchers Approved for	
	Version 2	Version 3	Version 2	Version 3
Under \$100 million	64	22	yes	yes
\$100 million to \$500 million	16	3	no	no
\$500 million to \$1 billion	3	3	no	no
More than \$1 billion	14	2	no	no

Version 2 of the Army WCF financial statements was issued to the Assistant Secretary of the Army (Financial Management and Comptroller) on December 14, 1999. The adjusting accounting entries valued at more than

\$100 million for version 2 were approved between January 10, 2000, and January 25, 2000. Version 3 of the Army WCF financial statements was issued to the Assistant Secretary of the Army (Financial Management and Comptroller) on February 2, 2000. The eight adjusting accounting entries for version 3, valued at more than \$100 million, were not approved as of March 30, 2000. DFAS Indianapolis Center should have the relevant authority review and approve all adjusting accounting entries for version 3 of the FY 1999 Army WCF financial statements valued at more than \$100 million.

Managerial Controls. The DFAS Indianapolis Center did not substantially meet any of the managerial controls. The Director for Accounting is required to review all adjusting accounting entries to determine whether they meet approval thresholds before submitting each version of the financial statements; determine whether supporting documentation is present and adequate; and review all reversing adjusting accounting entries to ensure that they are correctly prepared, reviewed, processed, and approved. The Director for Accounting reviewed and approved only adjusting accounting entries with values between \$500 million and \$1 billion. Further, the internal review office at DFAS Indianapolis Center did not include a review of adjusting accounting entries in its management control review process because the chief of the internal review office was not aware of the requirement.

Summary

The Inspector General, DoD, and AAA reported over the last 3 years that DFAS Indianapolis Center did not follow the Under Secretary of Defense (Comptroller) guidance for accounting entries supporting the Army WCF financial statements. To ensure that adjusting accounting entries meet the criteria as set forth in the DoD Financial Management Regulation and the expanded guidance that DFAS issued for FY 1999, DFAS Indianapolis Center must take additional action to comply with the Under Secretary of Defense (Comptroller) and DFAS guidance. The internal review office at DFAS Indianapolis Center should participate in the quality assurance review process.

Management Comments on the Finding and Audit Response

DFAS Comments. The Director for Accounting, DFAS, did not agree with categorizing as adjustments the 8,878 accounting entries, valued at about \$10.4 billion, made to roll over prior year ending balances of budgetary data. He also stated that the report failed to acknowledge that 27 of the 84 unsupported adjusting accounting entries, valued at about \$35.9 billion, were related to adjusting entries for intragovernmental eliminations as required by Office of Management and Budget guidance.

Audit Response. The introduction of financial data entered into the database used to prepare the financial statements are adjustments that should be documented as adjusting accounting entries. Intervention of a manual process to enter data into the database is necessary because of the lack of an automated

interface. The DFAS Indianapolis Center used adjusting accounting entries to document roll over of the FY 1998 ending balances as the FY 1999 beginning balances for the Army General Fund accounts. Further, although we acknowledge that 27 of the unsupported adjusting accounting entries were related to adjusting entries for intragovernmental eliminations, DoD guidance requires that all accounting entries be supported by documentation which was not there in this instance. The full text of management's comments is provided at the end of this report.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service Center for Sustaining Forces - Indianapolis, enforce the guidance on the preparation of adjusting accounting entries in the DoD Financial Management Regulation, volume 6, and implement the expanded guidance that the Defense Finance and Accounting Service provided. Specifically:

1. Establish and follow operational and managerial controls for the proper preparation of journal vouchers.

Management Comments. The Director for Accounting, DFAS, concurred, stating that DFAS was working with the Office of the Under Secretary of Defense (Comptroller) to include revised guidance in the DoD Financial Management Regulation. The revisions would include specific examples of the level of documentation needed to properly support each journal voucher.

2. Establish an independent quality assurance review team for reviewing the adjusting accounting entries made to the Army Working Capital Fund financial statements. Require the participation of the internal review office in the independent quality assurance review process.

Management Comments. The Director for Accounting, DFAS, partially concurred, stating that an independent quality assurance review would not improve the managerial controls over the preparation of accounting entries and would not add value to the process. However, he stated that the revised guidance would require the specific approval of the supporting documentation as part of the accounting entry approval process.

Audit Response. We consider the comments responsive to the recommendation. We continue to believe that a third party review would be of value in the preparation of accounting entries. However, we will defer further discussion of the issue pending our review of accounting entries during the audit of the FY 2000 Army Working Capital Fund financial statements.

3. Review and approve all adjusting accounting entries for version 3 of the FY 1999 Army Working Capital Fund financial statements valued at more than \$100 million.

Management Comments. The Director for Accounting, DFAS, concurred, stating that DFAS Indianapolis Center personnel will review and approve the adjusting accounting entries by September 30, 2000.

Appendix A. Audit Process

Scope

Audit Work Performed. Our audit work was limited to the examination of the DFAS Indianapolis Center's processes, procedures, and management controls for compiling financial data from field entities and other sources into the FY 1999 Army WCF financial statements. The data that we reviewed were used to prepare the FY 1999 Army WCF financial statements. The FY 1999 Army WCF financial statements reported total assets of \$13.9 billion, total liabilities of \$678 million, and net program costs of \$376 million.

Limitations to Audit Scope. We did not examine the accuracy of data that Army field accounting entities or other sources submitted or attempt to reconcile data with subsidiary records because of the lack of audit trails and support for accounting adjustments.

Audit of the FY 1999 Army WCF Financial Statements. The Inspector General, DoD, delegated the audit of the FY 1999 Army WCF financial statements to AAA. The AAA performed work at Army field entities, where it examined a limited number of accounting transactions of original entry. The Inspector General, DoD, and the AAA auditors jointly performed audit work on adjusting accounting entries made to the AR 1307 and the general ledger database file. The AAA disclaimed an opinion on the FY 1999 Army WCF financial statements, and we endorsed the disclaimer.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures.

- **FY 2001 DoD Corporate-Level 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. (01-DoD-2)
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. (01-DoD-2.5)
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. (01-DoD-2.5.1.)
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. (01-DoD-2.5.2.)

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 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 the DoD. This report provides coverage of the Defense Financial Management high-risk area.

Methodology

Audit Work Performed. We oversaw the AAA review of the adjusting accounting entries made to the AR 1307 database, adjusting accounting entries to the SF 133 database, and the passing of the AR 1307 database to the CFO Reporting Team.

Our audit work focused on the adjusting accounting entry process to correct the accounting data from the field. We examined the adjusting accounting entries to determine whether they had support for the changes to the general ledger accounting data from the field entities and whether they had appropriate approval. The adjusting accounting entries did not always have the necessary documentation to support the accounting transaction. Further, many of the adjusting accounting entries were not properly approved before the release of the financial statements.

Use of Computer-Processed Data. We did not rely on the computer-processed data used to prepare the FY 1999 Army WCF financial statements because the DoD accounting and related systems were unreliable. The unreliable computer-processed data used in preparing the financial statements and this report were the only financial data available. We reviewed the computer-processed transaction adjusting accounting entry adjustments, totaling \$181.8 billion, that the Departmental Accounting Directorate made. The adjusting accounting data entries included \$66.5 billion that the CFO Reporting Team made to the general ledger database file and \$115.3 billion that the WCF Team made to the AR 1307 database file. Additional unsupported budgetary data adjustments included \$10.4 billion the WCF Team made to the SF 133 database file.

Audit Type, Period, and Standards. We performed this financial-related audit at DFAS Indianapolis Center from August 27, 1999, through April 14, 2000. 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 with Office of Management and Budget guidance; however, we limited our scope as noted in this appendix. The audit included such tests of management controls and management's compliance with laws and regulations as we considered necessary.

Contact During the Audit. We visited or contacted individuals and organizations in the DoD audit and accounting community. Further details are available on request.

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 a reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We evaluated the adequacy of management controls over DFAS Indianapolis Center's processes and procedures for consolidating financial data from field organizations and other sources for preparing the FY 1999 Army WCF financial statements.

Adequacy of Management Controls. We identified a material management control weakness, as defined by DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, in DFAS Indianapolis Center's procedures for compiling the FY 1999 Army WCF financial statements. Management controls at DFAS Indianapolis Center were not adequate to ensure that adjusting accounting entries were adequately documented and recorded in accounting records. Recommendations 1. and 2., if implemented, will improve controls over adjusting accounting entries. A copy of the report will be provided to the senior official responsible for management controls for DFAS Indianapolis Center.

Adequacy of Management's Self-Evaluation. DFAS Indianapolis Center officials identified CFO Reporting as an assessable unit but did not perform an evaluation because no evaluations were scheduled to be completed until FY 2001.

Appendix B. Prior Coverage

Inspector General, DoD

Inspector General, DoD, Report No. 99-258, "Compilation of the FY 1998 Army Working Capital Fund Financial Statements," September 23, 1999

Inspector General, DoD, Report No. 98-216, "Compilation of the FY 1997 Army Working Capital Fund Financial Statements," September 29, 1998

Army Audit Agency

Army Audit Agency Report No. AA 99-161, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998: Report on Internal Controls and Compliance With Laws and Regulations," February 12, 1999

Army Audit Agency Report No. AA 99-37, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Accounting Support," November 25, 1998

Appendix C. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
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 Finance and Accounting Service
Director, Defense Finance and Accounting Service Center for Sustaining
Forces - Indianapolis

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

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

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ARLINGTON, VA 22240-5291
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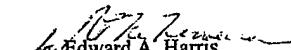
DFAS-HQ/ASF

JUN 20 2000

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

SUBJECT: Audit Report on Compilation of the FY 1999 Army Working Capital Fund
Financial Statements (Project No. D2000FI-0065.001) (formerly Project
No. OFI-2117.01)

Our comments to the subject draft report are attached. The primary point of
contact (POC) is Mr. Wayne Ebaugh, (703) 607-2857 or DSN 327-2857, and the
secondary POC is Mr. Adam Ochlis, (703) 607-5118 or DSN 327-5118.


Edward A. Harris
Director for Accounting

Attachment:
As stated

cc:
DFAS-IN/A
DFAS-HQ/DI

DFAS Comments on DoDIG Audit Report on Compilation of the FY 1999 Army Working Capital Fund Financial Statements (Project No. D2000FI-0065.001) (formerly Project No. OFI-2117.01)

Specific Comments:

Page 4, Paragraph 2, first sentence. The auditors identified \$10.4 billion as unsupported adjusting accounting entries relating to Working Capital Fund budgetary data. The identified amount represents the beginning balances created in the rollover of prior-year ending balances. The Defense Finance and Accounting Service (DFAS) does not agree with categorizing these items as adjustments.

Page 8, Table 1. The audit report acknowledges that the DFAS Indianapolis Center (DFAS-IN) prepared 84 adjusting accounting entries to the general ledger database file valued at \$42.4 billion without sufficient documentation. The report failed to mention that 27 of those entries, valued at approximately \$35.9 billion, related to adjusting entries for intragovernmental eliminations as required by Office of Management and Budget guidance.

Page 7

Responses to Recommendations

We recommend that the Director, Defense Finance and Accounting Service Center for Sustaining Forces – Indianapolis, enforce the guidance on the preparation of adjusting entries in the DoD Financial Management Regulation, Volume 6, and implement the expanded guidance that the Defense Finance and Accounting Service provided. Specifically:

Recommendation 1. Establish and follow operational and managerial controls for the proper preparation of journal vouchers.

DFAS Management Comments: Concur. The DFAS Headquarters (DFAS-HQ) is revising guidance on the preparation of accounting entries and journal vouchers. The revisions will include specific examples of the level of documentation needed to properly support each journal voucher. The DFAS-HQ is working with the Office of the Under Secretary of Defense (Comptroller) to include the guidance in the DoD Financial Management Regulation. The DFAS-IN will implement this guidance when it is issued.

Estimated Completion Date: September 30, 2000.

Recommendation 2. Establish an independent quality assurance review team for reviewing the adjusting entries made to the Army Working Capital Fund financial statements. Require the participation of the internal review office in the independent quality assurance review process.

DFAS Management Comments: Partially concur. The DFAS-IN prepares accounting entries as prescribed by DFAS-HQ guidance, "Journal Voucher Guidance," dated October 13, 1999 (attached). Instructions therein direct managerial internal controls at each level of management at the DFAS Centers to ensure proper oversight of journal voucher preparation.

The DFAS will require in the revised guidance (see Recommendation 1) the specific approval of the supporting documentation as a part of the accounting entry approval process. However, we perceive no added value in having accounting entries undergo a special additional quality assurance review.

Estimated Completion Date: September 30, 2000.

Recommendation 3. Review and approve all adjusting accounting entries for version 3 of the FY 1999 Army Working Capital Fund financial statements valued at more than \$100 million.

DFAS Management Comments: Concur. The DFAS-IN will perform the necessary review and approval of adjusting entries as recommended.

Estimated Completion Date: September 30, 2000.

Audit Team Members

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

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INTERNET DOCUMENT INFORMATION FORM

A. Report Title: Compilation of the FY 1999 Army Working Capital Fund Financial Statements

B. DATE Report Downloaded From the Internet: 08/29/00

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

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