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FINANCIAL REPORTING FOR OTHER
DEFENSE ORGANIZATIONS AT THE
DEFENSE AGENCY FINANCIAL SERVICES
ACCOUNTING OFFICE

Report No. D-2001-048

February 9, 2001

Office of the Inspector General
Department of Defense

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Abstract This report is the first in this series addressing the underlying financial reporting processes that cause abnormal balances on the trial balances of Other Defense Organizations. An account balance is abnormal when the reported balance does not comply with the normal debit or credit balance established in the general ledger chart of accounts. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare consolidated financial statements. The DoD Agency-Wide financial statements include a reporting entity entitled "Other Defense Organizations-General Funds." This entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol. The Defense Agency Financial Services accounting office at the Defense Finance and Accounting Service Center Indianapolis (Sustaining Forces) provides accounting support for 18 of these Defense organizations.		Monitoring Agency Acronym
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Acronyms

CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
ODC	Obligation Data Code
WAAS	Washington Headquarters Services Allotment Accounting System



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

February 9, 2001

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Financial Reporting for Other Defense Organizations at the
Defense Agency Financial Services Accounting Office
(Report No. D-2001-048)

We are providing this report for your information and use. 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.

The Defense Finance and Accounting Service comments conformed to the requirements 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. Charles J. Richardson at (703) 604-9582 (DSN 664-9582) (crichardson@dodig.osd.mil) or Ms. Sandra L. Fissel at (703) 604-9485 (DSN 664-9485) (sfissel@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. D-2001-048

(Project No. D2000FA-0146)

February 9, 2001

Financial Reporting for Other Defense Organizations at the Defense Agency Financial Services Accounting Office

Executive Summary

Introduction. This report is the first in this series addressing the underlying financial reporting processes that cause abnormal balances on the trial balances of Other Defense Organizations. An account balance is abnormal when the reported balance does not comply with the normal debit or credit balance established in the general ledger chart of accounts. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare consolidated financial statements. The DoD Agency-Wide financial statements include a reporting entity entitled "Other Defense Organizations-General Funds." This entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol. The Defense Agency Financial Services accounting office at the Defense Finance and Accounting Service Center Indianapolis (Sustaining Forces) provides accounting support for 18 of these Defense organizations.

Objectives. The audit objective was to determine the accuracy and completeness of the data that the Defense Agency Financial Services accounting office submitted to the Chief Financial Officer Team, also located at the Defense Finance and Accounting Service Center Indianapolis (Sustaining Forces), for inclusion in the FY 2000 Other Defense Organizations financial statements. In addition, we reviewed the management controls related to our objective.

Results. Trial balances prepared from accounting records that the Defense Agency Financial Services accounting office maintained included \$233.8 million of net abnormal balances, none of which were explained in required footnotes. We examined 81.4 percent of the abnormal balances on the March 31, 2000, trial balances and determined that in FY 2000:

- \$129 million of net abnormal balances occurred because the Indianapolis Accounting Office did not ensure that accruals and corresponding disbursements were both recorded as either Government or non-Government transactions; and
- \$61.2 million of net abnormal balances occurred because the Washington Headquarters Services Allotment Accounting System incorrectly posted adjustments for prior reporting periods to incorrect general ledger accounts in the current year, and because the Indianapolis Accounting Office incorrectly recorded accruals twice and posted adjustments to incorrect general ledger accounts to remove the duplicate accruals.

During the audit, the Defense Agency Financial Services accounting office took effective action to reduce deficiencies identified during the audit, thereby reducing reported year-end total net abnormal balances from \$215.8 million as of September 30, 1999, to \$75.6 million as of September 30, 2000.

Until abnormal balances and control deficiencies are corrected, FY 2001 and future financial statements prepared for the Other Defense Organizations will be misstated. Additionally, financial statement preparers will not be able to properly eliminate intra-DoD transactions of the Defense Agency-Wide financial statements. For details of the audit results, see the Finding section of the report. See Appendix A for details on the management control program.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Center Indianapolis (Sustaining Forces), review all accruals and disbursements and correct related transactions that are not consistently recorded as Government or non-Government transactions. We also recommend that control procedures be implemented to correctly record accruals and disbursements in the future. Further, we recommend revising current procedures to provide detailed guidance to accounting personnel on reviewing, researching, and correcting deficiencies identified on the trial balance financial reports and to prepare explanatory footnotes for remaining abnormal balances.

Management Comments. The Director, Defense Finance and Accounting Service, concurred with the finding and recommendations. The Defense Finance and Accounting Service Center Indianapolis (Sustaining Forces) is working with the Washington Headquarters Services to identify document numbers with mismatched obligation indicator codes for obligations, accruals, and disbursements; and Indianapolis personnel will review the related supporting documentation and manually correct related transactions. The Indianapolis office will also evaluate current procedures and develop new control procedures to correctly record accruals and disbursements. Further, the Indianapolis office is currently revising guidance for accounting personnel on reviewing, researching, and correcting deficiencies identified on the trial balance financial reports and on preparing explanatory footnotes. The Defense Finance and Accounting Service estimates completion of all actions by March 31, 2001. See the Finding section for a discussion of management comments, and the Management Comments section for the text of the comments.

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Background

Other Defense Organizations. The audit was performed as part of the continuing audit work of the Inspector General, DoD, in support of the Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994. Specifically, the DoD Agency-Wide financial statements include a reporting entity entitled “Other Defense Organizations-General Funds.” This entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index Symbol 97 (also referred to as Department 97). The Defense Finance and Accounting Service (DFAS) provides accounting support to a majority of the individual Defense organizations and funds.

Accounting Support. The DFAS Center Indianapolis (Sustaining Forces) has an accounting office known as the Defense Agency Financial Services Office (Indianapolis Accounting Office). The Indianapolis Accounting Office provides accounting support to 18 Other Defense Organizations. Accounting support includes receiving, recording, and analyzing obligations, accruals, and disbursements in several accounting systems and preparing miscellaneous budgetary reports and trial balances. The Indianapolis Accounting Office uses the Washington Headquarters Services Allotment Accounting System (WAAS) to record the transactions and to prepare quarterly trial balances that are consolidated at year-end into the financial statements for the Other Defense Organizations. As part of the overall quality control process, Indianapolis Accounting Office personnel are required to prepare trial balances on a quarterly basis to identify deficiencies when they occur and to correct those deficiencies before preparing the year-end financial statements. Inspector General, DoD, Report No. D-2000-153, “Compilation of the FY 1999 Financial Statements for Other Defense Organizations-General Funds,” June 23, 2000, states that the Indianapolis Accounting Office reported \$215.8 million of total net abnormal balances that were included in the year-end trial balances. An account balance is abnormal when the reported balance does not comply with the normal debit or credit balance established in the general ledger chart of accounts.

Washington Headquarters Services Allotment Accounting System. The Indianapolis Accounting Office uses the WAAS to perform general ledger accounting. The WAAS is a Washington Headquarters Services-owned automated, transaction-driven accounting system using DoD standard general ledger accounts. The WAAS is also able to produce trial balances by fiscal year and by appropriation. DoD adopted the U.S. Government Standard General Ledger as the DoD standard in FY 1999. However, since the WAAS is a DoD legacy system, its general ledger accounts were not changed and, therefore, do not fully match the U.S. Government Standard General Ledger. According to the DoD Financial Management Improvement Plan, Volume II, September 2000, consolidation of the WAAS into the Defense Joint Accounting System is scheduled for October 2004; however, development of the new system is unfunded.

Objectives

The audit objective was to determine the accuracy and completeness of the data the Indianapolis Accounting Office submitted to the CFO Team at the DFAS Center Indianapolis (Sustaining Forces), for inclusion in the FY 2000 Other Defense Organizations financial statements. Specifically, we determined why the Indianapolis Accounting Office was submitting large abnormal balances in its trial balances. In addition, we reviewed Indianapolis Accounting Office management controls related to our objectives. See Appendix A for a discussion of the audit scope, methodology, review of the management control program, and prior coverage related to the audit objectives.

Accuracy of Trial Balances

Trial balances prepared from accounting records that the Indianapolis Accounting Office maintained included \$233.8 million of net abnormal balances, none of which were explained in required footnotes. We examined 81.4 percent of the abnormal balances on the March 31, 2000, trial balances and determined that:

- \$129 million of net abnormal balances occurred because the Indianapolis Accounting Office did not ensure that accruals and corresponding disbursements were both recorded as either Government or non-Government transactions; and
- \$61.2 million of net abnormal balances occurred because:
 - the WAAS, as configured, did not properly identify accrual adjustments affecting prior reporting periods and, therefore, did not post those transactions to the correct general ledger accounts, and
 - the Indianapolis Accounting Office incorrectly recorded accruals twice and posted adjustments to remove the duplicate accruals to the incorrect general ledger accounts.

The condition also occurred because the Indianapolis Accounting Office did not have adequate written procedures to review trial balances and to disclose abnormal conditions and to coordinate reviews and corrective actions with relevant Other Defense Organizations. Also, the WAAS did not provide the requisite query interfaces in an executable format for Indianapolis Accounting Office personnel to effectively research and correct deficiencies.

The Indianapolis Accounting Office took action to correct deficiencies and improve the accuracy of the trial balance data for FY 2000. However, until control deficiencies are fully corrected, the FY 2001 and future financial statements prepared for the Other Defense Organizations likely will be misstated. Additionally, financial statement preparers will not be able to properly eliminate intra-DoD transactions on the Defense Agency-Wide financial statements.

Mid-Year Trial Balances

The March 31, 2000, trial balances prepared from accounting records that the Indianapolis Accounting Office maintained reported \$233.8 million of net abnormal balances in 29 general ledger accounts for 14 Other Defense Organizations. See Appendix B for a list of the general ledger accounts with abnormal balances. We reviewed the three general ledger accounts that reported the largest net abnormal balances, which totaled \$190.2 million and represented 81.4 percent of the total abnormal balances, as shown in Table 1.

Table 1. Three General Ledger Accounts With the Largest Net Abnormal Balances as of March 31, 2000			
<u>Account Title</u>	<u>General Ledger Account</u>	<u>Abnormal Balances (millions)</u>	<u>Percent of Total Net Abnormal Balance</u>
Accounts Payable-Government-Current	2111	\$129.0	55.2
Appropriated Capital Used	5700	33.1	14.2
Other Services Expense	6120	<u>28.1</u>	<u>12.0</u>
Total		\$190.2	81.4

An account balance is abnormal when the reported balance does not comply with the normal debit or credit balance established in the general ledger chart of accounts.

Matching Accruals and Disbursements. Of the \$233.8 million in net abnormal balances, \$129 million was reported in Accounts Payable-Government-Current (general ledger account 2111) because accruals and corresponding disbursements were not consistently recorded as either Government or non-Government transactions. We reviewed accrual and disbursement transactions valued at \$114.4 million. The abnormal balances were created because accounting personnel did not ensure that accruals and corresponding disbursements were both recorded as either Government or non-Government transactions, which created a mismatch between related accruals and disbursements.

Classification as Government and Non-Government. Each obligation, accrual, and disbursement transaction recorded in the WAAS is assigned an obligation data code (ODC), commonly referred to as the Government indicator code, that classifies the transaction as either occurring with other Government agencies, represented by a "G," or with non-Government entities, represented by an "N." Based on the ODC, the WAAS posts transactions to the Government and non-Government general ledger accounts. Government accruals and disbursements are posted to Accounts Payable-Government-Current (general ledger account 2111), and non-Government accruals and disbursements are posted to Accounts Payable-Public-Current (general ledger account 2113). The accrual and related disbursement must have the same ODC for the transactions to be matched and posted to the correct general ledger account, as shown in Table 2.

Table 2. ODC Classifications and General Ledger Accounts Used to Report Government and Non-Government Transactions			
<u>Type of Transaction</u>	<u>ODC for Accruals</u>	<u>ODC for Disbursements</u>	<u>General Ledger Account Number and Title</u>
Government	G	G	2111, Accounts Payable-Government-Current
Non-Government	N	N	2113, Accounts Payable-Public-Current

Recording Accruals and Disbursements. For related transactions where both the accruals and disbursements should have been recorded with the same ODC, accounting personnel recorded at least \$114.4 million of transactions with different ODCs for general ledger account 2111. Accounting personnel recorded all accruals with an ODC of “N” (posted to general ledger account 2113) and the related disbursements with a “G” (posted to general ledger account 2111). The normal balance for both general ledger accounts (2111 and 2113) is a credit balance and is calculated by subtracting total disbursements from total accruals. As a result, general ledger account 2111 had an abnormal debit balance of \$114.4 million, and general ledger account 2113, although reporting a normal credit balance, was overstated by the same amount, as shown in Table 3.

Table 3. Impact of Recording Related Transactions With Different ODCs				
<u>ODC Classification</u>	<u>Accruals (millions)</u>	<u>Disbursements (millions)</u>	<u>General Ledger Account</u>	<u>Balance¹ (millions)</u>
G	\$ 0	\$114.4	2111	(\$114.4) ²
N	\$114.4	\$ 0	2113	\$114.4 ³

¹Total accruals less total disbursements equals the balances for accounts payable.
²Abnormal balance for general ledger account 2111.
³Overstated balance for general ledger account 2113.

Impact on the Financial Statements and Elimination Process. If the abnormal balances and overstatements are not corrected, those balances, when transferred to the Other Defense Organizations financial statements, will cause the amounts reported for “Intragovernmental Accounts Payable” and for “Accounts Payable (to the public)” to be misstated on the Consolidated Balance Sheet. Additionally, when the Other Defense Organizations are compiled into

the Defense Agency-Wide financial statements, transactions with other DoD entities cannot be properly eliminated because those transactions are reported as being with the public.¹ The Indianapolis Accounting Office has already demonstrated laudable efforts in correcting existing transactions. To prevent a recurrence of these deficiencies in future fiscal years, the Indianapolis Accounting Office should create and implement written procedures to record related transactions with the same ODC.

Multiple Reporting Periods. Of the \$233.8 million in net abnormal balances, \$61.2 million was reported in two accounts because the accounting system, the WAAS, as configured, did not properly differentiate between accrual adjustments affecting multiple reporting periods and, therefore, did not post those transactions to the correct general ledger accounts, as shown in Table 4.

Table 4. Abnormal Balances Created by Not Identifying Prior Reporting Periods		
<u>Account Title</u>	<u>General Ledger Account</u>	<u>Net Abnormal Balances (millions)</u>
Appropriated Capital Used	5700	\$33.1
Other Services Expense	6120	<u>28.1</u>
Total		\$61.2

The WAAS uses a combination of accruals and other transaction data to calculate the balance for the capital and expense accounts.² During the current reporting period, accounting personnel adjusted accruals recorded in multiple reporting periods and the WAAS incorrectly posted all of those adjustments to the current year capital and expense accounts. General ledger accounts 5700 and 6120 are primarily intended to report adjustments for transactions recorded in the current reporting period. Adjustments affecting prior periods should be posted to Prior Period Adjustments (general ledger account 7400).

Adjustments Affecting General Ledger Accounts 5700 and 6120. We reviewed \$52.1 million³ and \$41 million of downward accrual adjustments that contributed to the net abnormal balances in general ledger accounts 5700 and 6120, respectively. Although the transactions affected multiple reporting

¹When financial statements for multiple entities are consolidated into a single financial statement, transactions between those entities must be eliminated. Only the transactions with external entities are to be reported.

²The WAAS records four types of transactions: commitments, obligations, accruals, and disbursements. The four transactions, along with various classification codes, are used to calculate balances that are later posted to general ledger accounts.

³An abnormal balance reflects the net amount by which the total abnormal transactions exceed the total normal transactions. Therefore, the total value of abnormal transactions is ordinarily larger than the amount of the abnormal balance.

periods, the WAAS posted all the adjustments to the two current reporting period accounts. As nominal accounts,⁴ general ledger accounts 5700 and 6120 are closed at the end of each year. Therefore, recording downward adjustments for a prior period in either account can create an abnormal balance when the total downward adjustments for prior periods exceed the total new accruals recorded in the current reporting period. To identify further opportunities for improvement, we performed additional analysis to determine why the Indianapolis Accounting Office recorded numerous downward accrual adjustments.

Downward Accrual Adjustments. Of the \$52.1 million and \$41 million of downward accrual adjustments in general ledger accounts 5700 and 6120, respectively, the Indianapolis Accounting Office recorded adjustments to remove duplicate accruals and to reverse accruals that were no longer considered valid, as shown in Table 5.

Table 5. Downward Accrual Adjustments Recorded in General Ledger Accounts 5700 and 6120				
<u>Account Title</u>	<u>General Ledger Account</u>	<u>Adjustments</u>		<u>Total Downward Accrual Adjustments (millions)</u>
		<u>To Remove Duplicate Accruals (millions)</u>	<u>To Reverse Invalid Accruals (millions)</u>	
Appropriated Capital Used	5700	\$38.1	\$14.0	\$52.1
Other Services Expense	6120	\$35.3	\$5.7	\$41.0

Accounting personnel duplicated accruals by recording accruals once during the prevalidation process,⁵ and again when recording the actual disbursements. Accounting personnel recorded disbursements with a liquidation indicator code⁶ of “P,” which initiated a system-generated accrual equal to the amount of the disbursement. Given that an accrual was already recorded during prevalidation, accounting personnel should have used a different liquidation indicator code that did not automatically trigger another accrual. For the adjustments that we reviewed, the Indianapolis Accounting Office removed the duplicate accrual in

⁴Nominal general ledger accounts are accounts that are closed each year and begin the following year with a zero balance, as opposed to real general ledger accounts, which begin the following year with the prior year’s ending balance.

⁵Prevalidation is the process in which the Indianapolis Accounting Office confirms that obligated funds are available to pay an invoice received from a vendor before a disbursement is made to the vendor. When obligated funds are available, the Indianapolis Accounting Office records an accrual in the WAAS, the payment is considered prevalidated, and the disbursing station is notified to make the disbursement.

⁶A liquidation indicator code is an attribute recorded as part of a disbursement entry that indicates the corresponding entry, if any, that the WAAS should record as a result of recording the disbursement.

one of the fiscal years following the original posting, which contributed to the abnormal balances in general ledger accounts 5700 and 6120.

Impact on the Financial Statements. If the abnormal balances are not corrected, those balances, when transferred to the Other Defense Organizations financial statements, will cause the amounts reported as “Other Appropriations Used” on the Statement of Changes in Net Position and as “Program Costs” on the Statement of Net Cost to be misstated. The Indianapolis Accounting Office has already demonstrated positive efforts in correcting existing transactions. To prevent a recurrence of these deficiencies in future fiscal years, the Indianapolis Accounting Office can reduce the magnitude of total accrual adjustments and reduce the risk of reporting an abnormal balance in the accounts by developing and implementing control procedures to record accruals only once in the WAAS.

Procedures for Reviewing Trial Balances

Required Reviews. DoD Regulation 7000.14-R, volume 6A, “Reporting Policies and Procedures,” chapter 2, “Departmental Financial Reports Roles and Responsibilities,” February 1996 (with changes through 1998), requires DFAS to review financial reports for the following:

- abnormal balances,
- mathematical accuracy,
- correct internal relationships for amounts that are interdependent and included on the same report, and
- unusual trends over multiple time periods.

When DFAS identifies deficiencies, it is required to initiate research and take action to resolve the deficiencies.

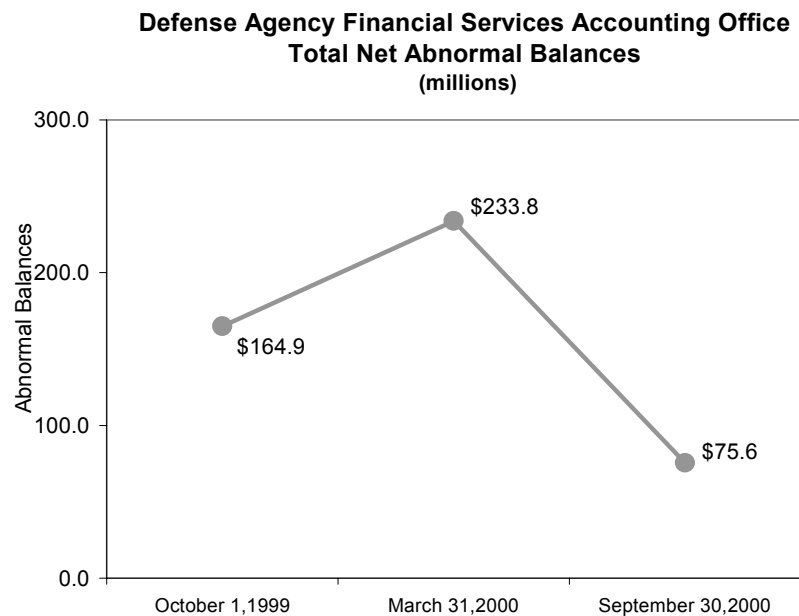
Large abnormal balances were reported on the March 31, 2000, trial balances because the Indianapolis Accounting Office did not perform the required reviews, initiate research, or take action to resolve the deficiencies. In the past, trial balances were forwarded to the CFO Team at the DFAS Center Indianapolis (Sustaining Forces) each quarter and at year-end for inclusion in the financial statements without the benefit of being checked for validity and accuracy. We reviewed 3 of the 29 general ledger accounts with abnormal balances; however, the Indianapolis Accounting Office should review and correct all remaining general ledger accounts with abnormal balances. The Indianapolis Accounting Office can directly improve the quality of the year-end trial balances and the resulting financial statements for the Other Defense Organizations by actively reviewing the quarterly trial balances and continuously working to correct deficiencies.

Written Procedures. Inspector General, DoD, Report No. D-2000-097, “Accounting Procedures and Controls Over Financial Data Supporting Selected

Other Defense Organizations,” March 9, 2000, recommended that the Indianapolis Accounting Office prepare written standard operating procedures to provide accountants with specific guidance for reviewing financial reports. In the new written procedures, the Indianapolis Accounting Office required personnel on the Reports Team to review trial balances for abnormal conditions. However, the new written procedure did not provide detailed guidance for performing the reviews and was never implemented. The Indianapolis Accounting Office can make the written procedures more useful by expanding them to include the following:

- the definition of an abnormal balance;
- descriptions of specific analytical techniques to use for detecting abnormal balances;
- sequential electronic steps for researching general ledger account balances; and
- descriptions of specific actions to correct problems, to include contacting the related Other Defense Organizations when necessary.

Corrective Actions. After being informed of the large abnormal balance on the mid-year trial balances, Indianapolis Accounting Office personnel performed a detailed review of the September 30, 2000, year-end trial balances. The Indianapolis Accounting Office identified the abnormal balances, corrected the majority of those balances, and successfully reduced the total net abnormal balances from \$233.8 million reported on the March 31, 2000, trial balances to \$75.6 million reported on the September 30, 2000, trial balances, as shown in the graph below.⁷



⁷In the graph, \$164.9 million of net abnormal balances as of October 1, 1999, represents the portion of the \$215.8 million of year-end total net abnormal balances as of September 30, 1999, that were transferred as beginning balances to FY 2000.

Based on prior year trends and the \$215.8 million of year-end total net abnormal balances as of September 30, 1999, the Indianapolis Accounting Office was likely to incur another large abnormal balance condition. However, the Indianapolis Accounting Office took action on our concerns and performed a detailed manual review of trial balances and related transactions to reduce abnormal balances for FY 2000 and future years' trial balances. On December 13, 2000, we demonstrated the use of the Trial Balance Analyzer⁸ and Trial Balance Tool Case⁹ to the Indianapolis Accounting Office personnel. The personnel plan to use both tools to review future quarterly trial balances.

Explanatory Trial Balance Footnotes. DFAS Center Indianapolis (Sustaining Forces) Memorandum, "Fiscal Year 1999 Year-End Instructions for Defense Agencies," June 9, 1999, requires accounting offices that submit trial balances to also prepare accompanying footnotes to explain abnormal balances. The Indianapolis Accounting Office did not prepare trial balance footnotes in the past. As a result, the Indianapolis Accounting Office forwarded trial balances to the CFO Team and the CFO Team included them in the financial statements without adequate information being available to make proper disclosures in the financial statement footnotes.¹⁰ The Indianapolis Accounting Office needs to update the standard operating procedure titled "Reports" to require Indianapolis accountants to prepare footnotes to the trial balances and to provide detailed procedures on how to prepare the footnotes.

WAAS System Capabilities

Query Programs. During the audit, we requested that the Indianapolis Accounting Office personnel provide detailed support at the transaction level for abnormal balances reported on the trial balance. However, they were unable to promptly provide the data because of limitations in the WAAS, a system that the Washington Headquarters Services supports. The WAAS contained predefined standard queries for conducting detailed research on general ledger account balances. But those queries were not available in an executable format for the Indianapolis accountants, who then contacted the Washington Headquarters Services and requested assistance. For each of the general ledger accounts in our audit, Washington Headquarters Services personnel modified the query interface and made the queries available in a format that the Indianapolis accountants could execute. The Indianapolis accountants then executed the query programs and provided detailed transactions to us for review. For the Indianapolis Accounting Office to properly conduct its own comprehensive review of the trial balances, all query programs for the general ledger accounts reported on the trial balance

⁸The Trial Balance Analyzer is an electronic database tool developed and distributed by the Inspector General, DoD, for analyzing trial balances and identifying abnormal balances.

⁹The Trial Balance Tool Case is a set of analytical procedures developed by the Inspector General, DoD, for reviewing trial balances and identifying obvious errors.

¹⁰Inspector General, DoD, Report No. D-2000-153 states that the Indianapolis Accounting Office submitted trial balances with \$215.8 million of abnormal balances without the required accompanying explanatory footnotes.

should be made available in a format that the Indianapolis accountants can readily use. Recommendations to correct this deficiency will be directed to the Washington Headquarters Services in a separate report.¹¹

System Manuals. The Washington Headquarters Services published a WAAS Design Manual and a WAAS User's Manual to assist users in operating the system. Updating the manuals to address trial balance reviews could substantially increase the usefulness of both manuals. The WAAS Design Manual should provide a detailed description of the queries available to research general ledger account balances, and of the mapping process used to transfer transactions to general ledger accounts. The WAAS User's Manual should provide specific instructions on executing queries and interpreting the results. Recommendations to correct this deficiency will be directed to the Washington Headquarters Services in a separate report.

Recommendations and Management Comments

We recommend that the Director, Defense Finance and Accounting Service Center Indianapolis (Sustaining Forces), direct the Defense Agency Financial Services Accounting Office:

1. Review all disbursements and accruals that are not recorded with the same obligation data code, identify which transactions are entered properly, and correct the corresponding entries.

Management Comments. DFAS concurred and stated the Defense Agency Financial Services Accounting Office is working to identify document numbers with mismatched obligation indicator codes for obligations, accruals, and disbursements, and accounting personnel will then review supporting documentation, determine the correct obligation indicator codes, and manually correct the codes of the mismatched transactions. The estimated completion date is March 31, 2001.

2. Develop and implement procedures that, at a minimum, require accounting personnel to:

a. Review related accruals and disbursements, and consistently use the same obligation data code.

Management Comments. DFAS concurred. The Defense Agency Financial Services Accounting Office will evaluate current procedures and develop new procedures as needed for reviewing the obligation indicator codes for related accruals and disbursements. The Customer Desktop Interface Standard Operating Procedures manual will be revised to include these procedures. The estimated completion date is March 31, 2001.

¹¹The Inspector General, DoD, issued a draft audit report for Project No. D2000FA-0146.002, "Financial Reporting at the Washington Headquarters Services," December 26, 2000, which addresses WAAS system capabilities.

b. Record in the Washington Headquarters Services Allotment Accounting System one accrual for each disbursement.

Management Comments. DFAS stated that the Defense Agency Financial Services Accounting Office suspended the process of recording accruals at the time of obligation pre-validation in July 2000.

3. Revise the existing standard operating procedure titled “Reports” to, at a minimum:

a. Define abnormal balances.

b. Describe specific analytical techniques that personnel can use to detect abnormal balances.

c. Enumerate procedures to use the accounting system to research detailed transactions that support general ledger account balances.

d. Outline the specific actions to correct deficiencies and to contact appropriate Other Defense Organizations as necessary.

e. Require Indianapolis accountants to prepare trial balance footnotes explaining abnormal balances.

Management Comments. DFAS concurred. The Defense Agency Financial Services Accounting Office is currently revising the “Reports” procedures guide to include all auditor-requested information listed in Recommendations 3.a. to 3.e. In addition, the Defense Agency Financial Services accountants will receive formal training in the preparation of trial balances and explanatory footnotes. Regarding Recommendation 3.e., the Defense Agency Financial Services Customer Interface Support Team will prepare the trial balances and the accompanying footnotes beginning with the December 2000 accounting data. The estimated completion date for Recommendations 3.a. to 3.d. is March 31, 2001; and for Recommendation 3.e. was to have been January 31, 2001.

4. Implement the standard operating procedure on financial reporting by conducting quarterly reviews of the trial balances.

Management Comments. DFAS concurred. The Defense Agency Financial Services Accounting Office will implement procedures requiring the Customer Interface Support Team to conduct quarterly reviews on trial balances. The estimated completion date was to have been January 31, 2001.

Appendix A. Audit Process

Scope

Financial Information, Procedures, and Controls Reviewed. We reviewed the procedures and related controls used by the Indianapolis Accounting Office to prepare financial reports. We narrowed our scope to focus on the preparation of trial balances and the supporting transactions. We reviewed detailed transactions of \$114.4 million for general ledger account 2111, \$52.1 million for general ledger account 5700, and \$41 million for general ledger account 6120. We reviewed written standard operating procedures, disbursing documents, Reports on Budget Execution, and trial balances for the FY 1999 and FY 2000 reporting periods. We also interviewed personnel to determine how information is obtained, recorded, and reported in the trial balance financial reports.

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 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 financial 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 objectives and goals:

- **Financial Management Functional Area. Objective:** Reengineer DoD business practices. **Goal:** Improve data standardization of finance and accounting data items. **(FM-4.4)**

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

Methodology

Review of Accounts Payable Government-Current (General Ledger Account 2111). We identified all entity account balances with abnormal balances greater than \$1 million as of March 31, 2000, and reviewed all related transactions greater than \$100,000, for a total review of \$114.4 million of transactions.

Review of Appropriated Capital Used (General Ledger Account 5700). We identified all entity abnormal balances greater than \$1 million as of March 31, 2000, and reviewed all related transactions greater than \$500,000, for a total review of \$52.1 million of transactions.

Review of Other Services Expense (General Ledger Account 6120). We identified all entity abnormal balances greater than \$1 million as of March 31, 2000, and reviewed all related transactions greater than \$500,000, for a total review of \$41 million of transactions.

Computer-Processed Data. We relied on computer-processed data contained in the WAAS, which is a Washington Headquarters Services system. We obtained information on obligations, disbursements, and accruals from the WAAS. We performed limited testing on the system by reviewing transactions supporting the trial balances. Our limited assessments of the system showed that, as configured, the WAAS was posting transactions to the incorrect reporting period. However, the lack of reliable information did not adversely affect our analysis and, when the data are reviewed in context with other available evidence, we believe that the opinions, conclusions, and recommendations in this report are valid.

Audit Type, Dates, and Standards. We performed this financial-related audit from April 2000 to October 2000 at the DFAS Center Indianapolis (Sustaining Forces) according to auditing standards issued by the Comptroller General of United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

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

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require 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 the Review of the Management Control Program. We reviewed the adequacy of the DFAS Center Indianapolis (Sustaining Forces) management controls over the Indianapolis Accounting Office and Department 97 financial reporting. Specifically, we reviewed the controls over preparing and reviewing trial balances. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified a material management control weakness for the Indianapolis Accounting Office as defined by DoD Instruction 5010.40. The Indianapolis Accounting Office controls over the preparation and reporting of trial balances were not adequate to ensure that trial balances were accurate and reliable. The weakness is material to both the trial balances prepared by the Indianapolis Accounting Office and to the financial statements prepared for the Other Defense Organizations-General Funds. The recommendations, if implemented, should correct the control weakness. A copy of the report will be provided to the Director, DFAS Center Indianapolis (Sustaining Forces).

Adequacy of Management's Self-Evaluation. Managers at the DFAS Center Indianapolis (Sustaining Forces) identified Department 97 accounting performed by the Indianapolis Accounting Office as an assessable unit and, in our opinion, correctly identified the associated risk as high. DFAS Center Indianapolis (Sustaining Forces) officials identified and reported trial balance reporting as a management controls weakness and developed a standard operating procedure to correct the weakness. However, the actions that the DFAS Center Indianapolis (Sustaining Forces) implemented did not correct the material management control weakness because the procedure, as written, was too general and was never fully implemented to affect the specific material weakness that the audit identified.

Prior Coverage

The following two Inspector General, DoD, audit reports issued within the past 5 years discuss financial and accounting information at the Indianapolis Accounting Office:

Inspector General, DoD, Report No. D-2000-153, "Compilation of the FY 1999 Financial Statements for Other Defense Organizations-General Funds," June 23, 2000

Inspector General, DoD, Report No. D-2000-097, "Accounting Procedures and Controls Over Financial Data Supporting Selected Other Defense Organizations," March 9, 2000

Appendix B. General Ledger Accounts With Net Abnormal Balances

<u>General Ledger Account Title</u>	<u>General Ledger Account Number</u>	<u>Net Abnormal Balance</u> (absolute value)
Accounts Payable-Government-Current	2111	\$129,033,236.60
Appropriated Capital Used	5700	33,112,131.02
Other Services Expense	6120	28,138,391.14
Uncommitted/Unobligated Allotment-Reimbursable-Current Period	4614	6,831,936.54
Accounts Payable-Public-Current	2113	5,144,930.01
Undelivered Orders Without Advance-Direct Program	4811	4,865,149.99
Equipment (Not Capitalized)	6122	4,177,054.13
Travel and Transportation of Persons	6116	3,733,628.34
Transportation of Things	6117	3,647,727.45
Funds Disbursed	1012	3,347,867.45
Accrued Expenditures-Paid-Direct	4931	3,325,710.87
Funds Collected	1011	2,056,224.63
Reimbursements Earned-Collected-Specific Apportionment-Funded	4254	2,056,224.63
Rent, Communications, and Utilities	6118	1,191,813.80
Accrued Expenditures-Paid-Reimbursable	4941	751,208.89
Funds With Treasury	1013	693,006.34
Allotments Received	4580	693,006.34
Accrued Expenditures-Unpaid-Direct	4910	319,374.29
Unfilled Customers Orders-Without Advance-Specific Apportionment-Funded	4232	190,690.27
Travel Advances	1411	114,423.04
Undelivered Orders with Advance-Direct Program	4812	114,423.04
Supplies and Materials	6121	112,867.12
Personnel Benefits-Civilian	6113	60,761.78
Personnel Compensation-Civilian	6111	57,246.14
Miscellaneous Reimbursements	5910	27,945.95
Undelivered Orders With Advance-Reimbursable Program	4822	6,500.00
Allotted Funded Reimbursement Authority-Subsequent Period	4583	4,995.50
Other Interest Expenses	6330	2,225.32
Depreciation of Equipment	6125	894.52
Total		\$233,811,595.14

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

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 Finance and Accounting Service
Director, Defense Finance and Accounting Service Center Indianapolis (Sustaining Forces)

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

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

**Congressional Committees and Subcommittees, Chairman and
Ranking Minority Member (cont'd)**

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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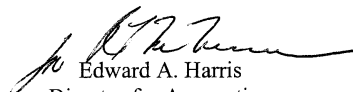
JAN - 4 2001

DFAS-DAS

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

SUBJECT: Audit Report on Financial Reporting for Other Defense Organizations at the
Defense Agency Financial Services Accounting Office
(Project No. D2000FA-0146)

Our response to the subject request is attached. The point of contact is Mr. David Arvin,
(703) 607-2857 or DSN 327-2857.


Edward A. Harris
Director for Accounting

Attachment:
As stated

cc:
DFAS-DDI
DFAS/AA-IN

**DFAS Comments on Audit Report on Financial Reporting for Other Defense
Organizations at the Defense Agency Financial Services Accounting Office
(Project No. D2000FA-0146)**

Response to Recommendations

We recommend that the Director, Defense Finance and Accounting Service Center for Sustaining Forces-Indianapolis, direct the Defense Agency Financial Services Office to:

1. Review all disbursements and accruals that are not recorded with the same obligation data code, identify which transactions are entered properly, and correct the corresponding entries.

Management Comments: Concur. The Defense Agency Financial Services (DAFS) Accounting Office, in conjunction with the DAFS Systems Office, and the Washington Headquarters Services are developing a data query to identify document numbers with mismatched obligation indicator codes for obligations, accruals, and disbursements. The DAFS accounting personnel will review documentation supporting queried document numbers and will determine the correct obligation indicator codes. The DAFS personnel will then manually correct the obligation indicator codes of the mismatched transactions.

Estimated Completion Date: March 31, 2001.

2. Develop and implement procedures that, at a minimum, require accounting personnel to:

a. Review related accruals and disbursements, and consistently use the same obligation data code.

Management Comments: Concur. DAFS will evaluate its current procedures, look for areas of improvement, and develop new procedures as needed for reviewing the obligation indicator codes for related accruals and disbursements. The Customer Desktop Interface Standard Operating Procedures manual will be revised to include these procedures.

Estimated Completion Date: March 31, 2001.

b. Record in the Washington Headquarters Services Allotment Accounting System one accrual for each disbursement.

Management Comments: Concur. The DAFS Accounting Office suspended the process of recording accruals at the time of obligation pre-validation in July 2000. This process was responsible for creating the double accruals. Currently a single, system-generated accrual is recorded at the time of the disbursement.

Completion Date: July 31, 2000.

3. Revise the existing standard operating procedure titled "Reports" to, at a minimum:

- a. Define abnormal balances.
- b. Describe specific analytical techniques that personnel can use to detect abnormal balances.
- c. Enumerate procedures to use the accounting system to research detailed transactions that support general ledger account balances.
- d. Outline the specific actions to correct deficiencies and to contact appropriate Other Defense Organizations as necessary.
- e. Require Indianapolis accountants to prepare trial balance footnotes explaining abnormal balances.

Management Comments: Concur. The DAFS is currently revising the "Reports" procedure guide to include all auditor-requested information listed in parts 3.a. to 3.e. In addition, the DAFS will include an overview of abnormal balances, applicable regulations, and an analytical tool to aid in the review and correction of abnormal balances. DAFS accountants will receive formal training in the preparation of trial balances and explanatory footnotes. At this time, DAFS accountants are scheduled to take the U.S. Standard General Ledger course. Regarding 3.e., the DAFS Customer Interface Support Team will prepare the trial balances and the accompanying footnotes beginning with the December 2000 accounting data.

Estimated Completion Date: March 31, 2001 for 3.a to 3.d. and January 31, 2001 for 3.e.

4. Implement the standard operating procedure on financial reporting by conducting quarterly reviews of the trial balances.

Management Comments: Concur. The DAFS will implement procedures requiring the Customer Interface Support Team to conduct quarterly reviews on trial balances.

Estimated Completion Date: January 31, 2001.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report, are listed below.

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