

A *udit*



R *eport*

COMPILATION OF THE FY 2000 FINANCIAL STATEMENTS
FOR OTHER DEFENSE ORGANIZATIONS-GENERAL FUNDS

Report No. D-2001-116

May 8, 2001

Office of the Inspector General
Department of Defense

Form SF298 Citation Data

Report Date <i>("DD MON YYYY")</i> 08May2001	Report Type N/A	Dates Covered (from... to) <i>("DD MON YYYY")</i>
Title and Subtitle Compilation of the FY 2000 Financial Statements for Other Defense Organizations-General Funds		Contract or Grant Number
Authors		Program Element Number
Performing Organization Name(s) and Address(es) OAIG-AUD (ATTN: AFTS Audit Suggestions) Inspector General Department of Defense 400 Army Navy Drive (Room 801) Arlington, VA 22202-2884		Project Number
Sponsoring/Monitoring Agency Name(s) and Address(es)		Task Number
Distribution/Availability Statement Approved for public release, distribution unlimited		Work Unit Number
Supplementary Notes		Performing Organization Number(s) D-2001-116
Abstract 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 annual audited financial statements. The FY 2000 DoD Agency-Wide Financial Statements include financial statements for a reporting entity entitled inOther Defense Organizations-General Funds. The entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol, also referred to as Department 97. (See Appendix C for a listing of Other Defense Organizations-General Funds.) Other Defense Organizations-General Funds reported \$42 billion in assets, \$201.6 billion in liabilities and \$58.1 billion in budget authority in the FY 2000 financial statements.		Monitoring Agency Acronym
Subject Terms		Monitoring Agency Report Number(s)
Document Classification unclassified		Classification of SF298 unclassified

Classification of Abstract unclassified	Limitation of Abstract unlimited
Number of Pages 44	

Additional Copies

To obtain additional copies of this audit report, visit the Inspector General, DoD, Home Page at www.dodig.osd.mil/audit/reports or contact the Secondary Reports Distribution Unit of the Audit Followup and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or fax (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Audit Followup and Technical Support Directorate at (703) 604-8940 (DSN 664-8940) or fax (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-4704

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@dodig.osd.mil; or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

DFAS	Defense Finance and Accounting Service
IG	Inspector General
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

May 8, 2001

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Compilation of the FY 2000 Financial Statements for
Other Defense Organizations-General Funds (Report No. D-2001-116)

We are providing this report for your information and use. We conducted this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. No written response to this report was required, and none was received. Therefore, we are publishing this report in final form.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Sandra L. Fissel at (703) 604-9485 (DSN 664-9485) (sfissel@dodig.osd.mil). See Appendix G for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in cursive script, reading "Thomas F. Gimble", is positioned above the printed name.

Thomas F. Gimble
Acting
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2001-116

May 8, 2001

(Project No. D2001FA-0016.001)

Compilation of the FY 2000 Financial Statements for Other Defense Organizations-General Funds

Executive Summary

Introduction. 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 annual audited financial statements. The FY 2000 DoD Agency-Wide Financial Statements include financial statements for a reporting entity entitled "Other Defense Organizations-General Funds." The entity represents a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol, also referred to as Department 97. (See Appendix C for a listing of Other Defense Organizations-General Funds.) Other Defense Organizations-General Funds reported \$42 billion in assets, \$201.6 billion in liabilities and \$58.1 billion in budget authority in the FY 2000 financial statements.

Objectives. Our primary objective was to determine whether the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) consistently and accurately consolidated and compiled financial data from supporting accounting offices and other sources for the FY 2000 Financial Statements for Other Defense Organizations-General Funds. Specifically, we evaluated whether the compilation of the financial information for the FY 2000 Financial Statements for Other Defense Organizations was complete, and whether the footnotes fully disclosed material discrepancies and additional information relevant to the financial statements. Appendix A discusses the audit scope and methodology. Our review of internal controls is discussed in Inspector General, DoD, Report No. D-2001-060, "Internal Controls and Compliance with Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations-General Funds," February 28, 2001.

Results. The Defense Finance and Accounting Service Indianapolis (Sustaining Forces) included unexplained abnormal and inconsistent balances in the FY 2000 Other Defense Organizations-General Funds Financial Statements. Problematic data elements continue to compromise the integrity and accuracy of the Other Defense Organizations-General Funds Financial Statements.

- At least \$3.9 billion of unexplained net abnormal balances and an absolute amount of \$89.5 billion of account balances that were not consistent with corresponding Reports on Budget Execution were included in trial balances used to prepare the FY 2000 Other Defense Organizations-General Funds Financial Statements. However, the accounting offices that support the Other Defense Organizations made commendable efforts in improving the timeliness of trial balance submissions to the Defense Finance and Accounting Service Indianapolis (Sustaining Forces) (finding A).

- At least \$150.5 billion of unsupported year-end departmental accounting entries were posted to force multiple accounting records to agree, to eliminate the effects of intragovernmental transactions, and to force the financial statements to agree (finding B).
- At least seven material lines of the FY 2000 Financial Statements were not reliable and not auditable. Also, the footnotes to the financial statements did not adequately disclose the limited reliability of the financial statements. Further, the financial statements that were presented to us for audit differed by \$390.2 billion from the final version of the financial statements used to compile the DoD Agency-Wide Financial Statements (finding C).

As a result, the FY 2000 Other Defense Organizations-General Funds Financial Statements were materially misstated.

Summary of Recommendations. Corrective actions needed for findings A, B, and C were provided in prior IG, DoD, reports. The reports and their respective recommendations are listed in Appendix B.

Management Comments. We provided a draft of this report on March 29, 2001. No written response to this report was required, and none was received. Therefore, we are publishing this report in final form.

Table of Contents

Executive Summary	i
Introduction	
Background	1
Objectives	2
Findings	
A. Consolidation of Financial Data	3
B. Year-End Departmental Accounting Entries	10
C. Reliability of the Financial Statements	17
Appendixes	
A. Audit Process	
Scope	25
Methodology	27
Prior Coverage	27
B. Prior Audit Reports With Open Recommendations	28
C. Other Defense Organizations-General Funds	30
D. Accounting Activities Submitting Abnormal Balances of More Than \$10 Million	32
E. Sub-Entities With Data Discrepancies Over \$500 Million	34
F. Financial Statement Lines That Were Materially Modified	35
G. Report Distribution	36

Background

Reporting Requirements. Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994, requires DoD to prepare annual audited financial statements. In addition, the Federal Financial Management Act of 1994 requires the Secretary of the Treasury, in coordination with the Director, Office of Management and Budget (OMB), to prepare Government-wide financial statements. The Inspector General (IG), DoD, is not required to render a separate opinion on the financial statements for Other Defense Organizations. However, information from audits of the financial statements of Other Defense Organizations contributed to the disclaimer of audit opinion on the DoD Agency-Wide Financial Statements for FY 2000.

Other Defense Organizations. The entity “Other Defense Organizations” represents a consolidation of financial information from 51 Defense organizations and funds that use the Treasury Index 97 symbol. The DoD Agency-Wide consolidated financial statements include two columns for Other Defense Organizations: an Other Defense Organizations-Working Capital Funds column that includes the financial activity of working capital funds not connected with the Military Departments, and an Other Defense Organizations-General Funds column that includes the financial activity of all remaining organizations and funds using the Treasury Index 97 symbol. This audit focused on Other Defense Organizations-General Funds, which reported \$58.1 billion in budget authority in the FY 2000 financial statements. (Later references to Other Defense Organizations in this report will generally refer to the Other Defense Organizations-General Funds reporting entity.) Appendix C provides a list of the 51 Other Defense Organizations-General Funds for FY 2000.

Accounting Functions and Responsibilities. During FY 2000, Defense Finance and Accounting Service (DFAS) provided accounting support for all Defense organizations that use Treasury Index 97 funds, except for the following:

- certain organizations supported by the Washington Headquarters Services Allotment Accounting System,
- the TRICARE Management Activity-West, and
- organizations required to perform their own accounting because of security considerations.

Compilation Responsibilities. DoD Regulation 7000.14-R, the “DoD Financial Management Regulation,” volume 6B, “Form and Content of the Department of Defense Financial Statements,” chapter 2, “General Instructions for the Financial Statements,” October 2000, requires DFAS, in coordination

with DoD Components, to prepare financial statements. Beginning in FY 1996, DFAS Indianapolis (Sustaining Forces), was responsible for preparing the financial statements for Treasury Index 97 funds.

In compiling and preparing the financial statements for Other Defense Organizations, DFAS Indianapolis (Sustaining Forces) did the following:

- obtained fiscal year-end trial balances and other financial information from the supporting accounting offices,
- consolidated the financial information received,
- made year-end accounting entries to post financial data to the accounting records and adjust trial balances, and
- used multiple accounting and reporting systems to compile the financial statements.

Reporting Policy. Other Defense Organizations use the same DoD form and content guidance as the DoD Components shown in DoD Regulation 7000.14-R, volume 6B. The guidance implements OMB Bulletin No. 97-01, “Form and Content of Agency Financial Statements,” October 16, 1996, as amended September 11, 2000. DFAS prepared the six principal statements for Other Defense Organizations discussed in OMB Bulletin No. 97-01: Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, Statement of Financing, and Statement of Custodial Activity.

Objectives

The primary audit objective was to determine whether DFAS Indianapolis (Sustaining Forces) consistently and accurately consolidated and compiled financial data from supporting accounting offices and other sources for the FY 2000 Financial Statements for Other Defense Organizations. Specifically, we evaluated whether the compilation of the financial information for the FY 2000 Financial Statements for Other Defense Organizations was complete, and whether the footnotes fully disclosed material discrepancies and additional information relevant to the financial statements. Appendix A discusses the audit scope and methodology. Our review of internal controls is discussed in IG, DoD, Report No. D-2001-060, “Internal Controls and Compliance With Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations-General Funds,” February 28, 2001.

A. Consolidation of Financial Data

Year-end trial balances for Other Defense Organizations included \$3.9 billion of net abnormal balances that were not all explained in required footnotes, and an absolute amount of \$89.5 billion of account balances that differed from corresponding amounts reported in the Reports on Budget Execution. The condition occurred because accounting offices that support Other Defense Organizations did not fully correct abnormal balances as appropriate, include footnotes to explain abnormal balances, or ensure that trial balances were reconciled to Reports on Budget Execution. The condition also occurred because DFAS Indianapolis (Sustaining Forces) did not fully implement prior audit recommendations to:

- establish detailed procedures to review and improve quarterly and year-end trial balances,
- identify abnormal balances and request that accounting offices submit corrected trial balances, and
- identify differences between trial balances and Reports on Budget Execution and coordinate corrections with supporting accounting offices.

As a result, the FY 2000 Other Defense Organizations-General Funds Financial Statements were materially misstated and contributed unreliable financial data to the FY 2000 DoD Agency-Wide Financial Statements.

Trial Balances With Net Abnormal Balances

DFAS Indianapolis (Sustaining Forces) prepared the FY 2000 Other Defense Organizations-General Funds Financial Statements from financial data supplied by the accounting offices supporting the Other Defense Organizations. Trial balances are the primary source of data used to prepare the financial statements; therefore, the quality of trial balances directly affects the quality of the financial statements. As in previous years, the trial balances supplied by the accounting offices to DFAS Indianapolis (Sustaining Forces) to be used for compiling the FY 2000 Financial Statements continued to have major deficiencies including material abnormal balances and balances that were not consistent with the Reports on Budget Execution.

Abnormal Balances. The accounting offices supporting Other Defense Organizations submitted trial balances to DFAS Indianapolis (Sustaining Forces) that contained \$3.9 billion of net abnormal balances in 85 proprietary general ledger accounts. Of the 85 general ledger accounts, 8 represented material net abnormal balances totaling about \$3.1 billion, as shown in Table 1.

Table 1. Absolute Value of Material Net Abnormal Balances Submitted to DFAS Indianapolis (Sustaining Forces)	
<u>General Ledger Account Title*</u>	<u>Abnormal Balance (millions)</u>
Funds Disbursed	\$ 968.0
Accounts Payable-Government-Current	467.4
Other Services Expense	375.3
Funds with Treasury	358.4
Appropriated Capital Used	349.9
Equipment	230.6
Appropriated Capital	160.8
Appropriated Capital Funding Canceled Payables	<u>135.6</u>
Total	\$3,046.0
*The accounts shown include nonstandard general ledger accounts that DFAS Indianapolis (Sustaining Forces) converts to U.S. Government Standard General Ledger accounts during the compilation process.	

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. For example, Accounts Payable-Government-Current, shown in Table 1, normally has a credit balance; therefore, a debit balance is an abnormal balance, which should be explained because it represents an abnormal financial condition. Although some abnormal balances may be appropriate, the accounting office submitting the abnormal balances should explain the cause of the abnormal balances in footnotes to the trial balances.

Accounting Offices. Eleven accounting offices submitted year-end trial balances containing about \$3.9 billion of net abnormal balances, as shown in Table 2.

Table 2. Accounting Offices That Submitted Net Abnormal Balances		
(listed in descending order based on FY 2000 balances)		
<u>Accounting Offices</u>	Net Abnormal Balances (millions)	
	<u>FY 1999</u>	<u>FY 2000</u>
DFAS Indianapolis (Sustaining Forces)	\$ 485.7	\$2,438.1
DFAS Cleveland	924.9	413.1
DFAS Columbus	690.8	395.0
DFAS Denver	368.4	272.2
DoD Dependent Schools	127.7	105.7
Defense Information Systems Agency	282.3	100.7
Defense Agency Financial Services (Indianapolis)	215.8	75.7
TRICARE Management Activity	102.1	30.9
Defense Threat Reduction Agency	13.3	17.2
Uniformed Services University of the Health Sciences	7.6	4.5
Defense Accounting Directorate (Washington Headquarters Services)	<u>159.2</u>	<u>3.1</u>
Total	\$3,377.8	\$3,856.2

Of the 11 accounting offices, 9 submitted trial balances that reported net abnormal balances greater than \$10 million for more than 54 sub-entities (see Appendix D for a list of the sub-entities).

Trial Balance Footnotes. Of the 11 accounting offices that submitted trial balances containing abnormal balances, 5 accounting offices prepared the required¹ footnotes to explain abnormal balances. The following six accounting offices did not submit footnotes:

¹DFAS Indianapolis (Sustaining Forces) “Year-End Instructions for Defense Agencies,” June 16, 2000, required preparers of reports to “properly footnote, with a detailed explanation, all net abnormal balances or conditions” on the trial balance.

-
- Defense Agency Financial Services,
 - Defense Information Systems Agency,
 - Defense Threat Reduction Agency,
 - DFAS Columbus,
 - DFAS Indianapolis (Sustaining Forces),² and
 - TRICARE Management Activity.

The footnotes accompanying the trial balances are required to include detailed explanations for each abnormal balance contained within the trial balance. The explanation should identify the cause of the abnormal balance, the circumstances involved, actions underway to resolve the abnormal condition, and an estimated date when the abnormal balance will be corrected. The footnotes submitted to DFAS Indianapolis (Sustaining Forces) were, in some cases, incomplete. For example, DFAS Denver provided footnotes for most abnormal balances but did not include an explanation for a \$106.5 million net abnormal balance reported in general ledger account 3105 “Appropriated Capital-Funding-Canceled Payables.” Additionally, many of the footnotes lacked specific information including explanations for corrective action and estimated completion dates. The quality of footnotes is important because footnotes provide a medium for communicating explanations of anomalies contained in the trial balances to financial statement preparers, who in turn can use the explanations to prepare adequate financial statement disclosures. Additionally, footnotes also serve as a mechanism for identifying anomalies and tracking the status of corrective actions.

Audit Recommendations Addressing Abnormal Balances and Trial Balance Footnotes. IG, DoD, Report No. D-2000-153, “Compilation of the FY 1999 Financial Statements For Other Defense Organizations-General Funds,” June 23, 2000, included recommendations to accounting offices and DFAS Indianapolis (Sustaining Forces) addressing abnormal balances and trial balance footnotes.

Recommendations to Accounting Offices. The IG, DoD, recommended that accounting offices correct abnormal balances, if appropriate, before submitting trial balances to DFAS Indianapolis (Sustaining Forces). At least two accounting offices, the Defense Agency Financial Services and Washington Headquarters Services, took corrective action during FY 2000 and successfully reduced the amount of net abnormal balances reported at year-end by 65 percent and 98 percent respectively from the amounts reported at the end of FY 1999. However, the trial balances prepared by DFAS Indianapolis (Sustaining Forces) for Department 97 funds sub-allotted to the Army reported a \$2 billion increase in the amount of abnormal balances reported at the end of FY 2000 from the amount reported at the end of FY 1999. Accounting personnel could not provide an explanation for the significant increase. Until all of the accounting offices fully implement the audit recommendation from prior reports, future trial balances will continue to report abnormal balances.

²DFAS Indianapolis (Sustaining Forces) performs accounting and reporting functions for Department 97 funds sub-allotted to Department of the Army, and submits those financial reports to the Other Defense Organizations Audited Financial Statements Team, also located at DFAS Indianapolis (Sustaining Forces).

The IG, DoD, also recommended that accounting offices prepare footnotes to fully explain abnormal balances reported in trial balances provided to DFAS Indianapolis (Sustaining Forces). Until the accounting offices fully implement those audit recommendations, the quality of the trial balance reporting process will be impaired.

Recommendations to DFAS Indianapolis (Sustaining Forces). The IG, DoD, recommended that DFAS Indianapolis (Sustaining Forces) establish and implement procedures to review the quarterly trial balances submitted by accounting offices and identify abnormal balances. However, DFAS Indianapolis (Sustaining Forces) did not have procedures in place during FY 2000 to analyze trial balances submitted each quarter by the accounting offices. As of February 2001, DFAS Indianapolis (Sustaining Forces) had developed the General Ledger Reconciliation Report which, as part of its function, will identify abnormal balances and will be used to notify accounting offices and Defense agencies of abnormal balances. DFAS Indianapolis (Sustaining Forces) intends to use the General Ledger Reconciliation Report to perform quarterly reviews throughout FY 2001, beginning with the first quarter of the fiscal year.

Trial Balances and Reports on Budget Execution

Differences Between Reports on Budget Execution and Trial Balances. The FY 2000 year-end Reports on Budget Execution and trial balances prepared for the 51 Other Defense Organizations differed by an absolute amount of \$89.5 billion when reporting similar categories of financial data. The discrepancies had a net value of \$67.3 billion, for which DFAS Indianapolis (Sustaining Forces) prepared accounting entries to remove the discrepancies (see finding B). For example, the trial balances from Army organizations receiving sub-allotments from the Ballistic Missile Defense Organization, (limit 2501), reported \$11.5 billion in unexpended appropriations; however, the corresponding Report on Budget Execution reported \$1 billion, a difference of \$10.5 billion. Appendix E lists the sub-entities whose reports had discrepancies exceeding \$500 million.

IG, DoD, Report No. D-2000-153 recommended that DFAS Indianapolis (Sustaining Forces) implement procedures to identify differences between trial balances and Reports on Budget Execution on a quarterly basis and request that accounting offices make corrections to the financial reports. DFAS Indianapolis (Sustaining Forces) has not implemented that recommendation. To reduce the large data discrepancies, DFAS Indianapolis (Sustaining Forces) should target those entities with the largest discrepancies and, in cooperation with the entities and the supporting accounting offices, aggressively work to identify the reasons for the discrepancies and, where appropriate, implement corrective actions.

Abnormal Balances and Inconsistent Balances. Financial reports prepared for 139 sub-entities included both abnormal balances and discrepancies between the Reports on Budget Execution and trial balances. Of the 139 sub-entities,

59 sub-entities had net abnormal balances totaling \$136.7 million that exactly matched the amount of the difference between the Reports on Budget Execution and the trial balances. DFAS Indianapolis (Sustaining Forces) should prioritize for improvement those sub-entities that have both abnormal balances and discrepancies between the two reports.

Submission of Trial Balances

Of the 11 accounting offices that submitted year-end trial balances, 5 submitted trial balances by the November 1, 2000, deadline established by DFAS Indianapolis (Sustaining Forces), and the remaining 6 accounting offices submitted trial balances by November 2. Compared to FY 1999, when the last trial balances were submitted on November 17, the accounting offices made significant progress in submitting reports to DFAS Indianapolis (Sustaining Forces) in a timely manner. The improvement is due, in part, to proactive measures taken by DFAS Indianapolis (Sustaining Forces), and its newly formed Other Defense Organizations Audited Financial Statements Team,³ to coordinate with accounting offices and ensure accounting offices submitted trial balances in a timely manner.

Conclusion

Because financial data for the Other Defense Organizations included abnormal balances and data from separate reports that did not match, the Other Defense Organizations contributed unreliable financial data to the FY 2000 DoD Agency-Wide Financial Statements. Until fully corrected, those major deficiencies will continue to inhibit DoD's progress toward a favorable opinion on the DoD Agency-Wide Financial Statements.

We are not making recommendations to address causes discussed in this finding because the needed recommendations were made in prior audit reports.

IG, DoD, Report No. D-2000-153 recommended that accounting offices supporting the Other Defense Organizations correct abnormal balances, if appropriate, and footnote all abnormal balances included on quarterly and annual trial balances submitted to DFAS Indianapolis (Sustaining Forces) for inclusion in the financial statements. At least five accounting offices complied with the recommendation. Of the six remaining accounting offices, three offices, the Defense Agency Financial Services, DFAS Columbus, and DFAS Indianapolis (Sustaining Forces), are part of DFAS which anticipated full

³DFAS Indianapolis (Sustaining Forces) created the Other Defense Organizations Audited Financial Statements Team during FY 2000 to provide dedicated financial preparation services to the Other Defense Organizations.

implementation of the recommendation to be complete by January 2001. The Defense Information Systems Agency and Defense Threat Reduction Agency had agreed to submit footnotes by September 30, 2000, but DFAS Indianapolis (Sustaining Forces) did not receive footnotes with the September 30, 2000, trial balances submitted by the two agencies. The TRICARE Management Activity did not respond to either the draft or final report, and made no attempt to comply with our recommendations.

In response to recommendations made in IG, DoD, Report No. D-2000-153, DFAS Indianapolis (Sustaining Forces) created a team of personnel dedicated to preparing the Other Defense Organizations-General Fund Financial Statements, and issued guidance to accounting offices requesting that the offices correct abnormal balances and footnote any remaining abnormal balances included in the year-end trial balances. DFAS Indianapolis (Sustaining Forces) originally anticipated a completion date of August 31, 2000, for establishing and implementing procedures for identifying abnormal balances and differences between trial balances and Reports on Budget Execution, and for coordinating corrective action with accounting offices. DFAS Indianapolis (Sustaining Forces) has developed the General Ledger Reconciliation Report to perform the recommended functions and anticipates using the report for the first quarter of FY 2001. The report will serve as a tool to assist in resolving abnormal balances and discrepancies in the financial statements.

Also see Appendix B for a list of open audit recommendations that address issues discussed in this finding.

B. Year-End Departmental Accounting Entries

As part of the process for compiling the Other Defense Organizations-General Funds FY 2000 Financial Statements, DFAS Indianapolis (Sustaining Forces) prepared 376 year-end departmental accounting entries totaling \$150.5 billion that were unsupported and 23 year-end departmental accounting entries totaling \$410.3 million that were improper. DFAS Indianapolis (Sustaining Forces) prepared the entries, in part, because of the poor quality of data generated from DoD accounting systems that were not general ledger based nor fully integrated. In addition, the major causes of the unsupported entries were because DFAS Indianapolis (Sustaining Forces) did not coordinate with accounting offices supporting the Other Defense Organizations to research, reconcile, and correct:

- differences totaling \$7.7 billion between the amounts reported for disbursements and collections in the Reports on Budget Execution and those reported in U.S. Treasury records,
- net differences of \$67.3 billion between amounts reported in the Reports on Budget Execution and corresponding amounts reported in the general ledger trial balances,
- differences of \$19.8 billion between the amounts reported for intragovernmental transactions by buyers and those reported by sellers, and
- differences of \$22.0 billion between the amount reported for Net Costs of Operations in the Statement of Net Cost and the amount reported for Net Costs of Operations in the Statement of Financing.

The entries were also unsupported because DFAS Indianapolis (Sustaining Forces) prepared \$11.2 billion of entries that did not contain an adequate justification fully explaining the purpose and rationale for the entry. Accounting entries were improper primarily because DFAS Indianapolis (Sustaining Forces) did not reconcile and correct abnormal balances totaling \$95.3 million in accounts payable for appropriation accounts scheduled to close at the end of FY 2000. As a result, the Other Defense Organizations-General Funds Financial Statements were materially misstated and contributed unreliable amounts to the DoD Agency-Wide Financial Statements.

Year-End Departmental Accounting Entries

Total of Year-End Accounting Entries. As part of the year-end process, DFAS Indianapolis (Sustaining Forces) prepared 1,238 journal vouchers totaling \$546.8 billion to adjust the accounting records used to compile the financial statements, as shown in Table 3.

Table 3. FY 2000 Year-End Departmental Accounting Entries*					
	<u>Supported</u>	<u>Unsupported</u>	<u>Improper</u>	<u>Not Reviewed</u>	<u>Total</u>
Dollar value (billions)	\$334.3	\$150.5	\$.4	\$61.6	\$546.8
Quantity	81	376	23	758	1,238
*Due to continued refinement and audit review, the numbers for the Other Defense Organizations-General Funds accounting entries were revised from those reported in IG, DoD, Report No. D-2001-070, "Internal Controls and Compliance With Laws and Regulations for the DoD Agency-Wide Financial Statements for FY 2000," February 28, 2001.					

We reviewed 480 entries that totaled \$485.2 billion and represented 89 percent of the total dollar value of the year-end departmental accounting entries.

Criteria for Accounting Entries. Among the responsibilities assigned to DFAS by DoD Regulation 7000.14-R, volume 6, chapter 2, "Departmental Financial Reports, Roles, and Responsibilities," three responsibilities specifically apply to the preparation of year-end departmental accounting entries. First, DFAS is responsible to identify obvious errors and inconsistencies in financial data and financial reports. Second, DFAS is responsible to research and reconcile discrepancies, and identify the appropriate accounting action to correct the deficiencies. Third, DFAS is responsible to prepare accounting entries that incorporate the outcome of the research and reconciliation in a valid accounting entry. A departmental level accounting entry should be the culmination of clearly documented research and, when prepared, should enhance the integrity of the data. To be supported, an accounting entry should include evidence that supports the need for the entry, a clearly written rationale and justification, and documentation to provide an audit trail.

Supported Accounting Entries

DFAS Indianapolis (Sustaining Forces) prepared supported accounting entries totaling at least \$334.3 billion to record data calls, year-end closing adjustments, and corrections of errors. Of the \$334.3 billion, at least \$94.1 billion, or 28 percent, were prepared to correct entries made earlier in the compilation process. Although the correcting entries were supported, DFAS Indianapolis (Sustaining Forces) can increase the efficiency of the compilation process by reducing the total number of correcting entries.

Unsupported Accounting Entries

DFAS Indianapolis (Sustaining Forces) prepared \$150.5 billion of unsupported year-end departmental accounting entries to overcome data disparities generated by DoD systems and differences between multiple accounting records. An accounting entry is unsupported when the entry lacks one or more of the elements required for a supported entry.

DoD Financial Systems. DFAS Indianapolis (Sustaining Forces) prepared year-end departmental accounting entries, in part, to overcome data disparities generated from DoD financial systems that are not integrated and are not general ledger based, including: budgetary systems, expenditure systems, and multiple accounting systems supporting the military departments and Other Defense Organizations. Each financial system accumulates, formats, displays, and exports financial data differently. The financial reports produced from those systems, including expenditure reports, budgetary reports, and trial balances, frequently do not agree. At year-end, the accounting offices supporting the Other Defense Organizations submit data to DFAS Indianapolis (Sustaining Forces) that include abnormal balances and data that are not reported consistently on multiple reports, as discussed in finding A. In an attempt to achieve greater consistency between multiple financial reports, DFAS Indianapolis (Sustaining Forces) prepares year-end departmental accounting entries forcing those reports to agree.

Differences Between Multiple Accounting Records. As part of the year-end process to prepare the financial statements for the Other Defense Organizations-General Fund, DFAS Indianapolis (Sustaining Forces) conducts a series of sequential steps to remove differences between multiple accounting records, to force those records to match, and to remove anomalies within individual accounting records, as shown in Figure 1.

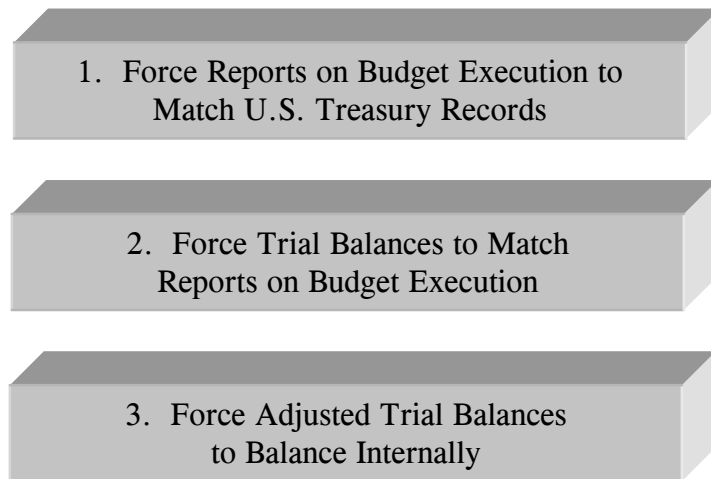


Figure 1. Sequence of Entries Made to Force Accounting Data to Agree

Reports on Budget Execution and U.S. Treasury Records. DFAS Indianapolis (Sustaining Forces) prepared \$7.7 billion in unsupported accounting entries to force the FY 2000 year-end Reports on Budget Execution to match the U.S. Treasury Records. Of the \$7.7 billion, \$5.8 billion was made to disbursements and \$1.9 billion was made to collections. The accounting entries were unsupported because DFAS Indianapolis (Sustaining Forces) did not reconcile differences between budgetary data received from accounting offices and the data received from disbursing stations, as required by the Department of the Treasury.⁴ After adjusting disbursements and collections, DFAS Indianapolis (Sustaining Forces) subsequently prepared entries to adjust other lines on the Reports on Budget Execution for the effect of the adjustments to disbursements and collections. Specifically, DFAS Indianapolis (Sustaining Forces) made adjustments of \$6.2 billion to Undelivered Orders, \$1.7 billion to Reimbursements Receivable, and \$721 thousand to Accounts Payable reported on the Reports on Budget Execution.

Reports on Budget Execution and Trial Balances. As described in finding A, the trial balances differed from the Reports on Budget Execution by a net amount of \$67.3 billion. During the compilation process, DFAS Indianapolis (Sustaining Forces) prepared unsupported accounting entries totaling \$67.3 billion to force the two sets of financial records to agree. The adjustments were unsupported because DFAS Indianapolis (Sustaining Forces) did not reconcile the differences between the reports.

⁴Treasury Financial Manual, volume 1, part 2, chapter 5100, "Reconciling Fund Balance With Treasury Accounts," October 1999, requires Federal agencies to reconcile the Fund Balance With Treasury account in the general ledger to the disbursing data prepared by disbursing stations.

Intragovernmental Transactions. DFAS Indianapolis (Sustaining Forces) prepared \$19.8 billion in unsupported accounting entries to force buyers' and sellers' records to match prior to eliminating the effects of intragovernmental transactions.⁵ DoD Regulation 7000.14-R, volume 6B, chapter 13, "Fiscal Year 2000 Adjustments, Eliminations, and Other Special Intragovernmental Reconciliation Procedures," directs DFAS to force the buyers' accounting records to match the sellers' records prior to eliminating transactions between the two parties. IG, DoD, Report No. D-2001-042, "Accounting and Disclosing Intragovernmental Transactions on the DoD Agency-Wide Financial Statements," January 31, 2001, reported that seller-side accounting records have not been fully reliable and that DoD has not demonstrated that seller-side information is sufficiently reliable to warrant sweeping adjustments to force buyers' records to match sellers' records.

Differences Between Financial Statements. DFAS Indianapolis (Sustaining Forces) prepared \$22 billion of unsupported accounting entries to force the amount reported for Net Cost of Operations on the Statement of Financing to match the amount reported for Net Cost of Operations on the Statement of Net Cost. DoD Regulation 7000.14-R, volume 6B, chapter 8, "Statement of Financing," October 2000 states that the two statements should report the same amount for Net Cost of Operations. During the compilation process, DFAS Indianapolis (Sustaining Forces) performed a limited reconciliation and determined that the amounts reported on the two statements did not agree. However, DFAS Indianapolis (Sustaining Forces) did not complete the reconciliation because they did not correct the causes of the differences. Instead, DFAS Indianapolis (Sustaining Forces) prepared unsupported accounting entries for \$22 billion to force the statements to agree.

According to Statement of Federal Financial Accounting Concept No. 1, chapter 6, "Qualitative Characteristics of Information in Financial Reports," March 1997, financial statements are the end product of a financial reporting process and should faithfully represent transactions posted to supporting accounting records. The supporting accounting transactions in turn should faithfully represent a specific financial event. Therefore, financial statements, to retain their integrity, must be representative of transactions that are based in true financial events. By not performing a reconciliation that includes identifying the causes of the differences between the amounts reported for Net Cost of Operations on the Statement of Net Cost and the Statement of Financing, DFAS Indianapolis (Sustaining Forces) reduced the reliability of both statements.

Adequacy of Written Justification. DFAS Indianapolis (Sustaining Forces) prepared \$11.2 billion in accounting entries that did not include an adequate justification clearly explaining the rationale for the entry. Some justifications stated what the accounting entry did, for example, "To reclassify 'Other Gains' between exchange and nonexchange," but did not explain why the reclassification was necessary. In addition, the accompanying documentation did not provide a clear indication as to the purpose for the entry.

⁵When an entity prepares consolidated financial statements from sub-entities, the effect of financial transactions among the sub-entities should be eliminated and the consolidated financial statements should only report transactions with external parties.

Improper Entries

DFAS Indianapolis (Sustaining Forces) prepared \$410.3 million in accounting entries that were improper. For example, when preparing the year-end FY 2000 Reports on Budget Execution, DFAS Indianapolis (Sustaining Forces) prepared improper accounting entries totaling \$95.3 million to remove abnormal balances from Accounts Payable for appropriation accounts scheduled to close at the end of FY 2000. Instead of researching, reconciling, and correcting the abnormal balances as required by the DoD Financial Management Regulation,⁶ DFAS Indianapolis (Sustaining Forces) offset the abnormal balances in Accounts Payable with normal balances in Undelivered Orders and Other Balances Currently Available. In another example, personnel attempted to reverse an accounting entry for \$280,000 made earlier in the compilation process but did not post the reversing entry to exactly the same accounts as the original entry. As a result, the original entry was not reversed.

Conclusions

We are not making recommendations to address causes discussed in this finding because the needed recommendations were made in prior audit reports.

IG, DoD, Report No. 99-139, "Internal Controls and Compliance With Laws and Regulations for the FY 1998 Financial Statements of the Other Defense Organizations," April 21, 1999, recommended that DFAS Indianapolis (Sustaining Forces) prepare an action plan for reconciling accounting records to the U.S. Treasury Records. To accomplish the reconciliation, DFAS Indianapolis (Sustaining Forces) developed the Cash Management Report to calculate balances with the U.S. Treasury at the appropriation and sub-entity level. The Cash Management Report provides the detailed information necessary to account for the differences between the accounting records and U.S. Treasury records. During FY 2000, DFAS Indianapolis (Sustaining Forces) attempted to use the Cash Management Report to adjust Reports on Budget Execution so that they matched the U.S. Treasury records; however, due to significant problems with sub-entity codes, DFAS Indianapolis (Sustaining Forces) stopped using the Cash Management Report to make the adjustments. DFAS Indianapolis (Sustaining Forces) has continued to work with accounting offices to develop a set of valid sub-entity codes and intends to resume the process of using the Cash Management Report to adjust Reports on Budget Execution in April 2001 for FY 2001 appropriations.

IG, DoD, Report No. 99-014, "Compilation of the FY 1997 Financial Statements for Other Defense Organizations," October 15, 1998, recommended

⁶DoD Regulation 7000.14-R, DoD Financial Management Regulation, volume 4, chapter 9, "Accounts Payable," requires DoD entities to annually reconcile reported accounts payable to supporting documentation, research differences, and fully document necessary adjustments.

that DFAS Indianapolis (Sustaining Forces) document and maintain complete audit trails for all year-end adjustments made to the Other Defense Organizations trial balances. During FY 2000, DFAS Indianapolis (Sustaining Forces) prepared the Recurring Journal Voucher Handbook, August 24, 2000, to provide documentation for accounting entries that are routinely prepared during the annual compilation process. In addition, DFAS issued a memorandum, titled "Journal Voucher Guidance," on August 2, 2000, to provide guidance on the preparation of year-end accounting entries. Notwithstanding these actions, our review of year-end accounting entries continued to identify instances where the supporting documentation was not complete.

Also see Appendix B for a list of open audit recommendations that address issues discussed in this finding.

C. Reliability of the Financial Statements

At least seven material lines on the Other Defense Organizations FY 2000 Financial Statements were not reliable, and the footnotes to the financial statements, although much improved from previous years, did not provide complete disclosures related to abnormal balances and the costs of military personnel. Additionally, the financial statements that were presented to us for audit and the financial statements that were issued as the final version differed by \$390.2 billion. The conditions occurred because:

- the quality of the financial data submitted to DFAS Indianapolis (Sustaining Forces) was poor, as reported in finding A;
- financial data were altered through the preparation of unsupported year-end departmental accounting entries, as reported in finding B;
- ending balances from FY 1999 were not correctly transferred as the beginning balances for FY 2000; and
- DFAS Indianapolis (Sustaining Forces) did not fully implement prior IG, DoD, audit recommendations addressing footnote disclosures.

The final financial statements for FY 2000 differed materially from the financial statements presented for audit because DFAS Indianapolis (Sustaining Forces) did not use all of the correct accounts for the financial statements presented for audit. The two sets of statements also differed because accounting personnel continued to post accounting entries after presenting the financial statements for audit. The problems with material line items caused the Other Defense Organizations-General Funds Financial Statements to be materially misstated, and directly contribute to the inability of DoD to obtain a favorable opinion on the DoD Agency-Wide Financial Statements.

Reliability of Material Financial Statement Lines

The reliability of the financial statements prepared for the Other Defense Organizations for FY 2000 was materially impaired because of the poor quality of data submitted to DFAS Indianapolis (Sustaining Forces) described in finding A, the unsupported accounting entries prepared by DFAS Indianapolis (Sustaining Forces) described in finding B, and because of additional anomalies in the financial statements and the compilation process. Those deficiencies are aggregated to show the effect on the following financial statement lines.

Fund Balance With Treasury. The \$32.4 billion reported for Fund Balance With Treasury on the balance sheet was not reliable. The amount, as reported, was not reliable because a total of \$19.4 billion in unsupported accounting entries were posted to Fund Balance With Treasury. The \$19.4 billion included \$7.7 billion to force the Reports on Budget Execution to match U.S. Treasury records and \$11.7 billion to force general ledger account balances to match Reports on Budget Execution.

Accounts Payable. The amounts reported on the Balance Sheet for Accounts Payable Intragovernmental of \$.7 billion and Accounts Payable (Public) of \$2.5 billion were not reliable. DFAS Indianapolis (Sustaining Forces) made unsupported accounting entries totaling \$4 billion affecting those accounts, as shown in Table 4.

Table 4. Accounting Entries Affecting Accounts Payable	
<u>Description of Accounting Entry</u>	<u>Amount (billions)</u>
Force buyers' records to match sellers' records	\$2.9
Remove abnormal balances for appropriation accounts scheduled to close at the end of FY 2000	0.9
Entries to force general ledger trial balances to match Reports on Budget Execution	<u>0.2</u>
Total	\$4.0

Program Costs. The \$53.9 billion reported for Net Program Costs on the Statement of Net Cost was unreliable because \$14.7 billion of unsupported adjustments were posted to adjust expense accounts in preparation for eliminating intragovernmental transactions.

Unobligated Balance-Beginning of Period. The \$10.8 billion reported for Unobligated Balance-Beginning of Period on the Statement of Budgetary Resources was not reliable. DoD Financial Management Regulation, volume 6B, Appendix B, "Reconciliation Requirements for the Annual Financial Statements," October 2000, and OMB Circular No. A-34, "Instruction on Budget Execution," October 1999, require the prior year Unobligated Balances Available and Unavailable to be carried forward as the following year Unobligated Balance-Beginning of Period. For FY 1999, the Unobligated Balances Available and Unavailable totaled \$12.5 billion; however, the FY 2000

Unobligated Balance-Beginning of Period reported \$10.8 billion, a difference of \$1.7 billion. DFAS Indianapolis (Sustaining Forces) did not document or explain the discrepancy in the footnotes to the financial statements.⁷

Obligated Balance, Net-Beginning of Period. The \$22.6 billion reported for Obligated Balances, Net-Beginning of Period on the Statement of Budgetary Resources was not reliable. The prior year Obligated Balance, Net-End of Period should transfer as the following year Obligated Balance, Net-Beginning of Period. For FY 1999 the Obligated Balance, Net-End of Period was \$22.2 billion, however, the FY 2000 Obligated Balance, Net-Beginning of Period reported \$22.6 billion, a difference of \$.4 billion, with no explanation in the footnotes.

Obligated Balance, Net-End of Period. The \$21.2 billion reported for Obligated Balance, Net-End of Period on the Statement of Budgetary Resources was not reliable because the amount included \$7.9 billion in unsupported accounting entries to Accounts Receivable, Accounts Payable, and Undelivered Orders. The unsupported accounting entries were prepared as part of the process for forcing Reports on Budget Execution⁸ to match U.S. Treasury records.

Total Outlays. The \$56.4 billion reported for Total Outlays on the Statement of Budgetary Resources was not reliable. The amount was not reliable because the amount included \$7.7 billion in unsupported accounting entries made to disbursements and collections as part of the process to force the Reports on Budget Execution to match U.S. Treasury records.

Notes to the Principal Financial Statements

DFAS Indianapolis (Sustaining Forces) made improvements to the footnotes accompanying the FY 2000 Other Defense Organizations Principal Financial Statements. The footnotes provide greater detail and more thorough explanations than those prepared in previous years. The notes generally complied with guidance provided by OMB and DoD, and recommendations made by prior IG, DoD, audits, except for disclosures related to abnormal balances and military personnel costs.

Abnormal Balances. Disclosures regarding material abnormal balances contained within normal balances were not explained in notes to the FY 2000

⁷OMB Circular No. A-34, Section 41.4 and DoD Financial Management Regulation, volume 6B, chapter 7, Paragraph 070104, state that any material discrepancies between the current and the preceding fiscal year's balances must be noted and fully explained.

⁸The Statement of Budgetary Resources, as prepared by DFAS Indianapolis (Sustaining Forces), is a summarization of budgetary data reported on the Reports on Budget Execution. Specifically, Obligated Balance, Net-End of Period on the Statement of Budgetary Resources is an aggregation of the amounts presented on the Reports on Budget Execution for Accounts Receivable, Unfilled Customer Orders, Undelivered Orders, and Accounts Payable.

financial statements. For example the abnormal balances discussed in finding A, such as the \$467.4 million abnormal balance in Accounts Payable-Government Current, were not disclosed or discussed in the footnotes.

IG, DoD, Report No. 99-191, "Compilation of the FY 1998 Financial Statements for Other Defense Organizations," June 24, 1999, recommended that DFAS Indianapolis (Sustaining Forces) explain material abnormal balances included within normal balances. DFAS did not explain all abnormal balances included within normal balances in the FY 2000 financial statements.

Military Personnel Costs. DFAS Indianapolis (Sustaining Forces) did not clearly explain in Note 1 to the FY 2000 Other Defense Organizations-General Funds Financial Statements that the costs for military personnel working in Defense Agencies were not included in the financial statements. IG, DoD, Report No. 99-014 stated that DFAS should disclose military personnel costs not included in financial data for Other Defense Organizations. Because military personnel are assigned to Other Defense Organizations but are not funded by Department 97 appropriations, Note 1 should clearly explain that military personnel costs are not included in the Other Defense Organizations Financial Statements.

Changes to Financial Statements

DFAS Indianapolis (Sustaining Forces) made changes to the financial statements totaling \$390.16 billion after presenting the financial statements to the IG, DoD, for audit. See Table 5 for the total value of the changes by financial statement and Appendix F for the total value of the material changes by line item.

Table 5. Changes Made to Financial Statements After Being Presented for Audit	
<u>Financial Statement</u>	<u>Total Value of Changes (billions)</u>
Balance Sheet	\$ 3.25
Statement of Net Cost	0.08
Statement of Changes in Net Position	1.26
Statement of Budgetary Resources	0.02
Statement of Financing	<u>385.55</u>
Total	\$390.16

DoD Financial Management Regulation, volume 6B, chapter 2, “General Instructions for the Financial Statements,” October 2000, requires DoD to provide the IG, DoD, with financial statements for audit. The financial statements presented for audit should report the same financial information as the final financial statements, except for changes recommended by the auditors. The changes to the Statement of Financing occurred primarily because DFAS Indianapolis (Sustaining Forces) did not use two accounts that were new in FY 2000 to prepare the financial statements presented to us for audit, but corrected the error prior to preparing the final financial statements.

We did not have adequate time to identify the causes of the remaining changes. Materially modifying the financial statements after presenting them for audit potentially undermines the ability of the auditors to produce audit results fully relevant to the final version of the financial statements.

Materiality to DoD Agency-Wide Financial Statements

The lack of reliable and auditable financial statements for the Other Defense Organizations-General Funds materially impacts the DoD Agency-Wide Financial Statements. For FY 2000, 50 lines on the Other Defense Organizations-General Funds Financial Statements were material to the DoD Agency-Wide Financial Statements. See Table 6 for an example of several selected lines that contribute significantly to the overall amount reported on the DoD Agency-Wide Financial Statements.

Table 6. Selected Other Defense Organizations Financial Statement Lines that Represent Significant Portions of the DoD Agency-Wide Financial Statements

<u>Financial Statement Line</u>	<u>Amount (billions)</u>	<u>Percent of DoD Agency-Wide</u>
Fund Balance With Treasury	\$32.4	18
Budget Authority	58.1	16
Obligations Incurred	60.9	13
Total Outlays	56.4	17

As shown in Figure 2, the Other Defense Organizations-General Funds are comparable to the Army, Navy, and Air Force General Funds.

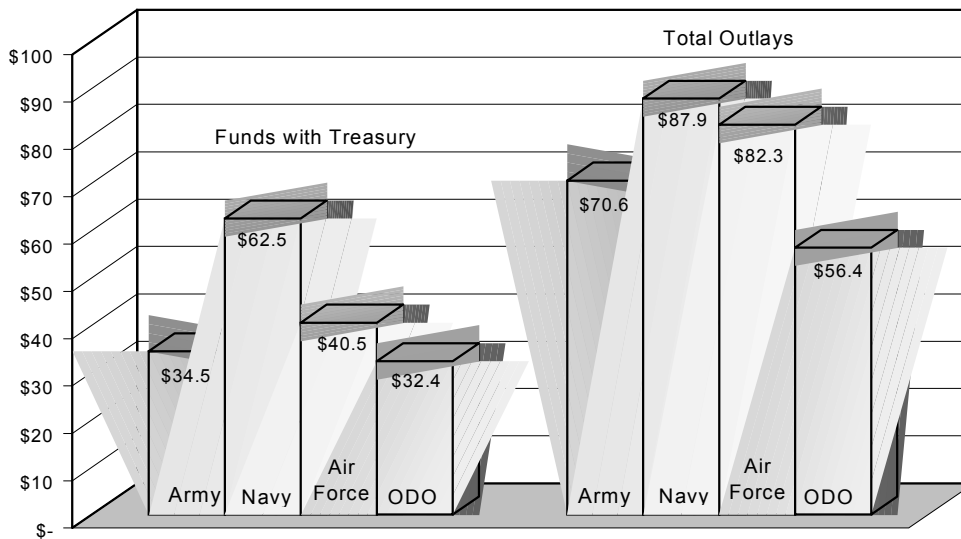


Figure 2. Comparison of Selected Lines for the General Fund Reporting Entities (billions)

Conclusion

We are not making recommendations to address causes discussed in this finding because the needed recommendations were made in prior audit reports.

IG, DoD, Report No. 99-191, recommended that DFAS Indianapolis (Sustaining Forces) explain, in the footnotes to the financial statements, material abnormal balances reported on the financial statements and disclose abnormal balances that were included in normal balances reported on the financial statements. DFAS Indianapolis (Sustaining Forces) agreed to make the disclosures by January 31, 2000. However, the financial statements prepared for FY 2000 did not fully make the recommended disclosures.

IG, DoD, Report No. 99-014, recommended that DFAS Indianapolis (Sustaining Forces) disclose that costs for military personnel were not included in financial data for Other Defense Organizations. DFAS Indianapolis (Sustaining Forces) concurred with the recommendation and estimated that the recommendation would be implemented by March 31, 1999. However, our review of the FY 2000 financial statements showed that the footnotes did not disclose that costs for military personnel were not included in the financial statements.

Also see Appendix B for a list of open audit recommendations that address issues discussed in this finding.

Appendix A. Audit Process

Scope

Financial Information, Procedures, and Controls Reviewed. We are not expressing an opinion on the FY 2000 Financial Statements for Other Defense Organizations. Our audit was designed to support the FY 2000 DoD Agency-Wide Financial Statements and we focused on Other Defense Organizations-General Funds. We reviewed the Reports on Budget Execution and trial balances, and we specifically looked at abnormal balances, differences between the Reports on Budget Execution and U.S. Treasury Records, and differences between the Reports on Budget Execution and trial balances. We also reviewed data supporting the Balance Sheet, the Statement of Net Cost, the Statement of Net Position, the Statement of Budgetary Resources, the Statement of Financing, the Statement of Custodial Activity, and notes to the financial statements. See IG, DoD, Report No. D-2001-060 “Internal Controls and Compliance With Laws and Regulations for the FY 2000 Financial Statements for Other Defense Organizations-General Funds,” February 28, 2001, for our review of internal controls.

Amounts Reported in the FY 2000 Financial Statements. The FY 2000 Other Defense Organizations-General Funds Financial Statements showed Total Assets of \$42 billion, Total Liabilities of \$201.6 billion, Budgetary Authority of \$58.1 billion, Net Cost of Operations of \$53.9 billion, and Obligations Incurred of \$60.9 billion.

Accounting Principles. Accounting principles and standards for the Federal Government have been issued and are undergoing further development and refinement. The Federal Accounting Standards Advisory Board was established by the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. On October 19, 1999, the American Institute of Certified Public Accountants recognized the Federal Accounting Standards Advisory Board as the body to establish generally accepted accounting principles for Federal governmental entities. Therefore, Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board are recognized as generally accepted accounting principles for applicable Federal governmental entities.

Agencies are required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 97-01, “Form and Content of Agency Financial Statements,” October 16, 1996, as amended on September 11, 2000. The hierarchy is as follows:

-
- standards agreed to and published by the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States;
 - interpretations of the Statements of Federal Financial Accounting Standards issued by OMB;
 - requirements for the form and content of financial statements outlined in OMB Bulletin No. 97-01; and
 - accounting principles published by other authoritative sources.

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 objective and goal.

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

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

Methodology

Auditing Standards. This financial related audit was performed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD, based on the objectives of the audit and the limitations to the scope described in this appendix.

Computer-Processed Data. We used computer-processed data in this audit; however, we did not confirm the reliability of the data because the accounting systems used to prepare the financial statements for Other Defense Organizations had serious limitations. The lack of reliable financial information was described as a material management control deficiency in the DFAS Annual Statements of Assurance for FY 2000. The lack of reliable information did not adversely affect our analysis.

Audit Period and Location. We performed this financial-related audit from October 2000 through March 2001 at DFAS Indianapolis (Sustaining Forces).

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

Prior Coverage

The General Accounting Office and the IG, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. IG, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil>.

Appendix B. Prior Audit Reports With Open Recommendations

For FY 2000, the DFAS Indianapolis (Sustaining Forces) Project Assessment Team continued to monitor and track financial reporting deficiencies and corrective actions taken. The Project Assessment Team used a tracking document known as the “DFAS Indianapolis (Sustaining Forces) Implementation Strategies for Other Defense Organizations-General Fund.” The team included representatives from each working group within DFAS Indianapolis (Sustaining Forces) responsible for initiating corrective actions, along with representatives from the IG, DoD. The Project Assessment Team continues to be an active and useful mechanism for monitoring the quality of the internal controls over financial reporting procedures at DFAS Indianapolis (Sustaining Forces). Our audit of the FY 2000 financial statements identified the following audit recommendations that have not been fully implemented or are in the process of being implemented.

IG, DoD, Report No. D-2000-153, “Compilation of the FY 1999 Financial Statements For Other Defense Organizations-General Funds,” June 23, 2000. Open Recommendations: We recommended that accounting offices supporting the Other Defense Organizations correct abnormal balances, if appropriate, and footnote all abnormal balances included on quarterly and annual trial balances submitted to DFAS Indianapolis (Sustaining Forces) for inclusion in the financial statements. At least five accounting offices complied with the recommendation. Of the six remaining accounting offices, three offices, the Defense Agency Financial Services, DFAS Columbus, and DFAS Indianapolis (Sustaining Forces), are under the purview of DFAS which anticipated full implementation of the recommendations to be complete by January 2001. The Defense Information Systems Agency and Defense Threat Reduction Agency had agreed to submit footnotes by September 30, 2000, but DFAS Indianapolis (Sustaining Forces) did not receive footnotes with the September 30, 2000, trial balances submitted by the two agencies. The TRICARE Management Activity did not respond to either the draft or final report, and made no attempt to comply with our recommendations.

We further recommended DFAS Indianapolis (Sustaining Forces) establish and implement detailed procedures to review the trial balances submitted for Other Defense Organizations at least quarterly to identify abnormal balances and differences between the trial balances and Reports on Budget Execution. DFAS Indianapolis (Sustaining Forces) developed the General Ledger Reconciliation Report to implement the recommendation and currently plans to use the report to perform a review of the trial balances submitted for the first quarter of FY 2001.

IG, DoD, Report No. 99-191, “Compilation of the FY 1998 Financial Statements For Other Defense Organizations,” June 24, 1999. Open Recommendations: We recommended that DFAS Indianapolis (Sustaining Forces) disclose material abnormal balances included in normal balances in footnotes to the financial statements. DFAS Indianapolis (Sustaining Forces)

agreed to make the disclosures by January 31, 2000; however, the financial statements prepared for FY 2000 did not fully make the recommended disclosures.

IG, DoD, Report No. 99-139, “Internal Controls and Compliance With Laws and Regulations for the FY 1998 Financial Statements of the Other Defense Organizations,” April 21, 1999. Open Recommendation: We recommended that DFAS Indianapolis (Sustaining Forces) prepare an action plan for reconciling accounting records to the U.S. Treasury Records. To accomplish the reconciliation, DFAS Indianapolis (Sustaining Forces) developed the Cash Management Report to calculate balances with the U.S. Treasury at the appropriation and sub-entity level. The Cash Management Report provides the detailed information necessary to account for the differences between the accounting records and U.S. Treasury records. During FY 2000, DFAS Indianapolis (Sustaining Forces) attempted to use the Cash Management Report to adjust Reports on Budget Execution so that they matched the U.S. Treasury records; however, due to significant problems with sub-entity codes, DFAS Indianapolis (Sustaining Forces) stopped using the Cash Management Report to make the adjustments. DFAS Indianapolis (Sustaining Forces) has continued to work with accounting offices to develop a set of valid sub-entity codes and intends to resume the process of using the Cash Management Report to adjust Reports on Budget Execution in April 2001 for FY 2001 appropriations.

IG, DoD, Report No. 99-014, “Compilation of the FY 1997 Financial Statements For Other Defense Organizations,” October 15, 1998. Open Recommendation: We recommended that DFAS Indianapolis (Sustaining Forces) document and maintain complete audit trails for all year-end adjustments made to the Other Defense Organizations trial balances. During FY 2000, DFAS Indianapolis (Sustaining Forces) prepared the Recurring Journal Voucher Handbook, August 24, 2000, to provide documentation for accounting entries that are routinely prepared during the annual compilation process. In addition, DFAS issued a memorandum, titled “Journal Voucher Guidance,” on August 2, 2000, to provide guidance on the preparation of year-end accounting entries. Notwithstanding these commendable actions, our review of year-end accounting entries continued to identify instances where the supporting documentation was not complete.

We further recommended DFAS Indianapolis (Sustaining Forces) disclose in the notes to the financial statements that costs for military personnel are not included in financial data for Other Defense Organizations. DFAS Indianapolis (Sustaining Forces) concurred with the recommendation and estimated that the recommendation would be implemented by March 31, 1999. However, our review of the FY 2000 financial statements showed that the footnotes did not disclose that costs for military personnel were not included in the financial statements.

Appendix C. Other Defense Organizations- General Funds

The list of 51 Other Defense Organizations-General Funds for FY 2000 compiled in this appendix includes trust funds and revolving funds not included in Treasury basic symbol 4930, Defense Business Operation Funds (known as “Defense Working Capital Fund”). DoD Regulation 7000.14-R, “DoD Financial Management Regulation,” volume 6B, chapter 2, “General Instructions for the Financial Statements,” October 2000, identifies most of the Other Defense Organizations. Additional Other Defense Organizations funded with Department 97 funds, but not listed in the DoD Regulation 7000.14-R, are included in the list below and distinguished by footnotes.

American Forces Information Service
Ballistic Missile Defense Organization
Defense Acquisition University
Defense Advanced Research Projects Agency
Defense Building Maintenance Fund

Defense Commissary Agency
Defense Contract Audit Agency
Defense Contract Management Agency
Defense Emergency Response Fund
Defense Finance and Accounting Service

Defense Health Program
Defense Homeowners Assistance Fund
Defense Information Systems Agency
Defense Intelligence Agency
Defense Legal Services Agency

Defense Logistics Agency
Defense Manpower Data Center Facility¹
Defense Medical Program Activity
Defense Prisoner of War/Missing Persons Office
Defense Security Cooperation Agency

Defense Security Service
Defense Threat Reduction Agency
DoD Component Level Accounts
DoD Education Activity
DoD Education Benefits Fund

¹This Department 97 funded organization is not listed in DoD Regulation 7000.14-R.

DoD Human Resources Activity
Federal Energy Management Program
Foreign National Employees Separation Pay Accounts Trust Fund²
Joint Chiefs of Staff
Joint Logistics Systems Command

National Defense Stockpile Transaction Fund
National Imagery and Mapping Agency
National Security Agency
National Security Education Trust Fund
Office of Economic Adjustment

Office of the Inspector General, DoD
Office of the Secretary of Defense (OSD)
Other Prior Year Residual “97” Funds
Other “97” Funds Provided to the Air Force by OSD
Other “97” Funds Provided to the Army by OSD

Other “97” Funds Provided to the Navy by OSD
Other “97” Funds Provided to Washington Headquarters Services by
OSD

Pentagon Reservation Maintenance Revolving Fund
Ready Reserve Mobilization Income Insurance Fund
Technical Research Institute

TRICARE Management Activity
U.S. Court of Appeals of the Armed Forces
U.S. Special Operations Command
Uniformed Services University of the Health Sciences
Voluntary Separation Incentive Trust Fund

Washington Headquarters Services

²This Department 97 funded organization is not listed in DoD Regulation 7000.14-R.

Appendix D. Accounting Activities Submitting Abnormal Balances of More Than \$10 Million

<u>Defense Activity or Accounting Office</u>	<u>Limit*</u>	<u>Entity or Sub-Entity Name</u>
Defense Agency Financial Services	1884	Defense Health Program
Defense Information Systems Agency	4300	Defense Information Systems Agency
DFAS Cleveland	1104	Office of the Secretary of Defense – Navy
	1634	Base Closure and Realignment Commission - Navy
	1882	Defense Health Program – Navy
	2004	Washington Headquarters Services – Navy
	2504	Ballistic Missile Defense Organization – Navy
	5604	Special Operations Forces, Defense – Navy
	6034	Section 6 - Navy Stateside Dependent Schools
DFAS Columbus	4600	Defense Contract Audit Agency
	5100	Defense Logistics Agency
	6101	Defense Acquisition University
DFAS Denver	0200	Department of the Air Force
	0202	Air Force National Guard
	1102	Office of the Secretary of Defense – Air Force
	1632	Base Closure and Realignment Commission – Air Force
	1883	Defense Health Program – Air Force
	25FF	Ballistic Missile Defense Organization – Air Force
DFAS Indianapolis (Sustaining Forces)	0000	Unallocated
	0100	Department of the Army
	1101	Office of the Secretary of Defense - Army
	1102	Office of the Secretary of Defense - Air Force
	11A1	Base Closure and Realignment Commission - Army
	11B1	Army Base Realignment and Closure Account
	1201	Organization of the Joint Chiefs of Staff - Army

*Appropriation limits are the four-digit suffixes to the U.S. Treasury account number (basic symbol) that identify a subdivision of funds, restrict the amount or use of funds for a certain purpose, or identify sub-elements within the account for management purposes. For Other Defense Organizations, the appropriation limit usually shows the organization or fund for which the appropriation provides funding.

<u>Defense Activity or Accounting Office</u>	<u>Limit</u>	<u>Entity or Sub-Entity Name</u>
DFAS Indianapolis (Sustaining Forces) (continued)	1301	Defense Advanced Research Projects Agency - Army
	1302	Defense Advanced Research Projects Agency - Air Force
	1401	TRICARE Management Activity - Army
	1801	Defense Health Program
	1881	Defense Health Program - Army
	2001	Washington Headquarters Services - Army
	2501	Ballistic Missile Defense Organization - Army
	2601	Ballistic Missile Defense Organization - Army
	3601	Civilian Military Program - Army
	40B1	Base Closure and Realignment Commission - Army
	40C1	Base Closure and Realignment Commission - Army
	40D1	Army Base Realignment and Closure Account
	4202	Defense Special Weapons Agency Field Command
	4300	Defense Information Systems Agency
	4365	White House Communication Agency
	4370	Defense Information Systems Agency - Pacific
	4371	Defense Information Systems Agency
	4500	National Security Agency/Central Security Service
	5600	Special Operations Forces, Defense - All Agencies/Services
	5601	Special Operations Forces, Defense - Army
	6041	DoD Dependent Schools - Army
	6400	Defense Commissary Agency
	7000	Defense Finance Accounting Service Operating Locations
DoD Dependent Schools	6001	DoD Dependent Schools - Germany Region
	6019	DoD Dependent Schools
	6021	DoD Dependent Schools - Europe
	6060	DoD Dependent Schools - Foreign Currency Fluctuation
TRICARE Management Activity	1886	Defense Health Program - Civilian Health And Medical Program of the Uniformed Services (CHAMPUS)
Defense Threat Reduction Agency	4200	Defense Special Weapons Agency

Appendix E. Sub-Entities With Data Discrepancies Over \$500 Million

<u>Limit</u>	<u>Name of Sub-Entity</u>	<u>Amount of Discrepancies (billion)</u>
1881	Defense Health Program - (Operations & Maintenance) Army	\$15.6
2501	Ballistic Missile Defense Organization - Army	11.9
9999	Pseudo Sub-Entity for Undistributed Funds	5.2
5600	Special Operation Forces, Defense – All Agencies/Services	4.2
0100	Department of the Army	4.1
1301	Defense Advanced Research Projects Agency - Army	2.2
1101	Office of the Secretary of Defense - Army	1.8
2520	Ballistic Missile Defense Organization – Washington Headquarters Services	1.7
2601	Ballistic Missile Defense Organization - Army	1.7
7000	Defense Finance and Accounting Service Operating Locations	1.4
1882	Defense Health Program - (Operations & Maintenance) Navy	1.1
0301	Operations and Maintenance for Chemical Agents and Munitions Destruction	1.1
5602	Special Operations Forces, Defense – Air Force	0.7
0201	Air Force Reserve	0.7
1897	Defense Health Program Undistributed Funds	0.7
4300	Defense Information Systems Agency	0.6
0004	Contributions for Proprietary Receipts and Burdensharing	0.6
2020	Washington Headquarters Services	0.6

Appendix F. Financial Statement Lines That Were Materially Modified

<u>Account Title</u>	<u>Amount of Change (billions)</u>
Balance Sheet	
Accounts Receivable	\$.9
Other Liabilities	.6
Military Retirement Benefits and Other Employment Related	.2
Other Liabilities	.4
Cumulative Results of Operations	.9
Statement of Changes in Net Position	
Imputed Financing	.1
Other	.8
Prior Period Adjustment	.2
Statement of Financing	
Financing Imputed for Cost Subsidies	.1
Financing Sources that Fund Cost of Prior Periods	192.6
Other-(Increases)/Decreases	.2
Financing Sources Yet To Be Provided	<u>192.6</u>
Total	\$389.6

Appendix G. 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 Cleveland
Director, Defense Finance and Accounting Service Columbus
Director, Defense Finance and Accounting Service Denver
Director, Defense Finance and Accounting Service Indianapolis (Sustaining Forces)
Director, Defense Information Systems Agency
Director, Defense Threat Reduction Agency
Director, DoD Education Activity
Director, TRICARE Management Activity
Director, Washington Headquarters Services
President, Uniformed Services University of the Health Sciences

Non-Defense Federal Organization

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
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

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.

F. Jay Lane
Salvatore D. Guli
Charles J. Richardson
Sandra L. Fissel
Jonathan R. Witter
Juana R. Smith
Karen J. Lamar
Jennifer R. Siwula
Alejandra P. Rodriguez
Dwayne A. Coulson
Carol J. Gresham
Lisa Rose-Pressley