

March 21, 2003



Financial Management

Recoveries of Prior Year
Obligations
(D-2003-067)

Office of the Inspector General
of the
Department of Defense

Constitution of
the United States

A Regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.

Article I, Section 9

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Acronyms

DFAS	Defense Finance and Accounting Service
FMR	Financial Management Regulation
OMB	Office of Management and Budget
SF-133	Standard Form 133 "Report on Budget Execution"
STARS	Standard Accounting and Reporting System
USD(C)/CFO	Under Secretary of Defense (Comptroller)/Chief Financial Officer
USSGL	United States Government Standard General Ledger



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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March 21, 2003

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE
(COMPTROLLER)/CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Report on Audit of Recoveries of Prior Year Obligations
(Report No. D-2003-067)

We are providing this report for your information and use.

We considered management comments on a draft of this report when preparing the final report. The Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Deputy Director, Defense Finance and Accounting Service Cleveland comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Raymond D. Kidd at (703) 604-9159 (DSN 664-9159) or Ms. Linda A. Pierce at (216) 706-0074, Ext. 234. See Appendix C for the report distribution. The team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General of the Department of Defense

Report No. D-2003-067

March 21, 2003

(Project No. D2002FC-0098)

Audit of Recoveries of Prior Year Obligations

Executive Summary

Who Should Read This Report and Why? Financial management officials throughout the Department of Defense who produce budget execution reports and create accounting logic in accounting systems databases should read this report. The report discusses how to properly record and report recoveries of prior year obligations (recoveries).

Background. The Defense Finance and Accounting Service (DFAS) Cleveland was established in January 1991 to perform accounting functions for the Department of the Navy (Navy). DFAS Cleveland developed the Standard Accounting and Reporting System to account for the transactions within the Navy General Fund. The Standard Accounting and Reporting System summarizes Navy accounting data to prepare monthly departmental reports and financial statements. Office of Management and Budget Circular No. A-11, Part 4, "Instructions on Budget Execution," requires recoveries to be reported on the Standard Form 133, "Report on Budget Execution." Recoveries are any cancellations or downward adjustments in the current year for obligations incurred in prior fiscal years that were not yet paid.

Results. DFAS Cleveland used a process to determine the recovery amounts reported on the Navy General Fund monthly Standard Form 133, "Report on Budget Execution," that was not reliable. In FY 2002, DFAS Cleveland posted 9,983 manual journal voucher entries using invalid general ledger accounts to record the recovery amounts in the Standard Accounting and Reporting System. As a result, the amounts reported for recoveries on departmental reports were unreliable, and processes used to enter recoveries were not in compliance with generally accepted accounting principles. Also, the effort DFAS Cleveland expended to manually post the recoveries data could have been put to better use. The unreliable queries and the use of invalid general ledger accounts would not be necessary if the accounting database was programmed to record recoveries as they occur at the transaction level. In addition, the DoD Financial Management Regulation should be updated to bring it in line with guidance issued by the Department of the Treasury. (See the Finding section of the report for the detailed recommendations.)

Management Comments. The Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Director, DFAS Cleveland each concurred with the finding and their respective recommendation; therefore, no additional comments are required. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

Role of the Defense Finance and Accounting Service Cleveland. The Defense Finance and Accounting Service (DFAS) Cleveland was established in January 1991 to perform accounting functions for the Department of the Navy (Navy). DFAS Cleveland developed the Standard Accounting and Reporting System (STARS) to account for the transactions within the Navy General Fund. STARS summarizes Navy accounting data to prepare monthly departmental reports and financial statements.

Office of Management and Budget. The Office of Management and Budget (OMB) requires all Federal agencies to submit the Standard Form 133, “Report on Budget Execution,” (SF-133) to fulfill the requirements of section 1511-1514, title 31, United States Code (31 U.S.C. 1511-1514). The SF-133 provides a consistent presentation of financial data, provides a basis for obligation patterns, ties agency financial statements to budget execution, and allows OMB to monitor the status of apportioned funds. OMB Circular No. A-11, Part 4, “Instructions on Budget Execution,”¹ (OMB Circular A-11) provides guidance for the preparation and submission of the SF-133 and requires that recoveries of prior year obligations (recoveries) be reported on line 4 of the SF-133. Recoveries are any cancellations or downward adjustments in the current year for obligations incurred in prior fiscal years that were not yet paid.

Department of the Treasury. The Department of the Treasury (Treasury) gathers and publishes Government-wide financial information that is used by the public and private sectors to monitor the Government’s financial status and establish fiscal and monetary policies. Treasury maintains and publishes the United States Government Standard General Ledger (USSGL). The USSGL provides a uniform chart of accounts and technical guidance to be used in standardizing Federal agency accounting, which supports the preparation of standard external reports required by central agencies. Treasury also publishes “approved scenarios” comprising further guidance demonstrating approved methods of accounting for specific events. Treasury created an approved scenario for upward and downward adjustments to expired appropriations. Treasury also agreed to create approved scenarios for upward and downward adjustments for unexpired and cancelled appropriations.

Under Secretary of Defense (Comptroller)/Chief Financial Officer. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD[C]/CFO) develops, promulgates, and interprets DoD-wide accounting policies. It implements within the DoD all aspects of the Chief Financial Officers Act of 1990 to include audited financial statements. The USD(C)/CFO is responsible for creating DoD-wide accounting policy that implements OMB Circular A-11 and USSGL policies. The USD(C)/CFO accomplishes this by publishing the DoD Financial Management Regulation (FMR). The DoD FMR, volume 1, chapter 8, specifies that OMB policy/guidance and the USSGL are above the DoD FMR in the hierarchy of accounting standards. Specifically,

¹ The instructions on budget execution were previously provided in OMB Circular No. A-34, “Instructions on Budget Execution,” which was rescinded on June 27, 2002.

volume 3, chapter 15, sections 150203.B13 and 14 of the FMR provide the guidance on how to account for recoveries for unexpired and no year appropriations. The DoD FMR does not provide guidance on how to account for recoveries for expired appropriations.

Generally Accepted Accounting Principles. The accounting profession developed a set of standards that is generally accepted and universally practiced. The resulting common set of standards—called generally accepted accounting principles—requires that equal increases and decreases in the general ledger be recorded for each occurrence or event using a two-sided entry with debits equaling credits. Using the double-entry system, accountants verify that debits equal credits within the general ledger through the trial balance used to produce the financial statements.

Objective

Our overall audit objective was to evaluate the adequacy of processes and procedures used by DFAS to capture, record, and report recoveries of prior year obligations. We also reviewed the adequacy of the management control program as it related to the audit objective. See Appendix A for a discussion of the audit scope and methodology and the review of the management control program.

Reporting Recoveries at DFAS Cleveland

DFAS Cleveland used a process to determine the recovery amounts reported on the Navy General Fund monthly SF-133 that was not reliable. In FY 2002, DFAS Cleveland posted 9,983 manual journal voucher entries using invalid general ledger accounts to record the recovery amounts in STARS. DFAS Cleveland used the unreliable process and invalid general ledger accounts in its journal vouchers because the STARS accounting system was not programmed to record recoveries at the transaction level. Also, guidance in the DoD FMR on reporting of recoveries was not in agreement with OMB Circular A-11 and the USSGL. As a result, the amounts reported for recoveries on departmental reports were unreliable, and processes used to enter recoveries were not in compliance with generally accepted accounting principles. In addition, the effort DFAS Cleveland expended to manually post the recoveries data could have been put to better use if the accounting system was programmed to record recoveries at the transaction level.

DFAS Cleveland Process for Calculating and Posting Recoveries

DFAS Cleveland used a process to calculate the recovery amounts reported on the Navy General Fund monthly SF-133 that was not reliable. In FY 2002, DFAS Cleveland posted 9,983 manual journal voucher entries using invalid general ledger accounts to record the recovery amounts in STARS.

Process Used to Calculate Recovery Amounts. DFAS Cleveland queried the STARS accounting database every month for obligation accounts of the Navy appropriations. The queries summed the month-to-date obligation balances by appropriation, fiscal year of the appropriation, and subhead.² If the net amount of the subhead was negative, it was considered a recovery and posted to the STARS database using a journal voucher entry. This process was not reliable for determining recovery amounts because the negative numbers could have included transactions that are not recoveries, such as refunds or upward adjustments, which should be reported on separate lines on the SF-133. If the net amount of the subhead was positive, it was not posted. However, the positive numbers could have included recoveries.

Journal Voucher Entries Used to Post the Recovery Amounts. The negative amounts from the queries were entered into the STARS database using journal voucher entries to subsidiary accounts of USSGL Account 4310, “Anticipated Recoveries of Prior Year Obligations.” In each of the journal voucher entries, one side of the entry is made to an invalid account. The valid USSGL accounts

² A subhead is a four-position alphanumeric field in STARS used to identify the major claimant in the first two positions, the specific budget activity in the third position, and a locally used identifier assigned by the major claimant in the fourth position.

are reported on line 4 of the SF-133, and the invalid accounts are not reported on any financial report or statement. Table 1 shows an example of a journal voucher entry made to post a recovery in the accounting database with an amount posted to an invalid general ledger account.

Table 1. Recovery Journal Voucher Entry Posted to an Invalid General Ledger Account			
General Ledger			
Account	Account Title	Debit Amount	Credit Amount
4310.2110	Recoveries of Prior Year Obligations - Direct Program		\$29,514,320
4310.4100	Funds Generated from Deobligations of Prior Year Funds	\$29,514,320	

In table 1, debits and credits equal, but one side of the entry was posted to an invalid general ledger account, 4310.4100, “Funds Generated from Deobligations of Prior Year Funds.” The account is considered invalid because it does not post to any financial report or statement. Therefore, the use of the invalid account violates the two-sided entry rule of accounting.

The unreliable queries and the use of invalid general ledger accounts would not be necessary if the accounting database was programmed to record recoveries as they occur at the transaction level. The scenario approved by the Treasury for recording recoveries at the transaction level is illustrated in Appendix B.

STARS Programming

DFAS Cleveland used the unreliable process and invalid general ledger accounts in its journal vouchers because the STARS accounting system was not programmed to record recoveries at the transaction level. The STARS accounting system did not have all of the specific USSGL accounts needed to post recoveries. In addition, STARS was not appropriately programmed to use the accounts it did have. These system deficiencies prevented DFAS Cleveland from correctly capturing and reporting recoveries.

DoD Guidance

The guidance related to recoveries in the DoD FMR is incorrect. Specifically, DoD FMR, volume 3, chapter 15, “Receipt and Use of Budgetary Resources - Execution Level,” section 150203.B13 and 14, issued by the USD(C)/CFO, is not

in agreement with published guidance in the USSGL. The guidance in the DoD FMR to account for recoveries of prior year obligations directs that Undelivered Orders and Delivered Orders accounts be debited (reducing them) and that downward adjustment accounts be credited. This is not the correct way to account for recoveries because the downward adjustment accounts have a normal debit balance, meaning that if you credit a normal balance debit account, you are reducing the amount in that account. According to the USSGL, the downward adjustment accounts are meant to be increased when a recovery of prior year obligation occurs. The DFAS Cleveland STARS program office was not following the guidance published in the DoD FMR, OMB Circular A-11, or USSGL.

Financial Impact

The amounts reported for recoveries on departmental reports were unreliable and the journal voucher entries used to post the recovery amounts were not in compliance with generally accepted accounting principles. Therefore, the monthly departmental reports and financial statements were unreliable. The incorrect guidance in the DoD FMR had a potentially adverse effect DoD-wide. Revising the DoD FMR would allow all Defense organizations to update their accounting systems to correctly capture, record, and report recoveries. In addition, the effort DFAS Cleveland expended to manually post the recoveries data could have been put to better use if the accounting system was programmed to record recoveries at the transaction level.

Actions Taken By Management

On April 25, 2002, DFAS Cleveland Departmental and Command Reporting division submitted a request for a programming change to the STARS accounting database to automate queries now used to post recoveries to line 4 of the SF-133. The Departmental and Command Reporting division is requesting this action because it will alleviate approximately 10,000 journal voucher entries required annually to post recoveries. However, the queries used to determine the amount of recoveries are not reliable. The programming change will not correct the problem, but will only make the incorrect accounting automatic rather than manual.

Conclusion

Unreliable processes resulted in unreliable financial reporting. Inadequate general ledger control and the use of invalid general ledger accounts in manual journal voucher entries were perpetuated by deficiencies in STARS. As a result, the departmental reports and financial statements were unreliable. Further, the guidance in the DoD FMR is incorrect. It is not in agreement with the USSGL. Reprogramming the DFAS Cleveland accounting systems and revising the

guidance provided in the DoD FMR will alleviate the incorrect reporting of recoveries of prior year obligations by DFAS Cleveland and enable DFAS Cleveland to put to better use the personnel effort required by manual journal vouchers.

Recommendations and Management Comments

- 1. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer revise the Financial Management Regulation to be consistent with recovery reporting guidance issued by the Office of Management and Budget and the Department of the Treasury.**

Management Comments. The Under Secretary of Defense (Comptroller)/Chief Financial Officer concurred and agreed to revise the Financial Management Regulation.

- 2. We recommend that the Director, Defense Finance and Accounting Service Cleveland program its accounting systems to properly capture, record, and report recoveries of prior year obligations.**

Management Comments. The Deputy Director, DFAS Cleveland concurred and agreed to program the Standard Accounting and Reporting System database to capture, record, and report recoveries of prior year obligations.

Appendix A. Scope and Methodology

The overall audit objective was to evaluate the adequacy of processes and procedures used by DFAS to capture, record, and report recoveries of prior year obligations. Specifically, we performed the audit at DFAS Cleveland. In addition to DoD, we had numerous contacts, both telephonically and electronically, with OMB and Treasury.

We reviewed the processes and procedures of the STARS accounting system that resulted in journal voucher entries made to invalid general ledger accounts. We queried the accounting database and downloaded all journal voucher entries produced for the first three quarters of FY 2002. The data were sorted to separate journal vouchers using invalid general ledger accounts and further sorted to isolate the ones specifically associated with recoveries. There were 9,983 journal voucher entries produced in this category, which equates to approximately 31 percent of all journal voucher entries produced in STARS for the Navy General Fund during FY 2002. We also reviewed the execution codes used by STARS for these entries.

We investigated and clarified the hierarchy of policy guidance from OMB, Treasury, and DoD concerning recoveries of prior year obligations. DFAS is required to follow the financial/budget reporting guidance of the OMB and Treasury and the financial guidance of the DoD FMR.

We performed this audit from March 2002 through December 2002, in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We relied on computer-processed data from the DFAS Cleveland STARS accounting database to identify journal voucher entries containing invalid general ledger accounts. We did not establish the reliability of the data because our goal was to obtain an approximate number of journal vouchers containing invalid general ledger accounts. Not establishing the reliability of the database will not affect the results of our audit.

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

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 evaluated DFAS Cleveland management controls over the processes and procedures for handling recoveries of prior year obligations. Specifically, we reviewed DFAS Cleveland management controls over the STARS accounting system and the preparation of monthly budget execution reports. We also reviewed the adequacy of management's self-evaluation of those controls.

Adequacy of Management Controls. We identified material management control weaknesses for DFAS Cleveland, as defined by DoD Instruction 5010.40. DFAS Cleveland management controls for the STARS accounting database and budget execution reporting were not adequate to ensure that recoveries of prior year obligations were captured and reported correctly. STARS was not coded to use the proper accounts necessary to capture and record these events. Also, DFAS Cleveland used invalid general ledger accounts in its journal voucher entries to manually post an amount on line 4 of the SF-133. Recommendation 2, if implemented, will prevent inaccurate and unreliable reporting of recoveries of prior year obligations. A copy of the report will be provided to the senior official responsible for management controls at DFAS Cleveland.

Adequacy of Management's Self-Evaluation. Management at DFAS Cleveland did identify the STARS accounting database and the Departmental and Command Reporting Division as assessable units. However, in its evaluation, DFAS Cleveland STARS program office and Departmental and Command Reporting Division did not identify the specific material management control weaknesses identified by the audit.

Prior Coverage

The General Accounting Office, the Office of the Inspector General of the Department of Defense (IG DoD), and the Naval Audit Service have conducted multiple reviews related to financial 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/audit/reports>. Naval Audit Service reports can be accessed on the Internet at <http://www.hq.navy.mil/navalaudit>.

Appendix B. Approved Method of Posting Recoveries

Treasury provided an approved scenario for upward and downward adjustments to expired appropriations that was effective beginning in FY 2000. Included in the approved scenario was guidance on how to account for recoveries at the transaction level. Table B-1 illustrates the accounting entry suggested by the approved scenario to post a recovery in the expired phase of an appropriation.

As shown in Table B-1, USSGL account 4871, “Downward Adjustments of Prior Year Unpaid Undelivered Orders – Obligations, Recoveries,” is being increased to account for the recovery from a prior year obligation. Account 4650, “Allotments – Expired Authority,” is being increased, thereby placing the deobligated funds into the expired allotment category. Table B-2 illustrates the accounting entry suggested by the approved scenario to close USSGL account 4871 at the end of the year.

Table B-1. Treasury Approved Scenario of Transaction-Level Entry for a Recovery of an Expired Appropriation			
General Ledger Account	Account Title	Debit Amount	Credit Amount
4871.0000	Downward Adjustments of Prior Year Unpaid Undelivered Orders - Obligations, Recoveries	\$100,000	
4650.0000	Allotments – Expired Authority		\$100,000

As shown in Table B-2, USSGL account 4871 is decreased and closed out to USSGL account 4801, “Undelivered Orders – Obligations, Unpaid,” thereby reducing the outstanding obligated amount.

Table B-2. USSGL Closing Entry for a Downward Adjustment (Recovery) for an Expired Appropriation			
General Ledger Account	Account Title	Debit Amount	Credit Amount
4801.0000	Undelivered Orders – Obligations, Unpaid	\$100,000	
4871.0000	Downward Adjustments of Prior Year Unpaid Undelivered Orders - Obligations, Recoveries		\$100,000

Appendix C. Report Distribution

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Under Secretary of Defense (Comptroller)/Chief Financial Officer Comments



COMPTROLLER

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

JAN 22 2003

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Draft Audit Report on Audit of Recoveries of Prior Year Obligations (Project No.
D200FC-0098)

This is in response to your memorandum of December 18, 2002, forwarding subject proposed draft audit report to this office for review and comment. The draft report recommends that the Under Secretary of Defense (Comptroller) revise the Department of Defense Financial Management Regulation ("DoDFMR") to be consistent with recovery guidance issued by the Office of Management and Budget and the Department of the Treasury.

I concur with the recommendation. Volume 3, Chapter 15 of the "DoDFMR" will be updated to alleviate the incorrect reporting of recoveries of prior year obligations. The estimated completion date for the revision is May 30, 2003.

My point of contact for this matter is Mr. Oscar G. Covell. He may be reached by e-mail: covello@osd.pentagon.mil or by telephone at (703) 697-6149.


Dov S. Zakheim

Defense Finance and Accounting Service Comments



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DFAS-AJI/CL


JAN 22 2003

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE (ATTN: MR. KIDD)

SUBJECT: OIG Draft Report, Project No. D2002FC-0098, "Audit of Recoveries of Prior Year
Obligations," December 18, 2002

The Defense Finance and Accounting Service is providing the attached response to
Recommendation 2 of the subject draft audit report (Attachment 1).

The point of contact is Mr. Stanley Koch, 216-204-7066 or DSN 580-5628.


Kenneth R. Sweitzer
Deputy Director

Attachment:
As stated

cc:
DFAS-DDI/AR
DFAS-DAS/AR

DFAS Comments to OIG Draft Report, Project No. D2002FC-0098, "Audit of Recoveries of Prior Year Obligations," dated December 18, 2002

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service Cleveland program its accounting systems to properly capture, record, and report recoveries of prior year obligations.

Management Comments. Concur. In October 2002, as part of an ongoing effort to improve our process, we began using the proper United States Standard General Ledger (USSGL) accounts to journal voucher recoveries. The accounts being used include the 4871 series (Downward Adjustment of Prior Year Unpaid Undelivered Orders, Recoveries) and the 4650 series (Allotments – Expired Authority). This change is applicable for all appropriations, Major Command Reporting (MCR) and Financial Departmental Reporting (FDR). The accounting entries are as follows:

<u>Direct Recovery</u>	<u>Auto Recovery</u>	<u>OTA Recovery</u>
Debit 4871.0310	Debit 4871.0320	Debit 4871.0330
Credit 4650.0310	Credit 4650.0320	Credit 4650.0330

These entries are consistent with postings recommended by the DoD IG and with guidance provided in the Treasury Financial Manual, Section III, USSGL Transaction D120.

A Systems Change Request (SCR) detailing program changes is being developed to allow the accounting system to properly capture, record, and report recoveries of prior year obligations. Once the SCR is completed, it will be sent to the Joint Requirements Board (JRB) for acceptance and funding. If accepted, the proposed changes to be programmed in the Standard Accounting and Reporting System (STARS) will be substantial.

Estimated Completion Date. Until the JRB and the Investment Board approve the project, a completion date will not be scheduled.

Team Members

The Defense Financial Auditing Service Directorate, Office of the Assistant Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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