

September 15, 2003



Financial Management

Controls Over DoD
Closed Appropriations
(D-2003-133)

Office of the Inspector General
of the
Department of Defense

Constitution of
the United States

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Article I, Section 9

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Acronyms

ADA	Antideficiency Act
DFAS	Defense Finance and Accounting Service
FMR	Financial Management Regulation
GAO	General Accounting Office
TI	Treasury Index



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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September 15, 2003

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

SUBJECT: Report on Controls Over DoD Closed Appropriations
(Report No. D-2003-133)

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 comments and the Director, Defense Finance and Accounting Service comments conformed with 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. Marvin L. Peek at (703) 604-9587 (DSN 664-9587) or Mr. Jack L. Armstrong at (317) 510-3846 (DSN 699-3846). For the report distribution, see Appendix C. The audit team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, reading "Paul J. Granetto", is positioned above the typed name. The signature is written in a cursive style and extends to the right with a long horizontal stroke.

Paul J. Granetto
Director
Defense Financial Auditing
Service

Office of the Inspector General of the Department of Defense

Report No. D-2003-133

September 15, 2003

(Project No. D2002FI-0082)

Controls Over DoD Closed Appropriations

Executive Summary

Who Should Read This Report and Why? This report should be read by DoD civilians and uniformed officers responsible for issuing policy on adjustments to closed appropriations, Defense Finance and Accounting Service (DFAS) personnel who account for and control closed appropriation adjustments, and other DoD personnel responsible for fund control. The report discusses the need for increased oversight of and stronger controls over the use of closed appropriations.

Background. In 1990, Congress changed the law governing the use of appropriation accounts by substantially restructuring the period of availability of appropriations. The new law specified that 5 years after the expiration of an appropriation available for a definite number of years, the appropriation would be closed and all remaining balances canceled. After an appropriation closes, agencies cannot use the funds for obligations or expenditures for any purpose. After an appropriation closes, obligations and adjustments to obligations that would have been properly chargeable to the appropriation before closing may be charged to currently available appropriations subject to limitations specified in title 31 U.S.C. section 1553 (b). In 1993, the Comptroller General of the United States ruled that under certain limited circumstances, the Department of the Treasury could restore canceled balances. Agencies could use the restored balances to correct reporting errors or clerical mistakes. However, the Comptroller General of the United States clearly stated that he did not intend for closed appropriation adjustments to correct an agency's accounting system deficiencies.

Even though balances in closed appropriations are canceled, records of the balances must be maintained to prevent Antideficiency Act violations due to permitted adjustments and expenditures charged to current appropriations. At the end of FY 2000, Treasury ceased reopening closed appropriations for accounting adjustments and stopped maintaining records of the canceled balances. DoD assumed responsibility for maintaining records of the canceled balances for closed appropriations. DFAS processes adjustments to closed appropriations and maintains the closed appropriation balances for DoD. During FY 2001 and the first half of FY 2002, DFAS reported \$3.1 billion (absolute value) of adjustments to closed appropriations to the U.S. Treasury.

Results. DoD did not have fundamental controls over the use of closed appropriations. Specifically, DFAS did not maintain accurate records of closed appropriation balances and did not effectively control closed appropriation adjustments. As a result, Congressional and DoD oversight over closed appropriations was impaired, and unspent funds in closed appropriations were vulnerable to abuse. In addition, DFAS approved closed appropriation adjustments based on inaccurate balances that could have resulted in over obligations and Antideficiency Act violations, and made improper* adjustments to

* Contrary to law, regulation, or Comptroller General guidance.

closed appropriations. The Under Secretary of Defense (Comptroller)/Chief Financial Officer should emphasize the importance of controls over the use of closed appropriations and monitor compliance with applicable laws and regulations. DFAS should establish specific standard procedures to ensure that accounting personnel approve only legal and proper adjustments to closed appropriations, and ensure that accounting personnel understand this new guidance. DFAS should validate the canceled balances and report any potential Antideficiency Act violations in accordance with section 1351, Title 31, United States Code. (See the Finding section of the report for detailed recommendations.)

Management Comments and Audit Response. The Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Director, DFAS concurred with the finding and recommendations; 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.

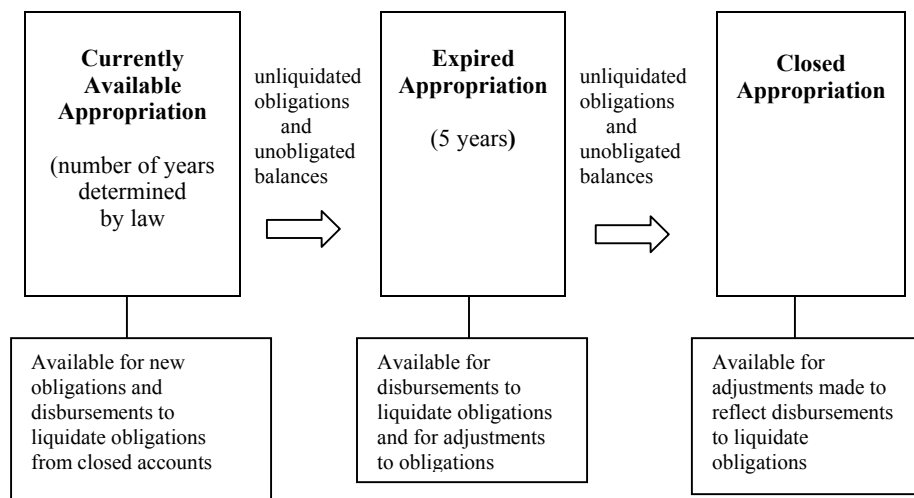
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Background

Use of Closed Appropriations. In 1990, Congress changed the law governing the use of appropriation accounts.¹ Public Law 101-510, “National Defense Authorization Act for Fiscal Year 1991,” November 1990, amended title 31, United States Code, sections 1551-1557 (31 U.S.C. 1551-1157), and substantially restructured the period of availability of appropriations. The act specifies that 5 years after the expiration of a fixed term appropriation, the appropriation is closed and all remaining balances canceled. After an appropriation is closed, agencies cannot use the appropriation account for obligations or expenditures for any purpose. Any collections authorized or required to be credited to an appropriation account, but not received before closing of the appropriation must be deposited with the U.S. Treasury as miscellaneous receipts. The following Figure describes the phases of an appropriation as provided in Public Law 101-510.

Provisions of Public Law 101-510



After an appropriation closes, obligations and adjustments to obligations that would have been properly chargeable to the appropriation before closing may be charged to currently available appropriations subject to limitations specified by 31 U.S.C. section 1553(b). The total amount of charges to a particular currently available appropriation may not exceed the least of:

- the unexpended balance of the closed appropriation;
- the unexpired unobligated balance of the currently available appropriation; or

¹ Appropriation accounts are sometimes called “appropriations” and sometimes they are called “accounts”. For consistency and understandability, we will use “appropriation” throughout this report.

-
- one percent of the total original amount appropriated to the current appropriation being charged.

Antideficiency Act. 31 U.S.C. 1341 (a) stipulates that an officer or employee of the Federal Government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation for that expenditure or obligation. The provisions of 31 U.S.C. 1554 extend this to include closed appropriations. 31 U.S.C. section 1351 states that if a Federal officer or employee does violate 31 U.S.C. section 1341(a), the head of the agency must report immediately to the President and Congress all relevant facts and a statement of action taken.

Comptroller General Decisions. In 1993, the Comptroller General of the United States (Comptroller General) stated that the Department of the Treasury (Treasury), if presented with convincing evidence that a reporting error has occurred because of an obvious clerical mistake, might restore such balances to correct the mistake, subject to reasonable time limitations. The Comptroller General also stated that Treasury may record a disbursement from a closed appropriation as a payment, provided that the disbursement was made before the appropriation was closed. However, the Comptroller General clearly stated that he did not intend for closed appropriation adjustments to correct an agency's accounting system deficiencies. In 1994, the Comptroller General stated that an agency "may not avoid adjusting an appropriation account and reporting any resulting Antideficiency Act (ADA) violation because (1) the appropriation has expired, (2) adjusting the appropriation will result in over obligations, or (3) the over obligations were unintentional." (See Appendix B for further detail on closed appropriation guidance.)

DoD Financial Management Regulation. Volumes 3 and 6A of DoD Regulation 7000.14-R, "DoD Financial Management Regulation," (FMR) address policies and procedures for recording and accounting for closed appropriations. Appendix B provides specific requirements from the FMR.

Memorandum of Agreement. On August 3, 2000, the Commissioner of the Financial Management Service of the Department of the Treasury, the DoD Deputy Chief Financial Officer, and the Deputy Commissioner of the Office of Management and Budget reached an agreement concerning controls over adjustments to closed appropriations. As part of the agreement, Treasury was to close all reopened DoD appropriations² before the end of FY 2000 and establish a new appropriation to process all corrections to closed DoD appropriations when the correction is between a closed and an open appropriation. With the establishment of this new appropriation, Treasury was no longer responsible for tracking individual closed appropriation balances. DoD agreed to internally maintain proper closed appropriation(s) records to prevent ADA violations. Thus the responsibility for maintaining individual closed appropriation balances transferred to DoD. DoD was to provide Treasury with a monthly report of detailed transactions identifying both the open appropriation and the closed

² Appropriations that were closed by operation of law under Title 31, USC, sections 1552, 1553, or 1557 and had been reopened to allow Treasury to process corrections between them and current appropriations.

appropriation to be charged or credited, and to maintain proper supporting documentation. DoD agreed to document processing of adjustments to provide an audit trail for the recording and reporting of corrections involving closed appropriations.

Defense Finance and Accounting Service Responsibilities. The Defense Finance and Accounting Service (DFAS) provides finance and accounting support for DoD. Support includes processing adjustments to closed appropriations and maintaining records of the unobligated and unliquidated balances of closed appropriations. Three DFAS central accounting sites (DFAS Cleveland, DFAS Denver, and DFAS Indianapolis) maintain the closed appropriation balances. DFAS Indianapolis also reconciles to Treasury records all the adjustments that central accounting sites make to closed appropriations. During FY 2001 and the first half of FY 2002, DFAS reported adjustments to closed appropriations with an absolute value of \$3.1 billion to Treasury. Table 1 shows the closed appropriation adjustments by Treasury Index (TI). The Treasury Index is a double-digit number that denotes a specific Department of the Federal Government. Treasury uses the numbers to distribute funds and track appropriations.

Table 1. Closed Appropriation Adjustments Reported to Treasury for the Period October 1, 2000, through March 31, 2002
(in millions)

Treasury Index	Department/Agency	DFAS Central Accounting Site Maintaining Closed Appropriation Balances	Net Value	Absolute Value
17	Department of the Navy	DFAS Cleveland	\$261.0	\$1,849.2
21	Department of the Army	DFAS Indianapolis	7.5	219.4
57	Department of the Air Force	DFAS Denver	(49.7)	818.1
97	Office of the Secretary of Defense	DFAS Indianapolis	98.3	261.5
Total			\$317.1	\$3,148.2

Objective

Our objective was to determine whether DFAS adequately accounted for and had effective control over closed appropriations. We also reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the scope and methodology, our review of the management control program, and prior coverage related to the objective.

Controls Over Closed Appropriations

DoD did not have fundamental control over closed appropriations. Specifically, DFAS central accounting sites did not maintain accurate records of closed appropriation balances and did not effectively control adjustments to closed appropriations. These deficiencies occurred because:

- DFAS had not established standard operating procedures that ensured compliance with the Comptroller General decisions or with the provisions of the August 3, 2000, Memorandum of Agreement for adjustments made to closed appropriation balances;
- DFAS central accounting sites used inefficient methods to maintain closed appropriation balances; and
- DFAS had not established effective oversight or supervision of closed appropriation adjustments.

As a result, Congressional and DoD oversight over closed appropriations was impaired and unspent funds in closed appropriations were vulnerable to abuse. In addition, DFAS approved closed appropriation adjustments based on inaccurate balances that could have resulted in over obligations and Antideficiency Act violations, and made improper adjustments to closed appropriations.³

Closed Appropriation Balances

DFAS central accounting sites did not maintain accurate records of closed appropriation balances, which left the closed appropriations vulnerable to ADA violations. This also violated the memorandum of agreement with Treasury and OMB. Specifically, DFAS personnel did not always:

- adjust the balance downward in a closed appropriation to reflect disbursements made (from currently available appropriations) to satisfy the closed appropriation's obligations;
- adjust the balance upward in a closed appropriation to reflect collections or reimbursements to the appropriation; and
- verify that adjustments they reported to Treasury were properly reflected in the closed appropriation balances they maintained.

DFAS central accounting sites either lacked standard operating procedures for maintaining closed appropriation balances or did not enforce the standard operating procedures that had been established. Established operating procedures

³ Contrary to law, regulation, or Comptroller General guidance.

are key to ensuring compliance with the Comptroller General decisions and the provisions of the August 3, 2000, Memorandum of Agreement. In the absence of effective standard operating procedures, not all of the adjustments DFAS made were included in the closed appropriation balances. DFAS must properly maintain the balances for the closed appropriations although new obligations cannot be made.

Adjustments Liquidating Obligations in Closed Appropriations. DFAS Denver and DFAS Indianapolis did not record \$34.6 million or more in reductions to closed appropriation balances to reflect disbursements made (from currently available appropriations) to liquidate closed appropriations' obligations. The FMR volume 3, chapter 10, states that the unexpended balance of a closed appropriation includes:

- the sum of the appropriation funds never obligated,
- the funds obligated but not disbursed before the appropriation closed, and
- obligations and adjustments to obligations that would have been properly chargeable to the appropriation before closing but were instead charged to current appropriations available for the same purpose.

DFAS Denver and DFAS Indianapolis should have recorded the disbursements to reduce the unexpended balances in the closed appropriations. Neither DFAS Denver nor DFAS Indianapolis personnel recorded the disbursements. Table 2 categorizes the total of disbursements made from currently available appropriations to liquidate closed appropriation obligations.

Treasury <u>Index</u>	DFAS Central Accounting Site Maintaining Closed <u>Appropriation Balances</u>	<u>Recorded</u>	<u>Unrecorded</u>
17	DFAS Cleveland	\$348.6	
21	DFAS Indianapolis		\$16.3
57	DFAS Denver		18.3
97	DFAS Indianapolis		0.0*
Total		<u>\$348.6</u>	<u>\$34.6</u>

* the amount provided by DFAS Indianapolis for TI 97 was \$8,655.75.

DFAS Denver and DFAS Indianapolis did not reflect disbursements from currently available appropriations in the closed appropriation balances for TI 21, TI 57, and TI 97. In December 2000, when DFAS Cleveland began factoring the disbursements into the TI 17 closed appropriation balances, the recalculations

revealed two potential ADA violations.⁴ DFAS Denver and DFAS Indianapolis failure to timely reflect the adjustments for disbursements from currently available appropriations in the closed appropriation balances caused overstatement of the balances of undispersed funds by at least \$34.6 million, which may have led to ADA violations.

Disbursements (from currently available appropriations) made by DFAS Denver network personnel to liquidate closed appropriation obligations may be \$279.6 million greater than the amount shown in Table 2. DFAS Denver used two special codes to monitor disbursements from current appropriations to liquidate closed appropriation obligations. One code designated liquidation of closed appropriation obligations. The other code designated disbursements from the current appropriations. DFAS Denver personnel stated that the amounts associated with each special code should be equivalent. However, we identified a \$279.6 million difference when comparing the amounts associated with each special code. DFAS Denver personnel researched the discrepancy and reported that they did not have any confidence in the reliability of the payment data reported by DFAS field accounting sites in their network that include the two special codes.

Adjustments Increasing the Balances of Closed Appropriations. DFAS Indianapolis did not consistently record adjustments that increased closed appropriation balances. The FMR volume 3, chapter 11, requires that the unliquidated balance of the closed appropriation be increased when a collection involves an amount that would have been deposited in a closed appropriation had that appropriation not closed. DFAS Indianapolis personnel stated that they did not report all adjustments to closed appropriations that increased the unliquidated balances for TI 21 and TI 97. One group at DFAS Indianapolis processed the closed appropriation adjustments and another group at DFAS Indianapolis maintained the closed appropriation balances. The group processing the closed appropriation adjustments stated that they were not aware that they needed to inform the group maintaining the closed appropriation balances that they had processed adjustments increasing the unliquidated balance. For example, the group processing the January 2001 monthly activity report for closed appropriation adjustments included an adjustment increasing closed appropriation 21-90-2035 for \$1.8 million, but this adjustment was not included in the closed appropriation balances. We were unable to determine the magnitude of these adjustments because of inadequate records. As a result, DFAS Indianapolis understated some of the closed appropriation balances.

Adjustments Reported to Treasury. DFAS did not verify that all the adjustments reported to Treasury were properly reflected in the closed appropriation balances it maintained. The closed appropriation balances DFAS maintained did not include \$119.7 million (absolute value) in closed

⁴ DFAS Cleveland personnel stated that they informed Navy fund managers of the ADA violations so that the managers could research them.

appropriation adjustments reported to the Treasury. Recalculated⁵ appropriation balances for TI 21 and TI 57 did not match the maintained closed appropriation balances. TI 21 closed appropriation ending balances were different in 92 (73 percent) of 126 closed appropriation balances, which resulted in \$16.5 million in overstatements. The TI 57 closed appropriation balances were different in 44 (31 percent) of 142 closed appropriation balances, which resulted in \$103.2 million in understatements. As a result, DFAS compromised the integrity of closed appropriation balances and may have caused ADA violations.

For example, the DFAS Indianapolis group maintaining the closed appropriation balances denied an adjustment to closed appropriation 21-93-2031 for \$26.7 million, and documented in the control log that the closed appropriation contained insufficient funds. Although the DFAS Indianapolis group denied the adjustment and did not reflect the \$26.7 million adjustment in the TI 21 closed appropriation balances, the adjustment was processed and reported to Treasury. Because this closed appropriation did not have sufficient funds to accommodate the \$26.7 million adjustment, a possible ADA violation has occurred. Following procedures in DFAS Indianapolis's guidance would not have ensured discovery of this possible ADA violation. When an adjustment calls for more funds than remain in a closed appropriation, DFAS should determine whether the adjustment is valid and whether it is a reportable violation of the ADA. DFAS should review all of the closed appropriation records and then recalculate the closed appropriation balances to ensure accuracy of DFAS records and identify potential ADA violations.

Closed Appropriation Adjustments

DFAS did not effectively control adjustments made to closed appropriations. In the August 3, 2000, Memorandum of Agreement, DoD agreed to maintain proper supporting documentation, maintain appropriate internal closed appropriation(s) records for ADA violation purposes, and provide an audit trail for the recording and reporting of corrections involving closed appropriations. Specifically, DFAS did not:

- maintain an accurate audit trail to determine the total number of adjustments made to closed appropriations;
- ensure that closed appropriation adjustments were necessary, valid, and accurate;
- comply with the FMR 6-month time limit established for closed appropriation adjustments; and

⁵ We recalculated the March 31, 2002, closed appropriation balances using the beginning balances supplied by DFAS Denver and DFAS Indianapolis and subtracting all adjustments reported by the three central accounting sites during the audit period. DFAS Cleveland is the only central accounting site that did not report adjustments between two closed appropriations to Treasury. During the audit period, each of the TI 21 and TI 57 closed appropriation adjustments processed by DFAS Cleveland were between an open appropriation and a closed appropriation.

- adhere to the Comptroller General decisions stating that closed appropriation adjustments were not to correct system deficiencies.

DFAS did not effectively control closed appropriation adjustments because DFAS provided neither adequate guidance nor effective oversight or supervision to monitor the adjustments.

Total Closed Appropriation Adjustments. We did not determine the total number or absolute value of adjustments DFAS field accounting sites made to closed appropriations and submitted to the central accounting sites. DFAS field accounting sites obtained approval from the DFAS central accounting sites for the closed appropriation adjustments based on the summary transactions that aggregated the adjustments for each appropriation. For example, DFAS Indianapolis approved a closed appropriation adjustment requested by DFAS St. Louis for \$2.6 million. However, the \$2.6 million was the net value of 17 SF-1081s, Vouchers and Schedules of Withdrawals and Credits, adjusting closed appropriation 21-92-2040 for an absolute value of \$7.3 million. The DFAS central accounting site personnel approving the closed appropriation adjustments do not see all the debits and credits affecting each closed appropriation; they only see the net effect on the closed appropriation.

Closed Appropriation Adjustment Review. DFAS did not ensure that closed appropriation adjustments were necessary, valid, and accurate. In the Memorandum of Agreement, DoD agreed to maintain proper supporting documentation. However, out of 37 closed appropriation adjustments we reviewed at three DFAS field accounting sites, only 3, totaling \$12.5 million, were supported. Table 3 categorizes the adjustments reviewed by number and dollar value.

<u>Category</u>	<u>Number of Adjustments Reviewed</u>	<u>Value of Adjustments Reviewed (in millions)</u>	<u>Percentage of Total Amount of Adjustments Reviewed*</u>
Improper	3	\$ 5.9	5
Unsupported	31	91.0	83
Supported	3	12.5	12
Total	37	\$109.4	100

* The percentage of the closed account adjustments related to the 37 adjustments reviewed cannot be projected to the population of adjustments from which the sample was selected. Our review did not include DFAS Columbus closed account adjustments because GAO reviewed those adjustments in their audit.

Improper Adjustments. Two of the three improper adjustments transferred prior year credits for “materials returned to store” to a more current

appropriation. Under 31 U.S.C 1552(b), if a repayment relates to an expired appropriation, then it must be deposited in the Treasury as miscellaneous receipts. Crediting the repayment to current funds is an augmentation of the current appropriation unless authorized by statute. Such an adjustment would make more funds available for obligation than were appropriated, which is contrary to appropriations law. The third improper adjustment incorrectly moved a collection received for a closed appropriation out of miscellaneous receipts and into the closed appropriation. The FMR volume 3, chapter 15, "Receipt and Use of Budgetary Resources," December 1996, states that collections authorized, or required to be credited to an appropriation account but not received before closing of the appropriation, shall be deposited in the miscellaneous receipt account, "Collections of Receivables from Canceled Accounts." DFAS needed to record the collection in the closed appropriation balance, but the collection also had to be recorded in miscellaneous receipts. The DFAS guidance was inadequate to prevent improper closed appropriation adjustments.

Unsupported Adjustments. Of the 37 adjustments reviewed, 31 were unsupported. Volume 3, chapter 10 of the FMR states that the documentation must provide an adequate audit trail to the adjusted or corrected transaction.

- DFAS Dayton, and DFAS St. Louis made six unsupported adjustments because their system records did not match other DoD system records. For example, DFAS Columbus made closed appropriation adjustments that also needed to be made at DFAS St. Louis. DFAS Columbus made internal adjustments to the Mechanization of Contract Administration Services system, which did not automatically update the system records at DFAS St. Louis. DFAS Columbus then sent a copy of the adjustment to DFAS St. Louis for input into the Standard Operation and Maintenance Army Research and Development System (Accounting).
- DFAS made 22 unsupported closed appropriation adjustments to correct previous closed appropriation adjustments. For example, DFAS Dayton adjusted an original transaction, but failed to correct the original error. DFAS Dayton prepared a second adjustment to correct the first adjustment. However, the second adjustment incorrectly doubled the error created by the first adjustment, resulting in the need for a third adjustment. Because DFAS Dayton processed the first adjustment without adequate review, two additional closed appropriation adjustments resulted. Each time DFAS had to make more than one closed appropriation adjustment to correct an original transaction, the ability to trace back to the original transaction became increasingly difficult or impossible.
- The remaining three unsupported vouchers had inadequate documentation. For two of the three, the Voucher and Schedule of Withdrawals and Credits (Standard Forms 1081) did not match the attached documentation. The third adjustment did not contain sufficient supporting documentation to complete the audit trail.

Time Limitations for Closed Appropriation Adjustments. DFAS did not comply with the FMR 6-month time limit established for closed appropriation adjustments. The 1993 Comptroller General decision stated that adjustments for closed appropriations should manifest themselves soon after the appropriations closed and that the passage of time only magnifies the difficulty inherent in reconstructing the facts needed to establish the error. The Comptroller General decision recommended establishing a reasonable time limit for requests for corrections to closed appropriations. The FMR volume 3, chapter 10 established a time limit of 6 months on requests for the correction of errors after the appropriation in question closed. However, DFAS did not follow this guidance. For example, DFAS Denver adjusted appropriations that had closed 7 years earlier. During FYs 2001 and 2002, DFAS Denver adjusted FY 1989 appropriations that closed in FY 1995. DFAS also made adjustments totaling \$155.8 million to appropriations closed on or before September 30, 1993. Because many of the closed appropriation adjustments did not manifest themselves within a reasonable time limit, DFAS was unable to reconstruct many of the facts to determine the propriety of the adjustments.

Correcting System Deficiencies. DFAS adjusted closed appropriations to correct accounting system deficiencies. The 1993 and 1995 Comptroller General decisions specifically state that closed appropriation adjustments are not meant to serve as a palliative for deficiencies in an agency's accounting systems. However, DFAS used closed appropriation adjustments to correct the effects of an accounting system deficiency referred to as the decade problem. For example, appropriations for fiscal years 1989 and 1999 would both be identified as appropriations for fiscal year 9. Transactions applicable to the older closed appropriation would be interpreted as applicable to the more recent current or expired appropriation and allowed to proceed. When this happened, a closed appropriation adjustment was prepared to move the funds from the current or expired appropriations to the closed appropriations. For example, DFAS Charleston processed an SF 1081, Voucher and Schedule of Withdrawals and Credits, closed appropriation adjustment totaling \$4.2 million to correct this type of error. DFAS should not have used closed appropriation adjustments to compensate for DoD accounting system deficiencies.

GAO Review of Closed Appropriation Adjustments. As a result of its review of the FY 2000 closed appropriation adjustments at DFAS Columbus, GAO concluded that DoD did not have adequate systems, controls, and management attention to ensure that adjustments affecting closed appropriations were legal and otherwise proper. GAO reviewed \$2.2 billion of the \$2.7 billion closed appropriation adjustments processed at DFAS Columbus in FY 2000 and found that \$615 million of the adjustments (28 percent) were illegal (\$146 million) or otherwise improper (\$469 million). DFAS Columbus estimated more than 21,000 staff hours (over 10 staff years) would be needed to correct the accounting for all of the affected FY 2000 transactions. In July 2002, GAO reported that DoD actions to resolve its problems with closed appropriation adjustments were beginning to produce positive short-term results at DFAS Columbus, possibly reducing its closed appropriation adjustments by up to 80 percent.

Controls Over Closed Appropriation Processes

Controls over closed appropriation processes were ineffective, specifically:

- DFAS had not established standard procedures that ensured compliance with the Comptroller General decisions for adjustments made to closed appropriation balances or with the provisions of the August 3, 2000, Memorandum of Agreement;
- DFAS central accounting sites used inefficient methods to maintain closed appropriation balances; and
- DFAS had not established effective oversight or supervision of closed appropriation adjustments.

DFAS processes led to inaccurate closed appropriation balances being used in decision-making, improper closed appropriation adjustments, and the loss of oversight over closed appropriations.

DFAS Operating Procedures. DFAS central accounting sites maintained inaccurate records of closed appropriation balances because DFAS had not established standard procedures and guidance. DFAS did not ensure compliance with the Comptroller General decisions related to adjustments to closed appropriations, the FMR, or the provisions of the August 3, 2000, Memorandum of Agreement. Each DFAS central accounting site maintaining closed appropriation balances issued its own guidance on closed appropriations.

Each DFAS central accounting site also established its own guidance for approving closed appropriation adjustments. All three DFAS central accounting sites' guidance allowed approval of an adjustment only if the closed appropriation had sufficient funding. For example, DFAS Indianapolis guidance states that if a requested closed appropriation adjustment meets certain criteria and the appropriation has sufficient funding, DFAS Indianapolis personnel will assign a control number; if not, they deny the adjustment. This is contrary to the Comptroller General decision. The 1994 Comptroller General decision states that an agency may not avoid adjusting an appropriation account and reporting any resulting ADA violation on the basis that (1) the account has expired, (2) adjusting the account will result in an over obligation, or (3) the over obligations were unintentional.

In addition, DFAS field accounting sites would prepare and enter adjustments to closed appropriations. DFAS central accounting sites only reviewed the adjustments for sufficient funds. If funds were available the central accounting sites would approve the adjustment; however, there was no evidence that that the adjustment was reviewed to determine if it was valid and supported. The DFAS central accounting sites did not retain the detailed supporting documentation. DFAS should establish standard procedures that:

- provide guidance on the maintenance of closed appropriation balances,

-
- provide guidance for preparing and supporting adjustments to closed accounts,
 - restrict the preparation of adjustments to the central accounting sites,
 - require that all closed appropriation adjustments be made no more than six months after the appropriation is closed, and
 - eliminate the practice of making adjustments to correct system deficiencies.

DFAS Accounting Methods. The methods used by DFAS central accounting sites to maintain the closed appropriation balances needed improvement. DFAS Cleveland and DFAS Indianapolis maintained the closed appropriation balances in Excel spreadsheets that rendered the closed appropriation balances vulnerable to human error. For example, DFAS Indianapolis maintained 119 closed appropriation balances for TI 21, but there were 126 TI 21 closed appropriations with adjustments reported to Treasury. As the FMR volume 3, chapter 11 requirement to maintain closed appropriation balances in perpetuity will remain in effect, better methods are needed. In addition, the number of closed appropriation balances to be maintained will continue to increase each year. As the number of maintained closed appropriation balances grows, it will become even more difficult to maintain these balances in Excel spreadsheets and the problems noted with the balances will become worse. DFAS should develop and implement a standardized process and system for the maintenance of accurate records of closed appropriation balances.

DFAS Oversight and Supervision. DFAS had not established effective oversight or supervision of closed appropriation adjustments. DFAS personnel prepared, and DFAS supervisors approved, adjustments that were improper, were inadequately supported, were not made within a reasonable time, and were used to correct accounting system deficiencies. In addition, DFAS approved closed appropriation adjustments based on inaccurate balances that could have resulted in over obligations and Antideficiency Act violations, and made improper adjustments to closed appropriations. GAO found similar deficiencies during its FY 2000 review at DFAS Columbus. DFAS should establish specific standard procedures that ensure that only senior managers at the central accounting sites approve only legal, proper adjustments to closed appropriations. In addition, DFAS should establish a process to monitor compliance with the standard procedures. During our visit to DFAS Dayton Field Accounting site, personnel stated that they had not received any guidance on closed account adjustments from DFAS Denver. Once DFAS has developed new standard procedures and a new process and system, DFAS personnel who will be responsible for the accounting for, and management of, closed appropriations accounts and adjustments should receive training.

Oversight and Use of Closed Appropriations

Because of inadequate controls over closed appropriation processes, Congressional oversight over closed appropriations was impaired and unspent funds in closed appropriations were vulnerable to abuse.

Congressional Oversight. GAO stated, in its July 2002 report on Canceled DoD Appropriations,

In 1990, Congress changed the law governing the use of appropriation accounts because it determined that controls over them were not working. In particular, the Congress found that DoD may have spent hundreds of millions of dollars for purposes the Congress had not approved. The 1990 law was intended to improve congressional control by providing that, 5 years after the expiration of the period of availability of a fixed-term appropriation, the appropriation account should be closed and all remaining balances canceled.

The practice of making accounting adjustments to closed appropriations constitutes a grave risk to the intent of Congress unless subject to exemplary control.

Use of Unspent Funds. By eliminating independent Treasury supervision of the closed appropriation balances and placing control of the closed appropriation balances in the hands of the original fund users, the August 3, 2000, Memorandum of Agreement only exacerbated this risk. Because of this lack of independence, the current environment may allow fund holders to manipulate funds. For example, fund holders might transfer a disbursement to a closed appropriation that was chargeable to an open appropriation without justification, thus increasing available funds in the open appropriation. Table 1 shows \$317.2 million in net adjustments that decreased the closed appropriation balances and increased the use of available funds by using unspent funds in the closed appropriations. We were unable to determine if these adjustments were legal, proper, and supported because of the control deficiencies identified during the audit.

GAO concluded in its July 2002 report on Canceled DoD Appropriations:

. . . the lack of fundamental controls and management oversight had fostered the idea among DoD contracting and accounting personnel that it was acceptable to maximize the use of available funds by adjusting the accounting records to use up unspent funds in the closed accounts, regardless of the propriety of doing so.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer should emphasize the importance of controls over the use of closed appropriations and monitor compliance with applicable laws and regulations. Also, the Under Secretary of Defense (Comptroller)/Chief Financial Officer needs to establish and use management performance metrics to monitor compliance with the laws and regulations applicable to closed appropriations balances and adjustments.

Conclusion

DoD did not have fundamental control over closed appropriations. DFAS had not established standard operating procedures that ensured compliance with the Comptroller General decisions or with the provisions of the August 3, 2000, Memorandum of Agreement for adjustments made to closed appropriation balances. In addition, DFAS central accounting sites used inefficient methods to maintain closed appropriation balances. Because of this, DFAS central accounting sites did not maintain accurate records of closed appropriation balances, leaving the closed appropriations vulnerable to ADA violations. DFAS central accounting sites should perform a one-time revalidation of closed appropriations balances and report any potential ADA violations. DFAS will continue to carry inaccurate closed appropriation balances on its records until those balances are corrected. The revalidation should include a one-time review of closed appropriation adjustments to determine if they are valid and supported, verify that all valid and supported adjustments have been properly recorded and included in the closed appropriation balances, and reverse all improper adjustments made to closed appropriations.

Because DFAS had not established effective oversight or supervision of closed appropriation adjustments, DFAS accounting sites did not effectively control adjustments to closed appropriations. Congressional and DoD oversight over closed appropriations was impaired, unspent funds in closed appropriations were vulnerable to abuse, and DFAS made and approved improper adjustments to closed appropriations.

Recommendations, Management Comments, and Audit Response

Deleted, Revised, and Renumbered Recommendations. We deleted draft report Recommendation 2.a.2. and modified and renumbered Recommendations 2.a.3. (now 2.a.2.), 2.a.4. (now 2.a.3.), and 2.a.5. (now 2.a.4.). We agree with the Director, Defense Finance and Accounting Service that adjustments made to closed appropriations should be prepared by the field accounting sites so long as the adjustments are properly approved and controlled by appropriate means. Recommendation 2.a.2. was revised to clarify the requirement for timely completion of closed account adjustments. Recommendation 2.a.3. was modified accepting alternate procedures concerning adjustments caused by system deficiencies, as proposed by Management.

1. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, in conjunction with the Director, Defense Finance and Accounting Service, establish and use management performance metrics to monitor compliance with the laws and regulations applicable to closed appropriations balances and adjustments and hold the Defense Finance and Accounting Service centers responsible for complying with the applicable laws and regulations.

Management Comments. The Under Secretary of Defense (Comptroller)/Chief Financial Officer concurred and stated that DoD would establish a performance metric for approved closed account adjustments. The Director, Defense Finance and Accounting Service also provided comments and concurred and acknowledged that controls over closed appropriations are sufficiently important to warrant a performance metric.

Auditor Response. The comments of the Under Secretary of Defense (Comptroller)/Chief Financial Officer were responsive although a completion date was not included. In subsequent correspondence, the Under Secretary of Defense (Comptroller)/Chief Financial Officer stated that the metric would be established by September 30, 2003.

2. We recommend that the Director, Defense Finance and Accounting Service:

a. Establish standard procedures that ensure compliance with Public Law 101-510 (31 U.S.C. 1551-1557), the Comptroller General decisions, and the provisions of the August 3, 2000, Memorandum of Agreement for adjustments made to closed appropriation balances. Specifically:

(1) Implement standard procedures for the preparation of adjustments to closed appropriations.

Management Comments. The Director, DFAS concurred and estimated that the standard procedures would be reviewed and updated by January 15, 2004. The Director, DFAS estimated that the standard guidance would be implemented by June 30, 2004.

(2) Require all closed appropriation adjustments be made not more than six months after the discovery of a clerical accounting error causing the adjustment or the completion of the reconciliation of a contract, provided that the adjustment can be properly supported and the adjustment is for a disbursement made before the cancellation of the appropriation.

Management Comments. The Director, DFAS did not concur with the draft report recommendation. The Director, DFAS pointed out that in B-251287.3, dated November 1, 1995, the Comptroller General stated that the requirement to maintain accurate accounting records was more important than completing adjustments within a set timeframe. The Director DFAS also pointed out that clerical errors are often discovered only during contract reconciliation. However, the Director, DFAS proposed that procedures to ensure that clerical accounting errors are corrected as soon as possible after discovery be added to the DFAS standard procedures discussed in management comments on Recommendation 2.a.1 for adjustments to cancelled appropriations.

Audit Response. Although Management did not concur, we consider the comments to be responsive. The Director, DFAS comments on B-251287.3 need clarification. In B-251287.3 the Comptroller General also stated that Federal agencies “should be able to complete their accounting and reporting within

established timeframes.” The Comptroller General also “recognized the possibility that DoD would not meet such timeframes.” B-251287.3 also stated that this applied to disbursements made prior to cancellation of the appropriations, and that adjustments “should be supported by documentary evidence and be able to withstand audit scrutiny.” As discussed in this report, DoD has not made a significant effort to meet established accounting and reporting timeframes, closed appropriation adjustments go unsupported, and the accounting process cannot withstand audit scrutiny. We do recognize the importance of maintaining accurate accounting records so long as adjustments are necessary to correct clerical errors and meet the other Comptroller General requirements. The proposed alternative actions meet the intent of the draft recommendation. No further comments are required.

(3) Identify accounting system deficiencies that cause adjustments to cancelled appropriations, correct the system deficiencies if possible, or establish preventative measures if not.

Management Comments. The Director partially concurred with the draft recommendation, stating that the requirement to maintain accurate accounting records was more important than the prohibition against using closed account adjustments to compensate for deficient accounting systems. However, the Director stated that DFAS did not intend to rely on adjustments as a palliative for accounting system deficiencies but pointed out that restriction on changes to existing accounting systems often precluded correction of known deficiencies. The Director proposed to establish formal procedures to identify accounting system deficiencies causing adjustments to cancelled balances, or develop interim preventative measures if system changes are not possible. These procedures are to be incorporated in the DFAS standard procedures discussed in Recommendation 2.a.1.

Audit Response. Although Management did not fully concur, we consider the comments to be responsive. The Comptroller General clearly differentiated between the correction of clerical errors and the use of closed account adjustments as a palliative for deficient DoD accounting systems (see 72 Comptroller General 343, September 29, 1993 discussed in Appendix B). The Comptroller General specifically disallowed that practice because of inadequate accounting systems. The reliability of the information used to support any adjustment to correct an error caused by a system deficiency is suspect. Both the Comptroller General and the Financial Management Regulation require that closed appropriations adjustments withstand audit scrutiny. We recognize the importance of maintaining accurate accounting records so long as adjustments are necessary to correct clerical errors and meet the other Comptroller General requirements. The proposed alternative actions meet the intent of the draft recommendation. No further comments are required.

(4) Restrict the approval of closed appropriations adjustments to senior managers at central accounting sites and retain copies of the supporting documentation at the central accounting sites.

Management Comments. The Director partially concurred and stated that procedures would be revised to include approval responsibility thresholds similar

to those used for other accounting adjustments. However, the Director did not concur with centralizing approval authority at the central accounting sites because of lack of available documentation and proposed alternative procedures. Each closed account adjustment would be approved by a responsible person. The responsibilities and core competencies for the position will be defined in the standard procedures and incorporated into the Department of Defense Financial Management Regulation. Adjustments currently processed through the Mechanization of Contracts Administration System are subject to controls already approved by the General Accounting Office. Other closed account adjustments equal to or exceeding \$1 million dollars must be subsequently reviewed by the field site director or the accounting officer. Adjustments below this threshold are subject to review by DFAS Internal Review. The DFAS Internal Review shall be responsible for the design and execution of a plan to review a statistical sample of such non-MOCAS processed closed account adjustments on an annual basis. These procedures are to be incorporated in the DFAS standard procedures discussed in Recommendation 2.a.1.

Audit Response. Management comments were responsive. The proposed alternative actions meet the intent of the draft recommendation. No further comments are required.

b. Implement a standard process and system for the maintenance of accurate records of closed appropriation balances.

c. Establish a process to monitor compliance with the procedures established pursuant to recommendation 2.a.

d. Conduct training in the standard procedures for all appropriate personnel on a regular basis.

e. Revalidate the closed appropriation balances and report any potential Antideficiency Act violations in accordance with 31 U.S.C. 1351. Specifically:

(1) Perform a one-time review of closed appropriation adjustments to determine if they are valid and supported.

(2) Verify that all valid and supported adjustments have been properly recorded and included in the closed appropriation balances.

(3) Reverse all improper adjustments made to closed appropriations.

Management Comments. The Director concurred and estimated that action on Recommendations 2.b., 2.c., 2.d., 2.e.1., 2.e.2., and 2.e.3. would be complete by June 30, 2004

Appendix A. Scope and Methodology

We reviewed the controls over closed appropriations established by central accounting sites at DFAS Cleveland, DFAS Denver, and DFAS Indianapolis. Specifically, we reviewed the guidance established by the three DFAS central accounting sites to process closed appropriation adjustments and maintain the closed appropriation balances. We reviewed the closed appropriation accounting records maintained by DFAS Cleveland, DFAS Denver, and DFAS Indianapolis for the period October 2000 through March 2002. DFAS reported \$3.1 billion in adjustments to closed appropriations for this time period.

We performed this audit from March 2002 through March 2003 in accordance with generally accepted government auditing standards.

We analyzed DFAS closed appropriation adjustment procedures to determine whether DFAS is adequately accounting for and effectively controlling closed appropriation adjustments. We reviewed the closed appropriation accounting records to separate the adjustments made in the Mechanization of Contract Administration Services from adjustments made in other accounting systems. We identified closed appropriation adjustments at the three DFAS central accounting sites that were not processed by DFAS Columbus. We visited one DFAS field accounting site for each DFAS central accounting site. Out of closed appropriation adjustments identified, we judgmentally selected the 37 closed appropriation adjustments that DFAS field accounting sites: DFAS Charleston, DFAS Dayton, and DFAS St. Louis, processed. We based the judgmental sample on the high-dollar value adjustments processed in the closed appropriation records at the DFAS central accounting sites. We assessed the supporting documentation and validity of those adjustments. We interviewed DFAS personnel responsible for accounting for and controlling closed appropriations.

We could not accurately determine the total number of adjustments made to closed appropriations for the period of the audit. The closed appropriation data processed by DFAS field accounting sites is at the appropriation summary level by the time the DFAS central accounting sites see the closed appropriation adjustments. In addition, closed appropriation records maintained by DFAS central accounting sites were not sufficient or reliable. Therefore, the closed appropriation balances could not be determined. In addition, we did not perform a review of the limitation to 1 percent of current year appropriations for obligations and adjustments to obligations that would have been properly chargeable to a closed appropriation.

We did not review the adjustments to closed appropriations made by DFAS Columbus. GAO had performed a review of the closed appropriation adjustments prepared by DFAS Columbus. The GAO review did not assess the controls over the closed appropriation balances. See “GAO Review of Closed Appropriation Adjustments” for additional details.

Use of Computer-Processed Data. We could not rely on the computer-processed data used by the DFAS central accounting sites to process closed appropriation adjustments and maintain the closed appropriation balances. Our

review of system controls and the results of data tests showed an error rate that casts doubt on the data's validity. However, the data, when reviewed in context with other available evidence, validates the opinions, conclusions, and recommendations in this report.

General Accounting Office High-Risk Area. The GAO has identified several high-risk areas in DoD. 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 reviewed the adequacy of DFAS management controls over closed appropriations. Specifically, we reviewed DFAS management controls over the maintenance of closed appropriation balances and the accounting for and control over closed appropriation adjustments. We also evaluated the adequacy of management's self-evaluation over those controls.

Adequacy of Management Controls. We identified a material management control weakness for DFAS as defined by DoD Instruction 5010.40. DFAS management controls for closed appropriation adjustments were not adequate to ensure that DFAS adequately accounted for and had effective controls over closed appropriation adjustments. The recommendations, if implemented, will improve controls over adequately accounting for closed appropriations. A copy of the report will be provided to the senior official responsible for management controls in DFAS.

Adequacy of Management's Self-Evaluation. DFAS officials did not identify controlling closed appropriation adjustments as an assessable unit, and only DFAS Cleveland and DFAS Charleston identified the maintenance of closed appropriation balances as an assessable unit. Therefore, DFAS officials did not identify or report the material management control weaknesses identified by the audit.

Prior Coverage

During the last 5 years, the GAO and the Inspector General of the Department of Defense (IG DoD) have issued four reports discussing closed appropriation adjustments. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted IG DoD reports can be accessed at <http://www.dodig.osd.mil/audit/reports>.

GAO

GAO Report No. GAO-02-747, "Canceled DoD Appropriations: Improvements Made but More Corrective Actions are Needed," July 2002

GAO Report No. GAO-01-697, "Canceled DoD Appropriations: \$615 Million of Improper or Otherwise Improper Adjustments" July 26, 2001

IG DoD

IG DoD Report No. D-2003-034, "Adjustments to the Intergovernmental Payments Account," December 10, 2002

IG DoD Report No. D-2000-030, "Recording Obligations in Official Accounting Records," November 4, 1999

Appendix B. Closed Appropriation Guidance

Comptroller General Decisions

The Comptroller General of the United States (Comptroller General) ruled that under certain limited circumstances, the Department of the Treasury (Treasury) could restore unobligated or obligated appropriation account balances (72 Comptroller General 343, September 29, 1993). Agencies could use the restored balances to correct reporting errors or clerical mistakes. Agencies could also record, as a payment from a closed appropriation, a disbursement made before cancellation of the appropriation. This is an accounting entry to reflect the liquidation of an obligation validly incurred and liquidated before cancellation. Treasury's authority to correct closed appropriations related only to obvious clerical errors, such as misplaced decimals or transposed digits. However, the Comptroller General specifically stated that the use of closed appropriation adjustments was not meant to serve as a palliative for deficiencies in DoD accounting systems. The Comptroller General decision also stated that correctable errors should manifest themselves soon after the appropriation closes.

The Comptroller General addressed the requirement to report potential Antideficiency Act (ADA) violations in appropriations that have been closed (73 Comp. Gen. 338, September 28, 1994). Prior to 1990, ADA violations could be avoided by delaying recognition of excess obligations or disbursements until the appropriation in question had closed into merged surplus authority and lost its individual identity. Since 1990, any needed adjustments are made to the agency's accounting records that relate to a closed appropriation, as opposed to the amount of obligations recorded against the appropriation account. Agencies may not pay from current appropriations obligations that exceed amounts that were available for that purpose in the closed appropriation. Agencies must adjust the closed appropriation balances accordingly in order to properly apply this limitation. Any ADA violation in an appropriation that is closed should be reported.

The Comptroller General reaffirmed the 1993 decision that Treasury's authority to correct appropriations did not extend to reporting errors caused by an agency's accounting system (Comptroller General Decision, B-257,825, March 15, 1995). The Treasury refused to make a closed appropriation adjustment to restore funds requested by the Federal Aviation Agency because the adjustment was not due to obvious clerical errors but rather to accounting system deficiencies. The Comptroller General upheld the Treasury's refusal.

DoD Financial Management Regulation

DoD Regulation 7000.14-R, "DoD Financial Management Regulation," (FMR) addresses policies and procedures for recording and accounting for closed appropriation adjustments.

Closed Appropriation Unexpended Balance. The FMR, Volume 3, Chapter 10, “Accounting Requirements for Expired and Closed Accounts,” December 2000, implements certain provisions of Title 31, U.S.C., relating to expired and closed appropriations. The FMR defines the unexpended balance of a closed appropriation as:

The sum of the unobligated balance plus the unpaid obligations of an appropriation at the time of cancellation, adjusted for obligations and payments which are incurred or made subsequent to cancellation, and which would otherwise have been properly charged to the appropriation except for the cancellation of the appropriation.

Antideficiency Act Violations. The FMR, Volume 3, Chapter 11, “Unmatched Disbursements, Negative Unliquidated Obligations, In-Transit Disbursements, and Suspense Accounts,” January 2001, prescribes the requirements for researching and correcting unmatched disbursements, negative unliquidated obligations, in-transit disbursements, and disbursements in suspense accounts. The FMR Volume 3, Chapter 11 requires that:

A potential violation of the ADA shall be reported and a preliminary review of an ADA violation initiated if posting an adjustment to a current, expired or closed appropriation would result in either (1) a negative unobligated balance or (2) disbursements that are in excess of the amount appropriated, at either the appropriation level or a portion thereof that has been subdivided for ADA purposes.

Perpetual balances of unobligated amounts and unliquidated amounts must be maintained for each closed appropriation. Should the unobligated balance in a closed appropriation be negative, or should the unexpended balance be negative, then a potential violation of the ADA would have occurred, and must be reported and investigated.

Collections of Receivables from Closed Appropriations. The FMR, Volume 3, Chapter 15, “Receipt and Use of Budgetary Resources Execution Level,” December 1996, prescribes departmental standards for recording transactions in the execution-level budgetary accounts. The FMR, Volume 3, Chapter 15, states that the obligational status of a canceled appropriation continuously must be maintained even though no expenditures or collections may be made to that appropriation. In addition, collections authorized, or required to be credited to an appropriation account but not received before closing of the appropriation, must be deposited in the miscellaneous receipt account “Collections of Receivables from Canceled Accounts” (Treasury Symbol 3200).

Supporting Accounting Entries. The FMR, Volume 6A, Chapter 2, “Financial Reports Roles and Responsibilities,” March 2002, requires that adjustments made by DFAS or by DFAS Customers must be supported by written documentation which is sufficiently detailed so that it provides an audit trail to the source transaction(s) that require the adjustments. This documentation shall include the rationale and justification for the adjustment, detailed numbers and dollar amounts of errors or conditions that are related to the transaction(s) or record(s) that are proposed for adjustments, the date of the adjustment, and the name and position of the individual approving the adjustment. The FMR, Volume 6A,

Chapter 2, also states that the documentation shall be sufficient for the approving official and others, such as auditors, to understand clearly the reason for preparing the journal voucher and to determine whether it is proper and accurate. Proper documentation, in either hard copy or electronic form, is necessary to support all journal voucher entries. The FMR Volume 3, Chapter 10, requires that, at a minimum, evidence should include the original accounting record from which the incorrect posting was made and a record showing the incorrect amount.

Appendix C. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service

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 and Financial Management, Committee on Government Reform

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

House Subcommittee on National Security, Emerging Threats, and International
Relations, Committee on Government Reform

House Subcommittee on Technology, Information Policy, Intergovernmental Relations,
and the Census, Committee on Government Reform

Office of the Under Secretary of Defense (Comptroller) Comments



COMPTROLLER

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

JUN 6 2003



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

SUBJECT: Draft Audit Report on Controls Over DoD Closed Appropriations (Project No.
D2002FI-0082) dated May 12, 2003

This is in response to your memorandum of May 12, 2003, forwarding subject proposed draft audit report to this office for review and comment. The draft report recommends that the Under Secretary of Defense (Comptroller), in conjunction with the Director, Defense Finance and Accounting Service (DFAS), establish and use management performance metrics to monitor compliance with the laws and regulations applicable to closed appropriation balances. I concur with recommendation 1 of the report and appreciate the opportunity to review the draft report and provide comments.

I am providing more detailed comments at the attachment. My point of contact 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

Attachment

cc: Director, Defense Finance and Accounting Service



INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (IG, DOD) DRAFT REPORT
MAY 12, 2003 (PROJECT NO. D2002FI-0082)

“DRAFT AUDIT REPORT ON CONTROLS OVER DOD CLOSED APPROPRIATIONS”

DEPARTMENT OF DEFENSE (DOD) COMMENTS
TO THE IG, DoD RECOMMENDATIONS

RECOMMENDATION 1: The Inspector General, DoD recommended that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, in conjunction with the Director, Defense Finance and Accounting Service establish and use management performance metrics to monitor compliance with the laws and regulations applicable to closed appropriations balances and adjustments and hold the Defense Finance and Accounting Service centers responsible for complying with the applicable laws and regulations.

DOD RESPONSE: The Department concurs. The Department will establish a performance metric to measure the number of approved correction requests vice the number of correction requests submitted for approval.

Attachment

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE


1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

AUG 27 2003

MEMORANDUM FOR TECHNICAL DIRECTOR, AUDIT FOLLOWUP & GAO AFFAIRS,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Draft Audit Report on "Controls Over DoD Closed Appropriations,"
(Project No. D2002FI-0082) dated May 12, 2003

Our response to the subject draft audit is attached. The point of contact is Mr. Jerry Shea,
(703) 601-3021 or DSN 329-3021.


Robert McNamara
Director, Accounting

Attachment:
As stated

**DFAS Comments to OIG Draft Audit Report, Project No. D2002FI-0082,
“Controls Over DoD Closed Appropriations,” dated May 12, 2003**

Recommendation 1. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer in conjunction with Director, Defense Finance and Accounting Service establish and use management performance metrics to monitor compliance with the laws and regulations applicable to closed appropriations balances and adjustments and hold the Defense Finance and Accounting Service Sites responsible for complying with the applicable laws and regulations.

Management Comments. Concur. We agree that the topic of controls over closed appropriations is sufficiently important to warrant a performance metric. Metric established must track both DFAS and Service or Agency performance or actions. Responsibility and accountability for adjustments is shared. For example, the personnel who certify the vast majority of SF 1081 vouchers, to process adjustments, are the responsible contract reconciliation agents. Many of these are employees of DFAS customers. DFAS will work with the Office of the Under Secretary of Defense (Comptroller) in accordance with its schedule to establish performance metrics.

Recommendation 2.a.1. We recommend that the Director, Defense Finance and Accounting Service establish standard procedures that ensure compliance with Public Law 101-510 (31 U.S.C. 1551-1557), the Comptroller General decisions, and the provisions of the August 3, 2000, Memorandum of Agreement for adjustments to closed appropriations balances. Specifically, implement standard procedures for the preparation of adjustments to closed appropriations.

Management Comments. Concur. The audit mentioned that the DFAS Central sites have implemented differing versions of standard operating procedures. The overall guidance will be reviewed and updated to ensure the Department’s guidance is standard with regard to compliance with applicable laws, regulations, and the Memorandum of Agreement with the Department of the Treasury and the Office of Management and Budget. DFAS estimates it will complete the review and update to the guidance, to ensure standard procedures for the preparation of adjustments to closed appropriations, by January 15, 2004. DFAS estimates it will have the standard guidance implemented by June 30, 2004.

Recommendation 2.a.2. We recommend that the Director, Defense Finance and Accounting Service establish standard procedures that ensure compliance with Public Law 101-510 (31 U.S.C. 1551-1557), the Comptroller General decisions, and the provisions of the August 3, 2000, Memorandum of Agreement for adjustments to closed appropriations balances. Specifically, restrict the preparation of closed appropriations adjustments to central sites.

Management Comments. Nonconcur. DFAS believes the underlying principle is not one of location, but rather of accountability. To expand, it is necessary to discuss document retention. In several of the DFAS networks, the central sites do not have access to the file records necessary

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to exercise adequate control over adjustments to closed appropriations. For example, in the DFAS-DE processing, the file records are maintained at the Air Force Financial Services Office and its supporting DFAS-DE Field Site and entitlement offices. Similarly, in the DFAS-IN network, the original supporting documents are maintained at field site accounting offices and the belief is that this work is better handled there. Moreover, financial processing is decentralized within the Department between DFAS and its customers. For example, entitlement documentation typically is retained at the DoD location, staffed by DFAS or its customers, that developed the initial entitlement. This location often differs from where the disbursement is made. The centralization of disbursing at central sites has made this a reality. Further, the detailed accounting is predominately performed at a field site.

Fundamentally, DFAS believes that, whether accounting for current, expired, or closed accounts or analyzing and processing legal adjustments for closed accounts, the key is to have proper clarification of responsibilities and accountability roles at the Central Sites as well as in all the Department's field operations. The Department can achieve the desired results and do it more efficiently and effectively by concentrating on holding personnel - within DFAS, the Military Services and Defense Agencies - accountable for the correctness of the adjustments. To accomplish this, the Department needs to communicate, monitor, and enforce the same standard practices and requirements to ensure that effective internal controls, appropriate supervisory approval, clear guidance, recurring training, vigilant management emphasis and periodic review is in effect at all financial management locations within the Department.

Recommendation 2.a.3. We recommend that the Director, Defense Finance and Accounting Service establish standard procedures that ensure compliance with Public Law 101-510 (31 U.S.C. 1551-1557), the Comptroller General decisions, and the provisions of the August 3, 2000, Memorandum of Agreement for adjustments to closed appropriations balances. Specifically, disallow all closed appropriation adjustment requests made more than six months after the appropriation closed.

Management Comments. Nonconcur. Generally, DFAS believes it must process these closed account adjustments when we discover the need to do so. There are thousands of contracts in MOCAS that are currently under reconciliation. Due to the nature of contract reconciliation, it can be years before the final contract reconciliation is finished. Moreover, it is frequently during the contract reconciliation process that DFAS discovers the need to process a closed account adjustment to correct the appropriation originally charged.

The original administrative window discussed in the initial Comptroller General Decision, B-251287 in 1993, greatly impacted DFAS Columbus's ability to close long running contracts. Subsequently, the concept of administrative timeline was revisited by the Comptroller General. In B-251287.3, dated November 1, 1995, the Comptroller General states, "We share the objective of accurate accounting and records for the federal government. Generally agencies should be able to complete their accounting and reporting for closed accounts within timeframes Treasury establishes for year-end closing reports and otherwise. Our reference to Treasury timeframes in 72 Comp. Gen. At 347 reflected this expectation, although we also recognized the possibility that DoD would not meet such timeframes. We did not intend to suggest that Treasury's timeframes

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for year-end closing reports, or any timeframes Treasury established in response to our decision, should serve to preclude correction of account inaccuracies or freeze in place inaccurate accounting for those accounts. Thus, we would support Treasury adjusting, without regard to administratively established timeframes, DoD cancelled appropriation account balances to reflect disbursements made prior to cancellations of the accounts.”

DFAS proposes what it believes is a workable alternative. DFAS will process closed account adjustments within six months after the completion of contract reconciliation or, for those adjustments not related to contract reconciliation, within six months of discovery of the need to process an adjustment. This requirement will be incorporated in the standard procedures discussed under 2.a.1.

Recommendation 2.a.4. We recommend that the Director, Defense Finance and Accounting Service establish standard procedures that ensure compliance with Public Law 101-510 (31 U.S.C. 1551-1557), the Comptroller General decisions, and the provisions of the August 3, 2000, Memorandum of Agreement for adjustments to closed appropriations balances. Specifically, eliminate the practice of making adjustments to correct system deficiencies .

Management Comments. Partially concur for the specific case described - the single digit fiscal year issue. DFAS agrees that reporting and recording the correct fiscal year for the closed account is important. However, DFAS does not define the specific issue as an accounting systems deficiency. DFAS considers that, when changing a single digit fiscal year to the correct fiscal year for a closed account, it is correcting an error. It is a reality of the way systems were programmed before Y2K. DFAS Columbus and DFAS Denver are in the process of testing an automated solution that will allow the Denver systems to recognize the fiscal year of the closed account. The MOCAS entitlement system at Columbus is undergoing a rehost and soon will enter a two-year moratorium on system changes.

DFAS will look into whether it is feasible and affordable - given the moratorium - to develop an offline PC-based program, as an interim solution, to convert the single digit fiscal year to make the fiscal year of the closed account recognizable to the other central accounting locations. If the off-line PC-base program is not feasible or affordable, DFAS commits to developing a workaround solution to fix the problem. DFAS will choose the form of the workaround solution. This solution will be developed and implemented after conducting an evaluation to find the best approach, automated or manual, that will allow the central site to be able to identify the closed account adjustments being processed and reported to the central site. Once the MOCAS rchost moratorium is over, approximately August 2005, DFAS will pursue an automated solution similar to the DFAS Columbus and DFAS Denver approach for the other central accounting sites. DFAS estimates an automated solution, after the moratorium, will be completed by August 2006.

Addressing the broader subject of processing adjustments and accounting systems deficiencies, DFAS does not concur with the general recommendation if the recommendation is intended to disallow the correction of the agency’s accounting records. The Comptroller General Decisions cited in the draft report provide that agencies may not restore account balances when the error is

the result of system deficiencies. The decisions do not absolve the agency from adjusting the records in order to ensure that the accounts are correct, regardless of the cause of the error. Other decisions of the Comptroller General provide that agencies are required to adjust their accounting records after closing in order to “determine the propriety of paying from current appropriations obligations that would have been properly chargeable to the closed account both as to purpose and amount See 31 U. S. C. § 1553(b) Further, any violation of the Antideficiency Act caused by such adjustments after the accounts are closed should be reported.” 73 Comp. Gen. 338 (1994). In B-251287.3, that decision was discussed: “we recognized the need for agencies to maintain and adjust when necessary the accounting records for closed accounts.” We believe that the agency must correct errors to its records so that it is not maintaining permanently inaccurate records. Additionally, it was clear, in the two recent audit reports involving closed account adjustments at Columbus, that the GAO emphasized the need for DFAS to reverse certain adjustments that had not processed correctly to closed accounts and to determine the correct accounting for those adjustments.

Nonetheless, regarding the general systems deficiency issue, the Department is committed to maintaining accurate records for closed accounts. The Department supports doing so by utilizing efficient systemic processes. It is not the Department’s intention to rely on processing closed account adjustments as a palliative for systems deficiencies in lieu of fixing systemic processes. However, given the limitation of financial resources, the Department has been cautioned in the GAO’s most recent report on the “D” systems to limit investment in such systems until we determine the benefits. The Department is trying to limit information technology investment to mission critical areas, where there is no manual workaround process, while the Department is actively pursuing the Business Management Modernization Plan. The Department is committed to ensure this initiative satisfactorily addresses efficient, accurate processing for closed accounts.

In the interim, DFAS will establish, in the standard procedures, a formal process to address any individual system deficiency that causes the need for processing closed account adjustments. The formal process will require notification, by the site that detected the systems deficiency, to the Accounting Business Line Executive. A formal assignment will be made to an individual who will evaluate the deficiency to see whether a feasible and affordable automated solution can be found. If there is no feasible and affordable automated solution, then DFAS commits to developing a manual workaround to fix the problem.

Recommendation 2.a.5. We recommend that the Director, Defense Finance and Accounting Service establish standard procedures that ensure compliance with Public Law 101-510 (31 U.S.C. 1551-1557), the Comptroller General decisions, and the provisions of the August 3, 2000, Memorandum of Agreement for adjustments to closed appropriations balances. Specifically, restrict the approval of closed appropriations adjustments to senior managers at central accounting sites.

Management Comments. Partially Concur. DFAS believes the underlying principle is not one of location, but rather of accountability. To expand, it is necessary to discuss document retention. In several of the DFAS networks, the central sites do not have access to the file records necessary to exercise adequate control over adjustments to closed appropriations. For

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example, in the DFAS-DE processing, the file records are maintained at the Air Force Financial Services Office and its supporting DFAS-DE Field Site and entitlement offices. Similarly, in the DFAS-IN network, the original supporting documents are maintained at field site accounting offices and the belief is that this work is better handled there.

Fundamentally, DFAS believes that, whether accounting for current, expired, or closed accounts or analyzing and processing legal adjustments for closed accounts, the key is to have proper clarification of responsibilities and accountability roles at the Central Sites as well as in all the Department's field operations. The Department can achieve the desired results and do it more efficiently and effectively by concentrating on holding personnel - within DFAS, the Military Services and Defense Agencies - accountable for the correctness of the adjustments. To accomplish this, the Department needs to communicate, monitor, and enforce the same standard practices and requirements to ensure that effective internal controls, appropriate supervisory approval, clear guidance, recurring training, vigilant management emphasis and periodic review is in effect at all financial management locations within the Department.

Specifically, DFAS believes the following represents a workable solution. Each closed account adjustment should be approved by a responsible person. For MOCAS-related adjustments for a closed account, the responsible person is a Responsible Contract Reconciliation Agent ("RCRA"). For the non-MOCAS contracts processed at field sites, there would be a responsible person similar to a RCRA. This individual's role would be to be a responsible non-MOCAS contract or vendor pay reconciliation agent. The responsibilities and core competencies for the position will be defined in the standard procedures and incorporated into the Department of Defense Financial Management Regulation. In either case, when approving a SF 1081 voucher to process a closed account adjustment, the responsible person is certifying that the adjustment is legal, necessary, and supported by the documentation required by the DFAS-wide standard policy and procedures.

Additionally, to enhance internal controls, each non-MOCAS processed closed account adjustment equal to or exceeding \$ 1 million dollars must be subsequently reviewed by the field site director or the accounting officer. Non-MOCAS processed closed account adjustments below this threshold are subject to review by DFAS Internal Review. The DFAS Internal Review shall be responsible for the design and execution of a plan to review a statistical sample of such non-MOCAS processed closed account adjustments on an annual basis.

Recommendation 2.b. We recommend that the Director, Defense Finance and Accounting Service implement a standard process and system for the maintenance of accurate records of closed appropriations balances.

Management Comments. Concur. Consistent with the DFAS response at 2.a.1. for review of standard procedures, DFAS will review its process and methods to ensure there is a standard process and system for the maintenance of accurate records of closed appropriation balances. DFAS estimates it will complete the review of its process and methods to ensure there is a standard process and system for the maintenance of accurate records of closed account balances by June 30, 2004.

Recommendation 2.c. We recommend that the Director, Defense Finance and Accounting Service establish a process to monitor compliance with the procedures established pursuant to recommendation 2a.

Management Comments. Concur. DFAS will establish a process to monitor the standard procedures referenced in response to recommendation 2.a. DFAS will include the controlling of closed account adjustments in its Management Control Program review. Additionally, since DFAS works in partnership with its customers, DFAS will work with the Military Services and Defense Agencies to achieve the desired compliance for personnel involved with adjustments for closed accounts. DFAS estimates it will complete the establishment of the process to monitor compliance for the standard procedures referenced in recommendation 2.a. by June 30, 2004.

Recommendation 2.d. We recommend that the Director, Defense Finance and Accounting Service conduct training in the standard procedures for all appropriate personnel on a regular basis.

Management Comment. Concur. DFAS has the responsibility to conduct training in the standard procedures on a regular basis for its Central Site and Field Site personnel. Some of these are RCRA personnel who process adjustments related to the MOCAS entitlement system. DFAS Columbus already has a training program in place for RCRA personnel. Others at field sites process non-MOCAS related adjustments. The latter will need training equivalent to the RCRA's with the exception of training specific to MOCAS (MOCAS, Contract Reconciliation System, and the Standard Contract Reconciliation Tool). DFAS will develop this training for the non-MOCAS personnel and estimates it will be implemented by June 30, 2004.

Recommendation 2.e.1. We recommend that the Director, Defense Finance and Accounting Service revalidate the closed appropriation balances and report any potential Antideficiency Act violations in accordance with 31 U.S.C. 1351. Specifically, perform a one-time review of closed account appropriation adjustments to determine if they are valid and supported.

Management Comments. Concur. DFAS has acknowledged in the past that the GAO was correct in reporting that deficiencies in the Department's controls and systems inhibited efforts to reconstruct documentation to support certain adjustments to closed appropriations. To the greatest extent possible, DFAS will perform a one-time review of closed appropriation adjustments to determine if they are valid and supported. DFAS estimates it will complete this review by June 30, 2004.

Recommendation 2.e.2. We recommend that the Director, Defense Finance and Accounting Service revalidate the closed appropriation balances and report any potential Antideficiency Act violations in accordance with 31 U.S.C. 1351. Specifically, verify that all valid and supported adjustments have been properly recorded and included in the closed appropriation balances.

Management Comments. Concur. DFAS has acknowledged in the past that the GAO was correct in reporting that deficiencies in the Department's controls and systems inhibited efforts to reconstruct documentation to support certain adjustments to closed appropriations. To the

greatest extent possible, DFAS will verify that all valid and supported adjustments have been properly recorded and included in the closed appropriation balances. DFAS estimates it will complete this verification effort by June 30, 2004.

Recommendation 2.e.3. We recommend that the Director, Defense Finance and Accounting Service revalidate the closed appropriation balances and report any potential Antideficiency Act violations in accordance with 31 U.S.C. 1351. Specifically, reverse all improper adjustments made to closed appropriations.

Management Comments. Concur. DFAS will reverse any adjustment that, upon review, is identified as an improper adjustment made to closed appropriations. DFAS estimates it will complete the review and reversal of any improper adjustments by June 30, 2004.

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