Report No. D-2009-044 January 23, 2009

Inspector General

United States Department of Defense

Defense Finance and Accounting Service Indianapolis Compilation of Other Defense Organizations General Fund Financial Data

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Acronyms

ADCFO	Acting Deputy Chief Financial Officer
CFO	Chief Financial Officer
CLRS	CFO Load Reconciliation System
DDRS	Defense Departmental Reporting System
DFAS	Defense Finance and Accounting Service
DoD FMR	DoD Financial Management Regulation
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
JV	Journal Voucher
ODO	Other Defense Organizations
OIG	Office of the Inspector General
USD(C)/CFO	Under Secretary of Defense (Comptroller)/ Chief Financial Officer
USSGL	U.S. Government Standard General Ledger

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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January 23, 2009

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

SUBJECT: Report on Defense Finance and Accounting Service Indianapolis Compilation of Other Defense Organizations General Fund Financial Data (Report No. D-2009-044)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Director, Defense Finance and Accounting Service Indianapolis provide additional comments on Recommendations 1 and 2. We request additional comments on all of the recommendations by February 23, 2009.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to AUDDBO@dodig.mil. Copies of management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to our staff. Please direct questions to me at (703) 601-5868 (DSN 664-5868).

Daniel R. Blair
for Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Department of Defense Office of Inspector General

Report No. D-2009-044 **January 23, 2009**

(Project No. D2007-D000FL-0195.000)

Defense Finance and Accounting Service Indianapolis Compilation of Other Defense Organizations General Fund Financial Data

Executive Summary

Who Should Read This Report and Why? Personnel at Defense Finance and Accounting Service and other DoD accounting offices supporting the Other Defense Organizations general fund, and preparers and users of the DoD Agency-Wide financial statements would benefit from the results of this audit.

Background. Defense Finance and Accounting Service Indianapolis provides accounting and financial reporting support for 42 Other Defense Organizations general funds. The Defense Finance and Accounting Service Indianapolis receives trial balance information from field accounting sites, which is used to prepare financial statements and budget reports. These 42 Other Defense Organizations general funds were a reporting component of the FY 2007 DoD Agency-Wide Financial Statements and had $140.5 billion in budget authority for FY 2007.

Results. Defense Finance and Accounting Service Indianapolis internal controls were not adequate. We identified a material internal control weakness in accounting adjustments made to Other Defense Organizations general fund accounting records. The accounting adjustments were not sufficiently supported and approved. Specifically, the controls did not ensure that:

- accounting adjustments were properly supported,
- journal entries recorded in the accounting system agreed with the control log, and
- cost estimates used on journal vouchers were supported and properly classified and disclosed on the financial statements.

These internal control weaknesses increased the risk that DoD materially misstated balances reported in the DoD Agency-Wide financial statements. In addition, the lack of footnote disclosures discussed in this report could mislead the users of the financial statements.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer should update the DoD Regulation 7000.14-R, "DoD Financial Management Regulation," to include requirements for financial statement footnote disclosures of the amounts of unresolved abnormal balances, as agreed to in DoD IG Report No. D2004-118, "Army General Fund Controls Over Abnormal Balances for Field Accounting Activities," September 28, 2004. In addition, he should make footnote disclosures on the DoD Agency-Wide financial statements to explain the methodology used to estimate contingent liabilities for future contract-financing payments.

The Director, Defense Finance and Accounting Service Indianapolis should:

- implement procedures to ensure that all Other Defense Organization journal vouchers are supported and reviewed by officials with the appropriate level of authority,
- implement procedures for Departmental Accounting supervisory review of the journal voucher control log,
- discontinue the delegation of authority for journal voucher review and approval to lower-level managers and supervisors, and
- make footnote disclosures on the DoD Agency-Wide financial statements to explain estimates used to adjust abnormal balances.

Management Comments and Audit Response. The Acting Deputy Chief Financial Officer concurred with the recommendation to update the DoD Regulation 7000 14-R to disclose abnormal balances but did not provide an implementation date. The Acting Deputy Chief Financial Officer nonconcurred with the recommendation to disclose the methodology DoD used for estimating contingent liabilities in the footnotes. We request that the Acting Deputy Chief Financial Officer reconsider his position on the footnote disclosures.

The Acting Deputy Chief Financial Officer agreed with the recommendation to improve procedures for supporting and reviewing journal vouchers; however, the Director, Defense Finance and Accounting Service Indianapolis nonconcurred, stating that the adjustments were adequately supported. As stated in the finding, there were unsupported adjustments, so we request the Director, Defense Finance and Accounting Service Indianapolis reconsider his position. Both the Acting Deputy Chief Financial Officer and the Director, Defense Finance and Accounting Service Indianapolis concurred with recommendation to have supervisory reviews of the journal voucher log but the Director, Defense Finance and Accounting Service Indianapolis needs to provide an implementation date. In addition, both the Acting Deputy Chief Financial Officer and the Director, Defense Finance and Accounting Service Indianapolis nonconcurred with the recommendation to discontinue delegating journal voucher approval authority.

Because the delegation of authority weakens the internal control, we request that the Acting Deputy Chief Financial Officer and the Director reconsider their positions. Also, the Acting Deputy Chief Financial Officer and the Director, Defense Finance and Accounting Service Indianapolis nonconcurred with the recommendation to disclose the method of estimating amounts to adjust abnormal balances. Because the disclosure for adjusting abnormal balances is important information, we request that the Acting Deputy Chief Financial Officer and the Director, Defense Finance and Accounting Service Indianapolis reconsider their positions.

We request that the Under Secretary of Defense (Comptroller)/Chief Financial Officer and the Director of the Defense Finance and Accounting Service Indianapolis provide comments on the final report by February 23, 2009. See the findings 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

Other Defense Organizations (ODO) are Defense agencies, offices, programs, commands, defense funds, and trust funds that are funded with Treasury Index 97 funds (also referred to as Department 97). The consolidated ODO financial statements are classified as either "general fund" or "working capital fund." The Office of Management and Budget does not require DoD to prepare separate audited financial statements for the consolidated ODO general and working capital funds. However, ODO general and working capital funds represent 2 of the 11 consolidated entities in the DoD Agency-Wide financial statements. Consistent with the FY 2002 National Defense Authorization Act (Public Law 107-107), DoD requires 11 of the 42 ODO general fund activities' accountants to prepare financial statements. This report addresses the compilation of the 42 activities' financial data that combine to form the ODO general fund balances reported in the DoD Agency-Wide financial statements. The 42 ODOs had a combined total of $140.5 billion in budget authority in FY 2007.

Defense Finance and Accounting Service. As of May 2007, Defense Finance and Accounting Service (DFAS) Indianapolis (referred to as DFAS Indianapolis) was responsible for compiling financial data for 42 ODO trial balances submitted by field accounting sites for budget execution reports and financial statements. Appendix C lists the ODOs that submit the trial balances DFAS Indianapolis compiles. Field accounting sites are responsible for recording, processing, summarizing, verifying, and reporting accounting transactions and then submitting general ledger trial balance information to DFAS Indianapolis on a monthly basis. The field accounting sites provide trial balances in both DoD Standard General Ledger and the U.S. Government Standard General Ledger (USSGL) formats.

Compilation Process for ODO General Fund Financial Data. The ODO trial balance financial data is compiled, adjusted, and reported in the DoD Agency-Wide financial statements. DFAS Indianapolis uploads electronic trial balances from ODOs into the Chief Financial Officer Load and Reconciliation System (CLRS). CLRS compiles data into a USSGL-compliant database for final processing by the Defense Departmental Reporting System (DDRS)-Audited Financial Statements subsystem. DFAS Indianapolis personnel prepare and record journal vouchers (JVs) to establish beginning balances, correct prior-period errors, estimate intragovernmental balances with trading partners, and adjust proprietary accounts to reconcile with budgetary accounts.

The ODO compilation process uses the USSGL account structure. The USSGL account structure provides a self-balancing set of budgetary accounts to record the appropriation, apportionment, allocation, commitment, obligation, and expenditure process. Proprietary asset and liability accounts cover the receipt of funds in the Treasury, the proper classification of assets (such as receivables, prepayment, inventory, and fixed assets), and the recognition and proper classification of liabilities. Revenue and expense accounts measure the realization of revenues from the sale of goods and services, and the recognition of costs through the use and consumption of assets. The financial control provided through accounting records for property provides managers with a tool that helps them effectively perform their stewardship functions.

The Centralized Trial-Balance System (FACTS II) is a computer program that allows agencies to submit accounting data. The data include mostly budgetary information that is required for the Report on Budget Execution and Budgetary Resources Standard Form 133 (SF 133) and the Year-End Closing Statement. The SF 133 ties an agency's financial statements to its budget execution. Figure 1 provides an overview of the ODO compilation process:

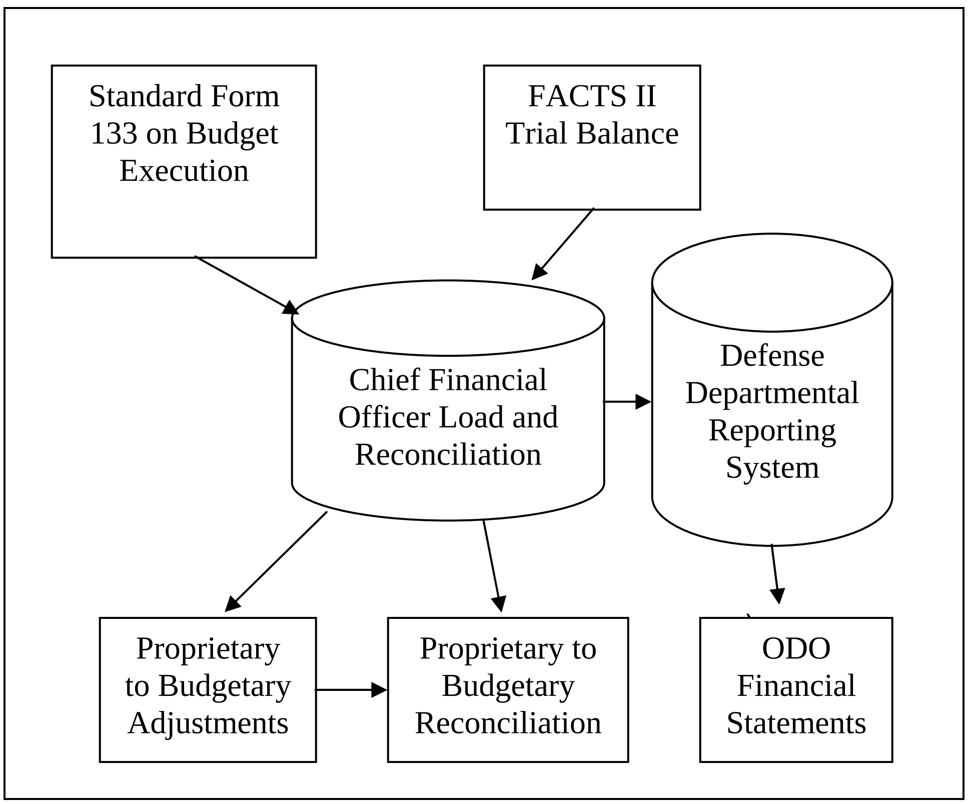

Figure 1. ODO Compilation Process

Defense Departmental Reporting System. DDRS provides tools for DoD accountants to produce audited financial statements, unaudited interim financial statements, and budgetary reports. DFAS Indianapolis uses the DDRS-Audited Financial Statements module to report compiled ODO general fund financial data in the DoD Agency-Wide financial statements. The DDRS-Audited Financial Statements module produces the DoD Agency-Wide balance sheet, statement of changes in net position, statement of net cost, statement of budgetary resources, and the statement of custodial activities. It also produces the interim and annual financial statement report footnotes, management reports, required supplementary information, and reconciliation reports.

Objectives

Our overall audit objective was to evaluate the processes used by DFAS Indianapolis for compiling and adjusting financial data for ODO general funds. We reviewed internal controls related to the audit objective. Appendix A contains a discussion of the audit scope and methodology and the review of internal controls. Appendix B shows prior audit coverage related to the audit objectives.

Accounting Adjustments and Estimates

The Defense Finance and Accounting Service (DFAS) Indianapolis did not implement an effective system of internal controls to ensure that accounting adjustments made to Other Defense Organization (ODO) general fund accounting records were sufficiently supported, approved, and reported. Specifically, the controls were insufficient for ensuring that:

- accounting adjustments were sufficiently supported and approved,
- journal entries recorded in Chief Financial Officer Load and Reconciliation System (CLRS) agreed with the journal voucher (JV) control log, and
- cost-estimate methods used on JVs were compliant with applicable standards and adequately disclosed on the financial statements.

This occurred because of DoD personnel's:

- noncompliance with Federal accounting standards and DoD Financial Management Regulations,
- lack of supervisory oversight of the JV control log, and
- ineffective accounting adjustment review and approval processes.

These internal control weaknesses increased the risk that balances reported in the DoD Agency-Wide financial statements were materially misstated. In addition, the lack of adequate financial statement note disclosures on the basis of the amounts presented could mislead the users of the financial statements.

Criteria

The DoD Regulation 7000.14-R, "DoD Financial Management Regulation," (DoD FMR) and Accounting Principles Generally Accepted in the United States (GAAP) for Federal reporting entities should be used to compile the DoD financial statements. GAAP is the highest-authority accounting guidance. The DoD FMR should implement GAAP. In financial statement audits, the auditors must obtain written representations from management affirming that it has or has not followed GAAP in preparing the financial statements.

DoD Regulations. DoD FMR contains two chapters that provide detailed guidance for supporting and approving JV adjustments and reporting estimated amounts.

Supporting and Approving Journal Vouchers. DoD FMR, volume 6A, chapter 2, prescribes JV-related supporting documentation and approval requirements. Proper documentation is necessary to support all JV entries. The documentation should allow approving officials and others, such as auditors, to understand clearly the reason for preparing a JV and to be able to tell whether it is proper and accurate. Reporting entity officials of varying ranks are responsible for approving JVs. The DoD FMR specifies approval thresholds and requires that all JVs for more than $1 billion be coordinated with the customer prior to processing. Table 1 shows the approval thresholds for the adjusting JVs.

Table 1. Journal Voucher Approval Thresholds

Threshold	Dollar Amount	Approving Official
1	Less than $100 million	Reporting Entity Branch Chief
2	$100-$500 million	Supervisory Reporting Entity Branch Chief
3	More than $500 million-$1 billion	Director for Accounting for the Reporting Entity
4	More than $1 billion	Director for the Reporting Entity

Adjustments to Intragovernmental Accounts. DoD FMR, volume 6B, chapter 13 prescribes requirements for making JV adjustments to intragovernmental accounts. It states that:

> The Department shall not make adjustments based on level 1 data received from its trading partners.[1] Currently, the Department's level 1 trading partners are not capable of providing transaction data with sufficient detail and documentation to support making an adjustment.

Accounting Standards. The Federal Accounting Standards Advisory Board's (FASAB) establishes Federal accounting standards. The Financial Accounting Standards Board (FASB) originates standards for financial accounting and reporting for business and nonbusiness organizations. Both organizations promulgate standards that are part of GAAP. The American Institute of Certified Public Accountants prescribes a hierarchy of accounting standards applicable to Federal Government financial reporting. FASAB accounting standards are at the top of the hierarchy, along with FASB-promulgated standards made applicable to Federal Governmental entities by a FASAB Statement or Interpretation. If not made applicable to Federal Government entities by a FASAB Statement or Interpretation, FASB-promulgated standards are at the bottom of the hierarchy, along with FASB Concept Statements and International Accounting Standards.

[1] Level 1 data is data received from non-DoD Federal trading partners.

Federal accounting standards include guidance for supporting and reporting estimated JV amounts and making proper disclosures in the financial statement footnotes.

Statements of Federal Financial Accounting Concepts and Standards. According to the Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," September 2, 1993, nothing material should be omitted from the information necessary to faithfully represent the underlying events and conditions; nor should anything be included that would likely cause the information to be misleading to the intended report user. Statement of Federal Financial Accounting Concepts No. 2, "Entity and Display," June 5, 1995, states that management is responsible for the accuracy and fairness of the information presented on the financial statements and that the associated note disclosures are necessary so that financial statement users understand the context of the reported information.

Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," September 1995, provides guidance for the recognition or disclosure of contingent liabilities. Contingent liabilities are recognized or disclosed in connection with an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. Exchange transactions that arise from government-acknowledged events[2] would be recognized when goods and services are provided. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.

Statement of Financial Accounting Concept. Statement of Financial Accounting Concept No. 4, "Objectives of Financial Reporting by Nonbusiness Organizations," December 1980, acknowledges that information provided by financial reporting often results from approximate, rather than exact measures. The measures commonly involve estimates, classifications, summarizations, judgments, and allocations. Financial reporting should include explanations and interpretations to help users understand financial information.

Management Representations. American Institute of Certified Public Accountants Professional Standards, Auditing Section 333, June 1, 2006, states that the auditor obtains written representations from management to complement other auditing procedures. Written management representations relate to the propriety of the financial statements and should address matters such as:

- acknowledgment of management's responsibility for the fair presentation of the financial statements;
- availability of all financial records and related data;

[2] Statement of Federal Financial Accounting Standards No. 5, "Accounting for the Liabilities of the Federal Government," states that Government-acknowledged events are events that are not a liability in themselves, but are those events that are "of financial consequence to the Federal Government because it chooses to respond to the event."

- plans or intentions that may affect the carrying value or classification of assets or liabilities;

- knowledge of significant estimates that are required to be disclosed; and

- violations or possible violations of laws or regulations, the effects of which should be considered for disclosure in the financial statements.

Supporting Accounting Adjustments

DFAS Indianapolis did not properly support and review all JV adjustments and disclose all cost estimates in the financial statements. The JV metric report is used by the Secretary of Defense (Comptroller)/Chief Financial Officer (USD[C]/CFO) to monitor DoD progress in reducing unsupported accounting adjustments. Of the 101 JVs for $43.4 billion reviewed, DFAS Indianapolis classified 5 JVs as unsupported and 96 as supported for the second quarter FY 2007 metric report submitted to the USD(C)/CFO. DFAS Indianapolis categorized the remaining 96 JVs as supported; however, we determined that 15 of 101 (15 percent) totaling $77.7 million were unsupported.

DFAS-Identified Unsupported Adjustments. Of the five JVs that DFAS identified as unsupported, DFAS staff recorded three JVs, totaling $2.7 billion, which lacked support for estimates used to adjust intragovernmental account balances. The JV descriptions indicated that the estimates were based on data calls with non-DoD (Level 1) trading partners. DFAS Indianapolis officials did not determine or document what portions of the amounts recorded were for non-DoD trading partners. The DoD Office of Inspector General (DoD OIG) previously reported that the design of internal controls did not provide reasonable assurance that trading partner data are supported by adequate documentation or valid estimating methodology.[3] The DFAS Indianapolis's use of Level 1 data received from its non-DoD trading partners deviates from the stated DoD FMR prohibition:

> The Department shall not make adjustments based on level 1 data received from its trading partners. Currently, the Department's level 1 trading partners are not capable of providing transaction data with sufficient detail and documentation to support making an adjustment.

Auditor-Identified Unsupported Adjustments. We determined that 15 of 101 JVs totaling $77.8 million were unsupported. Two JVs were related to adjustments made to avoid abnormal balances, four JVs were to record the effects of contract financing payments,[4] and nine JVs had other documentation issues.

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[3] DoD IG Report No. D-2006-008, "Report on Defense Departmental Reporting System and Related Financial Statement Compilation Process Controls Placed in Operation and Tests of Operating Effectiveness for the period October 1, 2004 through March 31, 2005," October 24, 2005.

[4] Federal Acquisition Regulations define contract financing payments as authorized Government disbursements of monies to a contractor prior to acceptance of supplies or services by the Government.

Abnormal Balance Adjustments. Two JVs, with an absolute value totaling $8.7 million, were used to eliminate abnormal balances in Federal accounts. These two JVs moved amounts from Federal to non-Federal liability accounts so that, according to DFAS officials, abnormal balances would not be reported in Federal accounts. The JVs and supporting documentation explained the nature of the adjustments and their impact, but did not justify the adjustments. DFAS Indianapolis should have reconciled the accounts and determined the causes for the abnormal balances. In a FY 2006 report, the DoD OIG reported that the processes used by DFAS Indianapolis to compile financial statements inherently masked or eliminated abnormal balances.[5] DFAS Indianapolis nonconcurred with the recommendation to establish and implement a process to identify abnormal balances in the financial data and to disclose the financial statement disposition of those anomalies.

Contract-Financing Payments. There were 4 JVs totaling $10.8 million that were recorded for estimated contingent liabilities and other assets. The JV contained the statement that it was recognizing "a contingent liability for the estimated future contract-financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product." However, there was not sufficient JV documentation to support the adjustments. The Department uses several different types of contract-financing payments, such as advances, performance-based payments, and progress payments based on cost. The JVs did not identify which types of contract-financing payments were made. If the payment type was an advance to the contractor, the four accounting adjustments should not have been made.

DFAS Indianapolis personnel said that the four JVs were made for future contract financing payments based on the USD(C)/CFO quarterly guidance related to progress payments based on contract cost. If so, the four adjustments resulted in the misclassification of future contract financing payments as "contingent liabilities" instead of other liabilities because the progress payments are for exchange transactions, and their associated future contract financing payments do not measure potential loss. DFAS Indianapolis personnel said that they followed USD(C)/CFO quarterly guidance based on an accounting policy memorandum issued by the USD(C)/CFO titled, "Change in Financial Reporting Practices for Progress Payments Based on Cost," December 7, 2006. However, the policy memorandum was not attached to the four JVs to explain why and how the estimate was determined, and DFAS Indianapolis personnel could not immediately locate it. Even after DFAS personnel found the policy memorandum and provided it to us, we questioned its applicability to the four JVs. The USD(C)/CFO policy did not comply with the Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," September 1995.

Other Documentation Issues. DFAS Indianapolis incorrectly classified an additional nine JVs for $58.3 million as supported. According to the DoD FMR, adequate support for JVs is important to ensuring that JVs accurately record a financial event and that documentation for a detailed audit trail exists.

[5] DoD IG Report No. D-2006-092, "Controls over Abnormal Balances in Financial Data Supporting Financial Statements for Other Defense Organizations," June 8, 2006.

Two of the nine JVs, totaling $12.7 million, changed the attributes of the USSGL "undelivered orders – obligations, unpaid" account entries in order to force agreement between balances reported in the financial statements and those reported in the SF 133 Report on Budget Execution and Budgetary Resources. DFAS Indianapolis did not adequately reconcile the amounts on the financial statements and the SF 133 to determine the cause of the differences. Another four JVs, totaling $17.2 million, affecting the Imputed Financing Sources and Imputed Costs USSGL, did not include adequate support or cited other JVs that had not been properly approved. The remaining three unsupported JVs were for:

- $10.2 million that was moved from Accounts Payable to Accrued Funded Payroll and Leave,
- $5.2 million that corrected another JV affecting Other Assets, and
- $13 million that affected Other Losses and Accounts Payable.

Journal Voucher Logs

There were 13 discrepancies between the JV log sheets and the JV adjustments in CLRS. The JV log sheets are an internal control over the compilation process designed to ensure that all JVs are properly recorded and provide the JV dollar amounts to management to use in making review and approval assignments based on established DoD FMR threshold amounts.

Recorded Journal Vouchers. We found five JVs that were recorded in the log but not recorded in the accounting records. A DFAS Indianapolis official said that the staff accountants failed to mark these "void" in the log at the time they were voided. An additional two JVs were recorded, then voided in the log, yet were recorded in the accounting records. The same DFAS Indianapolis official said these two JVs were incorrectly marked "void" in the JV log. He further stated that DFAS staff accountants systematically create "prep journal vouchers" to be:

> . . . better prepared to process their JVs once we get the quarterly data or quarterly trial balances and data call information. In the event, the accountant forgets or erroneously inputs another journal voucher for the same reason (forgetting the prep journal voucher was prepared), they must cancel one of the journal vouchers to eliminate any duplication.

Differences Between JV Log and Documents. There were six JV log entries that did not agree with the JV documentation. The differences ranged from $5,000 to $4.3 million, as shown in Table 2.

Table 2. Comparison of Amounts on the JV Log and JV Documents ($000)			
Item No.	JV Log	JV Document	Difference
1.	$64,518	$64,513	$ 5
2.	19,810	19,830	(20)
3.	91	272	(181)
4.	0	257	(257)
5.	3,200	6,400	(3,200)
6.	8,600	4,300	4,300

DFAS Indianapolis officials stated that amounts recorded in the JV log were inaccurate; however, there was no evidence that the JV log had been reviewed by supervisory personnel. Differences between the JV log and the accounting records bring into question the accuracy and completeness of the financial data. In addition, these types of errors have the potential to adversely affect the current JV review and approval procedures because JV review assignments are based on the dollar amounts shown in the CLRS JV Log in relation to the thresholds shown in Table 1.

Journal Voucher Review and Approvals

DFAS Indianapolis did not properly approve 24 JVs of the 101 we reviewed. The 24 JVs, which totaled more than $37 billion, had the following problems.

- DFAS Indianapolis did not coordinate five JVs, valued in excess of $1 billion each, with reporting entity customers. In addition, DFAS officials did not review and approve the JVs until after they were recorded and the financial statements were prepared.
- Eighteen JVs totaling more than $88 million were approved by a DFAS Indianapolis Team Leader, a rank below the lowest prescribed by the DoD FMR.
- One JV for more than $3 million was not approved at all.

Coordination of JV Reviews. DFAS Indianapolis officials approved five JVs valued at more than $1 billion each, but did not coordinate the approvals with reporting entity officials or customers, as required by the DoD FMR.[6] DFAS serves as an accounting service organization and should not assume ODO reporting entity management responsibilities for assertions in the financial statements by approving JVs. For ODO reporting entities issuing separate financial statements, DFAS Indianapolis officials should coordinate with the reporting entity officials who would make formal representations to independent auditors in connection with audits of annual financial statements. Statement of Federal Financial Accounting Concepts No. 2, "Entity and Display," May 1980, states that:

> . . . reporting entities are entities that issue general-purpose financial statements to communicate financial and related information about the entity. For an entity to be a reporting entity it would need to meet all of the following criteria: (i) there is a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget or a portion thereof, and held accountable for the entity's performance; (ii) the entity's scope is such that its financial statements would provide a meaningful representation of operations and financial conditions; and (iii) there are likely to be users of the financial statements who are interested in and could use the information in the statements to help them make resource allocation and other decisions and hold the entity accountable for its deployment and use of resources.

For ODO activities that do not issue separate financial statements, DFAS Indianapolis officials should coordinate with USD(C)/CFO officials who make formal representations to independent auditors. The nonissuer ODO activity financial reporting information is included in the DoD Agency-Wide financial statements.

Timing of JV Reviews. The DFAS Indianapolis Deputy Director's review and approval of the five JVs for more than $1 billion each occurred after the adjustments had been recorded and the financial statements prepared. Reviewing and approving JVs after recording them defeated the approval process internal control purpose, consequently reducing the likelihood that errors or omissions were detected and corrected in a timely manner.

JV Approval Delegations. A DFAS Indianapolis official holding a rank below the minimum required by the DoD FMR reviewed and approved 18 JVs totaling more than $88 million. In addition, DFAS Indianapolis delegated JV approval authority to employees more than one rank lower than those required by the DoD FMR. The DFAS Indianapolis Deputy Director issued a memorandum dated March 30, 2006, delegating authority to approve JV threshold amounts greater than $1 billion to the DFAS Indianapolis Branch Chief responsible for the ODO accounting. As noted in Table 1, Reporting Entity Branch Chiefs may only approve JVs for less than $100 million. The memorandum also stated that the

[6] The five JVs approved by DFAS Indianapolis officials but not coordinated with reporting entity officials affected the Defense Information Systems Agency, DoD Component-level accounts, and the Service Medical Activities of the Army, Navy, and Air Force.

Director will review and certify all journal voucher adjustments made for the designated thresholds upon completion of each quarter's financial statements.

On March 29, 2006, the DFAS Indianapolis Director of Accounting Operations issued a memorandum delegating authority to approve journal vouchers threshold amounts greater than $500 million but less than $1 billion to the DFAS Indianapolis ODO General Fund Branch Chief. This memorandum also stated that the Director would review and certify all journal voucher adjustments made for the designated thresholds upon completion of each quarter's financial statements. Contrary to statements found in both memorandums, we did not identify any after-the-fact Director approvals in connection with any of the JVs we reviewed.

DFAS Indianapolis personnel did not provide requested documentation giving them the authority to delegate review and approval authority. The delegations circumvented the approval authority structure prescribed in the DoD FMR. This defeats the intended purpose of the DoD FMR, which is ensuring that only qualified employees approve high-dollar adjustments. The risk of material misstatements in the financial statements is increased by delegating review and approval authority to inappropriate levels of authority.[7]

Financial Statement Disclosure

DFAS Indianapolis did not properly disclose the problems with abnormal balances in the ODO accounts and the methods used to estimate amounts for adjusting entries in the footnotes of the financial statements.

Abnormal Balances. DFAS Indianapolis did not properly disclose the abnormal balances because such disclosure is not a DoD FMR requirement. DoD IG Report No. D2004-118, "Army General Fund Controls Over Abnormal Balances for Field Accounting Activities," September 28, 2004, previously reported that DFAS Indianapolis did not effectively detect and report abnormal balances in the Army General Fund accounting records. The first quarter FY 2004 trial balance data for the Army General Fund included $884.4 billion of unresolved abnormal account balances. Neither the Army general fund nor the DoD Agency-Wide financial statements disclosed the unresolved abnormal balances. As a result, the footnote disclosures in the financial statements were inaccurate and misleading.

The DoD OIG recommended that the USD(C)/CFO revise the DoD FMR to require financial statement footnote disclosures of the amounts of unresolved abnormal balances. The Deputy Chief Financial Officer of DoD concurred with the recommendation and stated that her office will update the DoD FMR to require the disclosure of unresolved abnormal balances for all proprietary and budgetary accounts in the footnotes to the financial statements.

[7] American Institute of Certified Public Accountants Professional Standards as of June 1, 2006; Auditing Section 316, "Consideration of Fraud in a Financial Statement Audit," and Auditing Section 342, "Auditing Accounting Estimates."

The Assistant Secretary of the Army (Financial Management and Comptroller) and the then Director of DFAS Accounting Services–Army (Indianapolis) agreed to work together to improve the reporting and correcting of abnormal balances. The Director also stated that researching abnormal balances would be implemented as part of the DDRS-Budgetary Module to detect and correct all abnormal balances, which is part of the Business Enterprise Information Services. However, until the Business Enterprise Information Services is being used by DFAS Indianapolis to compile the financial statements and management reports, the magnitude of abnormal balances should be reported in the footnotes.

Accounting Estimates. DFAS Indianapolis did not disclose the methodologies used to estimate liabilities for future contract-financing payments in the financial statement footnotes, as specified by Statement of Financial Accounting Concept No. 4. The USD(C)/CFO accounting policy change for estimating contingent liabilities for future contract-financing payments was applied for the first time for the FY 2006 DoD Agency-Wide Financial Statements. DFAS Indianapolis should disclose and explain the policy change in future financial statements with reference to the FY 2006 implementation date. Accounting standards prescribe that a change in accounting policy should be made only if required by a standard or an interpretation or if the change results in the financial statements providing reliable and more relevant information on the effects of transactions, events, or conditions. Neither criterion was met in respect to implementation of the USD(C)/CFO accounting policy on estimating contingent liabilities. DFAS Indianapolis should account for changes in accounting policy retrospectively or include disclosures in the financial statements explaining why retrospective application is not practicable. The disclosure should include the period of change addressed by the policy memorandum.

Without such disclosures, financial statement users may be misled into believing that amounts reported were based on actual transactions, rather than estimates, or that the estimates were compliant with the DoD FMR and GAAP.

Conclusion

Maintaining effective internal controls over the preparation and recording of accounting adjustments has been a long-standing problem at DFAS Indianapolis resulting in increased internal control risk. The American Institute of Certified Public Accountants defines internal control risk as the risk that a material misstatement that could occur in an assertion will not be prevented or detected in a timely manner by the entity's internal control. The risk is a function of the effectiveness of the design and operation of internal control in achieving the entity's objectives for preparing the entity's financial statements.[8] The internal control weaknesses discussed in this report increased the risk that ODO general fund balances reported in the DoD Agency-Wide financial statements were materially misstated.

[8] American Institute of Certified Public Accountants Professional Standards as of June 1, 2006, Auditing Section 312, "Audit Risk and Materiality in Conducting an Audit."

DoD Agency-Wide Financial Statements. The amounts of potential misstatements or uncertainties in the financial statements are material. For FY 2007, DFAS Indianapolis made $172 billion in unsupported JV adjustments.

- Four JVs totaling $74 billion were not recorded in accordance with GAAP.

- Thirteen JVs totaling $98 billion were not properly supported.

Management Representations. Entity officials' written management representations provided to auditors could be compromised by not having reviewed and approved journalized adjustments. DFAS Indianapolis should coordinate approvals with reporting entity officials, who are its customers.

By not reviewing JVs prior to the financial statement submission deadlines, DFAS Indianapolis could process erroneous JVs that can only be corrected at the request of the USD(C)/CFO.[9] Prior to the submission deadlines, DFAS Indianapolis can process adjustments into the accounting systems without approval from the USD(C)/CFO. After these deadlines, only adjustments requested by the USD(C)/CFO can be processed in DDRS. By reviewing adjusting JVs after the submission deadlines, DFAS Indianapolis may unnecessarily complicate the process. If the reviewer determines that an adjusting JV is incorrect, any correcting JVs would need to be coordinated with USD(C)/CFO. Also, any corrections made after these dates would result in changes to the financial statements. By reviewing the adjusting JVs before the submission deadlines, DFAS Indianapolis can process corrections without USD(C)/CFO coordination and avoid additional reviews and reconfirmations.

Other Matters of Interest

During audit fieldwork, we determined that the DoD FMR did not contain an accurate and complete list of ODO appropriations. This occurred because Appendix A in DoD FMR, volume 6B had not been updated since November 2001. As a result, the Appendix contained inaccurate information and did not include appropriations enacted within the last several years. However, in September 2007, Appendix A was removed from the DoD FMR with an explanation that the U.S. Treasury Department maintains information on appropriations. This will eliminate the need to continually update information contained in the DoD FMR that has already been updated by the U.S. Treasury Department.

[9] American Institute of Certified Public Accountants as of June 1, 2006, Auditing Section 312.06 states: "…errors may involve unreasonable accounting estimates arising from oversight or misinterpretation of facts…and mistakes in the application of accounting principles relating to amount, classification, manner of presentation, or disclosure."

Management Comments on the Finding and Audit Response

We received comments on the report finding from the Acting Deputy Chief Financial Officer who responded for the Under Secretary of Defense (C)/CFO. The Acting Deputy Chief Financial Officer (ADCFO) provided recommendations

for changes to the report narrative. The full text of his comments is contained in the management comments section of the report. We summarized the comments and audit responses.

Management Comment. The ADCFO stated that the references to the $884.4 billion in the FY 2004 Army General Fund trial balance were misleading. In addition, he recommended deleting the entire Financial Statement Disclosure section.

Audit Response. The reference in the report was a factual statement to show that the problem is material to the DoD Agency-Wide financial statements. The FY 2007 Army General Fund trial balance contained more than $1 trillion in abnormal balances. We are not deleting the statements related to the Army general funds or those in the Financial Statement Disclosure section because they are true statements.

Management Comment. The ADCFO stated that the reference to the U.S. Government Standard General Ledger should be revised to U.S. Standard General Ledger.

Audit Response. We revised the report.

Management Comment. The ADCFO stated that the third bullet on page 4 should be revised to read: “cost-estimate used on JVs were not adequately disclosed on the financial statements.”

Audit Response. We are not changing the third bullet on page 4 because we believe it is accurate.

Management Comment. The ADCFO recommended deleting the last sentence of the paragraph discussing the prohibition from using Level 1 partner data and the DoD FMR citation. He also stated that DoD Components have been instructed to use Level 1 partner data to develop estimates in separate guidance.

Audit Response. Because the USD(C)/CFO has not changed the DoD FMR, the policy was still in effect. Regardless, the adjustment is a forced entry, and we consider it unsupported, like the Level 2 and Level 3 adjustments.

Management Comment. The ADCFO recommended that, on page 8, the parenthetical comment “(absolute value of debits and credits)” be added after the $8.7 million, for clarity. In addition, he recommended deleting the comment “ . . . so abnormal balances would not be reported” from the report.

Audit Response. We did not make the recommended changes because they would make the report statements inaccurate. The $8.7 million is only one side of the journal entry.

Management Comment. The ADCFO recommended deleting the last sentence in the first paragraph on page 8 in the Contract Financing Payments section that

reads: "If the type was an advance to the contractor, the four accounting adjustments should not have been made." In addition, he recommended deleting the second paragraph in its entirety.

Audit Response. We did not make the recommended changes because the statements are accurate.

Management Comment. The ADCFO recommended deleting the last paragraph under JV Approval Delegations on page 12. He explained that the OUSD(C) has approved delegations of JV approvals authority provided the JVs are properly approved within 10 days of completion of the financial reports.

Audit Response. We did not make the recommended change because the statements are accurate.

Recommendations, Management Comments, and Audit Response

Renumbered and Redirected Recommendations. The Director, DFAS Indianapolis stated that, beginning in FY 2007, the USD(C)/CFO granted the ODO Audited Financial Statements Branch a waiver from preparing consolidated footnotes 6 and 15, where the disclosure on the methodology used to estimate contingent liabilities would appear. As a result, we redirected Recommendation 2.d. to the USD(C)/CFO. We renumbered Recommendation 2.d. to 1.b. Former Recommendation 1 is now 1.a., and Recommendation 2.e. is now 2.d.

1. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer:

a. Update the DoD Regulation 7000.14-R, "DoD Financial Management Regulation," to require financial statement footnote disclosure of the amounts of unresolved abnormal balances, as agreed to in DoD IG Report No. D2004-118, "Army General Fund Controls Over Abnormal Balances for Field Accounting Activities," September 28, 2004.

Management Comments. The ADCFO partially concurred. He stated that the DoD FMR was previously updated to require the appropriate disclosure of abnormal balances. The DoD FMR will be further modified to require the disclosures for abnormal balances in the consolidated DDRS trial balance even when not apparent in the financial statements and footnotes.

Audit Response. Comments from the ADCFO are partially responsive. We request that the USD(C)/CFO provide a completion date for the DoD FMR modification in response to the final report.

b. Make footnote disclosures on the DoD Agency-Wide financial statements to explain the methodology used to estimate contingent liabilities for future contract-financing payments.

Management Comments. The ADCFO nonconcurred. He stated that the current procedures and disclosures were negotiated with the DoD OIG based on Report No. D-2005-062, "Report on Recording and Accounting for DoD Contract Financing Payments," May 10, 2005. He further stated that the agreement was reached with DoD OIG personnel in August 2006.

Audit Response. Comments from the ADCFO are nonresponsive. We found no evidence that the USD(C)/CFO reached an agreement with DoD OIG personnel concerning a footnote disclosure explaining the methodology used to estimate contingent liabilities for future contract-financing payments. The DoD accounting policy on reporting contingent liabilities discussed in this report indicates that the amounts reported are based on accounting estimates and explains the estimation methodology to be applied. The American Institute of Certified Public Accountants Professional Standards requires that financial statements properly disclose accounting estimates. These standards state that the presentation of financial statements in conformity with GAAP includes adequate disclosures of material matters, such as the basis of the amounts presented in the financial statements. We request that the ADCFO reconsider his position and provide additional comments in response to the final report.

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

a. Implement procedures to ensure that all Other Defense Organization journal vouchers are supported and reviewed by officials with the appropriate level of authority.

Management Comments. The ADCFO concurred but provided no details on how he intends to execute the recommendation.

The Director, DFAS Indianapolis nonconcurred with the recommendation. The Director stated that DFAS personnel clearly defined the source of data and the reason for the adjustments in the JVs. The Director also stated that DFAS personnel had requested that the DoD OIG provide documentation of the deficient JVs. However, after numerous requests, the DoD OIG did not identify the deficient JVs. Therefore, the Director could not make specific comments because DFAS was unclear as to the specific JVs being addressed in the report.

The Director further stated the DoD OIG deemed the contract financing JVs as unsupported, however, procedures and disclosures related to contract financing JVs are based on cost and were in accordance with OUSD(C)/CFO guidance. The Director also stated that, in relation to contract financing JVs, without reference of the specific JVs the auditors used in reaching their conclusions, we are unable to evaluate the accuracy of the conclusions.

The Director also stated that DFAS reviewed and approved all JVs at the appropriate levels of authority. The Director stated that the auditors adjudged some substantial journal vouchers as improper because DFAS Indianapolis did not review them prior to input. The Director also stated that DFAS Indianapolis

management does not believe that current practices for preparing, supporting, and authorizing journal vouchers to make accounting adjustments negatively affect balances reported in the DoD Agency-Wide financial statements.

Audit Response. Comments from the ADCFO are partially responsive. We request that the USD(C)/CFO provide the date and details on how the office will implement the procedures.

The Director, DFAS Indianapolis comments were nonresponsive. On May 7, 2007, we provided DFAS personnel with JV control numbers included in our sample selection. On July 8 and 9, 2008, DFAS personnel visited our office and then made copies of the documentation. DoD OIG personnel also shared some proprietary information with DFAS personnel as a professional courtesy. Most of this documentation we originally obtained from Departmental Accounting, which should have been readily available to DFAS.

DFAS is required to maintain this documentation for 6 years and 3 months. As discussed in the report, the information on or attached to the JVs was not convincing to ensure that the adjustments were accurate, proper, and justified. In addition, we discussed the adequacy of the supporting documentation with Departmental Accounting throughout the audit and at the exit conference on March 10, 2008, when we provided DFAS Indianapolis with a discussion draft of the report.

DFAS Indianapolis personnel should not have problems identifying the contract financing JVs because we provided the documentation. We originally obtained the 101 JVs from Departmental Accounting. Based on the supporting documentation provided, we were unable to determine whether Departmental Accounting recorded the JV adjustments for the financing payments in accordance with an USD(C)/CFO accounting policy. The issue discussed in the finding was the lack of documentation. While the accounting policy is not GAAP compliant, we recommended only that DFAS disclose the estimation methodology in the financial statement notes.

We disagree with the Director's statement that DFAS properly reviewed and approved JV adjustments. As discussed in the finding, in some examples, the Deputy Director reviewed and approved JVs after DFAS recorded the adjustment and prepared the financial statements. The report discusses other instances of improper delegations of review and approval of journalized adjustments. The American Institute of Certified Public Accountants Professional Standards states that "material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries." For estimate-based JV adjustments, these standards stress the importance of adequate review and approval by appropriate levels of authority.

Proper JV review and approval, as prescribed in the DoD FMR, is an important component of internal control over financial reporting. The DoD FMR prescribes specific approval authority levels by dollar amount thresholds to strengthen internal control over JV adjustments. Proper JV review and approval may have

helped prevent or detect JVs contributing to material misstatement in the financial statements. We request that the Director, DFAS Indianapolis reconsider his position and provide comments in response to the final report.

b. Implement procedures for Departmental Accounting supervisory review of the journal voucher control log.

Management Comments. The ADCFO concurred, but did not provide details on how the office will implement the procedures or the planned implementation date.

The Director, DFAS Indianapolis partially concurred and stated that DFAS Indianapolis has procedures for Departmental Accounting supervisory review of the JV control log. He stated that DFAS Indianapolis would update its processes to require the signature of the reviewer and the date of review. He did not provide the planned implementation date.

Audit Response. Comments from the ADCFO and the Director, DFAS Indianapolis are partially responsive. We request that they provide implementation details, including the dates.

c. Discontinue the delegation of authority for journal voucher review and approval to lower-level managers and supervisors.

Management Comments. The ADCFO nonconcurred. He stated that the OUSD(C)/CFO approves of DFAS managers delegating authority for JV review and approval in accordance with DoD FMR volume 6A, chapter 2.

The Director, DFAS Indianapolis also nonconcurred, stating that the DoD FMR does not specifically prohibit the delegation of authority for journal voucher review and approval.

Audit Response. Comments from the ADCFO and the Director, DFAS Indianapolis are nonresponsive. DoD FMR volume 6A, chapter 2 does not address delegation of authority for JV approvals. In fact, the DoD FMR prescribes specific approval authority levels by dollar amount thresholds to strengthen internal control over journalized adjustments. We request that the USD(C)/CFO and the Director reconsider their positions and provide comments in response to the final report.

d. Make footnote disclosures on the DoD Agency-Wide financial statements to explain estimates used to adjust abnormal balances.

Management Comments. The ADCFO nonconcurred and stated that the adjustments were not made to adjust abnormal balances, but rather to move amounts from Federal accounts to nonfederal accounts for which DFAS had no trading partner information.

The Director, DFAS Indianapolis also nonconcurred, stating that DFAS Indianapolis does not use estimates to adjust abnormal balances, but rather forces Federal accounts to agree with nonfederal account balances.

Audit Response. Comments from the ADCFO and the Director, DFAS Indianapolis are nonresponsive. The ADCFO and Director's comments describe an adjustment to force amounts to agree. In addition, the explanation on the JVs states: "This adjustment moves the abnormal Accounts Payable – Federal to Accounts Payable – Public, but does not impact the overall accounts payable balance for 2nd Quarter, FY 2007." DFAS Indianapolis did not provide adequate support for the JV adjustments. DFAS Indianapolis did not support the JVs by either transactional analysis or an adequate estimation methodology. The American Institute of Certified Public Accountants Professional Standards requires proper disclosure of accounting estimates. These standards further state that the presentation of financial statements should include adequate disclosures of material matters; such as the basis of the amounts presented in the financial statements. We request that the USD(C)/CFO and the Director reconsider their positions and provide comments in response to the final report.

Appendix A. Scope and Methodology

We performed this performance audit from April 2007 through January 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We evaluated the processes used by Defense Finance and Accounting Service (DFAS) Indianapolis for compiling and adjusting financial data for Other Defense Organizations (ODO) general funds. Specifically, we reviewed internal controls related to the financial statement compilation process and preparation. We tested the appropriateness of accounting adjustments made to the trial balance data. We obtained an understanding of the ODO general fund financial reporting process and the controls over journal entries and other adjustments.   We also reviewed applicable laws, regulations, and U.S. generally accepted accounting principles (GAAP).

For second quarter FY 2007, we reviewed the 263 entries recorded in the CFO Load, Reconciliation System (CLRS) journal voucher log (JV) to determine whether there were any inconsistencies between what had been logged, what had been vouched, and to determine whether there were adequate explanations for voided log entries. We reviewed the supporting documentation for 50 of the 263 CLRS adjustments recorded in the JV logs and for 51 Defense Departmental Reporting System (DDRS) JVs selected from 258 DDRS adjustments. We also reviewed 17 fourth quarter of FY 2007 JV adjustments made to ODO general fund data to compile the FY 2007 DoD Agency-Wide Financial Statements. We reviewed the JVs to determine whether DFAS Indianapolis properly approved and supported the JVs in accordance with applicable regulations and GAAP.

We were unable to review management’s self-assessments related to adjusting entries because the DFAS Indianapolis Departmental Reporting Directorate’s ODO Audited Financial Statements/Budget Execution Division did not provide the information needed in time.

Review of Internal Controls. We identified a material internal control weakness for DFAS Indianapolis as defined by DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” January 4, 2006. Specifically, DFAS Indianapolis controls over the systems and processes for adjusting ODO financial data were insufficient. Implementing the recommendations will improve internal controls for making adjusting entries recording liabilities. A copy of the final report will be provided to the senior official responsible for management controls at DFAS Indianapolis.

Use of Computer-Processed Data. We relied upon accounting adjustment data in the CLRS and DDRS. We compared the accounting adjustment data to the JVs to obtain reasonable assurance that the amounts shown on the JVs were properly recorded. We did not identify any deficiencies in the computer-processed data for adjusting entries.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the financial management high-risk area.

Appendix B. Prior Audit Coverage

During the last 7 years, the DoD OIG has issued several reports discussing the Other Defense Organizations financial data. Unrestricted DoD OIG reports can be accessed at www.dodig.mil/audit/reports.

DoD IG Report No. D-2008-008, "Defense Finance and Accounting Service Columbus Processes for Consolidating and Compiling Other Defense Organizations Financial Data," October 30, 2007

DoD IG Report No. D-2006-107, "Defense Departmental Reporting System and Related Financial Statement Compilation Process Controls Placed in Operation and Tests of Operating Effectiveness for the Period October 1, 2004, through March 31, 2005," August 18, 2006

DoD IG Report No. D-2006-092, "Controls over Abnormal Balances in Financial Data Supporting Financial Statements for Other Defense Organizations," June 8, 2006

DoD IG Report No. D-2006-008, "Report on Defense Departmental Reporting System and Related Financial Statement Compilation Process Controls Placed in Operation and Tests of Operating Effectiveness for the period October 1, 2004 through March 31, 2005," October 24, 2005

DoD IG Report No. D-2005-102, "Defense Departmental Reporting System - Audited Financial Statements Report Map," August 17, 2005

DoD IG Report No. D-2004-118, "Army General Fund Controls Over Abnormal Balances For Field Accounting Activities," September 28, 2004

DoD IG Report No. D-2002-130, "Accounting and Reporting Processes at Defense Finance and Accounting Service San Antonio," July 22, 2002

DoD IG Report No. D-2002-0096, "Major Deficiencies in Financial Reporting for Other Defense Organizations-General Funds," May 31, 2002

DoD IG Report No. D-2002-041, "Financial Reporting for the Defense Logistics Agency-General Funds at Defense Finance and Accounting Service Columbus," January 18, 2002

DoD IG Report No. D-2002-0038, "Financial Reporting for the Other Defense Organizations-General Funds at the Defense Finance and Accounting Service San Antonio," January 14, 2002

Appendix C. Other Defense Organizations

Other Defense Organizations General Fund Compiled At DFAS Indianapolis Operations	
1.	American Forces Information Services
2.	Building Maintenance Fund, Defense
3.	Business Transformation Agency
4.	Chemical Biological Defense Program
5.	Civilian Military Program
6.	Counter Intelligence Field Activity
7.	Court of Appeals of the Armed Forces
8.	Defense Acquisition University
9.	Defense Advanced Research Projects Agency
10.	Defense Information Systems Agency – General Fund
11.	Defense Intelligence Agency
12.	Defense Legal Services Agency
13.	Defense Prisoner of War/Missing Persons Office
14.	Defense Security Cooperation Agency
15.	Defense Technology Security Agency
16.	Defense Threat Reduction Agency
17.	Director, Operational Test and Evaluation
18.	DoD Component Level Accounts
19.	DoD Education Activity
20.	DoD Test Resource Management Center
21.	Emergency Response Fund, Defense
22.	Homeowners Assistance Fund, Defense
23.	Iraqi Freedom Fund
24.	Joint Chiefs of Staff
25.	Military Housing Privatization Initiative
26.	Missile Defense Agency
27.	National Defense University
28.	National Geospatial – Intelligence Agency
29.	National Security Agency
30.	Office of Economic Adjustment
31.	Office of the Inspector General, DoD
32.	Office of the Secretary of Defense (OSD)
33.	Other “TI-97” funds provided to the Air Force by OSD
34.	Other “TI-97” funds provided to the Army by OSD
35.	Other “TI-97” funds provided to the Navy by OSD
36.	Payments to the Military Retirement Fund
37.	Pentagon Force Protection Agency
38.	Pentagon Reservation Maintenance Revolving Fund
39.	Service Medical Activity
40.	TRICARE Management Activity
41.	U.S. Special Operations Command
42.	Washington Headquarters Services

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director, Program Analysis and Evaluation

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 Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform
House Subcommittee on National Security and Foreign Affairs, Committee on Oversight and Government Reform

Office of the Under Secretary of Defense (Comptroller) Comments

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

COMPTROLLER

JUL 7 2008

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

SUBJECT: Comments to Draft Audit Report, "Defense Finance and Accounting Service Indianapolis Compilation of Other Defense Organizations General Fund Financial Data," (Project No. D2007-D000FL-0195.000)

This memorandum forwards the Under Secretary of Defense (Comptroller) response to the subject draft DoD Inspector General report, dated June 4, 2008. Comments to the draft report and responses to the recommendations are attached.

We appreciate the opportunity to respond to your draft audit report. My point of contact is Ms. Kathy Sherrill. She can be contacted by telephone at 703-614-7524 or e-mail at Kathy.Sherrill@osd.mil.

David P. Smith
Acting Deputy Chief Financial Officer

Attachments:
As stated

Comments on <u>Discussion Draft for the DFAS Indianapolis Compilation of Other Defense Organizations (ODO) General Fund Financial Data</u>

Overall Summary: We recommend that the inflammatory and irrelevant references be removed from the report. The issue is compilation of the ODO financial statements. References to $884.4 billion in abnormal balances from the Army General Fund fiscal year 2004 trial balances are misleading. This is an audit of the ODO processes and the abnormal balances addressed in this report totaled less than $4 million. In addition, the report addresses recommendations with regard to contingent liabilities for future contract payments which are in conflict with procedures previously negotiated with the DoD IG.

We provide the following specific suggestions:

Page 1. References to the U.S. Government Standard General Ledger (USGSGL) should be revised to U.S. Standard General Ledger (USSGL) per the Treasury Financial Manual.

Page 4. Accounting Adjustments and Estimates. Recommend that the third bullet be revised to delete reference to noncompliance with standards. The bullet relates specifically to contingent liabilities for progress payments based on cost. The recognition and treatment of these liabilities was actually negotiated with the IG in 2006. The bullet should be revised to read: "cost-estimate methods used on JVs were not adequately disclosed on the financial statements."

Page 7. DFAS-Identified Unsupported Adjustments. Recommend you delete the last sentence of the paragraph discussing the prohibition from using level 1 partner data and delete the DoDFMR citation below and also on page 5. DoD Components have been instructed in separate guidance that it is acceptable to use level 1 partner data to develop estimates if better information is not available. The DoDFMR will be revised to incorporate this guidance.

Page 8. Abnormal Balance Adjustments. Recommend you insert the parenthetical comment "(absolute value of debits and credits)" after $8.7 million for clarity. In addition, recommend you strike the comment "…so that abnormal balances would not be reported in Federal accounts." The adjustment was not made to avoid the abnormal balances, but rather to move Federal balances for which DFAS did not have a trading partner identified.

Pages 8 and 9. Contract-Financing Payments. Recommend you strike the last sentence in the first paragraph which reads: "If the type was an advance to the contractor, the four accounting adjustments should not have been made," and strike the second paragraph in its entirety. The JVs were to recognize contingent liabilities for future payments for progress payments based on cost and were in accordance with OUSD(C) guidance. The procedures and disclosures were negotiated with the DoD IG based on DoD OIG Report

Pages 11 and 12. JV Approval Delegations. Recommend you strike the last paragraph in the section on page 12. The OUSC(C) has approved delegations of JV approval authority provided the JVs are reviewed and approved by an official of the appropriate level within 10 days of completion of financial reports in accordance with the requirements of DoDFMR Volume 6A, Chapter 2.

Pages 12 and 13. Financial Statement Disclosure. Recommend you strike the entire section. As discussed above, we believe the reference to abnormal balances from the FY 2004 audit report to be irrelevant and inflammatory. As to the issue of contingent liabilities for future contract financing payment, also as addressed above, this was previously negotiated with the DoDIG.

Pages 14 and 15. Other Matters of Interest. Recommend you delete this section. It is extraneous information and it adds no value to the report.

Attachment 1

DOD OIG DRAFT REPORT DATED JUNE 4, 2008
PROJECT NO. D2007-D000FL-0195.000

"DEFENSE FINANCE AND ACCOUNTING SERVICE INDIANAPOLIS COMPILATION OF OTHER DEFENSE ORGANIZATIONS GENERAL FUND FINANCIAL DATA"

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER) (OUSD)(C) RESPONSES TO THE DOD OIG RECOMMENDATIONS

RECOMMENDATION 1: We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer (OUSD(C)) update the DoD Regulation 7000.14-R, "DoD Financial Management Regulation," to require financial statement footnote disclosure of the amounts of unresolved abnormal balances, as agreed to in DoD IG Report No. D2004-118, "Army General Fund Controls Over Abnormal Balances for Field Accounting Activities," September 28, 2004.

OUSD(C) RESPONSE: Partially concur. The DoDFMR was previously updated to require the appropriate disclosure of abnormal balances. The DoDFMR will be further modified to require the disclosures also for abnormal balances in the consolidated DDRS trial balance even when masked in the financial statements and footnotes.

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

a. Implement procedures to ensure that all Other Defense Organization journal vouchers are supported and reviewed by officials with the appropriate level of authority.

OUSD(C) RESPONSE: Concur.

b. Implement procedures for Departmental Accounting supervisory review of the journal voucher control log.

OUSD(C) RESPONSE: Concur.

c. Discontinue the delegation of authority for journal voucher review and approval to lower-level managers and supervisors.

OUSD(C) RESPONSE: Nonconcur. The OUSD(C) approves of DFAS managers delegating authority for JV review and approval in accordance with DoDFMR Volume 6A, Chapter 2.

Attachment 2

__d.__ Make footnote disclosures on the DoD Agency-Wide financial statements to explain the methodology used to estimate contingent liabilities for future contract-financing payments.

__OUSD(C) RESPONSE:__ Nonconcur. The current procedures and disclosures were negotiated with the DoDIG based on DoD OIG Report No. D-2005-062, "Report on Recording and Accounting for DoD Contract Financing Payments," May 10, 2005. The agreement was reached with Mr. James Kornides in August 2006.

__e.__ Make footnote disclosures on the DoD Agency-Wide financial statements to explain estimates used to adjust abnormal balances.

__OUSD(C) RESPONSE:__ Nonconcur. The adjustments were not made to adjust abnormal balances, but rather to move from Federal accounts to nonfederal accounts balances for which DFAS had no trading partner information.

Attachment 2

Defense Finance and Accounting Service Comments

Final Report Reference

Final Report Reference

DEFENSE FINANCE AND ACCOUNTING SERVICE
8899 EAST 56 TH STREET
INDIANAPOLIS, INDIANA 46249

DFAS-JBI/IN

JUL 18 2008

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Defense Finance and Accounting Service Indianapolis Compilation of Other Defense Organizations General Fund Financial Data (Project No. D2007-D000FL-0195.000)

Indianapolis Operations is providing management comments for Recommendation 2, contained in subject draft report as follows:

Recommendation 2: We recommend that the Director, Defense Finance and Accounting Service Indianapolis Operations:

a. Implement procedures to ensure that all Other Defense Organization journal vouchers are supported and reviewed by officials with the appropriate level of authority.

Management Comments: Stakeholder: Dave Martin, 317-510-5554. **Non-concur.** Indianapolis Operations' Other Defense Organizations (ODO) journal vouchers are supported and reviewed by officials with the appropriate level of authority. We disagree with the auditors' findings that journal vouchers were not supported or were improperly coordinated, reviewed, and approved. The source of data for the adjustments and the reason for the adjustments were clearly defined in the journal vouchers. To better interpret the DoD IG position and effectively understand the issues at hand, Indianapolis Operations needs and has repeatedly requested information on the Journal Vouchers (JV's) used in the review. The DoD IG sampled 101 JVs in the audit, all of which were provided after numerous requests, however, the specific JVs reported as deficient were not identified so we cannot make specific comments as we are unclear as to the specific JVs being addressed.

On page 8 of the subject report, the DoDIG deemed the contract financing JV's as unsupported, however, procedures and disclosures related to contract financing JV's are based on cost and were in accordance with OUSD(C) guidance. The procedures and disclosures were negotiated with the DoD IG based on DoD OIG Report No. D-2005-062, "Report on Recording and Accounting for DoD Contract Financing Payments," May 10, 2005. The agreement was reached with Mr. James Kornides in August 2006. Without identification of the specific journal vouchers the auditors used in reaching their conclusions, we are not able to fully evaluate the accuracy of the conclusions, nor the efficacy of the recommendation.

All journal vouchers were coordinated with our Defense Agency customers as required. All journal vouchers were reviewed and approved at the appropriate levels of authority. Quarterly, the Stand-alone Defense Agencies submit Confirmation Letters stating "controls are in place to ensure that necessary adjustments made on behalf of the *Entity* in preparation of the financial

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statements have been reviewed at the appropriate level of management based upon established thresholds." We provided the auditors with copies of all memorandums by which the Director, DFAS, Indianapolis Operations, delegated review and approval authority. The auditors adjudged some large journal vouchers improper because Indianapolis Operations senior management did not review prior to input. The 21 day reporting schedule inhibits senior site management availability to review and approve journal vouchers prior to input, however the vouchers in question were reviewed and approved by the Deputy Director, Indianapolis Operations, in accordance with OUSD(C) mandated milestone dates. Additionally, we do not believe that current practices for preparing, supporting and authorizing journal vouchers to make accounting adjustments, negatively affect balances reported in the DoD Agency-Wide financial statements.

b. Implement procedures for Departmental Accounting supervisory review of the journal voucher control log.

Management Comments: Stakeholder: Dave Martin, 317-510-5554. Partially Concur. Indianapolis Operations has procedures for Departmental Accounting supervisory review of the journal voucher control log. We will update our processes to require the signature of the reviewer and the date of our review.

Estimated Completion Date: November 1, 2008.

c. Discontinue the delegation of authority for journal voucher review and approval to lower-level managers and supervisors.

Management Comments: Stakeholder: Dave Martin, 317-510-5554. Non-concur. Indianapolis Operations is compliant with the DoD Financial Management Regulation (DoDFMR) in delegating authority for journal voucher review and approval to lower-level managers and supervisors. The DoDFMR does not specifically prohibit the delegation of authority for journal voucher review and approval. It is not feasible to seek the review and approval from the Director, Indianapolis Operations during the AFS reporting schedule. The Director for Departmental Reporting (a senior level manager) actually approves all JVs $500 million and greater in both CFO Load and Reconciliation System and the Department of Defense Reporting System -AFS. Journal Vouchers $1 billion and over are reviewed by the senior executive Deputy Director (the Director's delegated authority) by the 15th calendar day following the end of the quarter as required.

d. Make footnote disclosures on the DoD Agency-Wide financial statements to explain the methodology used to estimate contingent liabilities for future contract-financing payments. Redirected 1.b.

Management Comments: Stakeholder: Dave Martin, 317-510-5554. Non-concur. Indianapolis Operations' ODO AFS Branch does not prepare the footnotes where such a disclosure would be made. Beginning in FY 2007, the OSD(C) granted the ODO AFS Branch a waiver from preparing ODO GF Consolidated footnote except for notes 3, 4, 5,8,13, and 17. The disclosures required by the DoDIG would appear in footnotes 6 and 15. The cost estimates the IG cites are part of an OUSD(C) mandated adjustment. The DoD Agency-wide AFS Division provides the data call on which the adjustments are made and makes the required disclosure in

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the Department's footnotes. Finally, the current procedures and disclosures were negotiated with the DoDIG based on DoD OIG Report No. D-2005-062, "Report on Recording and Accounting for DoD Contract Financing Payments," May 10, 2005. The agreement was reached with Mr. James Kornides in August 2006.

e. Make footnote disclosures on the DoD Agency-Wide financial statements to explain estimates used to adjust abnormal balances. Renumbered 2.d.

Management Comments: Stakeholder: Dave Martin, 317-510-5554. Non-concur. Indianapolis Operations' ODO AFS & BE Division does not use estimates to adjust abnormal balances. In addition the adjustments were not made to adjust abnormal balances, but rather to move from Federal accounts to nonfederal accounts balances for which DFAS had no trading partner information.

My point of contact is Dave Martin, Chief, ODO, Audited Financial Statements Branch, 317-510-5554.

Audrey L. Eckhart

for Steve R. Bonta
Director, Indianapolis Operations


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