Audit Report

DEFENSE HEALTH PROGRAM FINANCIAL REPORTING OF GENERAL PROPERTY, PLANT, AND EQUIPMENT

Report No. D-2000-128 May 22, 2000

Office of the Inspector General
Department of Defense

Additional Copies

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

Suggestions for Future Audits

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

OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

Defense Hotline

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

Acronyms

DFAS	Defense Finance and Accounting Service
TMA	Tricare Management Activity
USD (Comptroller)	Under Secretary of Defense (Comptroller)

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

May 22, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, TRICARE MANAGEMENT ACTIVITY

SUBJECT: Audit Report on Defense Health Program Financial Reporting of General Property, Plant, and Equipment (Report No. D-2000-128)

We are providing this audit 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. The Assistant Secretary of Defense (Health Affairs) concurred with the finding and recommendation, expressed concern about being able to implement the recommendation, and did not suggest alternative corrective action. We revised and renumbered Recommendation A.2. We request the Assistant Secretary of Defense (Health Affairs) comment on revised Recommendations A.2.a., A.2.b., and A.2.c. by July 21, 2000.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson at (703) 604-9582 (DSN 664-9582) (crichardson@dodig.osd.mil) or Mr. Ronald W. Hodges at (703) 604-9592 (DSN 664-9592) (rhodges@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-128 **May 22, 2000**
(Project No. D1999-D000FA-0041.000)
(formerly Project No. 9FA-2017.00)

Defense Health Program Financial Reporting of General Property, Plant, and Equipment

Executive Summary

Introduction. We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD to prepare annual audited financial statements. The DoD Agency-Wide financial statements include financial statements for a reporting entity called "Other Defense Organizations," a consolidation of financial information from various Defense organizations and funds, including the Defense Health Program. The Defense Health Program is a DoD appropriation account. The Tricare Management Activity distributes Defense Health Program funds to the Military Departments and itself. The Defense Health Program funds the operations of the Military Departments' medical treatment facilities, the development of DoD medical systems software, and congressionally directed research and development. The Military Departments and Tricare Management Activity are responsible for reporting accurate and complete accounting information on the execution of the Defense Health Program to the Defense Finance and Accounting Service. The FY 1999 financial statements for Other Defense Organizations reported total assets of $44 billion, which included $6.7 billion of general property, plant, and equipment. Of the $6.7 billion, $1.4 billion was for Defense Health Program general property, plant, and equipment. General property, plant, and equipment are property that DoD uses to provide goods and services or to support the entity's mission. Computer hardware and software and medical equipment at medical treatment facilities are examples of general property, plant, and equipment.

Objective. Our audit objective was to determine whether the Defense Health Program properly reported its general property, plant, and equipment on the financial statements for Other Defense Organizations. We did not review internal controls, compliance with laws and regulations, and the management control program over the process for preparing the financial statements for Other Defense Organizations because we previously reported on those issues.

Results. The Defense Health Program did not properly report its general property, plant, and equipment on the financial statements for Other Defense Organizations.

- The Tricare Management Activity of the Defense Health Program did not capitalize or allocate $247 million of software that it developed or acquired for multiple DoD medical treatment facilities. Additionally, Tricare Management Activity did not capitalize $51.4 million of planned software improvements in an inventory or work-in-progress account. As a result, the cost of general property, plant, and equipment for Other Defense Organizations was understated by at least $298.4 million. Unless the Tricare Management Activity capitalizes or allocates the costs of software that it developed or acquired for multiple DoD medical treatment facilities, general property, plant,

and equipment on the DoD Agency-Wide and Other Defense Organizations' financial statements will be understated in future years (finding A).

- Defense Finance and Accounting Service centers did not accurately report 26 percent of the $5.8 billion of general property, plant, and equipment on the financial statements for Other Defense Organizations. As a result, the financial statements for Other Defense Organizations overstated general property, plant, and equipment by at least $1.5 billion. In addition, the DoD Agency-Wide financial statements understated general property, plant, and equipment by $41.7 million (finding B).

Summary of Recommendations. We recommend the Under Secretary of Defense (Comptroller) provide more definitive guidance in DoD Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, on capitalizing or allocating software that was developed or acquired by one organization for various DoD organizations. We also recommend that the Director, Tricare Management Activity, use property records to accumulate software development costs and provide the Defense Finance and Accounting Service appropriate and accurate property information for inclusion on the Other Defense Organizations' financial statements.

Management Comments. The Deputy Chief Financial Officer stated that chapter 6, "Property, Plant, and Equipment," of volume 4 of the DoD Financial Management Regulation will be clarified to direct DoD organizations that develop or acquire software for other DoD organizations to capitalize and record software costs that exceed the capitalization threshold. The Executive Director, Tricare Management Activity, Assistant Secretary of Defense (Health Affairs), concurred with the finding and draft report recommendation but expressed concern that the Tricare Management Activity did not have an accounting system in place to record software development costs. A discussion of management comments is located in finding A of the report, and the complete text of management comments is located in the Management Comments section.

Audit Response. Although the Deputy Chief Financial Officer did not concur or nonconcur with the finding and recommendation, the planned action meets the intent of the audit recommendations. The planned clarification of the DoD Financial Management Regulation takes an alternative course of action, requiring DoD organizations that develop and acquire software for other DoD organizations to capitalize and record capitalized software costs that exceed the DoD capitalization threshold. As a result, we deleted the draft recommendation for DoD organizations to allocate an equitable portion of software costs to the organization using the software. Based on the Executive Director, Tricare Management Activity comments and the Deputy Chief Financial Officer's planned clarification of the DoD Financial Management Regulation, we revised the draft recommendation to clarify the intent for Tricare Management Activity to account for and capitalize software development costs in a general ledger account. The Tricare Management Activity should use property records to accumulate and report software development costs to the Defense Finance and Accounting Service for inclusion on the Other Defense Organizations' financial statements. We request that the Executive Director provide comments on the recommendations by July 21, 2000.

Table of Contents

Executive Summary i

Introduction

Background 1
Objective 2

Findings

A. Capitalizing Software Development and Acquisition Costs 3
B. Reporting General Property, Plant, and Equipment 7

Appendixes

A. Audit Process
Scope 10
Methodology 10
Summary of Prior Coverage 11
B. Report Distribution 12

Management Comments

A. Under Secretary of Defense (Comptroller) 15
B. Assistant Secretary of Defense (Health Affairs) 17

Background

Reporting Requirements. Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD to prepare annual audited financial statements. In addition, the Federal Financial Management Act of 1994 requires the Secretary of the Treasury, in coordination with the Director, Office of Management and Budget, to prepare Government-wide financial statements. Office of Management and Budget Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, establishes the minimum requirements for audits of Federal financial statements.

Other Defense Organizations. The DoD Agency-Wide financial statements include financial statements for a reporting entity called "Other Defense Organizations." Other Defense Organizations represent a consolidation of financial information from various Defense organizations and funds. The FY 1999 financial statements for Other Defense Organizations reported total assets of $44 billion, which included $6.7 billion of general property, plant, and equipment.

Defense Health Program. The Defense Health Program was established on October 1, 1991, to standardize, consolidate, and improve systems and operations and to reduce the costs of providing medical services in DoD. Although reported under the "Other Defense Organizations," the Defense Health Program is a DoD appropriation account. The Defense Health Program funds the operations of the Military Departments' medical treatment facilities, the development of medical systems software, and congressionally directed research and development. For FY 1999, the reported value of Defense Health Program general property, plant, and equipment was $1.4 billion.

Tricare Management Activity. The Tricare Management Activity (TMA) distributes Defense Health Program funds to the Military Departments and itself. The TMA share includes funds for its Tri-Service Information Technology Program. TMA develops and provides Tri-Service software products to the Military Departments free of charge but retains configuration control of the software. The Military Departments use Defense Health Program funds to operate their medical treatment facilities. The Military Departments retain control and own the assets at their medical treatment facilities regardless of the funds used to acquire the assets.

Accounting Functions and Responsibilities. The Under Secretary of Defense (Comptroller) (USD [Comptroller]) is responsible for providing guidance to DoD Components on implementing the requirements of the Chief Financial Officers Act. The USD (Comptroller) established the Defense Finance and Accounting Service (DFAS) in January 1991 to perform accounting functions for DoD. DFAS is under the direction, authority, and control of the USD (Comptroller). The five DFAS centers provided accounting support for the Military Departments and Other Defense Organizations. The DFAS Indianapolis Center, Indianapolis, Indiana, is responsible for preparing

DoD Agency-Wide, the Department of the Army, and Other Defense Organizations' financial statements by compiling accounting information from the DFAS centers supporting the Military Departments and Other Defense Organizations. The DoD Financial Management Regulation, volume 6B, chapter 2, "General Instructions for the Financial Statements," October 1999, states that DoD organizations are primarily responsible for the content of their financial statements.

General Property, Plant, and Equipment Accounting Standards. General property, plant, and equipment are any capitalizable property that DoD uses to provide goods and services or to support the entity's mission. Computer hardware and software and medical equipment at medical treatment facilities are examples of general property, plant, and equipment. The Statements of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," June 1996, and No. 11, "Amendments to Accounting for Property, Plant, and Equipment," October 1998, establish Federal property accounting standards for general property, plant, and equipment. The DoD Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, implements the Federal property accounting standards. Based on current DoD guidance, general property, plant, and equipment with an estimated useful life of at least 2 years and an acquisition cost of at least $100,000 should be capitalized on the financial statements of the owner or preponderant user. Capitalized costs include acquisition, development, and installation costs.

Objective

Our audit objective was to determine whether the Defense Health Program properly reported its general property, plant, and equipment on the financial statements for Other Defense Organizations. We did not review internal controls, compliance with laws and regulations, and the management control program over the process for preparing the financial statements for Other Defense Organizations because we previously reported on those issues. See Appendix A for a discussion of the audit scope and methodology and prior coverage related to the audit objective.

A. Capitalizing Software Development and Acquisition Costs

The Tricare Management Activity of the Defense Health Program did not capitalize or allocate $247 million of software that it developed or acquired for multiple DoD medical treatment facilities. Additionally, TMA did not capitalize $51.4 million of planned software improvements in an inventory or work-in-progress account. Those conditions existed because of the following:

- The Under Secretary of Defense (Comptroller) did not provide adequate guidance for capitalizing software that was developed or acquired by one DoD organization for multiple DoD organizations, and

- TMA did not implement the provisions of the DoD Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, which requires TMA, as the preponderant user, to accumulate the cost of developing assets in an inventory or work-in-progress general ledger account and to report them on the financial statements.

As a result, the cost of general property, plant, and equipment for Other Defense Organizations was understated by at least $298.4 million. Unless TMA capitalizes or allocates the costs of software that it developed acquired for multiple DoD medical treatment facilities, general property, plant, and equipment on the DoD Agency-Wide and Other Defense Organizations' financial statements will be understated in future years.

Capitalizing Defense Health Software

From FYs 1995 through 1998, TMA spent at least $298.4 million of Defense Health Program funds on software development and acquisitions for multiple DoD medical treatment facilities. However, TMA did not capitalize or allocate those costs. Table 1 shows software systems costs that TMA incurred for systems developed or acquired for multiple DoD medical treatment facilities and for planned software improvements for those systems. The costs of software in the table do not include software development and acquisition costs incurred before FY 1995.

Table 1. Software Systems Costs

(amounts in millions)

Software System	Cost of Software Developed or Acquired	Cost of Planned Software Improvements	Total
DMLSS[1]	$ 28.2	$30.1	$ 58.3
TMSSC[2]	0.8	0.0	0.8
CEIS[3]	6.8	0.0	6.8
Composite Health Care System	209.6	0.0	209.6
Health Standard Resource System	1.6	21.3	22.9
Total	**$247.0**	**$51.4**	**$298.4**

[1]Defense Medical Logistics Standard Support.

[2]Tri-service Medical Systems Support Center.

[3]Corporate Executive Information System.

Developed Software. TMA did not capitalize or allocate $247 million of software that it developed or acquired for multiple DoD medical treatment facilities because DoD policy was not adequate for capitalizing software that was developed or acquired by one DoD organization for multiple DoD organizations. The DoD Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, provides that software development and acquisition costs should be capitalized on the financial statements. However, the policy did not address whether the DoD organization that distributed software to multiple DoD organizations should capitalize or allocate for capitalization an equitable portion of the software costs to the users. Accordingly, the USD (Comptroller) should clarify its policy on capitalizing software that was developed or acquired by one DoD organization and distributed to multiple DoD organizations.

Planned Software Improvements. In the beginning of FY 1999, TMA did not capitalize $51.4 million of planned software improvements in an inventory or work-in-progress account, as required by the DoD Financial Management Regulation, volume 4. The guidance states that software development costs should be reported on the preponderant user's financial statements in an inventory or work-in-progress account until the software is installed. TMA was

the preponderant user of the $51.4 million of planned software improvements because the software improvements were not installed at DoD medical treatment facilities at the beginning of FY 1999.

Effect on Financial Statements

General property, plant, and equipment on the DoD Agency-Wide financial statements was understated by $298.4 million because TMA did not capitalize or allocate the cost of software that it developed or acquired for multiple DoD medical treatment facilities. Specifically, the cost was not included in the financial information and statements that DFAS Indianapolis Center used to compile the DoD Agency-Wide financial statements. Unless TMA capitalizes or allocates software development and acquisition costs, the DoD Agency-Wide and Other Defense Organizations' financial statements will be understated in future years.

Recommendations, Management Comments, and Audit Response

Deleted, Added, and Renumbered Recommendations. Based on management comments, we deleted draft Recommendation A.1.b. and renumbered draft Recommendation A.1.a. to Recommendation A.1. We also revised and expanded draft Recommendation A.2., and renumbered draft Recommendation A.2. to Recommendation A.2.a., A.2.b., and A.2.c.

A.1. We recommend the Under Secretary of Defense (Comptroller) provide more definitive guidance in DoD Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, to require the DoD organization that develops or acquires software that will be distributed to other DoD organizations to either capitalize the software cost on its financial statements or allocate the cost to each DoD organization.

Management Comments. The Deputy Chief Financial Officer stated that chapter 6, "Property, Plant, and Equipment," of volume 4 of the DoD Financial Management Regulation would specify the entity that should report the costs of capitalized software. Specifically, the DoD Financial Management Regulation will be clarified to direct DoD organizations that develop or acquire software for other DoD organizations to capitalize and record software costs that exceed the capitalization threshold. The policy will state that DoD organizations should make no effort to allocate the costs of the software to subordinate organizations using the software. The DoD Financial Management Regulation was revised and coordinated and is expected to be published in the near future.

Audit Response. Although the Deputy Chief Financial Officer did not concur or nonconcur with the finding and recommendation, the planned action meets the intent of the audit recommendations. The planned clarification of the DoD Financial Management Regulation takes an alternative course of action, which will require DoD organizations that acquire and develop software for Other Defense Organizations to capitalize and record capitalized costs that exceeds the DoD capitalization threshold. As a result, we deleted the draft recommendation that recommended that DoD organizations allocate software costs.

A.2. We recommend the Director, Tricare Management Activity, comply with DoD Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995. Specifically:

a. Use property record information to accumulate Defense Health Program software development costs, maintain the cost of the software after installation, and accumulate amortization costs.

b. Report the software development costs to the Defense Finance and Accounting Service for inclusion in an inventory or work-in-progress general ledger account.

c. Notify the Defense Finance and Accounting Service when the software is installed, to assure that the Defense Finance and Accounting Service moves the software development costs from the inventory or work-in-progress general ledger account to the Tricare Management Activity property, plant, and equipment account for inclusion in the Other Defense Organizations' financial statements.

Management Comments. The Executive Director of the Tricare Management Activity concurred with the finding and draft report recommendation but stated that the activity did not have an accounting system in place to record software development costs through a general ledger account for the Defense Health Program. The Executive Director recommended that before publishing a final report, the Inspector General, DoD, should gather insight on how other central design activities capitalize intellectual property.

Audit Response. Based on the Executive Director's comments, we conferred with operating and financial personnel regarding capitalization of intellectual property (software). Based on the Deputy Chief Financial Officer's planned clarification of the DoD Financial Management Regulation, we revised the draft recommendation to specify that the Tricare Management Activity should use property record information to accumulate software development costs; maintain cost records; accumulate amortization costs; report software costs in a general ledger account; and assure that the Defense Finance and Accounting Service properly accounts for software in the Other Defense Organizations' financial statements. We request that the Executive Director comment on the revised recommendation in response to this final report.

B. Reporting General Property, Plant, and Equipment

DFAS centers did not accurately report 26 percent of the $5.8 billion of general property, plant, and equipment on the financial statements for Other Defense Organizations because of the following:

- DoD property accounting standards contained in the DoD Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, did not clearly state how to determine the owner of general property, plant, and equipment at medical treatments facilities, and
- DFAS Indianapolis Center made unsupported adjustments to accounting information that it used to compile DoD financial statements.

As a result, the financial statements for Other Defense Organizations overstated general property, plant, and equipment by at least $1.5 billion. In addition, the DoD Agency-Wide financial statements understated general property, plant, and equipment by $41.7 million.

Property Accounting Standards

Ownership. The Federal property accounting standards did not state how to determine the owner of general property, plant, and equipment when doubt existed about which organization should report general property, plant, and equipment on the financial statements. The DoD property accounting standards partially addressed the issue by stating that preponderance of use or responsibility for maintenance and repair can be factors used to determine ownership. However, the DoD property accounting standards did not clearly state how to determine the owner of general property, plant, and equipment located at medical treatment facilities. Under the DoD property accounting standards, both the Defense Health Program and the Military Departments can claim ownership of general property, plant, and equipment located at medical treatment facilities. The Defense Health Program can claim ownership because it centrally manages and funds DoD health programs. The Military Departments can claim ownership because they execute DoD health programs; control access to general property, plant, and equipment; and maintain general property, plant, and equipment.

Application. DFAS centers did not consistently apply the Federal and DoD property accounting standards when determining ownership of general property, plant, and equipment located at medical treatment facilities. The DFAS Indianapolis Center considered the Defense Health Program the owner of general property, plant, and equipment located at Army medical treatment

facilities. The DFAS Cleveland Center determined ownership based on the funds used to acquire general property, plant, and equipment located at Navy medical treatment facilities. The DFAS Denver Center considered the Air Force the owner of general property, plant, and equipment located at Air Force medical treatment facilities. As a result, DFAS erroneously included $1.5 billion of general property, plant, and equipment located at Army and Navy medical treatment facilities in the $5.8 billion of general property, plant, and equipment that DFAS reported on the financial statements for Other Defense Organizations. Table 2 shows the amounts and line items of the general property, plant, and equipment that DFAS erroneously included.

Table 2. General Property, Plant, and Equipment Erroneously Included on the Financial Statements for Other Defense Organizations

Line Item	Amount (in millions)
Land	$ 7.1
Construction-in-progress	6.6
Buildings	2,479.7
Accumulated depreciation on buildings	(1,173.6)
Other structures	195.1
Accumulated depreciation on other structures	(128.1)
Equipment	404.1
Accumulated depreciation on equipment	(291.9)
Equipment in transit	29.8
Software	2.2
Total	**$1,531.0**

Revised Accounting Guidance. In an August 5, 1999, memorandum, the USD (Comptroller) provided additional guidance to the Military Departments and Other Defense Organizations on determining the owner and preponderant user of medical treatment facilities and equipment. The August memorandum states that the Military Department that owns the installation upon which a medical treatment facility resides should recognize the assets at that medical treatment facility on its financial statement regardless of the appropriation that funded the asset. In our opinion, the USD (Comptroller) adequately addressed the issue in the August 5, 1999, memorandum. Action officers within the USD (Comptroller) also stated that similar guidance would be included in the FY 1999 DoD financial statements' preparation instructions.

Adjustments to Accounting Information

As described in previous Inspector General, DoD, audit reports, DFAS Indianapolis Center continued to make unsupported adjustments when compiling DoD financial statements. Specifically, DFAS centers submitted $112.2 million and $41.7 million of Army and Navy equipment costs, respectively, to DFAS Indianapolis Center for the Defense Health Program to be reported on the FY 1998 financial statements for Other Defense Organizations. However, the DFAS Indianapolis Center did not report the $112.2 million of Army equipment on the FY 1998 financial statements for Other Defense Organizations. Instead, it increased the amount of Navy equipment from $41.7 million to $112.2 million. The unsupported adjustment caused the FY 1998 financial statements for Other Defense Organizations to exclude $112.2 million of Army equipment costs and to add $70.5 million to the Navy equipment costs. As a result, the DoD financial statements understated total assets by $41.7 million. Table 3 shows the difference of Army and Navy equipment costs submitted and reported by DFAS centers on the financial statements for Other Defense Organizations.

Table 3. Army and Navy Equipment Costs* That DFAS Centers Submitted and Reported for Other Defense Organizations
(amounts in millions)

DFAS Center	Amount Submitted	Amount on Financial Statements	Misstatement
Indianapolis	$112.2	$ 0.0	$(112.2)
Cleveland	41.7	112.2	70.5
Total	**$153.9**	**$112.2**	**$ (41.7)**

*Net of accumulated depreciation.

We did not make recommendations regarding the matter in this report because recommendations in prior Inspector General, DoD, audit reports addressed the condition of unsupported adjustments.

Appendix A. Audit Process

Scope

Work Performed. We reviewed the FY 1999 financial statements for Other Defense Organizations, which reported $6.7 billion of general property, plant and equipment. We reviewed FYs 1995 through 1998 contracts and purchase orders for $298.4 million of software. We also reviewed the Army and Navy trial balances for $1.5 billion of general property, plant, and equipment located at medical treatment facilities.

DoD-Wide Corporate-Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measure.

FY 2001 Corporate-Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2) FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5) FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**.

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

Methodology

Audit Period and Standards. We performed this financial-related audit from June through November 1999 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

Computer-Processed Data. We used computer-processed data in this audit; however, we did not confirm the reliability of the data because the accounting systems used to prepare the financial statements for Other Defense Organizations had serious limitations. The lack of reliable financial information

was described as a material management control deficiency in the DoD Annual Statement of Assurance for FYs 1997 and 1998. The lack of reliable information did not adversely affect our analysis.

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

Summary of Prior Coverage

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

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Health Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Surgeon General, Department of the Army
Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Surgeon General, Department of the Navy
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Tricare Management Activity
Program Executive Office, Military Health Systems Information Technology

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
General Accounting Office
  National Security and International Affairs Division
    Technical Information Center

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 Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

Under Secretary of Defense (Comptroller) Comments

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

COMPTROLLER

MAR 1

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

SUBJECT: Department of Defense Inspector General Draft Audit Report, "Defense Health Program Financial Reporting of General Property, Plant, and Equipment" (Project No. 9FA-3217 00)

This memorandum is in response to your request for comments on the subject draft audit report The report recommends that this office issue more definitive policy specifying which Defense Activity should capitalize and report software that is developed by one activity (Defense Health Program), and that is used without charge by other activities (Department of Defense (DoD) hospitals and clinics).

The draft report implies that there is insufficient policy in the "DoD Financial Management Regulation" ("DoDFMR") addressing when software costs should be capitalized It is my understanding that this point was discussed with Office of the Inspector General personnel responsible for the audit, and it was agreed that the "DoDFMR" already adequately addresses when software should be capitalized. I also understand that it was further agreed that the "DoDFMR" should be modified to address what entity should report the costs if capitalized software when the above situation occurs and, if appropriate, how capitalized software costs should be allocated A pending chapter on Property, Plant and Equipment will address these matters.

Specific comments applicable to the recommendations are contained in the attachment

The USD(C) appreciates the opportunity to comment on the draft report. The point of contact for this matter is Mr Michael Powers Mr Powers may be reached by e-mail: powersm@osd.pentagon.mil or by telephone at (703) 697-0536

Nelson Toye
Deputy Chief Financial Officer

Attachment

Final Report Reference

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)

Department of Defense Inspector General Draft Audit Report, "Defense Health Program Financial Reporting of General Property, Plant, and Equipment" (Project No. 9FA-2017.00)

* * * * *

Renumbered as Recommendation A.1.

RECOMMENDATION: We recommend that the Under Secretary of Defense (Comptroller) (USD(C)) provide more definitive guidance in Department of Defense Financial Management Regulation ("DoDFMR"), Volume 4, "Accounting Policy and Procedures," January 1995, to:

a. Require the Department of Defense (DoD) organization that develops or acquires software that will be distributed to other DoD organizations to either capitalize the software cost on its financial statements or allocate the cost to each DoD organization.

Deleted

b. Establish the basis and procedures to allocate an equitable portion of software costs to each DoD organization if a DoD organization has to allocate software costs.

OFFICE OF THE USD(C) RESPONSE: Chapter 6, "Property, Plant and Equipment," of Volume 4 of the DoD Financial Management Regulation, has been revised and coordinated and is expected to be published in the near future. Included in the revised chapter is guidance directing DoD activities that develop software, and make it available for use by other DoD organizations without charge, to capitalize such software--when the costs exceed the capitalization threshold--and report the capitalized costs in their financial statements. The policy states that no effort shall be made to allocate the costs of the software to subordinate activities using the software. This office believes that requiring a parent activity to capitalize and report the software costs is the appropriate approach in this instance.

Attachment

Assistant Secretary of Defense (Health Affairs) Comments

Final Report Reference

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
HEALTH AFFAIRS
SKYLINE FIVE, SUITE 810, 5111 LEESBURG PIKE
FALLS CHURCH, VIRGINIA 22041-3206

TRICARE MANAGEMENT ACTIVITY

FEB -4 2000

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL,
ASSISTANT INSPECTOR GENERAL FOR AUDITING
DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE

SUBJECT: DoD IG Discussion Draft Report, "Defense Health Program General Property, Plant, and Equipment Financial Reporting, Project No 9FA-2017.00

Thank you for the opportunity to review and provide comments on the draft report, "Defense Health Program General Property, Plant, and Equipment Financial Reporting." The following are my comments on the draft report

Overall, we concur with the findings and recommendations detailed in the draft report. However, we are concerned about our ability to implement Recommendation A2.

Recommendation A2 The Director, TRICARE Management Activity, accumulate software development costs and record the costs in an inventory or work-in progress general ledger account for the Defense Health Program as required by the DoD Financial Management Regulation, Volume 4, Accounting Policy and Procedures," January 1995

Revised and renumbered as Recommendation A.2.a., A.2.b., and A.2.c.

Response: At the present time the TRICARE Management Activity does not have an accounting system in place to record software developments costs via a general ledger account for the DHP Recommend prior to publishing the final report, the DoD IG query other DoD Central Design Activities (CDA's) to gather insight into how/where these activities capitalize their "intellectual property" assets This insight would assist us in establishing the controls identified in the IG recommendation.

My points of contact are Mr. Dave Hofflinger (functional) at (703) 681-8448 and Mr Gunther J. Zimmerman (GAO/IG Liaison) at (703) 681-7889.

H. James T. Sears, M.D.
Executive Director

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

F. Jay Lane
Salvatore D. Guli
Charles J. Richardson
Ronald W. Hodges
Dora Y. Lee
Robert P. Goldberg
Pauletta P. Pitter
Noelle Blank