Audit Report

OFFICE OF THE INSPECTOR GENERAL

**DEFENSE BUSINESS OPERATIONS FUND-
DEFENSE INFORMATION SERVICE ORGANIZATION
FINANCIAL STATEMENTS FOR FY 1994**

Report No. 95-209

May 31, 1995

Department of Defense

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Acronyms

JFMIP	Joint Financial Management Improvement Program
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-2884

Report No. 95-209 May 31, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER OF THE DEPARTMENT OF DEFENSE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY

SUBJECT: Audit Opinion on the Defense Business Operations Fund-Defense Information Services Organization Financial Statements for FY 1994 (Project No. 4RE-2005)

Introduction

We are providing this report for your information and use. Financial statement audits are required by the Chief Financial Officers Act of 1990. Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, requires the Inspector General, DoD, to express an opinion on financial statements and report on the adequacy of management controls and compliance with laws and regulations. This report contains our opinion on the Defense Business Operations Fund-Defense Information Services Organization (the Fund) for FY 1994. Ours is the first audit opinion to be issued on the Fund since its inception in May 1992.

Audit Opinion

We are disclaiming an opinion on the FY 1994 financial statements of the Fund. Our disclaimer of an opinion is based on the financial statements dated March 1, 1995, provided to us by the Deputy Chief Financial Officer of the Department of Defense.

More than 10 percent of the $892.5 million (the total value as of September 30, 1994) of the Fund's property, plant, and equipment account could not be reconciled (with 95-percent confidence) to source documentation. We will issue a separate report on the reportable conditions identified during the audit.

Audit Objectives

The primary audit objective was to determine whether the Fund's property, plant, and equipment balances reported on the Statement of Financial Position for FY 1994 were presented fairly in accordance with generally accepted accounting principles or the other comprehensive basis of accounting described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. We evaluated the management control

program established for the Fund, and we assessed compliance with applicable laws and regulations that could have a material effect on the financial statements.

Scope and Methodology

We examined the Fund's financial statements for the year ended September 30, 1994. The statements, dated March 1, 1995, included the Overview and Notes to the four Principal Statements: Statement of Financial Position, Statement of Operations (and Changes in Net Position), Statement of Cash Flows, and Statement of Budget and Actual Expenses. Our opinion is based on the March 1, 1995, financial statements.

Scope of the Review of Management Controls. We assessed the reasonableness of the property, plant, and equipment financial data reflected in the FY 1994 financial statements. We evaluated the procedures and controls that the Defense Information Systems Agency Western Hemisphere and the Defense Finance and Accounting Service-Cleveland Center used to prepare the FY 1994 financial statements. We believe that our audit provides a reasonable basis for our opinion. We performed this financial statement audit from April 1994 through February 1995.

Scope of the Review of Compliance with Laws and Regulations. To obtain reasonable assurance about whether the Principal Statements are free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements and compliance with laws and regulations designated by the OMB and DoD for inclusion in financial statement audits. We identified the key provisions of those laws and regulations, and we reviewed transactions, documents, and other records to verify that they complied with the provisions of those laws and regulations.

Reliability of Computer-Processed Data. We performed various reviews to determine the reliability of computer-processed data provided to us. We did not complete a review of the general and application controls of the computer-based systems used by management to control property-related financial transactions. Instead, we completed tests on transactions to determine whether the accounting entries were made in accordance with generally accepted accounting standards or the other comprehensive basis of accounting. Also, we reviewed the financial information in management's Overview of the Fund. To the extent that we reviewed the data, we concluded that the data were sufficiently reliable to meet our audit objectives.

Use of Statistical Sampling Methods. We used a multistage sampling plan to collect data during the management control testing and substantive testing phases of the audit. From a total universe of 51 sites, the Defense Information Systems Agency capitalized 44 sites from the Military Departments and Defense agencies into the Defense Business Operations Fund-Defense Information Services Organization during FY 1994. We grouped the 44 sites into 5 strata based on each site's former status as a Military Department or Defense agency organization. We selected 10 organizations for our sample: the 5 highest

dollar-value inventory of capital assets from each stratum and 5 randomly selected from the remaining sites. The sample capital asset line items that we tested at each organization were drawn using a probability proportional to size design, to make dollar projections with greater efficiency. More than 10 percent of the $892.5 million (the total value as of September 30, 1994) of the property, plant, and equipment account could not be reconciled (with 95-percent confidence) to the source documentation. The percentage of unreconciled capital asset valuations to source documentation was so great that it exceeded materiality. Consequently, we were obliged to disclaim an opinion.

Auditing Standards

We performed our audit in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin No. 93-06, January 8, 1993, and the general provisions of the President's Council on Integrity and Efficiency, "Federal Financial Statement Audit Manual," January 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements. To assess the materiality of matters that affect the fair presentation of the financial statements and related management control weaknesses, we relied on the guidelines suggested by the General Accounting Office and our professional judgment.

Accounting Principles

Accounting principles for use in preparation of financial statements required by the Chief Financial Officers Act of 1990 remain under development. The Federal Accounting Standards Advisory Board was established to recommend Federal accounting standards to the Director, OMB; the Secretary of the Treasury; and the Comptroller General of the United States. Those officials are the principals of the Joint Financial Management Improvement Program (JFMIP). The Director, OMB, and the Comptroller General of the United States issue specific standards agreed on by the JFMIP principals.

The Director, OMB, and the Comptroller General of the United States have not issued accounting principles that will govern all aspects of financial statement reporting and that will constitute "generally accepted accounting principles for the Federal Government." Until those principles are issued, agencies are required to follow the hierarchy of accounting principles described in OMB Bulletin No. 94-01. The hierarchy constitutes the "other comprehensive basis of accounting" to be used for preparing the financial statements of Federal agencies. A summary of the hierarchy defined and approved by the JFMIP principals follows:

- statements agreed to and published by the JFMIP principals,
- form and content requirements of the OMB,

- o accounting principles in agency guidance, and
- o accounting principles published by other authoritative sources.

To date, three accounting principles have been published by the JFMIP principals, so most accounting principles for the DoD "other comprehensive basis of accounting" are found in DoD accounting policy guidance. The DoD accounting guidance is primarily in the DoD Accounting Manual. The Office of the Under Secretary of Defense (Comptroller) has updated portions of the DoD Accounting Manual and has incorporated those sections into DoD 7000.14-R, "DoD Financial Management Regulation," (DoD Financial Regulation).

The DoD Financial Regulation will eventually serve as the single DoD-wide financial management regulation for use by all DoD Components for accounting, budgeting, finance, and financial management education and training. In the interim, unless superseded by published Federal accounting principles or requirements of OMB, the policy in the DoD Accounting Manual or in the DoD Financial Regulation, as applicable, is the authoritative basis for preparing financial statements in accordance with the "other comprehensive basis of accounting."

Concurrent Audits

This audit is one of two financial statement audits performed by the Inspector General, DoD, at the Defense Information Systems Agency pursuant to the Chief Financial Officers Act of 1990. We performed this audit concurrently with the audit of the Defense Business Operations Fund-Communications Information Services Activity (Project No. 4RD-2009). The audits provide audit coverage of the information services areas of the Defense Business Operations Fund within the Defense Information Systems Agency.

Background

The Defense Information Services Organization, under the direction of the Defense Information Systems Agency is responsible for providing information processing to DoD in support of the DoD mission. The Defense Information Services Organization (formerly the Defense Information Technology Services Organization) has gone through numerous realignments, consolidations, and name changes since its establishment on May 10, 1992. As of October 14, 1994, the Defense Information Services Organization was renamed Defense Information Systems Agency Western Hemisphere. The Defense Information Systems Agency Western Hemisphere provides information processing, software development, and related technical support to DoD customers on a fee-for-service basis.

As of September 30, 1994, the Fund's assets were $335.9 million and its liabilities were $98.0 million. The Defense Information Systems Agency reported the property, plant, and equipment account and related depreciation as $321.9 million, which was 96 percent of the Fund's assets.

Discussion

Management Controls. We reviewed the management control structure of the Fund and obtained an understanding of the management control policies and procedures relating to property, plant, and equipment. We also assessed the level of control risks relevant to the capital assets cycle, classes of transactions, and account balances. For the significant control policies and procedures that were properly designed and placed into operation, we performed sufficient tests to provide reasonable assurance that the controls were effective and working as designed. We identified management control weaknesses that we considered to be material or reportable under the standards established by OMB Bulletin No. 93-06. We will discuss those management control weaknesses in detail in a separate audit report.

The management control program within the Defense Information Systems Agency Western Hemisphere is discussed in a draft audit report (Project No. 4RE-2005.01) issued April 11, 1995.

Compliance With Laws and Regulations. We evaluated the Fund for material instances of noncompliance with laws and regulations for the fiscal year ended September 30, 1994. Such tests are required by the Chief Financial Officers Act of 1990. We identified material instances of noncompliance with laws and regulations, which will be discussed in a separate audit report.

The cooperation and courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529). Enclosure 1 lists the organizations visited or contacted. Enclosure 2 lists the report distribution. Audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosures

Organizations Visited or Contacted

Defense Organizations

Defense Finance and Accounting Service, Cleveland Center, Cleveland, OH
Defense Information Systems Agency, Washington, DC
- Defense Information Systems Agency Western Hemisphere, Fort Ritchie, MD
- Defense Information Systems Agency Western Hemisphere, Denver, CO
  - Army Information Services Center, Fort Ritchie, MD
  - Defense Megacenter Chambersburg, Chambersburg, PA
  - Defense Megacenter Columbus, Columbus, OH
  - Defense Megacenter Dayton, Wright-Patterson Air Force Base, OH
  - Defense Megacenter Mechanicsburg, Mechanicsburg, PA
  - Defense Megacenter Sacramento, McClellan Air Force Base, CA
  - Defense Megacenter St. Louis, St. Louis, MO
  - Defense Information Processing Center-Alexandria, Arlington, VA
  - Defense Information Processing Center-Puget Sound, Bremerton, WA
  - Defense Information Processing Center-Richmond, Richmond, VA
  - Defense Information Processing Center-San Antonio, San Antonio, TX
  - Defense Information Technology Contracting Office, Scott Air Force Base, IL

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- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Audit Team Members

This report was produced by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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