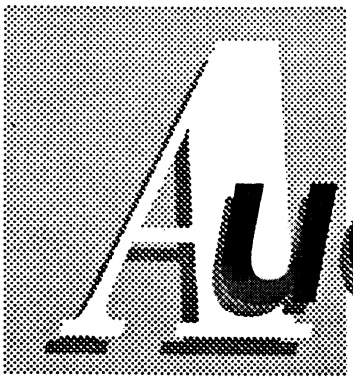

OFFICE OF THE INSPECTOR GENERAL

DEFENSE ACCOUNTING OFFICE, WASHINGTON HEADQUARTERS SERVICES, PROCEDURES FOR PREPARING FY 1994 FINANCIAL STATEMENTS FOR THE ADVANCED RESEARCH PROJECTS AGENCY

Report No. 96-048 December 19, 1995

Department of Defense

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Acronyms

ARPA	Advanced Research Projects Agency
DAO/WHS	Defense Accounting Office, Washington Headquarters Services
DFAS	Defense Finance and Accounting Service
RDT&E	Research, Development, Test and Evaluation

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

December 19, 1995

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Defense Accounting Office, Washington Headquarters Services, Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency (Report No. 96-048)

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

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Accounting Office, Washington Headquarters Services, did not comment on Recommendation 1. to establish procedures to ensure that future financial statements are prepared accurately. Comments were provided by the Defense Finance and Accounting Service, Denver Center, but were not fully responsive in relation to establishing a continuing education program. We request that the Defense Accounting Office, Washington Headquarters Services, and the Defense Finance and Accounting Service, Denver Center, provide comments on the final report by February 20, 1996.

Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529), or Ms. Deborah Carros, Senior Auditor, at (703) 604-9539) (DSN 644-9539). See Appendix F 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. 96-048 **December 19, 1995**
(Project No. 5RF-6010.09)

Defense Accounting Office, Washington Headquarters Services, Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency

Executive Summary

Introduction. The audit was performed as part of the Research for Audits of Defense Agencies' Financial Statements (Project No. 5RF-6010). Managers at the Defense Finance and Accounting Service, Denver Center, requested that we expeditiously report the audit results so that corrective adjustments could be made to the Advanced Research Projects Agency FY 1995 financial statements.

Objectives. The primary audit objective was to determine whether effective management control procedures were implemented by the Defense Accounting Office, Washington Headquarters Services (DAO/WHS), in preparing financial statements for the Advanced Research Projects Agency. Also, we evaluated the FY 1995 management control program coverage of general-purpose financial statements.

Audit Results. The DAO/WHS, a subordinate activity of the Defense Finance and Accounting Service, Denver Center, used budget execution data instead of proprietary general ledger account information to prepare the FY 1994 financial statement for the Advanced Research Projects Agency. In addition, the DAO/WHS methodology for preparing FY 1994 financial statements was flawed. As a result, the FY 1994 financial statement for the Advanced Research Projects Agency:

- o overstated assets by $2.2 billion,
- o overstated liabilities by $25 million, and
- o overstated equity by $2.3 billion (see Part I).

The audit identified a material weakness in that the DAO/WHS had not implemented a management control program to ensure that the integrity of financial data was maintained and that the data were accurately and reliably disclosed in financial reports (Appendix A).

The recommendations in the report will improve the DAO/WHS management control program and will provide reasonable assurance that FY 1996 and subsequent years' financial statements for the Advanced Research Projects Agency are prepared using the correct financial information sources. Appendix D summarizes the potential benefits of the audit.

Summary of Recommendations. We recommend establishing procedures to verify that FY 1996 financial statements are prepared in accordance with DoD guidance, training employees assigned to prepare financial statements, and implementing a management control program.

Management Comments. The Defense Finance and Accounting Service concurred in principle with the recommendation to provide financial statement preparation training; however, the Defense Finance and Accounting Service stated that it could not commit to providing continuing professional training. The Defense Finance and Accounting Service concurred with the recommendation to implement a management control program for the Defense Accounting Office, Washington Headquarters Services, and to include the results of the program in the Defense Finance and Accounting Service, Denver Center, FY 1996 Annual Statement of Assurance. See Part I for details on management comments and Part III for the complete text of the comments.

The Defense Accounting Office, Washington Headquarters Services, did not provide comments on establishing procedures to ensure that future financial statements for the Advanced Research Projects Agency are prepared accurately and in accordance with DoD guidance.

Audit Responses. The Defense Finance and Accounting Service comments were partially responsive. Although it will arrange for financial statement preparation training in FY 1996, the Defense Finance and Accounting Service needs to develop a continuing professional education program to ensure employees are trained to prepare future years' financial statements and to maintain proficiencies in the finance and accounting discipline.

We request that the Defense Finance and Accounting Service, Denver Center, and the Defense Accounting Office, Washington Headquarters Services, provide comments on the final report by February 20, 1996.

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Part I - Audit Results

Audit Background

The audit was performed as part of the Research for Audits of Defense Agencies' Financial Statements (Project No. 5RF-6010). The Chief Financial Officers' Act of 1990 (Public Law 101-576) established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, "The Federal Financial Management Act of 1994," requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The consolidated DoD financial statements for FY 1996 will include the financial statement for the Advanced Research Projects Agency (ARPA).

The Advanced Research Projects Agency. The ARPA is the DoD central research and development organization whose primary responsibility is to maintain U.S. technological superiority over potential adversaries. The ARPA relies on the Military Departments, Defense agencies, and other organizations to act as agents, who are funded by ARPA to conduct their research and development projects. The ARPA receives only Research, Development, Test and Evaluation (RDT&E) funding and received $2.7 billion and $2.6 billion in appropriated funds during FYs 1994 and 1995, respectively. The ARPA expects to receive about $2.3 billion in appropriated funding in FY 1996. Before March 1993, the Washington Headquarters Services provided the accounting and financial reporting services for ARPA.

Defense Accounting Office, Washington Headquarters Services. On March 7, 1993, the Defense Finance and Accounting Service (DFAS) capitalized part of the Washington Headquarters Services Directorate for Budget and Finance as the Defense Accounting Office, Washington Headquarters Services (DAO/WHS). The DAO/WHS assumed responsibility for preparing annual financial statements for the Advanced Research Projects Agency, the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General. The DAO/WHS uses the Washington Headquarters Services Allotment Accounting System as its official accounting system. DFAS assigned the DAO/WHS, located in the Pentagon, to its DFAS Denver Center.

The DAO/WHS performed the accounting function for about 50 percent of the appropriated funding for ARPA. The Military Departments, Defense agencies, and other organizations performed the accounting function for the remaining 50 percent of ARPA FY 1994 appropriated funds as a result of receiving ARPA funds on an allotment basis. The DAO/WHS, however, was responsible for the preparation of the ARPA annual financial statement, which must report the status and use of all ARPA financial resources. The DAO/WHS prepared the ARPA financial statement for the first time for FY 1994.

Audit Objectives

The audit objective was to determine whether the DAO/WHS implemented effective management control procedures for preparing financial statements for ARPA. Specifically, we determined whether DAO/WHS procedures for the preparation of the ARPA FY 1994 financial statement were in accordance with established DoD financial management regulations and guidance. Also, we evaluated the FY 1995 management control program pertaining to the preparation of general-purpose financial statements. Appendix A discusses the audit scope and methodology and the results of the management control review. Appendix B discusses prior audit coverage.

Defense Accounting Office, Washington Headquarters Services, Procedures for Financial Statement Preparation

Instead of using proprietary general ledger account information, DAO/WHS inappropriately used budget execution reports as the data source to prepare financial statements for ARPA. In addition, the DAO/WHS methodology for preparing FY 1994 financial statement reports was flawed.

The incorrect source information was used because DAO/WHS personnel had not been trained in financial statement preparation, and because DAO/WHS did not have management controls in place to ensure that proper sources of information were used to prepare financial statements or that financial statements were reviewed to ensure their accuracy and reliability.

As a result, the FY 1994 consolidated financial statements for ARPA were materially inaccurate and unreliable. The statements overstated ARPA assets by $2.2 billion, liabilities by $25 million, and equity by $2.3 billion. Also, until DAO/WHS implements procedures for correctly preparing financial statements, the ARPA reported annual financial position will not be accurate or reliable.

DoD Financial Management Guidance

DoD Directive 7000.14-R, "Financial Management Regulation," volume 1, chapter 3, May 1993, requires full financial disclosure and adequate financial information to be in required financial reports submitted to DoD managers and other Government officials. DoD Directive 7000.14-R, volume 1, chapter 2, May 1993, states that general ledger accounts shall be the source of required budget execution reports and annual financial statements submitted to the Department of Treasury.

DoD Directive 7220.9-M, "DoD Accounting Manual," chapter 94, October 1983, prescribes procedures for the preparation of annual financial statements for appropriated funds. DoD Directive 7220.9-M provides guidance to "crosswalk" information from the DoD approved standard general ledger accounts to the required financial reports. Chapter 94 provides guidance on the preparation of general-purpose financial statements and requires DoD Components to prepare the following financial statements:

- Report on Financial Position, Form 220;
- Report on Operations, Form 221;

- o Report on Cash Flow, Form 222; and
- o Report on Reconciliations, Form 223.

Chapter 94 states that the financial statements are to be prepared annually and submitted by all DoD Components to the Department of the Treasury and to the Office of the Under Secretary of Defense (Comptroller). Chapter 94 includes the proprietary general ledger accounts to be used to prepare each of the forms.

DoD General Ledger Account Structure

The DoD approved general ledger account structure is described in DoD 7000.14-R, volume 1, chapter 7, May 1993. The structure is applicable to all DoD accounting systems for all appropriations and funds and includes both proprietary and budgetary account series as shown in the following table.

General Ledger Account Structure

Account Series	Account
1000 series	Assets
2000 series	Liabilities
3000 series	Equity
4000 series	Budgetary
5000 series	Revenue
6000 series	Expense
7000 series	Gains, losses, and miscellaneous

All account series except the 4000 series are proprietary accounts. The DoD general ledger account structure consists of the accounts DoD Components use to prepare budgetary reports and general-purpose financial statements. Budgetary reports, which are derived from the 4000 series of accounts, primarily provide a status of appropriated funds, while general-purpose financial statement reports, derived from all other account series, primarily show the status and use of an organization's financial resources.

Preparation of FY 1994 Financial Statements

DoD Directive 7220.9-M, chapter 94, prescribes the specific proprietary general ledger accounts to be used to prepare annual financial statements (the Form 220 series of reports). Nonetheless, the DAO/WHS used budgetary information from budget execution reports to prepare FY 1994 financial statements for ARPA. Budget execution reports did not contain needed information to prepare accurate and complete FY 1994 financial statements. In addition, DAO/WHS materially overstated ARPA assets, liabilities, and equity

because RDT&E funds for ARPA were reported on two FY 1994 financial statement reports. This reporting error occurred because of inadequate management controls in the preparation of financial statements. The net effect of the DAO/WHS reporting errors resulted in a material overstatement of the ARPA financial position for FY 1994.

DAO/WHS Methodology for Preparing Financial Statements. The DAO/WHS did not implement management controls for preparing financial statements. The DAO/WHS accountants manually prepared Form 220 reports by appropriation type. The DAO/WHS prepared three Form 220 financial statements for RDT&E funds appropriated to ARPA, the Ballistic Missile Defense Organization, and the Joint Staff (because the Office of the Inspector General received no RDT&E funding, that office was not included on the Forms 220). The DAO/WHS combined the three Forms 220 into one Form 220 report and submitted it to DFAS Indianapolis Center. The DAO/WHS prepared one Form 220 report for all Operation and Maintenance, Procurement, and Military Construction funding appropriated to the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General (ARPA did not receive those types of funds for FY 1994) and submitted the Form 220 to DFAS Indianapolis Center.

For the purposes of this report, the Form 220 report that represents RDT&E funds for ARPA will be referred to as the ARPA Form 220, the consolidated RDT&E Form 220 report will be referred to as the RDT&E Form 220, and the Form 220 report that represents all other appropriations will be referred to as the Other Appropriations Form 220 report.

The DAO/WHS submitted the FY 1994 RDT&E Form 220 and the FY 1994 Other Appropriations Form 220 to DFAS Indianapolis Center. The information in those Forms 220 represents the combined financial position of the ARPA, the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General. The financial statements did not break down assets, liabilities, equity, or other accounting data specific to any one of the four agencies. We limited our review to the financial information reported for ARPA.

Budget Execution Reports as Source Data. The DAO/WHS inappropriately used budget execution reports (Forms 1176) as source data for preparing the RDT&E Form 220 report.* In addition, the crosswalk methods DAO/WHS used to transfer budget information from Form 1176 to Form 220 did not comply with DoD guidelines. Budgetary accounts do not contain needed financial information to prepare complete and accurate financial statements. Because the DAO/WHS used budget execution data to prepare the RDT&E

*The DAO/WHS prepared the Other Appropriations Form 220 by consolidating Form 220 reports prepared by other DoD Components. We did not determine whether source data for the Other Appropriations Form 220 report was proprietary or budgetary data. See Appendix A for audit scope limitations.

Form 220 report, the FY 1994 financial statement understated ARPA assets by $27 million, liabilities by $1 million, and equity by $2 million. See Appendix C for details on the understatements.

ARPA Assets Understated by $27 Million. As a result of using budget execution data to prepare the FY 1994 financial statements, the DAO/WHS understated ARPA assets on the RDT&E Form 220. The ARPA general ledger contained account balances for three asset accounts that were not reported on the RDT&E Form 220. The ARPA general ledger showed an Accounts Receivable balance of $24.5 million; an Advances and Prepayment account balance of $25,000; and a Property, Plant, and Equipment account balance of $2.2 million. The ARPA Form 220 report showed zero balances for all three accounts because budgetary source data do not provide details on Accounts Receivable; Advances and Prepayments; or Property, Plant, and Equipment.

ARPA Liabilities Understated by $1 Million. The DAO/WHS also understated ARPA liabilities on the RDT&E Form 220 as a result of preparing the financial statements from budgetary account data. The ARPA general ledger showed an Accrued Payroll and Benefits account balance of $563,000 and an Accrued Unfunded Annual Leave account balance of $416,000. The ARPA Form 220 report showed zero balances for both accounts because budgetary source data do not provide details on Accrued Payroll and Benefits or Accrued Unfunded Annual Leave.

ARPA Equity Understated by $2 Million. Because the DAO/WHS used budget execution data to prepare the FY 1994 financial statements, ARPA total equity was understated. The ARPA Form 220 report showed a zero balance for Investment Capital, an equity account, even though the ARPA general ledger showed an Investment Capital balance of $2.2 million. This disparity occurred because the budget data used to prepare the financial statement do not show details of Investment Capital.

Overstated ARPA RDT&E Appropriated Funds. The DAO/WHS materially overstated ARPA assets, liabilities, and equity on the Other Appropriations Form 220 report because the DAO/WHS reported RDT&E funds for ARPA on both the RDT&E Form 220 report and on the Other Appropriations Form 220 report. We determined that the Other Appropriations Form 220 included RDT&E funding for ARPA, even though the Defense Accounting Officer stated that the Other Appropriations Form 220 was prepared to include only Operation and Maintenance, Procurement, and Military Construction funding appropriated to the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General. The DAO/WHS should not have reported ARPA financial information on the Other Appropriations Form 220 report because ARPA did not receive Operation and Maintenance, Procurement, or Military Construction funding in FY 1994. Because the DAO/WHS did not implement management controls for the preparation and review of financial statements to preclude reporting RDT&E funds in the Other Appropriations Form 220 report, the FY 1994 financial statement overstated ARPA assets by $2.3 billion, liabilities by $26 million, and equity by $2.3 billion. Appendix C provides details on the overstatements.

ARPA Assets Overstated by $2.3 Billion. The FY 1994 Other Appropriations Form 220 inappropriately reported and, thereby, overstated $2.3 billion in ARPA assets. The DAO/WHS reported financial information for ARPA assets in the Fund Balance with Treasury line item for $2.2 billion; in the Accounts Receivable line item for $24 million; in the Advances and Prepayments line item for $25,000; and in the Property, Plant, and Equipment line item for $2.2 million.

ARPA Liabilities Overstated by $26 Million. The FY 1994 Other Appropriations Form 220 inappropriately reported and, thereby, overstated $26 million in ARPA liabilities. The DAO/WHS reported financial information for ARPA liabilities in the Accounts Payable line item for $25 million; in the Accrued Payroll and Benefits line item for $563,000; and in the Accrued Unfunded Annual Leave for $415,000.

ARPA Equity Overstated by $2.3 Billion. The FY 1994 Other Appropriations Form 220 inappropriately reported and, thereby, overstated $2.3 billion in ARPA equity. The DAO/WHS reported financial information for ARPA equity in the Unexpended Finance Budget Authority line item for $2.3 billion and in the Investment Capital line item for $2.2 million.

Net Effect of Reporting Errors on the ARPA Financial Position.

The net effect of the overstatements and understatements reported by DAO/WHS on the FY 1994 financial statements resulted in material overstatements in the ARPA financial position. Appendix C provides a summary of the net effects.

Net Effect of FY 1994 Financial Reporting Errors on ARPA Assets. The DAO/WHS understated the value of ARPA assets reported on the RDT&E Form 220 by $27 million and overstated the value of ARPA assets reported on the Other Appropriations Form 220 by $2.3 billion. The net effect was a $2.2 billion overstatement in ARPA assets, which was reported in the FY 1994 financial statement for ARPA, the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General.

Net Effect of FY 1994 Financial Reporting Errors on ARPA Liabilities. The DAO/WHS understated the value of ARPA liabilities reported on the RDT&E Form 220 by $1 million and overstated the value of ARPA liabilities reported on the Other Appropriations Form 220 by $26 million. The net effect was a $25 million overstatement in ARPA liabilities, which was reported in the FY 1994 financial statement for ARPA, the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General.

Net Effect of FY 1994 Financial Reporting Errors on ARPA Equity. The DAO/WHS understated the value of ARPA equity reported on the RDT&E Form 220 by $2 million and overstated the value of ARPA equity reported on

the Other Appropriations Form 220 by $2.3 billion. The net effect was a $2.3 billion overstatement in ARPA equity, which was reported in the FY 1994 financial statements for ARPA, the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General.

Training for Financial Statement Preparation

In FY 1994, the DAO/WHS personnel prepared FY 1994 financial statements for ARPA, the Ballistic Missile Defense Organization, the Joint Staff, and the Office of the Inspector General in FY 1994 without having received training on financial statement preparation.

FY 1994 Financial Statements Prepared by Untrained DAO/WHS Personnel. Because DAO/WHS personnel assigned to prepare the FY 1994 financial statement for ARPA received no training in preparing financial statements, the DAO/WHS accountant assigned to prepare the FY 1994 RDT&E Form 220 for ARPA did not use DoD guidance, which requires the use of proprietary general ledger accounts as the source for preparing annual financial statements. The DAO/WHS accountant used budget execution reports to prepare the financial statement because another employee advised the accountant to do so. In addition, the accountant's supervisor was aware that DAO/WHS personnel used budget data as the source for preparing the appropriated fund financial statement and did not plan to implement other procedures for preparing the FY 1995 financial statements. The same accountant has been assigned to prepare both the RDT&E Form 220 report and the Other Appropriations Form 220 report for FY 1995.

Need for Continuing Education Program. We believe that DAO/WHS needs to establish a continuing professional education program to train employees in the financial reporting requirements related to the Chief Financial Officers Act of 1990. The Chief Financial Officers Act imposed new reporting requirements on Federal accountants and auditors. The requirements are continually changing to improve the accuracy and usefulness of Federal financial statements.

Review of DAO/WHS Financial Reporting

The DAO/WHS submitted the FY 1994 RDT&E Form 220 and the Other Form 220 to DFAS Indianapolis Center without reviewing the forms for accuracy and completeness. The Forms 220 were not reviewed because the DAO/WHS did not implement management controls to ensure that financial statements were properly prepared and reviewed.

The RDT&E Form 220 Report. The DAO/WHS personnel prepared and submitted the RDT&E Form 220 report to DFAS Indianapolis Center without a supervisory review for accuracy and completeness. The DAO/WHS personnel

prepared the RDT&E Form 220 by manually consolidating a significant amount of data. No review procedures were in place to detect errors. The DFAS Indianapolis Center returned the RDT&E Form 220 to DAO/WHS because some line item amounts did not add up to the reported subtotals. The DAO/WHS corrected and resubmitted the RDT&E Form 220 to DFAS Indianapolis Center, again without a review. Because DAO/WHS had no management control procedures in place for preparing and reviewing financial statements, DAO/WHS personnel did not prepare accurate and reliable FY 1994 financial statements. The DAO/WHS should have reviewed the FY 1994 financial statements for accuracy before submitting the financial statements to DFAS Indianapolis Center.

The Other Appropriations Form 220 Report. The DAO/WHS prepared and submitted the Other Appropriations Form 220 report to DFAS Indianapolis Center without reviewing the report for accuracy and completeness. The DAO/WHS did not adjust financial data used to prepare the Other Appropriations Form 220 report for RDT&E data reported in the RDT&E Form 220, and no review procedures were in place to detect errors. The DFAS Indianapolis Center returned the Other Appropriations Form 220 because asset, liability, and equity totals were out of balance. The DAO/WHS resubmitted the RDT&E Form 220 twice before it balanced. Because DAO/WHS personnel inappropriately reported RDT&E funds for ARPA on the Other Appropriations Form 220, the ARPA financial position for ARPA was significantly overstated for FY 1994. The DAO/WHS should have reviewed the FY 1994 financial statements for accuracy before submitting the financial statements to DFAS Indianapolis Center.

Status of Management Control Program at DAO/WHS

On October 1, 1994, the Defense Accounting Officer at the Defense Accounting Office, Air Force District of Washington, DFAS Denver Center, established a management control program for DAO/WHS. The annual statement of assurance for DAO/WHS was to be in the FY 1995 Defense Accounting Office, Air Force District of Washington, annual statement of assurance because in 1994, the Air Force District of Washington was responsible for the DAO/WHS. However, when the DAO/WHS was realigned in May 1995 to the DFAS Denver Center, the Air Force District of Washington discontinued actions related to monitoring the DAO/WHS management control program. Management at DFAS Denver Center stated that the DAO/WHS did not implement the management control program the Air Force District of Washington established.

o The DAO/WHS did not establish management controls to ensure that proprietary general ledger account data were used as the source for annual financial statements submitted to the Department of Treasury.

o The DAO/WHS did not implement controls to ensure that personnel assigned to prepare financial statements were properly trained and that continuing professional education was used to maintain current skills.

o The DAO/WHS did not implement controls to verify that FY 1994 financial statements were properly reviewed for accuracy and reliability.

Until the DAO/WHS implements management controls for preparing financial statements, the financial position for ARPA for FY 1996 and subsequent years will not be accurate or reliable.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Defense Accounting Officer, Washington Headquarters Services, establish procedures to ensure that FY 1996 and subsequent years' financial statements for the Advanced Research Projects Agency are prepared accurately in accordance with DoD 7000.14-R, "DoD Financial Management Regulation," volume 1, May 1993, and DoD Directive 7220.9-M, "DoD Accounting Manual," chapter 94, October 1983, to include using proprietary general ledger account information as source data for Form 220 financial statement reports.

Defense Accounting Office, Washington Headquarters Services, Comments. The Defense Accounting Office, Washington Headquarters Services, did not comment on the recommendation. We request that the Defense Accounting Office, Washington Headquarters Services, provide comments in response to the final report.

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

a. Establish a continuing professional education program and train employees assigned to prepare general-purpose financial statements in the proprietary general ledger account structure.

b. Implement a management control program for the Defense Accounting Office, Washington Headquarters Services, and include the Defense Accounting Office, Washington Headquarters Services, in the Defense Finance and Accounting Service, Denver Center, FY 1996 Annual Statement of Assurance.

Defense Finance and Accounting Service Comments. The Defense Finance and Accounting Service concurred in principle with Recommendation 2.a., stating that although it cannot commit to providing continuing professional training a one-time financial statement preparation training will be provided in FY 1996. The Defense Finance and Accounting Service concurred with Recommendation 2.b., stating that the Denver Center will implement a

management control program for the Defense Accounting Office, Washington Headquarters Services, and include the results of the program in the Defense Finance and Accounting Service, Denver Center, FY 1996 Annual Statement of Assurance.

Audit Response. A continuing professional education program will ensure that Defense Finance and Accounting Service personnel maintain well-honed skills and proficiencies needed to properly and accurately fulfill the reporting requirements of the Chief Financial Officers Act. Providing one-time financial statement preparation training is no substitute for a continuing professional education program designed to educate accountants, accounting technicians, financial analysts, and other financial specialists who collectively impact one or more facets of Defense Finance and Accounting Service financial statements. We request that the Defense Finance and Accounting Service provide the specific actions it will take to ensure that employees receive training on continually changing financial reporting requirements.

Part II - Additional Information

Appendix A. Scope and Methodology

Audit Scope

We reviewed DAO/WHS procedures for preparing the FY 1994 financial statements for ARPA appropriated funds.

Limitations to Audit Scope. We limited the audit scope as follows.

o We did not assess the information DAO/WHS used to prepare the ARPA FY 1994 financial statements for accuracy or reliability.

o We reviewed only the process for preparing the Report on Financial Position, Form 220. We did not review the process for preparing Forms 221, 222, or 223 because DAO/WHS did not prepare those reports for FY 1994 RDT&E funds for ARPA.

o We limited our assessments to the funds for which DAO/WHS does installation accounting. Because the accounting data for those funds was maintained in the Washington Headquarters Services Allotment Accounting System, we were able to obtain a trial balance to crosswalk to the financial statements.

o We did not use statistical sampling procedures to test the validity of accounting records or for making projections or estimates on the results of the audit.

Audit Locations Visited. The audit was performed at the DAO/WHS, the office responsible to prepare the ARPA financial statements. We obtained FY 1994 trial balance data for ARPA funds from the Washington Headquarters Services, Directorate of Budget and Finance. Appendix E lists the organizations visited or contacted.

Computer-Processed Data. To achieve the audit objective concerning the manual procedures for financial statement preparation, we relied on the FY 1994 ARPA trial balance generated by the Washington Headquarters Services Allotment Accounting System. We did not assess the reliability of the computer-processed data due to the audit scope limitations. We assessed the reliability of the trial balance data to the extent necessary to determine that changes to total equity were based on the yearend closing of revenue and expense accounts.

Audit Methodology

The DAO/WHS did not implement management control procedures for the preparation of annual financial statements. To determine the procedures DAO/WHS used to prepare the FY 1994 financial statements, we reconstructed the statements based on data obtained from source documents and interviews. To determine whether budget source data had any effect on the accuracy and reliability of the financial statements, we compared information in the FY 1994 financial statements DAO/WHS prepared from budgetary sources to information in the ARPA proprietary general ledger accounts that should have been in the FY 1994 financial statements.

To accomplish our goals, we:

o interviewed DAO/WHS personnel responsible for preparing the financial statements to determine the specific procedures they used to prepare the FY 1994 financial statements;

o obtained source documentation, which included Forms 220, Forms 1176, and trial balances used to prepare the ARPA FY 1994 financial statements;

o compared the Form 220 Washington Headquarters Services prepared for DAO/WHS to the trial balance generated from the Washington Headquarters Services Allotment Accounting System to determine whether proprietary general ledger account information was used as the source data for the Form 220 preparation;

o reconstructed the Other Appropriations Form 220 using the source documentation obtained from DAO/WHS personnel;

o reconstructed the RDT&E Form 220 using the source documentation (FY 1994 Form 1176) obtained from DAO/WHS personnel;

o prepared a Form 220 for ARPA funds from the FY 1994 ARPA trial balance generated by the Washington Headquarters Services Allotment Accounting System using DoD 7220.9-M, chapter 94, as guidance;

o compared the Form 220 prepared by the auditor for ARPA funds to the Other Appropriations Form 220 to determine the amount of RDT&E funding in each Form 220 line item;

o compared the Form 220 prepared by the auditor for ARPA funds to the RDT&E Form 220 to determine whether all ARPA funds maintained in the Washington Headquarters Services Allotment Accounting System were reported on the RDT&E Form 220; and

o reviewed only those financial statement source documents that were prepared by the DAO/WHS.

Audit Period and Standard. We performed this financial-related audit from June through October 1995 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls considered necessary.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We assessed the management control program DAO/WHS implemented as a result of a recommendation in Inspector General, DoD, Report No. 95-231, "Vendor Payments-Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995, and the control techniques in place to ensure that financial statements were prepared in accordance with DoD guidance.

Adequacy of Management Controls. We identified a material management control weakness as defined by DoD Directive 5010.38. The DAO/WHS had not implemented management control techniques to ensure that the integrity of financial data was maintained, that the data were accurately shown in financial reports, and that financial statements were prepared in accordance with DoD guidance.

Recommendations in the report, if implemented, will improve the usefulness and credibility of ARPA FY 1996 and subsequent years' general-purpose financial statements and could result in other potential benefits (see Appendix D). A copy of the report will be provided to the senior official responsible for management controls within DFAS.

Appendix B. Summary of Prior Audits and Other Reviews

Office of the Inspector General, DoD, Report No. 96-003, "Defense Information Systems Agency FY 1994 General-Purpose Financial Statements," October 5, 1995. The report states that the Defense Information Systems Agency used budget execution reports instead of the DoD general ledger account structure to prepare FY 1994 financial statements and that the Washington Headquarters Service did not make annual accounting entries to close accounts in the standard general ledger account structure for the Defense Information Services Agency. As a result, the Defense Information Systems Agency FY 1994 general-purpose financial statements were materially incomplete and inaccurate, and the Defense Information Systems Agency FY 1995 opening general ledger account structure included materially incorrect account balances. The report recommends that the Director, Defense Information Systems Agency, require the use of the general ledger account structure in preparing the FY 1995 and subsequent years' financial statements and establish a continuing education program to train employees responsible for preparing the financial statements. The report also recommends that the Director, Washington Headquarters Services make appropriate yearend closing entries for FY 1995. The Defense Information Systems Agency and Washington Headquarters Service concurred with the recommendations and are planning to take the recommended corrective actions.

Office of the Inspector General, DoD, Report No. 95-231, "Vendor Payments-Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995. The report states that the DAO/WHS made incorrect or improper payments, improperly certified vouchers, did not update the accounting system, and did not maintain proper supporting documentation. Further, the DAO/WHS did not adequately use exception reports that identified accounting errors to ensure the integrity of accounting information, did not consistently perform certification of fund availability, and had not implemented a management control program. The report recommends that the Director, DAO/WHS, make improvements in accounting procedures, recoup duplicate payments, maintain adequate source documentation, certify fund availability, and implement a management control program. The Deputy Director for Finance, DFAS, agreed with all recommendations except for requiring that the disbursing officer certify fund availability. Corrective actions taken include validating and recouping duplicate payments, correcting erroneous payments, establishing procedures to minimize duplicate and erroneous payments, establishing an accounting system training program, establishing uniform filing procedures, and establishing a management control program.

Office of the Inspector General, DoD, Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," March 31, 1994. The report states that the DFAS Denver Center did not prepare complete, accurate, or reliable FY 1992 Air Force Financial Statements. The Denver Center did not comply with DoD guidance, used unreliable budgetary data to prepare the financial statements, and did not

include all information affecting Air Force operations in the Statement of Operations. The report recommends that the Director, DFAS, establish accounting systems, issue additional regulatory guidance, ensure compliance with existing regulations, enhance management controls, and implement formal management control procedures. Management took corrective actions on all recommendations related to the preparation of the financial statements except the recommendation concerning reconciliations with the Department of Treasury and use of the general ledger.

Appendix C. Net Effect of Overstatements and Understatements of FY 1994 Financial Statements for the Advanced Research Projects Agency

Form 220 Line Items	Overstatements[1]	Understatements[2]	Net Effect[3]
Assets			
Fund Balance	$2,234,768,858	--	$2,234,768,858
Accounts Receivable	24,493,062	$24,493,062	0
Advances and Prepayments	25,116	50,231	(25,115)
Military Equipment	1,984,633	1,984,633	0
ADP[4] Software	192,695	192,695	0
Total	**$2,261,464,364**	**$26,720,621**	**$2,234,743,743**
Liabilities			
Accounts Payable Federal Agencies	29,686,506	--	29,686,506
Accounts Payable Public	(4,283,999)	--	(4,283,999)
Accrued Payroll and Benefits	563,406	563,406	0
Accrued Unfunded Annual Leave	415,763	415,763	0
Total	**$26,381,676**	**$979,169**	**$25,402,507**
Equity			
Unexpended Financed Budget Authority	2,257,398,417	--	2,257,398,417
Investment Capital	2,177,328	2,177,328	0
Total	**$2,259,575,745**	**$2,177,328**	**$2,257,398,417**

[1]The overstatements represent Research, Development, Test, and Evaluation funds reported on the Other Appropriations Form 220 report.

[2]The understatements represent Research, Development, Test, and Evaluation funds not reported on the RDT&E Form 220 report.

[3]We calculated the net effect by offsetting the understatements against the overstatements.

[4]Automated Data Processing.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
1.	Compliance with Regulations and Management Control. Establishing procedures in accordance with DoD regulations will provide reasonable assurance that financial statements are prepared using the correct financial information sources.	Nonmonetary.
2.a.	Management Controls. Implementing a continuing education program will train personnel who prepare financial statements.	Nonmonetary.
2.b.	Management Controls. Implementing a management control program for the DAO/WHS and including an evaluation of the program in the FY 1996 Statement of Assurance for the Defense Finance and Accounting Service, Denver Center, will improve DAO/WHS financial management.	Nonmonetary.

Appendix E. Organizations Visited or Contacted

Defense Agencies

Advanced Research Projects Agency, Arlington, VA
Defense Finance and Accounting Service, Denver Center, CO
    Defense Accounting Office, Washington Headquarters Services, Arlington, VA
Defense Finance and Accounting Service, Indianapolis Center, IN
Washington Headquarters Services, Arlington, VA

Appendix F. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

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

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Advanced Research Projects Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Internal Control Officer, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations and Individuals

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

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

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 National Security, Committee on Appropriations
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

Part III - Management Comments

Defense Finance and Accounting Service, Denver Center, Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE
1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

DEC 12 1995

DFAS-HQ/GC

MEMORANDUM FOR DIRECTOR, FINANCIAL MANAGEMENT DIRECTORATE
INSPECTOR GENERAL, DOD

SUBJECT: Management Comments to DoDIG Quick-Reaction Report Defense Accounting Office, Washington Headquarter Services, Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency (Project No. 5RF-6010.09)

We have reviewed the subject report and provide the attached comments. Any additional questions may be addressed to Mr. Charles McIntosh on (703) 607-1120.

for Thomas F. McCarty
Deputy Director for General Accounting

Attachment

SUBJECT: Management Comments to DoDIG Quick-Reaction Report Defense Accounting Office, Washington Headquarter Services, Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency (Project No. 5RF-6010.09)

Recommendation 2.a: Recommend that the Director, Defense Finance and Accounting Service, Denver Center establish a continuing professional education program and train employees assigned to prepare general-purpose financial statements in the propriety general ledger account structure.

Management Response: Concur in principle. DFAS-DE can not commit to providing continuing professional training; however, they will arrange for a one-time financial statement preparation training in FY 1996.

RECOMMENDATION 2.b: Recommend that the Director, Defense Finance and Accounting Service, Denver Center implement a management control program for the Defense Accounting Office, Washington Headquarters Services, and include the defense Accounting Office, Washington Headquarters Service, Denver Center, in the Defense Finance and Accounting Service, Denver Center, FY 1996 Annual Statement of Assurance.

Management Response: Concur. DFAS-DE will implement a management control program for the Washington Headquarters Service and include the results of that program in the FY 1996 DFAS-DE Annual Statement of Assurance.

Audit Team Members

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

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