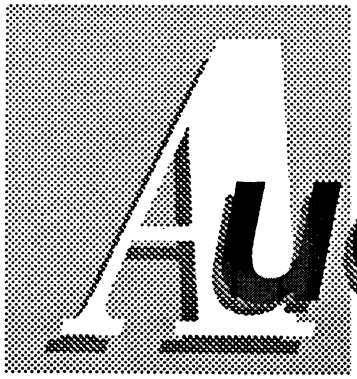

OFFICE OF THE INSPECTOR GENERAL

CONSOLIDATED FY 1995 FINANCIAL REPORT ON DEFENSE ORGANIZATIONS RECEIVING DEPARTMENT 97 APPROPRIATIONS

Report No. 97-017 October 31, 1996

Department of Defense

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Acronym

DFAS	Defense Finance and Accounting Service

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

October 31, 1996

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on the Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations (Report No. 97-017)

We are providing this report for review and comment. We performed the audit to determine compliance with the Chief Financial Officers Act of 1990 and the Federal Financial Management Act of 1994. Official Defense Finance and Accounting Service comments on a draft of this report were not received in time to be included in the final report, but informal comments were considered. Any response received will be considered comments on the final report and must be received by November 29, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Harlan M. Geyer, Audit Program Director, at (703) 604-9594 (DSN 664-9594) or Mr. Charles J. Richardson, Audit Project Manager, at (703) 604-9582 (DSN 664-9582). See Appendix F for the report distribution. Audit team members are listed inside the back cover.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-017
(Project No. 6RA-2014)

October 31, 1996

Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations

Executive Summary

Introduction. We performed the audit in compliance with the requirements of the Chief Financial Officers Act of 1990 (Public Law 101-576) and the Federal Financial Management Act of 1994 (Public Law 103-356). Public Law 103-356 requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. In his memorandum dated June 6, 1995, the DoD Deputy Chief Financial Officer notified the DoD Components of the FY 1996 requirement to prepare and submit financial statements in accordance with the Federal Financial Management Act of 1994. We reviewed the adjusted trial balance submissions of 29 Defense organizations that received a total of $37 billion in Department 97 funds for FY 1995. Department 97 funds are general fund appropriations allocated to Defense organizations and the Military Departments.

Audit Objectives. The overall audit objective was to assess internal controls and compliance with laws and regulations. In addition, we reviewed the financial information supporting the FY 1995 financial reports submitted to the Defense Finance and Accounting Service Indianapolis Center by various reporting organizations receiving Department 97 appropriations. Also, we evaluated the effect of any noncompliant actions on the FY 1996 financial statements. We limited our audit to a review of the adjusted trial balances prepared from financial information on Defense agencies, offices, programs, and universities and used by the Defense Finance and Accounting Service Indianapolis Center to prepare a consolidated Department 97 adjusted trial balance for the Department of the Treasury.

Audit Results. Under the first year of a new reporting requirement, the accounting organizations supporting all 29 Defense organizations submitted adjusted trial balances. However, the accounting organizations supporting 19 Defense organizations used data from sources other than a general ledger accounting control system to prepare their FY 1995 adjusted trial balances. Also, the Defense Finance and Accounting Service did not have complete information on all FY 1995 Department 97 funds received by Defense organizations. As a result, about $19 billion of Department 97 funding was not controlled through a general ledger accounting control system and about $820 million of FY 1995 funding was omitted from the Defense organizations' FY 1995 adjusted trial balance submissions to the Defense Finance and Accounting Service Indianapolis Center. Until those issues are corrected, the Department 97 financial data included in the consolidated DoD financial statements will not be complete, comprehensive, or readily auditable. Further, more than 50 percent of the FY 1996 Department 97 appropriation will not be controlled by complete general ledger accounting control systems. Implementation of the recommendation in this report will improve the preparation of the consolidated Department 97 adjusted trial balance.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, establish procedures and management controls for ensuring that all Department 97 fund recipients provide financial reports in compliance with the Federal Agencies' Centralized Trial-Balance System and the Federal Financial Management Act requirements.

Management Comments. Official comments on a draft of this report were received too late to be used in preparing this final report, but management informally concurred with the recommendations.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objectives 3
Defense Organizations' Adjusted Trial Balance Submissions 4

Part II - Additional Information

Appendix A. Audit Process 14
Management Control Program 14
Appendix B. Summary of Prior Audits and Other Reviews 16
Appendix C. Required Reporting Organizations' FY 1995 Funding 19
Appendix D. Defense Organizations' Implementation of General Ledger Accounting Control Systems 21
Appendix E. Organizations Visited or Contacted 23
Appendix F. Report Distribution 25

Part I - Audit Results

Audit Background

We performed the audit in response to the Chief Financial Officers Act of 1990 (Public Law 101-576), which 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 information for a reporting entity entitled "Other Defense Organizations." The "Other Defense Organizations" includes the financial information for the various Defense organizations, as well as financial information for that portion of the Department 97 funds suballocated to the Military Departments. The Department 97 appropriation is the Office of the Secretary of Defense general fund appropriation allocated to the Defense organizations. For purposes of this audit report, the term Defense organizations includes Defense agencies, offices, programs, and universities. In FY 1995, 30 Defense organizations were appropriated $37 billion of Department 97 funds for the performance of their missions and functions. As of June 30, 1996, the Defense Business Management University was disestablished and its resources were transferred to the Defense Finance and Accounting Service (DFAS); therefore, this report discusses only 29 Defense organizations. See Appendix C for the FY 1995 funding and Appendix D for a list of the Defense organizations.

Defense Organization Responsibility for Financial Statements. In his memorandum dated June 6, 1995, the DoD Deputy Chief Financial Officer notified the DoD Components of the FY 1996 requirement to prepare and submit financial statements in accordance with the Federal Financial Management Act of 1994. According to DoD 7000.14-R, "Financial Management Regulation," volume 6, chapter 2, February 1996, the DoD Components are responsible for the accuracy, completeness, and documentary support for all data submitted to DFAS for inclusion in financial reports.

Federal Agencies' Centralized Trial Balance System Requirement. In April 1995, the DFAS Indianapolis Center assumed responsibility for preparing the accounting reports for the Department 97 appropriations to include satisfying requirements of the Department of the Treasury's Federal Agencies' Centralized Trial-Balance System for FY 1995. The Federal Agencies' Centralized Trial-Balance System requires agencies to submit an adjusted trial balance using standard general ledger accounts. On June 25, 1995, the Deputy Director for Accounting Operations, DFAS Indianapolis Center, requested that the accounting offices submit an abbreviated trial balance using the general ledger accounts for the period ending September 30, 1995.

Audit Objectives

The overall audit objective was to assess internal controls and compliance with laws and regulations. In addition, we reviewed the FY 1995 financial information submitted to the DFAS Indianapolis Center by the various reporting organizations receiving Department 97 appropriations. Finally, we evaluated the effect of any noncompliant actions on the FY 1996 financial statements. Appendix A provides details on the audit process and results of the review of the management control program, and Appendix B summarizes prior audit coverage.

Defense Organizations' Adjusted Trial Balance Submissions

For the first year of the new reporting requirement, the accounting organizations supporting all 29 Defense organizations submitted adjusted trial balances. However, the accounting organizations supporting 19 of the Defense organizations used data from sources other than complete general ledger accounting control systems to prepare the FY 1995 adjusted trial balances. Also, the Defense Finance and Accounting Service did not have complete information on all FY 1995 Department 97 funds received by the Defense organizations. Accounting organizations used data from sources other than general ledger accounting control systems because the accounting systems that support the 19 Defense organizations were not complete general ledger accounting control systems. Also, the DFAS Indianapolis Center had not established the management controls necessary to ensure that all Department 97 fund recipients provided complete financial information for the preparation of the consolidated Defense organization financial reports. As a result, $19 billion of Department 97 FY 1995 funding was not controlled through a general ledger accounting control system and about $820 million of FY 1995 funding was omitted from the Defense organizations' FY 1995 adjusted trial balance submissions to the Defense Finance and Accounting Service Indianapolis Center. Until those issues are corrected, the Department 97 financial data included in consolidated DoD financial statements will not be complete, comprehensive, or readily auditable. Further, more than 50 percent of the FY 1996 Department 97 appropriation will not be controlled by a general ledger accounting control system.

Financial Management Requirements

Requirement for a General Ledger Accounting Control System. DoD 7000.14-R, "Financial Management Regulation," volume 1, chapter 3, March 1993, contains key accounting requirements for DoD financial reporting. Key Accounting Requirement Number 1, "General Ledger Control and Financial Reporting," states that the accounting system must have general ledger control and must maintain an appropriate account structure approved by DoD. The general ledger account structure must follow the general ledger accounts for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources. Full financial disclosure, accountability, adequate financial information, and reports must be provided for external reporting to the Office of Management and Budget and the Department of the Treasury.

DFAS Responsibilities. The mission of the DFAS is to implement standard accounting policies and procedures throughout the DoD. In addition, the DFAS goal is to develop a single, integrated financial management process that

produces reliable financial information for all levels of internal management and for external users as well as enhances the preparation of auditable financial statements.

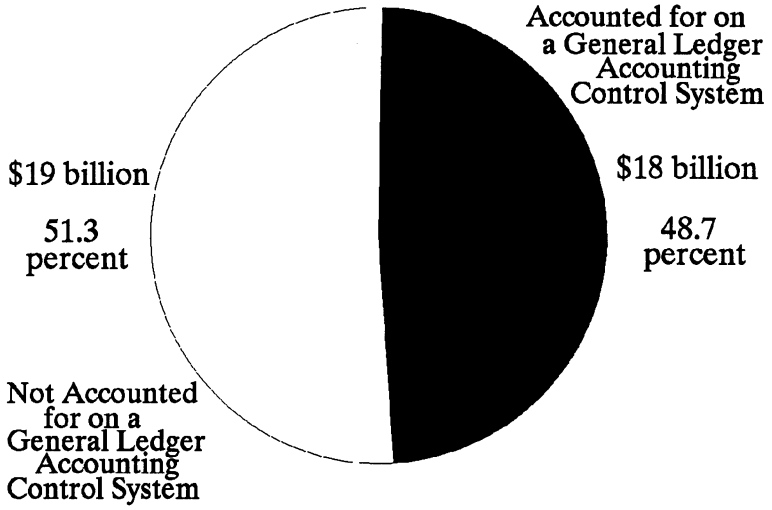
FY 1995 Adjusted Trial Balance Submissions

Department 97 Defense Organizations' Responses. In response to the DFAS Indianapolis Center memorandum dated June 25, 1995, the accounting organizations supporting all 29 Defense organizations submitted adjusted trial balance information, giving DFAS a basis for future planning of financial statement preparation. The Defense organizations can receive accounting support from various accounting offices. Of the 29 Defense organizations, 15 received primary accounting support through the Washington Headquarters Services Allotment Accounting System, 8 Defense organizations either obtained accounting support from their own accounting offices or received accounting support from another Defense organization, and 6 Defense organizations received accounting support from one of the DFAS centers. In addition, the Defense organizations received accounting support from the DFAS Indianapolis Center (Army), the DFAS Cleveland Center (Navy), and the DFAS Denver Center (Air Force) for the funds suballocated from the Defense organizations to the Military Departments. See Appendix C for the FY 1995 Department 97 funding of $37 billion for the 29 Defense organizations, as well as the amounts that are accounted for on general ledger accounting control systems and incomplete general ledger accounting control systems. See Appendix D for the types of accounting systems for each of the 29 Defense organizations.

Financial Information Submitted by the Defense Organizations. The financial information the DFAS centers and responsible accounting offices submitted to the DFAS Indianapolis Center accounted for about 98 percent of the FY 1995 Department 97 appropriation. Accounting offices did not submit financial information for the remaining 2 percent--about $820 million that had been allocated or suballocated by the Office of the Secretary of Defense, the Armed Forces Information Service, and the Defense Advanced Research Projects Agency. The accounting offices that received those suballocations were not known to DFAS-Indianapolis and failed to report the required financial information. A discussion of the incomplete adjusted trial balances and the status of the DFAS Indianapolis Center management controls for the preparation of the financial statements for the "Other Defense Organizations" is included later in the finding. Even though complete financial information had not been submitted, the DFAS Indianapolis Center was able to use budgetary information to account for the overall Department 97 funds allocated to the Defense organizations.

General Ledger Control as the Basis for FY 1995 Adjusted Trial Balances. Only 10 of the 29 Defense organizations were supported by accounting offices that used complete general ledger accounting control systems as the basis for preparing FY 1995 adjusted trial balances. The accounting offices that supported the remaining 19 Defense organizations did not use a

complete general ledger accounting control system for transactional accounting as the basis for preparing adjusted trial balances. The 19 Defense organizations that were supported by accounting offices that did not use complete general ledger accounting control systems are listed in Appendix D. The figure below shows how the Defense organizations accounted for the FY 1995 appropriation. At least $19 billion or 51.3 percent of the FY 1995 Department 97 funds was not accounted for on a general ledger accounting control system. The Defense organizations that used general ledger accounting control systems accounted for about $18 billion or 48.7 percent of the FY 1995 Department 97 funds. If the remaining Defense accounting organizations do not implement general ledger accounting control systems, less than 50 percent of the FY 1996 Department 97 funds will be accounted for under general ledger control as required by the Financial Management Regulation.



Percentage and Dollar Value of FY 1995 Department 97 Funds Accounted for on a General Ledger Accounting Control System

Status of General Ledger Systems Within the Military Departments

The DFAS Indianapolis Center produced an adjusted trial balance for the Army using proprietary information (assets, liabilities, et cetera) from a general ledger accounting control system. The DFAS Cleveland Center and the DFAS Denver Center did not produce an adjusted trial balance using proprietary information for the Navy and the Air Force, respectively, because the centers do not have general ledger accounting control systems. However, the DFAS Cleveland Center is developing a general ledger accounting control system and will be able to use that system to account for Department 97 funds. Also, the DFAS Denver Center has selected a general ledger accounting control system for the Air Force and will be able to use that system to account for Department 97 funds. Of the

$19 billion of FY 1995 Department 97 funds not accounted for under general ledger control, Navy and Air Force accounting systems accounted for a total of $14.3 billion.

DFAS Indianapolis Center General Ledger Reporting. The DFAS Indianapolis Center uses the Federal Financial System to consolidate Army accounting information and to prepare an adjusted trial balance using general ledger accounts. The Army organizations enter the adjusted trial balance information into a data base that the DFAS Indianapolis Center uses to prepare the Army portion of the Defense organizations' adjusted trial balances.

DFAS Cleveland Center Development Efforts. The DFAS Cleveland Center was developing a general ledger accounting control system, the Standard Accounting and Reporting System Fund Distribution and Departmental Reporting System (Navy Accounting System), for the Navy. The DFAS Cleveland Center expected to have the Navy Accounting System operational by October 1996 and can use it to account for Department 97 funds. For FY 1995, the DFAS Cleveland Center converted budgetary information to estimated amounts for the Navy portion of Department 97 funds suballocated from the Defense organizations.

DFAS Denver Center Development Efforts. The DFAS Denver Center initiated an evaluation of general ledger accounting control systems and selected the Corps of Engineers Financial Management System. For FY 1995, the DFAS Denver Center converted budgetary information to estimated amounts for the Air Force portion of Department 97 funds suballocated from the Defense organizations. The DFAS Denver Center personnel estimated full implementation of the selected accounting control system by December 1999.

Status of General Ledger Systems in the Defense Organizations

Accounting support for the 29 Defense organizations is divided among the accounting systems the DFAS centers have at Indianapolis, Cleveland, Columbus, and Denver; the Washington Headquarters Services Allotment Accounting System, and six other Defense organization accounting systems. Of the 29 Defense organizations, 8 received primary accounting support from incomplete general ledger accounting control systems. The eight Defense organizations received $4.1 billion in FY 1995.

The DFAS was responsible for the accounting systems that supported five of the eight Defense organizations. According to the DFAS FY 1995 Annual Statement of Assurance, DFAS planned to revise its accounting systems and to implement general ledger accounting control systems by 1997. The accounting offices at the DoD Education Activity, the Uniformed Services University of the Health Sciences, the Office of Civilian Health and Medical Program of the Uniformed Services and the DFAS Columbus Center had incomplete plans for developing complete general ledger accounting control systems. Inspector

General, DoD, Report No. 96-181, "Management Control Environment for the Department of Defense Education Activity," June 28, 1996, The DFAS Columbus Center provides accounting support to the Defense Logistics Agency, the Defense Contract Audit Agency, and the Defense Acquisition University. Since 1992, the DFAS Columbus Center has tried to convert the Defense Business Management System to a general ledger accounting control system. In response to the problems encountered at the DFAS finance centers in implementing general ledger systems, DFAS established the Defense Accounting Systems Program Management Office (the Program Management Office). The Program Management Office was tasked to implement electronically linked accounting systems within the DFAS data base that comply with generally accepted Government accounting principles and standards, comply with the Chief Financial Officers Act of 1991, and produce complete accounting reports and financial statements. The Project Management Office is directly involved in planning for upgrading the Defense Business Management System to a complete general ledger accounting control system.

No recommendations are made in this report to the DoD Education Activity, the Office of Civilian Health and Medical Program of the Uniformed Services, and the Uniformed Services University of the Health Sciences because of ongoing or future Inspector General, DoD, audits. The recommendations in Inspector General, DoD, Report No. 96-181, "Management Control Environment for the Department of Defense Education Activity," June 28, 1996, addressed the lack of a general ledger accounting control system at the DoD Education Activity. In addition, the ongoing audit of the "Financial Management at the Office of Civilian Health and Medical Program of the Uniformed Services" (Project No. 6LA-2002) is evaluating previously identified weaknesses in general ledger accounting control systems. Also, the Inspector General, DoD, is planning a future audit of the Uniformed Services University of the Health Sciences.

Future Implementation of General Ledger Control Systems

Chief Financial Officer Financial Management 5-Year Plans. The DoD Chief Financial Officer Financial Management 5-Year Plan, October 1995, describes the policy involving the selection of a single Standard Budget and Accounting Classification Architecture (the Standard Accounting Architecture) to replace the unique and incompatible accounting code structures the DoD Components use. The Standard Accounting Architecture is a prerequisite for any standard DoD accounting system, and the architecture format is structured so that it can uniformly support financial management information requirements.

The DFAS Chief Financial Officer Financial Management 5-Year Plan, October 1995, describes the efforts to develop general ledger controls in the accounting systems that were designated as migratory* and interim migratory.

DoD FY 1995 Annual Statement of Assurance. The DoD FY 1995 Annual Statement of Assurance lists Inadequate Financial Accounting Process and Systems as the first of seven systemic weaknesses. The effect of this weakness is that the DoD accounting systems are frequently not in compliance with generally accepted Government accounting standards or with internal management control objectives. As a result, the quality of financial information is frequently not reliable and the compilation of accurate financial statements is impeded, in part, by the lack of financial information. The DoD FY 1995 Annual Statement of Assurance establishes October 1, 2001, as the date for commencing the first complete fiscal year under new system architecture that will produce auditable financial statements.

DFAS FY 1995 Annual Statement of Assurance. The DFAS FY 1995 Annual Statement of Assurance lists problems related to General Ledger Control and Financial Reporting as an uncorrected weakness since 1991. The DFAS Annual Statement of Assurance asserts that an adequate internal control system must have general ledger accounting control and must maintain an appropriate accounting structure approved by DoD. The DFAS identified FY 1997 as the target date for achieving general ledger control.

Preparation of Auditable Financial Statements. In October 1994, the General Accounting Office requested that DoD perform an assessment of the DoD ability to prepare auditable agency-wide financial statements, beginning in FY 1996. In his memorandum dated January 24, 1995, the Under Secretary of Defense (Comptroller) responded that the DoD accounting systems are not designed to generate auditable financial statements and have demonstrated that a number of DoD Components experienced widespread diversions from generally accepted accounting principles and DoD policy. The problems with accounting systems remain a serious challenge to DoD and realistically will require a number of years to correct.

Target Dates for Implementation of General Ledger Control Systems. The DoD FY 1995 Annual Statement of Assurance identifies FY 2002 as the target date for producing the first auditable financial statements. Although DFAS identified FY 1997 as the target date for achieving general ledger control, The DFAS Cleveland Center and the DFAS Denver Center identified FYs 1997 and 1999, respectively, as the target dates for implementation of a general ledger accounting control system. Further, the accounting organizations supporting six Defense organizations have no firm target dates for obtaining accounting support that includes complete general ledger accounting control systems. As a

*A migratory system is an existing automated information system or a planned and approved system, officially designated as the single system to support standard processes for a function.

result, DoD will be unable to meet requirements related to the Federal Agencies' Centralized Trial-Balance System and the Federal Financial Management Act for FY 1996 and probably FY 1997.

Status of Management Controls for Ensuring Completeness of Adjusted Trial Balance Submissions to the DFAS Indianapolis Center

Requirement to Establish Management Controls. DoD 7000.14-R, "Financial Management Regulation," volume 6, chapter 2, February 1996, states that the DFAS shall establish internal controls to ensure that data provided by each DoD Component are recorded accurately, processed timely, and checked to identify significant errors, omissions, and distortions. The DFAS is also required to establish controls to ensure that the financial reports it prepares are supportable, reliable, and accurate. In addition, the DFAS Indianapolis Center must establish procedures to ensure that the process for preparing financial reports is consistent, timely, and auditable.

Management Controls at DFAS Indianapolis Center. The DFAS Indianapolis Center management controls were not established to ensure that the FY 1995 financial information received from the Defense organizations was adequate to produce supportable, reliable, and accurate adjusted trial balances. Specifically, the DFAS Indianapolis Center did not have management controls in place to effectively monitor the submissions of the Defense organizations that received Department 97 funds. Therefore, about $820 million of Office of the Secretary of Defense, Armed Forces Information Service, and Defense Advanced Research Projects Agency funds were not reported. In addition, the DFAS Denver Center and Columbus Center did not properly report $90.7 million of the Emergency Response Fund, Operation and Maintenance funds, and the Humanitarian Assistance Fund were not reported properly to DFAS Indianapolis Center. After processing the FY 1995 adjusted trial balance submissions, the DFAS Indianapolis Center may have a better basis for establishing procedures and management controls to ensure that all Department 97 funds are reported in future adjusted trial balances.

Office of the Secretary of Defense Suballocations. The Office of the Secretary of Defense suballocated about $3 billion for a variety of purposes to include testing and evaluation. Of that amount, all but $97.3 million was reported to DFAS Indianapolis Center on adjusted trial balances. Kirkland Air Force Base did not report $24.9 million; Aberdeen Proving Grounds did not report $35.4 million; the Defense Intelligence Agency did not report $28 million; and the National Security Agency did not report $9 million.

Armed Forces Information Service Allotments. The Washington Headquarters Services submitted three adjusted trial balances to the DFAS Indianapolis Center, reflecting $94.4 million of the $103.7 million total FY 1995 appropriations for the Armed Forces Information Service. However,

the DFAS Indianapolis Center did not include two of the three adjusted trial balances, valued at a total of $24.1 million, in the consolidated trial balance for Department 97 appropriations. The DFAS Indianapolis Center does not have record of receiving the two trial balances generated by the Washington Headquarters Services for the Armed Forces Information Service.

Defense Advanced Research Projects Agency Suballocations. The Defense Advanced Research Projects Agency suballocated about $1.2 billion to DoD Components in FY 1995. However, about $700 million of the $1.2 billion was not accounted for on the FY 1995 Defense Advanced Research Projects Agency adjusted trial balance submitted to the DFAS Indianapolis Center. The Defense Advanced Research Projects Agency suballocations are discussed in Inspector General, DoD, Report No. 96-213, "Financial Management at the Defense Advanced Research Projects Agency," August 20, 1996.

DFAS Denver Center Submission. The DFAS Denver Center did not submit the Air Force portion of the Emergency Response Fund. The DFAS Denver Center did not submit a trial balance for the $69.4 million that was the Air Force portion of the Washington Headquarters Services suballocated Emergency Response Fund. Because the DFAS Indianapolis Center did not have controls in place to determine that the Air Force portion was missing, the DFAS Indianapolis Center used budgetary information to "plug" the Air Force portion of the overall Emergency Response Fund appropriation.

DFAS Columbus Center Submission. Similarly, the DFAS Columbus Center submitted incomplete adjusted trial balances to the DFAS Indianapolis Center for $21.3 million in Operation and Maintenance funds and the Humanitarian Assistance Fund that the Washington Headquarters Services suballocated to the Defense Logistics Agency. The DFAS Columbus Center used only two of the four digits in the Washington Headquarters Services limit code; therefore, the DFAS Indianapolis Center could not determine which organization received the suballocation and placed the adjusted trial balance amounts in a Defense organization limit code specifically created for adjustments to the Washington Headquarters Services.

Recommendations for Corrective Actions

We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, establish management control procedures for ensuring that all the recipients of Department 97 funds provide financial reports in compliance with the requirements of the Federal Agencies' Centralized Trial-Balance System and the Federal Financial Management Act. Specifically, for FY 1996:

1. Coordinate with the Defense organizations to identify all the accounting offices that support the DoD organizations that receive suballocations of Department 97 funds.

2. Reconcile the FY 1996 Department 97 adjusted trial balance submissions received as of November 1 of each fiscal year to the complete list of accounting offices, and inform the accounting offices and their next higher headquarters, as well as the Chief Financial Officer of the Defense organization, of any adjusted trial balances not received as of that date.

3. Review the Department 97 report consolidation process as part of the Defense Finance and Accounting Service self-evaluation. Appendix A provides details on the adequacy of management's self-evaluation.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology. We reviewed 29 Defense organizations that received $37 billion in Department 97 funding for FY 1995. We also reviewed the FY 1995 adjusted trial balances submitted by the Defense organizations to the DFAS Indianapolis Center. Further, we reviewed the process for consolidating the FY 1995 Department 97 adjusted trial balances. In addition, we identified the FY 1995 suballocations for each Defense organization. We reviewed the general ledger capability of the accounting organizations responsible for reporting a trial balance for the Defense organizations' suballocations. We also reviewed the trial balance submissions to determine whether the accounting organizations had submitted the required trial balances for the Defense organizations. The audit was limited to a review of the adjusted trial balances prepared from Defense organization financial information and used by the DFAS Indianapolis Center to prepare a consolidated Department 97 adjusted trial balance to be submitted to the Department of the Treasury.

Use of Computer-Processed Data. We used computer-processed data without confirming the reliability of the data because the reliability of the data did not materially affect the audit results. We did not determine reliability of the data because our review was to determine whether the Defense organizations used complete general ledger accounting control systems to report adjusted trial balances.

Audit Period, Standards, and Locations. We performed this financial-related audit from March through June 1996, in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary. Appendix E lists the organizations we visited or contacted.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, 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 the Management Control Program. The scope of our review was limited to the DFAS Indianapolis Center management control program. We also reviewed the FY 1995 DoD Annual Statement of Assurance and the Department 97 general ledger accounting control systems. In addition, we reviewed the adequacy of management's self-evaluation of applicable management controls and of the management controls applicable to the preparation of the consolidated Department 97 adjusted trial balance.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Directive 5010.38, for the DFAS Indianapolis Center. The DFAS Indianapolis Center did not establish management controls for the consolidation of the Department 97 adjusted trial balances to ensure that the financial data submitted by the Defense organizations were complete. Recommendations 1., 2., and 3., if implemented, will correct the deficiencies. A copy of the final report will be provided to the senior official responsible for management controls at the DFAS Indianapolis Center.

Adequacy of Management's Self-Evaluation. Management's self-evaluation did not detect and report the management control weaknesses identified in this report because the DFAS Indianapolis Center did not assess the consolidation of the Department 97 adjusted trial balances as part of the DFAS Indianapolis Center management control program.

Appendix B. Summary of Prior Audits and Other Reviews

The Office of the Inspector General, DoD, issued seven reports in 1995 and 1996 that relate to accounting controls applicable to the preparation of financial statements as part of the Chief Financial Officers Act of 1990.

Inspector General, DoD, Audit Report No. 96-215, "Financial Management at the Defense Advanced Research Projects Agency," August 28, 1996, states that the Navy and Air Force organizations responsible for accounting for the suballotments of FY 1995 funds from the Defense Advanced Research Projects Agency did not provide complete and accurate adjusted trial balance information to the Defense Finance and Accounting Service Indianapolis Center. As a result, the FY 1995 Defense Advanced Research Projects Agency adjusted trial balance was understated by at least $697 million. In addition, the Military Equipment account in the adjusted trial balance was understated by at least $48 million. The report recommends that research organizations for the Defense Advanced Research Projects Agency prepare the adjusted trial balances needed to generate Department 97 financial statements. Defense Advanced Research Projects Agency management did not concur with the recommendation to establish procedures for reporting by Military Department research organizations because management did not believe that it had the authority to direct changes to its systems.

Inspector General, DoD, Report No. 96-213, "Financial Accounting for the National Security Agency," August 20, 1996, states that the financial accounting system used by the National Security Agency was capable, if modified, of producing information necessary for financial statements required by the Chief Financial Officers Act. However, the National Security Agency must correct deficiencies in the accounting system and establish effective management controls for producing accurate financial statements for inclusion in the DoD consolidated statements. The report states that the National Security Agency had not programmed the accounting system to produce necessary information for developing accurate financial statements and that recorded balances of equipment, real property, and inventory were incorrect, misstated, or not supported. As a result, the general ledger and supporting information could not be relied on for information necessary to produce accurate financial statements required by the Chief Financial Officers Act. The report recommends that the National Security Agency reprogram its accounting system to produce required information for financial statements. The National Security Agency fully concurred with the recommendations.

Inspector General, DoD, Report No. 96-181, "Management Control Environment for the Department of Defense Education Activity," June 28, 1996, states that the DoD Education Activity did not have a general ledger accounting system because the DoD Education Activity did not adequately plan for the development of a general ledger accounting system and did not place a high priority on correcting previously identified accounting system deficiencies.

As a result, the DoD Education Activity was unable to provide the information necessary to produce auditable and accurate financial statements required by the Chief Financial Officers Act. The DoD Education Activity did not concur with the recommendation that it should plan and establish, in conjunction with the Under Secretary of Defense (Comptroller) and the DFAS, a general ledger accounting system that uses the DoD Uniform Chart of Accounts. The Director, DoD Education Activity, did not acknowledge the need for a general ledger accounting control system.

Inspector General, DoD, Report No. 96-161, "Compilation of FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service, Indianapolis Center," June 13, 1996, states that the DFAS Indianapolis Center consistently and accurately compiled financial data from field entities and other sources into the FY 1995 consolidated financial statements for the Army General Fund. The efficiency of and internal control environment for the compilation processes significantly improved since FY 1993 (the last time the Inspector General reported on the compilation process). However, improvements in the compilation process were still needed. The DFAS Indianapolis Center could have better explained that variances of up to $6 billion in financial statement line items from year to year occurred, because FY 1995 financial data were not comparable to FY 1994 financial data. Further, the DFAS Indianapolis Center did not prepare a required footnote for the financial statement. Also, controls over making 15 auditor-recommended adjustments for about $19.5 billion and preparing 165 accounting adjustment vouchers needed improvement. The audit also reviewed the progress of the DFAS Indianapolis Center in assuming the new task of maintaining accounting records and preparing financial reports for all Defense organizations. As of June 13, 1996, preparations were not yet completed for the compilation of FY 1996 Chief Financial Officers Act financial statements for Defense organizations other than the Army. Basic planning and analysis have been completed, and Defense agency data have been integrated into some parts of the process used to compile the financial statements. The report recommends that the Director, DFAS Indianapolis Center, improve internal controls over the processes used to compile the Chief Financial Officers Act financial statements. The Director, DFAS, concurred with all the audit recommendations. He agreed that year-to-year financial statement line item variances should be explained. The Director also agreed that all required footnotes should be prepared, and the DFAS Indianapolis Center has already implemented procedures that allow for tracking the recording of auditor-recommended adjustments by field accounting entities. Finally, the Director agreed to subject the adjustment journal voucher process for Defense agencies to the same control procedures used for the adjustment journal voucher process used for the Army General Fund.

Inspector General, DoD, Report No. 96-159, "Quick-Reaction Report on Potential Anti-Deficiency Act Violations at the Department of Defense Education Activity," June 13, 1996, states that the DoD Education Activity inappropriately used $4.1 million and potentially some or all of another $24.9 million in Operation and Maintenance funds, rather than Procurement funds, to purchase capital equipment and software. As a result, Anti-Deficiency Act violations may have occurred. Also, the DoD Education Activity obligated and disbursed foreign currency fluctuation funds in excess of funds allocated,

resulting in a potential Anti-Deficiency Act violation. The DoD Education Activity did not concur with the recommendation to obtain an opinion from the Office of the General Counsel to determine whether automated information system equipment purchases should be classified as investment or expense items, because the DoD Education Activity maintained that it purchased stand-alone components, not computer systems. The DoD Education Activity also nonconcurred that any Anti-Deficiency Act violations occurred; however, the DoD Education Activity agreed to monitor exchange rate fluctuations and report a potential Anti-Deficiency Act violation for currency fluctuations.

Inspector General, DoD, Audit Report No. 96-080, "Annual Reviews of User Accounting Controls for the Washington Headquarters Services Allotment Accounting System," February 29, 1996, discusses annual accounting system reviews to determine whether DoD accounting systems are in compliance with accounting principles, standards, and related accounting requirements established by the General Accounting Office, the Office of Management and Budget, the Department of the Treasury, and DoD. The report concludes that annual reviews for FYs 1994 and 1995 were not fully coordinated with Washington Headquarters Services Allotment Accounting System users. As a result, annual reviews of the Washington Headquarters Services Allotment Accounting System were incomplete and cannot be relied on to verify the adequacy of principal user accounting system controls. DFAS management did not concur with the recommendations to fully coordinate annual reviews. Instead, in 1995, DFAS developed an automated system-specific annual review process.

Inspector General, DoD, Audit Report No. 95-301, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements," August 29, 1995, identified four major deficiencies that prevented auditors from rendering audit opinions on Army and Air Force general fund financial statements. The four deficiencies were that adequate accounting systems were not in place, assets were not adequately reported or properly valued, disbursements and collections were not adequately accounted for, and contingent liabilities were not recognized or adequately disclosed. The report contains no recommendations because the needed recommendations were made in other reports. The report is intended to help Congress and DoD assess progress made toward the goal of preparing general fund financial statements that can receive an audit opinion other than a disclaimer.

Appendix C. Required Reporting Organizations' FY 1995 Funding

($ in thousands)

Defense Organizations	FY 1995 Funding	Accounted for on General Ledger	Not Accounted for on General Ledger
Defense Health Program	$10,274,677[1]	$4,353,100	$5,921,577
Other	8,349,746[2]	4,858,084	3,491,662
Office of the Secretary of Defense	3,439,541	1,649,148	1,790,393
Ballistic Missile Defense Organization	2,740,086	2,205,625	534,461
Defense Advanced Research Projects Agency	2,177,239	1,392,030	785,209
Special Operations Command	1,822,507	586,946	1,235,561
Defense Logistics Agency	1,396,765	0	1,396,765
DoD Education Activity	1,280,078[3]	0	1,280,078
Washington Headquarters Services	1,277,457	565,464	711,993
Defense Information Systems Agency	903,274	663,764	239,510
Defense Mapping Agency	835,269	0	835,269
Defense Nuclear Agency	723,818	723,818	0
Joint Staff	480,029	425,617	54,412
Defense Contract Audit Agency	334,701	0	334,701
Defense Investigative Service	210,273	0	210,273
Federal Energy Management Program	170,715	62,414	108,301
Inspector General, DoD	140,912	140,912	0
American Forces Information Service [4]	103,679	102,596	1,083
Corporate Information Management	103,474	103,474	0
Defense Acquisition University	93,634	27,741	65,893
On-Site Inspection Agency	71,000	71,000	0
Office of Economic Adjustment	38,889	38,889	0
Defense Prisoner of War/Missing in Action Office	10,961	10,961	0
Defense Technology Security Agency	9,760	9,760	0
Defense Legal Services Agency	7,023	7,023	0
Totals	**$36,995,507**	**$17,998,357**	**$18,997,150**

[1]Amount includes funding for the Office of Civilian Health and Medical Program of the Uniformed Services, the Defense Medical Support Activity, and the Uniformed Services University of the Health Sciences. The Office of Civilian Health and Medical Program of the Uniformed Services has general ledger information to reflect budgetary information. The amount excludes $2.9 million in Military Construction funds that was undistributed to the Military Departments in FY 1995. In addition, the name of the Defense Medical Support Activity was changed to the Defense Medical Programs Activity.

[2]Amount includes funding for the National Security Agency, the Central Imagery Office, the Defense Intelligence Agency, etc.

[3]Amount includes funding for Section 6 Schools.

[4]The American Forces Information Service funds of $23.4 million in FY 1995, were allotted to the Armed Forces Radio and Television Service Broadcast Center and were accounted for on the adjusted trial balance prepared by the Washington Headquarters Services using the Washington Headquarters Services Allotment Accounting System. This trial balance was not included in the consolidated report the DFAS Indianapolis Center prepared.

Appendix D. Defense Organizations' Implementation of General Ledger Accounting Control Systems

The 19 Defense organizations that received accounting support from accounting offices that did not have complete general ledger accounting control systems are identified below (in italics). The incomplete general ledger accounting systems are identified in the second column.

Defense Organization	General Ledger Accounting Control System	*Incomplete General Ledger Accounting Control System[1]
*American Forces Information Service**	WAAS[2]/Army/AFRTS[3]	Navy/Air Force
Ballistic Missile Defense Organization	WAAS/Army/CAFRMS[4]	Navy/Air Force
Central Imagery Office	GAC[5]	
Corporate Information Management	WAAS	
Defense Acquisition University[6]	Army	DBMS[7]
Defense Advanced Research Projects Agency	WAAS/Army/GAC[8]	Navy/Air Force
Defense Contract Audit Agency[6]		DBMS
Defense Information Systems Agency	WAAS/Army	Navy/Air Force
		DBMS
Defense Intelligence Agency	GAC	
Defense Investigative Service		Air Force
Defense Legal Services Agency	WAAS	
Defense Logistics Agency[6]		DBMS
Defense Mapping Agency		Air Force
Defense Medical Program Activity	WAAS/Army	Air Force/Navy
Defense Prisoner of War/ Missing in Action Office	WAAS	
Defense Special Weapons Agency	CAFRMS	
Defense Technology Security Agency	WAAS	
DoD Education Activity[6]		Navy/FCS[9]
Federal Energy Management Program	WAAS/Army	Navy/Air Force
Inspector General, DoD	WAAS	
Joint Staff	WAAS/Army	Navy/Air Force
National Security Agency	GAC	
Office of Civilian Health and Medical Program of the Uniformed Services[6]		RAMS[10]
Office of Economic Adjustment	WAAS	Air Force
Office of the Secretary of Defense	WAAS/Army/GAC/CAFRMS	Navy/Air Force
		CUFS[11]/FCS
		DBMS
On-Site Inspection Agency	CAFRMS	
Special Operations Command	Army	Navy/Air Force
Uniformed Services University of the Health Sciences[6]		CUFS
Washington Headquarters Services	WAAS/Army	Navy/Air Force
		FCS/DBMS

[1]We categorized accounting systems as incomplete general ledger accounting control systems if the system did not use or have a complete DoD uniform chart of accounts. The Resource Accounting Management System, College and University Finance System, Fund Control System, and Defense Business Management System were identified as general ledger systems that did not have a complete DoD uniform chart of accounts.
[2]Washington Headquarters Services Allotment Accounting System.
[3]Armed Forces Radio and Television Service Allotment Accounting System.
[4]Centralized Accounting and Financial Resource Management System.
[5]Although the Central Imagery Office and the Defense Intelligence Agency used the General Accounting and Reporting Subsystem (GAC) as their general ledger accounting control system for funds appropriated beginning in FY 1994, those agencies chose not to query the system to produce adjusted trial balances by appropriation. Program changes to the GAC were recommended in Inspector General, DoD, Report No. 96-213, "Financial Accounting for the National Security Agency," August 20, 1996, to simplify the process of producing trial balances by annual appropriation.
[6]The Defense organizations that receive accounting support from accounting organizations that do not have complete plans to bring their financial data under the control of a general ledger accounting control system.
[7]Defense Business Management System.
[8]General Accounting and Reporting Subsystem.
[9]Fund Control System.
[10]Resource Accounting Management System.
[11]College and University Finance System.

Because of suballocations of funds to other DoD Components and to other Defense organizations at remote locations, 13 of the 29 Defense organizations received accounting support from more than one accounting office. Some organizations will have a portion of their funds accounted for on a general ledger accounting control system and a portion not accounted for on a general ledger accounting control system. For example, the Defense Advanced Research Projects Agency received accounting support from the Washington Headquarters Services Allotment Accounting System and from the DFAS centers supporting the Army, Navy and Air Force. Both the Army accounting support system and the Washington Headquarters Services Allotment Accounting System are categorized as general ledger accounting control systems. Conversely, the Navy and the Air Force do not have general ledger accounting control systems.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence), Washington, DC
Assistant Secretary of Defense (Economic Security), Washington, DC
Joint Staff, Washington, DC
Washington Headquarters Services, Washington, DC

Department of the Navy

Assistant Secretary of the Navy, (Financial Management and Comptroller), Washington, DC

Other Defense Organizations

American Forces Information Services, Alexandria, VA
  Armed Forces Radio and Television Service Broadcast Center, March Air Force Base, CA
Ballistic Missile Defense Organization, Washington, DC
Defense Acquisition University, Alexandria, VA
Defense Business Management University, Arlington, VA
Defense Contract Audit Agency, Fort Belvoir, VA
Defense Finance and Accounting Service Cleveland Center, Cleveland, OH
  Defense Finance and Accounting Service, Pensacola, FL
Defense Finance and Accounting Service Columbus Center, Columbus, OH
Defense Finance and Accounting Service Denver Center, Denver, CO
  Defense Accounting Office, Kirkland Air Force Base, NM
Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN
  Defense Accounting Office, Aberdeen, MD
  Defense Accounting Office, Fort Belvoir, VA
  Defense Accounting Office, Washington Headquarters Services, Washington, DC
Defense Information Systems Agency, Arlington, VA
Defense Investigative Service, Alexandria, VA
Defense Logistics Agency, Fort Belvoir, VA
Defense Medical Programs Activity, Falls Church, VA
  Defense Medical Resource Office, Falls Church, VA
Defense Prisoner of War/Missing in Action Office, Arlington, VA
Defense Special Weapons Agency, Alexandria, VA
Defense Systems Management College, Fort Belvoir, VA
Inspector General, DoD, Arlington, VA

Other Defense Organizations (cont'd)

Office of Economic Adjustment, Arlington, VA
On-Site Inspection Agency, Washington, DC
Uniformed Services University of the Health Services, Bethesda, MD
U. S. Special Operations Command, MacDill Air Force Base, FL

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense for Personnel and Readiness
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense for Command, Control,
  Communication, and Intelligence
Assistant to the Secretary of Defense (Public Affairs)
Director, Joint Staff
Director, Washington Headquarters Services
Director for Budget and Finance, Washington Headquarters Services

Department of the Army

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

Unified Command

Commander in Chief, U.S. Special Operations Command

Other Defense Organizations

Director, American Forces Information Service
Director, Ballistic Missile Defense Organization
Director, Corporate Information Management
President, Defense Acquisition University
Director, Defense Advanced Research Projects Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Cleveland Center
  Director, Defense Finance and Accounting Service Denver Center
  Director, Defense Finance and Accounting Service Indianapolis Center
    Defense Accounting Office, Washington Headquarters Services
Director, Defense Health Program
Director, Defense Information Systems Agency
Director, Defense Intelligence Agency
  Inspector General, Defense Intelligence Agency
Director, Defense Investigative Service
Director, Defense Legal Services Agency
Director, Defense Logistics Agency
Director, Defense Medical Programs Activity
Director, Defense Special Weapons Agency
Director, Defense Technology Security Agency
Director, Department of Defense Education Activity
Director, National Imagery and Mapping Agency
Director, Federal Energy Management Program
Director, National Security Agency
  Inspector General, National Security Agency
Director, Office of Civilian Health and Medical Program of the Uniformed Services
Director, Office of Economic Adjustment
Director, On-Site Inspection Agency
Director, Defense Prisoner of War/Missing in Action Office

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

Non-Defense Federal Organizations and Individuals (cont'd)

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

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